

**Gold standard and gold-standard mentality
in Switzerland 1929-1936**

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May 2003

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1. Introduction

The Great Depression has been called a “defining moment” of the 20th century.¹ This is certainly an adequate description from the point of view of the economic historian. But is just as valid from the perspective of the historian of economic thought. The worldwide recession of the 1930s, with its enormous declines in output and employment and the breakdown of international trade and capital flows, was a unique episode in macroeconomic history.² It set the stage for Keynesian macroeconomics, which would, in turn, deeply influence economic policies and the evolution of institutions in the era after World War II.

The recent decade has seen a renewed interest in the analysis of the interwar years. This research is characterized by a vision of the depression as an international phenomenon. The latter was pioneered by Kindleberger (1973) who stressed the diverse origins of the depression, which he traced back into the 1920s and across the globe. This contrasted starkly with the focus on the United States, which had characterized much of the earlier research. Kindleberger’s contribution is also part of a debate between Keynesian and Monetarist explanations of the depression. Friedman and Schwartz (1963) on the one hand and Temin (1976) on the other, represent core arguments of this controversy. Both sides, however, shared a framework of analysis which made the demand shock at the beginning of the depression the center of attention. The controversy was about whether the origins of the shock were in a monetary contraction or an autonomous decline in demand. The pattern of explanation in both implied that an extraordinary demand shock led to a *great* depression. However, doubts emerged on whether it was justified to claim that developments in the late 1920s were of such extraordinary quality, especially considering the international nature of the slump. This led to a restating of the question guiding research on the Great Depression. How did a fairly normal shock, at the beginning of the crisis, turn into an

¹Bordo, Goldin and White (1998)

²The term Great Depression was used by American historians for the recession of the 1930s, whereas British scholars referred to this era as the Great Slump (Eichengreen 1992b, 213). I follow the American usage, which seems to have come to dominate. It has spilled over into the German-language discourse. The traditional term for the period is “Weltwirtschaftskrise” and suggests, like the French “crise mondiale,” that the international character of the crisis governed perceptions on the continent.

extraordinary downturn that accelerated as it spread through the world economy? The propagation, and not the initial disturbance, thus moved to the center of attention.

Peter Temin's *Lessons from the Great Depression* (1989) and Barry Eichengreen's *Golden Fetters* (1992a) are milestones in this line of research. It inspired giving attention to the role of the international monetary regime at the onset and in the propagation of the crisis. This brought forth a consensus on the main ingredients to an explanation of the Great Depression, although controversy persists on details. The central hypotheses of this explanation, the relationship between the gold standard and the depression, provides the starting point for this study. In Eichengreen's words: "The gold standard of the 1920s set the stage for the Depression of the 1930s by heightening the fragility of the international financial system. The gold standard was the mechanism transmitting the destabilizing impulse from the United States to the rest of the world. The gold standard magnified that initial destabilizing shock. It was the principal obstacle to offsetting action. It was the binding constraint preventing policymakers from averting the failure of banks and containing the spread of financial panic. For all these reasons, the international gold standard was a central factor in the worldwide Depression. Recovery proved possible, for these same reasons, only after abandoning the gold standard." (Eichengreen 1992a, xi).

The Eichengreen-Temin explanation of the Great Depression

The following draws on Eichengreen's (2002) presentation of the stylized story that emerges from this research. He reviews recent contributions. The earlier literature is surveyed in Eichengreen (1992b). Balderston (2003, 1-7) provides a concise account of the Eichengreen-Temin explanation of the Great Depression. I concentrate on those aspects of the story relevant to my discussion of developments in Switzerland. The explanation of the onset of the depression builds on the foundations laid by Friedman and Schwartz (1963). Apart from the monetary tightening in the United States analyzed by these authors, monetary policy mistakes in Germany and France are seen as origins of the decline in world money supply.³ These impulses were propagated by the gold standard. As capital flows reverted, several capital importing countries experienced

³The European financial crisis of 1931 receives particular attention. It is interpreted as a result of public policies restrained by "golden fetters" to avert banking collapses and spreading panic (Balderston 2003, 4).

recessions even before the downturn in the United States. Their central banks were forced to increase interest rates in order to stem capital outflows. The United States benefitted from this effect, as capital inflows moderated the impact of interest rate increases. Monetary policies were not changed, even after the downward trend in output and employment gained momentum. In part, this was due to the contemporary perception that the exuberance of the preceding credit boom needed to be undone.

