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# INFLATION AND HOW SWITZERLAND IS FIGHTING IT

Mr. Olivier Hay, Vice-President of the Swiss National Bank, came to speak to the Anglo-Swiss Society at Old Merchant Taylor's Hall on October 4th. This new kind of Anglo-Swiss function attracted members in great numbers as well as many City businessmen. The meeting was chaired by the Earl of Selkirk and our Ambassador, Dr. A. Weitnauer, was also among the panel.

The subject of Mr. Hay's exposition was the problem of inflation and how Switzerland was facing it. Although it brought forth no new elements, it was extremely useful in clarifying one's ideas on the subject. The main conclusion that can be derived from his speech is that Switzerland's anti-inflationary instruments are quite inadequate.

Mr. Hay began by outlining the present Swiss economic context. Switzerland, he said, had emerged from the second world war economically unscathed. Very early on, its industry could start off at full capacity while other neighbouring countries were struggling to rebuild their infrastructure. Appeal was made to foreign labour, and they streamed in from Germany and Italy. The post-war boom was fortunately accomplished with a remarkable price stability and the rate of inflation in the late 40's was about 1.2 per cent.

But a decade later the tide of foreign workers began to make itself felt both economically and politically. The situation today, where 15 per cent of the home population is foreign, carries the endemic virus of inflation. Such a formidable alien population calls for heavy investments in the way of housing and social equipment. Thus more money is spent on non-productive investments than if Switzerland were not burdened with so many foreign people. This was an important inflationary factor. A parallel effect resulting from the dependence on imported labour was the tendency to put off technological investments allowing in many cases for a less labour-intensive production.

Switzerland's mounting exports are themselves a cause of inflation in that they whip up home demand, particularly in housing, and tend to press rates and the rents upward. This also puts companies in a position to offer very high salaries to their skilled employees. Their bulging order books make it imperative for them to outbid competitors in their struggle for competence, and this element contributes more to inflation than any collective wage demands unmatched by increases of productivity.

But the most general cause of inflation, the one which covers all the others, lies in the consuming mentality of modern society. Mr. Hay said that people today have been trained to forget the distinction between *primary and secondary needs*. Everything has become primary and the modern consumer becomes increasingly insatiated.

All of these factors account for a national inflation of the order of six per cent. What can the Government do about it? Mr. Hay enumerated the three, particularly Swiss, characteristics which from the start saddled any resolute action.

## Liberalism bars State intervention

The first was a firmly imbedded liberal tradition. State intervention was anathema to the leaders of a notably free economy. At present the Constitution provides for those periods of serious economic crises marked by mass unemployment. In such cases the Government is entitled to intervene in the economy. But nothing has been foreseen in cases of "overheat" and there is nothing decisive the Government can constitutionally do at present. It can adapt its fiscal policy, but with relatively small effect because only 35 per cent of public expenditure is handled by the Confederation. The federal budget is in fact balanced, whereas the total deficit of communal budget runs to over a billion francs. For budgetary restraint to work, it would be necessary for all the cantons and communes to follow the federal example.

The next impediment is the mechanism of direct democracy. The Government could, for example, propose to raise more income tax. But its limits are constitutionally laid down, so that if Parliament decides to alter the Constitution to lift them, the people and the cantons have to ratify this decision. If they won't there is nothing more the State can do. This is just what happened to Parliament's agreement to eliminate the constitutional limits on federal income tax — it was turned down by the people. On the other hand all new fiscal measures can be neutralised in an optional referendum, staged after the collection of 30,000 dissenting signatures.

Therefore, barring an Article in the Constitution laying down the Confederation's responsibilities in conjunctural matters, the Government has limited powers in fighting inflation. The other instruments are of a monetary nature, and this is where the Swiss

it had less influence than other central National Bank comes in. However, Mr. Hay's exposé amply showed that banks.

The Swiss franc was a good currency. It had only been devalued once (in 1936) in 125 years of existence. Thus many banks and companies were eager to get hold of safe francs in exchange of less secure money. This was a cause of inflation because the Swiss National Bank had generally to intervene on the money market by buying excess foreign funds and creating the equivalent in Swiss francs.

## Inadequate monetary instruments

The means of monetary action of the Swiss National Bank were small. Owing to the great propensity of the Swiss to save, the banks at home were so liquid that they didn't have to rely on Central Bank borrowing. In fact the bills discounted by the Swiss National Bank amounted to about one per cent of its balance sheet. Thus the alteration of the Bank Rate was a completely ineffectual instrument.

The National Bank had much less influence than ordinary market forces in determining the rate of mortgages. It lay at 3.5 per cent seven years ago, and today it is still one of the lowest at about five per cent. Interest rates on savings are low in Switzerland (about five per cent) and the National Bank will see to it that they remain lower than those practised abroad, so that investable funds are attracted out of the country. This is perhaps its major scope for effective action. It furthermore has a certain supervision on the rates of interest of international loans made abroad.

Deprived of the backing of the law, the Swiss National Bank has to rely on voluntary co-operation with its economic partners. The history of post-war interventions by the States dates from 1964, when the first pressures of an overheated economy induced the National Bank to demand more powers. A kind of "obligatory gentlemen's agreement" was put into effect, not without considerable political opposition. It bore mainly on credit restrictions for the building industry.

In 1968 a proposed National Bank law calling for the compulsory credit deposits and statutory limitations of currency holdings was rejected by a liberal-minded parliament. This led in 1969 to a second honourable convention between the National Bank and

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private banks. Its object was, as expected, to control the dispensation of credit and discourage the inflow of foreign funds into Switzerland. It worked well as long as interest rates abroad were high. Now that these rates are no longer so engaging money is tending to come back and can be found for investment purposes outside the banking circuit. For this reason, the imposition of a credit ceiling is no longer very efficient.

