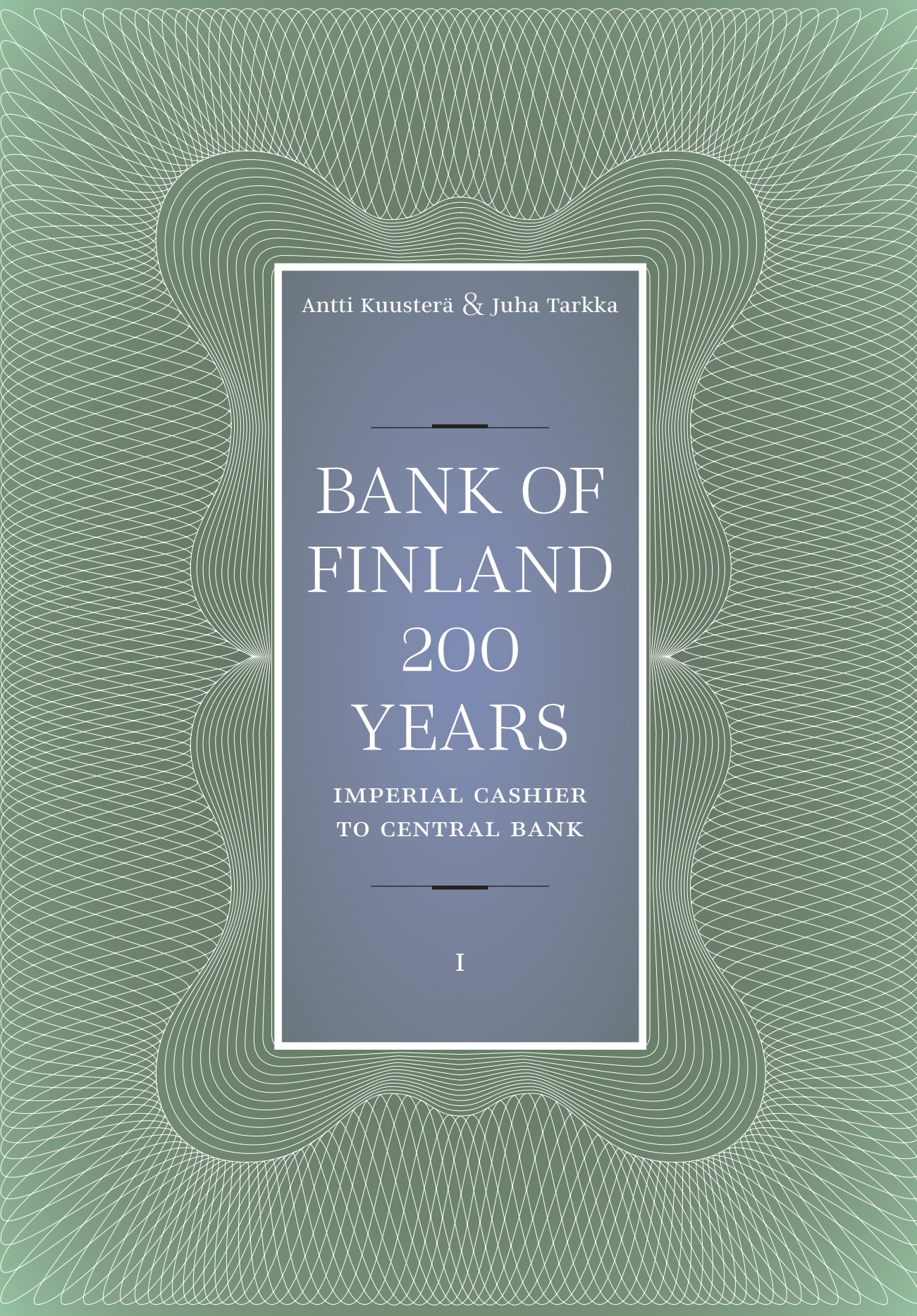




Antti Kuusterä & Juha Tarkka

BANK OF
FINLAND
200
YEARS

IMPERIAL CASHIER
TO CENTRAL BANK

I



EUROJÄRJESTELMÄ
EUROSYSTEMET

**BANK OF
FINLAND
200 YEARS**

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Helsinki 22 February 2011

Antti Kuusterä and Juha Tarkka

PROLOGUE

It was 1811 when Tsar Alexander I, the Emperor of Russia, ratified the establishment and operations of *An Office for Exchange, Lending and Deposits in the Grand Duchy of Finland*. The date of the proclamation, December 12th, is regarded as the founding moment of the Bank of Finland although it was not until April 1st in the following year that the board of the *Office* first convened, under its chairman Claës Johan Sacklén. The other two directors on the three-member board were Gustav Gadolin, a cathedral dean and professor of theology, and Johan Jakob Dreilick, an industrialist who owned an iron works. The bank was entirely lacking funds at this point so the board's first act was to ask the Governing council of Finland to grant it an advance of 1 500 roubles in banknotes for the purchase of office supplies. In the months to come, it gradually accumulated a small fund of capital "from tax surpluses" and was able to open its doors to the public on 14 August 1812. Some eight months had elapsed since the founding proclamation.¹

The Bank of Finland is regarded as the fourth oldest central bank in the world. The factual basis for this statement is that, of central banks now in operation, only those of Sweden, England and France are older; Sveriges Riksbank was founded in 1668, the Bank of England in 1694 and Banque de France in 1800. However it is a considerable simplification to claim the Bank of Finland as the world's fourth oldest central bank. Firstly, it was not a real central bank for decades after its establishment because Finland had no other banks or even real banking houses, unlike London, Paris or Stockholm. Until the second half of the 19th century, the Bank of Finland was in reality a governmental bank of issue, and it gained the status of a central bank only gradually as the rest of Finland's banking system developed.

Secondly, at the time that the Bank of Finland was established, there were several other government-owned banks of issue, the most important in the Baltic region being Russia's State Assignat Bank in St. Petersburg and Denmark's Kurant Bank in Copenhagen. Still, these institutions subsequently closed down so the Bank of Finland's fourth ranking among the world's senior central banks is not obviously false either.²

The Russian Empire had annexed Finland from Sweden in the war of 1808–1809. A grand duchy was established in the conquered land, making it a territory of limited autonomy ruled by the Tsar of Russia. The Grand Duchy of Finland was given a central administration separate from Russia's. Not officially renamed a bank until 1817, the *Office for Bills of Exchange, Lending and Deposits* was part of the new administrative machinery. It became the Office's practical function to lend money and to issue small-denomination bills, intended to remedy the shortage of metallic coins in Finland.

In issuing notes the bank's role was to support the objective of Finland's Imperial Governing council: to drive out the Swedish riksdaler and skillingar in general circulation in Finland, and replace them with Russian roubles and kopeks. Even lending by the *Office* was, according to the proclamation of Tsar Alexander I, intended to help "our faithful Finnish subjects in discharging the debts with which many are burdened, either to public funds or to various financiers in Sweden". Thus it is clear that one of the main objectives in founding a Bank of Finland was to wean the new Grand Duchy of Finland from its dependence on the old mother country, Sweden, and link it more closely with the Russian monetary system. Naturally the newly established government of Finland also required practical assistance in managing its monetary affairs and the Bank of Finland became not only an issuer of banknotes but also an institution where state funds were deposited and managed.

Finland was not the only conquered country where a national bank of issue was established after the Napoleonic wars. Norges Bank was founded in a similar way in 1816 in Norway, soon after Sweden had annexed it from Denmark and wished to end its dependence on the Danish monetary system. Another example is Bank Polski, which was set up in 1828 in the new Kingdom of Poland, also known as Congress Poland, established as part of the Russian Empire. In other respects

too, Poland's status with regard to the Russian Empire makes an interesting parallel with Finland's.

The establishment of banks in conquered lands at the start of the 19th century was a new phenomenon of the age but it was a logical consequence of the development of money. In the second half of the 18th century, banknotes had become more widespread as a medium of payment in various European countries, and the Napoleonic Wars spurred this trend because large quantities of paper money were issued everywhere to finance military spending. Banknotes made the monetary system far more political than the previous economy, based on silver coins. Until 1808 Finland had been part of the Swedish monetary system and a considerable volume of Swedish paper money was in circulation. When Finland was annexed, the question naturally arose of linking its monetary system to Russia and replacing Swedish currency, and this was the basis of Russia's policy in establishing the Bank of Finland. But having a national bank of issue and lending also suited the aspirations of the Finns, as clearly shown by the interest in the matter expressed by the Diet of Porvoo, held in summer 1809.

SLOW START IN TURKU

The Bank of Finland began operations in Turku, then Finland's largest town, where the Governing council was also first based. Turku in the 1810s suffered from a great shortage of buildings suitable for official use, and the bank had to be located in rented premises. It was initially on the upper floor of the wooden house of board member Gustav Gadolin, a professor of theology, who lived in the very centre of Turku between the Cathedral and the River Aura. The bank leased three rooms, which the board regarded as "well-nigh suited to needs and function". Gadolin had used the rooms for lectures to his students. The bank also had the use of two strong-rooms equipped with iron doors. However, operations in Gadolin's home were only interim and the bank was subsequently a tenant in the private houses of various other prominent Turku residents, before moving in 1819 to Finland's new capital, Helsinki, along with other central government organizations.³

Although Turku was Finland's largest town when the Bank of Finland was founded, it had only about 10 000 inhabitants. The number of residents in all of Finland at that time was about 860 000. Although

Finland under the Swedish crown had not constituted a single administrative unit but had been a collection of provinces, the position of the town of Turku as the de facto capital had been undeniable; it was the bishopric, its Cathedral was the main church of Finland and it also contained what was then the country's only university, the Royal Academy. In an economic sense too, Turku was the most important of Finland's towns, not least because of its proximity to Stockholm. It was the main port, where wood was exported and where mainly salt but also tobacco, wines and sugar and other colonial goods were imported.

Even banking was not completely unfamiliar in Turku at the start of the 19th century. Before the establishment of the Bank of Finland, a credit institution named Åbo Diskont Werk had operated there for several years and had issued certificates of deposit similar to banknotes. This discount office was closed when the Russian army conquered Finland but it had provided a legacy of valuable practical experience in banking. Many of the men who were involved with it also influenced the establishment and administration of the Bank of Finland. It is noteworthy that the Bank of Finland's first chairman, Claës Johan Sacklén, had been a member of its board and that Gustav Gadolin had been one of its auditors.⁴

The early years of Bank of Finland operations were characterised by a leisurely pace and a modest scale. In addition to the three-member board, the bank's staff originally consisted of ten persons. When operations were beginning, chairman Sacklén had estimated that the bank's work could be handled by one board member at a time. It was not quite so undemanding but the pace of work was still sedate and allowed Gustav Gadolin to combine his duties with those of a dean and professor. The main source of practical work in the bank was the production and issue of small banknotes, put into circulation to serve as small change. This began in autumn 1812.

Design of the first banknotes was entrusted to G.E. von Haartman, head of the Financial department of the Finnish Imperial Governing council, who modelled them on both Swedish and Russian banknotes. The wording on the notes was in Swedish while their nominal value was written in Russian, Finnish and Swedish. In their external appearance these Bank of Finland banknotes bear a close resemblance to bills of exchange, with the serial numbers and date and names of the bookkeeper and board member all handwritten. Printing plates

and a suitable press had to be found, and their signing also had to be organised. The printing work itself was commissioned from the printing shop of the Royal Academy of Turku, owned by J.C. Frenckell. The move to Helsinki meant that printing was transferred to Jakob Simelius' printing house.⁵

Initially the banknotes were worth 25, 50 and 75 kopeks. These "small notes" were intended to replace the small silver coins that had disappeared from circulation after inflation had pushed their official conversion rate below their metallic value. Later the Bank of Finland also issued one, two and four-rouble banknotes. These notes were redeemable with rouble banknotes from Russia's State Assignat Bank. In the early years of its operations, the value of the Russian assignat rouble notes had already fallen to about a quarter of the value of a silver rouble.

According to the minutes of the board, the greatest operational problem was the slow rate at which notes were issued. Initially the value of the note and all the signatures were written by hand but the head of the Financial department of the Governing council regarded the daily output as too small. To simplify matters the value and the signature of a board member were added by stamp, which managed to speed up production. Signing banknotes was the main duty of the bank's two bookkeepers and each was instructed to produce 3000 notes a week, but the target was too ambitious and was lowered to 2000 notes. The bank engaged two additional bookkeepers in its founding year to expedite banknote issuance. Economic incentives were employed from the outset; a bonus of one rouble per 100 banknotes was paid for all production in excess of the target.⁶

An ordinary customer came to the Bank of Finland either to apply for a loan or to amortise one. These procedures exemplified the stiff bureaucracy of the bank. Opening times were short and strict schedules were defined for all operations. A loan applicant left his written application to the bank's secretary, who examined it. Then the customer took it to the chancery officer, who recorded the application in the Bank's journal. A loan decision was made by the board on the basis of the secretary's proposal. If the decision was favourable, the secretary passed the documents to the cashier, from whom the applicant was to draw down the loan no later than midday on the morrow of the board's meeting. After that it was the turn of the bank's senior clerk, to whom

the cashier passed the documents against signature, at which point the clerk recorded the loan granted in the main loan ledger. Another clerk recorded the loan in the lending diary and an office scribe marked it in the loan catalogue and the loan register. Even more complex accounting manoeuvres were involved in recording loan amortisation, to say nothing of how difficult everything had been made to the payer.⁷

Considering the bureaucratic procedures, limited capital and the right to issue only small denomination bills suitable for giving change, it is not surprising that the bank's operations did not come to play a very important role in the economy during its early years. The author of the bank's centennial history, Emil Schybergson, characterised its operations with the phrase "a lack of animation". The Bank's growth took place gradually over about eight decades, as it became responsible firstly for all paper currency in Finland and then for a national currency, as it joined the gold standard and eventually developed into a full central bank. When the bank celebrated its centenary in 1911 Emil Schybergson wrote that it had grown "from modest beginnings ... into what, for the times, is a magnificent financial institution".⁸ The background and progress of this evolution are the theme of the chapters ahead.

THE BANK IN PERSPECTIVE

The Bank of Finland has often been seen as playing a very central role in the history of the nation and as having a far more crucial position than is typically accorded to most other central banks. Only the Bundesbank in the political history of the German Federal Republic after the Second World War played a role comparable to the Bank of Finland's.

This image of the Bank of Finland's political importance is partly a consequence of subsequent events, such as the notable influence on Finnish political life of many people who also held prominent positions in the Bank. Partly, too, it is because the Bank was established more than a century before Finland became independent and was, in its way, at the forefront of the institutional progress which resulted in Finland's gradual evolution into an independent nation. At the time that the country became independent in 1917, Finland had already acquired all of the central institutions typical of a nation state at the time, with the exception of its own army. The Bank of Finland and the national unit

of currency founded in 1860, the Finnish markka, belong to the narrative of independent Finland's birth.

This fairly widespread, politically charged image of the role of the Bank of Finland in the nation's history persists to this day and is not entirely false. It is underpinned by the fact that the Bank was transferred to the ambit of the Diet and subordinated to it in 1868, soon after regular Diet sessions had begun in Finland. From this time until independence, the Bank of Finland was the most important state institution entirely under national parliamentary control. The Imperial Finnish Senate, which was the government of Finland and ran the other administrative machinery of the country, was not, at least formally, answerable to the Diet. It operated under the auspices of the Emperor of Russia because the Tsar, in his capacity as Grand Duke of Finland, appointed Senate members and ratified their decisions. Thus it was that the Bank of Finland constituted an outpost of parliamentarianism in the otherwise imperial administrative machinery of Finland and foreshadowed the system of parliamentary rule that became established after independence.

Perspectives on the historical significance of the Bank of Finland have naturally varied over the years, influenced by prevailing political and economic tendencies and financial circumstances. When Emil Schybergson described the Bank of Finland's first century in his book, written in 1914, he analysed the bank as a medium and instrument of Finland's modernisation. He saw the Finnish monetary system and the Bank of Finland's monetary policy as an important element of the rapid economic growth that had been underway since the late 19th century. Schybergson conceded the "universality" of this favourable economic development but, in his view, the Bank of Finland had played a leading role in ensuring that the Finns shared in it.⁹

In an account of the Bank's 125 years, written in 1939 by A.E. Tudeer, the perspective is tinged by the struggles and disputes over the markka's value that had taken place during the preceding decades. The period from the beginning of the First World War to the eve of the Second can be divided into three formative sections, throughout which the Bank of Finland's operations and monetary deliberations focused on the exchange rate question. During the First World War, the Bank of Finland and its governor Clas von Collan had been subject to strong conflicting pressures when trying to support the markka's value. On

the other hand, it was in the interests of the Russian government to use the Bank to finance military spending and to keep the exchange rate between the markka and the plummeting rouble as steady as possible.¹⁰

Between World Wars, exchange rate matters were also critical. After the war had ended, the decisive question was how the markka's value would be restabilised and linked to gold as part of the process of reconstructing an international gold standard. Contemporaries regarded the return to the gold standard in 1926 as a major victory and the Bank of Finland was in practice responsible for creating the conditions that allowed this. It had halted inflation and stabilised the markka against the dollar, which had at that time become the leading gold-backed currency.

The Bank of Finland's operations during the economic crisis of the 1930s have also been seen specifically from the perspective of protecting the monetary system. The Bank was criticised for keeping monetary policy tight at the start of the 1930s and appeared to contemporaries as a fortress of orthodoxy regarding the gold standard and monetary value. More recently the same view has been put forward by Jorma Kalela in his study of economic debate at the time (*Pulapolitiikkaa*, or Great Depression Policy).¹¹ On the other hand Sixten Korkman and Jukka Pekkarinen have advanced the proposition that the Bank of Finland was soft on monetary policy between World Wars; they point to the strong depreciation of the markka before it joined the gold standard in 1926 and again before it was pegged to the pound sterling in 1933.¹²

Nevertheless it had become the mainstream image that the Bank between World Wars was a stern defender of the markka's value. In the words of Tudeer, written in spring 1939: "It was only after great exertions that the collapse threatening the currency system was avoided". The Bank of Finland acted as a guardian of monetary stability and of purchasing power in sometimes stormy conditions. This was not an easy task because, as Tudeer writes: "Experience ... shows ... that a central bank has very little possibility of controlling trends in the money market or even of maintaining the currency system when extraneous, international forces upset balance in the world."¹³

Hugo Pipping's wide-ranging and comprehensive studies of the history of the Bank of Finland, published in the 1960s, cover operations

from its foundation to the outbreak of the First World War. Pipping pays close attention to political questions. His work emphasises the gradual disengagement of the Finnish monetary system from Russia's and then the defensive battle for Finland's separate monetary system after Russia had joined the gold standard in 1897. The Tsar's February Manifesto of 1899 led to a general political dispute between the Finns and the Russians over the competence of Imperial legislation in the Grand Duchy of Finland.

Simply the titles of Pipping's works "From paper rouble to gold markka" and "In the gold standard haven" show his view that the first century of operations was part of a broader train of development, as Finland grew apart from Russia. At the end of his history Pipping writes: "If the foregoing devotes much space to attacks from the east against Finland's monetary independence, this is partly because they often appeared ominous and partly because deliverance was no gift of destiny but the outcome of unremitting vigilance. Its main fortress was the Bank of Finland."¹⁴

From a modern perspective the Bank of Finland appears principally as an instrument for international integration of the Finnish economy and for the active promotion of this course. To an observer from the modern era, the matter is evident from the very beginning of the Bank's existence and this view is reflected in the work to hand. In the earliest decades of the bank's operation, the international monetary system was represented by the silver standard of northern Europe. The Bank of Finland played an instigating role when Finland first joined the silver standard in 1840 and again in 1865 after the hiatus caused by the Crimean War. Over the decades of the silver standard, the Bank and its foreign correspondent banks constituted the main channel for international payments of Finnish companies engaged in foreign trade. Indeed, Finland's achievement of its own monetary unit linked to silver in the 1860s was not a consequence of political separatism but of an effort to stabilise the value of money on an internationally accepted standard. It was only the failure of Russia – for reasons unrelated to Finland – to maintain rouble convertibility to silver or to reinstate the silver standard, that led to the divergence of the Finnish and Russian monetary systems.

Correspondingly, Finland's adoption of the gold standard reform of 1878 appears from a modern perspective as an integration project

and indeed a successful one, because joining the gold standard improved Finland's international creditworthiness and made it possible to obtain large international loans on relatively inexpensive terms, as Mika Arola has shown.¹⁵ Joining and remaining within a gold-based monetary system, the most important objective of the Bank of Finland, was a key factor for initiating economic growth in Finland, as Schybergson determined 100 years ago.

In a comparable way, only an international perspective can explain the main theses of interwar monetary policy: the stabilisation of the markka within the gold standard in 1926, the defensive struggle for the gold standard in 1929–1931 during the international economic crisis, the disengagement from gold together with Britain and the Scandinavian countries in 1931 during the great currency crisis and finally the pegging of the markka to the pound in 1933. These appear as part of surprisingly consistent efforts by Bank of Finland leaders to determine the main direction of international currency policies and to link Finland to it. The gaze of Risto Ryti, the leading light of Finnish monetary policy between the wars, was unremittingly focussed on protecting and strengthening Finland's capacity for economic integration.

From the viewpoint of international integration policies, a history of the Bank of Finland takes the form of recurring efforts to connect Finland to the international monetary system that was the most stable possible and the most favourable for foreign economic relations, and to maintain that connection. One after another, these systems have collapsed amid international crises, after which it has become the task of monetary policy to stabilize monetary value and connect Finland appropriately to each successive western monetary system. That this line of reasoning seems obvious at the start of the new millennium says as much about the present day as it does about the Bank of Finland's past, which is the subject of this work. What seems beyond dispute, however, is that Finland's astonishingly favourable economic development over the past two centuries has occurred largely as a result of, and on the terms of, international integration. This may vindicate the approach chosen in the narrative to hand.

INTERNATIONAL INTRIGUE ENGULFS FINLAND

RUSSIAN MILITARY SUPERIORITY

A grasp of the early stages in the Bank of Finland's history is impossible without looking at the fundamental change that took place in Finland's political position in the early 19th century, when the country was detached from the Realm of Sweden and appended to the Empire of Russia. Although Finnish historical studies generally stress continuity, noting that laws and the legal system remained unchanged despite an altered political status, there was in fact significant institutional change involved in the shift from being a group of provinces in Sweden to becoming a Grand Duchy within the Russian Empire. As a result of this change, Finland obtained its own central administration and constituent institutions for the first time. The foundation of the Bank of Finland was part of this development.

Finland's annexation to the Russian Empire in 1809 was a consequence of European great power politics in which Finland was a pawn. The backdrop was a struggle between France and its main adversary, Britain, during the Napoleonic Wars. Under Napoleon's leadership France sought to rule all of Europe, while England was its most unrelenting opponent. For a few years of this struggle, Russia and Sweden ended up on opposite sides, which proved to be fateful for Finland.¹⁶

The young Tsar of Russia at this time was Alexander I, who had ascended to the throne in 1801. During the first years of his reign Russia remained on the sidelines but in 1805 it joined a coalition against Napoleon, organised by England and supported by Austria,



■ Napoleon I of France and Alexander I of Russia met at Tilsit in 1807 to settle the borders of their empires and ambitions. Finland was one part of the patchwork. – Adolphe Roehn, oil on canvas, 19th century. Bridgeman Images.

Sweden and, later, Prussia. In 1805–1806 Russia and Sweden were therefore at war on the same side. However the forces of the British-led coalition were no match for Napoleon’s army and one country after another deserted the coalition. Austria withdrew after the Battle of Austerlitz (1805), and Prussia in turn suffered a major defeat in the Battle of Jena (1806), after which it was no longer an effective match for the French. The Battle of Friedland in East Prussia in summer 1807 proved a decisive rout for Russia, leaving the French army almost on the Russian border.

After his defeat in Friedland, Alexander was ready to make peace with Napoleon. The two leaders met for their historic conference in the town of Tilsit on the River Neman in July 1807. The Tilsit negotiations led to a peace treaty whereby Russia changed sides, aligning itself with France against England. Napoleon’s main demand was that Russia should join the trade blockade against the British Isles, known as the Continental System.

Napoleon had declared a general blockade against Britain in November 1806, shortly after the Sea Battle of Trafalgar had demonstrated that the French navy could not overcome Britain’s mastery of the seas. Instead Napoleon resorted to economic sanctions, aimed at severing all links between the island kingdom and continental Europe. Trade routes between Britain and its main partners were to be closed and Britain was to be brought to its knees. The trade blockade ultimately had little effect on Britain but for Napoleon it became a foreign policy cornerstone to which he clung with almost obsessive persistence.

The Tilsit Treaty urged Russia to bring Sweden, too, into the blockade against Britain, if necessary by force of war. Mere diplomacy did not, indeed, have the desired effect on Sweden. Like Britain, Sweden was one of Napoleon’s most tenacious adversaries and was economically very dependent on Britain, the main market area for its exports. Furthermore King Gustav IV Adolf of Sweden was extremely hostile to revolutionary France and saw Napoleon as the “Beast of the Book of Revelations”. These were factors that had led to Sweden’s participation in the British-led anti-French coalition in autumn 1805.¹⁷

After Tilsit, Alexander I was initially fairly passive towards Sweden, and the French sent several dispatches to St. Petersburg, urging the tsar to force Sweden into the Continental System. However, covert military preparations were under way for an attack on Finland. One of the chief

planners was Finnish-born Major General Göran Magnus Sprengtporten, who had entered Russian service in 1786 and had long advocated detaching Finland from Sweden. Before changing sides, Sprengtporten had even drawn up a draft constitution for a Republic of Finland. (Judging from extant parts of this document, it apparently contained regulations for the establishment of a national banking institution.)¹⁸

Russia believed that a rapid attack would force Sweden to turn against Britain so that the war could be brought to a swift conclusion. At the same time, Sprengtporten, serving as the military planner advising the tsar, continued to entertain ambitions for separating Finland from Sweden and making it into a buffer state under the protection of Russia. He believed that the people of Finland were now more prepared to countenance separation from their old mother country and later events showed that he was not entirely wrong. Many key figures of influence in Finnish society showed surprising willingness to cooperate with the Russians.¹⁹

In February 1808, Russian forces crossed the River Kymi and the war against Sweden began. The Swedes withdrew and military success by troops under General F. W. Buxhoevden led rapidly to the occupation of all of southern Finland. By 22 March, Turku had fallen into Russian hands. The surrender of Sveaborg sea fortress in May 1808 is regarded as a military turning point. Hardly any reinforcements reached Finland from Sweden, so the Russian occupying force enjoyed distinct superiority of numbers. Buxhoevden tried to prevent harsh measures by the army of conquest, with the result that a significant number of officials in Finland began cooperating with the occupiers at an early stage. Among broad circles, faith in Swedish victory, and in Finland's future as a part of Sweden, had evaporated.²⁰

At the start of April, Tsar Alexander announced that he had taken the part of Finland that had previously belonged to Sweden to be "an eternal province" of his empire. The aims of the war were now clear. However, the conquest of Finland was not a simple matter for the Russians because, although the exalted elite of Finnish society proved crucially willing to cooperate, the ordinary people long remained faithful to their old ruler. Furthermore Sweden's military fortunes improved after a poor start and by summer the Russians in turn were compelled to retreat. Resistance also began to take on the form of local guerrilla fighting, which tied down ever more Russian troops. By the

end of summer the Russian occupation was confined to the southern part of Finland and the aim of separating the Finnish provinces from Sweden had still not yet been achieved.

It was militarily important for Russia's ruler to bring the war in Finland to an early conclusion and pacify the country. In autumn the Russians launched a new attack. Their troops had been reinforced and the position of the Swedish army had deteriorated. Russia seized the rest of Finland and military operations in Finnish territory ended in an armistice signed at Olkijoki on 20 November 1808. The Russians now set about organizing the rule of Finland and its future position vis-à-vis the Russian Empire. The war continued, meanwhile, in the area that is now northern Sweden and did not formally end until the following autumn in the Treaty of Hamina (Fredrikshamn in Swedish), signed on 17 September 1809. Sweden agreed that its five Finnish provinces, including the Åland Islands, would be annexed by Russia. In Lapland the border was drawn along the rivers Tornio (Torne) and Muonio. At the same time Sweden agreed to observe the blockade of Britain.²¹

The Treaty of Hamina also contained economic articles aimed at ensuring the uninterrupted continuation of traditional trading relations between Finland and Sweden and the payment of Finnish debts to Sweden "within the periods and on the terms prescribed". No attempt was made to isolate Finland from Sweden economically. This policy, an original component of the peace treaty, was later to have great significance for the economic development of Finland, which did not become a Russian periphery in an economic sense but developed into a distinctly individual economic area that remained in continuous close contact with its former mother country across the Gulf of Bothnia.²²

Defeat by Russia meant catastrophe for Sweden and the end of the old Swedish realm. King Gustav IV Adolf was deposed and imprisoned after a coup d'état in March 1809. Gustav's childless uncle was chosen to replace him as King Carl XIII but de facto power soon shifted to a Marshal of France, Jean-Baptiste Bernadotte, who in 1810 was elected heir apparent to the Swedish throne. Bernadotte quickly rose to an influential position in Sweden although he was not crowned until the old king had died in 1818, then under the name of Carl XIV Johan.

It was a sign of the status of Crown Prince Carl Johan that he led the negotiations in which relations between Sweden and Russia were

finally normalised. Cordial relations were confirmed at a meeting between Alexander and Carl Johan in Turku in August 1812. A few weeks earlier Napoleon had attacked Russia and Carl Johan had turned against his former emperor, Napoleon. A sixth coalition was formed against France, with Russia, Britain and Sweden joined by Prussia, Austria and a number of German states. Sweden's alliance with Russia shows that its new leaders no longer dreamed of restoring the connection with Finland. The Grand Duchy of Finland had become a political reality. To compensate Sweden for Finland and to reward it for its alliance, Russia promised to support the union of Sweden with Norway, which took place shortly.²³

FROM SWEDISH PROVINCES TO A GRAND DUCHY

It was important for Finland's development that, after conquest, the country was not administratively integrated into Russia but was formed into a Grand Duchy, which had broad *de facto* autonomy. Historians have conducted a long and intricate debate on the judicial basis and precise nature of the autonomy that Finland was granted.²⁴ These questions of principle became particularly relevant at the end of the 19th century and in the early 20th century when Finnish national tendencies came into conflict with Russian efforts to unify the Empire. From a historical viewpoint, theoretical analyses are less relevant than the fact that Finland after 1809 received a status where, at least in practice, it had its own legislation, its own separate machinery of government and, before long, its own bank.

Finland's autonomous position was shaped by Russia's political conditions while a *western tendency* was in vogue in Russian government circles. After the Treaty of Tilsit Tsar Alexander I and his trusted advisor Mikhail Speransky drafted a broad administrative reform aimed at modernising the system of government in the whole empire, modelled on Western Europe. In this situation the legal system in use in Finland, originating from Sweden, was not regarded in St. Petersburg as a threat but as one potential model for later reform of the empire. Finland was not the only borderland with a special administrative position. The Baltic provinces of the Russian Empire, Estland, Livonia and Courland, had their own laws and diets at the

start of the 19th century. After 1815 another border territory with a special position was Poland which, following the Congress of Vienna, was briefly granted much stronger autonomy than Finland had. Poland and how its status changed in the 19th century makes an interesting point of reference and contrast with Finland.²⁵

The main decisions for the future governmental and administrative position of Finland were made in 1808–1812. A brief alliance between Russia and France, begun in Tilsit and continued until spring 1812, was a crucial external factor. While Alexander and Napoleon as leaders of the two great powers, Russia and France, were agreeing on the fates of many minor European states and regions, new French ideas such as the *Code Napoleon* gained credence among the elite of St. Petersburg. However the harmonious alliance between France and Russia lasted for only a few years and soon Russia was forced to prepare for a new onslaught by Napoleon's army. This in turn was reflected in its strategy for Finland, which had to be separated from the former mother country Sweden rapidly and with not too much trouble, so that Russian military resources could be moved as quickly as possible from Finland to the front against Napoleon.

These strategic patterns offer an explanation for why Alexander preferred beneficence in trying to win over the Finns. The argument was based on views about Finland's position that separatists, principally Sprengtporten, had been proposing over the years. The effort to win Finnish favour had started in the early stage of the war. As soon as Russian troops had crossed the border, a declaration was issued, signed on 18 February 1808 by General F.W. Buxhoevden, emphasising that the Russians had come to Finland as friends and not as enemies. The Finns were offered the generous protection of the Tsar of Russia. The rights and privileges of inhabitants would remain unchanged and local officials could keep their posts. Foodstuffs and other commodities requisitioned by Russian forces would be paid for in full. Peasants were promised unchanged status, to avert their fears of serfdom.

From the initial stages of the war onwards, news was spread to Finland about plans to call a meeting of the Estates as soon as Turku had been taken. This had been urged by Sprengtporten, whose designs for Finland's future had all featured a Diet underlining Finland's independent status. To representatives of Russia's ruling elite, the question of summoning a Diet had many more ramifications. The

constitution of autocratic Russia had no place for a national assembly so the promise of Diet sessions was seen mostly as an instrument for legitimising the completed conquest of Finland and a way of pacifying public opinion. On the other hand the Governorates of Estland, Livonia and Courland, which had been incorporated into Russia, contained functioning Diets consisting of local nobility and exercising a degree of autonomy.²⁶

In summer 1808 the Russian provisional authority began to demand pledges of allegiance from inhabitants of the conquered part of Finland. The original aim was for all citizens to swear an oath but it proved impossible in practice and the Russians contented themselves with an oath from high officials, such as provincial governors and the clergy. The way was smoothed by senior officials of the Southern Finnish provinces, under the leadership of the governor of Turku and Pori, Knut von Troil, and the Bishop of Turku, Jakob Tengström, who had already made their peace with the new power structure.

Opinions in the country were divided and the dividing line ran between the elite of officialdom and the commoners. The great mass of ordinary people had deeply ingrained memories of the Russian invasion in the Great Northern War and later occupation during the Russo-Swedish War, which had caused years of brutality and deportations to Russia. The masses also put their faith and trust in the King of Sweden. Officialdom, including the clergy, took a more realistic approach to the situation and no longer anticipated Sweden assistance. Voluntarily acclimatisation and acceptance of a new master offered them a more promising future than compulsory adaptation and submission in defeat.²⁷

Sprengtporten's proposal, made back in January 1808, about summoning a Diet after the conquest of Finland initially met an alien reception from the tsar and many leading officials in St. Petersburg. As the war dragged on, Russian attitudes towards Finland toughened and plans for a Diet session received still less attention. The idea was not completely abandoned, however, and in place of a Diet it was decided to summon a delegation consisting of representatives of the four Estates to St. Petersburg in autumn 1808 to meet the tsar. A total of 22 representatives, selected and approved by the provincial governors, were invited. Together with the expert advisers of Commander-in-chief Buxhoevden, the governors ensured that the

deputation consisted of members of each Estate who were both able and willing to cooperate.

In those times, a deputation such as this was a common *modus operandi*. Representatives of a conquered area would meet their ruler and give him a pledge of loyalty, in return for which he would assure the representatives of his new subjects that the conquered area would retain its laws and that the privileges and rights of the Estates would be unchanged. This was to be the role of the deputation from Finland. However, under their chairman Count C.E. Mannerheim, the delegates emphasised that they could never act as a substitute for a session of the Diet because the law of Sweden, which was in force, had not been observed in the choice of members of the group. The most vociferous critics of the composition of the delegation were the representatives of the nobility. Under the law, participation in the Diet by nobles was a birthright, not a favour. The creation of a delegation by selection had therefore violated the rights of the Estate of nobility, a view accepted by the emperor, or more correctly, the high Russian officials who represented the tsar.

The deputation's visit to St. Petersburg, which lasted all autumn, was not a mere formality. One of its concrete tasks was to draw up a memorandum for the tsar about the main administrative measures that lay ahead. Among the more important matters of principle was the request for a Diet to be summoned and for machinery of government to be established, led by a governor general but composed of Finns. The tsar's acquiescence to these proposals was received at the very beginning of 1809. In reality his replies had been drafted by a three-man committee consisting of G.M. Sprengtporten, who had just been appointed governor general of Finland, together with Russian War Minister Arakcheyev and Deputy Foreign Minister Count Saltykov.²⁸

From Finland's perspective it was significant that, at this first official contact with Finnish representatives, the Russian emperor had already recognised Finland's position as a special case and did not relegate the deputation to receiving the conventional pledge from the ruler and giving a promise of loyalty. While the delegation was holding its meetings, there was still a state of war between Russia and Sweden, which made the tsar's marks of "graciousness" towards the Finns tactically understandable. But at the same time it showed how far the delegation members had already gone in renouncing their loyalty to

the Swedish crown. In his response to the delegation, the tsar promised to summon a Diet. The first such promises had been proclaimed in the opening stages of the war and, as it dragged on, Sprengtporten had kept the question a diet on the agenda.

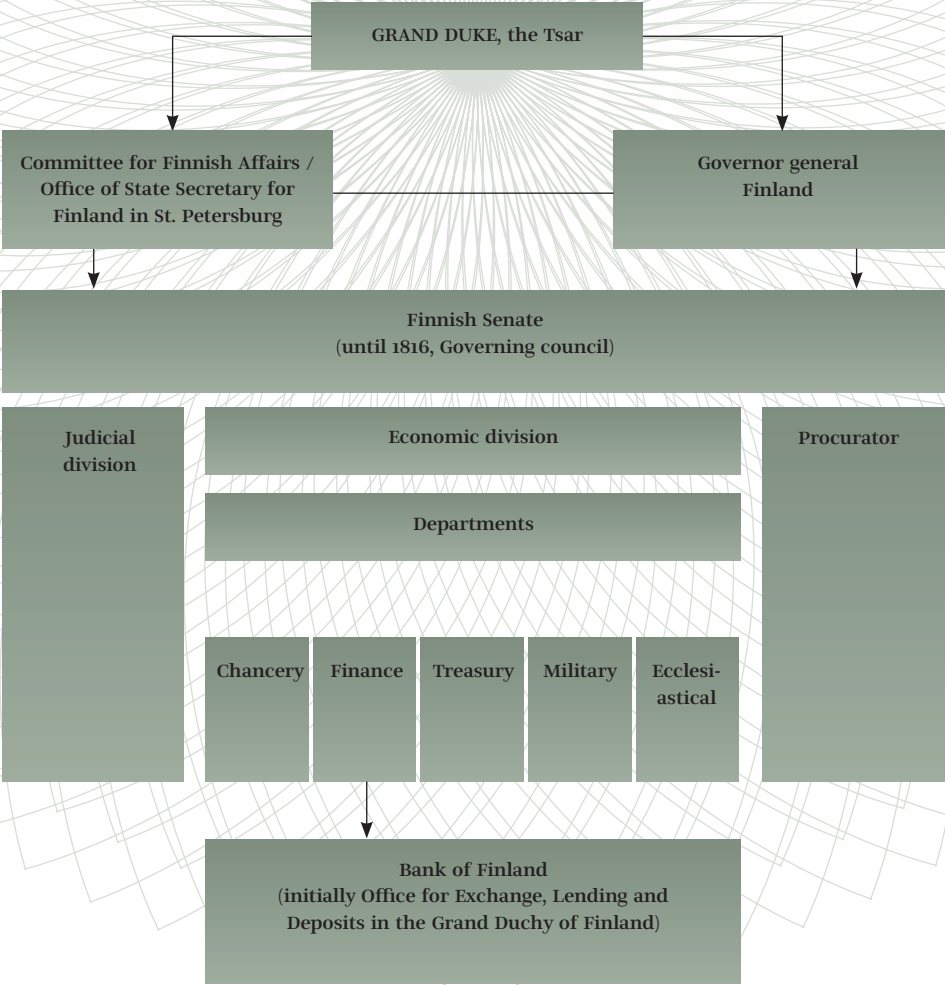
SEPARATE GOVERNING BODY TAKES SHAPE

The tsar kept his promise; the summons was issued on 1 February 1809 and the first Diet of the Grand Duchy of Finland held sessions in Porvoo from 25 March to 19 July 1809. (Finns often use the word “national assembly” although a better translation for the Swedish *lantdag* would be “provincial assembly”.) In the choice of Diet members in Porvoo, Sweden’s parliamentary laws were observed. Not all those entitled to attend did so. Some Finns felt that it was impossible to participate as long as no formal peace treaty had been signed and that their pledges of loyalty to the Swedish king were still in force. In reality the King of Sweden had been deposed two weeks before the Diet was summoned so in this sense a promise of loyalty had lost some of its significance.

The main matters of principle at the Diet of Porvoo were the pledge given to the Diet by Tsar Alexander I as Grand Duke of Finland and the oath of loyalty that he received from the Estates of Finland. Partly these reiterated the same formalities of the previous autumn in St. Petersburg when the deputation from Finland and the tsar had met. The emperor repeated his assurance that he would maintain unchanged the country’s religion, constitution and the privileges granted to each Estate. To this he added the promise to respect the right of private property. In his closing speech in Porvoo, Tsar Alexander I noted that its sessions had “promoted Finland to a nation among nations” (the French words he used were “*placé désormais au rang des nations*”).²⁹

The emperor’s decision, made as early as 1 December 1808, that all laws concerning Finland were to be presented direct to him and not via a Russian minister, proved to be crucial for Finland’s political position. With this promise, Finland’s special status was confirmed at the highest possible level in St. Petersburg. The implementation of this decision meant that the Grand Duchy of Finland was not subordinated

STATUS OF THE BANK OF FINLAND
IN THE GOVERNMENT OF THE GRAND DUCHY
IN THE FIRST HALF OF THE 19TH CENTURY



Source: Savolainen, 1994, p. 179.

to the government of Russia but was ruled by the emperor via state bodies especially created for this purpose. These were a Committee for Finnish Affairs located in St. Petersburg (from 1820, the Office of the Ministerial State Secretary for Finland) and the Governing council

operating in Finland (from 1816 called the Senate). The chair of the Senate was held by the Governor general of Finland.³⁰

The Governing council – later the Senate – was divided into two parts. The Judicial division acted as the highest court of justice of the land while the Economic division acted as the governmental body. There was a separate official, the procurator, who acted as the supreme prosecution authority. The Economic division was divided into departments, of which one, the Financial department, handled monetary affairs. The Bank of Finland was established in 1811 as an institution under the Financial department.

If modern equivalents are sought for the structure of the Governing council or Senate, the vice-chairman of the Economic division can be regarded as the prime minister of the Grand Duchy and the head of the Financial department could be its finance minister. The Financial department naturally prepared the annual budget proposal, and the draft of this was submitted to the emperor for his approval.

The governor general was the emperor's representative in Finland and was ex officio the chairman of the Governing council/Senate but the Governing council/Senate took collegial decisions and the governor general's authority in civil matters was strictly limited. The Governing council/Senate had no direct contact with the emperor, to whom matters were presented by a Secretary of State in St. Petersburg, later renamed the Ministerial State Secretary. Finland's special status was underlined by the fact that, throughout the 19th century, all state secretaries after Mikhail Speransky were Finnish citizens. The governor general in Finland, who also had the emperor's ear, was Russian, so there was a certain Finnish-Russian dualism in the administration of the Grand Duchy of Finland, but it did not generally have an effect on the Bank of Finland's operations.³¹

Finland's position and political unity grew stronger at the end of 1811 when Alexander I decided to combine the governorate of Vyborg, known as *Old Finland*, with the recently established Grand Duchy of Finland, which in those times was known in Russia as *New Finland*. Old Finland consisted of territory that Sweden had ceded to Russia in the 1720s and 1740s, and that had since had been ruled as Russian provinces. Although the Swedish law traditional to the area had been applied, Old Finland had been administratively appended directly to Russia. Russians had been appointed as its local officials and Russian

ministries handled central government decisions about it. Merging Old Finland back into New Finland in 1811 was a very significant matter of principle because, at the time of Finland's conquest in 1808, one option had been the converse, the merging of the newly conquered areas into the parts of Finland that were already Russia.³²

NORTHERN EUROPEAN MONETARY CONDITIONS AT THE TIME OF FOUNDATION

CONSTANT WAR AND MONETARY INSTABILITY

When Finland was separated from Sweden and the first plans were made for a Bank of Finland, monetary conditions in Sweden, Russia and indeed the whole of northern Europe were in serious disarray. The main cause was the wars that had raged in the area for two decades, causing multiple disruptions to local monetary systems and banking.

Until the early 1780s, some sort of order had prevailed, with a degree of standardisation between monetary systems of the region. The traditional money of northern Europe was silver coinage. Its main unit was the silver Thaler, which was in use in most countries of the region though with slightly varying silver content. The underlying model was the German Reichsthaler, a large silver coin whose weight and silver content had originally been defined by the Holy Roman Empire at Augsburg as early as 1566. The Diet of Augsburg decided that the Reichsthaler was to contain the fine silver of one ninth of a Cologne Mark, meaning 25.98 grams in modern terms. Thalers circulated widely in northern Europe and, before long, all the nations of the region began to mint their own. Initially they were used mostly for foreign

trade but over time they became the basis of the whole monetary system in many countries.³³

The uniformity of the Thaler system began to deteriorate over time as variations developed in different countries and many rulers debased the coinage to save silver, but the overall impression is that the German-based Thaler system had a very durable effect in the Baltic area. One sign is that, when Sweden reformed its monetary system in 1776, it took the riksdaler as its monetary unit and main currency. A riksdaler was 25.70 grams of silver, little different from the Reichsthaler defined more than two centuries earlier in Augsburg. It is not often realised today that the State referred to by the “riks” part of the name is not Sweden but the Holy Roman Empire of the German nation.

Thus the monetary system of the Kingdom of Sweden at the start of the 19th century was based on the silver riksdaler. It was divided into 48 skillingar and each skilling into 12 rundstycken. This complex formula was the Lübeck system, originating in Germany and in use at the time in Hamburg, an important financial centre for Sweden. The riksdaler and its subunits were adopted in the currency reform of King Gustav III in 1776. At the same time, Sweden renounced the mark, a monetary unit that it had used since medieval times, and also the old Swedish silver and copper dalers, which had lost their value. This reform reconnected Sweden for a while to the most stable and dependable monetary system then in force in northern Europe, the silver-based Reichsthaler of Hamburg.³⁴

Like the rest of Northern Europe, Russia was officially on the silver standard. The unit of currency, defined in silver, was the rouble, created by Tsar Peter the Great and based on the German Thalers in use in Russia at the start of the 18th century. The rouble was divided into 100 kopeks. Since 1762, during the reign of Tsar Peter III, the silver rouble had been defined as containing 17.99 grams of fine silver so it had somewhat less monetary value than the original Reichsthaler.³⁵ Under the silver standard, the rates of exchange between currencies were determined by their silver content. This means that a Swedish silver riksdaler, for instance, was worth 1.43 silver roubles (or 143 kopeks). The converse relationship was more complex because the Swedish monetary system, based on Germany's Lübeck system described above, was not decimal. A silver rouble, at 0.7 Swedish riksdaler, would have been worth just over 33 skillingar and 7 rundstycken in coins.



■ Silver Thaler coins were once the hard currency of the Baltic Rim. Shown here, a Swedish riksdaler.
– Bank of Finland.

Russia's monetary system was not entirely uniform because the Governorates of Livonia and Courland enjoyed partial autonomy and had their own traditional money. Livonia's system was particularly important economically because the capital of its governorate, Riga, was one of the largest export ports in the empire. Livonia's monetary system was based on the silver *Albertusthaler*, which was not minted in the area but imported from the Netherlands. The *Albertusthaler* was slightly lighter than the original *Reichsthaler* but considerably more valuable than the rouble.³⁶ At the time of the Diet of Porvoo, therefore, it was still possible to find examples of differing monetary systems in the Baltic provinces of the Empire. However, the era of Russian monetary exceptions was coming to a close. In 1810 the rouble was declared the official unit of Livonia and in 1814 payment in foreign coins (including the *Albertusthaler*) was forbidden outright.³⁷ On the other hand, when Poland was appended to the Russian Empire in 1815 as an autonomous kingdom, it was initially allowed to keep its traditional monetary system based on the *złoty* (the Polish gulden). It was simply decreed that 10 *złoty*ch would be equivalent to 1½ silver roubles.³⁸

Silver specie was therefore, in principle, the judicial basis of the monetary systems of all northern European states. However, coins were practically unimportant for the monetary economy in the early years and decades of the 19th century. In their stead, the money in general use was paper – banknotes no longer convertible into precious metal that had consequently lost value in relation to silver. Contemporary attitudes to paper money were dismissive; it was regarded as a mark of dysfunction in the monetary system, resulting from mismanagement of public finances. This diagnosis is in fact rather apt. Since the 1780s all the Baltic Rim countries had become involved in expensive wars, continuing well beyond 1810 in the form of the Napoleonic Wars, and this long period of hostilities had burdened public finances and disrupted monetary systems. For Sweden, the period of monetary disorder began with Russo-Swedish War of 1788–1790, known in Finland and Sweden as the War of Gustav III. Meanwhile Russia's monetary economy was suffering not only from Gustav's war but also from the simultaneous state of belligerency with Turkey. The period of successive hostilities lasted until 1815 and the Congress of Vienna, when the Napoleonic Wars finally came to an end.³⁹

The rising number of banknotes in circulation and the fall in their value were sure signs of the monetary disorder brought on by war. Full-weight silver coins had almost disappeared from circulation in many countries. Sweden and Russia were among the countries that been forced by war to issue large numbers of banknotes and, before long, to discontinue their convertibility into silver. As the value of the notes fell, their governments needed to tackle numerous problems resulting from the difference in value (the *agio* as it was called) between metal and paper money and to make plans for a return to a normal monetary system.

At the turn of the century, as the countries of the Baltic region looked for ways of stabilising their monetary systems, their focus fell on the money market of Hamburg and its Mark banco. This was a monetary unit issued by the city's municipal banking institution, the Hamburger Bank, and defined as worth a third of the silver Reichsthaler. Russia and Sweden, like Denmark and Prussia, closely followed the market quotations of each currency, which showed their exchange rates against the Hamburg Mark banco. Because the silver content of the Mark was guaranteed, this rate also showed the value of each currency in silver. The general aim was to stabilise the value of the faltering currencies in silver and to return to a unified monetary system based on the silver standard. How this was to be done, by what schedule and at what eventual exchange rate remained, at least until the 1830s, the main economic policy questions in northern Europe.

BANKING AT THE START OF THE 19TH CENTURY

The Bank of Finland has been described as the world's fourth oldest central bank after those of Sweden, England and France, which is arguable if the central banks still operating today are the only ones counted. In fact the Bank of Finland had plenty of other antecedents. At the time that it was established, quite a number of *banks of issue* or other public institutions resembling prototype central banks were operating in the north of Europe. These banks had certain common features that clearly influenced the Bank of Finland in its founding period. This was natural. The functions and organisational structure of the Bank of Finland were obviously not born from a vacuum but

reflected the thinking of the times and prevalent banking practices of the north of Europe.

Among the most important central banking prototypes operating in the Baltic region at the start of the 19th century were the Amsterdamsche Wisselbank and the Hamburger Bank, operating in Amsterdam and Hamburg. These were *banks of exchange*, which accepted deposits of silver that the depositors (local merchants and private bankers) could then reassign by means of payment orders. This avoided the need to transport, appraise and exchange a variety of silver coins every time a payment was made. The silver remained in the vault of the bank of exchange and payment was made with bank money that was backed by the silver in the bank, called the *banco florin* in Amsterdam and the *Mark banco* in Hamburg. Banks of exchange made some loans to the governments of their home towns, and also provided short-term credit for private customers but only against silver security. They did not issue banknotes as such but their certificates of deposit were in circulation in their towns, rather like banknotes (although they were generally written for very large sums).⁴⁰

At the time that the Bank of Finland was established, the Amsterdam and Hamburg banks of exchange were already very old and revered institutions. The Amsterdamsche Wisselbank had been founded as early as 1609 and the Hamburger Bank only 10 years later. The heyday of the former was already behind it because Hamburg had taken over Amsterdam's role as northern Europe's financial centre in the 1790s. Although the direct operations of these banks were confined to their home towns, they had a wider influence because, thanks to their dependability as banks of exchange, bills of payment drawn on merchants of Amsterdam and Hamburg were accepted as tender in foreign trade throughout the Baltic region.⁴¹

The banks of Amsterdam and Hamburg were models for the founders of many other banks in northern Europe, including the world's oldest extant central banks, the Bank of England and Sveriges Riksbank. These later banks did not content themselves with the tightly prescribed operations of their Amsterdam and Hamburg precursors but issued banknotes, took deposits and granted various loans. A common feature of the lending of Baltic banks of issue was the great importance of real collateral, such as pledged goods and mortgaged real estate. They also granted many loans to governments. It could be

said that the early northern European banks of issue constituted a particular model characterised by the issue of banknotes against long-term credit.⁴² In the early 19th century, the central banks of both Russia and Sweden were institutions like this. Their nascent development will be studied in more detail later but they had traits in common with the Kurent Bank in Copenhagen (which was founded in 1736) and the Königlische Bank in the Prussian capital of Berlin (founded 1765). Also the national banks of issue of Norway (founded 1816) and Poland (1828) operated largely on the basis of long-term lending against real estate collateral. The widespread use of real estate (agricultural estates and also townhouses) as security for lending naturally reflects the agriculture-based structure of livelihoods in northern Europe in the 18th and early 19th century. Moreover, major landowners were politically powerful in the region and formed the dominant social class, so their interests obviously had a critical influence on the structure of banking.

The theoretical roots for the northern European model of a bank of issue lie in the *mercantilist* (or more accurately *cameralist*) theory of banking, which favoured tangible collateral for banknotes issued. One of the leading theoreticians of cameralist economic policy, James Steuart of Scotland, argued for lending against the value of property because it was the most secure form of collateral and in any case more reliable than commercial loans, such as bills of exchange based on the anticipated business profits.⁴³

In his study of credit conditions prevailing at the end of the 18th century, Per Andreen described the philosophy where the value of a banknote depends on the quality of the underlying loan as the *collateral doctrine*.⁴⁴ Furthermore, the issue of banknotes based on mortgaged property would increase the supply of payment tender, which mercantilists regarded as important. According to the economic theory of the age, the shortage of tender, “circulating capital”, was a serious problem. This was also the reason why John Law, who became famous as the financier behind France’s Mississippi bubble, had established a bank of issue based on mortgaged property at the start of the 18th century.⁴⁵

Apart from real estate collateral, another basis for bank lending in the Baltic region was short-term *commercial credit* granted against the value of merchandise, sometimes known as Lombard loans. This form

of lending was intended to promote trade because the goods financed were typically imports or exports. Trading houses often needed finance to build up stocks and would pay off the loan as the stocks were sold. The underlying merchandise was tangible and so, the contemporary doctrine went, it could be regarded as secure and thereby a suitable form of lending for a bank of issue. Banks in the Baltic region often maintained detailed lists of various types of goods that were valid collateral for a short-term loan.

At the same time as banking based on mortgaged land and pledged goods was still dominant in the Baltic area, a distinctly different theory of banking was taking shape in the financial centres of Western Europe. Under the *real bills doctrine*, of which Adam Smith is regarded as the author, lending by a bank of issue should consist mainly of commercial bills of exchange. A bank should restrict its lending to purchasing from merchants (or discounting, to use the contemporary term) the bills that they had received as promises of payment after an agreed period of time.

According to the real bills doctrine, commercial bills of exchange were the ideal form of credit for a bank of issue because they were self-liquidating. This meant that the commercial activity underlying the bill automatically generated the funds with which the debtor could redeem the bill. Thus a bank would be able to convert its investment in the bill back into cash when needed, relatively quickly and easily – at least in theory. Furthermore, the doctrine went, a bank of issue that gave credit only against commercial bills of exchange would be in no danger of issuing too many banknotes. “Little or no expense can ever be necessary for replenishing the coffers of such a bank.”⁴⁶

At an early stage the real bills doctrine had become the guiding light of operations at the Bank of England. Its management built its defence on this doctrine during the Bullionist Controversy, a renowned monetary policy dispute in the 1810s, when the bank was accused of fanning inflation by lending too much. When Napoleon established the Banque de France in 1800, it was instructed to operate according to the real bills doctrine, and could lend only in the form of commercial credit. On the northern periphery, however, the discounting of commercial bills of exchange was still fairly rare among banks of issue in the countries of the Baltic Sea rim, even at the start of the 19th century. Several more decades were to pass before it became a normal

part of business operations. In many of Finland's neighbouring countries, the idea that lending against commercial bills of exchange was the ideal mode for a bank of issue did not become established until the middle of the century.

The third banking doctrine, conflicting with the previous two, was that banknotes or other forms of payment created by banks should only be substitutes for existing metal coins and their issue should be limited to the bank's holdings of precious metal. This doctrine had deep roots as the guiding principle of the Amsterdam and Hamburg banks of exchange, and it enjoyed broad support when the monetary system in the world was based on the gold or silver standards. Per Andreen calls this the *reserve doctrine* because the value of a banknote depends on the reserve of metal that backs it.⁴⁷ Later in the 19th century this doctrine developed into the *currency principle*, which was followed when the Bank of England was reorganised by Peel's Bank Act in 1844. In the 1870s, as the gold standard spread from England to other countries, it came to influence many other banks of issue as well.

EARLY BANKING IN THE KINGDOM OF SWEDEN

STOCKHOLMS BANCO

Many of the oldest features underlying the operations and organisation of the Bank of Finland were a legacy of Sweden's state bank. The roots of the Bank of Sweden, in turn, stretch back to an institution named Stockholms Banco, established in 1656. This was Sweden's first bank and the first institution in Europe to issue banknotes. Stockholms Banco is also known as Palmstruch's Bank after its founder Johan Palmstruch, who patterned it on the banks of Amsterdam and Hamburg. These are also mentioned in its charter, which was signed by the King of Sweden. The charter's preamble specifically refers to Palmstruch's offer to create a bank of issue "for the realm and provinces of Sweden" in line with the Amsterdamsche Wisselbank and the Hamburger Bank. Johan Palmstruch, born in Riga as Hans Witmacker, had worked for several years as a merchant in Amsterdam, where he had even spent time in debtor's prison. On his release, he had moved to Sweden and was later ennobled there, taking the name Palmstruch.⁴⁸

The usefulness of a bank was not in doubt, at a time when a normal medium of payment in Sweden was a strange and very cumbersome currency, copper plates denominated in dalers. Ninety of these dalers were minted from one Ship's pound (= 136 kg) of copper, so each weighed about 1½ kilograms.⁴⁹ Palmstruch's proposal for a bank noted its beneficial effects on trade but he also argued that it could earn large profits from lending. He cited the large sums that he said the Amsterdam bank had earned for its owner, the city

of Amsterdam, although he seems to have greatly exaggerated its profitability. At any rate, the use of deposits for lending was a central part of Palmstruch's original plan, as shown by the structure of the bank, which consisted from the outset of two departments with separate accounts. The Wäxel-Banco department was to act as a bank of exchange and serve as a centre for payments traffic, and it soon also began to issue banknotes. The Låne-Banco department in turn granted loans and accepted interest-bearing deposits.⁵⁰

Stockholms Banco was unlike its continental prototypes, in that it was set up as a private company, admittedly under the strict supervision of the Crown as laid down in its charter. The banks of Amsterdam and Hamburg had been entirely municipal institutions. In its practical organisation, though, Stockholms Banco was more like a state institution than a private company. Its regulations were confirmed by the King, who also nominated its top officials. Its "shareholders" were chosen by its governor (in this case, Johan Palmstruch) and they apparently invested nothing although the regulations stated that they were to receive a quarter of its profits. Half were to go to the Crown and the remaining quarter to the city of Stockholm.

Operations differed from the banks of Amsterdam and Hamburg in two significant respects. The first was that Stockholms Banco had far more flexible lending principles. The Amsterdam and Hamburg banks were mere banks of exchange, which did not provide credit to private individuals except against pledges of precious metals as security. By contrast, the loan department of Stockholms Banco provided loans against several other forms of security, such as merchandise and real estate. Of the many types of security mentioned in its charter, the most common in practice was real estate. Loans were also often granted against a personal guarantee and sometimes even without collateral.⁵¹

The most important innovation of Stockholms Banco, separating it from all its predecessors and giving it a special position in monetary history, was that it issued Europe's first real banknotes. What can be called a banknote is of course a question of definition and is open to some interpretation but the *Credityf-Sedlar* (credit notes) issued by Stockholms Banco differed from previous payment orders written on paper in the sense that they were specifically meant to circulate as means of payment and were designed with this in mind. They were written for fixed, round sums that made them suitable for use as currency. Furthermore they

were issued directly in connection with bank lending, without any corresponding deposits of metal being required.⁵²

The credit notes of Stockholms Banco quickly became very popular because of their convenience and initially they traded at a premium compared with copper plates. However the bank's rapidly rising lending and the consequent growth in the number of notes led to a fall in the exchange rate of the Swedish daler and the large-scale flight of copper from Sweden. The bank also began to experience demand for copper as increasing numbers of notes were presented for redemption. Eventually its copper reserves fell so low that the convertibility of notes had to be restricted in autumn 1663. After this the value of its credit notes began to decline against copper. Palmstruch proposed to resolve the crisis by acquiring more copper, but the run on the bank meant that all the copper obtained and all the coins that were minted disappeared abroad immediately. The crisis worsened and the value of the credit notes fell ever more steeply.⁵³

Sweden's parliament discussed the bank's troubles in 1664 and reached the conclusion that the bank was a useful institution in itself but that the problems had been caused by credit notes. It concluded that the way to restore faith in the bank was to withdraw the notes from circulation. On 3 August 1664 it was proclaimed that all credit notes would to be redeemed "within a year and a day". In practice this meant that the bank was rescinding all old loans and refusing to make new ones. The result was an economic crisis and the end of Stockholms Banco operations in the same autumn, although this had not been Parliament's intention. The bank's liquidators continued loan collection and credit redemption after other operations had ceased, until May 1667.⁵⁴

Palmstruch himself was imprisoned and ordered to pay compensation for the bank's losses on pain of death, though he was later pardoned. He died in 1671, just a year after being released from prison.⁵⁵

STOCKHOLMS BANCO, TURKU OFFICE

The charter of Palmstruch's bank referred to the intention to bring banking to the provinces, not merely Stockholm. Stockholms Banco did indeed set up a branch in Turku, the first attempt to practice banking in Finland, although it did not last long.

The Turku office was one of three Palmstruch's banks opened outside Stockholm. It was not entirely separate from Stockholms Banco but had a certain independence, formal as well as operational. Evidence of this is the key role played by the municipality in obtaining a bank office for its town and in guaranteeing its operations. The banknotes, obtained from the bank in Stockholm to establish the office, were specifically "entrusted" to the town although, for safety's sake, they were also personally guaranteed by Customs supervisor Didrik Backman and Mayor Nicolaus Leitzen. In his study of the Turku office, Bruno Lesch concludes that it was somewhere between a branch and a separate bank, a part of Stockholms Banco but a municipal credit institution at the same time.⁵⁶

Bank operations in Turku began in summer 1663. Following the example of head office in Stockholm, and in line with the Hamburg model, the Turku office was divided into two departments, an exchange department and a loan department. The exchange department existed solely to exchange copper plate money for banknotes received from Stockholm. The demand for notes was so strong that within a few months all of the notes received from Stockholm were in circulation. Obviously the cumbersome nature of copper coinage at the time created a demand for alternatives in Finland, too. The operations of a bank of exchange also made it far easier to arrange payments between Turku and Stockholm because money could be transported in the form of paper rather than heavy metal. Operations in Turku came to an abrupt end when Stockholms Banco ceased operations in 1664.⁵⁷ The bank in Turku was thus but a flash in the pan and 140 years would elapse before there was any other type of banking in Turku or elsewhere in Finland.

As a consequence of Finland's geographical separation in the realm of Sweden, especially in winter when there could be no shipping, it is quite understandable that the matter of a bank in Finland was raised from time to time after the Stockholms Banco Turku office had closed. The copper coinage in circulation in Sweden in the 17th and 18th centuries made large payment transfers extremely difficult, which of course underlined Finland's geographical isolation. As long as copper was the main means of payment, it cannot have been very convenient to depend on distant Stockholm for banking services.

FOUNDING OF A SWEDISH NATIONAL BANK

In June 1668, a short while after liquidation of Stockholms Banco had been completed, the Council of the Swedish Realm, acting in the name of King Charles XI, who was a minor, asked the assembled Diet of the Estates “whether the bank should perish or be rebuilt”. The Estates of nobility, clergy and burghers responded with their desire “to defend, protect and nurture” the bank but the representatives of the peasantry did not concur “because of the great damage that credit notes have caused them”. On the basis of this response the council granted the Estates a charter to operate a bank and to determine its establishment, structure and administration “insofar as it is efficacious and expedient”. On 22 September the Diet approved a banking statute by which a bank of Stockholm named the Bank of the Estates of the Realm (*Riksens Ständers Bank*) would recommence operations in a new form, now as a distinct national bank.⁵⁸

The initiative seized by the Swedish Diet in 1668, when it decided to resume banking operations under its own auspices, had significance that stretched 143 years into the future, when the Bank of Finland was established. It was the beginning of what, for the times, was a very exceptional arrangement, whereby a state bank of issue (which later developed into the central bank) was subordinated to parliament and thus separated from the Crown, then the executive. Generally central banks have either developed from private companies operating under a public charter and public supervision (such as in England), or have been owned by the government from the outset and thereby subordinated to the ministry of finance (for example in Russia). There have also been many examples of mixed public/private ownership⁵⁹ but it was apparently a Swedish innovation to make parliament the proprietor and manager of the central bank. The Bank of Finland’s current administrative position has the same Swedish origins.

After the establishment of a Swedish national bank, its operations and internal organisation followed the example of Stockholms Banco. It was again divided into two departments, for exchange and for loans. Most of the lending of the loan department took place against real estate security, generally agricultural property. Many loans were also granted to the Council of the Realm and its institutions. Initially loans were for no

longer than a year but it became common to renew them so their real duration increased and mortgages became in practice almost perpetual. The loan department also accepted long-term interest-bearing deposits.

The exchange department followed the example of the Amsterdam and Hamburg banks in accepting deposits of precious metal that the depositor could then assign to another account holder by means of a payment order. The issue of banknotes was initially forbidden to prevent a repetition of the experiences of Stockholms Banco but in 1710 the bank began to issue transfer notes (*transportsedlar*) whose issue was gradually increased until, in the course of the 18th century, they became the main medium of payment in the realm of Sweden.⁶⁰

As was often the case, the history of paper money in the Kingdom of Sweden is a chronicle of financing wars and of consequent inflation. Sweden's history in the 18th century was characterised by repeated hostilities that cost it its position as a great power. The country was weak and unstable both economically and politically. After the catastrophic reign of Charles XII, its kings were stripped of real power and the Diet, under the leadership of the nobility, exercised both executive and legislative authority. The competing factions of the Diet, known as the Hats (Hattarna) and the Caps (Mössorna), sought support from foreign powers.

In the Diet of 1738, the pro-French Hats rose to power and began to pursue a mercantilist industrial policy and a foreign policy that sought to avenge earlier losses to Russia. Both endeavours proved expensive to the public purse and were financed by borrowing from the Bank of the Estates of the Realm. This resulted in a sharp rise in the number of banknotes. The Swedo-Russian War of 1741–43, known as the *Hats' Russian War* in Sweden and remembered in Finland for a period of occupation by Russian troops known as the *Lesser Wrath*, had a decisive monetary effect. The war ended badly and, in the peace treaty, the south-east corner of Finland was ceded to Russia. The value of money began to fall and in October 1745 the convertibility of banknotes was suspended. Sweden had moved to a fiat system.⁶¹

The wars did not end here. In 1757 Sweden entered the Seven Years' War that had engulfed Europe, attacking Prussia in allegiance with France and Austria. The Pomeranian War, as it is known in Sweden, after the then-Swedish territory of Pomerania where the Swedish army fought, ended in Sweden's defeat. Another wave of inflation ensued.

After the move to paper money, the general price level rose steeply. From 1741, when the Swedo-Russian War began, to 1765, when the rival Caps faction rose to power in the Diet, prices more-than-doubled. Plans were made to halt inflation and reverse it. According to its exchange rate in Hamburg, the Swedish paper daler was now worth only about 40 % of what it had been before inflation started in the 1740s. The Caps' plan to restore the daler rate to its original level was fundamentally unrealistic and the attempt to do it by slashing the amount of money in circulation led to a serious economic crisis.⁶²

A Finnish member of the Diet, Anders Chydenius, who was one of the Caps' most influential economic experts, saw the dangers of his faction's deflation plans. In his 1766 work "Rikets Hjelp, Genom en Naturlig Finance-System" (Assisting the Kingdom through a Natural Monetary System) he stated that the only sensible alternative was to accept the existing depreciation of the currency and restore convertibility to metal at the established market exchange rate.⁶³ Returning to a metal standard but at a lower rate was an option called *realisation*. This pamphlet can be regarded as the first monetary study by a Finn. It was not heeded and Chydenius was expelled from the Diet for writing it. Monetary realisation, in line with Chydenius' recommendation, would come later implemented by King Gustav III.⁶⁴

THE REFORM OF GUSTAV III

In August 1772, King Gustav III, then only 26 years old, seized power in Sweden and imposed a new constitution on the country. The King's coup ended the period of domination by the Estates, known as the Age of Liberty. The form of government imposed by Gustav in 1772 was later to have great influence on Finland's political development throughout the 19th century and also on the future status of the Bank of Finland. When Tsar Alexander I promised the Diet of Porvoo that he would uphold Finland's "constitutions", he was interpreted, at least in Finland, to mean the form of government of Gustav III. Under this interpretation, Alexander became the constitutional monarch of Finland, although Gustav's constitution gave the King very broad prerogatives.

The new form of Swedish government confirmed the traditional subordination of the national bank to the Diet. The 55th article of Gustav's constitution stated that "the Bank of the Estates of the Realm shall

■ Anders Chydenius, rector of Kokkola and a Finnish member of the Diet, criticised Swedish monetary policy so harshly that he was expelled from the Diet in 1776. – J.F. Martin, stipple engraving and aquatint, 1805. Board of Antiquities.



remain as hitherto, at their disposal and subject to the instructions and regulations that have been imposed or that the Estates may yet impose.”⁶⁵ The constitution allowed the Diet to elect members to a banking committee, to which the operational management of the bank reported.

In practice however, the Diet’s decision to delegate financial stabilisation measures to the King, including policy on exchange rates, meant that the king now had ultimate authority in monetary matters.⁶⁶ The King and his minister of finance Johan Liljencrantz applied an exchange rate policy that imposed strict limits on monetary policy and left the bank hardly any room for independent decision-making.

The bank discontinued its deposit and lending operations, which had been substantial until now, and set about reducing its credit portfolio. During this phase of preparations for monetary reform, Sweden’s money market was extremely tight and lending by the Bank of the Estates was seen as too inflexible to satisfy the great demand for credit that existed at the time. The bank granted loans only against security in real estate or metal, and not against personal guarantees, nor did it discount bills. However, Finance Minister Liljencrantz had a more liberal attitude towards business than had previously been pursued, and wanted to improve the availability of commercial credit. He therefore arranged for the establishment of a separate discounting body alongside the Bank of the Estates.

In 1773 a “gracious charter” was granted to a private credit institution named the *Discont-Compagniet*, which has been regarded as Sweden’s first commercial bank. Its aim was to provide short-term commercial credit, which it financed by borrowing. For every deposit, the Discount Company wrote a promissory note that was equivalent to a depository certificate. Because there was a great shortage of tender at the time, its depository certificates began to circulate as a medium of payment and in practice became paper money. According to Sven Brisman, depository certificates of the Discount Company circulated throughout the country, especially after it began issuing them for round amounts, like banknotes.⁶⁷

To ensure that operations were profitable, the Bank of the Estates loaned 100 000 riksdaler to the Discount Company at 3 % interest. For this amount, the Discount Company wrote bearer payment orders, which entered general circulation. The funds that it obtained were used for lending at 6 % interest. Loans were granted against payment orders, depository certificates and promissory notes. Under the terms

of its charter, it could grant credit only to businesses and the amount that a private individual could receive was strictly defined. The operations of the discount company were very profitable but its charter ran out in 1785 and was not renewed. Gustav III had decided that the state should take over its business, no doubt attracted by its profitability but also probably by his calculation that the Crown would be able to obtain loans more easily from a discount bank that was in state hands.⁶⁸ After the company's charter had expired, a new General-Discount-Contoir was established in 1787, to carry on its business.⁶⁹

Preparations for the currency reform were entrusted to Finance Minister Liljencrantz, who held long and convoluted talks about the matter with the banking committee and the management of the Bank of the Estates. The King and Liljencrantz were strongly in favour of swift execution but the banking committee had reservations about a rapid timetable. Apart from timing, the key issues to be decided were the target exchange rate, what reserves of silver the bank would need for convertibility and how the silver reserve was to be obtained.

The main decision was made on 26 November 1776 and the currency reform took effect at the start of the following year. Sweden returned to the silver standard after a 30-year period of paper money that had been for the most part chaotic. The rate chosen for converting old daler notes meant that their value in silver was fixed at exactly half what it had been at the start of the 18th century when the notes had last been convertible into metal. The redemption rate for old paper money was exactly the rate proposed by Anders Chydenius in 1766, for which he had been expelled from the Diet.⁷⁰

The decade after 1777, when silver coinage and paper money convertible to silver (plus copper change convertible to silver) were the only legal tender in the realm, was good for the economy of Sweden and Finland. The operations of the Swedish national bank were defined in banking regulations in 1779 and 1786, which laid out the bank's objectives, its policies on issuing notes and credit and how it was to be managed. The regulations reflected Swedish views prevailing at the end of the 18th century about how a healthy bank of issue should function. It is useful to compare these regulations and the banking procedures they defined with the ideas and wishes put forward at the Diet of Porvoo about the future operations of a Finnish bank as well as how the Bank of Finland actually functioned. This comparison shows the

extent to which the ideas presented at the Diet and the Tsar's ultimate decisions corresponded with the concept of operations of a bank of issue, formed during the period of Swedish power and to what extent they differed from the Swedish model.

In his study of the nature of paper money and the determination of its value, Per Andreen divides the Swedish debate into three schools of thought: quantity theory, bullion theory and mortgage theory. The theory of quantity treated banknotes as a means of payment, bullionists saw them as redeemable depository certificates and the mortgage school regarded them as the bank's debts. The regulations of 1779 and 1786 put the bank's function in very bullionist terms. The main aim was to safeguard the achievements of the currency reform and ensure the convertibility of notes into silver, which was best done by ensuring a reserve of metal in the bank. According to the quantity theory, Andreen states, the value of notes would be protected by preventing their excessive issue while mortgage theorists thought that their value depended on the general capital adequacy of the issuing bank, ultimately the quality of its lending.⁷¹

According to its regulations, the national bank was to aim in all ways at covering its redeemable notes and other commitments by ensuring that its silver reserve accounted for $\frac{3}{4}$ of its liabilities. The other commitments consisted of deposits made in giro accounts at the bank of exchange, which were transferable by payment order. With a target reserve ratio of three-quarters, the bank would reach a condition where "in accordance with the primary objective of its creation, it would remain a general establishment for the safekeeping of funds of persons of the realm, possessing the same protection of monetary content and virtue as if they had managed and secreted their own money; particularly when the bank, for the quarter part that is lacking from available reserves, can turn to its real estate receivables...". This excerpt reveals the main features the bank's operations: an almost complete silver cover for banknotes, with the unbacked portion of funds invested in real estate loans.⁷²

Among the ways of attaining and maintaining a suitable reserve ratio, the most important was a reduction in the supply of banknotes, achieved by restricting the amount of lending. With this aim, the regulations stated that real estate loans should be subject to a 2 % annual amortisation charge in addition their 4 % interest. This overturned the

regulation of 1756 by which property loans were entirely exempted from amortisation and thus became perpetual. At the same time the silver reserve was strengthened. The banks copper reserves were to be sold and converted to silver. In its new loans the bank was to be temperate. The regulations stated that, until the decreed three-quarters reserve ratio was achieved, loans were to be granted only for a predetermined short period and only against easily liquidated deposits of metal.⁷³ This regulation, which was strictly observed, led to very tight lending and soon proved to be unrealistic. It threatened to eliminate the national bank's position at the fulcrum of Sweden's monetary system.

THE NATIONAL DEBT OFFICE

The tight limits on banknote issue by the Bank of the Estates, imposed after the currency reform of Gustav III, were intended to ensure sustainability of the silver standard and so prevent the recurrence of the inflation caused by the Hats' Russian War. The bank's regulations proved inadequate for this task when the king declared war on Russia. The government now needed money but, because of its strict reserve principles, the bank was unable to oblige.

Gustav III's War began in June 1788 when Russia was at war with Turkey. Gustav felt that circumstances favoured him and launched an attack across the River Kymijoki in Finland, then the border. The king's aim was to retake the territories of south-east Finland that had been lost to Russia early in the century. Although most of the Russian army was in the south, tied up in operations against Turkey, the war went badly for Sweden and the conquest of "Old Finland" failed. The war ended inconclusively with the Treaty of Värälä in 1790, which left the border unchanged, but even if it achieved nothing, the war was extremely expensive for Gustav III. It weakened the financial state of the realm so greatly that Sweden was forced to return to a fiat money system. The stability created by the currency reform of 1776 had lasted little more than a decade.

Financing Gustav III's War was impossible by normal methods, and the Bank of the Estates was prevented from granting loans by its regulations on banknote cover. Instead 1789 saw the creation of a new institution, the Riksens Ständers Riksgälds-Contoir, later called simply the Riksgäldskontoret or National Debt Office. This was separate from

the national bank and, although formally subordinate to the Diet, it was in practice entirely under the King's thumb. The National Debt Office financed public expenditure by issuing treasury notes. These were originally interest-bearing securities but were in fact intended for use as a medium of payment, as evidenced by their smallest denominations, which were lower in value than the notes of the Bank of the Estates. The smallest banknotes were two riksdaler, which was a fairly large sum at that time, whereas the smallest treasury notes had a nominal value of only 12 skillingar, or a quarter of a riksdaler. In 1791 interest was abolished on treasury notes. Redemption of treasury notes in precious metal ceased almost as soon as it began, after which their value began to decline against silver and banknotes. As a consequence, treasury notes became inflationary paper money. Sweden had returned to the chaotic parallel currency system from which the country had suffered earlier.⁷⁴

Once redemption of treasury notes was suspended, the obstacles to financing state spending with paper money were swept aside. Despite the peace treaty of Värälä, the volume of treasury notes in circulation went on rising in the years that followed. At the same time the number of banknotes fell. By the end of 1791 the number of banknotes was only half that of the pre-war period and two-thirds of the paper money supply were treasury notes. The ratio continued to move to the "detriment" of the bank, and, by the end of 1800, banknotes were only 8 % of the paper money in circulation.⁷⁵

After treasury notes had become tender and their value had been separated from banknotes tied to silver, the National Debt Office became the de facto central bank, replacing the Bank of the Estates. The final stroke came in 1789, when a banking institution offering loans in treasury notes was established alongside the National Debt Office. The "Discont Werk med Ständers Contoirs Credit-Sedlar", or State Discount House, had a few private shareholders but was mostly state-owned and was controlled by the National Debt Office.⁷⁶

Because banknotes redeemable in silver remained in circulation alongside debased treasury notes, Sweden had created a rather unusual parallel monetary system, with two currencies that fluctuated in value against each other. On the one hand was the *riksdaler banco* or banknote riksdaler, and on the other the *riksdaler riksgälds* or treasury note riksdaler. Treasury notes were not decreed legal tender, which could not be refused as payment, but they were accepted as payment



■ The Bank of the Estates of the Realm operated in the 18th and 19th centuries from a building designed by Nicodemus Tessin the Elder on Stockholm's Järntorget square. – Copperplate by Willem Swidde after Erik Dahlberg 1691. Original sketch in Erik Dahlberg's work *Suecia antiqua et hodierna* (Ancient and modern Sweden) I.

Board of Antiquities.

by the state, which naturally enhanced their legitimacy in private business operations, too. In practice treasury notes came to constitute the main medium of payment and also became a general measure of value, except in foreign trade. The other main use for banknotes, apart from payments abroad, was to amortise old debts, because loans received in bank money generally had to be discharged in bank money.

The growing volume of treasury notes stoked Sweden's rising inflation. According to Åmark the general price level measured in treasury note riksdaler rose about 77 % during the inflationary period lasting from 1789 to 1800. The value of a treasury riksdaler fell substantially against the banknote riksdaler and stable foreign silver coinage. For example, the rate of a Hamburg mark banco in Stockholm in 1800 was almost 40 % higher than it had been when the treasury note riksdaler was first issued. Finally, in the early 19th century, the value of the treasury note riksdaler settled at about two-thirds of the value of the banknote riksdaler.⁷⁷

At the turn of the century the operations of Sweden's national bank were at a nadir. The first of the three reasons was that the increased volume of treasury notes had driven out banknotes as the prevailing means of payment. The second cause was the strict reserve requirement imposed on the bank in the currency reform of 1777, which demanded that a full three-quarters of the value of notes issued should be backed by silver, compelling the bank to keep lending at a very low level. The third reason for the declining significance of the national bank in the late 18th century was that most commercial loans were being granted by state-run discount houses. Of the Bank of the Estates of the Realm, writes Brisman, there were "only ruins left". The low point was 1799, when its operations were almost at a standstill.⁷⁸

CURRENCY "REALISATION" OF 1803

The fact that notes of fluctuating value were the main means of payment created difficult and undesirable uncertainty in monetary matters. In 1800 the Diet agreed on a currency reform plan that would have stabilised the exchange rate for treasury notes but not at a level as low as the market rate had fallen to. The plan called for treasury notes to be replaced by new "current notes", which in turn would have been redeemed and taken out of circulation within 15 years.⁷⁹ This

complex plan was not implemented despite the Diet's approval of it. Instead the government of Sweden decided on a different reform programme that was implemented in 1803.⁸⁰ The reform meant acceptance of the depreciation of treasury notes; their convertibility into silver was to be restored, not at their original parity, but at a lower rate that took into account their loss in value: it was thus a currency realisation. One riksdaler in silver or in banknotes was now worth exactly 1½ riksdaler in treasury notes. The Bank of the Estates was put in charge of redemption and was therefore made responsible for the treasury notes that had been issued by the National Debt Office. In compensation, it was allowed to book receivables from the State for each treasury note that it redeemed. In practice the treasury notes remained in circulation and long retained their dominant role as a medium of payment. Once redemption had begun, however, their exchange rate against banknotes was completely fixed and the treasury note riksdaler now became a subunit of the official riksdaler. Despite the reform, Swedish money sums were commonly calculated in treasury note riksdaler right up to the 1850s. This was in accordance with the aims of the 1803 currency reform; that treasury notes would remain in use as a medium of payment but would now be backed by the bank so that their value against banknotes was stable.⁸¹

The 1803 reform and the start of treasury note redemption meant a return to the silver standard in the Kingdom of Sweden. This rebirth of the Gustavian system of 1776 was to be short-lived because banknote convertibility into silver had to be interrupted again in 1808 when Russian forces attacked into Finland.

For the Bank of the Estates, the 1803 reform meant that it had regained its central position in Swedish monetary matters and the credit market. All paper money became its responsibility and so did the state discount houses. The "General-Discont-Contoir" and the "Discont Werk med Ständers Contoirs Credit Sedlar" were terminated and a new "Riks-Discont-Werk", or National Discount Office, was set up in their place. The institution is described by Brisman as "superficially independent" but in practice a department of the Bank of the Estates. It was a limited company that was mainly owned by the national bank but had some private shareholders. Its activities differed from those of its predecessors in that it was not engaged in borrowing from the public by issuing promissory notes or by accepting deposits.⁸²

TURKU DISCOUNT OFFICE

Sweden set great hopes on discount houses at the end of the 18th century and the start of the 19th, believing that they would stimulate business life. Initially they were established in Stockholm but it was part of the currency reform plan of 1800 that private discount offices would be set up in “the most distant, populous and vigorous” cities. The aim was to alleviate the tightness of money markets that the planned currency reform was expected to induce.

Alongside the “Riks-Discont-Werk” of Stockholm and under its control, three provincial discount offices were established between 1802 and 1805 in Göteborg (Gothenburg), Malmö and Turku. Like the National Discount Office in Stockholm, the provincial offices granted credit, not merely against security but also against personal guarantees (like bills of exchange). Unlike the National Discount Office, they were also engaged in borrowing, by issuing promissory notes yielding 3 % interest. In addition they widely issued banknotes – payment orders, named assignats – which were equivalent to paper money and which the Bank of the Estates in Stockholm was responsible for redeeming.

For the issue of assignats by a discount office, the Bank of the Estates operated as the cashier. When an office granted credit, it did not need to provide the sum in cash but instead gave the recipient an assignat, which was an order payable by the Bank of the Estates. These payment orders were issued against an account held at the Bank of the Estates. In practice assignats were not usually presented for redemption immediately but circulated for long periods as a medium of payment equivalent to banknotes. Their banknote-like qualities were enhanced by the fact that they were printed and issued for fixed sums. The values of assignats were between 5 and 100 riksdaler, so they complemented the large-denomination promissory notes that paid 3 % interest. The low denominations of assignats indicate that they were meant for general circulation as a medium of payment.⁸³

The Turku Discount Office has a crucial place in the history of the Bank of Finland because in many respects it can be regarded as its de facto predecessor. It deserves broader study because it was Finland's only banking institution in the period immediately preceding the establishment of the Bank of Finland. As will emerge later, many of the men centrally concerned with establishing the bank and involved

in its early operations received their practical banking experience as officials, shareholders and customers of the Turku Discount Office. The Bank of Finland was not created from scratch but, in terms of skills and human resources, took over where the discount office had left off.

The King signed the charter of the Turku Discount Office (Åbo Discont Werk) in 1805 for 15 years. The bank's capital was set at 150 000 riksdaler specie, which was to be paid in items of silver, foreign silver coinage and defunct Swedish coins. The amount was less than the 200 000 riksdaler of the office in Göteborg but greater than the 100 000 riksdaler of Malmö. It was to be deposited with the National Discount Office, which would issue the Turku office with banknotes. In addition to this capital, the Turku Discount Office could received credit from the National Office against its own 3 % promissory notes up to the amount of its own capital, 150 000 riksdaler. The Turku Office was also allowed to borrow funds from private individuals by issuing limited-duration 3 % promissory notes written for the sum of at least 100 000 riksdaler, which could be redeemed not only in Turku but also at the Bank of the Estates in Stockholm.

Lending by the discount office was in the form of promissory notes. Their term could not be longer than six months and the interest rate was set at half a percent a month. The interest was deducted from the sum lent when the loan was drawn down, explaining the word "discount" in the institution's name. In addition to promissory notes, the office was also permitted to discount payment orders and domestic and foreign bills of exchange, so the financing of commerce was obviously regarded as within its remit.

Shares in the Turku Discount Office were offered in September 1809 and greatly oversubscribed. Finnish would-be investors were disappointed that more than three-quarters of the shares went to investors from across the sea in Stockholm, who were thereby entitled to the lion's share of future profits. The Finnish investment was less than half the amount offered. Yet despite the large number of shares in the hands of Stockholm residents, only people of Turku were elected to the board of the Turku office. At the first company meeting, Gabriel Erik Haartman, Claës Johan Sacklén and Jean Tjaeder were appointed directors. Haartman became the chairman of the board. He and Sacklén later served in the most important posts of Finland's financial administration after the country had been

N:o 3127

R 50



Herrar Commisfarier i Riksfens Ständers Bank behagade till
Sedehafvaren vid anfordran betala en Summa af Femtio
Riksdaler Specie. Ställandes denne Summa på Åbo Discont
Werks Räkning N:o 2

Åbo d. 13 Mars 1807.

R 50

Wiisä Kymmendä Kowa Niikin
Taleria.

Gabriel Haartman

Jean Tjaeder

■ A note for fifty riksdaler issued by the Turku Discount Office in 1807. The signatories are G.E. Haartman and Jean Tjaeder, leading bankers in Finland in the early 19th century. – National Museum of Finland / Numismatic collection.

Board of Antiquities / Outi Järvinen.

annexed to Russia. The discount office operated out of the premises of Tjaeder's firm in Kirkkokatu Street, Turku and apparently Tjaeder was in charge of operations, serving as a kind of managing director.

The Turku Discount Office opened on 1 August 1806. Despite the simplicity of its business, activities expanded surprisingly fast during the brief time that it remained in operation. By the end of 1806 it had granted loans worth 221 680 riksdaler and by 1807 a full 1 079 520 riksdaler. By spring 1808, when war forced its sudden closure and its funds were confiscated to Stockholm, more than 1600 loans had been granted. Even at the end of 1808, its financial statement showed a loan portfolio of 619 500 riksdaler. Both the number of loans and their total amount were rather large in view of the small size of the Finnish national economy at that time. They were also substantial compared with the size of early Bank of Finland operations.⁸⁴

The fast expanding business of the Turku office came to an abrupt close when the Russian army attacked Finland in February 1808. Even before the outbreak of war, in 1807, speculation in Sweden had caused investors there to begin presenting Turku discount office notes to the Bank of the Estates for redemption. When news of the Russian attack reached Stockholm on 29 February, a week after it had begun, panic among depositors spread to all discount offices. The banking committee of the Estates decided to grant loans to rescue the offices from bankruptcy and redeemed notes of the Turku Discount Office to a total of 232 000 riksdaler. The Malmö discount office received even more support.⁸⁵

Two weeks after the outbreak of war, on 7 March 1808, the board of the Turku discount office received a semaphore telegram from the banking committee of the Bank of the Estates in Stockholm, instructing it to transfer the whole office including all documents to Stockholm immediately. Fairly soon afterwards, on 11 March, the office assets were despatched by sea from Turku but, judging from extant records, the shipment was compelled to wait in the Åland Islands for two weeks because of difficult ice conditions. The crossing to the Swedish mainland could not take place before 23 March, in other words a day after Turku had fallen to Russian forces. On 6 April Captain Seippel, in charge of the shipment, returned to Turku to tell that the cargo was safe in Stockholm.

By this time the board of the Turku Discount Office had already petitioned General Buxhoevden, leading the occupation forces, for protection of the Office's assets, in the event that they would have to be

sent back from Åland to Turku. The grounds for their request were that the funds of the office were private property. Buxhoevden granted their request but at the same time asked the Governor of the Province of Turku and Pori to make sure that the assets were indeed returned. When news that they had reached Stockholm was received, office director Tjaeder informed Buxhoevden, who had no choice but to accept the situation.

After this evacuation, the operations of the Turku office were not restarted. It was put into liquidation and dismantled. For a brief while, an interim board operating out of Stockholm acted as liquidators but responsibility was transferred back to the original board in Turku at the end of 1809. The last company meeting was held in Turku at the end of May 1812, just as the recently-established Bank of Finland was beginning its operations in the same town. Interestingly, the complicity of board directors Haartman and Sacklén in the operation to evacuate the discount office under the noses of the Russian occupying army seems to have done no harm to their later brilliant careers as members of the Imperial Governing council of the Grand Duchy of Finland.⁸⁶

VALUE OF SWEDISH MONEY DURING THE FINNISH WAR

When the Finnish war began, Sweden's Bank of the Estates began to restrict the redemption of banknotes for silver, although no formal decision was taken on ending convertibility. As Heckscher notes, this was the third time that war against Russia had forced Sweden off a metal standard. Initially the restrictions on redemption of banknotes were only tentative but by 1809 banknotes were convertible into metal "in name only".⁸⁷ Regardless of the far-reaching consequences of going off the silver standard and, in effect, renouncing the achievements of the 1803 currency reform, the restriction and ultimate discontinuation on convertibility were apparently decided by no higher authority than the banking officials, under duress. The banking committee of the Bank of the Estates did not consider the matter officially until March 1810.⁸⁸ As a consequence of their now limited convertibility, the value of banknotes in silver and in Hamburg silver Marks began to fall, at first gently but soon more steeply.

In Finland, however, there was surprisingly strong faith in the enduring value of Swedish banknotes. As late as summer 1809, the Diet

of Porvoo treated the banknote riksdaler as if it had the same value as a silver riksdaler although the banknote rate against the Hamburg Mark had already fallen about 13–18 %. The Porvoo debate about exchange rates mainly concerned the value of the rouble, in other words the relative silver values of the rouble and the riksdaler, and the value of a rouble banknote against a silver rouble. From these the Diet wanted to calculate an appropriate exchange rate between Swedish and Russian banknotes circulating in Finland. The faith of Diet members in the value of the riksdaler proved to be excessive. As 1809 neared its end, Swedish banknotes were worth ever less.⁸⁹

In the years to come their value continued to decline. This is understandable because Sweden's Bank of the Estates had doubled its banknote issue in 1807–1812 at the same time as the real demand for notes had obviously declined because of the loss of Finland. Admittedly a significant amount of Swedish paper money remained in circulation in Finland for a long time to come. For Sweden the war years were marked by inflation and a fierce expansion of credit, described by Brisman as "the great age of speculation".⁹⁰

Swedish monetary policy remained very important for Finland even after political separation because a large amount of Swedish money remained in use, if unofficially and sometimes illegally, for another 30 years. What makes this peculiar is that the people of Finland, or at least the commoners, do not appear to have entirely grasped how much the riksdaler had fallen in value in the early 1810s, in Sweden and on international currency markets. Swedish money therefore enjoyed a premium in Finland, with the result that it constantly flowed from Sweden to Finland, where it was gladly accepted as payment.⁹¹

In autumn 1812, after Crown Prince Karl Johan had restored friendly relations with Russia, Sweden began to tighten monetary policy in order to halt inflation. Inflation was indeed halted by 1813 but the general price level was now almost twice as high as in the period before the war and so the value of paper money had fallen by half. The trend on currency markets was similar. By 1813 the riksdaler was worth about half as much in Hamburg silver Marks as in the pre-war period. Even after this, the riksdaler exchange rate remained fairly volatile, fluctuating until 1834 when Sweden finally returned to the silver standard. Sweden's decision to go back on the silver standard was crucial for Finnish monetary history and will be examined in more detail later.

MONETARY DEVELOPMENT IN RUSSIA

FEATURES SHARED WITH SWEDEN

When Russia attacked into Finland, its money began to circulate alongside Swedish currency. It was important for Russia to establish the validity of its money in Finland, and Commander Buxhoevden issued a proclamation as early as 12 April 1808 that Russian currency had to be accepted as a means of payment. The proclamation set the exchange rate as five rouble assignats (the Russian form of paper money) for 3 riksdaler and 16 skillingar in Swedish treasury notes. This put the official exchange rate for paper money at 1 rouble for $\frac{2}{3}$ riksdaler in treasury notes, or 21 skillingar and 4 rundstycken in banknotes (1 riksdaler in banknotes was worth $1\frac{1}{2}$ riksdalers in treasury notes). Pipping calculates that Buxhoevden's proclamation overvalued the paper rouble by at least 17 %, probably motivated partly by the desire to keep down military expenditure. Buxhoevden was also trying to establish a simple conversion rate between paper roubles and the treasury notes circulating in Finland, which the $\frac{2}{3}$ rule certainly achieved.⁹²

Russia in the 18th and 19th centuries has many features of monetary history in common with Sweden in the same period. These include the development of a banking system largely founded on the state, the early adoption of paper money, and inflation caused by numerous wars. Both countries also experienced periods when copper was the metal on which the money system was really founded. In this sense the disordered and unstable Russian monetary system that the Finns

came to know from spring 1808 onwards did not fundamentally differ much from the monetary confusion that they were familiar with and had been forced by circumstances to accept during their period under the Swedish Crown.

The history of the Russian rouble begins with Peter the Great who, in addition to his many other reforms, reorganised the monetary system at the start of the 18th century. Russia's monetary unit became the silver rouble, which was divided into 100 kopeks. Originally the silver rouble was modelled on German Thalers, which had been in general circulation in Russia. Over the years, however, the silver content of the rouble was reduced, making it lighter and less valuable than the German Reichsthaler and the Swedish riksdaler, also based on the Reichsthaler. When Russia conquered Finland the silver content of the rouble was almost exactly 18 grams of fine silver. Because the Swedish riksdaler contained about 25.7 grams of silver, the theoretical parity between these two currencies was about 1.43 silver roubles per silver riksdaler.⁹³

In practice, the silver rouble was not a significant medium of payment during the Finnish War because Russia had resorted to a paper money system. In circulation was a great volume of notes – bank assignats, meaning roubles in paper form – which the government had ceased to redeem for silver because of its lack of funds. The state had been financing expenditure with paper money so the value of the assignat rouble had fallen greatly. In December 1811, for example, when the Bank of Finland was established, a rouble banknote was quoted on the St. Petersburg Exchange at only 26 silver kopeks. Silver money was rarely encountered in circulation.⁹⁴

Russia had begun to issue paper money in 1769 during the reign of Catherine the Great. Her government had claimed to be motivated by the convenience of payments in paper money but the principal reason was the cost of the war being waged against Turkey. To ease the burden on silver reserves, the government financed some expenditure with paper notes. These assignats, as they came to be called, were issued with a promise that they would be redeemed on demand in metal (silver but in practice generally copper) “without the slightest delay or prevarication”. Exchange banks were set up in St. Petersburg and Moscow in 1769 to handle redemption and Russia's subsequent state banknote system developed from these. Assignats held their value fairly well up to 1786, when one rouble in assignats was quoted at 98 silver kopeks.⁹⁵

In 1786 Catherine the Great left an enduring stamp on Russia's state banking system by establishing two interconnected institutions, the State Assignat Bank and the State Loan Bank. The Assignat Bank was intended to serve as a bank of issue and was created by combining the exchange banks of St. Petersburg and Moscow, mentioned above. Apart from issuing banknotes, it was authorised to discount bills of exchange, make payment orders abroad and trade in gold, silver and copper, but this job description, modelled largely on the Bank of England, remained irrelevant in practice. The Assignat Bank was to concentrate on financing state expenditure with paper money.⁹⁶

The other cornerstone of the Russian banking system, the State Loan Bank, had the main function of granting twenty-year mortgages on agricultural estates and stone townhouses. The mortgage value of a manor was defined by the number of its serfs at 40 roubles per head. In addition, the bank accepted interest-bearing deposits from the public, which could be freely withdrawn subject to a brief period of notice. According to their founding statutes, the State Assignat Bank and the State Loan Bank would operate "as one, aiding each other for the successful prosecution of affairs".⁹⁷

After the establishment of the assignat and loan banks, the structure of Russia's state credit system remained almost unchanged until the 1860s. One characteristic of the system was its ownership and management by the state. The two interconnected banks completely dominated the credit system. Another feature was that lending was almost entirely to finance state expenditure and the needs of the landowning aristocracy. This naturally reflected Russian economic and social conditions. Supporting the landowning aristocracy was politically important for the stability of the tsar's regime. A related feature peculiar to Russia was the use of serfs as security for credit, or at least as a measure of the collateral value of land.⁹⁸ This policy tied the Russian state credit system tightly to the feudal economy and was probably part of the reason why, after 1809, the remit of Russia's State Loan Bank was not extended to include Finland, where there was no vassalage. Finland needed its own credit institution adapted to local conditions – the Bank of Finland.

After the creation of the assignat and loan banks, the issue of paper money increased rapidly and the value of the assignat rouble began to drop. The money supply rose because of continual wars financed,

literally, by printing money. In 1787–92 there was another war against Turkey, from which Russia gained the Crimean peninsula and some Black Sea coastline. While the fighting was continuing, Sweden attacked across the Russian border with Finland, the start of Gustav III's War of 1788–90. Even before the peace treaty with Sweden had been signed at Värälä, Russia had begun a new war against Poland, ending in that country's second partition in 1793. It was followed by a national uprising in Poland, led by Tadeusz Kościuszko, which the Russian army crushed prior to the third partition of Poland in 1795.

The burden on the state's finances from recurring wars meant that the volume of assignats could not be contained despite solemn pledges to this effect, and their redemption in silver was restricted and ultimately discontinued. As the money supply increased and its convertibility was terminated, a natural consequence was a collapse in the value of the assignat rouble. At the end of the reign of Catherine the Great in 1796 there were 158 million assignat roubles in circulation, the great majority of which had been created by the government's financial deficit. Only 18 million assignat roubles were the result of public deposits of copper or credit given to the public by the State Loan Bank. By this time the assignat exchange rate had already fallen to 69 silver kopeks. During the reign of Catherine's successor, Paul I, various efforts were made to restore the value of the rouble⁹⁹ but these foundered when Paul joined an alliance against France in 1799, after which its military expedition to Italy boosted the state's financial needs again.

Although the Russian state banking system was principally designed to meet the credit requirements of the state and major landowners, the government also tried to improve the availability of short-term commercial credit. Its intention was to promote exports. An edict proclaimed during the reign of Paul I established a discount office for bills of exchange and merchandise in St. Petersburg alongside the State Assignat Bank. In 1806 similar discount offices were established in Moscow and certain port cities, such as Arkhangelsk and Odessa.¹⁰⁰ Their operations remained fairly small-scale, partly because of the 1807 Treaty of Tilsit, in which Russia joined the trade blockade against Britain. Until that time Britain had been Russia's most important trading partner so the blockade was catastrophic for Russian exports.

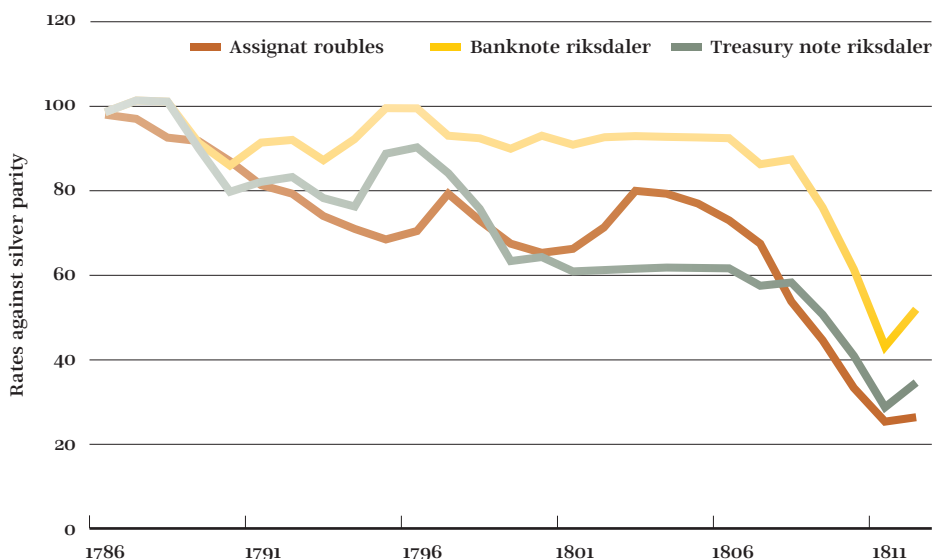
MONETARY POLICIES OF ALEXANDER I

Alexander I rose to the throne in 1801 after a coup in which his father Paul I was murdered. Characteristic of his early reign was Alexander's interest in reform and rationalisation of the empire and its system of government. He even considered enacting a constitution that would have converted Russia from an autocracy to a constitutional monarchy. These ambitious plans did not advance.

Among the works of reform undertaken early in Alexander's reign were his attempts to bring stability to public finances. A Finance Ministry was established in 1802 as part of a broad reform of government, and among its duties were the creation of the first budgets in Russian history. The government also made a few efforts to stabilise the value of money and to attract privately hoarded or exported metal coins back into circulation. In December 1803, an edict ended the tax on minting coins and the government produced a significant volume of gold and silver coinage, although they did not remain in circulation because of the large supply of assignats. However, the value of assignats on the St. Petersburg Exchange (against silver) and the rouble's rising foreign exchange rate in the early years of Alexander's reign showed that the government's attempt to balance public finances had a calming effect on the money market even without special measures to support the rouble. The government's restraint in issuing assignats during this period even caused protests from merchants, who thought the money supply was too small.¹⁰¹

Russia re-entered the war against France in 1805, after which the volume of assignats soared. Negotiations on the 1808 budget after the Treaty of Tilsit proved to be extremely difficult and the Finnish War threw public finances into "complete disorder".¹⁰² At a time when state revenue could not be raised, when foreign credit was not available and when borrowing from the state banks could not be increased indefinitely, a decision was taken in August 1809 to issue domestic bonds. The issue was not a success. The public preferred to invest in state credit institutions at 5 % interest, from which they could withdraw their funds at will. Furthermore, the bonds could only be subscribed in St. Petersburg. Certificates of deposit from state credit institutions circulated widely as a medium of payment.¹⁰³

VALUE OF SWEDISH AND RUSSIAN PAPER CURRENCIES 1786–1812



Sources: Bank of Sweden; Heller K., 1983.

The volume of assignats more-than-doubled during the first decade of Alexander’s rule and their value in silver kopeks dropped from 70 to about 44 kopeks. With the constant rise in the amount of paper money, the redemption of assignats could not be maintained even in copper, which had until now been taken for granted. This led to such a serious shortage of copper coins that in parts of Russia they changed hands at a premium of 20 % over their nominal value. Now speculation was taking copper coins, too, out of circulation. There were complaints that the lack of copper coins was hurting trade and the government was strongly urged to mint more copper coins or to issue low-value assignats to serve as change.¹⁰⁴

SPERANSKY’S FINANCIAL PLAN

In these disordered times, Count Dmitri Guryev became finance minister at the start of 1810, although he was not to become a key architect of Russian monetary policy for several years. This role initially fell to state

secretary Mikhail Mikhailovich Speransky. At the end of 1809 Alexander had asked Speransky, his trusted right hand, to draw up a plan for monetary stabilisation and the overhaul of state finances. In the decades ahead, Speransky's financial plan of 1810 became the point of focus and comparison for all projects to reform monetary conditions.¹⁰⁵ The first part of the plan concerned the 1810 budget and the second dealt with the organisation of state monetary affairs in the future. In the short term the aim was to make economies in all but the most essential items of expenditure, one of these exceptions being the servicing of state debt. In the longer term it was to strengthen the revenue base of the state, for which Speransky favoured an increase in direct taxation.¹⁰⁶

Concerning the monetary system, Speransky believed that it was specifically the state that had suffered from assignat-induced inflation because the real value of its (tax) revenues had fallen at the same time as its many items of expenditure had become more expensive. Other injured parties were public officials and people living on interest income. On the other hand, he said, landowners and merchants had not suffered from inflation but had actually benefited from it. Speransky believed that a prerequisite for monetary stabilisation was that the state should be able to cover running costs from normal sources of revenue without resorting to borrowing.¹⁰⁷

Speransky's objective was a financial system based on silver currency plus so-called credit notes pegged to silver that would be redeemable without restriction. Silver should be the general measure of value and the unit in all private and public accounting. The justification for paper money in the form of credit notes was that it would save silver that would thus be freed to circulate as a medium of payment and could be used to pay down foreign debt. Credit notes would also reduce the need for copper coins, thus releasing another metal for more useful purposes.

Speransky's financial plan aimed at restoring the silver value of the assignat rouble and its convertibility into silver. For this purpose the number of assignats was first to be frozen and then reduced. In the longer term, after the gradual restoration of the value of assignats, they would be entirely redeemed and replaced with silver-backed credit notes. As a means for reducing the number of assignats, the plan called for the state to borrow domestically and to sell land to private individuals.¹⁰⁸

In Speransky's view, the function of banks was to increase the general availability of credit rather than to cover state expenditure. To this end, he proposed the establishment of a joint stock silver bank, owned by private investors alongside the state. The capital of the bank was to be 10–20 million silver roubles, half from the state and half from the private sector. The bank would trade in silver and gold, discount bills of exchange and manage the new domestic borrowing of the state. Its lending was to be short-term and tied to specified purposes. Speransky believed that earlier loan and deposit banks should be converted into mortgage institutions, and that the operations of the assignat bank should be scaled back as the number of assignats declined.¹⁰⁹

It would be interesting to know the precise origins of Speransky's ambitious and radical programme. His plan represents the recurring efforts by Russia's leaders to modernise their country on a western European model. Speransky was known to be a Francophile and these sympathies later cost him his career. The administrative reforms that he advocated were based to a large extent on French ideas. Heller believes that his banking plan resembles the views of Count Mollien, who reorganized the Banque de France. Both presupposed that a bank of issue was for financing short-term commercial bills of exchange only, not for covering state spending. In the plan, Speransky himself mentions the examples of the banks of Amsterdam, Hamburg, England and France.¹¹⁰

A manifest issued on 2 February 1810 began to implement Speransky's plan. Assignats were recognized as a debt of the state, backed by all the assets of the state. It was promised that no new assignats would be issued and that assignat debt would be paid down. To achieve this, taxation was tightened. In May 1810, new domestic bonds were issued to raise funds for taking assignats out of circulation. In August the rate of exchange between silver and copper was legally fixed, and state lands were put up for sale. From late-1810 to 1811 the Russian finance ministry was reorganised.¹¹¹

In the end, Speransky's programme could not be implemented in the desired way. In May 1812, when the bond subscription period ended, only 6.5 million roubles had been raised. This was a disappointment compared with the value of assignats in circulation at the time, 580 million roubles. Sales of state land were even less successful. It was becoming obvious that the funds raised would not be enough to withdraw assignats from circulation.¹¹²

SPERANSKY'S PLAN TERMINATED

Growing tension between Russia and France led to Speransky's dramatic dismissal in spring 1812. In June Napoleon attacked, beginning a state of war between Russia and France that would not end till spring 1814, when a Russian army of occupation and Alexander himself marched into Paris. The effects of the war on Russian public finances and the rouble's value were predictable; Speransky's stabilisation plan was halted and more assignats began to be issued. To ensure acceptability of the paper rouble, it was declared legal tender in 1812 but not at par. Its value was to be the market rate in the exchange, a peculiar arrangement that took Russia into a dual currency system resembling the one that had prevailed in Sweden from Gustav III's Russian war until 1803. Taxes were set and collected in assignat roubles.¹¹³

After Speransky's ousting, Finance Minister Guryev became the master of Russian monetary policies for more than a decade. Following the restoration of peace in 1815, he continued Speransky's efforts to prune the amount of paper money in circulation and thus raise its value back to parity with silver. To obtain funds for redeeming and eliminating assignats, he sought to increase long-term borrowing by the state. The plan was very ambitious and, it must be said, completely unrealistic. The exchange rate of the assignat rouble had plunged to about 20 silver kopeks in the closing stages of the Napoleonic War.¹¹⁴ A return to silver parity would thus have required the value of paper roubles to be raised by a factor of five. Ultimately assignats could not be revalued but Guryev's monetary policies did succeed in halting their depreciation after 1815, when the value of the paper rouble settled at 25–26 silver kopeks. Apart from some temporary fluctuations this level was maintained for some two decades.¹¹⁵ Guryev's monetary policies thus created a passably sustainable basis for operations by the Bank of Finland, which was established to operate and grant long-term loans in assignat roubles.

With peacetime, the question of financing exports returned to the agenda. This had earlier been attempted by establishing discount offices but with only modest success. In 1817 a new and more successful effort was made to develop export financing, by converting the discount office of St. Petersburg into the State Commercial Bank. The other

discount offices were closed at this time although the State Commercial Bank later opened offices in various towns, such as Moscow in 1818 and Riga in 1820. By supporting Russian exports, it was meant to shore up the rouble's exchange rate. It provided short-term credit against security in merchandise, of which it accepted various export items. It also discounted bills of exchange and accepted deposits from the public.¹¹⁶

From this point onwards the State Commercial Bank, alongside the State Assignat Bank and the State Loan Bank, constituted the third pillar of the Russian banking system. It had central importance for later developments in Russian banking because in 1860 it was turned into the Russian State Bank, which, after a tumultuous series of events, is still Russia's central bank today.¹¹⁷ From time to time, the State Commercial Bank served as the place of deposit for cash surpluses of the Bank of Finland. These were sometimes quite large and constituted, at least in the 1820s and 1830s, the most important link between the Finnish and Russian money markets.¹¹⁸ Moreover, the principles of the State Commercial Bank served as an important model in 1840 when the regulations of the Bank of Finland were modernised and its ambit enlarged to include trading in bills of exchange.¹¹⁹

FIRST PROMISES OF A BANK OF FINLAND

GETTING DOWN TO WORK

The question of reorganising monetary affairs and the currency of Finland had been raised even before its annexation was complete. The Russians published various circulars and declarations, promising to resolve these questions in a manner acceptable to the Finns. The first manifestation can be regarded as the announcement by Foreign Minister Count N.P. Rumyantsov on 8 April 1808, that “as soon as peace has been made with Sweden, his Royal Majesty will decree the opening of a loan bank for landowners and a discount office for the promotion of payments beneficial to commerce”. Various other such statements were drawn up during 1808, undertaking to modernise Finland’s disorganised monetary affairs and satisfy the need for credit. They were fairly imprecise in their wording. The shape and administration of the future banking institution remained indistinct.¹²⁰

Russian officials had not been properly aware of the conditions prevailing in Finland so promises about a bank were partly propaganda aimed at pacifying the people and encouraging them to view their new mother country favourably. Emigrants in St. Petersburg, such as General G.M. Sprengtporten, General B. von Knorring and Colonel K.H. Klick, influenced these statements, but as they had almost no impact on what would be eventually decided about the bank, no further analysis is merited. There is of course some academic interest in that the proclamations reflect current views about money

and banking in the central administration in St. Petersburg, as well as what Russia's supreme leadership was planning for Finland.¹²¹

In autumn 1808 a clearer view emerged of Finland's future status. The balance had swung irrevocably away from Stockholm towards St. Petersburg. Tangible evidence of this came when a Finnish deputation was invited to St. Petersburg to discuss how Finland would be governed. The delegation and the reason for its journey were mentioned earlier but it is worth examining the financial expertise of the delegates.¹²²

Only a few members were closely familiar with questions of banking and money. The top financial expert emerges as Jean Gabriel Tjaeder, a Turku merchant who had been apprenticed to a major Amsterdam trading and banking house early in his career and was familiar with the practice and theory of European banking in the early 19th century. Tjaeder understood how foreign trade was paid for and how trading houses financed it. As a money and banking expert he had earlier been chosen to the board of the Turku Discount Office and been appointed its manager. Also Professor Gabriel Erik Haartman knew how banking worked because he had been a member of the board of the Turku Discount Office. The chairman of the deputation, Carl Erik Mannerheim, had been a shareholder of the Turku Discount Office. After a military career, Count Mannerheim was now the owner of the large Louhisaari Manor, so he certainly knew the problems of landowners who required long-term credit.

Apart from the three members who had worked with the Turku Discount Office, the deputation contained a fourth person with banking experience. He was Ivar Wallenius, a doctor of theology, who had obtained his financial experience in Stockholm. When the Swedish National Debt Office was established he had been elected to its supervising committee and had held the post for a total of 10 years. In the Diet of 1807 Wallenius was picked to inspect the accounts of the Bank of the Estates of the Realm and the National Debt Office but he declined on grounds of conflict of interest. In his view a person who had previously held a supervisory role could not be an auditor of the same organisations. This background meant that Wallenius was well aware of the monetary disarray in Sweden.

The Tsar has asked the deputation to draw up a list of matters to be determined as soon as possible and which could be settled by administrative decisions without the approval of the Diet of the Estates.

The deputation did not directly express the desire for a national bank but, in a signed statement on December 14, merely emphasized the difficulties created by fluctuations in the exchange rate between Russian and Swedish currency. The exchange rate question had emerged as a problem soon after Russian forces had conquered southern Finland. Already in spring 1808, Commander Buxhoevden of the Russian army had ordered that paper roubles were to be accepted in both public and private payments at the officially sanctioned exchange rate.¹²³

The rouble exchange rate ordered by Buxhoevden proved to be far above the rate prevailing in the market. This created distrust towards Russian money and constant losses by private individuals in Finland. To solve the problem, the delegation proposed that administratively fixed exchange rates should be replaced by market exchange rates, in practice the rate between the assignat rouble and Swedish paper money that prevailed in the St. Petersburg bourse. At the same time the deputation suggested the establishment of special offices of exchange in Finland to satisfy the demand for small denomination notes needed in normal transactions and to simplify payments traffic.

The emperor's answer came within a month, at the start of January 1809. He stated that he had already decided to establish a bank of exchange in Finland, the details of which would be found in the Governor general's regulations, completed at the end of 1808. Thanks to these reforms, monetary conditions would be reorganised and conversions between Russian and Swedish paper money would cause no problems in future.

The Governor general's regulations were based on a memorandum drawn up in St. Petersburg, which outlined the shape of Finland's future government. The memorandum had been drafted by Sprengtporten, the Russian Minister for War Arakcheyev and General Knorring and it was completed as Sprengtporten was being invested as Governor general on 1 December 1808. The last article of the regulations stated that bank offices were to be established in Helsinki and Turku and provided with sufficient funds at the expense of the Crown. They were to issue Russian assignats and at the same time redeem Swedish paper money and take it out of circulation.¹²⁴

The drafting of the Governor general's regulations and the visit by the Finnish deputation are a coincidence that is, in itself, interesting,

showing that the issue of establishing a bank was already resolved in St. Petersburg when the post of Governor general was created. The main role of the deputation seems to have been to underline the importance of the matter.

The regulations speak only of bank offices and allow various interpretations. It is clear that the intention was a state-owned banking institution aimed mainly at satisfying the demand for tender by issuing paper money, but it is unclear whether the institution envisaged was to be a Russian bank or an independent Finnish one. In any case it is clear that Finland and Russia were assumed to have the same monetary system in future. Naturally at this stage the design of Finland's future government was mainly in Russian hands and a visit to St. Petersburg by a Finnish delegation was not going to change that.

THE QUESTION OF MONETARY REORGANISATION

A decision on the principle of establishing a bank in Finland was made at the end of 1808, at a time when the creation of the Grand Duchy of Finland was still at a nascent stage. It is not, therefore, surprising that no practical progress was made for a long time; the Governor general had more important matters to deal with. However the question was raised again at the Diet of Porvoo in spring and early summer 1809. The matter had been placed on the agenda in a proposal issued in the emperor's name. The Estates were not seen as having genuine power but the tsar's intention was to bring up for discussion some administrative matters that needed early resolution. At the same time it gave the representatives gathered in Porvoo an opportunity to express their own objectives and wishes to the emperor. The underlying purpose in summoning a Diet was the new ruler's desire to legitimise his position but he also wanted a working relationship with Finland's highest circles. The emperor's advisers were confident that summoning a Diet would increase confidence among the people of Finland in their ruler.

The question posed by the tsar to the Diet "regarding money and a financial institution" was phrased very vaguely. It noted that a Finnish financial institution was closely connected with the country's political status, which was a direct reference to the need to bring monetary

conditions into harmony with Finland's new political position. At the same time it stressed that a monetary reform was in the private and public interest combined. In his preface the tsar expressed the wish to receive a proposal on ways in which these aims could be achieved.

Although the Estates did not have genuine authority, the phrasing of the proposal gave them fairly free hands in expressing their own views. The basis for their debate was a report drawn up by their Financial committee, dated 6 May 1809 and signed by C. E. Mannerheim (nobility), N. Aejmelaeus (clergy), I. Holmsten (burgher) and Thomas Eliasson Seppälä (peasantry). The report was founded on the view that monetary order was of primary importance for all societal development but that concrete action could not be taken until hostilities between Sweden and Russia had been concluded and Finland's position officially confirmed.¹²⁵

Firstly the monetary disorder of the country had to be resolved. While the war continued, Swedish and Russian money were circulating side by side. In both Russia and Sweden the underlying official currency was silver – the rouble and the riksdaler – but both countries had been forced off the silver standard. Silver money remained an accounting unit and measure of value but the practical medium of payment was paper of fluctuating value – treasury notes and banknotes from Sweden and assignat roubles from Russia. For small change, the people used Russian and Swedish copper coins. Their value in turn was tied to their respective paper money and varied with its value.

On the basic principles of monetary reform the Estates were completely unanimous. According to the Financial committee memorandum, only money tied to silver was secure in value. Of course paper money could also circulate but its value had to be constant in relation to the underlying silver money. Only a metal standard could ensure the necessary monetary stability and predictability. The contemporary attitude to fluctuations in the value of money was that they were an offense against private property rights. Furthermore, changes in the value of money were thought to encourage diverse speculation and fraud, from which the poorly informed general public would suffer the worst.

Regarding the choice of monetary unit, the only realistic alternative left was the Russian silver rouble and its sub-unit, the kopek. Adoption of the rouble as Finland's monetary unit was justified by two main



■ Imperial glory mingles with the grave peasantry at the Diet of Porvoo 1809. – R. W. Ekman, oil on canvas, 1858. Council of State. Board of Antiquities / Markku Haverinen.

factors, one technical in nature and the other political. The Russian system was decimal, the rouble being divided into 100 kopeks. This was regarded as technically superior to the Swedish formula in which the riksdaler was made up of 48 skillingar and each skilling of 12 rundstycken. Meanwhile, the political reality was that Finland could not retain the monetary system of the old mother country.

Most of the money in circulation in Finland was from the former mother country. The Diet felt the most urgent task was to determine the actual silver content of Russian and Swedish silver coins in circulation in Finland, in order to establish the correct rate of exchange between the rouble and the riksdaler. Johan Gadolin, a professor of chemistry, and Gustaf Hällström, a professor of physics, were appointed to the job and set about measuring the precise weight and silver content of sample Russian and Swedish silver coins. Their task was complicated by the fact that the money in circulation consisted of silver coins minted in different periods and also some were more worn than others. Nonetheless they reported that one silver rouble was equivalent in value to 33 skillingar and seven rundstycken in Swedish silver coin. The professors also assayed the value of the copper coins in circulation.¹²⁶

The Financial committee proposed that Finland should change currencies from the start of 1810, after which the unit of all business transactions and accounting would be the silver rouble. The obstacle, however, was that the money in circulation consisted almost entirely of paper, which fluctuated in value against silver. Finns felt bitterly about the exchange rate that had been imposed by officials since the war began and the Estates were adamant that this could not continue and that the rate should be determined by the market. On the other hand, taxes and other such state payments could hardly vary on a daily basis so the Estates proposed that a rate for the paper rouble be set for a year at a time, based on its quotation on the St. Petersburg Exchange. It was also felt that, alongside Russian money, Swedish currency ought to be acceptable for payments to the state as long as it remained stable in value and enjoyed public confidence in Finland.

The proposal of the Financial committee aroused much debate. It was a matter that touched the life of every Diet member so their interest was not surprising. Records of the discussions show a genuine accord about what constituted a proper monetary system. Only money

tied to silver would guarantee dependability. A functioning system would not be possible unless the people could have absolute trust in the constant value of money. The prevailing view in those times was that only under a metal standard could trust be created.

The greatest source of disagreement among the Estates concerned the position of Swedish currency. The nobility, under their chairman Mannerheim, were opposed to continuing the validity of Swedish money. Their reasons were largely political, meaning a desire to show solidarity with the new mother country. The continuing circulation of money from Sweden was seen as an unnecessary reminder of the past. Admittedly the nobility were not entirely agreed on this position and some of their members were ready to permit the use of Swedish money for payments to the state, at least for the time being.¹²⁷

The attitudes of the other Estates can be described as largely pragmatic. They felt that Sweden would remain the main trading partner so its money would continue to flow into Finland. Money was also a question of trust and Swedish money was expected to continue to enjoy public confidence in Finland. Consequently no official bans would work and any such demands would be a great inconvenience to the people and might also increase distrust in Russia. It was also noted that some other areas annexed to Russia, such as Livonia, were continuing to use non-Russian currency, so political factors were not thought to demand the exclusive use of Russian money. Demonetising the Swedish currency would cause unreasonable social difficulties.

The Estate of burghers took the most extreme view. A majority of its members supported the preservation of Swedish money – the silver riksdaler and its subsidiary units skillingar and rundstycken – as the country's currency. Because Finland still had no bank of its own, this proposal inevitably meant that Finland would have remained dependent on Sweden for its paper money. The clergy and peasantry, meanwhile, supported the adoption of the silver rouble but were insistent that Swedish money should be equally valid for taxes and other payments to the government. Both Estates were aware of the dominant position Swedish money as a practical medium of payment and feared that a ban would create trouble for the general public.¹²⁸

ADVOCACY BY JAKOB TENGSTROM AND PETTER BLADH

The weightiest views were expressed by Bishop Jakob Tengström of Turku, representing the clergy, and Petter Bladh, a former cargo superintendent first-class of the Swedish East India Company, representing the Estate of burghers. Their views are worth more detailed analysis because they reflect not merely practical considerations but also the underlying economic philosophy of the age.

Jakob Tengström was a doctor of theology by training who, before joining the clergy, had worked as a teaching assistant, professor and librarian at the Royal Academy of Turku. His earliest association with monetary theory had come in his youth from his uncle, Anders Chydenius, the church rector regarded as the principal Finnish economic thinker of the 18th century. Because of his father's early death, Tengström had been in fairly close contact with Chydenius. This is also indicated by Tengström's other writings on monetary questions, which refer specifically to Sweden's experience.¹²⁹

His memorandum on the Financial committee's report started from an acceptance of realities. Circulating in Finland was both Russian and Swedish money of fluctuating value and there was no reason in the near future to proscribe its validity in either private or public payments. Naturally Finland's altered political status meant that Russian money would gradually become the dominant currency but it would take a long time.

Tengström then examined the risks involved in using Swedish currency. The greatest risk was that Sweden's Bank of the Estates or its National Debt Office might refuse to redeem Swedish paper money from Finland. However, he regarded this as a minor danger because such an interference in the right to private property would be contrary to all principles of law. It would be equivalent to denying creditors right of repayment. Another barrier to discrimination against Swedish money from Finland was that there was no means of distinguishing it from Swedish money held in Swedish hands. Although Sweden had earlier reformed its monetary system in the so-called realisation programme, replacing old notes with new ones, the old notes had remained valid.

Finland's annexation to Russia would not sever its old trading connections with Stockholm and other cities, so it would still receive Swedish money in the future. Furthermore, after its separation from the Kingdom of Sweden, taxes and other such fees paid to Sweden would end so a greater proportion of the Swedish money entering the country would remain here.

The greatest monetary problems were caused by paper money, which accounted for the bulk of currency in circulation. According to venerable financial axioms, the value of vouchers or paper money could not be imposed artificially by laws or regulations because profit-seeking individuals would always discover ways of depreciating an overvalued currency. Thus, the monetary system prevailing in Finland would preclude permanence and stability. Tengström accepted only silver as the durable basis for a monetary system. "Silver and coins minted from silver have long served as the jointly accepted measure of value between all nations of the world." In this respect he closely followed the thinking of his famous uncle Anders Chydenius, a strict believer in the metal standard, who thought that money derives its value from its silver content.

A first step to monetary reorganisation would be to determine the relative values of different currencies in circulation. Initially the relationship between the Russian silver rouble and the Swedish riksdaler would be calculated on the basis of the precise silver content of each. This ratio would allow taxes and other payments, decreed by law in terms of Swedish currency, to be converted justly into silver roubles.

