The Swiss National Bank: 1907–2007

Werner Abegg, Ernst Baltensperger, et al., contributors
Zurich: Neue Zürcher Zeitung Publishing, 2007, 823 pp. (Also in shorter French, German, and Italian editions.)

The Swiss franc is the world's best-performing currency over the last century: it has lost only about 87 percent of its value in terms of gold, compared to 97 percent for the U.S. dollar and more than 99 percent for almost all other currencies. Switzerland's avoidance of wars, which is part policy and part lucky geography, has contributed to the relative stability of the franc. So have the conservative financial habits of its citizens, which have been reflected in the country's generally prudent government finances. But some credit undoubtedly belongs to the central bank, the Swiss National Bank. It has consistently pursued monetary policies that have produced low inflation, and has made few consequential errors since it was established in 1907. Its experience therefore should be of interest far beyond the borders of Switzerland. This centennial volume, by a constellation of 40 Swiss and foreign authors, is a history and an examination of issues in monetary policy the central bank has faced. It is typically Swiss in its occasionally ponderous thoroughness, pleasing design, and high quality.

The book is divided into three parts: a history of the central bank's first 75 years, a more detailed analysis of the last 25 years, and assessments of policy issues from the recent past into the near future. Michael Bordo and Harold James summarize the central bank's history from 1907 to 1946 in a deft analytical account that focuses on the problems the central bank faced and how its responses fit into the politics, economics, and economic theory of the time. Intriguingly, their brief discussion of the central bank's origins implies that there was no real economic necessity for the institution. Before central banking, Switzerland had a system of decentralized, competitive note issue that on the whole worked well. Its main flaws—certain problems with notes, coins, and foreign exchange—resulted from government regulations that impeded banks from devising solutions.

Peter Bernholz follows with a chapter on the remaining years until the bank's 75th anniversary in 1982. The goals of maintaining a pegged exchange rate and keeping inflation very low sometimes conflicted, because Switzerland at times received large inflows of speculative capital. Exchange controls were not on the whole effective against the inflows, and Switzerland ended them in 1979. In January 1973, near the end of the Bretton Woods system of pegged exchange rates, the Swiss National Bank floated the franc. Searching for an anchor to replace the exchange rate and produce low inflation, the bank targeted growth rates in measures of the money supply (M0, M1) starting in 1975, but it found that doing so led to undesired exchange-rate volatility on occasion.

The two remaining parts of the book are comprised of 16 more specialized chapters, some by multiple authors. It would be tedious to describe them all, so I will simply say that only a couple failed to hold my attention. Readers interested in central banking will find various chapters worthwhile according to their tastes, though few will read the book from cover to cover.

In the second part of the book, covering the 25 years to 2007, a major topic is the switch from targeting money-supply measures to inflation targeting, which began in 2000. There are good discussions of the particular targets, techniques, and communication strategies the Swiss National Bank considered and chose—the nitty-gritty of going from the idea of inflation targeting to fairly successful practice. Another important topic is how the bank conceives of financial stability and its role in bank regulation. In 2005, Switzerland's two leading commercial banks, UBS and Credit Suisse, had combined assets equal to eight times Switzerland's gross domestic product. This vulnerability has led the Swiss National Bank and the Swiss government to develop approaches to regulation and bank liquidation that are worth a look by other countries that want to limit taxpayer exposure to failed banks. (After this book was published, the Swiss National Bank and the Swiss government took steps to support UBS. Their actions begin a new episode in Swiss bank regulation.)

The last part of the book is a series of essays by academic economists, assessing policy issues from the recent past into the near future. Ernst Baltensperger's chapter is particularly valuable because it summarizes what in his view the Swiss National Bank has done right and wrong in monetary policy since adopting a floating exchange rate. He considers the worst mistakes to have been responding too slowly to rising inflation. To put things in perspective, though, one should note that elsewhere (p. 231) another contributor writes, "By the end of 1989, inflation had soared to 5 percent." There are plenty of countries where inflation of 5 percent would be considered a great achievement, not a source of worry. William R. White brings insights of the Austrian School to bear on the pursuit of price stability by central banks, arguing that as currently implemented, it risks creating financial imbalances that can take a long time to undo.

Because the book is focused on the Swiss National Bank rather than being a comparison to other central banks, it does not directly discuss what I consider the most important question about the bank: What accounts for its excellent performance relative to its peers? Even so, the historical account and the analyses in the book suggest that the bank's good performance does not result only from the happy accident of being located in Switzerland. The Swiss National Bank has some unusual organizational characteristics that seem to have helped it focus on monetary stability. One is dispersed ownership. The Swiss federal government owns no shares in the bank. Private persons own about 55 percent of the shares, while Swiss cantons (subnational political units) and banks owned by cantonal governments own the remainder. Shareholders have some power to influence the bank's action at the bank's annual meeting and through the election of a minority of members to the bank's governing board, the majority being appointed by the federal government.

A related feature is that unlike the case with most central banks, the Swiss National Bank's profits do not all accrue to the national government. Shareholders receive dividends whose maximum amount is set by law. Of the remaining profits, two-thirds are paid to the cantonal governments and only one-third to the federal government.

Finally, except for a brief period in the early 1970s, the Swiss National Bank has always had a clear anchor for monetary policy, well known to the public. Initially it was the exchange rate with gold, then growth of measures of the money supply, then inflation. Even when the anchors have had some problems, they have promoted lower inflation and quicker correction of mistakes by providing explicit standards of performance. Countries where the anchors of monetary policy have been vaguer have done worse.

By avoiding the catastrophic blunders that many other central banks have made, the Swiss National Bank has contributed to Switzerland's stability and prosperity. For reasons I described in the opening paragraph, it would be inaccurate to refer to the Swiss National Bank as the gold standard, but among central banks it has been the next best thing, and this book offers some insights into how it got to be that way.

Kurt Schuler[1]
U.S. Treasury

[1]These are my personal views; they express no official position of the U.S. Treasury.