Under these circumstances a downward spiral of deflation and income decline developed.⁴ It was driven by the contraction of money supply both on a national as well as on a global level. Several mechanisms explain this phenomenon. The decline in output and asset values led to a compression of banks' balance sheets, reducing their ability to lend and thus precipitating banking crises. The replacement of gold for financial assets on the level of private investors similarly aggravated the autonomous decline in money supply. Furthermore, as reserve-currency countries' commitment to gold was increasingly questioned, central banks replaced their foreign exchange holdings for gold. As currency and banking crises developed, the scramble for gold reached its peak. "Under these circumstances, the gold standard became an engine of deflation." (Eichengreen 2002, 15). World money supply contracted.⁵

The recovery is explained as being a result of abandoning the gold standard. "The timing and extent of depreciation explain much of the variation in the timing and extent of economic recovery." (Eichengreen 1992b, 232). Departing from the standard freed money supply from its "golden fetters." In theory, it allowed central banks to actively expand domestic credit. With memories of post-World War I inflation still looming large, few actually made use of this new-found freedom. At least in part, this explains why the recovery was not more robust. The objection

⁴According to Balderston (2003, 2) the analysis of the question why monetary contraction produced output and employment decline remains outside the analytical core of the Eichengreen-Temin argument. The supply-side effects of monetary contraction manifest themselves in increasing real wages. Analyses of their impact can thus be understood as a complement to the core of the Eichengreen-Temin story (e.g. the work collected in Eichengreen and Hatton 1988, and the literature discussed in Eichengreen 2002, 31-2).

⁵Eichengreen (2002, 16-18) decomposes the decline in money supplies to estimate the relative importance of these effects.

that expansionary monetary policy would have been ineffective, is refuted by Eichengreen (2002, 26-7). The liquidity trap, which had developed under the deflationary conditions of the early 1930s, was overcome by a shift in expectations brought about by lowering the exchange rate. Expectations of increasing price levels as a result of increasing import prices lowered real interest rates. Depreciation further stimulated domestic production by temporarily shifting demand from foreign to domestic products.⁶

The Eichengreen-Temin explanation of the Great Depression thus goes beyond the Monetarist and Keynesian explanations of the previous era, but integrates many of their arguments. It also transcends explanations of contemporary experts, who saw aberrations during the preceding boom period as the roots of the Great Depression. However, many of their arguments are also stressed by scholars pursuing research in line with the Eichengreen-Temin hypothesis, as for example, the distorting heritage of war debts and reparations which figured prominently in Gustav Cassel's interpretation of the crisis. Eichengreen and Temin's success in unifying scholars studying the Great Depression can thus be interpreted along two lines. On the one hand, their approach provides a coherent, if complex, story of the occurrences in the interwar period. On the other hand, it is flexible and allows the integration of arguments from outside a narrowly defined economic sphere to include e.g. domestic and international political events.⁷

⁶Eichengreen (2002, 28-29) discusses the evidence for these theoretical arguments.

⁷Balderston (2003, 7) furthermore explains the success of the Eichengreen-Temin analysis by the appeal to economists of its clear-cut policy conclusions, which can be applied to modern issues of the international financial regime. Historians, according to Balderston, are attracted by the complexity and historical sensitivity of the story. This second aspect is not manifest in the short account presented in my text.

Figure 1: Index of real GDP and cost of living, 6 countries, 1929=100⁸



⁸Sources: Real GDP: Maddison 1995, table C-16a, p. 180-3. Cost of living index: League of Nations 1939, table 122, p. 234-6. Dates in titles refer to the abandoning of the gold standard by the country, for Germany to the introduction of exchange controls. Further details in the text.

Switzerland and the Eichengreen-Temin hypothesis

Switzerland's macroeconomic developments during the years of the Great Depression differ in some crucial respects from the main story-line presented above. The elements of difference are, however, closely linked to the working of the gold standard. Furthermore, they reflect characteristics of the Swiss economy as a "very" open small economy as will be argued in chapter 2. Figure 1 allows a comparison of the depression's course in Switzerland with that in her four main trading partners (Germany, Great Britain, United States and France in the order of their importance as export destinations at the end of the 1920s, see p. 32). Sweden is added to the diagram as a counterfactual to Switzerland's path, given its early decision to devalue and introduce price-level oriented monetary policies.