This would be merely the first step. It was at least as important to determine the silver value of the paper money in circulation. For this purpose Tengström placed his entire trust in the market, as noted above. The value of paper roubles used for payment would be based on their rate on the St. Petersburg Exchange. This information would be delivered at least once a week to Turku and published in its Åbo Tidning newspaper. In this way the correct value of money would be set by its silver content or its exchange price, not by the number stamped on it. In practice, public fees could not be set according to a constantly changing exchange rate and would have to be fixed for a year ahead. This could be done at the same time as provincial tax rates were published, possibly by taking the average rate from the preceding 12 months.

Public and private accounting could change over to the rouble and kopek from the start of 1810. To simplify the transition Tengström recommended the printing of special publicly approved tables, converting riksdaler, skillingar and rundstycken into silver roubles. However he emphasized that this would be only an interim measure to alleviate the excesses and injustices induced by money of fluctuating value. To achieve a permanent solution a national bank would have to be established.¹³⁰

Petter Bladh, representing the Estate of burghers, was another significant monetary policy figure present at the Diet of Porvoo. He had been born in Vaasa in 1746, the son of an important merchant and court quartermaster, Johan Bladh. After matriculating from school, Bladh entered the service of the Swedish East India Company, where he rose rapidly from assistant to the position of first cargo superintendent in 1776. During his career he made various trips to China and was the manager of the company's Canton office for five years. On his travels he wrote about Chinese geography and natural conditions as well as trading relations with Europe. Among his predictions were that trade with China would cease to be profitable as soon as Britain and the Netherlands liberalised their foreign trade. His writings were so esteemed that in 1779 he was invited to become a member of the Royal Swedish Academy of Sciences. Bladh returned to Finland in 1784 to take over his father's business. He rose immediately to an exalted position, as shown by his participation in the Diets of Stockholm in 1789 and 1792. He also continued to write actively and sent various reports to the Finnish Economic Society in which he examined ways of promoting business in Finland. In the light of these writings he can justifiably be regarded as an economic liberal in the footsteps of Anders Chydenius.¹³¹

Bladh's stand on the question of money was unambiguous. Stable conditions could be achieved and maintained only under the silver standard. Paper money had no guarantee of permanent value but could cause silver money to disappear. "Bad money always drives better money out of circulation. Silver money produces a superior yield if it is left unused rather than if it is traded for paper money that may be devalued. Silver will disappear and only paper money will circulate. Distrust and uncertainty will advance and all prices will rise". This excerpt shows Bladh's grasp of the monetary principle known as Gresham's Law and its applicability to conditions in 19th century Finland.

Posterity remembers Bladh best as an uncompromising advocate for Swedish currency. He strongly opposed making the silver rouble the monetary unit of Finland. The Diet's Financial committee report had stressed the superiority of the decimal rouble and kopek, both in actual payments and as an accounting unit, and Bladh admitted this was true, but only in theory. In his view the smallest silver monetary unit was the 10 kopek coin. Most practical payments were in smaller copper kopeks, pegged in value to assignats, paper roubles. Thus the simplicity of the rouble's decimal system would be lost.

The Financial committee's second argument for the silver rouble was its prediction that Swedish money would disappear from circulation before long. Bladh overturned this view. He believed patterns of trade in the decades ahead would remain unchanged, creating a surplus that would pump Swedish money into Finland. He saw no problems in this because he believed that Sweden would readopt the silver standard fairly soon. His prediction that trade would continue to bring Swedish money to Finland proved to be correct but Sweden's return to the silver standard did not take place until a quarter of a century after the Porvoo Diet.

If the riksdaler remained Finland's unit of currency, Bladh saw the advantage that regulations and laws concerning Finnish taxes and other public payments would not have to be rewritten. The general public could continue comfortably with an old and familiar unit. In conclusion, Bladh stated that the ruler of all Russia would scarcely care whether Finnish public and private accounting used the riksdaler or the rouble. Retention of the old currency was therefore politically viable.¹³²

Bladh's statement reflects his background in foreign trade. In his eyes, a monetary unit did not represent a ruling family or a nation. The function of silver specie was to serve as a medium of payment across national borders as well as within them. It was natural for businessmen engaged in trade to regard the silver riksdaler as the more convenient and effective alternative. This pragmatic attitude comes across tangibly when Bladh's views are contrasted with those of Mannerheim, one of the leaders of the Estate of nobility. Mannerheim thought it politically questionable to retain the validity of a foreign country's currency, and saw no guarantees that Sweden's Bank of the Estates would remain solvent or that public trust in Swedish money would endure.

THE IMPORTANCE OF A NATIONAL BANK

In practical terms, all the delegates to the Diet of Porvoo were agreed that immediate action was needed to reform the country's disordered monetary system. The task was felt to be so urgent that it should be started immediately without even waiting for the conclusion of peace between Russia and Sweden. Once peace had returned and monetary conditions were stable there would be an opportunity for more leisurely follow-up planning, in which the establishment of a national bank would play a key part. Only with its own bank would Finland be able to safeguard monetary stability in the future. The Diet felt that it could be modelled on Sweden, where the national bank operated under the auspices of the Estates. Members of the Finnish Diet had been participating in the direction and supervision of the Bank of the Estates of the Realm of Sweden for many years.

The founding capital of the new banking institution was proposed as 2 million silver roubles. This was a rather large sum and the new government of Finland did not have such a surplus at its disposal, so the committee proposed borrowing the amount from the country's new sovereign. The emperor could thus show trust in his new subjects. The loan would be interest-free for 20 years, after which the bank would begin to amortise it and to pay three percent interest. The security for the loan would be a joint guarantee by the Estates. The committee also proposed that the bank's capital should be strengthened with regular contributions from the state, possibly by diverting the yield from stamp duty.

Under the proposed model, the bank would have operated under the guarantee of the Estates. Following the Swedish model, it would be managed and supervised by the Estates, which would appoint a special supervisory council for this purpose. It would contain six members from each of Estate, 24 in all. The bank's ownership would be reflected in its name, Finland's Ständers Bank, the Bank of the Finnish Estates. No new legislation would be necessary because the regulations of the Bank of the Estates of the former mother country could be applied. Sweden's Bank of the Estates was seen as a great success so there was no need for amendments in legislation. The Finnish bank could also borrow its regulations and accounting system outright from Sweden.

The Estates' desire for a subordinate bank was not manifestly unrealistic; the tsar had promised to rule Finland according to the old "constitution" and, under the Swedish constitution, the national bank operated under the auspices of the Estates. The representatives convened for the Diet in Porvoo could not have envisioned that the constitutional trend in vogue in Russia in 1809 would be short-lived nor could they have known that, after Porvoo, no Diet would be convened in Finland for more than half a century.

The functions of the intended national bank were to be modelled on the Swedish example. An important aim was to satisfy the need of landowners for long-term credit. The development of agriculture was seen as the driving societal force. What made a new credit institution especially important was that many land-owning gentry were members of the Estates who were in debt to Sweden and feared that they would be asked to repay their loans immediately, which most of them would not have been able to do. Alongside lending to agriculture, the intended Finnish bank would, to a lesser extent, have granted short-term credit for commerce, shipping, mining, manufacturing and engineering. The funds for lending would consist of the bank's founding capital, the annual surplus transferred from the state, and deposits by the public.

The needs of business would moreover be served by a separate discounting office to be established under the bank, also on the Swedish model. The bank would own two-thirds of it and private shareholders one-third. Its founding capital was to be equivalent to at least 210 000 silver roubles. Its funding would be supported by loans from the parent bank.

There was active debate about the report in all four Estates. The report was approved without amendments by the peasantry. Their representatives openly admitted to knowing little about banking and were not about to meddle with a jointly agreed report. Among the other Estates, discussions focused on the new bank's capital. The clergy felt that one million silver roubles would suffice. The nobility and the burghers preferred two million but conceded that operations could begin with lesser capital of one million silver roubles, which could be raised to the proposed two million after the bank was up and running.

The Estates differed over the source of the bank's annual capital injection from the state. The report had mentioned the yield from stamp duty but the burghers and clergy felt that the Castle Repair Tax

was more suitable because it had been levied to help repair the Royal Castle in Stockholm and would no longer be payable. All the Estates agreed on the need for a discount office. There was some support in all of them for raising its founding capital to 300 000 silver roubles.¹³³

Among individual speakers in the Diet the weightiest views were put forward by Tengström. In his view the main function of a national bank was to issue credit notes that would be stable in value. Because of their stability citizens would trust in the inviolability of their property and would feel safe in keeping part of their assets in the form of paper without fear of loss.

Tengström pointed to the history of money. From the earliest times it had consisted of precious metals like gold, silver and copper, which offered a generally accepted measure of value and at the same time served as a medium of exchange. In large transactions, it was impractical to transport metal coins from one place to another, so the “great minds of Europe” had devised various payment orders (such as bills of exchange, assignats and credit notes) to serve as money substitutes, backed by private or public deposits of precious metal. Using money that represented metal eliminated the practical problems of transporting metal money, so trade and other livelihoods flourished. To meet the need for paper money, banks of exchange and lending had been established in various European countries, charged with ensuring that public trust in money would not be shaken by fluctuations in its value. Monetary stability eliminated the opportunities for profiteering and speculation, which always resulted from the depreciation of money. At the same time, banking institutions could nurture various enterprises by offering the opportunity to borrow at a reasonable rate of interest.

Until now, Finns had been able to use the services of the Bank of the Estates of Sweden which, it was generally accepted, had done great service to the whole country. Now that the ties with Sweden had been severed, the Estates of Finland could no longer trust that they would be able to participate in running the Swedish bank nor enjoying its fruits. Naturally there were also banks in St. Petersburg but their operating methods and organisation were unfortunately so alien to the Finns that the general public would not gain much benefit from them. The banks of St. Petersburg would moreover be hard to use because of the long and arduous journey, Russia’s strange and difficult language,

its peculiar laws and business methods and a monetary unit that was too large for Finnish conditions. The only viable remaining way of providing society with an adequate supply of money was to establish a national bank.

A precondition for a bank of Finland, Tengström said, was adequate founding capital. He believed the minimum requirement was one million silver roubles, which was half the amount proposed by the Financial Committee. The smaller amount would be sufficient because Russian and Swedish money would be in circulation alongside the notes issued by the Finnish bank. Furthermore Finland's population was small and its economy underdeveloped so the demand for money would be less than Sweden's.

Tengström believed that the necessary capital could be obtained in a variety of ways. Firstly the Estates could turn to the tsar directly and request a donation of one million silver roubles. The new ruler had expressed sympathy for his new subjects in many ways so there would be nothing improper about such a request. "The Emperor would certainly be glad to grant Finland a million silver roubles when He has had to devote ten times that sum merely to conquer the country," Tengström predicted. A second alternative would be to request the sum as a loan from the tsar, meaning from Russian government funds. The loan would be requested as interest free for the first 20 years but to be repaid subsequently according to terms to be drawn up later. The third alternative was to put aside some of the state's revenue surplus each year but amassing the bank's capital in this way would be fairly slow and more than a decade would pass before the bank's operations would reach a proper level. Tengström also took into account the possibility that none of the founding capital would be available from the state. In this case, he believed, the bank should be established in the form of a joint stock company financed by private investors. Although the limited company still did not exist as a legal form in Sweden, there had been long experience of different joint-stock companies. They were known in Finland, too; the Turku Discount Office had been one.

Tengström took as an example the private "London bank" of issue, meaning the Bank of England, which was entirely privately owned and yet had rendered great service to the state. He proposed that the private bank to be established in Finland should issue 20 000 shares of 500

silver roubles each, thus raising the necessary million silver roubles. If shares were not subscribed according to plan, at least enough capital would be raised to open a discount office. To ensure continuity of operations, the bank should be given a charter of 20–30 years.

This kind of banking institution based on private capital would, Tengström believed, be a last resort in case the necessary capital proved to be unavailable from the authorities of St. Petersburg or Finland's own government.¹³⁴

The Estates' proposal can be summarised as replicating the example of Sweden's Bank of the Estates. This was entirely natural. The Swedish institution, operating under the Estates' guarantee, was familiar to many delegates at the Diet, who saw no reason to abandon this model. An extra incentive was the tsar's repeated assurance that he would uphold Swedish law, in which a public bank operating under the Estates was explicitly mentioned.

A CONVOLUTED CREATION PROCESS

UNDERLYING CONDITIONS

Founding the Bank of Finland was part of creating a central national administration. The debate in the Diet of Porvoo had given impetus to the establishment of a bank but at least an equal role was played by institutions operating in St. Petersburg. These were the Russian central government together with the Commission for Finnish Affairs and its successor, the Committee for Finnish Affairs, which reinforced the influence of Finnish officials in Russia's capital. At the same time major changes were taking place in power groupings at home and in Russia, changes that were reflected in the ultimate shape of the new bank.

At the time when Finland's government was being planned and established, Mikhail Speransky was a highly influential government official in Russia. It had been decided at the end of 1808 that matters concerning Finland would be presented directly to the emperor, and Speransky was the Secretary of State responsible for this. He was assisted in Finnish matters by R.H. Rehbinder, who had begun his career as an official in Stockholm but had moved to Turku to be an assessor at the Court of Appeal of Finland. In autumn 1809, Speransky was put in charge of the Commission for Finnish Affairs, the part of the Russian government which dealt with "Old Finland" (meaning the Governorate of Vyborg, the part of Finland that had belonged to the Russian Empire since the 18th century) and was now also responsible for the affairs of "New Finland". The commission was a Russian bureau; its members were Russian citizens, its wages were paid by the Russian

government and its working language was Russian. But when the commission's orbit was widened to cover the whole of Finland, it recruited an expert in Finland, R.H. Rehbinder.

Speransky's workload was so great that the system did not function properly. Far from being able to concentrate on Finnish affairs, he was working on an enormous project to reorganise the whole administration of Russia. As part of this rationalisation, a Committee for Finnish Affairs was established in autumn 1811 to replace the old commission. The initiative for a Committee for Finnish Affairs had come from Speransky but its organisational planning was greatly influenced by Gustaf Mauritz Armfelt, who had moved to St. Petersburg in spring 1811 and quickly established himself in the tsar's inner circle. Thanks to Armfelt, and with the support of Speransky, the Committee for Finnish Affairs, responsible for preparing all matters to be presented to the emperor, became a bureau consisting of Finnish citizens. Armfelt was appointed its chairman, with a status comparable to that of the Russian minister. The top official on the committee was a Secretary of State and Rehbinder was appointed to this position.¹³⁵

Finland's transition from military to civilian rule got underway at the end of 1808 when G.M. Sprengtporten was appointed Governor general and the first regulations of the position were confirmed. The initial aim was a system of government that would have revolved closely around St. Petersburg, characterised by a strong Governor general and ruled from the Russian capital. However, the Diet of Porvoo had reinforced national considerations, boosting the relative status of the Governing council of Finland, which had begun operations in Turku in autumn 1809. The Tsar appointed a total of 14 members to the two departments of the Governing council, for legal and financial matters. The term of members was three years, they were to be Finnish citizens and half of them members of the nobility. The Governing council ruled in the name of the emperor as the supreme authority of the country and the Governor general chaired its general sessions.

A power struggle ensued as the Governor general and the Governing council vied for authority. The Governor general's influence was significantly curtailed in revised regulations in 1812.

Thus the system of government that took shape in Finland at the start of the 1810s was headed by the Tsar of Russia and his representative

MIKHAIL SPERANSKY (1772–1839)

It was not merely Tsar Alexander I but also his close advisers who were instrumental in establishing the Grand Duchy of Finland. A sign of Finland's special position was Alexander's decree at the end of 1808 that matters concerning Finland should be presented directly to him without the intervention of other ministers. Mikhail Mikhailovich Speransky was the first secretary of state responsible for presenting Finnish matters to the emperor, alongside his many other important duties.

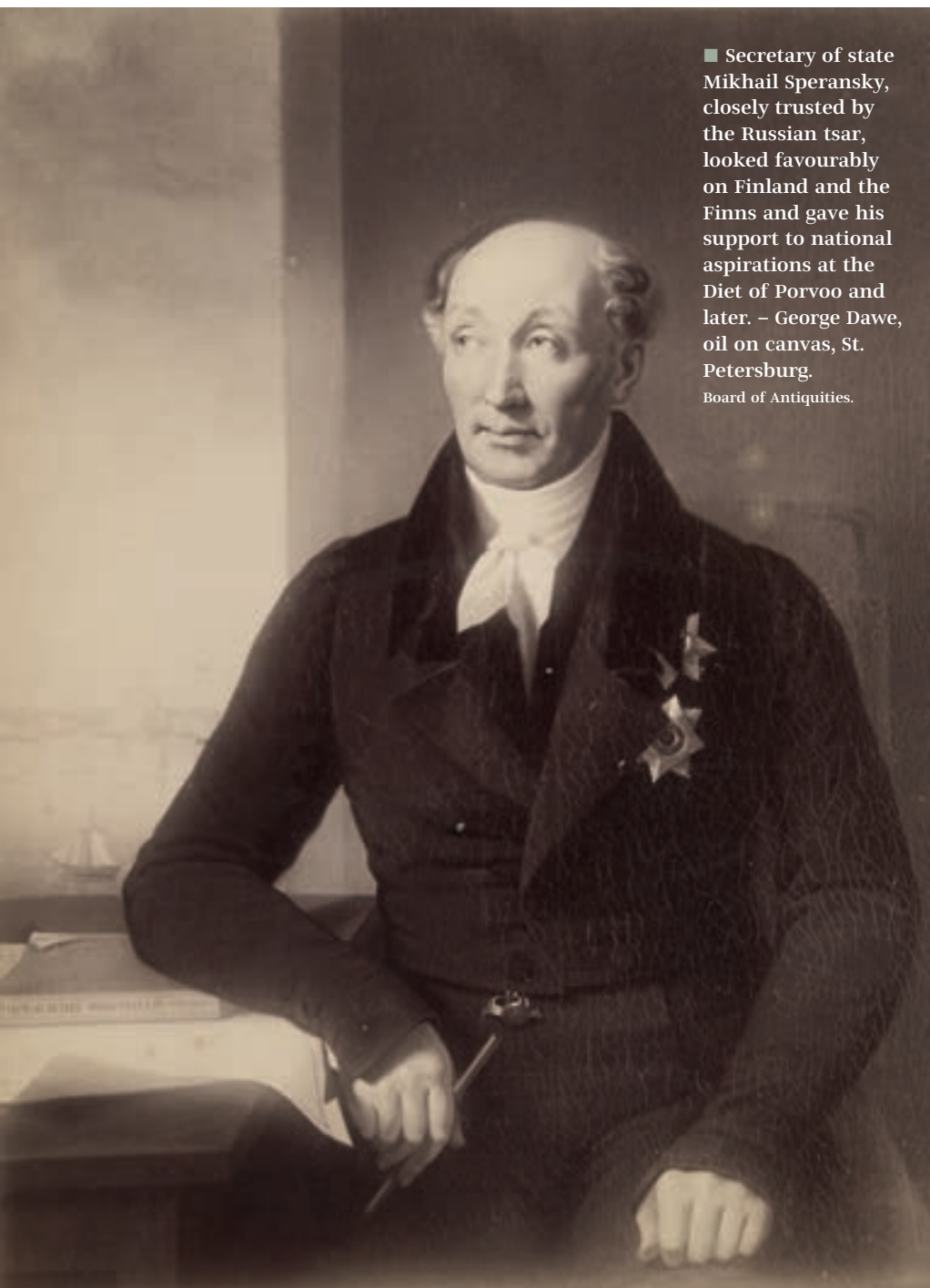
Speransky had risen from modest beginnings to be the tsar's closest counsellor. He was an admirer of the age of enlightenment and the rule of law, and was keenly interested in government reforms in France and in the Code Napoléon, the uniform set of French laws. In Speransky's view, government based on clear laws and regulations was the best source of protection for the people. At the start of the 19th century, however, Russia set its own limits on the principles of enlightenment and not even Speransky questioned the absolute authority of the emperor. On the contrary he felt autocracy to be the best safeguard for the tsar's subjects against ruthless aristocrats.

In Finland, where he was known affectionately as Mikael Mikaelson, Speransky was esteemed for the support he gave to Finland's special position within the Russian Empire. Speransky's memorandum to the tsar in 1811 reiterated that Finland was "a nation, not a governorate".

Constructing the machinery of Finnish government involved drafting the first regulations of the Governing council, on the basis of proposals by a committee under Bishop Jakob Tengström. Together with his Finnish assistant R.H. Reh binder, Speransky modified the committee report so that it would be accepted both in Finland and in St. Petersburg.

Speransky's views on Finnish monetary affairs were coloured by their proximity to a major financial reform that he was planning, to stabilise Russian public finances and return the rouble to the silver standard. He understood the importance to Finland of its own banking institution and supported the desires of the Diet of Porvoo for the creation of a national bank. Russia was unwilling to pledge that the Diet would meet regularly, however, so Finland's wish for a bank operating under the Estates was sacrificed, and it was established under the Governing council of Finland. Speransky also rebuffed Finnish hopes that Russian funds would be provided to establish the bank.

Regarded as a francophile, he was overthrown and exiled dramatically from St. Petersburg in spring 1812 when Russia's relations with France were severed. However he returned to important duties under the rule of Tsar Nicholas I. It was then, under Speransky's leadership, that the complete body of law of the Russian Empire, the *Polnoye Sobraniye Zakonov*, was collated and published.



■ Secretary of state Mikhail Speransky, closely trusted by the Russian tsar, looked favourably on Finland and the Finns and gave his support to national aspirations at the Diet of Porvoo and later. – George Dawe, oil on canvas, St. Petersburg. Board of Antiquities.

in Finland, the Governor general and his various secretariats, but the real authority was the Governing council consisting of Finns. A peculiar extra feature of this institutional structure was the Committee for Finnish Affairs, which prepared and presented matters to the supreme arbiter, the Tsar, without the intervention of Russian ministries. It confirmed Finland's special position. In other parts of the Russian Empire in the early 19th century, only Poland had a similar status that was, for a while, even stronger than Finland's.¹³⁶

While the establishment of a Bank of Finland was being prepared, Ministerial State Secretary Speransky was still at the height of his power and had a strategically crucial influence on the preparations. In autumn 1811, when the Commission for Finnish Affairs handed over its functions to the Committee for Finnish affairs led by G.M. Armfelt, all important decisions concerning the establishment of a Bank of Finland had already been taken. In this connection it is worth emphasising that the foundation of the Bank of Finland coincided with a project, begun under Speransky's leadership, to reform Russia's financial administration. The various phases in the establishment of the bank are understandable only against this background. The view in St. Petersburg was that solutions regarding Finland had to be harmonised with the reforms planned for Russia. Speransky's exceptional personality also played an important role. This progressive bureaucrat, who embodied the principles of the Age of Enlightenment, was an admirer of the rule of law and its attendant model of government in Western Europe and particularly France. Speransky was well informed about the Swedish system of government and, even publicly, regarded it as a suitable exemplar for Russia. As heir to the Swedish tradition, Finland seemed to Speransky to be a model country that deserved special status compared with other regions of Russia.

In 1812, the situation suddenly changed. Tensions had increased between Russia and France as Napoleon prepared to attack. The new foreign situation cast a shadow over Russia's domestic policies, stifling the spirit of reform that had lasted since the beginning of Alexander's reign. Many reforms were associated with France and a French connection now became a burden in Russia. Speransky epitomised French influences and, in March 1812, the tsar suddenly dismissed his old favourite. The loss of position seems to have come as a complete surprise to Speransky, promptly exiled from St. Petersburg to the town of Nizhny Novgorod deep inside Russia.

French sympathies alone did not precipitate Speransky's downfall. The reforms he had initiated had been controversial and the source of a power struggle between the reform-minded and the old landed nobility who had been dominant for many centuries. Speransky's perceived French sympathies handed a weapon to the opponents of his reform programme, just as the approach of war reinforced nationalistic attitudes. By appealing to nationalism, the old landed nobility and officialdom were able to halt administrative reform. Even Finns may have had a role in overthrowing Speransky; his biographer Mark Raeff lists G.M. Armfelt as one of the conspirators. In any case, Speransky's dismissal meant a conservative turn in Russian domestic and economic politics.¹³⁷

SPERANSKY'S PROPOSAL

At the end of 1809, St. Petersburg began to deliberate the Porvoo Diet's request for a national bank. The statement by the Commission for Finnish Affairs can be regarded as the first step. The commission's view had been anticipated; it found the idea of a bank operating under the Estates to be impossible. A state bank was to be specifically a bank of the state and there was no reason for an intermediate authority. Issuing money into circulation was a right of the state so it was equally unthinkable to remove this royal prerogative from the ruler. The commission's statement seemed to postpone the establishment of a national bank into the distant future although it raised no other objections to the plan.¹³⁸

However, a very significant decision of monetary principle was made on 17 December 1809, when an imperial manifesto declared that the only monetary unit in Finland was the Russian silver rouble and its sub-units. In Russia, the decision to return to the silver standard was made in 1810, as part of Speransky's great financial plan which came to nothing after Napoleon's attack in summer 1812.

St. Petersburg's refusal to sanction a bank subordinate to the Estates aroused some annoyance in Finland but there was little that could be done about it. Behind the scenes, however, the Finns were worried, not least because of the terms of the Peace Treaty of Hamina (Fredrikshamn), signed in autumn 1809. Under article 14 of the treaty, all private and public loans from Sweden to Finns or from Finland to

Swedes were to be repaid according to their loan terms. The gentry owners of large Finnish manors had the greatest debts to Sweden and now faced foreclosure. The only practical option that they could see was to convert their debts into domestic loans. If this failed, numerous manors might be repossessed. The most influential members of Finnish society were at risk, so the peril was taken seriously.

The matter was raised in the Governing council of Finland in winter 1810, by C.E. Mannerheim, who had been appointed head of its Chancery Department the previous autumn. The Council despatched a humble proposal to the Tsar, begging him to take action to assist debtors who had been placed in a difficult position, but the phrasing was not very specific. The Governor general, Fabian Steinheil, appended a note to the request, intended for Speransky, providing a detailed explanation of Finland's problems. Steinheil suggested a course of action in which debtors would be granted relief from the terms of their loans and would thereby obtain extra time to get their affairs in order. Another solution would be for Finnish landowners to be granted the right to obtain mortgages from the State Loan Bank of Russia, setting them on a par with Russian borrowers. Once the acute problems have been solved, Steinheil proposed measures to establish a Discount Office in Finland, in line with the plans put forward at the Diet of Porvoo.¹³⁹

The question was considered in St. Petersburg during the spring and early summer of 1810. The response was drafted within the Commission for Finnish Affairs or at least by officials connected with the Commission. Their basic answer was that Finnish landowners could not be given the right to receive loans from Russian banks, at least not in the near future. Speransky's justification was that plans were under way for a reform of the entire credit system, so this was not a time to increase the number of borrowers from the State Loan Bank. The negative response was probably also motivated by the need to reserve scarce funds for Russian landowners, whose political influence in St. Petersburg was naturally greater than Finnish ones.

Two outline responses were drawn up in St. Petersburg. The author of the first, according to Pipping's research, was J.A. Jägerhorn, a member of the Commission for Finnish Affairs. The author of the other response is uncertain but Pipping believes it was probably Carl Johan Walleen, who was working as Reh binder's assistant in the Commission. Walleen was well-informed about the operations of the Turku Discount

Office because he had been one of its agents. He had also, in his official capacity, drawn up a report on the operations of the Turku office for Speransky's use. After his years in St. Petersburg, Walleen had a prominent career in public service, as a member of the Senate and its long-time procurator.

Both Walleen and Jägerhorn made the point that economic conditions in Finland were not yet ripe for the establishment of a national bank but that a credit institution was needed anyway. The way forward was therefore to establish an independent discount office on the Swedish model. The appropriate amount of founding capital would be 600–800 000 paper roubles, with the state of Russia as a minority shareholder. Walleen proposed moreover that a short-term loan should be obtained from banks in St. Petersburg that would allow operations to begin before the entire founding capital had been subscribed. The discount office would provide loans for commerce and industry too, but its primary function would be to finance agricultural property and the term of these loans could be as long as 25 years. The discount office would be entitled to accept deposits in both Russian and Swedish currencies, on which it would pay three percent interest. To improve national liquidity, the office would have the right to issue small-denomination banknotes.¹⁴⁰

Both responses emphasised the close links of the project to the now-defunct Turku Discount Office. A comparison of the responses shows Walleen to have been better informed about banking principles; among other things, he stated that the right to issue paper money should be strictly in proportion to the size of the discount office's capital. He also stressed the need for cooperation with banks in St. Petersburg.

On receipt of these papers, which were fairly similar in their underlying principles, Speransky requested a statement from his own Russian officials. Their statement expressed opposition to the idea of a discount office that granted long-term mortgages. According to the banking doctrines of the age, a discount office was for granting short-term credit for commerce and industry. The Russian officials also doubted the ability of the Finns to obtain the necessary founding capital from their own country and the ability of the envisaged office to repay a loan from Russia. The concept of accepting deposits in Swedish money was regarded as impossible. The statement said that

no progress could be made on the basis of these plans. It also expressed consternation that, while requesting Russian assistance for establishing a bank, the Finns were presuming that the bank's operations would be founded on Swedish legislation and on Swedish banking tradition.

In the view of Speransky's officials, a loan bank could indeed be established in Finland but it should be a state institution. Its founding capital should total 1.25 million paper roubles, paid by the Russian state. Founding capital of such a great size would also allow the establishment of a separate discount office, if one were deemed necessary. There would be no talk of a metal standard in connection with the establishment of this loan bank; its founding capital would consist of bank notes. The Governor general and the Governing council would jointly draft regulations and a budget for the bank, and these officials would also be responsible for supervising its operations. As a general rule, the hope was expressed that the number of bank officials would be kept to a minimum. Finally the Russian officials stated that a Russian loan bank of this kind would accelerate Finland's convergence with its new mother country, Russia.

On the basis of these views, Speransky drafted his own report to the Governing council. Although his experts had rejected the establishment of a discount office in Finland, he himself endorsed the discount office model. The content of Speransky's proposal was rather interesting because he began by analysing the operations of the Turku Discount Office. In his view, the keys to its success had been a stable monetary system tied to the silver standard and close cooperation with the Swedish parent bank. Monetary stability made it easier to find shareholders for a discount office because an investor could be certain that his investment would retain its value. Furthermore the promissory notes issued by the discount office would be a store of value. Cooperation with the Swedish bank – the possibility of having an interest-bearing savings and loan account in the bank, and also of having a loan quota proportional to shareholders' equity – had in turn made it easier to manage the liquidity of the discount office while providing a place where surplus funds could be invested and yield interest. Without such cooperation with a central bank, the discount office would have a poor probability of success, Speransky felt.

Yet the discount office now being planned lacked these favourable factors. Its founding capital would consist of paper roubles that

fluctuated in value. At least at a time when their value was declining, it would be unrealistic to expect private individuals to invest funds for up to 25 years with no guarantee that their assets would not dwindle away. Amid Russia's own monetary reform, it was also unrealistic to expect that a discount office in Finland could be accorded a privileged position vis-à-vis state banks in St. Petersburg, comparable to the relationship between the Turku Discount Office with the national bank of Sweden. However the Finns so greatly desired the institution that it was worth considering anyway, despite the obstacles, Speransky concluded. The founding capital should be at least 1 million roubles in banknotes but the treasury of Russia could not be expected to contribute more than 250 000. In Speransky's view, the objective should be to finance the project entirely from Finnish funds. To bolster its operations, the discount office should have the opportunity to borrow from St. Petersburg and the right to deposit funds in banks in St. Petersburg. However a discount office, by its very nature, would be able to grant only short-term loans to its customers.¹⁴¹

The response from St. Petersburg to the proposal drafted in the Diet of Porvoo was therefore negative. Even the officials working at the St. Petersburg Commission for Finnish Affairs did not regard the establishment of a bank under the Estates to be realistic or viable. What is surprising is that the response from St. Petersburg also rejected plans for a monetary system based on the silver standard, which the Porvoo Diet had treated as a precondition. Formally the condition had already been met because in autumn 1809 the silver rouble had been decreed the official monetary unit of Finland and, in 1810, Russia had embarked on a return to the silver standard. It is hard to find a reasonable explanation for the paradox, especially when official planning in St. Petersburg for the Finnish bank was ultimately directed by Speransky, who was also urging Russia's return to the silver standard. Perhaps the instigators of the plan, Speransky and his close assistants, did not really believe their stabilisation plan would succeed.

In St. Petersburg the plans regarding Finland were linked to a reform project for all of Russia. For this reason the idea that Finnish landowners would become debtors of banks in St. Petersburg was rejected outright. Under Speransky's plan, the phase of reforming the Russian banking system was just beginning and under no circumstances should the banks be encouraged to accept new customers. Another

notion that influenced the decisions in St. Petersburg was that any national bank in Finland should be established in a way that had minimal impact on the economy of Russia, which is why backing was given to a model in which the bank's founding capital would be raised in Finland, with Russia providing only a small share. The fear that Finland would be an economic burden seems rather exaggerated. At a rough estimate, the debts to Sweden of the owners of Finnish manor houses were in the region of half a million paper roubles, while the debts of the Russian state totalled 677 million roubles.

GOVERNING COUNCIL REVISITS THE PLAN

After Speransky's report, the issue of establishing a national bank was sent back to Finland for preparation by the Governing council. Leading members of the council did not support the model endorsed by Speransky, so planning for the bank was transferred to a separate committee. Initially it was hoped that Bishop Tengström would chair the committee but he was too busy with other affairs so Colonel H.C. Reuterskiöld was appointed to the job. Born in Stockholm in 1765, Reuterskiöld moved permanently to Finland in 1810, where he had a prominent administrative career in the Governing council and its successor, the Senate of Finland. He worked mainly in the military commission but was also regarded as an expert in financial matters and served as an adviser on various monetary committees. The other committee members were Professor Gabriel E. Haartman, Professor Gustaf Gadolin, merchant Jean Tjaeder and assessor Algoth Björkbom. The committee was instructed to obtain statements about Speransky's report from the owners of the country's leading trading houses, Petter Bladh of Kaskinen, P.M. Unonius of Loviisa, J. Solitander of Porvoo and J. Sederholm of Helsinki. The country's top business experts were thus involved in the committee's work.¹⁴²

The Governing council set up the Committee in mid-August 1810 and gave it less than a month to report, so the pace of work had to be unusually intense. In the committee's view, it would not be justified to establish a discount office under current conditions. The pressing need was for Finnish landowners to obtain loans so that they could pay off their mortgages from Sweden and a discount office providing short-term lending could not have done this. A discount office would also

fail to take Swedish money out of circulation. Furthermore, as it would be based on paper money, its activities would increase the supply of artificial money with the result that metal coinage would disappear from circulation, ultimately harming all economic activity. The committee pointed to Sweden's National Debt Office and the treasury notes it had issued as an ominous example of this eventuality.¹⁴³

The committee also doubted whether a discount office could be successfully established. The number of wealthy individuals in Finland was too low to contribute the capital needed. Furthermore, while the value of money was fluctuating, individuals would prefer to invest their funds in short-term projects with a reliable outcome. Under such conditions there was no guarantee that the office would receive deposits either. An even greater question mark hung over the willingness of bankers in St. Petersburg to invest their funds in Finland.

The experts who gave evidence to the committee concurred that there was no reason to establish a discount office. The most strident opposition came from Petter Bladh, who stated that "every thinking person would be wise to abandon such an endeavour". In place of the discount office, the committee proposed the establishment of a loan bank subordinate to the Governing council. Future tax surpluses, which initial calculations showed would exist each year, could be used for the founding capital of such a bank. This solution was regarded as politically realistic because the emperor had promised that all revenue of the government of Finland could be used for the country's own needs.

The Financial department of the Governing council's Economic division issued a statement at the start of December 1810, endorsing the committee's report. It believed that a state bank could be established with founding capital of 1.5 million silver roubles, or about 3 million paper roubles at the current rate of exchange. Budget surpluses could contribute 600 000 paper roubles annually, so the entire founding capital could be accumulated in five years. The bank's lending would take place in accordance with the regulations of Sweden's Bank of the Estates as long-term mortgages. It also proposed that an office to issue small denomination notes be set up in connection with the bank. At least a quarter of the value of this small change would be backed by banknotes tied to silver.¹⁴⁴

But preparations in the Governing council did not end there. The head of the Chancery department, C.E. Mannerheim, issued his own

■ Carl Erik
Mannerheim was a
political realist and
one of the founding
statesmen of the
Grand Duchy of
Finland. He also
drafted the first
outline regulations
of the Bank of
Finland. – Joseph
Oleszkiewichs, oil
on canvas, 1825.
National Museum
of Finland.
Board of Antiquities.



CARL ERIK MANNERHEIM (1759–1837)

The transformation of Finland from a part of the Swedish realm into a Grand Duchy of the Russian Empire offered good opportunities for talented administrators, such as Swedish-born Carl Erik Mannerheim. Appointed junior major of Turku Regiment in 1783, Mannerheim was part of the Anjala League in 1788. For this opposition to the policies of King Gustav III of Sweden, he was sentenced to death but pardoned soon afterwards and allowed to keep his rank. He left the military in 1795 and purchased Louhisaari Manor in Finland.

Quiet life in Louhisaari came to an end when Russia invaded Finland. After the conquest, one of the first acts of Russian policy was to invite a deputation composed of the four Estates to St. Petersburg in autumn 1808. Carl Erik Mannerheim was appointed its chairman. The delegation was intended to express loyalty towards Finland's new ruler and present proposals to the tsar about how Finland should be ruled.

Mannerheim played an important role at the Diet of Porvoo. He served as chairman of its Financial committee, which was preparing proposals to the emperor about how the monetary and banking affairs of Finland should be organised. Meanwhile, the emperor had established a committee under Bishop Jakob Tengström to draft regulations for the Governing

council of Finland and Mannerheim was invited to join this committee too. These credentials made him a natural choice for membership of the first Governing council. He later became deputy head of the Senate's Economic division, approximately equivalent to prime minister of Finland. He was granted the hereditary title of count in 1824.

His role in the history of the Bank of Finland was to draft a crucial memorandum on its founding principles. These diverged from the wishes of the Diet of Porvoo, which had looked to Russia for the founding capital and had wanted the bank to operate under its auspices. Mannerheim's proposals for the shape of the bank were approved by the Governing council and then the Tsar almost without changes.

Mannerheim was a political realist. At a politician he sought solutions that would serve Russian and Finnish interests at the same time. He held old Swedish law in high esteem but could be flexible when the situation required it. Russia had no traditions of a Diet so it was not appropriate to make the establishment of a national bank conditional on Diet sessions in Finland. The issue was so important for the Finnish economy that compromises could be made in institutional formalities.

Carl Erik Mannerheim was the great-grandfather of C.G. Mannerheim, the Marshal of Finland.

rather extensive written statement on the matter, which was to be decisive for the future shape of the bank. As the chairman of the Economic division at the Diet of Porvoo, Mannerheim had already expressed strong views on the monetary question, urging Finland's early adoption of Russian, and preferably silver, money. Elaborating on this theme, he now stated that one of the most important functions of the new bank would be to create a framework for transition to the new currency. His other premise was that it would be impossible to establish a bank on the silver standard because the only money in circulation throughout the Russian Empire was paper and because uncertain conditions had choked off economic activity. A bank could certainly be started with silver capital but money backed by silver would inevitably disappear and be replaced by paper of little value.

The founding capital of the bank could be accumulated from surplus state funds, Mannerheim stated, although the exact sum could not yet be set. To stimulate trade the bank should have the right to issue small notes, redeemable on request, to the value of 600 000 roubles, the smallest worth 20 kopeks. These small banknotes would be valid only within the Grand Duchy of Finland. The bank would grant loans against mortgaged property from its founding capital. The loan period would be 20 years and the interest rate five percent. The bank would need a separate fund to back the banknotes in circulation, and from this it could grant short-term loans of less than a year, secured by merchandise or mortgage. These loans would promote industry and business. All revenue of the Crown would be deposited in the bank, which would keep accounts in accordance with the Swedish example. The bank would operate under the Governing council. Its financial statement would be audited annually by two members of the Council, who would report to the Council on its management. If the Tsar were to permit the establishment of such a bank, the task of the Governing council would be to draft its regulations and initiate its operations.¹⁴⁵

Mannerheim's proposal was debated in the Council and approved by all members, who decided to send it to the sovereign in St. Petersburg at the start of December 1810. The proposals were despatched by the Governor general in two parts. The first petition, sent on 20 December, noted only that the Governing council was opposed to the establishment of a discount office. In a second petition, sent exactly a week later, a proposal was made to the Tsar on establishing a bank. The reason for

this two-stage approach is not clear but was apparently tactical. Another sign of strategy is that the first budget for Finland was presented to the emperor at the same time. It showed a significant surplus so raising the founding capital to the bank would not be problematic.

The Governing council's proposal for a bank was very different in its principles from the proposal sent to the Council half a year earlier by Speransky. In view of this, it is astonishing how quickly matters advanced in St. Petersburg. By 23 February, an edict was received in Finland via the Governor general that authorised the Council to establish an *account office* and to set its capital at one million roubles in surplus revenues. The same edict ordered the Council to commission without delay a complete proposal on the establishment and regulation of the bank. Bank operations could begin once these proposals had been examined and properly approved in St. Petersburg.¹⁴⁶

The edict made an interesting reference to Porvoo, noting in its second article that the Diet had requested "that a bank be established in Finland". The similarity ended there. This was no longer to be a bank subordinate to the Estates nor founded on silver. The idea of economic assistance from St. Petersburg had also been abandoned. The modesty of the plan now approved was reflected in the use of the term "account office" and a related discount office was no longer included.

A CONSTITUTIONAL ODYSSEY

The emperor's edict was presented in the Governing council on 9 March 1811 and referred to the Financial department, where final preparations could be made for the bank's establishment. It was soon apparent, however, that matters were not advancing. The head of the department, Erik Tulindberg, noted that reform of the administration required so much work that there was simply not enough time to plan for the bank. At this point the Governing council set up another committee to draft proposed regulations for the bank. Its chairman was the already familiar Professor Gustaf Gadolin and its members were provincial treasurer Arndt Johan Winter and merchant Jean Tjaeder. All on the regulations committee had been exceptionally active participants in the debates on monetary and banking matters at the Diet of Porvoo and also had experience of the operations of the Turku Discount Office.¹⁴⁷

Their report was completed in three months and its contents were shocking. It was openly critical of Mannerheim's plan and returned to the original proposal made at the Diet of Porvoo. The whole premise of an institution founded on Russian paper roubles was deemed unsound. "If even a discount office granting short-term credit is possible only under conditions of monetary stability based on silver, how can a bank granting long-term credit ever manage without the stability of a metal standard?" When paper roubles collapsed in value the bank would destroy itself; if they rose in value its debtors would be doomed. The committee members were obviously well informed about the problems of inflation and deflation and their implication for banking.

In their view Finland needed a silver-based monetary system separate from Russia and a banking institution based on this. Finnish money would differ from Russian money and would not be valid as tender outside Finland. Correspondingly, Russian paper roubles would no longer be accepted in official payments in Finland. As for Mannerheim's plan for the issue of small-denomination banknotes, the committee saw no need for them and thought that small Swedish notes were enough to satisfy the demand for change. In fact the issue of notes might increase the volume the amount of money in circulation excessively and thus lead to inflation. There were already signs of this, the committee thought.

Finally it recommended that the whole idea of a bank be abandoned. In its place it proposed a simple fund managed from provincial offices, in which there would be separate accounts for silver money and paper money. The main function would be to grant loans to landowners who had mortgages from Sweden. This would be only a temporary solution and once the loans had been amortised the fund could be discontinued.

An interesting detail of the report is its analysis of the professional requirements for the bank's managers. The committee took the view that the bank's leaders had to be well-informed about the fundamentals of banking practice. Men were needed who "were used to managing their own funds and the funds of others with prudence and who were by nature inclined to thrift and meagre habits and known for their decency and exacting ways".¹⁴⁸ To run the bank a set of rules would not be enough. The tone would be set by its leadership.

It would be interesting to know what the regulations committee actually intended with these proposals. In the light of current realities

they had not the slightest chance of being implemented and might even have created serious friction in St. Petersburg. Hugo Pipping deliberated this question in his history of the Bank of Finland (1961), and reached the apt conclusion that the silver standard and the bank's status subordinate to the Estates were matters of principle to the committee. Evidently these principles would not be adhered to, and there was a danger that a bank operating under the Governing council would become established. If this happened, there would no chance of transferring it to the ambit of the Estates at a later date, so the best solution would be an unimportant and temporary fund that would create no precedent.

THE MATTER RESOLVED

The work of the regulations committee was too radical to be used so preparation of the bank's regulations passed back to the Financial department. Apparently the urgent matters mentioned by Erik Tulindberg had been completed so department officials now had more time. Mannerheim's memorandum on the principles of the bank made the work far easier and came to constitute the framework of the final proposal. The department was able to concentrate on the details and its proposals were approved in the Governing council on 4 July 1811. They were subsequently amended by Governor general Steinheil, who lowered the bank's permitted expenses, mostly by reducing the number of bank commissioners – the members of its board – from four to two. The proposal was dispatched to St. Petersburg at the end of August.¹⁴⁹

In the Russian capital, the completion of the proposal to be submitted to the emperor came at an important juncture. A Committee on Finnish Affairs was being formed to replace the old Commission on Finnish Affairs, with the result that responsibility for presenting matters about Finland to the emperor was transferred from Russian Secretary of State Speransky to a Finn, G.M. Armfelt. No significant amendments to the proposal were made in St. Petersburg. Pipping believes that the credit for this belongs with Armfelt, who had already unofficially discussed the question with the tsar and was thus certain of its success.¹⁵⁰

In St. Petersburg, the nature of the bank to be established in Finland was described by contrasting it with the banks of France and Sweden.

Kejsarillisen Majestetin
Armollinen
R E G L E M E N T I
Waihetus (Wärelä) Laina-
la
Depositioni Contorille
Suomen Suuren Ruhtinanmaasa.

Annettu St. Pietarborissa sinä $\frac{30}{12}$ Marraskuussa 1811: Joulukuussa

Turussa, Prändättö JOH. CHR. FRENCKELLIN tofönd.

■ Alexander I ratified the Bank of Finland's first regulations at the end of 1811, although banking did not start till the following summer.

—Bank of Finland.

The greatest difference from the Banque de France was organisational because it was a company while the Bank of Finland would be a state institution. Speransky had had a company in mind from the beginning. He was known to be an admirer of the French system of government developed under Napoleon and his financial plan included the establishment in Russia of a bank of issue like the Banque de France. The Bank of Finland differed from the Swedish national bank in its relationship to the monarch and the national assembly. In Finland the bank would operate in the name of the sovereign under the Governing council but in Sweden it was subject to the Estates. It was also stressed in St. Petersburg that the bank would be an important source of banknotes. This would boost the money supply and stimulate trade, making the country wealthier. The bank's minimum founding capital was determined as one million silver roubles, 2 million paper roubles at the exchange rate at the time.

The emperor's approval for the establishment of the bank came on 12 December and its regulations were published under the title "His Imperial Majesty's Gracious Ordinance on an Office for Exchange, Lending and Deposits in the Grand Duchy of Finland". Although initially very modest in shape, the bank would have far-reaching and favourable consequences for Finland's economic development. The decision to establish it and the form it took were influenced by several parallel factors. The idea of a national bank had been put forward first by G.M. Sprengtporten in a draft constitution decades before Finland was separated from the Kingdom of Sweden. After the Russian army had invaded Finland, the occupation authorities had given repeated promises about a bank. These were politically motivated but there was also an obvious need for a bank or at least an exchange office. Plans for its concrete form came from the Diet of Porvoo, which enunciated the national desire for organising the affairs of the Grand Duchy, including banking, in a way familiar from Swedish tradition. The bank's final form was influenced in successive planning work involving Russian and Finnish officials in St. Petersburg and officials of the Finnish Governing council in Turku.

Perhaps the most influential individual in St. Petersburg was State Secretary Speransky, whose attitude to a bank in Finland was rather pragmatic. He postulated that it should be no burden on the Russian public purse nor on Russian state banks but saw it as a way to

remove Swedish money from circulation and assist in the repayment of loans from Sweden. Speransky's known sympathies towards Finland and the wishes of its people are revealed by comparing his banking plans with those of his subordinates. In the very final stages of establishing the bank, the newly appointed chairman of the Committee for Finnish Affairs, Gustaf Mauritz Armfelt, took centre stage, almost like a midwife.

On the Governing council of Finland the weightiest views on banking questions were expressed by C.E. Mannerheim. His attitude to Finland's new political status was firmly realistic. This is clear from his actions in the final stages of the bank's establishment, when he sidestepped the opinion of the Diet of Porvoo that the bank should have the same institutional position as Sweden's Bank of the Estates. Mannerheim sought a compromise that would be both in line with Finland's interests and acceptable in St. Petersburg.

The significance of the Turku Discount Office is apparent. Although it had operated for only a few years, it had provided practical experience in banking fundamentals. Those with most cogent views on the theory of banking – such as Tjaeder – had had close connections with the Turku Discount Office. The Diet of Porvoo can also be regarded as another source of valuable schooling in banking and money. Its minutes show how much weight was attached to monetary questions and how vigorously its members participated in debates about a bank and a monetary unit.

SLOWLY MOVING FINLAND

THE AGRARIAN PERIPHERY

The Finland that Russia annexed in 1809 was a sparsely populated land that was mostly cut off from the rest of the world for 4–5 months of the year when sea lanes iced over. At the end of 1810 the population was some 860 000 although it rose above 1 million a year later when the “Old Finland” that had been inside Russia since the wars of the 18th century was combined with the Grand Duchy and reunited with the rest of the nation.

In the early 19th century, Finland was an agricultural society where more than 90 percent of the working population made their living from the land. There was very little urbanisation; the combined population of all towns was less than 50 000. About 12 000 people lived in the largest town, Turku, but only a few thousand in each of the others.

In the countryside, land ownership was mostly in the hands of peasants. Most farming land belonged to members of the Estate of peasantry. There were some manors owned by nobility, mostly in the grain-producing areas of the south-west, Uusimaa province and south Häme, but they were not very numerous, not very large and not very important for grain production as a whole. In land ownership Finland differed greatly from Russia or the Baltic provinces, where there were large landed manors. In Russia until the 1860s the peasants were serfs. Serfdom was abolished in the Baltic provinces in the reforms of 1816–1819, when the peasants became tenants of the landowners.¹⁵¹

Although the landowning aristocracy in Finland was the most influential strata of society in the first half of the 19th century, they were small in number. From the point of view of banking, the significance of Finland's pattern of land ownership was that the mortgage value and creditworthiness of country manors was much lower than in, for example, Russia. This explains why, as Finland's credit markets developed in the pre-industrial era, long-term agricultural credit remained much less important than in Russia or the Baltic provinces.

The lack of industrial development is partly explained by conditions under the Swedish Crown. From the Swedish point of view there were serious political risks associated with Finland so investment in its development had been modest even in the 18th century. Public funds had been used to try to establish an iron industry in Finland, based on ore from Sweden, but with modest success. Economically more important investments in Finland were related to clearing farming land because, after it lost its position as a great power, Sweden sought to replace lost territories with greater field area. Actual manufacturing in Finland was negligible at the start of the 19th century; the total number of all factory workers in the last years of Swedish power was only 2000. Most of the population were engaged in subsistence production so the number of craftsmen was also low, less than 7000.¹⁵²

Although the country was largely self-sufficient in agricultural produce, the prospects for agriculture were uncertain at the start of the 19th century. In eastern Finland most people still supported themselves by ash farming although this was reaching the end of the road. By nature, burn beating is an extensive form of farming requiring large land areas that were no longer available because the population had grown. As fields were shifted to a shorter cycle, the harvests deteriorated. The situation in the arable areas of western Finland was better but, even there, agricultural production could scarcely keep pace with the growing population. The country ceased to be self-sufficient in grain and imports began from Russia.¹⁵³

A very pronounced feature of the early years of Finland's autonomy was the great variation between regions both economically and in the lives of the people. The way of life in the countryside was archaic and there were few links with the outside world. Technical improvements

in agriculture had been adopted mostly in the arable areas of southern Finland. Even there they were confined to a few large manors, too sparse to spread innovations properly into the surrounding area. The economy was entirely dependent on the harvest and years of crop failure were reflected in a steep rise in mortality.¹⁵⁴ The coastal towns of the South and West were more advanced economically. Their most successful businesses were trading houses operating under various privileges, which had benefited from the partial liberalisation of foreign trade in the second half of the 18th century. As the dominance of Stockholm had subsided, they had built up more foreign connections, which had fostered the spread of new ideas and concepts into Finland, including areas that had previously been peripheral.¹⁵⁵

More than 90 percent of the population lived in the countryside and received their living either directly or indirectly from agriculture. In the subsistence economy of the countryside, even wages were largely paid in produce and only a tiny proportion of goods was sent to market. For most of the people the monetary economy was unimportant. Even among employees of the government, military and civilian officials alike received most of their wages in the form of the right to use official residences and levy certain taxes. In this respect differences between the countryside and the towns were great. In towns a barter economy had already given way to a money economy.

Economically the relationship between Sweden and Finland was that of a metropolis to a periphery. Finland had little potential for spontaneous economic development. Its economy produced hardly any surpluses so the investments required for economic growth were small-scale. From an economic perspective, then, Finland's position at the start of the 1810s was problematic. Economic dependence on Sweden could not be severed overnight because time was needed to build new trading connections and develop new forms of business. This situation was taken into account in the Peace Treaty of Hamina, signed between Russia and Sweden in autumn 1809.

According to article 17 of the treaty, Finland was entitled to freely import Swedish ores, pig iron and other industrial products required by its ironworks, which were dependent on these raw materials. Correspondingly the Finns were allowed to continue selling Sweden rustic goods such as dairy produce, grain, fish, tar, firewood and lumber. The aim was to safeguard the position of the rural population

on Finland's western coast amid the new political conditions. Originally the agreement was to be in force for one year only but the situation continued until 1817, when the special terms for trade between Finland and Sweden began to be gradually dismantled. They were finally discontinued in a trade agreement signed in 1838 but even this contained transitional regulations, so the rules did not become fully applicable until 1844. The fact that this process lasted over three decades shows the great magnitude of the problems caused by Finland's economic dependence on Sweden.¹⁵⁶

Finland at the start of the 1810s was thus a poor, peripheral society that lagged economically well behind the countries of Central Europe. It was far from self-evident that economic development could be started under these conditions. In fact it was to require fundamental reforms, in which the Bank of Finland would later play a significant role.

FINLAND A SPECIAL CASE?

It is worth comparing monetary conditions in the Grand Duchy of Finland with those of other areas that had special status within the Russian Empire. Finland was not the only country that Russia accorded separate administrative and judicial status. The positions of Poland and the Baltic provinces of Russia, in particular Livonia, were somewhat similar so a study of their monetary and banking systems can help put Finland's conditions and development into perspective.

Even in Finland, in debates among the Estate of burghers at the Diet of Porvoo, Livonia was cited as an example of why Finland need not adopt the rouble even though it had become a part of the Russian Empire. However, Livonia's separate monetary system was terminated soon after Finland had been annexed to Russia.¹⁵⁷ When Russia joined the continental blockade against Britain, Livonia's economy was thrown into crisis. In 1810 the rouble was decreed its official unit of currency and from the start of 1815, the use of any money that was not denominated in roubles was entirely forbidden in Riga and Livonia.¹⁵⁸

Riga had a local guild-owned banking institution, Diskontokasse, that had been established in 1794, but it remained very small scale in operations. Russia's state banking system expanded into Livonia



■ Interior view of Tervik Manor in Pernå. Its owner, Lord Marshall Count Robert Wilhelm De Geer, was by far the Bank of Finland's largest debtor during its early years.

– National Museum of Finland / Signe Brander.

in 1820, when the state commercial bank established a branch office in Riga.¹⁵⁹ Regarding agricultural credit, however, local conditions prevented complete integration with Russia. Serfdom was abolished in Livonia in 1819, long before Russia took the same course. Because the business of Russia's State Loan Bank was founded on the mortgaging of serfs, agricultural credit remained in the sphere of a local institution, the Livonian Noble Mortgage Society (*Livländische adelige Güterkreditsozietät*), established in 1802 on Prussian lines. It granted long-term loans to the owners of manors and its operations expanded considerably during the early years of the 19th century. Its long-term agricultural lending was many times larger than that of the Bank of Finland, for instance.¹⁶⁰

The Kingdom of Poland makes an even better point of reference than Livonia. Poland was annexed to Russia after the creation of the Grand Duchy of Finland, when the Polish Kingdom was established by the Congress of Vienna in 1850. The Polish constitution then created a personal union between Poland and Russia, in which the tsar of Russia was the king of Poland. Poland had its own silver monetary unit, the *złoty*. Polish autonomy was initially far stronger than in Finland, until the country was incorporated into Russia after the uprising of 1831. At that time the constitution of Congress Poland was overturned and meetings of its Diet were terminated.

Poland's reform-minded finance minister Ksawery Drucki-Lubecki established first a Prussian-type agricultural mortgage bank, the Land Credit Society (*Towarzystwo Kredytowe Ziemskie*) in 1825 and finally in 1828 a national bank of issue (*Bank Polski*). However, the termination of Poland's constitutional autonomy also terminated the development of a national financial system. During the 19th century, while Finland's monetary system was developing into a national one separate from Russia, Poland was moving in the reverse direction. The *złoty* was replaced by the rouble in 1841 and eventually *Bank Polski* was eliminated by combining it with the Russian State Bank in 1886.¹⁶¹

If Finland is compared with these other countries on the western border of the Russian Empire, it can be said that Finland's autonomy in monetary affairs was not unique in the early decades of the 19th century. Poland had a monetary economy that was more distinctly separate from Russia, and Livonia had, if not its own bank of issue, at

least a separate credit market and banking institutions. It was only after the middle of the century that Finland's special status became pronounced. Its monetary system diverged from the Russian rouble while Poland's autonomy was demolished and Livonia was integrated into the ambit of Russian banks.

THE BANK OF FINLAND'S EARLY YEARS

REGULATIONS UNTIL THE LATE 1830S

After the reforms of the early 1810s, the absence of social development in Finland combined with a conservative turn in Russian government opinion were clearly reflected in the status and operations of the Bank of Finland until the late 1830s. Tsar Alexander I was succeeded by his brother Nikolai I, whose rule was characterised by militarism and political conservatism.¹⁶² In Russia's financial administration, the anti-liberal trend of the era was symbolised by Egor (Georg) Kankrin, who became finance minister in 1823. His mission was to defend the status quo in Russia, especially regarding the landed nobility. The spirit of the age shows in operational bureaucracy at the Bank of Finland.

Extensive preparations in St. Petersburg and Turku had been concluded and the bank's regulations were ready by the end of 1811. The preface to the regulations reveals the modest shape of the bank's initial form. The institution to be founded was not yet called a Bank of Finland or anything similar, but an "Office for Exchange, Lending and Deposits". The name shows that it was not regarded as a fully fledged bank but rather as an bureau of the state that handled some bank-like operations. The name "office" was retained in the regulations until 1817, when it was replaced with the word "bank". The shorter name Bank of Finland was adopted officially in 1840, when the regulations were revised in connection with a monetary reform, although this work uses the name Bank of Finland from the outset.¹⁶³

One of the first tasks of the new exchange, lending and deposit office was to assist manor owners who were in debt to Sweden, allowing them to repay loans from “public funds” or private lenders. Secondly, its role was to bring order to the country’s monetary system and promote the use of a single currency, the Russian rouble. In this way it would benefit the whole of society, meaning farmers, traders and so on.¹⁶⁴

Of the four main sections of the regulations, the first concentrated on the grounds for the bank’s establishment. Its founding capital was set at one million silver roubles, to be gradually amassed from annual tax surpluses. Finland did not, however, have such reserves of silver and the regulations made allowance for the possibility that the capital would be paid in assignats, in other words paper roubles. Capital of a million silver roubles would be regarded as paid up when two million paper roubles had been accumulated but in fact the exchange rate of one silver rouble to two assignats was unrealistic. In the second half of 1811, when the regulations were being honed, a silver rouble was already worth almost four paper roubles on the St. Petersburg Exchange, so the value of a paper rouble had fallen to around 25 silver kopeks. The two million paper roubles referred to in the regulations were therefore worth only half the amount of one million silver roubles that the regulations set as the bank’s founding capital.¹⁶⁵

The bank was subordinated to the Governing council, which was to monitor its operations and could also give instructions about them. At the same time the regulations stressed that the Bank of Finland had the same rights and privileges as Sweden’s Bank of the Estates. Thus Swedish statutes regarding the Swedish national bank could be applied where practical to the Bank of Finland.

To relieve the shortage of money the Bank of Finland was empowered to issue banknotes of 20, 50 and 75 kopeks, which would be valid only in Finland and which the Bank was required to redeem with Russian paper roubles. At this point, before the silver standard was in force, the bank’s reserves consisted of Russian paper money. It was generally assumed that Swedish money would soon cease to be valid in Finland, at which time there would be greater demand for the bank’s own small banknotes. The bank was also required to look after the quality of Russian paper money in Finland, replacing worn or damaged Russian assignats, which it would exchange for sound notes in the banks of St. Petersburg.¹⁶⁶

According to its regulations the Bank of Finland was to operate as a bank of exchange on the central European model. In practice this meant accepting interest-free deposits, which could then be transferred by means of payment orders, making transactions easier to arrange. At this point the modern reader should note that the word “exchange” (våxel) in the office’s name refers specifically to this function of facilitating payments and not to the granting of credit on bills of exchange (våxlar) . According to the regulations, discounting bills of exchange was in fact not within the sphere of the bank’s operations.

The second section of the regulations laid down the conditions for lending. From the primary capital fund, provided by its founding capital, the bank was allowed to grant mortgages to landowners. If the collateral was a tax-exempt noble estate, the sum borrowed could be up to two-thirds of the value of the property. In the case of taxable land, such as peasant freeholdings, the loan could be no more than half of its value. The duration of the mortgage was 20 years and the interest rate five percent. The Bank of Finland had the right to demand repayment after ten years.¹⁶⁷

In addition to long-term loans from its primary capital fund, the bank was allowed to make short-term loans from the separate fund that covered its small banknotes. To be able to redeem the notes it had issued, the Bank of Finland had to keep a reserve of Russian paper roubles but part of this fund could be used for credit for the public. According to section 3 of the regulations: “Insofar as it is not to be expected that a large amount of small Bank Notes should be offered for redemption at the same time, a third or half of the sum held as their security may be lent for a shorter period that is not, however, less than six months, up to one year”. The collateral for these loans was generally to be merchandise or a guarantee, and they were intended mainly for owners of iron works and factories. The interest rate was fixed in the regulations at five percent and the maximum amount of loans was set at 10 000 paper roubles.¹⁶⁸

There is no direct reference in the regulations to the currency unit that the Bank of Finland should use in its bookkeeping. On the other hand, it was stated that the loans should be granted and paid in paper roubles, so the accounts were drawn up in Russian paper roubles from the outset. Russia’s contemporary intention to return to the silver standard is apparent from the fact that the bank’s primary capital was



■ This was how Finland's largest town, Turku, looked in 1823. – Lithograph after Carl von Kugelgen. National Museum of Finland.

stated first in silver roubles. The regulations also regarded a return to the silver standard as possible, although this would require monetary stability and a proposal on the matter by the Governing council, as the following quote shows:

“Whereas the Primary Capital of the Office will therefore take the form of Bank Notes, better times may lie ahead through an increase of commerce and wider industry, when the occasion may arise to convert this Capital by degrees into Silver; wherefore the Office is authorised, according to circumstances and if it be beneficial, to act upon the conjuncture; which matter, following presentation by the Governing council, will come under Our closer consideration; whereupon still greater steadiness in the Money affairs of the Country will be gained.”¹⁶⁹

The third section of the regulations defined the organisation of the Bank of Finland. Its board was to consist of two banking commissioners, one of whom would have legal training. Its permanent officials would be two senior clerks, one secretary, two cashiers, two bookkeepers, an attorney and several porters and money handlers. The commissioners would be appointed by the emperor following a proposal by the Governing council of Finland. The senior officials down to the bookkeepers would be appointed by the Governing council at the proposal of the banking commissioners. Lower officials would be chosen by the commissioners directly. A member of the Economic division of the Governing council would always be present in board meetings that considered loans of over 10 000 paper roubles. If the banking commissioners disagreed, the member of the Economic division would have the casting vote.

The fourth and final section of the regulations defined the legal framework of the Bank of Finland. This section clearly shows the model of the former mother country, Sweden. The old statutes and regulations that had governed the Bank of the Estates of the Realm formed the judicial basis for lending. These included Sweden’s 1757 statute defining the value of loan security, its 1798 statute on bankruptcy and a statute from 1781 on the realisation of collateral that had been seized by the bank. The oldest Swedish statutes on banking operations dated from as far back as the 17th century. Naturally the Swedish regulations had to be adapted to Finland’s new political status. Disputes concerning the Bank of Finland were to be heard by the Court of

Appeal in Turku and the highest court was the judicial division of the Governing council, not of course the (Swedish) Svea Court of Appeal, as was the case for the Bank of the Estates of the Realm.¹⁷⁰

These first regulations from 1811 show how a few important matters had changed since the original plans. Although the preface mentioned that the Bank of Finland had been created at the express wish of the Diet of Porvoo and through the actions by the Governing council, the bank was entirely subordinate to the government. It served as a subdivision of the Economic division of the Governing council, where it had a similar status to central administrative agencies like the Chief Customs Board or the Surveying Office. In fact the Bank of Finland had slightly less independence from the Governing council than its central agencies. They had collegial boards consisting only of the officials of the institution in question but a representative of the Council's Financial department had the casting vote in meetings of the Bank of Finland's board.¹⁷¹

The most significant policy statement in the regulations concerned the unit of currency. Although the founding capital was stated in silver roubles, it was noted in the same connection that it would be paid in paper roubles. The regulations for lending clearly said that the monetary unit used by the Bank of Finland would be the paper rouble. This was an interesting choice because the monetary unit used by departments of the government was the silver rouble. All state accounts were formally expressed in silver roubles, even when payment itself was made in paper roubles. Furthermore state bookkeeping performed the conversion into the silver rouble at an administrative exchange rate that was independent of its market value. From the very outset, then, the bank and the state kept their accounts in different currencies.¹⁷²

The reason for the difference was the time lag. Finland's government was established in autumn 1809 when the silver standard was still notionally in force and influential officials in St. Petersburg and Turku believed that a return to silver was imminent. It was therefore natural for them to organise the running of Finland on the assumption of a silver standard. However the establishment of the Bank of Finland took a couple more years. Faith in a return to the silver standard, at least among the leading officials of St. Petersburg, had faded amid mounting state financial problems and the growing military threat

from France. Thus, when the regulations of the Bank of Finland were being honed in autumn 1811, they recognised the reality that no early return to the silver standard could be expected. The practical situation was thus conflicted. While the state was keeping its accounts in silver roubles, the office that handled its monetary transactions used paper roubles, a unit of fluctuating value.

By and large, the regulations are fairly concise and a few important matters were left entirely open. It was stated that the Bank of Finland would serve as the depository for surplus state revenues but other regulations on deposit operations were entirely absent. Thus, the word “deposit” in the name of the office was something of an exaggeration.

REVISING THE REGULATIONS

The first amendments to the regulations were made in 1816 and 1817, when experience had been gained in how the bank operated and there were indications of what needed to be changed. In fact even before operations had begun, it had been realised that a board of two banking commissioners would be too small, so three were appointed. The amendments in 1816 concerned lending from the small banknote fund. To improve its potential, the maximum amount that could be lent was raised from half of the fund to two-thirds. In the same connection the interest on these loans was increased to 6 percent, the highest rate permitted by law.¹⁷³

In 1817 the name “bank” was adopted when the official title of the institution became the Exchange, Deposit and Loan Bank of the Grand Duchy of Finland. The change spoke of the bank’s improved status, no longer a minor bureau but a real bank. At the same time another far more significant name change was being made in the administrative machinery of Finland when the Governing council was retitled the Imperial Senate of Finland. This emphasised Finland’s special position in the Russian Empire. Calling its government a Senate showed that it was not under the Russian government but a state body directly subordinate to the emperor and comparable in status with the Senate of Russia.¹⁷⁴

In the same connection in 1817, the bank’s regulations were modified in some other small respects. In the first regulations, loans of over 10 000 paper roubles had required the approval of a member

of the Governing council. Now this was needed only if the three board members disagreed, in which case the head of the Financial department of the Senate would decide the outcome. The new set of regulations also increased the accountability of the board. Its members were now jointly and separately responsible for board decisions, although this formulation was rather ambiguously expressed and may not have had any practical significance. The senior member of the board now became its chairman; previously he had been separately appointed. In other respects the regulations of 1811 remained in force.¹⁷⁵

In 1821 the bank's accounting year became the calendar year whereas previously it had started on 1 April. In other respects, changes in the regulations in the 1820s and 1830s were minor. They were mostly technical refinements related to the issue of banknotes and to lending.

The bank's operational framework changed little until the start of the 1840s. The bank itself was not entirely satisfied with its regulations, and its board members drafted various proposals for reform. The first to do so was a member of its first board, Gustaf Gadolin. His proposal, completed in 1816, tackled the philosophy of regulation in an interesting way. He believed that the bank's operations should not be regulated in too much detail because of great impending changes. Banking was best managed by giving the board relatively free hands to respond smoothly to changes in its environment. In his view, a change in the regulations could have been delayed for a while until more practical experience had been accumulated. This proposal was not without significance because the review of 1817 took it into account and it also provided unofficial operational guidelines.¹⁷⁶

The next proposal for a new set of regulations was completed in 1820 and the author was now C.J. Idman, appointed to the board in 1816. He put forward fairly detailed regulations, consisting of 144 articles, compared with only 31 in the four main sections of the 1811 regulations. Idman was in favour of elaborate rules for the whole process of lending and the work of individual officials. This can be regarded as the first attempt to codify all the statutes, regulations and unofficial models of banking. It too gathered dust in the minutes of the board. In the 1830s a reform of regulations returned to the agenda when two board members, J.G. Winter and C.E. Stjernvall, both proposed new draft regulations. The board decided that Winter's proposal was the better and the Senate began to prepare a new set of regulations on its basis,

but the time was still not ripe for implementation and the project was shelved.¹⁷⁷

In addition to its official set of regulations the bank was directed according to the old Swedish statutes and rules mentioned previously and the standing orders of its officials, drafted from the 1820s onwards. These laid out in detail the responsibilities and rights of each employee. The proposals for reforming the bank's regulations, referred to above, played a large role in developing them. The standing orders adopted in 1826 actually give the best view of how the bank's operations were organised in the years after its establishment, how many employees it had, the relative powers of its officials and what tasks were performed on different levels.¹⁷⁸

The regulations and various changes made before the 1830s reveal the narrow basis of the bank's operations and its conservatism. It is no exaggeration to describe the bank as operating under the tight leash of the Senate's Economic division and its Financial department. Another noticeable feature was the strong influence of Swedish law. Bank lending took place on the practical foundations provided by old legislation from the period of the Swedish Crown. This was true in all matters, from the determination of the mortgage value of land to the realisation of repossessed securities. Although officials in St. Petersburg had had a major impact during planning for the establishment of the bank, they had not wanted to intervene in these practical matters. Finland's system of law was a separate entity, entirely different from Russia's.

BANK ORGANISATION

The number of bank officials and other employees remained below 30 until the start of the 1840s. The organisation was simple; below the board were only two departments, the chancery and the chamber office. Responsibilities were divided between board members. The chairman was responsible for general management while the member with legal training managed the chancery. The public economist on the board, meaning the one with skills in finance and bookkeeping, was responsible for issuing banknotes and monitoring lending.

The chancery was headed by a legal secretary who presented upcoming matters to the board, made sure that loan applications were

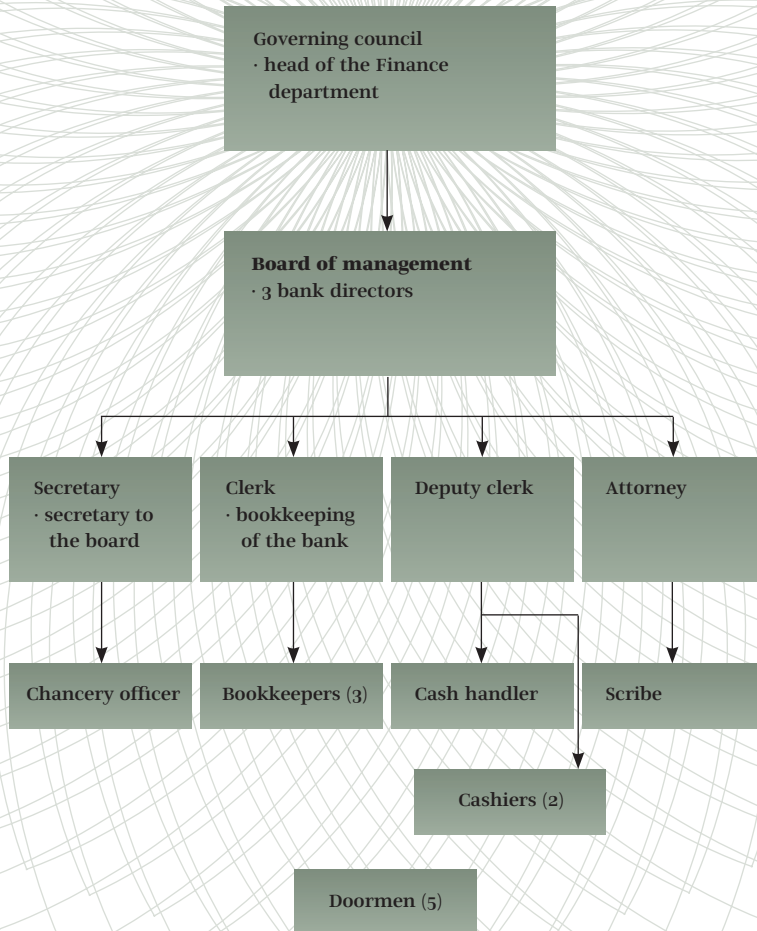
judicially correct, drafted the minutes of the board and monitored implementation of board decisions. Assisting the legal secretary was a scribe, who recorded incoming and outgoing letters in a journal, and a chancery officer. After 1826, the secretary gained another important assistant, an attorney who represented the bank in court. The attorney was therefore responsible for collection of the bank's receivables, the validity of mortgages used to secure loans and the listing of all accounts outstanding. The attorney also handled the sale of collateral repossessed by the Bank of Finland.

The chamber office managed the bank's day-to-day bookkeeping and the closing of accounts, the disbursement of loans and the receipt of amortisations, the maintenance of a loan directory, cash management and the management of surplus revenues received from the state's provincial offices. The issue of small banknotes was also handled from the chamber office. Its work was done by a senior clerk assisted by two other clerks, three cashiers and two bookkeepers as well as a number of assistants. Responsibilities within the chamber office were divided by fund. Each clerk handled his own fund and the duties of cashiers were divided in the same way.

The most intriguing official titles were to be found in chamber office's banknote department. Among its employees was a banknote issuer, whose responsibilities included the precise registration and safekeeping of banknote sheets. An enumerator was responsible for printing serial numbers on each banknote. The note cutter divided the sheets into individual banknotes. Each note had to receive the signatures of a board member and two accountants. For a long time the work remained almost entirely manual and was time-consuming. In the early years of the bank, issuing banknotes was the bottleneck in operations.¹⁷⁹

Expressed in modern terms the chamber office handled the bank's accounting, cashier operations and actual banking. By far the greatest amount of work was caused by the granting of loans and the collection of amortisations. Until the start of the 1840s deposit operations were minimal. Other laborious duties included the receipt of state revenue surpluses and the transfer of funds between different institutions of the state, as well as banknote issue. This assessment is based on a sample of the matters recorded in board minutes between 1811 and 1840.

BANK OF FINLAND HIERARCHY AFTER THE REORGANISATION IN 1817



Source: Bank of Finland, Regulations 1812, 1817.

Although this describes the Bank of Finland's operations as a whole, its work was divided in practice according to funds. On the old northern European model, the bank consisted of two departments, one concentrating on lending and the other on issuing money. In the Bank

of Finland's case, the two funds were the primary capital fund and the small banknote fund. The former consisted of founding capital received from the state plus accumulated interest payments, and was used for long-term loans. The latter was to cover the small banknotes issued, therefore consisting of the bank's cash reserves and short-term lending. The accounts of the funds were kept strictly separate but operating costs were divided inconsistently. In the first few years of operation, they were divided equally between each fund. Then for a few years all costs were charged against the small banknote fund, until the system again changed and they were all charged against the primary capital fund.

The situation became more complex in 1824, when two new lending funds were established, the agricultural fund and the manufacturing fund. The doctrine of fund accounting was so entrenched that the Bank of Finland did not draw up a summary even at the closing of accounts but handled them all separately. The number of funds was not restricted to these four; from 1817 onwards the Bank of Finland handled money traffic and lending for other government funds. The main ones were the Poorhouse Fund, the Military Hospital Fund and the Housing Fund for Military Officers. They were not thought of as constituting parts of the Bank of Finland, however.¹⁸⁰

By the end of the 1850s there had been only one truly significant change in the Bank of Finland's organisation. This was caused by the establishment of its first offices in Turku, Vaasa and Kuopio in accordance with the regulations of 1840. The practical reason was that the bank was implementing a large-scale banknote exchange operation, replacing old Swedish, Russian and Finnish notes with new Bank of Finland ones. At the time that they were established, these exchange offices had high status and their managers were appointed from the bank's board. Organisationally the situation was complicated by the fact that provincial governors also oversaw the new exchange offices, because of their duties in managing state money transfers. After the monetary reform of 1840 had been completed, the exchange offices gradually developed into proper banking branches and their managers long held high formal status in the Bank of Finland's hierarchy.¹⁸¹

INTERNAL OFFICIAL HIERARCHY

The bank's hierarchy is shown by the pay structure of its officials. Naturally some small changes took place over the years, especially when operations were widened and branch offices were established in the early 1840s, but a good general picture is provided by the pay scales, below, from the mid-1830s. These show annual wages and are expressed in paper roubles.¹⁸²

BANK OF FINLAND SALARIES AT THE END OF THE 1830S

Function	Annual wage in roubles
Chairman of the Board of Management	5000
Board member	4500
Secretary and Senior clerk	2500–3000
Other clerks, Cashier	1500–2000
Attorney	1250
Scribe, Chancery officer, Bookkeeper, Assistant clerk, Cash handler	600–1000
Porter, Note cutter	350

Most of the Bank of Finland's staff were middle-level officials and the pay differences between levels in the hierarchy were great. A member of the board earned almost 15 times as much as a porter. The best indicator of social status in 19th century society was the ranking of professions that was rigorously applied to all public positions. The rank of each new position established had to be confirmed by statute. There were nearly 20 ranks in all and they were based on the table of ranks used in Russia.

A member of the board of management of the Bank of Finland belonged to the sixth rank, as did the director generals of the Board of Customs and the Board of Surveying, so the Bank of Finland was regarded as equivalent to a central administrative agency of the Senate. In the Senate a referendant had the same rank. The board's secretary, senior clerks and cashiers were ranked between 12 and 13. Accountants were in the 14th rank. In general government the 12th rank was for provincial secretaries, the police commissioners of Turku and Helsinki and army officers with the rank of lieutenant.

The table of ranks shows that military officers were rather highly regarded in 19th century society compared with civilian officials. In the Bank of Finland's own hierarchy, the senior clerk and board secretary were highly placed, immediately below the board itself, but in the social table none of these officials outshone a lieutenant.¹⁸³

PROFESSIONAL DEMANDS

Around the time of its establishment, a grasp of banking issues was regarded as especially important when positions at the Bank of Finland were being filled. It's clear that, in the selection of board members, great value was placed on previous banking experience, which could only really have come from the Turku Discount Office. The skills thus obtained should not be exaggerated, however, because operations of the Turku office had been rather modest in scale and had lasted for only a couple of years. The other group that knew about banking consisted of owners of trading houses engaged in exporting and importing. They were familiar with the financial centres of northern Europe, most importantly Amsterdam and Hamburg, and had personal experience of international methods of payment and credit arrangements in foreign trade. Both these groups had positions in the early years of the Bank of Finland. The bank was operating in Turku and its leadership obviously had contacts with the major trading houses of that town.

The situation became very different in 1819, when the Bank of Finland, like the Senate, moved to the new capital of Helsinki. This sparked a change in the bank's nature, of which the most striking feature was a growth of bureaucracy. It was increasingly regarded as a government bureau concentrating on lending. The focus on officialdom meant at the same time that the professional demands for its employees changed. More emphasis was given to skills in public administration. The bank's culture shifted from that of a trading house to that of a government department.

The bureaucratisation of the bank shows in the development of its regulations. Initially these were fairly concise, leaving the board plenty of room to manoeuvre. From the early 1820s onwards, however, the bank adopted detailed standing orders for its officials. These made it far easier to monitor operations but at the same time created operational rigidity. The process culminated in the regulations of 1840,

which were extremely detailed and included all the instructions that had previously been recorded separately.¹⁸⁴

In those years the Bank of Finland was indeed seen as riddled with bureaucracy. Even the methods of customer service were strictly defined. Loan applications could be delivered to the bank only at certain times. If approved, the loan had to be withdrawn at a certain time on the following day. There were more detailed rules on amortisation. Of course the job of an individual official was clear when all possible operations were regulated in detail. By following the rules, he could minimise the danger of professional misconduct.¹⁸⁵

No comprehensive data is available on the qualifications of the bank's officials but a collation of extant educational data produces the following picture of the background of employees during the period 1811–1840.¹⁸⁶

Training	Board members		Other officials	
	persons	%	persons	%
Law degree	12	63	21	29
Public economy degree	-	-	6	8
Other degree	1	5	15	21
Military officer	4	21	6	8
School certificate	-	-	8	11
Other	2	11	16	23
Totals	19		72	

In the light of these figures, the level of education among Bank of Finland officials seems to have been high from the start. Almost two-thirds of board members had a background in law. The next largest group were military officers. After Finland's political position had changed, the country was left with a fairly large number of officers, men who had made a career in the Swedish army, who did not want to relocate to Sweden where they were not needed anyway, but could not join the army of the new mother country because of their lack of skills in Russian. They looked for a new career in Finland's civilian administration. At a time when the central government was being created, Finland needed trained bureaucrats and officers were one reserve of them.

The training of officers was wide-ranging and covered languages and mathematics. The military had experts in many fields, and good leadership skills. Military training offered opportunities to study the bookkeeping used in government, and experience from fortification work was immediately applicable to large infrastructure projects. Many a former officer had a prominent later career in civil administration. The bank's board members also included a bishop and a few people without formal education who had obtained their training while working in business.

Among lower-level officials, the largest single group were those with a legal background. The rest were divided roughly equally between officers, school diploma holders and those who had completed some other course of study. There were also quite a few with no formal training at all. Most of these had, after a minimal amount of basic schooling, learned the principles of accounting on the job and began work as lowly scribes. Diligent work could then lead them towards tasks of more responsibility in public administration.

ADVANCEMENT

Studies of the government of the Grand Duchy of Finland have often noted how a system of favourites formed around the ruler. This was pronounced in Russia but similar features can be observed in Finland. It was no wonder because, even in the Realm of Sweden, rulers had placed their own favourites in important positions. This was true in a minor way among the families of senators. A tight network of nepotism prevailed within and between influential noble families, allowing the scions of the famous to obtain high position within the official hierarchy.¹⁸⁷ Even so, the importance of favouritism should not be exaggerated. In early 19th-century society there was a constant lack of trained government bureaucrats. The families of leading senators understood the importance of a good education and were able to offer people of above-average skills for high government position.

An extreme example of the importance of family is Alexander Armfelt, born in 1794. He was the son of a count, General Gustaf Mauritz Armfelt, and received both legal and military training. In both areas he was a cosmopolitan. His degree in jurisprudence was from Turku University but during his courses he had also studied at the universities

■ Strict regulations about official costumes were common throughout Russian bureaucracy, but efforts to extend the practice to Finland did not meet with widespread success. A proposal for a bank uniform in the 1820s. – Bank of Finland. Board of Antiquities.



*Рисунокъ Мундиру, для Чиновниковъ
Финляндскаго – Банка.*

of Uppsala and Edinburgh. Immediately after graduation, he joined the Russian army in time to fight against Napoleon. By 1821 he had risen to the rank of captain and, when his military career ended in 1827, he had served as adjutant to two Governors general, Fabian Steinheil and Arseni Zakrevski.

He left the army when he was appointed to the board of the Bank of Finland in 1827, a job he obtained with the support of Governor general Zakrevski. The bank was only a springboard because in 1831 he transferred to the Office of the State Secretary in St. Petersburg. He became Deputy-Assistant to the State Secretary in 1834, this time helped by Governor general Count Alexander Menshikov. After the death of Privy Counsellor R.H. Rehbindler, he was ultimately appointed Ministerial State Secretary in St. Petersburg in 1840.¹⁸⁸ His career is not merely a case of nepotism. His educational background alone justified his appointment to the board of the Bank of Finland, although the Armfelt name certainly helped him get the position. At the same time, it shortened the time he had to spend there. For a person of his background, the board of the Bank of Finland was far too unimportant in the long run.

August Mannerheim is another example of the importance of family background to an official career, if a slightly different one. His father, Count Carl Erik Mannerheim, was one of the leading statesmen in the first decades of autonomy and played a key role at the Diet of Porvoo and in establishing the Bank of Finland. The high point of Carl Erik's career was his appointment to the Senate's Economic division in 1822 as deputy chairman. The son, August, obtained a civil service diploma from Turku University in 1826 and then began his career in St. Petersburg as an extraordinary chancery officer at the State Secretarial Office in 1826. However, he showed so little interest in his official duties that his career did not advance much despite his fine background, and in the mid-1840s he was working as an official at the Russian Embassy in Stockholm. This did not prevent his brother-in-law Lars Gabriel von Haartman from appointing him to the board of the Bank of Finland in 1845. He sat it out for two decades, until retirement.¹⁸⁹

Relations among the elite were not essential to success, as shown by Johan Gustaf Winter, born in 1776. His father had been a surveyor, one of the narrow strata of officials in Finland under the Swedish Crown, and the son followed suit, getting a job as a provincial scribe at

the start of the 19th century. His career advanced by stages till he became the treasurer of Turku and Pori Province in 1809. Winter had little formal training but practical experience made him into a first-class official accountant. This skill was needed at the Bank of Finland and he became a member of the board in 1817. It was the start of a long career; he did not retire until 1841.¹⁹⁰ Winter may not have advanced solely on his own merit because his uncles J. Gustaf Winter and Arndt Johan Winter had worked as clerks in the Financial department but there is no evidence that they helped get him appointed to the Bank of Finland's board.

SPRINGBOARD OR CAREER HIGHPOINT?

The Bank of Finland was, until the 1860s, the country's only banking institution. There were still no commercial banks and the few savings banks in operation were public thrift associations rather than professionally run financial institutions. Apart from the Bank of Finland and the savings banks, Finland's very undeveloped financial sector consisted of a few pension funds and fire insurance associations. They, too, were small in size. In such circumstances the Bank of Finland gradually became a place that offered an upwardly mobile young official excellent opportunities to learn the mysteries of public accounting and the foundations of banking. The grandstand view of the economy from the bank became even wider after the early 1840, when its regulations were revised and it began to operate in bills of exchange internationally, creating close relationships with foreign agents in various financial centres. The Bank of Finland therefore offered its officials good opportunities for becoming professionals in the money market, public sector finance and accounting.

By 1859 a total of 22 people had been appointed to the board. More than half of these stayed with the board until their retirement. More than a third moved on to other duties in the central government within a few years. The Senate and particularly its Financial department offered a logical place for career development after the Bank of Finland. The bank's first chairman Claës Johan Sacklén became head of the Financial department in 1816. Robert Trapp is another example, moving in 1856 from the Bank to the Senate, where he served as the head of a total of three different departments. Other routes for

advancement were offered by the highest posts of the judicial administration and the Committee for Finnish affairs in St. Petersburg. An interesting exception to an official career is shown by the first members of the interim board, Gustaf Gadolin and Jakob Dreilick. The former left the board after only a few years and resumed his old posts as a Professor of Theology and Cathedral Dean; the latter spent four years in the board and then went back into business to run the Högfors ironworks, admittedly with scant success.¹⁹¹

Among lower officials there was far less turnover than on the board. Of those who had been recruited by 1859, about 70 percent stayed with the bank, eventually retiring or dying “with their boots on” before they reached retirement. After joining the bank as a lowly office worker or something similar, one rose higher over years of service to a position like senior clerk or even board member. The establishment of branch offices in the 1840s increased the number of senior positions so there was less need to leave the bank for career development. For many the Bank of Finland became a lifetime employer.

About 20 percent of bank employees transferred to other duties in the state administration. This generally meant the service of the central government in the Senate, local government in provincial administrations or some central agency. Obviously the bank had a limited number of good positions so there could be better opportunities for a prominent official career outside it. Naturally there were also cases where the official’s personal attributes were unsuited to banking, in which case the move to a different job was in the interests of both. Ten percent left an official career entirely, in most cases to run a manor farm; for one reason or another, acquiring a farm usually led to its becoming a full-time job. On the other hand there were only a few exceptional cases when the official went into business in the private sector.¹⁹²

The small scale of operations at the Bank of Finland generally meant that people with the greatest ambition, the finest education and the best social networks did not remain there despite the incentive of a safe position on the board. They sought out superior routes for advancement that began from the Senate or St. Petersburg. Job mobility between the bank and other organisations of the central government certainly helped the flow of information in the government. This was particularly true between the Bank and the Financial department of the Senate.

■ Legal counsellor Claës Johan Sacklén was the first chairman of the Bank of Finland's board of management and held the position till 1816, when he became head of the Financial department of the Senate.

– Bank of Finland.



Sacklén

CLAËS JOHAN SACKLÉN (1762–1840)

The scion on a family of lawyers, Claës Johan Sacklén worked at the city administrative court and the provincial administration of Turku when Finland was part of the Swedish realm. He was appointed chief judge of Turku in 1805, having previously been granted the title of Lagman (senior judge). Citing poor health he resigned from the court in 1809 and announced he was withdrawing to his estate. A skilled lawyer and administrator, he allowed himself to be enticed back to public service amid the new political conditions created by the Russian conquest. Among the first tasks of this second career was to chair a commission charged with obtaining from Stockholm the documents related to Finland under the Treaty of Hamina between Sweden and Russia. Sacklén also belonged to a second commission that drew up a report about Finnish claims on Sweden and claims by the Swedish crown on Finland.

In early 1812, the first board of the Bank of Finland was being formed. It needed members who understood public economy, banking and business life. Sacklén was one of the three men chosen. His work on the aforementioned commissions had made him one of Finland's foremost experts in public economy, and he also represented continuity between the old government of the Swedish period and the new administration of Finland. His skills were not limited to public finances because he had

been on the board of the Turku Discount Office and thus understood practical banking. And thanks to his active involvement in the Finnish Economic Society, he was aware of the latest trends in economic philosophy.

At the time that he joined the board of the Bank of Finland, Sacklén dictated a statement into the minutes, complaining about his poor state of health and blaming his great sense of responsibility for his inability to decline the task offered. However, he calculated that the work of the board could be carried out by one member at a time so the task would not be too onerous for him. He joined the board as its chairman. His intention was to adhere tightly to the legal formalities on which Sweden's Bank of the Estates of the Realm had been founded, so one of the first tasks of the board was to assemble all the old Swedish statutes and regulations referring to banking. The oldest ones dated from the 17th century.

In 1816 Claës Johan Sacklén succeeded Erik von Haartman as head of the Financial department of the Finnish Senate, a post he held until 1820. Although he resigned from the Bank of Finland's board at that time, his new position put him in charge of the bank and made him the ultimate authority over its operations. As a reward for his distinguished service he was elevated to the nobility in 1818 and took the name Edelsköld.

BANK LEADERSHIP

At the summit of the Bank of Finland was the board of management but its authority was strictly limited because the Financial department of the Senate supervised the bank strictly until 1868, when it was transferred to the “rule and responsibility” of the Diet. The head of the Financial department had the right to participate in board meetings and, if the board was not unanimous, his view prevailed. In addition to these formal rights, he also certainly had great unofficial scope for influencing the bank’s operations. This unofficial power would have been particularly strong when some board member took up a post in the Senate, taking with him the knowledge of how the board operated and how its remaining members acted. A senator with a background at the Bank of Finland was well placed to influence its board. Between 1812 and 1859, three board members, Claës Sacklén, Carl Trapp and Axel Born, moved from the board to become head or deputy head of the Financial department.

Of all Financial department heads, the one to intervene most actively at the Bank of Finland was the famous and long-serving Lars Gabriel von Haartman, nicknamed “Haartman the Horrible”. He entered the picture at the end of the 1830s when he began to head a committee on increasing state revenues, which also considered the Bank of Finland and its operations. The following year two committees were established to prepare implementation of a monetary reform and Haartman was appointed chairman of both. The operation to redeem Swedish money from circulation and at the same time move to the silver standard was in the ambit of the Bank of Finland, but it was run in practice by Haartman, who had been appointed head of the Financial department in 1840. The fact that he was simultaneously deputy chairman of the Senate’s economic division made him still stronger. Until the end of his term in 1858 he was certainly Finland’s most influential official and strongly influenced the bank’s operations. The board was answerable to him and he was prepared to intervene directly in running the bank.¹⁹³

The formation of a hierarchy within the board was a gradual process. The first regulations from 1811 made no real mention of a board chairman, stating only that there would be two banking commissioners, one of whom was to have legal training and chair its

meetings. In the revised regulations of 1817 the number of board members was formally raised to three and at the same time the oldest member of the board was designated the chairman. This practice continued until 1840, until the new regulations stated that the board would be chaired by the member who had been appointed its chairman. This strengthened the position and was the first step towards the situation where one could genuinely talk of a governor of the Bank of Finland.

The esteem enjoyed by a member of the board was closely related to the length of his career; a few years was understandably insufficient to amass expertise and prestige in the banking sector. By the end of the 1850s only two board members, Otto Herman Lode and Johan Gustaf Winter, stood out in this respect. The former was chairman for eight years and the latter for a full 15 years. Most other board members held their positions for 3–5 years.

Lode had a military background, having been a lieutenant colonel in 1810 when he resigned from the Swedish army and moved to civilian administration. He was first appointed provincial governor and then became a member of the Bank of Finland board in 1816. He became its oldest member and thus its chairman in 1820. It was during his term that the bank relocated from Turku to the new capital, Helsinki. The move has been noted to have entailed a more official and bureaucratic style of operations at the bank, which suited Lode well. According to available sources he took a fairly passive attitude to his work and did not excel among his colleagues. For him the board of the Bank of Finland was a peaceful post that provided the wherewithal of his life. He found its content in the social life of the new capital.¹⁹⁴

The longest serving chairman of the board, Johan Gustaf Winter, had a very different relationship with the bank. As noted previously he had been a provincial treasurer before joining the bank in 1817. He spent nearly a quarter of a century – 24 years – on the board, not retiring until 1841. Seniority made him the chairman in 1827. In his board work he stood out from his colleagues as an expert in public accounting and was exceptionally interested in banking down to the smallest detail. Winter was an active force in bureaucratising the bank's operations. This took concrete form in 1836 in his proposal for new regulations. The most important policy issues he proposed concerned the bank's status which, he believed, should be distinctly

subordinated to the Crown, contrary to the wishes of the Diet of Porvoo. Winter also wanted to reinforce the status of the board's chairman, which could best be achieved if he were appointed directly by the sovereign.¹⁹⁵

In the 1830s and 1840s Winter understood better than anyone else how the Bank of Finland worked. A sign of this is the systematic summary he made of the activities of all its funds during the period 1812–1840. This is a 259-page manuscript in Swedish: “Abbreviated Overview of activities at the Bank of Finland from its first establishment in 1812 and Its final position at year-end 1840, on the eve of the Reform of 1841”. He began to produce this compendium of accounting ledgers after his retirement in 1841 and had it ready in 1852 after 10 years’ toil. If this work is included, Winter’s period of service to the Bank of Finland lasted 34 years.

Gustaf Wilhelm Blidberg had an even longer career at the bank, lasting almost half a century. A lieutenant who resigned from the army in 1812, Blidberg had degrees in public economy and the law so his formal training was ideal for the Bank of Finland, where he began in 1812 as a bookkeeper. He was appointed extraordinary clerk in 1817 and full senior clerk three years later. At this point his career halted and he remained a senior clerk until 1841, when a place opened for him on the board. He was designated its chairman in 1859, a post he held until his death in 1861. For his service to the Bank he was made an honorary Councillor of State in 1859.¹⁹⁶

The contributions of other board chairman were much shorter. Of these at least the first members of the interim board deserve attention. It was under Claës Johan Sacklén (1812–16) and Gustaf Gadolin (1812–17) that the foundations of the bank’s future were laid. Gadolin drafted a proposal for new bank regulations which, although not implemented, served as unofficial operational guidelines until the reform of the 1840s, as previously noted.

The next important board members and chairmen are from the 1840s and 1850s, when the bank was comprehensively reorganised. Operations expanded and its types of banking became more diverse. The bureaucracy yielded to a more bank-like style. Of the board members of this new era, it is worth mentioning the Trapp brothers Carl Wilhelm Trapp (1841–53, although part of this time on leave) and Robert Trapp (1854–56) as well as Frans Ivar Edelheim (1856–58).¹⁹⁷

Carl Trapp served as board chairman for most of the early 1840s so it was under his term that the monetary reform was completed and the bank adapted to the framework created by the new regulations, confirmed in 1840. The greatest innovation in this reform was the move to the silver standard and downsizing the number of banknotes issued to the limits imposed by silver cover.

Research literature invariably credits the deputy chairman of the Senate's Economic division, von Haartman, with management and planning the monetary reform. This is justified but the role of Carl Trapp as Haartman's assistant should not be overlooked. According to Pipping at least, Trapp was engaged in planning the reform and not merely implementing orders received from above. Completion of the reform and the subsequent enlargement of banking operations required a comprehensive rethinking of the board culture, which in turn required that a complete outsider be recruited to the board and the post of its chairman. By profession Trapp was a lawyer who had been a prosecutor at the Turku Court of Appeal, but he also had a knowledge of business life. His father Christian Trapp was the owner of a major trading house engaged in exports and imports and thus a worthy member of the commercial aristocracy of Turku.

Because of his family background Trapp knew the systems of payment in foreign trade and understood what businessmen expected from the Bank of Finland. The fact that they both hailed from Turku made it easier for Trapp to get on with the famously difficult von Haartman. The Bank of Finland was not enough for an official of Trapp's calibre and he stayed with the board were only five years. In 1845 he became assistant head of the Financial department of the Senate, continuing to become head of its Chancery department and finally procurator at the Supreme Judicial Administration.

After the currency reform, the next critical phase for the bank came in the late 1850s, when the Crimean War forced Russia and then Finland off the silver standard and back to unstable paper roubles. The state of war disrupted foreign trade links for a couple of years, so when peace returned, there was pent-up import demand to be satisfied. This kept the Bank of Finland busy because it was now, in practice, solely responsible for trade in foreign bills of exchange. In 1857 conditions became still more difficult when the first real international financial crisis was felt as distantly as Finland. Sources of foreign finance dried

up and the main foreign trading houses ran into difficulties. The Bank of Finland responded actively and tried, within the limitations of its resources, to assist troubled companies with short-term credit, moratoria and other such measures.

During this period the chairman of the board was initially Robert Trapp (1854–56) and then Frans Edelheim. For the first time the Bank of Finland was now engaged as a central bank in crisis policymaking. The professionalism of its management was severely tested when it had to pursue economic strategy and not merely practical banking. Trapp and Edelheim were both lawyers by training who had had successful careers in central government, but they were not traditional bureaucrats. Both knew what business expected of the Bank of Finland and flexibly adapted lending policies to ease the difficult situation faced by trading houses and iron works.¹⁹⁸

For both men, a position on the Bank of Finland's board was merely one step in their advancement. The culmination of Trapp's career was to be head of the Senate's Financial department and Edelheim's to be head of its Treasury department. These examples and many others confirmed the contemporary view of the Bank of Finland's board as an "incubator for Senators".

THE BANK AS A LENDER, 1813–1840

SMALL-SCALE OPERATIONS

One of the objectives at the time that the Bank of Finland was established, perhaps the most important one, was to create a credit institution to help the owners of large manor estates repay long-term mortgages from Sweden. Although this task ultimately proved more minor than expected, lending still had a central place in the bank's operations from the outset. In structure, the Bank of Finland had two funds, its primary capital fund and the small banknote fund that was collateral for the notes that it issued. Its scope for lending was determined by the size of these funds.

Operationally, the primary capital fund can be regarded as the basis of the bank's capital adequacy, meaning a buffer against possible losses. Its size was tied to the founding capital and accumulated operating surpluses, and it could be invested entirely in long-term mortgages. The small banknote fund was equivalent to the bank's liquidity reserve and it grew automatically as more banknotes were issued. Liquidity had been regulated from the bank's beginnings; the first regulations stated that no more than half of the paper roubles covering the small notes issued were to be used for short-term loans against various forms of security. Later the proportion of the small banknote fund that could be lent out was increased somewhat.

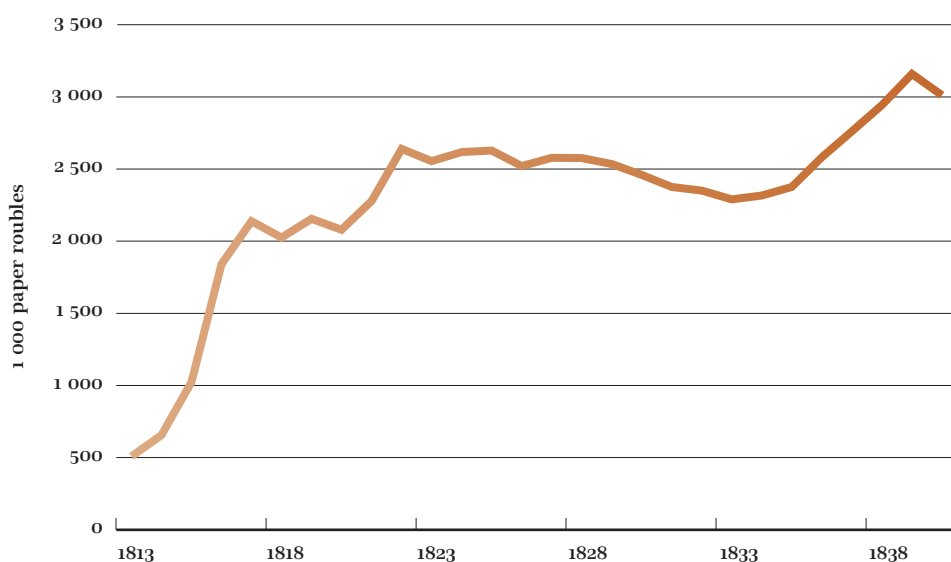
There was also lending from several other funds assigned to the bank. These appropriations were made into separately managed funds, the agricultural fund and the manufacturing plant, in the bank's early years.

Their functions are evident from their names. The regulations for the manufacturing plant were explicit about the sectors for which loans could be granted. They excluded producers that used wood as a raw material and favoured entrepreneurs operating in engineering and textiles.¹⁹⁹

The bank's founding capital was a loan from the state of its surplus revenues, the last instalment of which was paid in 1817. At that time the fund totalled one million paper roubles, only half of the amount originally planned. The volume of small rouble-denominated banknotes in circulation remained low throughout this period and never exceeded 2 million roubles. The bank's lending was constrained by these amounts because its other forms of funding long remained insignificant. Admittedly its regulations permitted the bank to accept deposits but its borrowing was on a very small scale up to 1840. It paid no interest on deposits, a sign of its concern about capital adequacy and caution about expanding operations.

Lending had begun from zero so the relative rate of growth was rapid in the 1810s. At the start of the 1820s it faded and went into a slow decline that lasted until the mid-1830s. At this point the loan portfolio

BANK OF FINLAND'S STOCK OF LENDING 1813–1840



Source: Bank of Finland. Fund main ledgers 1813–1840, Bank of Finland archives.

was worth nearly 2.5 million paper roubles. At the end of the period under review it had risen to 3 million. Lending largely meant investing the founding capital because the volume of loans granted from the small banknote fund settled around 0.5 million paper roubles during the 1830s. One reason why lending declined was that money from the small banknote fund was set aside and deposited with the State Commercial Bank in St. Petersburg. In 1821, for example, these deposits were 860 000 paper roubles, which was about the same amount as the fund had granted in loans.²⁰⁰

Loans were also made to the public by the state, meaning the Senate. These were available from various state funds and revenue surpluses. Practical management of these funds was a duty of the Bank of Finland; it handled the work related to their lending. It started to manage state lending in 1819 and the proportion of loans from the Senate settled at some 60 percent of all public sector (Bank and Senate) loans. In the late 1830s, the bank's own lending operations picked up and came to account for a greater proportion of all public loans. At the end of the period under review in 1840, when the Bank of Finland was reorganised, its loans were more than 70 percent of all state lending.²⁰¹

The number of new loans granted annually was consistently low. The bank managed to lend only 50 000–200 000 roubles per year in long-term mortgages from its primary capital fund and about 300 000 roubles a year in shorter-term loans, up to one year, from its small banknote fund. The total number of new loans granted by the Bank of Finland during its early years was 300–500 per year. In practice the bank was open six days a week for 11 months of the year, so the number of banking days was about 250 per year. In the light of these figures one can conclude that the bank was granting approximately two new loans per day, which cannot have meant a great deal of office work. Admittedly there were also the loans it granted from Senate funds, which increased the number to be processed by about a third.

Over the first decades of its operation, Finland's system of banking and credit was very underdeveloped. The Bank of Finland, the state funds it managed and the savings banks were the only official credit institutions. In this period the savings banks were so small that the loans they issued had no overall significance. Apart from the official credit institutions, there was some lending by a few funds for widows and orphans and the Urban Fire Protection Association. There is no

systematic data on their lending but at a rough estimate the public loan portfolio of the Bank of Finland and the State combined was about 70 percent of total loans in Finland's "national economy" at this time. Loans granted by the Bank of Finland were about half of this.²⁰²

An analysis restricted to the financial sector does not, however, give a comprehensive picture of credit conditions in the first half of the 19th century because private trading houses and individuals were also important lenders. There is no precise information about the loans they granted but the accounts of individual trading houses suggest that their role in financing enterprise may have been quite significant. Similarly, old deeds of inventory show that the number of loans granted by private individuals may have run to several hundred. The flow of non-institutional credit was therefore significant.

CREDIT RECIPIENTS

The character of Bank of Finland lending in this period is cameralist and reflected the philosophy of privilege that pervaded the whole society. Its lending was also fiscal, aimed primarily at obtaining a yield on available capital. Only a small proportion of funds was used to promote specific goals of economic policy. The "right" to a loan was closely bound up with a person's social status, his rank in the Estates. Instead of trying to change or develop the economy and its structures, bank lending in fact sought to maintain the status quo. This concept of entitlement is clearest in the Bank's early years.

The lending regulations of the different fund in the period 1813–1840 were as follows:²⁰³

BANK OF FINLAND LENDING REGULATIONS

	Primary capital fund	Small bank- note fund	Agricultural fund	Manufactu- ring fund
Collateral	Mortgage	Merchandise security	Mortgage or guarantee	Merchandise security
Size of loan (roubles)	< 30 000	< 10 000	< 3 000	< 15 000
Duration	20 years	6–12 months	12 years	12 years
Interest	4 %–5 %	6 %	2 %	2 %

Sources: Bank of Finland regulations 1812–1840.



■ Apothecary John Julin acquired Fiskars iron works in 1822 and set about converting it into a modern engineering mill. Seen here in 1840, it still has the appearance of a manor estate. – Lithograph by P.A. Kruskopf from the work *Finland framställt i teckningar 1845–1852*. Helsinki City Museum picture archives.

The mentality of the early 19th century shows in the Bank of Finland, whose accounts, for example, do not record the livelihood of the borrower by distinguishing between commerce or different fields of industry. The bank categorised its loans according to the type of security and the social status of the borrower. It wanted to know how the loans were distributed between the Estates of society but was not concerned about their division between different kinds of industry.

This attitude comes across most clearly in lending from the primary capital fund. During the early years its loans went to nobility in the highest strata of society, as the following recipients indicate: Lord Marshall Count Robert De Geer, His Highness Count G.M. Armfelt, Baroness I.L. Ramsay, Governor J.B. Ramsay, Mistress L. von Willebrand.²⁰⁴

Count De Geer, a Lord Marshall from the Diet of Porvoo and a member of the Governing council throughout the 1810s, was in a class of his own. By decision of the council he received a loan of 147 500 roubles, an enormous sum by the standards of the age. He received it before the Bank of Finland even began operating; the bank's regulations set a maximum amount of 50 000 roubles to be lent to any single individual. De Geer was in such a hurry for the money that he could not wait for the founding capital of the Bank of Finland to be amassed and it came direct from council funds.²⁰⁵ The loan was equivalent to 40 percent of lending by the bank in 1830 so, simply from the viewpoint of risk management, it was in conflict with normal banking principles. After De Geer's death, the loan was taken over by his estate and paid off over the next 20 years.

After the initial period, the spread of borrowers became slightly more balanced. In addition to noble owners of manors, loans were made to officials, as indicated by the names Clergyman J. Sundvall, Surveyor G.J. Jack, Professor J. Bonsdorff, Secretary of the Economic Society C.C. Böcker, Provincial Secretary B. Krook and Constable O.M. Gestrin. Other frequently occurring titles were military. The first peasant farmer received a loan in 1815; he was Freeholder J. Johansson of Säppilä Village in Kokemäki.²⁰⁶

Short-term loans from the small banknote fund were granted more evenly to different groups of society. For example loans granted in 1830 were divided as follows by the socio-economic status of the borrower: officials 31 %, officers 23 %, merchants 17 %, craftsmen 5 %, farmers

15 % and others 9 %. It can be regarded as surprising that, judging from the titles of the recipients, there were few real industrialists among the borrowers.²⁰⁷

The borrowers included well-known entrepreneurs such as Apothecary J. Julin, Honorary Councillor A. H. Falck, Honorary Councillor W. af Petersen, Merchant H. Borgström and Ironworks Proprietor J. J. Dreilick. Loans from the small banknote fund were not only to finance enterprise; alongside the merchants and businessmen in the loan ledgers are quite a few people who could be classed as students or distressed gentlefolk.

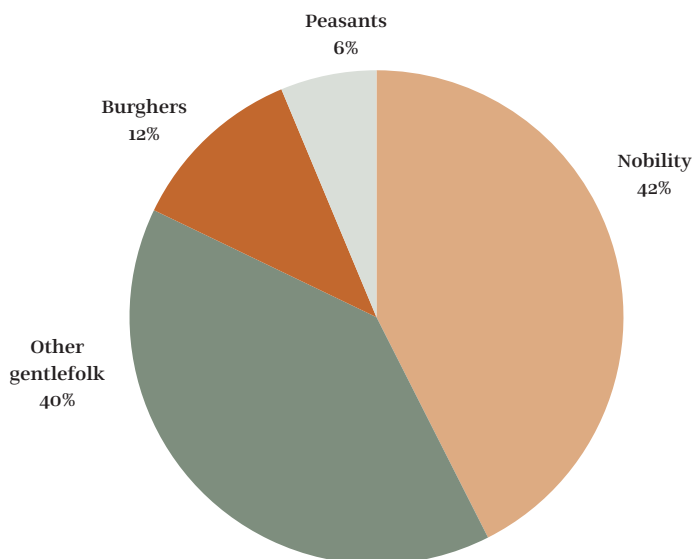
SOCIO-ECONOMIC STRUCTURE OF BORROWERS

The division of loans by the Bank of Finland according to social status of the borrower is shown in the diagram overleaf. It does not include borrowers from the manufacturing fund because there is not enough detailed information about their social status. For the overall picture, however, this is unimportant because the manufacturing fund accounted for only six percent of all loans granted by the Bank of Finland at this time.

Up to 1840 loans had been granted almost exclusively to the nobility and other gentlefolk; the combined share of the two groups exceeded 80 percent. The list of recipients includes the owners of the country's largest manors and the elite of officialdom. The largest individual group consisted of officers who had settled in large numbers in their manors after the army was disbanded. The division by social status is therefore extremely skewed. In the whole population of Finland at this time, the combined proportion of the nobility and gentry was about two percent, according to a study by V. O. Kilpi. The nobility alone was only a few tenths of a percent, in absolute terms fewer than 3000 people.²⁰⁸

There was major lending from the funds controlled by the Senate in the first half of the 19th century. Senate funds charged no interest but the Bank of Finland aimed to obtain a yield on available capital so it granted interest-free loans only in a few exceptional cases. A couple of times it supported a distressed widow and in one case it granted interest-free credit to a town in financial difficulties. The sums were so small that the interest foregone had no effect on the bank's financial position.

LENDING BY SOCIAL STATUS OF BORROWER, 1840

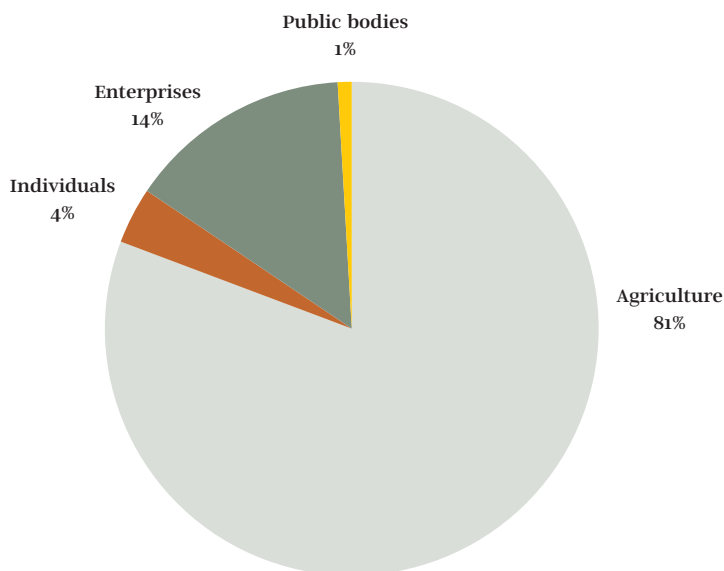


Source: Winter, G.J., Memorandum on Bank of Finland operations 1812–1840, Bank of Finland archives.

Apart from the social structure of borrowing, it would be interesting to see how it was divided between different sectors of activity. As noted above, there is no direct data available but a rough approximation can be reached from the regulations on lending, information about collateral and the personal background of the borrowers. On this basis, loans have been grouped into credit for agriculture, business credit, personal loans and loans to public bodies.

In the first half of the 19th century Finland was a predominantly agricultural society so the number of loans to agriculture, about 75 percent of all loans, is in no way surprising. This was not, however, a sign of deliberate policies to promote agriculture because only a tenth of these loans were from the agricultural fund, which had specific objectives in the development of farming. The size of Bank of Finland operations was further curbed by the slow loan cycle. Most loans to farmers were for a long period; the rules of the primary capital fund allowed 20 years. After the first half of the 1820s, only about 10 new loans of this sort could be granted each year.

STRUCTURE OF BANK OF FINLAND LENDING, 1840



Source: Winter, G.J., Memorandum on Bank of Finland operations 1812–1840, Bank of Finland archives.

The number of new loans granted each year was also curbed by the bureaucratic process involved in handling encumbrances. A mortgage could not be obtained before the nature of the land's ownership had been analysed in detail. This was needed to safeguard the lender's legal rights in possible cases of repossession. Next a detailed assessment of the land was drawn up to estimate its economic value. Obtaining an encumbrance confirmed by the courts was therefore economically expensive and time-consuming. Because of the high costs, only large loans were worth applying for and, in practice, the only people who could apply were the owners of fairly large farms. Loans granted by the Bank of Finland therefore suited only a small minority of the country's farmers. It was evidently for this reason that ordinary farm freeholders, who constituted the vast majority of farmers, accounted for less than a tenth of the total loan portfolio.

Loans to enterprises were about a fifth of the portfolio, nearly 600 000 roubles. The sum was so small that one single borrower, Jakob Julin, the owner of Fiskars ironworks, dominated it in the mid-1830s

with his loan of 150 000 roubles. Other sectors of industry that received credit included cloth factories and rag pulping mills. Loans to commerce were relatively low. Systematic data on the financing of enterprises in the early 19th century is not available but information from individual companies indicates that international trading houses tended to rely on credit from their foreign partners. In addition there were commonly credit relations between entrepreneurs.²⁰⁹ The minor role of the Bank of Finland in financing enterprise was also due to the highly bureaucratic nature of its operations. The bank's senior management and its officials interpreted lending regulations with extreme dogmatism, so loan applications were handled slowly. An entrepreneur did not have time to wait months for a decision.

On the basis of loan ledgers, we calculate the proportion of personal loans to be about four percent of the Bank's lending, which is rather small. However the way that loans were classed according to the form of security led to the understatement of "consumption lending". Because the Bank's regulations put the emphasis on security, they were often backed by mortgaged property and were consequently recorded as credit for agriculture when they were in fact for personal expenditure. Short-term loans of less than a year from the small banknote fund were the best suited for "consumer credit". The sums were generally a few thousand roubles.

Only a small part of Finnish society had properly joined the money economy by the middle of the 19th century. There were very great regional and societal variations in the use of money. The towns were more advanced but in the countryside most wages continue to be paid in natural products or in various privileges. At the same time, a steadily increasing proportion of taxes was levied in money and it was via taxation that the use of money was spreading into remote areas. The owners of coastal trading houses engaged in exporting and importing were the best informed about questions of money and credit because they understood the systems of payment in the major trading and financial centres of continental Europe. These entrepreneurs were used to operating on the international capital market and to obtaining the credit they needed from abroad. Bank-like operations, such as obtaining advance remittances or granting long payment terms, formed a significant part of their business operations. Because of their financial connections they managed without the assistance of the Bank of

Finland.²¹⁰ On the other hand the owners of ironworks, which enjoyed the special protection of the state, were well aware of the opportunities available and were used to turning to the state when they needed credit. In line with the philosophy of privilege of the age, they even expected to receive loans without interest charges.²¹¹ However, the great majority of the people lived outside a comprehensive money economy, using money only occasionally. Because of the backward state of development, the demand for credit was low and so opportunities for borrowing from the Bank of Finland concerned a very small segment of society.

In the society of the early 19th century, noble officials who, in addition to their public posts, owned manors or at least were related to manor owners, were in a position of hegemony. The lending system of the Bank of Finland suited the needs of this cream of society, even if the size of its primary capital fund was so small that it could never have completely solved the problems related to the availability of agricultural credit. It was ideal for manor owners that the terms of lending were drafted so that the owners of large farms had the best opportunities for borrowing.

LENDING LOSSES

Lending inevitably involves a risk of losses and the Bank of Finland experienced these from the outset. Problems first came to the fore as loan delinquency, when debtors were unable to pay the interest charges and amortisation specified in their loan agreements. The sanctions imposed on delinquent debtors were harsh. Initially the contract allowed the interest rate to be doubled. If delinquency continued the loan was ultimately reclaimed by law. In the case of a mortgage this meant compulsory sale; if the security was merchandise goods they were seized and sold, and if the security was a guarantee the guarantor was compelled to pay. The position of attorney was established at the bank to handle these collection tasks. His work was initially part-time but there was so much work involved that the job was soon made into a full-time one. The attorney ensured that the loan documents were unimpeachable and that mortgages did not expire. It was also naturally his responsibility to monitor the recovery of unserviced loans.

The direct credit losses in 1830–1840 were relatively low. The primary capital fund and small banknote fund had to be written down

by only 90 529 paper roubles during this period, less than 0.3 percent of the total value of loans made over this period. Most of the write-offs were of short-term loans from the small banknote fund, where security and guarantees were not always enough to ensure that the bank could really recover its money. Write-offs of larger loans came in the mid-1830s, probably the result of crop failures in the first half of the decade. Enterprises in distress were another concern. The best-known problem customer was J. J. Dreilick, the ironworks owner who had been on the first board of the Bank of Finland. Dreilick left the first board as early as 1815 to manage the Högfors ironwork which he owned, but he was a complete failure in business.²¹²

Accounting write-offs from Bank of Finland loans give too rosy a picture of the bank's operations. A better indicator of the problems faced in lending is the number of unserviced loans that were subject to recovery. Unfortunately this data is not systematically available until after 1842 but the situation in that year, which reflects problems that had built up in previous years, probably gives a good impression of the trend in the 1830s.

In 1842 the number of unserviced loans that were being forcibly recovered totalled 14 535 silver roubles. In proportion to the credit portfolio at the time, these bad loans were only 1.1 percent but there were significant differences between the funds. Of loans from the primary capital fund, bad loans were only 0.2 percent, but the proportion from the small banknote fund was a full 29 percent. Underlying this large difference was the nature of lending and collateral. Loans from the primary capital fund were mortgages, which required relatively tough collateral requirements before they could be granted. These served to weed out bad customers. On the other hand the small banknote fund was used for many short-term loans for consumption and enterprise, and were far easier to obtain. Another reason for the relatively high proportion of bad loans from the small banknote fund was that its lending was reduced in the reform of 1841. After that, the remaining accounts contained a relatively large proportion of problem cases.²¹³

EFFORTS TO REPLACE SWEDISH CURRENCY

ACTION ON SWEDISH MONEY IN THE 1810S

In Finnish monetary history the first decades of the 19th century were an exceptional and interesting phase. As early as April 1808, even before Finland was officially detached from Sweden, Russian commander-in-chief Buxhoevden announced that the use of Russian paper roubles in crown payments would start immediately at an officially established rate. In another declaration at the end of the next month, the tone was tougher; all payments to or from the crown would in future use Russian banknotes. Only indigent taxpayers were granted the right to pay using Swedish money and, even then, no more than half. However, there was hardly any Russian money in circulation so Finland's first Governor general Sprengtporten had to relax the regulations. On 27 February 1809 he sent a letter to provincial administrations stating that taxes could be paid in Russian or Swedish banknotes, depending on which the taxpayer had.²¹⁴

Subsequently a series of new attempts to eliminate Swedish money were announced but, despite various bans and restrictions, most of the money in circulation remained of Swedish origin for three decades. In monetary matters there was a sharp conflict the announcements and regulations of officialdom and the reality of life.²¹⁵

No new restrictions were announced after 1822 but this was certainly not because the regulations had led to the desired result in eliminating Swedish money from circulation. On the contrary, it was a sign that the

authorities were resigned to the situation in which Swedish money was still the dominant medium of payment. From the start of the 1820s to the early 1830s, they granted constant exemptions to the existing regulations. Particularly in the countryside, there was such a severe shortage of Russian money that, at least in years of crop failure, they had no choice but to accept payments in riksdaler. Without these concessions, taxes could simply not have been paid. The shortage of Russian money was particularly acute in western and northern Finland.

The situation in the two decades after 1810 shows the ineffectiveness of regulations unsupported by economic measures. The Governing council and its successor, the Senate, were quite willing to publish circulars banning the use of Swedish currency but it was a long time before the Senate or the government in St. Petersburg were ready to take action to redeem Swedish money. It was tried only twice, first in 1811 and then in 1820–1821.²¹⁶ In fact the government actually stimulated the use of Swedish money in Finland because, even after proclaiming restrictions on its use, it continued to pay some wages with the Swedish money it held. Not even the government, then, had enough Russian paper roubles. The main changeover to the rouble in state finances did not take place until the early 1820s.

ROLE OF THE BANK OF FINLAND

The Bank of Finland's role in the battle against Swedish money was, for a long time, a passive one. In its early years the board of the bank spent its time creating an administration and setting up operations. Almost all the matters of principle concerning the status of Swedish money were determined in the Economic division of the Senate, which hardly ever consulted the Bank of Finland even during planning. The bank's subordinate role shows concretely in 1812 when an attempt was made to exchange Swedish riksdaler for Russian paper roubles. The conversion operation was initiated by Gustaf Mauritz Armfelt, head of the Committee for Finnish Affairs in St. Petersburg, who had managed to obtain the tsar's promise of a loan of 1.5 million paper roubles to finance the conversion. Professor G.E. von Haartman, a member of the Economic division of the Governing council, was invited to head the operation and the practical work was done by offices of provincial administrations.²¹⁷

The lack of Russian money was most apparent in the countryside, where rural taxpayers – freehold and tenant farmers – had only Swedish money at their disposal. For this reason the whole exchange operation was restricted to rural parishes. Representatives of the provincial offices offered farmers and other local taxpayers the opportunity to swap their Swedish cash for paper roubles. The sums to be changed were relatively modest, up to a few dozen roubles. Apparently even the officials had a shortage of roubles because in a few municipalities, farmers swapped their riksdaler and skillingar for grain instead.

The results of this operation were far from adequate. Only a third of the sum intended was disbursed. Taxes due could now be paid in roubles but Swedish money had not been removed from circulation. One factor contributing to the failure of the exchange operation was that the rate offered was not as good as the prevailing market rate. The administrative exchange rate valued a paper rouble at 32 paper skillingar, but the market rate in Hamburg put it at only 29 skillingar, so the rate offered overvalued the rouble by nearly 10 percent. However the importance of the Hamburg exchange rate as a reference should not be overestimated, because common folk in the countryside were unlikely to have been properly informed about market rates. Then, in summer 1812, Napoleon's attack on Russia shifted Speransky's planning for a monetary reform in the whole Empire into the distant future, thus postponing it in the Grand Duchy of Finland, too.

By the end of the 1810s, the bank's organisation was functioning and the board had time to consider general economic questions. In a report on operations, drawn up in 1817, it noted that the money in circulation now contained quite a lot of relatively new Swedish banknotes that had been issued since 1813. According to a statute dating from 1812, these notes should not even have entered the country and the board proposed, in accordance with the letter of the law, that Swedish notes issued after 1813 should be confiscated. The proposal was not merely a mark of respect for the law; the board was also concerned about fading demand for its own small banknotes, denominated in kopeks and roubles. The Senate concurred and a statute published on 12 December 1817 stated that small Swedish banknotes would be confiscated from 1819 onwards. The board of the Bank of Finland was very pleased with the Senate's action and predicted

that demand for its own notes would pick up as small Swedish notes disappeared from circulation.²¹⁸

Its prediction was borne out because, by the end of April, so many illegal Swedish banknotes had been paid to the state and deposited in the bank's vaults that space was running out. As a solution the board proposed that small Swedish banknotes should be exchanged for larger Swedish banknotes, which the Senate approved at the start of June. During 1818, small banknotes worth 178 320 riksdaler were exchanged for Swedish notes of larger denominations. At the same time an order was issued that loans would no longer be granted from military funds in Swedish currency and that this money would also have to be changed into Russian banknotes. During the year 300 000 riksdaler of funds were exchanged. By this point, however, the value of the Swedish currency had turned down sharply. Measures to swap it for Russian money were then abandoned because, from an accounting viewpoint, continued swap operations would have resulted in losses for the state.²¹⁹

The chief consul in Turku for Sweden-Norway, G.A. Bruncrona, was appointed to exchange the banknotes. He had handled a previous operation to exchange Swedish money for the Russians authorities in Finland in 1809. The Swedish banknotes could not be exchanged directly for Russian banknotes. Instead they were used in financial centres such as Hamburg to purchase bills of exchange, which were then changed in St. Petersburg for paper roubles.