The efforts at taking fiscal action of the Government have been frustrated by the popular will and Berne is currently attempting to ensure closer co-operation with the Cantons, and hopes to obtain from them a correct financial behaviour.

### Revaluation long overdue

Mr. Hay said that, although a change of parity of the franc could conceivably be considered as an economic tool, this had never been the case in the mind of the Federal Council. The revaluation of seven per cent of the Swiss franc performed on 9th May had been triggered by the unsettled world monetary climate but had anyway been long overdue. Mr. Hay said that Switzerland had been in surplus on current account for at least 12 years. For the last five or six years the Swiss franc had been pushing against its upper limit of fluctuation with respect to the dollar (the franc can fluctuate freely between 4.29 and 4.35 to the dollar before the Swiss National Bank intervenes) with the result that vast amounts of dollars had to be bought to support it. This situation was a clear pointer that the Swiss franc was undervalued. Mr. Hay said that revaluation didn't come at the best time, since Switzerland's trading position is now tending to deteriorate, but that it had to come. It eased for a while the pressure of foreign funds.

The latest measures by the Government was to halt building projects in certain cities and to enforce a new convention binding the banks to a blockage of inflowing foreign funds and a suppression of interest on foreign deposits. This made Swiss banks less attractive to foreign money from the point of view of yield. These directives had already been published when Mr. Nixon introduced his 10 per cent surcharge on all imports. But that same week, the Swiss National Bank had mopped up millions of dollars.

### The death of the monetary system

With the declared inconvertibility of the dollar into gold, the international monetary system devised at Bretton Woods 25 years ago had practically come to an end. Mr. Hay, who im-

plicitely condemned America for this failure, said that it had been a good system and that whatever new system will be introduced, it will not work unless each country abides by the rules.

Finally, he touched on the relevance of a wages policy in combatting inflation. He recalled that the Peace of Labour agreement of 1937 had secured a sane social climate in industry and prevented wage demands from being a primary factor in the rise in the cost of living. A wages policy, with statutory limits on wage increases, had never been officially considered so far. Switzerland had been far too liberal for such a possibility to be taken seriously. It had however been raised by the President of the Vorort, an employers' organisation, in a recent and controversial speech. This personality had demanded a statutory wage freeze,

a price freeze and two to four hours more work a week everywhere. Needless to say, the trade unions were not pleased and his suggestions received little support.

Mr. Hay said that it was indeed too early to consider taking such extreme measures. Even if the Government were to consider such a possibility, it would have to consult the cantons and the organisations involved in the matter according to a traditional procedure. Then Parliament would have to give the go-ahead, which of course could still be frustrated by the negative outcome of an optional referendum.

Things move slowly sometimes in Switzerland and the country is, as yet, not properly geared to face the surprises of an unsettled world economy.

(PMB)

## BRIEFING BY A THEORETICAL PHYSICIST

*The Institute of Theoretical Physics of the "Eidgenössische Technische Hochschule" is an old and creaky building off the Hochschule, on the wooded and residential Zurichberg. It is an ideal retreat for the few mathematical dons who spend their life there, thinking and attempting to find the quantified solution to the secrets of the Universe. There we were fortunate in meeting Professor Klaus Hep, recognised by his co-researchers to be among the very top theoretical brains in Switzerland, and were briefed in the nature of his arcane research.*

Professor Hep is a youngish man in his middle thirties. He was lounging from one of the stuffy rooms of his Institute along the lined corridor to another when we met him. A simple man in sport shirt-sleeves and a friendly smile. A quick look at his forehead revealed that his cortical dimensions were quiet in the ordinary. He struck one by his simple and genial appearance. Who knows, his IQ may have been quite standard. We were standing in a room which had doubtless been the seed-bed of many ingenious theories — the kitchenette where the indispensable coffee cups were washed up and the biscuits stored.

To begin with, he explained that the Zurich theoretical group had specialised for many years in "axiomatic quantum field theory". What the dickens is that supposed to be? will ask 90 per cent of laymen confronted with this weird notion for the first time. Well, as far as I can gather from the hasty scribble of my note-pad, it is a branch of physics that seeks to unravel the innermost secrets of matter

by starting from a minimal number of basic and logical principles.

But first, it is useful to make the distinction between the three terms *quanta*, *field* and *axiom*.

Quantum mechanics was discovered by the German physicist Max Planck in 1905. He made a break with classical mechanics by postulating that energy was chopped up into fundamental grains or "quanta", a hypothesis which worked wonderfully. The discontinuity of other observable physical quantities such as linear and angular momenta was later postulated with great success. Therefore, just as matter is made up of atoms, which are its smallest building blocks, all physical quantities are made up of elementary "quanta". At a later stage, physicists discovered that the *quantum* aspect of matter was just the dual facet of its *wave* nature. They developed the unifying mathematical framework, known as wave mechanics, during the 1930s. These were the heady days of theoretical physics.

A *field* is a portion of space with given physical properties, two examples being the gravitational field and the magnetic field. This notion was introduced in the new physics when researchers attempted to express the results of quantum mechanics (applicable to the infinitely small) and those of relativity (applicable to the infinitely large) in an all-embracing theory. They have been at this task for over 30 years and, as Professor Hep underlined, are nowhere near a final solution yet.

The notion of *axiom* is a little more involved. If I understand Professor Hep correctly, the general idea