In general, the perception of the Great Depression is shaped by the developments in the United States and Germany where sharp declines in output and employment started in 1930. Great Britain's seemingly mild downturn was nonetheless accompanied by high unemployment rates, in part carried over from the 1920s. In all cases, the downturn saw a strong decline in consumer prices. This illustrates the account of the onset and deepening of the depression summarized above. Trends were reversed between 1931 for Great Britain and 1933 for the United States, in line with the argument made by Eichengreen and Temin about the need to abandon the "golden fetters" for recovery to set in. Germany was the first country to sever its ties with the gold standard regime by introducing exchange controls in July 1931 in the wake of the banking and currency crises. Great Britain left the gold standard in September of the same year, which led to the devaluation of Pound Sterling by 30 percent by the end of the year. The United States followed in March 1933 and restabilized the Dollar in January 1934 at 41 percent devaluation. In all cases the recovery was accompanied by increasing price levels.

The developments in France and Switzerland, both destinations for large capital flows in the early years of the depression, followed different patterns. Whereas real output declined early in France, price levels increased well into 1930, when prices started to fall. The overall decline in prices was far less severe than in other countries. France's belated devaluation by 30 percent in September 1936 was followed by inflation, which quickly drove the cost of living index beyond its pre-crisis level. The onset of the recession in Switzerland was delayed. Mild output losses in 1930 turned into pronounced decline in 1931 and 1932. The recession was brought to Switzerland through a

sharp decline in exports between 1929 and 1932. Once export levels stabilized, the decline in production for domestic markets gained momentum. The second phase of the recession in Switzerland, a stagnation in output and prices, was characterized by tightening monetary conditions (see chapter 2). The decline in the overall output stayed far below that of the large depression countries Great Britain and the United States. Switzerland also fared better than France, another member of the gold-bloc.⁹ Stagnation was overcome with the devaluation of the Swiss franc in September 1936 together with the French franc. Consumer prices declined sharply in the early phase of the downturn, reflecting the collapse of world market prices, despite liquid monetary conditions into the year 1931. Deflation was most pronounced in those years in which Switzerland experienced the largest gold inflows. The price level remained fairly constant at low levels until 1936, independent of tightening monetary conditions.

Sweden was basically spared a *great* depression. Still growing in 1930, the recession set in even later than in Switzerland. Sweden abandoned gold together with Great Britain in September 1931 and introduced price-level oriented monetary policies. The recovery started in 1932 and soon turned into strong growth. On the background of the Eichengreen-Temin argument about the conditions for recovery this result can be attributed to the profound change in expectations brought about by the decisive shift in monetary policy. Overall deflationary effects during the downturn were relatively mild, as were price level increases after the devaluation.

Sweden’s experience suggests that Switzerland might have been able to avert a severe crisis had she decided to devalue between 1931 and 1933. World trade started recovering in 1933, a trend to no avail of Swiss exporters due to the overvaluation of the currency. Whereas Sweden managed to increase exports per capita between 1928 and 1938, the figure for Switzerland declined by more than one third in the same period, thus falling behind Sweden’s (see table 1, p. 24). Considering that the beneficial effects of abandoning gold set in quickly and allowed the respective countries

⁹Maddison (1995, table 3.7, p. 69) calculates “biggest cyclical (peak to trough) GDP movement within the years 1928-1935.” For the countries considered here, they are reproduced in the following table.

France	Great Britain	Germany	Sweden	Switzerland	U.S.
-14.7	-5.8	-24.5	-6.2	-8	-29

to revert downward trends in output, employment and prices, this raises the question why Switzerland, together with France and the Netherlands, remained on gold. It took these gold-bloc countries five years to acknowledge the end of the international gold standard which had all but disappeared in the fall of 1931 when more than 20 countries depreciated their exchange rates.¹⁰