The swap operations did not end here. A significant proportion of the roubles obtained were due to be exchanged again for roubles issued by the Bank of Finland. The aim was that notes from the Bank of Finland would replace the Swedish money held in common hands and ensure that ordinary people could pay their taxes in roubles. All provinces of the country except for Vyborg were allocated a quota of roubles for this purpose. It was intended that the money should be used only in the countryside, because the Senate believed that the towns had enough Russian money to pay taxes. The swap operation was only half successful. The Finns were still not enthusiastic about abandoning their Swedish currency and the project ground to a halt, as the head of the Financial department noted in a report, dated 23 September 1820.²²⁰

During this first period of the bank's history, the final attempt to drive out Swedish money came in 1820. The swap was initiated by a

secret edict from the emperor dated June 1819, which set parameters for the operation. These fixed the exchange rate and also granted the Bank of Finland the right to issue larger-denomination banknotes than before, worth 1, 2 and 4 roubles. The rationale for creating a wider spread of denominations was that it would be easier for the bank to replace Swedish banknotes. The aim was to convert into Russian paper roubles all the Swedish currency reserves of the government and the Bank of Finland.

G. Ladau and N.G. af Schulten, members of the Senate's Economic division, were appointed to run the operation, assisted by Protocol Secretary J.G. Hornborg. From the Bank of Finland, J.G. Winter participated. Others involved were the aforementioned G.A. Bruncrona in Turku and Commercial councillor J.H. Heidenstrauch in Helsinki. The choice of management reflects the nature of their duties. Ladau, in charge of the operation, was director of the Postal Administration and familiar with questions of transport, so he was responsible for moving the money. Af Schulten was a mathematician so his job was to supervise the calculations of the operation, involving many different types of money with varying exchange rates.²²¹

The task was completed during 1821, at which time a total of 794 774 riksdaler in Swedish banknotes had been swapped. These notes were mainly used to acquire bills of exchange, pounds sterling and Hamburg Marks in Stockholm, which were then exchanged in St. Petersburg for paper roubles. It is worth noting that neither the Senate nor the Bank wanted to obtain silver. During the period 1818–21 a total of nearly 1.3 million riksdaler in Swedish banknotes from state funds were exchanged into roubles. At the exchange rate in 1819 they were worth 2.6 million paper roubles. At the end of 1821 the total value of Bank of Finland funds was nearly 2 million paper roubles so the volume of Swedish banknotes exchanged in this period was quite significant. Another sign of the great volume of money exchanged is that the Bank of Finland was unable to keep pace with its lending and issuing. The roubles obtained in the swaps were invested at 5 percent interest with the State Commercial Bank of St. Petersburg.²²²

After all these operations the Senate was able to report to the tsar in May 1821 that the people of Finland now had enough paper roubles at their disposal to pay taxes and loans. The situation seemed to be so good that, in July 1821, a decree was issued that all payments to the

state were to be made in roubles from the start of the following year. Official circles, at least, now believed that Swedish currency was no longer the dominant form of money in Finland.

In the years ahead most of the taxes and fees due to the state were indeed handled in roubles, nor did the state need to continue making payments, such as wages, in Swedish currency. This did not mean that the money of Finland had been entirely reorganised. In the countryside, most transactions between private individuals continued to be in Swedish money, and the shortage of roubles meant that taxpayers often had to resort to barter when paying their taxes. The shortage of roubles became particularly problematic in years of crop failure, when roubles were used up in purchasing grain. Again and again the common people in the countryside complained about being subjected to the despotism of officials and money changers when they needed to swap Swedish notes for roubles to be used in paying taxes. Swedish paper riksdaler and treasury notes were constantly used more than the official unit of currency, the paper rouble, so the problems had not disappeared.

Efforts between 1818 and 1821 to remove Swedish money from circulation were not, therefore, entirely successful. The reasons for the failure can be summarised as, on the one hand, the conflict between official regulations and their supervision and, on the other, the gap between objectives set for monetary reform and the methods used to attain it. For example, a decree issued at the end of 1812 clearly forbade the import of Swedish banknotes into Finland but at no point was the ban imposed in an effective way. Although officials had the legal right to confiscate imported Swedish banknotes, this was done in only a few exception cases. It was not until the 1830s that the position of Swedish money in Finland became a pressing topical issue again, when external circumstances had changed fundamentally. Sweden was returning to the silver standard.

WHY DID SWEDISH MONEY PERSIST?

The tenacity of Swedish currency as Finland's dominant medium of payment stems from several factors, some of which were first raised in debate at the Diet of Porvoo. Firstly the Finns were used to Swedish money and their country's altered political position did not shake their

faith. Although the decimal system of the rouble appeared more practical, they still preferred their Swedish riksdaler, skillingar and rundstycken despite the arithmetical complexity. After 1810, familiarity with the Swedish system was reinforced by greater relative confidence. Napoleon's attack on Russia threw its monetary affairs into disarray, raising doubts about the rouble. At Napoleon's behest a great number of counterfeit rouble banknotes had been spread in Russia and there were rumours about such forgeries in Finland.

Secondly, the structure of foreign trade promoted the retention of Swedish currency. Until the end of the 1830s, Finland's balance of trade with Sweden showed a distinct surplus, bringing a constant flow of Swedish money into the country. Correspondingly, trade with Russia was predominantly in deficit, which took roubles out of Finland.²²³

The changing relative values of Russian and Swedish money had even more influence. During the second decade of the 19th century, Russia successfully stabilised its paper rouble, after which its exchange rate movements were very subdued. The rate against the silver rouble was almost constant and it did not fluctuate much against the Hamburg Mark Banco, the international currency of the Baltic area. On the other hand, Swedish paper money remained volatile even after the Napoleonic wars had ended. The value of the riksdaler against the Hamburg Mark Banco fell until the early 1830. By the end of the 1820s the value of Swedish banknotes against the paper rouble was nearly 40 percent lower than at the time of the conquest of Finland.²²⁴

Ordinary people in the Finnish countryside were not aware that the external value of the riksdaler had fallen. Their confidence in the familiar money of the past remained strong and the riksdaler was gladly accepted in payment. This led to a situation where it was extremely advantageous for businessmen to use Swedish money in Finland. They obtained a greater number of them when trading in Sweden but did not have to pay any premium when using them for purchases in Finland, where their depreciation had not been widely noticed. Using paper riksdaler in Finland was a source of extra profits and they remained the most common medium of payment by far in large parts of the country.

The following quotation from a study by J. V. Tallqvist, published in 1900, describes the situation vividly. "In these conditions, bank assignats and their substitutes, the small notes of the Bank of Finland, were on

the losing side. At tax collection time, the coffers of the Crown filled with Swedish money. With their constant hunger for profit, tradesmen brought great volumes of Swedish banknotes into the country, either to sell them at an inflated rate to taxpayers or to use them to acquire rustic goods from the common man, in whose eyes their worth had remained unchanged.”²²⁵

This imperfect market also had an impact on how the authorities behaved. Although the use of Swedish currency was officially forbidden, even the government circumvented the regulations, using riksdaler in the public purse for official purchases. The alternative would have been to send it to Sweden for conversion into roubles, would have resulted in an exchange rate loss. Thus it was that the government itself put the riksdaler that it acquired back into circulation.

Exchange rate differences offered profitable opportunities not merely for merchants doing business with Sweden but also for public officials. In all areas of the country except the east, the rural public generally had only Swedish riksdaler at their disposal but they needed paper roubles to pay taxes. Their only option was to convert riksdaler into roubles before payment, with the same tax-collecting officials acting as money changers. Ordinary country people had no grasp of the correct exchange rate, and the money changers could exploit their ignorance. The problem was recognised by the government but no remedy was found. In the words of J. V. Tallqvist: “Unfortunately the ignorant peasant was the greatest victim of this deception. At tax collection time he had to obtain Russian money, which was not in circulation, at the price set by usurers. His only alternative was to persuade the tax collector to accept Swedish money at the payer’s risk and the official’s unfavourable terms.”²²⁶ Although these words are from a study published decades later, the discrepancy was already recognised at the time.

The 1810s and 1820s thus created conditions in Finland where a debased paper riksdaler prevailed over a stable paper rouble. Without the will for proscription or the funds for redemption, the situation became established and continued for as long as Sweden and Russia remained on a fiat money standard. It was Gresham’s Law in practice, the bad driving out the good.

SWEDEN'S CURRENCY REFORM

KING KARL JOHAN YIELDS

Finland's monetary conditions were obviously influenced strongly by Sweden's monetary policies as long as Swedish paper money remained in general use. Although Sweden had managed, soon after peace was restored, to halt inflation and to lessen the volatility of the riksdaler, it was a long time before there were any real prospects for a return to the silver standard. The legality of suspension of its convertibility remained controversial until spring 1818, when the Swedish Diet officially released the national bank from responsibility for redeeming banknotes with silver.²²⁷ The riksdaler still fluctuated quite a lot on the foreign exchange market but its price from 1815 onwards was never as much as half its silver parity. Extremely tight, deflationary monetary policies would have been required to restore the currency from this level to its statutory value. For Finland, constant changes in the value of Swedish money were naturally detrimental to state finances and business life.²²⁸

Karl Johan, who ruled Sweden first as Crown Prince and then as King, took a strong personal interest in money matters and was an enthusiastic supporter of bullionist policies. His government set the long-term objective of raising the debased riksdaler exchange rate level and eventually of re-instituting the old silver parity. This was the objective of several ambitious currency operations, managed by Secretary of State Carl David Skogman, who had been born in Loviisa, Finland but had moved to Sweden. Around the same time, Skogman

also played a central role in establishing the first savings banks in Sweden. The currency operations, employing the purchase and sale of bills of exchange, were expensive for the public purse and still did not produce the desired result of a stronger riksdaler. Awareness was gradually growing that Sweden's return to the silver standard would have to take place at a realistic silver value, meaning one that corresponded to the prevailing exchange rate.²²⁹

The rates that would be used for redeeming paper money were set by the Diet in 1830. The silver riksdaler would again become the underlying currency of the Swedish monetary system. Its silver content was reduced by an insignificant 0.75 %, and the rate for exchanging banknotes was set at approximately the current exchange rate. The Diet decided that one silver riksdaler would be equivalent to $2\frac{2}{3}$ riksdaler in banknotes (or, equivalently, 128 skillingar in banknotes). The rate for exchanging treasury notes issued by the National Debt Office was to be even simpler; one silver riksdaler would be worth exactly 4 riksdaler in treasury notes, or 192 treasury note skillingar. The ratio between banknotes and treasury notes was therefore left unchanged at 1:1½. It was the rate that had been in force since the currency reform of 1803.

The Diet's decision of 1830 did not lead to an immediate return to the silver standard because the silver reserves of the national bank were regarded as insufficient. The redemption of paper money in silver was not commenced until the start of October 1834, the date on which the silver value of the riksdaler was finally fixed in practice. Sweden had then been using a system of fiat money for 90 years – that is, since 1745 – apart from a couple of brief periods.

Curiously, the Swedish currency reform of the 1830s went only halfway. It fixed the value of paper money against silver but did not eliminate the confusion of parallel currency units. The forms of money used hitherto were not withdrawn from circulation and the denominations of notes remained unchanged. New banknotes entering circulation were still denominated in riksdalers banco (meaning, in banknotes) and skillingar banco, although their value in relation to the silver riksdaler was now fixed. At least in 1834 the National Debt Office ceased to issue treasury notes, the other form of paper money, but these old notes also remained in circulation and most prices continued to be stated in treasury note riksdaler and treasury note skillingar.²³⁰

The monetary reform in Sweden set the conditions for Finland's reform, of which a key part was to redeem the Swedish money still in circulation in Finland and transport the notes to Stockholm to be converted into silver. The rate of exchange and the convertibility of Swedish currency into silver at Sweden's national bank were therefore crucial for monetary reform in Finland.

EFFECTS IN FINLAND

Sweden's decision to return to the silver standard initially had no influence on Finnish monetary policy but, in 1833, Lieutenant general Alexander Thesleff, deputising for Governor general Alexander Menshikov, made a new proposal to the Senate's economic division that Finland should henceforth use roubles only and that all Swedish money should be forbidden on penalty of confiscation. One reason for Thesleff's action was that the riksdaler had regained lost ground in Finland in the second half of the 1820s. It was still the principal currency in private business transactions and, except for the eastern areas of the country, items were generally priced in banknote riksdaler and not in roubles. The lower external value of the riksdaler against the rouble also encouraged its use. At the beginning of the 1830s, even the government had begun to reuse its Swedish currency when paying wages of state employees. The bad money – the riksdaler – had driven out the rouble.²³¹

In his proposal Thesleff made several interesting observations about monetary risks. Could Sweden's Bank of the Estates of the Realm declare money in circulation outside Sweden to be void? What risk was involved in transporting Swedish banknotes by sea to Stockholm? How much danger was posed by the existence of counterfeit Swedish banknotes? He offered no answers to these questions, nor did his proposal lead to concrete action at the time. Most of the members of the Senate's Economic division felt that existing regulations would be enough to curb the use of Swedish money if only they were observed.

The question of Swedish money was raised in the Senate again in 1835 but, once more, no real action was taken. At the same time Finnish economic policy became slightly more active. In the mid-1830s several committees were established to look at ways of developing the economy.²³² The central figure on most of these committees was Lars

Gabriel von Haartman, who saw monetary stabilisation as an important objective for the whole of society. In a statement on monetary reform made in 1836 to Ministerial State Secretary Robert Henrik Rehbinder, Haartman was critical of previous attempts by the Senate, describing them as half-baked and doomed to failure. He gave the example of the regulations on confiscating the small Swedish banknotes in circulation in Finland at the same time as the large notes were still allowed. On the other hand, he predicted, if the use of all Swedish banknotes was forbidden, there was a danger that Swedish coinage would flow into the country.

In Haartman's view the problem ought to be handled by a swap operation managed by the Senate and not by compulsory confiscation. But a swap would not succeed as long as the official exchange rate for Swedish notes remained 6–7 percent below their market value. In planning the swap operation, a distinction should be made between losses to the public purse and losses to the economy as a whole. The matter should be entrusted to experts, he said, and not merely to officials.²³³

At the same time as asking for Haartman's views, Rehbinder had requested a statement from A.H. Falck, the former head of the Financial department. Falck's statement was fairly unassuming. He did not see any real problem posed by the existence of Swedish money in circulation. On the contrary the more money there was in the country, the better business and commerce would flourish. The tenacity of Swedish money was a consequence of the trust in it and, now that Sweden had returned to the silver standard, this confidence was more justified than ever. No new declarations were required. It would be enough to retain the old practice whereby payments to the state could not be made in Swedish money.²³⁴

Ministerial State Secretary Rehbinder continued to be interested in currency questions and chaired a committee on the matter. Lars Sackleen, a member of the Senate, and L.G. von Haartman, then still serving as a provincial governor, were appointed members of the committee and John Julin, owner of the Fiskars ironworks, and Henrik Borgström, owner of the Borgström trading house, were asked to make statements as representatives of business and commerce. The timetable was fairly tight because the report was completed by the end of February 1836. It is surprising to note that, even at this stage, members

of the board of the Bank of Finland did not participate in any committee work, nor was the Bank even asked for its views on monetary reform.²³⁵

The committee report's shows that official attitudes towards Swedish money had mellowed, which was understandable at a time when Sweden had returned to the silver standard. The tie to silver had stabilised the value of Swedish money and consequently paper roubles were also expected to remain steady in value. Backed by silver, the riksdaler would again act as a stable measure of value, so it could be used as such in Finland until an equally good domestic measure of value, a silver-backed rouble, was available to replace it.

The committee did not fix a schedule for implementing the silver standard. Most members were in favour of cautious progress, with a final return to silver taking place in the course of 1840. Regarding the elimination of Swedish money, the majority deplored outright bans and confiscations. It had finally been grasped that the success of a money changeover was crucially dependent on the exchange rate at which it was implemented. The committee realised that Swedish notes had hitherto been undervalued in terms of Russian roubles, so that attempts to swap them were doomed from the outset.

To implement a swap, provincial offices and the Bank of Finland would have to participate. The plan called for Swedish paper money to be exchanged for paper roubles issued by Russian banks and the Bank of Finland. It was calculated, however, that the funds of the government and the Bank of Finland would be insufficient to complete the operation, so a loan from Russia would be needed. The size of the loan was estimated at about half a million paper roubles. The reserve of silver required for a silver standard would be obtained by exchanging the old Swedish banknotes in Stockholm for silver.

Lars Sackleen, head of the Financial department, reiterated old official attitudes in the views he expressed to the committee. He was in favour of retaining the old policy of strictly prohibiting the import of Swedish money. He did not, moreover, believe that any borrowing would be required for completion of the swap operation; it could be done by stages using state revenue surpluses.²³⁶

In their statement, John Julin and Henrik Borgström, representing business and commerce, stressed that a silver standard was indispensable. As long as the domestic rouble-based monetary system was unstable, there was no reason to reject Sweden's now-stable

riksdaler. The economy needed a currency that was a steady measure and store of value, which the riksdaler, tied to silver since Sweden's monetary reform, offered. However the ultimate objective should be a national currency tied to silver, so the Bank of Finland should begin issuing silver-backed rouble notes as soon as possible. They proposed that the rate of exchange between the old and new rouble should be 1:3.6 – in other words 3 roubles and 60 kopeks in paper would be equivalent to one silver rouble. The silver required by the reform would be obtained from St. Petersburg, acquired on the money market of the Russian capital using paper roubles. Swedish currency in turn would automatically disappear from Finland after the reform, so no swap operation would be needed.²³⁷

In connection with the reform, Julin and Borgström wanted monetary and banking conditions to be developed in other ways, and saw the Bank of Finland as the platform to initiate this. The bank's lending facilities should be enlarged by eliminating the size restrictions on loans from the founding capital fund and by allowing townhouses to be used as collateral. The ceiling for loans from the small banknote fund should also be abolished, the permitted types of merchandise security should be expanded and the interest rate should be lowered to 5 percent. Bank of Finland deposit operations should be broadened and developed, among other things by permitting the use of payment orders against deposits.

Julin and Borgström also made a completely radical proposal; that private banking companies should be established in Turku, Oulu and Vyborg, creating a network of banks covering the largest towns. It was the first time that the establishment of private banking institutions in Finland had been proposed. In his history of the Bank of Finland, Hugo E. Pipping believes that John Julin was the author. The issue was first raised in public in an unsigned article published in 1832 in the newspaper *Helsingfors Tidningar*. It stated that the only way to eliminate Swedish money from circulation would be for Finland to move to the silver standard and establish private banks.²³⁸

The 1836 committee report and the concomitant statement by Julin and Borgström show that, by the mid-1830s, officialdom and enterprise had adopted a wider approach to monetary reform. A common feature was the view that a return to the silver standard was vital. In this respect they were harking back to the objectives advanced at the Diet

of Porvoo. Their stipulation of a return to silver also showed in their more pragmatic attitudes towards Swedish currency. The riksdaler, now tied to the silver, was no longer to be feared because Finland's move to the silver standard would automatically eliminate Swedish currency from Finland.

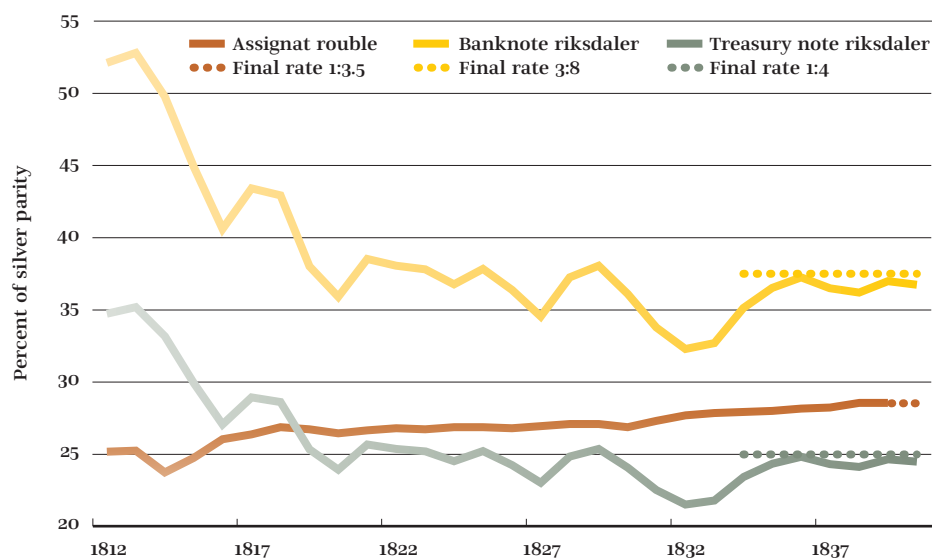
THE ROUBLE GOES BACK ON SILVER

KANKRIN'S PASSIVE RESISTANCE FOUNDERS

Stabilisation of Finland's system of money required both a silver standard in Russia and a monetary reform in Sweden. A return to the silver standard had long been an objective of the Russian government, at least in principle, and was part of Speransky's financial plan, approved in 1809. The war against Napoleon's France had disrupted the financial basis for its implementation, however, and Russia continued to use fiat money even after peace had been restored. Since the early 1820s, Finance Minister Dmitri Guryev had deliberately reduced the amount of paper money in circulation, with the aim of raising its value, but this policy was discontinued in 1823 when Egor Kankrin became Finance Minister. Instead Kankrin froze the volume of assignats in circulation for two decades. Subsequent external crises, such as the war against Persia in 1826–28, the war against Turkey in 1828–1829 and the crushing of the Polish uprising in 1830–31, were a series of burdens on the public purse that postponed any reforms.

Kankrin treated the idea of returning to the silver standard with suspicion and caution. He was an ultraconservative who mistrusted large reforms. His actions as finance minister were focused on cutting government spending and in this he was successful. As the finances of the state became more robust the value of assignats – paper roubles – stopped falling. At the start of his term as finance minister, the value

VALUE OF SWEDISH AND RUSSIAN FIAT MONEY 1812–1840



Sources: Björkqvist, H., 1968, and the Bank of Sweden.

of the paper rouble hovered around 27 silver kopeks, and the market price of a silver rouble was 3.6–3.7 assignat roubles.

The underlying objective of Kankrin's policies was preservation of the status quo in society, which in practice meant the hegemony of the landed aristocracy and defence of their way of life. Kankrin believed that a return to the silver standard would entail deflation, a fall in prices that would bring economic distress to indebted owners of country estates. This was the very social group whose interests he was committed to defending.²³⁹

By the 1830s, however, the situation has changed in a way that made a return to the silver standard look feasible. Economic conditions had improved and the value of the assignat rouble had stabilised but, at the same time, the disadvantages of the assignat system began to emerge. Until 1833 the assignat remained stable in value but then it began to appreciate. At the start of 1834 its price on the St. Petersburg Exchange passed 3.6 per silver rouble, which was the official value in

state payments. It continued to strengthen and by 1837 the exchange rate was 3.55. This created new tensions in payments to and from the state, because state payments were permitted in silver coin as well as assignats since 1831. With an emerging gap between the real and official values of the two currencies, the people began to prefer metal coins for paying their taxes and levies but were unwilling to accept coins in payment from the state.²⁴⁰

In the years ahead the assignat continued to strengthen and by the end of 1838 the silver rouble was worth 3.52 assignats. The assignat was now worth 5 percent more than at the start of the decade. If this trend were to continue, the finances of the indebted landed nobility were sure to suffer.²⁴¹ At the same time the conversion rate applied by ordinary people in everyday transactions was distinctly different from the rate on the St. Petersburg Exchange, which could be exploited in various ways. Walter Pintner points out that the rising market price of assignats widened the gap between the real value and everyday conversion rates during the 1830s, offering opportunities for speculation and fostering discontent.²⁴² The traditional rate used by the common people was four assignat roubles per silver rouble but, by the late 1830s, this undervalued the assignat by 10–12 % compared with its quotation on the St. Petersburg Exchange.²⁴³

It is hardly surprising that confusion in the Russian monetary system and uncertainty about the real value of money was a constant source of public complaint. In 1836 the tsar demanded that Kankrin explain the reason for the discontent. His report, given in 1837, was in keeping with his conservative disposition. He believed that the prevailing monetary system was fundamentally sound and he offered prohibition and punishments as the best ways to force a change in everyday conversion rate, after which there would be no more uncertainty about the value of money and abuses would end. In addition he proposed the establishment of offices for silver deposit, which would be able to issue certificates redeemable in silver and usable for payments in place of silver. At this point in time, the idea was mainly to reduce the logistic problems faced by the state in transporting silver money but it came to constitute the main basis of monetary reform in the years ahead.²⁴⁴

Russia's Council of State deliberated monetary reform from the end of 1837 to the spring of 1839. Two prominent participants in the

discussions were Admiral Aleksey Samuilovich Greyg and Count Ksawery Drucki-Lubecki, who both presented the council with devaluation plans. Greyg was a second-generation naval officer whose father, Admiral Samuel Greyg, had repulsed an attack by the Swedish fleet on St. Petersburg in 1788, while Drucki-Lubecki had been Finance Minister of Congress Poland during the 1820s. Greyg thought that the weight of the silver rouble should be reduced so that it corresponded to the prevailing value of the assignat. This reform could have been implemented without trying to modify the prevailing prices of assignats. Drucki-Lubecki urged that a new kind of banknote should be issued, denominated in silver roubles and redeemable in silver, for which the assignats could be exchanged at their fair value. Also Mikhail Speransky, who had made a political comeback and been reappointed to the Council of State, drew up his own proposal for monetary reform shortly before his death.²⁴⁵

Initially Kankrin opposed both Greyg and Drucki-Lubecki but, under pressure and after studying Speransky's plan, he finally saw the need for monetary reform, and proposed that the fall in the value of assignats should be formally recognised, after which they could be exchanged for silver money. In May 1839 Kankrin presented the Council of State with his own proposals to make silver legal tender for all payments from the beginning of 1840. Assignats would be exchanged for credit notes denominated in silver roubles and redeemable in silver from the start of 1841.

Kankrin proposed the conversion rate of 1:3½ between silver roubles and assignats but the council majority preferred 1:3.6 which was the rate that had long been used for state payments and which Speransky had supported in his own proposal. The tsar personally resolved the matter by choosing 1:3½ and Kankrin's plan was approved.²⁴⁶ Kankrin had picked a higher rate for assignats because he obviously feared that there would otherwise be a run on state banks as depositors tried to withdraw assignat deposits before the conversion took place. By spring 1839 the assignat rouble had risen to a value where a conversion rate of 1:3.6 would have caused losses to their holders.²⁴⁷

After long period of dragging his heels, Kankrin had finally endorsed the conversion of assignats at a rate that recognised that they were not par with silver roubles although, in opposing the reform plan

of Admiral Greyg at the end of 1837, he had rejected this possibility and insisted that assignats could still gradually be returned to their par value.²⁴⁸ One can only speculate on the reasons for his change of heart. Levicheva believes he was swayed by Speransky who “established that the monetary cycle can be stabilised only by systematic reform of its foundations” – in other words, by returning to a metal standard. Pintner believes that pressure from the tsar and other members of the Council of State had grown too great for Kankrin to resist.²⁴⁹ Another quite credible explanation is that Kankrin was being faithful to his political beliefs and was concerned about the effect on landowners of the rising trend in assignat values. At least he explained it in these terms, stating in his reform proposal of May 1839 that “the appreciation of assignats, which causes manifold distress, must be halted.”²⁵⁰

THE ROUBLE CEMENTED IN SILVER

Two manifestos proclaimed on the first day of July 1839 laid out the details of Russia's silver standard reform. Silver money was now the only legitimate measure of value in Russia, as it had been in 1810–1812, at least in the letter of the law, when Speransky was implementing his reform programme. All contract sums were to be denominated in silver money from the start of 1840. Stock exchange prices and foreign exchange rates would be quoted in silver roubles from that date. Assignats were designated an auxiliary currency that had a fixed value of $3\frac{1}{2}$ per silver rouble in all public and private payments. The monetary system was also to have certain bimetallic features. It was decreed that a ten-rouble gold coin (an Imperial, as it was called) would be worth 10 roubles 30 kopeks in silver coins, meaning that gold was given a 3 percent premium. This set the relative value of silver to gold at 1:15.45, which was close to the ratio of 1:15.5 used in most continental European countries. Regarding copper coins it was decreed that until new ones had been minted, the value of old ones would be $3\frac{1}{2}$ copper kopeks per silver kopek.²⁵¹

The silver standard reform involved the issue of new paper money denominated in silver roubles. From the start of 1840, deposit offices were opened in conjunction with the State Commercial Bank, which accepted deposits of silver from the public in return for deposit notes valued 3, 5, 10 and 25 roubles, and later additionally 1, 50 and 100

roubles. The deposit notes were backed 100 percent by silver and were intended to circulate as legal tender for all payments to their full silver value. The deposit office at the Commercial Bank would redeem the notes “immediately without the slightest delay or commission, for a sum of silver money equivalent to their face value.”²⁵²

This period at the turn of the 1840s coincided with crop failures in Russia, which caused an economic crisis lasting until 1842 and delayed the final part of the reform, the removal of assignats from circulation. Because the crisis led to a budget deficit, the state began to issue an additional new form of paper money, credit notes, in 1841. These differed from deposit notes in that they had only one sixth silver cover compared with the 100 percent cover of deposits notes. (The name credit note is derived from this partial cover, five-sixths of their value being a form of credit to the state.²⁵³) There were now three kinds of paper money in circulation in Russia: the old assignats and two new kinds of note, both denominated in silver roubles and redeemable in silver but backed by different proportions of silver. Although their silver cover was only partial, credit notes achieved good public acceptance, which gave encouragement and direction to the completion of Russia’s monetary reform.²⁵⁴

At the start of 1843 Kankrin responded to the tsar’s summons with a plan for the gradual removal of remaining assignats from circulation and their replacement with deposit notes. Tsar Nicholas then rejected Kankrin’s proposal as too cautious and put forward his own. It was founded on the confidence enjoyed by credit notes and aimed at redeeming the entire existing stock of paper money and assignats with credit notes partially backed by silver. Under the tsar’s plan, no new deposit notes would be issued and deposit notes that the state received in taxes and fees would be destroyed, their 100 percent silver cover being used to create credit notes with one-sixth silver cover.

According to a decree confirmed on 9 July 1843, assignats still in circulation would be exchanged for credit notes.²⁵⁵ A State Credit Note Bureau would be established under the Finance Ministry, to issue the notes and receive a metal reserve for covering their value and redeeming them. The bureau was given the duties and responsibilities previously held by the State Assignat Bank so it became Russia’s de facto bank of issue, a position it held until 1860. The conversion of assignats into credit notes began at the start of November 1843, and the

State Assignat Bank closed after 57 years of operations. Silver deposit notes were no longer issued but were redeemed with credit notes, which released their metal cover for use by the Credit Note Bureau.²⁵⁶

The monetary reform of 1839–1843 put the Russian monetary economy on a healthy footing in many respects. Pintner describes the reform as the first significant change in Russia's monetary system since Catherine the Great had created assignats.²⁵⁷ The change was truly historical because Russia had been using fiat money since 1786, but the return to the silver standard had not been sudden. It can be seen as having started back in 1830 when silver money was given a fixed rate that could be freely used in state payments, even if the rate at that time of 1:3.6 was not the ultimate one. Nor was the monetary reform concluded in 1843, because a large proportion of the assignats in circulation were exchanged for credit notes during 1844 and 1845. The swap operation continued at an ever-slower pace until the end of the 1840s, when 99 percent of assignats had been repurchased by the state with credit notes.²⁵⁸

The result of the reform was to create a monetary system that was close to a pure silver standard, because credit notes were redeemable in silver and citizens had an unlimited right to have silver coins minted. These features maintained reasonably stability in the silver value of money. On the other hand the system had certain weaknesses. Like coins, credit notes were legal tender, meaning they had to be accepted as payment at a value equal to silver money. This feature, intended to ensure the validity of the new credit notes, was later to prove fateful for Finland's monetary system. Moreover, the monetary system created in Russia in 1839 had certain features of a bimetallic standard because paper money was also redeemable in gold and coins could be minted from gold bullion without restriction.²⁵⁹

The operation of a silver standard depends, of course, on the redemption of paper money on demand. Despite Russia's great size and the poor communications of the time, credit note holders had to travel to the State Credit Note Bureau in St. Petersburg to be able to redeem an unlimited number of notes. Other offices imposed a maximum; at the State Commercial Bank in Moscow it was 3000 roubles in credit notes, at other regional offices the maximum was 100 roubles.

The monetary system based on the silver standard, constructed in 1839–1843 by Tsar Nicholas I and Finance Minister Kankrin, worked in

a fairly stable way until the outbreak of the Crimean War. The number of credit notes increased steeply but, until the Crimean War began, their metal cover was much greater than the statutory one-sixth. The silver reserve of the Credit Note Bureau was generally about one half of the value of notes in circulation. It was severely tested in 1848–1849, first by a serious crop failure, then by an epidemic and a military operation, very large in scale for those times, to suppress the Hungarian Revolution, but the system did not collapse. The silver reserves that backed credit notes were reduced temporarily and their quotation dropped to 95 percent of their face value, but calm was restored in 1850. After this there were no major disturbances before the start of the Crimean War.²⁶⁰

FINLAND PREPARES FOR A REFORM

THE POSITION OF THE GRAND DUCHY

The completion of the reform that restored Russia to the silver standard soon led to similar action in Finland. This was an independent administrative measure because the Grand Duchy of Finland was a separate financial state, which implemented and financed its own fiscal reforms. The recent monetary reform in Sweden was an important, even indispensable, prerequisite for a silver standard in Finland. Eventually Finland would have had to conform with the new mother country anyway, but the fact that the old mother country was again on the silver standard made things much easier. Now that Swedish banknotes were convertible, the Bank of Finland could acquire silver by withdrawing Swedish notes from circulation in Finland and presenting them for redemption by Sweden's Bank of the Estates of the Realm. Without this possibility, the reform might have been too expensive. Since Sweden had restored convertibility in 1834, there had been open discussion in Finland about the conditions for a return to the silver standard. The Russian government's decision in summer 1839 finally put the matter on the active agenda.

Publication of Russia's money manifesto did not immediately precipitate concrete action in Finland and there was initially some discussion between officials about the extent to which the manifesto affected Finland.²⁶¹ Doubts were dispelled in autumn 1839, when the tsar answered a question on the matter from the Ministerial

State Secretary for Finland, R.H. Rehbinder. On November 2nd, Tsar Nicholas replied affirmatively that Finland as a part of the empire was affected by Russia's monetary reform, and he ordered the formation of two committees. The first was to prepare general implementation of a monetary reform and ensuing changes to Finland's separate system of taxation. In practice this meant deciding the exchange rate that would be used for silver money when taxes were calculated and a possible need for reform of taxation principles. The task of the second committee was to plan how Swedish money would finally be removed from circulation in Finland. Provincial governor Lars Gabriel von Haartman was appointed chairman of both committees. The other members of the monetary reform committee were Lars Sackleen, head of the Senate's Financial department; Carl Gerhard Hising, a member of its judicial division; Johan Gabriel von Bonsdorff, clerk of the Senate; J.G. Winter, board member of the Bank of Finland; and Carl Trapp, Prosecutor at the Turku Court of Appeal. The committee on eliminating Swedish money was composed only of Haartman, Sackleen and Bonsdorff, and its work was declared secret.²⁶²

The schedule for reform was exacting; both committees were instructed to complete their work by the end of the same year. After this the matter was presented in the Senate, followed by an Imperial proclamation on monetary reform in Finland. The proclamation, made on 28 March 1840, began as follows:

"Having regard in equal share to the perpetual place in Our Realm of the Grand Duchy of Finland; and to the gracious declaration given on 17th (29th) of December 1809 in strict conformity with the constitution of Finland that the silver money of Russia is instituted as its principal and prime currency; We have mercifully deemed imperative that the principles recorded in Our Imperial Manifesto on monetary reform issued in July of last year shall be applied in this land, insofar as the separate system of taxes and hitherto prevailing monetary conditions allow; and subsequent to a special committee having studied this important affair and having received a humble statement on the matter from Our Senate of Finland, We are graciously desirous to ordain the following."²⁶³

The proclamation emphatically underlined that the Grand Duchy of Finland was part of the Russian realm and that the Russian silver

rouble had been decreed its main currency as long ago as 1809. A monetary reform could be carried out in Finland along the same lines as the one ratified in Russia the previous summer. However in implementing the reform, Finland's separate system of taxation and its monetary conditions (meaning the great importance of Swedish money) were special factors to be taken into account. The new monetary system was due to be implemented at the start of 1841. From that point onwards all taxes and payments as well as all prices were to be stated in silver roubles.

EXCHANGE RATE CONUNDRUMS

Changing over to the silver rouble in fees and wages paid to and from the state was a surprisingly difficult operation because the conversion rates between silver and paper roubles that had been used in these payments had been purely administrative and not even constant. For taxes and wages 3 paper roubles were equivalent to 1 silver rouble, while customs duties had applied the rate of 1:3.6, meaning that a silver rouble was worth an extra 60 paper kopeks. This rate of 1:3.6 had long been the official conversion rate in Russia too, but 1:3.5 was the rate that had been used in Russia's monetary reform. While the reform was being planned, there was fierce argument about how wages paid by the state would be determined in silver roubles. At the same time as assignat roubles were to be converted into the new credit notes redeemable in silver, Finland was also required to take many kinds of Swedish banknote out of circulation. Official conversion rates would have to be set for this operation.

Since the money reform in Sweden, decided in 1830 and carried out in 1834, the slightly lighter riksdaler coin had contained an amount of silver equivalent to 1.41723 silver roubles. Taking into account the fixed rates set in Sweden's monetary reform for conversion between the silver riksdaler and the types of Swedish paper money, the theoretical parities against the silver rouble from 1834 onwards had been:

- 35.43 silver kopecks per riksdaler in treasury notes
- 53.146 silver kopecks per riksdaler in banknotes

These imputed conversion rates, calculated from silver content, constituted a starting point when the rate for redeeming Swedish money was decided. The rate had to be sufficiently attractive to

persuade private individuals to part with their Swedish money but not so high as to overburden the public purse. The rates used in a large-scale swap also had to be fairly simple so as to avoid tricky calculations and operations.

A manifesto issued by the Emperor on 19 August 1840, which again prohibited the use of small-denomination Swedish paper money in Finland, set the official exchange rates in roubles and kopeks at which the Bank of Finland would redeem Swedish money. The largest Swedish notes (up to a maximum of 10 banknote riksdaler) were priced at 35 silver kopeks per treasury note riksdaler and 52.5 silver kopeks per banknote riksdaler. This was equivalent to an exchange rate of 1.4 silver roubles per riksdaler coin.²⁶⁴

This same conversion rate was to be used when market prices, rents, wages and other such transactions previously expressed in Swedish money were stated in roubles. The rate of 1.4 was advantageous for the Bank of Finland because it was below silver parity but at the same time it was profitable for holders of paper money because it was better than the prevailing market rate. In early 1840 the average quotation for the silver rouble on the Stockholm Exchange was 93.2 banknote skillingar, which meant that one banknote riksdaler had been worth only 51.6 silver kopeks. The conversion rate applied in Finland was clearly better than this.²⁶⁵

Holders of small Swedish paper money were offered an even more attractive swap. Notes worth less than a treasury note riksdaler would be purchased at 36 silver kopecks per riksdaler treasury note and 54 silver kopecks per banknote riksdaler. This exchange rate valued the riksdaler coin at 1.44 silver roubles, a premium of 1.6 % on its silver parity and even more above the prevailing market rate for Swedish paper money. The reason for this overvaluation was to ensure that the everyday use of Swedish notes in Finland would come to an end, by giving their holders good reason to swap them for roubles and kopecks.²⁶⁶

The swap operation did not proceed according to expectations in the early months of 1841 and in April its duration was extended to the end of the year. At the same time, the conversion rate was lowered to 1.38 silver roubles per riksdaler coin, meaning that a holder of Swedish treasury notes received 34.5 kopecks per riksdaler while banknote holders received 51.75 kopecks per riksdaler. Apparently most of the

money converted to roubles during the whole operation was exchanged at this lower rate.²⁶⁷

The rate of 1:1.38 in force during the extended duration of the swap operation was a full 2.6 percent worse than the theoretical parity of Swedish and Russian coins based on their silver content, but it still cannot be regarded as unrealistic, because it was in line with prevailing market rates. In the second half of 1840 the silver rouble was quoted on the Stockholm Exchange at an average of 92.45 banknote skillingar, meaning conversely that a banknote riksdaler was worth 51.92 silver kopecks. The new official rate adopted in Finland in spring 1841 was very close to this market rate. Another sign that the rate of 1:1.38 was realistic is that the redemption of Swedish banknotes was successfully completed at this price.²⁶⁸

MONETARY REFORM IN PRACTICE

Practical operations of the monetary reform were conducted by a temporary (and secret) section established under the Senate's Financial department, headed by Haartman and consisting of senators B.U. Björkstén and K.E. Heurlin. When the latter became unwell, he was replaced by Lars Sackleen. Björkstén was head of the Treasury and Accounting department of the Senate's Economic division and Heurlin was deputy head of its Financial department. Their choice can be seen as a mild vote on no-confidence in the professional skills of the Bank of Finland's board of management, but was also in line with long-standing tradition. All questions of principle connected with monetary matters were decided in the Senate. The Bank of Finland was regarded merely as an agency of the Senate.²⁶⁹

From the perspective of how affairs were handled, the choice proved to be an excellent one. Heading the reform, Haartman had broad authority so questions that arose could be settled quickly without time-consuming bureaucratic manoeuvres. He probably enjoyed his position of power in this compact, three-man section; later in his career he was accused of autocratic tendencies.

The monetary reform advanced by stages. One of the first tasks was to order new banknotes from St. Petersburg. The total order was for 3.3 million roubles worth and the notes were to be produced during autumn 1840, so that they could be issued at the start of the following

year. In relation to the small scale of Bank of Finland operations, this was an enormous order and the costs of producing each note rose to about three kopeks. It is illustrative that the board of the Bank of Finland would have settled for a significantly smaller order but the number was increased at Haartman's insistence and he proved to be correct. At the same time, old assignat roubles began to be converted into silver in St. Petersburg. There were assignat roubles in various state funds, in cash and on deposit at the Commercial Bank in St. Petersburg, in the accounts of the Russian crown and as collateral at the Bank of Finland for the small banknotes it had issued. The combined value of assignats exchanged was about 0.7 million silver roubles. In addition, a short-term loan of 0.3 million silver roubles was received from Russia for implementation of the reform.²⁷⁰

To redeem assignats the Bank of Finland had to issue extra small banknotes although it had already been decided that these would be withdrawn from circulation and destroyed. The value of small banknotes in circulation during the period 1836–39 had been 1.2–1.3 million roubles but in 1840 it rose by 1.8 million roubles to 3.15 million. Such a large increase was in preparation for the withdrawal of Swedish money from circulation. Although allowing small old-style Bank of Finland notes to remain in circulation for a while conflicted with the letter of the money manifesto, there were no serious practical problems involved. Public trust in them remained high and they were eliminated gradually. When their redemption finally ended in 1852, it was calculated that old notes to the value of 46 000 silver roubles were still outstanding. This constituted extra profit for the Bank of Finland.²⁷¹

The third stage of the reform was the removal of Swedish paper money from circulation. The exchange operation may not have been absolutely necessary; the direction of trade flows was changing and the period when exchange rates favoured the use of Swedish currency was coming to an end, so it would probably have gradually disappeared from circulation anyway. However Haartman, in charge of the operation, wanted to be free of Swedish money as quickly as possible, to underline the status of the Grand Duchy of Finland as part of the Russian Empire. Another important consideration was that Sweden's Bank of the Estates of the Realm, subject to the many requirements of the silver standard, was obliged to redeem old Swedish banknotes to

LARS GABRIEL VON HAARTMAN (1781–1859)

Lars Gabriel von Haartman was the individual with the strongest influence on Finnish economic policy in the first half of the 19th century. For nearly two decades, he served as deputy head of the Senate's Economic division and head of its Financial department, approximately equivalent to prime minister and finance minister in modern terms. His personality earned him the soubriquet "his Horribleness" from contemporaries. At that time the Senate controlled the Bank of Finland so its board answered to him.

He was born in Turku, the son of a professor of medicine. After Finland was annexed to Russia, his father Gabriel Erik von Haartman served for a while as head of the Senate's Financial department, the job that was to be Lars Gabriel's calling. The son studied first at the University of Uppsala and then at the Royal Academy of Turku. Upon receiving his university degree, he became a career civil servant. He served for a long period on the Committee for Finnish Affairs in St. Petersburg.

Haartman's knowledge of economic and administrative questions was exceptionally broad for the period in question. He also accumulated experience on a long study trip undertaken in 1827–1830 via Sweden to France, Italy, Germany and Great Britain.

In 1831 he became governor of the province of Turku and Pori, while continuing to provide expert services to the government. After Russia

had decided to return to the silver standard in 1839, he was charged with planning the reform in Finland. In spring 1840 he became deputy chairman of the Senate's Economic division and at the same time head of its Financial department. He was now responsible for practical implementation of the silver standard.

Politically Haartman was an archconservative. He regarded a close connection with the Russian Empire to be in Finland's interest but despite his conservatism he actively pushed through many economic reforms, such as the start of steam shipping services in Finland. He regarded the construction of the Saimaa Canal as perhaps his greatest achievement. Also important was the customs reform that he implemented, which increased Finland's foreign trade while greatly boosting government revenue.

He was compelled to resign from his positions in 1858 after repeated disagreements with the new, reform-minded Governor general F.W.R. Berg. He died at his manor house at Lemsjöhölm in south-western Finland in 1859.

In 1837 he had adopted his orphaned seven-year-old nephew Victor von Haartman, who was to have an important career in the civil service and thus continue the family traditions in government of the Grand Duchy. In 1865 Victor was appointed to the board of the Bank of Finland and became its chairman in the following year.



■ Of the heads of the Senate's Financial department, the most active at the Bank of Finland was L.G. von Haartman, who headed the operation to remove Swedish currency from circulation during 1840–1842.
– Timoleon von Neff, oil on canvas, undated. Sinebrychoff Art Museum.
Central Art Archives.

their full value in silver money, which provided the Bank of Finland with the silver cover it desperately needed.

The plans for eliminating Swedish paper money had been made in the three-man committee mentioned previously, consisting of Haartman, the head of the Senate's Financial department Sackleen and the clerk of the Senate Bonsdorff. The committee drew up proposals about the exchange rates at which the money would be redeemed and also the schedule for redemption. Haartman and Sackleen clashed over the size of the premium to be paid in the swap. Sackleen wanted to keep it as small as possible, in the belief that a high premium would suck extra Swedish paper money into Finland and thereby increase the costs of the reform. Haartman's view was that without a respectable premium the swap would not work, and he was not concerned about a deluge of extra Swedish money. Although Sackleen as head of the Financial department was Haartman's superior in the hierarchy of government, "his Horribleness" had more influence and his opinion prevailed. Henceforth there was no doubt about who was in charge of the reform. It was characteristic that decision-making throughout this period took place in secret. Naturally the secret could not be kept indefinitely and by 26 May 1840, when a statute was published prohibiting the import of foreign paper money, educated people realized what was coming. After this the Swedish money that had accumulated at provincial offices was collected together and sent to Turku, where one of the three exchange offices of the Bank of Finland had been established. In return for their riksdaler, the public received small banknotes of the Bank of Finland, issued one last time with extended validity. As a consequence the volume of small banknotes in circulation increased from 1.3 million paper roubles in 1839 to 3.2 million. The upcoming reform was announced in Imperial proclamations on 18 and 19 August 1840. The first reiterated that small Swedish notes were invalid. The second told that they would be exchanged for Russian ones. On the same day information was released about all the notes which would be in circulation from the start of 1841 and their mutual exchange rates.²⁷²

For ordinary people, a monetary reform was naturally a difficult matter to grasp. To spread information, the Senate mandated that provincial administrations, the clergy and the constabulary should explain the reform and its significance to people in their areas. At

church services, the congregation were reminded, among other things, that Sweden had decided in 1835 that the riksdaler would cease to be valid in 1845 so all old Swedish paper money should definitely be exchanged before then.

The Bank of Finland did not become properly involved until autumn 1840, when the swap operation itself began. Three exchange offices were established, in Turku, Kuopio and Vaasa, by S. W. von Troil, A. F. Boije and C. G. Stjernvall. All were long-term members of the Bank of Finland's board; Boije had been a member since 1826. The appointments were a message to the public about the great importance of the task. Troil as head of the Turku exchange office was to play the key role because the paper money collected by all exchange offices was to be sent via Turku to Sweden. The first batch was shipped in 1840 but the main deliveries began the following year, when 2.3 million riksdaler were despatched to Stockholm. Shipments in the following year exceeded 2.6 million riksdaler but thereafter shipments declined and were less than 50 000 riksdaler in 1848–49. In total the Bank of Finland and, to a lesser extent, the government, sent 6.1 million riksdaler in banknotes to Sweden. Finnish trading houses directly exchanged an additional quantity of riksdaler for silver but there is no data about the amounts. In practice Swedish money was removed from circulation in Finland within a couple of years, a speed that exceeded all expectations.

In Stockholm various persons and companies were recruited to handle the exchange operation. Troil of the Turku office visited Stockholm on several occasions and so did the Postmaster of Turku, Carl Tammela. Of trading houses in Stockholm, at least Tottie & Arfwedson, Michaelson & Benedicks and C. R. Forsgren were involved. Russia's chief consul in Stockholm, Alexander Lavonius, assisted in the operation. As will be apparent from the section on Swedish monetary affairs, the Bank of the Estates of the Realm faced major problems in 1842 and 1843 in redeeming riksdaler from Finland. There was even the threat that redemption might have to be discontinued because of the lack of silver. By a small majority, Sweden's bank council agreed that, to retain public trust, the demands of holders of old notes had to be met, regardless of whether the riksdaler had come from Finland. The decision was eased by the awareness that the number of notes arriving in Sweden would decline in the months ahead.²⁷³

The Finns had expected the notes to be redeemed with full silver riksdaler coin, but instead the Swedish national bank offered small silver coins. These were unacceptable because of their lower silver content. Good foreign bills of exchange would have been acceptable but there was little supply of these in Stockholm. Among the more exotic media used were old Spanish piasters, said to have constituted the earliest silver reserves of the Bank of the Realm and now used in this moment of need. Even these were not uncontroversial because the Finnish and Swedish sides had differing views about the applicable exchange rate for piasters.²⁷⁴

The silver destined to be metallic coins was then shipped directly from Stockholm to St. Petersburg, where Swedish silver money was sold to the Mint for silver roubles. Also the bills of exchange obtained from Stockholm were sold in St. Petersburg. These trades involved numerous negotiations about exchange rates to be used and various commissions to be paid. The Finns were unfamiliar with such negotiations so the Bank of Finland hired the banking house of Gustaf Sterky & Son. The choice was made by Haartman, now head of the Financial department of the Senate, who had become acquainted with chief consul Gustaf Sterky while working earlier in St. Petersburg. This banking house also handled the exchange of Finnish rouble banknotes in St. Petersburg. Haartman had originally imagined that banknotes issued by the Bank of Finland would be valid in Russia too but in practice they were not. Russian exporters who received payment in Finnish banknotes tried to change them into Russian banknotes as quickly as possible and these exchange operations were the practical monopoly of Gustaf Sterky & Son for two decades. The board of the Bank of Finland had never been confident that their banknotes would be valid outside Finnish borders.²⁷⁵

Unlike all previous efforts to stabilise monetary conditions in the country, the reform went extremely well. The extra section of the Senate's Financial department worked with exceptional efficiency. The old assignat roubles were quickly withdrawn from circulation. The redemption of Swedish banknotes and treasury notes circulating in Finland was a major challenge but Haartman's decision to pay a slight premium to their holders proved to be correct. The incentives to give up Swedish money operated as had been expected, but the exchange

rate premium was not so great as to encourage the systematic import into Finland of old Swedish paper money. By the end of 1843, 80 percent of the Swedish paper money in circulation in Finland had been redeemed.

CRITICISM AMID SUCCESS

Published research treats the monetary reform as one of the greatest achievements in Haartman's long career as a statesman. The exception to these assessments comes in the criticism of Emil Schybergson, the author of the first history of the Bank of Finland. But even Schybergson concedes Haartman's merits in carrying out the reform: "He was omniscient and omnipresent, and found time for every matter, both great and small. In brief he showed incomparable vigour in prosecuting the reform, earning the second nickname, Silver Lasse."²⁷⁶

The basis of Schybergson's criticism was the tight connection that monetary reform created with the Russian monetary system. According to the fifth article of the Bank of Finland's new regulations, the bank had to redeem in metal not only its own banknotes but also Russian banknotes. This meant that in fact the reform went only halfway, as the Crimean War years would show. Moreover Schybergson believed that redemption of all Swedish banknotes from circulation was a political miscalculation. The link with Russia's monetary system and the absence of Swedish notes caused difficulties in the 1850s when Russia was forced off the silver standard and again in the 1860 when Finland returned to it. If the Bank of Finland had not been obliged to redeem Russian banknotes, there would have been no need to follow Russia in leaving the silver standard. Moreover if there had still been Swedish banknotes in circulation in the 1860s, a Finnish monetary reform could have been justified by the need to get rid of them, which would certainly have made it easier to obtain permission from St. Petersburg. This matter was first advanced in the 1860s by J. J. Nordström, a banking theorist who had moved to Sweden.

On these grounds, Schybergson's history of the Bank of Finland states that "von Haartman's monetary reform was (...) a misjudgement, possibly deliberate in keeping with his sympathy for Tsar Nicholas I, possibly an accidental one because he could hardly have anticipated that after more than a decade Russia would reimpose a compulsory

rate for banknotes, but in any case an unavoidable one because a more comprehensive reform was not yet viable”.²⁷⁷

This criticism of Haartman, tinged with Schybergson’s Scandinavianist attitude, appears unreasonable. Article 5 of the Bank of Finland’s regulations of 1840, which had been inserted specifically at the demand of Russian officials, stated that “the bank is also required within the limitations of its funds to redeem all valid coins and notes elsewhere issued in the Empire, in the same way as foreign gold and silver money, at the rate set for each and announced to the public”. Russia’s monetary reform specifically emphasized the harmonisation of monetary conditions throughout the Empire so it is difficult to imagine that Finland could have obtained any sort of exceptional status at that time.

SIZE OF THE MONEY SUPPLY

Up till Finland’s monetary reform, there is extremely vague information about the volume of money in the country. The only reliable data concerns the small banknotes issued by the Bank of Finland, which had a volume of 1–2 million paper roubles. In 1821 the amount topped 2 million roubles but then began to decline for more than a decade, reaching its lowest point, some 0.8 million roubles, in 1833. Although the people of Finland still lived in a largely barter economy, such a small amount of money was nowhere near enough to satisfy demand. The other official form of money was the Russian assignat rouble note but there were not many of them either. Until the monetary reform, the prevailing method of payment in much of the country was old Swedish paper riksdaler. The volume was impossible to monitor so there is no reliable data about money supply in the period 1812–1840.

Fortunately the reform, which redeemed assignats and paper riksdaler, offers some indications about the amount of money in circulation at the end of the 1830s. The first estimates were published thanks to the Diet of the Estates summoned for 1863–64. On its agenda was an account, given in the name of the Emperor, on the operations of the Bank of Finland from its foundation until the start of the 1860s. According to a numerical appendix, the various kinds of money in circulation in 1840 had a total value of 5.5 million silver roubles. These

figures were recalculated by J.V. Tallqvist in a study that appeared in 1900, arriving at a slightly higher figure, 6.7 million silver roubles.²⁷⁸

The monetary development of Finnish society was still at a nascent phase. Some taxes were paid in agricultural produce instead of money, and there were officially sanctioned rates for payment in kind. The proportion of wages paid in money was also small. Central government officials were the first to move to a monetary wage but in agriculture, which sustained the majority of the population, only a minor part of wages was paid in money. Similarly domestic commerce was still mostly barter. This was reinforced by the fact that trading rights were a monopoly of the towns, and peasant farmers visiting town always stayed with and traded with the same merchant, an arrangement known as the accommodation system.

The amount of money in circulation was still relatively large at 4.7 silver roubles per head. This figure was certainly influenced by the fact that, except for a few savings banks, there were no other banking institutions at the time. Savings were not held as bank deposits but as money stowed “under the mattress” or in the form of articles that would hold their value. This allows diverse conclusions to be drawn, some of them conflicting, about the amount of money in circulation. On the one hand, the money supply can be seen as a sign that the money economy was spreading but on the other, it can be interpreted as a mark of how underdeveloped society was. Because of the rudimentary state of banking, there were no dependable ways of making deposits, and the lack of functional systems for transactions meant that plenty of money was needed. However, a comparison with Sweden suggests that the amount of money per head there was about the same.

Currency	share
Swedish notes	48 %
Russian notes	45 %
Bank of Finland notes	7 %

The shares of different types of notes, consisting of Russian assignats, Swedish riksdaler and small Bank of Finland banknotes redeemed in the money reform are given in the table. The proportions of Swedish and Russian paper money were about the same, but most of the money

held by the private sector was in riksdaler, while assignats predominated in the numerous funds of the government. The volume of the small banknotes issued by the Bank of Finland was almost insignificant during this period, never amounting to as much as a tenth of the money in circulation. This confirms how small-scale and modest the Bank's operations still were at the end of the 1830s.²⁷⁹

EFFECTS OF THE REFORM IN SWEDEN

Finland's monetary reform had a powerful impact on the state of Sweden's Bank of the Estates of the Realm and the Swedish money market. When the earlier Swedish reform was being planned, it was realised that Swedish banknotes were circulating in Finland but no one was sure how many. It was also uncertain whether the Finns would continue to use Swedish money after the reform. Also, in 1834 there could have been no knowledge of Russia's upcoming monetary reform. It was generally felt that the volume of Swedish paper riksdaler in Finland was not particularly great. Many believed that Sweden's return to the silver standard might actually increase the amount of riksdaler circulating in Finland rather than reducing it, because the silver standard would make Swedish money more stable and dependable than before.²⁸⁰

Sweden's monetary reform apparently did not bring Swedish money flooding back from Finland but it did allow the Finnish Senate to implement its own reform, in which the large-scale conversion of Swedish riksdaler would transfer a significant proportion of the precious metal of the realm of Sweden to Finland. Finland's move to the silver standard after 1840 ended the use of Swedish money almost completely and the banknotes taken out of circulation were transported to Stockholm to be redeemed. The Bank of Finland sent a total of about 6 million paper riksdaler to Sweden, an amount equivalent to 22 % of the stock of Swedish banknotes.

The most significant effect on Sweden of the Bank of Finland's redemption operation was that it significantly eroded the reserves of the Swedish national bank. At the end of 1840, silver held by the bank had been worth 15.7 million paper riksdaler so the silver received by the Bank of Finland reduced the reserve by almost a third (32 %).²⁸¹

The negative impact did not end there. A private flight of currency began from Sweden, mainly to Hamburg. At the same time, individuals

began to redeem money so as to build up their own silver reserves. In total, the Bank of the Estates of the Realm lost 58 percent of its silver during this period. According to sources quoted by Davidson it seems probable that the redemptions carried out by the Bank of Finland caused widespread unrest and concern in Sweden about whether the national bank would be able to live up to its commitments. This lack of confidence explains both the flight of currency to Hamburg and the withdrawals of silver from the national bank.²⁸²

The run on the bank affected Sweden's money and foreign exchange markets. On the foreign exchange market, the value of the Swedish currency depreciated significantly; in Hamburg it dropped by as much as four percent from its average rate of 1840. When a country is on a metal standard this is a significant variation. With the decline in its metal reserve, the Bank of the Realm found that it was unable to meet its regulations of $\frac{1}{2}$ cover for banknotes issued. Before the start of Finland's monetary reform, it had considerable excess cover and so could have issued more banknotes. In 1843, however, its cover was below $\frac{1}{2}$ and at the end of the year, the value of banknotes in circulation was arithmetically 22 % too great. This situation compelled the bank to begin tightening its lending policies in order to downsize the issue of banknotes. In the years ahead it greatly reduced discounting of bills of exchange and its lending against security in merchandise.

The crisis caused in the Swedish money markets by the exodus of silver left its mark on Sweden's Banking Act. The system of partial cover for banknotes used by Sweden since 1834 meant that changes in silver reserves caused a disproportionate change in the national bank's right to issue banknotes (in Sweden's case by a multiple of $\frac{8}{5}$). This magnified fluctuations in economic conditions; changes in the balance of international payments, for example, caused even greater changes in the money market. Sweden's crisis of 1842–43 was a textbook example.

A new banking act, deliberated by the Swedish Diet in 1844–45, relaxed the banknote cover regulations and made them less sensitive to economic conditions. The new law, which came into effect in 1845, replaced the system of fractional cover for banknotes with a quota system that allowed the national bank to issue a certain prescribed volume of banknotes without metal cover (20 million paper riksdaler). Notes issued in excess of this amount had to be covered 100 percent by metal reserves and by metal currency receivables from abroad.²⁸³

The new law resolved the banknote cover crisis but it also had certain theoretical advantages, which had been noted in debates in England leading up to Sir Robert Peel's Bank Act of 1844. The quota system implemented the currency principle, a banking doctrine that regards the ideal system as one in which the volume of banknotes in circulation exactly reflects fluctuations in banknote cover.²⁸⁴

BANK OF FINLAND REGULATIONS 1840

HISTORICAL CONTINUITY AND RUSSIAN INFLUENCE

The monetary reform in Finland and the attendant move to the silver standard meant that the entire regulations of the Bank of Finland now finally had to be revised. The basis of the revision was laid out in proclamations by the Emperor dated 21 April 1840, which announced a monetary reform in the Grand Duchy of Finland, its implementation and the new organisational shape of the Bank of Finland. The last-mentioned proclamation summarised the tasks of the bank, its operations and its administration under the new conditions. It was the outcome of collaboration between the Economic division of the Senate and the Office of the Ministerial State Secretary for Finland, in which senior management of the Bank of Finland had played a rather modest role. In reality the reform reflected the views of Lars Gabriel von Haartman, who had been appointed head of the Financial department in 1840. Haartman did not enter the Senate until 1840 but had headed various committees since 1838, working on the development of Finland's economic conditions. Thanks to this committee work Haartman was well-informed about how the Bank of Finland worked.²⁸⁵

Preparations began in spring 1840 on detailed proposals for new regulations, on the basis of the Emperor's declaration. The work was aided by two earlier proposals for reform, drawn up in the 1830s by board members J.G. Winter and C.G. Stjernvall. Both had codified all

of the rules concerning the Bank of Finland and standing orders for individual functionaries, so almost all the preparatory work had already been done.²⁸⁶ Moreover, a secret Senate protocol to the Bank of Finland's regulations, issued in the name of Tsar Nicholas I, was already known at this stage. Sent to the bank's board on 27 May 1840, it dealt with bank lending and questions related to the silver reserve.²⁸⁷

The regulations were published in the statute book as early as 18 November 1840, so the work had been completed in about half a year. The new regulations were significantly broader than the previous ones and contained a total of 151 articles. Rules were also laid down for the new exchange offices and for the documents to be used for all the loans and guarantees granted by the bank's different funds.

The first article of the regulations laid out the Bank of Finland's functions and its constituent funds. The bank's privileges and perquisites were also defined. The regulations re-emphasised historical continuity, noting the proposal made by the Diet of Porvoo on the creation of a national bank. The functions of the Bank of Finland were to simplify payments by individual citizens and institutions; to improve their access to loans; and to unify and safeguard monetary conditions in the country. Unification did not stop at the borders of Finland; the reform would lead to a common monetary system that would integrate Finland more closely into the Russian Empire.

The core of the Bank consisted of two main funds, the primary fund and the hypothecary fund. The first consisted of the bank's own capital while the latter continued the operations of the small banknote fund, in that it served as collateral for banknotes issued. There were also two more funds, the ageicultural fund and the manufacturing fund, created specifically for lending purposes. There was no mention in the regulations of the size of the primary fund or the hypothecary fund.

To make transactions and payments easier, the Bank of Finland was empowered to issue "deposit notes" with the fixed values of 25, 10, 5 and 3 silver roubles. The bank was committed to redeeming these notes in silver at no extra cost and the notes were decreed legal tender in all transactions between the state and private individuals. To facilitate transactions with St. Petersburg the bank was to appoint an agent in St. Petersburg to mediate payments by private individuals. The minimum size of a money order was set at 300 roubles.²⁸⁸



■ After its move to Helsinki, the Bank of Finland initially operated from the house built by Helsinki merchant Johan Sederholm (second building from the right). In 1824 it moved the recently completed Senate Building (centre). – F. Liewendahl, tone lithograph, 1851.

Helsinki City Museum picture archives.

The largest policy changes in the new regulations concerned the bank's lending and borrowing. The bank was to borrow from private individuals by issuing public bonds with values of either 300 or 900 silver roubles. The following year the value of the smallest bond was set at 100 silver roubles. On these bonds the bank would pay four percent interest. Maturity was 10 years but the bank was required to redeem bonds on demand after three days' notice. The maximum total value of bonds issued was set at 700 000 silver roubles. The bonds were written for the first investor but they were nevertheless transferable bearer bonds that the bank would redeem from any bondholder. They could also be used for paying customs duties so they could be regarded as large-denomination banknotes. They became the model for the method used to finance the Saimaa Canal, known to the public as Saimaa Bonds. Similar financing instruments had been used in Russia, for example at the start of the 1830, when the Polish uprising had led to a steep rise in military expenditure. In Russia they were called state treasury bonds.

The bank was also to continue taking deposits from private individuals and public institutions. As before, no interest was to be paid on these deposits and the minimum deposit was 100 silver roubles. The minimum withdrawal permitted was 20 silver roubles.

DETAILED LENDING REGULATIONS

Lending from the hypothecary fund, which covered the small banknotes issued by the Bank of Finland, was comprehensively revised. The earlier small banknote fund had accepted guarantees as security for loans, as an alternative to collateral, but guarantees were not accepted by the hypothecary fund. New forms of permissible collateral were bonds issued by the Bank of Finland or Russian banks, bills of exchange and promissory notes between private individuals in Finland, shares and separately listed products and raw materials. The list of collateral types in the regulations included agricultural products like grain and wool; metal products like iron ingots, pig iron and copper; glass, potash, sugar, cotton thread; and imperishable produce in general. The goods used as security had to be kept under the custody of a town court or a country bailiff, in a fireproof warehouse. Determining the value of goods used as collateral was the job of the Bank's board. The interest rate on loans was four percent and the loan

period was at least six months and at most two years. The minimum value of a loan was 100 silver roubles and the maximum 6000.

The hypothecary fund was also allowed to make 10-year loans to public bodies such as towns to finance general construction and roads at five percent interest against the borrower's collective collateral.²⁸⁹

To facilitate payments by enterprises, the Bank of Finland was, for the first time, allowed to discount bills of exchange, payment orders and negotiable promissory notes. They were to be drawn against and approved by persons enjoying general trust and repute. The discount rate would be determined annually by the head of the Senate's Financial department. Surprisingly, the regulations did not say which fund would do the discounting but, in the event, the hypothecary fund was used. In 1843 the right to discount bills of exchange was widened significantly when the Bank of Finland was granted the right to deal in foreign bills. This change allowed the Bank to trade in foreign currencies and to handle foreign transfers. It led in the same year to the start of quotations for foreign bills of exchange – currency exchange rates. The first foreign bills quoted by the Bank of Finland were for Hamburg and Stockholm. The range of quoted currencies later increased as the network of the Bank's foreign correspondents grew.²⁹⁰

The shape of lending from the Bank's primary fund was left largely unchanged. Loans were granted to landowners against a first mortgage. The value of the mortgage was to be determined by the form of ownership, freehold land up to two-thirds and leased land one-half. The maximum loan was 10 000 silver roubles. The interest rate was set at four percent and the loan duration at 50 years. The regulations contained extremely detailed instructions about how to appraise the value of the land to be mortgaged. Valuation was entrusted to a local magistrate aided by two local residents well informed about agriculture. The valuation was to consider all aspects of the property to be mortgaged, to establish its total income and expenditure. This information would be the basis for determining its overall value and thus the maximum size of the loan sought. It shows that, back in the early 19th century, there was good awareness of the problems of asymmetric information and the need to establish an applicant's financial standing. Loans from the agricultural fund were granted for land clearing and similar improvement work, either against a mortgage or a guarantee. Every farmer in the country was entitled to apply but

priority was given to those living in the interior. The sum lent could be no more than 1500 silver roubles. The interest rate was 2 percent and the loan period 12 years. The regulations also specified ways of monitoring how the sum borrowed was used.²⁹¹

Loans were granted from the manufacturing fund to manufacturers and the owners of small-to-medium sized factories. Again the regulations specified in detail which fields of business could receive loans. It is striking how the metals industry was favoured while forest industry sectors were not even mentioned. The maximum size of a loan was 4500 silver roubles, the interest rate 2 percent and the maximum loan period 12 years. Repayment took place as amortisation during the three last years of the loan.²⁹²

The board and administration of the Bank of Finland remained largely unchanged. The head of the Senate's Financial department no longer participated in board meetings with a casting vote but if the board was split he was to present his own view in writing. The Economic division of the Senate was still in charge of monitoring the bank's operations, but the participation of representatives of the Estates was an innovation of significant principle. The Senate implemented this by appointing four delegates annually, each representing one of the four Estates, to audit the bank alongside representatives of the Senate's Economic division.²⁹³

The articles regulating lending and the bank's board and administration are typical of the fine detail in the new regulations, which in fact integrated all the official instructions drawn up over the preceding decades. This meant an institutionalisation of the bureaucratic features that had been characteristic of the bank. This trend towards strict officialdom is not surprising; at the time when the regulations were published, the influence of Tsar Nicholas I was at its strongest.

The regulations of 1840 also refer to the upcoming monetary reform. Small rouble banknotes were to be converted to silver coin, and the issue of small banknotes was to end with the start of 1840. Their disappearance meant in turn that the small banknote fund, which covered the notes, could be converted into the hypothecary fund, as mentioned above. In practice, existing loans from the former small banknote fund were revoked and had to be repaid within four years.

As a practical aid for the currency changeover operation, the Bank of Finland established exchange offices in Turku, Oulu and Kuopio. These exchange offices quickly developed into the bank's branches because, in addition to exchanging money, their duties included receiving loan applications and granting loans after approval by the board. An interesting detail in the regulations concerned the task of monitoring the exchange offices, which was transferred to the governor of the province in question. He was to receive monthly data about exchange office operations, which he then compared with the office's cash balance.²⁹⁴

SECRET COVER REGULATIONS

Despite their depth and detail, the regulations contained no real mention of the equity required of the Bank of Finland nor about cover for the banknotes issued, a surprising omission in view of the fact that cover regulations had previously been explicit. In reality there were indeed regulations about banknote cover, but they were declared secret. Because they could not be published in the regulations, they were sent as a Sub Secreto order to members of the Bank of Finland's board of management.²⁹⁵

This document expressed the cover regulations in a fairly complex way. Firstly it ordered that the volume of banknotes could be no more than a fifth greater than the bank's reserves of silver, this excess being regarded as covered by outstanding claims of the bank's primary fund. On the other hand, it stated that a third of the silver fund could be lent to private individuals and organisations as hypothecary fund loans. Thirdly, the bank was entitled to grant a loan to the state for up to 18 months at 4 percent interest, thus relieving the government of the burden of keeping excessively large cash reserves in its provincial offices and allowing it to use these funds to the benefit of general liquidity. The Bank of Finland was, however, to ensure that the ratio of silver cover to banknotes in circulation did not fall below $\frac{7}{15}$.

The revised regulations with their supplementary secret protocol provided an institutional framework for a significant growth and diversification in Bank of Finland operations. Having acted until this time as a modest public agency, the Bank of Finland now began to develop towards a genuine bank of issue. It was now, for the first time,

responsible for all note circulation in Finland. At the same time, the increased issuance of banknotes provided it with resources to more-than-double its lending over the next decade. The new regulations provided many new instruments, such as the possibility to discount bills of exchange, to improve the efficiency of the money market. This was the first step on the path that culminated in monetary and interest rate policy-making. Understandably, the adoption of these new instruments was a slow process and the reforms were not visible until the 1850s. According to Emil Schybergson the regulations meant a rebirth of the Bank of Finland.²⁹⁶

Russian influence is clearly visible in the regulations regarding lending. The forms of security required by the hypothecary fund were very similar to the corresponding regulations of the State Commercial Bank in St. Petersburg.²⁹⁷ The Russian capital may also have provided the model by which the Bank of Finland was empowered to grant revolving credit to the state and for the use of state treasury notes in the form of bonds. It was certainly in line with the traditions of Russian government to declare some of the most important regulations secret. On the other hand Swedish influence is still apparent in the concept that the Estates had an interest in the bank, which was recognised when representatives of the Estates were accepted as auditors, admittedly subject to their selection by the Senate. Thus the idea mooted by the Diet of Porvoo, of a bank subject to the Estates, remained alive even though new Diet sessions had not been called.

INTERNATIONAL DEVELOPMENT OF CENTRAL BANKING PRINCIPLES

THE BANK OF ENGLAND'S EXAMPLE

The regulations that were conferred on the Bank of Finland in 1840 and the monetary reform carried out at the same time made it into a genuine national bank of issue. It was practically independent in its responsibility for all the banknotes of the country. It had independent metal reserves to cover them. With the discount rate, it had monetary policy tools. It was now a player in a pan-European trend, the evolution of national banks of issue into policy-making central banks.

The classical modes and principles of central banking took shape in stages in the 19th century. The main international instance driving this trend was the Bank of England. Its role was natural in view of its status, London at the time being the world's foremost financial centre. Paris competed for this position, at times with some success, particularly as a source of long-term capital (even Finland's foreign borrowing focused on Paris at the end of the century), but in short-term money markets (which in the 19th century meant the market for bills of exchange) London was the undisputed centre, at any rate from the second half of the 1820s. French monetary policy had global significance but it was concerned more with the markets for the precious metals of silver and gold and for international monetary diplomacy than with central banking.²⁹⁸

If the monetary policy pursued around Europe in the first half of the 19th century is examined from a modern perspective, one of the most

striking features is how unimportant interest rates and interest rate policies were. At that time monetary policy and the activities of the banks of issue were thought of in terms of regulating the quantities of credit and banknotes. Interest rates were not regarded as the key instrument that they are today. Banks held their rates constant for years or even decades. Policy generally concerned loans to be granted, or the volume of bills of exchange to be discounted, and the security demanded.

This was also the state of affairs up to the 1850s in Russia, Sweden and Finland. Bank of Finland operations in this period reveal mostly Russian and Swedish influences. When the lending rate of Russia's State Loan Bank was changed in 1857, it was apparently for the first time in the bank's 70-year-long history.²⁹⁹ In Sweden too, no true interest rate policy was practiced before the 1850s. The National Discount Office, which served as the discounting department of the national bank in Sweden, applied a steady 6 percent discount rate from the day it was established in 1800 until 1824, when the rate was lowered to 5 percent. It was not touched again until the start of 1858 when it was raised back to 6 percent.³⁰⁰

The transition of an increasing number of central banks to active use of interest rates as an instrument of monetary policy began with England. The need for responsive interest rates had first been observed at the time of the Napoleonic Wars, when Britain was forced off the gold standard and onto fiat money. The Bullion Committee, set up to study monetary problems, observed in 1810 that the laws on usury made monetary policy hard to pursue. It found that the maximum permitted interest rate – 5 percent – was insufficient under those conditions to choke off demand for credit. If the bank had been able to charge a higher rate it would, in the committee's view, have been able to restrict lending more easily and thus control growth in the amount of paper money, a measure that the committee regarded as essential for maintaining the value of money.³⁰¹

The recommendations of the bullion committee were rejected by England's parliament without further ado and its observations had no immediate impact, but a policy on interest rates began to emerge in 1821 when Britain went back on the gold standard. In 1833 the law of the land was changed at the Bank of England's request so that the 5 percent interest rate ceiling otherwise in effect would no longer apply to the discounting of three-month or shorter bills of exchange. Since



■ The Bank of England was the exemplar of world central banks in the 19th century. – Thomas Shutter Boys, lithograph, 1842.
Private Collection/ The Stapleton Collection/ Bridgeman Images.

the Bank of England did not discount any bills longer than three months, the change eliminated the legal obstacles to the development of an active policy on interest rates.³⁰² Subsequently interest rates became a more important element in monetary policy and quantitative lending restrictions were de-emphasised. This was to be crucial for the development of the British banking system. When a bank was certain of being able to convert a portfolio of bills of exchange into money at the Bank of England, its liquidity was enhanced and it no longer needed to keep large reserves in a liquid, unproductive form such as deposits or banknotes. Rediscountable (“eligible”) bills of exchange became a bank’s secondary reserve.³⁰³

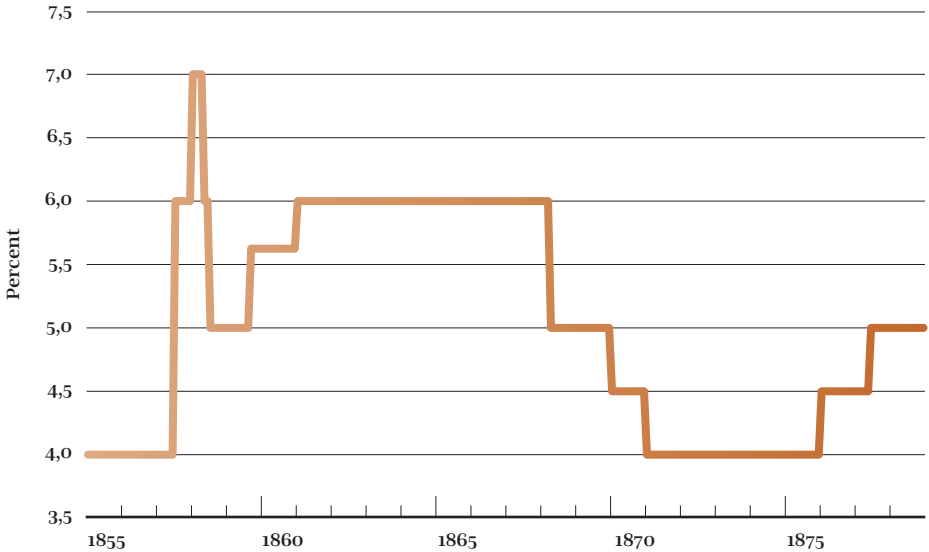
This new mode of Bank of England operations became prominent in the next international money market crisis of 1847. A panic led to a steep increase in the demand for cash, which in turn meant that the demand for credit from the Bank of England exceeded the amount allowed by its cover regulations. With the viability of the banking system under threat, the government granted the bank permission to continue lending, promising to grant it retroactive exemption from legal regulations if this were to become necessary. Because of the desire to avoid quantitative credit restrictions, the role of interest rates was reinforced and the rate was raised for a few weeks in October 1847 to 8 percent, the highest level in the bank’s history.³⁰⁴

It is a mark of the Bank of England’s more active stance on interest rates that it changed its discount rate 142 times between 1847 and 1866, on average more than seven times a year. This was a clear departure from previously rigid rates. The new policy was recognised publicly in 1857 when deputy governor Neave told a committee of the House of Commons that directors of the bank “look mainly to the raising of the rate of interest as the mode of protecting the bullion”.³⁰⁵

In 1857, during another panic, the Banque de France was forced to raise its discount rate to a record 8 percent to protect its reserves. Only a little earlier the French central bank had been exempted from the 6 percent interest rate ceiling set by the law on usury.³⁰⁶ Following the removal of this restriction, the Banque de France began to pursue active interest rate policies similarly to those of the Bank of England, although its rate changes were fewer.

Sweden’s bank council was given the right to set the discount rate, previously determined by parliament, in November 1856.³⁰⁷ This laid

**BANK OF FINLAND DISCOUNT RATE
BEFORE THE GOLD STANDARD 1855-1878**



Source: Bank of Finland.

the way for adopting a modern policy on interest rates, although Sweden did not do so until the 1860s. The active use of interest rates in monetary policy was not possible before the discounting of bills of exchange had been accepted as a permanent part of the operations of the Bank of the Estates. This precondition was met in 1863, when the Swedish parliament decided to make the Bank Discount Office, which had been formally a separate institution, into a department of the national bank.³⁰⁸ In the years ahead short-term acceptance credit became the main form of credit granted by the bank, in line with the classical central banking model. The active use of interest rates had traditionally been limited by legislation on usury, which forbade rates above 6 percent. This law, which admittedly was sometimes ignored, was not overturned until 1864. In 1866 the Bank of the Estates of the Realm raised its discount rate for the first time above the old 6 percent ceiling to 7 percent.³⁰⁹

The financial panic of 1857 had a potent effect not merely by forging international monetary policy in the great financial centres of Europe but also more directly for Finland. The consequent collapse in the rouble exchange rate – the rouble had gone off the silver standard a few years earlier during the Crimean War – marked the start of efforts to return Finland to the silver standard. If necessary, Finland was ready to do this independently of Russia, a posture which culminated in the creation of the Finnish markka. The same panic led – via a decline in confidence in the rouble – to an outright crisis in Russia's old state banking system, its collapse and ultimately the establishment of the Russian State Bank in 1860.

Although the “interest rate weapon” had, by the 1850s, clearly become the main tool of monetary policy at the pioneering Bank of England, and although the Bank changed its interest rates very frequently in the second half of the 19th century (in 1873 by a record 23 times), it was being responsive rather than proactive. The philosophy of the age was that the bank should seek to apply the interest rate that was “natural” for the period in question and thus respond to the state of the market.

R.G. Hawtrey states that, until as late as the 1890s, the interest rate applied by the Bank of England was a fairly involuntary reaction to variations in banknote cover and the number of banknotes. If the bank lost gold or if the volume of notes in circulation increased, money market liquidity was reduced and individual banks were compelled to obtain credit by rediscounting their customers' bills of exchange (i.e. by offering them for purchase by the Bank of England). When the bank increased its interest rate under these conditions, it at least appeared to be merely following the market.³¹⁰

The Bank of Finland began to use the interest rate more actively in the 1850s. In July 1857 it raised its discount rate for the first time, then to 6 percent because of disturbances caused by the Crimean War and the international economic panic.³¹¹ This coincided with similar activity in other countries that had close influence on the Finnish economy.

PEEL'S BANK ACT AND THE PRINCIPLES OF BANKNOTE ISSUE

Beyond interest rates, the early decades of the 19th century saw further significant international development in the lending and reserve policies deemed suitable for a bank of issue. In this matter too, England's example proved the determining one over time.

The leadership of the Bank of England had previously held the view that lending could not create an excessive supply of money. It was thought that the amount of money responded to demand, so any excess banknotes would immediately flow back to the bank.³¹² But the panic of 1825, during which the Bank of England was barely able to maintain the convertibility of its banknotes into gold, and needed to borrow from the Banque de France to do so, showed that, under the gold standard, the issue of banknotes could indeed be excessive and jeopardise their convertibility. For sustainable convertibility a policy on lending was required that would maintain the bank's reserves (its stock of gold) at an adequate level over both the short and long term.³¹³

The crisis initiated a renowned policy dispute, "the currency contra banking" controversy, which was resolved by the start of the 1840s when the currency principle became monetary policy orthodoxy. The principle is associated with David Ricardo, who had laid out its precepts in his works *Proposals for an Economical and Secure Currency* (1816) and *Plan for the Establishment of a National Bank* (1824).

The currency principle was both a theory and a policy doctrine. On a theoretical level it was founded on a simple quantity theory of money and the effect on the international balance of payments of the movement of gold. This held that monetary stability would be constant and self-correcting if a bank of issue (or banks of issue) were to act so that the monetary system mimicked a purely metal system, i.e. one in which gold or silver were the actual medium of payment. Banknotes were of course more practical than metal money for actual transactions but, to ensure that the monetary system operated naturally, the issue of banknotes should not be allowed to influence the quantity of money. Notes were merely "stand-ins" for gold. This state of affairs would be achieved if banknotes were covered 100 percent by reserves of gold or at least if changes in the reserves of the issuing bank were proportionally and exactly reflected in the volume of banknotes. The doctrine

contained the notion that only metallic coins and banknotes were money. For example, bank deposits, even those at the Bank of England, were not treated by the theory as money.³¹⁴

The framework within which the Bank of England operated was revised by the Bank Charter Act of Sir Robert Peel in 1844. It was based on the principles advanced by the currency school, which sought to make the operations of a bank of issue mechanical, so that despite the use of banknotes, it would operate as if gold were the currency. This was achievable by tying the volume of banknotes to the bank's metal reserves. Peel's Act divided the Bank of England into two departments, an issue department and a banking department. The former was responsible for putting banknotes into circulation and for their cover. Its banknotes were to have full metal cover apart from a fixed amount, a quota that could be covered by bills of exchange. The quota was the only credit that the issue department was allowed to grant and it had to remain unchanged regardless of conditions in the money market. This mechanism was intended to maintain the important currency school principle that changes in the volume of banknotes would exactly match changes in gold reserves. It would protect the value of money and also ensure balance in the nation's payments account, because there could be no inflation nor flight of money abroad if the central bank was forbidden by law to finance these.

Meanwhile, the banking department of the Bank of England operated like a normal banking establishment. It granted acceptance credit from the funds that it obtained from the public as deposits and from the quota of the issue department. Moreover it had its primary capital which, under the terms of its charter, was invested in a long-term loan to the state.³¹⁵

However financial market panics in 1847, 1857 and 1866 demonstrated that it was impossible to adhere to the parts of Peel's Bank Act that restricted central bank lending. To protect the functioning of the London money market and ultimately the whole economy, the Bank of England broke the legal banknote cover regulations and granted credit against Exchequer bills. At the same time as it (and consequently other central banks) began to assume the role of the lender of last resort, the role of interest rates increased. The interest rate was needed to regulate the bank's lending and the volume of banknotes at times when restrictions on the quantity of lending would be impracticable,

because the liquidity of the whole banking sector was dependent on credit from the bank of issue.³¹⁶

But regardless of the fact that Britain repeatedly had to deviate from the principles of Peel's Bank Act in times of crisis, this system became the international model and benchmark for operations of banks of issue. Many other countries, including Finland, moved from a system of partial banknote cover to quota-based cover regulations in the second half of the 19th century. It is interesting that Sweden, which was so often a pioneer in developing and experimenting with monetary policy, moved to a quota-based banknote system independently of Britain. Interestingly, too, this was because of the financial crisis caused by Finland's monetary reform at the start of the 1840s.

MONETARY CONSEQUENCES OF THE CRIMEAN WAR

RUSSIA'S STRUCTURAL WEAKNESSES REVEALED

The Crimean War was a major turning point in Russian history in many respects, and imposed serious financial strains on the national budget and monetary system. In addition to the cost of military engagements, the war had damaging effects on Russia's foreign trade and customs revenue, because its new adversary, Britain, had hitherto been its most important partner in foreign trade. The state budget was deeply in deficit in 1854–56 and redemption of banknotes for silver had to be curtailed. In the short term, the monetary effects were not major, the rouble exchange rate did not weaken much, and there was no need to suspend the silver convertibility of credit notes officially, but the war greatly boosted the amount of money in circulation and weakened Russian banks in a way that later proved fateful for the banking and monetary system at the end of the 1850s.

The war lasted nearly two years. Already tense relations between Turkey and Russia reached crisis point in May 1853 when Tsar Nicholas I sent Turkey an ultimatum about the status of Orthodox Christians in the Ottoman Empire. In summer the Russian army invaded the Danubian principalities of Wallachia and Moldavia, which were under Turkish suzerainty, and on 30 November Russia destroyed the Turkish fleet in port at Sinop on the northern Turkish coast. Britain and France then came to Turkey's aid and declared war on Russia on 28 March



■ In the wake of the Crimean War, the rouble was forced off the silver standard. The theatre of the war extended as far as the Gulf of Finland. In August 1855 the Anglo-French fleet bombarded the fortress of Viapori in Helsinki. – Louis Lebreton, oil on canvas, 1856, colour lithograph, Bibliothèque nationale, Paris. Archives Charmet/ **Bridgeman** Images.

1854. At the end of March, there were landings by allied troops in the Balkans and in May the allied fleet bombarded Odessa. The British-French fleet also operated off the coast of Finland, and in August 1854 received the surrender of the fortress of Bomarsund in the Åland Islands. In September the allies landed in the Crimean Peninsula and laid siege to the city of Sebastopol. At the end of January 1855, the kingdom of Sardinia joined the war alongside Britain and France.

Tsar Nicholas I died at the start of March and his son Alexander II became the Emperor of Russia. Following Austria's threat in the summer to declare war on Russia, Russian forces withdrew from the principalities of Wallachia and Moldavia, which Austria then occupied. Hostilities were renewed in the Baltic and the British-French fleet bombarded Helsinki's sea fortress of Sveaborg on 9–11 August. In Crimea, Sebastopol succumbed to the allies' long siege in September 1855, the final sign that Russia was spent. After an ultimatum from Austria in December, Russia sued for peace.³¹⁷ An armistice began on 29 February 1856 and the Treaty of Paris was signed at the end of March.

Although there was no clear victor in the Crimean War, its consequences were catastrophic for Russia, both economically and politically. Historians generally take the view that the war exposed the country as far weaker than the Russians themselves had imagined during the reign of Nicholas I, and showed that far-reaching modernisation was necessary. In this way the war touched off the many economic and political reforms that were begun under Tsar Alexander II, such as the emancipation of serfs and the start of Diet sessions in Finland.³¹⁸

The Russian government financed a large part of its military effort by increasing the number of credit notes. Their volume shot up in January 1855 when the State Credit Note Bureau of the Finance Ministry was granted the right to issue unbacked notes. According to the statute, the notes were to be redeemed within three years of the end of the war but this did not happen. In 1856 their redemption in silver was entirely halted following the failure of administrative measures intended to hinder redemption.³¹⁹ Yet despite the increase in money supply and restrictions on silver convertibility, the rouble exchange rate, which had slipped during the war, returned to almost its normal level when the war ended.³²⁰

The surprising strength of the rouble lasted for about 18 months after the end of the war. Zieliński believes it is explained by government measures to support the rouble and by the fact that the international payments account was strong during the international economic upturn prevailing after the war. Nonetheless the economy still contained excess liquidity because of the great number of credit notes in circulation and Finance Minister Brok was entirely unsuccessful in his handling of the situation. In February 1857 the Ministry tried to restore convertibility of credit notes and to fix the rouble exchange rate but redemption had to be discontinued in May of the same year. So many notes were presented for redemption that silver reserves were inadequate.³²¹

The growth in liquidity showed in deposits with the state banks, which were unable to find enough productive investments for the funds deposited. Cash reserves rose steeply but still the government failed to act to neutralise excess liquidity, for example by issuing bonds. Instead it decided in June 1857 to reduce the deposit and loan interest rates of banks in the hope that this would push deposited funds back into circulation. The deposit rate was lowered from 4 to 3 percent and interest on all loans from 5 to 4 percent.³²² This rate cut has been seen as sealing the fate of the Russian monetary system because of the damage to the banks and its inflationary effect.

RUSSIA'S MONETARY AND BANKING CRISIS

A worldwide financial panic, described as the first real global economic crisis in history, struck in autumn 1857. It began in the United States and spread to Britain, where the Bank of England was compelled to interrupt the redemption of its banknotes for gold. In November 1857 the bank raised its discount rate briefly to the unprecedented level of 10 percent. From Britain the crisis spread to Paris, Hamburg and other financial centres. A large number of banking houses around the world became insolvent, at least temporarily, and the revered Hamburger Bank suffered damage from which did not recover.³²³ In Sweden the Bank of the Estates of the Realm was forced to arrange extraordinary financing that was in breach of its own regulations, in order to prevent trading houses in Stockholm from becoming insolvent.³²⁴ The 1857

panic is generally linked to a bottoming out of money market speculation that had continued since the Crimean War, although causes in the real economy have also been proposed.³²⁵

The international financial panic of autumn 1857 destroyed Russia's chances of returning to the silver standard for many years. In November the rouble slumped on currency markets by about 10 percent and the value of the credit note also weakened significantly against the silver rouble. In spring 1858 there was a run on Russian deposit banks and in April the government froze all lending against real estate and forbade the rescheduling of existing loans. The condition of the banks proved untenable and the newly appointed finance minister Aleksandr Knyazhevich established a committee to prepare reforms of the banking system. It was composed of young liberal reformers such as Nikolai Bunge, Evgeny Lamansky and Mikhail von Reutern.³²⁶ Of these Reutern and Bunge subsequently served as finance ministers while Lamansky became governor of the national bank.

Russia tackled the banking crisis by dissolving its existing banking institutions and establishing a new bank of issue, the State Bank of the Russian Empire. Before the reform the largest possible share of private deposits in the banks was converted into long bonds. The first bond issue, offering four percent interest, was not a popular success. However the issue in September 1859 of 37-year bonds yielding five percent succeeded in converting a significant proportion of deposits that were redeemable on demand into long-term bonds, although admittedly at a very expensive price compared with the prevailing interest rate on loans.³²⁷ As a consequence of bond subscriptions, deposits with the banks fell by two thirds during 1859, from 967 million roubles to only 328 million.³²⁸ Russia's banking system was being dismantled at exactly the same time as the government was preparing its land reform, aimed at ending serfdom. The land reform was also undermining the system of collateral, based on the mortgaging of serfs, by which the State Loan Bank had operated.

A manifesto on the reform of the banking system and the establishment of the new State Bank was issued at the turn of June 1860. The State Commercial Bank and its offices became the Russian State Bank. The manifesto terminated the other state banking institutions, meaning the State Loan Bank, which had provided agricultural credit, and the Credit Note Bureau of the Finance Ministry,

which had issued banknotes and was the successor of the old Assignat Bank. Their liabilities and assets were transferred to the Russian State Bank, which began operating in June 1861.

According to its statutes, loans to private individuals by the Russian State Bank could be short-term only. It could provide credit by issuing bills of exchange up to six months, by discounting state or local government securities or by granting Lombard credit against security in precious metals, securities or merchandise. It could accept deposits and could trade in precious metals and securities. The fact that it was restricted to short-term credit was a major change in principle because, as Zieliński points out, 90 percent of the (private) lending of the preceding state credit institutions had consisted of long-term agricultural loans by the State Loan Bank.³²⁹

In practice, though, the new banking system was not very different in all respects. The Russian State Bank, as the successor to the Credit Note Bureau, was required to issue extra credit notes at any time upon the demand of the Finance Ministry and its metal reserves were at the government's disposal. The bank could not issue banknotes (credit notes) on its own behalf but only at the order of the Finance Ministry.³³⁰ The system remained the same until Russia adopted the gold standard at the end of the 1890, at which time the State Bank gained some independence.

Its surpluses were to be used by the state, particularly for reducing government debt. To compensate for its lack of independence, the state guaranteed the bank's solvency and gave it the necessary operating funds, such as its 15 million roubles of founding capital. Continuity with respect to the previous system also meant that a large part of the operations of the State Bank was quite unrelated to private sector business, and consisted of managing state debts and payments. In practice much of its lending was also to the state.

RUSSIA FAILS TO RETURN TO SILVER STANDARD

In November 1861 Evgeny Lamansky, then the deputy governor of the Russian State Bank and later its governor, presented Finance Minister Knyazhevich with proposals to restore silver convertibility of the rouble.³³¹ Like Ksawery Drucki-Lubecki's plan for the previous monetary reform in 1837, Lamansky's proposals were founded on the financial plan of Mikhail Speransky from 1810.

Lamansky proposed that the State Bank should be reorganised as a private limited company and made independent of the Finance Ministry. Silver and gold reserves should be transferred from the government to the control of the reformed State Bank, along with 400 million roubles-worth of government bonds and state property. The State Bank was to become a bank of issue operating on the same principles as the central banks of western European countries.

Mikhail von Reutern, who took over the post of Finance Minister in January 1862 soon after Lamansky presented his plan, did not pursue it. Instead he sought to restore the convertibility of the rouble with the aid of foreign borrowing and without changing the status of the central bank. Reutern's stabilisation programme commenced with a statute of 25 April, which ordered the State Bank to begin redemption of notes with silver and gold, either coin or bars, at the rate of 560 kopecks per half-imperial (5 gold roubles) and 108.5 kopecks per silver rouble. The silver and gold rates were to be reduced gradually until official parity was reached.

In 1862 the Russian government took a loan of 15 million pounds from European capital markets, arranged by the Rothschild banking

houses in London and Paris. The loan was intended to supply the reserves with which the State Bank could begin redeeming credit notes for silver. It provided the government with currency worth about 94 million roubles but only 44 million were used to increase reserves. At the start of 1862, reserves were 80 million roubles while notes in circulation were worth 714 million; at the end of the year, reserves had been boosted to about 120 million but were still less than a fifth of the value of notes. Such modest cover was obviously not enough to restore convertibility and confidence in the rouble was weak. Over the year there was a flight of currency from Russia by the net amount of 34 million roubles.³³²

At the time that Reutern's programme was announced at the start of May, the rate for a silver rouble was 110.5 kopeks in credit notes. Under the plan the value of credit notes was to be raised by half a kopek each month, so that the rate would reach 106 kopeks at the start of 1863 and parity (one silver rouble equal to 100 credit note kopeks) would be achieved at the start of 1864. To carry out the plan Reutern negotiated a loan from the Rothschilds in spring 1862, after which the government had 169 million roubles in metal reserves at its disposal, to back and redeem credit notes. As the operation began, credit notes in circulation were 691 million roubles so, including the Rothschild's loan, metal reserves available were equivalent to about a quarter of the notes in circulation.

The operation proceeded according to plan until November 1862, when redemptions had depleted currency reserves by only 12 million roubles. In January 1863 came the Polish Uprising, which took nearly one and a half years and, by some calculations, 72 million roubles to quell. Russia's exports were also hard-hit by the Polish problem. The foreign trade deficit, which had to be settled in gold or silver, was about 66 million roubles in 1863.³³³

Under these conditions, more foreign borrowing was needed to continue the plan to restore convertibility. In spring 1863 the Rothschilds agreed to arrange a new loan but in September they changed their minds and now refused to participate. During 1863 confidence in the viability of the monetary reform steadily weakened, but the government continued to support the rouble, with the aid of funds created by the Finance Ministry by issuing bills of exchange. By the end of 1863 Russian currency reserves, which had been 120 million roubles when the operation began, were now reduced to 55 million.

MIKHAIL VON REUTERN (1820–1890)

For Finland, the two most important monetary decisions of the 19th century were to return to the silver standard in 1865 and to move to the gold standard in 1878. These reforms laid the way for stronger economic autonomy and neither could have been undertaken without the approval of the Russian government. In both cases instrumental support was provided by Russia's Finance minister Mikhail von Reutern.

Descended from Baltic German nobility, Reutern had been recruited in the early 1850s by Grand Duke Konstantin, the brother of Tsar Alexander II, to head the Admiralty. Liberal Konstantin put together a young team of like-minded administrators at the Admiralty, which became the incubator for Russian modernisation. They looked to the west for reform models and Reutern, too, made a three-year study trip to Prussia, France, Britain and the United States, where he examined systems of government and budgeting.

After returning from this wide-ranging tour he was appointed secretary of state in 1858 and soon won his economic spurs on the railway committee. Throughout his career, he regarded railway construction as vital for Russia's economic development. He was also a member of the important commission that planned the overhaul of the crisis-stricken banking system and the establishment of the Russian State Bank, which was done in 1860. In

1862, Alexander II appointed Reutern as his Finance minister, charged with reshaping the Empire's public finances.

Mikhail von Reutern was therefore the counterpart of J. V. Snellman, the head of the Financial department of the Finnish Senate, in the negotiations in St. Petersburg in 1863 and 1864 about Finland's return to the silver standard. Perhaps because of his Baltic German background, Reutern was favourably disposed to the autonomy of special territories of the Russian Empire. For him, Finland represented a model system of government, from which Russia had much to learn. On these grounds he argued first that Finland should be allowed to go on the silver standard and later for its move to the gold standard. This is borne out by a memorandum he sent to the Russian finance committee debating Finland's move to the gold standard in 1877. Its unreserved support for the move is regarded as the key reason for the committee's favourable verdict. In supporting Finland Reutern was even ready to defy the ultranationalism that was rising in Russia at the time.

He resigned from the finance ministry in 1878 after the war with Turkey, which he had opposed and which had wrecked Russian public finances. In 1882 Alexander III recalled him to duty as chairman of the Russian Council of Ministers. He filled the post until his resignation in 1887 because of failing eyesight.

A sepia-toned portrait of Mikhail von Reutern, an elderly man with a full white beard and mustache, wearing round-rimmed spectacles and a dark, high-collared coat. The portrait is set against a light, textured background.

■ Mikhail von Reutern, who served as Russia's Finance minister in 1862–1878, lent his support to Finland's monetary reforms.
– Bank of Finland.

GRAF MICHAEL REUTERN

In October 1863, a sternly worded speech on the Polish situation by Napoleon III of France led to speculation that Britain, France and Austria would declare war on Russia because of its heavy-handed treatment of the Poles. This caused panic on the St. Petersburg Exchange, where short-term interest rates rose from 3 percent to 7 percent. On European markets the value of Russian bonds dropped steeply. Amid this crisis Reutern concluded that Russia's entire metal reserves would soon be exhausted unless the redemption of notes was stopped. On 5 November 1863 the Russian state bank announced that "with imperial consent, the redemption of credit notes at the State Bank is terminated until further notice". The Tsar wrote in the margins of the papers presented to him: "there is no alternative but I am greatly saddened". The silver standard project was now dead and buried.³³⁴

The collapse of Russia's plan to return to the silver standard had far-reaching consequences for Finland. Three years earlier the Finnish markka had been defined as worth a quarter of a rouble. If Russia had succeeded in its effort to stabilise the rouble by the start of 1864, the Finns would not have needed to forge ahead with their own national silver standard reform in the years to come. The markka would have become a mere sub-unit of the silver rouble, much as the Polish zloty had been at the start of the 19th century. It is clear that the separateness of Finland's monetary system from Russia's would have remained only superficial and it is very questionable whether Finland could have implemented its own separate gold standard, as it did in 1878. The failure of rouble stabilisation in 1863 was therefore perhaps the single most important factor that, over the decades ahead, drove a wedge ever deeper between the monetary systems and economic lives of Finland and Russia.

The rouble crisis of 1863 was also a turning point for Russia because it had the practical result of postponing plans for a return to the silver standard indefinitely. In 1866 Reutern wrote to the tsar that, under current conditions, he regarded it as impossible to restore the value of the rouble, at least within the next few years, and called for the acceptance of this reality. At the same time, however, he believed that the government could and should strive "to give a solid footing to the money circulation".³³⁵

Finance Minister Reutern saw the rouble exchange rate principally as being determined by the balance of payments and not from the

monetary perspective, which he rejected, at least in its strictest bullionist form. The setting of an exchange rate was not, in his view, simply a monetary policy question but one of broader economic policy. He emphasised the control of government expenditure and the promotion of exports as ways to support the value of the rouble. In Reutern's view the main way to stabilise the currency was to encourage exports and this in turn was crucially dependent on the construction of railways from the productive areas of the Empire to its coasts and borders: "In the railway lies not only the future of our currency and exchange rate but our entire economic development and finances, in fact the future relevance of the Russian state in general".³³⁶ In emphasising the importance of railways Reutern's views paralleled those of J. V. Snellman in Finland. Both saw rail as infrastructure in the service of exports and not, for example, as a military institution. This latter aspect of the railway had considerable support in Russia because of experiences in the Crimean War.

TOWARDS MONETARY REFORM IN FINLAND

EN ROUTE TO A NATIONAL MARKKA

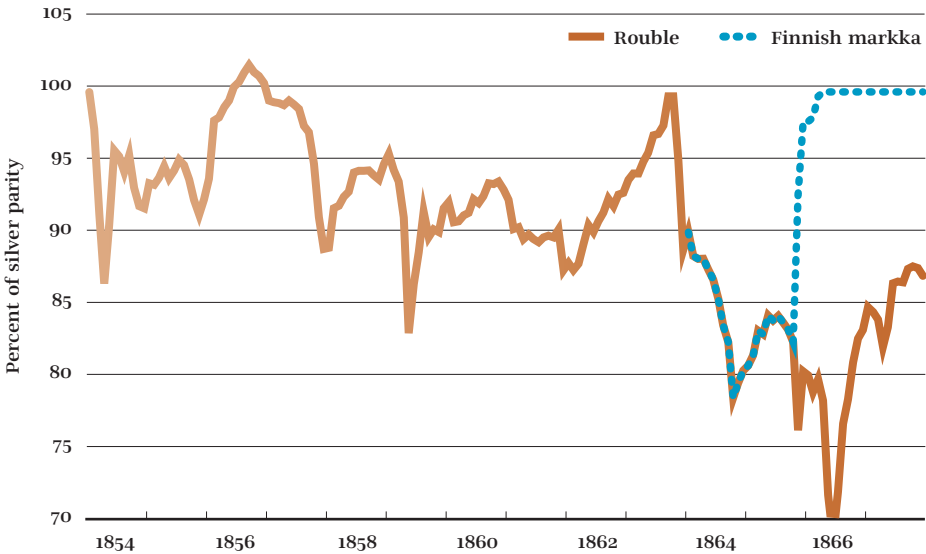
Although Finland had enjoyed a metal standard for little more than a decade after the monetary reform of 1840, there was strong faith that it would bring stability and, as soon as the Crimean War was over, Finnish minds turned again to the silver standard. As noted previously, preparations for a return to silver were under way in Russia, so the chances of rapid progress seemed good. There was still nothing in Finnish plans at this point that hints at an attempt to disengage from the Russian monetary system. In 1857, however, the situation changed rapidly when a financial panic originating in the United States extended its grip over Europe. The exchange rate for the paper rouble turned down once more and the value of Bank of Finland banknotes naturally followed suit. This made monetary stability an even more important issue.

From Finland's perspective the key question was the status of the Russian paper rouble as legal tender, which it had been since the reform of 1840. As long as Russian credit notes were legitimate means of payment in Finland, the Bank of Finland was required to accept them at their nominal value, as it did its own notes. This stopped Finland going on the silver standard separately; if it had tried to, the Bank of Finland would have been obliged to use its own silver reserves to redeem not only its own banknotes but also notes issued by Russia's Credit Note Bureau, which was a practical impossibility. The market value of the paper rouble had fallen so low that the opportunity for

redeeming the notes of the whole Empire in silver at the official rate would quickly have emptied the Bank of Finland's coffers.

The question of stability in the monetary system was related to the broad economic and social reforms that were initiated around the same time, the end of the 1850s. One target for modernisation was the structure of Finland's banking system. In the liberal spirit of the age, an open debate had begun in Finland about the possibilities for establishing private banks alongside the state bank. The government's monopoly in banking was no longer regarded as axiomatic and inevitable. However it was seen as a precondition for private banks that the value of money should first be fixed to the silver standard. Under conditions of monetary instability, the public would not be willing to risk investing the necessary equity capital in private commercial banks. Changes in Finland's political leadership were another sign of the emergence of liberal trends. The old grey eminence von Haartman had been displaced in 1858 and Fabian Langenskiöld had succeeded him as

EXCHANGE RATE AGAINST THE HAMBURG SILVER MARK 1854-1867



Source: Björkqvist, H., 1968.

head of the Senate's Financial department. A few years earlier Count Friedrich W. Berg, a reformist from Estland, had become Governor general.³³⁷

Monetary stability was desired not merely to allow the financial system to be restructured. An acute problem was that silver coinage was disappearing from circulation. A fall in the exchange rate between the paper and silver rouble had created a situation where the metallic value of silver coinage was greater than its nominal value so it had begun to be hoarded. A chronic shortage of change had become a problem for the economy. The trouble was well understood and, thanks to the new and more open atmosphere in society under Alexander II, matters were no longer confined behind the closed doors of the Senate. An example of openness was a petition, drawn up by some of the most influential businessmen of Turku and Helsinki and sent to the Senate in 1859, proposing a change in the law to make silver coin of a defined weight and purity the only legal tender in Finland. The board of management of the Bank of Finland had sent a similar letter to the Senate.³³⁸

The matter was raised in a Senate meeting on 1 December 1859, at which members said that the current monetary situation could not be allowed to continue. Fluctuations in the value of paper money had created uncertainty about the inviolability of property rights, had caused public insecurity and loss of faith in the future, and had stifled enterprise. In the Senate's view the Bank of Finland would be in an untenable position as long as it was compelled to use its own modest metal reserves to answer for Russian banknotes too and, worse still, at their nominal value. The Senate saw the only solution as a change in the law to make Russian paper money valid in Finland at its market value only, as set on the St. Petersburg Exchange. A return to the silver standard would also solve the shortage of good coin automatically, because Russian token money would no longer flow into Finland. The shortage of change also presented a natural opportunity to suggest that Finland should adopt a smaller monetary unit than the rouble.³³⁹

The Senate's proposal for this change in the law was sent to St. Petersburg for the Emperor's approval in January 1860 but the response was negative. The explanation hinted that the measure requested by the Senate of Finland would have a disruptive effect on the validity of paper money in use in the Empire. Quite obviously it was thought to

be in conflict with the currency manifesto published in Russia in 1840. Even so, there was understanding in St. Petersburg for the problems caused by the disappearance of change and the Bank of Finland was allowed to exchange 50 000 silver roubles of Russian state credit notes for new silver roubles each year. At the same time, it was granted the right to issue copper coins as small change.³⁴⁰

But the most historically significant concession was that the Senate was offered the opportunity to adopt a smaller monetary unit in Finland, fixed in its relation to the silver rouble. Finland seized this opportunity. The matter was first discussed by the board of the Bank of Finland, which took the view that the new smaller monetary unit would be ideal for Finland's modest economy. There were also hopes that it would lead to a reduction in the price level because it would make pricing easier. The board proposed that the new unit should be called the "mark" and that its subunit should be the "osa", meaning "part". The mark would be a quarter of a silver rouble and would be divided on decimal principles into a hundred parts.

The Senate re-examined the name of Finland's money, deciding to use the Finnish "markka" in place of "mark" and "penni" instead of "osa". Mark was an old European measure of weight for precious metals and a monetary unit that had been in use in Finland and Sweden from mediaeval times until the 18th century. Penni stemmed from the Finnish word "pieni" meaning "small". Other proposals were also heard in the Senate and some of them suggested a return to old names of Swedish origin, like taaleri (daler) and äyri (öre) but an absolute majority was in favour of markka and penni.³⁴¹

The Senate's proposal for a new markka as a subunit of the rouble was accepted in St. Petersburg and a proclamation on the subject was issued on 4 April 1860. From the start of 1863 the markka was to replace the rouble not only in all state accounts but also in private transactions in Finland.

In his history of the Bank of Finland, Hugo E. Pipping considers how far acquiring a national currency was part of a deliberate endeavour to distance Finland from the Russian monetary system. It is difficult to give a definitive answer. The solution was explicitly determined in St. Petersburg, where at least one motive was to pacify public opinion in Finland at a time when Russia was rejecting more far-reaching Finnish proposals to make silver money the only legal

tender and thereby restrict the validity of inconvertible paper money. Among Finnish figures of influence, Ministerial State Secretary Alexander Armfelt played a part in securing a national unit of currency for Finland, as Osmo Jussila notes in his study. On the Russian side, an active role was taken by Governor general Platon Ivanovich Rokossovsky, who served as a conduit in St. Petersburg for most matters concerning Finland at this time. In other respects, Rokossovsky was critical of Finland's efforts to disengage from the Russian monetary system. On the basis of available material, it would therefore appear that this was not part of a conscious policy of monetary disengagement.³⁴²

IN TANDEM WITH RUSSIA

The tsar's refusal did not put an end to Finnish aspirations to return to the silver standard, and new initiatives were set in motion. At the start of 1861 a committee preparing the establishment of the Mortgage Society of Finland and a private commercial bank had sent a proposal to Governor general Berg suggesting that "contracts based on silver should be executed in silver, meaning that only silver coin of a regulated purity would be legal tender in Finland". Governor general Berg, together with Fabian Langenskiöld, head of the Senate Financial department, forwarded this proposal to St. Petersburg, but the response was negative. According to Russia's financial committee, the change would have meant that rouble credit notes would cease to be valid in Finland and would thereby have caused a more widespread loss of confidence in the value of the rouble. The financial committee proposed instead that execution of contracts denominated in markka would be according to its external exchange rate.³⁴³

Langenskiöld regarded this as such an important principle that he transferred it to a broad committee consisting of leading figures of societal influence, chaired by Johan Philip Palmén, a professor of jurisprudence. The committee's report, issued in spring 1861, rejected the model proposed. It noted that payment according to a rate of exchange would be difficult in practice and would lead to disputes. It reiterated that the only viable solution was for the Bank of Finland to move to the silver standard and that metallic money should be decreed the only legal tender in Finland. The Senate concurred, so the proposal from St. Petersburg regarding payment according to the rate of exchange lapsed.³⁴⁴

It was around this time that publicity and public opinion began to gain significance in Finnish politics. A relaxation of the censor's grip was one sign of the new and more liberal conditions. To hasten the move to the silver standard, a mass petition of 2180 signatures was now sent to the Emperor. Its content had been drawn up by Henrik Borgström Junior, who had a close relationship with Langenskiöld of the Financial department, and the text echoed the committee report described above. The delegation consisted of such elite members of Finnish society as Henrik Borgström Senior, Carl Magnus Dahlström and J.F. Hackman, all commercial councillors, as well as Count August Armfelt and freehold farmer Nils Kosonen. However, such public manifestations were alien to Russia's culture of government and the tsar refused to receive them officially, although he did meet their representatives unofficially.³⁴⁵

Despite the negative response to this petition, the Senate under Langenskiöld's leadership persevered. Yet another proposal was sent to St. Petersburg arguing for a metal standard and silver coin as legal tender. There was even a programme and schedule for the reform attached to the proposal. The appendix had nominally been drawn up by Langenskiöld but he had been advised by Henrik Borgström Junior. According to the programme (a) the Bank of Finland should set its own rate of exchange as soon as the reform statute was published. (b) Bank of Finland banknotes would be legal tender until the start of 1863 and after that Russian notes would cease to be a valid means of payment in Finland. (c) The Bank of Finland would exchange all its rouble notes for markka notes. (d) Payments in silver would commence at the Bank of Finland at the start of 1863. (e) From the same date, Bank of Finland banknotes would be replaced as legal tender by coins of real value, meaning silver coins denominated in markkaa, Russian metal roubles, Swedish silver riksdaler and French metal francs. On that date too, all state accounts would be re-denominated in markkaa and all government bearer bonds would be converted into long-term amortisation loans.³⁴⁶

The proposal had received the tacit approval of Governor general Rokossovsky, recently appointed in Berg's place, who had promised not to oppose it. This was a significant concession because Rokossovsky, working in St. Petersburg before his appointment, had actively criticised Finnish plans. In support of the proposal, it was stated that the reform



■ A period of liberal reforms began at the end of the 1850s. Fabian Langenskiöld, head of the Senate's Financial department, played an important role in implementing them. Board of Antiquities / Julius Steffen.

FABIAN LANGENSKIÖLD (1810–1863)

Fabian Langenskiöld majored in mathematics at Helsinki University and even wrote a mathematical textbook in Swedish “The study of logarithms with elements of plane trigonometry” (1838). However his working career began as a teacher of Russian, in which he was aided by his long years of study in Russia. In the early 1840s he was engaged by the Senate as a translator. It was the start of a buoyant official career, during which he worked at the Office of the Ministerial State Secretary for Finland in St. Petersburg and served as governor of various Finnish provinces. In 1853 he was appointed to chair a committee into public finances, established in the wake of criticism of the head of the Senate’s Financial department L.G. von Haartman. When Haartman was ultimately forced to resign, Langenskiöld succeeded him in 1858. Still under 50, he had blazed a path from translator to de facto finance minister.

Major challenges awaited him at the Financial department. Following the Crimean War, redemption of the rouble in silver had been suspended and its value had plummeted. Russia’s banking system at the end of the 1850s was in crisis. Finland felt a growing desire to stabilise the value of money on a national basis, amid the liberal currents of opinion fostered by Alexander II. During Langenskiöld’s term, most of the reforms that culminated in

Finland’s freedom of business and livelihood were initiated. Although his own philosophy was conservative, he absorbed liberal ideas from his closest advisers, and Henrik Borgström Junior had particularly great influence in questions of money and banking.

In Finnish history Langenskiöld is known as “markgreven” (meaning Count Markka), a pun on the German title “margrave”, because of his key role in the negotiations that resulted in 1860 in Finland receiving its own monetary unit, albeit initially pegged to the rouble. He also drew up plans for Finland’s move to the silver standard and obtained approval in principle for them from the Russian government. Unfortunately circumstances compelled the reform to be postponed and Langenskiöld did not live to see it implemented; incurably sick, he left the Senate in 1863 and died soon afterwards. The completion of the monetary reform fell to his successor, J. V. Snellman.

His son Karl Langenskiöld (1857–1925) trained in law and went on to enjoy a brilliant career in banking. He was appointed to the board of the Nordic Bank for Trade and Industry in the 1880s but in 1892 relocated to Sweden, where he held executive positions with the Scandinavian Bank. He took Swedish citizenship and in 1901 was appointed chairman of the board of the Bank of Sweden, a post he held until 1912.

would in no way jeopardise Russian interests and that it would have far-reaching impact on the whole of Finnish society. In particular it stressed that the Emperor's promise of a currency reform would increase the trust that Finns felt towards Russia.

When the reform proposal was sent to St. Petersburg in March 1862, the atmosphere there had changed. Russia's new, progressive finance minister, Mikhail von Reutern, was planning Russia's own return to the silver standard. In the first half of the year, the rouble exchange rate appeared to have stabilised so the conditions for a return to silver looked good. Under Reutern's programme, the external value of the rouble was to be raised gradually until it reached its original value in silver at the start of 1864. Then the silver standard could be reinstituted.

Langenskiöld judged that the situation called for the fastest possible progress. Finland had to seek permission for its reform before Russia's own return to the silver standard was complete. This conclusion was supported by the prevailing mood of sympathy towards Finland in St. Petersburg, as shown by the decision to summon the Diet of Finland for the first time since its 1809 sessions in Porvoo. Langenskiöld's approach paid off, because in June 1862 he received an invitation to participate in a session of the Russian finance committee. He told the committee that Finland was ready to return to the silver standard as soon as it had obtained foreign loans to reinforce its metal reserves, converted short-term domestic loans into long-term ones and begun production of new banknotes. At this point the committee approved Finland's proposal although it also decided to postpone a final decision until 1 September 1863. After that silver money could be decreed the only legal tender in Finland.³⁴⁷

The decision was permission in principle for Finland to carry out a currency reform. A great deal of credit for this achievement belongs to Fabian Langenskiöld, who advanced the matter in St. Petersburg in partnership with Ministerial State Secretary Alexander Armfelt and his deputy Emil Stjernvall-Walleen. Nor would it have succeeded without Russian support and, in the final phase, crucial backing from Reutern, the Finance Minister. Reutern entirely understood the significance of the silver standard as a guarantor of monetary stability and saw no problem in the lack of synchronism between the Finnish and Russian solutions. For him this was not a matter of national prestige. He wanted Finland to serve as a beacon that might accelerate the reform in Russia.

The plan now called for a foreign loan to be secured. It was to be Langenskiöld's swan song because he was already incurably ill and had to resign in April 1863. His gastric cancer was advanced and he died after a couple of months. J. V. Snellman, a professor of philosophy and leader of the rising Fennoman nationalist movement, was appointed his successor as head of the Senate's Financial department. It fell to Snellman to see the reform through.

PARTING OF THE WAYS

Just as Snellman took over at the Financial department, major problems loomed. The loan obtained via the banking house of Rothschild & Söhne of Frankfurt am Main had mostly been used up in paying for grain imports after a crop failure. Snellman needed a new way to obtain the necessary finance. Around this time, the Mortgage Society of Finland had been negotiating a foreign bond loan but the talks were stuck because the foreign lender imposed the condition of either monetary stability or a government guarantee. Snellman decided to combine the needs of the Bank of Finland and the Mortgage Society. Foreign currency worth eight million markkaa from the Mortgage Society's loan would be deposited with the Bank of Finland, providing the bank with sufficient reinforcement for its silver cover. In the same stroke, the move to the silver standard could be concluded and the exchange rate risk eliminated, which would remove any obstacle to granting a government guarantee to the Mortgage Society's loan.

On the basis of these plans Finland received a new and more explicit confirmation from the Emperor that the reform could go ahead. A message from St. Petersburg in August 1863 stated that "as soon as the Mortgage Society of Finland has deposited eight million markkaa in good foreign currency with the Bank of Finland, then metal coin of the markka and penni can become the only legitimate measure of value in Finland, with effect from the day that, upon closer consideration, the Imperial Senate of Finland determines". In August 1863 the situation therefore looked excellent. The execution of the reform was now in national hands because the Senate had been authorised to set a final timetable once the conditions were met. What is particularly surprising in the promise from St. Petersburg is that it mentioned only the markka and penni as silver coin and so, literally

interpreted, even the silver rouble would no longer be valid in Finland after the reform.³⁴⁸

But the apparent *fait accompli* sailed into new storms in November 1863, when Russia's plans for a return to the silver standard collapsed. The slump of the rouble on currency markets had of course dragged the markka down with it. At the same time international capital markets had become distinctly tighter and these conditions continued in 1864. Finland's currency reform faced a delay of more than a year. Another complicating factor was that, with the failure of Russia's own efforts to return to the silver standard, the Governor general had become more wary of the reform in Finland. Another separate set of obstacles was posed by the tight state of Finland's national finances after recurrent years of crop failure, which had cut tax revenue and raised expenditure.

Despite difficulties the reform advanced. Contrary to expectations the Mortgage Society of Finland managed to obtain a foreign loan from Germany at the end of 1864 and deposited the stipulated eight million markkaa with the Bank of Finland at the start of 1865. At this point Snellman had already held talks about whether the reform could go ahead if the deposit were smaller – four million markkaa. Officials in St. Petersburg had also begun to be concerned that the promise given in 1863 had spoken only of the silver markka and penni and not of the silver rouble, so Snellman drafted a new memorandum to the Emperor that proposed, subject to certain limitations, the equal validity of the silver rouble and also Russian small change of inferior silver content. This revised proposal was approved in talks conducted by Snellman in St. Petersburg and a secret imperial manifesto on the subject was issued on 20 January 1865.³⁴⁹

The importance of Snellman's compromise has long been acclaimed, starting as early as Th. Rein's biography, published in the 1890s. In winning the tsar's favour for the reform, Snellman himself compared his solution to the egg of Columbus, an insightful solution that looks obvious afterwards. In reality it was not much of an insight because Snellman's memorandum to the tsar had returned to the formulation used in Langenskiöld's time. A main difference was that Russian silver change of less than full metal content was added to the coinage to be valid in Finland.³⁵⁰

The completion of the monetary reform had now been postponed once more and, as economic conditions deteriorated, criticism of the

idea had increased in Finland, too. Its most vociferous opponents were a group of influential owners of manors, iron works and large Vyborg businesses. The Elimäki group, as it was known, was organised around J.G Schatelowitz, a manor estate owner. They feared that the reform would have deflationary effects and that a changeover to the markka would cause problems in business with Russia. Meanwhile, Russian criticism of the Finnish reform had grown stronger and was largely nationalist and pan-Slavic in character. This carried weight with the Governor general, who also feared that the reform would raise the cost of maintaining the Russian army in Finland.³⁵¹

In August 1865 the Senate finally sent a proposal to St. Petersburg on implementation of the reform. Its timing was mandated by the need to get the silver standard in force before the end of the sailing season, so as to reduce import prices, but the issue made no progress in St. Petersburg for several months. The tsar made his final decision on the currency reform on 2 November and signed it two days later. The Imperial Manifesto was brought before the Senate on 8 November and could then be published. The Finnish public finally heard about their silver markka on the following Sunday, when the matter was proclaimed in all the churches of the land.

Under the terms of the manifesto, Russian and Finnish silver money was declared Finland's only legal tender with effect from 13 November. For practical reasons old Bank of Finland banknotes would retain their status until 13 March 1866, after which the bank would begin redeeming them in silver. The long struggle of more than a decade, to give Finland its own silver coinage, had been concluded. Because Russia's plans for a return to the silver standard failed, the Finnish currency reform was to mean a *de facto* separation of the monetary systems of Russia and Finland, despite the fact that Russian silver coin maintained its legal status as tender in Finland.

There had been many stages in the currency reform process, and for much of the time Finland's solutions had been tied to developments in Russia. Fabian Langenskiöld had initially played the leading role as head of the Senate's Financial department when the principle had been approved in St. Petersburg. It was left to his successor, J.V. Snellman, to bring the reform to its conclusion at a time when the linkage with Russia's own plans had been severed. The reform was the joint achievement of these two great Finnish historical figures.

J. V. SNELLMAN (1803–1881)

Johan Wilhelm Snellman was one of the most prominent figures in Finland's national awakening, its main ideologist and the founder of the political press in Finland. In the 1860s he headed the Senate's Financial department, equivalent to finance minister of the Grand Duchy, and is credited with fixing the Finnish markka to the silver standard. This, in effect, separated Finland from Russia's monetary system. Snellman's reputation as the founder of Finland's monetary system is shown by the position of his commemorative statue, sculpted by Emil Wikström, exactly in front of the Bank of Finland (1923).

The son of a Finnish sea captain, he was born in Stockholm, but the family soon returned to Finland and settled in Kokkola on the west coast. He studied first in Turku and then in Helsinki after the university had relocated to Finland's new capital. In his work he was drawn to the philosophy of Hegel.

