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Did nordic countries recognize the gathering storm of World War II? Evidence from the bond markets ☆

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Abstract

This paper analyzes and compares different ways of assessing how people perceived impending threats of war in the past. Conventional Nordic historiography of World War II claims there were few, if any, people in the Nordic countries who perceived a significantly increased threat of war between 1938 and early 1940. At the same time, historical methods face problems when it comes to capturing the often tacitly held beliefs of a large number of people in the past. In this paper, we analyze these assessments by looking at sudden shifts in sovereign debt yields and spreads in the Nordic bond markets at that time. Our results suggest that Nordic contemporaries indeed perceived significant war risk increases around the time of major war-related geopolitical events. While these findings question some—but not all—of standard Nordic World War II historiography, they also demonstrate the value of analyzing historical market prices to reassess the often tacitly held views and opinions of large groups of people in the past.
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1. Introduction

Wars have a huge impact on societies and their citizens, and therefore even the expectation of an outbreak of war could greatly influence people's behavior in various ways, which in turn would affect real economic and political outcomes. Understanding the formation of widely held war risk assessments is important in order to fully comprehend the developments in countries experiencing extremely turbulent times.

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At the time of the outbreak of World War II in Europe, the Nordic countries had become a region of central strategic importance. Without Swedish iron ore, the German arms industry would not have lasted many months after the outbreak of the war. The coast of Norway offered an ideal starting point for launching a naval attack on Great Britain, and Finland's dominant position in the Gulf of Finland was a latent problem for the Soviet leaders. All of Europe's superpowers therefore had strong vested interests in keeping their enemies out of the Nordic region, and they all had long-term plans of military interventions in line with these interests.[2]

To what extent did contemporaries in the Nordic countries perceive this mounting threat of war? And did the perceived threats differ, on one hand, for each of the Nordic countries and, on the other, the Nordic region as a whole? Given the significance of public threat perceptions to the overall development of a country, it is not surprising that historians have gone to great lengths to analyze these questions. According to conventional Nordic World War II historiography, there were few, if any, people in the Nordic countries who truly believed in a war in their own countries around the outbreak of World War II. But the historical method used to generate these results is associated with some important methodological problems. Historians primarily rely on in-depth analyses from various written sources, but widely held notions of pending threats of war are typically not systematically documented, and are therefore largely unobservable to historians. Historians are well aware of another potential problem, and that is that they themselves may be influenced by their own social and political context so that their selection and interpretation of historical facts depend on what they conjecture that their readers wish to read.[3]

In the present paper, we examine an alternative way of gaining insights into the war threat assessments of people in the past. This method, originally proposed by Willard et al. (1996) in their study of currency price fluctuations around the time of the U.S. Civil War, is based on analyzing sudden changes in yields of government bonds that were traded continuously at the time of the war outbreak, and linking them to major geopolitical pre-war events. We argue that this will show if, and when, significant war risk increases occurred, as reflected by market prices. The underlying idea is that wars put extraordinary pressures on countries' fiscal balances and may even provoke governments to repudiate their sovereign debt. An increased risk of war will translate into an increased sovereign risk or, equivalently, higher yields on traded sovereign debt.[4] Naturally, the overlap, on one hand, between the general public and, on the other, between traders and investors in government bonds, is not perfect. Still, on the whole, they had access to the same publicly available information and should hence have shared roughly the same threat perceptions at each point in time (see our discussions in Section 3).

Our empirical analysis begins by estimating the widely held threat assessments from shifts in Nordic sovereign yields and spreads traded on the Nordic bond markets at that time. We then compare these market-based estimates with the corresponding ones in conventional historiography, which we retrieve from reading a large number of writings by well-known and reputed Nordic World War II historians. The final result is a comparative analysis, which not only conveys information about whether the Nordic political and military preparations for an enemy attack were in line with the general views about external threats of war, but also addresses the important question of whether conventional historiography is robust to alternative assessments of certain historical phenomena.[5]

[2] See, e.g., Norborg (1970, pp. 204ff) and Tooze (2006, pp. 380f).

[3] Well-known discussions of these problems, and how to deal with them, are found in Carr (1961) and Marwick (1970). For example, winners often write a biased account of the history of wars and, in the case of Denmark, Bryld (2001, pp. 14–29) argues that the official Danish postwar account of the country's resistance movement during World War II is steeped in patriotism as a result of historians giving in to contemporary pressures for a history of legitimization and national unification.

[4] Naturally, this also requires minor changes in other standard bond yield determinants, such as the coupon rate, the time to maturity, the tax status of cash flows, redemption clauses and the discount rate. Although these were mostly constant, we estimate the breaks using yield spreads and hence canceling out market-specific determinants.

[5] Nordic historians agree today that the Nordic countries, possibly with the exception of Finland, were not sufficiently prepared in terms of mobilization of armed forces around the outbreak of World War II (e.g., Åhslund, 1982; Olsson, 1977, p. 12; Gram, 1986, pp. 18f; Skodvin, 1991, p. 309). At the same time, many historians argue that this was a deliberate strategy on the part of the Nordic governments, since they believed a low level of armaments to be a credible signal of peaceful intentions (e.g., Lidegaard, 2005, p. 152 on the case for Denmark).

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