Ideas and economic policy

The explanation of the Great Depression presented above necessarily raises the issue of economic policy choices in the depression years. Eichengreen and Temin (2000) develop a comparative perspective and try to devise common characteristics of the developments in different countries, thus going beyond studies which analyze political developments in individual countries during this eventful period.¹¹ While the triggers of the downturn can be understood as beyond the reach of economic and monetary authorities, the policies pursued in the years of depression did shape the development of the crisis. Eichengreen and Temin (2000, 183) argue that “[t]he gold-standard mentality and the institutions it supported limited the ability of governments and central banks to respond to adversity.” They trace the belief in the gold standard as a guarantor of stability in a single economy as much as in international economic relations back to the era of the classical gold standard before World War I. On this background, they conclude, little thought was wasted on alternatives to the return to an international monetary system based on gold after the world war. Contemporaries considered “[t]he gold standard as a defence against chaos” (Eichengreen and Temin 2000, 186). After the disruptions of the war it would ensure a return to normality. Along similar lines, Tanner (2000, 61-73) analyzes the role of the gold standard in Switzerland’s pronounced “stability culture” of the interwar era.

Country after country restablized their currencies on gold, some at great cost, as, for example, Great Britain. In the depression years of the 1930s the traditional reactions to economic crises destabilized rather than stabilized the system. “Actions that worked well in prewar prosperity had damaging results as economies contracted in the early 1930s.” (Eichengreen and Temin 2000,

¹⁰The Scandinavian countries followed Great Britain immediately off gold. Together with New Zealand they later formed the Sterling bloc. Canada and a host of Latin American countries depreciated or introduced exchange controls even before 1931. Japan, which had only briefly adhered to gold, abandoned the standard in 1931 (Eichengreen 1992a, 188-90).

¹¹Bernstein (2002) similarly stands out by tracing the obsession with gold through history.

195). Contemporaries were unable to appreciate this. Instead, they argued that the depression was the result of a failure to comply with gold-standard policy prescriptions in the preceding boom period. The credit expansion had led to speculation which, in turn, precipitated the crisis. “The sins of the speculators were to be laid upon their children, as the Shakespearean proverb goes, but in this case they were also to be laid upon the sinners themselves... No one was to be allowed to escape the choking grip that the process of deflation *cum* moral redemption was to impose.” (Bernstein 2000, 306). Eichengreen and Temin (2000, 195-201) show how policy makers in the United States and the large European countries clung to the gold standard, hoping it would bring about the adjustments necessary for recovery. The retrenchment would be brought about by wage and price declines, by balanced budgets and interest rate policies aimed at protecting the exchange rate. “That the solution to the Depression might lie in rejecting gold was beyond the pale.” (Eichengreen and Temin 2000, 198). When Great Britain nonetheless abandoned gold in 1931, it came as a shock to authorities around the world.

The contraction in the world economy was not stopped by the British step, despite the wave of devaluations it brought about. Expansionary policies were introduced only cautiously and with considerable delay. The gold-standard mentality survived the abandoning of the gold standard for some time (Eichengreen and Temin 2000, 203). The deflationary pressure in the countries remaining on gold led to increasing resistance, which eventually manifested itself in elections. Considering how entrenched the set of beliefs described as the gold-standard mentality were, a change in policies could only be brought about by a replacement of decision makers. Eichengreen and Temin (2000, 203-6) invoke the developments in the United States, in Germany and in France to prove their point. They conclude that “[t]he world economy did not begin to recover when these people changed their minds; rather, recovery began when mass politics in its various guises removed them from office.” (Eichengreen and Temin 2000, 185).

As outlined in the preceding paragraphs, the argument with the pervasiveness of the gold-standard mentality is an indispensable part of the Eichengreen-Temin hypothesis. The explanation of perverse policy decisions in the early phases of the depression and the prolonged adherence to gold in the gold-bloc countries relies on the dominance of ideology in national policy decisions. Several issues are raised by this account, not least with regard to an explanation of the developments in Switzerland.

From the perspective of an historian of economic ideas, Eichengreen and Temin’s delineation of

what the gold-standard mentality entailed in terms of theoretical concepts remains vague. It is circumscribed as a “world view,” an “ideology,” as incorporating “strands of financial orthodoxy.”¹² The ingredients they hint at recall debates among economists who had tried to understand the working of an international monetary system based on specie in the 18th and mid-19th centuries. By the time the Great Depression set in, national money supplies had been dominated by notes issued by central banks and by commercial banks’ credit for quite some time. The debates within the economics profession had moved on to reflect these developments. Knut Wicksell’s work on the credit economy, published in the late 1890s, was highly influential on the continent. In the United States, Irving Fisher had advocated price-level stabilization as basis for stable macroeconomic growth since his theoretical analysis of 1911 and John Maynard Keynes’s *Tract on monetary reform* was published in 1923, to name only a few of the milestones of monetary economics in the period preceding the Great Depression. Furthermore, tremendous efforts had been exerted on theoretical and empirical business cycle research on both sides of the Atlantic in the years before and after World War I.