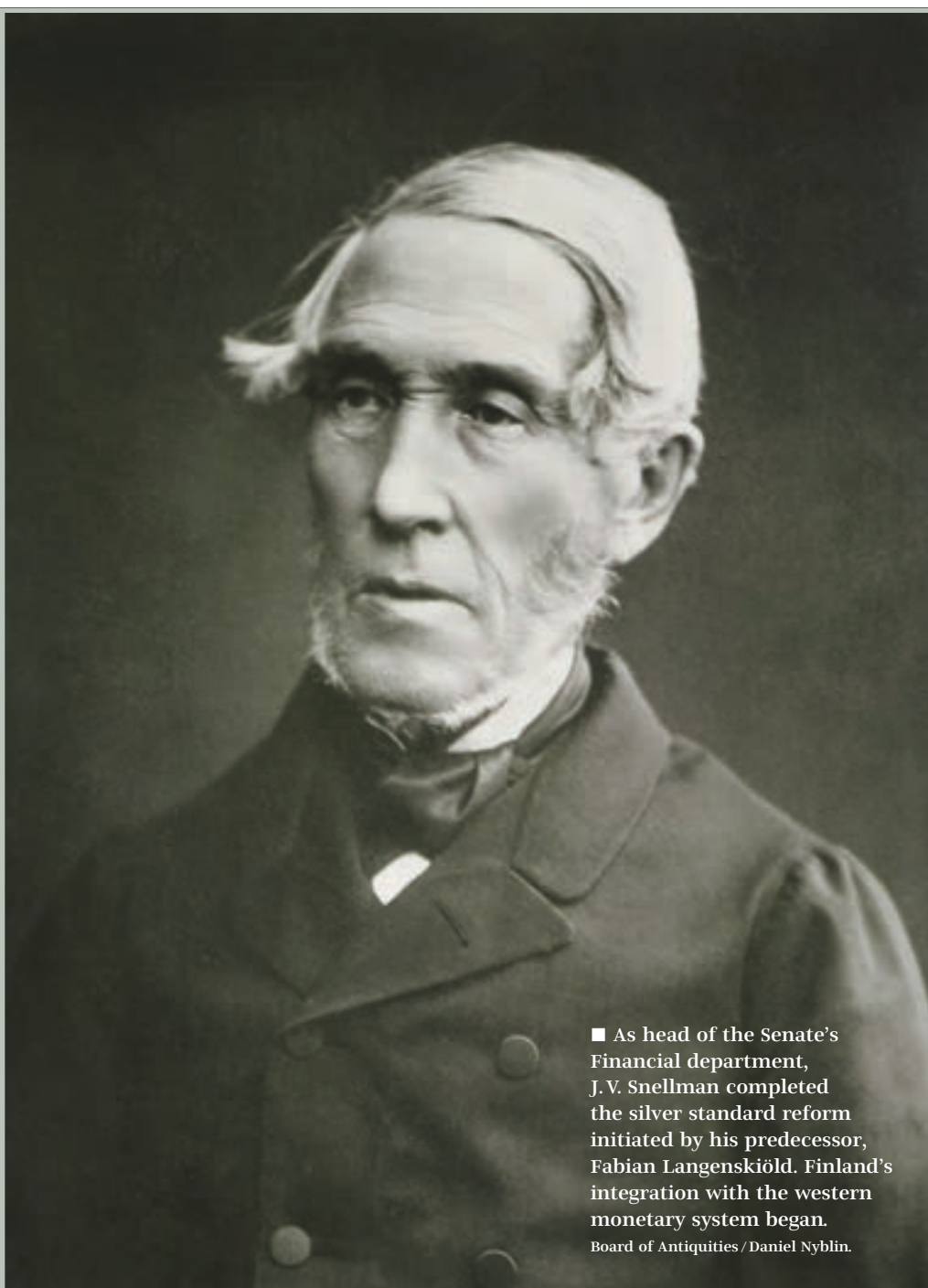
Snellman was a nationalist, who sought the development of a national language and Finnish culture. At the same time he believed in Realpolitik, accepting Finland's position vis-à-vis the Russian Empire and opposing the Scandinavian and separatist tendencies of the age.

In 1844 he founded a Swedish-language newspaper "Saima" in the central town of Kuopio, which can be regarded as the kernel of social journalism in Finland. When the censor closed it down, he continued his social argumentation in a new

paper entitled "Litteraturblad för allmän medborgerlig bildning" (Journal for General Civic Education).

The accession of Alexander II as tsar of Russia reversed the course of Snellman's career. An alienated journalist regarded as a radical became an esteemed statesman. In 1856 he was appointed professor of "systematic ethics and science" at Helsinki University and in 1863 became a senator and head of the Senate's Financial department. In the economic sphere Snellman's main achievement was the monetary reform of 1865. The language decree that he successfully promoted can be regarded as having even more far-reaching consequences; it made Finnish an official language alongside Swedish. As head of the Financial department, he also transferred control of the Bank of Finland from the Senate to the Diet, although reluctantly.

His career as a senator was overshadowed by the crop failures of 1866 and 1867 and his failure to alleviate the ensuing catastrophic famine. His fiscal policies were highly controversial and he had to resign from the Senate in 1868. He subsequently became chairman of the Mortgage Society of Finland, while continuing to advance his political agenda in the Diet and the press. He died in 1881 at his summer residence in Kirkkonummi.



■ As head of the Senate's Financial department, J.V. Snellman completed the silver standard reform initiated by his predecessor, Fabian Langenskiöld. Finland's integration with the western monetary system began.

Board of Antiquities / Daniel Nyblin.

It was also a significant phase in Finnish history because of the major role played by public opinion. There was exceptionally active debate on the matter in the press. Via the Mortgage Society of Finland, the Diet was also involved. Indeed, this created an interesting conflict between Snellman and the Diet, the former fearing that the latter's participation would complicate matters.

All monetary reform plans had proceeded from the assumption that the value of the markka would be fixed to silver at the rate which had prevailed in the years preceding the Crimean War. Consequently the Bank of Finland consistently sought to raise the markka's external value in the early 1860s. It was successful while Russia's own silver standard programme was advancing and, by the end of 1863, parity was very close. That would have been the optimal time for implementing the reform but it had not been possible because of the collapse of Russia's programme. The markka's external value fell steeply from the end of 1863 onwards.

At this point domestic opposition increased. The reform plan now entailed a revaluation of nearly 20 percent, and businessmen and major landowners realised what such a steep drop in the price level would mean for indebted businesses and estates. Demands began to be heard for a postponement of the whole reform or its implementation at prevailing exchange rates, whereby deflation could be avoided. Fabian Langenskiöld had also considered this option shortly before his resignation. Of the arguments raised, the weightiest line of reasoning against implementation at prevailing exchange rates was the constitutional protection of property. According to the constitutional laws confirmed by the Emperor, citizens had a right of ownership and to accept a devaluation of the value of money was interpreted as a violation of this right. The only option was therefore a reform at parity. Snellman saw the political side of the question with great clarity. Since the first permission in principle had been granted in St. Petersburg, parity had been assumed and to compromise on this point could have wrecked the whole reform. It was to Snellman's credit that the reform was completed unwaveringly and ultimately by ignoring the domestic resistance it aroused.

MARKKA AND ROUBLE PUT TO THE TEST

The significance of the silver standard and the divergence of the Finnish and Russian monetary systems became obvious in May 1866, only weeks after the Bank of Finland had begun redeeming its notes in silver. The largest private banking house in the London money market, Overend, Gurney & Co., was suddenly declared insolvent, setting off a panic that shook the money markets of London and the world.

The underlying cause of the crisis was extended speculative lending by Overend and some other banking houses. It later transpired that accounting irregularities were also involved. The London market suffered a drop in confidence in banking houses during the spring, leading to greater discounting by the Bank of England and a rapid fall in its gold reserves. The central bank responded by raising its interest rates steeply in May 1866. This rate hike and its decision to discontinue funding for Overend, Gurney & Co finally triggered the panic.³⁵² Money markets remained very tight even when the crisis had ended; bank rate was raised to an all-time record high of 10 percent and held at this level for the summer of 1866.

The value of the rouble fell during summer 1866, weakening about 16 percent against the pound sterling and the Dutch guilder, but the Finnish markka remained at its silver parity. Finnish money markets did become extremely tight but the tough lending policies of the Bank of Finland managed to prevent any major depletion of silver reserves. A sign of market tightness is that the volume of banknotes in circulation fell very steeply during spring 1866 (by a full 23 percent in six months), even though the bank borrowed abroad to be able to lend to domestic customers. The system of fractional silver cover imposed by the Bank's regulations amplified the effects of the payments account deficit on the volume of banknotes and on the bank's scope for lending.³⁵³

The return to the silver standard and consequent revaluation, in combination with the poor grain harvest, are generally blamed for Finland's weak economic state at the start of the crop failure year of 1867. But the Overend crisis also had a powerful effect on the foreign currency market and it would be worth examining its contribution to the plight of Finnish trading houses and business life even before the great year of famine. In 1866 the Finnish money market was certainly

very tight anyway, as shown by the large proportion of non-performing loans among Bank of Finland receivables, examined later in this work.

In fact the entire 1860s was a dire period in Finnish history. The silver standard, or rather the processes that culminated in it, are often seen as a cause but such a simple explanation is inadequate. The state of economic crisis was the outcome of a number of simultaneous and mutually independent elements, which combined to disrupt society. The critical factors were the extremely poor harvests in 1862, 1865 and 1867, agriculture being the most important sector of production; the postponement of the silver standard reform in 1863; the international financial panic of 1866; the change in economic policy after 1865; and the crisis in the European grain trade of autumn 1867.

Although several grain harvests in the 1860s were worse than usual, 1862 and 1865 can be regarded as years of outright crop failure. To provision the nation, the Senate increased grain imports from 1863 and they remained high even in the years between, in order to replenish stocks. To finance imports the Senate granted rather generous credits to importers who, in turn, sold the grain on credit, so the increase in grain purchases meant a general rise in indebtedness throughout society.³⁵⁴

Deflation, discussed in more detail earlier, proved problematic for the entire economy. The Bank of Finland followed tight deflationary policies, in which a key element was reducing the stock of outstanding loans by 25 percent between 1862 and 1865. This phase of loan downsizing harmed all sectors of business life and farmers, the size of the problem being largely dependent on the degree of indebtedness. After the move to the silver standard, monetary policy became still tighter when the international financial panic was felt in Finland. In these circumstances, indebted businessmen and farmers were unable to service debts that had increased in real terms. The wave of business failures was the largest in Finnish history to date. Some of the largest iron works, textile factories and landowners went under.³⁵⁵

Even at the time there was public debate about whether the authorities should intervene to prevent the wave of bankruptcies. As head of the Senate Financial department J. V. Snellman took a very strict stand. In his view, the debts of entrepreneurs were largely a consequence of their decisions and the excessively lax lending policies of the state. Using exactly the same arguments Snellman had criticised

the lending of the Bank of Finland at the end of the 1850s and there had been heated debate between him and Henrik Borgström Junior on the nature of central bank monetary policy. With his background in philosophy, Snellman presented arguments based on orthodox “currency doctrine” while Borgström as a practical businessmen supported the pragmatic approach of the “banking doctrine”.³⁵⁶

The crop failure of summer 1867 therefore came at a time when most segments of Finnish society were already in trouble. Snellman had been concerned for some time about the poor state of public finances and had tried to bring about a change in policies. He sought to end the use of public funds for importing grain and believed that grain aid should not be dispensed gratuitously. Large-scale relief works were not the favoured solution, though, because bringing all the needy together in large gangs would have led to even greater problems. Instead Snellman proposed a large-scale increase in cottage industry, its production to be used for acquiring grain. Snellman also linked assistance to thrift. If the savings rate were increased at all levels, there would be less need for charity. These ideas suited the recently adopted silver standard. Snellman wanted to ensure that there would be adequate silver cover in all circumstances so caution was required in procurement of foreign grain.³⁵⁷

Until August 1867 he believed that the domestic grain harvest would be sufficient but by this time the facts of an almost complete crop failure were indisputable. Decisions could no longer be delayed and in September he began talks with the banking house of M.A. von Rothschild in Frankfurt am Main. After tough negotiations Finland received a short-term loan of 5.4 million markkaa, but the delay in reaching the decision meant that grain imports could not begin properly until the turn of October. This was fateful because European grain markets were already tight in autumn 1867 and it was difficult to obtain the quantity that Finland required. Shipments got underway so late that early ice cover in shipping lanes prevented the arrival of cargos.³⁵⁸

By the end of autumn 1867 and winter 1868, Finland had reached the state where, even after grain imports, the shortfall was about a third of normal requirements. Ahead lay a severe famine throughout the country although there were considerable regional differences. Hopes of self-assistance based on cottage industry came to nothing

MAYER CARL VON ROTHSCHILD (1820–1886)

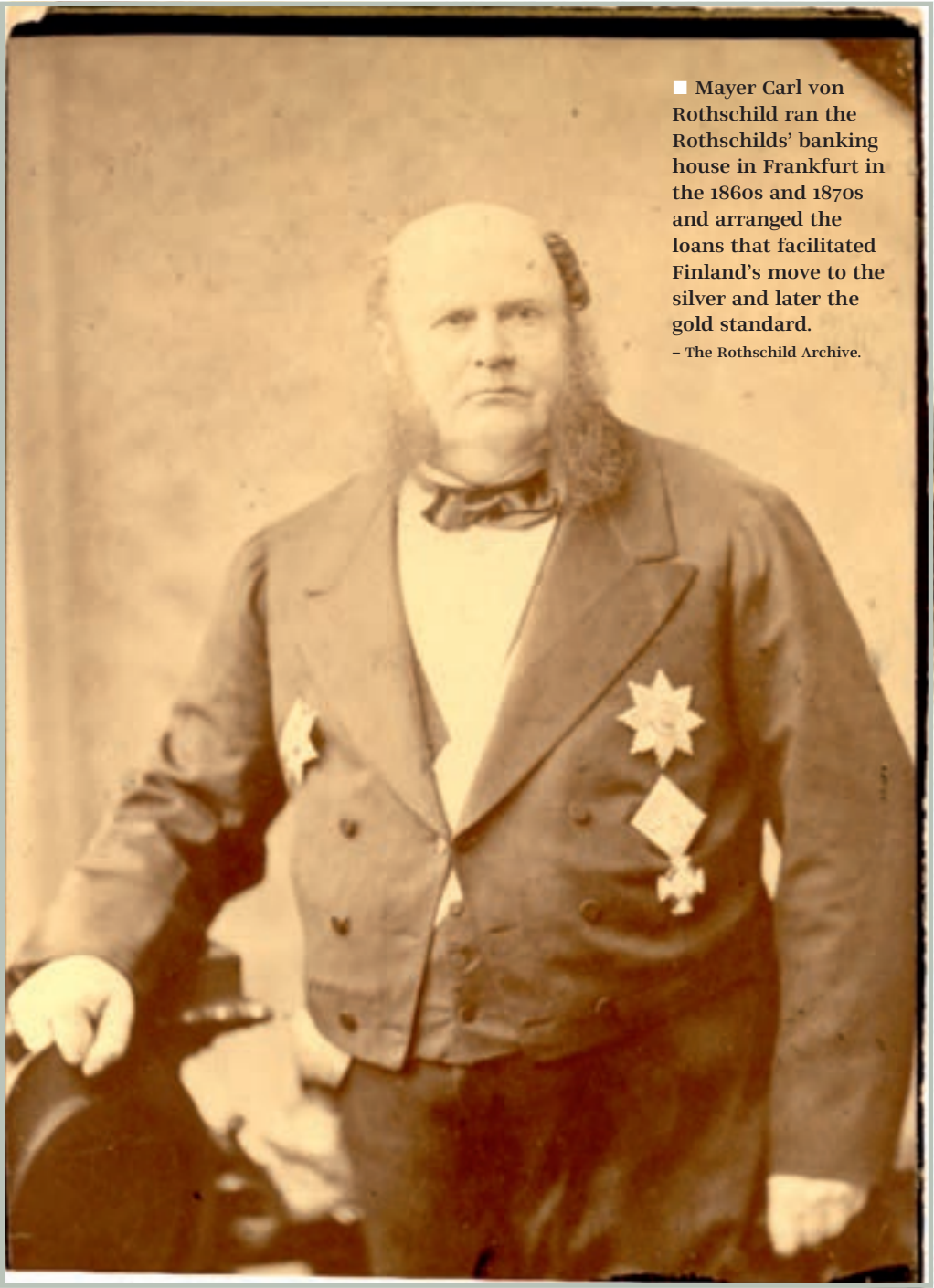
Baron Mayer Carl von Rothschild was grandson of Mayer Amschel Rothschild, the founder of the famous banking dynasty. In the first half of the 19th century the family established a network of banking houses in various European financial centres (Frankfurt, Vienna, Paris, London and Naples) and became the leaders of the age in issuing government bonds. Mayer Carl worked at the Rothschild's bank in Frankfurt (M. A. Rothschild & Söhne) at the start of the 1840s and became its manager in 1855. Charles, as family members called him, was a politician as well as a banker and participated in sessions of the National Assembly of the North German Confederation.

For a long period in the second half of the 19th century the Rothschilds' banking house in Frankfurt held a virtual monopoly on managing Finnish government bond issues abroad. The relationship began in 1863, when M. A. Rothschild & Söhne arranged the Finnish government's first European bond issue, worth 4.4 million Prussian Thaler. The next major transaction came when the newly established Mortgage Society of Finland took its first foreign loan, 3 million Thaler, also under Rothschild management. These loans were crucial for the 1865 monetary reform, in which the Finnish markka was fixed to the silver standard. Later Finnish bond issues arranged by the Rothschilds were used mainly

for constructing railways. Via bond issues the Rothschilds significantly advanced awareness of Finland's conditions and political position in the financial centres of Europe.

Mayer Carl von Rothschild developed close relations with Finland and frequently corresponded with J. V. Snellman of the Senate's Financial department and with the board of the Bank of Finland. The relationships were very important in September 1867 when a total harvest failure was leading to famine in Finland. Snellman wrote to Mayer Carl "in distress to a friend" to ask for credit to purchase grain, while Reinhold Frenckell from the Bank of Finland's board travelled to meet him. Rothschild granted the government of Finland a short-term loan of 1.5 million Thaler from his own funds.

He died in 1886. The year after, Chancellor Bismarck of Germany issued his Lombardverbot, forbidding the acceptance of Russian bonds as collateral by Germany's national bank. This led to a cooling of the long and important business relationship between Finland and the Rothschilds' bank in Frankfurt. The Grand Duchy of Finland issued its last bonds in Germany via the Rothschilds in 1889, after which it shifted its foreign borrowing to the capital market of Paris. The Palace of Mayer Carl von Rothschild on the River Main in Frankfurt is currently used by the city's Jewish museum.

A sepia-toned portrait of Mayer Carl von Rothschild, an elderly man with a full white beard and mustache. He is wearing a dark, double-breasted suit jacket over a white shirt and a dark bow tie. Several medals are pinned to his left breast, including a large star-shaped medal and a diamond-shaped medal. He is holding a dark hat in his right hand. The background is a plain, light-colored studio backdrop.

■ Mayer Carl von Rothschild ran the Rothschilds' banking house in Frankfurt in the 1860s and 1870s and arranged the loans that facilitated Finland's move to the silver and later the gold standard.

- The Rothschild Archive.

because it was not an option for the landless majority of the rural population. When officials failed to distribute the scarce foodstuffs available, tens of thousands took to the roads to beg. The hordes of beggars spread contagious diseases to add to the general anguish. In 1867 and 1868, Finland's population fell by more than 100 000. The situation was at its worst in 1868.³⁵⁹

The agricultural historian Arvo Soininen describes the 1860s as the closing chapter of traditional Finnish agriculture, which culminated in catastrophic famine. The consequences need not have been so dire because public authorities could certainly have found ways of mitigating them. The excessive delay in commencing foreign grain imports can be regarded as a fateful error. The silver standard had no direct impact on this question but in fact improved Finland's ability to obtain foreign credit.

EFFECTS OF THE STATE FUND REFORM

After the currency reform the first complete revision of Bank of Finland regulations took place in 1859. At this point there was great pressure in Russia for a fundamental reorganisation of the monetary and banking system, as explained previously. Liberal personalities representing new ideas, under the leadership of the future finance minister Mikhail von Reutern, were involved in this reorganisation. In the same way new forces such as the liberally inclined Fabian Langenskiöld had emerged in Finland to take the place of the conservative von Haartman as head of the Senate's Financial department.

The reform meant that supervision of the Bank of Finland moved up in the organization from the Financial department to the Economic division of the Senate. This brought a reduction in the direct influence of the head of the Financial department and thus greater status for the Bank of Finland. At the same time the role of the Bank's board of management grew stronger.³⁶⁰

The reform of regulations was part of a complete reorganisation of the state's financial system. A separate amortisation fund was established to manage the state's existing debt. The Bank of Finland transferred to this fund the million paper roubles that it had received from the state in 1812–1817 as its founding capital, the agricultural and manufacturing funds and the remaining capital of the small banknote fund. In this way the Bank's debt to the state was discharged. The capital of the amortisation fund totalled 1.2 million roubles, of which the Bank of Finland paid 630 000. The capital of the amortisation fund was lent to the public so interest income could cover the state's interest payments. The establishment of an amortisation fund meant greater

efficiency in the lending operations of both the state and the Bank of Finland. Not all state lending was from the amortisation fund, however; old state funds like the Poorhouse Fund and the Military Hospital Fund continued lending as before, managed by the Bank of Finland. The establishment of an amortisation fund can also be seen as a cautious step towards separating the finances of the Bank of Finland and the government.³⁶¹

Bank of Finland regulations regarding lending from its own funds were little changed. The founding fund, now reduced in size, continued to grant long-term (33-year) mortgage loans against real estate. The minimum loan size was 800 roubles and the maximum 20 000 roubles. Loans granted from the hypothecary fund were to be short-term, meaning no longer than two years. As previously, loans from the hypothecary fund required collateral either in the form of a mortgage or of pledged merchandise but the types of merchandise that were acceptable security were increased significantly and now included sawn goods in various forms. The regulations on discounting domestic and foreign bills of exchange were almost unchanged. The discount rate was to be determined by the Senate on the basis of a proposal from the bank's board. The regulations also allowed a new form of banking; private individuals and organisations could open what were called deposit-and-withdrawal accounts – in modern language current accounts. The hypothecary fund also had the right to grant current account overdrafts, loans up to a predefined amount that could be drawn down on demand.³⁶²

To improve the effectiveness of its deposit-taking operations, the Bank of Finland could now pay interest on deposits. One of the arguments for this was that it would encourage profitable use of funds now lying idle. The interest rate was not defined in the regulations beyond the stipulation that it could not be higher than the lending rate. In more detailed instructions issued in autumn 1859, the deposit rate was set at 3.5 percent.³⁶³ The issue of bond-like bearer notes, mentioned in the regulations of 1840, was discontinued.

The regulations of 1859 continued a trend that had started in the regulations of 1840, in which the demands of operating a genuine bank of issue and not merely a credit institution were incorporated into the institutional framework. The greatest principle that changed was transparency, because there was now no need for secret instructions

and all matters could be publicly presented in the regulations themselves. While the regulations were being planned, the influence of the former mother country Sweden was probably at its lowest level and this reform was carried out purely on a Helsinki-St. Petersburg axis. Compared with the reform of 1840, the changes were slight and in many points the new regulations referred to articles in the old ones. Under the new rules the board was required to issue supplementary instructions, but it was years before this was done.

The regulations of 1840 had taken a small step towards the idea proposed in the Diet of Porvoo for a bank of the Estates. This done by stating that representatives of the four Estates should be among the bank's auditors. The repayment of state capital, part of the regulations of 1859, can be regarded as a small parallel step. When the Bank of Finland was founded, it was stipulated that the state would grant an interest-free loan to the bank and so, with the establishment of the amortisation fund, this had been repaid. The repayment of the founding capital underlined the fact that the funds of the bank and the government were now separate and the bank was an independent financial unit, even if it was controlled by the Senate. In the new regulations the ratio of silver cover to banknotes issued was set at $\frac{7}{15}$ but uncontested foreign claims in metal currency could now be deemed part of silver cover.³⁶⁴ This expansion of the definition of cover had been on the agenda in the mid-1850s when the bank's silver reserves had fallen sharply, but the idea foundered on the opposition of von Haartman of the Senate's Financial department.

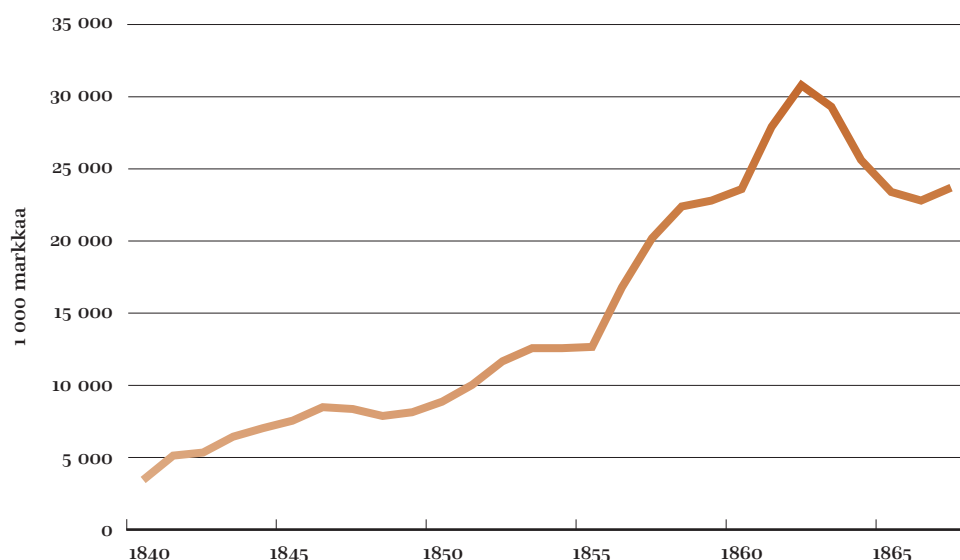
THE BANK OF FINLAND AS A LENDER 1841–1867

PORTFOLIO TRENDS

In studies of Finland's monetary system, the first part of the history of the Grand Duchy is generally regarded as having ended when the Crimean War forced the Russian Empire off the silver standard, when Finland obtained its own markka, or when it reinstated the silver standard at the end of 1865.³⁶⁵ This book is from the perspective of the Bank of Finland and its management so 1867 is taken as a natural dividing line. Until the end of 1867 the Bank of Finland still operated under the Senate. The move to supervision by the Estates changed the conditions under which it operated so much that the period for a review of lending should last until the end of 1867.

The monetary reform of 1840, with the move to the silver standard, brought about monetary stability. Investment was encouraged and a general increase in demand for loans was a logical consequence. Rouble banknotes issued by the Bank of Finland and redeemable in silver replaced Swedish money at this time. The number of the bank's own notes increased many times over in a short period, so the bank's scope for lending was directly increased. The hypothecary fund, which issued the banknotes, was therefore well placed to respond to the increased demand for credit. On the other hand there were far more limited opportunities to lend from the primary capital fund, which constituted the other half of the Bank of Finland. It provided long-term mortgage loans so the portfolio had a slow turnover. Only as the fund

BANK OF FINLAND STOCK OF LOANS 1840–1867



Source: Bank of Finland. Fund main ledgers 1840–1867, Bank of Finland archives.

was swelled by interest payments and amortisation of existing loans could new credit be granted, so it could not increase lending rapidly. A very different situation prevailed in the hypothecary fund, which provided short-term loans of 6 months to 2 years duration, and acceptance credit of up to 6 months on bills of exchange. Its rapid turnover gave the Bank of Finland more flexibility in adapting to changes in the economic environment. Central bank lending was therefore divided into two parts that were separate and very different in nature.

After a recession lasting many years, the loan portfolio of the Bank of Finland began a period of continuous growth in the mid-1830s which continued through the 1840s and 1850s except for a downturn in 1847–48. Around the mid-1840s the loan portfolio topped 2 million silver roubles and at the end of the 1850s was approaching 6 million. Its brisk growth continued until the start of the 1860s, when plans for a return to the silver standard forced the bank to rein in lending. By 1867 the loan portfolio was about 24 million silver markkaa, which was



■ The Saimaa Canal was Finland's most important construction project of the time (1844–1856). Its completion reduced economic dependence on Sweden and extended the money economy into much of eastern Finland. Photo from the early 20th century.

Board of Antiquities / K. E. Ståhlberg.

considerably less than at the start of the decade.

Throughout this period the Bank of Finland remained responsible for the management of other funds that were controlled by the government. Here there were clear changes in focus. The Bank could increase lending from its own funds more easily than the government, which first had to allocate more resources to them. As a consequence the Bank of Finland's share of all public lending increased steadily until the 1850s, when it settled at about 80 percent. The situation changed in the 1860 when the bank had to restrain its own loan portfolio, reducing its proportion of all public loans. At the close of 1867 its share had fallen to some 60 percent. This trend was reinforced in the reform of 1859 by the establishment of the amortisation fund, to which some of the loans granted by the Bank of Finland were transferred.³⁶⁶

In the 1860s Finland's banking market experienced its greatest transformation so far when the first private credit institutions were established. The emergence of private commercial banks, in particular, changed the whole field of operations of the Bank of Finland. The first step was the establishment of the Mortgage Society of Finland (*Suomen Hypoteekkiyhdistys*) in 1860. In keeping with its name, the society granted long-term mortgage loans to agriculture, equivalent to the lending of the central bank's founding capital. The Mortgage Society began operations under a state guarantee and got off to a brisk start, its loan portfolio reaching 23 million markkaa by the end of 1867. At the same time the stock of mortgage loans granted by the Bank of Finland declined by 4 million markkaa, and the central bank's share of mortgage loans to agriculture was now only about 15 percent.³⁶⁷

The Union Bank of Finland (*Suomen Yhdys-Pankki*), established in 1861, was the first private commercial bank and became a new financier for business life alongside the Bank of Finland. At the Bank of Finland, loans to business were made from the hypothecary fund, which provided domestic bills of exchange as well as short-term secured loans against merchandise. In 1867 the stock of loans granted by the Bank of Finland's hypothecary fund was about 14 million markkaa while equivalent loans by the Union Bank totalled 7 million markkaa. The Bank of Finland's stock of domestic bills of exchange was 5.6 million markkaa and foreign bills of exchange 0.46 million markkaa, while the corresponding figures for the Union Bank were 7.4 and 0.14. In the light of these figures the Union Bank of Finland had quickly

reached a position of complete equality with the Bank of Finland. There was, however, no real competition between the two because the management of the Bank of Finland had had a distinct change of heart at the turn of the 1860s. It no longer jealously defended its monopoly but entirely accepted the idea that its operations complemented those of private commercial banks.³⁶⁸

It was during this period that the lending of the Bank of Finland first began to genuinely reflect Finland's integration into international capital markets. Its own decisions were no longer dependent on solutions reached in Russia alone. Its operations were now influenced in many ways by what happened on western European markets. This shows for the first time in the contraction of Bank of Finland lending in 1847, coinciding with a severe financial panic in Britain.³⁶⁹ It seems that a reduction in exports had reduced economic activity in general, with consequent lower demand for loans from the hypothecary fund, and thereby a reduction in the total loan portfolio.

The next financial panic in Europe came in 1857.³⁷⁰ In continental Europe it caused the most difficulties in Germany and, to an even greater extent, Russia. The Bank of Finland was exceptionally active during the panic. It was a time of pent-up import demand after the end of the Crimean War, which put pressure on currency reserves. A pan-European recession following the panic curbed Finland's exports and exporters also suffered from insolvency among foreign buyers. The national economy was faced with the threat of tighter liquidity, which the Bank of Finland sought to mitigate with active lending policies to ease the plight of business. The value of bills of exchange discounted annually was now many times higher than at the start of the decade, as the following figures indicate; in 1852 discounting totalled 0.9 million roubles; 1856, 1.6 million roubles; 1857, 2.4 million roubles; 1858, 3.8 million roubles; and 1859, 4.4 million roubles. The same trend is visible in short-term loans granted from the hypothecary fund, 0.5 million roubles a year at the start of the 1850s and 1.5 million in 1859.³⁷¹ In addition to increasing its lending the bank also relaxed loan repayment terms with deferrals and even small-scale moratoria. It is significant that although the knock-on effects on Russia of the 1857 financial crisis were extremely widespread, and ultimately led to the collapse of its banking system, Russia's problems had hardly any impact on the Bank of Finland's operations.

The downturn in the Bank of Finland's loan portfolio in 1863 can be explained by domestic factors and, in a sense, Russian factors too, if the effort to reinstate the silver standard can be characterised as such. The Emperor had promised a return to the silver standard in principle in 1862 and measures were then begun to restore the external value of the markka to parity after years of depreciating fiat money. In practice this meant a gradual reduction in the value of banknotes in circulation, which was carried out by downsizing the loan portfolio of the Bank of Finland. However the return to the silver standard was postponed so the phase of restrictive Bank of Finland lending lasted longer than anticipated. The currency situation was then exacerbated by the international financial panic in Britain and France in 1866.³⁷²

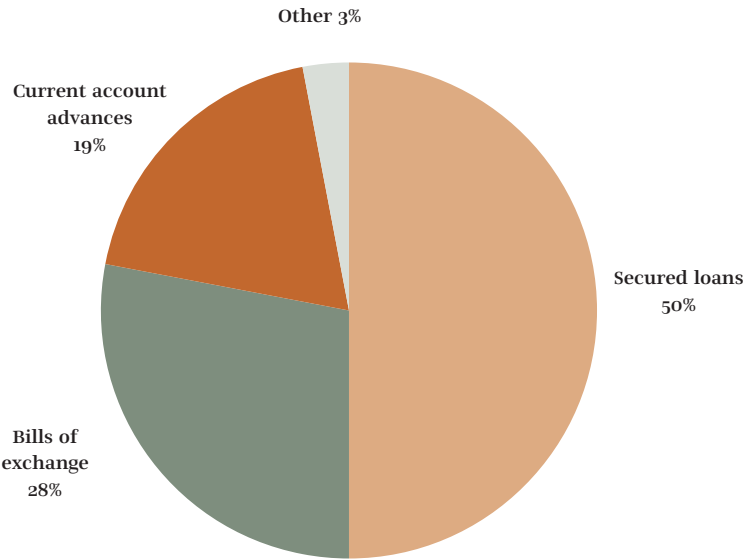
RESTRUCTURING THE LOAN PORTFOLIO

In the 1860s Bank of Finland lending was dominated by the hypothecary fund, as shown by the rapid rise of the proportion of loans to enterprises. In 1867 it was already above 80 percent, meaning that it was approximately as large as loans to agriculture from the primary capital fund had been in 1840. The stock of mortgage loans granted from the primary capital fund had grown very little since the early 1850 and in 1875 the bank stopped granting these loans entirely, although the last did not disappear from the balance sheet until 1908.

The loans to public entities in the diagram overleaf denote long-term loans given to various public sector organisations and were the vestiges of old Bank of Finland lending. No new such loans were granted after the 1850s. Another relic was shipbuilding credit, which the Bank of Finland had granted to replace losses in the Crimean War. These loans remained on the accounts of the loan portfolio to a diminishing extent for some 10 years.

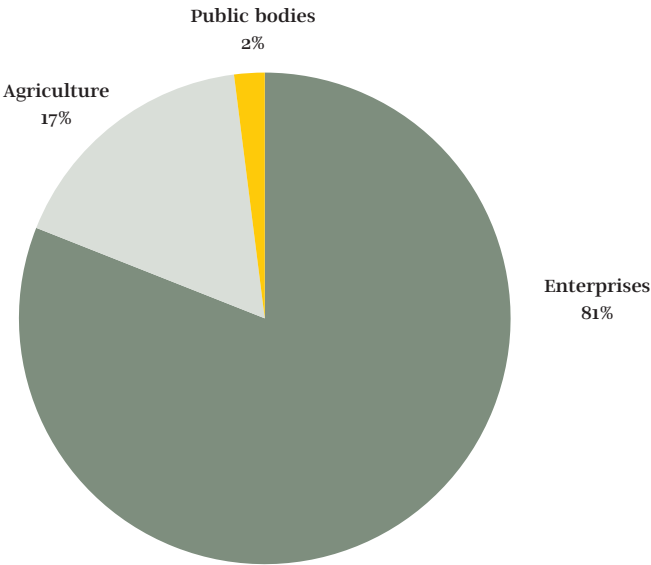
In practice all new loans intended for enterprises came from the hypothecary fund. Although this certainly represented a change in focus towards short-term lending, the rules that applied to hypothecary fund lending from 1859 still contained remnants of past practices. A guarantee alone was no longer accepted as security but all eligible items were still listed separately. However, the list was longer than

HYPOTHECARY FUND LOANS BY CREDIT TYPE 1867



Source: Bank of Finland. Supervisory Council report 1868.

STOCK OF BANK OF FINLAND LOANS BY SECTOR 1867



Source: Bank of Finland. Supervisory Council report 1868.

before, and now included products made of wood. Changes concerning collateral also meant that a smaller proportion of loans went to finance consumption by private individuals.³⁷³

The diagram at left, showing loans from the hypothecary fund according to loan type, offers an overall view of the situation.

The diagram clearly shows the emergence of new and more modern forms of credit. Alongside short-term secured loans against pledges of merchandise as security, there were now domestic bills of exchange and withdrawable credit limits. The operations of the Bank of Finland were being adapted to the demands imposed on a central bank by the metallic standard in the late 19th century. Bills of exchange and current account advances were ideal for this purpose but the secured loans granted by the bank were still somewhat problematic. They included forms of credit that were alien to central bank operations, and reflected features of lending policies in the 1830s and 1840s and echoes of even earlier times.

Discounting bills of exchange represented a new Bank of Finland lending policy, dating from 1842. Initially lending against bills of exchange was fairly modest in scope, but the volume of discounting turned up sharply after the Crimean War. Correspondingly, Bank of Finland lending was cut back from 1863 onwards by reducing the discounting of bills. This shows that the management of the bank had realised the value of the real bills doctrine. When circumstances required it, the amount of discounted short-term bills could be rapidly downsized and the money invested in them returned to the bank.

The large importing houses were especially keen users of acceptance credit. They went to the Bank of Finland to discount bills of exchange drawn on their customers, who were smaller merchants. The opportunity to discount bills of exchange was extremely important because trading houses engaged in importing needed to finance purchases from abroad. Another group that used acceptance credit were domestic industrialists, who brought to the bank the bills of exchange drawn on their customers. What is striking in the ledger is the continuity of relationships established between discounting clients and bill drawers. The same names recur year after year.

Among the first discounters were the trading house of Hackman & Co.; the wholesaler P. Wahl; and the trading house of Rosenius & Seseman, all of Vyborg. Another was the manufacturer A. W. Wahren.

All were among the largest and most influential entrepreneurs in Finland in the mid-19th century. New names appearing in the ledgers in the 1850s were deputy consul F. Sneckenström; merchant Cristian Trapp; trading house H. Borgström & Co and merchant A. Alfthan; manufacturer A. J. Frietch; and trading company T. Tichanoff & sons. The lists of debtors, meanwhile, reveal the narrowness of the business base midway through the period of autonomy; there were fairly few entrepreneurs in either commerce or industry. Until the 1860s the Bank of Finland was the only banking institution in Finland that discounted bills of exchange. As a consequence all of the most important enterprises in the country discounted their bills of exchange at the Bank of Finland.³⁷⁴

PROBLEMS WITH LENDING

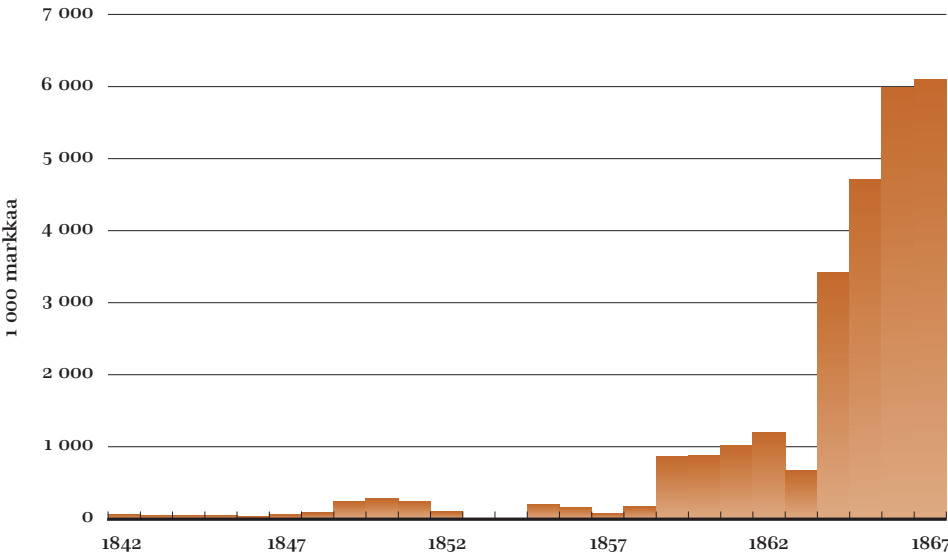
A common feature of trends in the lending policies of the Bank of Finland was an increase in the proportion of short-term business loans. At the same time this meant a greater exposure to lending risk although it had already been experienced in the previous period ending in 1840. Since 1842 systematic reports are available, drawn up by the attorney, of the Bank of Finland's non-performing loans; the reports prefer the terms "subject to debt recovery" or "uncertain receivables". These did not inevitably lead to an equal amount of credit losses because the bank still had the opportunity to claim the loan from its guarantor or to realise the loan security. The bank was indeed very long-suffering and was in no haste to collect non-performing loans or sell collateral. It could wait for the right moment.

The attorney's annual reports about non-performing loans provide a very interesting and useful perspective on Bank of Finland lending. They help to show how successful the Bank of Finland was in assessing the ability of borrowers to live up to their commitments. With some slight generalisation it can be said that they illustrate the performance of the bank in one of its fundamental duties. At the same time data on non-performing loans provides a rapid and vivid indicator of general business conditions. The fastest indicator would be the volume of loans that were shifted to the category of "uncertain receivables" during the year but this presentation is confined to examining the changing size of the complete stock of non-performing loans. A small deficiency is

the lack of reports for 1853 and 1854 but from an overall viewpoint the gap is not greatly significant.

The main source of problem loans at the Bank of Finland was business credit. Apart from the crisis years in the mid-1860s, long-term lending to agriculture from the primary capital fund produced only a moderate volume of problem loans and its share of all problem loans remained at a tolerable level. A rising number of financial problems emerged for the first time at the end of the 1850s, when almost a tenth of loans from the hypothecary fund had to be reclassified as “uncertain”. This was in fact the starting point to the crisis of the next decade. The policy of reducing the stock of outstanding credit commenced in 1863 and was reflected almost immediately in the amount of uncertain loans. The milestone of two million markkaa was exceeded in 1863 and henceforth the rate of increase was very steep. In 1867 the stock of non-performing loans had reached 6 million markkaa. The situation was most catastrophic for acceptance credit, of which more than 36 percent

**BANK OF FINLAND UNCERTAIN RECEIVABLES AND LOANS
SUBJECT TO RECOVERY PROCEEDINGS 1842–1867**



Data not available for 1853–1854.
Source: Attorney’s report 1840–1867, Bank of Finland archives.

became uncertain receivables. By this point the owners of large country estates were in trouble and more than a tenth of the stock of lending from the primary capital fund capital had been classified as uncertain.³⁷⁵

In the critical years of the 1860s Bank of Finland lending had reached an impasse because nearly 30 percent of outstanding lending had been classed as uncertain receivables. This sum was a full 57 percent of the combined total of Bank of Finland's own funds, so the Bank's state on the eve of its transfer to the control of the Estates was very weak. It is worth recalling, though, that a significant proportion of these receivables were ultimately recovered, either from their guarantors or by realising collateral.

THE BANK OF THE ESTATES

A BROAD MODERNISATION PROCESS

Since its foundation all the regulations of the Bank of Finland had recalled that it had been established in accordance with the wishes of the Diet of Porvoo. This kept alive the idea of a bank subject to the supervision of the Estates although, from the bank's early stages, government representatives in St. Petersburg had made it clear that the bank was subordinate to the Governing council and its successor, the Senate of Finland. Another reason why it was impractical for the Bank of Finland to be answerable to the Estates is that, after 1809, a Diet of the Estates was not summoned for more than 50 years.

At the end of the 1850s, after the rise to power of Tsar Alexander II, a wide-ranging reform of Finnish institutions was initiated. The principles of property rights in Finland and their permanence were already a secure legacy of the period of Swedish rule but there were numerous legal limitations on the mobility of productive inputs and the freedom of enterprise. A common denominator of the reforms was the aim to safeguard free movement of factors of production and to bring vital predictability and continuity to all economic activity. The stability of the monetary system was associated with property rights, predictability and continuity so the question of money was an intrinsic part of the reform process.³⁷⁶

In Finland modernisation might have begun of its own accord at the start of the 1850, but the outbreak of the Crimean War had frozen all reform projects. The change of Russian ruler in 1855 can be taken

as the starting point of the reform process. The conservative Tsar Nicholas I was succeeded by Alexander II and with him Russia moved to a new more liberal regime. Alexander signalled the new atmosphere in Finland when he visited the country in 1856 and sketched the outlines of upcoming reforms in an appendix to the minutes of the Senate. Naturally the programme had not been drafted by the Emperor himself but had involved the leading men of the Senate and the office of the Ministerial State Secretary for Finland. In Helsinki this meant the deputy head of the Senate's Economic division, Lars Gabriel von Haartman, who could be called the "prime minister" of Finland, and in St. Petersburg the Ministerial State Secretary Alexander Armfelt, the Emperor's "Minister for Finnish Affairs". Von Haartman's role is especially interesting because historical studies portray him as antagonistic to all liberal reforms. He was, however, well aware of the new winds in economic thinking and understood how important the free movement of factors of production was. On the basis of the Emperor's speech, various committees were set up to shape upcoming reforms, of which the first entered into force before the end of the decade.³⁷⁷

Alexander II was the third consecutive Russian Tsar and Grand Duke of Finland who had promised, upon assuming the title of Grand Duke of Finland, to uphold Finland's extant constitutional laws. Now this promise was being tested because the constitution – in practice the form of government from the period of Swedish King Gustav III – required an endorsement from the Estates for most of the reforms envisaged. This could not be done without summoning a Diet. There were no plans for the creation of a diet or parliament in Russia at the time so the situation was tricky. The government and ruler in St. Petersburg had to be convinced of the necessity for a Finnish Diet, which was already challenging enough because of resistance to the idea in St. Petersburg. A major obstacle was the instability of Poland. The Russian government feared that summoning a Diet in Finland would send the wrong signal to the Poles.

Amid heavy pressure to hear the views of the Estates, the tsar agreed to the compromise of summoning a committee of their representatives. It was to be composed of 12 members from each estate and a manifesto on the subject was published in spring 1861. This body, known in Finland as the January committee, began to

meet at the start of 1862. There was criticism of this solution in Finland, even in the Senate, because the January Committee was regarded as conflicting with prevailing constitutional laws. There were fears that it would threaten the status of the entire institution of the Diet and could be a sign that no Diet would be summoned. The doubts prevailing in Finland were understood in St. Petersburg and the Emperor soothed public opinion by stressing that the Diet was not being circumvented and the Committee was being used only to hear the views of the Estates on matters that, according to the constitution, were the remit of the ruler alone. The situation could have continued unresolved but once again international politics intervened; amid instability in Poland and in Russia, the tsar needed to ensure the continuing loyalty of the Finns.³⁷⁸

In 1862 the Finnish Senate was ordered by the Emperor to prepare for a summoning of the Diet. There was an uprising in Poland at the start of the following year and Finnish circles, including students, voiced their support for the Poles. Alexander II headed off their criticism by announcing in June 1863 that a Diet would indeed be summoned. He wanted to win over the Finns and he succeeded completely.

STATUS OF THE BANK OF FINLAND

Finland's first Diet for more than half a century was solemnly inaugurated in Helsinki on 18 September 1863. Its sessions now allowed the question of the Bank of Finland's status to be raised. The historical backdrop was the proposal of Tsar Alexander I on reorganising the monetary system and banking in Finland, to which the Diet of Porvoo had replied that the system should be based on the silver standard and that the country needed a bank operating under the ambit of the Estates. The currency reform of 1840 had indeed shown how propitious a stable monetary system was and, after the Crimean War, a lively debate had begun in Finland about returning to the silver standard. Discussions gained impetus after the international financial panic had precipitated a collapse in the rouble exchange rate in 1857. At the very end of the 1850s the debate became still more animated and now encompassed plans for a reform of all banking. The idea of private commercial banks had also been put forward in Finland and the most

progress had been made in the establishment of the Mortgage Society of Finland, which granted long-term mortgage loans to agriculture.

In the prevailing liberal atmosphere, the question of putting the Bank of Finland under the control of the Estates was pertinent. All the Estates at the Diet of Porvoo had agreed on this point. A change in the status of the Bank of Finland had been facilitated by the 1859 decision to clarify the division of tasks between the Bank of Finland and the government by transferring the responsibility for public debt away from the bank. The Senate became responsible for it and a separate amortisation fund was set up to meet debt management costs. The capital of the new fund was obtained partly by transfers from the Bank of Finland and partly by transfers from state funds. In total, 630 000 roubles were paid by the Bank of Finland to the new amortisation fund, by which the Bank paid the capital of, and interest on, one million assignat roubles (0.286 million silver roubles) that it had received from the state as its founding capital in 1813–1817.

The Diet of 1863 was therefore presented with a proposal by the Senate, in the name of the Emperor, for the supervision and management of the Bank of Finland to be transferred to the Estates. The proposal is interesting in that it did not explicitly mention the Bank of Finland but referred to the bank's two funds, the primary capital fund and the hypothecary fund that served as cover and collateral for banknotes. The combined value of these funds was 2.2 million silver roubles. Practical management of other funds, interpreted to be part of the government budget, remained with the Bank of Finland but supervised by the Senate. In this respect the bond between the Bank of Finland and the Senate had not been entirely severed.

In the proposal to the Diet on changing the status of the Bank of Finland, there were two points that aroused brisk debate and on which the Estates and the Senate took opposing sides. The first concerned the way in which members of the Bank of Finland board would be appointed. The Estates wanted to follow the Swedish model whereby the supervisory council of the Bank, selected by the Estates, would appoint the board. Because the bank managed state funds, the Senate for its part wanted equal authority with the supervisory council in appointing board members. In practice this would be done by creating a board on which only two directors would operate under a mandate from the Estates. Any other board members and the chairman would

be appointed by the Emperor on the basis of a proposal by the Economic division of the Senate. But the Estates felt this way of selecting the board could easily lead to the creation of rival factions.

The other source of disagreement between the Senate and the Estates involved the Bank of Finland's obligation to transfer a sum of 44 000 roubles annually to the government, to cover the cost of care for the insane, maintenance of secondary schools and aid to agriculture. The reasoning for using the bank's surplus to pay government running costs was that losses in the Crimean War and repeated crop failures in recent years had crippled the government's finances. Once the budget was on a firmer footing the matter could be reconsidered.³⁷⁹

The estates were favourably disposed to the main question, meaning that they were prepared to take the Bank of Finland under their wing. The distant precedent used was the Diet of Porvoo, but they also emphasised that the sanctity of property rights required not merely the rule of law but also the stability of money, which would be best achieved by transferring the Bank of Finland to their management and supervision. It would strengthen public confidence in the bank.

But the Estates did not approve the model proposed for the selection of board members, and wanted to reinforce the role of the supervisory council, selected by the Estates. Their counterproposal was that, when a vacancy opened on the board, the council should select three candidates, from whom the Economic division of the Senate would then make a choice to be presented to the Emperor for his confirmation. The chairman of the board would be chosen from among the members of the board in the same way. The Estates were even more strongly opposed to the annual transfer of part of the bank's profits to cover government running costs. On the contrary, they felt that the move of the Bank of Finland to the ambit of the Estates was an opportunity to return to the Bank all the capital that it had given to the government over the decades. This would efficiently guarantee the bank's ability to carry out its main function, to ensure stability in the value of money. With these reservations the Estates were willing to accept the task of administering and supervising the Bank of Finland's primary capital and hypothecary funds.

A banking committee established by the Estates drafted a fairly comprehensive report on this issue, which spanned the entire operations of the bank over its history of half a century. The report is

an important document in at least two senses. It is the first systematic presentation of the bank's operations in the period 1811–1863, and it analysed important questions of principle related to Bank of Finland fundamentals. Thus it gives an overview of how the Bank was generally regarded.³⁸⁰

The committee's report defined protection of the value of money as the bank's main task. This required a return to the silver standard, for which a promise in principle had already been received at this time. In the committee's view the silver standard could be adopted as soon as the bank's silver reserves had been increased sufficiently. The bank's effectiveness could be reinforced by raising the amount of silver cover, which could be achieved by discontinuing lending from the primary capital fund and investing the money thereby released in secure bonds that could then be used at any time for the purchase of silver. The committee was also critical of the principle of defining uncontested foreign claims as equivalent to metal reserves. It saw these items as subject to such sudden reversals of fortune that they could not be simply added to the amount of metallic cover. A direct means of increasing metallic cover would be to take a foreign loan guaranteed by the Estates.

Several interesting dissenting views were appended to the report. Victor von Haartman expressed doubt over the cover ratio. In his view the fractional $\frac{7}{15}$ system of cover would create to a situation in which a change in reserves would lead to twice as great a change in the number of banknotes. This would inevitably cause immoderate fluctuations in the number of notes issued. Instead, von Haartman proposed the quota system. His statement of views also raised the position of private commercial banks. He thought there was no need to return all the capital that the Bank of Finland had previously transferred to the government because increased capital would make the bank too strong a competitor for private banks. Several other statements also stressed that banking should under no circumstances become a state monopoly.³⁸¹

The committee's report reflected a distinct mistrust for Russia's monetary system. The obligation to redeem Russian roubles in silver had forced the Bank of Finland off the silver standard in the 1850s and the committee looked forward to a future where money convertible to metal would again be the only legal tender. Finland would then be free

of the insurmountable pressure that Russian government credit notes had caused, so the likelihood of being forced off the metallic standard in future would be lower.

The Diet had no authority so the Estates merely drafted a response to the proposal. Then the Senate voiced its own view and these would form the basis for an ultimate decision by the Emperor. Before any decision was taken, however, each Estate appointed a bank supervisor and deputy, and an auditor and deputy. Even at this early stage, primary importance was attached to the professional skills of those selected. A concrete example was the choice of Professor Johan Rosenborg as bank supervisor for the Estate of Peasantry.³⁸²

The Estates' response then passed back to the Senate where the matter became more complicated. The original aim had been to change the institutional position of the Bank of Finland but the Diet had now tacked on the question of Finland's return to the silver standard. The Estates thought that Finland could return to the silver standard on the basis of a joint decision by the Senate and the supervisory council of the Bank of Finland, after a foreign loan had augmented the bank's metal reserve. However, Snellman, who was in charge of monetary reform in the Senate, foresaw excessive difficulties in this form of cooperation between the Senate and the Estates and thought that the whole reform might even be jeopardised. Such a sensitive matter could not hinge on the whims of the supervisory council. He also remarked that, for most councillors, "banks and banking are unknown territory". In Snellman's view the only option was to delay the decision on transferring the Bank of Finland to the ambit of the Estates so that the main issue, monetary reform, would not be endangered.

Snellman's views were not widely endorsed. All the other senators were ready to present the matter to the Emperor for his resolution and the Governor general was also ready to propose the transfer of the Bank of Finland to the ambit of the Estates. Snellman did not defer to the Senate's rejection of his views but wrote a letter to the Ministerial State Secretary in St. Petersburg, threatening to resign from the Senate if his views were not heeded.³⁸³ The fact that the transfer of the Bank was called off also meant that the supervisory council chosen in the Diet sessions of 1863–64 never met.

UNANIMITY ATTAINED

Disagreements about the position of the Bank of Finland meant that the matter went no farther and was presented again in the 1867 session of the Diet, where the views of the Estates were to be considered insofar as they were applicable. This formulation was largely rhetorical in nature because the two main issues of disagreement, the choice of chairman of the board and the annual transfer of money to the government, were still on the agenda. The Estates regarded the transfer of the Bank of Finland to their control as so important that they were now prepared to accept the proposal without reservations.³⁸⁴

The banking committee of the 1867 Diet again held an extremely interesting debate about the Bank of Finland. Information was now public for the first time about the exceptionally large credit losses of the Bank of Finland, partly a legacy of the problems of the late 1850s and partly the result of the monetary reform. The committee took the view that the losses were not great enough to threaten the position of the bank nor to pose an obstacle to its transfer to the ambit of the Estates. The drawbacks of the fractional cover system, discussed in the previous Diet, were now discussed in greater detail and the quota system was proposed instead. This would moderate fluctuations in the number of banknotes in circulation. However, the members refrained from demanding a change in the bank's regulations, which might have endangered the transfer of the bank to the Estates.

The most radical views were put forward by Professor Robert Montgomery, representing the Estate of Nobility. He had closely studied the position of central banks in Britain, France and Sweden and considered how much equity the Bank of Finland needed. He quoted the view of the English banker James William Gilbart that the equity capital of a bank of issue should be at least two-thirds of its liabilities. By this measure the equity of the Bank of Finland was insufficient and Montgomery believed that the best way to increase it would be to convert the bank into a joint stock company, with "private capitalists" as shareholders alongside the state. Montgomery went even further, proposing the separation of the Bank of Finland into two institutions. The capital of the first would come from the hypothecary fund and from private shareholders, and it would be responsible for issuing banknotes and for short-term lending. The capital of the second

institution would come from the primary capital fund and from private shareholders and its function would be to grant long-term credit to agriculture. The second institution would not have the right to issue banknotes and would obtain funds for lending from the bond market. A model for this two-part structure was the Bank of England. Montgomery regarded the participation of private shareholders not merely as a way of increasing capital but also of giving continuity to the governance of the bank. He was not confident that the supervisory council, appointed for periods between Diets, would do this properly.³⁸⁵ However, his views were regarded as too radical and were omitted from the report of the banking committee.

ROBERT MONTGOMERY (1834–1898)

A professor of jurisprudence, Robert Montgomery was elected chairman of the Bank of Finland's supervisory council when it was first formed in 1867, after authority over the bank had been transferred from the Senate to the Diet of the Estates. He continued as chairman for 15 years until 1882. It was thanks to the strength of his personality that the council achieved a very solid position during those years, not only in overseeing the bank but also in its operational management. Indeed, the council played a far more prominent role than the bank's board. Montgomery made a major personal contribution when Finland went on the gold standard in 1878. He had first proposed this at the start of the 1870s and renewed his call in 1876. He was then appointed to head the gold standard committee that planned the move.

Politically Robert Montgomery was a liberal and, together with his friend Leo Mechelin, a core member of the constitutional liberals, who had a shared background in academia. His official career was magnificent; after postgraduate studies in Switzerland, France, England, Germany and Sweden, he was appointed professor of civil and Roman law in 1870, procurator of the Senate in 1882, president of the Vaasa Court of Appeal in 1886, senator in 1887, a member of the committee for Finnish affairs in St. Petersburg in 1888, and finally deputy chairman of the Senate's Judicial

division in 1896. On the other hand his uncompromising adherence to constitutionalism caused him problems when disagreements about the nature of Finnish autonomy vis-à-vis Russia came to a head towards the end of his career.

Before taking up his university position Montgomery had been a member of the board of Finland's first commercial bank, the Union Bank, in 1864–1867. When he became a member of the supervisory council he therefore had exceptionally good practical knowledge of banking, which was clear from all his statements of opinion on the subject. Another of Montgomery's striking features was his skills in building broad relationships abroad, which he used while heading the gold standard committee. Even before its first meeting he wrote to A.O. Wallenberg, the director of Stockholm Enskilda Bank, asking for material about the gold standard to be sent to Finland. Wallenberg responded enthusiastically and penned a wide-ranging memorandum on the subject.

As a scholar, Montgomery was internationally oriented, which shows clearly in his actions as chairman of the supervisory council. Under his term the bank closely followed the international debate on the role of central banks and its board became familiar with the fundamentals of central bank policy. Finland too moved towards the classical central banking model, largely inspired by Montgomery.



Robert Montgomery

■ Professor Robert Montgomery headed the Supervisory council in 1867–1882 and ensured that, from its inception, it had a strong grasp of banking principles.
– Bank of Finland.

SUBORDINATE TO THE DIET

NEW MANAGEMENT STRUCTURES

A statute transferring the Bank of Finland to the ambit of the Estates was published on 9 December 1867 in accordance with the proposal made to the Diet. A supervisory council appointed by the 1867 Diet began work on 1 January 1868. Its members were Robert Montgomery, a professor of jurisprudence chosen by the Estate of Nobility; J.W. Rosenborg, a professor and doctor of jurisprudence chosen by the Clergy; C.A. Örnberg, a Court of Appeal assessor chosen by the Burghers; and C.G. Borg, a university lector chosen by the Peasantry.³⁸⁶ The councillors picked Montgomery as their chairman. He was to play a very important role in the development of the Bank of Finland and Finnish monetary policy from then until 1882.

The statute made the council responsible for supervising the Bank of Finland but the supervision of funds managed by the Bank of Finland board was the duty of the Senate. Auditors were to be chosen from each Estate. The Economic division of the Senate remained responsible for approving the bank's financial statement, and so was to receive the auditor's report, the supervisory council's report and possible responses by the board to these reports. If the Senate's Economic division and the council were to disagree, the Emperor would decide whether to discharge the board from liability.³⁸⁷

The chairman of the Bank of Finland's board was to be appointed by the Emperor following the procedure used hitherto or decreed by the Emperor in future. Regarding the other three members of the

board, whenever a place fell vacant the council was to have the absolute right to propose three candidates. The Senate's Economic division would make a statement to the Emperor about each candidate and he would then appoint one of them. A deputy board member would be appointed by the Senate's Economic division on the basis of a proposal by the council. For filling the positions of manager of the Bank of Finland's exchange office, the bank's secretary, its attorney, its senior, second and third clerk or its senior cashier, the board was to make a proposal and the council its own statement. The choice of other members of the bank's staff was entirely at the board's discretion.³⁸⁸

In fact, all of the duties that had previously been performed by the Economic division of the Senate were taken over by the supervisory council. Its members had the final say concerning limitations and changes in Bank of Finland lending; interest rates, the discount rate and the longest allowed term for discount loans; handling charges for domestic bills of exchange; and settlements agreed with debtors. In all of these matters, a proposal by the board of the bank was to serve as the basis for the council's decision. The council was to receive monthly summaries of the state of the bank and to ensure that information about the bank's circumstances was published.³⁸⁹

The prerogative of the head of the Senate's Financial department, or any other designated senate member, to participate and vote in board meetings, was restricted. The statute stated that this right of participation concerned only matters related to state funds being managed by the board.³⁹⁰

The role of the supervisory council was reinforced by a decision of the 1867 Diet that the first council chosen should immediately begin preparing new Bank of Finland regulations. The proposal for new regulations was to be debated in the following Diet of 1872, after which the Emperor could ratify them. So it was, although the new regulations did not come into effect until 1876 because, around the same time, the Senate was preparing to set up a new body of its own, to manage all state funds previously managed by the Bank of Finland. The State Treasury began operations in 1875, handling all government financial traffic and leaving the Bank of Finland to concentrate on central banking. This move clarified the function of the Bank so that its supervision could be left entirely to the Estates.

REVISION OF REGULATIONS

The revision of regulations had already been prepared in the Diet of 1863–64, as mentioned above. The change of the greatest principle concerned the right to issue banknotes. The existing system of fractional cover of banknotes had drawbacks that had long been recognised. It caused unreasonably abrupt fluctuations in the quantity of notes in circulation and so amplified economic cycles, as had occurred in the difficult years of the 1860s. In 1872, when the Diet was in session, business conditions were exceptionally good and moreover the government had taken a large loan from Germany. As a consequence, the number of banknotes was more than twice as great as in the middle of the preceding decade. It was proposed to replace the fractional cover system with a fixed quota system, which would allow the issue of up to 16 million markkaa of uncovered banknotes, plus an additional number that would be entirely covered by metal reserves or receivables. This additional amount would thus fluctuate directly in proportion to cover.

In the Diet debate, Robert Montgomery, the chairman of the supervisory council, once more took a strong stand. He noted that the model for the quota system was Peel's Bank Act of 1844 in England but at the same time he pointed out that, during the financial panics of 1847, 1857 and 1866, the Bank of England had been compelled by circumstances to deviate from its regulations. The British central bank had rescued the banking system by issuing more notes than Peel's Act permitted. In the argument between supporters of the currency and banking doctrines, the flexibility of the banking doctrine had prevailed during years of crisis even though Peel's Bank Act followed the currency doctrine. Montgomery said that a suitable solution for the Bank of Finland would be a quota system, in which the quota of uncovered banknotes was 20 million markkaa, somewhat more than the 16 million proposed by the bank councillors. His explanation for why 20 million was appropriate was that the volume of banknotes in circulation in Finland had never been less than this. The proposal was incorporated into the new regulations.³⁹¹

With the establishment of private commercial banks the Bank of Finland had begun to assume a role more in keeping with a central bank. This was reflected in its regulations. The Bank ceased to accept

interest-bearing deposits, although it still operated interest-free current accounts, mainly intended for large companies. Also, making long-term loans to agriculture from the primary capital fund was discontinued.³⁹²

In several places, the regulations clarified the balance of power between the Senate, the supervisory council and the Bank of Finland's board. The auditing of accounts and discharging the board from liability now became the responsibility of the council alone. The bank's primary capital was set at 6 million markkaa, and 9 million markkaa of profits were to be transferred annually to the reserve fund. Part of the annual surplus could still be used for "purposes alien to banking", meaning the amount that had to be transferred to the government each year. Back in 1863, this annual payment to the government had become a precondition for the transfer of the Bank to the ambit of the Estates. With the establishment of the State Treasury, the number of bank employees had declined somewhat, which was reflected in the board, where the number of members fell to three, one of whom was the appointed chairman. The supervisory council felt it would have been consistent if they, as the masters of the bank, were to appoint both board members and propose the board's chairman to the Emperor. On the other hand they conceded that the main functions of the bank, preservation of the value of money and facilitation of payments, also fell within the remit of the national government, which should therefore have a say in choosing the bank's board. Thus the Senate and the Emperor retained their influence in appointing board members but, in other respects, the Senate's power over appointments was curbed. Only the heads of branch offices were to be appointed by the Economic division of the Senate. All other appointments became the prerogative of the board. The situation could not arise where the Senate or the council could impose a bank official that the Bank of Finland's board did not want.³⁹³

A new element in the management regulations was the creation of discount committees in branch offices. These were to be chaired by the head of the branch office, with two other members who were local residents and well informed about business. The discount committees were to consider the purchase of foreign and domestic bills of exchange and the granting of loans and current account advances. The discount committee was to meet at least twice a week. Its function was to keep



■ In autumn 1863 the Diet of Finland convened, the first for more than half a century. The sessions were opened by Tsar Alexander II in Helsinki.

– R.W. Ekman, oil on canvas, 1865.

House of Nobility: Douglas Siven.

the bank in touch with business developments and thus keep credit losses under control.³⁹⁴

The reforms of the 1860s and 1870s brought about a fundamental change in the status of the Bank of Finland and the nature of its operations. A state agency under the strict control of the Senate had evolved into a Bank of the Estates in line with the Swedish model. The restructuring of the whole banking system that took place at this time, with the emergence of private commercial banks, marked the start of the Bank of Finland's journey towards genuine central banking. This progress was promoted by its reassignment to the control of a council chosen by the Diet, who immediately took a firm grasp of operational management and supervision. Capability and banking experience were crucial criteria for council members and their skills were soon reflected in growing expertise on the bank's board. The mentality of government bureaucrats yielded to the culture of bankers.

Until the monetary reform in the mid-1860s, Finland's monetary system had been firmly tied to Russia's but, as soon as Diet sessions resumed after a hiatus of half a century, the decisions of the first Diet of Porvoo again returned to Finnish minds. In 1863–64 the Diet openly debated the question of a bank operating under the estates and also regarded it as self-evident that Finland would reinstate the silver standard. It regarded the obligation to accept Russian credit notes in payments as the biggest obstacle to monetary stability in Finland and made no attempt to disguise its desire to separate Finland from the Russian monetary system in this respect. The conflict with the views prevailing in the Russian government was obvious.

The Senate saw the situation in a more balanced way. Snellman, in particular, feared that if the Estates were too forthright, there could be a political impasse. This was the backdrop to a dispute that arose between Snellman and the Estates on how reform of the Bank of Finland and monetary conditions should proceed. There was no disagreement about the fundamentals but no agreement about the right rate of progress and methods to be used. The final result, however, was what both parties desired and a delay of a few years in transferring the Bank of Finland to the ambit of the Estates did not, with hindsight, matter much.

INTERNATIONAL MOVES TO GOLD

LATIN MONETARY UNION

In 1865, when Finland went on the silver standard and the practical operation of its monetary system separated from Russia's, there were ongoing plans in Europe for broad monetary integration and even the establishment of a world currency founded on the French franc. These plans did not ultimately come to fruition but they strengthened the development of an international monetary area in the south of Europe, the Latin Monetary Union. Its members – France, Italy, Belgium and Switzerland – had a common monetary system based on the franc between 1865 and 1914. Greece also became an official member of the union from the start of 1869. The metallic coins of the Latin Monetary Union were legal tender in all its countries regardless of where they were issued.

The Union was spurred by the need to coordinate the technical characteristics of coins and the number minted in the countries with monetary systems based on the French franc (or an identical unit) as a legacy of Napoleonic rule. The metal coins of France, Italy, Belgium and Switzerland circulated fairly freely throughout all these countries but small differences in their weight and purity were troublesome.

The Union's monetary system was bimetallic; both gold and silver coins were legal tender and the public had the general right to have money minted from either metal. A five-franc (or lira, or drachma) coin, the *écu*, was minted from silver, while ten-franc and twenty-franc “Napoleons” were minted from gold. The mint ratio of gold to silver

was set at exactly 15½:1. The five-franc silver écu weighed exactly 25 grams (of which 90 percent was fine silver), and a 20-franc gold Napoleon had to weigh $\frac{8}{31}$ as much.³⁹⁵

What made the Latin Monetary Union interesting to Finland was that the Finnish markka was defined in 1860 in a way which made it equivalent in silver content to the French franc. This in turn was based on the old-established silver content of the silver rouble, coincidentally equivalent to four silver francs. Subsequently, when Finland later went on the gold standard in 1878, Finland's gold markka was defined in its gold content and other respects in terms of the ten and twenty-franc French gold coins. In the value of its money, Finland thus became a de facto part of the European franc system, although it did not become a formal member of the Latin Monetary Union, with the attendant legal recognition of its currency. Nevertheless, according to a study by Luca Einaudi, two applications were made to the Union and, for a while, Russia's gold rouble had the status of legal tender in France. Finland made no official enquiries but the Swede, A.O. Wallenberg, probably presented the matter in Finland's name.³⁹⁶

Bimetallism has a certain inherent instability. If the market rate of exchange between the two monetary metals differs from their mint ratio, it is profitable to mint coins from the cheaper metal and make payments in it only. The more expensive metal is better used, not as money, but as metal to be melted down, exported and sold. Theoretically this means that the coinage in circulation will be either all gold or all silver, depending on which is the cheaper.

Despite its unstable tendency, the bimetallic system proved effective until the 1870s, when the price of silver fell too low for it to function. The viability of the system, which may seem surprising, can be explained by two factors. Acquiring metal bars and minting them into coins, or melting down coins and selling them as ingots, involved additional expenditure so it was not profitable if prices differed only a little from their mint ratio. Furthermore the existence of a bimetallic monetary system as such, and the large volume of metal committed to it, had a stabilising effect on the prices of monetary metals in the market for bullion. Small fluctuations in supply or demand were not certain to disrupt relative prices, which tended to stick close to the mint ratio.³⁹⁷

After the members of the Latin Monetary Union had ratified their founding treaty in 1866, the French began a diplomatic offensive aimed

at expanding the franc-based system into a global one that would cover “all civilised nations”. Via its diplomatic missions France invited the other European countries (including Russia and Turkey) and the United States to join the Union and participate in an international monetary conference. The conference was indeed arranged in connection with the Paris World Exposition in June – July 1867, and was the zenith of France’s efforts to turn the franc into a universal currency. At the same time it marked the start of the rise of the gold standard as the international monetary system. This was not to happen until the 1870s and very differently from the way envisaged by the French.³⁹⁸

TOWARDS THE GOLD STANDARD

When Finland joined the zone of Northern European silver standard countries in the mid-1860s, the era of the silver standard as an international monetary system was approaching its demise. In the 1870s one country after another moved to the gold standard. Finland changed over in 1878, one of the last countries of Northern Europe to do so, although before Russia.

Moving to the gold standard reinforced Finland’s connection to the money markets of Western Europe and Scandinavia. At the same time it put greater distance between the monetary systems of Finland and Russia because the silver rouble lost its status as legal tender in Finland. The gold standard reform stimulated Finland’s economic development mainly by increasing its creditworthiness and facilitating capital imports, which were very significant in the final decades of the 19th century. In deciding to move to the gold standard, Finland showed that its monetary and fiscal policies were in fact independent of Russia’s because it successfully implemented the reform at a time when the Russian monetary system was in serious disarray in the wake of the Russo-Turkish war. Among Finland’s western neighbours, Sweden and Denmark adopted the gold standard in 1873 and Norway the following year. At the same time these countries established the Scandinavian Monetary Union.³⁹⁹

In a sense, Finland’s move to the gold standard came at the eleventh hour, when the value of silver was falling fast. The changeover from silver to gold took place at the conversion rate of 1:15½, the legal mint ratio used in the French bimetallic system. By 1878, the value of silver

had already dropped so far below this rate that Finland's changeover brought a substantial revaluation of the markka. However, a postponement of the reform would have left Finland as practically the only silver standard country in Europe. There was also a danger that the value of silver might fall still more, making Finland's revaluation even steeper if it adhered to the mint ratio of the franc system.

As early as the 1860s the concept of the gold standard as the monetary system of the future was gaining ground. The main stimulus was the increased use of gold in countries on the bimetallic system, principally France. Large finds of gold at the end of the 1840s had served to push down its market price, leading to a steep rise in the 1850s and 1860s in the proportion of gold coins in bimetallic system countries. Marc Flandreau believes that by the end of the 1860s France had six times more gold than silver coins in circulation although silver had been the predominant coinage at the start of the 1850s.⁴⁰⁰

Of the countries represented at the international monetary conference in Paris in summer 1867 (Austria, Baden, Bavaria, Belgium, Denmark, Spain, the United States, France, Great Britain, Greece, Italy, the Netherlands, Portugal, Prussia, Russia, Sweden-Norway, Switzerland, Turkey and Württemberg) all but the Netherlands stated that they were in favour of an international gold standard. The conference did not lead to concrete results but it is evident that the gold standard had broad international support even then.⁴⁰¹

Luca Einaudi has drawn attention to French differences of opinion about monetary systems at the end of the 1860s. French premier de Parieu was a supporter of the gold standard while the National Assembly and the Banque de France wanted to retain bimetallism. Einaudi believes that it is unrealistic to imagine that the National Assembly would have agreed to demonetise silver at this time.⁴⁰² The positions of the other delegates were not binding on their countries' governments either, so the conclusions of the French monetary conference merely show the undercurrents of the age.

In Germany there was active debate on moving to the gold standard as early as the 1860s, before German unification. Commercial and industrial circles were vociferous in these demands, mainly because gold had become far more important than silver in foreign trade. Germany conducted a large proportion of its trade with Great Britain, where the gold standard had been in force since 1821. Germany also

traded greatly with France, where gold had become the main monetary metal by the 1860s, after gold strikes in California. In 1869 the Parliament of the German Customs Union approved a declaration inviting the member states of the union to adopt a gold standard based on the franc as soon as possible. Einaudi emphasises, though, that before 1870 the German “gold standard party” was not in favour of separate national action but sought the gold standard as part of a unified international system founded on the franc.⁴⁰³

It would not even have been possible before 1870 for Germany to embark on concrete measures for a gold standard. The obstacles were procuring the gold reserves that would be required and selling the silver that would become unnecessary. There was no solution in sight until war transformed the situation. The series of events that led to the worldwide spread of the gold standard began from the Franco-Prussian War of 1870, which culminated in the unification of Germany and the downfall of the French Empire of Napoleon III.

The German Empire, established in 1871, decided to unify its monetary system on the basis of the gold standard. This was a major reform, for its money had traditionally been based on silver. Adoption of the gold standard was made possible by the indemnity of five billion gold francs that France was ordered to pay in the peace treaty. The impact was significant even though only a small part of the reparations was actually paid in gold; most was paid in bills of exchange payable in London, Amsterdam, and other international financial centres. When the gold standard came into force in Germany in 1873, it increased the supply of metallic silver on world markets because Germany no longer needed so much silver as coinage in general circulation nor as metal reserve for its banks of issue. Although a large amount of silver could, in the traditional manner, be exported to India and China where the silver standard was still in use, Germany's move to the gold standard triggered a major fall in the market price of silver.⁴⁰⁴

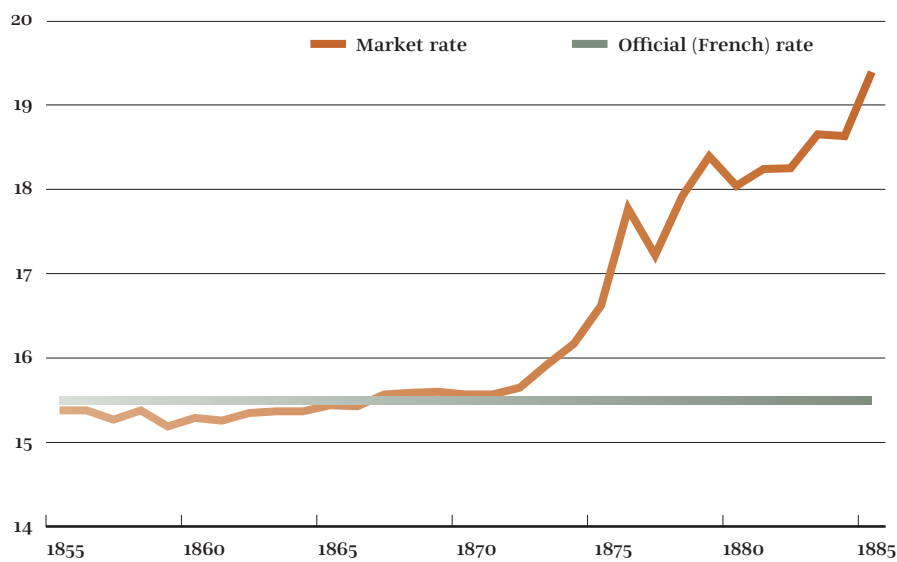
Since the end the Napoleonic wars and Britain's return to the gold standard, the relative price of gold and silver had remained close to the mint ratio used by France's bimetallic system, where one gram of gold was worth 15½ grams of silver. In 1873, after Germany had moved to the gold standard, the ratio began to change fast. By 1879, one gram of gold would buy 18.4 grams of silver, meaning that the price of gold had risen about 19 percent.

The drop in the silver price caused turmoil in countries such as France that used a bimetallic system. They were flooded with great volumes of silver because their citizens had the legal right to mint coins from it – in France the five-franc silver écu had been the cornerstone of the monetary system. Silver arbitrage threatened to create a run on the gold reserves of France and its partners and thereby to shift the Latin Monetary Union entirely onto the silver standard.

To avoid arbitrage in silver, France began to restrict the minting of silver coins in 1875. The first statute to this effect was enacted in September 1873 but, under the Latin Monetary Union, the silver coinage of all members had a degree of validity in all the countries so France’s unilateral measures were obviously not enough to stabilise the situation. In January 1874, France reached agreement with the other members of the union on restricting on minting of silver coins.

These restrictions on the use of silver in coins had very far reaching consequences and were the next step, after Germany’s decision, towards a worldwide gold standard. Flandreau calls the restriction on

EXCHANGE RATE BETWEEN GOLD AND SILVER 1855–1885



Source: Björkqvist, H., 1953.

minting silver coins “the pebble that started the avalanche”. When the public could no longer convert silver into coins without restriction, the value of silver began to fall ever faster. By restricting the use of silver as a monetary metal, France and its partners precipitated its decline, the very thing that was undermining their system.⁴⁰⁵

In the years ahead silver continued to become cheaper. At the same time it was increasingly obvious that some form of gold standard was the future of the entire Latin Monetary Union. In August 1876 France stopped the minting of silver coinage entirely and Belgium followed suit later the same year. In a conference in October 1878, the members of the Latin Monetary Union agreed that minting of five-franc solid silver coins would be terminated although Italy was granted a transitional period of one year.

With these decisions France had moved to a “limping gold standard” meaning that both gold and silver coinage was in circulation but only gold coins could be freely minted. The value of silver coins in these circumstances no longer depended on their metal content but on the willingness of the Banque de France to redeem them on demand for banknotes and ultimately for gold. Silver had become token coinage.⁴⁰⁶

France’s limping gold standard functioned almost in the same way as a pure gold standard where silver was not legal tender. The main monetary difference was that the Banque de France had the right, in theory, to redeem its banknotes with silver instead of gold if it so wished, because silver was still legal tender. In practice the bank redeemed notes with gold and the franc’s value in gold thus remained stable until the outbreak of the First World War.

Flandreau has analysed alternative explanations for the failure of bimetallism in the Latin Monetary Union and the United States and for the rise of the gold standard as a quasi-universal monetary system during the 1870s. The traditional explanation is based on the production of precious metals and the effect of increased supply on their value. It concludes that large finds of silver in the Americas (Nevada and Mexico) at the start of the 1860s boosted the supply of silver and pushed down its price, forcing governments to demonetise silver in order to protect the value of money.⁴⁰⁷

Flandreau has sought to show that the volume of metal in circulation in France was so great that the bimetallic system would actually have been able to absorb the increased production of silver.

As a consequence, gold would have been partly replaced by silver in circulation in France and other members of the Latin Monetary Union, the opposite of the process that occurred in the 1850s and 1860s when large gold finds increased the proportion of gold in circulation in the Union.

Flandreau looks elsewhere for the changeover to the gold standard and concludes that the immediate reason was “Bismarck and (the battle of) Sedan”, in other words the politics of the 1870s and particularly the Franco-German war. On the other hand it is clear that Germany’s decision to move to the gold standard was also motivated by certain underlying factors, particularly the key position of Britain, a gold standard country, in German foreign trade and the whole global economy. Gold was also superior as a medium for international trade and payments, because its greater value made gold coins easier to transport and store than silver ones. Thus the triumph of gold was partly the result of “network effects”, the desire to use the same money as trading partners, and also of transaction costs.⁴⁰⁸

WAR IN THE BALKANS PROLONGS ROUBLE WEAKNESS

At the same time as Western Europe and, eventually, Finland were moving to the gold standard, Russia was struggling with monetary instability. It had not even managed to restore convertibility into silver and, for a long while, the gold standard was no more than a distant mirage. After the rouble crisis of the 1860s, during which Finland's silver standard reform had effectively separated its monetary system from Russia's, the rouble languished for decades. Full-purity coins of both silver and gold had disappeared from circulation and the only metal coins were small change linked to the paper rouble which itself had an unsteady value.

In 1877, when the gold standard was sweeping Western Europe, the Russian Finance Minister Mikhail von Reutern wrote that, until the second half of 1875, he had believed it would be possible to restore rouble convertibility into silver. It was in 1875 that conditions began to deteriorate and the rouble weakened on currency markets. Reutern blames this partly on a bad harvest, partly on tension in foreign policy.⁴⁰⁹

In April 1877 Russia declared war on Turkey and its army advanced south through Bulgaria. There were Finns among the Russian forces and the exploits of the Guard of Finland lives on today in Finnish songs like "A thousand young men left Helsinki port..." The war was extremely bloody and Russia suffered heavy losses but ultimately proved to be militarily stronger than Turkey.

In January 1878, after Russia had conquered the city of Adrianopolis, Turkey offered a truce. Russia accepted but continued advancing

towards Constantinople until the threat of British intervention on Turkey's side forced Alexander II to make peace. A sign of Turkey's difficult military position at the end of the war is that the headquarters of Russian forces were on the outskirts of Constantinople in the town that is today called Yeşilköy.

At the Congress of Berlin in summer 1878, Europe's great powers (Russia and Turkey as well as Britain, Italy, Austria, Germany and France) made peace and reorganised the countries of the Balkans. The final outcome was a great disappointment to Russia both in terms of its war objectives and in relation to the great sacrifices it had made to obtain military victory. It was clear that the other great powers of Europe would not permit Russia to gain its political objectives in the Balkans.

Economically the war was catastrophic for Russia and led to the resignation of Finance Minister von Reutern in summer 1878. He had opposed the war and defied the risk of unpopularity by warning the tsar of the destructive economic and societal consequences. Reutern said that war between Russia and Turkey was not merely a bilateral matter but concerned the interests of all the states of Europe, who would not give Russia free hands in the Balkans.⁴¹⁰ His predictions proved accurate politically and economically. During the war the external value of the Russian rouble dropped about 40 percent and Russia's creditworthiness collapsed, downgrading its government bonds. The improvements in infrastructure and credit conditions that Reutern had sought were in jeopardy.⁴¹¹

Olga Crisp, a researcher in Russian economic history, notes that the Russo-Turkish war wiped out all of Reutern's achievements to date in strengthening the rouble and avoiding sharp fluctuations in its exchange rate. She says that Russia's "active foreign policy did not merely damage Russia's finances but also indirectly consigned the country to economic backwardness because all possible savings were collected as tax and used for unproductive purposes, military and otherwise".⁴¹²

FINLAND MOVES TO THE GOLD STANDARD

THE SILVER PRICE FALLS

Money became more stable in Finland after the silver standard had been adopted and when the credit market had recovered from the years of crop failure. The general public could now enjoy the dependability of a metal standard. Below the surface, however, conditions were precarious. The main worry, as in many other European countries, was the varying price ratio of the alternative monetary metals, silver and gold.

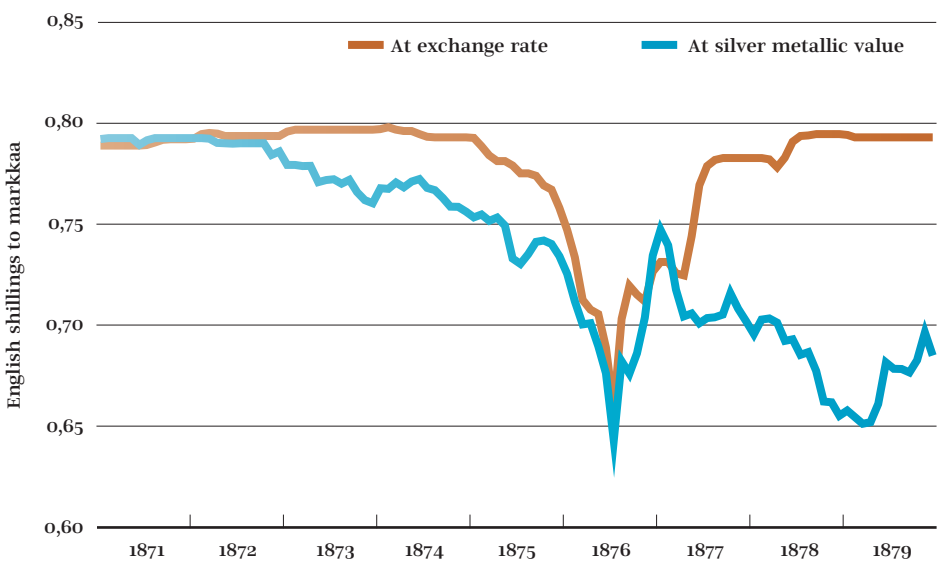
Finland closely followed international trends and they were the subject of discussions in the Bank of Finland's supervisory council in the early 1870s. In the annual report for 1872 it explored the scope for moving to the gold standard and, although the matter did not advance for several more years, this was not merely a trial balloon. The board of the Bank of Finland had begun to build up gold reserves. By the end of 1874 it already had 15.5 million markkaa in gold, which was nearly 60 percent of its precious metal holdings. At the same time, its silver reserves were deliberately reduced towards the legal minimum of 10 million markkaa.⁴¹³ Currency discussions were not confined to the Bank of Finland; there was active debate in the Diet as well as the press. The most prominent views were presented in the newspaper *Helsingfors Dagblad*, which was controlled by Swedish-speaking liberals. This circle also contained the most competent experts in monetary and banking theory and practice.⁴¹⁴

By autumn 1873, the situation had become serious for the Bank of

Finland, because the price of silver was falling steeply. As before, the main source of concern was the link with Russia's monetary system. According to the law of 1866, Russian silver specie was valid for payment in Finland. After the value of silver had fallen, the Russian State Bank had reduced its price but the Bank of Finland could still have been required to accept it at nominal value. Another risk was that worn coins with a lower silver content would be attracted to Finland. In response to these matters, the Board proposed adopting the same purchase price for silver as the Russian State Bank, and also paying a lower rate for worn coins. The matter advanced only sporadically but by the start of 1875 the Senate had reached agreement on restrictions on the validity of silver coins. The matter did not advance farther because Finland's move to the gold standard made it unnecessary. Fortunately there was no large-scale rouble speculation against the Bank of Finland during those years.⁴¹⁵

Another source of concern for the board of management was speculation in silver. Despite the lower silver price, the Bank of Finland

VALUE OF THE FINNISH MARKKA IN GOLD 1871-1879



Source: Björkqvist, H., 1953.

was endeavouring to hold the external value of the markka constant and not to let it fall in line with silver. This situation remained manageable until the start of 1872, when the downwardly spiralling silver price moved so far from the markka's exchange rate that there were opportunities for currency arbitrage and speculation. The wider the gap became between the external value of the markka and its official silver value, the more attractive it would be to import silver into Finland and have coins minted from it. In the view of the board, Finland needed to renounce a fundamental principle of the metal standard, the freedom to convert metal into money, meaning the right of private individuals to mint coins. The unfettered convertibility of metal was of course originally intended to prevent the monetary unit from becoming more valuable than the monetary metal, and this set strict limitations on the Bank's room for manoeuvre.

From the start of 1874 onwards, the Board sought to limit the private right to mint money. Initially the supervisory council was against this because, in the view of its chairman Robert Montgomery, the restrictions would mean in practice that Finland was leaving the silver standard. The restrictions were strongly attacked by the press too, especially the liberal Helsingfors Dagblad. In the capital, the Merchants' Association arranged a public debate on the question and afterwards sent a memorandum in its name to the head of the Senate's Financial department, Herman Molander. There could be no interference with the freedom to import and export precious metals, it said. The right of individuals to have their silver minted should be unfettered. A decision to restrict minting was again postponed.

The price of silver began to drop steeply in 1875, and the board of the Bank of Finland was compelled to re-examine its exchange rate policy. It now allowed the external value of the markka to fall close to its actual silver value, so as to curb the incentive to import silver. Silver prices were fluctuating so much that it was no longer a viable monetary metal, so the question of moving to the gold standard was now very pressing. At the turn of 1876 all the institutions with a bearing on the matter – the Governor general of Finland, the Ministerial State Secretary in St. Petersburg, the Senate, the Diet and the Bank of Finland – were agreed.⁴¹⁶

It was during 1875 that the Senate Economic division finally grasped how expensive it would be for the government to remain on the silver

standard. A key consideration was the cost of servicing foreign loans. State loans were almost entirely from Germany, which had moved to the gold standard. As long as Finland was on the silver standard, the cost of amortisation moved in inverse proportion to the silver price.⁴¹⁷

ST. PETERSBURG LETS PLANNING ADVANCE

The initiative for moving to the gold standard came from the Bank of Finland's supervisory council, which reached a unanimous decision on the matter on 12 February 1876. It asked for a committee of experts to be empowered to draft a full proposal on the measures required for adopting the gold standard. The petition was formally addressed to the Emperor so that the matter could proceed as quickly as possible. The other alternative would have been a petition from the Estates but it was thought that this would take too long. The council's proposal was drawn up by Robert Montgomery and argued that the gold standard was needed mainly because of fluctuations between the value of gold and silver, which had caused problems for the Bank of Finland in particular and monetary stability in general. Between the start of 1873 and the start of 1876 the price of silver had dropped 10 percent.

Another argument presented was that these fluctuations had not been temporary and that, as ever more countries had moved to the gold standard, the role of silver as a measure of monetary value was over. Thirdly the petition pointed out that staying on the silver standard would cause great costs to Finland in payments abroad. Not even a rise in the silver price would now solve the problem because silver was no longer acceptable in payments to the gold standard countries. Finally the council praised the qualities of gold as a monetary metal and predicted that the gold standard would gradually become the universal monetary system. In the national interest it wanted to move to the gold standard without delay. The proposal conceded that there were political obstacles because many leading officials in St. Petersburg might regard the move to the gold standard as extreme separatism. For this reason it wanted to advocate the matter with the utmost discretion.⁴¹⁸

Although the initiative formally originated from the supervisory council, this was in fact a joint governmental project backed by all the main institutions, meaning the Governor general, the Ministerial State

Secretary, the Senate and the Bank of Finland. The approval of the Governor general's office may seem somewhat surprising. Both Governor general Nikolai Adlerberg and his assistant Bernhard Indrenius supported the move to the gold standard throughout the process. From time to time Adlerberg was on leave of absence because of ill health and his duties were performed by the Finnish-born Indrenius, so both gentlemen played an important role.⁴¹⁹

After being debated in the Senate, the council's proposal went before the Governor general and the Ministerial State Secretary, and was finally presented to the Emperor at the end of March 1876. The tsar said no; Finland could not move to the gold standard before the entire Russian Empire had done so. This unconditionally refusal was a shock to the Finns and, at least according to deputy Ministerial State Secretary Casimir Palmroth, the move to gold now seemed to be on hold for eternity, "*ad calendas graecas*". Heimer Björkqvist, who has studied this question the most closely, believes that the tsar responded negatively because Ministerial State Secretary Stjernvall-Walleen presented the matter to him prematurely, when it was still being prepared in the Senate. The proposal was made unofficially and did not delve into political aspects sufficiently. It has even been said that the language of the presentation document was stylistically poor.⁴²⁰

Plans for the gold standard were not entirely abandoned. Acting Governor general Indrenius grew up a memorandum on the question, which was used by Ministerial State Secretary Stjernvall-Walleen and his office to try to restart it. By mid-April 1876 Stjernvall-Walleen had managed to obtain the tsar's permission to re-present the matter and this time Alexander II said yes to the Finnish plan. At the start of May the Senate was instructed to establish a committee to draw up a proposal for moving to the gold standard.⁴²¹

Montgomery was the obvious choice to chair the committee. Professor Leopold Mechelin, Baron Jean Cronstedt, Lector Nils Nordenskiöld, Baron S.W. von Troil and Consul Wilhelm Hackman⁴²² were appointed as other members. The committee's composition was somewhat surprising because five of its six members had close ties to the country's first private commercial bank, the Union Bank of Finland. Montgomery and Mechelin had been members of its board, Cronstedt was its managing director, von Troil was the manager of its Turku office, and Hackman was the superintendent of its Vyborg office.⁴²³

There was not a single representative from the State Treasury nor the board of the Bank of Finland. This bias aroused some public criticism but mainly about the lack of representatives from industry. The chief conclusion to be drawn from the composition of the committee is that Finland had so few experts in money and banking in the 1870s.

Robert Castrén, a lawyer, was appointed secretary of the committee. In early 1876 he had been in Paris on post-graduate studies, listening to lectures from economists like Paul Leroy-Beaulieu. Castrén was particularly interested in monetary questions, which had been under active discussion in Paris. The move to the gold standard was a very topical question there, too, and he had sent articles entitled “The Money Question in France I – II” to Helsingfors Dagblad newspaper.⁴²⁴ Even so, the information obtained from the Paris trip was not sufficient for the needs of the gold standard committee and, immediately upon his return to Finland, Castrén faced a herculean task of reading. Montgomery and Mechelin had used their European contacts to obtain the latest data on currency systems in all possible countries. As well as studies and press articles, the committee had access to monetary planning papers. A.O. Wallenberg, the director of Stockholms Enskilda Bank, was a very useful source. He was an old acquaintance of both Montgomery and Mechelin and had been involved in planning Sweden’s adoption of the gold standard.

The committee began its work in very dramatic circumstances because the price of silver dropped to a record low level at the start of June 1876. The board of the Bank of Finland and the supervisory council convened in emergency session to consider ways of preventing silver speculation, or more precisely of restricting the free convertibility of the metal, but still could not reach agreement. The fall in the silver price reinforced their already firm belief in the necessity of the gold standard and this view was reciprocated on the highest possible level. Tsar Alexander II visited Helsinki on 14–17 July 1876 and was briefed on Finland’s economic position by Molander and Adlerberg, the head of the Diet’s Financial department and the Governor general. They took the opportunity to raise the monetary question and presented the tsar with memoranda stressing the financial losses that the silver standard would cause to Finnish government finances. Björkqvist says that the tsar was favourably disposed towards adopting the gold standard.⁴²⁵

Circumstances required the gold standard committee to work at a hectic pace and its 119-page report was completed within a few months. Its proposals, made at the start of October 1876, were very forthright. Finland had to move to a new monetary system where gold would be the only measure of value. The committee saw no alternatives: "Finland should not give a moment's consideration to such a profligate system as the bimetallic standard". The committee believed there was no need to create a new monetary unit but proposed the adoption of the gold franc system. The options were the systems of Britain, France and Germany, and trading relations were the strongest with Germany and Britain, but there were political reasons for using France as Finland's model, because the committee expected Russia to move to the gold standard in future and to adopt the franc system. It would also be convenient for a gold markka to be naturally equivalent in value to a gold franc.

In this connection, there is no need to reiterate the regulations on the weight and purity of the gold markka proposed by the committee. It based them mainly on the laws in force in the other Nordic countries and the Netherlands. The report also contained draft instructions on the right to mint coins, on minting charges and on the parameters for a coin of full value.

The committee report was not explicit about the position of Russian money in Finland but stated that the country's only legal tender would be 10- and 20-markka gold coins and banknotes issued by the Bank of Finland. For small change it proposed silver and copper coins minted in Finland. The logical implication was that Russia's metal rouble would lose its status in Finland completely.

The changeover from the silver markka to the gold markka would be implemented at the traditional parity of $15\frac{1}{2}:1$. This was the only point on which the committee members could not agree. Montgomery and Nordenskiöld both appended dissenting views to the report, proposing a conversion rate that would take into account the fall in the value of silver since 1872. The rate proposed by Montgomery would have meant a devaluation of about 4 percent from the rate in the committee report. Nordenskiöld wanted a devaluation of about eight percent.⁴²⁶

PROJECT PASSES TO ST. PETERSBURG

The Senate was preparing a changeover to the gold standard at the same time as the gold standard committee was working on its report. The project seemed to be going well. In mid-August Molander, the head of the Senate's Financial department, visited Stjernvall-Walleen, the Ministerial State Secretary in St. Petersburg, and also met Russian Finance Minister Reutern, who expressed approval for the Finnish project. Admittedly the approval was not unreserved because the Russian side was utterly opposed to accepting the gold markka as Finland's only legal tender. The silver rouble had to have the same status.⁴²⁷

Around this time, talks were being concluded between the Senate and the Committee for Finnish Affairs in St. Petersburg on presenting the matter to the Emperor. This was done at the tsar's summer residence in the Crimea on 1 September 1877 and his verdict was favourable: "Let it be so, but on condition that before I confirm the proposal on moving to the gold standard, the matter must be studied in the Financial Committee. Alexander. Livadia Palace 1/13 September 1876."⁴²⁸

This chain of events is a fine illustration of the tortuous progress of matters concerning Finland. In spring 1876 the Emperor had given the go-ahead for the establishment of a committee to draw up a report for the changeover to the gold standard. Now, half a year later, new permission was required from the Emperor in order for the Senate to draw up a proposal for a changeover to the gold standard, based on the report of the previous committee. And permission was still required from the Russian Financial Committee, then the confirmation of the Emperor and finally the approval in Finland of the Estates.

The job of the Senate was to draft a final proposal on adopting the gold standard. Herman Molander, an expert in relations with Russia, made a decisive contribution to this, as did Victor von Haartman who, as a former chairman of the board of the Bank of Finland, was well-informed about Finland's monetary system and made an excellent partner for Molander. The position of the Finnish negotiators was reinforced by the support of Adlerberg, who had resumed his duties as Governor general. The first negotiations in St. Petersburg began at the start of January. It was by this point, at the latest, that the Finnish

side led by Molander, realised that the Russian silver rouble had to remain valid in Finland. Without this concession the negotiations would have been deadlocked. The only leeway was in the limitations that could be imposed on its validity.⁴²⁹

The attitude of the Russian Financial Committee was crucial. Every vital matter of finance in the Russian Empire passed through this committee, which had, just over a decade earlier, considered Finland's application to adopt the silver standard. It was chaired by the tsar's brother, Grand Duke Konstantin Nikolayevich, and its members were the highest officials of the Russian financial administration led by Finance Minister Reutern. It was encouraging for Finland that, when the adoption of the silver standard had been discussed, both Grand Duke Konstantin and Finance Minister Reutern had backed the plan.

When the proposal for Finland to adopt the gold standard was presented to the committee on 26 March 1877, Molander and Casimir Palmroth, the deputy to Ministerial State Secretary Stjernvall-Walleen, were invited to attend. Finland's representatives in St. Petersburg had been preparing the matter behind the scenes and were aware that Reutern was favourably disposed to it. Even before the meeting, he had sent the Finns a memorandum that he had drafted for the Financial Committee, endorsing the Finnish application. But they were also aware of the misgivings of a majority of committee members: "How can any great power permit a colony to have a monetary system separate from the mother country?"

To open the event Reutern delivered a broad review, stressing the importance of the gold standard to Finland. He said Finland's solution would cause no financial problems for the Russian government. In his view, the Finnish proposal was so well drafted that it could be approved with only minor modifications. Discussions became less comfortable for Finland when they moved from economic matters to political arguments; moving to the gold standard would sever the last ties between the monetary systems of Russia and Finland. Once again, Reutern defended the Finnish position, arguing that Finland had already gone on the silver standard 13 years previously and that adopting the gold standard would change nothing. It was motivated only by the fall in the price of silver, which had thus become unsuitable as a monetary metal. He added that Finland had made good preparations for this change because the necessary gold reserves were already in place.⁴³⁰

The Finns present, Molander and Palmroth, said that it was even easier than they had expected to win approval for their proposal, and that Reutern's wide-ranging memorandum had played a crucial role. After the discussion in the Financial Committee, the matter was approved by the Emperor on 5 April and then adopted without amendment by the Estates at the end of May.⁴³¹ The matter was thus concluded. Finland's only concession was to give limited validity to the Russian silver rouble. Private individuals and government offices were to accept silver roubles as small change up to the amount of 2 roubles 50 kopeks. On the other hand the Bank of Finland was not obliged to convert silver roubles into gold markkaa.

HOW FINLAND SUCCEEDED

Finland could not have moved to the gold standard without approval from the highest government circles in Russia. It was greatly aided in obtaining this approval by the consensus existing between all the institutions with a bearing on the matter throughout the period of preparation. In contrast to the period when Finland's adopted the silver standard, the Governor general steadily supported the Senate over the question of the gold standard. It was also important that this was part of a broader European trend. Finland was able to remain within the monetary system of Europe, even though it could not, of course, have a seat in international negotiations about it. Thanks to their broad network of contacts, both Montgomery and Mechelin had up-to-date information about current developments in the systems of continental Europe and Great Britain.

The changeover to the gold standard could not have been achieved through domestic forces alone. The support of Russian Finance Minister Reutern proved absolutely vital. To him the gold standard was the most advanced monetary system of the age, which Russia should also adopt. During his term, plans were made and action taken to allow Russia to move to a metal standard, but external factors conspired to prevent it. On several occasions Russia could have met the necessary conditions but, time and again, military conflicts arose at the last moment that rendered it impossible. This was the case in the 1870s, when relations between Russia and Turkey became inflamed. Reutern offered his resignation but Alexander II refused to let the efficient

administrator withdraw and persuaded him to continue until the Turkish crisis was over. He remained Finance Minister for two more years, until 1878. In 1876, when Finland was seeking to adopt the gold standard, Reutern knew he would soon be retiring from public service so it was easy for him to stand up to Russian public opinion.⁴³²

The Finance Minister's favourable attitude towards Finland over the gold standard became the subject of public discussion in Russia in the 1880s. This was a decade of greater pressure on Finland from Russian slavophiles and Reutern had become a target of their attacks. In some writings he was even accused of initiating Finland's move to the gold standard, the godfather to a Finnish conspiracy. It was said that his pro-Finnish sympathies derived from his noble background as a Baltic German who had lived in Livonia during his youth and that he had concentrated on developing the western periphery of the Empire while finance minister, rather than serving Russia's Slavic core. In reality Reutern's inclination to support Finland was influenced by the fact that Finland had managed to carry out many of the reforms that he gave high priority to. The finances of autonomous Finland were in fine shape compared with those of Russia. Its monetary system enjoyed the stability of a metal standard – Finland was on the silver standard unlike Russia – and its institutional framework was supporting nascent economic development.

Ultimately the move to the gold standard could not have taken place without the permission of Alexander II but the tsar's contribution to the reform was relatively neutral. He trusted the judgement of his finance minister and approved the project after the original Finnish proposal had been amended in the ways demanded by Reutern. The talks in Helsinki in summer 1876 between the tsar and his chief officials showed that he was aware of the special features of the Finnish economy and also understood how important the gold standard was to it.⁴³³

FIXING THE ROUBLE TO GOLD

CONTINUING INSTABILITY IN RUSSIA

When Finland moved to the gold standard, the Russian monetary system remained unchanged. It was based in theory on the silver rouble but the actual medium for payments was the debased credit note and the small change that served as its subunits. By the early 1880s the value of the paper rouble had fallen about 24–27 percent below its silver parity; the silver rouble was quoted in St. Petersburg at an average of 1.36 roubles in banknotes.

As described earlier, the devalued state of the rouble was the result of war in the Balkans. Even when the war ended, it took almost a decade before Russia again embarked on effective measures to the restore the value of money. By the 1880s, the question was no longer how to return to the silver standard although Russia's currency was legally founded on it. The world had moved on, and the aim of Russian monetary policy was now to bring the gold standard into force. There were various obstacles, the same as Russia had encountered previously, during Finance Minister Egor Kankrin's stabilisation programme in the 1830s and Finance Minister Mikhail von Reutern's ill-fated programme in the 1860s.

One stark problem was the value of money. Russia's old currency law recognised a gold rouble. Some ten-rouble "Imperials" and five-rouble "half Imperials" had even been minted although they did not have the status of legal tender. The gold rouble had now become

extremely valuable. Not only had the paper rouble declined in value against silver, but the value of silver had fallen against gold. To raise the value of the paper rouble to the level of the existing gold rouble would have needed an even greater revaluation than to restore silver convertibility. Monetary policy would have had to be tightened greatly, causing a rise in the real value of debts, among the other usual perils of deflation.

Another barrier in the rouble's path to the gold standard was that Russia could not begin redeeming banknotes before it had built up adequate gold reserves. Its balance of payments also had to be strong enough to eliminate the risk that reserves would be exhausted by a foreign trade deficit or a flight of capital. The gold reserves of the Russian government and Russian State Bank were still inadequate in the mid-1880s and the balance of payments was weak. The underlying cause was the government deficit.

Reform of Russia's monetary system began in the mid-1880s under Finance Minister Nikolai Bunge. He had been appointed in 1881 and had begun to tackle the problems of monetary instability with an enthusiasm equal to Reutern's. The main models were the systems of France and the other countries of the Latin Monetary Union. A new currency act that came into force at the start of 1886 retained the silver rouble as Russia's main currency but reduced the gold content of gold coins by about 3.33 % at the same time as the alloy used for the coins was slightly improved. After these changes the Half Imperial (five-rouble) gold coin was the exact equivalent of the 20-franc gold coin of France, both in weight and metal content. The conversion rate between gold and silver was also changed. Previously Russia had used the ratio of 15:1 but it now adopted 15½:1, used by France and the Latin Monetary Union.

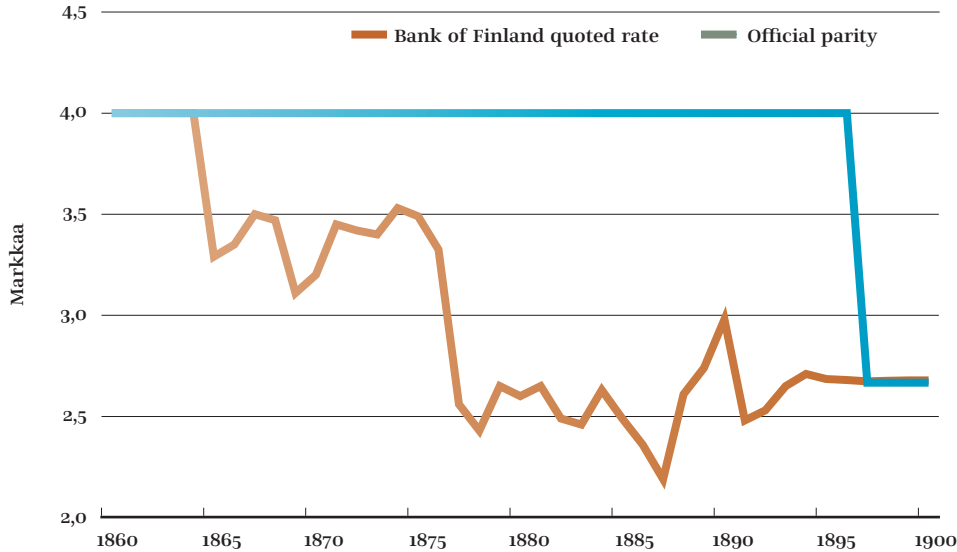
It is clear that the main purpose of the new law was to prepare the monetary system for closer integration with international markets and to do so in accordance with the standards of the Latin Monetary Union. At the time Russia was becoming politically estranged from Germany and drawing closer to France. The whole reform showed French influence.⁴³⁴

Because the gold coins in use in Finland since 1878 – like the Russian coins minted after Bunge's reform – were equivalent to French coins in weight and metal content, the Russian reform meant that a Half-Imperial was now exactly the same in gold value and purity as a

Finnish twenty-markka coin. In this sense the reform brought Russia's monetary system closer to Finland's as well as France's but this did not matter much for Finland while Russia used fiat money and did not have gold money in general circulation. As long as all payments in Russia could be made in paper roubles, which were legal tender, gold coinage obeyed Gresham's Law and was either hoarded or sent abroad.

Bunge's reform had not yet resolved the main question, which was to stabilize the value of paper money in relation to gold and make it redeemable again. After he had been forced to resign at the end of 1886, having demanded a reduction in military spending, the job of creating conditions for a return to the gold standard fell to the next finance minister, Ivan Vyshnegradsky. Soon afterwards, the Russian government reversed its earlier intention to restore the paper rouble to its old official parity. Instead it proposed to stabilise the paper rouble at two-thirds of the value of a gold rouble, and make it redeemable at this rate. The aim was also to strengthen gold reserves and make gold a legal medium of payment. The tsar endorsed the plan on 10 July 1887.⁴³⁵

VALUE OF THE ROUBLE AGAINST
THE FINNISH MARKKA 1860-1900



Source: Autio, J., 1992.

ROUBLE EXCHANGE RATE STRENGTHENS

Vyshnegradsky managed to improve Russia's trade account, balance the budget and build up gold reserves during his term of office. Initially his policies were very successful in boosting the external value of the rouble, and the exchange rate in autumn 1890 was almost 50 percent higher than its all-time low in 1888. The improvement did not last long. In November 1890 London was hit by a panic, precipitated by Baring's bank, which destabilised international money markets. The Russian rouble was seen to be exceptionally vulnerable to turns in the international money market and its value began to fall steeply. The following year Russia suffered a very serious crop failure and consequent famine, which led to a ban on grain exports. This in turn hurt the balance of payments and thus prolonged the rouble weakness that had started with the London Panic. During Vyshnegradsky's term as finance minister, the rouble exchange rate was less stable than ever before.

He had to resign in autumn 1891, and was succeeded by Sergei Witte, who had won his spurs at the director of the Russian railways. Vyshnegradsky has often been criticised for excessively severe economic policies; it is said that he "bled the Russian peasant dry" for the sake of the government treasury. The renowned researcher in Russian financial history, Olga Crisp, claims that this image does not bear closer examination. She believes that Vyshnegradsky's term of office brought about an enormous improvement in Russian finances and took the country close to final implementation of the monetary reform. This is supported, at least, by Russia's gold reserves, which more-than-doubled to 580 million gold roubles during his term.⁴³⁶

Upon becoming finance minister, Sergei Witte began determined and successful measures to stabilise the exchange rate. The rouble's value in 1894 fluctuated only a little and in 1895 hardly at all. It was now at the level targeted by the plan of 1887; the paper rouble was worth two-thirds of its theoretical gold parity, so one gold rouble was quoted at 1.5 paper roubles.⁴³⁷

Events in the world silver market at the same time hastened Russian's legal move from the silver to the gold standard. The value of silver in relation to gold began to fall rapidly in the early 1890s and by

1893 the paper rouble was worth more than the silver rouble for the first time in decades. Under these circumstances, if the public had still been allowed to mint silver metal into coins, the value of the rouble would have been pushed towards its silver parity, preventing further appreciation, and Russia would have moved, in practice, to the silver standard. To prevent this, the right of private individuals to commission silver coins was forbidden by statute on 13 September 1893. This eliminated the obstacle to continuing appreciation of the rouble against silver,⁴³⁸ and changed the nature of silver roubles and kopeks, which became mere small change with a metallic value lower than their monetary value.

After eliminating silver's threat to the move to the gold standard, Witte embarked on measures to encourage the use of gold coins. A law published in 1895 permitted gold to be specified for execution of contracts and to be used in payments; commitments agreed in gold could be discharged in banknotes only at their quoted value on the St. Petersburg Exchange, not at their nominal value. Thus the obligation to accept banknotes at nominal value was partly overturned and conditions were improved for the use of gold as a medium of payment. During 1895 the government also began to accept payments in gold coins at the fixed rate of one gold rouble to 1½ paper roubles. From the start of 1896 the Russian State Bank was required to buy and sell gold at this same rate, the ten-rouble Imperial coin for 15 paper roubles. This measure had the effect of pegging the value of paper money.⁴³⁹

Russia's monetary reform was completed with a statute issued in February 1897. It redefined the rouble's weight in gold, setting the value of a gold rouble at the level compatible with the value of banknotes in gold, set the previous year. The new gold coins had two-thirds of the gold content of the old gold coins: for example a ten-rouble coin contained 11.61 grams of fine gold. The purity of the alloy was not changed but was kept at French standard fineness of $\frac{900}{1000}$. The first new, lighter gold coins were minted in 1897 and 1898.⁴⁴⁰

Russia's implementation of the gold standard has been criticised as excessively conservative because the government built up rather substantial gold reserves in proportion to the banknotes in circulation. Having a large reserve naturally involved costs because the funds could have been used in other ways, for example to pay

■ Sergei Witte served as Russia's Minister of Finance in 1892–1903. Under his leadership, Russia finally went on the gold standard, about a decade later than Finland.

– Board of Antiquities.



CABINET- PORTRAIT.

down government debt.⁴⁴¹ It has also been claimed that the tough economic policies preceding Russia's move to the gold standard delayed its industrialisation.⁴⁴² On the other hand it is worth noting that by joining the international gold standard system Russia increased the amount of incoming investment and thus boosted its economic growth. Promotion of industrialisation and improvement of creditworthiness were indeed the key objectives of the whole reform and, after the rouble had stabilised, economic growth accelerated significantly.⁴⁴³

DEMANDS FOR MONETARY UNIFICATION

For Finland, Russia's gold standard reform of 1897 had dual significance. From an economic perspective, it was a policy that brought spin-offs for the Finnish economy by accelerating Russian economic development. In particular, going on the gold standard attracted more foreign capital to Russia, this being one of its main objectives. As the Russian economy began to grow faster, demand for Finnish exports increased, which had a favourable effect on Finland. The other significant consequence of the reform was political. After the gold standard was in force in Russia, Russia began to exert strong pressure on Finland to unify its monetary system with the Empire's.

The matter had already been raised before Russia adopted the gold standard. Attitudes in ruling circles towards Finland's special rights became more censorious in the 1880s. This was particularly true of Finland's separate customs system but it quickly developed into demands for a unified monetary system. Tsar Alexander III expressed views to this effect to Governor general Count Feodor Heiden in spring 1889. The Governor general was doubtful about many of the demands presented by St. Petersburg but could not ignore them. On the subject of monetary unification he requested the opinion of the Senate of Finland and received a response drafted by Herman Molander, the long-term head of the Senate's Financial department.

In his memorandum Molander emphasized the special status of the Bank of Finland as subordinate to the Estates, the bank's strong position abroad as well as at home, the great respect it enjoyed in the eyes of the public and the advantages of having a small monetary unit,

the markka. The rouble had long had a privileged position in Finland so the Finns saw no reason for merging their monetary system with Russia's.⁴⁴⁴ When Heiden presented his report in December of the same year, the tsar's reaction was very intemperate, as the excerpt below indicates. The note is famous but it is so revealing of prevailing attitudes in St. Petersburg that it is worth repeating here:

"I have perused all these presentation briefs and find myself surprised – do they relate to a part of the Russian Empire or a foreign state? How is this matter to be understood; does Russia belong to Finland, or is it a part of it, or does the Grand Duchy of Finland belong to the Russian Empire? I regard a harmonised board of customs as indispensable; I know that it is not easy to do and requires much work but it can be done. As for postal and monetary institutions, it is inexcusable that there is still some difference between them; their harmonisation into an Empire-wide system is vital. I request that matters be directed to this end."⁴⁴⁵

This statement, appended to the presentation brief, left no room for conjecture, even if the tsar was content to conclude with the expression "I request", rather than I demand or I decree.

Under these circumstances, preparations had to be started for the unification of monetary systems. For this purpose a joint Finnish-Russian commission was established in 1890, chaired by Feodor Heiden and with two Finnish members, Herman Molander and Voldemar von Daehn, the assistant Ministerial State Secretary. Its other members were representatives of the Russian government. The composition of the committee is interesting in that the Bank of Finland was not represented at all. The planning of this matter in Finland had clearly moved to the Senate and remained in Senate hands until the very end. To the committee's report, Molander appended a dissenting opinion expressing the same views that he had presented a year earlier in his memorandum to the governor general.⁴⁴⁶

No tangible changes in Finland's monetary system resulted from the report. It was indeed presented to the Emperor but its outcome was that the Currency Act of 1877 would remain in force until Russia and Finland could achieve the complete harmonisation of monetary institutions. Pipping believes that this inertia was largely the work of Finance Minister Vyshnegradsky. Russia was preparing its move to the gold standard so there was no urgency about Finland. A part may also

have been played by Bleichröder Bank, which had in 1889 arranged a large bond issue for Finland. The bank wanted the status quo in Russian and Finnish monetary systems to be preserved so that Finland's debt servicing ability would not be jeopardised. There is no certain information about Bleichröder's activity in St. Petersburg but correspondence between it and the Bank of Finland suggests that Finland's monetary status may have been discussed in St. Petersburg. Although the role of the Bank of Finland remained unchanged, there was a fairly sharp conflict at the start of the 1890s between the Emperor and the Bank of Finland's supervisory council, representing the Diet. A concrete example of this is the discord between the Emperor and the estates, presented on page 365, about the number of bank councillors.⁴⁴⁷

In Helsinki during these years, the position of the Bank of Finland came to be regarded as good under the circumstances. No major reforms were required so, in the years ahead, efforts could be focused on defending what had already been achieved. The leading Finnish officials were realists who understood that at least some slight concessions would have to be made to Russia, in practice about the validity of Russian money in Finland. This was expensive for the state because it had to accept debased Russian silver coin at its nominal value, but the losses were tolerable as long as the crucial issues – a Bank of Finland responsible to the Estates and responsible for a Finnish markka – could continue as before.

After Russia had moved to the gold standard in 1897 monetary diversity returned to the agenda, and in November 1898 a new joint committee was set up to consider merging the Finnish and Russian monetary systems. Secretary of state Eduard Frisch from St. Petersburg was appointed its chairman and its Finnish intercessors were the new head of the Financial department E.R. Neovius and Senator G.E. Fellman. After five years of little activity, the committee began work in 1903. Because Russia was now on the gold standard, the Finnish side was less well placed to influence the report than in previous years, a position the Finnish negotiators recognised.⁴⁴⁸ Moreover in 1903–1904 Governor general Bobrikov, whose policy was to unify the Grand Duchy with Russia, was at his strongest, which certainly weakened the negotiating position of the Finns. One of their few advantages was the disunity among Russian officials. Relations between Finance Minister

Sergei Witte and Governor general Bobrikov were known to be poor, which may have improved the position of Finnish side. Witte was also known as a principled friend of Finland who respected the discipline with which the Finnish government budget was managed.⁴⁴⁹

Even so, there was no doubt about the outcome, so great were the pressures from the government in St. Petersburg towards Finland's special status. On 9 June 1904 the Emperor endorsed a gracious statute "on measures to achieve a connection between the monetary systems of the Empire and the Grand Duchy of Finland". Russian gold coinage was to stand alongside the gold coins of Finland as legal tender in the Grand Duchy and was to be freely accepted in payments to the state and in transactions between private individuals. Moreover the statute decreed the unlimited validity of Russian silver coin of full purity and Russian credit notes for payments to the government. However only relatively small amounts of these currencies had to be accepted in transactions between private individuals. The last article of the statute stated that it would enter into force on a date determined by the Russian Minister of Finance after consultation with the Imperial Senate of Finland.⁴⁵⁰ Decision-making about closer monetary union between Russia and Finland had thus been transferred from Helsinki to St. Petersburg and the Diet of Finland had been entirely sidelined.

It is surprising that this statute remained a dead letter and after Russia had been forced off the gold standard by the outbreak of the First World War, the statute was even regarded as having expired although it was never formally rescinded. Once again, Finland's position was decisively influenced by Russia's difficulties in great power politics. The Russian Finance Minister specifically demanded the postponement of attempts to unify the monetary systems because in his view "political difficulties prevailing in the Far East (in 1905) mean that an enlargement of the remit of the gold coinage of the Empire could have various less desirable influences on our gold reserves".⁴⁵¹ The Far East obviously meant Japan, where Russia was being trounced.

Indeed, Finland's autonomous monetary system and Russian military history have a fateful connection. Finland's unaccompanied move to the silver standard in 1865 can be explained largely by insurrection in Poland and the subsequent economic obstacles to Russian monetary reform. Finland's separate move to the gold standard

BANKNOTE SYMBOLISM

During its first few decades of operation, the Bank of Finland's banknotes contained few national symbols. The lion of Finland was present, but the coat of arms was placed within Russia's two-headed eagle. An important change after the monetary reform of 1840 was an increase in the amount of Finnish-language text on the notes, but even the creation of a national monetary unit in the 1860s did not result in banknotes of a distinctly national appearance. However, the transfer of the Bank of Finland from the Imperial Senate to the Diet of the Estates in 1868 gradually led to an increasing amount of national and political symbolism.

Finnish nationalism began to appear in banknotes when the gold standard was adopted. The romantic landscape in the 500-markka note of 1877 was taken from a painting by Hjalmar Munsterhjelm. The 50 and 100-markka notes were illustrated with views of Uuraansalmi harbour near Vyborg and Helsinki from the sea. Landscapes were discontinued in the banknotes of the 1880s and Finland's identity began to be emphasised in a more political way; the coat of arms with the lion of Finland became the main pictographic element in 1886, and the heraldic eagle of the Russian Empire was very small.

The symbolism of the banknote series approved in 1898 displays complete political nationalism. Its inspiration was the statue of Alexander II, unveiled in Helsinki in

1894, which had sculptures by Walter Runeberg on its pedestal. These scenes, depicting law, work, peace and light, were used to illustrate the banknotes. The imagery of the 500-markkaa banknote was especially political. The statuary depicted Lady Justice, standing alongside the lion of Finland, holding a sword and bearing a shield engraved with the word "Lex".

The stress on law points to the constitutional dispute that began from the late 1880s, when Russia toughened its position on Finland's separate status and Finns felt their autonomy to be under threat. The statue of Alexander II, who initiated Diet sessions in Finland, became the symbol of the constitutional struggle. The group of pedestal statues that represented law were given special significance and came to symbolise Finland defending its constitutional rights. Lady Justice was thus at the same time the maid of Finland.

The banknote series of 1897–1898 was obviously too much for Russian officials because a decree was issued in 1903 transferring the manufacture of Finnish banknotes to St. Petersburg. However the decree was not implemented and was overturned in 1906. Instead the Finnish architect Eliel Saarinen was engaged to design a new series of banknotes, approved in 1909, in which the imagery returned to politically neutral subjects. These notes were artistically magnificent, dominated by national romantic

themes. Their imagery stressed the countryside and forests, but trade and industry also had their place. The sailing ship and lighthouse on the 50-markka banknote can be interpreted as illustrating Finland's

aspirations for international markets.

For more on Finnish banknotes see Talvio, T., The Coins and Banknotes of Finland (Bank of Finland 2003).



■ Banknote symbolism at the end of the 1890s sought to emphasize Finland's autonomous position within the Russian empire. The 500-markka banknote type shown is from 1898. – Bank of Finland.

was occasioned by Russia's war against Turkey and the consequent failure of Russia's own gold standard plans. The unification of Finnish and Russian monetary systems in turn was prevented initially by Russia's defeat in the war against Japan in 1905 and then by the First World War.

THE ECONOMY PICKS UP

SLOW STRUCTURAL CHANGE

During the second half of Finland's period as a Grand Duchy, its population continued to grow relatively fast. It passed two million in 1879 and reached three million in 1912. The worst features of underdevelopment had been left behind, and the standard of living was no longer entirely dependent on the harvest. This was concretely shown at the start of the 1890s, when a year of crop failure did not result in a dip in the population. In the mother country, Russia, the famine of 1891–92 blighted the lives of 10–15 million people and led to a steep increase in mortality.⁴⁵²

Although agriculture and forestry continued to remain important, the scale of industry and construction grew so great in the last decades of the 19th century that these sectors began to be an important source of new employment for the landless rural population. The growth of industrial centres and large towns accelerated and internal migration created strong regional differences in population growth. It was fastest in the provinces of southern Finland, while growth was sluggish inland in the provinces of Mikkeli, Kuopio and Vaasa. In 1880–1920 the urban population trebled to half a million. Alongside internal migration, emigration increased and many Finns sought their fortunes across the ocean to America. According to estimates for the period 1881–1914, about 280 000 Finnish emigrants moved to America although nearly 100 000 of these later returned.⁴⁵³

Until the 1910s the absolute number of rural inhabitants continued

to rise but their relative proportion of the whole population had turned down, falling below 70 percent by the outbreak of the First World War. The proportion engaged in industry and construction, in turn, had risen to nearly a fifth and those working in the service sector to almost a tenth. By international standards Finland was still one of the most agriculturally based societies of Europe, with an economic structure corresponding to that of eastern central European countries such as Hungary and Romania. Actually this comparison gives a slightly misleading picture. The figures for the Finnish agricultural population included people working in forestry, many of whom could also have been classified as industrial or transport sector workers. The size of the agricultural population was thus overstated, but the overall picture was correct; compared for example with Sweden to the west, the socioeconomic structure was very different.⁴⁵⁴

After a brief downturn in the 1890s, the Finnish economy entered a phase of distinctly faster growth and GDP per capita also increased. The underlying influences were a favourable development of exports and rising domestic demand. For the next two decades, the value of merchandise exports doubled every ten years; on the eve of the First World War the volume of exports was almost 4½ times higher than at the start of the 1890s. What makes the trend surprising is that exports had not increased at all in the period 1876–1892. The share of exports in GDP increased, from around 10 percent in 1860 to nearly 25 percent in 1914. Thus Finland entered the international community of open economies. Export growth was reinforced by a favourable trend in export prices after the end of the 1870s. The terms of trade improved particularly strongly after the end of the 1870s and by 1910 were 50 percent better.

