Jean-Pierre Roth: Seventy years after – the final collapse of the gold standard in September 1936

Opening remarks by Mr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank and Chairman of the Board of Directors of the Bank for International Settlements, on the occasion of the Conference "Seventy Years After: The Final Collapse of the Gold Standard in September 1936", University of Zurich, 15 December 2006.

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I am pleased and honoured to open this conference on the final collapse of the gold standard in September 1936. This event, 70 years ago, marks one key date in the history of the Swiss National Bank.

From the middle of the nineteenth century, gold played a pivotal role in Switzerland's monetary regime. It was central, as the foundation of the international monetary system and the anchor of the Swiss franc. And what is more, people took it for granted that the gold-based system would prevail. A hundred years later, after the Second World War, its role began to fade, although a gold parity of the franc continued to exist until 2000.

When the Swiss National Bank was created, in 1907, the international gold standard stood as a potent symbol of a world characterised by free markets and free movement of capital and labour. In the memorable words of Keynes "The inhabitant of London could secure forthwith, if he wished it, cheap and comfortable means of transit to any country or climate without passport or other formality, could despatch his servant to the neighbouring office of a bank for such supply of the precious metals as might seem convenient, and could then proceed abroad to foreign quarters, …, bearing coined wealth upon his person …. But, most important of all, he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable."[1]

When Keynes wrote these words in 1919, the First World War had destroyed the old economic order. The international monetary system was in shambles, international trade was disrupted, and social and political unrest was making it hard to achieve any progress on economic issues. At the beginning of the war, Switzerland, like most other countries, had suspended the convertibility of its currency. Such a suspension, in a wartime emergency, was in line with gold standard thinking, as long as convertibility was resumed once the emergency had passed. After the end of the war, however, misalignments in price levels made it necessary to leave flexible exchange rates in place for the time being. Later, Switzerland was one of the countries to restore pre-war parity. In 1924, the SNB moved the exchange rate towards that goal, finally achieving it by the end of the year. Thus Switzerland was part of the gold-exchange standard that constituted the international monetary system from about 1925 to 1931. In 1929, legislation was adopted to prepare the ground for a return to a pure gold standard, with convertibility of notes into gold coins. While this pure standard never actually came about, it demonstrates that Switzerland regarded gold as the natural foundation of its monetary regime.

The gold standard in the Great Depression

In 1929, at the outset of the worldwide economic downturn that led to the Great Depression, the dominant view in the Swiss government, and certainly in the SNB, was that depressions were unavoidable. A downturn must run its course until good times returned, as they inevitably would. But as the depression worsened, a hands-off policy of this kind became increasingly difficult to pursue. By 1931, the situation in Switzerland was aggravated by the decision of a large number of countries to come off gold. The British suspension of convertibility in the summer of 1931 was followed by the countries of the Empire and the Scandinavian states. Then, in 1933, the United States allowed the dollar to float, before stabilising it again one year later at a vastly lower rate.

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1 John Maynard Keynes, "The Economic Consequences of the Peace", Harcourt Brace Jovanovich, 1920 (reprinted by Penguin Books, 1988).

With the Swiss franc greatly overvalued against key currencies, the options were either deflation or devaluation. As the Swiss later realised, it would have been better to follow the British example. In 1931 and 1933, however, that option was not seen as the appropriate response. The SNB saw Britain's suspension of convertibility in 1931 as a regrettable step that could not last. Empirical evidence showing that Britain and others had fared better after devaluing their currencies was routinely dismissed with the argument that the structure of the Swiss economy was different, since it was highly dependent on imports. It seemed to both the SNB and the Swiss government that gold was the only stable element in a turbulent world, and that the only way to restore the competitiveness of the Swiss economy, therefore, was reducing domestic costs and prices.

