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Launch of commemorative publication *The Swiss National Bank 1907–2007*

Remarks by Harold James

From 1907 to 1946: a happy childhood or a troubled adolescence?

(Michael Bordo/Harold James)

This article traces the evolution of the doctrine and practice of central banking in Switzerland, and the legacy of the debates and controversies of the interwar period for the formulation of monetary policy after 1945. It also examines the debate about the SNB's politically and economically flawed policy in buying German gold during the Second World War, as well as the effect that the controversy had in isolating Switzerland from the international community and the philosophy of the Bretton Woods monetary order.

The SNB was conceived as a way of rationalising the payments system in a small country on the fringes of the interconnected world of the international gold standard as it had evolved in the late nineteenth century. The major fundamentals that shaped the room for policy – the metallic convertibility of currency and the freedom of capital movements – arose from the circumstances and requirements of the system, and not from the choice of legislators or central banks. The central banks were facilitators, but not coordinators of the gold standard world. Like the US Federal Reserve, the SNB was a late birth, conceived in response to the perception of market failures in the payments system. Within a relatively short time, the international financial system of that era was swept away by the First World War, and the new central banks had to live in the very different circumstances of inconvertibility and the widespread imposition of exchange and trade controls.

Unlike earlier central banks, the SNB was also the creature of a democratic age, in which participatory politics mattered much more, and in which political requirements, in the composition of the Bank Council, and in the length of the mandate of the Bank, were designed to make the Bank responsive to national needs and requirements.

The test of the new central bank in practice came with international crises: immediately in 1907, with the suspension of gold payments that followed the outbreak of war in 1914, and with the post-war depression. Compared to other central banks, the SNB handled all these problems quite well. Switzerland did not have to suspend internal convertibility (of deposits into currency) in 1907, as was the case in the US or take drastic action to cut back bank credit, as in Germany or Italy. Unlike other central banks in Europe and the United States, the SNB engineered a relatively smooth disinflation in 1919, with a severe, but very short-lived downturn. The others waited for another year of inflation before contracting, thereby precipitating a much more serious depression. Even in the Great Depression of the 1930s, the SNB did not obviously fail in policy terms, at least in comparison with other more prominent central banks. In the United States, Britain, Germany and France, the central banks' response to the collapse of the liberal international economic order was woefully flawed. The Federal Reserve System failed to prevent the monetary and banking collapses of 1930–1933. The Bank of England was humiliated by the circumstances of the departure of sterling from the gold standard in 1931 and did not recover its institutional rationale (and operative independence) until the end of the century. The German Reichsbank was effectively brought down by the German bank crisis of 1931; and the Banque de France was subject to ferocious and fundamental political attacks.

We employ modern macroeconomic models to test two of the most controversial policy features of interwar Switzerland: firstly, policy simulations from a simple mainstream small open economy macromodel, a modified McCallum-Nelson model, are presented with the aim of analysing the appropriateness of the exchange rate policy pursued by the SNB between the devaluation of the British pound in September 1931 and the Swiss abandonment of the gold parity in September 1936. We show that in 1935, when the world depression was at its worst in Switzerland, output would have been 18 percent higher had Switzerland pegged its currency to the British pound in September 1931, and 15 percent higher had it followed the devaluation of the US dollar in April 1933. Secondly, a modern Taylor (interest rate) rule model is used to evaluate the historical impact of the central bank's interest rate (discount) policy. The retrospective fitting of the SNB's recent Taylor rule makes clear the sustained deflationary bias of policy in the 1920s and 1930s. It also shows that over much of the pre-World War II period monetary policy was not closely geared to either inflation or output stability.

In Switzerland in the 1930s, the central bank was the subject of much less controversy than in any of the major industrialised countries. To be sure, there were debates about Swiss policy and the maintenance of the gold standard, but they were conducted in a more general framework and focused on the policy of the federal government, not on the alleged influence of the central bank; and after the devaluation of 1936, the major political discussion focused less on who was responsible than on how the devaluation profits of the SNB should be divided up between Bank and government. While the policies of the Federal Reserve System, the Bank of England, the Banque de France and the Reichsbank increasingly became the focus of national political controversy in the 1930s, the Swiss debate focused less on the National Bank. Perhaps because of the increasingly threatened geo-political position of Switzerland, the central bank increasingly became part of a consensus about national institutions. In the Second World War, there was surprisingly little controversy about the SNB and its actions. The SNB thus moved from being the focus of considerable debate in its early years to becoming a venerable national institution.

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The relatively uncontentious performance from 1907 through the 1930s explains why, domestically, the SNB was able to maintain a tradition and a philosophy that – by comparison with what was happening in other countries – looked quite outmoded. It did not adopt the deliberate use of stabilisation policy and domestic and international controls followed by the other advanced countries after the 1930s. The (legitimate) international criticism of its role in the Second World War (in which the SNB behaved in the very different political and moral circumstances arising out of Nazi Germany's grasp for power in much the same way as it had during the more 'normal' circumstances of the First World War) isolated the National Bank from peer pressure that might have been applied by other central banks, which were now being run on very different lines. The result was that the SNB retained a high level of commitment to a culture of monetary stability, and a low proclivity to see its mission as harnessed to government-led efforts at macroeconomic stabilisation. The policies of the 1930s thus created a useful monetary starting point for the post-war era, and laid the foundations for a later stability culture. As an approach to monetary policy, the highly unfashionable Swiss view at the middle of the century proved to be the prevailing view among international economists and central bankers from the 1970s onwards. It may be that Switzerland needed a certain political isolation in order for that philosophy of central banking to have continued despite a hostile intellectual and political climate.