However, the structure of exports shows that, in many ways, Finland's economy was still in the early stages of development. Exports to western European markets were mostly raw materials or unrefined products such as timber, unplanned sawn goods and butter. The Russian market was the exception because by 1910 its main purchases from Finland were paper and paperboard. At that time Finland's two main export markets were Great Britain and Russia, which took roughly equal amounts. In 1840–1880 Russia had dominated Finnish exports but western Europe's rising purchases of timber had changed the situation.⁴⁵⁵

Economic growth did not spring from exports alone; private consumption growth began to pick up at the same time. The main influence was a change in the consumption behaviour of rural farm owners, who were sending an increasing proportion of their produce to market and so had new purchasing power. A decisive factor was the fast rise in cattle farming, spurred by a good rise in dairy prices compared with the price of grain. Finland adapted to global agricultural trade because it had no customs barriers to protect its farm products. Meanwhile the entire rural community benefited from the growth of the forest industry, which brought income from the sale of wood and wages from forest felling and harvesting. The expansion of the forest industry led to a strong improvement in real incomes throughout the rural community.⁴⁵⁶

The 1890s can be regarded as the culmination of a process, beginning in the 1860s, of substantial public investment in infrastructure and of broad institutional reforms. The expansion of the railroad network throughout the country was of great importance for societal development. The railways speeded up the transition of the rural community from barter to a market economy. They also expanded the potential of forests throughout the country and the zone where forests were not exploitable shrank greatly. These factors integrated Finland into a single economy, levelling out the steep differences in development between the coast and the interior that had been typical of the first half of the 19th century. Institutional reforms in turn laid the ground for a breakthrough of market-oriented activity, which made private enterprise more responsive to the changes created by economic growth both at home and abroad.

THE ECONOMY MODERNISES

Qualitative economic changes served to promote development of the entire national economy. Not least among these was the rise of a private banking sector from the 1860s onwards, creating a functional division of labour in the financial markets between commercial banks, mortgage credit banks, savings banks and the public sector, meaning the government and the Bank of Finland. The position of the Bank of Finland at the hub of the financial system was reinforced in 1886 when a revised Banking Act defined banknote issue as a central bank

monopoly. The Bank of Finland's function of regulating liquidity grew stronger, as shown by the start-up of its interbank clearing system in 1907.

From the 1890s onwards, as the position of the private banking sector improved, society began to transform. A central part was played by the spread of money into all strata of society. An ever-greater proportion of people began to receive money wages and a greater share of agricultural production was sent to market. Thanks to the good geographical coverage of the banks, a growing proportion of payment traffic was channelled through the banking system, which improved the efficiency of society in connecting sources of capital to those who needed it. It was thanks to a well-functioning banking system that capital began to be used more effectively.⁴⁵⁷

For Finland to be more closely integrated into the global economy, production in all sectors of the economy had to be made more efficient, as evidenced by the growth in investment required by business. Old trading houses run by family companies no longer had the resources nor could bear enough risk, and were supplanted by joint stock companies with diverse shareholders. This phenomenon was especially clear in the paper industry, where groundwood feedstock had replaced rag pulp from the 1860s onwards. Even greater investments were needed at the end of the 19th century when chemical pulp began to rival mechanical pulp. At the same time an equivalent change was taking place at sea, as wooden sailing ships were replaced by vessels with iron hulls.

By international standards, the spread of limited companies and the development of the capital markets was fairly tardy in Finland. Stock exchange trading did not begin until 1912, when the Helsinki Bourse was opened; the plans had been around since the 1860s but reached fulfilment only after a delay of half a century. Quite obviously, until the start of the 20th century, trading in shares and other financial instruments like bonds had been so modest that operations could be handled outside an exchange. The formal procedures of a bourse certainly made the capital market more efficient; shares and bonds became established as instruments with secondary market value.

But although economic growth turned up and stabilised after the early 1890s, and despite significant qualitative changes in business life



■ Paper mills were the first major enterprises in Finland established as limited companies. One of them was Ab Kuusankoski Oy, which built mills on the River Kymijoki in the 1870s. – Board of Antiquities.

at the same time, Finland in the early 1910s still seemed to many to be part of Europe’s economic periphery.

FINNISH GDP PER CAPITA COMPARED TO GREAT BRITAIN, SWEDEN AND RUSSIA (%) IN 1870, 1900 AND 1914

	1870	1900	1914
Great Britain	34	32	39
Sweden	66	63	64
Russia	108	133	130

Source: Bairoch, Angus, *Monitoring the World Economy 1820–1992*, Development Centre Studies, OECD 1995, p. 194–201, 1995.

The comparison is with Great Britain, the pioneer of industrialisation; Sweden, Finland’s former mother country; and Russia, the new mother country. Figures for the Russian economy contain unusually large margins of error and the image they create should be regarded as merely indicative.

Finland’s standard of living was extremely low compared with Britain’s, although the figures show that the gap began to decline in the early 20th century. Finland was also well behind Sweden and the gap hardly changed over the decades, meaning that GDP per capita was increasing in both countries at roughly the same rate. In Russia the resources of society were devoted to financing constant wars, so there were scant opportunities for raising personal living standards. This explains why Finland’s relative position against Russia, at least in the light of these figures, began to improve distinctly in the latter part of the 19th century.

The figures show that Finland had become a full participant in the growth of international trade that got under way in the second half of the 19th century and is generally known as the first phase of globalisation. With technological innovation, freight costs fell greatly, improving the relative position of remote Finland on the world market. Moreover, demand for the most important Finnish raw material – wood – increased as urbanisation accelerated throughout Western Europe. Finland thus enjoyed both increasing demand and rising export prices. On the other hand, prices of grain and other agricultural

products fell as global markets developed, which hurt various countries of eastern central Europe. Having been till now at roughly the same development level as countries like Poland, Romania and Hungary, Finland now left them behind. Globalisation brought Finland a stronger economic position and rising living standards, while the others faced a period of slow development and greater relative backwardness.

MONETARY POLICY UNDER THE GOLD STANDARD

CENTRAL BANK HARMONISATION

While the gold standard was in force, the main function of a central bank was to maintain the value of its currency in gold. To do so, it had to be ready to redeem on demand the banknotes that it had issued, buying them back with gold coin or foreign currency backed by the metal. Banknotes had to be redeemed in gold at the legal value of the currency.

During the period that Finland was on the gold standard, the monetary policy practices of the Bank of Finland converged with the international mainstream of central banking. Discounting bills of exchange became its most important form of lending and the item in its balance sheet that varied according to the state of the money market. This development had taken place by the 1880s and the bank thus adopted the “real bills” doctrine that had influenced the operations of the central banks of England and France throughout the 19th century.

It was also typical of the gold standard era that monetary policy was managed principally via interest rates. In practical terms this meant that the bank almost mechanically discounted bills of exchange that were of an adequate quality. In this way it moved from credit rationing to a monetary policy steered by the interest rate. Within the limitations that the bank’s own liquidity imposed, it adapted its interest rate to reflect the market situation. Changes in the foreign currency reserves had a clear impact on the central bank interest rate.

In practice, the Bank of Finland kept its interest rates fairly stable compared with, for example, the Swedish national bank; rate changes were less common than in Sweden. There was no direct link between Finnish and Swedish interest rates although they generally moved in the same direction. On the other hand, interest rate data shows that the policies of the Bank of Finland were generally entirely independent of those of the Russian State Bank. This was particularly clear before Russia went on the gold standard at the end of 1897.

The period of the international gold standard before the First World War has been regarded as the first phase of globalisation and capital was certainly remarkably mobile in the final decades of the 19th century.⁴⁵⁸ Arthur Bloomfield's research has drawn attention to the fact that during the classical gold standard period (approximately 1880–1914) the discount rates of “almost all” central banks usually moved in the same direction. He attributes this only partly to the international mobility of capital, which forced the central banks to follow each other's examples to prevent a run on their gold reserves. The more important reason for the correlation, Bloomfield thinks, is that under the gold standard, the economic cycles of different countries coincided. The gold standard led to a convergence of real economies, which was reflected in monetary policy.⁴⁵⁹

The functioning of an international gold standard has been thought to require the observance of the so-called rules of the game. A country receiving gold (where the central bank had increasing gold or foreign currency reserves) should reduce its interest rates and a country with falling reserves was forced to raise its interest rates in order to stem the outflow of gold and currencies. If all countries observed these principles, the distribution of gold reserves between them could be stable and the system could operate in a sustainable way.

Under the gold standard, central bank interest rates were influenced not only by international gold and currency movements but also by domestic demand for money. When demand for money boosted the volume of banknotes in circulation, there was a danger that the banknote cover regulations imposed on the central bank would be violated. In this case, the discount rate could be raised to curb the growth of money supply and to attract gold reserves to the central bank. Correspondingly a fall in the demand for money made it possible to lower the interest rate.

From a contemporary perspective, as represented by Emil Schybergson's history of the Bank of Finland under the gold standard, published in 1914, the state of the Finnish money market and the interest rate policies of the Bank of Finland were seen as dependent on the availability of foreign credit.⁴⁶⁰ This makes good sense because Finland's balance of payments on the current account was negative throughout the gold standard period and foreign capital had to be imported to cover the deficit. Fluctuations in the availability of foreign credit show as changes in the currency reserves of the Bank of Finland and thereby in its liquidity and interest rates.

From the monetary policy viewpoint, the gold standard period in Finland can be divided into two parts of roughly equal length. Before 1894 was a period of slow growth and an isolated money market. This was followed by a period of internationalisation and a fast-growing economy which lasted from 1894 to the outbreak of the First World War.

During the first half of the gold standard period, Finland's interest rate was relatively inflexible and was not influenced by the rates prevailing in continental Europe. In 1878–1895 the Bank of Finland changed its lowest discount rate 10 times, on average every 22 months. Matters were significantly different during the second half of the period, from the start of 1896 to the outbreak of the First World War, when the Bank of Finland changed its discount rate 19 times, on average once a year. Admittedly interest rates were still inflexible compared with the Bank of England, which changed its interest rates 240 times in 1878–1914, on average six times a year. On the other hand, in the same period the Banque de France, renowned for the stability of its rates, changed them on average once a year.⁴⁶¹

The gold standard period was a time of international integration of capital markets. Because the exchange rate risk between currencies on gold was practically non-existent, the money and securities markets served to shift capital from countries where the interest rate was low to countries where it was higher. This promoted the convergence of national interest rates although capital mobility was never so smooth as to completely harmonise the interest rate level.

Correlation analysis reveals the degree of dependence of the Bank of Finland's discount rate on foreign money markets. It shows that the Finnish money market became genuinely international only in the

second half of the classical gold standard period. During the first half, in 1878–1895, the only foreign discount rate that influenced the Bank of Finland was Sweden's. The correlation between discount rates in Finland and Sweden was fairly high (0.58) but the Finnish rate had zero or even negative correlation with the rates in other relevant foreign money markets.⁴⁶²

DISCOUNT RATE CORRELATIONS BETWEEN FINLAND AND
SELECTED COUNTRIES 1878–1895 (WEEKLY DATA)

Finland–Sweden	0.58
Finland–Germany	−0.02
Finland–Russia	−0.12
Finland–Britain	−0.22
Finland–France	−0.34

In the latter half of the gold standard period the connection between the Finnish discount rate and foreign interest rates was different. Now Finnish money market fluctuations clearly paralleled those of continental Europe and Great Britain. The connection between Finland and Sweden, visible earlier, remained.

DISCOUNT RATE CORRELATIONS BETWEEN FINLAND AND
SELECTED COUNTRIES 1896–1914 (WEEKLY DATA)

Finland–France	0.66
Finland–Sweden	0.64
Finland–Germany	0.50
Finland–Britain	0.45
Finland–Russia	0.07

It is interesting that although Finland and Russia were both on the gold standard from 1897 onwards, there is still no sign of a statistical interdependence in their interest rates. Finland's money market seems to have been primarily linked to the financial centres of Western Europe, including Stockholm.

Part of the impact of foreign interest rates on the discount rate of the Bank of Finland was direct but to a considerable extent it was

indirect. The state of foreign money markets influenced capital movements and thereby the foreign currency reserves of the Bank of Finland. Because the bank had to protect its reserves in order to maintain the value of money and remain on the gold standard, an outflow of capital when international money markets were tight required the interest rate to be raised. Correspondingly, easier foreign money markets usually boosted foreign currency reserves in Finland and thus made it possible to lower the discount rate.

FIRST HALF OF THE GOLD STANDARD PERIOD

When Finland joined the gold standard in 1878, the markka had depreciated steeply because of the change in the relative values of gold and silver and because the foreign currency reserves were low. The situation had been difficult for a couple of years. The exchange rate and currency reserves had begun to decline in 1875 and at the start of 1876 the Bank of Finland's lowest discount rate, which had been held steady for many years at 4 percent, was raised to 4½ percent. In June 1877 it was raised again to 5 percent. Despite these hikes, foreign currency reserves remained under pressure even after the gold standard was adopted. To ease the shortage of foreign currency, the bank arranged a credit facility with M.A. Rothschild & Söhne of 5 million German marks in July 1878. The underlying motive was to bolster the bank's reserves when the convertibility of banknotes to gold (or to currencies backed by gold) came into force in July 1878. In December 1878 it was decided to raise the discount rate one more time and the rate of 5½ percent came into force from the start of 1879.⁴⁶³

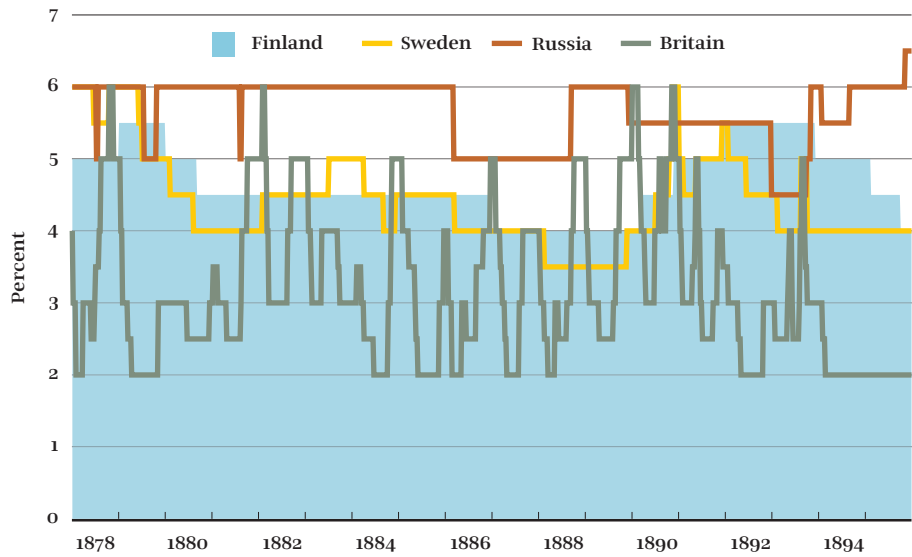
In the second half of 1879 and over the following year, foreign currency reserves improved significantly and interest rates could be lowered. This happened in two stages in 1880, first in January to 5 percent and then at the start of September to 4½ percent. The rate was then held at the same level for more than six years before being reduced to 4 percent on 3 December 1888. Pipping says the new cut was made possible by an improvement in the balance of payments and the consequent easing in the liquidity situation.⁴⁶⁴

After distinctly easy money markets at the end of the 1880s, they

became far tighter in 1890, which can be described as a crisis year. The Bank of Finland faced much stronger demand for credit and raised its interest rates on two occasions. On 18 March 1890 its lowest rate was raised to 4½ percent. In summer the money market became still tighter and a recently established commercial bank, Kansallis-Osake-Pankki, had to resort to large-scale rediscounting of its bills of exchange. Although there had previously been small-scale discounting of bills of exchange, the liquidity support granted to Kansallis Bank in 1890 can be regarded as a decisive moment when the Bank of Finland adopted a central banker's role in relation to the evolving commercial bank sector.⁴⁶⁵

Autumn saw a continuing rise in demand for credit from the Bank of Finland and there was soon serious concern about the adequacy of its foreign currency reserves. Apart from the poor state of the economy at home, the money market was also affected by tighter international money. In the first week of November, the bank of Baring Brothers &

CENTRAL BANK DISCOUNT RATES IN SELECTED COUNTRIES IN 1878–1895, THE FIRST HALF OF THE GOLD STANDARD PERIOD



Sources: Central bank annual reports; Hawtrey, R., 1938; Global Financial Data.

Co. in London had to be rescued from insolvency by the Bank of England, which then raised its own discount rate to 6 percent on 7 November. The Swedish national bank raised its rate a week later and on 18 November the Bank of Finland followed suit, raising its lowest discount rate to 5 %.⁴⁶⁶

The operation mounted by the Bank of England to rescue Baring Brothers has been seen as the start of a new era. The rescue proved successful, a worse money market crisis was averted and, after the storm had abated, Baring Brothers proved to have adequate capital; the panic surrounding it was groundless. The management of the Baring crisis validated the famous advice given almost 2 years earlier by Walter Bagehot in his book “Lombard Street”, that a central bank should grant credit generously in time of crisis but only against good security and at a higher interest rate than usual. Afterwards Bagehot’s doctrine became the norm for several decades, which central banks tried to observe with varying degrees of success. It is interesting that adoption of a central banking role by the Bank of Finland – in safeguarding the liquidity of Kansallis Bank – came at exactly the same time as the Bank of England adopted Bagehot’s principles in rescuing Baring Brothers.

Immediately after an interest rate hike in November 1890, the board of the Bank of Finland drew the attention of the supervisory council to the “substantial decline in the banknote issue reserve”, and stated that demand for credit in the winter ahead would probably continue strong. The board therefore proposed that the Bank of Finland should borrow 7 million markkaa from the government to “reinforce its banknote reserve”. In the previous year the Finnish government had decided to take a foreign loan of nearly 33 million German marks or 40.6 million Finnish markkaa, a large amount for the times. The loan had been arranged by a consortium consisting of the Rothschilds in Frankfurt and Bleichröder and Disconto-Gesellschaft in Berlin. After this loan the government had a large amount of foreign currency at its disposal so it was able to support the Bank of Finland’s position. The credit was granted to the Bank of Finland on 27 December and was initially intended to be for one year.⁴⁶⁷

The foreign currency reserves of the Bank of Finland remained under pressure in 1891 so at the end of the year it was decided to continue the loan from the government for another 12 months till 1 December

1892. To support the reserves another foreign credit facility of 10 million markkaa was agreed in 1892 although little of it needed to be drawn down. Even so, interest rates had to be raised one more time, at the start of December 1891, when the lowest rate was set at 5½ percent.⁴⁶⁸ The last time interest rates had been so high was during a foreign currency shortage immediately after Finland had adopted the gold standard in 1879 and, before that, after the serious famine years in 1868.

GROWTH AND INTERNATIONALISATION FROM THE EARLY 1890S

After the Baring panic, the world economy gradually recovered. An international economic upswing began in the early 1890s and brought a historically significant turn for Finland's economy and society. In 1894, Finnish exports began a sustained growth that continued until the First World War. Alongside the recovery of international markets, Finnish sales abroad received new impetus from the improvement of transport infrastructure at home; by the start of the 1890s the important railway lines to Savo and Ostrobothnia had been completed. More export income meant that the foreign currency reserves of the Bank of Finland began to increase steeply from 1894 onwards.

Another significant change for Finland that occurred around the same time was that Russia finally moved to the gold standard. This did not legally take place until 1897 but Finance minister Sergei Witte had created the necessary preconditions several years earlier so the changeover was, in effect, gradual. The rouble exchange rate settled at the level equivalent to its gold parity as early as 1894, so it stabilised against the Finnish markka at the same time as the other aforementioned changes occurred. Rouble stability was thus one of the factors that distinguished the latter part of Finland's gold standard period (1896–1914) from its former part (1878–1895).

Mika Arola has noted that, after the early 1890s, the rate paid on long-term Finnish bonds became more closely correlated with Russian bond prices. A natural explanation is that Russia's move to the gold standard eliminated one important factor that separated the Finnish and Russian monetary systems. Previously the two countries had paid different rates for foreign borrowing, Finland distinctly less, but after Russia's move to the gold standard became inevitable, the differential

fell and from the start of the 1890s until the First World War the two countries' bond rates were very close to each other.⁴⁶⁹

The rapid increase in foreign currency reserves that began in 1894 allowed the Bank of Finland gradually to reduce interest rates and by autumn 1895 the lowest discount rate was 4 percent, an all-time low. The subsequent period of easy money markets and low interest rates lasted several years. For a long period there was little demand for credit from the Bank of Finland, but it turned up in 1896 and the bank raised its lowest discount rate by half a percentage point to 4½ percent on 20 October 1896. Even so, this can be regarded as a sign of normalisation after a period of exceptionally easy money.⁴⁷⁰

The money market became much tighter in 1898 and especially 1899, when Finland's balance of payments deficit widened and the need for credit from the Bank of Finland rose. Import demand was stimulated by a crop failure in 1899. It was also generally known that customs duties would rise significantly from the start of the following year, so importers predated their purchases. This caused a major burden on the liquidity of private commercial banks. The central bank tightened the money market, raising its interest rate first in October 1898 by half a percentage point to 5 percent and then twice in October 1899 by half a percentage point each time, bringing the lowest discount rate to an all-time high of 6 percent. The rate hikes in Finland in October 1899 came after the Bank of England had raised its own "bank rate" by 1½ percentage points in the first week of the month.⁴⁷¹

While the supervisory council of the Bank of Finland was deciding on the second rate hike in October, it also proposed to the Senate's Financial department that the government should reinforce the Bank of Finland's foreign currency reserves by making a new loan from the foreign receivables of the Treasury of Finland. At the start of 1900 the Bank of Finland received a state loan worth 7 million markkaa, which it repaid in 1902. The money market eased in the years ahead, central bank foreign currency reserves increased and international interest rates generally turned down. In September 1901 the Bank of Finland reduced its lowest discount rate to 5½ percent and in February 1902 to 5 percent.

It's interesting that although Bank of Finland interest rates in the latter half of the classic gold standard period were already clearly dependent on foreign money markets, there was little or no linkage with



■ Railway construction in Finland was at its height from 1870 to the end of the century. Track projects were financed by foreign bond issues, made possible by the stability of the gold standard.
– Otava picture archives.

Russian interest rates. This was established statistically by the preceding correlation analysis but a more concrete example was the behaviour of interest rates during the Russo-Japanese War and the 1905 Russian Revolution. War broke out between Russia and Japan in February 1904 and only days later the Russian central bank raised its discount rate by half a percentage point to 5½ percent. After the war had ended in Russia's defeat, there was widespread unrest in Russia, and in December 1905 a full-scale rebellion in Moscow.⁴⁷² At the end of 1905 and start of 1906, the Russian central bank raised its interest rate by stages as high as 8 percent and kept it high for several years, lowering it only gradually. The upheaval had political consequences in Finland, with a general strike in October-November leading ultimately to major political reforms; in summer 1906 a new unicameral parliament was established and universal suffrage was implemented.⁴⁷³ Yet despite the turmoil in Russia, the Bank of Finland was not compelled to raise interest rates and its lowest discount rate remained at 5 percent throughout.

It was not until 1907 that Finland's interest rate began to rise. In February the lowest discount rate was raised to 5½ percent because of excess domestic demand for credit.⁴⁷⁴ In October the Knickerbocker Panic in New York spread to other money markets, pushing up interest rates; in London the Bank of England's bank rate reached 7 percent in the first week of November although it had been only 4 percent in August.⁴⁷⁵ A report by the supervisory council, however, said that Finland was spared the full weight of the problems felt abroad:

"The difficulties faced by Finland and its financial institutions were mitigated by the fairly modest extent to which the business life of our country depends on capital borrowed from abroad (...) There was no overproduction to mention, and the bankruptcies that occurred were not major or large."⁴⁷⁶

Finland's external debt consisted mostly of long-term bonds, most of them government bonds. However, at the end of the year the foreign currency reserves of the Bank of Finland declined significantly and when its main German correspondent bank Haller, Söhle & Co. of Hamburg collapsed in October 1907, its deposits there, worth 1.88 million German marks, were lost.⁴⁷⁷ In October 1907 the Bank of Finland embarked on the measures required by the economic climate:

"At a time when the Bank of Finland's foreign assets had fallen by about 10 million markkaa in a brief period, and while domestic lending

had increased by twice that sum and still showed a propensity to rise, it became essential to undertake special measures to fulfil the function of maintaining the country's monetary affairs on a stable and safe footing and promoting and facilitating its money transactions. In keeping with its duties, the administration of the bank therefore embarked on such measures regarding the interest rate level that had proved to be required equally by domestic economic conditions and the bank's standing as well as the state of foreign markets."⁴⁷⁸

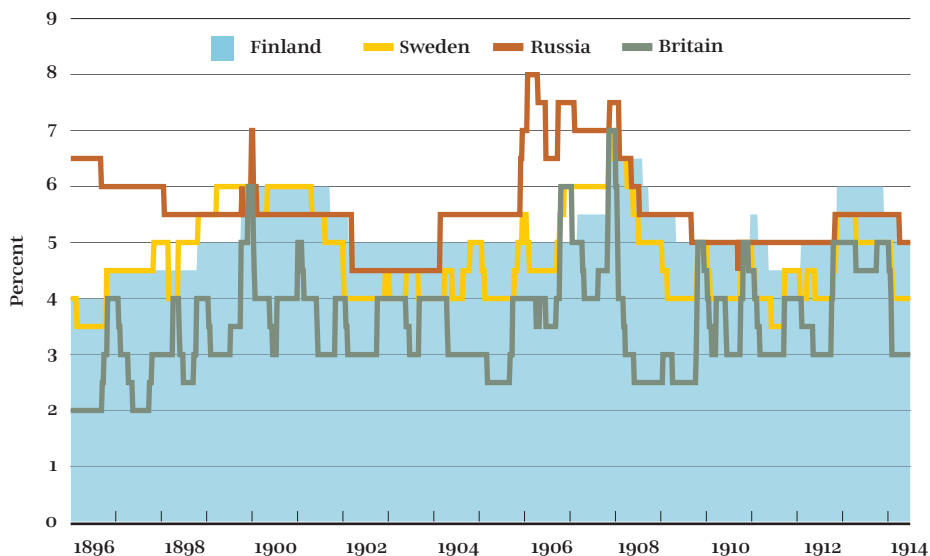
In practice, measures regarding the interest rate level meant raising interest rates twice in November 1907 by a total of one percentage point, at which time the lowest discount rate was 6½ percent. In 1908 the money market experienced prolonged tightness but, with autumn, an improvement in the balance of payments and a fall in foreign interest rates made it possible to cut rates. The lowest discount rate was reduced twice in August 1908 to 5½ percent.⁴⁷⁹

Finland's political position weakened and relations with Russia became inflamed from the start of 1908 when Tsar Nicholas II began to dismantle the autonomy of the Grand Duchy, pressing Finland to integrate with the Russian Empire. In 1909 all members of the Finnish Senate resigned in protest against the policies of russification. When no Finnish politicians or officials could be found to replace them, a new Senate was appointed in 1909 whose members were Finnish-born but with Russian careers, mostly military. Major general Vladimir Markov was appointed to head the Senate as deputy chairman of the Economic division, in practice the prime minister. At the same time, Lieutenant general Frans Albert Seyn, an active advocate of russification, was appointed Governor general of Finland.

Markov led the Senate from 13.11.1909 to 21.4.1913 and his successor Mikhail Borovitinov from 16.5.1913 until the March revolution in 1917. Because of the composition of admirals and generals, the Finns called these the Sabre Senates. The official language of the Senate became Russian. Its relationship with Finland's new unicameral parliament was tense, which complicated discussion of matters related to public finances.⁴⁸⁰

Mika Arola has shown how the complexity of Finland's political position damaged the availability of long-term credit.⁴⁸¹ Schybergson's contemporary perspective put most of the blame on politics for the tight Finnish money market in the early 1910s⁴⁸² but this view may be

CENTRAL BANK DISCOUNT RATES IN SELECTED COUNTRIES IN
1896–1914, THE SECOND HALF OF THE GOLD STANDARD PERIOD



Sources: Central bank annual reports; Hawtrey, R., 1938; Global Financial Data.

tinged by his political opinions and may overstate the impact of political problems on capital imports and the money market. As late as 1911, Finland was raising capital with foreign bond issues and although the Bank of Finland's lowest discount rate began to diverge from Sweden more than previously, the gap was still not very great. Finland's interest rate in 1903–1908 had averaged 0.4 percentage points higher than Sweden's, while from 1909 to the outbreak of the First World War, the average differential increased to 0.8 percentage points.

In 1909, Finland obtained a large amount of foreign capital by issuing long-term bonds (totalling nearly 60 million markkaa), which made it possible to reduce interest rates. The lowest discount rate was cut as the money market eased (in other words, as demand for credit from the Bank of Finland fell) to 5 percent in April.⁴⁸³ Capital imports fell in 1910 and, when foreign interest rates increased, the Bank of Finland raised its lowest discount rate in 1910 by half a percentage point to 5½ percent.⁴⁸⁴ The hike was short-lived; Finland obtained much

long-term foreign capital (as long-term bonds totalling 65 million markkaa issued by private credit institutions and municipalities) in 1911, allowing the discount rate to be cut to 5 percent in February and 4½ percent in May.⁴⁸⁵

At the end of 1911, foreign currency reserves turned down and international interest rates rose. In January 1912 Finland raised its rate back to 5 percent. Strong business conditions and a growth in borrowing from the Bank of Finland caused the lowest discount rate to be raised one more time in November 1912 to the rather high level of 6 percent.⁴⁸⁶

In the second half of 1913 and again in spring 1914, foreign currency reserves grew strongly and the money market eased. The Bank lowered its discount rate in March to 5½ percent and, as general foreign rates continued to decline at the start of 1914, the Bank followed suit and cut its lowest rate to 5 percent in April 1914. Its rates then remained unchanged until the outbreak of the First World War in summer 1914.⁴⁸⁷

BECOMING A CENTRAL BANK

EARLY PHASES OF PRIVATE BANKING

The period when the private banking sector was established in Finland is closely related to age of reforms that began in the late 1850s. It began from a broad public debate about the direction of modernisation. The most vigorous participants were young liberals whose mouthpiece was the newspaper *Helsingfors Dagblad*⁴⁸⁸ but in fact public opinion had already changed and the advocates for giving a banking monopoly to the Bank of Finland were few and far between. Most people regarded it as natural that, once the monetary system of the country had been stabilised by the silver standard, measures would be undertaken to develop a private banking system. Agriculture was still the entirely dominant livelihood so the first step was to allow the establishment of a mortgage institution to grant long-term mortgage loans to landowners. This was also a politically logical approach because Governor general Berg was publicly in favour of a mortgage institution. Thanks to his Baltic background Berg was familiar with the mortgage credit institutions established on the Prussian model in Estland and Livonia.

A private commercial bank was planned in close connection with a mortgage society. Its functions would include assisting the mortgage society with bond issues, perhaps by allowing credit to purchasers of the society's bonds against the security provided by the same bonds. Plans did not advance in quite this way. The idea of this interconnection

was immediately rejected and it was decided instead to plan the establishment of two entirely separate institutions.

The Mortgage Society of Finland, which granted long-term loans to agriculture, was established in 1860 as a mutual liability company. It was thus modelled on the mortgage associations that operated in the Baltic governorates of the Russian Empire, whose function was to provide credit for large estates. Finnish agriculture had a very different structure, with nowhere near as many large estates, so the mortgage society faced difficulties from the outset in finding its own market niche. It did not grow to quite the stature that had perhaps originally been anticipated.

The first private commercial bank – the Union Bank of Finland (Suomen Yhdys-Pankki) – received its charter in 1862. The charter came to form the basis for the banking law that entered into force in 1866 and laid down the framework for private commercial banking. The basis of the first Banking Act was fairly liberal. A private commercial bank could be established as a partnership, where the owners would have separate and joint liability, or as a joint stock company where the shareholders would have limited responsibility. At least two-thirds of the bank's board members had to be Finnish citizens. The model of unlimited liability was not used by a single commercial bank in Finland, all of which were established as limited companies. The minimum capital required of a commercial bank was 1½ million markkaa, which was a rather large sum by the standards of the time. Apart from that, the law contained no regulations about capital adequacy or liquidity. The charter of the Union Bank of Finland did not give it the right to issue banknotes but the law of 1866 did. However banknote issuance required the separate and individual permission of the Economic division of the Senate, which would set both the maximum number of notes and their nominal values. Operations were strictly limited to banking proper. The right of a commercial bank to own shares or property unconnected with banking was strictly controlled. The law placed the task of supervising the bank primarily in the hands of its owners and customers. To make this supervision effective, the bank was required to satisfy certain standards of transparency in its business operations. Its result and balance sheet had to be published monthly in newspapers. The operations of each commercial bank were also to be monitored by a public attorney

appointed to the bank by the Senate's Economic division. At this stage all banking operations were still subject to usury regulations dating from the 18th century. The highest permitted rate on loans was 6 percent.⁴⁸⁹

The Banking Act was revised in 1886. The changes of the greatest principle referred to the right to issue banknotes and to founding capital. Commercial banks were no longer allowed to issue banknotes, which became a monopoly of the Bank of Finland. Minimum founding capital was no longer fixed and the law stated that "a bank should have the fund of capital laid down in its articles of association". In removing the minimum capital requirement the aim was to make it easier to establish 'People's Banks' on the Swedish and German model. In practice the Economic division of the Senate required a bank to have minimum capital of 0.3 million markkaa.⁴⁹⁰ The interest-rate ceiling was also relaxed and the six-percent maximum rate applied only to contracts longer than one year.

The high minimum capital requirement, the prohibition of banknote issue and the interest-rate ceiling were reflected in how commercial bank operations developed. A large number of shareholders was needed to obtain the necessary share capital, and commercial banks had many times the number of founding shareholders that other limited companies did. Because banknotes issue was banned, funding was based on deposits. To maximise deposits the commercial banks established networks of branch offices throughout the country. Interest rate controls also had an impact on operations because, even before the law was relaxed, a bank could sidestep the controls by concentrating on acceptance credit. In the early 20th century almost half of the stock of lending of commercial banks was against bills of exchange, and before the turn of the century their share had been even larger.⁴⁹¹

As a national economy Finland was still small in the second half of the 19th century so there was not room for many large banks. On the eve of the First World War there were only 13 banks, a relatively low number. Furthermore the commercial bank system was very concentrated because the 3–4 largest banks controlled nearly 80 percent of the market. This situation was exceptional by international standards. Norway, which had a distinctly smaller population, had a full 120 commercial banks in 1914 while in Sweden the number of

commercial banks peaked at 83 in the early 1910s.⁴⁹² Finland lacked the unlimited company (*enskilda*) banks that were typical of Sweden, where a small number of owners had unlimited responsibility. There were few Finnish banks that operated only in certain provinces or regions of the country and there was no room in Finland for People's Banks with a small amount of capital.

The early history of the country's second oldest commercial bank shows the resilience of the Finnish model for national commercial banks. The Nordic Bank for Trade and Industry (*Pohjoismaiden Osake-Pankki Kauppaa ja Teollisuutta varten*) was founded in 1872, a giant by Finnish standards because its founding share capital was planned to be 30 million markkaa. The German banking houses involved in the project believed that they would gain access to the Russian market via Finland. German investors were especially attracted by the opportunity of exploiting the interest rate differential between Germany and Russia. The bank's business concept was also exceptional because it planned to be an active player in the foundation and reorganisation of companies. The aim of gaining a presence in the St. Petersburg market via Finland failed, however, and the German investors quickly withdrew from the project. As the shareholders became predominantly Finnish, the bank began to resemble other Finnish commercial banks in its modes of operation.⁴⁹³

The savings banks had taken root in Finland before commercial banks, in the 1820s. They remained fairly unimportant until accelerating economic growth and changes in rural society increased the opportunities for personal savings and their position grew stronger in the 1890s. This showed in their regional spread; by the 1910s the number of savings banks was close to the number of municipalities. By this time they had also established their own limited-liability central institution, formally a commercial bank, which brought more bank-like conduct to the operations of the whole savings bank movement. They were fairly strictly controlled in their operations by the Savings Bank Act, which entered into force in 1896. The aim of the law was to protect depositors, because the authorities were not confident that savings bank customers would themselves be able to monitor their banks' operations.⁴⁹⁴

The cooperative banking organisation, which specialised in credit for the rural poor, was established in 1902. It consisted of credit

societies in the form of cooperatives, plus the Central Lending Fund of Cooperative Credit Societies, a limited liability company that served as their central institution. Until the early 1920s the organisation’s operations consisted of intermediating agricultural credit received from the state. Operations were so small-scale that in 1910 they did not account for even one percent of all bank lending.⁴⁹⁵

STRUCTURE OF THE
BANKING SYSTEM

DOMESTIC LENDING BY BANKING GROUP, %, 1870–1910

	1870	1890	1910
Bank of Finland	28	21	8
Commercial banks	31	48	58
Mortgage credit banks	30	11	14
Savings banks	11	20	20
Cooperative banks	...	...	0

Source: *Finnish economic history 3*. Historical statistics, ed. Vattula, K., 1983.

With the growth of the commercial bank sector, the status of the Bank of Finland as Finland’s most important lender changed rapidly. It did not try to compete with commercial banks for corporate customers but began to concentrate on regulating the aggregate liquidity of the national economy. In practice this meant a change in the nature of the Bank of Finland’s lending. After the second half of the 1860s it ceased to grant long-term mortgage loans and all new loans were for no longer than a year. The main form of lending became short-term credit granted against bills of exchange or realisable collateral.

From the outset, lending by commercial banks grew rapidly and came to dominate Finland’s credit market within a couple of decades. At the start of the 1890s commercial bank lending accelerated again. By the start of the 20th century their lending accounted for well over half of all credit.

The shrinking relative share of the Bank of Finland was not because it had deliberately reduced its lending but rather because its operating logic was different to that of the commercial banks. The Bank of

Finland's opportunities to lend were tied to the volume of banknotes in circulation, which increased from nearly 50 million markkaa in 1882 to some 140 million markkaa in 1914. Meanwhile the lending of commercial and savings banks was tied to their stock of deposits, which increased in 1880–1914 from 55 million markkaa to 1000 million markkaa. The growth potential of lending by commercial banks was therefore in a completely different league from the Bank of Finland's.⁴⁹⁶

The growth of deposits in the private banking sector accelerated after the early 1890s, not merely because the national economy in general grew but also as the money economy spread to all areas of society. In the countryside wages increased at the same time as production for sale displaced production for own use. Extra impetus for the ubiquity of the monetary economy came from a permanent growth of forestry, which dispersed income from the sale of wood throughout the countryside. As a consequence of these changes, money began to reach even remote rural areas and the savings of society were channelled into the banking sector. The monetisation of society promoted efficiency in the allocation and use of capital, which in turn served to accelerate economic growth.

The relative share of mortgage credit institutions was subject to fairly acute fluctuations. The start was rapid in the early 1860s when the Mortgage Society of Finland began operating but a credit institution dependent for its growth on large-scale agriculture soon reached its limits and by the 1890s its share had fallen steeply. A new upswing began with the founding of mortgage banks concentrating on financing property in towns, the pioneer being the Finnish Town Mortgage Fund (*Suomen Kaupunkien Hypoteekkikassa*), established in 1895. That late date corroborates the image of Finland's late urbanisation.⁴⁹⁷

The early 1860s were a decisive turning point in the history of Finnish banking. The Bank of Finland finally abandoned its old practice of granting long-term mortgage credit to owners of the largest estates. Initially the Mortgage Society of Finland was envisioned as replacing the Bank of Finland as Finland's most important credit institution, a plan that received support from St. Petersburg, but matters fairly soon moved in a different direction. Growth in the private banking sector came not primarily from mortgage credit institutions but from joint stock commercial banks. The old banking principle, which had once prevailed throughout the Baltic Sea rim, that mortgaged real estate

offered the firmest foundation for banking, had finally been laid to rest in Finland.

In a couple of decades a “Finnish deposit banking model” developed. It was characterised by large commercial banks spanning the whole country with broad networks of branch offices, by the confinement of operations to banking proper, by the absence of foreign banks and by a very high degree of concentration; commercial banks acted as universal banks for the public, with a clientele spanning all sectors of society. This model influenced how relations with the Bank of Finland developed. The commercial banks were nationwide so a proportion of payments happened within the same bank, which may have retarded the adoption of a clearing system managed by the central bank. Having a broad network of offices also made it easier for each commercial bank to manage its liquidity. Furthermore, the small number of major banks brought stability to the system and simplified interbank cooperation.

INTERNATIONAL DEVELOPMENT MODEL

The various national banks of issue developed into real central banks in the second half of the 19th century, when serving as “the bank of bankers” became their most important task. Strictly speaking, even under the gold standard, other banks used banknotes of, or deposits at, the central bank as their reserve of liquidity, instead of holding large quantities of gold coin. A two-tier banking system developed in which the liquidity of the general public was increasingly based on accounts at deposit banks such as commercial and savings banks, while the liquidity of the deposit banks was based on their reserves held in central bank money. In a monetary system based on the gold standard, the external liquidity of the nation depended ultimately on its reserves of gold and foreign exchange, which were best held jointly by the national central bank.

National banks of issue evolved into central banks at different rates in different countries, depending on how soon the country developed deposit banks serving the public. In Finland the deposit bank sector grew slowly, beginning with the establishment of the Union Bank of Finland in 1862, which may be why several more

decades elapsed before the division of responsibilities between the deposit banks and the Bank of Finland came to resemble a two-tier banking system. One milestone was passed in the early 1880s, when the value of public deposits with the commercial banks overtook the value of Bank of Finland banknotes in circulation. In practice, however, the Bank of Finland's specialisation as a central bank was still at a nascent stage.

In various countries, the position of central banks at the core of the financial system was reinforced by legislation, for example by giving them a monopoly on the issuance of banknotes (or at least by restricting or taxing the issue of notes by other banks). In many countries the notes of central banks were also made legal tender, which creditors were obliged by law to accept in payment of any debt. These measures boosted the profits of central banks, offsetting the costs that naturally arose from holding a large gold reserve that did not yield interest, unlike funds that could be used for lending. In many countries the status of legal tender given to central bank banknotes (in England as early as 1833) provided the bank with a certain protection from money market panics because the public had no reason to worry about the validity of central bank notes. Considerations of state also argued for granting special rights to central banks; a banknote monopoly raised the profits that a state-controlled bank of issue could transfer to the government, though national systems of course varied in this respect.

In Finland the central bank was not given the legal monopoly to issue banknotes until 1885, when the right of commercial banks to issue notes was rescinded. Nor did Bank of Finland notes become legal tender; until the First World War, only gold coin held this status. The institution of a legal banknote monopoly had no great economic significance for the Bank of Finland nor for society in general because only one other bank, the Union Bank of Finland, had issued banknotes before the monopoly was enacted. Moreover, the Union Bank of Finland had issued very few banknotes, only 3–4 percent of the amount of Bank of Finland notes in circulation. When the law was changed in 1885, the Union Bank was given until 1892 to withdraw its notes from circulation.

A committee had been established in 1883 to prepare a new commercial banking law, chaired by Baron S.W. von Troil, head of the

Turku office of the Union Bank of Finland. The committee had reached the conclusion that private banks should retain the right to issue banknotes; in this and other questions the committee took a liberal line on banking regulation. However, the board of the Bank of Finland and the supervisory council were both opposed to allowing private banks to continue issuing notes. The Bank of Finland believed that the principle of freedom to choose a livelihood should not apply to banknote issuance. The council was not unanimous but only Lorenz Lindelöf, representing the burghers, defended the proposal of von Troil's committee. The chairman of the council, Dean Hjelt, representing the clergy, Agathon Meurman for the peasantry and Fredrik Stjernvall deputising as representative for the nobility, were all opposed to allowing private banks to issue banknotes. On the basis of these statements, the Senate sent a proposal to the Diet on "banking business carried on by a company". The proposal included rescinding the right of issuance by commercial banks. The Senate's proposal was approved by the votes of three estates, only the burghers being opposed to it.⁴⁹⁸

The status of a central bank also brought responsibilities. The commercial banks that became its important customers began to depend on the central bank for credit, expecting short-term loans whenever liquidity was temporarily impaired. One form of credit was a short-term loan granted against collateral in securities, often called Lombard credit. Another was for the central bank to rediscount bills of exchange held by commercial banks. Towards the end of the 19th century, rediscount credit became the most important form, used by central banks everywhere to provide liquidity to the commercial banking system when it was needed.

Rediscount credit was so useful because buying commercial bills of exchange from the public (in other words, discounting them) had become the most important form of short-term lending by commercial banks at the end of the 19th century. Each commercial bank therefore had a large portfolio of short-term bills of exchange, most of which consisted of short-term revolving credit for trading houses and industrial establishments. If the bank needed to raise cash, it could offer bills of exchange to the central bank to be purchased, meaning rediscounted.

Rediscount credit to commercial banks became the main instrument of monetary policy in all countries. These loans had the

advantage that, because of their short maturity, their total volume could rapidly be adjusted. The amount of rediscounting could be managed by changing the rediscount interest rate. Changing the rate of interest used to rediscount bills of exchange became the main tool of monetary policy throughout the world and long remained so.

As early as the mid-1870s the Bank of Finland granted one commercial bank, the Nordic Bank for Trade and Industry, a smallish number of short-term loans. They were mostly in the form of Lombard credit against collateral in securities but rediscounting bills of exchange was also tried in 1874–1875. However, the lending operations of 1875 were isolated and were followed by a long period when the commercial banks did not need short-term credit from the Bank of Finland. The Europeanization of monetary policy in Finland did not take place until the late 1880s and after the money market had become tighter in the 1890s. It was then that rediscounting the bills of exchange of commercial banks became an established practice at the Bank of Finland. It remained the key part of its monetary policy toolset for many decades.⁴⁹⁹

BANK OF FINLAND BECOMES A PAYMENTS CENTRE

It is part of the job of a central bank to offer other banks a reliable means of making payments to each other. In principle banks could keep their reserves in the form of central bank banknotes and interchange them to make payments but obviously this is neither efficient nor secure. In pursuit of efficiency the commercial banks in Finland, as in other countries, did not keep liquid funds in banknotes but as deposits in accounts with the central bank. The commercial banks could then use these current accounts to obtain cash when required, or to make payments to each other. Payments traffic between commercial banks increased rapidly as business life became accustomed to using postal payment orders drawn on a commercial bank and, later, cheques. This increased the payments traffic passing through their accounts at the central bank.

Accounts were opened by commercial banks at the Bank of Finland at almost the same rate as new commercial banks were established, as the table overleaf indicates. As these accounts

developed into the most liquid place for a commercial bank to keep its funds, the Bank of Finland consolidated its position at the summit of Finland’s “liquidity pyramid”. Admittedly the accounts were initially more important for handling payments than for depositing liquid funds. This shows in the great velocity of circulation in these accounts. The Bank of Finland’s accounts developed into the core of the nation’s payment system, at a time when payment flows between banks were already extremely significant in proportion to the size of the national economy. It is illustrative that in 1913, on the eve of the First World War, payments to banks’ and other customers’ accounts at the Bank of Finland totalled 450 million markkaa, which was slightly more than the total value of Finnish merchandise exports in that year and about 28 % of Finnish GDP.⁵⁰⁰

NUMBER OF COMMERCIAL BANKS AND THEIR DEPOSIT
ACCOUNTS AT THE BANK OF FINLAND 1870–1910

year	accounts	commercial banks
1870	1	1
1880	2	3
1890	4	6
1900	5	9
1905	5	9
1910	9	12

Such a great volume of interbank payments would have tied up considerable funds if a netting mechanism had not been introduced. In Britain current accounts at the Bank of England had become a medium for interbank clearing much earlier, developing gradually during 1854–64.⁵⁰¹ Germany’s Reichsbank had established an interbank payment clearing system in 1883.⁵⁰² In 1906 the Bank of Finland decided to provide this service at its head office and later at its branch offices, too. In clearing, the receivables of each commercial bank from the other banks were matched daily with the payables of the same bank to other banks so that its account with the Bank of Finland was only charged or credited with the net amount. Now that interbank clearing was centralised at the Bank of Finland, it became the undisputed core of Finland’s payments system. The number and value of payments in

clearing increased fast and by 1913 the Bank of Finland cleared more than 86 000 cheques and postal payment orders worth a total of 197 million markkaa.⁵⁰³

STAYING ON THE SIDELINES

From the 1860s the general view began to develop that a central bank was responsible not only for the value of money but also for general monetary stability. The Overend Panic in London in 1866 was something of a milestone in this respect. After the extremely destructive run on Overend, Gurney & Co., the editor-in-chief of *The Economist*, Walter Bagehot, published his famous pamphlet “*Lombard Street*” (1873), in which he demanded and that, at times of crisis, a central bank should lend freely against normal security but at higher-than-normal interest. In Bagehot’s view the fear that money might not be available at any interest rate would lead to panic when the money market was tight. His principles soon won widespread support and became part of generally accepted practice among central bankers. Confidence in Bagehot’s view of the central bank as “the lender of last resort” was reinforced in the Baring Panic in 1890. In this money market crisis, the Bank of England was seen as having acted in accordance with Bagehot’s principles and succeeded in preventing the problems of London’s Barings Bank from developing into such a widespread panic that the market might have collapsed completely.

According to the first clause in the Bank of Finland’s regulations confirmed in 1875, its function was to maintain Finland’s monetary system on a stable and secure basis and to promote and facilitate payments. In normal conditions this article meant safeguarding the liquidity of the whole financial system, which was done mainly by varying the discount rate, by rediscounting bills of exchange offered by commercial banks and sometimes also by granting them short-term credit against good security. The regulations pertained to the country’s financial system as a whole and not to individual institutions. It was seen as axiomatic that the supervision of commercial bank operations was primarily the responsibility of each bank’s owners and not public authorities. In fact a firewall was built between private commercial banks and the government because the first commercial banking act, drawn up in 1866, explicitly stated that no commercial bank was



■ Bank architecture of the 1880s.

The photo shows office space on the second storey at the head office of the Bank of Finland, a building completed in 1883.

– Helsinki City Museum picture archives.

entitled to support from authorities. "Let no private bank be expectant of any financial assistance from state funds or other aid from the government; nor shall the state involve itself in private enterprises or come to the rescue of any bank." The banking act was revised in 1886 but this section was kept in force.⁵⁰⁴

The ineffectiveness of banking supervision was an undisputed shortcoming during the latter half of the period when Finland was a Grand Duchy. Instead of a centralised monitoring system, a public attorney was appointed for each commercial bank who had the right to be present at meetings of its directors and to append possible memoranda to the minutes of company meetings. He had no direct authority to intervene in the bank's operations. The commercial banking sector in particular swore by the principles of liberal economy, one mark of which was unshakable faith in the effectiveness of market-driven supervision, meaning that its owners and customers would oversee its managers. This in turn required banking operations to be transparent, which was reflected in the legal requirement for a bank to publish a summary report on its state and an annual review, according to a formula confirmed by the Senate, of the bank's result and balance sheet. This system placed its faith, on the one hand, in the high moral standards of the banks operational management and, on the other, in the competence of owners and customers to assess the bank's economic condition and fitness to cope with business risks. The ban on public support was intended not merely to protect public funds but also to ensure neutrality in competition between commercial banks; the state was not to favour one to the disadvantage of the others.⁵⁰⁵

The clause in the banking law outlawed aid only when it was granted directly from government funds but in practice it also tied the Bank of Finland's hands when a bank in crisis needed rescuing. There was a high threshold to granting credit to a commercial bank on preferential terms. The duty of the Bank of Finland was understood to be the safeguarding the stability of the whole system but not automatically of protecting its individual parts. The explicit ban on granting public support referred only to commercial banks and was observed for them only. At times, other financial institutions such as the Mortgage Society of Finland and the Central Lending Fund of Cooperative Credit Societies received regular support from the state.⁵⁰⁶

CRISES OF INDIVIDUAL BANKS ONLY

Support for an individual commercial bank was first needed at the start of the 1890s. The international financial crisis known as the Baring Panic had an impact on Finland but still greater problems stemmed from domestic factors, mainly the growth of Helsinki and the consequent fast rise in demand for credit in the real estate sector. The recently established Kansallis Bank was the hardest hit. The Bank of Finland was concerned about the immoderate growth of its lending, particularly because the growth was underpinned by bold exploitation of rediscounting. Fortunately the situation was saved by a rapid intervention by the Bank of Finland and a change in the top management of Kansallis, and the bank was successfully stabilised within a few years. Part of this normalization resulted from the resignation of the bank's first general manager, Otto Hjelt.⁵⁰⁷

The next individual bank crisis to threaten the stability of the banking system came at the start of the new century. The Bank of Finnish Agriculture and Industry (Suomen Maanviljelys- ja Teollisuuspankki) had been established 1897 with the business concept of granting credit to both industry and agriculture. This did fill a notional gap in the financial market but its launch was too ambitious for its resources and liquidity was under pressure from the start. It soon emerged that the bank had resorted to unhealthy practices in its funding, mainly by paying oversized commissions on deposits obtained and by using fabricated certificates of deposit. There were also certain irregularities in the loan collateral required by the bank, but the greatest risk lay in the fact that most of its loans had been made to a few major customers.⁵⁰⁸

The management of the Bank of Finland had been doubtful about the Bank of Agriculture and Industry from the start, because it mistrusted the professionalism of its managers. The bank had appointed as its general manager Otto Hjelt, who had failed in this position at Kansallis Bank. The Bank of Finland felt that its regulations concerning neutrality required it to rediscount the bills of exchange of the Bank of Agriculture and Industry, but it imposed strict limits, permitting their total to be no more than half the bank's equity. As the liquidity of the Bank of Agriculture and Industry worsened, the Bank of Finland

granted it short term Lombard credit backed by certificates of deposit, but the bank continued to deteriorate in autumn 1900 and its management was changed. Alfred Charpentier and August Ramsay were invited to become managers, with the aim of restoring confidence among the public and officials. The former had been a chairman of the Bank of Finland's board and head of the Senate's Financial department, the latter was a senior insurance supervisor and the managing director of the Finnish Town Mortgage Fund.

As soon as they had examined the bank, Charpentier and Ramsay concluded that its situation was untenable and they terminated its operations. The aim was to liquidate it amicably but this proved impossible and in winter 1902 the Bank of Agriculture and Industry was put into bankruptcy. The liquidation of its assets proved to be exceptionally difficult because its estate contained 85 other bankrupts. The final accounts were not drawn up until 1917. They recorded the bank's debts at 9.44 million markkaa and its assets at 3.7 million markkaa. The shareholders of the Bank of Agriculture and Industry lost everything that they had invested and the depositors lost 30 percent of their deposits. The Bank of Finland took a loss of 1.5 million markkaa. The State Treasury had also held considerable funds on deposit with the bank.

The failure of the Bank of Agriculture and Industry was the biggest in Finnish banking history to date and aroused great public attention. A striking part of the rescue operation had been a change in its management in 1900. Although Bank of Finland minutes show that the central bank played no role in this, prestigious names point to at least indirect support for the operation. However the Bank of Finland had no desire to initiate a rescue as such, beyond the credit that it had already granted. Minutes of meetings of the supervisory council contain mere mentions of the difficulties facing the Bank of Agriculture and Industry. In his study of the reasons for its failure, Paavo Korpisaari stresses the negligence of the bank's managers and deficiencies in its governance. Korpisaari regards the Bank of Agriculture and Industry as a model for how a bank should not be managed and supervised, so the central bank's unwillingness to participate in a rescue is understandable. A similar case, although much smaller in proportions, was the bankruptcy of Nykarleby Bank in 1913. Established in 1899, it had been managed very negligently

and unprofessionally, but the bank's public attorney allowed the situation to continue until the final blow came when bank's largest debtor went bankrupt in 1913. The liquidator's report shows that the public attorney had stated the bank to be entirely sound just two days before it declared bankruptcy. Its shareholders lost their investment and its depositors about 40 percent of the value of deposits. From the perspective of the Bank of Finland, Nykarleby Bank was such a minor player that its operations did not merit attention. It is an interesting detail that, when Nykarleby Bank was established, one of its largest shareholders had been the aforementioned Bank of Agriculture and Industry.⁵⁰⁹

INITIAL DEBATE ABOUT THE NATURE OF BANK SUPERVISION

Both of these bank failures gave rise to a lively public polemic about the nature of and need for supervision of commercial banks. By the time Nykarleby Bank failed, there was a strong body of opinion that depositors were not adequately protected by shareholders' supervision combined with decentralised public control in the form of a public attorney for each bank. At the same time a dispute arose between the advocates of public supervision and supporters of market-driven supervision by customers and shareholders. The mouthpiece of the aforementioned group emerged as Paavo Korpisaari, whose dissertation had been on the subject of banking theory. In two articles appearing in *Helsingin Sanomat* newspaper in autumn 1913, he stressed that banking depended on the trust that banks enjoy and that proper public supervision was important for fostering this trust. He regarded the alternatives as a bank inspector operating under the Senate's Financial department or an inspection department established at the Bank of Finland.⁵¹⁰

A prominent advocate for market-driven supervision was Emil Schybergson, the long-term chairman of parliament's Banking Committee (1907–1917) and the managing director of the Mortgage Society of Finland. Schybergson immediately answered Korpisaari's writings with his own in the pages of *Hufvudstadsbladet* newspaper, stating that there was no need for the government to take over a responsibility that was the duty of a bank's owners and depositors. In

his view, it was unreasonable for shareholders to criticise a bank's public attorney because the same shareholders had already elected their representatives to monitor the bank's operations. The basis for supervising any commercial bank should be criticism of its balance sheet, based on the principle of transparency. Schybergson said that Korpisaari's proposal for centralised public supervision would establish a principle that would undermine healthy competition between banks. Extra public supervision of banks would make the government responsible for the soundness of a bank, which would tend to favour banks with feeble economic resources. His reasoning was that, if supervision were stronger, a small bank with little equity would enjoy the same trust among depositors as a large bank, whose decades of profitable operations had increased its equity many times over.⁵¹¹

The question of toughening bank supervision came up in parliament the following year, in 1914, in the form of a proposal from the parliamentary group of the Agrarian League, headed by Kyösti Kallio. The party sought more effective public supervision in line with Paavo Korpisaari's views. The decisive debate on the subject took place in parliament's Banking Committee, which was led by Schybergson. The supporters of the proposal stressed the role of the government as a guardian of commercial bank depositors, while the supporters of market-driven supervision appealed to the importance of unfettered competition. In both the Banking Committee and the Grand Committee of parliament, the majority favoured the existing arrangement so the plan for tougher supervision lapsed. Part of the proposal for establishing a committee to study transferring supervision to the Bank of Finland lapsed at the same time.⁵¹²

The debate in Parliament might suggest that, in the mid-1910s, there was still surprisingly strong faith in the supremacy of market-based supervision, but this was not merely a question of ideological differences. The debate turned on the troubled relations between Russia and Finland. Finland was just enduring its second period of attempted russification and Russia was greatly mistrusted. Under these conditions it was feared that moving to a centralised system of supervision, possibly led by the Senate, might offer officials in the Russian sphere of influence the opportunity to interfere with the operations of Finnish banks. Under no circumstances was this to be allowed, so it was preferable to leave things as they were. Ultimately

the matter was determined by political rather than economic considerations.

The Bank of Finland was largely a bystander in the debate about organising bank supervision. Although it was mentioned as one possible supervisory authority on a few occasions, neither the management of the Bank of Finland nor the supervisory council discussed the question. This type of bank supervision was obviously not regarded as a suitable job for a central bank.

STRUCTURES OF GOVERNANCE

DUAL SUPERVISION ENDS

The transfer of the Bank of Finland in 1868 to the ambit of the Estates meant a fundamental change in its management structure. In practical terms, the task of monitoring the bank moved from the Senate to the supervisory council chosen by the Estates. In fact the complete transfer of responsibility was not completed until 1875. There was a transitional period because even after 1868 the Bank of Finland continued to manage certain government funds, which meant that the Senate maintained the right to oversee the bank in this respect. Thus the Bank of Finland operated simultaneously under the supervision of two bodies, the supervisory council of the Estates and the Economic division of the Senate.

The council drew immediate attention to this anomaly and the matter became public in 1872 when the Diet debated a council proposal for new Bank of Finland regulations. These aimed to transfer management of the government funds to a separate authority established for this purpose. It would simplify the position of the Bank of Finland's board, which would no longer be torn between the bank's interests and the government's or have to decide whether to obey the Senate or the supervisory council.

Only a few representatives in the Diet were against the proposal. The best-known opponent was Robert von Trapp, who had been chairman of the Bank of Finland's board in the 1850s and head of the Senate's Financial department until 1871, and was now chairman of the

Diet's banking committee. In his view it was completely unnecessary to subordinate the Bank of Finland to the Estates and he also saw no reason for transferring the management of government funds away from the Bank of Finland. Of the opposite view was J.V. Snellman, who had strongly opposed the transfer of authority over the Bank of Finland at the time of the 1863–64 Diet, when he was head of the Financial department, but had changed his mind as a member of the Diet in the 1870s.⁵¹³

Although there was general support among the Estates for the matter itself – transferring the management of government funds away from the Bank of Finland – there was a vigorous debate about the formalities of the proposal, which hindered a conclusion of the matter. The greatest obstacle was perceived to be that the supervisory council did not have the right to propose such a major matter, which was the prerogative of the Emperor and the Senate. Despite these doubts, the Diet ultimately decided to propose to the Tsar that management of government funds be transferred to a new organisation so that the Bank of Finland could concentrate on central banking and be overseen by one body only.

The Diet's decision was sent to the office of the Governor general, which passed it to the office of the Ministerial State Secretary in St. Petersburg, which then returned it to Helsinki to be prepared by the Senate. These procedures took about a year, and it was finally presented to the Emperor in December 1873. He gave his assent and, at the start of 1874, the Senate set up a committee to prepare the establishment of a new authority to manage government funds. It was composed of Senator Herman Molander, Senator Viktor von Haartman, the chairman of the Bank of Finland's board August Florin, referand Julius Thilen, clerk Wilhelm Brummer and the secretary of the Estates' supervisory council Svante Dahlström. After nearly a year's work the Senate confirmed the proposal, which was in turn ratified by the Emperor, to establish a State Treasury to begin operations from the start of 1876.⁵¹⁴

With the creation of the State Treasury the complex duality of Bank of Finland supervision was eliminated and the role of the council became clearer. A concrete sign of this was that, from 1875, the council rather than the Senate was the body that discharged the Bank of Finland's board from liability at the end of each accounting period. The

Bank of Finland did not escape the Senate's embrace completely. It did not have the right to take loans from abroad, so any such loan was taken in the name of the Senate, which then deposited the foreign currency with the Bank of Finland. The Bank of Finland was also obliged to pay the state an annual amount of 180 000 markkaa for the promotion of agriculture, the upkeep of secondary schools and the care of the insane. After the establishment of the State Treasury the sum was raised to 250 000 markkaa per year.⁵¹⁵ The increase was explained in terms of the costs that the Bank of Finland had saved when the State Treasury was established.

FORMAL STATUS OF THE SUPERVISORY COUNCIL

The regulations for the Bank of Finland of 1867 and the revisions in 1875 and 1878 created a strong position for the Estates as the supreme authority over the Bank of Finland but in a few important points the status of the Senate remained unchanged. The right to choose the chairman of the Bank of Finland's board was held directly by the Emperor. All three bodies – the supervisory council, the Senate's Economic division and the Emperor – were involved in choosing the other permanent board members. First the supervisory council was allowed to nominate three candidates, the Economic division made its own statement about them to the Emperor, and the tsar then exercised his prerogative to make the appointment.⁵¹⁶ The strong position of the Emperor in appointing the bank's management reflected Russia's autocratic system. Finns accepted this; the tsar's right to make appointments was never challenged.

In 1895 the regulations were modernised and at the same time the process for nominating the chairman of the board was redefined. The 1875 regulations had stated that "the foreman of the board is nominated by his Imperial Majesty in the order which has hitherto been used or which his Imperial Majesty shall in future decree". After the reform the wording was: "The chairman is appointed by the Emperor and at the proposal of the Economic division of the Senate of the Grand Duchy." An extra regulation adopted in the same connection added a member to the board, whose appointment was to be confirmed by the Senate's economic division on the basis of a proposal by the supervisory

THE SECURITY PRINTING HOUSE

The few banknotes issued in the first years of the Bank of Finland were technically undemanding. Sheets of notes could be produced in Finland, first at the Royal Academy's printing works in Turku, owned by J. C. Frenckell, and later at Jakob Simelius' printing house after the bank had moved to Helsinki.

At the start of the 1820s, Russia began to use engraved plates to deter counterfeiting. Finnish printing houses lacked the capability so, for four decades, banknote production moved to St. Petersburg, where they were also designed. After Finland obtained its own currency in 1860, the printing of small banknotes was transferred back to Finland, where they were ordered from lithographers such as F. O. Liewenthal and Ferdinand Tilgmann. Larger denomination notes were initially produced by the Prussian state printing house in Berlin. From the 1870s until 1887, H. H. Thiele's printing house in Copenhagen was used.

The idea of establishing Finland's own security printing house was first raised in the Diet in 1882 but not agreed; it was decided in the next Diet sessions in 1885. Construction began in 1886 on a site owned by the Bank of Finland. A contract to manage the printing house was signed with Ferdinand Tilgmann, whose relationship with the bank went back to the 1860s. The

Bank of Finland was responsible for the costs of the property, the printing machines, the plates and the paper, while Tilgmann paid for maintenance, other materials and wages. When the contract was renewed in 1909, Tilgmann took over the cost of acquiring new printing machines. Finnish banknote production was not entirely self-sufficient, because in 1897 a contract for printing the front of banknotes was made with Britain's Bradbury, Wilkinson and Co, although only for a few years.

In 1911 Ferdinand Tilgmann stepped aside and his son Ernst took over. This entrepreneurial arrangement ended in 1921, when Tilgmann was unwilling to undertake a large investment in machinery. The Bank of Finland acquired the machines and set up its own department with Tilgmann as manager. The whole staff of 62 became Bank of Finland employees. A new four-storey building was completed as an extension of the old printing house in 1921. Operations continued in these premises until the 1950s, when the Security Printing House moved to a new building nearby at 19 Rauhankatu Street.

The Mint of Finland was established in 1865 under the senate's Financial department and has always operated separately from the Bank of Finland.

council.⁵¹⁷ These revisions increased the authority of both the Senate's Economic division and the Estates' supervisory council in the appointment of board members. Probably the greatest change of principle was the appointment of an extra member on the basis of a proposal by the council.

The right to appoint senior officials below the board, such as the secretary, clerks, cashiers and the attorney, was still held by the Senate's Economic division in the 1867 regulations. In 1878 this right was transferred to the board and the practice continued until independence. The heads of branch offices – using the terminology of the time, the bank commissioners – constituted a completely separate group among the bank's officials. These appointments were always made by the Senate's Economic division, although the revised regulations of 1875 gave the board the right to choose the three that it regarded as the most suitable from among the applicants. The supervisory council then made a statement about these, after which the Senate Economic division finalised the appointment. Another aspect of appointment rights concerned the members of the discount committees, which were appointed at branch offices from 1875 onwards. They were chaired by the head of the branch office but the two other members were outsiders, chosen annually. They were required to be well informed about local business conditions, upstanding and of good repute. The head of the branch office made a proposal after discussing the matter with the board, and the choices were confirmed by the council.⁵¹⁸

It's an interesting curiosity that, with the regulations of 1895, officials were required for the first time to have a command of the Finnish language. Admittedly the stipulation was still fairly relaxed; according to regulation 53, "a candidate must show that he can use spoken and written Finnish and Swedish to the extent that the nature of the position requires". The language question had first been brought up in 1879, when a member of the banking committee G. Z. Forsman (who used the Finnish-language name Yrjö-Koskinen after 1882) had asked the board for a report on the position of the Finnish language in the Bank of Finland. In 1881 a statute on the status of Finnish in government offices and institutions came into effect. However, the Senate argued that this statute did not affect the Bank of Finland, which operated subordinate to the Estates, because it had been an

administrative Senate decision and not a decision of the Diet. This interpretation suited the pro-Swedish management of the Bank of Finland well but the motivation that was at least as important was that Russia had begun to plan the unification of the Finnish and Russian monetary systems in the 1890s. There was no wish to raise the language question at a time when it might lead to demands for the use of the Russian language.⁵¹⁹

Generally speaking, the duties of the members of the supervisory council were clear. The Bank of Finland operated under the guarantee and management of the Estates, so the job of supervising the bank belonged unequivocally to only one body, the Diet. The Diet had in turn delegated practical supervision to the supervisory council, to which each estate could appoint one permanent member and, for every member, two deputies. The number of permanent members, four, was fairly small. The Diet based its supervision of the Bank of Finland on the annual report of the supervisory council and the minutes of its meetings. Using these, the 15-member banking committee selected by the Estates drew up a report on the management and state of the Bank of Finland, which was then debated in each Estate separately. The introduction of universal and equal suffrage and a unicameral parliament in 1906 changed this system slightly. The number of member of the supervisory councillors was raised to six and the parliamentary discussion took place in the banking committee and in a plenary session of the parliament.

As long as the number of councillors was four, meetings were held by the full council under a chairman selected from among the members. The approval of accounts, drafting of an annual report and inspections of the treasury took place according to predetermined schedules. To deal with other matters the council met at the invitation of the chairman. This changed when the number of councillors rose to six in 1907. An inner council of three members was now formed, which convened at the chairman's invitation as often as necessary. The full six-member council met regularly four times a year and additionally at the chairman's behest. The duties of the inner council were to take inventories as laid down in the regulations, to inspect lending each month and to prepare matters to be presented to the full council.⁵²⁰

The job description of the supervisory council was relatively

broad; the preamble to the regulations stated that it was to supervise and manage. It was therefore actively engaged in the bank's operational activities, too. Council members had the right to attend board meetings, although not the right to speak, and to examine all bank's accounts and documents. The duties of the council spanned the following areas:

- a) to act as a conduit between the Bank of Finland, the Senate and the Diet
- b) to oversee the Bank of Finland in general and to inspect its treasury and other reserves and the validity of credit documents monthly
- c) to make proposals on the establishment or discontinuation of branch offices and foreign correspondent bank relations
- d) to confirm changes in lending terms on the basis of proposals by the board
- e) to decide on the hiring of extra officials, the payment of fees to officials and the granting of leave of absence.

The list is fairly wide-ranging but often the work was either to take a decision on the basis of a proposal prepared by the board or to send a proposal to the board to be prepared. However the list clearly shows that the council was involved in day-to-day matters. Evidence of this is that the councillors were subject to the requirement of secrecy in the banking matters of individual customers. The same confidentiality concerned matters where they could have benefitted from advance information,⁵²¹ for example when lending conditions or cover regulations were about to be changed.

From the start of the 1870s until the 1880s, the tasks that most occupied the council were planning and preparing for the gold standard. It required the bank's regulations to be modified on several occasions and the guidelines for the bank's top officials were revised at the same time. As a legacy of the 1850s and 1860s the Bank of Finland's balance sheet contained an exceptionally large number of loans that were subject to repossession, and the bank had also become the owner of real estate and entire industrial premises. All of these had to be handled by the supervisory council and page upon page of its decisions on these matters can be found in its annual reports. It was in this period that the lending operations of private commercial banks grew up alongside the Bank of Finland, allowing it to develop gradually into a central bank, operating as a bank of

bankers. It needed to regulate liquidity in the banking system more carefully, which in turn meant more active use of interest rates and other lending terms to control lending throughout the financial system.⁵²²

At the end of the 1880s and especially in the 1890s the operations of the Bank of Finland began growing quickly, placing great pressure on the bank's staff. The number of employees was tied tightly to the regulation on annual appropriations, which was fairly difficult to change. In almost every case the board and the supervisory council were willing to increase the number of employees in line with the burden of work but the banking committee of the Estates was often reluctant. At the end of the 19th century it became established practice to append a separate allowance for hiring extra officials to the annual appropriation, after which personnel management became more flexible.⁵²³

The supervisory duties of the council remained largely unchanged during the period in question. Among the most important tasks was inspection of the financial state of the bank, using accounting data. For ongoing supervision, the main emphasis was on monthly treasury inspections and on making sure that the branch offices were monitored.

Council members served as external trustees at the bank, but still the amount of council work was quite appreciable and at times resembled their primary occupation. This was reflected from the outset in the fees that they received, 6000 markkaa per year from 1868 to 1906.⁵²⁴ Councillors living outside Helsinki were paid additional compensation of 2000 markkaa.

In the 1870s the chairman of the Bank of Finland's board earned 10,500 markkaa. A bank council member living in Helsinki received nearly 60 percent of that amount and almost the same as the wage of the senior clerk. At the start of the 20th century the fees were reduced to 4000 markkaa a year, just over a fifth of the board chairman's salary. By this time, it was widely understood that a councillor held a position of trusteeship that was not comparable to his main occupation.⁵²⁵

DISCUSSIONS ON THE BANK'S INDEPENDENCE

Beginning in the very first Diet sessions in 1863–64, delegates had vigorously debated the status of the Bank of Finland, how it should be governed and how it would interact with other administrative bodies. These debates did not always lead to concrete measures but are an interesting reflection of the spirit of the times and prevailing views about the role of the Bank of Finland.

While Finland was on the gold standard, Diet members constantly emphasised the need for the bank to be independent of the government, which in Finland's case meant the Senate. A metal standard needed monetary stability and it was thought that this could be guaranteed only by a central bank that acted independently. There was serious concern that the government might jeopardise the gold standard by using its central bank as a source of finance. Government borrowing from the central bank was seen in a very negative light. On the other hand the Bank of Finland's role at the hub of the payment traffic of the government required smooth cooperation with the Senate.

These questions were pondered as early as 1867 by Robert Montgomery, a professor of jurisprudence, a Diet representative of the Estate of Nobility and the first chairman of the supervisory council. He advanced the idea of converting the Bank of Finland into a joint stock company where private and public shareholdings would coexist. Share issues would offer a way of raising capital eroded by credit losses. Also, the participation of private investors would make it easier to recruit officials with a knowledge of banking principles. In Montgomery's view, the idea of having the Bank of Finland supervised by four council members elected by the Estates was already outdated. The central bank was so crucial for Finland's economy that its supervision could not be left merely to the Estates but required skills in business. These could best be obtained by allowing private investors to become shareholders, who would then help to monitor the bank's operations.⁵²⁶ Montgomery saw the Bank of Finland specifically as a bank operating in a free market. It could not be successful unless it adopted businesslike modes of operation and put aside its bureaucratic mentality.

Questions about the form of bank governance next arose in a committee, set up by the Estates on 5 June 1882, to draft new bank

regulations and supervisory council instructions.⁵²⁷ Its chairman was Alfred Charpentier and its members were N.I. Fellman, W. Hackman, G.A. Lindblom and A.F. Wasenius. Charpentier was an expert in finance who was chairman of the Mortgage Society of Finland before being appointed to chair the board of the Bank of Finland in 1884. Fellman in turn was a member of the board of the State Treasury. The other three members were also members of the top business elite of the time. Originally Montgomery, the long-term chairman of the supervisory council, had been tipped to head the committee but was unable to take up the position.

The committee may have benefitted from the work of a banking committee set up slightly earlier in Sweden, which had examined in great detail the history of the Swedish national bank, the prevailing situation and policies for the future. In its report, the Swedish committee analysed the position of almost all European central banks, in particular their supervision and prevailing management structures. The most frequent form for a central bank was a joint stock company, although the banks of Sweden and Finland were exceptions. The prevalence of joint stock companies was explained by two factors. Either a private joint stock bank had gradually developed into a central bank or else private investors had been the best source of the capital that a central bank required. Sweden was planning a reform of its whole financial sector, which would grant the national bank a monopoly in the issue of banknotes. This could not be done before its capital was sufficient to be able to redeem the stock of banknotes in circulation, and the committee felt the easiest way to reinforce capital would be to transform the national bank into a joint stock company with private shareholders. It could even point to the early history of the Swedish national bank, because its predecessor had been the private Stockholms Banco. The conflict between public and private interests had been resolved in most joint-stock central banks either by placing the majority of shares in government ownership or by separate regulations to ensure that the government was in charge. The only exception was the Bank of England, where, formally at least, private shareholders were dominant. Government hegemony was evident in the right to appoint the governors of central banks, which in most countries belonged to either the ruler or the government, even when the bank was a limited company.⁵²⁸

The committee set up by the Estates in Finland understood these questions because it had obtained information from Sweden even before the Swedish committee had completed its report. The expediency of incorporating the bank as a joint stock company had also been discussed in Finland, where its advantages for obtaining capital and for arranging effective governance had been noted. On the other hand, the Bank of Finland already had such strong capital adequacy that no circumstances were envisaged when it would need an extra injection. Although private banks at that time still had limited rights to issue their own banknotes, Finnish banknote circulation was the practical responsibility of the Bank of Finland, for which its capital was entirely sufficient, even if issuance became the bank's monopoly.

The main problem besetting the Bank of Finland was that supervision carried out by the council on behalf of the Estates was too narrow. According to Diet regulations, each Estate could select only one full member to the supervisory council and so this supreme decision-making body contained only four people. One of these acted as chairman, whose view prevailed in the case of a tied vote. The small size of the council entailed at least two problems. For the council to have adequate expertise, each member would have needed almost superhuman skills. And because a vote could be won by the chairman and one other member, decisions concerning the whole of society could be taken by just two people.⁵²⁹

Another problem lay in the illogical distribution of work between the bank's board of management and the supervisory council. The council did not serve merely as supervisors of the board but had some operational duties – such as setting rates of interest, which could cause friction between the two. A clear sign of the important operative role of council members was the size of the fees they received, quite comparable to the salaries paid to board members.⁵³⁰

A third question raised in the committee was the procedure for selecting the board. The Estates being the supreme authority for the Bank of Finland, they needed a proper say in the appointment of board members. In addition to the right to nominate the members, the committee wanted to modernise the selection criteria to take into account expertise in banking and business life and not merely a distinguished official career. Only by increasing professionalism in banking would it be possible to avoid a repetition of the 1850s and 1860s,

when credit losses were so great that the whole existence of the Bank of Finland was threatened. The bank's role as a link between government and private business imposed exceptional demands on its management.⁵³¹

To clarify structures of governance, the committee proposed that the number of supervisory council members be increased to 12, giving each estate three representatives instead of one. This large council would serve only as the supervisor of Bank of Finland operations, meeting three times a year, discharging the board from liability at the closing of accounts, and confirming appointments. A meeting of the full council would therefore have been equivalent to the general meeting of a limited company.

Within the bank council the committee proposed the establishment of an inner four-member council, which would handle operational functions and duties. The inner council would work in close cooperation with the board and be equivalent to the board of supervisors at a commercial bank. It would meet as often as the chairman felt necessary and its membership would be practically a full-time job for which regular compensation would be paid.⁵³²

The committee also wanted to strengthen the council's rights to appoint the directors of the central bank but felt it was not appropriate to interfere with the Emperor's prerogative to nominate the chairman of the board. The committee's reasoning was the Bank of Finland's governance should reflect a balance between all organs of government – the Monarch, the Senate and the Estates – and that this balance should not be disturbed. At the same time the chairman would give the board continuity, because the committee wanted the appointments of the other board members be made for a fixed term only, either for three or five years. Appointments for a limited term would prevent excessive bureaucratisation of the board and ensure constant renewal. The committee had also considered the idea of creating a discount committee at head office to assist the board with loan decisions. but an arrangement that had worked out well at branch offices was, for many reasons, thought unsuitable for head office, and the idea was rejected.⁵³³

The committee's report was completed in 1884 but its proposals for revising the regulations were kept under wraps for decades. Legal matters emerged as the greatest barriers to change. There was an ongoing unresolved disagreement between authorities – the Diet and the Emperor – on interpreting the law about the Bank of Finland.

According to article 4 of the statute approved in 1867, “from all Estates shall be chosen bank proxies, one for each Estate”. The council felt that this regulation had already been overturned in the new Diet regulations of 1869, where article 68 stated that “from each Estate at every Diet an equal number of bank councillors shall be chosen”.⁵³⁴

The Diet of 1891 reverted to the matter when the supervisory council of the Bank of Finland proposed that the Estates should elect twelve councillors, four of them experts in business. The Diet’s own banking committee, led by former council member Leo Mechelin, agreed but the Estates were divided. The nobility and burghers supported the proposal but the peasantry and the clergy were against it. The same dividing lines had been apparent earlier. The Estate of peasantry, in particular, was opposed to anything that might impose extra burdens on the public purse and wished to keep the size of the supervisory council as small as possible. The opponents of this particular proposal also pointed to the problems of finding sufficiently talented people for the council. It was felt that the most capable representatives of business life were already serving on the boards of supervisors of private banks so there would be no applicants left for the central bank. Because the Estates were divided, mediation was needed. The compromise agreed was to increase the number of supervisory council members by four to eight.

Four new bank councillors were selected from among the country’s leading businessmen. The most important criteria were that the individual should have expertise in banking and should represent a certain region, but it was not necessary for him to be chosen from within a certain Estate. Those selected were Wilhelm Hackman for the nobility, Hemming Åström for the clergy, Fredrik Rosenlew for the burghers and Otto A. Malm for the peasantry.⁵³⁵

The new expanded supervisory council actually began work in 1891 but the matter was not over. The Bank of Finland regulations prepared by the Estates were already the subject of distrust during their Senate debate and the Emperor steadily refused to ratify them, citing the 1867 statute and the four bank council members mentioned in it. The dispute continued until 1894 but the tsar would not give way and the proposal for increasing the number of councillors was in abeyance for more than a decade. A new opportunity for expanding the council was presented by the 1906 parliamentary reform. At that time the council made a

proposal to increase their number to six, three of whom would constitute the core. The committee preparing a new act on parliamentary procedure proposed raising the number to nine but the Senate settled on six.⁵³⁶

CENTRAL AND COMMERCIAL BANK RELATIONS

The 1880s had seen an animated debate on the position of the Bank of Finland. Public interest was not confined to the central bank but ranged over its relationship with commercial banks and banking conditions in general. At a time when the banking system of an industrialising country was taking shape, this interest was natural. Relations between the central bank and the commercial banks were also examined in a committee established in 1884 to modernise legislation on commercial banks. Its chairman was S.W. von Troil, who had been on the gold standard committee and was still at this time head of the Turku branch of the Union Bank of Finland, although he would be appointed to the Senate within a couple of years. The committee also contained other representatives from commercial banks such as T.H. Wegelius of the Union Bank and F.K. Nybom of the Nordic Bank for Trade and Industry.

The committee concentrated on two main questions, the right to issue banknotes and the share capital required of a commercial bank. On the question of issuance it took a line that favoured the commercial banks and proposed a major increase in their rights to issue their own notes. This is hardly surprising because F.K. Nybom, representing the Estate of Burghers, had proposed a reform of banking legislation that would specifically have expanded banknote issuance rights.⁵³⁷ Regarding the minimum share capital required of a private bank, the committee advised one million markkaa, which was a relatively small sum. Its argument was that the country needed smallish 'People's Banks' on the continental model and that demands for high capital would hinder their establishment. A third proposal in the committee's report was the establishment of a centralised bank inspection bureau to oversee bank operations. The general tone of the report was relatively liberal: "banking promotes the greatest benefit to a country if it is constrained as little as possible by binding legal regulations".⁵³⁸

However, formal statements responding to the committee's

report indicated how attitudes had been changing during the 1880s. All the main instances – the supervisory council of the Bank of Finland, the board of the Bank, the Senate and the State Treasury – were opposed to enlarging the right of commercial banks to issue banknotes. On the contrary, they wanted the Bank of Finland's monopoly in this respect to continue, citing a banking committee report that had recently been completed in Sweden and had been widely noted in Finland.⁵³⁹ To the liberal Finnish committee members who represented private banks, these statements from key official bodies were a great disappointment. They had expected support from Leo Mechelin, the influential liberal spokesman, who had just been appointed to the Senate and had been expected to pursue liberal objectives there. Instead, he had now switched to supporting a complete banknote monopoly for the Bank of Finland. Mechelin argued that his opposition to granting issuance rights to private banks was justified by the change in Bank of Finland operations in 1875. The bank had stopped accepting deposits from the general public, and the end of its competition with commercial banks in this area had been reflected in an immediate improvement in their results. Consequently private commercial banks no longer needed the right to issue their own banknotes.⁵⁴⁰

The opposition of the supervisory council to the committee's proposal was largely explained by the personnel changes that had taken place in the council. Its long-term chairman Montgomery, who held ultra-liberal views, had left the council and had been appointed procurator of the Senate. In 1882–85 the chairman of the council was Dean Frans Hjelt, representing the Estate of the Clergy and predominantly conservative Fennoman views. The Nobility were represented by protocol secretary Fredrik G. Stjernvall, who had had a long career in the Senate and, simply because of his position, tended to back monopoly status for the Bank of Finland. Agathon Meurman for the Estate of Peasantry had a history of being against liberal proposals of this type. Lorenz Lindelöf was the only banking councillor who was willing to expand the issuance rights of private commercial banks.

The committee had also proposed that the supervision of banks be transferred to a new banking inspection bureau operating under the Senate. This would have replaced the existing practice in which there

was no centralised supervision but each bank had its own special public attorney. The same idea had been endorsed by a banking committee in Sweden but did not win broad backing in Finland, largely because of political considerations. There was constant fear among officials and in the Diet about growing Russian interference in Finnish affairs. To create a bank inspection system concentrated in one bureau would have offered Russian officials too easy a conduit for meddling in the operations of private banks.

After these two committee reports had been completed, public debate on Finland's monetary system, the role of the Bank of Finland and the commercial banks died down. The main reason was that Russia's central government had tightened its grip on the country. The end of public debate was regrettable, because the discussions had shown that Finnish banking experts were well abreast of trends in monetary and banking theory and their practical forms. The polemics aired in the Diet and in public had spread information about matters vital to a market economy, raising public understanding of banking and spreading it throughout society. After the debaters had fallen silent, Finland faced a period of almost two decades when hardly a word was said in public about these questions.

DE FACTO STATUS OF BANK COUNCIL MEMBERS

The legal position of the bank council was extremely strong. The regulations did not confine its authority to matters of supervision but gave it significant operational remit. Bank council members participated in all of the most important practical decisions. However real power is not defined by regulations alone but depends at least as much on practical matters. Informal influence was shaped by the personal characteristics of the councillors and their prestige. The historical setting also played a role; patterns of behaviour that evolve in an early phase of operations can endure for decades in an organisation and have an influence that spans generations.

All bank council members are listed in an appendix at the end of this volume. During 1868–1917 the chairmen of the council were as follows:

Montgomery, Robert A.	Professor, Senator	nobility	1868–1882
Hjelt, Frans G.F.	Dean	clergy	1882–1885
Lindelöf, Lorenz L.	Professor, Director general	burghers	1885–1900
Donner, Otto	Professor, Senator	clergy	1900–1905
Stjernvall, Fredrik G.O.	Referand, Senator	burghers	1905
Hallberg, Emil Fr.M.	Merchant, Councillor of state	burghers	1905–1907
Palmén, Ernst G.	Professor, Councillor of state	clergy	1907–1917

The members of the council were generally chosen from the most esteemed figures in the Diet. Among the best-known are Robert Montgomery (who served in 1868–1882), Leopold Mechelin (1877–1882), Georg Z. Forsman, later known as Yrjö-Koskinen (1877–1882), Agathon Meurman (1882–1905), Wilhelm Hackman (1891–1894), K.J. Ståhlberg (1905, 1908–1917) and Ernst Nevanlinna (1909–1912). Membership of a particular estate was not relevant; the decisive criterion in selecting a member was the individual's ability. Well-known academic figures might successively represent the burghers, peasantry and nobility. The creation of a unicameral parliament changed this slightly and, from 1907 onwards, the party allegiance of candidates played a larger role than before.

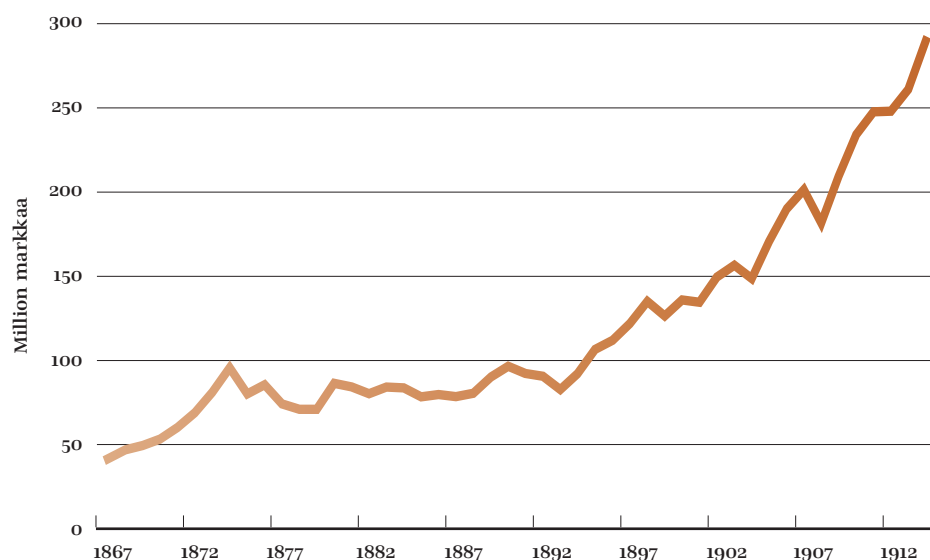
OPERATIONS AND STAFF

CHANGE ACCELERATES IN THE 1890S

For decades the Bank of Finland had spent a quiet existence as a modest agency of the Senate pervaded by bureaucracy. The tasks of individual officials were defined by detailed regulations, which ensured the legality of operations and the equal treatment of customers but hindered modernisation. The first real changes took place with the monetary reform at the start of the 1840s, when branch offices were established. Moreover, the move to granting short-term acceptance credit on bills of exchange meant an enormous change in the nature of lending operations and the amount of work involved, with a leap in the number of loans taken and repaid each year. Professional skills were now in demand. Risk management required an understanding of loan customers and the bank also began to operate on international capital markets. Its internationalisation is clearly shown by the number of its foreign agents, which increased steeply.

Changes in the bank's total assets give a good general picture of the extent of its operations. Until the early 1890s, assets had grown very sluggishly. Admittedly, the balance sheet total had sometimes fluctuated abruptly but the trend was almost horizontal and the total settled at around 80 million gold markkaa in the 1880s. In the mid-1890s it turned sharply upwards and thereafter its growth was very rapid. The balance sheet total exceeded 150 million markkaa in 1902 and, as the

BANK OF FINLAND BALANCE SHEET TOTAL 1867–1914



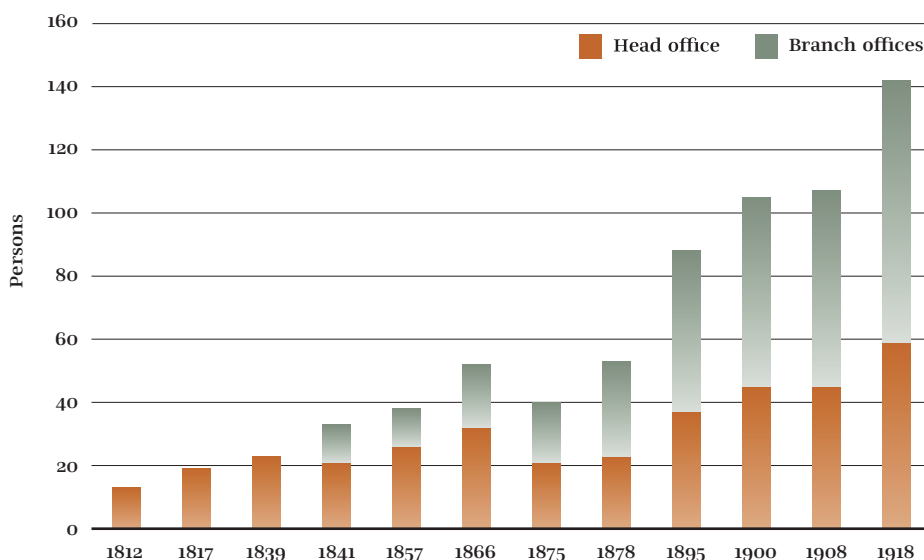
Source: Bank of Finland annual reports 1867–1914.

First World War began in 1914, it was already nearly 300 million markkaa, $3\frac{1}{2}$ times as much as in the 1880s. This was almost entirely real growth. There was little inflation under the gold standard and in its early years average prices actually fell.

An important factor underlying the early torpid development of Bank of Finland operations was the change of the whole banking sector. The first commercial banks had become established by the mid-1870s, and the Bank of Finland had lost its monopoly among private customers. This was a time when the bank's turnover and balance sheet total grew more slowly and sometimes halted. During the subsequent period of more than a decade, it was as if the Bank of Finland were seeking a new role as a genuine central bank serving private banks. It found it in the early 1890s and from then onwards the direction was up.

Initially the size of the Bank of Finland payroll changed little for many years but it began to grow after the monetary reform at the start of the 1840s. In the next decade the growth rate accelerated and

BANK OF FINLAND EMPLOYEES TOTAL, 1812–1918



Source: Bank of Finland. Wage regulations 1812–1918, Bank of Finland archives.

remained relatively rapid until the time of Finland's independence. At this point the bank employed nearly 150 people, some 40 percent of them at head office and the rest in the branch offices. The number of assistants increased the most, while the number of senior officials was fairly stable. This was quite natural because banking in those days was still entirely manual work. The age of typewriters, calculators and accounting machines had not yet arrived.

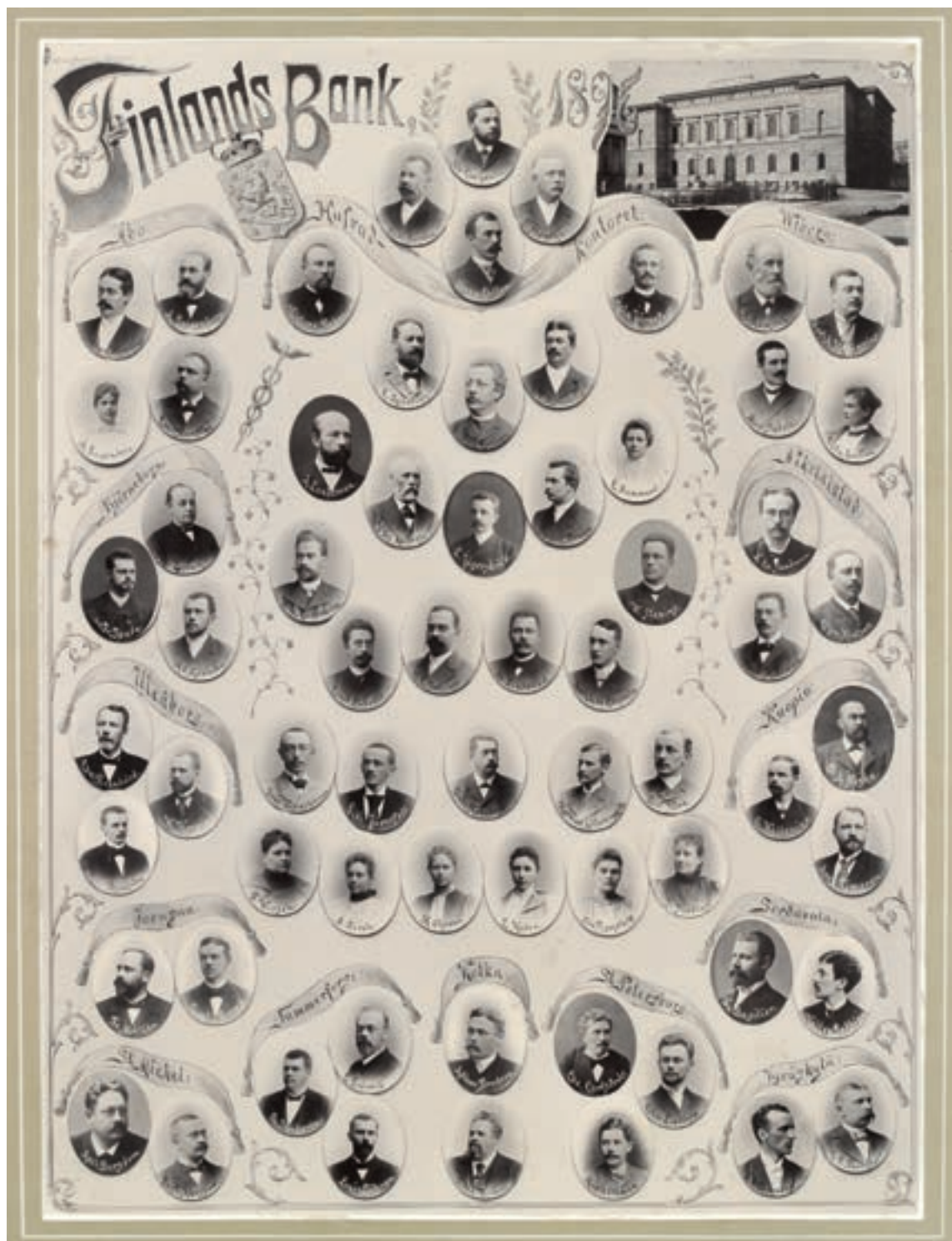
Payroll growth was restricted by bureaucratic procedures for establishing new positions. First a change in the annual appropriation to the Bank of Finland had to be approved by the Diet, which was invariably critical of all reforms that would increase public sector expenditure. The procedural practice was for the board of the bank to propose an increase to the supervisory council, after which the proposal went to the banking committee of the Diet and then to each individual Estate. After approval by the Estates, ratification by the Emperor was required. The entire process took several years and

regulations allocating wages often remained unchanged for 10–15 years.

The number of employees fell in 1875, when the management of government funds was hived off into the recently established State Treasury and the Bank of Finland no longer handled payments to and from the funds. The creation of a state treasury was not supposed to increase public sector expenditure. In practice the reform was implemented by transferring the people who managed government funds from the Bank of Finland to the State Treasury. The physical move was minor because the State Treasury began operations in premises that had been used by the Bank of Finland. A member of the Bank of Finland's board, Reinhold Frenckell, was appointed director of the State Treasury, in addition to which two clerks, a cashier and a bookkeeper moved to the Treasury.⁵⁴¹ The diagram at left shows that staff at Bank of Finland headquarters declined by five in 1875 because the vacated positions were not filled with new employees. At the same time, the number of employees in branch offices overtook the number at head office.

A sign of the growing strength of the Bank of Finland was the commissioning of premises to emphasise its status on the street then known as Nikolainkatu (later Snellmaninkatu). The new premises were a few hundred metres from where the bank had previously been located, in the Senate building. The new Bank of Finland head office was opened to the public for the first time on 12 March 1883. The building, which cost 1.1 million markkaa, also contained space for the State Treasury. The building project is explained in more detail on pages 378–379.

The contribution of the Bank of Finland to Helsinki's cityscape was reinforced in early 1891 when the House of the Estates was completed on a plot facing it. Its construction had been planned since the early 1880s and the Estates decided in 1882 that the costs were to be paid by the Bank of Finland. The bank allocated 1.2 million markkaa to the project, plus 0.5 million for the plot. By financing their premises in this way, the Estates wanted to stress their independence from the Imperial Senate. The financing decision was made possible by a rapid improvement in the financial condition of the Bank of Finland after the crisis years of the 1860s. In the ten-year period 1882–1891, the bank's net profit before transfers to the Senate had averaged 1.99 million



■ The managers and officials of head and branch offices, under the watchful gaze of Alfred Charpentier, the governor. Among the faces are eleven female officials.

– Board of Antiquities / K. E. Ståhlberg.

markkaa annually.⁵⁴² Apart from funding business projects, the Bank was able to increase its reserves. Bank of Finland funds were also used to finance a frieze of bronze figures by Emil Wikström for the tympanum of the House of the Estates, symbolising the role of Tsar Alexander I as the guarantor of the constitution of the Grand Duchy. The figures were unveiled in 1903 amid the first russification campaign of 1899–1905.⁵⁴³

The number of employees is surprisingly uncorrelated to the bank's total assets. The balance sheet total grew very slowly until the start of the 1890s but the number of employees began to rise several decades earlier, first from the 1850s and then at a rapid pace in the 1870s. The underlying factors included the move to the gold standard in 1878, the creation of a monopoly on banknote issue in 1886, the growth of foreign payments traffic with economic growth, the establishment of private commercial banking institutions, and the new importance of the Bank of Finland as a clearing centre for the entire financial system. This asynchronism can also be studied by contrasting qualitative improvements with quantitative growth. From the 1850s onwards, banking operations underwent major qualitative changes, for which the bank constantly needed new employees. However there was a relatively long delay before these qualitative changes were reflected in the breadth of operations, and turnover and the balance sheet total did not turn up sharply until the 1890s. The fact that qualitative and quantitative growth were out of sync also allowed the Bank of Finland to train and acclimatise its staff for new modes of operation before the period of growth truly got underway.

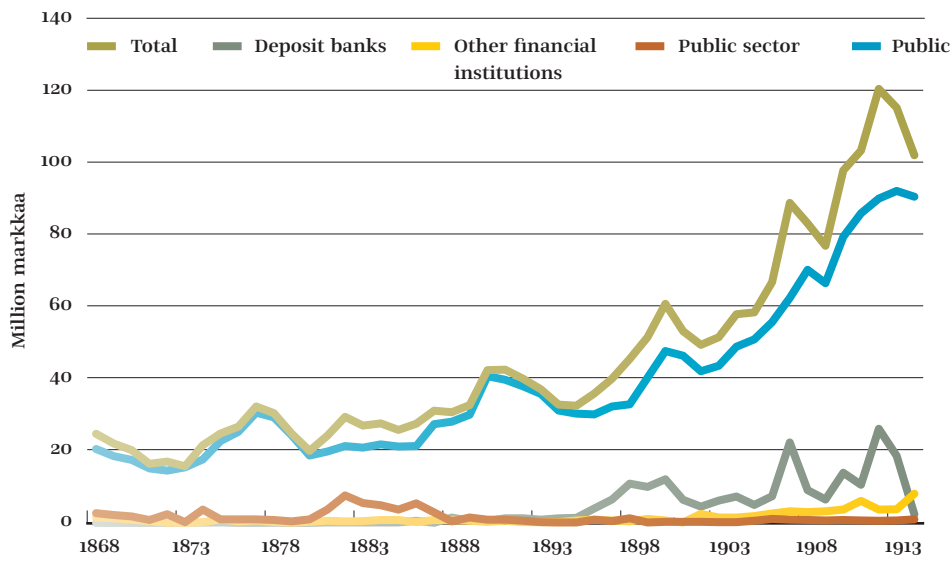
At the time when the Bank of Finland was being established, Finland took the lead in many respects from the Bank of the Estates of the Realm of the former mother country, just as the Bank of Finland followed Swedish developments very closely in the first half of the 19th century. Among other things, the Bank of Finland immediately obtained copies of all new statutes regulating the operations of the Swedish national bank. Against this background it is worth examining the extent to which operational similarities are still observable with the onset of the new century. The number of employees at the Bank of Sweden was 379 at the start of the 20th century, which was slightly over three times as many as the Bank of Finland had⁵⁴⁴ but direct comparison

is misleading and allowance should be made for the different sizes of the countries. The population of Sweden in 1905 was 2.7 million, nearly twice as many as in Finland. Economically Sweden was far more advanced and its GDP was almost 3 times as much as Finland's. Taking these factors into account the number of central bank employees was roughly equal in Finland and Sweden in relative terms. The efficiency of the central banks was also in the same league; Sweden had 0.62 million markkaa of banknotes in circulation per central bank employee while Finland had 0.67 million.⁵⁴⁵

MODEST LENDING GROWTH

After the bank came under remit of the Estates, its lending policy reflected not only its experiences in the 1860s, when it had made large credit losses, but also the emerging trend towards a modern “classical” model of central banking.⁵⁴⁶ The former factor shows in the extremely slow growth of its stock of loans until the end of the

BANK OF FINLAND LENDING 1868–1914



Source: Bank of Finland. Annual reports 1868–1914.

1880s and the latter in the major changes that took place in the structure of lending.

Lending by the Bank of Finland can be broken down into loans to the general public (i.e. the non-financial private sector), credit to banks and other financial institutions, and lending to the public sector. The Bank of Finland granted no direct loans to the government in this period apart from a few minor exceptions but the bank did invest in government bonds and its bond purchases are included here in the stock of central bank lending.

The stock of lending was dominated by loans to the general public, which, in many years, accounted for nearly 90 percent of all lending. Lending to banks remained extremely small until the start of the 1890s, apparently because there was no significant demand for central bank rediscounting, as noted earlier. From the late 1890s onwards, the share of loans to private banks increased slightly, reflecting the Bank of Finland's growing role of providing liquidity to the banking system. Its support was needed for example at the very start of the 20th century and in 1907–08. Loans to financial institutions other than banks were quite different in nature. During the first few decades of the period, the Bank of Finland supported the Mortgage Society of Finland with long-term credit that resembled a subsidy.⁵⁴⁷

Looking at the whole period, the Bank of Finland's investment in government bonds remained fairly modest apart from a few exceptional years when it acquired bonds issued abroad by the government. In this way it sought to facilitate the sale on international markets of Finnish state bonds denominated in foreign currencies. This investment activity was most active in the 1880s. In 1882, for example, the bank invested 7.6 million markkaa in government bonds denominated in foreign currency, a sum equivalent to a quarter of all its lending. After 1887 these bond acquisitions were of minor importance.

The modernisation of the Bank of Finland shows most clearly in lending to the general public. Regulation of liquidity in the whole financial system was becoming the bank's strategic responsibility, and no new long-term mortgage loans were issued after the 1860s. However, these loans continued to haunt the balance sheet for decades because their amortisation period was 33 years; the last such mortgage loan was paid off in 1909. The focus of new lending was now short-term acceptance credit. At the start of the period, this accounted for only

BANK OF FINLAND BUILDING

After the Bank of Finland had moved in 1819 from Turku to the new capital of Helsinki, it first settled in the house of the merchant Johan Sederholm on Aleksander Street but this was only a temporary location. Construction of the new monumental city centre was already underway and when the handsome Senate Building, designed by C.L. Engel, was complete, the bank moved to its south wing in 1824. It was only a stones' throw away from the Sederholm house.

A separate building for the Bank of Finland became germane soon after it had been transferred from the ambit of the Senate to the Diet. The Senate premises had become too cramped and a location in the government building was thought inappropriate for a bank of the Estates. A decision to build was taken in the Diet session of 1872 and a couple of years later a plot was purchased on Tallinmäki Hill in the central district of Kruununhaka.

Finland's first international architectural competition was organised in 1878 for the design of the building. It was won by a German, Ludwig Bohnstedt (1822–1885). Born in St. Petersburg, he had previously designed the German theatre in Riga (today the Latvian National Opera) and had also won a competition for the Reichstag building in Berlin although his design was not ultimately implemented.

Bohnstedt's Bank of Finland was an Italianate neo-renaissance palace that hinted stylistically at the Palazzo

Medici of the ancient banking family in Florence. The cornerstone of the building was laid in May 1879, a year after the Finnish markka had been fixed to the gold standard. The building can be seen as a monument to Finland's new, European monetary system, reiterated by the cementing of 10 and 20-markka gold coins in the cornerstone. In his speech at the event, the chairman of the supervisory council of the bank, Robert Montgomery, expressed the hope that the walls would defy time and protect the property of the Finnish people. The Bank of Finland moved into its new headquarters in 1883.

Soon afterwards, a building was erected behind it for use by the Security Printing House (1886). It was later demolished and in 1960 a flank to the Bank of Finland building was erected there, designed by Harry Schreck.

The main building of the Bank of Finland is an integrated unit of townscape, the Snellman statue at its fore, the House of the Estates facing it across the road. The latter building, designed by Gustaf Nyström and completed in 1891, was intended for Diet sessions and financed from Bank of Finland profits. Its location emphasized the Bank of Finland's status as the bank of the estates. After Emil Wikström's statue of J. V. Snellman had been unveiled in 1923, the square in front of the bank contained an exceptionally powerful concentration of historical and political symbolism.



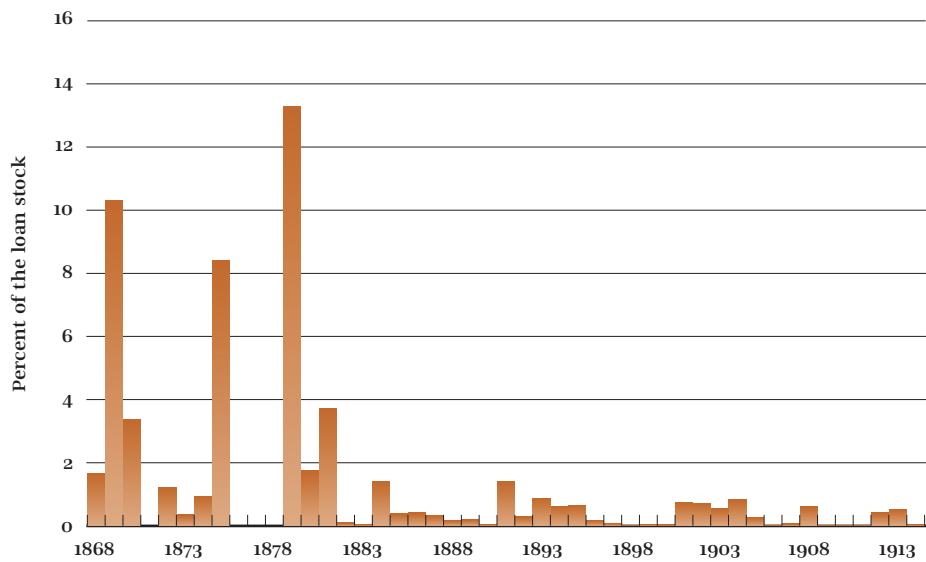
■ The cornerstone of the Bank of Finland's new head office was ceremonially laid on 13 May 1879. The building was ready for occupation in February 1883. The architect was Ludwig Bohnstedt, a German born in St. Petersburg. Board of Antiquities / Axel Lindahl.

about a fifth of lending but by the very end of the century it was over 50 percent and in 1914 nearly 70 percent.⁵⁴⁸

The security used for short-term secured (Lombard) credit provides more evidence of the modernisation of operations. In the 1860s and 1870s the collateral used for 20–25 percent of these loans was still merchandise, as had been the prevailing practice at the start of the century. A sawmill or a trading house engaged in exporting would pledge its stock of timber as security for a loan. In the 1880s the bank fairly quickly discontinued accepting such old-fashioned collateral and in the new century, short-term credit was secured by merchandise in exceptional cases only. In place of goods, the collateral for short-term credit became securities – shares and bonds.⁵⁴⁹

The greatest credit losses came in two periods, at the ends of the 1860s and 1870s, when they sometimes topped 10 percent of the loan portfolio. An explanation for both periods was monetary reform and the process of a deflation that it entailed, but other factors had an influence. In the 1860s, the number of customers rose steeply, even

BANK OF FINLAND CREDIT LOSSES 1868–1914



Source: Bank of Finland. Supervisory council reports 1868–1914.

though the loan portfolio shrank, and the bank did not have sufficient expertise to assess them. The 1870s, in turn, were a period when sawmilling first began to expand strongly, and the Bank of Finland helped to finance it. In 1878, international demand for sawn goods collapsed, their price dropped, and the whole sector plunged into crisis.⁵⁵⁰ The Bank of Finland suffered its own share of the high credit losses. From the early 1880s onwards, credit losses were at a distinctly lower level although still not entirely satisfactory; in several years they were between 0.5 and 1 percent of the stock of loans.

ORGANISATION UNCHANGED

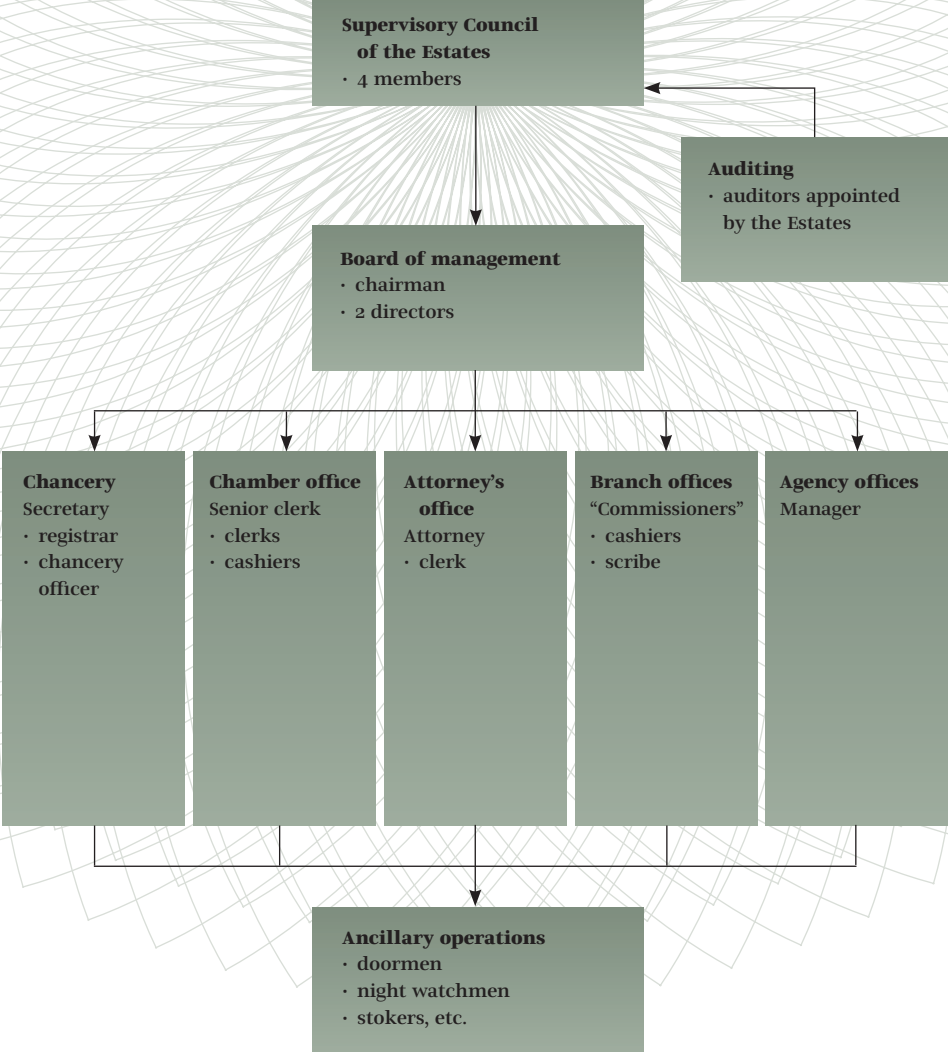
The Bank's operations were divided into three departments, the chancery, the chamber office and the attorney's office. The chancery, managed by the secretary to the Board, handled bank administration and correspondence, incoming and outgoing. The chamber office, run by the senior clerk, dealt with cash transactions, lending and bookkeeping. The attorney, in his own office, made sure that judicial matters related to lending were beyond reproach.

The basic structure of the Bank's organisation remained practically unchanged throughout the 19th century. Naturally operations had become more complex and their scale had risen many times over but the bank had responded to these demands mostly by increasing staff and establishing a few new departments. A complete reorganisation had not been attempted.

By far the largest department was the chamber office, as shown by the bank's hierarchy. The new position of chief clerk, superior to the senior clerk, rapidly became the most important in status below the board. This was reflected, among other things, in how the wage level of the chief clerk rose.

The end of the fund-based accounting principle can be regarded as a major change. The Bank of Finland was originally divided into its primary capital fund and a hypothecary fund and, as late as 1867, when it was transferred to the ambit of the Estates, the decision was expressed in accounting terms as the transfer of these two funds. Moreover, the financial statement of the Bank consisted of the accounts for the two funds, which were balanced separately. From 1868, however, a unified balance sheet was drawn up for the whole Bank of Finland. This can

**BANK OF FINLAND HIERARCHY
1875 TO THE 1890S**



Source: Bank of Finland regulations 1875–1891.

be seen as a step away from a legacy of the 18th century, the distinction drawn between a loan bank and a bank of exchange, which had lived on in the Bank of Finland’s primary and hypothecary funds.

The Bank’s organisation also showed how, with the approach of the 20th century, it had been transformed into a modern central bank focusing on providing liquidity. This is concretely expressed in a report drawn up by its board: “As the Bank of Finland has grown into the central bank of the country, and has begun to seek investments that are as short and liquid as possible, thus have the Bank’s litigation activity and its reposessions and mortgage applications shrunk to a minor level. The reduction has become particularly evident as the loans from the primary capital fund, granted by the bank against mortgage, have gradually been amortised. Consequentially the burden of work on the bank’s attorney has been eased to the extent that there is hardly reason to retain a separate official for this function, much less such a well remunerated one.”⁵⁵¹ The bank’s attorney at this time was Ernst Viktor von Rehausen. When he retired in 1917, no replacement was sought. As a principle, this was a major organisational change because it eliminated the last relics of the Bank’s operations in providing long-term mortgage loans.

BRANCH OFFICES

The greatest operational change came when branch offices were established outside Helsinki and some lending operations were transferred to them. Branch offices were established in the following towns and years:

Turku	1840	Joensuu	1884
Vaasa	1840	Jyväskylä	1887
Oulu	1842	Sortavala	1887
Vyborg	1842	Mikkeli	1887
St. Petersburg	1859	Kotka	1890
Pori	1861	Hämeenlinna	1901
Tampere	1878		

Source: Reports of the Supervisory Council 1868–1914.

The branch network was complemented by a few agency offices. Those in Tampere and Sortavala were later converted into branch offices but the agency office established in 1866 in Käkisalmi (now Priozersk in Russia) withered away and was closed in 1884.

There was a clear strategy for locating branch offices. To assist the state in its payments traffic, Bank of Finland branches were established over the years in each of the capitals of Finland's eight provinces. The last to get a branch office was Hämeenlinna in 1901. The office set up in St. Petersburg in 1859 was to handle rouble-based transactions. The separate agency offices in Sortavala and Käkisalmi were established because of the 1865 monetary reform, to exchange roubles to markkaa. Branches were established in Pori, Kotka, Tampere and Jyväskylä with a view to serving enterprise.

By the 1860s a major problem of the Bank of Finland, now operating under the supervision of the Estates, was its exceptionally large credit losses. At the end of 1868, receivables subject to debt recovery and bankruptcy proceedings totalled 6.7 million markkaa. Lending to businesses proved to be extremely unprofitable from the 1850s onwards. The councillors now overseeing bank operations thought that a major problem was that Bank of Finland officials did not understand business very well and could not assess lending risks.⁵⁵² Expressed in modern terms, they lacked skills in managing asymmetric information. The solution seemed to be to delegate lending decisions to branch offices close to the customers and to co-opt local business experts to help make loan decisions. A regulation was approved in 1875, establishing a discount committee at every branch office, composed of people who knew the region well but chaired by the head of the branch office. In practice, the discount committee members consisted of one who knew local businesses and one prominent representative of local officialdom. The discount committee met twice a week to handle credit and overdraft applications and the purchase of domestic and foreign bills of exchange.⁵⁵³ In this way, the Bank aimed to have reliable and up-to-date information about the financial situation of the company or entrepreneur applying for a loan. The supervisory council felt that head office in Helsinki would also have benefited from this system but the proposal did not receive sufficient support. However, there was no disputing that the Bank of Finland's board needed greater understanding of how business worked, and the solution chosen was to create an



Viipuri. Kauppatori ja Suomen Pankki.

Viborg. Salutorget och Finlands bank.

■ The fourth Bank of Finland branch office to be established was in Vyborg (Viipuri) in 1842. It soon had the largest turnover of any branch. At the start of the 1910s it was housed in its own building on Market Square. – Board of Antiquities.

extra position on the board for a junior member from 1895 onwards. The new member's tasks specifically included monitoring the bank's lending.

From 1866 onwards, data is available on Bank of Finland turnover by branch office, which makes it possible to evaluate the relative importance of different branches. At the same time these figures give an indication of how economic activity was distributed around Finland. Until the 1870s the position of head office in Helsinki was very dominant and it accounted for more than 70 percent of the bank's turnover. It was at this time, however, that operations began to be decentralised. The importance of the branch offices grew quickly and the proportion of turnover generated by head office shrank to 44–58 percent. The fluctuations in the share of head office are fairly large and no clear trend explains them.

After head office the most important branch office was St. Petersburg, which sometimes accounted for as much as 15 percent of turnover. In the second half of the 1880s this share turned down and settled at 5–7 percent. The outbreak of the First World War reversed the situation, as large orders of materiel for Russia revived activity at the St. Petersburg branch. Its contribution to total turnover rose steeply to nearly a fifth in 1916. Of the domestic branch offices, Vyborg constantly had the greatest turnover. Until the end of the 1880s, Turku and Pori were close rivals for second place, joined in the 1890s by Finland's most important industrial city, Tampere. Companies used the Bank of Finland as a major source of short-term credit so the distribution of lending between its different offices is also interesting. Bills of exchange discounted by the bank and short-term secured loans were divided between head office and the main branches as follows:

BANK OF FINLAND'S DOMESTIC BILLS OF EXCHANGE AND
SHORT-TERM SECURED LOANS, BY BRANCH, %

	1883	1895	1906
Head Office	41	41	33
Viipuri	18	11	19
Turku	13	12	11
Oulu	8	3	1
Vaasa	6	5	5
Pori	5	6	11
Tampere	4	4	8
Kotka	0	6	5
Other branches	4	12	8
Total	100	100	100

Source: Supervisory council reports 1868–1914.

Figures show that lending by the Bank of Finland was fairly concentrated at its major places of business because, dissected in this way, head office and the five largest branch offices accounted for 85–90 percent of the bills of exchange discounted and secured loans granted during a year. Head office naturally accounted for the most because it managed the liquidity of the whole banking system, by discounting bills of exchange offered by commercial banks. The bank's own customers for credit were trading houses engaged in exporting and importing and exporters of sawn goods. Vyborg was a typical centre for this kind of business but Turku had also retained a strong position as an export and import hub. Pori, Vaasa, Oulu and Kotka were predominantly export ports and the Bank of Finland's branch offices there served the same function. It is clear from this data that, throughout the period of autonomy, economic activity was concentrated in port towns along the coast between Vyborg and Oulu. The only inland town among the top five branch offices was Tampere, which enjoyed freedom from customs duties.

CORRESPONDENT BANKS

In overseas business operations the Bank of Finland was aided by foreign correspondent banks which acted as its agents. They operated at the interface of Finland's foreign payments traffic, where they accepted bills of exchange and cheques that were used for Finland's imports and other payments abroad. The Bank of Finland had entered into its first correspondent relationships at the start of the 1840s, with banking houses in St. Petersburg, Stockholm and Hamburg, to carry out exchange operations related to the monetary reform.⁵⁵⁴ The number of foreign correspondent banks started to increase properly after Finland adopted the silver standard in 1865. By the end of the 1860s the network already covered Hamburg, London, Paris, Stockholm, Riga, Amsterdam and Berlin. After the gold standard was adopted the network expanded as far as Spain and at the beginning of the 20th century, the first relationships began with American correspondent banks, as the map shows. Naturally the network also included St. Petersburg but, after the Bank of Finland had established its own branch office there in 1859, a correspondent bank was no longer needed for all banking operations in St. Petersburg. Nevertheless the Bank of Finland had a continuing close relationship with several banks in St. Petersburg and, in 1909, re-established a correspondent bank relationship there. In the most important cities, the Bank of Finland reduced its counterparty risk by having agreements with 2–3 different correspondent banks. By the 1910s it had correspondent bank agreements with at least 30 foreign banks.⁵⁵⁵

The correspondent network allowed the Bank of Finland to make international payments more efficiently and quickly. International payments were naturally also facilitated by the adoption of the silver standard and, from 1878, the gold standard. The external value of the Finnish markka was then determined by its precious metal content, and the exchange rate between currencies on the gold standard fluctuated only within a narrow band, between what were known as gold points. The large trading houses that engaged in foreign trade had built up close relations with their own foreign agents over the decades so Finland's foreign correspondent bank network was not essential to them. On the other hand new Finnish companies entering international markets benefited greatly from the assistance offered by the Bank of



■ The branch in Kuopio rose to new prominence during the First World War, when the gold reserves of the Bank of Finland were moved to safety there. This is how it looked at the start of the 20th century. – Board of Antiquities.

WOMEN JOIN THE BANK

According to a statute of 1864, women became legally competent at the age of 25 although married women were subject to the guardianship of their husbands. This statute allowed women to take up official careers, and the first to do so at the Bank of Finland was Ida Paldani, a widow engaged in 1869 to handle foreign correspondence. She was 35 when she joined the bank.

Gender was raised in the supervisory council in the mid-1870s after the board had proposed the hiring of an extra change cashier. The council approved the proposal but suggested that the job should go to a female official, for whom an annual salary of 1000 markkaa would suffice instead of 2400. This was done and Miss Olga Sjöman became the second female official in the bank's history. The door was open to women and from the end of the 1870s the bank began to engage more and more of them. In 1876, for example, Fanny Wirzen started work in the office for bills of exchange and remained with the bank until 1916, when she retired at the age of 71. From 1891 onwards, women could be appointed to permanent positions at the bank.

The first female officials had generally attended girls school or matriculated from secondary school, and worked in office jobs for the state or private commercial banks. A typical example seems to be Ida Tigerstedt, who graduated from Helsinki's Swedish language girls school in 1874, completed a diploma

in German in 1877 and studied French in Paris. Tigerstedt began her career as a teacher but in 1884 became an office assistant in the Hämeenlinna branch of the Nordic Bank for Trade and Industry. She was hired by the Bank of Finland in 1894.

The career advancement of women was hindered by the fact that when they married they became wards of their husbands and so could not hold jobs with financial responsibility. It was the practice that, after marrying, a female banking official would resign from the bank or move to less demanding duties. At the Bank of Finland this pattern was broken by Karin Jääskeläinen (née Jansson), who married in 1912 but then returned to work in her old position as a registrar. Informed by the board that it was unsuitable for a married woman to be a registrar, she refused to resign and the board took the matter no further, allowing her to continue in the job. This barrier to women's career development ultimately disappeared in 1930, when the law was changed so that a wife was no longer a ward of her husband.

The number of female officials at the Bank of Finland began to increase in the early 20th century and by the mid-1920s they filled a third of all posts. The glass ceiling remained a reality, however, because women did not advance to managerial positions yet. The gender gap also appeared in pension regulations after 1938, when the retirement age for women was lowered to 55 years.



■ In 1891, the right to hold a permanent position at the Bank of Finland was extended to women. A female official at the Turku branch office in the 1910s.

– Bank of Finland.

Finland in handling foreign payments. The correspondence banks trusted the Bank of Finland as a counterparty and its customers enjoyed the same trust. This kept the transaction costs involved in exporting and importing at a moderate level. It is hardly surprising that, when the Bank of Finland established a new correspondent bank relationship, it often did so at the initiative of some representative of business and industry.

In practice the Bank of Finland began the relationship by making an advance deposit with the bank in question, which ensured that it guaranteed repayment of a bill of exchange drawn on a Finnish importer. In fact, the Bank of Finland had far more assets invested in its bank network because it held some of its foreign currency reserves as deposits with large international banks.

The regional spread of the network illustrates the globalisation of the whole Finnish economy. At the beginning, in the 1840s, Finland operated mostly within the economic area of the Baltic basin. Later its payment connections expanded to Great Britain and south as far as the Mediterranean. In the final stages of the pre-war gold standard, the network had reached North America.

ENLARGEMENT OF THE BANK OF FINLAND'S
CORRESPONDENT BANK NETWORK 1866-1918



Sources: Supervisory council reports 1866-1918, Bank annual reports 1866-1918.