This raises the question of how the image painted by historians of economic thought of the 1920s and the 1930s as a revolutionary period in economic thinking can be brought into agreement with the pervasiveness of a backward-looking gold-standard mentality identified by Eichengreen and Temin. Which role did professional economists play in supporting or, alternatively, in undermining traditional beliefs? This question has received considerable attention in analyses of the discourses in Germany, in Great Britain and in the United States.¹³ However, this literature focuses on the new ideas rather than on the “orthodoxies” that were questioned. Therefore, they contribute little to specifying the ideas underlying Eichengreen and Temin’s gold-standard mentality. For Switzerland, no analysis of the development of economics in the interwar period is available.¹⁴ In

¹²Quotes from Eichengreen and Temin 2000 and 2003.

¹³For Germany see Backhaus (1983), Borchardt (1982) and Korsch (1976) for overviews of the debate and the volumes edited by Bombach (1976a, b and 1981). Clarke (1988) and Corry (1996) review the debates in Britain, Barber (1985 and 1996) and Davis (1971) those in the United States.

¹⁴This holds for other periods, too. The history of the discipline in Switzerland has received little attention. Individual economists, whose influence reached beyond the borders or who spent parts of their careers in Germany figure in German histories of economic thought.

light of the small size of the economics profession, an additional question is to what extent recent research reached and could be absorbed by the rather small circle of academic economists.

These considerations motivate my research on the Swiss economic policy debates during the depression.¹⁵ My study aims at specifying the meaning of the term gold-standard mentality in this particular context. The orthodoxy as spelled out most prominently in the communications of the Federal Council (Bundesrat) and of individual members of the government is analyzed.¹⁶ Its inspiration by the ideas of “defunct” and living economists receives particular attention. Furthermore, the origins of the resistance to the government’s economic policies and their theoretical content are analyzed. The ideas absorbed in Switzerland are discussed in the context of the contemporary controversies in the German-speaking economics profession. This allows an assessment of the Swiss debates in a broader perspective and an evaluation of the level of the debate.

Focusing on ideas in an analysis of policies runs counter to the trend of explaining economic policies as a result of economic interests inspired by political economy.¹⁷ As detailed above, my approach is inspired by the Eichengreen-Temin explanation of the depression and the weight the notion of gold-standard mentality has in the argument. My outlook on Swiss economic policy debates is also provoked by debates among Swiss historians. Recent research on the policy decisions of the interwar years, focusing on economic interests, presents several puzzles. The received view argues that the Swiss government’s gold-standard policies reflect the dominance

¹⁵Accounts of aspects of the economic policy debates in Switzerland during the 1930s can be found in several dissertations (Hohl-Slamova 1983, Morandi 1995, Prader 1981, Rutz 1970, Schärner 1983, Scheiben 1987). Müller (2001) in an unpublished *Mémoire de licence* provides a thorough analysis of Swiss economic policy debates in the period and covers much of the ground discussed in the following. None of these authors is interested in the relationship of the arguments dominating the political debates to contemporary economic thought, a concern central to this study.

¹⁶Translations of German terms referring to the Swiss political system have been taken from Swiss Federal Chancellery, Information Service (2003).

¹⁷Balachandran (1996, 8-12) provides a excellent discussion of the tension between ideology and interests in arguments on economic policy in view of the British interwar gold-standard policies. Arguably, the case of Switzerland presents itself differently.

of financial interests in the political process at the cost of the interests of the Swiss export industries (Arlettaz 1982). This view is questioned by Baumann and Halbeisen (1999) who show that the Swiss Bankers Association's commitment to the Swiss National Bank's crusade for the adherence to gold was rather limited. Perrenoud et al. (2002) furthermore present evidence that by the mid-1930s Swiss banks were well prepared for the event of a devaluation, an event from which the large banks eventually benefitted immensely. In contrast, the Swiss industry organization (Vorort) remained a staunch defender of the gold parity, officially to the day of the devaluation, a fact which occupied several authors (Margrit Müller 1999 and 2002, Müller 2001).¹⁸ The exporters' position was mostly driven by the fear that price-level increases would countervail short-term gains in competitive advantage due to the high import-dependence of the Swiss economy. This reasoning points to the importance of ideas. The world views that guide economic actors' understanding of reality are crucial when it comes to appreciating what they themselves perceived as their own best interest.