As it turned out, the advocates of deflation miscalculated on several accounts. For one, they did not foresee that deflation would make very little progress over the coming years. Deflation policies were strongly opposed by labour and other special interest groups. Backed by the threat of referendum, this undermined the willingness of government and parliament to take an uncompromising stance. As a consequence, state interventionism was on the rise, self regulation of markets was hampered and rigid price and cost structures protracted the depression. At the same time, it appears that the advocates of deflation policies overestimated the inflationary consequences of devaluation in the countries that did devalue. The SNB repeatedly warned of the inflationary effects of devaluation, yet price increases in the UK and the US were moderate and – until World War Two – neither country regained pre-depression CPI levels. As a result, the Swiss franc remained overvalued right through to 1936, with the extent of the overvaluation changing little throughout this period.

From a modern-day perspective, it may appear surprising that markets largely considered the Swiss government capable of staying the course, despite these difficulties. Most indicators suggest that the credibility of Switzerland's commitment to the gold standard was still intact after 1933. Its gold stocks had risen – modestly at first in 1929 and 1930, and then more dramatically in 1931, when many currencies had come under pressure and had to come off gold. Between 1933 and 1935 stocks decreased significantly but were still considerably larger at the time of the devaluation in September 1936 than they had been before 1931. The movement in forward premiums on the foreign exchange market suggests the same interpretation. The premium for the British pound against the Swiss franc was modest even at the time Belgium was forced to devalue in 1935, as well as during the spring and summer of 1936. Thus the likelihood of a devaluation of the Swiss franc was seen as relatively small.

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The devaluation, when it came in September 1936, was widely regarded in Switzerland as an externally imposed step. To many, it came as a shock, since over the course of many years the Federal Council and the SNB had been constantly emphasising their view that devaluation was no remedy. The decision to devalue by about 30 percent was taken in the early afternoon of September 26, a Saturday, shortly after the devaluation of the French franc. This was followed the next day by a radio address to the nation, given by the President of the Confederation in order to reassure the Swiss people. His famous sentence, "One franc remains one franc," was intended to boost the public's confidence in the value of money. In the following week, on the Monday and the Wednesday, respectively, the two chambers of parliament endorsed the decision of the federal government. After some heated debate in the parliamentary groups, voting on the issue had been by and large along party lines.

It is interesting to note how the policy reversal was explained to the public. The trigger, of course, was the French devaluation. Attention was drawn to a number of consequences of the French decision. First, the devaluation of the French franc was a further blow for the export industry and for tourism. Second, an unchanged Swiss franc parity would increase the risk of speculative attacks. Although the gold reserves were regarded as sufficiently large to hold out for some time, it could be assumed that speculation against the Swiss franc would begin right away. It was better, therefore, not to use up the gold reserves in a struggle that in all probability could not be won. The authorities conceded that the policy of the preceding years had not succeeded in restoring the competitiveness of the economy vis-à-vis the countries which had already devalued. Finally, they pointed out that the Tripartite Agreement between the American, British and French governments opened up the way for a new beginning and a more cooperative international framework. Surprisingly, perhaps, this argument was put forward as a crucial one in the early statements. However, it rapidly became clear that the hopes placed in the Tripartite Agreement might have been excessive.

With the devaluation of the Swiss franc, Switzerland's monetary authorities had reneged on a fundamental commitment. But in most other ways the monetary standard remained unchanged. The currency continued to be gold-backed, and the gold parity continued to be essential. The operating procedures had not changed and, in contrast to some other countries in that period, the relationship between government and central bank was not altered at the expense of the central bank. Thus, the devaluation was seen as a painful setback in Switzerland's monetary history, but not as the dawn of a new era.

Fixed exchange rates, of course, were carried over to the Bretton Woods system in the post-World War II world. And although Bretton Woods differed in many ways from the interwar gold-exchange standard, a central banker of the 1930s would have adapted without major difficulties to the world of the 1960s. The collapse of the Bretton Woods system and the subsequent move to flexible exchange rates in 1973 were far more important events in the SNB's 100-year history than the devaluation of 1936. Indeed, the crisis of the international monetary system in the early 1970s essentially transformed the SNB's task and scope for action. Switzerland gained full control of its money supply, price stability became the primary objective of monetary policy and the legal framework of the SNB was gradually amended accordingly.