THE WORLD WAR AND MONETARY SYSTEM

RETURN TO FIAT MONEY

The international gold standard that operated until 1914 has sometimes been portrayed as a semi-automatic system that left central banks with minimal room to manoeuvre in monetary policy. This view is probably oversimplified judging from the extent to which central bank interest rates moved independently of each other, in ways that cannot be entirely explained by currency movements. Still, it is clear that the gold standard served to focus the attention of central banks on their nation's balance of payments and currency movements. By monetary policy – principally interest rates – the banks tried to prevent cumulative outflows of currency/gold in order to preserve the convertibility of their monies into gold and at the same time to avoid building up excessive gold reserves that would have hurt their profitability. On the other hand, the gold standard meant – or was thought to mean – that the value of money settled automatically at its equilibrium level and practically no central bank action was needed to control inflation or combat deflation. The gold standard was also thought to guarantee exchange rate stability, except for small fluctuations, as long as each central bank maintained the convertibility of its money into yellow metal.⁵⁵⁶

The gold standard may not, in fact, have been such a mechanical system but it did provide a fairly stable framework for monetary operations by gold standard countries and the whole world economy for several decades. Money founded on gold had begun to seem like the natural and permanent state of affairs, when the whole structure

suddenly collapsed at the outbreak of the First World War. The Great War in Europe began when Austria-Hungary declared war on Serbia on 28 July 1914. Russia mobilised to support Serbia, followed by Germany's declaration of war on Russia on 1 August. The Russian army invaded East Prussia on 7 August. The outbreak of war laid waste to the world's monetary system. One after another, central banks stopped redeeming their notes for gold. Exchange rates began to fluctuate in a way that had been unimaginable for decades. A standard that had prevailed for about 40 years collapsed and a period of worldwide fiat money and inflation ensued.

Central banks, forced onto a fiat standard, became responsible not merely for the interest rate level but now also for exchange rates and inflation. It was a new state of affairs for most of them. As in previous periods of unbacked paper money, the responsibility was initially hard to discern and acknowledge. Matters were complicated by wartime conditions, when inflation and exchange rate movements were influenced by many factors other than monetary policy, such as restrictions on foreign trade and capital movements, the effect on production of mobilising an army, government efforts at price control, and so on. Even if central banks had aimed at effective monetary policy, they would not have been freely able to apply tools like interest rates or credit rationing. In wartime the overriding objective of each state was to finance essential production cheaply, to support public finances and military efforts.

For the Bank of Finland, an immediate consequence of the start of war was that the rouble plummeted on foreign exchange markets. Although Finland had a monetary system separate from Russia's, it was part of the Empire and could not avoid the monetary effects of the war. For three years, from summer 1914 until the Russian Revolution, the Bank of Finland was preoccupied with the deteriorating value of the rouble and the growth in domestic money supply as it was compelled to redeem the roubles that flowed into Finland. Another immediate effect of the declaration of war was that Finnish claims on Germany and Austria were frozen or confiscated outright. Thus a proportion of the currency reserves of the Bank of Finland became, at best, illiquid assets and, in realistic terms, very uncertain receivables. According to the accounts for 1914 these funds totalled about 33 million markkaa, or 11 % of the bank's balance sheet total.⁵⁵⁷

There was no real gold panic in Finland when the war broke out, although an exceptional amount of cash was withdrawn from banks. Consequently lending to the banks by the Bank of Finland increased significantly. By 8 August it had increased by 30 million markkaa, which meant that the volume of banknotes in circulation had risen by about a quarter. The Bank of Finland could not discontinue redeeming its notes in gold without the permission of the Senate but it did try in a variety of ways to deter redemption.⁵⁵⁸

The collapse of the gold standard naturally disrupted the domestic money market and monetary policy. During the early years of the war, most of the effects on the Finnish economy came via Russia, where the war and the end of the gold standard had led to severe paper-money inflation. For political reasons Finland was obliged to tie its markka to the rouble of the mother country. Although this peg was not absolute, and Finland did manage to let the rouble depreciate slightly against the markka, the price of the rouble in 1914–1917 had a decisive effect on Finnish monetary policy and the value of the markkaa.

Calculated from the rouble's value in gold, parity in London was 9.46 roubles per pound sterling; in the months before the war, the market quotation in London varied between 9.50 and 9.60, averaging about one percent less than parity. The outbreak of war had a dramatic effect; by the first week of August the rouble had fallen as low as 11.5 to the pound, about 28 % below parity.⁵⁵⁹

The Bank of Finland had already reacted a little earlier to the changing political situation by reducing its rouble quotation. Parity in Finland was 266.67 markkaa per hundred roubles and in early 1914 the Bank of Finland's selling rate was close to this, as was normal. Its buying rate was slightly lower. On 23 July the buying rate was cut to 264 markkaa, on 27 July to 260 markkaa and on 31 July to 245 markkaa. The Bank of Finland also raised interest rates by two percentage points; on 4 August its lowest discount rate became 7 percent.

Understandably, the lower rouble exchange rate applied by the Bank of Finland displeased Russian officials, who regarded it as a sign of disloyalty and mistrust in the Empire. Matters of prestige may have mattered even more than the important economic question involved, meaning the purchasing power in Finland of rouble assets at the disposal of Russian officials.



■ During the First World War, Russia brought workers from as far away as China to fortify defences. Fortification work increased the volume of roubles being converted into markkaa at the Bank of Finland. Photograph taken at Själören, Espoo, west of Helsinki, in 1916.
– Board of Antiquities / F.W. Westerlund.

The representatives of the Russian government demanded that the rouble exchange rate be raised and the Bank of Finland acceded. It raised its buying rate to 252 markkaa on 8 August and to 256 markkaa on 19 August. This rate, only about 3 % below the pre-war rate, remained in force for almost a year until August 1915. Fixing the markkaa to the rouble had an effect on the markka's rate against other currencies and its value abroad; as the rouble fell, the markka followed.⁵⁶⁰

The rouble's purchasing power in Finland did not depend merely on what the Bank of Finland quoted but also on the rates applied by other banks, so the Governor general issued an order on 12 August that no bank in Finland could quote a lower rouble rate than the Bank of Finland. This mandatory rate tied the markka to the sinking rouble. However, from autumn 1914 onwards the Bank of Finland no longer sold currencies at quoted exchange rates "in other than exceptional cases", so its rates did not reflect the real state of the market. For this reason the Finnish Bankers' Association began to quote distinctly higher rates for the use of members from 9 October 1914. These separate quotations continued until November 1917. Most foreign trading in the Finnish markka took place in Stockholm.⁵⁶¹

The war meant the end of the gold standard almost everywhere. In Russia this happened as early as 27 July 1914, when a law was enacted that terminated the rouble's convertibility. It also increased the amount of banknotes that the Russian State Bank could issue. The formal reason was to protect the State Bank's gold reserves from the uncertainty and speculation caused by the war, but another reason was that the state had to resort to printing money in order to finance military expenditure. The law of 27 July raised the permitted quota of rouble banknotes unbacked by gold from 300 million roubles to 1.5 billion roubles (the gold reserves were about 1.5 billion roubles). Later the imperial government increased the quota of unbacked banknotes further; by the end of 1916 it had reached 6.5 billion roubles.⁵⁶²

The political tension of July 1914 had an impact on Finland despite the belief that the country would be able to remain outside actual military operations. An official state of war was declared in Finland on the last day of July and uncertainty was now felt throughout the financial sector. This took the form of a run on deposits held at commercial and savings banks, which compelled the Bank of Finland to increase its own lending in order to maintain the liquidity of the

banking system. However there was no real panic. The public continued to trust Bank of Finland banknotes and few were presented for redemption in gold. The Finns had not been used to demanding gold for their banknotes and did not do so even in these exceptional circumstances. The stock of gold at the Bank of Finland remained almost unchanged in these first months of the war.

Nevertheless, the Bank of Finland felt it was impossible to remain on the gold standard. In November 1914 the board of management proposed to the supervisory council that conversion of banknotes into gold should be interrupted. The word "interrupted" is very illustrative of prevailing attitudes; that the war would end soon and that conditions would normalise as soon as peace was restored. The war was not expected to have long-lasting effects on the monetary system.⁵⁶³

The "interruption" of convertibility was not sanctioned as quickly as the board desired, and a decision took a surprisingly long time. The supervisory council was divided on the question, half of its six members being ready to support the board's proposal while half were against it. The opponents underlined the constitutional nature of the question and demanded changes in the law, which would require parliamentary debate. This faction, under K.J. Ståhlberg, contained council members who had trained as lawyers. However, the council's chairman E.G. Palmén supported the board's proposal, believing that the matter could be implemented simply by modifying the bank's regulations, which could be ratified by the tsar without consulting parliament.

In the Senate, too, opinions were divided. Senate members felt that the bank's supervisory council had exceeded its authority in a matter that was the province of the Governor general and the Senate. A majority of Senate members feared that Finland was once more appealing to constitutional arguments unacceptable to Russia. The same dispute had marred relations between the supervisory council and the Senate since the end of the 19th century. Accordingly the Senate sent a proposal to the tsar stating its view that the question of renouncing the gold standard was not within the province of the council and was therefore invalid. The tsar agreed on 11 April 1915 but his decision was a mere formality because, at the same time, he stated that Finland should cease to redeem banknotes with gold coin because of the extraordinary conditions prevailing in time of war. An edict on the matter was published on 15 April 1915. Thus the formal decision

was reached to go off the gold standard. The delay of nearly half a year did not cause major problems because in practice the Bank of Finland had stopped redeeming banknotes back in November 1914.⁵⁶⁴

In 1914 the board of the Bank of Finland sent the supervisory council a proposal on revising its regulations. Because operations had grown, the founding capital and the reserve fund required topping up and the minimum amount of gold reserves needed to be increased. However, parliament did not meet and all the proposals lapsed. Only because rouble claims were classed as undisputed foreign receivables was it possible to continue operating within the framework of the old regulations. The value of rouble-denominated assets backing banknotes in circulation rose from 113 million markkaa in 1913 to 421 million at the end of 1916. In the early stages, little concern was felt about the growth of rouble assets and the related exchange rate risk because the war was expected to end soon and the value of the rouble to rise again. Although Finland had left the gold standard, it continued to think in terms of the old principles.⁵⁶⁵

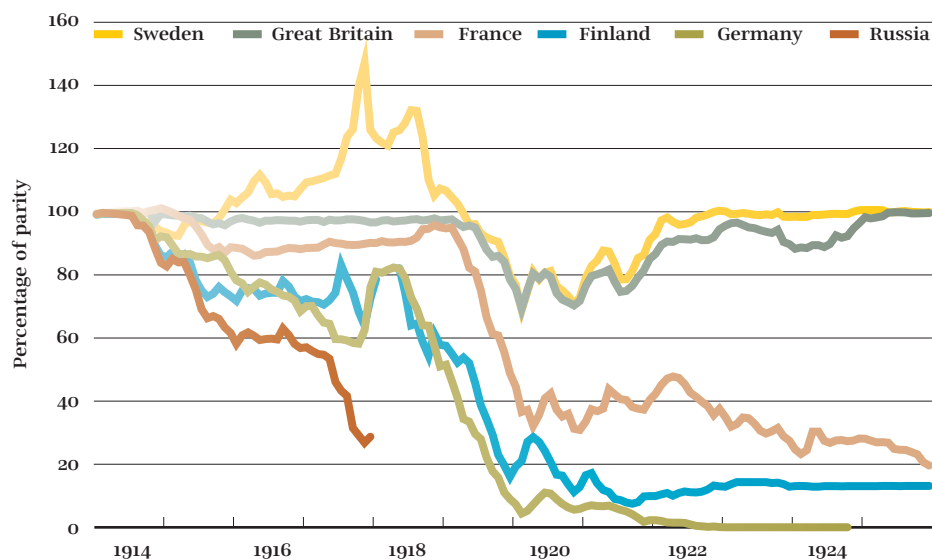
THE ROUBLE / MARKKAA QUESTION

On international currency markets the rouble fell gently at first but started to plummet when the armies of Germany and Austria-Hungary made a breakthrough on the Eastern front during the Gorlice-Tarnow offensive in Galicia at the start of May 1915. During May-July Russia suffered very heavy losses on this sector, and Germany eventually overran Poland. Warsaw fell at the start of August. These military setbacks pushed the rouble rate in London down to the level of 150, which was 37 % below its gold parity. In Stockholm, the rate dropped 30 % below parity.⁵⁶⁶

In these circumstances the Bank of Finland tried to mitigate the extent to which the markka followed the declining rouble, as it had a year earlier when the war had begun. On 6 August 1915, just a day after the fall of Warsaw, it lowered its rouble purchase rate to 250 markkaa, about 5 % below the level of July 1914.⁵⁶⁷

In comparison with the speed of the rouble's decline on international markets, the rate adjustment applied by the Bank of Finland was small, nor was it enough to prevent the spread of rouble inflation into Finland, but it had great political significance. It served

EXCHANGE RATES AGAINST THE DOLLAR 1914-1925



Sources: Bank of Sweden, Katzenellenbaum, S., 1925.

as a catalyst for the process, continuing throughout autumn 1915, that resulted in the Bank of Finland regaining at least part of the exchange rate independence that it had lost when the war began.

On 9 August, within days of the Bank of Finland's rate adjustment, Governor general Seyn asked the Senate to instruct the Bank of Finland to raise its rouble quotation to at least the level prior to the last reduction. The Russian Finance Minister, Pyotr Bark, asked the Governor general whether the Imperial statute, issued on 9 June 1904, on the validity of Russian paper money in Finland, could come into effect. The Finns felt that this statute was illegal, because it lacked the assent of the Finnish Diet. It would have made the rouble legal tender at the parity of 266.66 markkaa per 100 roubles, in all tax and other payments to the government. Its implementation would have had the practical result of fixing the markka to the rouble.⁵⁶⁸ But despite the Russian reaction, the Bank of Finland reduced the rouble purchase rate again on 31 August, to 246 markkaa per 100 roubles, which was 8 % below parity.

On 17 September Russia's Council of Ministers informed the Senate of Finland that a special committee would be set up to consider the rouble exchange rate in Finland. It was to have representatives from both Finland and Russia and be chaired by Pavel Haritonov, a Russian Inspector general. The Bank of Finland was represented on the committee by the chairman of the board Clas Herman von Collan. When the committee met on 9 October, it rejected the idea of setting a fixed rate of exchange between the markka and the rouble. Instead it proposed that the markkaa funds required by Russia could be obtained from Finland as a loan. This compromise proposal was contrary to the position of the Governor general but was approved anyway by Russia's Council of Ministers on 17 November 1915.⁵⁶⁹

The result of the committee discussions meant, in practice, that the Bank of Finland had won a certain amount of independence in setting the exchange rate, but at the cost of promising to make loans to the Russian State. The Bank of Finland lowered its rouble quotation several times during the autumn, while talks with Russia were continuing, and again after the outcome had been approved by Russia's Council of Ministers. After an exchange rate change on 3 January 1916, the rouble selling rate was now only 216 markkaa per 100 roubles, 19 % below parity. The rouble had declined far more against other currencies, for example 43 % against the Swedish krona, so the exchange rate changes implemented by the Bank of Finland were insufficient to restore the markka's value against the krona. They did however mean that the markka had fallen against the krona by only about half of the depreciation of the rouble.⁵⁷⁰

After the major exchange rate adjustments implemented between August 1915 and January 1916, the Bank of Finland made no more use of the ability it had acquired to bolster the markka against the rouble. The mutual exchange rate was held fairly constant, rising or falling no more than 1 %, until the February Revolution and the spring of 1917.

Negotiations on foreign currency credit for Russia were protracted and it was not until 15 July 1916 that the Bank of Finland made its first loan. A total of four loan agreements were made between Finland and Russia, the last in summer 1917, until the Bolshevik Revolution in Russia and Finland's independence put an end to financing the government of Russia with loans from Finnish banks.⁵⁷¹

ROLE OF MONETARY POLICY IN WARTIME

The growing rouble reserves of the Bank of Finland brought about a corresponding increase in the volume of central bank money. There was a strong increase in liquid funds, mainly banknotes in circulation but also in the "deposit and withdrawal accounts" of other banks at the central bank (in modern terms, their current accounts). The flood of money created an easy money market and demand for credit from the Bank of Finland fell. Bank rediscounting declined into insignificance as early as autumn 1914 and subsequently stopped entirely.

Such a growth in money supply was naturally inflationary, especially at a time when the volume of goods available in the market for consumers and investors was also declining because of the war. Formally, however, the Bank of Finland was operating in accordance with its regulations because the growth in banknotes and current-account deposits was more-than-matched by rising currency reserves of the Bank of Finland. The accounts of foreign correspondent banks, including Russian ones, could be treated as banknote cover and the Bank of Finland's swelling rouble assets were therefore valid collateral.

Efforts to curb inflation focused on foreign exchange policies, meaning that the Bank of Finland attempted to stem the flow of roubles into the country and their conversion into markkaa, among other things by adjusting the exchange rate to make the markka stronger against the rouble. Meanwhile interest rates, the most important monetary policy tool in peacetime, lost practically all significance. While the money market was easy, there was little demand for credit from the Bank of Finland. Moreover the bank had been accustomed to using interest rates to control the volume of banknotes in proportion to its currency and gold reserves and, in this respect, there was no problem. Currency reserves (denominated in roubles) were steadily growing so the Bank actually started to cut interest rates despite rising inflation.

The discount rate had been raised by two percentage points from 5 to 7 percent at the outbreak of war but in September it was lowered back to 6 percent, in January to 5½ percent and in May 1916 to 5 percent. It was kept at this level until the end of the war.⁵⁷² Measured by the

official cost of living index, the rate of inflation accelerated to 25 % in 1915, to 47 % in 1916 and to 98 % in 1917 so these relatively low interest rates had no practical economic impact. All that was left of monetary policy was the conversion of roubles and the adjustment of the markka/rouble exchange rate within permissible limits. This is how the situation remained until summer 1917.

RESULTS OF THE FEBRUARY REVOLUTION

Political tensions increased dramatically in Russia at the start of 1917. A shortage of food and fuel, combined with war-weariness, led to riots and great demonstrations, culminating in the February revolution and the overthrow of the tsar. On 11 March 1917, soldiers were ordered to fire on demonstrators in St. Petersburg, and the following day the garrison of St. Petersburg mutinied. Tsar Nicholas II abdicated on 15 March in favour of his brother Grand Duke Michael, who handed over power to a Provisional Government the next day. The prime minister became Prince Georgy Lvov of the Constitutional Democratic Party (known as the Kadets).

The February Revolution resulted, in Finland, in the resignation on 29 March 1917 of the russified Senate that had ruled the country since 1909. On the same day Prince Lvov's provisional government appointed a Senate of Finns led by Oskari Tokoi, a Social Democrat. A social democratic businessman, Väinö Tanner, who was managing director of the Elanto consumer cooperative society, became head of the Senate's Financial department. Thus power in Finland was back in Finnish hands – even if the country did not formally renounce the authority of Russia's provisional government until the summer, when the Finnish Parliament proclaimed itself the sovereign authority. This Enabling Act was issued in July 1917, at a time when Russia was again in ferment, instigated by the Bolsheviks, although the provisional government was still managing to suppress it. During this crisis, ministers belonging to the Constitutional Democratic Party in Russia's provisional government resigned and Alexander Kerensky of the Socialist Revolutionary Party became prime minister. Kerensky refused to ratify Finland's Enabling Act and dissolved its Parliament, setting in train a series of events that led half a year later to the Finnish Civil War.⁵⁷³

The February Revolution and the rise of Tokoi's Senate left its mark on Finland's monetary policy. From April 1917 the Bank of Finland began to lower the markka value of the rouble, so that the markka exchange rate in Stockholm stopped falling for a few months. This improved the Bank of Finland's ability to curb the growth of its rouble reserves and thereby limit the soaring volume of banknotes. The last loan by the Bank of Finland to the State of Russia was made on 11 June, although in September previous loans were rescheduled "for a year" because the provisional government had been unable to repay them.⁵⁷⁴

In July the Bank of Finland's negotiating position was already so much stronger that Russia agreed after discussions that the markka amounts required for the upkeep of armed forces in Finland and other expenditure would be paid in western currency, meaning pounds and dollars, instead of roubles. The sums actually exchanged did not amount to much, however.⁵⁷⁵

The lower rouble exchange rate, in effect from April, did not permanently protect the value of the markka, which began to fall steeply again in Stockholm from September onwards, now for reasons unrelated to the rouble. In its yearbook the board of the Bank of Finland blames the deteriorating domestic situation, meaning political factors. Another possible reason for the markka's renewed weakness was that the Bank of Finland had begun granting short-term credit to the Finnish government in the summer. Indeed, from the second half of 1917, financing the State of Finland became the new reason for excessive banknote issuance, replacing the previous "rouble deluge" as the driving force behind inflation.⁵⁷⁶

MONETARY POLICY ABROAD

Before the Great War the gold standard had been the undisputed basis of the international monetary system. The outbreak of war transformed the situation immediately. One country after another stopped exchanging its banknotes for gold and began to restrict the export of gold in an effort to protect its central bank's gold reserves and maintain international solvency. Russia terminated banknote convertibility on 27 July 1914, Germany on 4 August and France the day after. Of the world's great economic powers, Great Britain and the United States

formally maintained convertibility during the war but in reality they too restricted the operations of the gold standard.⁵⁷⁷

Sweden was crucial for Finnish currency and monetary policies during the First World War. From the outbreak of war until 1918, Sweden was the only country, apart from Russia, with which Finland could trade. This was due not only to geography but also to Sweden's neutrality. As long as Finland was part of the Russian Empire, i.e. until the end of 1917, economic relations with Germany and the other Central Powers were out of the question. Commercial relations were possible with the Entente Powers, such as Britain, France or the United States, but only via Sweden because shipping in the Baltic and Straits of Denmark was controlled by Germany. Thus Stockholm became the key foreign exchange market for Finland. It was here that trade could be conducted in Finnish markkaa and where it was possible to exchange markkaa and roubles for other currencies, although admittedly at an exchange rate that worsened year after year.

At the outbreak of war Sweden experienced the same wave of distrust that other countries did; significant amounts of banknotes were presented for redemption and the krona began to fall against the pound and dollar. To protect its gold reserves Sweden stopped redeeming its banknotes for gold on 3 August and, at the end of the month, a law was proclaimed that increased the amount of banknotes that the Bank of Sweden could issue. The same law authorised the issue of one-krona banknotes, intended to help reduce the need for coins.⁵⁷⁸

As the war passed into its second year, Sweden and other neutral countries gradually realised that they faced a monetary problem that was the reverse of the problem of countries at war. Among the belligerents the gold standard could not be used because mistrust in the value of their banknotes threatened to exhaust their gold reserves. Meanwhile, Sweden (like Denmark, Norway, the Netherlands and Switzerland) faced a great influx of gold. The growth of gold reserves at the end of 1915 and start of 1916 triggered a rise in money supply and threatened to spur inflation. At the same time the growing amount of gold held by central banks in neutral countries hurt their profitability because gold reserves, unlike other assets, did not yield interest.

Reassured by the rapid growth of its gold reserves, the Bank of Sweden recommenced redemption of banknotes for gold. This was not a return to the gold standard because a law of February 1916 relieved

the bank of the obligation to purchase unlimited amounts of gold at the krona's official price. Denmark and Norway, Sweden's partners in the Scandinavian monetary union, followed the Swedish example in April. After this the krona's value in gold (and in relation to the pound and dollar) began to climb steeply. The currencies of Denmark and Norway also strengthened although not as much as in Sweden. The change in exchange rates between Scandinavian currencies disrupted the operation of the Scandinavian Monetary Union for more than a decade.⁵⁷⁹

From the outbreak of the First World War until spring 1918 Sweden and Russia were Finland's only significant trading partners. Trade with Russia dried up almost entirely in spring 1918. At the same time trade restarted with Germany and the volume was soon about as great as with Sweden. However, the total of foreign trade remained very low and did not begin to recover until 1919 and 1920. During the recovery Great Britain became Finland's main trading partner. Prior to the war Britain had been Russia's closest rival as Finland's main export market.

EVALUATING WARTIME MONETARY POLICY

As described above, the Bank of Finland's main way of protecting the value of the markka during the First World War was by making the markka as strong as possible against the rouble within the constraints imposed by political conditions. The better it did so, the better Finland was able to separate itself from Russia's raging inflation. The Bank's success in its efforts to protect the markka's value can be measured from its external value, expressed in exchange rates, and from its purchasing power, expressed in indices of wholesale prices or the cost of living in Finland. An analysis of price indices is the more rewarding, because wartime conditions greatly restricted foreign economic relations (except with Russia) and thereby the significance of exchange rates. Furthermore, exchange rate movements were not caused by monetary policy alone but also by an obviously large amount of speculation about military events.

The usefulness of exchange rate analysis is mainly in that it can show to what extent the markka lost the statutory gold value that it had when Finland was on the gold standard. It is difficult to measure

even this; during the war the gold market was free only in the United States so changes in the markka's value in gold can be estimated only by looking at the value of the markka vis-à-vis the dollar.

The table below shows the rising price level during the war years, measured by cost of living indices in Finland and Sweden and the Gosplan index in Russia.⁵⁸⁰ It indicates that Finland's inflation during the war was significantly lower than Russia's and in this sense the policies of the Bank of Finland had notable success in keeping Finland separate from the general inflation raging in the Empire during the war. Even Sweden was unable to hold the purchasing power of its money steady. It benefitted rather than suffered from the war, and its currency strengthened against the dollar and gold, but it was infected by inflation because its payments surplus injected money into the country.

PRICE INDICES IN FINLAND, RUSSIA AND SWEDEN
1913–1918

	1913	1914	1915	1916	1917	1918
Finland	100	100	120	160	310	1060
Russia	100	101	130	184	675	...
Sweden	100	101	116	130	164	241

From the perspective of exchange rates, too, Finland managed to maintain the external value of the markka fairly well, given the circumstances. The table opposite shows the markka's value against the dollar, which was the currency that most closely represented gold during the First World War and afterwards. If the markka were measured against the Swedish krona, the picture would look considerably worse, but the appreciation of the krona against the dollar and the pound in 1916–1918 makes that comparison misleading. The krona strengthened against gold because Sweden built up a trade surplus after the Bank of Sweden had ceased in 1916 to buy gold, in order to curb money supply and inflation. On the other hand, the Swedish krona rather than the US dollar was the most important Western currency for Finland, so the markka/krona exchange rate was naturally of great significance.

VALUE OF SELECTED CURRENCIES AGAINST THE DOLLAR
1913–1918, FROM QUOTATIONS IN STOCKHOLM⁵⁸¹

	1913	1914	1915	1916	1917	1918
Finnish markka	100	97.2	80.0	75.0	73.3	61.5
Russian rouble	100	96.2	74.1	60.1	44.7	...
Swedish krona	100	98.7	97.2	107.1	119.8	121.4

The table shows that the Bank of Finland achieved results in 1917 and 1918 in gradually detaching the markka from the downward spiralling rouble. By 1916 the markka had fallen against the dollar by two thirds as much as the rouble had. By 1917 the markka's dissociation from the plummeting rouble was a reality, and its value had fallen by only half as much.

BANK OF FINLAND DURING THE CIVIL WAR MONTHS

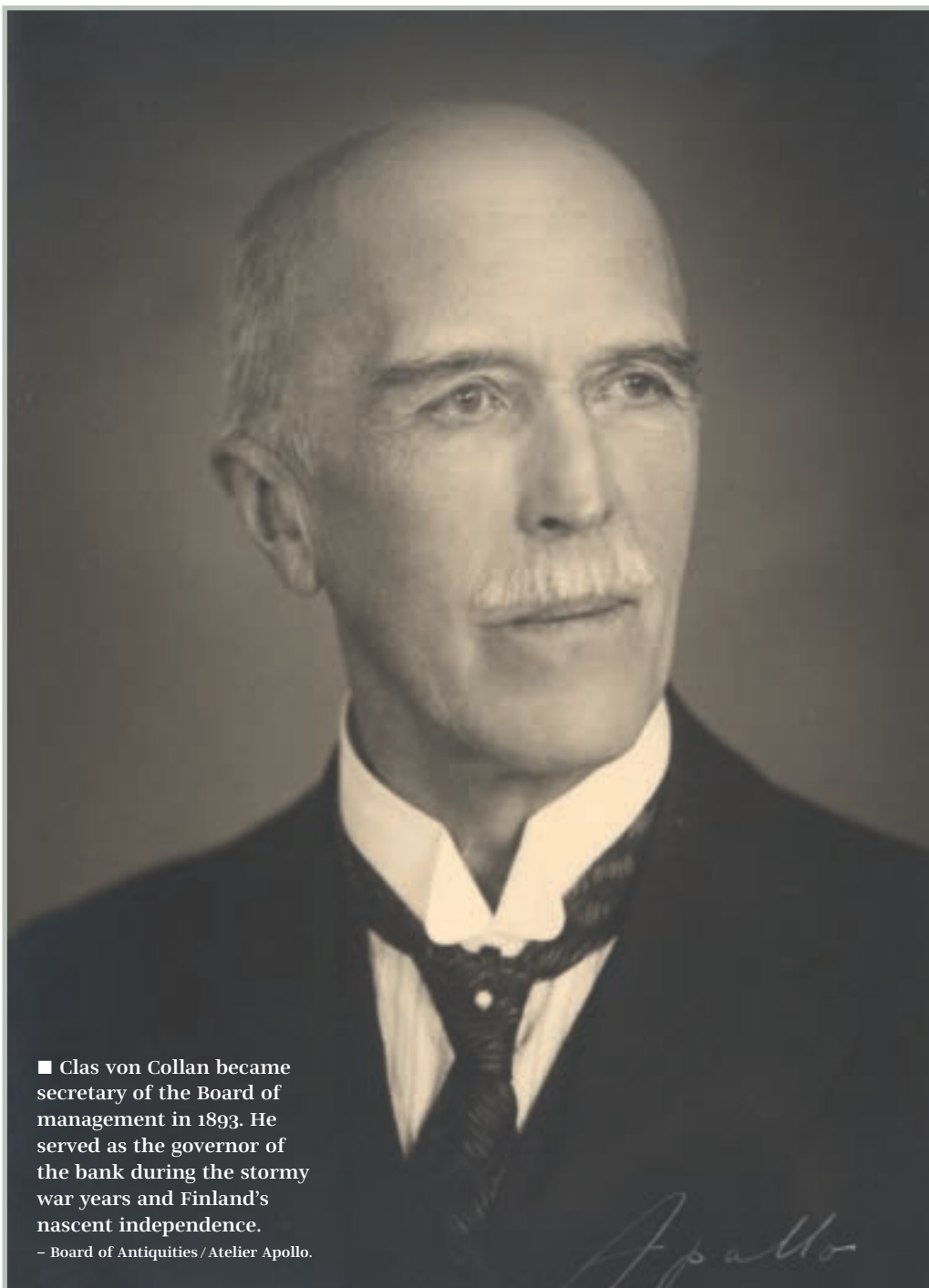
PARLIAMENTARY REFORM CHANGES BALANCE OF POWER

The introduction of a unicameral parliament, elected by universal and equal suffrage, fundamentally changed how politics was organized in Finland. Political participation was no longer based on an individual's origins or position in the Estates but rather on political ideology. The people began to organise themselves into parties according to social beliefs. This meant in effect the establishment of five political parties in Finland. Rightist and centrists views were represented by the Conservative Fennoman Party, the Constitutional Fennoman Party, the Swedish People's Party and the Agrarian League while leftist ideology was represented by the Social Democratic Party.⁵⁸²

From the first elections in 1907 onwards, the Social Democrats were by far the largest group, with a share of parliamentary seats that settled at just above 40 percent.⁵⁸³ This strong position was a surprise for the non-socialist parties because in the era of the Diet, most socialist supporters had not even had the right to vote. Until the reform of parliament, political hegemony was in the hands of the old Swedish-speaking gentry and the Fennoman movement that had risen alongside it, and these groups were not ready simply to throw in the towel. Despite their internal divisions, the representatives of the non-socialist groupings combined forces to exclude the social democrats from the reform work going on in parliamentary session. The selection of



■ The Senate, led by Oskar Tokoi, meeting in summer 1917. Of the then-senators, Kyösti Kallio went on to serve on the Board of management of the Bank of Finland while Väinö Tanner, Väinö Wuolijoki and Julius Ailio became members of the Supervisory council. – Board of Antiquities / Eric Sundström.



■ Clas von Collan became secretary of the Board of management in 1893. He served as the governor of the bank during the stormy war years and Finland's nascent independence.

– Board of Antiquities / Atelier Apollo.

CLAS VON COLLAN (1862–1939)

Clas von Collan, governor of the Bank of Finland during the russification campaigns and the First World War, was born in St. Petersburg, where his father worked as a personal physician in the imperial court. Although young Clas went to school in Helsinki, he retained an excellent command of Russian, along with other languages. International by disposition, he was the first head of the bank to regularly visit foreign correspondent banks.

After studies in jurisprudence his career as a civil servant began at the Trade and Industry department of the Senate. He transferred to the Bank of Finland in 1893 to become legal secretary to the board. In 1896 he was appointed supplementary board member and when governor Theodor Wegelius became head of the Senate's Financial department in 1906, von Collan succeeded him. The appointment was accompanied by a fierce language dispute, because the representatives of the Conservative Fennoman Party would have preferred their own man, Otto Stenroth, in the post. Von Collan's moderate disposition assuaged their fears and it was while he was at the helm, at the start of 1908, that the administrative language of the bank changed from Swedish to Finnish.

Clas von Collan's term at the Bank of Finland, from 1907 to 1918, spanned the difficult years of russification and the First World War. Russian officials were trying to unify the

two countries' monetary systems and von Collan, representing the Bank of Finland, was thrust into an important role in the negotiations. Thanks to his language skills and understanding of Russian culture, he was highly esteemed not only by Finns but also among Russian members of the Finnish financial committee and top figures of Russia's financial administration. The negotiations generally produced results acceptable to the Finns.

He spent the Finnish Civil War in Stockholm, where he had travelled in January 1918 on the eve of its outbreak. From this vantage point he was able to negotiate credit for the White Senate in Vaasa from Swedish bankers. He was also able to contact the Bank of Finland's foreign correspondent banks and ensure that the Red leadership of the Bank of Finland, appointed by the People's Delegation, was unable to lay its hands on the bank's foreign assets.

In autumn 1917 he had been involved in a bitter conflict with socialist members of the supervisory council of the bank and had tendered his resignation. A change of governor was undesirable amid difficult times and he was persuaded to continue for the time being. Although the political situation had changed completely by autumn 1918, he held to his decision and quit at the end of the year. He remained in banking, however, and served as managing director of the Real Estate Bank of Finland until 1933.

members of the Parliamentary Supervisory Council of the Bank of Finland shows this porcupine defence. By combining forces the other parties ensured that hardly any candidates from the Social Democratic Party were elected to the council. The only exceptions were Heikki Lindroos (1907–1909), Yrjö Sirola (1909–1910) and Matti Paasivuori (1911–1912) while Edvard Gylling and Oskari Tokoi managed to be elected deputy councillors in 1911–1912. This understandably aroused annoyance among the social democrats, who constituted the largest single party in parliament.⁵⁸⁴

After the 1916 parliamentary elections the situation changed again because the Social Democratic Party now achieved an absolute majority, 103 of the 200 seats in parliament. This parliament did not sit for long because new elections were held in the following year after the Russian government of Kerensky had dissolved the Finnish parliament. In the elections of 1917 the number of social democrats elected fell to 92, but the previous brief socialist-majority parliament had elected social democrats to fill all four places on the supervisory council that became vacant in 1917. Thus the balance of power on the council changed radically. The four outgoing members were Gösta Björkenheim, whose background was in trade; Hjalmar Paloheimo, a major industrialist; Heikki Renvall, who taught economics at Helsinki University; and Karl Söderholm, a justice at the Court of Appeal in Vaasa. They were replaced by socialist representatives, Anton Huotari and Evert Huttunen, who were journalists, Dr Edvard Gylling who was a statistician, and J. Mäki who had been a small farmer. The only continuity in the council was provided by professors E.G. Palmén and K.J. Ståhlberg.⁵⁸⁵

In 1916–1917, the Social Democratic Party's representatives, under the leadership of Edvard Gylling, embarked on a fierce attack on the Bank of Finland and its operational management. They did so both in the press and in the banking committee of parliament, where the operations of the Bank of Finland were debated on the basis of the annual report by the supervisory council. Gylling, who had become chairman of the council, accused the management of the Bank of Finland of embezzling, stealing and misappropriating hundreds of millions from the bank. His message was that, by overvaluing the rouble, the bank had weakened the value of the markka to the detriment of the working class. He also meant that the bank's leadership had contravened the regulations on banknote cover and

thereby jeopardised the existence of the country's monetary system. Gylling accused the management of unfairly defending the interests and maximising the profits of industry at the expense of the rest of society.⁵⁸⁶

Gylling pointed to consultations in 1915, attended by governor von Collan of the Bank of Finland and the general managers of the main banks. At this event the head of the Nordic Union Bank, August Ramsay, had referred to the negative consequences of lowering the rouble price. In Ramsay's view, making the rouble cheaper would paralyse the industries that mainly exported to Russia and thereby create major economic problems for all of society. In Gylling's view, rouble overvaluation also benefited speculators, and he included in their number the previous members of the supervisory council who had fixed the rouble exchange rate too high in order to protect their own economic interests. Although Gylling's strident criticisms of the Bank of Finland should be seen largely as a tactical political attack on the non-socialist parties, they were underpinned by a general concern about the inflation unleashed during the war years and the consequent difficulties of the working class. The accusations were also published in two social democratic party newspapers, *Kansan Tahto* (People's Will) and *Työmies* (Working Man), as part of the election struggle that took place in autumn 1917.⁵⁸⁷

The articles were vexatious for Bank of Finland directors and the old member of the supervisory council because they were picked up by the foreign press and thereby exacerbated doubts about the markka's value. This became clear to the board at the start of October 1917, when it received a letter from a banker in Stockholm enclosing a news item from *Aftenposten* newspaper in Norway entitled "Store bedragerier i Finlands Bank" (Major fraud at the Bank of Finland), based directly on Gylling's articles.⁵⁸⁸

The matter was on the agenda at the supervisory council meeting on 16 October 1917, held after the elections. It was chaired by the recently elected councillor Edvard Gylling but the real authority was with the former chairman E.G. Palmén, whose opening speech was scathing; "I cannot refrain on this occasion from noting the dissimulation, which first trumpets unfounded criticisms to the corners of the world, slandering the administration of the Bank of Finland while boasting of its own non-existent merit, and then, when

the world answers and our people and the value of their money suffer the damage, puts on a face as innocent as a lamb". He went on to note that, even in early 1917, Russia's grip had been so overpowering that it was impossible for the Bank of Finland to reject its demands about the exchange rate. Although the Bank of Finland had been in a perilous position at times over the years, it had never fallen into alien hands and had managed to hold the losses suffered within reasonable bounds. Palmén rejected the excuse that the mistaken and unfounded criticisms were mere excesses in the heat of an election struggle, because they had spread abroad, with immediate economic consequences. They reinforced foreign suspicions about the markka's external value, and thereby served to deepen its decline.⁵⁸⁹

What had been done could not be undone but the council decided to try to mitigate the damage by sending domestic and foreign newspapers a correction in its name. This correction would refute Gylling's accusations and state that the bank's management during the war had been as good as was possible under the circumstances. The correction was to be signed by Gylling as chairman. The council's decision was unanimous, meaning that Gylling accepted the rebuff.

The criticism of the Bank of Finland's management was largely motivated by political calculations but reflected the fact that social democratic party representatives had long been excluded from bank decision-making. The claim that exporters and speculators had been favoured at the cost of the working class was rhetorical but also reflected an inadequate understanding of central banking matters among socialist members of parliament. The left had been sidelined in central banking matters so they had had no opportunity to learn about the Bank's operations or the strictures that Russia had imposed on it.

This episode illustrates how Gylling's election to chair the supervisory council transformed the smooth relationship between the council and the Bank of Finland's board into a troubled one. Even so, it is worth noting that he soon grasped the banking theory required of the central bank's supervisors. His training in statistics and his understanding of the structure of Finnish society will have helped greatly. He was especially interested in the factors behind the collapse in the value of money and in ways of restoring it to its pre-war level. As a scientist he was also aware of international debate on money matters and banking theory, and he urged the governor of the bank,

von Collan, to consult Gustav Cassel and David Davidson, who were internationally renowned Swedish monetary theorists, and Karl Langenskiöld, a former governor of the Bank of Sweden, who had a Finnish background. He felt they could assess Finnish monetary conditions, consider the methods appropriate for curbing the growth of banknotes or even reducing them, and predict the influence of these measures on the whole national economy. Collan's upcoming working trip to Stockholm seemed to present a suitable opportunity although in fact the outbreak of Finland's civil war postponed these projects far into the future.⁵⁹⁰

Although the attitudes of socialists towards the Bank of Finland's leadership became less antagonistic towards the end of 1917, such tough and even ruthless criticism had left wounds that did not heal easily. Collan as governor had suffered a particularly fierce attack and had announced his resignation from the board even before the criticism voiced by Gylling in the supervisory council became public. In those uncertain times, the consequences of Collan's departure could have been disastrous, and the general managers of the major commercial banks and the recently appointed head of the Senate's Financial department Väinö Tanner persuaded him to stay on.⁵⁹¹

The articles published abroad damaged the public esteem enjoyed by the Bank of Finland and the correction drawn up by the supervisory council had no great impact. Collan took even greater offense at accusations, which he regarded as unreasonable and unfounded. The attacks hurt not merely his dignity but also his health, although he was still years from normal retirement age. In summer 1918, at the age of 56, he felt unable to continue his duties as governor and announced that he was leaving the board. However, the search for a successor took rather a long time so he continued to chair the board until the end of 1918.

TOWARDS CIVIL WAR

From summer 1917, Finland's internal situation became steadily more difficult as Russian political conditions changed. Following the February Revolution, the Russian provisional government overturned the regulations and statutes that had circumscribed Finnish autonomy during a decade-long russification campaign, and restored previous rights. Finland's pro-Russian Senate resigned and was replaced by a



■ Edvard Gylling became the first socialist chairman of the Supervisory council of the Bank of Finland in May 1917. During his term, the Bank of Finland was seized by the People's Delegation in January 1918.

– Bank of Finland.

Edvard Gylling

Senate of Finns, led by Social Democrat Oskari Tokoi, in which power was equally shared between socialists and non-socialists.⁵⁹²

Nonetheless, political tension in Finland was quickly rising, fanned by the dissolution of the social-democrat dominated parliament. In the October elections, the number of seats held by Social Democrats fell by nearly 10 and the party lost its absolute majority. The loss was a tough blow to the party, which became strikingly more radical afterwards. Many socialists regarded the decision to dissolve parliament as a betrayal and became disillusioned with parliamentarianism as a method to advance reform. The radicalisation of the left was spurred by the Bolshevik Revolution in Russia on 7 November 1917. Messages arrived in Finland from St. Petersburg, signed by its new rulers Lenin and Stalin, exhorting the working class to seize power. A concrete mark of tension was the declaration of a general strike in Finland on 14 November. A power struggle was breaking out within the socialist camp between the majority of the Social Democratic Party that favoured legality and an extra-parliamentary grouping that advocated armed insurrection.

The installation of a new Finnish government at the end of March, consisting of only non-socialist members of Parliament, did nothing to allay the mistrust of the left. On 6 December, the government under P.E. Svinhufvud proposed a declaration of independence, earning its later epithet of the 'Independence Senate'. Parliament endorsed the proposal, but it soon became clear that foreign powers would not recognise Finland as independent before Russia did. The government was initially unwilling to contact the Bolsheviks who had seized power in Russia but did so in the last week of 1917. On 4 January 1918 the Council of People's Commissars, under Lenin, recognised Finnish independence. Far from calming the internal situation in Finland, the decision inflamed radical socialists, who regarded the whole process as illegal, from the decision to dissolve parliament onwards.

Independence meant that Russia's grip over Finland was broken, and there was a danger that order would break down entirely. The power vacuum was being filled by two antagonistic armed factions, the Red Guard of the socialist camp and the Civil or White Guard of the non-socialists. In January 1918 tensions were heightened when the Helsinki Red Guard occupied the house of the Governor general. Parliament countered on 12 January with a decision to authorise the

White Guard to establish law and order in Finland. For the Red Guard the decision was tantamount to a declaration of war and, in a few weeks, the Red Guard and radicals who supported armed rebellion gained the upper hand in the Social Democratic Party. A decision was taken on 26 January for a general uprising and a timetable for seizing power, with military operations to start on the same evening. A revolutionary government, the People's Delegation (Kansanvaltuuskunta), was declared established on 28 January. Its chairman, the de facto prime minister, was Kullervo Manner, who had earlier served as speaker of parliament. Jalo Kohonen, a journalist, was named monetary delegate, the equivalent of finance minister.⁵⁹³

BANK SEIZED BY THE PEOPLE'S DELEGATION

Although there had been an armed revolution, the People's Delegation sought to take over the Bank of Finland from Parliament in a surprisingly restrained way; in the early stages it could even be described as the pursuit of legality. The question of the Bank of Finland's status under the new government was first raised on the same day that the People's Delegation was established, 28 January 1918, when chairman Gylling of the supervisory council held talks with the board of the bank about how operations should proceed in the prevailing situation. It was jointly decided that the bank would keep its head office closed because there was no guarantee that conditions would remain peaceful. At the same time it was decided to convene the supervisory council of the bank on the following morning.⁵⁹⁴

When the council met as agreed on 29 January, the socialist side was represented by Gylling, Mäki and Huttunen, plus Albin Karjalainen deputising for Huotari. On the non-socialist side were deputy chairman Palmén and Ståhlberg. Also present were board members Järnefelt, Basilier and Broberg. The only matter on the agenda was the opening of the bank's head office. Gylling proposed that the bank should try to remain outside the conflict so as to avoid aggravating the situation. He promised to negotiate with the People's Delegation about ways of guaranteeing the bank's safety. He was in favour of opening the bank although he expressed it in a rather vague way. The three other socialist councillors present took a slightly different view. They felt that it was

ultimately up to the board, which would take its decision on whether to start operations after discussing the matter with the chairman of the council.

In contrast, Palmén, the deputy chairman of the supervisory council, felt that conditions were so unstable that it was impossible to open the bank, and the members of the board agreed with him. The other non-socialist member of the council, Ståhlberg, was in favour to the principle of opening the bank but felt that the supervisory council could not order it if the bank's board was opposed to it. The majority of the council therefore took the view that it was for the board to decide whether to open the bank. At this point a board member, Broberg, said that the situation was being muddled further by plans for a forthcoming strike of civil servants. The supervisory council decided to reconvene on the following morning, after the members had obtained the necessary information about external security and the possible civil service strike.⁵⁹⁵

The council met again on 30 January at 10 a.m. The meeting was attended by the same people as before except that councillor Huotari was now available and so his deputy was not present. Gylling as chairman underlined once again the importance of starting up bank operations. He said that no violence had been offered to the bank but that keeping it closed could lead to unpredictable consequences. Mäki agreed but Huttunen continued to insist on a joint decision by the board and the council. Huotari went a little further, stating that if the board and the chairman of the council were unable to agree, the question should be submitted to the council. The Bank of Finland's board felt that the external situation, being unchanged, was still unsuitable for opening the bank. The non-socialist councillors Palmén and Ståhlberg agreed with this. Ståhlberg also raised the rhetorical question about whether the supervisory council was acting under a mandate from the Parliament of Finland or from some other body. Huttunen and Huotari replied in almost the same words which, under the circumstances, were extraordinary. They said they were operating under the authorisation of parliament until further notice. The three proposals that had been put forward were then voted on and the greatest support was received by Huotari's: at a time when the bank's board and the supervisory council's chairman were disagreed, the decision should be taken by the bank council members.⁵⁹⁶

After two meetings of the supervisory council held on successive days, the situation was still unresolved so the council met once more on the following day, 31 January. Compared with the composition of the previous meeting, the only change was that Evert Huttunen was now absent and Karjalainen was deputising for him. The mood was tenser than before. Gylling said that he and the board had been unable to agree on opening the bank. Furthermore the board had announced that the bank's officials had joined the general strike of civil servants against the People's Delegation, so the bank could not be opened. Gylling said that it ought to be opened that same day.

Anton Huotari then made the proposal that was carried: that the supervisory council should decide about opening the head office of the Bank of Finland that very day. The chairman of the council was mandated to ask those in power to guarantee the external safety of the bank. The chairman was also to take steps to have the branch offices opened as soon as possible. The views of Palmén and Ståhlberg were unchanged; the bank could not be opened in the prevailing situation, just as the board had told the council. A central bank could not be run by three board members alone. The socialist members of the council supported Huotari's proposal, which passed by 4 votes to 2. At the same time the socialist majority on the council deplored the strike by the staff, describing it as anarchistic and illegal.⁵⁹⁷

The pressure to open the Bank of Finland was now so great that hopes of obtaining the agreement of the whole supervisory council and the board had been set aside. A decision by the socialist majority on the council would have to suffice. However, this did not lead to the opening of the bank because the strike by the staff had paralysed its operations.

The People's Delegation, which had declared itself the government of Finland, had considered the future of the Bank of Finland on 29 January 1918. It wanted the bank to be reopened within two days at the start of February. The bank was to operate under the department headed by monetary delegate Jalo Kohonen, but in other respects its framework would be the same as before. Before the bank could be opened, an inventory of its treasury would have to be carried out. This work was begun on 1 February and completed on 6 February.

The inventory ordered by the People's Delegation meant that the bank's doors and strong room had to be forced, because the keys could

not be obtained during the strike by the bank staff. For the start of the inventory on Friday, 1 February at 11 a.m., council member Ståhlberg and the bank's chief clerk A. Mannelin were present, summoned by an order signed by the commander of the Red Guard. The People's Delegation had intended that all members of the council would be in attendance but Palmén had eluded them. Initially Gylling, Mäki and Huotari were the only councillors present apart from Ståhlberg. The People's Delegation was represented by Jalo Kohonen. By this time, the situation had changed so much that Ståhlberg was not summoned as a council member but as an "impartial" consultant and an expert in legalities, who could give advice that might be needed so that the acting government could take possession of the bank in the proper manner. Ståhlberg resolutely refused this role, as the following quotation from his report indicates:

"Ståhlberg, the undersigned, made a stern protest against the way that the Bank of Finland was broken into and its funds seized. I had no right to relinquish the funds of the Bank of Finland nor was I able to make any inventory for this purpose. By force of arms I could be compelled to attend, but only for as long as I was physically prevented from leaving. I also protested that, although a Finnish citizen and member of parliament, I was brought here under illegal arrest."

Mannelin, the chief clerk, endorsed Ståhlberg's protest, adding that he also protested against his illegal arrest, to which the chairman of the supervisory council alone answered; "Well, what is law, and what is not law". By Gylling's own account, his role at this stage was to supervise the execution of an inventory as a council member on behalf of the bank. In practice his role included managing the inventory.⁵⁹⁸

Although the Parliamentary Supervisory Council had by now been sidelined in the takeover of the Bank of Finland, there was still one council meeting ahead, held after the completion of the inventory on 6 February. In attendance were chairman Gylling, deputy chairman Palmén, members Mäki and Ståhlberg and deputy members Evert Eloranta and Albin Karjalainen. Even after it had seized the Bank of Finland, the People's Delegation wanted to operate according to the bank's regulations. The meeting differed from the previous ones in that members of the bank's board were absent. At the start of the meeting, Gylling gave a detailed report on how the seizure of the bank had proceeded and asked the council members for a proposal on how the

bank's operations should be organised. Gylling himself proposed the installation of an interim board to replace the board that had recused itself. Eloranta seconded Gylling's proposal. Palmén and Ståhlberg both condemned the forcible seizure of the Bank of Finland, stressing that it had taken place illegally. They felt their position as council members to be untenable and, immediately after making their statement, they exited. This left the meeting without a quorum so it had to be adjourned.⁵⁹⁹

The following meeting, held on 8 February, was no longer attended by non-socialist bank councillors. Those present were Gylling, Huotari and Mäki, as well as socialist deputy members Frans Evert Eloranta, Albin Karjalainen and Karl Harald Wiik. There was no negotiating in this meeting, which moved directly to electing a new board for the Bank of Finland. Huotari was appointed chairman, Einari Laaksovirta and Mikko Virta ordinary members, and Jaakko Ekstedt as extraordinary member.⁶⁰⁰ The People's Delegation approved the appointment of a new board on 9 February. At the same time it deemed the old board to have resigned from the start of February.

Anton Huotari, the chairman of the bank's red board, was a member of parliament and editor-in-chief of *Kansan Lehti*, a social democratic newspaper in Tampere. He was politically close to Gylling who, almost to the end, had sought power through parliamentary means. Once an armed revolt had taken place, however, Gylling and Huotari were ready to serve in the People's Delegation in seizing power and in waging war on the "Whites". Einari Laaksovirta (formerly Dahlström) was the son of the owner of Nisula Manor, near Luhanka, and one of the few academically educated members of the People's Delegation. He had legal training and was known as a lawyer used by labour unions and the Social Democratic Party. He not only served on the Bank of Finland's board but also, in partnership with his brother-in-law O. W. Kuusinen, drew up a new constitution, although it was never put into force.⁶⁰¹ Mikko Virkki had been a member of parliament since the sessions of 1908. His knowledge of business was derived mainly from the positions of trust he had held in cooperatives.

BANK BRANCHES IN RED HANDS

The disposition of Bank of Finland branch offices during the civil war was largely determined by the front line. Generally speaking, the Red Guard ruled Finland south of a line connecting Pori, Heinola, Lappeenranta and Rautu. The seven branches in this area, in Pori, Turku, Tampere, Kotka, Hämeenlinna, Vyborg and St. Petersburg, were seized outright, without intervening negotiations. Armed men of the Red Guard appeared and demanded the keys to the vault. Almost without exception, those in charge refused to cooperate, whereupon the Red Guard representatives declared them suspended from office. In most branches the vaults had to be opened by force. The funds in them were used largely for paying Red Guard wages. Turku was the first to be opened, at the end of January. Pori on 18 February was the last.

The direst events occurred at the Hämeenlinna branch, where the manager of the branch Bertel Sundgren and the cashier Henrik Gummerus both defied an armed threat and refused to open the vault. Initially the tension dissipated and both were allowed to leave but they then decided that the best course of action was flight from Hämeenlinna. They carried the keys to the vault with them to the nearby parish of Hauho but did not manage to elude their pursuers for long. When they were captured by the Red Guard each paid the supreme penalty of immediate execution without trial, Sundgren on 31 March and Gummerus on 4 April 1918, according to the research of the War Victims' Project. With the help of "professionals" brought in from Helsinki, the Red Guard managed to break into the vault at Hämeenlinna and get their hands on the Bank of Finland's cash.

The most dramatic events took place outside the area of military operations, at the branch in Kuopio. When the First World War broke out, the Bank of Finland had moved its gold reserves from coastal Helsinki to inland Kuopio, which was regarded as safer. The transfer had been handled discreetly but apparently the People's Delegation was aware of it. On 28 January, even before the Bank of Finland's head office had been seized, the head of the Red Guard in Kuopio, Antti Mäkelin, received a telegram from the head of general staff in Helsinki, Eero Haapalainen, instructing him to occupy the Kuopio branch office by force of arms and keep it in the hands of the Red Guard. The head



■ In spring 1918, the People's Delegation struck a number of 5-penni copper coins. The text encircling the trumpets reads "PEOPLE'S LABOUR, PEOPLE'S POWER". – National Museum of Finland/Numismatic collection. Board of Antiquities/Outi Järvinen.

of the branch, A.O. Wallenius, learned of the impending threat and set about organising its defence, together with the local chief of police. He also informed Mäkelin that he would not obey instructions from the Bank of Finland unless they were issued in the name of the old board. Many volunteers joined in the defence of the office and repulsed attempts to seize it on 1–3 February. After this Mäkelin's Red Guard withdrew from the whole town and operations of the Kuopio branch were normalised without financial losses. The success at resisting the seizure of the branch seems surprising because the Red Guard in Kuopio was said to have had many times more weapons than the White Guard.⁶⁰²

THE BANK UNDER THE PEOPLE'S DELEGATION

The prominent experts in public finances within the People's Delegation were the chairman of the supervisory council Edvard Gylling and the monetary delegate Jalo Kohonen. Compared with the other parts of the People's Delegation, the monetary department was distinguished by the high level of education of its main figures, Gylling and Kohonen. The former held a doctorate and the latter a master's degree. Both were entirely aware that the People's Delegation faced almost insuperable problems in organising its finances. The new government was still being created so effective tax collection was impaired. The core of the tax system inherited from the previous government consisted of indirect taxes – import and excise duties – which yielded nothing during a state of war. To cover its military and administrative expenses the People's Delegation would be entirely dependent on what it could obtain from the Bank of Finland. In the months ahead the bank would be its main source of funds.⁶⁰³

The new board of the Red Bank of Finland convened for the first time on January on Saturday, 9 February 1918. The new members present were Huotari, Virkki, Eksted and Laaksovirta, appointed by the socialists on the supervisory council. Of the appointees only Huotari had previous experience of central banking, and that was confined to less than a year as a member of the supervisory council. At the start of the meeting the board noted that the People's Delegation had dismissed the old board and officials because they had defied a decision

of the council and refused to come to work on 31 January 1918. One of the first duties of the board was to appoint new officials in place of those dismissed.⁶⁰⁴ Finding candidates with the right skills was understandably difficult but by the end of February 53 people were employed at head office. This was almost the normal number; there had been 59 at the end of 1917.

An official announcement of the changed status of the Bank of Finland was published on 11 February. Translated into Russian, German and English, it noted that all instructions and assignments issued by the old board after the end of January were void. The declaration was signed by the new members of the board, by Edvard Gylling on behalf of the supervisory council and by Kullervo Manner on behalf of the People's Delegation.⁶⁰⁵

The history of the Red Bank of Finland lasted, in reality, until 8 April, when the People's Delegation and their bank directors fled the capital to Vyborg. Head office was closed and operations could not be restarted amid the convulsions of Vyborg. There is limited systematic information about the operations of the Red Bank of Finland because most major matters were decided in the People's Delegation and its monetary department and there is scant documentary evidence about them. Most of the decisions were made by Jalo Kohonen and Edvard Gylling. The Bank of Finland archives do in fact contain board minutes for the period 9 February to 8 April 1918, but they generally deal with minor matters and do not illustrate operating principles. Even more deficient are the minutes of the supervisory council; all that is left are notes drafted by Gylling himself.

The Bank of Finland played a crucial role in financing Red Finland and its entire banking operations. When the People's Delegation seized the bank and branch offices, they held almost 170 million markkaa in banknotes. The banknote printing house had an additional amount of about 77 million in partially completed banknotes. The total that could be quickly obtainable was therefore over 240 million markkaa. The People's Delegation also believed that it could soon obtain the bank's gold reserves and its assets held in foreign correspondent banks.⁶⁰⁶

The bookkeeping value of the gold reserves was 42 million markkaa but its real value was much higher. Assets with foreign correspondent banks totalled 420 million markkaa, but the Red Bank of Finland obtained no part of these. The gold reserves had been moved to Kuopio,

outside the area controlled by the Red Guard, and foreign correspondent banks treated the seizure of the Bank of Finland as an illegal act and ignored instructions from the new board. Apart from the aforementioned assets, the bank also had a sizeable portfolio of bonds worth in total about 440 million markkaa.⁶⁰⁷

As explained above, the People's Delegation tried to observe legal niceties in its seizure of the Bank of Finland. The same applied to how it appropriated the funds controlled by the Bank of Finland, which were formally taken as loans to the state. About 220 million markkaa were disbursed while the bank was in socialist hands. The first payment of 120 million markkaa had actually been authorised by Parliament in autumn 1917, when it had approved a communications department fund proposal to borrow 120 million markkaa. A decision on the next short-term loan of 100 million markkaa was taken at the very start of April. Osmo Rinta-Tassi calculates that the People's Delegation spent nearly 240 million markkaa, all of which were obtained from the Bank of Finland. Most of the money went on civil administration and Red Guard wages.

In addition to financing the socialist government, the Bank of Finland handled payments through its branch offices in the area controlled by the Red Guard. The availability of cash presented problems. Change quickly disappeared from circulation, and business people were particularly wary of banknotes issued under the People's Delegation, which they recognised from their serial numbers. They tried to avoid accepting them and got rid of any they received as quickly as possible.⁶⁰⁸

The Bank of Finland had an important position in the future plans of the People's Delegation, which saw it as the hub of the whole banking system. An extra reason was that other banks, particularly the larger commercial banks, were reluctant to cooperate with the new authorities, and kept their offices closed throughout the period when the People's Delegation was in power. Outside the doors stood Red Guard members who not only provided security but also prevented bank officials from absconding with securities. Despite the uncertain and even chaotic conditions, the larger commercial banks were protected throughout the civil war and their losses were relatively minor. Tampere was the only town in Red Finland where the branch offices of commercial banks were kept open. A special agreement was

made between the banks' management and Red Guard representatives on keeping the banks open, so that factories would be able to pay wages despite the war.

Although the head offices of commercial banks were unscathed, their owners and managers were greatly concerned about the future. The People's Delegation had made it clear that private commercial banks would be outlawed in socialist Finland. It was not hard for bank managers to choose sides and despite many difficulties they did everything to facilitate payments in White Finland.⁶⁰⁹

Because there were hardly any commercial bank operations in Red Finland, the Bank of Finland had to provide a substitute. This did not clash with the principles of the People's Delegation, as a news item from the social democratic newspaper *Työmies* on 8 February 1918 shows. It described the transformation of the Bank of Finland into the country's leading commercial bank, which "with its stability, comparatively abundant assets and inexpensive lending will be able to draw large sections of industry into its sphere of influence, at the same time as the expanding business operations of the state increase [its] economic significance immediately".⁶¹⁰ The Bank of Finland's status was bolstered by the fact that the Helsinki Workers Savings Bank refused to have anything to do with the People's Delegation.⁶¹¹

It is a mark of the exceptional conditions of the period that, from early February onwards, the Bank of Finland began to disburse money to the holders of deposit accounts in commercial banks that were closed. Admittedly the payment incurred a separate tax, half of which was levied on the deposit owner and half on the bank. The money was paid from each commercial bank's own account at the Bank of Finland. In the same way the Bank of Finland began to accept payments due to private banks. To increase the funds available, the Bank of Finland accepted deposits from private individuals, on which it paid interest of 4 percent. It also created current accounts, intended mainly for companies, which had an interest rate of 1 percent. At the order of the People's Delegation, the Bank of Finland allocated a separate sum to be used for loans to municipalities. Its loans to companies were intended mainly for paying wages. Priority was given to financing the companies that had been taken over by the People's Delegation.⁶¹²

The Bank of Finland operated no longer than two months under the People's Delegation. Throughout this period the bank's former

officials were on strike. The new officials hired in their place knew little about banking and had inadequate professional skills so operations concentrated on the most essential routine matters. Consequently the two-month period under the People's Delegation left no permanent trace on the bank's structure and modes of operation.

A couple of days after Helsinki had been retaken by German forces aiding Finland's White Army on 12 April 1918, the old board arrived at the Bank of Finland to investigate possible losses. Their immediate impressions were that the building, at least, had been treated with respect and no major damage was apparent. The inventory of the bank's treasury took about a week. The office was then reopened for business on 22 April.⁶¹³

THE REASONS BEHIND RED POLICIES

What happened at the Bank of Finland's head office during the months of the civil war can be described as an illegal seizure dressed up in legality. The representatives of the monetary department of the People's Delegation tried to conduct the seizure by observing the bank's regulations as far as their objectives allowed. There were several factors behind this, the first one being the political composition of the supervisory council. Since spring 1917 the majority on the council had been chosen from the Social Democratic Party and there had not been time to select new councillors after the autumn 1917 elections, so even at the beginning of 1918 the majority of the council were ready to submit to the People's Delegation.

Finnish socialists were divided into three groups at this point; those who were utterly opposed to armed revolt, those in favour of it and an intermediate group who primarily sought a "parliamentary solution" but ultimately joined in the coup. Of those involved with the Bank of Finland, Edvard Gylling, Anton Huotari, Albin Karjalainen, K.H. Wiik and Evert Huttunen belonged to the last group, men who would have preferred parliamentarianism. When the revolution began Gylling, Huotari and Wiik felt duty bound to participate although they found violence repugnant. It was their influence that led to the emphasis on legal niceties during the phase when the Bank of Finland was seized.⁶¹⁴

■ E.G. Palmén continued the long tradition that the Supervisory council was led by a professor of Helsinki University. He served on the council from 1905 to 1919.

– Board of Antiquities /
Atelier Apollo.



Contributory roles were played also by Jalo Kohonen and the lawyer Einari Laaksovirta. As head of the monetary department of the People's Delegation, Kohonen was the ultimate master of the Bank of Finland while Laaksovirta, who had a strong position in the whole People's Delegation, oversaw the implementation of the Delegation's interests at the Bank of Finland from the position of board member. Although both supported armed rebellion, they acted with moderation towards the Bank of Finland, probably because of strategic assessments. They grasped from the outset that the monetary affairs of the People's Delegation could not be handled unless the Bank of Finland was allowed to continue operating with a minimum of disturbance. As people familiar with administration and questions of money they understood the professional requirements of banking. At least in the early stages of the uprising, they still hoped that many officials would remain at their desks, and perhaps for this reason tried to make the transfer of power at the Bank of Finland as smooth and non-violent as they could. One method was to observe the bank's regulations. However, hopes that the staff would work for new masters proved to be unfounded.

THE CENTRAL BANK IN WHITE FINLAND

In the early days of February 1918, the non-socialist members of the supervisory council, the board and practically all the officials of the Bank of Finland stopped work. For those in senior positions, the weeks ahead were spent in hiding if they did not leave Helsinki; many leading officials and politicians were on the Red Guard's wanted list. The time was not entirely wasted, however. Once the bank had been taken over by the People's Delegation, Professor E.G. Palmén, a long-term council member, and A. Mannelin, the chief clerk, contacted the representatives of foreign states in Helsinki to inform them of the illegal seizure, information that they would forward to their governments. Meanwhile, the governor of the bank, Clas von Collan, had travelled to Stockholm on 27 January in keeping with a council decision. He spent the entire civil war period in Stockholm, where he was free to inform all the correspondent banks of the Bank of Finland that the new administration had no claim on the bank's assets abroad.⁶¹⁵

The messages from Helsinki and from von Collan in Stockholm convinced foreign banks that the Red Bank of Finland should not be given access to its foreign assets. The only exceptions were the rouble-denominated assets in banks in St. Petersburg. It was useful that, since at least 1907, when the banking firm of Haller & Soehle had failed, von Collan had visited all the most important correspondent banks, so he knew their directors personally. Relationships of trust between the parties strengthened the position of the old Bank of Finland leadership.

Despite rising Finnish political tension from spring 1917 onwards, the situation was still expected to remain peaceful, even when Svinhufvud's government, the Independence Senate, was beginning its work at the end of November. At no point did the Senate urge the Bank of Finland to take precautions against a future domestic crisis. Hardly any preparations were made for the possibility of a Red uprising although, a few days before the People's Delegation was established, Svinhufvud government members – senators Heikki Renvall, Alexander Frey and J.E. Pehkonen – travelled to Vaasa, where they were joined a few days later by a fourth, Juhani Arajärvi. They were to form the so-called Vaasa Senate, chaired by Renvall. Together with White Army forces under General C.G. Mannerheim, the Vaasa Senate began on 28 January 1918 to disarm Russian forces in Finland and to restore legal order.

The other senators including chairman Svinhufvud were initially stranded in Helsinki and were forced to go into hiding when the People's Delegation came to power. The flow of information between Helsinki and Vaasa was not always smooth and there were some contradictory decisions. It was not until the end of March that the situation was normalised when Svinhufvud managed to escape from Helsinki and reach Vaasa, where he resumed his position at the head of the government. The duality of the White government also shows in the fact that collaboration with German forces in Finland was organised mainly via the Senate members that stayed in Helsinki.⁶¹⁶

The Vaasa Senate faced the same problem as the Helsinki People's Delegation: how to finance warfare when taxation did not work. The fundamental position of White Finland appeared even worse. The People's Delegation controlled the head office of the Bank of Finland, its printing house and the main branch offices with their cash reserves. The Red Guard also kept watch over the head offices of all major

commercial banks. From Vaasa, the Senate had immediate access only to the branch offices outside red Finland – in Vaasa, Oulu, Kuopio, Joensuu, Sortavala, Mikkeli and Jyväskylä – and the branch offices of commercial banks in these areas. The Bank of Finland's head office and the treasuries of the branch offices controlled by the Reds contained almost 170 million markkaa of banknotes while the branches situated on the White side had cash reserves of only 10 million.⁶¹⁷

These figures make the difference between the sides look very great but in reality the situation was much more equal. A seamless unity of purpose prevailed between the Vaasa Senate and private financial sector, exemplified by Senate membership. Senators Frey and Arajärvi were board members of the Nordic Bank for Trade and Industry and Kansallis Bank respectively. As soon as the civil war had begun, the directors of the main commercial banks convened in Vaasa and provided Arajärvi, who was in charge of state finances, with a written commitment that the Senate would have the funding it required. This commitment was not in fact used. Initially the Senate obtained funding from Bank of Finland branch offices and short-term acceptance credit. A few short-term loans were also obtained from western neighbouring countries.

To bolster its financial position the Senate decided at the end of March to issue domestic bonds worth 200 million markkaa. The issue of these “liberty bonds” was extremely successful and the sum subscribed reached 279 million markkaa. Savings banks, commercial banks and companies were among the organisations that subscribed out of a sense of duty. Senator Arajärvi also discussed the bond issue with governor von Collan of the Bank of Finland's board.⁶¹⁸ Collan had remained in Stockholm after the conclusion of his official trip there at the end of January, as noted above.

The Bank of Finland's printing house was in the capital, controlled by the People's Delegation, so the lack of currency soon became an acute problem for the Whites. In this case too, smooth cooperation with the commercial banks facilitated a solution. In cooperation with the Senate, Vaasa Bank issued cheques to the amount of 20 million markkaa which served as banknotes. Similar cheques were issued by several Bank of Finland branch offices in areas controlled by the Whites. Other substitutes for banknotes were postal payment orders written for round amounts and drawn on commercial banks, and

payment orders payable by banks issued by large organisations. These instruments successfully replaced banknotes as currency.⁶¹⁹

The monetary affairs and money supply of White Finland were therefore managed in a more decentralised way than in Red Finland. At the same time an interesting exchange of roles took place in these competing camps. The Bank of Finland in the capital took on some functions of a commercial bank while remaining the centre of the monetary system, while a group of commercial banks under Vaasa Bank became the *de facto* central bank of White Finland. All in all, the Senate managed its monetary affairs and the supply of currency better than the People's Delegation. Better professional skills undoubtedly played an important role in this. The Vaasa Senate could call on the country's leading banking experts, whose skills made up for a lack of material resources. In managing monetary affairs, experienced bankers were more accomplished and efficient than the self-made journalists and party functionaries used by the Reds.

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ГОСУДАРСТВЕННЫЙ
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 на нарицательный капитал
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ОБЛИГАЦІЯ
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Облигація сего займа выпускается на деньги злата и платины и на предъявителя, достоинствомъ въ 50, 100, 500, 1000, 5000, 10.000 и 25.000 рублей.

Надлежаще настоящей облигаціи участвуютъ въ займѣ сужены изъ 500 рублей, приходящей ПЯТЬ ОТЪ ПОЛОЖИМОЮ ПРОЦЕНТОВЪ въ годъ дохода по погашеніи облигаціи; тебѣе процентовъ начисляется съ 1 Января 1916 года.

Уплата капитала и процентовъ по сей облигаціи освобождается навсегда отъ обрета въ доходъ отъ движимыхъ капиталовъ.

Проценты по облигаціи уплачиваются два раза въ годъ: 1 Января и 1 Мая, по предъявленіи купоновъ изъ Государственныхъ Банковъ и его Контроръ и Отдѣленій въ Канцеляріяхъ тѣхъ городовъ, гдѣ по закону учреждены Государственные Банки.

1 Января 1925 года облигація сѣя будутъ выкуплены по нарицательной цѣнѣ.

Каждая облигація Государственного 5 1/2% военного краткосрочнаго займа 1915 г. омыблется двадцатью купонами. Купоны отъ сѣихъ облигацій подлежатъ оплате въ теченіе 10 лѣтъ съ наступленія по какому сроку, а облигація — въ теченіе 30 лѣтъ со срока, назначеннаго для кака выкупа.

Сей облигація принакляется по цѣнѣ, установленной на каждае купонѣ Министерствомъ Финансовъ и утверждаемой чрезъ Правительствующій Сенатъ въ-заказѣ: 1) по каментному подражать и аспавать, 2) по разороченному аспаву и 3) по общенному тѣмъ же каменту.

Держатели Государственнаго 5 1/2% военного краткосрочнаго займа 1915 г. будутъ предпочтительно право обрѣтать каждака у кака облигація на облигація Государственныхъ займовъ того же или кака больше продолжительныхъ сроковъ, каужимъ быть каужимъ каужи каужи каужи въ теченіе 1916 года, каужимъ въ уплату по каужимъ каужимъ будутъ принакаться облигація каужимъ займа по кака каужимъ каужимъ.

Утверждена Государственной
 Комиссіей Погашенія Долговъ

Въ-заказѣ

■ The Bank of Finland was required to invest its funds in bonds such as these, used by Russia to finance military spending in the First World War. After the Russian Revolution, the bonds became worthless. – National Museum of Finland / Numismatic collection. Board of Antiquities / Outi Järvinen.

BANK'S FINANCES IN THE CRISIS YEARS

BUILD-UP OF ROUBLES

The economic effects on Finland of the First World War were neither all good nor all bad. On the one hand, economic relations with the west were severed. On the other, the Russian government's appetite for materiel seemed almost limitless and spurred a genuine boom in some sectors. The wide-ranging fortifications commissioned by Russia stimulated economic activity, especially in the south of the country. But for the Bank of Finland these years were financially catastrophic, because of Finland's dependence on the rouble economy, described earlier.

Although the board of the Bank of Finland was able to lower its rouble quotation somewhat, the rate reductions were minor compared with the slump in the rouble abroad. The bank's obligation to accept roubles at an artificially high mandatory rate therefore meant financial losses. It had entered a period when it was flooded with roubles for various parallel reasons. Russian officials, both military and civilian, brought roubles to the Bank of Finland. At the same time, growing uncertainty in Russia led to a capital flight, and these roubles were channelled to the Bank of Finland, where they could be exchanged for markkaa. Finnish exporters also sought to exchange their rouble earnings for markkaa as quickly as possible.

During 1917 Russia's political system collapsed, with a consequent effect on relations with Finland. Representatives of the Russian central government no longer dictated how Finland should act. This bolstered

the negotiating position of the Bank of Finland, which was no longer compelled to accept roubles or state promissory notes. Initially the bank proposed that it would sell markkaa for gold held by the Russian central bank but the Russians rejected this idea. They accepted an alternative solution; to buy markkaa for pounds and dollars from the Russian central bank. The right of private individuals to exchange roubles for markkaa was also subjected to strict daily limits. Apart from the risk caused by the mandatory rouble exchange rate, there was risk in the Bank's expanded portfolio of rouble-denominated bonds, which it had been obliged to subscribe in relatively large quantities.⁶²⁰

The Board had become concerned about the rapid increase in its rouble assets by summer 1915, when they stood at 150 million markkaa, compared with 12 million at the start of 1914. It was a problem not only for the central bank but for the whole financial sector and the many government agencies that were required to accept roubles. To gain an overall picture of the situation, the Senate arranged an event in August 1915, to which it invited von Collan of the Bank of Finland, along with August Ramsay, J.K. Paasikivi and Emil Schybergson from the commercial banking sector and Jonathan Wartiovaara, the inspector general of the State Treasury. During the discussions it was agreed that a financially strong central bank was essential in troubled times, but that the bank's finances would be unable to bear the losses sustained from roubles exchanged at an overly strong exchange rate. However, although the mandatory exchange rate was recognised as a major problem, August Ramsay said it was also to the benefit of private industry, and he felt that lowering the rouble exchange rate would destroy the profitability of exporting.⁶²¹

As explained previously, the question of the rouble conversion rate was politically resolved in the Haritonov committee in autumn 1915. The compromise eased the situation of the Bank of Finland, which obtained more leeway in setting the exchange rate. On the other hand it did nothing to reduce the bank's exposure to credit risk from Russia. Under the compromise agreed, the Russian government would henceforth obtain the markkaa it required in the form of loans, which meant that the Bank of Finland was now selling markkaa for state promissory notes written in the form of bills of exchange.⁶²²

ROUBLE LOSSES

There are problems involved in setting an exact sum on the rouble losses sustained during the years of the First World War, if only because of the high inflation prevailing in that period. Moreover some of the losses were borne by the State and not merely the Bank of Finland. Technically, an assessment of the losses is complicated by the existence of many different parallel exchange rates. The fundamental rates at least were the rouble's parity; its quotation on the Stockholm Bourse, which gives an indication of its market value; its quotation in Helsinki, which shows the mandatory administrative exchange rate; and the bookkeeping rate used in the Bank of Finland's accounts, which generally was about halfway between the Stockholm and Helsinki quotations.

BANK OF FINLAND CAPITAL 1913

	million markkaa
Primary capital	25.0
Reserve fund	65.2
Real estate	3.0
Unused profits	14.2

Source: Bank of Finland annual report 1913.

At the close of 1913 the two capital funds of the Bank of Finland totalled 90 million markkaa, in addition to which the bank had unused profits of 14 million markkaa, although some went automatically to the government. The total capital of the Bank of Finland in the last year of peace was therefore in excess of 100 million markkaa.

ACCOUNTING RESULT IN THE WAR YEARS

	profit million markkaa	loss million markkaa
1914	6.5	...
1915	...	21.3
1916	4.2	...
1917	...	90.9

Source: Bank of Finland annual reports 1914–1917.

Examined in the light of these accounting figures, the situation was already unsustainable by the end of 1917, because the cumulative results for 1914–1917 show a loss of 101.5 million markkaa. The bank's primary capital and reserve fund had been drained by the losses. At the end of 1917 there was no capital left.

Even these bookkeeping figures do not reveal the true extent of losses, which are better evaluated in the light of the exchange rate losses and write-downs recorded at the closing of accounts. What makes this indicator apt is that the disintegration of the Russian Empire ultimately led to a situation where all receivables from Russia became worthless. At the same time this method gives an idea of the point in time when the losses suffered by the Bank of Finland could be recognised in its accounts.

Calculated at parity, the total of assets and bonds held by the Bank of Finland were 724.2 million markkaa at the end of 1917.⁶²³ Naturally such a large sum never appeared in its balance sheet total because the rouble loans had been made at a rate lower than parity, and the bookkeeping rate could be even lower.

With hindsight, the Bank of Finland might in theory have been wiser to exchange its roubles for western currency in Stockholm as soon as possible, without regard to the exchange rate loss incurred. To some extent it did so in 1914–1915 but in 1916 Russian officials forbade the sale of roubles in Stockholm by the Bank of Finland and private banks. In Russia's view, the sale of Finland's roubles in Stockholm would cause a steeper decline in the rouble exchange rate, so it was prohibited outright.⁶²⁴

The exchange rate losses and write-downs from Russian receivables and bonds denominated in roubles during the period 1914–1921 are shown in the table overleaf.

ROUBLE EXCHANGE RATE LOSSES AND
WRITE-DOWNS 1914–21

	million markkaa
1914	4.0
1915	35.7
1916	22.5
1917	165.4
1918	223.8
1919	29.4
1920	17.4
1921	9.3
Total	507.5

Source: Bank of Finland Yearbook 1921.

Another 91.6 million markkaa could be added to the losses for 1921 because, after the signing of the Peace Treaty of Tartu that year, promissory notes of that value were transferred from the Bank of Finland's balance sheet to the State of Finland, and the loss on them was therefore not booked by the bank. Even at that time, not all claims from Russia had yet been written off and more than 50 million markkaa were gradually eliminated as the bank's financial state allowed.

The losses could justifiably be described as horrific, the expression used by J.K. Paasikivi, the statesman who has recently resigned from the State Treasury to become chief general manager of Kansallis Bank. From the Bank of Finland's viewpoint the losses were certainly severe. The greatest beneficiary was naturally the government of Russia, because the losses represented a transfer of resources from Finland to Russia during the war years. During the 1920s Finns spoke widely of "war tax" when referring, among other things, to the costs imposed by the mandatory exchange rate. Another great beneficiary was Finnish industry, which exported military supplies to Russia. The mandatory exchange rate had bolstered the profits of exporters while the Bank of Finland had born the exchange rate risk contained in rouble payments. There was also a sizeable group of speculators who profited from the opportunities offered by multiple exchange rates.

SPRING 1918

To safeguard the operations of the bank while exchange rate losses were continuing, the supervisory council made a proposal to the Senate on 1 June 1917 for a domestic bond issue in the amount of 200 million markkaa. These funds would be transferred to the Bank of Finland, which would correspondingly transfer its Russian rouble bonds to the state, thus repairing the bank's capital structure. At the same time, an issue of 200 million markkaa of bonds would mop up domestic liquidity, which had risen greatly, and thus help keep inflation at bay. The council proposal was indeed approved but it was not implemented during 1917 because parliament was dissolved.⁶²⁵ The bank's accounts for 1917 show its primary capital as 4.7 million markkaa, but this was creative accounting; in reality both funds had been exhausted. The losses did not stop there, because civil war broke out in 1918.

After about two and a half months in the hands of the People's Delegation, the Bank of Finland returned to its old management on 14 April 1918 and opened its doors for business a week later. It immediately began to calculate the costs it had suffered from the civil war. Roughly estimated they consisted of the following amounts:

BANK OF FINLAND LOSSES DURING THE CIVIL WAR

	million markkaa
Sums seized from current accounts by the People's Delegation	156.0
Loans to local government institutions controlled by the People's Delegation	14.9
Sums missing from the treasury	
Head office	0.4
Branch offices	4.9
Remittances to St. Petersburg	6.7
Invalid banknotes issued	77.2

Source: Report of the Supervisory Council 1918.

According to the final calculation, costs to the bank of the "rebellion" were estimated at 116.2 million markkaa. The losses were reduced the most by Parliament's decision that the Bank of Finland was not

responsible for redeeming any of the banknotes issued by the Reds and now declared void, except for one-markka notes. This exception was dictated largely by common sense, because separating them from the valid ones would have been more expensive than they were worth.

Compared with the losses caused by the mandatory rouble exchange rate, the real costs of the civil war to the Bank were therefore relatively small. This was not much comfort to the Bank of Finland because the losses had come at a time when its capital had already been wiped out by the loss of its rouble assets. The only possible solution was state aid and fortunately the groundwork had already been laid by parliament's decision of spring 1917 to reinforce the bank's capital.

In summer 1918, when the civil war had ended and a new government, the Senate under J.K. Paasikivi, had been formed, the supervisory council proposed that the state should issue bonds worth 350 million markkaa, which would be transferred to the Bank of Finland where they could be recorded as capital. During parliamentary debate the terms were toughened. The interest rate on the tax-free state bonds was lowered to 4.5 percent and the Bank of Finland was forbidden to sell the bonds to other banks, institutions or private individuals before obtaining the government's consent. Furthermore the sum of money required to amortise the bonds would automatically be transferred to the state from the bank's annual surplus.⁶²⁶

By setting a low interest rate on the bonds and restricting their sale, the government wanted to ensure that the Bank of Finland would not compete with the government for funds on the tight money market. In this it was successful because the Bank of Finland never sold the bonds. In practice, therefore, the operation did not require financial sacrifices by the government. It was an accounting operation that allowed the Bank of Finland to record the necessary write-offs and depreciation in its bookkeeping. Parliament's decision on the transfer of 350 million markkaa to the bank was ratified on 10 September and the government bonds were recorded as assets in the bank's accounts on 31 October.⁶²⁷

The 350 million markkaa were used entirely for depreciation and write downs. First the Bank wrote off the losses of 116.2 million that it had suffered during the period of the People's Delegation. The

remaining 233.8 million markkaa was used to write down the value of rouble assets. In the accounts for 1918, the bank's primary capital remained at 4.7 million markkaa, the same as in the accounts for 1917.

The central bank of independent Finland therefore began operations in a position where its assets had been wiped out and even the support obtained from the government was largely cosmetic. In fact its financial state was not quite as bad as the balance sheet suggested. Its gold reserves were intact and their book value in the accounts for 1918 was recorded as 42.6 million markka. The gold was still booked at its legal price set in 1878 but in reality the price of gold was many times greater at this time. If it had been calculated by the dollar exchange rate – the dollar being the most convertible currency – the value of gold reserves at the end of 1918 would have been about 72 million markkaa. By valuing its gold at the old exchange rate, the Bank of Finland had created a major hidden reserve.⁶²⁸

GROUND ZERO: MONETARY POLICY IN 1918–19

COVER REGULATIONS UPDATED

The accelerating decline in the rouble's external value during 1917 had led to a situation where the leadership of the Bank of Finland had no alternatives left. The rouble assets that served as banknote cover had been booked at an artificially high value, while the other assets backing banknotes, mostly foreign bonds and Finnish government bonds, did not meet the cover requirements set in the bank's regulations. However, it was impossible to write down rouble assets in the direction of their real value because this would have compelled a steep reduction in the banknotes in circulation, causing excessive problems throughout society. In this situation, the cover regulations had to be changed, to bring the bank into at least formal compliance with them.

As an immediate solution, the board proposed that the right to issue unbacked banknotes should be raised from the 70 million markkaa set in 1914 to 200 million markkaa. It also proposed a significant broadening of the definition of cover. Existing regulations allowed undisputed receivables denominated in foreign currency to be classed as banknote cover but the value of such claims was now insignificant. The board proposed that markka bonds of the Finnish government and other should be valid banknote cover. This could not be immediately implemented because of the civil war but by summer 1918 conditions had stabilised enough and the cover regulations were

changed on the basis of a board proposal made at the end of 1917. At this point the Bank of Finland's position was so critical that the new regulations were already applied when the accounts for 1917 were drawn up, although they did not take effect until 27 July 1918. Because of the civil war, the accounts for 1917 were closed in spring 1918.⁶²⁹

The new cover regulations meant the final disappearance of the principles of the gold standard. Precious metal or foreign currencies backed by it were no longer needed for banknote cover, and there was no upper limit on the amount of lending by the central bank to the government. The new cover regulations of 1918 were by nature an emergency solution. Once the bank had been stabilised, formally at least, a more fundamental reform of its regulations could be considered. The first reforms concerned the size of its primary capital and its reserve fund. The value of the markkaa had declined permanently so primary capital was set at 100 million markkaa and the minimum reserve fund at 50 million markkaa. The objectives were relatively modest because primary capital had already been 25 million markkaa before the First World War. However, the Bank of Finland had lost practically all its capital in 1917–18 and had to begin as if from scratch, as noted above.

The changes in the bank's environment were so great that mere adjustments of individual regulations were insufficient. In spring 1921 the board proposed to the supervisory council that a committee be established to draw up completely new regulations. Three of the committee's members – Wille Lavonius, Ernst Nevanlinna and Väinö Tanner – were to represent the supervisory council and two – Otto Stenroth and Ernst Gråsten – the board. It was immediately agreed that Stenroth, the governor, would produce draft new regulations to serve as the basis for the committee's work. Matters did not advance entirely according to plan because, as soon as the committee had been established, the banknote regulations had to be altered. The committee initially concentrated on this, more urgent, problem.⁶³⁰

After the revision of regulations in 1918 all government bonds had been counted as banknote cover. As the finances of the state were gradually stabilized, it began to repay its loans to the Bank. This meant a reduction in banknotes, which was actually so severe that the bank directors urged a reform of the cover regulations.

The committee's aim was to forge cover regulations that would operate under the prevailing conditions of fiat money but would at the

same time be applicable to a future metal standard and support preparations for it. The regulations had to prevent excessive banknote issue in an explicit way. They had to demonstrate that there was no longer a possibility that banknote issue would erode the value of money. Only in this way could the international credibility of the markka be restored.

The supervisory council felt that this would be best achieved by setting an absolute upper limit on banknotes and comparable notes payable on demand, and clearly defined cover for them. The council's proposal was not implemented in quite this way. The proposal finally approved by the government on 30 December 1921 stated that banknotes issued could exceed the bank's gold reserves and uncontested foreign assets by no more than 1.5 billion markkaa.

According to regulation §18 "the primary cover for banknotes is the bank's gold reserve and its uncontested claims on foreign agents, minted Finnish silver coin, commercial bills of exchange payable abroad, bonds in foreign currency that are quoted on foreign bourses and interest coupons and notes in foreign currency. If the volume of notes issued by the bank is greater than the aforementioned assets, their cover may be domestic bills of exchange no longer than three months drawn on at least two financially sound firms or enterprises".⁶³¹

The new cover regulations reflected the dire experiences of past years. They reverted to the principles in use before the First World War when banknote cover consisted principally of gold reserves and uncontested foreign claims. Foreign bonds were acceptable only if they were quoted on foreign bourses. Shunning government promissory notes, the regulations recognised domestic receivables as valid cover only within the limits of a fixed quota and only if they were short-term and drawn against individuals or companies. The new cover regulations came into effect on the last day of 1921 and thereafter government expenditure could no longer be financed by loans from the central bank. However, to eliminate sudden changes in the volume of banknotes, the bank was allowed to use as cover the bonds and other state promissory notes which it held at the time that the law came into force. This was intended to soften the impact of the new regulations on money supply. Under exceptional circumstances the bank had the right to exceed its quota of 1.5 billion markkaa by 100 million markkaa,

but only temporarily and only after the president of the republic had approved such a proposal by the supervisory council.

These reforms to the bank's regulations, which finally took effect at the end of 1921, revealed a policy consensus. At least among the bank's senior management, meaning the board of management and the supervisory council, a return to the pre-war value of the markka was no longer felt to be realistic. A seven-year period of inflation had irreversibly eroded its external and internal value. The new aim was to halt inflation and to stabilise exchange rates at their new level. Although there would be no return to the past, the regulations showed firm confidence that Finland would return to the gold standard.

In this connection the composition of the board was clarified and changed. In addition to a chairman (i.e. the governor), four members were to be elected, one with legal training. In practice this meant that the position of extraordinary board member was made permanent and one entirely new member appointed. At the same time the appointment process was changed to match Finland's new political system. There was no longer a tsar but, in line with the new constitution of 1919, Finland was a republic with a president. Regarding the appointments to the board of the Bank, the supervisory council now made its proposals to the government, and ultimately the decision was made by the president of the republic in a presidential session of the government.

POST-WAR EXCHANGE RATES

After the war ended, international efforts began to rebuild a stable and effective monetary system. The general ideal was a return to the "good old times", meaning the pre-war gold standard. The period from 1920 to 1922 was a time of intense international financial diplomacy on this subject. In many ways, these years mark the breakthrough of even more significant and far-reaching multilateral financial discussions than the Paris monetary conferences in the previous century, but they did not give rise to an international monetary and currency system based on any multilateral treaty. Practical measures for rebuilding the monetary system were made at a national level, in the end without efficient coordination. Admittedly the League of Nations, founded in 1919, became a forum of debate and a developer of economic statistics of some significance, but no multilateral system of monetary or

currency policies was created by it. This did not, of course, mean that the decisions of different countries could be made in isolation. The solutions chosen by the great powers – the United States, France and Britain – had very powerful effects on each other's monetary policies and also on the position of small countries like Finland.

The United States ended its ban on importing and exporting gold at the start of 1919. New York's gold market was again free and the United States once more on an internal gold standard. This did not yet mean a return to the gold standard internationally and exchange rates based on it. In fact exchange rates became all the more volatile in 1919. As wartime financial arrangements were dismantled, the US and Great Britain stopped supporting the pound against the dollar in March 1919, after which the pound's exchange rate began to fall sharply. The wartime peg of the French franc to the dollar was ended at the same time. The currencies of many countries began to fall rapidly against gold and the dollar.⁶³²

This was the starting point of a worldwide period of floating currencies, which lasted until each country fixed its monetary system to the gold standard. The international gold standard was eventually rebuilt almost without coordination, one country at a time, although conferences in Brussels and Genoa in 1920 and 1922 attempted to set common principles for how an international monetary system would be linked to gold.

Historians have generally regarded these conferences as failures, an assessment that was surely confirmed in part by the collapse of the system at the start of the 1930s. A new international gold system founded on sensible principles, which Brussels and Genoa tried to create, was never properly constructed and the interwar gold standard finally collapsed in 1931, pushed over the edge by the Great Depression. The gold standard that Brussels and Genoa tried to foster has even been regarded as the main cause for the slump.⁶³³ Today economists who favour a monetary system based on gold are very rare; most share Keynes' opinion of gold as a "barbarous relic."⁶³⁴ It is therefore understandable, seen from the period since the Great Depression to the present day, that the conferences of Brussels and Genoa appear as the last embodiments of an outdated gold standard ideology.

Regardless of whatever benefit or damage the conferences of

Brussels and Genoa did to the international monetary system, they were major milestones in the eyes of contemporaries. They were very significant for Finnish monetary policy and the Bank of Finland. This is especially true because, for Finnish economic policy, it was a time of unusual opportunity. 1919 has justifiably been called year zero. The country's monetary system, public finances, foreign trade and international creditworthiness had to be rebuilt, perhaps not from scratch but from fairly close to it. In these circumstances Finland naturally was keenly interested in international guidelines and in creating conditions where it would receive the approval of the international community. The Brussels conference in 1920 seems to have been a particularly major event in monetary policy.

For Finland the conferences of Brussels and Genoa, and the economic cooperation at the League of Nations that they initiated, were a breakthrough in the international arena. As part of the Russian Empire, Finland had been unable to participate in international financial diplomacy before the First World War. Now it could for the first time.

BRUSSELS FINANCIAL CONFERENCE

The League of Nations convened an international monetary conference in Brussels on 24 September – 8 October 1920 to draft guidelines for rebuilding the international monetary and economic system. Representatives from 39 countries, including Finland, participated. There were no Germans or Russians present. The Finnish delegation consisted of the governor (chairman of the board) of the Bank of Finland, Otto Stenroth, and the chief general manager of a commercial bank, the Nordic Union Bank, J.O. Wasastjerna.

Jean Monnet of France, then deputy secretary general of the League of Nations, acted as secretary of the chairman's office in the Brussels conference. Monnet later became famous as the founder of the European Coal and Steel Community and thereby one of the 'founding fathers' of the EU. There were four main questions on the Brussels agenda: public finances, international trade, currency & exchange, and credit. The conference divided into four committees, one for each question. Otto Stenroth of the Bank of Finland took part in the work of the public finances committee.⁶³⁵

As a basis for the conference, the Secretariat of the League of Nations had drawn up a wide-ranging report, "Currencies after the War", under the leadership of Arthur Salter. It was based on an international survey of monetary conditions carried out by the secretariat in September 1919, and its preface was dated 20 February 1920. The report placed Finland in the group of unsettled nations, about which "no detailed statement of the currency and exchange position (...) can be given." The other countries in the group were Austria, Hungary, Poland, Yugoslavia and Czechoslovakia. The report stated that these nations could not be separately analysed because "the more detailed and accurate the portrayal, the more ephemeral and useless it would be." According to the introduction of the report, statistics on these countries were unreliable and "the evidence of individuals differs so much that it seemed better to record none of it." It added that their conditions were so unstable that "data collected today would be obsolete and almost useless six months hence."⁶³⁶

The Finnish government regarded this picture of Finnish monetary conditions as so damaging that its delegation provided the conference with a 14-page rebuttal, in the name of the Ministry of Finance, entitled "Finnish currency after the war: a supplement to and correction of the publication 'Currencies after the War'". This attempted to show, among other things, that there was no reason to cast doubt on the stability of the financial position of the State of Finland and that concerns about the country's political situation, which had weakened the markka exchange rate, were "partly unfounded, partly exaggerated."⁶³⁷

Considering that a return to the gold standard was the main general objective of practical economic policy makers and influential academic figures at this time, the concluding statement of the conference can be regarded as surprisingly cautious and realistic. Instead of recommending an early return to the gold standard and pre-war gold parities, the recommendations of Brussels conference focused on creating conditions for monetary stability. The 16-point conclusions of the currency and exchange committee stated that the primary mission was to halt inflation. Underlying the inflationary growth of money supply was the use of central banks to finance government deficits, and the committee demanded that national budgets be balanced and banks of issue protected from political pressure. Short-term state loans

■ Otto Stenroth was compelled to resign his chairmanship of the Board of management after just four years but his influence extended much further. The Bank's 1925 regulations, drafted by Stenroth, remained in force for several decades.

– Board of Antiquities / Rembrandt.



Otto Stenroth
1921.

should either be paid off or consolidated into long-term bonds. Until lending could once more be managed in a normal way by interest rates, credit should be granted only in cases of real need. Foreign trade should be deregulated and all unnecessary expenditure avoided.

The currency and exchange committee regarded a return to the gold standard as extremely desirable for the countries that had been forced off it, but was unable to say when this would become possible. In its conclusions, however, it came down on the side of opposing an early return to the gold standard. To raise currencies back to their old gold parities would in many cases require enormous deflation. If this were to be done, the committee felt, it needed to be done gradually and with great caution, to prevent a potentially destructive disruption of lending and trade.

The committee also opposed the regulation of currency exchange and “artificial” controls of exchange rates. In its view all government interference in trade, including currency exchange, would be detrimental to the improvement in economic conditions that was vital for healthy and stable exchange rates.⁶³⁸

The Ter Meulen Plan, drafted in the credit committee, is regarded as the most concrete outcome of the Brussels Conference. The plan was to allow central European countries that had suffered the most from the war to borrow under guarantees from the international community against surety provided by their governments. However, although negotiations were conducted with Austria and other possible recipients, the plan did not lead to practical results and ultimately failed. Eichengreen regards the reluctance of the United States as the main reason why the plan for reconstruction loans was not implemented.⁶³⁹

All in all, the conclusions of the conference came to constitute a manifesto of orthodox economic policy without being particularly tangible in any respect. Nor was it binding on the participants, even League of Nations members, but was in the nature of a recommendation. Harry Siepmann from Britain, who participated as secretary of the credit committee, assessed the conference’s main contribution to have been, not its conclusions, but the states of mind that the participants carried back to their home towns. Siepmann said that they returned in trepidation, having understood what imminent dangers threatened Europe but at the same time encouraged by the genuine spirit of cooperation that had prevailed at the conference.⁶⁴⁰

It's difficult to say how far the Brussels conference directly influenced Otto Stenroth of the Bank of Finland or other Finnish economic policymakers but in the years ahead Finland did apply the policies concluded in Brussels fairly exactly. A new forum, the Economic Council, was set up on 22 October 1920, soon after Stenroth had returned. As a member of the Council Stenroth declared that foreign exchange controls should be abolished because they had lost their effectiveness and only appeared to be working. The Brussels conference had endorsed the abolition of foreign exchange controls, Stenroth added.⁶⁴¹ Finland abolished foreign exchange controls on 28 October, less than three weeks after the end of the Brussels conference.⁶⁴²

Among the other recommendations of Brussels that Finland observed, the state budget was balanced in 1921 and most of the government's short-term debt to the Bank of Finland was paid during 1922. At the end of 1920 the Bank of Finland's portfolio had contained 304 million markkaa of government bills of exchange but by the end of 1922 there were only 72 million left. The entire government debt to the central bank was not paid off before 1928, though.

Finland was one of the countries that succeeded in obtaining credit from the United States when hostilities had ended. In 1919 and 1920, even before the Brussels conference, it had negotiated a five-million markka loan from US Grain Corporation for grain purchases from the United States. Of the dollars thus obtained, half were given over to the Bank of Finland.⁶⁴³

FROM EXCHANGE CONTROLS TO CREDIT RATIONING

When the foreign exchange controls, introduced in July 1918, were terminated at the close of October 1920, monetary policy had to be tightened. To do this, the Bank of Finland resorted to quantitative limits on its own domestic lending, controlling the volume of rediscounting instead of raising interest rates. By credit rationing it obviously had some success in curbing the growth of money supply because the fevered stock exchange speculation that had begun after the civil war now abated and bank lending began to grow more slowly. After foreign exchange controls were dismantled, the Bank developed new ways of coping with a floating exchange rate even if its foreign

currency reserves were very small. It did so by currency market interventions and by restricting currency trading to licensed banks and banking houses.

The bank set about raising the markka exchange rate in December 1920, soon after foreign exchange controls had been lifted, by means of market interventions via a couple of small banks in Stockholm. Korpisaari described this as the “first experiment in foreign exchange policy”.⁶⁴⁴

The new Economic Council, set up by the Finance Ministry in summer 1921, presented its report on 10 November. It singled out the trade balance as the key to stabilising the value of Finnish money. In its view “the value of our currency under present conditions depends principally on our balance of payments, which has been adversely affected by the large export deficits of recent years and consequent foreign indebtedness.” Nonetheless the Council felt that foreign exchange policy measures could be useful for stabilising the markka. It acclaimed the newly introduced system of limiting currency trading to a few licensed banks. Because these banks and banking houses were now dependent on a permit from the Finance Ministry and its renewal, they had “at the initiative of the Bank of Finland began to act in ways that have had a positive effect on the value of the Finnish markka”.

The Council urged the Bank of Finland “to participate more effectively in foreign exchange trading”. It recommended that the exchange rate should no longer be allowed to float freely and proposed that the bank adopt the principle of “leaning against the wind”. It should smooth exchange rate fluctuations “by buying a significant volume of foreign currencies when their exchange rates were falling, thereby preventing the markka rate from climbing while also building up foreign currency reserves”. By selling this reserve when foreign currencies appreciated, the bank would correspondingly control exchange rate movements in the reverse direction. “The Bank of Finland should make stabilisation of the markka’s value its primary objective,” the Council recommended.⁶⁴⁵

In autumn 1921 the Bank of Finland purchased markkaa in Stockholm to raise the value of the currency. These market interventions of October-November took place at a time when the markka had just passed its lowest point. In September the Bank of Finland had been quoting the dollar as high as 80.50 markkaa and on the free market in

Helsinki the rate had been even higher, 84 markkaa. The markka subsequently began to strengthen and by the end of the year a dollar was worth only 53.25 markkaa. The Bank of Finland's small currency interventions cannot be seen as having played a large part in stabilising the markka in autumn 1921. The more probable cause was that Finland's payments account was stronger because export markets had recovered after a couple of poor years. Perhaps the improved state of public finances in autumn 1921 also helped.⁶⁴⁶

GENOA CONFERENCE

In 1922 the governments of France and Britain sponsored a new international conference aimed at getting the United States involved in an international economic partnership. It was held in Genoa, Italy from 10 April to 19 May 1922, at a time of great political instability in Italy; just a few months later the fascists marched on Rome and Mussolini became prime minister. There were 34 countries at the Genoa conference, including Germany and Soviet Russia, which had not been present in Brussels. Finland's delegation was larger than in Brussels. It was led by prime minister Juho Vennola and contained Ernst Nevanlinna, the deputy chairman of the supervisory council of the Bank of Finland and council member Väinö Tanner, a member of parliament and chairman of the Social Democrats. Politically the delegation was very influential, containing the top men from the National Progressive Party, the National Coalition Party and the Social Democratic Party. But for some reason chairman Stenroth of the Bank of Finland's board and Finance Minister Risto Ryti, who later became governor of the central bank, did not participate.

The Genoa Conference unanimously adopted a 12-point communiqué that was intended to guide the various countries in fixing their currencies to the gold standard. The monetary policy contained in the communiqué was largely the work of R.G. Hawtrey of the British Treasury.⁶⁴⁷ The recommendations aimed at conserving world stocks of gold, in order to avoid a situation where a return to the gold standard would have increased the demand for gold. It was feared that rising demand for gold would cause a shortage of international liquidity and a general deflation as the price of gold would rise against other commodities.

Two means were advanced for reducing demand for gold in the new international monetary system. Firstly, central banks were to be able to treat currencies of other gold standard countries as gold cover for their banknotes. The world's central banks would have been divided into gold centres (such as London and Paris) and peripheral countries, whose reserves would have been partly in the form of currencies – pounds, francs or dollars – that were themselves convertible into gold. The new system would be a gold exchange standard, rather than the simple gold standard that had demanded banknote cover in the precious metal itself.

In addition to minimising the need for gold reserves, the communiqué also sought to avoid the use of gold as a monetary metal in general circulation. It recommended that central banks not be required to redeem their notes in gold coins. It would suffice that the banknote redemption requirement could be fulfilled in gold bars. It would be a gold bullion standard rather than a gold coin standard. Gold coins would not have to be minted and the use of gold metal as a medium of payment would be minimised, except in settlements between central banks.

Regarding ways of introducing the gold standard, the recommendations of the Genoa Conference followed the conclusions of the Brussels Conference. The prerequisites for monetary stability were central bank independence and government budget balance. According to the communiqué, fixing the gold value of a currency was a step which could only be taken after these prerequisites had been achieved. Once the economic conditions had been met, a country would be able to decide whether to revert to its old gold parity or adopt a new one roughly equivalent to the exchange rate of its currency at the moment the decision was taken. This reference to a later choice in choosing the gold parity was the only part left of a formulation sought by British delegates, who had wanted a country whose currency had lost more than 20 % of its value to be required to “devalue”. In Britain's view, such countries ought to choose a new gold parity corresponding to the actual exchange rate. The French resisted this stipulation because their official policy at the time was still to return the franc to its pre-war value in gold, regardless of the fact that its market value was now 60 percent lower.

The communiqué of Genoa also tried to draft ways of making gold standard operations less sensitive to cyclical conditions and crises than

the pre-war classical gold standard. It sought an international monetary treaty for cooperation between central banks, intended to stabilise the value of gold (meaning the general price level in gold standard countries). Nothing came of the plan, though.⁶⁴⁸

In the view of Finnish delegation member Väinö Tanner, the Genoa conference failed entirely in its main purpose, which he regarded as a rapprochement between Soviet Russia and the Western allies.⁶⁴⁹ On the other hand, in the three years after the conference, Finland did stabilise its monetary system in almost exactly the way that Genoa had prescribed. This was done despite the fact that an expert assessment, requested by the supervisory council from Professor Eli Heckscher soon after the conference, took a different tack from Genoa in several respects. This reinforces the impression that, for Finland, this was a conference of considerable importance.

BACK TO THE GOLD STANDARD

SWEDEN LEADS THE WAY

Sweden was to be the first country in Europe to reinstate the gold standard. Due to its neutrality during the war, the country was in an unusual position. In principle the Bank of Sweden had been prepared to redeem banknotes on demand for gold since the start of 1916, during the war, but because the krona was above its gold parity at that time, hardly any notes were exchanged. The redemption requirement thus had no significance nor was the gold standard actually in force. The krona was strong because of Sweden's great trade surplus during the war and because, in 1916, Sweden had suspended the regulation compelling its central bank to buy gold at its official rate.⁶⁵⁰

After the war had ended, the krona began to fall steeply and dropped below its gold parity during 1919. It dropped so fast that by February 1920, after just a few months, the krona was on average 31 % below its parity with the dollar. According to the letter of the law, the krona was still redeemable for gold, but this did not prevent the exchange rate falling because (in accordance with an agreement with its partners in the Scandinavian Monetary Union) Sweden had imposed a ban on gold exports. The ban isolated Sweden from the gold market of New York and meant that international arbitrage did not hold the krona exchange rate close to its gold parity.

Economic experts in Sweden were fiercely critical of monetary policy, which they thought to be too easy and the cause for the krona's decline against the dollar and gold. Many believed that instead of

accepting inflation, Swedish monetary policy should have sought to return prices to their pre-war level. However, measured by the cost of living index in 1920, Swedish prices were now 2.7 times higher than before the war so a return to the pre-war price level would have required extremely tight, deflationary monetary policy, principally through higher interest rates and lending restrictions.

During 1920 Swedish monetary policy was indeed severely tightened, leading to strong deflation in 1921–1922. On the one hand this caused considerable economic harm but on the other it created preconditions for a return to the gold standard at the old parity. Tighter monetary policy was at least partly a consequence of pressure from academic economists. To force the Bank of Sweden to raise interest rates, Professor Eli Heckscher published an article in Stockholms Dagblad newspaper on 11 March 1920, pointing out that banknotes truly were convertible into gold and that this was a way to obtain gold from the Bank of Sweden far below its international market price. The article aroused great interest and the supervisory council of the Bank of Sweden responded on the same day by asking the government to abolish the banknote redemption requirement. The Swedish prime minister Hjalmar Branting compared Heckscher to a saboteur. Sweden was not yet willing to return to the gold standard so banknote convertibility was suspended by royal decree on 17 March and the discount rate was raised by one percentage point. The fluctuation band for the Swedish krona had now lost both its limits, the ceiling of the gold purchase requirement and now the floor of the banknote redemption requirement.⁶⁵¹

From spring 1920 the krona was in entirely the same position as the other currencies that had left the gold standard and lost value. Even so, the suspension of convertibility and the related hike in interest rates (at a time when the international upswing was flattening out) had halted the rise in prices and pushed them sharply into decline by the second half of 1920.

In spring 1921, with deflation in full swing, questions began to be raised about whether it was sensible to try to return the currency to its old gold parity. The banking committee of parliament now felt that a continuing fall in prices would be intolerable over the longer run and that the future exchange rate between the krona and gold could not be predetermined. At the same time, however, the committee set

the objective of a return to the gold standard, so the undrawn conclusion was that the krona's official value in gold would have to be lowered at that time. In spring 1921 the krona was about 13 % below its parity against the dollar. Despite the committee's stand, a majority in parliament supported the policy of Finance Minister Beskow to target the old parity if possible. At this point, then, the official Swedish line was to wait and see; the objective was the pre-war gold parity but without a schedule for achieving it or fixing the krona to the gold standard.⁶⁵²

A year later, in March 1922, Sweden's parliamentary banking committee reiterated its support for a return to the gold standard if possible and urged planning for its implementation. Meanwhile, it extended the Bank of Sweden's exemption from the obligation to redeem its banknotes. During the year the Swedish krona strengthened to a level close to its gold parity (calculated from its dollar exchange rate), and remained fairly close to parity from then onwards, although nearly one and a half years would elapse until the official return to the gold standard.⁶⁵³

Thus, in 1923, Sweden already enjoyed considerable exchange rate stability, close to gold parity but without the final seal of the gold standard, banknote convertibility. The leadership of the Bank of Sweden was particularly apprehensive about restoring convertibility and going on the gold standard before Britain. Responding to an enquiry from parliament about whether banknote convertibility should remain suspended, the central bank council said in spring 1923 that if Sweden were to be the only country in Europe to reinstate the gold standard, it would become linked to the American price level, which faced an uncertain future. The council members felt that a better course would be to proceed at the same pace as Britain: "Conditions would be different if our country went on the gold standard together with Britain (...) when the burden of maintaining price stability would surely be borne by Britain."⁶⁵⁴

Although the Bank of Sweden remained uneasy about an irreversible return to the gold standard, there was a growing political commitment to maintaining the exchange rate that had been achieved, equivalent to the old gold parity. While approving an extension of the central bank's exemption from redeeming banknotes, Parliament noted that it was postponing a return to the gold standard only on condition that

monetary policy would nonetheless be managed as if the gold standard were in force. The central bank council was therefore to maintain a stable krona exchange rate and could deviate from the current rate only in conditions which, under the gold standard, would have caused the same deviation.⁶⁵⁵

As late as spring 1924 governor Moll of the Bank of Sweden and the supervisory council of the bank proposed postponing the return to the gold standard on the same grounds as the year before; as Europe's only gold standard country, Sweden's money market might be subject to gold speculation. There had been unrest on the Swedish foreign exchange market during the preceding winter. When the Bank of Sweden had responded by restricting its currency sales, a parallel set of market-driven dollar quotations had emerged that was somewhat different to the bank's own quotations. But, despite the views of the central bank governor and the council, parliament restored the Bank of Sweden's obligation to redeem its banknotes on 1 April 1924. Sweden had become the first European country to return to the gold standard after the First World War. The decision had been made for political reasons and contrary to the central bank's wishes.⁶⁵⁶

MARKKA MOVEMENTS AND THE HECKSCHER REPORT

Sweden's resolution of the gold standard question was naturally important for Finland. Apart from serving as a practical example, Sweden also provided an intellectual stimulus in economic policy, as it had before and would again. On 30 June 1922, just a few weeks after the Genoa conference had ended, Finland's parliamentary supervisory council decided to request expert foreign opinions on how the value of money could be stabilised. It turned to the renowned Swedish professor Eli Heckscher and a Finnish-born Swedish banker Karl Langenskiöld, who had been governor of the Bank of Sweden. Langenskiöld (the son of Senator Fabian Langenskiöld, "father" of the Finnish markka) declined so Heckscher's report was the only expert statement received on a return to the gold standard.⁶⁵⁷

Heckscher was a firm believer in the gold standard. In Sweden's debate on foreign exchange policy, he had advocated an early return

ELI HECKSCHER (1879–1952)

Eli Heckscher is one of the top international names of Swedish economics, both as a theoretician and an economic historian. As an invited expert advisor, he had a major influence on Finnish economic policy in the 1920s, when the markka was re-fixed to the gold standard after the monetary chaos caused by the First World War and Finland's civil war.

Heckscher studied first at Uppsala University and then under Professor Gustaf Cassel at Stockholm. His main subject was history but he specialised in economic questions from the outset and even the theme of his doctoral thesis was the importance of railroads for Swedish economic development.

When the Stockholm School of Economics was established in 1909, Eli Heckscher was appointed professor but his uncompromising opinions, regarded as arrogance, led to a falling out with many colleagues. In 1929 he was offered the opportunity to give up teaching and start running an institute of economic history research, established alongside the School. It was there that he wrote his great work "*Sveriges ekonomiska historia från Gustav Vasa*", presenting the entire economic history of Sweden.

In the field of economic science Heckscher is best-known for the Heckscher–Ohlin model of international trade, developed together with his student Bertil Ohlin. The theory explains the structure of trade between countries

by the relative abundance of their factors of production and explains why capital-poor countries export labour intensive products. At the same time it predicts that free trade will lead to international convergence between relative prices of factors of production.

In June 1922 the supervisory council of the Bank of Finland requested a statement from Heckscher on how the value of Finnish money should be stabilised. His report was ready by August the following year. In the debate in Sweden, Heckscher had taken the "realistic" view that the krona should be fixed to gold as soon as possible and at the prevailing exchange rate, without trying to restore money to its pre-war value. This view did not prevail in Sweden but it became the basis for Finnish gold standard policies. Although not all of Heckscher's proposals were implemented in Finland, his report constituted a major premise for the work of Finland's gold standard committee.

Eli Heckscher served for many years on the board of Sweden's National Economic Association but resigned in a dispute over the status of the Finnish language. He was opposed to the use of Finnish in Nordic economic conferences and when it was decided that the Finnish language would be permitted, albeit with Swedish interpretation, at a conference in Helsinki in 1938, he resigned from the board.



■ The renowned Swedish economist Eli Heckscher. At the start of the 1920s, he was asked by the Bank of Finland for his views on how the value of Finnish money should be stabilised.
– Otava picture archives.

to the gold standard and at the prevailing depreciated exchange rate. He had opposed deflation, which he believed would be required by a return to the old gold parity. On the other hand he was doubtful about purchasing power parity, the theory of his mentor Gustaf Cassel that was very influential in the 1920s. In Cassel's view, the guideline for fixing exchange rates should be the relative rates of inflation since 1914 in the countries in question.⁶⁵⁸

The Finnish markka began to appreciate strongly in October 1922 and in the first few days of November. It was a very abrupt turn that completely changed monetary conditions. Since 1919, the Bank of Finland's foreign currency reserves have been very small and the money market very tight. The bank took advantage of the new situation and purchased large quantities of foreign currencies, raising its currency reserves greatly. On 4 November it instructed its agent in Stockholm to sell unlimited amounts of markkaa so as to prevent the currency from rising above 40.25. The Finnish discount rate, which had been 9 percent, a very high rate by international standards especially when inflation had fallen, could now be lowered to 8 percent (10 November 1922).⁶⁵⁹

Professor Heckscher was alarmed by the markka's fast climb in November and redoubled his efforts to complete the expert statement requested from him. In a letter to Wille Lavonius, chairman of the supervisory council, on 26 November, Heckscher said that he had already begun a memorandum on stabilising the Finnish currency but that it had unfortunately been superseded by more pressing work. Now that the markka had started to rise, Heckscher said he would now give priority to his report for Finland.

In his letter he warned of the danger of a "deflationary crisis" facing Finland, which could result from the markka's fast climb, a situation that he had no doubt was "inappropriate". He was convinced that the most certain way to avoid such a crisis was to immediately link to the international currency system in one form or another, because the price level in other countries was stable or even slightly rising.⁶⁶⁰

Heckscher's report was completed in August 1923 but was not published in printed form until the start of December. The main theme was his recommendation of a return to the gold standard at the prevailing exchange rate. At the start of his report he summarily

disposes of the idea of a “free” monetary system, meaning one not based on a metal standard. He admits that the purchasing power of gold fluctuates and that “if the matter is viewed merely from the perspective of principle, the ideal could hardly be other than keeping the value of money itself – i.e. the purchasing power of the monetary unit measured in goods – as steady as possible, because this state of affairs is a prerequisite for the undisturbed flux of economic life”. One might imagine that stability in the general price level would make a better benchmark for monetary policy than stability in the price of gold, but Heckscher points out that the weakness of such a system is that the exchange rates of “free currency” countries would fluctuate constantly, thereby destabilising the value of money in the very countries that were trying to stabilise it.⁶⁶¹

Heckscher also points out that, while a system of floating exchange rates independent of gold allows the domestic value of money to be fixed, it also contains the possibility for unlimited fluctuations in the value of money. Examples of this were countries such as Germany, which suffered hyperinflation after the World War. Heckscher’s report therefore rejects a permanently floating exchange rate, the alternative that Keynes recommended in his article in the *Manchester Guardian* newspaper in 1922 and on the basis of which he wrote his famous work “A Tract on Monetary Reform”.⁶⁶² Heckscher opts for the opposite, fixing the markka’s value in gold.

Next he rejects the idea of raising the markka’s value to its old, pre-1914 gold parity. In his view it was entirely unrealistic because it would have required a reduction in the general price level in Finland to about a seventh of the level of 1923. Heckscher comments that “one cannot find many examples of a monetary unit that has been successfully raised back to its old gold parity after having lost more than half of its value.” The reason for this, he indicates, is the social cost imposed by deflation: “Nothing paralyses all economic activity so completely as a long-term, steep fall in prices”. This had been experienced in 1920–1922 in various western countries, where the general price level had fallen greatly, causing losses “some of which can be measured in economic terms and some which cannot”. Heckscher’s home country, Sweden, was a prime example; in a two-year period to 1922 the krona had been raised to its pre-war exchange rate, a rise of as much as 30 % (against the dollar), with a corresponding fall of about 30 % in consumer prices.⁶⁶³

At the same time as he warned the Finns against attempting to carry out deflation, he congratulated Finland for allowing the markka to fall by about the same amount as gold had risen against merchandise. Finland's price level had remained unchanged (since early 1921) while Sweden and other countries were suffering deflation.

Heckscher thus reached the conclusion that the markka should be fixed at its prevailing value but he still needed to decide whether its value should be based on purchasing power parity or the prevailing market rates. After the spread of Gustaf Cassel's theory of purchasing power parity, Finns had often tried to use Cassel's principles to find out whether the markka was undervalued by its exchange rate. Heckscher, however, was extremely critical of Cassel's theory in general and this shows in his report on Finland.

The general view in Finland was that the markka was undervalued abroad, but Heckscher thought that the theory of purchasing power parity was erroneous in its assumptions and that calculations based on it were unreliable. His report tried to show that the calculations gave partially contradictory results for 1923 depending on whether they were based on wholesale price indices or cost of living indices. His conclusion was that the belief in an undervalued markka was unjustified and that it would be wiser to accept the markka's current (summer 1923) dollar exchange rate as the level at which it should be fixed.

Heckscher's report then moves on to consider the size and name of the future monetary unit. In his view the name "markka" could not continue to be used unless the new unit had the same gold content as the former gold markka. Even then he felt that it was not entirely proper to keep the old name. In any case, because he had recommended the markka's "devaluation" (meaning a reduction in its official gold value), he recommended a new monetary unit with a new name. He proposed the "talari".

As for the value of the new unit, Heckscher thought it should have a simple relationship to some major foreign currency unit. He considered the idea of a unit of the size used in the other Nordic countries, so that Finland could join the Scandinavian Monetary Union although, at this time, the operation of the Union was suspended in practice. Ultimately he decided to propose that the value in gold of Finland's new unit of currency should be $\frac{1}{20}$ of an English pound so it

would be the same as a shilling (at the time there were 20 English shillings in the pound). Thus the gold content and value of Finnish 20 and 10-talari coins would be exactly the same as the familiar British one-pound and half-pound coins, the gold sovereign and half sovereign. In this case, the markka would be ultimately fixed at 36.9 per gold dollar. The other alternative Heckscher presented was for Finland to return to the gold standard at a level where the new markka would be worth $\frac{1}{7}$ of the old gold markka. In this case the rate would have been 36.26 to the dollar.

In his report Heckscher distanced himself from the recommendations of the Genoa conference regarding the type of gold standard. For reasons discussed above, Genoa had decided to recommend that most countries should adopt a gold exchange standard in place of a proper gold standard. Convertibility requirements could thus be met by reserves of currencies backed by gold and not necessarily the metal itself (in coins or bars). In Heckscher's view, the gold exchange standard did not offer enough certainty that the value of money would truly remain unchanged; its only guarantee of exchange rate stability was that the central bank was required to maintain parity against foreign currencies while, under a proper gold standard, exchange rate stability was certain as long as banknotes were redeemable. In Heckscher's view the gold exchange standard "cannot be regarded as an option for the permanent shape of the monetary system of Finland". Monetary stability should be founded on the proper gold standard.⁶⁶⁴

DE FACTO DOLLAR PEG

Soon after Heckscher completed his report, the markka began to weaken against the dollar. In November 1923 the rate of decline increased despite support by the Bank of Finland, which used its foreign currency reserves to purchase markkaa. In a few weeks the bank lost a third of its currency reserves. This made action imperative and on the last day of November the bank raised interest rates steeply by two percentage points. The lowest discount rate was now 10 %, the highest in the bank's history to date.⁶⁶⁵ On the same day it abandoned its previous exchange rate policy which, in modern terms, would be called managed floating, and moved to a pegged rate. The exchange rate was now to be held at 40.50 markkaa to the dollar, meaning an

overnight devaluation of 4 %.⁶⁶⁶ Since 28 August, the date recorded in Heckscher's report, the markka had already dropped 11 %. It had now been fixed at a rate that was 9 % lower than the report had recommended – 36.99 per dollar.

In January 1924 the government of Prime Minister Kallio resigned and Risto Ryti, who had been serving as finance minister, finally took up the post of governor of the Bank of Finland, to which he had been appointed a year earlier. Kallio's first government fell because of disagreement with President Ståhlberg about early elections.⁶⁶⁷ Ryti took up his position at a time when the markka had just been pegged, at a rate that was only about two percent weaker than the level at which it was formally fixed two years later. The question of when Finland would go on the gold standard was still entirely open, nor had the ultimate fixed exchange rate been decided.

Finland's move to the gold standard was decisively influenced by the currency policies adopted by the foreign powers most important in its foreign trade. Their policies were conclusive for the timing of Finland's decision, while the role of the Brussels and Genoa conferences was in helping to shape Finland's view of the policies required for monetary stability, including a balanced budget.

The benchmark country for Finland's gold standard decision was Great Britain. In the years leading up to Finland's return to the gold standard, Britain already took about 40 % of Finnish exports, and no other country came close. Sweden and Germany provided Finland with far less foreign currency. In 1923, for example, they each took just six percent of Finnish exports while Great Britain's share was 41 percent, hence the dominant role of British currency policy. At the start of 1924 this meant that Finland's policy would be largely one of wait and see, because Britain's decision on the gold standard was more than a year off. Sweden mattered too, because the markkaa exchange rate was determined mostly on the Stockholm foreign exchange market, at least in the view of contemporaries. Most trade in Finnish markkaa had shifted to Stockholm during the First World War.

Other countries had less impact on Finnish currency policy although, for example, Germany's return to the gold standard in 1924 did significantly raise the share of gold currencies in Finnish foreign trade. Germany was the source of about a third of Finnish imports in 1922–1924, so it was almost as important for imports as Britain was for

Finnish exports. However, Germany's gold policy was motivated by such extraordinary and exceptional factors that it could not serve as a model for Finland. Germany hyperinflation had, by 1923, rendered the old unit of currency practically worthless. It needed a new gold Reichsmark that represented an entirely new beginning.

FINLAND'S GOLD STANDARD COMMITTEE

Preparations for the Finnish markka's return to the gold standard gained fresh impetus at the start of 1924 after Risto Ryti had become chairman of the Bank of Finland board of management. The first lines of reasoning for the markka's value were set out on 12 January at a meeting of the supervisory council, at which Ryti was present as the appointed governor although he had not yet taken up the post. The markka then stood at 40.18 to the dollar.

Council chairman Lavonius stated that the markka again needed to be reinforced against the dollar. He also proposed that the bank should approach the government and suggest the establishment of a committee to prepare a monetary reform. He thought a memorandum should be sent to the government, stating that the exchange rate prevailing before the markka's deterioration in autumn 1923, 37.20–36.05, had been suitable in terms of the markka's purchasing power. Lavonius felt that a good fixed rate would be 37.31 because it had a simple relationship to the gold value of the Swedish krona. The markkaa would thus be fixed at one tenth of the value of the krona, and a new monetary unit could be created that was equivalent to a krona or half a krona.⁶⁶⁸

The council did not adopt Lavonius' proposal and instead set a moderate short-term exchange rate (then 40.50–39.50). The subject of the markka's future fixed rate came up again at a supervisory council meeting on 21 February. Governor Ryti noted that the preceding spring had appeared to be a suitable time for setting a fixed rate but that turbulence in the foreign exchange market had delayed the matter. Now that the market had calmed down, Ryti said that he had talked with the members of the inner supervisory council and agreed that the board would make a statement on what he called the "devaluation point", meaning the markka's future fixed rate.

■ In the 1920s and 1930s the Bank of Finland played a strong role in influencing the nation's economic policy. Its influence was consolidated by the unchallenged authority achieved by Risto Ryti, who was appointed governor at the age of 34.

– Otava picture archives /
Theresa Bonney.



RISTO RYTI (1889–1956)

Of the bank's governors, Risto Ryti may have done the most to make the position so prominent and esteemed in Finland. During his long term the Bank of Finland became the focal point of Finnish economic policy, operationally and intellectually.

The son of a wealthy freehold farmer from Huittinen, Ryti obtained his degree in jurisprudence from Helsinki University at the age of only 20 and began work as a lawyer. On the eve of Finland's civil war, while serving as legal adviser to Alfred Kordelin, a major industrialist and businessman, he witnessed Kordelin's murder by red Russian sailors at Mommila in autumn 1917. The lives of Ryti and his young wife Gerda also hung by a thread at that time.