On this background, the following paragraphs provide a brief review of the patterns of the Swiss economic policy debates and an overview of the argument in chapters 3 to 8.

Political debates and the gold-standard mentality in Switzerland

If the recession set in late in Switzerland, economic policy debates were even more delayed. This is shown in chapter 3. The Federal Council was reluctant to acknowledge the existence of a downturn and was far from perceiving it as an extraordinary downturn. Industry representatives on the one hand, the social democratic opposition on the other, had demanded government action from as soon as the effects of the world slump had reached the export industries. Well into the year 1932, the Federal Council refused to formulate an official position on the economic developments. However, measures to mitigate the effects of the crisis had been introduced in the course of 1931. Several implied a continuation of interventions introduced in the 1920s, such as the support for the watch-making industry and for agriculture or the subsidies to private unemployment insurances. The large-scale and longer-term unemployment in the export industries

¹⁸This debate will be taken up in chapter 7.

caused the introduction of direct aid to the unemployed (Krisenhilfe). Furthermore, import restrictions were implemented starting in December 1931 as a reaction to the explosion of the trade deficit in the preceding year.

Only in March 1932 did the government come forward with a statement containing an assessment of the economic situation and a few policy guidelines. This was not the encompassing economic policy program demanded by the left and by the export industries, albeit based on contrarious notions of adequate crisis policies. The Federal Council would not formulate anything close to a complete policy program in the following years, which was in part a result of diverging opinions within the government. The policy guidelines accommodated the demands of the export industries for a reduction in price and wage levels. This adjustment was considered necessary to restore world-market competitiveness of Swiss exporters. It was furthermore seen as consistent with the logic of the gold standard in view of the overvaluation of the Swiss franc which had resulted from the first round of devaluations set off by Great Britain in September 1931. That the exporters' demands for decreases in domestic prices and wages preceded the recession is worth mentioning. They can be traced back into the 1920s and have remained notorious ever since. Although the government confirmed the demand, no measures towards their realization were taken. The Federal Council expected adjustment to result automatically from reduced demand as incomes and employment opportunities declined in the course of the recession.

The second cornerstone of the government's policy guidelines was also in line with gold-standard prescriptions. The Federal Council underlined the importance of balanced budgets to preserve the credit of the country and stabilize the currency. As further increases in expenditures in support of the unemployed, of agriculture and industry were expected, spending cuts and revenue increases were envisioned for the future. On the one hand, the government thus spelled out policy guidelines consistent with the orthodoxy. On the other, it confirmed its ad-hoc policies of government support aimed at alleviating the repercussions of the downturn. This contradiction persisted all through the depression years, a fact which was criticized frequently by contemporaries from across the political spectrum.

Faced with rapidly deteriorating public finances, the federal government submitted a proposal entailing the reduction of wages and salaries of public employees to parliament. This was

presented as a perfect measure to implement the prescriptions of the gold standard, suggesting that the adjustment of public sector wages could serve as a model to the private sector. The proposal met with fervent resistance from the social democratic opposition. Although parliament finally passed the bill, the opposition called a referendum. In May 1933 the proposal was rejected by a clear majority.

The wage-reduction bill dominated the first phase of economic policy debates. It was a debate about the orthodoxy of adjustment policies implying price and wage decline and balanced public budgets. Beyond that, adjustment was soon to be understood as an inevitable downward retrenchment of living standards. Levels of economic status were portrayed as excessive not only in comparison to those of the trading partners, but also considering the limited resources of Switzerland. Thus, the “puritanical strand” of the gold-standard mentality, alluded to above, was also present in the Swiss debates. While the opposition questioned the adjustment strategy, the adherence to the gold standard was not challenged at this stage. Quite to the contrary, the consensus on currency policies eliminated this issue from political debates.