Beyond the gold standard

As I said at the outset, the role of gold has faded over the years. But gold had an afterlife long after it ceased to be relevant in any form for the conduct of monetary policy. First and foremost, the legal link between the Swiss franc and gold continued to exist until very recently. The constitutional changes that severed this link took effect in 2000, followed, within the same year, by the corresponding changes in the relevant law. The new law no longer includes an obligation on the part of the SNB to redeem banknotes for gold – an obligation which – in practice – had been suspended for decades. Moreover, it has abolished the minimum gold coverage of the banknotes in circulation and the gold parity of the Swiss franc. With these changes, gold finally became a normal and marketable asset for the SNB. In May 2000, the SNB began to sell part of its gold stock. About 50 percent of the gold once owned by the SNB has now been sold. I should emphasise that the SNB will continue to hold gold as a monetary reserve, but the legal relics of the gold standard era no longer immobilize the gold stock as they did for decades.

A second aspect of the afterlife of the gold standard is its presence in discussions on domestic and international monetary standards. In the 1970s and 1980s, when inflation was high and exchange rates volatile, a small but vocal group endorsed the gold standard as an alternative to the paper standard of the post-Bretton Woods era. Judged by practice, they were on the losing side. There appears to be a widespread consensus – both among economists and central bankers – that a gold standard generates few positive things that cannot be provided by other means. For one, the gold standard has all the drawbacks of fixed exchange rates. That is, monetary policy cannot be used to achieve domestic goals and the parities are vulnerable to speculative attacks. Also, the gold standard has all the disadvantages of a commodity standard. In other words, the system is not only expensive to maintain, it also allows the supply and demand conditions for the commodity in question to affect the general price level.

Some advocates of the gold standard did not propose the gold standard as an international system but promoted it as a tool for solving domestic problems. In particular, they argued that the link to gold, by providing a credible anchor, would keep inflation under control. This argument is valid as far as it goes, but ignores the fact that a gold standard has its own credibility problems. If countries can tie their currencies to gold, they can also untie their currencies from gold. This is what happened in the 1930s. The markets know that and form their expectations accordingly.

For this reason, most countries preferred to go other ways. In recent years, many of them have adopted clear mandates for their central banks which specify price stability as the primary goal. They then try to achieve this goal with some form of inflation target – be it implicit or explicit. Results have been good so far, although not all can be attributed to improved policy making. Some have argued that globalisation and the move towards more competitive markets have reduced inflationary pressures, thus making inflation targets easier to reach. But whatever the reasons, the results in recent years have been encouraging. I believe that as long as this continues, and central banks succeed in keeping inflation under control, the appeal of the gold standard will remain limited. But I have no illusions that commodity money will be discussed again as an alternative should central banks fail to achieve their goals and inflation rise to high levels.

In concluding, let me re-emphasise the fact that the devaluation of the franc was a major event in our monetary history. But although this devaluation was considered to be of great importance, it was not seen to herald the end of the gold-backed system. It took about 40 years – and many other difficulties – before flexible exchange rates were regarded as a feasible option, and more than 60 years before the gold parity of the franc was removed.

Today the 1936 devaluation remains vivid in the memory of the general public. The Swiss like to remember that their currency has only been devalued once since its creation in 1850. With or without the gold standard, the history of the Swiss National Bank has been marked by a continuous search for a stable anchor. In order to protect the purchasing power of money and the price competitiveness of a country largely dependent on exports, monetary stability has been the overriding target of SNB policy throughout its one hundred year history. Of course, seen from a modern-day perspective, mistakes have been made and decisions taken too late – the 1936 devaluation can be seen as an example of this – but the fact that we can still use the set of coins introduced in 1850, when the franc was created, shows that Switzerland, thanks to prudent policy, has succeeded in avoiding the monetary disorders that have plagued so many European countries since the nineteenth century.