He was elected to parliament as a representative of the National Progressive Party in 1919 and two years later became Finance minister in J. H. Vennola's second administration. As a minister Ryti was successful in balancing public finances, an essential precondition to stabilising the value of money after years of raging inflation. He left the finance ministry to become governor of the Bank of Finland in 1924.

As an individual Risto Ryti was regarded as exceptionally intelligent but very reserved. Even so, he managed to build up a network of international relations that was exceptionally large for the time and he enjoyed esteem in banking circles abroad as well as at home. In economic policy he can be seen as a

liberalist, supporting conservative principles, monetary stability and a balanced budget, but he saw the development of export industries as the key to Finnish prosperity. After the international gold standard collapsed in 1931, he focused on making Finland's balance of payments stronger, in order to reduce its dependence on international credit markets.

After the outbreak of the Winter War he was appointed prime minister. In this capacity he travelled to Moscow to agree on peace terms while fighting on the front was at its fiercest. After the resignation of President Kallio, he was elected president in December 1940. As a wartime president, he is remembered particularly for the letter that he wrote to Hitler after the start of a major offensive by the Soviet Union in June 1944. In it, he promised that Finland would continue to fight alongside Germany, in return for military aid. Five weeks later he resigned the presidency, giving Finland a free hand to disengage from the war.

After resigning, Ryti returned to the Bank of Finland but his position was untenable in the new political circumstances. At the demand of the supervisory council he tendered his resignation in June 1945 and he was put on trial for culpability in the war later the same year. He was sentenced to 10 years imprisonment and served three of them before being pardoned by President Paasikivi in May 1949. By this time he was incurably ill.

Lavonius, who had raised the matter back in January, now commented that “the matter had not been premature” and that unless “the devaluation point were fixed, the bank’s operations would lack a firm objective, which might easily lead to vacillation”. The council then approved a statement that “currency policy measures should target a dollar/markka exchange rate that would allow the adoption of a fixed rate of 37.30”. This was the same as Lavonius had asked for in January, and almost the same as Heckscher had proposed, but it was 7 % below the quotation on the day. The council proposal therefore implied that the markka should be strengthened.⁶⁶⁹

In practice, the board did not take steps to bring the dollar rate into line with Lavonius’ proposal and the council’s stated objective. While naturally abiding by the target set by the council, the board suggested that the dollar rate should be brought down only as and when the pound rate rose. At the time the pound was about 12 percent below its gold parity. Before long, Britain was expected to return to the gold standard at the pound’s old parity, so the pound would strengthen. If the dollar rate were lowered in step with a rising pound rate, Lavonius’ target rate could be achieved without raising the average value of the markka to the detriment of exporters.

In May, Wille Lavonius was replaced on the supervisory council. His term ended, he was not re-elected and his place was taken by Hugo Wasenius (subsequently Vasarla), the managing director of the Central Organization of Cooperative Retail Associations, SOK. Ernst Nevanlinna, previously the deputy chairman, took over as chairman of the council. If Ryti and Lavonius had differed over currency policy, Lavonius’ effort to force the board to raise the markka’s external value had now been resolved in Ryti’s favour.

In the late summer the council discussed the exchange rate question again, now under chairman Nevanlinna. At that time, on 22 August 1924, Ryti pointed to the difficult conditions in the foreign exchange market. During the first half of the year the bank had lost more than half of its currency reserves and in July had needed to draw down a foreign loan, agreed in January, to reinforce its reserves. He also noted that the pound’s exchange rate had risen, which should have led to a corresponding reduction in the dollar rate if the bank had followed the council’s instructions given at the start of the year. “However, in view of the sensitivity of the timber

market at that point and uncertainty about the permanency of the pound's appreciation, the board regarded it as more fitting to leave the dollar exchange rate unchanged". Chairman Nevanlinna of the supervisory council made no criticism of this violation of the council's instructions, and said he felt the board had acted correctly in not lowering the dollar exchange rate as the pound rose. "It is true that (this) was previously the intention among council members and that instructions to that effect were issued to the board (...) However, in view of the longstanding nature of the present dollar rate, and the fact that holding the pound rate unchanged would have placed our timber industry in a position of disadvantage relative to competitors in countries where the value of the currency did not appreciate with the pound, there would seem to have been no reason to push the dollar price lower". The replacement of Lavonius by Nevanlinna had clearly swayed the council's view of exchange rates.⁶⁷⁰

At the time of this council meeting, the dollar rate was 39.85, practically the same as it had been in February when the board had been instructed by the supervisory council about the conditions on which it should be lowered. Exchange rate movements in the months ahead were also quite marginal, up till early November when it was frozen at 39.70. The same rate would be written into law when Finland officially went on the gold standard in just over a year's time.

The alternatives for the gold value of the markka were 37.31 advocated by Lavonius and 39.70 implemented by Ryti. The choice was made during the period that began in spring 1924 after Lavonius had left the scene and ended in autumn of the same year, when the council sanctioned the board's decision not to react to the stronger pound. The difference between the alternatives was about 6.5 % and of course it is very difficult to say what would have happened to the economy in the years ahead if Lavonius' "strong markka" had been implemented instead. Later studies have regarded the rate chosen as something of an undervaluation.⁶⁷¹ On the other hand inflation did not accelerate in the 1925–1927, as would have been expected if the markka had been fixed at a distinctly undervalued level. On the contrary, the price level remained rather stable, measured by both the wholesale and consumer price indices. At the same time Britain, Finland's main export market, suffered deflation, so a hypothesis could be made that, by choosing a slightly undervalued rate, Finland may have avoided a similar deflation

and that the exchange rate proved to be right for price stability, at least over the next few years.

The contemporary official view favours the argument that a slightly undervalued rate was deliberately chosen. Writing in the *Bank of Finland Yearbook* in spring 1925, K.J. Kalliala comments: "Certainly at the end of the year timber prices improved and the rise of the pound became so significant that timber sales could resume. But at that time the higher dollar rate (for the markka) had already been in force for so long that it seemed belated to change it. Furthermore, in a country that imports capital, it is wise to give the currency a gold value that is slightly too low rather than too high, so as to avoid suspicions that foreign loans are being used to hold exchange rates artificially lower than the domestic purchasing power of the currency would justify."⁶⁷²

Now that the markka exchange rate had, in effect, been locked, all that remained was the official implementation of a gold standard. At Ryti's proposal, the supervisory council established a committee on 13 November 1924 to prepare the gold standard's return. One of the councillors, Väinö Tanner, believed that the question was still premature but concurred "because setting up a committee does not mean that the measure will be put into effect but only that the preparatory steps will be taken". Councillors Ernst Nevanlinna, Väinö Tanner, Hugo Wasenius and E.Y. Pehkonen were appointed to the committee, along with the governor of the bank Risto Ryti. Representatives of the private sector – chief general manager J.K. Paasikivi of *Kansallis Bank*, board member J.O. Wasastjerna of the *Nordic Union Bank* and managing director Einar Ahlman of *Kymi pulp and paper company* – were also invited.

The gold standard committee was given a six-point mandate. It was to explore what a successful transition to the gold standard demanded from the national economy and the Bank of Finland. It was to examine the methods and measures that would create these preconditions. It was to propose the gold value of the markka and to consider the possible adoption of a new monetary unit. And it was to draw up proposals on the legal changes required.⁶⁷³ The committee began work on 26 November, when Nevanlinna was elected chairman and K.J. Kalliala, head of the Bank of Finland's statistical department, was appointed secretary. The committee decided to follow a programme of work prepared by Risto Ryti, a sign of the governor's key role.

Its report was completed on 1 April 1925. The committee felt that the only realistic alternative was for the markkaa to have the value in gold at which it had already in practice been fixed. The parity recommended, 39.79 markkaa per gold dollar, was in fact slightly weaker (by about 0.2 %) than the rate of 39.70 at which the markka had been held since 5 November 1924. The reason may have been that, by choosing a gold value that was marginally weaker than the prevailing exchange rate, a flight of gold from the country could be prevented. Although the committee endorsed the Heckscher report, insofar as the markka was fixed at its prevailing value, the rate against the dollar proposed was about seven percent weaker than Heckscher had recommended.⁶⁷⁴

On 24 April, soon after the committee's work was complete, Risto Ryti made a presentation to the Finnish Economic Society in which he presented broader arguments for a return to the gold standard and explained the proposals of the committee. In his analysis of the gold standard, he looked at the advantages and drawbacks of a "managed currency", as proposed by Keynes. He conceded that there was a conflict, pointed out by Keynes in 1923, between exchange rate stability and price level stability but he believed that practical considerations argued for exchange rate stability and therefore the gold standard, especially in a small country such as Finland that was dependent on foreign trade. In fact, Keynes had explained that his recommendations really referred only to Britain and the United States and that other countries should peg their currencies to either the dollar or the pound. For European countries he recommended the pound.

Ryti believed that the gold standard would again become the international monetary system and that the main reason for joining it was to establish the nation's creditworthiness; "Finland has rich, unexploited natural resources and a relatively fast-growing population, so it is clear that we will long remain a country that imports capital. But our foreign credit will depend greatly on the degree of trust in our monetary system." He pointed to Sweden, noting that its move to the gold standard had reinforced its credit and that Swedish interest rates had remained low while rates elsewhere were generally rising. He summarised his position rhetorically: "To have a good monetary system is not enough, we need one that enjoys foreign trust." This trust had increased at the start of February, when Ryti had travelled to the

United States and negotiated a 25-year loan of 10 million dollars to the government of Finland, to be used for building up the Bank of Finland's foreign currency reserves.⁶⁷⁵

BRITAIN RETURNS TO THE GOLD STANDARD

There are interesting parallels between events in Finland and Britain at this time. Although Sweden was already on the gold standard, it was hardly realistic for Finland to move to gold before a decision had been taken in Britain, by far its largest export market. Britain's decision had been slow in coming but by spring 1925 it was becoming germane, at the same time as the Finnish gold standard committee was sitting. The British Chancellor, Winston Churchill, reached his decision on 3 March, when Finland's gold standard committee was in its final phase. Britain's decision was officially published on 28 April, almost a month after the Finnish committee had delivered its report. Ryti's presentation to the Economic Society came four days before Churchill's announcement, vindicating Ryti's prediction to the Society that Britain would formally return to the gold standard by the end of the year at the latest but "in reality this may occur even earlier."⁶⁷⁶

A committee had been set up in Britain at the start of 1918 to examine the monetary problems of (post-war) reconstruction and "to report upon the steps required to bring about the restoration of normal conditions in due course."⁶⁷⁷ The committee, chaired by governor Walter Cunliffe of the Bank of England, published its interim report in August 1918 and its final report in December 1919. It called for an early return to the gold standard and tight monetary policy to facilitate this but its recommendations were not observed. The return to the gold standard was postponed after a steep fall in the pound's exchange rate and a post-war international recession. It became politically (and perhaps also economically) unrealistic to expedite the pound's return to its old gold value by means of tight monetary policy. Consequently, when the gold market was opened in the United States and currency controls to support the pound were ended, Great Britain responded by prohibiting the export of gold in spring 1919. This foretold that Britain's return to the gold standard would be delayed. At the same time, it eliminated barriers to a falling exchange rate. The pound continued to drop

steeply; by spring 1920 it was already 23 % below its parity with the dollar and gold.

While Finland (and Sweden) were considering exchange rates and the gold standard from 1923 onwards, the only generally known vector for assessing when Britain would return to the gold standard was that temporary British legislation of 1920 forbidding the export of gold would expire at the end of 1925.⁶⁷⁸ Whether this marked the actual date of return was imponderable. In fact the decision was made in the spring of 1925.

Serious preparations for a return to the gold standard began in summer 1924, when the Bradbury Committee was established. Its formal mandate was “to consider whether the time has now come to amalgamate the Treasury Note Issue with the Bank of England Note Issue”, which was a reference to one of the Cunliffe Committee’s recommendations for stabilising the pound. In reality “the committee knew and the Treasury knew and the Bank knew that (...) these terms of reference were a convenient cloak giving additional secrecy to review of the basic problem, that of restoring the gold standard.” Initially the committee was chaired by Austin Chamberlain but when he became foreign minister Lord Bradbury took his place. Its report was completed on 5 February 1925 but the historian Richard Sayers states that talks about the date for restoring the gold standard between the governor of the Bank of England and Chancellor Churchill continued until 20 March 1925. It was then decided that the decision would be announced in the last week of April and put into effect immediately.⁶⁷⁹

As agreed, Churchill announced the restoration of the gold standard in his budget speech on 28 April. The Bradbury Committee report was published at the same time. The Gold Standard Act was passed on 13 May 1925, after which Britain was officially on the gold standard. The law followed the recommendations of the Geneva conference, in seeking to prevent the use of gold as a medium of payment. Although banknotes were redeemable, the Bank of England would redeem them not with gold coins but with gold bars. To ensure that gold would not be used for payment it was further decreed that the bank would not redeem banknotes for smaller amounts than a bar containing 400 ounces (about 12.4 kg.) of fine gold.⁶⁸⁰

Keynes was strongly critical of Britain’s gold standard decision in

his article *The Economic Consequences of Mr. Churchill*, in which he stated that the pound had returned to the gold standard at a rate that was distinctly overvalued, by about 10 %. Britain's restoration of the gold standard did indeed lead to a period of deflation, greater unemployment and problems for the nation's mines and exporters. The question of the pound's value in gold is relevant for evaluating Finland's own decision. If the pound was overvalued, Finland would have suffered the same consequences if it had chosen a rate based on purchasing power parity with Britain.⁶⁸¹

A NEW GOLD MARKKA IS BORN

The Parliamentary Supervisory Council discussed the findings of the gold standard committee on 14 May and again on 9 September 1925. The majority endorsed the committee's views although one council member, Professor Arthur af Forselles, forcefully argued his own variant. He felt that the markka should be fixed at the level of 40 to the dollar, after which Finland should adopt a new unit of currency ten times the size of the present one (therefore equivalent to a quarter-dollar). It was to be named the talari, as Eli Heckscher had earlier proposed.⁶⁸² Forselles was a member of parliament for the Swedish People's Party and on the supervisory board of the Nordic Union Bank.

The Bank of Finland was given the option of redeeming its banknotes either in gold coin, gold bars or foreign gold-backed currencies. The new Finnish gold standard of 1925 therefore followed the recommendations of the Genoa Conference for peripheral countries, in that it created a gold exchange standard. Finland had loyally implemented the concluding document of Genoa and created a monetary system which, while based on gold, was economical in the amount of gold it required. Banknote cover held in metallic gold was small, only 15 % of the notes that would have to be redeemed on demand. The new Currency Act and the Bank of Finland's new regulations both came into effect from the start of 1926.⁶⁸³

In connection with planning of the Currency Act, work had been resumed on a complete reform of the banks regulations, a project that had started in 1921. At this point Finland was finally restoring the gold standard and only determination of the date and the technical preparations lay ahead. The new regulations were based on a draft

prepared by former Bank of Finland governor Otto Stenroth in 1924, concerning the changes that the gold standard would entail. The regulations were to be skeletal in nature, containing only the matters determined by Finland's national legislature. Matters to be decided by the bank's board of management were presented in a separate set of rules, complemented by instructions governing the procedure of the supervisory council. The aim was that the regulations would provide a general framework that would not constantly need to be modified; adjustments could be made by changing the lower-level instructions.⁶⁸⁴

Naturally the main function of the Bank of Finland had not changed at all. The task of the central bank was still to maintain stability and security in the monetary system and to assist and facilitate the circulation of money. To safeguard the bank's operations, its primary capital was set at 500 million markkaa and the reserve fund at the same amount. Until these levels of capital were achieved the entire annual surplus was to be used to raise the primary and reserve funds. After that, at least a third of the annual surplus was to be transferred to the reserve fund while the rest could be used for public purposes decided by parliament.

The reform of regulations in 1921 had already taken the first steps towards restoration of the gold standard, so the principles were unchanged in the new regulations. The banknote quota, meaning the maximum allowed volume of notes in circulation in excess of gold reserves and undisputed foreign claims, was set at 1.2 billion markkaa. Foreign currency assets used as banknote cover were to be booked at a rate no higher than their value on the stock exchanges of countries on a gold standard, converted into Finnish markkaa at gold parity. Bonds could not be booked above their nominal value. Markka-denominated government bonds or short-term treasury notes held by the Bank of Finland could therefore no longer be used as banknote cover.

Although the main emphasis in the bank's lending continued to be discounting bills of exchange, it still had the right to grant other forms of credit, although this was not to exceed more than half of the bank's own assets. Unlike bills of exchange, promissory notes were no longer valid banknote cover. This restriction was intended to ensure that the bank's liquidity remained good and emphasized the previously defined shape of the bank's lending.

The regulations required a significant increase in the bank's primary capital and reserve fund. This in turn was facilitated by the new valuation of gold contained in the Currency Act. The price of gold was raised from 3444.44 markkaa per kilo (1878) to 26 388.89 markkaa. This meant that the value of the bank's gold reserves, previously 43.3 million markkaa, could now be booked as 331.6 million. The formal profit of 288.3 million could be entirely transferred to the bank's capital, which certainly helped the transition to a gold standard regime.⁶⁸⁵

The relationship between the supervisory council and the board was not significantly affected by the new regulations. The supervisory council remained indisputably in charge of the bank and its supervision.⁶⁸⁶ In the years after restoration of the gold standard, the bank's financial surplus was even better than predicted and, by the start of 1929, the combined value of its primary and reserve funds had reached the level of 1 billion markkaa stipulated in the regulations. This would have meant that two-thirds of future profits could have been reallocated by parliament, but the bank's leadership felt that the capital should be increased at the same rate as the bank's operations were expanding. It was therefore proposed that primary capital should be doubled to 1 billion markkaa by moving 500 million from the reserve fund. After this, half of the annual surplus would be transferred to the reserve fund until it also reached 1 billion markkaa. Only then would parliament be able to use two-thirds of the annual surplus for public purposes. These changes to the regulations were ratified in summer 1929.



■ Great Britain restored the gold standard in 1925, while Winston Churchill was chancellor of the exchequer. This laid the way for Finland's own gold standard decision. – The Illustrated London News Picture Library, UK/ Bridgeman Images.

MONETARY POLICY ON THE GOLD STANDARD

INTERNATIONAL MONETARY CONDITIONS

Finland returned to the gold standard between Europe's great financial powers, Britain and France. When France had finally fixed its franc to gold at the end of 1926, it was generally felt that the international gold standard had been resurrected; the project that had begun with the Brussels Financial Conference in autumn 1920 was seemingly complete. It was hoped that this meant a return to the pre-war conditions in which the international financial system, although not without its problems, had operated astonishingly well for decades. It had provided its participant countries – which were ultimately all the nations important for the world economy except for silver-standard China and Mexico – with stable average price levels and in that sense stable monetary conditions.⁶⁸⁷ There had been price cycles from time to time, linked to fluctuations in business conditions, but as Risto Ryti noted, the general price level on the eve of the First World War was the same as in the 1850s.

The gold standard had also provided a framework for the internationalisation of financial markets. Thanks to this, a large amount of investment capital had flowed from surplus countries, like France and Britain, to countries that had unexploited natural resources and labour reserves, such as Finland. The infrastructure of Finland had been built on the proceeds of bonds, issued during the period of the

gold standard. While it was true that international financial markets had suffered occasional disruptions, the monetary system based on gold had withstood them surprisingly well.⁶⁸⁸

Although the aspiration was a return to the good old times, the gold standard between world wars was not the same construct as the classical gold standard of the 19th century, but was significantly more fragile. Furthermore the great imbalances of the world economy in the 1920s and 1930s put greater pressure on the international monetary system than had been experienced at the end of the 19th century and start of the 20th. The system was fragile because it was more dependent on debt and trust than the classical gold standard had been. This was indeed a deliberate choice. As Gustav Cassel had long argued and as the Genoa Conference in 1922 had recommended, the monetary system established in the 1920s sought to reduce demand for gold by operating as much as possible on the basis of deposits and banknotes and as little as possible on actual gold coins and reserves. It was feared that a return to the gold standard would otherwise increase the demand for gold, pushing up its price and causing global deflation. On the national level, the new gold standard tried to minimise the use of gold coins as a means of payment and object of public investment. On the international level it sought to concentrate gold reserves at a few centres (New York, Paris, London), where “small” central banks would keep their reserves, in the form of gold currencies (dollars, francs, pounds) on deposit.⁶⁸⁹

For the Bank of Finland this gold exchange standard had not been a new system. Even before the First World War, Finland had been one of the few countries that had allowed gold currencies to be counted as banknote cover. Now others were doing the same, which saved gold but worked only as long as there was confidence and depositors did not demand the large-scale conversion of their reserves into gold. The constantly lurking danger was a stampede into gold, and it was this element that made the system more fragile than the old one.

The newly established monetary system was under great pressure, for three main reasons. Firstly, the gold parities at which different currencies had been fixed did not always reflect the relative price levels of their different countries. Gustav Cassel had repeatedly stressed this aspect in his articles and at many international conferences.⁶⁹⁰

Great Britain in particular suffered from having fixed the pound to gold at a rate that required the government to impose deflation and kept the country's balance of payments weak.⁶⁹¹ Another burden on the international monetary system stemmed from Germany's large reparations to the Allies and the wartime debts of the European allies to the United States. In particular this hurt Germany's balance of payments and had a strong effect on the monetary policies of Britain and France. Payment flows related to reparations and war debts were a source of ongoing financial diplomacy and economic uncertainty from the 1919 Treaty of Versailles until the early 1930s, when these debts became effectively void. The third factor that disrupted operations of the monetary system was protectionism in international trade and capital investments.

These structural weaknesses and other problems related to post-war political conditions ultimately proved fatal for the interwar gold standard and led to its collapse in the early 1930s. It has also been convincingly shown that the dysfunctional gold standard – and the short-sighted policies of the countries on it – was the main reason for the Great Depression of the 1930s. In his 2000 Nobel lecture, economics professor Robert Mundell went so far as to claim that the gold standard caused the rise of National Socialism in Germany and thus finally the Second World War.⁶⁹²

It was the fate of small countries to conform to what others decided, and this was particularly true of Finland, which had deliberately chosen economic policies that favoured integration. As in the other Nordic countries, the Finnish economy was dependent on the British market, and even more tightly so than Sweden and Norway were. Although US capital markets were more important than London as a source of credit, Finland was a virtual satellite of Britain in its general monetary policy from the mid-1920s until the outbreak of the Second World War; the markka was tied to the fate of the pound. Another key feature of Finnish monetary policy was the high priority given to maintaining and improving access to foreign funds. Creditworthiness was regarded as vital for a small country dependent on foreign trade and this assessment guided the many important economic policy choices of the period.

THE PROBLEM OF HIGH INTEREST RATES

After Finland had restored the gold standard at the start of 1926, the main objective in monetary policy became to normalise the financial market and link it to international capital markets. This meant an effort to lower interest rates, a natural consequence of economic conditions in the mid-1920s. Reino Rossi aptly summarises the monetary conditions of the time thus: "The value of money had been fixed and the country was again safely on the gold standard. At the same time all of the extraordinary troubles that had disrupted the money market in earlier years had been swept away. The money market and the banks were clearly in a stronger position. The availability of foreign capital had improved. Public finances were balanced and stable. The only flaw was 'abnormally' high interest rates, a legacy of the years of inflation."⁶⁹³

Finland's interest rate level was really high. Although the Bank of Finland had managed gradually to lower the discount rate from its record 10 % level at the turn of 1924, to "only" 7½% when the gold standard legally came into force, it was still far from what had come to be regarded as normal in the pre-war years. The bank's lowest discount rate in the gold standard years of 1878–1913 had averaged 4.9 %. The highest rate during this period had been 6 %, which was generally needed only in exceptionally difficult conditions and then only for short periods. Compared to this, 7½% seemed high indeed as a normal interest rate. The 6 % ceiling had been abolished in 1920 so it no longer constrained interest rates.⁶⁹⁴

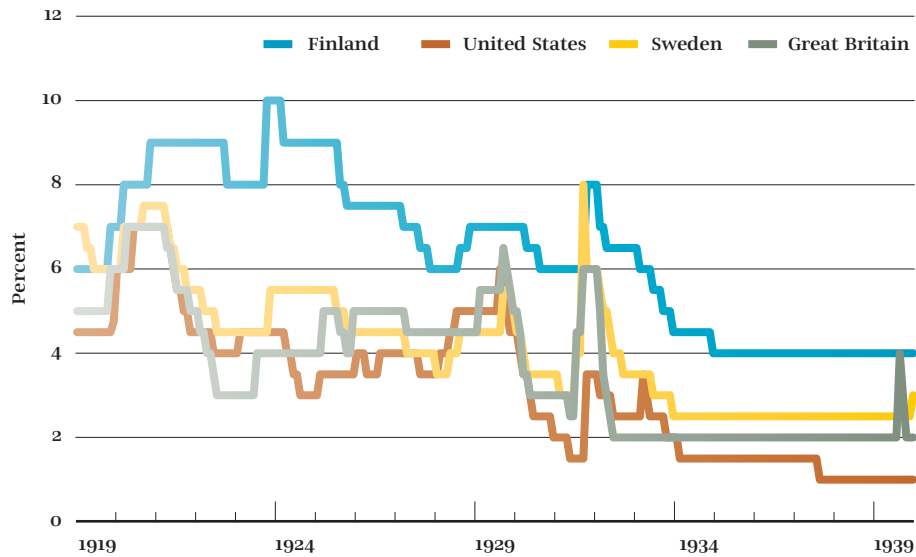
By international standards, too, Finland was one of the countries of high interest rates in the latter half of the 1920s. In the countries that were most important for Finnish financial markets, rates were much lower. At the start of 1926 the discount rate in New York was 4 %, in London 5 % and in Stockholm 4½%. Measured by its interest rate Finland indeed belonged to the group of peripheral politically unstable European countries that similarly suffered from a "capital shortage" and poor international creditworthiness.

The diagram overleaf shows interest rates in foreign countries important for the Finnish money market and the striking difference between them and the Finnish rate.

What made the interest rate problem even more acute was that the interest rates of other banks in Finland during the 1920's were far higher still. A study by Jaakko Autio shows that at the end of 1926 the commercial banks generally charged 10¼% for acceptance credit and 10½% on loans, which was three percentage points more than the central bank. Prior to the First World War the rates applied by commercial banks had been very close to central bank rate.⁶⁹⁵ The general price level in the 1920s was rather stable so the real interest rate paid by borrowers was extreme.

Under these circumstances, the complaints of businesspeople and especially farmers were hardly surprising. Among political parties, the Agrarian League was very active on the subject. Its members of parliament made repeated proposals for a law to control interest rates. The contents of the bills varied somewhat. The first, introduced in parliament in February 1926, proposed a ceiling on lending rates three percentage points above the rate that major banks paid on deposits.

CENTRAL BANK DISCOUNT RATES 1919–1939



Source: Rossi R., 1951.

The bill was signed by most parliamentary members of the Agrarian League, including the chairman of their parliamentary group Eero Hahl. In summer 1926, the party conference endorsed legal controls of interest rates and the party leader, Kyösti Kallio, who was prime minister at the time, proposed that the highest permitted interest rate should not exceed the lowest discount rate of the Bank of Finland by more than 2½ percentage points.⁶⁹⁶ Interest rate controls continued to be a subject of intermittently fierce political discussion until the mid-1930s.

In 1926 the Bank of Finland felt unable to lower its discount rate, mainly because its currency reserves had been shrinking for most of the year. Furthermore it had cut its rate twice, in August and October of the previous year, by a total of 1½ percentage points. After these cuts, it was focusing its attention on getting private banks to bring their own rates closer to central bank rate. It believed that the rates that private banks charged were high not only because of wide interest margins but also because of competition between savings and cooperative banks for deposits. Indeed, the savings banks and cooperative credit societies paid more interest on deposits than the current discount rate of the Bank of Finland. High deposit rates were a cost factor that banks passed on to borrowers. The margin between bank deposit and lending rates was also significantly wider than before the war, although the banks felt that this merely reflected their higher operating costs.⁶⁹⁷ In 1926 the Bank of Finland put pressure on the savings and cooperative banks to lower their deposit interest rates but with little success.⁶⁹⁸

The following year the Bank of Finland became more active in trying to push down bank interest rates. It lowered its own discount rate three times, in March to 7 %, in August to 6½% and in November to 6 %. Its explanation was that the money market had become easier, it now had greater reserves relative to banknote cover regulations and its position was more stable.⁶⁹⁹ The trend in interest rates abroad was also downwards so the difference between the rates applied by the Bank of Finland and those of the central banks of Sweden, Britain and the United States, regarded as the main benchmarks, it did not shrink much.

The problem remained of getting Finland's other banks to follow suit. The Bank of Finland tried in various ways, one of them being to increase its own direct lending to private customers somewhat. In May

1927 it took a more forceful approach, when the board of management sent a circular to the banks, threatening to refuse to discount their bills unless they lowered their highest deposit rates to the level of the central bank's discount rate.⁷⁰⁰

Lower interest rates remained on the political agenda. In autumn 1927 parliament debated a new bill from the floor, by members of the Agrarian League, that the highest permitted lending rate should be fixed to the Bank of Finland's discount rate with a margin of 2½ percentage points, as Kyösti Kallio had proposed the previous summer. Kallio's government had resigned at the end of the previous year and he had been appointed to the board of management of the Bank of Finland on 25 May 1927. Despite this position he had continued as a member of parliament for the Agrarian League, and would later serve as speaker of parliament and again as prime minister while still on the Bank of Finland's board.

The proposal on interest rate controls was not carried. Parliament's banking committee summarised the expert opinions it had heard as follows: "The statements show that all were agreed that the worthy objective of the proposal, being to prevent interest profiteering and to bring down the prevailing level of rates in the country, could not be achieved by the method proposed and, on the contrary, that the proposed legislative measure would have harmful consequences (...) (The experts that had been heard) felt that the lowest discount rate of the Bank of Finland was an unsuitable basis for an interest-rate ceiling, especially as the discount rate is not set solely according to the needs of the domestic money market but also takes into account foreign money markets and matters of currency policy (...) In general it was considered probable that interest rate controls, i.e. fixing the highest permitted interest rate level, would not lead to the intended result, i.e. a general fall in the levels of interest rates, no matter how desirable."⁷⁰¹

One of the statements that the banking committee referred to was from the Bank of Finland. Its board of management felt that the proposal on interest rate controls should be rejected while, at the same time, it recommended development of the money market to improve the availability of agricultural and real estate credit. When this statement was discussed on 4 November 1927, the board had not been unanimous and Kallio had appended his dissenting opinion to the minutes: "Except for a few rare exceptions, our credit institutions pay

more for long-term deposits than the lowest discount rate of the Bank of Finland, rendering expensive their funding, on which they further seek a good yield, so the interest rate will continue to be at such a high level as to harm economic life." Despite his new position on the Bank of Finland's board, he had not modified his opinion on interest rate controls and still supported legislative action.⁷⁰²

The diaries of J.K. Paasikivi record that, while the matter was still under parliamentary process, he and the chairman of the Finnish Bankers' Association Leon Pfaler had visited the Bank of Finland to try to persuade it to drop its rediscounting ban on the banks that paid more interest on deposits than the lowest discount rate. They had stated that this regulation could encourage the commercial banks to try to end their dependence on central bank credit, by keeping their reserves abroad and obtaining credit when needed from abroad. Governor Ryti had responded by defending the Bank of Finland's attempts to lower interest rates and, perhaps to put pressure on Paasikivi and Pfaler, had said he believed that parliament would pass the law on interest rate controls, although he himself did not favour it.⁷⁰³

In 1927 three interest rate cuts were implemented while the political debate was in progress. This was during an extremely strong business upswing and an easy money market. The economy responded with all the signs of overheating; the following year, the balance of payments deteriorated steeply, the money markets tightened to crisis levels and business conditions in the real economy also turned down. Research since the Second World War has treated the monetary policy of the Bank of Finland in 1926–1927 as excessively expansive. Easy money has been regarded as the main cause for the money market crisis in Finland in 1928 and the reason why the recessionary period of the 1930s began in Finland earlier than in other countries, even before the United States.⁷⁰⁴

It is beyond doubt that if monetary policy had been used to curb the growth of domestic demand, the trade deficit of 1928 would not have been so critically great. It is also the case that if the Bank of Finland had built up larger foreign currency reserves before the international financial crisis struck, about 18 months after the Finnish money market tightened, the economic downturn would have hit Finland later and perhaps less severely. However, such criticism, voiced



■ Kyösti Kallio, Adolf Burgman and Lauri af Heurlin, members of the Board of management, in their shared office in 1931.

– Otava picture archives.

KYÖSTI KALLIO (1873–1940)

In the 1920s and 1930s Kyösti Kallio was the most influential politician in the Agrarian League. He was also a board member of the Bank of Finland from 1927 until he was elected president of the republic in 1937.

By occupation a farmer, the young Kallio served in many local positions of trust, including that of a part-time clerk at Nivala Municipal Savings Bank. He was elected to the Diet in 1904 and was a long-term member of parliament and frequently a minister. He was prime minister four times. His appointment to the Bank of Finland's board was political, stemming from governor Risto Ryti's belief that the board needed a member who enjoyed the confidence of the agrarian population. His appointment also brought closer relations between parliament and the bank because, for almost his entire term on the board, he was the speaker of parliament at the same time.

Kallio's position on the board became unexpectedly uncomfortable, after the Great Depression had worsened into a crisis in agriculture in the early 1930s. High interest charges and plunging prices for agricultural and forestry products led to widespread debt problems in the countryside. Amid farm foreclosures, the farming population demanded change in the direction of economic policy. The Depression Movement that grew up around Finland exerted pressure on the Agrarian League, whose members of parliament began to demand urgent action to relieve

the slump in agriculture.

Most members of the Bank of Finland board were opposed to the demands of the Depression Movement and the Agrarian League, which put Kallio in a difficult position. He was hurt most by attacks from his own home region, Kalajokilaakso, where the Depression Movement had gained a very strong foothold and regarded him as a traitor. The attacks continued even after the economy had picked up and he barely received enough votes to be re-elected to parliament in the elections of 1933.

His most severe public critic in the early 1930s was Professor Yrjö Jahnsson, who had set himself up as the economic guru of the Depression Movement. In Jahnsson's view the Bank of Finland had taken Kallio as a shield, or "sacred cat", so that representatives of the Agrarian League would not attack it. The criticism was not entirely fair because, as a board member, Kallio supported the League's proposals for lowering interest rates and imposing administrative interest rate controls. He repeatedly appended dissenting opinions to the minutes of board meetings.

Kallio influenced the course of events at the Bank of Finland even after becoming president. It was he who historically persuaded governor Risto Ryti to become prime minister after the outbreak of the Winter War. Kallio died dramatically of a heart attack at Helsinki railway station in 1940, just after Ryti had been chosen to succeed him as president.

by Rossi (1951) among others, is not founded on the same premises that underpinned monetary policy in the 1920s. Seen within its own framework and philosophy, policies pursued in the years after the restoration of the gold standard seems fairly inevitable.

DID THE FINNISH ECONOMY OVERHEAT?

Among foreign researchers, Richard Lester has compared the economies of Finland and Sweden after restoration of the gold standard with the experiences of Norway and Denmark in the same period. He regards Finland and Sweden as examples of adroit monetary policy that managed to stabilise purchasing power, the internal value of money, in addition to its exchange rate. From 1925 to 1928, while Norway and Denmark were suffering extreme deflation and a typical recession, Finland and Sweden enjoyed a very favourable economic climate.⁷⁰⁵

Economy conditions in those years provided no obvious justification for abandoning attempts to reduce interest rates and imports of long-term capital, at least not if the economy is examined as contemporaries did. The Bank of Finland gauged and justified its action on interest rates from a narrow examination of the state of the money market and the foreign currency position. This was in line with the rules of the game of the gold standard, and the concept, typical of the period, of a “natural interest rate”. Under the gold standard, monetary policy was to be set primarily according to the balance of payments. An inflow of currency, which eased the money market, was acceptable grounds for reducing interest rates, while a currency outflow required rates to be raised, to protect currency reserves and maintain the country on the gold standard.

Even if the criteria are broadened to include the balance of trade and the current account, there were still no signs in 1927 of the crisis that lay ahead. Finland’s foreign trade was practically in balance in 1925–1927, the current account slightly in surplus and, although imports were increasing rapidly, export growth was keeping up. The national economy as a whole was therefore not importing foreign capital although Bank of Finland governor Ryti propounded the theory in 1925 that a comparatively capital-poor country such as Finland should import

capital to develop its natural resources and export industries. This line would have justified a significant current-account deficit for Finland, as long as the capital imports were used to expand productive capacity.

Even figures for price stability, which might have hinted at economic imbalance, gave no clear indicators of overheating in 1927. The Finnish wholesale price index had been very stable since 1923. The index for 1928 was within one percent of the index for 1925, the year before restoration of the gold standard. There were no signs of inflation or deflation.

The clearest warning signal, which could have been interpreted in the 1920s as requiring tighter monetary policy, was stock exchange speculation. Paavo Korpisaari made a presentation on the principles of discounting to the Finnish Economic Society, entitled "Commercial crises and banking policy", in which he pointed to speculation as a suitable criterion for setting interest rates. Share prices in Helsinki rose 88 % in the first two gold-standard years from January 1926 to January 1928, which was much more than in Stockholm (40 %), London (18 %) or New York (34 %). This could have served as a wake-up call for the Bank of Finland to stop trying to reduce interest rates and raise them instead. On the other hand the Finnish share market mattered little while the needs of agriculture and housing production were of great social and political importance.⁷⁰⁶

The overheating that ended the economic upswing of the late 1920s originated mainly from construction. According to a report of the Parliamentary Supervisory Council "in Helsinki (alone) last year (1928) about 16 800 rooms were completed, 47 % more than in 1928 and 81 % more than in 1926 although construction was lively in those years too."⁷⁰⁷ Figures for the whole country in 1926–1928 are similar. Mikko Tamminen's study found that the number of dwellings completed in 1927 rose 39 % and, in the peak construction year of 1928, 30 %.⁷⁰⁸

Capital imports by the Residential Mortgage Bank of Finland (Suomen Asuntohypoteekkipankki) contributed to this strong growth of building output. The bank was established in 1927 to improve housing conditions in Finnish towns. It borrowed 2 million pounds (386 million markkaa) from abroad in its first year of operations and another 10 million dollars (397 million markkaa) the following year. The loan in 1927 alone brought so much foreign currency into Finland that it had a strong effect on the national money market.

When the Residential Mortgage Bank was being planned in 1925, the Bank of Finland had issued a statement criticising the idea of importing foreign capital to finance residential construction although it approved of the establishment of mortgage credit institutions as such. In the bank's view, foreign credit should be used only for directly boosting production.⁷⁰⁹ The warning was ignored and the Residential Mortgage Bank's loan of 1927 was a major reason for the easier money market, which caused the Bank of Finland to implement its third interest rate cut that year.

THE CRISIS BEGINS

The Finnish money market took a sharp turn for the worse in 1928. It obviously came as a great surprise to economic policymakers that sentiment had changed so rapidly. At the start of the year the market was still very easy but a dramatic deterioration of the trade account during the year eroded foreign currency reserves. At the same time, bank liquidity deteriorated distinctly for the first time since the restoration of the gold standard and the banks were forced to resort to large-scale rediscounting at the central bank. The Bank of Finland reacted to the trade account deficit and the tighter money market in accordance with the rules of the gold standard; it raised interest rates twice in autumn 1928, on 7 August by half a percentage point to 6½% and again on 15 November to 7 %.

Initially only the money market was hit while production and employment continued unaffected but, by the start of 1929, a downturn in the real economy also appeared likely. According to the annual report of the Bank of Finland (which A. E. Tudeer dated March 1929) a reversal in the domestic market was already in sight: "the main issue (so far) has been a shortage of money and capital. Apart from the decline in sawn goods output, caused by weaker foreign demand, production is apparently continuing unabated. However it is clear that declining purchasing power and spending propensity among broad strata of the nation may gradually force industry supplying the home market to curb output."⁷¹⁰

At the same time, money markets abroad were becoming tighter fast. Market interest rates had begun to rise in the United States in 1928 and in 1929 the trend spread to London. At the same time the world's



■ The US stock market crash at the end of October 1929 is regarded as the starting point of the Great Depression. 400 extra policemen were needed on Wall Street to contain shocked investors. – Corbis/Bettmann/Finnish Press Agency.

gold reserves began to flow towards New York and Paris.⁷¹¹ Finland's foreign currency situation remained tight throughout 1929 and the volume of bills of exchange rediscounted at the Bank of Finland remained at the record level that it had reached the previous autumn. By this time, the shortage of foreign currencies was not due merely to Finland's trade deficit but also to tightness in foreign money markets. Finland's interest rate was not attracting sufficient capital.

During 1929, money market conditions began to have a distinct effect on the real economy in Finland. The effects showed first in output of the home market sector. Towards the end of the year construction had fallen steeply. As domestic demand shrank, the number of bankruptcies and protested bills of exchange increased. Both these indicators showed a sharp turn for the worse at the start of 1929. The volume of exports, on the other hand, was still growing in 1930.

In 1930 it appeared briefly that the worst was over in the money market. In the final weeks of 1929, the world had seen unprecedentedly steep and widespread cuts in interest rates, which continued in 1930. After the stock exchange collapse in October 1929, the New York Federal Reserve Bank had reduced its discount rate from 6 % to 2½% by summer 1930, lower than ever before. Correspondingly England's bank rate had been reduced from 6½% to 3 % and the Bank of Sweden's discount rate from 5½% to 3½%. However, easing of monetary policy, extremely rapid and simultaneous as it was, failed to prevent the world economy's plunge into deflation. Measured by wholesale price indices, prices in 1930 fell by 18 % in Great Britain, 17 % in the United States, 15 % in France, 13 % in Sweden and 10 % in Finland.⁷¹² Prices of agricultural produce suffered particularly. Inflation was being driven by a decline in aggregate demand and a worldwide rush to pay off debts and invest in gold and other liquid assets. The fall in the price level had wiped out the benefits to debtors of easier money.

In Finland, too, the money market eased quickly during spring 1930. The current account was again positive – as domestic demand collapsed – and currency reserves increased. The liquidity of commercial banks rose correspondingly. The Bank of Finland responded by cutting its interest rates twice, in April and August, by a total of one percentage point.

INTEREST RATE PACT

Although the Bank of Finland had reduced its discount rates twice in 1930, down to 6 %, a familiar problem resurfaced; the interest rate applied by private banks had not fallen correspondingly over the year. Long-running efforts to restrict competition for deposits between the banks were stepped up in June. The commercial banks reached a mutual agreement on deposit interest rates in June, after which the central organisations of savings and cooperative banks sent their member banks a letter in July, urging them to cut interest rates on deposits.⁷¹³

These efforts did not have the desired effect. Although deposit rates came down somewhat, and some changes trickled down to lending rates, the interest charged on a variety of forms of credit remained extremely high. According to Jaakko Autio's study, at the end of 1930 the most common rate charged by the commercial banks for acceptance credit was still 10½% and the normal rate on loans was about the same.⁷¹⁴ At a time when the price level, particularly for agricultural produce, had fallen steeply, the real cost of loans was unbearably high. The high interest rate level had already been a subject of political dispute in the good years of the 1920s; now it was politically explosive.

Members from the Agrarian League introduced a new proposal in Parliament in October 1930, to set a legal ceiling on interest rates 3 percentage points above the lowest Bank of Finland discount rate. Bankers were now coming to realise that cooperation to restrict interest rate competition was needed in order to avoid legislative controls.⁷¹⁵ J.K. Paasikivi, the chief general manager of Kansallis Bank, noted in his diaries that he contacted governor Ryti of the Bank of Finland on 15 December about arranging broad negotiations and "Ryti promised to do it".⁷¹⁶ This initiative led the following spring to an interest rate pact between all financial institutions and the establishment of a joint organisation for regulating bank interest rates.

The interest rate question flared up at a time when Finland's political situation was very heated and unstable. A radical right-wing organisation, the Lapua Movement, had been trying to force the resignation Prime Minister Kyösti Kallio and organised a military-style demonstration, the Peasants' March, in Helsinki at the start of July 1930. It was a sign of the strength of the movement that the government

resigned before the march and was replaced by a new government under P.E. Svinhufvud, who enjoyed the trust of the right. The movement subsequently kidnapped leading social figures and carried them symbolically to the Russian border; the victims included the social democratic speaker of parliament Väinö Hakkila and the former liberal president of the republic K.J. Ståhlberg.⁷¹⁷

The main objective of the Lapua Movement was to suppress communist activity in Finland but it was so dependent on farmers that it also made demands concerning interest rates. At its Great Depression Meeting at Loimaa on 7 January 1931, it approved the following resolution: "Because it is clear that, under normal conditions, Finnish farming is entirely unable to yield more than 2–4 % on the capital invested in it, and other forms of productive activity probably not much more, the maximum rate of interest charged must be fixed by law, loans with real collateral at 6 % and loans without real collateral at 7½%, including commission and other possible fees."⁷¹⁸ The meeting heard threats "to move from words to deeds" unless the voice of the farmer was better heeded in Helsinki. In the previous year the Lapua Movement had given plenty of evidence of its readiness for direct action; now it was threatening to expand from repressing socialists to fighting the recession.⁷¹⁹

Negotiations between all financial institutions on a general interest rate pact were begun in 5 January 1931, at the behest and under the leadership of Risto Ryti of the Bank of Finland. The pact between commercial banks, savings banks, cooperative banks and cooperative credit societies was signed on 24 March.⁷²⁰

While negotiations on the pact were still continuing, a presidential election was held, resulting in the election of prime minister P.E. Svinhufvud on 16 February 1931. This precipitated a change in government and the new prime minister became J.E. Sunila of the Agrarian League, who was an inspector general at the board of agriculture. His government's measures to ease the plight of indebted farmers did not satisfy the parliamentary group of his own party, which wanted interest rates to be controlled by law. Later Sunila's administration was forced to resign over a bill concerning interest rate controls.⁷²¹

The 1931 interest rate pact was a cartel between banks that fixed the interest rates for different types of deposit accounts. It was agreed that

money on deposit for longer than six months, for which there had been extremely fierce competition, “would be discontinued entirely”. The pact covered all financial institutions that accepted deposits – commercial banks, the Real Estate Bank of Finland, the savings banks and their central bank SKOP, the cooperative credit societies and their central fund, and also the savings societies that operated alongside cooperative shops. Deposit interest rates were fixed on a graduated scale. The commercial banks paid the lowest rate of interest; the savings banks, the cooperative and savings societies 0.25 percentage points more than the commercial banks; and the smallest savings banks and credit societies 0.5 percentage points more than the commercial banks. The parties agreed to do no business with any financial institution accepting deposits but not observing the regulations.

The pact was to enter into force on 1 July 1931 and to be administered by a joint organisation, the general banking commission, chaired by the governor of the Bank of Finland. The commission’s main function was naturally to set deposit rates. At its meeting on 12 May, it decided to lower the highest permitted interest rates so, when the pact came into force, the deposit rate ceiling for commercial banks was 5½% and the rates paid by other institutions were according to the scale set out in the pact. In practice the pact lowered the deposit rates paid by commercial banks by half a percentage point but the rates paid by most savings banks and cooperative credit societies came down by 1–1½ percentage points.⁷²² The sanctions contained in the pact were so severe that there was no real doubt about whether interest-rate competition would end. The Savings Bank newspaper (*Säästöpankki*) wrote in May:

”Taking the pleasant decision (to cut interest rates) is now easy, if only because no other financial institution can stick to higher rates because all are subject to the same threat of ostracism; there is no need even to enquire their intentions, for all must now stand side by side. (...) Declining interest rates will bring major relief to borrowers. One hopes that households and enterprises on a healthy footing will now be better able to bear the burden of the recession and endure till better times; also that the passion aroused in many circles by the interest rate question will abate.”⁷²³

The pact itself had a distinct downward impact on interest rates, mainly among the savings banks and cooperative credit societies but

also to some extent among commercial banks. The lending rate now moved slightly closer to the official discount rate of the Bank of Finland. In controlling fierce competition, particularly from the savings banks, it also boosted bank profitability, which had been strained by the recession. However borrowers did not benefit from any very great interest rate reductions because uncertainty in foreign exchange markets prevented the Bank of Finland from lowering its own rates, as it had been planning to do in the spring. By autumn the situation became even worse, when a currency crisis forced the Bank of Finland to raise its discount rates steeply.⁷²⁴

The interest rate pact of spring 1931 set the course of the Finnish money market far into the future. It suppressed interest-rate competition for decades and imposed a system of mostly administrative interest rates. The system became entrenched in the 1940s, during the war, and remained in force – with certain technical modifications – as late as the 1980s.

CURRENCY CRISIS, GOLD STANDARD ABANDONED

FOREIGN DEVELOPMENTS

In summer 1931 a banking crisis hit Europe, ending the gold standard as the international currency system. In May 1931 the largest bank of Austria, Credit-Anstalt für Handel und Gewerbe (Credit Institution for Trade and Industry) announced major losses and asked for government aid. Austria's financial system was precarious because long-term industrial investments were financed by banks funded by short-term foreign loans. This arrangement is very vulnerable in a world recession. Credit-Anstalt owned about 60 percent of Austrian industry and was so large that its difficulties plunged the country into an immediate balance of payments crisis. Uncertainty spread from Austria to the banks of Hungary, Czechoslovakia, Poland and eventually Germany.⁷²⁵

On 20 June, US President Hoover responded to the growing European currency crisis by declaring a one-year moratorium on all war reparations and war debt payments, covering interest as well as amortisations. The main aim was to ease the position of Germany and the shortage of foreign currency afflicting continental Europe. By 6 July the proposal had been endorsed by 15 countries and the moratorium came into effect, but Hoover faced an uphill struggle in his own country, where Congress was very reluctant to reschedule war debts and did not ratify the moratorium until December. The autumn was therefore a time of prevailing uncertainty although repayment of debts

had practically ceased. When the moratorium ended at the close of 1932, most countries continued to leave their debts unpaid.

Finland had been liable to make payment on a fairly small US food credit, dating from 1919. Although this was subject to the moratorium, Finland continued to pay interest and amortisation, generating great positive publicity for the country in the United States. The event symbolises the enormous attention paid to war debts in the political arena between the two world wars.⁷²⁶

Despite the moratorium, the banking crisis spread to Germany in July, and the country's second largest bank, Danat-Bank, defaulted on 13 July 1931. As the crisis worsened, Germany imposed controls on currency trading and its central bank was compelled to raise discount rates sharply despite the downward spiralling economy. The interest rate was raised to 10 percent and even for a while to 15 percent. At the end of July repayment of foreign debts by Germany was suspended by an international "standstill agreement".⁷²⁷

Britain now experienced the true vulnerability of its position as a financial centre with only modest gold reserves in proportion to its international commitments. In the first half of 1931 the position of the Bank of England had still been strong enough to let it lower its discount rate to 2½% in May. During the early stages of the European currency crisis, it had also been able to provide support credit to the central banks of Austria and Germany but in July, as the German crisis erupted, uncertainty spread to the London money market. The report of the Macmillan committee, on the reasons for the British economic recession, was published on 13 July, exposing London's dependence on short term foreign deposits in British banks. Although the main report of the committee rejected a devaluation for correcting the pound's overvaluation, an appendix signed by Keynes and other radical members of the committee alluded to its possibility "if an adjustment of money incomes becomes plainly unavoidable". However, Keynes and the other signatories of the appendix regarded higher customs duties and export subsidies as a better way of solving the problem of the pound's overvaluation than devaluation.⁷²⁸

Regarding the decline of confidence in the London money market, it is hard to say how much was due to the Macmillan report, how much to the effect on Britain's balance of payments of German debt rescheduling and how much to the budget problems of Ramsay

MacDonald's Labour government, which led to its collapse in August. In any case, from the middle of July the Bank of England began to lose its gold reserves at an accelerating rate and discount rate hikes at the end of the month (first to 3½% and then to 4 %) did not solve the problem. Ultimately, on Sunday 20 September 1931, the Bank of England suspended convertibility of the pound into gold and raised the discount rate to 6 % "to combat inflation". The next day, the pound weakened 13 % against the dollar on the foreign exchange market and it continued downhill in the days and weeks ahead. By the end of 1931, the pound's rate against the dollar had already fallen to 30 % below its old gold parity.⁷²⁹

Britain's abandonment of the gold standard was perhaps the most devastating event for international currency policies between the world wars. It brought a realisation that the structure of the international monetary system, created in the 1920s, had failed and the world economy had drifted into new, uncharted waters. Severing the link to gold hit the countries with strong economic ties to Britain the hardest. These were not only the colonies. In Europe it had a strong effect on Nordic countries like Finland that received a large proportion of their export earnings in pounds. About 40 percent of Finnish exports went to Britain and the pound was even more important as an invoicing currency so the decline in its exchange rate had a strong impact on Finland's foreign trade. The impact was amplified by the fact that Britain provided a relatively small proportion of Finnish imports, only 13 %, while Germany, the largest source of imports, kept its exchange rate firmly fixed to gold. Moreover a large share of Finland's currency reserves were pound-denominated deposits in London banks.

Britain's decision put the Nordic central banks in a difficult position. Initially they reacted by raising interest rates. Sweden's discount rate was increased immediately by one percentage point and a few days later by one more, but this did not help and the currency flight continued. On Sunday 29 September, a week after Britain abandoned the gold standard, there was a meeting in Stockholm of heads of Nordic central banks; Ivar Rooth of the Bank of Sweden, Nikolai Rygg of the Bank of Norway, Hans Rosenkrantz of the board of management of the Danish National Bank and Risto Ryti of the Bank of Finland. The next day, Sweden and Norway abandoned the gold standard and Denmark followed the day after. They also raised interest rates. For the Bank of

Sweden it was the fourth hike in 1931, bringing the rate to 8 %, the highest figure in its history.⁷³⁰

Finland did not yet follow suit. In Stockholm Ryti had urged the others to wait and he continued lending his prestige to a defence of gold. On Tuesday, the day after Sweden and Norway have gone off the gold standard, he spoke on the subject to the Economic Society, Finland's most influential forum for economic policy debate. His presentation "The gold standard and the concomitant duties and opportunities of a central bank" treated the prevailing currency crisis as a "transient disorder". No better monetary system had yet been discovered, he said, and predicted that the countries that had been forced off gold by the current economic crisis would return to it before long, "although perhaps at a value of money that has been somewhat lowered in one way or another". He defended the narrow concept of a central bank's duties under the gold standard. It should concentrate, he said, on maintaining the monetary system as decreed by law, because its powers "will be unequal to the task of eliminating a shortage of capital or combating the national effects of a world recession".⁷³¹

Ryti's struggle for the gold markka was forlorn. Finland's situation was unsustainable because its currency reserves had fallen at an accelerating rate since June and of course the decision of the other Nordic countries to abandon the gold standard did nothing to stem the exodus. On 1 October the Bank of Finland raised its interest rate by 1½ percentage points to 7½% to protect its reserves, but they continued to dwindle. More action was needed and on 5 October legal controls were imposed on currency trading, to be in force until further notice but no longer than until the year-end.⁷³² Despite the interest rate hike and foreign exchange controls, in the first three weeks of October the bank lost currency worth about 500 million markkaa, which was most of the reserves that were left after the difficult September.

A study by Jaakko Autio concluded that the Bank of Finland delayed its decision because Risto Ryti had put his faith in international cooperation, which he hoped could still save the world's gold standard. Ryti had several discussions with General manager Pierre Quesnay of the Bank for International Settlements (BIS) which, Autio believes, influenced Ryti's policies in these critical weeks. The leadership of the BIS was strongly in favour of the gold standard. In a telephone

conversation on 3 October, Quesnay advised Ryti to postpone action because the crisis might be settled at a BIS meeting in Basel on 12 October. Ryti had negotiated with Quesnay about a possible a loan of 200 million francs to reinforce the Bank of Finland's foreign currency reserves. Quesnay had also recommended controls on currency sales, which Finland put into effect almost immediately.⁷³³

Hopes for a rescue of the gold standard were dashed and Finland was soon forced to follow the path charted by the other Nordic countries. The change was global. At the start of 1931, a total of 47 countries had been on the gold standard. At the end of 1932, the only ones left were Belgium, France, Italy, the Netherlands, Switzerland, Poland and the United States.⁷³⁴ The US itself abandoned the gold standard in spring 1933. The currency system of the world would never be the same again.

FINLAND BOWS TO THE TREND

It was in fact against the law (its regulations) for the Bank of Finland to refuse to redeem banknotes with gold. A retroactive change in the law, ratified on 30 October 1931, gave the government the right to exempt the Bank of Finland, temporarily, from redeeming its banknotes during a crisis, and also exonerated the bank for having already done so contrary to its regulations. The bank was now allowed to waive banknote redemption in time of war or financial recession, for a fixed period, in practice a calendar year, so the exemption had to be renewed annually. It could be done after a proposal to this effect, by the board of management, had been ratified by the supervisory council. In the same connection the requirement of a gold reserve of at least 300 million markkaa was eliminated.⁷³⁵

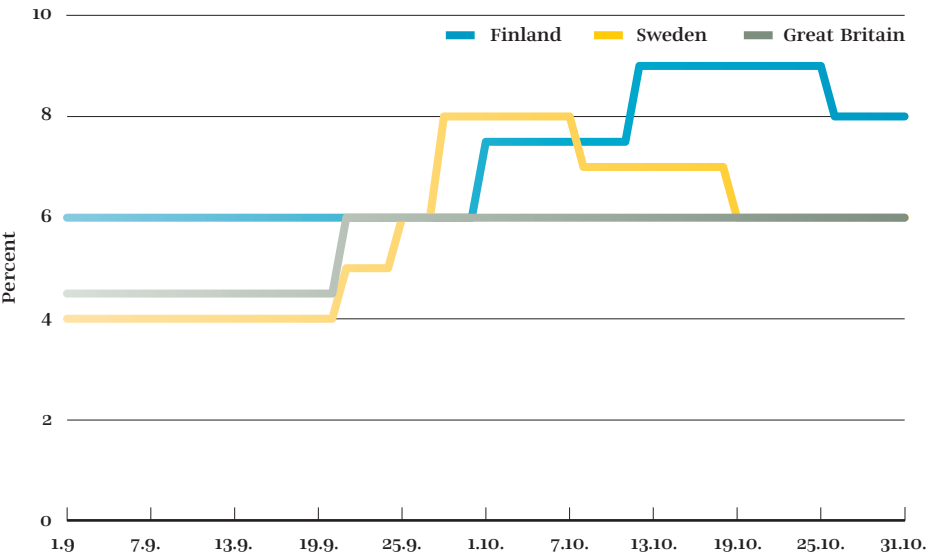
The fact that the bank's annual surplus in 1932 and 1933 was, at the request of the Finance Ministry, entirely used for government spending, also amounted to a change in the regulations. However the bank resisted having this written into its regulations, in an effort to ensure that this was temporary, and the transfers were done by a separate emergency act. The first changes to the regulations themselves were made only in 1938, largely because of a strong increase in the bank's operations. Its primary capital was then increased by 250 million markkaa to 1.25 billion and the banknote contingency was raised to 1.8

billion markkaa. The increase in primary capital was made possible by a rise in the price of gold and the value of bonds held by the bank.⁷³⁶

After the Bank of Finland had conceded defeat and detached the markka from gold, the board of management published a statement in the daily press on 13 October that “it is likely that the near-term value of Finnish money abroad and of foreign money in Finland will be disadvantageous to us. The management of the Bank of Finland will, however, do everything in its power to maintain the value of Finnish money. There are also good prospects for this, at a time when business in our country has generally acclimatised to the present value of the markka and our trade account is positive.”⁷³⁷

At the same time the discount rate was raised by half a percentage point to 9 %. The aim, of course, was to defend the value of the markka after its convertibility into gold had been terminated. The rate hike proved temporary; on 26 October 1931 it was lowered to 8 % although foreign exchange markets had not become noticeably less volatile.

CENTRAL BANK DISCOUNT RATES IN AUTUMN 1931



Sources: Central bank annual reports; Hawtrey R., 1938.

After the markka went off the gold standard, the Bank of Finland initially stopped quoting official exchange rates. The markka was allowed to depreciate against gold-backed currencies by approximately the same amount as the pound had weakened, meaning that the Bank of Finland took as its reference rate the old pound exchange rate of about 193.50 markkaa to the pound. It transpired that this level was not sufficient to balance supply and demand, and foreign currency was not available even for purposes that would normally have been entirely acceptable. In this situation, the foreign exchange market had to be reorganised, and talks on the matter were held with the commercial banks. The solution, adopted on 9 December 1931, was to lower the markka exchange rate even more and move to a kind of floating exchange rate system. Alongside the official “nominal” exchange rates, market exchange rates, used in actual business operations, were also quoted. These rates were determined jointly by the Bank of Finland and the largest commercial banks, who tried to assess the price at which each currency would be available in the free market. The system could perhaps be described as managed floating. At the same time, the temporary restrictions on currency trading that had been in force since the start of October were dismantled.⁷³⁸

On 10 December, the first day of the new system, the dollar was quoted as high as 74.95 markkaa, which meant that the markka had fallen 47 % from its old gold value at the start of October. On the days ahead, however, the market became somewhat calmer, the markka somewhat stronger and the floating rates less volatile. In mid-December the pound was fixed at about 236 markkaa for the rest of the year. The markka had now depreciated about 18 % against the pound, but the pound, too, was a weak currency. Against the dollar and other gold currencies, the markka’s year-end rates were about 43 % down.

DOMESTIC POLITICAL SCUFFLING

The most difficult slump year in Finland was in 1932, for economic policies and for politics in general. By many measures, the slump bottomed out in the early months of the year. Industry felt a distinct turn, although industry in Finland never suffered as severely as in many other countries. The volume of industrial output fell only 15

percent from its zenith in 1928 to its nadir in 1931. After this, Finland's active policy on exchange rates reversed the falling export trend and put the volume of all industrial output back on a growth path.

The domestic market sector was the hardest hit by the slump. This was especially true of construction and agriculture, for which 1932 was a very difficult year. The number of farm foreclosures topped 2500, compared with about 1600 in 1931.⁷³⁹ Unemployment statistics in 1932, admittedly very incomplete, presaged no improvement in the labour market, either. The number of registered unemployed in every month of the year was greater than in the corresponding month of 1931. The number was at its highest in March 1932 when over 90 000 persons were registered as out of work.⁷⁴⁰

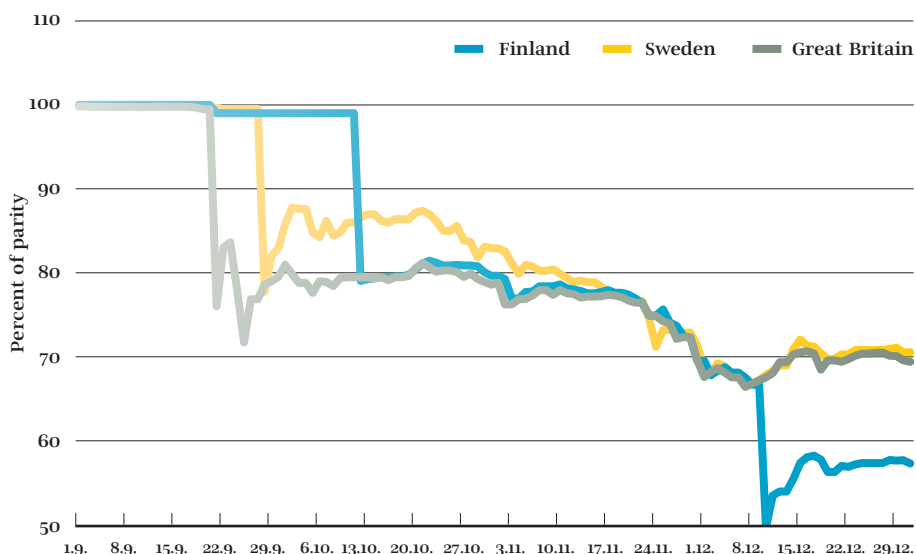
The plight of agricultural producers stemmed from farm indebtedness on the one hand and lower prices on the other. A dissertation by Klaus Waris shows that the weighted price index for agricultural produce fell about 32 % from its peak in 1928 to the bottom of the recession in 1932. The main source of extra income for Finnish farmers was wood sales but the recession was even worse in forestry than in agriculture. The stumpage earnings of forest owners declined a full 72 % between 1928 and 1931. Even in 1932, when the market had been stimulated by a devaluation of the markka, stumpage earnings were still 51 % lower than before the recession.⁷⁴¹

The economic gloom was of course reflected in politics. The extreme indebtedness of agriculture was particularly tough on the Agrarian League, and its leadership came under great pressure from the new political force, the Depression Movement. At the end of January the parliamentary group of the League presented its own depression programme, which amounted to an attack on the government, even though prime minister Juha Sunila was from the Agrarian League.

The Depression Movement was a populist organisation supported mainly by smallholders. The activities of the movement (although in fact it was a very loose grouping) were largely extra-parliamentary and it had little success in elections. The Smallholders' Party, representing one wing of the movement, received less than 2 % of votes in the 1930 parliamentary elections and received one seat in parliament. In the next elections in 1933, the party won three seats.

The Depression Movement blamed high interest rates on the banks

EXCHANGE RATES AGAINST THE DOLLAR IN AUTUMN 1931



Sources: Bank of Finland annual report 1931; Bank of Sweden.

and particularly the deflationary monetary policy of the Bank of Finland. The economic experts of the movement, professors V.F. Johansson and Yrjö Jahnsson, wrote in the press urging easier money and a policy of protective customs duties in order to halt deflation and raise the price level. The Agrarian League came in for very strident criticism; in the Finnish Smallholders' newspaper *Pienviljelijä*, Yrjö Jahnsson described it thus:

"In Agrarian League circles there is an already widespread view that the monetary policy of the Bank of Finland means for Finnish farmers what the arrival of the Persians meant for Egypt: economic servitude and debt slavery. The decisive reason that the Agrarian League has not resisted this policy more fully is that its leader is involved in it."

The leader Jahnsson referred to was Kyösti Kallio, who was on the board of management of the Bank of Finland as well as being speaker of parliament.

Soon after the publication of Jahnsson's article the members of the Agrarian League on the supervisory council of the Bank of Finland

became active in demanding a change in monetary policy. On 29 January 1932, councillors Juhani Leppälä, Vihtori Vesterinen and Jalo Lahdensuo, all of the Agrarian League, sent a letter to council chairman Nevanlinna, demanding a reduction in the discount rate, a lower margin between bank deposit and lending rates, and even a change in Bank of Finland regulations to allow the bank to increase its lending. Banknote cover regulations were to be relaxed and regulation §11, which curtailed forms of lending apart from acceptance credit on bills of exchange, was to be made less restrictive.

At its meeting on 4 February 1932, the supervisory council requested a statement from the board of management but, before this statement could be discussed, the board proposed that the discount rate should be lowered by one percentage point. The justification it gave did not refer to the letter from the Agrarian League councillors but pointed to an easing of the money market and the fact that the foreign currency reserves seemed to be growing. When the board's proposal for a rate cut was debated in the council on 12 February, councillor Erik von Frenckell opposed it and proposed a cut of half a percentage point instead. Frenckell, from the Swedish People's Party, was backed by Nevanlinna, a member of the National Coalition Party, and Tanner and Ailio of the Social Democratic Party, but was outvoted when Helo of the Social Democratic Party and Junnila of the National Coalition Party aligned themselves with the Agrarian League. It was thus decided to reduce the interest rate by a full percentage point.

The board's statement on the letter from Leppälä, Vesterinen and Lahdensuo was debated in the council meeting on 17 February 1932. The board took a negative stand on the proposals in the letter. However Leppälä, Vesterinen and Lahdensuo said that, now that the discount rate had been reduced, they would abide by the board's statement in all respects except for a change in Bank of Finland regulations, which they still demanded. They were outvoted so the attempt to initiate a change in the regulations lapsed.

At the same time, another change in the regulations was pending in parliament. Proposed by members of the Agrarian League, it would have made bonds backed by either land or industrial property valid without restriction as banknote cover.⁷⁴² The aim was thus to allow Bank of Finland lending to be expanded and directed towards long-term mortgage loans. In its statement, the board of management of the

Bank of Finland was critical of the proposal. When the supervisory council debated the matter on 3 March, the representatives of the Agrarian League were outvoted and the council adopted the negative stance of the board.

Jalo Lahdensuo of the Agrarian League had been unable to participate in the council meeting. As defence minister in the Sunila government, he was under great pressure in the early days of March, after extra-parliamentary activity by right-wing radicals in the Lapua Movement had turned into an armed uprising. The Mäntsälä rebellion was an attempted coup against the government and was intended to suppress the Social Democrats. Lahdensuo played a key role in keeping the Army's loyalty and putting down the rebellion, which was ultimately achieved without force of arms. The failure of the rebellion meant a significant loss of political influence for the Lapua Movement and, in retrospect, marked the start of more stable times. Contemporaries could not be sure of this, of course, and the mood long continued to be tense.

Interest rate controls were back on the agenda in April when the banking committee of parliament asked the Bank of Finland for its views on a new proposal from Agrarian League members to enact a law on interest rates. The majority of the board of management was against it but Kyösti Kallio asked for the minutes to record his dissenting opinion: "interest rate limits, subject to certain provisions, are desirable, so that the law will more clearly regulate what is regarded as usury". Kallio believed that it was legitimate to fix the greatest permitted differential between bank lending and deposit rates and he also proposed legal status for a commission that would "jointly confirm the magnitude of deposit interest rates to be paid by each bank". In the supervisory council on 7 April the representatives of the Agrarian League gave their backing to Kallio but were outvoted, and the council took a negative stand on legislating interest rates.

A few days after the bank had opposed interest rate controls (18 April 1932) the board of management proposed to the council that the discount rate should again be lowered because "although foreign currency reserves are more likely to decline than to rise over the next few weeks, and even demand for credit may become brisker, perhaps because of spring imports and log driving, the board ventures to propose in these difficult economic circumstances

ERNST NEVANLINNA (1873–1932)

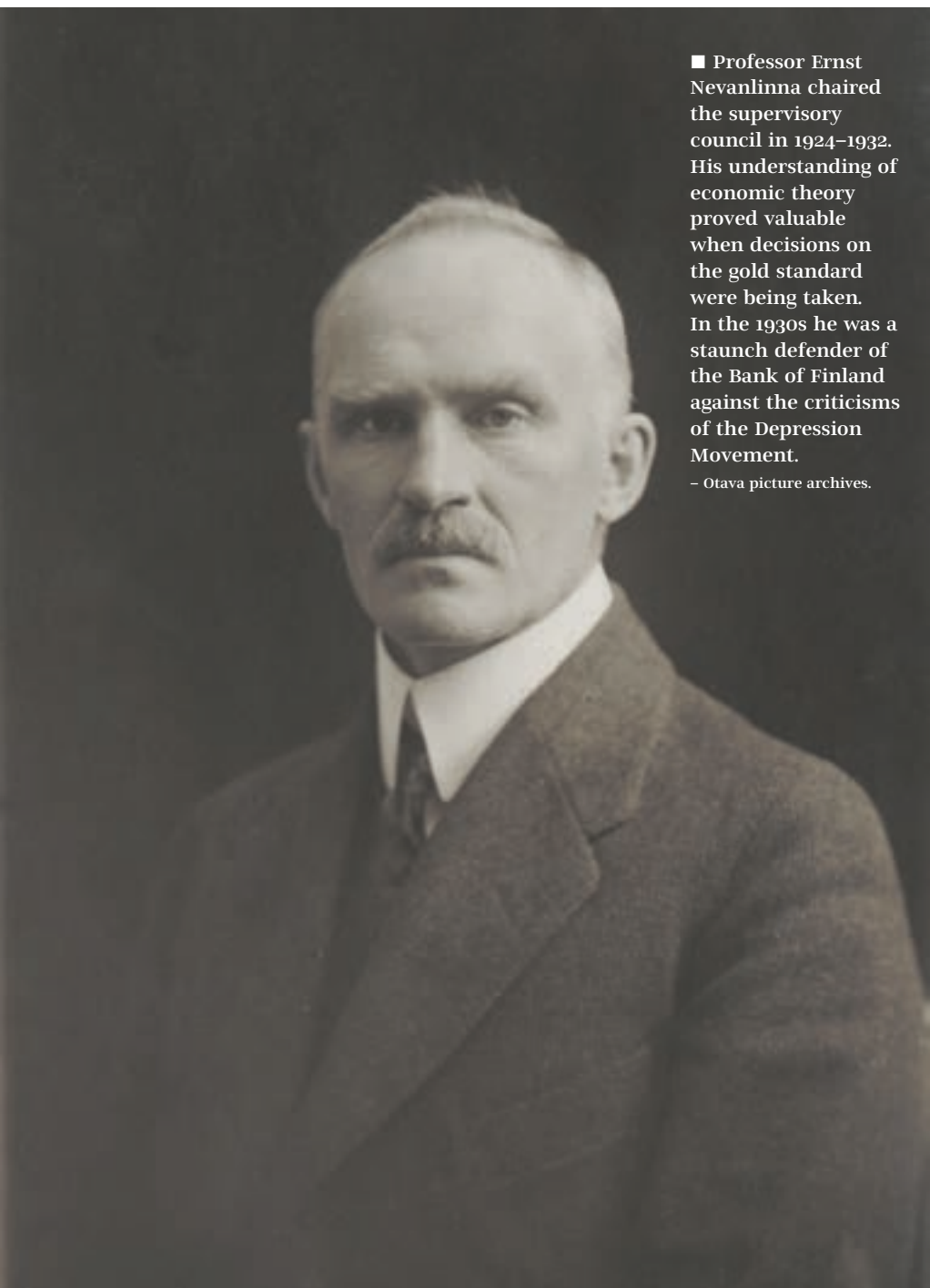
Ernst Nevanlinna became a member of the Senate in 1905 at the tender age of 32. It was the start of a prominent political career as a member of parliament and chairman of the Conservative Fennoman Party. At the same time he was editor-in-chief of *Uusi Suometar* newspaper and its successor *Uusi Suomi* (New Finland). Politics yielded to an academic career from 1922 onwards when he became a professor of economics, but he continued to serve on the supervisory council of the Bank of Finland even after ceasing to be a member of parliament. Except for a brief hiatus, he was a council member from 1909 until his death in 1932, and council chairman from 1924 onwards.

His career as an economist began as a student of history professor J. R. Danielson-Kalmari, imbibing the German historical school of economics. Nevanlinna studied budgeting and taxation as well as the history of the Bank of Finland, and he can be regarded as the leading contemporary expert on public finances. In the 1920s his views were influenced by Gustav Cassel and he turned towards analytical economics. As an economist he was a bridge between the historical school and the analytical approach in Finland.

The challenge to Finland in the early years of independence was to balance the government budget, in which Nevanlinna's expertise was highly respected. He was also several times chairman of the Finance

committee of parliament so, in his various roles, he served as a link between parliament and the Bank of Finland at the time when the wartime practice of financing expenditure by issuing banknotes was ending and inflation was being halted. He also exercised political influence as a journalist. His collaboration with Risto Ryti began in the early 1920s and continued smoothly when Ryti was governor and Nevanlinna headed the supervisory council.

In the Great Depression of the early 1930s Nevanlinna gained a reputation as a consistent defender of the monetary policies of the Bank of Finland. He wrote frequent articles about the bank and its policies, responding to attacks by the Agrarian League and the Depression Movement. His pamphlet "The Bank of Finland: What it should do, what it can do, what it cannot", published in 1931 can be seen as one legacy of the man. It argued that a central bank is principally responsible for the external value of the country's currency, for facilitating the circulation of money in general and for ensuring the stability of the financial system. To this end a central bank could discount bills of exchange only if they were short-term and invest its funds only where they could be quickly liquidated. The Bank of Finland could not therefore provide long-term credit, to landowners or anyone else, nor should its policy on interest rates be aimed at anything other than safeguarding the value of money.



■ Professor Ernst Nevanlinna chaired the supervisory council in 1924–1932. His understanding of economic theory proved valuable when decisions on the gold standard were being taken. In the 1930s he was a staunch defender of the Bank of Finland against the criticisms of the Depression Movement.

– Otava picture archives.

a reduction of half a percentage point in the interest rates applied by the Bank of Finland”.

The responses of the Bank of Finland board to demands from the Agrarian League seem to contain a tactical element. While rejecting proposals that would have subverted the classical principles of monetary policy (such as interest rate controls and a relaxation of banknote cover regulations to increase the amount of long-term credit), the board was ready to cut interest rates. Perhaps this was partly of its own free volition for policy reasons but perhaps the rate cuts were also a gesture to conciliate Agrarian League members. The latter interpretation is supported by the timing of both interest rate cuts, after the Agrarian League had made its strongest demands for changes in monetary policy. On the other hand, compared with the dramatic interest rate reductions taking place abroad, the measures of the Bank of Finland were extremely cautious.

The constant lodestar of the bank in setting interest rates was the balance of payments and Finland's consequent foreign currency position. It wanted to avoid making monetary policy so easy that a new currency flight would be triggered. Since the turn of the year the markka had become stronger so a turn for the better had taken place, but there was prevailing uncertainty about the interest and exchange rate combination that would be sustainable. At the start of April, the pound exchange rate had been stabilised at 216.50 (i.e. 11 % below gold standard parity) and it was held at this level until the end of June. However, current exchange and interest rates were obviously not mutually compatible because foreign currency reserves continued their steady decline throughout the spring. By the end of June the bank had lost about 30 % of its funds in foreign correspondent accounts and its currency reserves were now less than they had been at the end of September 1931, when the international crisis was at its worst.

Jitters on the foreign exchange market at the end of June 1932 cut currency reserves again. Instead of hiking interest rates, the bank lowered the value of the markka against the pound by about 10 % in the first week of July. This was the third time the value of the markka had been moved significantly since the gold standard had been abandoned. It was also the last such informal devaluation before the markka was repegged. Between July and the end of the year, the markka gradually appreciated and by December it was 227.50 against

the pound. It had now depreciated about 15 % against the pound, twice as much as the Swedish krona had.

Proposals for a change in the foundations of monetary policy returned to the agenda for the third and final time in December 1932, with a report of a committee led by Emil Hynninen, managing director of the Confederation of Finnish Cooperatives (Pellervo-Seura). The committee had considered a programme of public works and questions of prices and interest rates.⁷⁴³ Among leaders at the Bank of Finland, both Risto Ryti and Väinö Tanner had been on the committee while Tudeer, the head of the bank's statistical department, had served as its secretary. The committee report itself attracted less public attention than a dissenting opinion appended to it, written by committee chairman Hynninen himself with the managing director of Valio Cooperative, F.M. Pitkäniemi. They proposed a change in the foundations of Bank of Finland monetary policy, in line with the proposals made at the start of the year by members of the Agrarian League on the supervisory council.

The supervisory council asked the bank's board of management for its views on the committee report. The statement it received is perhaps the most comprehensive response to the recurrent criticism that the Agrarian League had been making of the Bank of Finland since the start of the year. It also reveals the principles on which the board's monetary policy was constructed.

The board's reasoning started from the premise that the goal of a central bank's monetary policy should be to strengthen confidence in the value of money. Under no circumstances should its actions "incite the fear of inflation that has spread in certain public circles because (...) in today's restless and nervous conditions, this would result in making it harder to maintain the external value of money (i.e. the markka exchange rate) at even its present debased level". The board had no doubt that "a continuous deterioration in the value of the Finnish markka would be exceptionally detrimental, above all to the state and others who have debts denominated in foreign currency, but also to the whole of society, and that the benefits that producers and exporters expect would not, in reality, be achieved". Constant talk about inflation and ways of raising the price level would only fan dangerous inflation expectations and weaken the value of the Finnish markka on the foreign exchange market.⁷⁴⁴

The board also opposed the idea of lowering interest rates by law which, it thought, might not even be successful. It would furthermore exacerbate operations of the whole financial system because interest rates set an artificially low level would probably lead to a steep contraction in the supply of credit. An interest rate agreement between the banks had already entered into force so rates could be expected to fall in future anyway. Nor did the board regard the establishment of a special government commission on interest rates to be necessary, although it admitted that it might accelerate the decline in interest rates to some extent and harmonise the operations of the different credit institutions on the interest rate question.⁷⁴⁵

In their dissenting opinion, Hynninen and Pitkäniemi had urged the Bank of Finland to begin an active lending policy “similar to that of the United States Federal Reserve under President Herbert Hoover”. The agricultural and industrial mortgage loans granted by the Bank of Finland should be transferred to a mortgage credit institution, from which the bank in turn would purchase an equivalent number of state-guaranteed bonds. Thus short-term loans to farmers could be converted into stable long-term loans, and the lending potential of local and commercial banks would be enhanced.⁷⁴⁶

The board thought the idea was unsuited to Finnish conditions. Even in the US, it argued, these measures had been interpreted as an inflationary policy, had damaged confidence in the dollar and had caused a flight of funds from the dollar abroad and into gold. Finland could ill afford this outcome. A tiny country had slighter possibilities for a successful policy of reflation than the United States, which could at least influence world markets: “We cannot embark on a similar experiment (...) in the hope of improving business conditions (...) because no action of ours could lead to a rise in world market prices. Finland is too small and remote for this. If we were to achieve a rise in prices, it would remain a domestic, isolated phenomenon and the only outcome would be a deterioration in our balance of payments and the continuing decline in the value of the markka. On this matter, all economists are agreed that, however desirable it is to raise prices, a single country, particularly a small one, cannot independently of other countries embark on a separate policy to raise its price level without ruinous consequences. In this respect Finland is even more dependent than most countries on developments in world markets because it

exports a larger proportion of its production to foreign markets than any other country with the possible exceptions of Denmark and Switzerland.”⁷⁴⁷

For the lending strategy of the Bank of Finland to be changed in the way proposed by Hynninen and Pitkäniemi, the bank’s regulations would have to be changed. The board was negatively disposed to this idea, too. Naturally a change in regulations would not automatically lead to reckless monetary policy but it could prompt false expectations among the general public and at the same time place the bank’s management in a difficult position. If such changes were to be made in the regulations, it would be better if they were made under stable conditions and not at a time of crisis such as the early 1930s.⁷⁴⁸

On the board of the Bank of Finland, Kyösti Kallio was again discomfited by this statement because he was also a member of parliament and leading figure of the Agrarian League. He had to counterbalance the demands of the parliamentary group of the league with the views of the bank’s board of management. Once again, Kallio appended a dissenting opinion to the board’s statement, stressing the need to push the interest rates lower and his approval for legal interest rate controls, contrary to the views of a majority of board members.⁷⁴⁹ Such were the political pressures on him that he had no real alternative but to take issue with the policies of other board members. A dissenting opinion apparently caused the least trouble for the board.

The board’s statement was presented at a meeting of the supervisory council on 2 December 1932, at which the members presented the views that they could have been expected to. Vesterinen, Leppälä and Lahdensuo of the Agrarian League had not changed their minds and were dissatisfied with the board’s response. The board’s statement was endorsed by the representatives of the other parties, with the exception of Johan Helo of the Social Democratic Party, who wanted an interest rate commission to be established immediately and, if its operations did not produce results, the imposition of controls.

This was in fact the last joust over matters of principle between the members of the supervisory council because the second government of Juho Sunila fell on 14 December amid disagreement over the same question. The government had proposed a bill to control interest rates

by law and resigned when President Svinhufvud refused to ratify it. Sunila's government was followed by a government led by T.M. Kivimäki, in which the main posts were held by members of the National Progressive Party and non-party ministers with similar liberal views. The Agrarian League had only two places in this government. At the same time it began to be clear that the Finnish economy had indeed turned the corner. This drained the political strength of the Depression Movement, making it easier for members of the Agrarian League to support the conservative monetary doctrines of the other parties.

The 1932 crisis over principles and lines of monetary policy has left posterity with the impression that the policy of the Bank of Finland was exceptionally severe. Obviously this image served the bank's own purposes at a time when it was trying to maintain confidence in the markka's value both at home and on the foreign exchange market. The board of management was manifestly scared of unleashing inflation, probably to a large extent because of experiences during the First World War, the previous occasion when the gold standard had been abandoned. This time things were different and no inflationary pressures ever ultimately arose. The board's concern for the value of the markka on the foreign exchange market was more justified, as demonstrated by the difficulties encountered in stabilising the exchange rate in late 1931 and in spring and summer 1932.

In reality, however, the monetary policy of the Bank of Finland after the gold standard was abandoned has to be judged as far less severe than its reputation. If it is assessed by how well it managed to halt deflation and stabilise the general price level, it was even "softer" than in Sweden, which is sometimes taken as a model for countercyclical policies in the 1930s. It was thanks to Finnish exchange rate policies (or at least to exchange rate movements) in autumn 1931 and in 1932 that deflationary pressures in Finland were effectively mitigated. In 1932 the wholesale price index rose about 7 %, cancelling out the deflation of 1931; wholesale prices in 1932 were on average the same as in 1930. Also the cost of living index remained stable. Sweden's exchange rate policy was much more cautious and it was not entirely successful in combating deflation. The Swedish wholesale price index fell about 10 % during 1931 and 1932 and the cost of living index 4 %. In Finland, deflation in 1931–1932 was confined to agricultural producer prices.

Naturally the fall in prices in this sector had large social and political consequences because two-thirds of the population still received its livelihood from agriculture. The great difference between general price trends and agricultural price movements goes a long way towards explaining the battle lines that were drawn up in monetary policy debate in 1932.

THE STERLING CLUB

CRISIS ABATES

In December 1932 Finland's foreign exchange and money markets experienced a turn for the better that continued throughout 1933. Foreign exchange began to flow into the country and the money market eased. The Bank of Finland felt that the cause was a restoration of confidence. According to the bank's official analysis, this was due "partly to the receding fear of inflation, partly to the realisation that business life in our country was beginning to recover and that the servicing of foreign payments had not been insuperable for our economy. The decisive factor was a large export surplus..."⁷⁵⁰ Reacting to the easier money market, the bank reduced its interest rates by half a percentage point on 1 February 1933. The lowest discount rate was now 6 %, the same as it had been before autumn 1931 when the foreign exchange crisis struck.

In spring 1933 preparations were under way for the World Monetary and Economic Conference, called by the Council of the League of Nations. In October 1932, the governor of the Bank of Finland, Risto Ryti, had been appointed to an international expert commission charged with preparing the meeting's agenda. The commission met in Geneva for the first time in November 1932 and at the turn of February 1933. Ryti was part of its select group for financial questions.⁷⁵¹

Finland's 18-month-long period of "managed floating" ended on 3 March 1933, when the markka was pegged to the pound sterling. The fixed rate of 227 markkaa to the pound was then maintained until the outbreak of the Second World War. The peg was unofficial in nature

because it was authorised only by the board of management of the Bank of Finland and not ratified by any formal decision of the supervisory council, the national government or parliament. Finland was one of a rather large group of countries which took the stabilisation of their exchange rate against the pound as the guiding principle of monetary and currency policies. The group was called the sterling club to distinguish it from the countries that remained on the gold standard (such as France), which became known as the gold bloc.⁷⁵² The stronger balance of payments, which made the exchange rate peg possible, also eased the Finnish money market, and the Bank of Finland lowered its interest rates three more times in 1933 (3 June, 5 September and 20 December) by half a percentage point each time. After these cuts the lowest discount rate was only 4½%.

Finland's decision to fix the markka to the pound coincided with a watershed in the world monetary system. On the day after Finland's decision was made, Franklin D. Roosevelt was sworn in as US president and began forthwith to take the US off the gold standard. American banks were closed by presidential order on 6 March 1933 and when they were reopened, redemption of claims in gold was forbidden. US gold reserves were nationalised; US citizens, private individuals, companies and banks had to hand all their monetary gold holdings to the US Federal Reserve. Later these regulations were expanded and, among other things, the export of gold was forbidden. In the summer, Roosevelt quashed the League of Nations' Monetary and Economic conference by suddenly refusing any international commitments in the area of monetary and exchange policy.

The club that Finland had joined was politically a rather diverse group of countries with various relationships to Britain and its currency. Its members could be divided into at least three categories. Firstly there were the British colonies and overseas possessions, whose monetary systems were pegged to the pound by law. Then there were self-governing dominions that had complete sovereignty in monetary policy but had, with the exception of Canada, decided to stabilise their exchange rates against the pound. Exchange rate coordination within this group was contractual and based on a declaration issued on 28 July 1933 between Britain, its self-governing dominions and India. The third category in the sterling club contained countries that had joined by unilateral decision – Finland and the

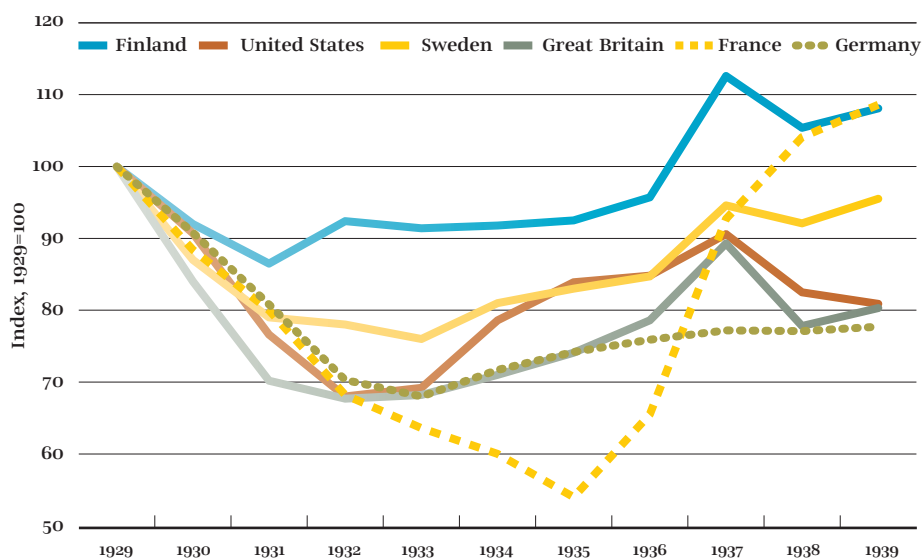
other Nordic countries as well as Estonia and Portugal. Yet another set of countries, non-members of the sterling group, linked their exchange rates to the pound but more loosely than members. These included Argentina and Japan.⁷⁵³

The Bank of Finland's board regarded the resolution of the exchange rate question in 1933 – pegging the markka to the pound – as a kind of non-commitment, in the sense that Finland continued to have the *de jure* freedom to vary its exchange rate despite the *de facto* peg. In a presentation in April 1933, Risto Ryti noted that, under the prevailing conditions of uncertainty and instability, small countries that had been forced off the gold standard “could hardly have any legitimate monetary policy objective other than the one that they had taken, of achieving the greatest possible stability in the domestic price level”.⁷⁵⁴ This contains paradoxical elements; despite the publicly declared objective of domestic price stability, practical policy from spring 1933 onwards was to keep the pound exchange rate completely unchanged.

In fact Ryti was well aware of the conflict, at least in principle, between a stable exchange rate and a stable price level. In his presentation “Back to the Gold Standard” of 1925, he had compared the two objectives with reference to Keynes’ classic pamphlet “A Tract on Monetary Reform”. Unlike Keynes he had come down on the side of a system of fixed exchange rates, which the international gold standard then represented.⁷⁵⁵ However now that Britain had abandoned the gold standard, and the gold standard countries had suffered a destructive spiral of deflation, the situation was different. Ryti may well have concluded that, once the markka had been devalued at the end of 1931 and in summer 1932, a suitable way of combining the objectives of price and exchange rate stability was to follow the pound.

Britain was still Finland's most important market by far, taking about half of exports. The devaluations had weakened the markka about 15 % by the end of 1932, but no fundamental conflict arose between a peg to the pound and price stability. A sign of this is that deflation in Finland, which began in 1929, ended after Finland left the gold standard in 1931. The price level remained very stable for several years until inflation flared up in 1937. The monetary and exchange rate policy of Finland achieved its declared objective of stabilising the price level from 1932 onwards, at the same time as the exchange rate was also being stabilized.

WHOLESALE PRICE MOVEMENTS IN SELECTED COUNTRIES IN THE 1930S



Sources: League of Nations statistical yearbooks.

The countries of the sterling club differed from each other in one more respect. Some had pegged their currencies to the pound at the gold standard parity that prevailed before autumn 1931 while others had allowed their currencies to fall in value first. This difference was naturally a potential subject of dispute between club members. Albert Baster gives Finland as an example in his article on the sterling club: “Exchange-dumping, which is what under-valued currencies produce, is an embarrassment for the sterling area, since the constituent countries produce closely competitive products in wheat, meat, cotton, timber, wool and butter, and they gain in the British market largely at one another’s expense. Choosing the original stabilisation rates for the Scandinavian currencies, for instance, was awkward, particularly when the Finnish mark was allowed to drop to 226 from a parity of 193.23, whereas the Swedish crown fell only from 18.16 to 19.” The rates Baster quotes imply a devaluation against the pound of 14½% for the Finnish markka and 7 % for the Swedish krona.⁷⁵⁶

The table below gives an overall picture of the members of the sterling club, the pound exchange rates they chose as a percentage of the rate preceding the crisis, and the date of the peg.

STERLING CLUB MEMBERS AND THEIR CURRENCY PEGS,
PERCENT OF 1930 EXCHANGE RATES IN POUNDS STERLING

	Rate	Date
Egypt	100	9/1931
India	100	9/1931
Iraq	100	9/1931
Portugal	100	9/1931
Australia	80	12/1931
Thailand	100	8/1932
South Africa	99	12/1932
New Zealand	80	1/1933
Denmark	81	2/1933
Finland	85	3/1933
Norway	91	6/1933
Sweden	94	7/1933
Estonia	100	9/1933
Latvia	100	9/1936

The members also differed in how free their foreign exchange markets were. In Finland there were no foreign exchange controls except for the period October-December 1931. However nearby Estonia, Latvia and Denmark began controlling foreign exchange before fixing their exchange rates to the pound and continued to do so afterwards.⁷⁵⁷

By the end of 1934 Finland's money market had eased for two years and on 3 December the Bank of Finland cut its lowest discount rate to 4 %. It had never been lower and had last been as low in the 19th century, for a few months in 1895 and longer periods in 1871–1875 and 1886–1890. The liquidity position of the banks had been so good since 1933 that they had not needed to rediscount any bills of exchange at the central bank.

In February 1934, after a year-long period of floating exchange rates, the United States made a partial return to the gold standard, but only in relation to international gold markets. Its central bank, the

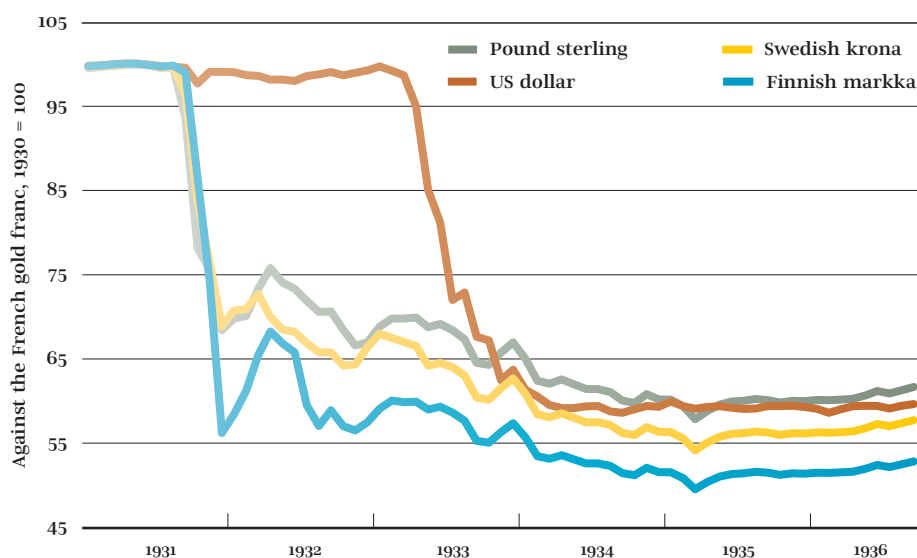
Federal Reserve, again began to exchange dollars for gold, but this opportunity was offered only to foreign monetary officials; US citizens could still not demand redemption of their dollar banknotes in gold. At the same time the United States implemented a major devaluation. The dollar's value in gold was reduced about 41 % and set at \$ 35 per ounce (previously \$ 20.67). This devaluation was approximately the same as the fall in the dollar on foreign exchange markets since Roosevelt had become president. The dollar was now officially fixed at this level against the gold currencies, which in practice meant the French franc.⁷⁵⁸ However, the US devaluation and its return to an external gold standard had no effect on Finland's exchange rate policy and the markka peg to the pound was kept unchanged. It remained in force until August 1939, when the outbreak of the Second World War led to the re-assessment of exchange rate policy.

PRICE OR EXCHANGE RATE STABILITY?

As stated above, even after the markka had been pegged to the pound, governor Ryti had said that the primary objective of monetary policy was stable domestic purchasing power of the currency; stable exchange rates had only secondary and indirect significance. This meant that no conflict was seen between an exchange rate peg and price stability under prevailing conditions, at least at the peg chosen as the new fixed point for exchange rates. The objective of a stable price level was never formalised at the Bank of Finland so any conflict with exchange rate stability is a matter of interpretation only.

This is not to say that talk of price stability was mere transient rhetoric; the bank put genuine new effort into monitoring domestic price movements. It had already begun to calculate its own consumer price index at the start of 1932, with the intention of assessing how the price level was moving relative to conditions that had prevailed in July 1931. By having its own index, the bank could rapidly obtain information to base monetary policy on, which explains why the index was calculated weekly and not monthly, the normal method used by the Central Statistical Office for the official cost of living index. Sweden served as an example; it also began to calculate a weekly consumer price index around this time.⁷⁵⁹

EXCHANGE RATES IN THE 1930S

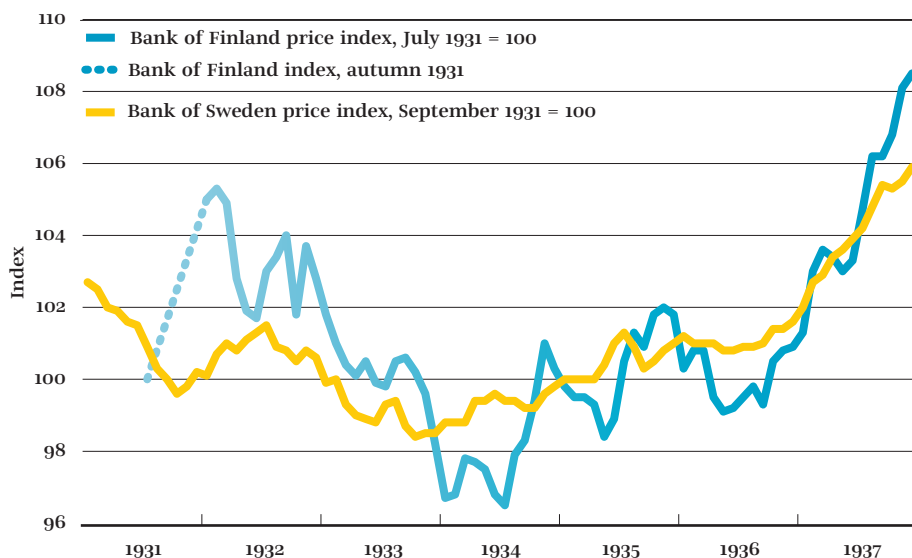


Source: Autio, J., 1992.

In autumn 1935 the bank asked Leo Törnqvist, a postgraduate student of statistics who later became a professor at Helsinki University, to revise the way the index was calculated. The result of this commission was Törnqvist's variant of the continuous Divisia index. The Divisia-Törnqvist index later gained international renown and may be the most precise formula ever devised, because it is not distorted by changes in the basket of items consumed. The findings were published in the Bank of Finland monthly bulletin in 1936, along with retroactive consumer price index data from 1932 onwards.⁷⁶⁰ The bank's own consumer price index was then published regularly in the Monthly Bulletin until the outbreak of war in autumn 1939.

One can of course ponder how seriously the bank took the stated objective of price stability compared with its concrete policy of a stable exchange pound against the pound. Which would have carried the day if they had become mutually incompatible? In a report to the supervisory council in 1937 as part of current preparations for a reform

CONSUMER PRICE INDICES OF THE BANK OF FINLAND AND BANK OF SWEDEN



Sources: Bank of Finland Monthly Bulletin; Lindahl, E., 1933; Lindahl, E. and Lundberg H., 1938; Central bank annual reports.

in Bank of Finland regulations, the board of management and governor Ryti laid out their views on monetary policy objectives since autumn 1931. Initially they noted the main features of monetary and exchange rate policies since the gold standard had been abandoned:

“In numerous countries such as Britain, the Netherlands, the Scandinavian countries and Finland, the currency is not pegged to gold in any fixed ratio but is left as a free paper currency, with a domestic purchasing power and a relationship to foreign currencies that the central bank, by monetary policy, has tried to keep as stable as possible. Thus our markka and the kronor and kroner of the Scandinavian countries have been in a close relationship with the pound sterling since 1933, while the price levels of these countries have remained relatively stable.”

In its assessment of the future the board noted that the price of gold had proved to be very unstable, and that merchandise prices had not followed fluctuations in gold prices but had charted their own

courses. In these circumstances, the board reasoned, “a return to a fixed gold standard, if Finland, which cannot itself influence gold price movements, were to go it alone, would not be a better guarantee of domestic price stability or a stable relationship with the currencies most important to us, than what has been achievable by a free paper currency.”

After this the board rejected the idea of setting an official fixed exchange rate, for example by law, because this would remove from monetary policy the flexibility that was desirable:

“... another possibility for a return to a statutory monetary system would be to tie our markka to some other currency by defining in law a fixed relationship between the markka and this currency. But, if the country to whose currency the markka was connected was on a free money standard (i.e. not the gold standard), this would make the value of the markka entirely dependent on developments there and on the decisions and actions of that country’s currency officials. We would then lose the opportunity to consider whether (these decisions and actions) were always in keeping with our interests. Particularly under the present uncertain conditions it would hardly seem appropriate to abandon the opportunity to pursue independent monetary policy.”⁷⁶¹

The above excerpt may indicate that, at least under prevailing conditions (which were characteristically uncertain and in some ways regarded as a temporary state of the international monetary system), the primary objectives of monetary policy were domestic. The only goal mentioned by the board was price stability. The board seemed to be ready, if necessary, to deviate from exchange rate stability in order to safeguard domestic equilibrium. What was not said was how much the domestic price level had to move before the exchange rate would be allowed to respond in order to combat inflation or deflation.

The priorities of monetary policy were tested in practice during 1937, when an upswing in international raw material markets raised export prices of the forest industry sharply. Finnish export prices rose by about 23 % and by much more in some categories for a brief period. Import prices also rose greatly, by 17 %. This acute spurt in international prices naturally had effects on the domestic price level, boosting inflation. The cost of living index in 1937 was 6 % higher, and the wholesale price index 18 % higher, than the year before. Such great

hikes had not been seen since 1920. However, the Bank of Finland's own consumer price index rose by only 5 %, and the international price spike proved to be temporary. The following year wholesale prices began to fall and the cost of living index settled at the level it had reached at the end of 1937. There was thus no permanent acceleration of inflation.

Under these conditions, the Bank of Finland kept the pound exchange rate unchanged at 227 markkaa although it could have sought to combat the inflationary impulse from international markets by allowing the markka to appreciate against the pound. Naturally there was discussion in Finland about a response via the exchange rate. In a memorandum apparently intended for Risto Ryti, written in January 1937, the respected head of the bank's Economic Research Department, Dr Bruno Suviranta, assessed the benefits and disadvantages of a stronger markka. He noted that, because of asymmetry between the internal and external purchasing power of the markka (i.e. its undervaluation) the economic upswing had been very export-oriented and pointed out that relative price equilibrium could be achieved either by domestic inflation or exchange rate appreciation. If the markka were to become stronger against the pound, faster inflation could be avoided but at the same time the profitability of industry, on which the recovery had been based, would be hurt. Suviranta concluded that even a small rise in the value of the markka would help to curb inflation but, if this were done, the high level of business activity should be supported, for example by lowering interest rates. In his view, the strong state of the payments account and the currency reserves offered opportunities for these measures.⁷⁶²

The option that Suviranta highlighted was not pursued. The exchange rate was kept unchanged in 1937 and inflation was allowed to accelerate temporarily. This could be taken as a sign that price stability was not the main objective of monetary policy, despite the pronouncements to the contrary. With hindsight, however, the line taken could be defended from the viewpoint of price stability because it did not ultimately lead to a permanent increase in the rate of inflation. The price spike was short-lived and world market prices fell steeply the following year. Even in Sweden, where price stability was more distinctly the leading principle of monetary policy, the pound

exchange rate was not adjusted when raw material prices rose. Two well-known Swedish economic experts, Gustav Cassel and Eli Heckscher, did propose that the krona be raised in value against the pound to stabilise the value of money, but this was not done. Swedish prices rose in 1937 by far more than for a long time. Wholesale prices increased by 15 %, almost as much as in Finland, although the cost of living index went up by only 3 %.⁷⁶³

One reason for the unwillingness of Sweden and Finland to adjust their exchange rates against the pound may have been that multilateral international currency cooperation had been revived in autumn 1936, three years after the unsuccessful London conference. Since the conference, the United States had fixed the dollar against gold (although at a value 41 % lower than before) and France, the main country still clinging to the gold standard, had entered a harsh deflationary spiral. Great Britain, France and the United States reached agreement on monetary stabilisation in September 1936. The agreement is often associated with France's devaluation, which happened on the day that it was published. The franc was devalued 26 % and exports of gold were forbidden. Neighbouring Switzerland and Holland, part of the gold bloc with France, followed suit by devaluing on the same day. The gold bloc had in practice ceased to exist. Meanwhile the trilateral agreement initiated treaty-based monetary cooperation. Each party committed itself to exchanging its currency held by another party for gold on demand. The agreement created external convertibility for the US dollar and constituted a precursor to the Bretton Woods system established after the Second World War, which also allowed countries to convert their dollar assets into gold in the United States.⁷⁶⁴ At the end of 1937, in a book celebrating the 20th anniversary of Finnish independence, governor Ryti wrote about the principles of monetary policy in a way that can be understood as stressing currency stability far more than his previous statements of 1933–1936:

“Our national economy is dependent, more perhaps than any other country's, on foreign trade, and moreover on trade with a certain few countries. By our exchange rates we have achieved a balance that is largely satisfactory. Under these prevailing conditions, strong reasons would have to be advanced before we could renounce the relationship that we have so far maintained as stably as possible with the other

currencies of the sterling countries and begin to chart our own course. This is all the more justified by the probability that the country leading the sterling bloc will manage its economy and currency policies in a satisfactory way, as it has done to this date.”⁷⁶⁵

It would apparently have required a rather great upheaval of economic policy to detach the markka from the pound after the peg had operated well for several years. When it was discontinued in August 1939, the reason was not a disturbance in Finnish price stability but a crisis in world politics that led to the outbreak of World War on September 1, when Germany attacked Poland. Political tension began to show in the pound exchange rate in the last week of August. The Bank of Finland discussed policy with the other Nordic central banks and a joint course of action was agreed: the pound peg was discontinued. On 28 August, when the pound's value in New York had already fallen about 10 %, the pound exchange rate was lowered from 227 to 210 markkaa, that is, about 7 %.

After Germany attacked Poland on 1 September 1939, Finland declared its neutrality. On 3 September Britain and France declared war on Germany. During the first week of the war, the Bank of Finland quoted no foreign currency rates but, when quotations were resumed on 9 September, the dollar exchange rate was set at 49.35 markkaa and held at this rate for several years. The pound was again allowed to fall, to 202.5 markkaa. The pound peg had been exchanged for a dollar peg.

Quoted currency rates were less important after the outbreak of war, because the freedom to exchange currencies was restricted. Already on 8 September, a day before rate quotations were resumed, everyone who held foreign currency or had debts or claims abroad was required to notify the Bank of Finland. On 25 October the government issued a statement initiating wartime currency regulations and making foreign exchange operations the monopoly of the Bank of Finland. The export of money and securities was made subject to license and all claims denominated in foreign currency had to be surrendered to the Bank of Finland, which was to oversee the appropriate use of currency.”⁷⁶⁶

Finland's neutrality in the new great war did not last long. By 5 October the Soviet Union had invited representatives of the Finnish government to Moscow to negotiate on “concrete political questions”,

meaning the surrender of territory demanded by Moscow. Finland began mobilising its army on 9 October under the name of “extraordinary refresher exercises”. When negotiations ended inconclusively, the Soviet Union attacked Finland on 30 November 1939. The Winter War had begun.

THE BANK OF FINLAND AS BANK RESCUER

SPECULATIVE LEGACY OF THE GREAT WAR

From the outbreak of the First World War to the early 1920s was an exceptional period in the history of Finnish banking. Operating parameters changed fundamentally when the gold standard was abandoned and the country entered a period of rapid inflation. Until 1916 the economy was in overdrive and the financial system contained striking excesses of liquidity. This was largely the consequence of general insecurity in the war years, which halted long-term investment projects such as construction. Another cause were the roubles brought to Finland by exports to Russia and by the Russian army, which were then converted into markkaa. The uncertainty did not inhibit risk-taking by Finland's banking sector; on the contrary, a record number of new commercial banks, mostly speculative in nature, were established. Between 1916 and 1919 the number of commercial banks almost doubled from 13 to 24. The busiest years were 1917 and 1919, when five new commercial banks were established each year.⁷⁶⁷

Apart from a few exceptions the new banks had little founding capital, 1 million to 5 million markkaa. The markka had collapsed to nearly a tenth of its pre-war value so these capital sums were extremely small. With inflation, the minimum amount of capital required by law had been reduced in real terms, lowering the barriers to establishment. Suspicions were also aroused by the small number of shareholders in the new banks, which meant that the bank might have close and

unhealthy links with the other businesses of its shareholders. Many managers of small banks had a striking lack of professional skills and banking experience. This was all the more visible in the working of the new boards of management and supervision of the new banks. Often the impetus for establishing a bank was to exploit currency arbitrage, occasioned by confused foreign exchange conditions. Little effort was put into basic banking. In fact, the common denominator for all the new banks was speculation.⁷⁶⁸

Public officials were alarmed by the arrival of new players in the banking market and, when conditions were somewhat more settled in 1920, a committee was established to draw up proposals for more effective monitoring of commercial banks. The driving concern was to ensure that these small speculative banks did not fail; no one wanted to see a repetition of the Nykarleby Bank fiasco.⁷⁶⁹ In the debate in parliament, members were overwhelmingly in favour of the establishment of a new central monitoring organisation. The discord was largely over the number of bank inspectors and how they would be supervised. According to the government proposal, operations would be overseen by a college consisting of an inspector general and delegates proposed by the Central Chamber of Commerce. In the proposal that was approved, these delegates were omitted and the bank inspectorate, consisting of an inspector general and two bank inspectors, operated under the auspices of the Ministry of Finance. The proposal was opposed most strongly by J.E. Hästbacka of the Swedish People's Party, who felt that inspection meant state nannying and an endorsement of monopoly powers.⁷⁷⁰ The new bureau began operations in March 1922. The division of responsibilities with the Bank of Finland was clear because the Inspectorate was responsible for monitoring individual banks while the central bank's remit, as defined by its regulations, was to maintain the (overall) monetary system on a stable basis.

From the Bank of Finland's perspective the biggest systemic problem at the start of the 1920s was the collapse in the external value of the markka and the resultant problems for credit institutions that had taken foreign currency loans. The first to get into trouble was the Finnish Town Mortgage Fund, one of the country's largest mortgage credit institutions. This bank concentrated on providing credit for urban real estate and operated closely with Kansallis Bank and Suomi

Insurance Company. Its large short-term loans from Sweden, Denmark and Switzerland fell due in autumn 1920 and it had no way of repaying them because the markka exchange rate had collapsed. Guarantees for the loans had been provided by Kansallis Bank and Salama Insurance Company, which now refused to renew them. The Town Mortgage Fund said that its only hope of rescue was for the Bank of Finland to guarantee the loans and promise to pay the exchange rate losses. Otherwise it would have to file for bankruptcy.

This put the Bank of Finland in a disagreeable position; such direct support for a private bank was alien to it. On the other hand, the position of newly independent Finland in international capital markets was at best weak and might not have withstood the “badwill” caused by a failure to service foreign bonds. The board of management and the supervisory council of the Bank of Finland decided to ask parliament for permission to do as requested but the matter did not go that far. Questions were asked about why the responsibility should be borne by the Bank of Finland alone, and a new contract was drawn up in spring 1921, in which half of the losses were to be paid jointly by the original guarantors and half by the Bank of Finland, but with a ceiling of 3.5 million markkaa set on the liability of Kansallis Bank and Suomi Insurance. In compensation the Bank of Finland was to receive the shares in the Town Mortgage Fund held by Kansallis and Suomi. This proposal was ratified by parliament, and the Bank of Finland agreed to bear a loss of 3.5 million markkaa. It was soon clear, however, that this support would not be enough and the Bank of Finland again turned to parliament for permission to make the capital injections necessary. Parliament refused and the Fund went into bankruptcy in January 1922. At this point the Bank of Finland held more than 80 percent of its shares and its final losses exceeded 10 million markkaa, far more than the sum approved earlier by Parliament.⁷⁷¹

There was loud public criticism of this operation, particularly in the Swedish language press. One target of criticism was the dual role of the chairman of the supervisory council of the Bank of Finland, Wille Lavonius, who was also managing director of Suomi Insurance Company. There was certainly a conflict of interest. It is hardly surprising that, after tempers had cooled in 1924, Lavonius left the council. The biggest problem in handling the problem had been the slowness of decision-making. The board of management of the Bank

of Finland and the supervisory council had been able to act quickly enough but having to confirm their decisions in parliament was far too slow a process. On the other hand, the bank had succeeded in its objective of preserving international confidence.⁷⁷²

The other large mortgage credit institution, the old and respected Mortgage Society of Finland, faced difficulties with its foreign creditors around the same time. Its loans had a state guarantee so the Bank of Finland did not have to foot the bill. In 1920 it did have to grant the Mortgage Society a large loan for servicing upcoming amortisations but the rest of the support needed came from the government.⁷⁷³

The small commercial banks established during the First World War met the fates that had been feared. The stabilisation of the exchange rate, and the foreign exchange restrictions enacted before that, put an end to currency arbitrage, the business that many of these banks had been set up for. Moreover the abolition in 1920 of what was left of usury laws led to fierce competition for deposit funds, raising interest rates to levels that the new banks could not afford. Foreign currency loans taken during the war, which were fairly large in comparison with their equity, proved impossible to repay after the steep decline in the markka's external value. However the banks were so small that they had no impact on the stability of the domestic financial market as a whole, nor on Finland's international credibility. The central bank regarded the situation as far from critical.

It was, however, concerned about the large number of small commercial banks and the consequent lack of cohesion in the banking system, which made systemic stability harder to monitor. It regarded the best solution as takeovers by larger banks, mergers between smallish banks into more viable units or liquidation of operations either voluntarily or via bankruptcy proceedings.

Nylands Bank, the Industrial Bank of Finland (Suomen Teollisuuspankki), and the Commercial Bank of Finland (Suomen Kauppapankki) were merged with the Bank of Helsinki (Helsingfors Aktiebank) in 1919–1924. Helsinki Private Bank (Privatbanken i Helsingfors) was acquired by the Nordic Union Bank (Pohjoismaiden Yhdys-Pankki) in 1922. Three provincial commercial banks – the Bank of Turku (Turun Osakepankki), Vaasa Bank (Vaasan Osakepankki) and the Farmers Bank (Landtmannabanken) – were merged to create the Allied Bank of Finland (Suomen Liittopankki) in 1920. Two smaller

banks – Helsinki Discount Bank (Helsingin Diskonttopankki) and the Bank for Foreign Trade (Osakepankki Ulkomaankauppaa varten) – ceased operations in 1921 and 1923, when the shareholders of the former lost their entire investment. The Bank of Finland supported these solutions mainly in the form of rediscount credit but did not offer outright support for the reorganisations.⁷⁷⁴

Nascent concentration of the banking system is therefore observable in the first half of the 1920s although it did not reach its conclusion until the economic depression at the start of the next decade. In the late 1920s banks that were large by contemporary standards ran into trouble, creating an increased danger of crisis in the whole financial system. This required more active intervention by the Bank of Finland, but it kept unchanged its fundamental line of not rescuing small banks that were minor to the whole system. Active intervention was reserved for only a few banks. Compared with previous decades, its operations were facilitated by the more established position of the bank inspectorate and the consequent improvement of official information about the true financial state of banks. Close cooperation between the governor of the Bank of Finland and the heads of the main commercial banks provided another source of information that was at least as important. The diary entries of J. K. Paasikivi in the period 1914–1934 are evidence of this; most references are to conversations with Risto Ryti.⁷⁷⁵

THE GREAT DEPRESSION AND BANK PROBLEMS

After the markka had stabilised in value, there came a more tranquil period but banks began to face tougher times again from 1929 onwards. The underlying domestic factor was an exceptionally strong construction boom, which began from the return to the gold standard in 1926 and once again had speculative features. On top of it, the international economy went into recession, initially hitting Finland as fading sales of the main export item, sawn timber. The first to turn to the Bank of Finland was Atlas Bank, which in 1928 applied for an increase in its already large rediscounting quota. The Bank of Finland granted the increase but a worsening economic climate further undermined the bank's position and its financial state soon proved

untenable. The only solution was to terminate its operations and to transfer its debts and assets to the Bank of Helsinki. Atlas Bank depositors kept their deposits but the shareholders lost almost everything.⁷⁷⁶

From the Bank of Finland's perspective, the largest and longest rescue operation surrounded the Provincial Bank (Maakuntain Pankki). It had been established in 1929 when the Central Bank of the Provinces (Maakuntain Keskuspankki), jointly owned by four regional banks, had merged with two of its parents, Bank of Tampere (Tampereen Osake-Pankki) and the Bank of Western Finland (Länsi-Suomen Osake-Pankki). Problems had already been visible a year earlier at the Central Bank of the Provinces, when it had faced an impending liquidity crisis because of the failure of funding. Its funds came mainly from short-term deposits while a large proportion of its lending was long-term credit to the real estate sector. The Bank of Finland responded by increasing its rediscounting quota and also by initiating the merger negotiations that led to the creation of the Provincial Bank in the following year. An acute problem of the Provincial Bank was the repayment of a large short-term loan from Sweden, which it managed only after the Bank of Finland had provided a fairly large loan. A chronic problem was its extremely large proportion of non-performing loans. By 1931 the bank was a serious source of concern to the Bank of Finland, especially because, according to its balance sheet total, it was the third largest commercial bank in Finland.

From summer 1931 onwards, governor Ryti of the Bank of Finland had repeated discussions with the chief general manager of Kansallis Bank, J.K. Paasikivi, about the state of the Provincial Bank. The impression gradually formed that the only viable solution was a takeover but Kansallis was not prepared to accept the Provincial Bank without support from the Bank of Finland. It was also difficult to determine the true value of the Provincial Bank because of imprecise, or at least disputed, information about the magnitude of impending credit losses.⁷⁷⁷

At the proposal of the Bank of Finland's board, the supervisory council approved a plan for the Bank of Finland to subscribe Provincial Bank preference shares worth 30 million markkaa on condition that Kansallis Bank subscribed the same amount. The Bank of Finland was also to grant the Provincial Bank a fairly large loan to eliminate its

acute problems. After this Kansallis Bank would take over the Provincial Bank. Its incentive for doing so was central bank rediscount credit worth 200 million markkaa at an interest rate of five percent when the prevailing rediscount rate was eight percent. The arrangements were completed at the end of 1932. It was a heavy burden on Provincial Bank shareholders who, under the merger terms, lost about 90 percent of their investment.

The parliamentary supervisory council of the Bank of Finland rarely criticised proposals by the board of management about how bank problems should be managed. The only really interesting debate of principle was conducted in connection with the rescue of the Provincial Bank in 1931. Council member Erik von Frenckell objected to the board's rescue proposal because, in his view, the difficulties were caused not by the general financial crisis but by bad management, which ruled out central bank support. In the vote, Frenckell was supported by only one other councillor, Johan Helo of the Social Democratic Party.⁷⁷⁸ In fact Frenckell could also have criticised the plan on the grounds that the regulations of the Bank of Finland did not give it the right to own shares. It lent weight to his views that he represented Swedish-speaking liberals and was a former member of the board of the Bank of Finland.

Another fairly large merger had been completed a little earlier, when the Allied Bank had been taken over by the Bank of Helsinki, but the financial position of the Allied Bank was reasonably good so no special support was needed from the Bank of Finland. Even so, Allied Bank shareholders lost some 16 percent of their investment.

Aid was needed to shore up the largish Bank of Finnish Agriculture, (Suomen Maatalous-Osake-Pankki), which had already received Lombard loans from the Bank of Finland at the end of the 1920s, in addition to conventional rediscount credit. As the depression deepened its credit losses grew and, as shareholders' equity evaporated, it faced either a takeover or a cessation of operations. The Bank of Finland discussed the matter with the Nordic Union Bank and the Bank of Helsinki but neither was willing to take it over. At the same time its large size prevented it being shut down so the solution was a capital injection to guarantee its capital adequacy. This was granted in 1933 by the Bank of Finland, Nordic Union Bank and the Bank of Helsinki jointly, for a period of up to five years. The bank's position stabilised

so quickly that the Bank of Finland received its loan back the following year.

In addition to the events described, six small commercial banks got into trouble in the Great Depression of the 1930s. In their case the Bank of Finland was consistent in not offering support beyond normal rediscount credit. Most of the banks were in such a bad state that the Bank Inspectorate ordered them to be closed. Closure meant that shareholders lost part or all of their investment and depositors lost up to 66 percent of their deposits. By far the worst managed were the Export Bank of Finland (Suomen Vientipankki) and the regional Bank of Southern Ostrobothnia (Etelä-Pohjanmaan Pankki). Of the former, the managing director and the chairman of the board of supervisors were charged with misconduct and neglect and received unconditional prison sentences. The managing director of the latter was found to be not of sound mind.⁷⁷⁹

The greatest amount of public money was used to rescue the Central Lending Fund of Co-operative Credit Societies, an institution that funded local cooperative institutions that lent mainly to agriculture. In autumn 1934 it had issued bonds worth 300 million francs to a consortium led by Credit Lyonnais of France. The sum raised had allowed it to convert the short-term loans of more than 7000 farmers and 165 rural municipalities into stable long-term amortisation loans. Finland left the gold standard in autumn the following year and the markka declined steeply against gold bloc currencies including the franc. This put the Central Lending Fund in an entirely untenable position because most of its debtors were patently unable to make such steeply increased amortisation payments. The government came to their rescue by paying the exchange rate losses from 1933 onwards, a total of 249 million markkaa. The bonds had a government guarantee so the rescue operation had no financial effect on the Bank of Finland. It did, however, play a key role in the tough negotiations conducted with the French in 1938–1939 on repayment of the loan.⁷⁸⁰

In the light of board and management minutes, there was relatively little discussion at the Bank of Finland about the problems of stabilising the banking system. The central bank's premise was that it would protect the stability of the financial system as a whole, and come to the aid of an individual bank only if its collapse threatened the whole

system. However the Bank of Finland does seem to have had a policy on restructuring. Discussions between Risto Ryti and J. K. Paasikivi of Kansallis Bank are marked by Ryti's wish to consolidate the financial system. The Bank of Finland saw the large number of small commercial banks as a destabilising factor, so bank mergers and closures were to be welcomed rather than feared. It achieved this objective; by the end of 1934 the number of commercial banks had shrunk to nine. Structurally the commercial bank system was now very close to its state in 1914. Small speculative banks had disappeared and the market was dominated by major banks with great capital and broad branch networks. Competition was restricted in other respects too because in 1931, at Ryti's initiative, an interest rate pact between the banks had been agreed, to restrict competition for deposits. The high concentration and often weak interest-rate competition characteristic of the Finnish commercial bank system became more pronounced. The competitive 1920s were indeed only a transient and exceptional period in the history of Finnish banking, although perhaps the wild years at the end of the 1980s offer a similar vista.

A MORE BANK-LIKE APPEARANCE

PERSONNEL

In the 1920s and 1930s the Bank of Finland was at the hub of economic and monetary policies. Admittedly it had made a faltering start after the war but by the mid-1920s its position was very strong, as shown by the increased volume of work at head office in Helsinki and at branch offices in provincial towns. Independence had led to a downgrading of economic relations with Russia, and the branch office in Petrograd/St. Petersburg was closed down, but it was the only one to close. No new branch offices were established so the number stayed constant at thirteen. There was nonetheless a small regional expansion because agencies were established in 1926–1927, first in Rovaniemi in Lapland and then in Kajaani in the north-east. An agency handled money exchange and redeemed postal drafts issued by the Bank of Finland. The bank did not establish its own offices for the agencies but purchased the necessary services from local commercial banks, the Nordic Union Bank in Rovaniemi and the Bank of Helsinki in Kajaani.⁷⁸¹

The number of employees increased steadily during the 1920s but remained practically unchanged in the following decade. This was due mainly to a slight reduction in the number of branch staff. As transport and communications connections improved, functions were relocated from the branch offices to head office so the amount of work at the branches declined somewhat. In practice it was lending decisions that were shifted back to head office, in order to ensure that the discounting

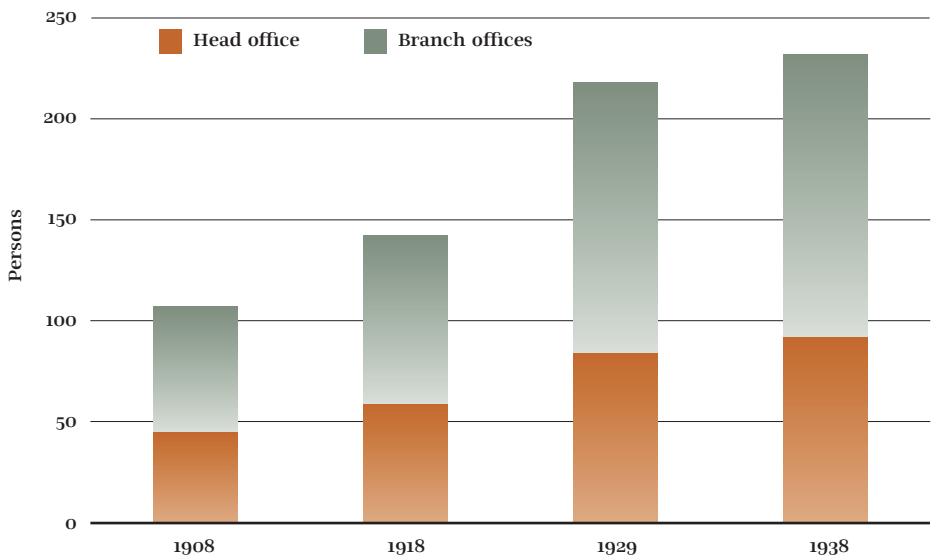
policies of the central bank were reflected as rapidly as possible throughout the country.

Although the Bank of Finland had a relatively good reputation as an employer, there were problems in recruiting competent officials, particularly in the first half of the 1920s. This was due to two factors: increased competition in the labour market and rigid salary policies at the central bank. During the First World War the number of commercial banks had almost doubled, creating strong demand for skilled employees. The new commercial banks targeted some of their recruitment at the Bank of Finland, which found it hard to compete. It had an inflexible official hierarchy and could not offer such impressive job titles. A growing number of employees had the status of supplementary official because it was difficult to establish new permanent positions.

The system of salaries in use caused an even greater problem. Wages were initially set according to the pay scales approved by parliament and subsequently by the supervisory council. While Finland had been on the gold standard, prices had hardly moved so a system that remained unchanged for years worked well. The surge in inflation during the First World War led almost to impasse because it was impossible to modernise the pay scales in those exceptional times. Real wages fell steeply. In fact there was no real effort to reorganise the system because, until the early 1920s, it was widely believed that price rises were only a temporary phenomenon and that, with peacetime, the gold standard would be reinstated and prices would return to their pre-war level.⁷⁸²

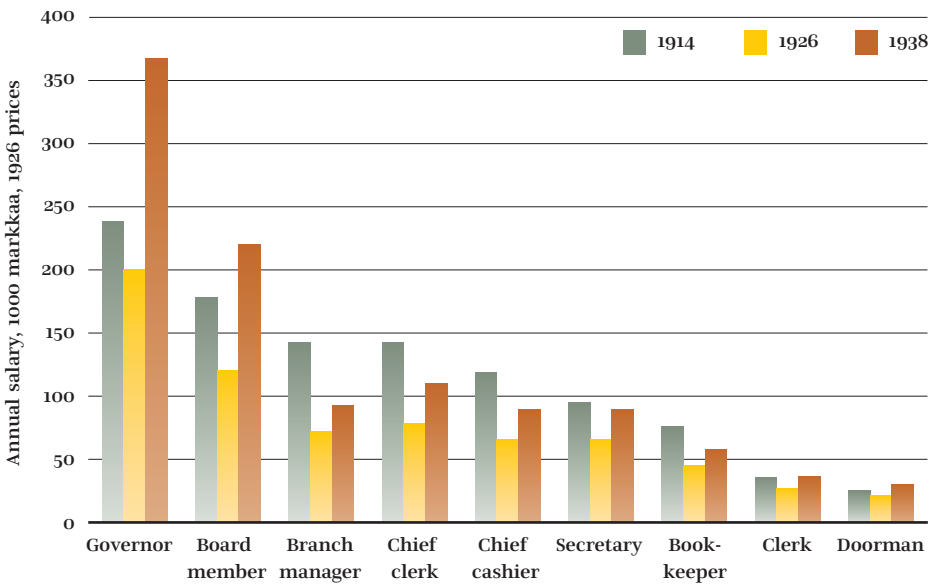
Although the bank's officials and managers were agreed that salaries had fallen behind, they made no reorganisation plans and applied temporary solutions instead. In 1915 the bank started using "costly period wage supplements". They were intended to ensure minimum livelihood levels and the worst paid received the greatest absolute increases. The number of children in an employee's family was taken into account in determining the increases. The greatest increases went to those who earned no more than 1800 markkaa a year and had at least five family members to support. To pay these supplements the bank had to draw up exact statistics for each employee's children for the first time. Similar supplements were paid to all public sector officials, and were increased steadily during the

BANK OF FINLAND PERSONNEL 1908–1938



Source: Bank of Finland. Wage regulations 1908–1938, Bank of Finland archives.

REAL WAGES OF BANK OF FINLAND STAFF 1914, 1926, 1938



Source: Bank of Finland. Wage regulations 1914–1938.

war as inflation advanced. A reform of the entire salary scale was finally proposed in 1919 but the supervisory council felt that conditions were still too unstable so the old system of supplements was continued. Salaries of government officials were reorganised in 1921 but the Bank of Finland continued using temporary supplements for another couple of years. Substantial across-the-board wage increases were finally implemented in 1923, setting the level that became the basis for new pay scales ratified at the end of 1925 and applied at the start of 1926. This was the basis on which the bank paid salaries until 1937, when the supervisory council approved a new pay scale. It was adjusted once more in 1939.⁷⁸³

Apart from the pay scales, the bank's pension rules were also modernised, taking effect from 16 January 1926. Pensions were largely similar to those of government officials. The biggest difference was the pensionable age for female employees, which was lowered to 55 years. The board of management argued that "banking work strains the nerves of female officials to such an extent that their performance deteriorates and they are already in need of rest by their sixtieth year". A compulsory retirement age was added to pension regulations in 1938. For women it was set at 60, for men at 67 years.⁷⁸⁴

Hence the Bank of Finland operated for almost two decades using a temporary salary system that led to an indisputable fall in real earnings of the staff. This was widely recognised; recruitment of a new governor in 1918 was delayed several months because the position could not be declared open before Parliament had ratified a sizeable salary increase. The diagram at left gives a concrete picture of the development of real earnings until the eve of the Second World War.

The decline in average real earnings between 1914 and 1926 was great, around 40 percent. At the same time salary differences narrowed because the smallest salaries fell by less than 20 percent in real terms while the wages of the highest group of officials sometimes fell by more than 40 percent. The position of the chairman of the board, i.e. the governor was relatively good because, when Risto Ryti had been appointed in 1923, a significant annual salary increase was implemented. Thus the real wages of the governor had fallen only 16 percent since the pre-war period. The heads of the branch offices had fared worst of all; in a few cases their real earnings dropped by as much as 50 percent.



■ Bank of Finland employees at Hotel Grand in 1936, amid grandiose celebrations of the bank's 125th anniversary. – Bank of Finland.

The relative position of the staff deteriorated considerably during the First World War. Before the war they had been far better paid than government officials but by the early 1920s the positions were reversed. Their wage rates had fallen even further compared with similar private-sector workers.⁷⁸⁵

Even in the 19th century Bank of Finland officials had been accustomed to presenting wage demands jointly and their degree of organisation increased again in 1918. This was a phenomenon that concerned all officials; in December 1917 the national Central Organization of Civil Servants' Associations was formed to present collective claims on behalf of officials. A meeting was held on 15 December 1917 to establish a staff association at the Bank of Finland, to look after the economic and social interests of officials, as article 1 of its statutes stated. Its first chairman was senior bookkeeper Henry Smedslund although the leading personality at the time of its establishment was the future chief clerk Johan Hammarén.⁷⁸⁶

Because it proved impossible to achieve decent across-the-board increases in the pay scales during the first years of Finland's independence, the board resorted to other ways of recruiting staff. One incentive was employer-owned dwellings. Initially the bank bought apartments individually for the use of its officials but in 1926 it acquired an entire apartment building at No. 1 Vironkatu Street, near head office. According to reports of the supervisory council, the difficult housing situation had resulted in the expulsion of a large number of head office officials from their rented accommodation so there really had been no alternative.⁷⁸⁷ Another new perk was a canteen from 1923 onwards. This was needed because competing commercial banks offered free lunches. In other respects the Bank of Finland had little opportunity to respond to wage competition from the private sector. In fact its only way was a system of seniority allowances, which meant that wages automatically rose as employees grew older. According to the 1925 pay scales, each seniority allowance meant a hike of 4–5 % in wages. A maximum of four such allowances could be paid. In the lowest wage groups, family allowances based on the number of children were retained. Seniority allowances raised average wages by nearly a tenth.

The pay scales approved in 1925 were not updated until 1937 but this did not cause problems of the magnitude of the First World War period. Although the cost of living increased slightly in 1927–1928, it

was followed by the Great Depression and general price deflation. The cost of living index was at its lowest in 1934, nearly 17 percent lower than in 1926. Salaries at the Bank of Finland remained the same in nominal terms so real earnings rose automatically and the position of officials at the bank improved relative to the rest of society. Moreover basic salaries were increased 8–9 percent in the pay scales of 1937, so real wages began to approach the level of the pre-war years. Wage differentials were large, though. The wages of board members were no longer set by parliament but decided by the supervisory council, so decision-making was more flexible and wages could be raised to a competitive level. Another striking feature was that salary increases were targeted mainly at the lowest wage groups; for example, the relative position of a doorman improved significantly towards the end of the 1930s. Bank staff in the central and upper strata fared the worst, and at the end of the 1930s their real earnings were still less than they had been in 1914.

The position of Bank of Finland staff also improved significantly compared with private banking sector employees. From the mid-1920s onwards the number of private commercial banks had turned down steeply, reducing the competition for skilled workers in the banking sector. Although wages at the Bank of Finland were not equal to wages paid by the commercial banks, the difference had shrunk so much that by the early 1930s the central bank was able obtain the employees it needed.

FAST TURNOVER AMONG BOARD MEMBERS

THE STENROTH AFFAIR

The principles for recruiting senior management at the Bank of Finland changed after the war, altering the composition of the board. Before Finnish independence the traditional route to board membership was a long and impeccable official career. In fact the only exception to this was the governor, who was sometimes recruited from outside, either from the private banking world or from the civil service. Of the board of management of 1918, governor Clas von Collan had originally come to the bank as board secretary in 1893, Uno Broberg and Karl Basilier had started as supplementary bookkeepers at head office in 1879 and 1884, and Jalo Järnefelt had begun as board secretary in 1897. Broberg had had the longest official career, rising via the branch offices of Kuopio and Kotka to be chief clerk in 1904 and ending his career with a brief period on the board. All had retired by 1923.⁷⁸⁸

Basing the selection on a long official career reduced the risks of finding surprises in the history or characteristics of the person chosen but this procedure was also problematic, particularly in fast-moving times, when it was hard to find directors who had the prerequisites for change. After the early 1920s, a period of rapid changes, a long official career was no longer enough and a grasp of banking theory and practice became an equal and often more important merit. Selection to the board was also increasingly influenced by political factors,

meaning that a politically representative range of board members was sought. Admittedly the new criteria were not applied with notable consistency.

The renewal of the board began with the selection of Otto Stenroth as governor from the start of 1919. Before joining the Bank of Finland as governor he had had long experience in leading positions in the banking sector and a prominent political career as a senator and as the first foreign minister of independent Finland.⁷⁸⁹ His governorship at the bank ended in 1923 after a very public and unpleasant series of events. In December 1922 the board had been strongly criticised in parliament during a debate on a report of the banking committee. On 18 December, in the plenary session, J.E. Hästbacka and Georg Schauman, representing the opposition Swedish People's Party, made conspicuous speeches attacking the management of the bank. After first criticising the handling of the Town Mortgage Fund, they then accused the Bank of Finland and its management of involvement in illegal currency trading in October 1922.⁷⁹⁰ The controversy was taken up by the press; one newspaper, *Mercator*, editorialised that "the national interest demands that confidence in the Bank of Finland's management, which has long been wavering, must ultimately be restored."⁷⁹¹ Public pressure on the board of management rose to unprecedented heights.

The debate in parliament and the press led to an investigation by the inner supervisory council, consisting of Lavonius, Nevanlinna and Tanner, carried out at the turn of 1923. According to their findings as recorded in the minutes, neither Stenroth nor any other board member had breached currency regulations or acted illegally in any other way. Indeed, the currency operation in question had "served to promote the objectives of the Bank of Finland at that time". Even so, "the council members felt that (...) the (governor of the bank) should not have engaged in the currency operations in question. But, when the undersigned (council) chairman Lavonius, who has previously mentioned in these meetings that Stenroth was considering resigning from his post in order to spare the bank from continuing attacks, noted on 4 January that Stenroth had finally announced his decision to resign, the council members felt there was no need to issue a rebuke". Regarding the other members of the board (Basilier and Gråsten as well as von Frenckell, who had joined the board in 1922) the bank council saw no need for action.⁷⁹²

The report of the bank council did not describe the underlying insider trading in which Stenroth had engaged. Lavonius noted in the minutes only that Stenroth had told him the purpose for which “the profit resulting from Stenroth’s purchase order had been intended and had been used”. Lavonius conceded that it was not the “noble” purpose that Georg Schauman had demanded in his parliamentary speech but was acceptable anyway. Nonetheless he felt that Stenroth “should not have embarked on the transaction in question in pursuit of a covert aim”. Stenroth’s resignation was accepted on 16 January 1923.⁷⁹³

The matter remained unclear until finally Stenroth, in his old age, told K.J. Kalliala, the head of the bank’s statistical department, what it was all about. In the early stages of the Great War, he had taken a large foreign currency loan from Sweden. The falling value of the markka had made it hard to repay so he decided to pay it off at the same time as a foreign exchange market intervention by the Bank of Finland, which raised the value of the markka against the krona. The practical arrangements of the deal had been handled by Emissioni Oy, a banking house headed by Erik von Frenckell, who had subsequently been appointed to the Bank of Finland’s board. Following the investigation of the affair, Frenckell had also had to resign from the board.

On the basis of Stenroth’s account, Kalliala drafted a personal memorandum about the chain of events, which Erik von Frenckell confirmed to be true with his own signature. Kalliala placed this memorandum in the Bank of Finland’s archives in 1967. It was appended to the minutes, relating to Stenroth’s resignation, of the supervisory council and the board. The reasons had emerged after a lag of 45 years.⁷⁹⁴

Stenroth’s relationship to the bank was not entirely severed by his resignation because afterwards he was commissioned by the supervisory council to draft new regulations for the Bank of Finland. The work was apparently done well because the regulations, which came into force when Finland returned to the gold standard at the start of 1926, remained in force with only small changes until the 1990s.

Although the governorship of Otto Stenroth ended with an insider trading scandal that jeopardised the prestige of the bank, his achievements as governor deserve acclaim. It was during his term of office (January 1919 to January 1923) that conditions were successfully created for the stabilisation of the markka; in the final

months of his governorship the exchange rate settled at about 40 markkaa per dollar, which, over the next three years, formed the premise for Finland's return to the gold standard. Another of his achievements is that raging inflation was halted as early as 1921. Nor should it be forgotten that Stenroth first took the bank into international financial diplomacy, leading Finland's delegation to the great financial conference in Brussels.

RISTO RYTI JOINS THE BOARD

At the time that Stenroth's successor was being selected, the financial position of the Bank of Finland was still weak and there was little confidence in the Finnish markka so much was expected from a new governor. There was no suitable person on the board of management so the search moved outside the bank. The names of leading commercial bankers J.K. Paasikivi and Alexander Frey were put forward. Both had at least adequate merit, doctors of jurisprudence who had risen in politics to the Senate and taken positions at the helms of the country's two largest commercial banks, Kansallis and Nordic Union, but neither was willing to leave his well-paid position in a private bank. Clas von Collan was another name raised – he had left the board in 1918 – but, at least according to Paasikivi's memoirs, he was not thought to have the required "toughness" to see through the difficult decisions that lay ahead.⁷⁹⁵

The post was finally offered to 34-year-old Risto Ryti, then serving as finance minister. Despite his youth he had already won his spurs in the private sector and in politics. Upon completing his degree in law he had done postgraduate studies in England and worked as an attorney. His first steps in business life had been as a close adviser to the most significant private investor in Finland of the 1910s, Alfred Kordelin. In 1919 he had been appointed managing director of Valtamerentakainen Kauppa company (Overseas Trade Ltd), a job where he worked closely with J.K. Paasikivi. In spring 1921 he had become finance minister in the second government of Juho Vennola. The move to the ministry also meant a personal choice between the private and public sectors and, after a 6-month interregnum, he had become finance minister again in the first Kallio government. As finance minister Ryti had realised the importance of the central bank

for economic policy. At the same time those at the central bank had observed the exceptional talent of the finance minister and his ability to take difficult decisions. Supply and demand met and the supervisory council decided unanimously to propose Ryti as the new chairman of the board of management. The president of the republic ratified the proposal on 30 January 1923 although Ryti did not take up the governor's position until the end of January a year later, when the Kallio government resigned.⁷⁹⁶

Ryti's year-long delay in becoming governor was troublesome for the Bank of Finland. The long-lasting public controversy that had led to the resignation of Stenroth and von Frenckell had eroded the credibility of the board, and urgent action was needed from a new governor to restore trust in the bank among the general public. At the same time a generation change was taking place on the board so a stand-in of the same stature could not be found there. A transitional governor had to be recruited from outside the board. They did not need to look far; the choice fell on Councillor of State August Ramsay, who had served on the supervisory council.

Ramsay was born in 1859, a scion of a well-known family of ironworks owners, and had begun his career as a teacher of mathematics. He continued in academic life until his doctoral dissertation was complete and then moved into business. He had extremely wide-ranging practical experience, having worked in leading positions in mortgage institutions, banks, insurance companies and private commercial businesses. He was also a member of the board of numerous companies. Beyond business life he had a high profile in the political arena, where he had been both a senator and a minister of finance. He belonged to the influential core of Finnish society in the 1910s and 1920s and represented continuity from the end of the 19th century to the early years of independence. His most important task was to restore trust in the Bank of Finland and he succeeded.⁷⁹⁷

CONSTANT CHANGES

Of the new members of the board of management, the first was Ernst Gråsten, appointed in autumn 1920. Born in May 1865, he had obtained a master's degree before beginning his career as a language teacher at Hamina cadet school. At the turn of the 20th

century he had changed direction, becoming first the managing editor of *Nya Pressen* and then editor-in-chief of *Aftonposten*, two Swedish-language newspapers. At the same time he had continued his studies to obtain a degree in jurisprudence. In the final years under the Russian Empire, he worked in the Office of the Ministerial State Secretary for Finland in St. Petersburg and on the Finnish-Russian export committee. On the board of the Bank of Finland he was responsible for international relations. His membership was interrupted in summer 1922 when he became finance minister in Cajander's first government, a non-political administration. He retired from the board in 1930 although he did not entirely leave the banking world but sat on the supervisory council of the Bank of Finnish Agriculture until his death in 1942.⁷⁹⁸

In February 1922, two new members were appointed to the board at the same time, Erik von Frenckell, mentioned earlier, and Lauri af Heurlin. Frenckell was appointed as an expert in currency questions and represented a new age group on the board; at the time of his appointment he was only 35. He had studied engineering at Dresden in Germany. Before coming to the board he had been managing director of Emissioni Oy, a private capital investment company (1917–1921) and chairman of the board of Sähkö Oy AEG. He had also served on numerous committees involved in economic relations between Finland and Germany.⁷⁹⁹ He did not take up his position on the board until after a two-month study trip in Europe and the United States, and his career was unfortunately cut short after only a year, as noted earlier in connection with the Stenroth affair.

Lauri af Heurlin (b. 1875) was a master of laws who owned large manors in Espoo and Helsinki Rural District. He was one of the leading economic lights of the Social Democratic Party and had an important position in the progressive cooperative movement, being on the board or council of Elanto Cooperative, Kansanvalta Publishing, OTK Wholesale Cooperative, the Central Union of Consumer Cooperatives and the Helsinki Workers Savings Bank. He also worked for periods with the National Board of Customs and as the head of the Senate publishing house. In 1922 he was the ideal candidate when a representative of the left was needed on the board of the Bank of Finland. Like Väinö Tanner he had withdrawn from the operations of the Social Democratic Party in autumn 1917. He had therefore not been

involved with the People's Delegation during the civil war and had no political encumbrances in post-war Finland. His background as a large-scale farmer may also have helped win the confidence of the agricultural population. At the Bank of Finland Heurlin was responsible principally for the banknote printing house and questions related to the bank's real estate. His career at the bank continued until 1942, when he retired on a full pension.⁸⁰⁰

In the first half of 1923, the question of fixing the markka's value was still open, and a rapid replacement, skilled in currency matters, was needed for Erik von Frenckell, who had been forced to resign in connection with the Stenroth affair. After a search of several months, the supervisory council decided to propose Bengt H. Broms, a master of laws. Born in 1892 Broms had begun work in a lawyer's office but, just after Finland became independent, he had become a partner in the banking house of Fröjdman & Broms. He subsequently headed the currency department of Credit Bank (Luottopankki), established in 1917, and was soon on its board. On joining the board of management of the Bank of Finland, Broms was 31 and had some three years of experience in currency questions.⁸⁰¹ His career at the central bank was to be rather brief, because of the deteriorating state of his personal finances. He resigned in spring 1926 at the urging of the supervisory council and went back to being a lawyer.⁸⁰²

In autumn 1923 there was still one vacant place on the board. This was filled by Johannes Lundson, a master of laws who had had an impressive career both in the banking world and in politics. He was a well-known member of the Constitutional Fennoman Party, who had been forced to resign from the post of mayor of Lappeenranta in 1903 because of his political views. He then went to work for the Nordic Bank for Trade and Industry, rising to be head of its Vyborg office. The next step would have been a place on the bank's board but its merger with the Union Bank of Finland in 1919 appeared to close that window, because there were no vacancies on the board of the large bank created. Instead he became managing director of Valtamerentakainen Kauppa company, the post vacated when Risto Ryti became a government minister. In addition to business life, Lundson had a prominent career in politics. After the election of autumn 1917 he had become speaker of parliament and, as speaker, had ratified Finland's declaration of independence on 6 December. In August 1919 he had been appointed

minister of finance in the first Vennola government. The Bank of Finland did not long satisfy a man used to high position and independent action. He spent only three months on the board before becoming chief general manager of the Artisans' Bank of Finland (Käsitéollisuuspankki), a small commercial bank.⁸⁰³

According to new regulations, approved at the end of 1925, the board of management of the Bank of Finland consisted of a chairperson and up to 4 other members. In the first half of the 1920s the board was generally smaller, with a chair and three ordinary members. When Broms had to leave the board in 1926, there were only two ordinary members left and the search was on for at least one more. By this time Ryti was well established as governor so he had a say in the choice, alongside the supervisory council. It was felt that the ideal candidate should enjoy the confidence of the farming population, so the post was offered to Kyösti Kallio, who had succeeded Santeri Alkio as the most influential figure in the Agrarian League. In the early years of Finnish independence Kallio had held the posts of minister of agriculture and prime minister. He joined the Bank of Finland in spring 1927, after his second government had collapsed at the end of the previous year. The appointment was an effort to bring agrarians behind the economic policies spearheaded by the central bank. Kallio continued as a board member until 1937, when he was elected president of the republic. In the meantime he had kept his place on the board despite being a minister or speaker of parliament on several occasions. According to legend, the order of parliamentary business in the 1930s was determined by the availability of Kyösti Kallio when he was not otherwise engaged at the Bank of Finland.⁸⁰⁴

A MORE STABLE 1930S

The next vacancy opened up on the board of management in 1930 when Ernst Gråsten retired. The bank needed someone who understood the export industry and was acceptable to the leadership of the Swedish People's Party. The choice fell on Adolf Burgman, who had long worked as head of forestry for Kymmene, a forest products company, and since 1920 as the head of the transport department of the National Board of Forests. His banking experience came from his place on the board of the Industrial Mortgage Bank of Finland. He left the board of

management of the Bank of Finland in 1938 to take a sickness pension at the age of 66.

No major changes took place on the board in the 1930s until the end of the decade. The first vacancy opened when Kyösti Kallio was elected president. The stamp of the governor, Risto Ryti, was clearly visible in the choice of J. W. Rangell, a master of laws and the managing director of the Central Lending Fund of the Cooperative Credit Societies (OKO). Ryti and “Jukka” Rangell had worked together since 1925, when Ryti had been chosen as the Bank of Finland’s representative on OKO’s supervisory board and 31-year-old Rangell had joined OKO as a lawyer and board secretary. The rapport that had developed between them became even closer in the first half of the 1930s, when they made several joint working trips to the main banking centres of Europe. Rangell had joined Ryti’s circle of close friends, which included Rainer von Fieandt, Bruno Suviranta, A. E. Tudeer and Kaarlo J. Kalliala. Their common denominators were a background in banking and trust in neoclassical market-oriented economic policy.⁸⁰⁵

For the board position vacated by Kallio, Ryti and the chairman of the supervisory council Väinö Tanner wanted a professional who understood international banking as well as the special features of Finnish banking, in this case specifically conditions in the countryside. Managing director Rangell of OKO met these requirements exceptionally well, so the supervisory council endorsed his appointment. This support was not unblemished, though. Councillor Leppälä of the Agrarian League noted that “the Bank of Finland being parliament’s bank, the council should, when proposing members for its board of management, while not ignoring individual competence, take into account the political ideals that are represented in Parliament”. Leppälä did not propose an alternative but contented himself with appending his views to the minutes.⁸⁰⁶

Rangell’s transition was facilitated by a loan, in francs, that had improved OKO’s previously troubled financial position, so he could feel comfortable about leaving it in the hands of his colleague Valde Hyvönen. Now in the prime of his working life, Rangell wanted more challenging work, which he certainly would find during the war, when he was prime minister for two years.

Although his appointment to the board was formally unanimous, there was dissatisfaction with the choice in Agrarian League circles.

With Kyösti Kallio, the League had lost its representative on the board of management and not even Rangell's background at OKO, and agricultural credit institution, could fill the gap because he was a member of the liberal National Progressive Party. The opportunity to correct the situation arose in autumn 1938 when Adolf Burgman retired. Since 1924 the board had consisted of a chairman (the governor) and only three other members, while the regulations allowed four. In 1928 it was decided to appoint two new members, thereby providing the board with both banking experience and social representation. Moreover the supervisory council felt that the bank's expanding operations justified an enlargement of the board, which would give it a quorum during members' holidays and numerous foreign trips.

As an expert in banking, the bank's chief clerk Dr. Kaaperi Kivialho was nominated, while Professor Kalle Jutila became the second new member. Having studied history Kivialho had worked initially as an educator although a spell as editor-in-chief of Turun Sanomat newspaper took him away from his professorial chair for a while. In 1920 at the age of 36 he changed field completely and became manager of the Kallio branch of the Artisans' Bank. Studying in his free time, he obtained a doctorate in economic history and also wrote a textbook on national economy. When the position of chief clerk at the central bank became vacant in 1935 he applied and was selected. It was the most senior position in the bank apart from the board, which was just a step away, if a rather long one.⁸⁰⁷

For the other board vacancy, the inner supervisory council proposed Kalle Jutila, who was thought to have not only a good understanding of the national economy but also a thorough grasp of agriculture and agricultural policies. Jutila had been minister of agriculture several times and since 1928 had been professor of agrarian policies at Helsinki University. He was a very internationally oriented researcher, having visited Western European countries, the Soviet Union, the United States and Canada.⁸⁰⁸

In the full supervisory council, the nomination of Jutila stimulated a lively exchange of opinions. In the view of councillor Vesterinen, the board needed someone who knew the practice of agriculture and not merely its theory and who enjoyed the full confidence of the Agrarian League. The members of parliament of the Agrarian League felt the most suitable candidate to be the then-minister of agriculture P.V.

Heikkinen, who was a farmer. "Counterbalancing Professor Jutila's scientific merit, Heikkinen would bring practical experience and the confidence of the Agrarian League's parliamentary members, which must be regarded as outweighing scientific merit." Councillor Leppälä endorsed Vesterinen's stand and said that proposing Jutila would be a vote of no-confidence in the majority of the population.

Councillor Helo went even further in bringing politics to the selection of the board of management. He demanded that the relative strengths of parties in parliament be exactly reflected in the composition of the board. This would have given the Social Democrats two board places. However, the chairman of the supervisory council, Väinö Tanner, felt it was not appropriate for parliamentary groups to intervene in the selection of candidates and that the members of the supervisory council were entitled to complete freedom in making their proposals to the government.

The governor, Risto Ryti, also participated in the debate. He noted that the council was elected directly in proportion to party strengths of parliament. In choosing the board, however, a determining factor was the competence of each candidate. Naturally the board did not have the authority to prefer one candidate over another but it ought to have the right to express doubts about some candidate if the bank's interests or smooth operation required this. Of the names that had now been put forward, the board had no such doubts. Regarding the candidates that had caused dissent, Ryti regarded Professor Jutila as more competent than Minister Heikkinen. The vote followed the lines of the discussion detailed above; the Agrarian League representatives endorsed Heikkinen while the other members of the supervisory council backed Jutila. For the positions on the board the council therefore proposed Kaaperi Kivialho unanimously and Kalle Jutila after a vote. They were then appointed.⁸⁰⁹

NO COMPROMISE WITH ACCOMPLISHMENT

Appointments to the Bank of Finland board of management are an interesting reflection of the difficult start that independent Finland faced. Many challenges lay ahead when the civil war ended in spring 1918. Finland had to rebuild the machinery of government that an



■ Finance minister Kyösti Järvinen with supervisory council members Jalo Lahdensuo and Erik von Frenckell, leaving the Bank of Finland in early October 1931, after a meeting to discuss exchange rate policy alternatives. – Otava picture archives.

independent nation required, public finances needed balancing, and the markka had to be stabilised. Many matters were now completely different so problem-solving required new fortes and the top decision-makers needed diverse backgrounds and experiences. It is interesting to observe the ongoing personal links that prevailed between the Ministry of Finance and the Bank of Finland. In the period between 1919 and 1925 the country had a full nine governments and the life span of one could be as little as four months. In these nine governments the finance minister was either a member of the Bank of Finland board or someone who soon would be. These men were August Ramsay, Johannes Lundson, Risto Ryti twice and Ernst Gråsten. The shuttling of the same people between the Bank of Finland and the finance ministry ensured a smooth exchange of information between the two centres of power vital for the national economy. A striking feature of these difficult years was that the central bank and the finance ministry got on well together. Their objectives were parallel although the central bank might express them more explicitly. The alternating appearance of the same people at the top of the finance ministry and the bank also illustrates how small the number of skilled experts was in newly independent Finland.

Until the restoration of the gold standard, the country lived under conditions of floating exchange rates, which imposed great pressures and demands on the leadership of the Bank of Finland. A long official career alone was not enough; senior management needed a detailed grasp of central banking theory and practice, which was reflected in rapid changes in the composition of the board. As conditions changed, the board needed people who were familiar with banking, currency questions and business life in general. They could not be found in the civil service, and they were often recruited from the private financial sector. Another noteworthy feature is the youthfulness of board members; for a few years all new members of the board were below the age of 36. Organisational rejuvenisation is typical of critical periods when the balance of power in society changes abruptly. Such critical periods are also associated with individual risk, which shows in the very fast turnover of board members, especially in the 1920s.

In the 1930s the bank's position in society had become established and it was dominant in the shaping of all economic policies, not merely monetary ones. The chief general manager of Kansallis Bank, J.K.

Paasikivi, aptly remarked that one of the most influential figures of overall economic policy was the central bank governor, along with the heads of the main commercial banks.⁸¹⁰ The more settled political conditions at the end of the 1930s were reflected in the board. Parliament understood the great social role of the central bank in its control of monetary policy. It was regarded as important that all parties in parliament should be represented on the central bank board. Board members could not be selected merely on the basis of their formal qualifications but also according to how well they represented the nation politically. This consideration was accepted by the governor of the bank itself, Risto Ryti.

BANKING IN THE 1920S AND 1930S

IN PURSUIT OF ORGANISATIONAL CLARITY

Until Finnish independence the Bank of Finland as an institution was characterised by a classic bureaucratic culture, in which the bureaucrats were largely old-style gentlefolk with a Swedish-speaking upper-class background. It was dominated by operating modes refined over bygone decades. The chasm between customer and official could be very wide indeed. Since the early 1910s the pressure had been growing to reform outdated methods but clashes with the Russian government engendered by the second campaign of russification, lasting until the Russian revolution, put a brake on all internal reform in Finland. The leadership of the Bank of Finland focused all their energies on safeguarding the external position of the bank. Internal reforms were paralysed. The outbreak of the First World War and Finland's civil conflicts after 1917 aggravated the situation and it was not until summer 1918 that modernisation of the bank's internal mechanisms could be considered. Even now the time was not ripe, because the governor Clas von Collan had announced that he was resigning as soon as a successor could be found.

When the new governor, Otto Stenroth, began work in spring 1919, a period of active reform lay ahead. Before joining the board Stenroth had been a board member of Kansallis Bank in 1889–1906 and chairman of the board of the Real Estate Bank in 1907–1918. He therefore had experience of running a private bank stretching back over three

decades. However internal reforms at the Bank of Finland began only gradually because first the disorganized monetary conditions of the country had to be stabilised.

Among the first tasks of the 1920s was a modernisation of the whole organisation to match operational changes that had already taken place. In a reorganisation that took effect in 1922 the bank moved from a pure line organisation towards one based on functions. Hierarchical position was no longer determined by a person's title but by the tasks he was set.

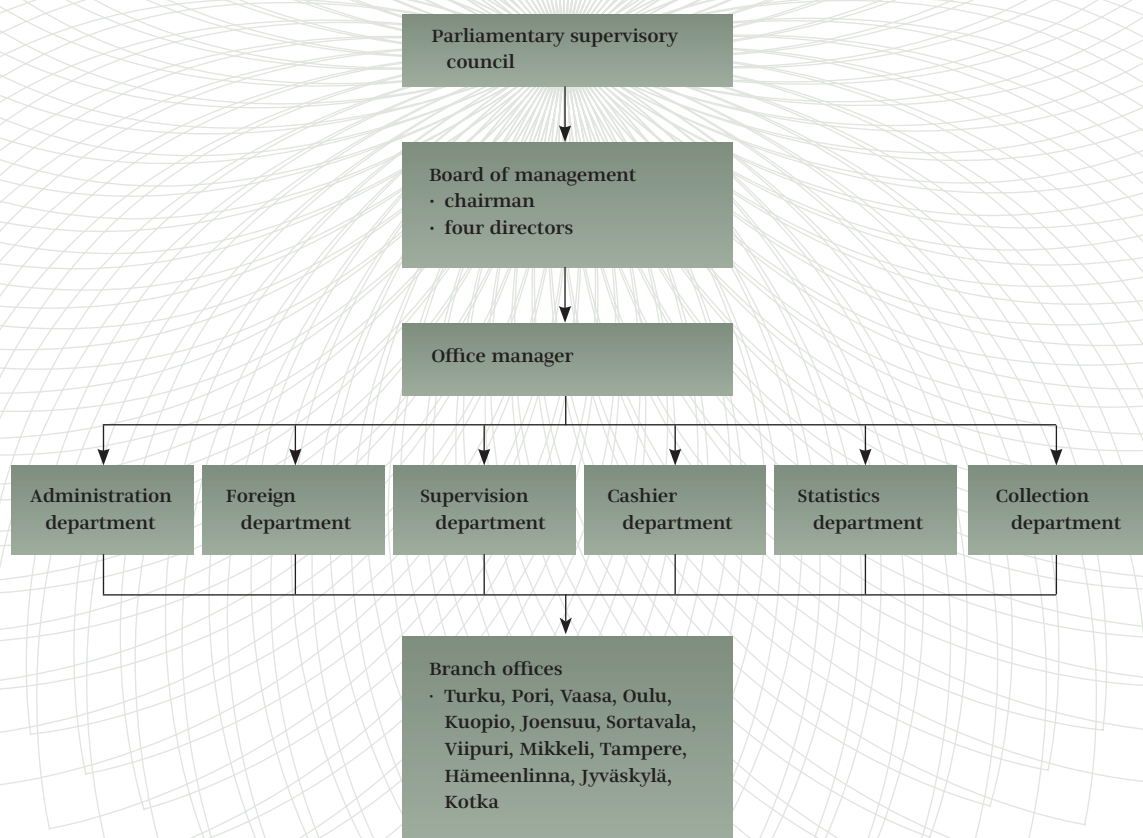
To simplify the running of the bank, the status of chief clerk was raised to make him responsible for the operations of all sections. Instructions from the board to the departments flowed via him. In a 1922 memorandum on the board's new organisation, he was described as the office manager.

A new department for statistics had been established in 1919. It consisted of three areas: calculation of statistics on the bank's own operations; acquisition of statistical material required in monetary policy, and dissemination abroad of information regarding Finnish economic conditions. The second two functions – developing economic data of vital importance to monetary policy and spreading information abroad – were entirely new. The main job was to draw up Finland's balance of payments, an operation that began around this time in almost all European countries on the basis of a recommendation from the League of Nations. In 1931 the statistical department was expanded and an economic research department was established alongside it. In 1943 these two departments were merged to create the Bank of Finland research institute.⁸¹¹

The division of responsibilities between head office in Helsinki and 13 branches in the countryside was not significantly modified during this period. From the 1920s to the early 1930s, about 70 percent of turnover came from Helsinki and correspondingly about 30 percent from the branches. Although decision-making powers were shifted from the branches to head office in the 1930s, the proportion of turnover generated at branch offices had actually risen slightly by the end of the decade and was now approaching 40 percent.⁸¹²

In terms of size, the branch offices constituted two distinct groups. Vyborg, Turku, Oulu, Vaasa, Tampere, and Pori were the large branches. A common feature was their location near large industrial enterprises.

BANK OF FINLAND HIERARCHY 1922



Source: Bank of Finland, minutes of the Board of management 22 May 1922.

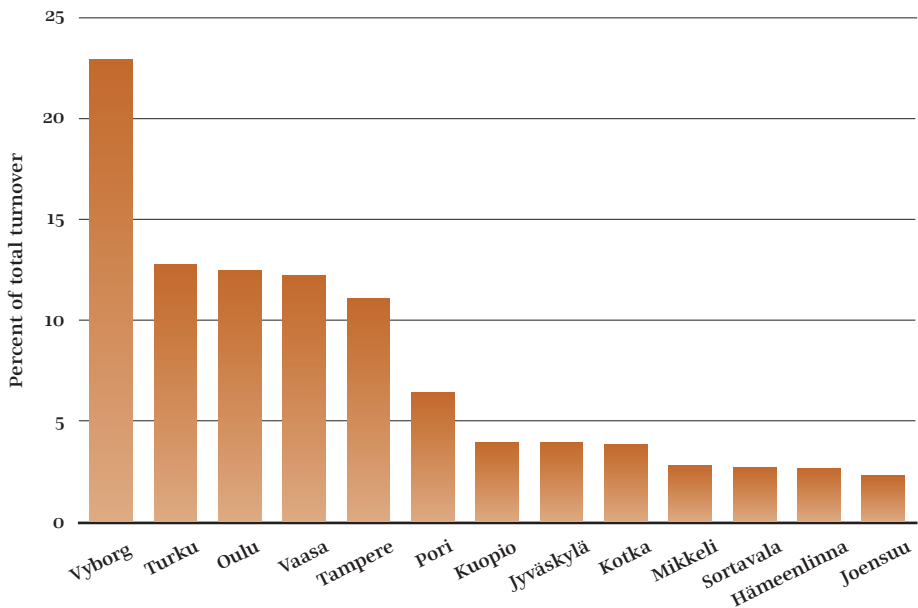
With the exception of Tampere, they were all in harbour towns and at junctions between the port and the railway. The group of lesser branch offices consisted of Jyväskylä, Kuopio, Kotka, Hämeenlinna, Mikkeli, Sortavala and Joensuu. They had developed rather sluggishly and the rationale for the existence of the smaller ones was already looking weak. A restructuring of provincial divisions in 1901 had created a Bank of Finland branch office in the main town of every province but by the 1930s the trend showed that the economies of mere administrative centres such as Mikkeli or Hämeenlinna no longer required the bank's presence. However no concrete steps were yet taken to prune the network.

TOWARDS MORE BANK- LIKE OPERATIONS

The reforms of the new central bank governor, Otto Stenroth, began with business hours, which were only four a day. This was a legacy of the culture of government offices in the 19th century, although naturally the bank's working hours were much longer than its opening hours. From February 1919 onwards, head office kept the same hours as commercial banks, from 10:00 in the morning to 3:30 in the afternoon. This made it easier for customers to do business with the central bank. In the 1920s the bank also drew up written instructions on how customers were to be treated. The underlying principle was that all should receive equal treatment. Customers were to be served in the order in which they arrived and the customer's status was not to influence the level of service. The official language of the Bank of Finland was to be Finnish but a customer was to be addressed in Finnish or Swedish, depending on which he used. The aim of these instructions was to dispel the long-standing impression that the Bank of Finland, even in the 1920s was a bastion of Swedish. In the 1920s and 1930s Finland experienced a rather bitter battle over linguistic hegemony, which the bank sought to avoid by defining the position of Finnish and Swedish as explicitly as possible.⁸¹³

In routine operations the bank concentrated on improving the effectiveness of lending risk management and interbank payments traffic, i.e. clearing. Credit losses had certainly been a problem until the 1890s, when they had sometimes reached 1–2 percent of the stock of lending. Even in a private commercial bank, this would have been far too high and for the central bank it was worse because of the principle of granting credit against only first-class bills of exchange or extremely good collateral. Furthermore, lending was intended to be short-term. Internal instructions were drawn up to ensure that collateral was good and that the credit granted would serve monetary policy objectives. In practice this came to mean a stronger role for head office at the expense of branch autonomy. So that the financial position of loan customers could be monitored, they had to provide the bank annually with a report on the previous year, including a summary of their profit and loss account and a statement of the volume of turnover or manufacturing output. Borrowers also had to list their outstanding

TURNOVER AT BANK OF FINLAND BRANCH OFFICES 1933



Source: Bank of Finland. Yearbook 1933.

receivables. This information was forwarded to the board of management for it to study.⁸¹⁴

Acceptance credit showed the influence of classical central banking theory, i.e. the principle that the function of a central bank is only to discount commercial bills of exchange where the underlying transaction involves trade in merchandise. In fact the Bank of Finland also discounted financial bills of exchange (i.e. bills without origin in trade) but it charged higher interest on them. To intensify monetary policy operations, the bank drew up credit regulations containing detailed instructions for distinguishing between commercial and financial bills of exchange. An example of a purely commercial bill of exchange was one where the payee was a manufacturer or other producer and the drawer a wholesale merchant or processor; or where the payee was a wholesaler and the drawer a retailer or reseller. Bills of exchange involving the purchase of productive machinery also counted as commercial but those where the underlying transaction

was a vehicle purchase or the financing of house construction did not. The Bank of Finland took great care of its export industry customers and this was reflected in its credit regulations. Seasonal bills of exchange of exporters were to be treated as commercial bills of exchange if, on the basis of the status and scale of the firm, it was probable that the bill would be paid in the same export season. Even if a bill was rolled over once or twice, it would not long remain on the Bank of Finland's books. Bills other than those thus described were defined as financial bills of exchange and subject to a higher rate of interest.⁸¹⁵

A letter written by the board of management to the finance minister in spring 1924 is a tangible example of how risk was monitored. It was extremely blunt in criticising Ab. W. Gutzeit & Co; its accounts had given far too rosy a picture of its financial position and they had been closed without consulting the company's largest creditor, the Bank of Finland. The letter further noted: "The company's reorganisation should now, in our view, be completed by also setting its bookkeeping on a healthy and accurate footing, because the aforementioned bookkeeping values that do not reflect reality have served to damage the company in its external relations and given a false image of its true position; therefore we urge that the company's accounts be corrected in the respects referred to. This would best be done at the company meeting when the decision is taken to ratify the accounts." The Bank of Finland's board believed that the best way to do this would be for the government's representative at the upcoming company meeting to be instructed how to act.⁸¹⁶ The incident shows that, in Finland, the relations with credit customers or the government could not be as neutrally remote as the classical principles of a bank of issue might imply. The interaction between the bank and its borrowers was more intimate.

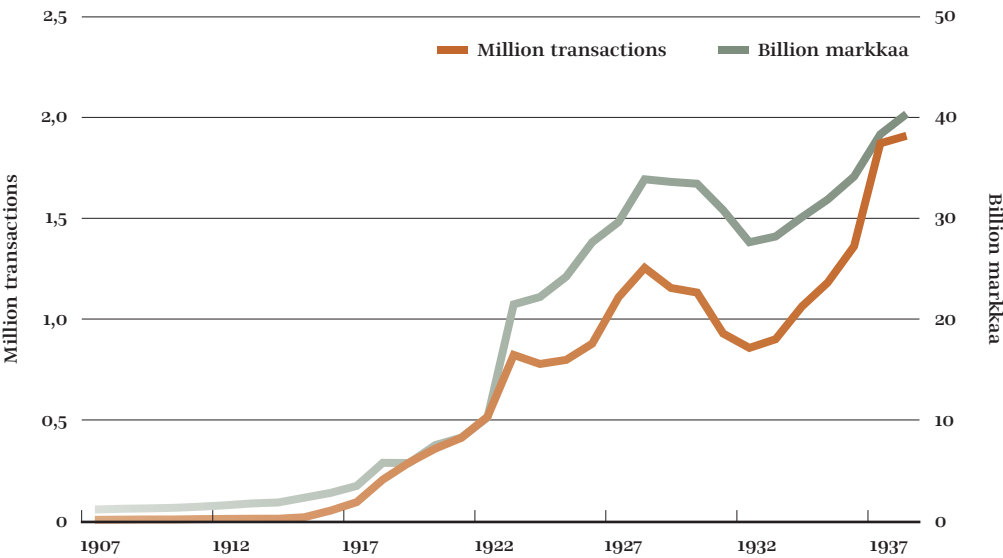
At the core of a system of financial infrastructure is clearing for payments between banks, which the Bank of Finland had established in 1906. This daily netting system allowed the amount of money tied up in the financial system to be reduced significantly and thereby helped society use capital more efficient. Finland's need for clearing was influenced by the structure of its banking system. One of its characteristics until the First World War was the small number of commercial banks, just 13 in 1914. Most of them had broad networks of branch offices that covered the whole country. Unlike the other

Nordic countries, Finland had relatively few provincial commercial banks. At the same time the banking system was very concentrated and the three largest commercial banks accounted for a very large share of banking, whether measured by the stock of deposits, the stock of loans or total assets; for example, in 1914 it was over 70 percent. A structure like this naturally needs less clearing than a decentralised banking system, because a bank with a nationwide network of branches can handle some of the payments traffic between localities internally, without interbank payments.

Despite the concentrated structure of Finnish banking, the Bank of Finland's clearing grew very quickly in the years between the world wars. The diagram below gives a good overview of the growth in clearing transactions and their value.

In 1922 clearing was rationalised by decentralising some of it from head office to the Bank of Finland's branches in Vyborg, Turku, Tampere, Vaasa, Oulu and Jyväskylä. At the same time clear rules were introduced. Every bank participating in clearing had to maintain a non-

BANK OF FINLAND CLEARING 1907–1938



Source: Bank of Finland. Yearbooks 1914–1938.

interest-bearing current account at the Bank of Finland that was large enough to cover its clearing debits. If the debit exceeded the account's balance, the deficit had to be covered on the same day before the bank closed. Offices were opened for clearing at 11:30 and closed at 13:15 hrs. During this period participating banks delivered the promissory notes, postal orders and cheques to be redeemed that day by other banks. At 14:00 hrs, when clearing had ended, each bank's attorney received a written statement of the amounts paid and received by the bank and of the sum that would either be credited to or debited from the bank's current account.⁸¹⁷

The number of clearing transactions began to rise rapidly during the First World War and continued to increase steadily until 1928. It increased from 100 000 transactions in 1914 to 1.7 million transactions in 1928. The recession in 1929 was reflected immediately in clearing, where the number of transactions and the annual sum turned down. This continued until 1933. The 1928 level was not regained until 1936.⁸¹⁸ Several factors lay behind the steep increase in clearing in the 1920s; new banks had entered the market, general economic activity had increased and the structure of the national economy had changed. The changes included an expansion of industry, regional diversification of production, growth of private demand and a final breakthrough in money wages even in agriculture and forestry. All these led to more money traffic and thereby a need for more efficient clearing.

GROWING IMPORTANCE OF ECONOMIC DATA AND ANALYSIS

The establishment of the Bank of Finland's statistical department was related to the increased macroeconomic responsibilities of central banks after the First World War. Effective monetary policy required real-time data from the different sectors of the economy. Hitherto, economic statistics had generally been calculated after a long lag and most phenomena were reported at an annual level but this was no longer enough. Data had to be compiled quickly to illustrate monthly or even weekly changes. The minimum requirements for a central bank were figures on government debt, income and expenditure; domestic and foreign price levels; export and import volumes; and domestic manufacturing output.

The new statistical department could not, understandably, be made responsible for gathering and calculating all the necessary statistical material from scratch. Instead it aimed to be a coordinating unit which, as far as possible, used data already gathered by officials such as the Central Statistical Office and the statistical departments or offices of the Board of Social Welfare, the Customs Board and the Board of Railways. Where their statisticians did not provide all the bank needed, supplementary material was obtained from other sources, such as sectoral industrial organisations.⁸¹⁹

Outside the central bank, too, economic data had become steadily more important to society. Dissemination of this information can be regarded as part of social infrastructure, a point that the Bank of Finland grasped. An example worth noting was its collaboration with the Finnish Broadcasting Company. The Bank of Finland supported the establishment of a national broadcaster by subscribing its shares when it was set up in summer 1926. The bank obviously saw the opportunities that broadcasting offered for spreading economic information. As soon as radio began in autumn 1926, the bank decided to pay 3000 markkaa a month for exchange rates to be read out regularly, thus giving everyone equal access to this information.⁸²⁰

The acute economic downturn in 1929 alerted the board of management to the need to be better prepared for economic reversals. It asked the head of its statistical department A.E. Tudeer to give his views on how the bank should reinforce its own economic research. Tudeer's memorandum on the subject noted that: "even if actual forecasts are eschewed, it would be extremely useful to be aware of the phenomena associated with changes in the economic climate. It would make it easier for banks, industry, commerce and agriculture, for the consuming public and also for central and local government, to adapt to the changes required by the economic circumstances in question and to embark on precautionary action and measures to ease the consequences of a slump. Understanding and monitoring the economic climate are especially important for a country's central bank, whose policies on credit and discounting must essentially correspond to the demands of economic cycles."

The statistical department had nowhere near the personnel resources required for such analysis, and Tudeer thought it unnecessary to follow the international trend in establishing a large institution with

dozens of researchers. He recommended a cautious start, the creation of a department for macroeconomic research alongside the statistical department. Initially this would mean the hiring of a skilled researcher and a few assistants. The supervisory council approved the proposal in autumn 1929.⁸²¹

Dr. Bruno Suviranta was recruited from the department of tariffs and control at the Board of Railways to be the bank's first macroeconomic researcher. Suviranta was one of the young generation of economists who no longer revered the traditional German historical school but founded their economics on English and American neoclassicism. He actively followed international developments in economics and had exceptionally broad foreign connections. During the 1930s he became established as Finland's leading macro-economic researcher. From 1928 onwards he had been secretary of the Economic Council, the consultative body founded by the government, where his connections with Risto Ryti had begun, leading to the invitation to transfer to the Bank of Finland.⁸²²

Economic research at the bank was again upgraded in autumn 1937. A proposal sent by the board of management to the supervisory council stressed how various countries had been investing more in economic research and that Finland should follow the trend. The board put forward three alternative models: a) an entirely private research institute funded by private donations; b) a research institute operating in connection with a government bureau such as the Central Statistical Office; or c) the expansion of the Bank of Finland's macroeconomic department into an economic research institute.

The model of a private institute contained the danger that individual interest groups would put pressure on it, while the state model held the risk of political dependence. The board decided to propose the third alternative of gradually expanding the bank's macroeconomic department. The supervisory council agreed and the development of an economic research institute was begun in 1938. It still appeared in the bank's hierarchy as a department, however, and did not formally become a research institute until the war years.

To improve cooperation between the research institute and other sources of economic data, a decision was taken at the same time to establish an advisory committee for macroeconomic research. The head of the statistical department, A.E. Tudeer, was appointed its

chairman. Its members were to be inspector general Martti Kovero of the Central Statistical Office, head of bureau Gunnar Modeen of the Social Research Office, director V. Lindgren of the statistical department of the Board of Customs, chief inspector Eljas Kahra of the Council on Unemployment and director O.W. Willandt of the market research institute of the Pellervo Society.⁸²³ All committee members were closely involved in producing the main statistics that monitored economic conditions and the committee reinforced the Bank of Finland's role as a statistical coordinator. Bruno Suviranta continued as director of the research institute.

The economic analysis of the Bank of Finland thus had its origins in a minor statistical department consisting of one official. Although resources were gradually increased they remained modest until the start of the 1940s. Nevertheless the work of the statistical and macroeconomic departments had major repercussions throughout Finland's economy and society. K.J. Kalliala, recruited to be the first manager of the statistical department, wasted no time in putting the bank's statistics and economic analysis on a solid footing.

BUILDING INTERNATIONAL CONFIDENCE

From the 1920s onwards the Bank of Finland played a major role in disseminating information about the Finnish economy abroad. In the early years of independent Finland, the country had a questionable position on international capital markets. Trust in the economy and particularly in Finland's political position was shaky. The Bank of Finland adopted a forceful programme of spreading information in the main foreign centres about the nation's economic conditions. To do so, it created a monthly bulletin in English, which first appeared in autumn 1921. The bulletin always began with a short review of the financial market, foreign trade, industry and the labour market. This introduction was followed by statistical reviews of the Bank of Finland, the commercial banks, the savings banks and other financial institutions, government finances, foreign trade, domestic transport, price indices and the labour market. There were also brief articles on special issues. In terms of comprehensiveness and quality, the publication was, from the outset, in a class of its own compared with

other publications containing economic information on Finland. Nothing of the sort had previously been available in English.

Via its monthly bulletin, the Bank of Finland tried to provide an international audience with the broadest possible, accurate image of public finances and the national economy. It was a way to increase trust in Finland on international capital markets. Finland's improving position as a foreign borrower shows it worked. Another sign of success was that by the 1930s the Bank of Finland had achieved a rather esteemed position among central banks. This was certainly aided by its measured work to develop international relations. In connection with Finland's return to the gold standard it had stepped up cooperation with other central banks and was no longer merely the passive party. In 1927 it had participated in two central bank consortia that granted credit to the central banks of Poland and Italy. Understandably Finland's share of the loans was rather modest, only about 1–2 percent.⁸²⁴

The Bank of Finland was also involved in the Bank for International Settlements, established in 1930. The background of the BIS was, as its name indicates, the rescheduling of war reparations payable by Germany at the end of the 1920s. The reparations question was discussed in a committee headed by US representative Owen G. Young and agreement was reached at the end of summer 1929 when the amount of compensation was set at 26.3 billion dollars to be paid over 58 years. Part of the Young Plan was the establishment of a special financial institution to collect the reparations and make the payments. The central banks of Belgium, France, Italy, Great Britain, Japan, the United States and Germany were represented in the founding negotiations. After lengthy talks it was agreed to establish a joint stock financial institution with the immediate task of gathering and administering the reparations. In addition, the new BIS would coordinate cooperation between central banks. Basel in neutral Switzerland was chosen as its location and Switzerland agreed to guarantee the bank's judicial position. The final accord on establishing the BIS was signed in Rome on 27 February 1930. The founding shareholders were the aforementioned five European central banks, plus banking consortia from Japan and the United States, whose monetary authorities were not permitted by their regulations to participate in the project. Although the BIS was a comparable institution

to the League of Nations it was decided to incorporate it as a limited company, to ensure its political independence and the position of the founding banks in administering it.⁸²⁵

In spring 1930, the central banks of the Netherlands, Switzerland and Sweden were also invited to become shareholders. In the next stage in June 1930 the invitation was extended to Austria, Bulgaria, Czechoslovakia, Denmark, Finland, Greece, Hungary, Poland and Romania. The offer was made only to the central banks of countries where monetary conditions were stable and which were on the gold standard. Even before receiving the invitation the Bank of Finland had contacted the BIS and announced its willingness to subscribe shares. In a letter on the subject to the supervisory council, the board of management of the Bank of Finland had stressed that Finnish participation in the BIS was not merely useful but indispensable. The council approved the proposal unanimously and the Bank of Finland decided to subscribe 4000 BIS shares with a nominal value of 2500 Swiss francs each.⁸²⁶ Only a quarter of the share capital had to be paid immediately; the rest would be collected at a time set later by the BIS. The nature of the bank's operations changed soon after its establishment, when President Hoover declared a moratorium in 1931 on the payment of reparations and debts because of the European currency crisis. The BIS subsequently concentrated on fostering closer cooperation between central banks.⁸²⁷

In the 1920s and 1930s, direct contacts were established between the main international figures of influence in the financial world and the senior management of the Bank of Finland, in practice mainly Risto Ryti. Communications improved significantly during these decades, allowing Ryti to visit Europe's main financial centres regularly and meet the leaders of major central banks. At least once a year he made a tour of Germany, France, Great Britain and Switzerland. On several occasions he also visited the United States. Ryti's closest contacts were with the central bank leadership of Britain and Sweden. These active relations had brought him a respected international position and he participated in the work of several committees of the League of Nations.

BANK OF FINLAND

MONTHLY BULLETIN

No 1—9

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1921

FINNISH MARKET REVIEW.

THE MONEY MARKET.

The demand for capital in excess of the supply, which was a feature of last year, has continued during the first three quarters of 1921. This lack of proportion has not depended on an unusually slow formation of available capital. From the commencement of the year to the end of September home deposits in the commercial banks have grown from 3,613.3 million marks to 3,820.4 million marks. The increase is thus 207.1 millions or 5.7 $\frac{1}{2}$ %, more than the corresponding average increase during the years 1910—1913. In addition, the deposits in Finnish marks of foreign depositors in the commercial banks showed an extremely strong increase. The cause of the tight condition of the money market has been chiefly the large demand for credit. The loans of the commercial banks increased during the first nine months of the year from 5,553.4 mill. marks to 6,259.3 mill. marks; the increase being thus 705.7 mill. marks, or 12.7 $\frac{1}{2}$ %. The corresponding increase in the years 1910—1913 averaged, on the other hand, 2.7 $\frac{1}{2}$ %. The great demand for credit depended on many reasons, the most important being the binding of large amounts of capital in stocks of goods on account of the small demand for our export wares at the beginning of the year, and further, the fact that belated taxes for several of the preceding years fell due during 1921, which in many cases obliged taxpayers to seek the assistance of credit.

Although the money market has been specially tight, a crisis in this connection cannot be spo-

ken of. No figures are as yet available of the number of bankruptcies during the present year, but their amount would not seem to be much out of the ordinary. Neither does the number of bills protested this year show signs of increase. Most clearly, the tight condition of the money market is shown by the decrease in the turnover of the Stock Exchange. But favourable results of the tightening of the market are also discernible. A considerable amount of capital and labour, used hitherto for speculation purposes, has now been directed to more profitable fields.

The net indebtedness of the commercial banks to foreign countries has grown from 741.3 mill. marks at the beginning of the year to 1,052.4 mill. marks at the end of September, or by 311.1 millions. The increase is accounted for chiefly by the fact that during the depressed state of the export market, foreign currency had to be bought with Finnish marks, which were generally left on deposit in the banks here. This foreign debt decreased considerably in February, owing to the action of the Finnish Government in borrowing from the credits of Scandinavian mark-holders in Finnish banks, a sum of 250 mill. marks.

The Bank Rate has been, since Nov. 10th, 1920, 9 $\frac{1}{2}$ %. The Market rate has been during the whole year 9 $\frac{1}{2}$ —12 $\frac{1}{2}$ %. On deposits payable on demand the commercial banks pay 5—6 $\frac{1}{2}$ % and for deposits for a longer period 6 $\frac{1}{2}$ —7 $\frac{1}{2}$ $\frac{1}{2}$ %.

The note circulation of the Bank of Finland was at its highest, 1,493.3 mill. marks, on March

OPERATIONAL PROFITABILITY

The extent of Bank of Finland operations can naturally be measured in many different ways, such as the number of employees, size of turnover, total assets, currency reserves or banknotes in circulation. However some of the indicators are more indicative of the level of economic activity than the size of the central bank. For simplicity the balance sheet totals from the bank's accounts are used here. Admittedly, because of some undervaluations in the bookkeeping, they are slightly less than corrected figures would be, but contemporaries judged the bank by these accounting figures so their use is justified to that extent at least.

The disarray in the national economy and the Bank of Finland's finances, caused by the First World War and the 1918 civil war, had already been repaired by the early 1920s. At this stage the balance sheet of the Bank of Finland totalled about 2 billion markkaa. By 1923 there was stronger confidence that the markka could be permanently stabilised and the whole national economy developed favourably from then onwards. This shows in a rise in the bank's balance sheet to around 3 billion markkaa in 1928. The slump in Finland began to show in 1929, when the balance sheet dipped slightly, and continued until 1934. From then until the end of the period under review, assets continued to expand rather briskly, passing the 5 billion markkaa level in 1938. If deflation in the first half of the 1930s is taken into account, the dip caused by the Great Depression looks less acute and shorter; only in 1932 did the balance sheet decline in real terms.

The total assets of the Bank of Finland grew far faster than Finland's GNP, although the first GNP figures were calculated only later. This fact confirms the view that, even after the First World War, Finnish society was still continuing to develop as a monetary economy. The main components of the Bank of Finland's financial result were interest income, meaning interest on domestic credit granted, interest on funds held in foreign correspondent bank accounts and the yield from domestic and foreign bonds held by the bank. By far the largest of these items was the interest earned on lending, bond income came second and interest paid by foreign correspondents third. Interest income was strikingly great between the mid-1920s and the mid-1930s. In this period high interest rates were a problem for the whole economy and, although

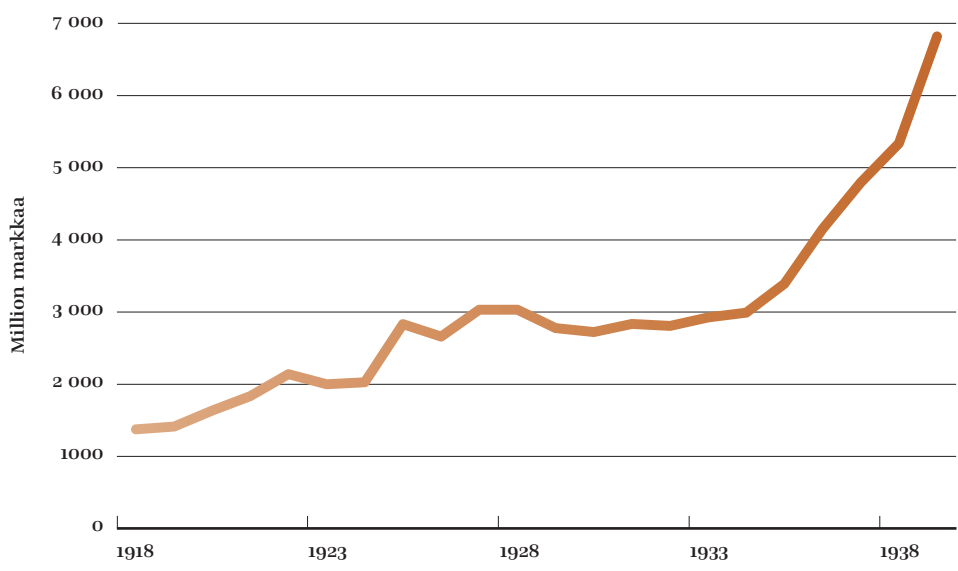
the Bank of Finland was trying to bring them down, its financial statement benefited from the high interest rate level. The structure of the bank's income was relatively stable apart from two exceptional periods. The first was in 1919 and 1920, when price gains shot up, largely because the value of foreign currency reserves had risen. The second exceptional period was 1923–1927, when preparations were being made for a return to the gold standard and the bank was seeking to build up assets held in correspondent bank accounts abroad. At that time interest income from foreign correspondent banks rose.⁸²⁸

Most of the expenditure of the Bank of Finland consisted of wages, banknote production, miscellaneous expenses, bond write-downs and exchange rate losses. Exchange rate losses occurred in two years, 1921 and 1922, and were part of the process of trying to stabilise the external value of the markka. From 1923 onwards, write-downs on the bond portfolio became the largest individual cost item. This was clearly a matter of accounting flexibility. By writing down asset values, the bank was building hidden reserves into its balance sheet and thereby easing its transition to the gold standard. Another objective was to reduce the bank's accounting profit, by which it reduced the funds that had to be transferred to the government. Bonds were not written down after 1932.⁸²⁹

The diagram on page 581, showing accounting profit and the proportion transferred annually to the government, gives an overall picture of the development of the bank's accounting profits.

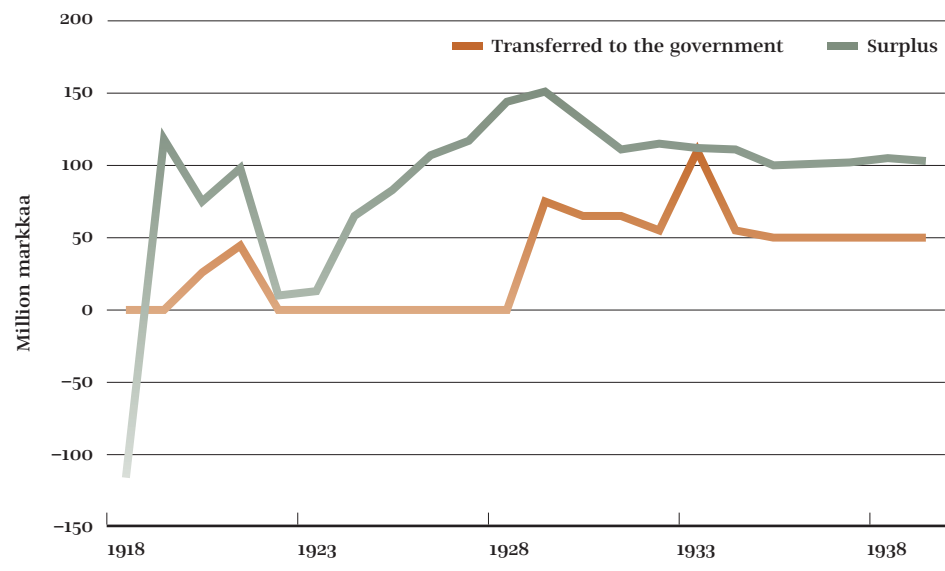
Until the regulations of 1895, the Bank of Finland had paid the government an annual fixed sum that was earmarked for certain forms of education and the support of mental asylums. It was also intended as compensation for the savings accruing to the Bank of Finland after 1874, when the government's financial traffic had been transferred to the State Treasury. For a long period this sum was 249 541 markkaa annually. According to article 5 of the 1895 regulations, the Estates could order that the annual surplus was to be used for general government purposes after part of the surplus, also set by the Estates, had been transferred to the bank's reserve fund. In fact this regulation confirmed the prevailing practice because bank surpluses had been used for purposes designated by the Estates already since the 1870s. Section 30 of regulations that took effect in 1925 continued this practice; after the bank's capital had reached the minimum amount stated in

BANK OF FINLAND BALANCE SHEET TOTAL 1918–1939



Source: Bank of Finland. Yearbooks 1918–1939.

BANK OF FINLAND SURPLUSES AND THEIR DISTRIBUTION 1918–1939



Source: Bank of Finland. Reports of the supervisory council 1918–1938.

the regulations, at least a third of the annual profit was to be transferred to the reserve fund. The part of the profit that was not used to increase the bank's capital reserves could be allocated for general purposes by parliament. In 1897 the Bank of Finland paid the aforementioned fixed sum to the government for the last time. From 1900 onwards, the share of the bank's surplus transferred to the government was decided by the Estates and later by Parliament.⁸³⁰

Accounting procedures allowed the bank to adjust the size of the profits it reported. The main accounting decisions were taken annually at a meeting of the supervisory council, on the basis of a proposal by the bank's board of management. The main areas of accounting discretion were the bookkeeping values of currencies and the principles for valuing bonds. In practice the board and the council had to agree on how the bank's financial solidity would be developed. The aim was to show a relatively constant accounting profit and to build up hidden reserves that gave the bank financial room to manoeuvre.

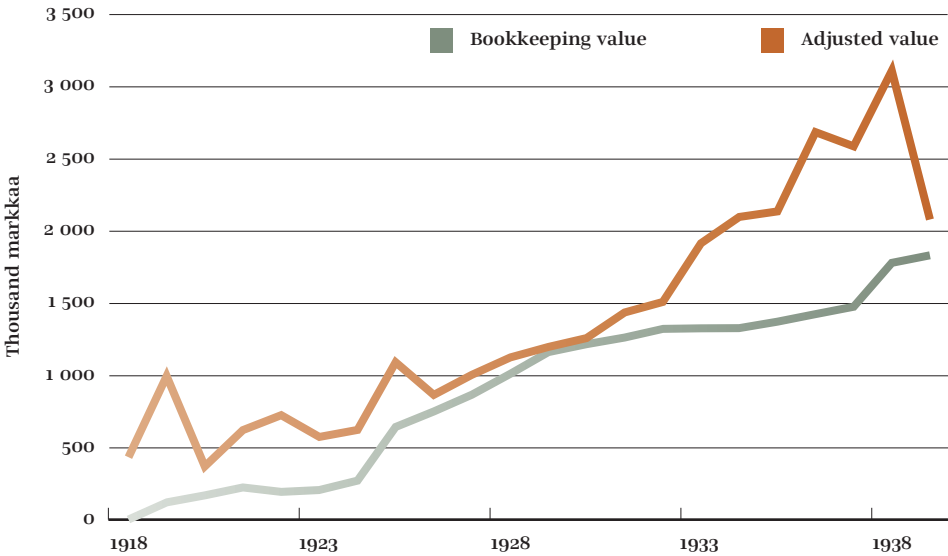
The external value of the Finnish markka was successfully stabilised in 1923 and a return to the gold standard began to be possible. More stable exchange rates eased the operations of the Bank of Finland and its surplus grew immediately. Preparations for a return to the gold standard began around the same time. They required a deliberate build-up in the bank's capital resources, and the hidden reserves in the bank's balance sheet also increased. Parliament tended to allow the bank's entire surplus to be transferred to the reserve fund until the end of the 1920s, when the bank's capital was deemed to have risen adequately and, after a hiatus of five years, part of the surplus began to be transferred to the government. The slump in the early 1930s created a crisis in public finances and in 1932 and 1933 the government took the bank's entire surplus. More normal times returned in 1934 and from then onwards half the surplus went to the reserve fund and half to the government.⁸³¹

Ultimately it was the supervisory council that decided how profits should be divided but in practice it always supported the board's line; bolstering capital adequacy was the main objective and providing funds for the government was only secondary. An economically viable central bank with a strong balance sheet was in the interests of the whole economy. However the conflict between finances of bank and government emerged in a concrete way immediately after Finland's independence.

To reinforce the bank's capital, the government provided 350 million markkaa in 1918, in the form of bonds to be redeemed around the middle of the 1920s. The government in 1920 and 1921 demanded from the Bank of Finland a sum of money equivalent to the imputed interest on the bonds. The bank's board of management and the supervisory council felt the demand was unreasonable, especially as it had not been agreed when the capital injection had been made. The bank ultimately acceded to the demand but it was not repeated after 1921.⁸³²

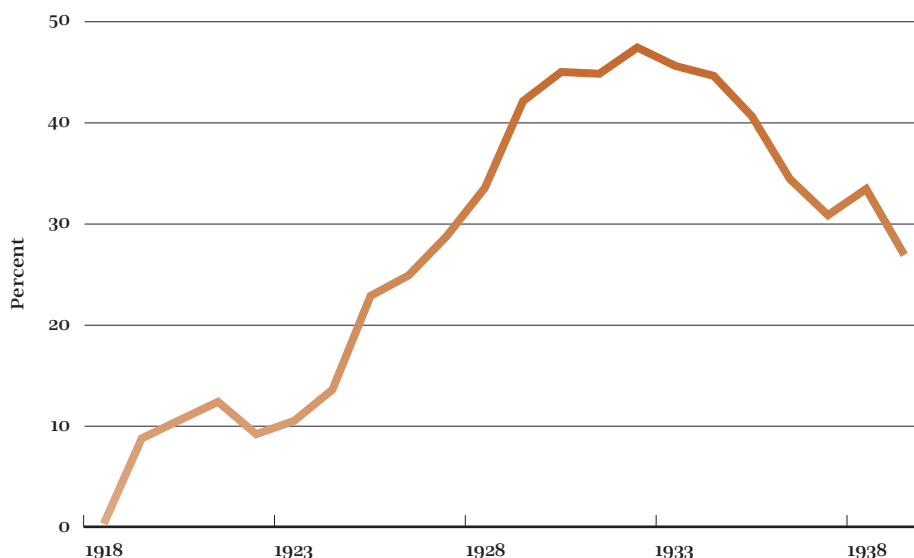
When the Bank of Finland's operations were restarted in spring 1918, after the civil war, the cupboard was almost bare. All the capital from previous years had been used up and the accounts for 1917 could not even have been closed without assistance from the government. However, because of a general rise in interest rates, the bank's profitability developed favourably, apart from one setback at the start of the 1920s. Soon after the return to the gold standard, capital had reached almost 1 billion markkaa. During the Great Depression of the 1930s, when the entire surplus was transferred to the government, the

BANK OF FINLAND CAPITAL 1918–1939



Sources: Bank of Finland. Yearbooks; Ikonen, V., 1995.

CAPITAL / BALANCE SHEET TOTAL 1918–1939



Source: Bank of Finland. Yearbooks 1918–1939.

bank’s capital remained unchanged. From 1934 onwards it began to rise again and at the close of the period under review in 1939 it had reached nearly 2 billion markkaa.

As noted above, the accounting principles applied by the Bank of Finland were fairly cautious. Consequently the bookkeeping value of its gold reserves, its bond holdings and other such assets were at times very far below their true value. When the gold standard was reinstated and a new official price was fixed for gold, the hidden reserves thus created were unwound into capital, after which the bookkeeping and adjusted capital figures were very close to each other. After the Great Depression the corrected capital figure diverged again from the bookkeeping value. The gap was greatest in 1938 when the bookkeeping value was less than 60 percent of actual capital.⁸³³

Naturally the absolute size of capital alone gives an inadequate picture of the solidity of the Bank of Finland and needs to be seen in proportion to the breadth of operations or in this case the bank’s balance sheet.

From the return to the gold standard onwards, the Bank of Finland had good capital adequacy. At its highest it was nearly 50 percent in 1933. If it had been measured from its corrected value and not the capital shown in the accounts, the ratio of capital to balance sheet total would have risen above 50 percent.

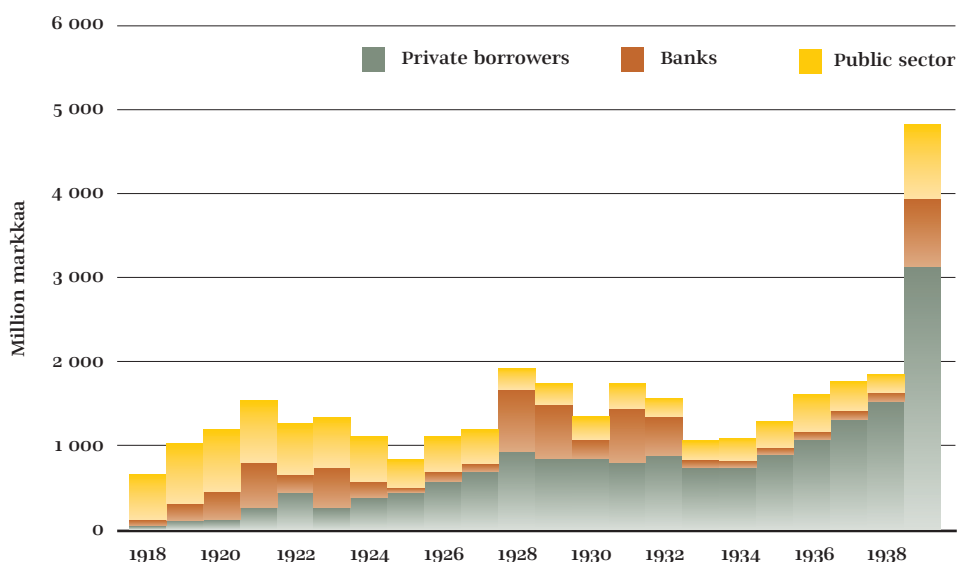
The bank's improving capital adequacy during the Great Depression is partly explained by the fact that the balance sheet total stopped growing during the slump. This shows concretely in a fall in the bank's stock of lending. Lending was at its highest, 1.9 billion markkaa, at the start of 1929 and at its lowest, 1.0 billion markkaa, at the start of 1934. The board of management reported that the balance sheet was shrinking mainly because of weaker demand for credit. For example, lower exports reduced the need for short-term working capital among exporters, which was then reflected in a decline in the bills of exchange discounted by the central bank. Also lower demand for credit meant that commercial banks were providing less short-term finance, so their liquidity remained good and they rarely needed to rediscount bills at the central bank. The decline in lending would surely have been even steeper if the Bank of Finland had not granted relatively large loans to a few troubled commercial banks during the depression. In studying the lending trend it must be borne in mind that, even during the depression, the Bank of Finland tried to adhere to the lending principles that were regarded as healthy for a bank of issue. This meant that it should concentrate on providing short-term commercial credit against bills of exchange or good collateral in securities.

CAUTIOUS LENDING POLICIES

Domestic lending by the Bank of Finland in the 1920s and 1930s consisted of credit granted to companies including banks, loans to the government and bond investments.

From the First World War years to the 1920s the government of Finland was compelled to rely on substantial borrowing from the central bank, in effect by printing money, as the diagram overleaf indicates. However it proved possible to stabilise the government budget fairly rapidly and from 1922 onwards, credit granted to the private sector gradually came to dominate the lending of the Bank of Finland. Particularly after adoption of the gold standard, the volume

BANK OF FINLAND LENDING BY SECTOR 1918–1939



Sources: Bank of Finland. Yearbooks 1918–1939; Ikonen, V., 1995.

of credit to the private sector turned steeply upwards until this trend was interrupted by the economy’s descent into slump. Then came a period of unstable development until 1934, when the stock of loans turned upwards once more. The peak of 1928 was not passed until 1938.

According to classical central banking theory, government spending should not rely on central bank financing except in temporary and exceptional circumstances. At the Bank of Finland, the management thought and acted according to this maxim. In the early years of Finland’s independence the amount of credit granted to the government was still high but the last such new loans were granted in 1921. In practice, government debt consisted of short term promissory notes (bills of exchange) that the government had been forced to issue to the Bank of Finland before taxation had been reorganised to meet Finland’s new circumstances. Furthermore the Bank of Finland had agreed to accept a large quantity of state bonds, which the government was committed to redeeming later. These included the previously mentioned capital injection of 350 million markkaa obtained from the state in

1918, which was technically implemented by transferring bonds of that amount to the bank. The government was committed to redeeming the 350 million markkaa in bonds with foreign currency so as to strengthen the reserves of the central bank.⁸³⁴

Granting loans to the government was seen as being distinctly in conflict with the gold standard so their repayment was accelerated as soon as the decision had been made to reinstate the gold standard. The final instalments were paid in 1928. To help repay them, the government took foreign loans, thus allowing it to pay with the foreign currencies that the bank needed under the gold standard. From then onwards the government had no remaining debts to the central bank before 1939, when the outbreak of the Winter War again forced it to resort to direct central bank financing.

The bank did not regard investment in bonds issued by the government as an undesirable form of government financing but as part of normal investment operations. The Bank of Finland had claims on the government in the form of bond investments throughout the interwar period. It began to buy bonds in significant amounts around 1925, at the time of the move to the gold standard. From then onwards its stock of bonds increased fairly steadily, passing the level of 500 million markkaa in 1937. Its portfolio was divided fairly equally between bonds denominated in markkaa and those in foreign currencies. Investments in bonds fulfilled two functions. Firstly the bank's participation in Finnish bond issues helped the issues to succeed. The bank participated in arranging several bond issues by subscribing them at the time of issue and then selling them, when possible, in the secondary market. At the same time, bonds offered a stable source of interest income and in this sense complemented the bank's investment operations. As marketable instruments they were in principle liquid investment items and so suited a central bank's investment arsenal. The bank also took advantage of the opportunities for accounting flexibility that were contained in bond investments. By undervaluing them, it could make hidden reserves and thereby control its accounting profits. Overall, however, bond investments were not very important in the bank's balance sheet. For one thing, its regulations restricted the amount of bonds that could be used as banknote cover, and domestic bonds could not at all. Funds for bond investments therefore came from the bank's capital.

The focus of the bank's lending was in private credit, which was termed "home lending" in its accounts. This credit was mostly granted to private companies and sometimes also to banks. Its regulations allowed the bank to discount and rediscount bills of exchange, to make Lombard loans with collateral in securities, and to permit advances on current accounts. In acceptance credit on bills of exchange, companies were granted quotas for the bills they could discount. Bills of exchange were generally granted for three months at a time and the interest rate was determined by the nature of the bill; the rate for commercial bills of exchange was lower than for financial bills of exchange. Secured loans were similarly short-term, for no longer than three months, but could be renewed once without amortisation. Acceptable collateral for them was government bonds, for example, or promissory notes secured by mortgage. Current account advances were granted for six months at a time and also had to be secured by collateral approved by the Bank of Finland.

In the initial years of the period under review, the Bank of Finland had granted credit to commercial banks against the government bonds that they held, on condition that the banks would redeem them at an agreed time. In modern terms these could be called repo agreements. Commercial banks were also offered the opportunity to rediscount government bills of exchange that they held. The purpose of both these forms of credit was to ease the plight of government finances.⁸³⁵

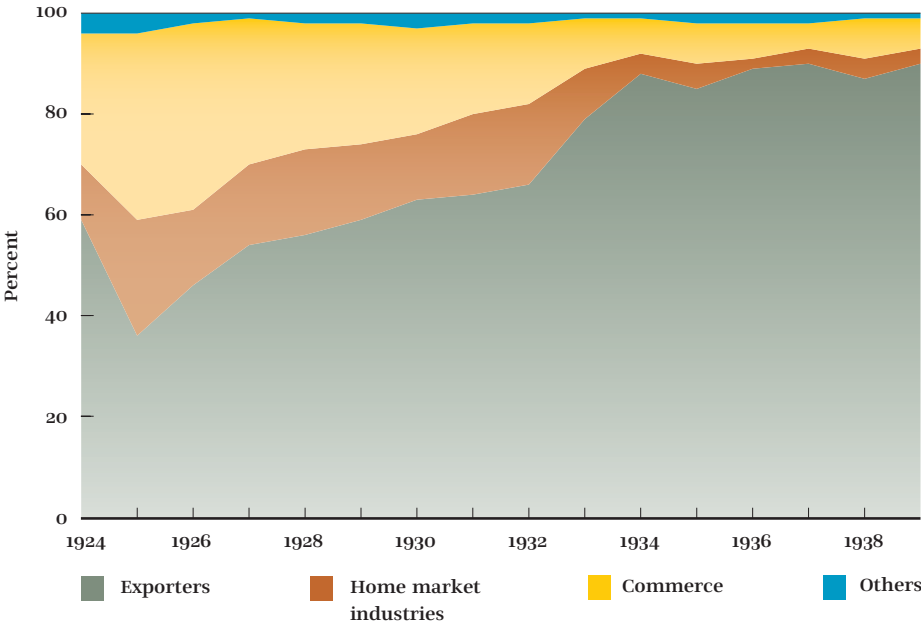
By far the most important form of Bank of Finland lending was discounting private bills of exchange which, at its highest point, accounted for more than 80 percent of all lending. Another significant item was rediscounting bills of exchange of commercial banks, which was proportionally greatest at the beginning of the period and after the economy had turned down in 1928 and 1931. In 1932, at the low point of the Great Depression, the share of rediscounting had already begun to shrink and after October 1933 liquidity in the financial system was again so good that, for the rest of the decade until 1939, there was no rediscounting at all. Then, general uncertainty strained the liquidity of commercial banks and in September 1939 they started rediscounting again. At the end of the year, rediscounting were already 300 million markkaa.

The stock of secured loans and current account overdrafts remained very low throughout the period and was of little importance in the bank's lending. However the outbreak of the Winter War changed the

situation. In 1939 the stock of secured loans soared because the commercial banks drew down some 400 million markkaa in credit, which the Bank of Finland classed as secured loans.

Private borrowers were divided between companies and banks in a fairly stable way. Generally companies accounted for 75–90 percent and commercial banks 10–25 percent. The main exceptions were 1928–1929 and 1931, when commercial bank liquidity was very tight and substantial rediscounting raised their share of central bank loans above 40 percent. Otherwise the low share of loans to banks reflects the special features of Finland’s financial system, such as the dominant position of major banks with broad branch office networks. Large banks had the resources to regulate their own liquidity and did not need central bank aid, at least not regularly. Another striking feature was exceptionally good liquidity throughout the financial system from 1933 onwards.

**BANK OF FINLAND ACCEPTANCE CREDIT BY SECTOR
1924–1939**



Source: Bank of Finland. Reports of the supervisory council 1924–1939.

The distribution of acceptance credit on bills of exchange says a lot about the lending policies of the Bank of Finland. The diagram shows a distinct change of direction in bank lending around the middle of the 1920s. Exporters had always received the largest share of acceptance credit but the sectors of commerce and industry serving the home market, combined, had received about as much. After the middle of the decade, however, an ever larger proportion went to export companies and after the mid-1930s their share began to approach 90 percent. It remained equally high until the end of the decade.⁸³⁶ This high figure confirms the impression of the bank's role in implementing policies for export-led growth. At the same time it reflects the great need for working capital of Finnish exporters, especially true of sawmills.

The other customers for Bank of Finland credit were mostly large companies in the export and domestic market industries, large wholesalers and the central wholesale organisations of the retail chains. On the other hand, because of the conditions attached to its loans, the Bank of Finland did not become their only banker. Each would have a large commercial bank as its main bank.

More careful screening of customers and a reform in lending procedures at the start of the 1920s led to a rapid reduction in credit losses. In proportion to the bank's entire stock of lending, the credit losses recorded were generally negligibly small. The exception was 1924, when a forest industry company, Oy Rauma Wood Ab, which had become overextended, caused the bank problems. To remedy the situation, the largest creditors of the firm, led by the Bank of Finland, agreed on a debt settlement which subsequently appeared in the Bank of Finland's account as a rise in credit losses to nearly 2 percent of the total stock of lending.

Surprisingly the depression years of the 1930s did not, practically speaking, caused the bank any credit losses. A small number of debts were transferred to the category of uncertain receivables in 1931 but even then they accounted for only a thousandth part of the bank's stock of lending. This confirms the impression noted earlier in other connections that even during the Great Depression, the bank did not depart from its classical central banking principles. While it lent funds to major companies that were in trouble, the problems were tackled in cooperation with the main commercial bank of the company in

question. The management of the Bank of Finland and the commercial bank jointly agreed the measures required and it remained the task of the commercial bank to monitor the problem customer.

At the depths of the depression in 1929–1932, demand disappeared for high-quality acceptance credit and loans backed by securities so the stock of Bank of Finland, lending contracted in the absence of creditworthy borrowers. Complaints were heard throughout the economy about the difficulty of obtaining loans, and the agricultural population were especially critical of the bank's lending policies. They wanted the bank to expand its lending and provide long-term credit, for example against agricultural property. This criticism was echoed in parliament, as described earlier. As the economy began to recover in 1933 the demands for new lending principles gradually died down and no real changes had to be made in the bank's policies.

THE PARLIAMENTARY SUPERVISORY COUNCIL

POLITICKING AT THE TURN OF THE 1930S

Two periods can be distinguished in the operations of the Parliamentary supervisory council during the 1920s and 1930s. The first phase extends approximately until the gold standard was adopted at the start of 1926. At that time, the senior management of the Bank of Finland under three different governors – Stenroth, Ramsay and Ryti – implemented major reforms. Counterbalancing rapid change in the board, the council represented continuity and it played a large role in matters such as the stabilisation of the markka and the subsequent return to the gold standard. Its status was thus rather strong, as evidenced by the appointment of councillor Ramsay as governor when an acting governor was urgently required for a one-year transitional period after Stenroth's resignation. It was important for relations between the board and the council to remain good despite the change of governor

By the time that the gold standard was adopted, Risto Ryti already had a firm position as governor and this was reflected in the status of bank councillors. Their active grip on the operational running of the bank was relaxed and the council became more of a supervisory body. Ryti's reputation for autocratic leadership may have been exaggerated because throughout his career at the central bank he accepted the role of the council as the board's supreme overseer. On the other hand there was some disagreement about the extent to which parliament

could directly intervene in the bank's operations. This was at the heart of a fundamental question of central banking: how independent should a central bank be?

The decline into recession at the end of the 1920s bred tension throughout Finnish society. The disappearance of forest work, the collapse in stumpage prices and the worldwide fall in prices of agricultural products caused major problems in the countryside. At their worst they culminated in the repossession of farms, causing especially strong pressures within the Agrarian League. The Depression Movement appealed specifically to that party.

The activation of members of parliament of the Agrarian League is particularly evident in 1932, when they proposed several private bills and made interpellations demanding measures to lower the interest rate or increase money supply and thereby improve the scope for central bank lending.⁸³⁷ The League's members on the supervisory council showed similar animation. J. Leppälä, V. Vesterinen and J. Lahdensuo took the initiative in proposing changes in the basis of monetary policy despite the objections of the council majority and the board of management, as noted earlier in connection with monetary policy.⁸³⁸ These criticisms in parliament and the council came at the low point of the Depression. In the following year, 1933, the economy began to grow and criticism of Bank of Finland management by Agrarian League councillors subsided. After this the traditional spirit of cooperation between the council and the board continued unbroken into the 1940s.

STRONG CHAIRMEN

In the 1920s and 1930s the supervisory council of the Bank of Finland was personified by its chairmen. If one year-long period is ignored, there were three such chairmen, Wille Lavonius (1920–1924), Ernst Nevanlinna (1924–1932) and Väinö Tanner (1933–1945).

Wille Lavonius (born 1874) was first elected a deputy council member in 1912. He was a member of the liberal National Progressive Party who had taken part in the Diet of 1905–06 but not in the sessions of the new unicameral parliament. In the early years of the 20th century he held important positions in cooperative businesses, on the boards of organisations like the Central Organisation of Finnish Co-

operative Societies (SOK) and the Butter Export Cooperative Valio but he withdrew from these when appointed managing director of Suomi Insurance Company in 1906, where he became one of Finland's top experts in insurance. As chairman of the Parliamentary supervisory council, he was actively involved in drafting plans for fixing the value of the markka and returning it to the gold standard. At an early stage he threw in his lot with those who felt that there could be no return to the old markka parity; economic realities should be recognised and the markka would have to go on the gold standard at prevailing exchange rates. In this respect Lavonius was a follower of the leading international expert, Gustav Cassel.⁸³⁹ Even so, he was not in complete agreement with Risto Ryti, who became governor during his term. Lavonius felt that the return to the gold standard should have been implemented at a slightly stronger markka value than the one ultimately chosen.

In 1924 he was not re-elected to the Council and he was succeeded as chairman by Professor Ernst Nevanlinna (born 1873), a representative of the conservative National Coalition Party. Nevanlinna was a respected official from a family of mathematicians (the family name until 1906 was Neovius) who had also served as head of the financial department of the Senate and as editor-in-chief of *Uusi Suomi* newspaper, which was allied to the National Coalition Party. As an economic expert, he represented a bridge between the older historical school of economics and the new analytical trend.⁸⁴⁰

Nevanlinna was first elected to the supervisory council in 1908 so by the time he became chairman in 1924 he had strong experience and opinions regarding the council's position and duties. This long experience was of great assistance to Risto Ryti, who joined the bank as governor in the same year. One of Nevanlinna's legacies in monetary policy was a publication from 1931 entitled: "The Bank of Finland. What it should do, what it can do, what it cannot". This was a succinct pamphlet that defended the operations of the central bank during the early years of the Depression against attacks from the leaders of the Depression Movement and the representatives of the Agrarian League. These had been demanding active central bank measures to reduce the interest rate level and a change in lending policies to allow credit to be granted directly to farmers in trouble during the slump and others in need of support. Nevanlinna believed that even in a slump a central

bank should not depart from classical principles, which were concretely summarised at the end of his booklet. "As a financial institution with these responsibilities, what the Bank of Finland can actually do is this: grant appreciable credit only by discounting short-term first-class commercial bills of exchange and, in other respects too, investing its funds only where they can be easily be liquidated. (It) cannot therefore grant long-term loans to landowners and or any others, nor set its interest rate with regard to any consideration other than what is required to protect the value of money and what is demanded by the true state of the capital market."⁸⁴¹ The same sentences could equally well have been written by Risto Ryti; the views of the council and board chairmen on central bank policies during the slump years were entirely parallel.

Nevanlinna's sudden death in autumn 1932 meant that a new council chairman was required. His deputy Väinö Tanner was not interested in the position, so it went to Jalo Lahdensuo of the Agrarian League, who had been on the council since 1927. Lahdensuo had held a rather distinguished position in his party and been a government minister several times. When he was elected council chairman, he was defence minister in the second Sunila government. His election may seem slightly surprising because relations between the board of management and the Agrarian League were icy at the time, and Lahdensuo had been a council critic of prevailing monetary policy. On the other hand there was obviously a need to increase the League's trust in the Bank of Finland and Lahdensuo's appointment surely served this purpose.⁸⁴²

His term was brief. The very next autumn Väinö Tanner was elected chairman by 5 votes to 4.⁸⁴³ Tanner was the dominant figure in the Social Democratic Party, a lawyer who was not only a politician but also managing director of the Helsinki consumer cooperative Elanto. He had been a member of parliament in 1907–1917 and head of the financial department – i.e. Minister of Finance – in the government of 1917, known as the Tokoi Senate. He was one of the socialists who had not participated in any way in the operations of the People's Delegation in spring 1918, which facilitated his return to national politics after Finnish independence. He won a seat in parliament in the elections of 1919 and at the same time became a member of the supervisory council, where he quickly rose to prominence, becoming

VÄINÖ TANNER (1881–1966)

Born to a modest working-class family in Helsinki, Väinö Tanner, whose family name was originally Thomasson, was the most prominent leader of the Finnish labour movement in the first half of the 20th century. From the outset he displayed great resolution and sense of purpose. He matriculated from secondary school at the top of his class, enrolled at Helsinki Business College and continued his studies even after beginning work, obtaining a degree in law in 1911.

Even as a young man he held influential positions in both politics and business. He was elected to parliament as a representative of the Social Democratic Party in 1907 and became head of the Financial department of the Senate in 1917. He was on the political right of his party and played no part in the attempted revolution of 1918. After the Civil War he was elected party chairman and became the first socialist prime minister of independent Finland in the minority social democratic administration of 1926–27. He was a minister in five subsequent governments during the 1930s and the war years.

His business career was in the cooperative movement. He was appointed managing director of Helsinki's Elanto Cooperative in 1915 and built a broad network of connections in cooperative movements abroad as well as at home. He was elected to the supervisory council of the Bank of Finland in

1919, the start of a council term that continued until 1962, interrupted only by a sentence of imprisonment for his wartime actions. His position at the Bank of Finland was especially strong in 1933–1945, when he was the chairman of the supervisory council.

His close cooperation with the long-term governor of the bank, Risto Ryti, had begun in the 1920s and they were agreed on many questions of economic policy, such as the importance of balanced public finances. Tanner believed that the stable value of money served the interests of the working class and refused to back the demands made by the Agrarian League in the 1930s for legislative controls on interest rates or for expanding the note issue to raise the price level. As chairman of the supervisory council he enjoyed a harmonious working relationship with Ryti, which continued during the war years; he served as foreign minister in Ryti's government during the Winter War and subsequently as minister of trade and industry and minister of finance under President Ryti.

After the war, Tanner was put on trial for culpability in the war and was sentenced to 5½ years' imprisonment. He was released on probation in 1948. He returned to the Parliamentary supervisory council in autumn 1951 but the political times had changed. He still enjoyed esteem on the council but was no longer a leading light in bank policymaking.

■ Väinö Tanner's period on the Parliamentary supervisory council spanned six decades. He was first elected to the council in 1919 and his service did not end until 1962.
– Board of Antiquities / Pietinen.



deputy chairman as early as 1924. His views on monetary policy were very similar to those of his predecessors Lavonius and Nevanlinna and of the bank's operational management. Although Tanner was a leading social democrat in the 1920s and 1930s, his stands on monetary policy may have reflected his experience as a business leader rather than any socialist ideology. All his work, including that as chairman of the supervisory council, was characterised by pragmatism.⁸⁴⁴

Tanner's term as chairman continued without interruption until 1945. During the same period he served one term as prime minister and six as a government minister, usually at the finance ministry. It was felt at the time that a minister was not disqualified from serving as a member of the supervisory council so Tanner's status as its chairman formed a "personal union" between the finance ministry and the central bank when he was minister. Naturally this kind of arrangement might have been questionable for the independence of the central bank but at least in the exceptional conditions of the war it can be regarded as appropriate. After the war he was tried and convicted for responsibility for the war, but this did not terminate his career on the council; in 1951 he was re-elected and continued on the council until 1962. He was thus a council member for almost 40 years.

One of the most prominent ordinary members of the council was Erik von Frenckell, a representative of the Swedish People's Party, who was elected to the council in 1930 and continued there until 1945. This was certainly a pleasant return to respectability for him, because he had been compelled to leave the Bank of Finland in 1923 together with Otto Stenroth. His profile on the council was as a consistent liberal voice for classical central bank policies, concerned about the dangers of inflation even during the war years.⁸⁴⁵

In the 1920s and 1930s the central bank had a crucial position in shaping economic policies for the whole country although its formal responsibility was mainly for monetary policy. From the adoption of the gold standard onwards, the bank was personified by Risto Ryti, its strong governor. The image was reinforced by Ryti's supremacy within the board. However, the important role played by the three council chairmen mentioned above deserves attention. They provided the political rearguard that the governor needed vis-à-vis parliament, not as passive guarantors but by actively supporting the policies of the

governor and the whole board. Over these two decades, only a few other Finns – the chief general managers of Kansallis and Nordic Union Banks, J.K. Paasikivi and Alexander Frey, and the commissioner of the Central Chamber of Commerce Yrjö Pulkkinen – were in the same league of influence as economic policymakers.

THROUGH FORTUNE AND ADVERSITY TO “A MAGNIFICENT UNDERTAKING”

In this volume we have described the history of the Bank of Finland from its establishment in 1811 to the outbreak of the Winter War in late autumn 1939. The time frame was chosen thus because of continuity at the Bank of Finland during the period. Even a milestone like Finnish independence in December 1917 did not permanently alter the position of the Bank of Finland or the foundations of its monetary policy. The bank continued to follow the precepts that had taken shape in the period of the classical gold standard from the 1870s onwards. Nor did leaving the gold standard in 1914 and returning to it in autumn 1931 change these precepts. The bank's management believed that the interregnum was only a transient episode in the history of Finnish money and the fundamentals of monetary policy were not perceived differently even at the end of the 1930s.

Sweden's Bank of the Estates of the Realm is generally regarded as the original model for the Bank of Finland. So it was to a large extent, but attention must also be paid to the Bank of Finland's broader connections with the early model of a bank of issue that developed in the Baltic region in the 18th century. In this model, the issue of banknotes was guaranteed by mortgaged real estate, and short-term lending typically consisted only of secured "Lombard" credit issued against merchandise security. In the large financial centres of Western Europe, such as London and Paris, developments took another direction. By the early 19th century, those banks of issue were already

operating by the real bills doctrine – that lending should be in the form of short-term commercial bills of exchange, which ensured the good liquidity the bank required. The Bank of Finland began moving towards this newer model in the 1850s and by the following decade it was already the guiding principle. 1868 was also the year when the Bank of Finland was transferred from the Senate to the ambit of the Diet, implementing the will of the Diet of Porvoo after a lag of nearly six decades.

After the emergence of large deposit banks, the national banks of issue of various countries developed, from the mid-19th century onwards, into bankers' banks, i.e. central banks in the literal meaning of the word. The paragon was the Bank of England, which rose to be the world's leading central bank. The almost worldwide move to the gold standard, which had begun in the 1870s, created unified parameters for all participating central banks, harmonising their modes of operation in many respects, in what could be called the "classical" model of central banking. The most important tool of monetary policy became the central bank discount rate, which steered the interest rates applied throughout the banking system. Interest rates were raised and lowered with the main aim of guaranteeing the dependable convertibility of money into gold. Towards the end of the 19th century it began to be understood that central banks had a second important function, to safeguard the stability of the whole financial system. This required cautious but potentially flexible lending policies.

By the early 1890s, the Bank of Finland can be regarded as operating according to these principles and thus already conforming to the model of a "classical" central bank. Admittedly the principles were compromised during the First World War, when the Bank of Finland had to discontinue redeeming banknotes for gold and to finance government deficits, first Russia's and then Finland's. The same phenomenon, where the monetary principles of the gold standard period were put aside for many years, was visible elsewhere and not only in countries at war.

The first regulations of the Bank of Finland stressed its duty as a lender to business and agriculture. Gradually the definition of tasks changed and by the 1870s they were expressed in a way that already conformed to the classical central bank model. According to the regulations of 1875, the function of the bank was to "sustain the

monetary system of the country on a stable and solid footing and to promote and assist payments traffic in the country". This formulation would remain practically unchanged until the 1990s. In carrying out these tasks, common to most other central banks, the Bank of Finland became a major player in the internationalisation of the Finnish economy. As a small and initially underdeveloped national economy producing unrefined raw materials, Finland was dependent on international trade for its economic development. To jump-start economic growth it also needed a great deal of capital to finance public and private investments, which would not have been adequately available without capital imports. To import capital Finland required credibility on international capital markets, and the Bank of Finland was an important player and pioneer in achieving international credibility. Meanwhile, for foreign trade, it was significant that, at an early stage, the Bank of Finland had created a network of international correspondent banks to facilitate external payments.

Without doubt the bank's greatest achievement in its first decades of operation was the harmonisation and stabilisation of disordered monetary conditions via the monetary reform of 1840. It finally succeeded in removing old Swedish currency from circulation and replacing it with roubles pegged to silver. The parallel and socially detrimental use of many units of currency was over. At the same time the Bank of Finland became responsible for most of the banknotes in circulation in Finland, in practice as well as principle. The silver standard that took effect with the monetary reform ensured the stable value of money. It became the bank's duty to sustain the silver standard in Finland – which it did until external factors in the form of the Crimean War destabilised the rouble in the mid-1850s.

The first real crisis in the history of the Bank of Finland lasted for the whole decade of the 1860s. The first problems had arisen in the late 1850s, driven by the Crimean War, the subsequent financial crisis in Russia and the effect on the Russian rouble and Finland. The situation was worsened in the following decade by tight deflationary policy required by a return to the silver standard, and then a new international financial crisis in 1866. Adding to an already difficult economic situation, there was a catastrophic crop failure of 1867. Nonetheless, the Bank of Finland persevered with tight monetary policy in order not to jeopardise the recently adopted silver standard. Conditions were

untenable for indebted entrepreneurs and farmers and the Bank of Finland was to suffer rising credit losses, which used up practically all the capital that it had accumulated so far. When it was transferred to the ambit of the Estates in 1860s, it was almost starting from scratch. Its operations were secured, not by its own capital, but by the guarantee of the Diet.

The return to the silver standard in November 1865 created long-term foundations for Finnish monetary stability, reinforced by the move to the gold standard in August 1877. The decades after the move to the gold standard until the outbreak of the First World War constituted perhaps the most successful period in Finnish monetary history. It is true that the price level fluctuated annually, depending on the harvest among other things, but viewed over the whole period the price trend was almost horizontal. This period from metal standard reforms to the First World War was also crucial for Finland's economic internationalisation and the development of its industry. Under conditions of stable exchange rates, the country obtained a large amount of long-term foreign capital, which was used for projects like building railways.

The years of the First World War were a chapter of their own in the history of setbacks experienced by the Bank of Finland. One country after another, Finland included, was forced off the gold standard and rapid inflation lay ahead. A particular problem for the Bank of Finland were the roubles that political reasons compelled it to accept for a long period at an overvalued exchange rate dictated by the Russian government. After Finland's declaration of independence, monetary problems continued unabated because government finances were initially dependent on credit granted by the Bank of Finland. The banknote cover regulations were changed and a large part of government spending was financed by printing money. Inflation consequently remained rapid in the early years of independence and by the start of the 1920s the markka's value in gold was only one-ninth of its pre-war parity. In these years the Bank of Finland not only failed in its mission to protect monetary stability but, largely because of the losses caused by the mandatory rouble exchange rate and then the Russian Revolution, lost all of its capital for the second time in its history. It could continue operating only thanks to a large bond loan from the government.

The Bank of Finland and the monetary system under Russian rule played a role in Finland's political development. In the first half of Finland's period under the Russian Tsar, Finnish and Russian monetary systems converged and the monetary reform of 1840 created a very tight link; in the following two decades, the two systems were practically the same although the banknotes and the banks of issue were different. However, the Crimean War and the subsequent abandonment of the silver standard led to a gradual divergence. The first step in this process was the establishment of a national currency unit in 1860, the second was Finland's return to the silver standard and the third was the adoption of the gold standard. While Russia's own move to the gold standard in 1897, a decade after Finland, threatened the independence of Finland's monetary system, political crises in Russia prevented the ultimate unification of Finnish and Russian currencies. Finland's autonomy within the Russian Empire was especially clear in its financial autonomy, and a separate monetary system was vital for this.

In stabilising monetary conditions in the early 1920s the Bank of Finland was very successful by international standards. The runaway inflation that had begun in the war levelled off in 1921 after the government budget was balanced. The external value of the markka stabilised during the following year. Finland reinstated the gold standard in 1926. It was advantageous for the whole economy that the leadership of the Bank of Finland realised at the very start of the 1920s that it was unrealistic to try to restore the markka's pre-war value in gold and that the return to the gold standard would have to be based on prevailing exchange rates. In fact it was done at a slightly undervalued rate, largely to make Finnish exporters very competitive. This avoided the tough deflationary policies that caused considerable problems in the 1920s for the Scandinavian countries and others, including Britain. Bank of Finland policy in fixing the markka and returning to the gold standard largely followed the recommendations agreed at the financial conferences of Brussels and Genoa in 1920 and 1921. In his book published in 1928, Gustav Cassel, one of the most influential economic experts at these conferences, cited Finland as a model of how the gold standard should be re-established.⁸⁴⁶

Although the prevailing image of the Bank of Finland in the 1920s and 1930s focused on the toughness of its monetary policy and its

stubborn adherence to the gold standard even a fortnight after Britain and then France had left it, the bank's exchange rate policies were actually more flexible than was generally perceived, even in the 1930s. The economic crisis at the start of the 1930s was a severe test for the bank, in which it battled defensively for the gold standard, successfully cooperated with other Finnish banks to stabilise the banking system and resisted the political pressures of the time, caused by the agricultural debt crisis and repossessions.

After leaving the gold standard on 12 October 1931 the Bank of Finland initially allowed the markka to decline against gold (and the dollar) by as much as the currencies of Britain and Sweden did. However, later in the autumn and again in July 1932, it let the markka depreciate distinctly more. Its external value was finally pegged to the pound in March 1933, at a rate about 15 percent lower. Like Finland, Sweden joined the "sterling club" of currencies pegged to the pound in 1933 but devalued the krona against the pound by much less, so the exchange rate policy pursued by the Bank of Finland in the crisis years can be characterised as soft by international standards if not outright proactive. By its actions on exchange rates, the Bank of Finland served to create a framework for export-led growth, which helped the Finnish economy to begin expanding again as early as 1933. With export recovery Finland got back on its feet rather sooner than other countries affected by the global depression.

In the 1920s and 1930s the main worry of many central banks was price stability. They were not, however, generally concerned about inflation but more often about a fall in prices – deflation – which was destructive in many countries. The Bank of Finland also paid great attention to questions of price stability, which it maintained with relative success after the start of the 1920s. The wholesale price index shows that the most critical phase was in 1930–1931, when wholesale prices fell about 14 percent over a two-year period. However, by international standards, Finland's price level was relatively stable: its wholesale prices fell less than in Sweden, for example, during the Great Depression of 1929–1933. Consumer prices also fell only moderately. This does not mean that deflation was no problem in Finland. Farmers suffered the most and the decline in prices of the main agricultural and forestry products at the start of the 1930s created great difficulties throughout rural society. From the mid-1930s onwards

the fear of deflation abated and the general price level changed little. The only exception was 1937, when there was a wave of short-term price rises originating from the export market.

In setting interest rates the Bank of Finland had serious problems in the interwar period till around the middle of the 1930s. Until 1927 real interest rates on bank loans varied between six and nine percent; by the start of 1931 they had risen to nearly 20 percent because of deflation. Such high real rates were a severe strain on all areas of economic life but especially for indebted farmers. It was widely recognised that, given the level of agricultural productivity, farmers would never be able to afford such high real rates. There was strong political pressure to lower interest rates but under the gold standard a central bank had limited possibilities to influence the interest rate level by monetary policy alone.

The high interest rate level of the 1920s was largely due to a structural imbalance between supply and demand for credit. Economic uncertainty throughout society had begun during the Great War and continued into the early years of Finnish independence, in part because the future value of the markka was unknown. Agriculture had suffered similar uncertainty about the future that was influenced by the question of land reform and its consequences. After some ten years, the stabilisation of the markka, news of an upcoming move to the gold standard and the start of land redistribution to small farmers ended this period of uncertainty with its concomitant reluctance to invest. Ahead lay a decade of discharging pent-up investment needs, and demand for loans rose to an entirely new level. At the same time major changes within the private banking system led to tougher competition for savings and thereby higher interest rates on deposits. The combined effect of these factors was that lending rates rose to unprecedented heights at the very start of the 1920s, as noted previously. A downturn in the general price level in 1929 exacerbated the situation because real interest rates were now significantly higher than nominal ones and debts became even harder to service.

The Bank of Finland's action on interest rates at the end of the 1920s and start of the 1930s was a balancing act between two conflicting objectives. On the one hand it sought a lower interest rate level but on the other it had to consider the country's foreign currency reserves. Especially in the first half of the 1920s, the reserves had been low,

compelling the bank to keep the discount rate relatively high. Discount rates in Finland were considerably higher than in Sweden and Britain, countries with which the Finnish money market was closely linked. The Bank of Finland had limited scope for lowering its own interest rate. It saw the only solution as foreign capital imports, to achieve a better balance between supply and demand for credit. With the support of the Bank of Finland, the largest financial institutions, such as commercial banks and mortgage credit institutions, began to negotiate foreign loans. The Bank of Finland was certainly aware of the hazards of borrowing abroad but, amid a prevailing capital shortage, it was seen as the only way of bringing down the high domestic interest rate level and spurring economic growth. The bank also faced political pressures for lower interest rates, as members of parliament repeatedly urged a legislated ceiling on interest rates. In the view of the Bank of Finland and representatives of the private banking sector, legal interest rate controls were the wrong course of action.

Unfortunately, capital imports were so great that they caused overheating in the national economy and particularly the house building sector in 1927 and 1928. The overheating was worsened by the fact that the Bank of Finland had bowed to political pressures and lowered its discount rate. Overheating in construction led in 1928 to a large and sudden growth of Finnish imports and a steep decline in foreign currency reserves, and the bank had to respond by quickly tightening the money market. This in turn drove Finland's national economy into recession even before the Great Depression was felt in Finland about a year later. In the view of many researchers, Finland's early downturn was largely because the monetary policy of the Bank of Finland was excessively expansive in the 1920s in relation to the growth potential of the Finnish economy.

The international economic crisis hit the money market and foreign currency reserves first, making it hard to lower interest rates. It was not until some time after Finland had abandoned the gold standard that the problem of high interest rates abated; the keys were the balance of payments, which moved into surplus, and banking competition, which was restricted. In 1931 the bank groups operating in Finland signed an interest rate pact at the behest of the Bank of Finland in which interest-rate competition for deposits was practically eliminated. The pact did not have an immediate impact on lending

rates but began to push them down within a year. Admittedly at the same time demand for credit had fallen off, so the imbalance between its demand and supply had lessened. By 1934 real interest rates had already fallen to about five percent. Abandoning the gold standard had stopped deflation and an improvement in the balance of payments allowed nominal interest rates to be lowered.

The internationalisation of the Finnish economy can be regarded as the Bank of Finland's greatest success over the whole period from the 1840s to the start of the Second World War. Characteristically for the central bank of a small country, it operated mainly in the sphere of exchange rate policies, either by maintaining a metal standard or, after it had collapsed, by working to establish stable exchanges with foreign countries. Joining the silver and then the gold standard integrated Finland with the currency and financial systems of developed Western countries, opening the entire Finnish economy to international influences. Finland can be seen as a good example of a country which, from the late 19th century onwards, has successfully exploited the growth and development opportunities offered by a global economy. Without internationalisation Finland could not have escaped from the trap of the periphery, and monetary policy to promote creditworthiness and monetary stability was a prerequisite for internationalisation. The Bank of Finland also had an important operational role in organising foreign payments.

The title of this section is taken from the first official history of the bank, written by Emil Schybergson and published in 1914.⁸⁴⁷ It is an apt description of how contemporaries perceived the bank as having grown during the first century of operations from modest beginnings to a genuine central bank meeting international standards. The same characterisation could perhaps be applied to the entire period covered here, up to the Second World War. Just as the Bank of Finland had, by the outbreak of the First World War, achieved a strong financial position where it was able to meet all the demands that could reasonably be imposed on a central bank under the gold standard, so by the final years of the 1930s had the bank again secured its position and safeguarded the foundation of the Finnish monetary system despite two new intervening crises. One of these was the collapse of the bank's finances in the final stages of the First World War and the other was the Great Depression of the 1930s and the collapse of the interwar gold standard system.



■ Nervous buyers of foreign exchange wait in line at the head office of the Bank of Finland. When Sweden left the gold standard, Finland was compelled to introduce currency rationing on 5 October 1931. – Otava picture archives.

By the 1930s the Bank of Finland had managed, with perhaps surprising success, to achieve financial solidity and to stabilise the national economy. It had also risen to an undisputed position of pre-eminence in national economic policymaking. The prestige of its management and particularly its governor, and their position in Finnish political life, were now stronger than ever before. It is a mark of this trust and status that, when prime minister Cajander's government resigned at the outbreak of the Winter War in November 1939, the governor of the Bank of Finland, Risto Ryti, was invited to form a new government. Persuading him to become prime minister were his old partners, president of the republic Kyösti Kallio and the finance minister and chairman of the supervisory council, Väinö Tanner. The start of the war and Ryti's move, first to the prime minister's office and then to the president's palace, marked the start of an entirely new and fateful period in the history of Finland and its bank.

NOTES

BoF = Bank of Finland

BoFA = Bank of Finland archives

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- 3 Schybergson, 1914, 74–75; Pipping, 1961, 67–68.
- 4 On the Turku discount office, Granfelt, 1909.
- 5 On early banknote issue, Talvio, 2003, 18–24.
- 6 Pipping, 1961, 90.
- 7 Officials of the Bank of Finland 1811–1967, 12.
- 8 Schybergson, 1914, 280.
- 9 Schybergson, 1914, 277–280.
- 10 Tudeer, 1939.
- 11 Kalela, 1987.
- 12 Pekkarinen – Vartiainen, 1995.
- 13 Tudeer, 1939, 345.
- 14 Pipping, 1969, 415.
- 15 Arola, 2006.
- 16 On the international situation at the start of the 19th century, e.g. Paasivirta, 1978; Paasivirta, 1988.
- 17 Tommila, 2008, 12–20.
- 18 Sprengtporten in more detail, e.g. Ramel, 2003.
- 19 Danielsson-Kalmari, 1933, 1–112, 133–151, 460–492.
- 20 Lappalainen – Wolke – Pylkkänen, 2009
- 21 Tommila, 2008, 21–47.
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- 23 Den svenska historien 8, 1809–1865, 1968; Höjer, 1935.
- 24 For more detail Jussila, 2004, 11–26.
- 25 On western orientation e.g. Raeff, 1969.
- 26 Jussila, 2004, 47–52.
- 27 Jussila, 1987; Jussila, 2004.
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- 33 On Thaler history e.g. Rittmann, 2003.
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- 35 Parker Willis, 1897.
- 36 Oddy, 1807, 133 and 154.
- 37 Buchholtz, 1899, 28; Stieda, 1909, 109.
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- 40 Dillen, 1934, 79–124; Sieveking, 1934, 125–160.
- 41 Sperling, 1962; Sieveking, 1934, 146–155; Järvinen, 1921.
- 42 Tarkka, 2009.
- 43 Steuart, 1767, 479–483.
- 44 Andreen, 1956.
- 45 Law, 1994.
- 46 Smith, 1991, 269.
- 47 Andreen, 1956.
- 48 Sveriges Riksbank 1918, Appendix IV; Wetterberg, 2009, 25–26.

- 49 Heckscher, 1941; Agardh, 1865, 81; Tingström, 2004.
- 50 Brisman, 1918, 13–28.
- 51 Brisman, 1918, 45–53.
- 52 Brisman, 1918, 54–65.
- 53 Brisman, 1918, 65–69.
- 54 Brisman, 1918, 69–75.
- 55 Wetterberg, 2009, 44–45.
- 56 Lesch, 1925.
- 57 Lesch, 1925.
- 58 Brisman, 1918, 81–96.
- 59 See appendices in Goodhart, 1988.
- 60 Brisman, 1918, 127–166; Heckscher, 1949, 733–751.
- 61 Hallendorff, 1919, 210–219.
- 62 Eagly, 1969; Montgomery, 1920, 50–68.
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- 64 Chydenius' fate in detail, see Virrankoski, 1986.
- 65 Constitutional laws from the period of Swedish rule are collated in Schybergson, 1907.
- 66 Hallendorff, 1920, 51.
- 67 Brisman, 1924, 2–12.
- 68 Brisman, 1924, 12–13.
- 69 Hallendorff, 1920, 134–137.
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- 71 Andreen, 1956.
- 72 Hallendorff, 1920, 79–89.
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- 92 Pipping, 1961, 27–28.
- 93 Parker Willis, 1897; Chaudoir, 1836, 77–84, 136–138 and 174–175; Heckscher, 1941, 7–8.
- 94 Heller, 1983, 74–78 and 248; Björkqvist, 1968, 293. Björkqvist tabulates the agio (premium) of the silver rouble until 1821, from which the price in silver of the paper rouble can be calculated.
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- 96 Heller, 1983, 28.
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- 109 Heller, 1983, 82.
- 110 Heller, 1983, 82.
- 111 Zieliński, 1898, 11; Raeff, 1957, 102.
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- 113 Pintner, 1967, 185; Heller, 1983, 93–97.
- 114 Björkqvist, 1968, 293. The silver rouble agio, at its highest in May 1815, was a full 387 kopeks, which puts the value of the assignat rouble at 20.5 silver kopeks.
- 115 Pintner, 1867, 188–190; Heller, 1983, 118–129.
- 116 Levicheva, 2004, 52–74; Heller, 1983, 135–146.
- 117 See e.g. Levicheva, 2004, 75–106.
- 118 BoF Hufvudboken öfver primitiva och småsedelsfonderna, 1821, BoFA.
- 119 For this purpose, the regulations of the Russian State Commercial Bank, among others, were translated into Swedish, BoFA, Board archives, Proposal for Bank of Finland regulations, binder 11, BoFA.

- 120 Neovius, 1898.
- 121 Pipping, 1961, 28.
- 122 Castrén, 1879.
- 123 Pipping, 1961, 26.
- 124 Jussila, 1996, 65–72.
- 125 Diet 1809, minutes of the Estate of Burghers, 247–252.
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- 129 On-line biography of Tengström at the Finnish Literature Society.
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- 131 For more on Bladh, see Nordlund, 1931, 274–280; Heikkinen – Kuusterä, 2007, 35–37.
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- 136 Jussila, 2004, 132–138.
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- 147 Pipping, 1961, 48–52; Neovius, 1898, 153–154.
- 148 Pipping, 1961, 61–62.
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- 150 Korhonen, 1963, 88; Pipping, 1961, 55.
- 151 Dovring, 1965; for large-scale agriculture in Finland, see Jutikkala, 1932.
- 152 Schybergson, 1980, 407.
- 153 Soininen, 1975.
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- 158 Buchholtz, 1899, 28; Stieda, 1909, 108–110.
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- 172 See Heikkinen – Tiihonen, 2009, 101.
- 173 Statutes 31.1.1816.
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- 179 The organisation is deduced from instructions for officials, 1826 and 1836.
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- 181 Statutes 18.11.1840.
- 182 BoF Proposal for regulations 1837, BoFA.
- 183 Statutes 17.7.1826.
- 184 Statutes 18.11.1840.
- 185 Schybergson, 1914, 67–77.
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- 187 Savolainen, 1994.
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- 193 For more on Haartman, see Kalleinen, 2001; Pipping, 1961, 176–188, 194–224, 296–303.
- 194 Pipping, 1961, 130.
- 195 BoF Förslag till Banco Ordning, 1836; Instruction för Bankens tjänstemän, 1836, BoFA.
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- 209 See e.g. Kallioinen, 2002; Nikula, 1948.
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- 218 Tallqvist, 1900, 41.
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- 240 Schmidt, 1875, 44.
- 241 Björkqvist, 1968, 293–296.
- 242 Pintner, 1967, 260–263.
- 243 Thorough study of unofficial Russian exchange rates in Schmidt, 1875, 115–138.
- 244 Pintner, 1967, 197–198.
- 245 Heller, 1983, 221–231.
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- 251 PSZ II, No. 12.497 and No. 12.498.
- 252 Schmidt, 1875, 228–229.
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- 276 Schybergson, 1914, 91.
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- 833 For more details on valuation methods, see Ikonen, 1998.
- 834 Tudeer, 1939, 178–227.
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- 838 E.g. BoF Supervisory council minutes 4.2.1932, BoFA.
- 839 Lavonius, 1925.
- 840 Nevanlinna, 1913.
- 841 Nevanlinna, 1931, 37–38.
- 842 Kakkuri, 1999.
- 843 BoF Supervisory council minutes 26.10.1933, BoFA.
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- 845 A good example is Frenckell's demand at a Supervisory Council meeting at the end of 1940 for the discount rate to be raised. BoF Supervisory council minutes 16.12.1940, BoFA.
- 846 Cassel, 1928.
- 847 Schybergson, 1914, 280.

APPENDIX

HEADS OF THE SENATE FINANCIAL DEPARTMENT, MEMBERS OF THE SUPERVISORY COUNCIL AND GOVERNORS OF THE BANK OF FINLAND

Heads of the Senate's Financial department until 1868

E.E. Tulindberg	1809–1812
G.E. von Haartman	1812–1815
C.J. Sacklén (Edelsköld)	1816–1820
A.H. Falck	1820–1833
L. Sacklén (Sackleen)	1833–1840
L.G. von Haartman	1840–1858
C.F.T. Langenskiöld	1858–1863
J.V. Snellman	1863–1868

Members of the Parliamentary supervisory council of the Bank of Finland 1868–1939

R.A. Montgomery	1867–1882, chairman 1867–1882
J.W. Rosenborg	1867–1871
C.G. Borg	1868–1875
C.A. Öhrnberg	1868–1877
F.W.G. Hjelt	1872–1882, ch. 1882–1885
G.Z. Forsman (Yrjö-Koskinen)	1877–1882
L.H.S. Mechelin	1877–1882
R.O. Lagerborg	1882
L.L. Lindelöf	1882–1900, ch. 1885–1900
A. Meurman	1882–1905
F.G.O. Stjernvall	1882–1905, ch. 1905
O. Donner	1885–1905, ch. 1900–1905
W. Hackman	1891–1894 (not recognised by senate)
O.A. Malm	1891–1894 (not recognised by senate)
F.W. Rosenlew	1891–1892 (not recognised by senate)
H. Åström	1891–1894 (not recognised by senate)
E.F.M. Hallberg	1900–1907, ch. 1905–1907
E.G. Palmén	1905–1919, ch. 1907–1917, 1918–1919

K.J. Ståhlberg	1905, 1908–1919
G.A. Björkenheim	1907–1917
A.L. Gripenberg	1907–1908
W.A. Lavonius	1907–1909, 1920–1924, ch. 1920–1924
H. Lindroos	1907–1909
H.G. Paloheimo	1907–1917
E.F. Nevanlinna	1909–1912, 1919–1932, ch. 1924–1932
Y. Sirola	1909–1910
M. Paasivuori	1911–1912
H. G. Renvall	1912–1917
K.G. Söderholm	1912–1917
E.O.V. Gylling	1917–1918, ch. 1917–1918
A. Huotari	1917–1918
E.J.V. Huttunen	1917–1919
J. Mäki	1917–1919
L.K. Relander	1918–1921
E. Schybergson	1918–1920, ch. 1919–1920
K.T. Heinonen	1919–1922
V.A. Tanner	1919–1945, 1951–1962, ch. 1933–1945
A. Ramsay	1920–1923
E.Y. Pehkonen	1921–1927
H.R.W. Wuolijoki	1922–1928
A. af Forselles	1923–1930
H.V. Vasenius	1924–1927
J. Lahdensuo	1927–1939, ch. 1932–1933
Y.R. Pulkkinen	1927–1929, 1932–1933
J. Helo	1928–1933
R.W. Itkonen	1928–1930
N. Liakka	1928–1929
A. Raatikainen	1928–1930
M.F. Rosenberg	1929–1930
V. Vesterinen	1929–1954, ch. 1948–1954
J.E. Ailio	1930–1933
E. von Frenckell	1930–1945
T.A. Junnila	1930–1932, 1932–1939
J. Leppälä	1930–1951
E. Kilpi	1933–1945
A.J. Ryömä	1933–1939
A. Hackzell	1939–1945
J.E. Pilppula	1939–1951

Chairmen of the board of management (governors) of the Bank of Finland 1812–1939

C.J. Sacklén (Edelsköld)	1812–1816
C.J. Idman (Idestam)	1817–1820
O.H. Lode	1820–1827
J.G. Winter	1827–1841
C.W. Trapp	1841–1853
A.L. Born	1853–1856 (act. 1845–1853)

A. Federley	1853–1854 (act.)
R. Trapp	1854–1856 (act.)
F.I. Edelheim	1856–1858
W. Blidberg	1858–1861
C.I. Björkman	1862–1866
V.G. von Haartman	1866–1870
A.W.O. Florin	1870–1875
G.A.S. von Troil	1875–1884
G.R.A. Charpentier	1884–1897
K.T.A. Wegelius	1898–1906
C. H. von Collan	1907–1918
O.E. Stenroth	1918–1923
A. Ramsay	1923–1924 (act.)
R.H. Ryti	1923–1940
J.W. Rangell	1939–1941 (interim)

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When the original language (other than Finnish) of the source is indicated, the following abbreviations are used: *sw* = Swedish, *en* = English, *ru* = Russian.

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- Acts
- Senate Archives, Financial department
- Secret documents
- Gold standard committee report
- Private archives
- J.K. Paasikivi
- Bruno Suviranta

Bank of Finland archives (BoFA)

- Supervisory council minutes
- Board minutes
- Governors' archives
- Staff records
- Attorneys' reports
- Fund ledgers
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Journal of the Swedish Economic Association	Ekonomiska Samfundets tidskrift	<i>sw</i>
<i>Studies on Administrative History in Finland</i>	<i>Hallintohistoriallisia tutkimuksia</i>	<i>fi</i>
Journal of the Swedish Historical Society	Historisk tidskrift	<i>sw</i>
Handbooks of the Finnish Economic Society	Kansantaloudellinen käsikirjasto	<i>fi</i>
Finnish Literature Society	Suomalaisen Kirjallisuuden Seura	<i>fi</i>
Finnish Historical Society	Suomen Historiallinen Seura	<i>fi</i>
Finnish Society of Sciences and Letters	Suomen Tiedeseura – Finska Vetenskaps-Societeten	<i>fi</i> <i>sw</i>
Journal of the Swedish Numismatic Society	Svensk Numismatisk Tidskrift	<i>sw</i>
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