The critique of the opposition was aimed at rejecting the government’s views by presenting counter arguments. A concise alternative policy path was spelled out in May 1934, after the government had implemented measures to balance the budget in the fall of 1933.¹⁹ These were passed under emergency procedures in the “first fiscal program.” Emergency procedures most importantly withheld legislature from popular ballot. Parliament, and not the electorate, had the final word, thus limiting the influence of the opposition in the parliamentary process. Under normal procedures, the opposition had more power to insist on an integration of their views by threatening to call a referendum on proposals they challenged. Emergency procedures were applied to budget decisions during the entire period up to 1938 and to a wide range of other legislation in the years of economic crisis.

The political debate was reflected in an academic controversy about adequate crisis policies, as will be shown in the analysis in chapter 4. Both sides of the argument drew on contemporary

¹⁹ These consisted of tax increases and spending cuts including the reduction in wages and salaries previously rejected in the referendum.

business cycle explanations. Overinvestment theories, widely held in Europe at the time, were used to support the government's approach. Underconsumption or purchasing power arguments were presented to criticize the government. They drew on a long tradition in the labor movement and also played significant roles in German and British policy debates. Apart from analyzing the contributions of the Swiss authors in their own right, they are discussed in the context of the debates in the German-language economics profession.²⁰ Although German-speaking economists achieved important advances, especially methodological insights, they were barely absorbed by the larger parts of the profession at this stage. No such advances originated in Switzerland, but the Swiss academics were neither untypical when compared with the majority of their German and Austrian colleagues, as an analysis of the debates at the annual meetings of the respective professional organizations will show. In these discussions majority perceptions were articulated, which tend to be outside the interest of historians of economic ideas who concentrate their attention on the vanguard of the profession.

Chapter 5 takes up the plot developed in chapter 3 and returns to the analysis of political debates. Given emergency legislation, the opposition resorted to presenting their economic policy alternative of expansionary measures and government intervention in a people's initiative in the spring of 1934. The issues raised by this proposal dominated the second phase in the economic policy debates. The measures suggested to replace the government's adjustment strategy included government interventions to control further price level decline and credit-financed public spending on employment programs and in support of export and tourism industries. The proposal also envisioned the regulation of capital markets with the goal of preventing capital exports. Interventions in capital and financial markets were furthermore proposed as means to control the business cycle through macroeconomic planning. Unsurprisingly, this provoked fierce resistance by the banking and insurance industry.

The campaign over the crisis initiative was bitter. The Federal Council rejected any debate about the suggested measures and underlined this position by refusing to present a counter-proposal

²⁰Furthermore, the pre-Keynesian business cycle theories, which provided arguments in the Swiss policy debates, are discussed as a complex hybrid of classical and Keynesian macroeconomics.

which would have conciliated the conflict. The critics argued that the initiative would prepare the path to socialism. More immediately, it would lead straight to devaluation. This claim was rejected by the proponents of the initiative. They considered the suggested measures as a last attempt to salvage the gold standard in Switzerland. Only by overcoming the deflationary pressure, so the argument, could the economy be revived and restored to the strength that would justify the current exchange rate. Thus, both sides to the debate justified their positions in an unwavering support for Switzerland's adherence to the gold standard. This is remarkable as by the time the vote over the initiative took place in May 1935, the gold bloc had shrunk to three members: France, the Netherlands and Switzerland. While the recovery of the world economy had begun in 1933, these gold-bloc countries experienced worsening economic conditions.

Chapter 6 follows upon several lines of explanation for this intellectual commitment to gold. The successful return to the pre-war parity after World War I was seen as having provided the basis for growth and recovery. It had confirmed the perception that Switzerland, as a small open economy, depended on trade and thus on constant international price relations and that the large financial sector relied on the trustworthiness of a country that honored its obligations. On the background of the expectation, maintained throughout the Great Depression, that the world would return to gold once the crisis was overcome, Switzerland's adherence to the parity would reinforce the prestige of a dependable guardian of international financial wealth.

The significance of the almost effortless return to gold after World War I goes, however, beyond shaping beliefs. More importantly, monetary policy in Switzerland had avoided becoming politicized in the interwar period. In contrast, the Bank of England had become the target of popular critique. Interest rate increases in defense of the gold parity were attacked as being adverse to the provision of jobs (Balderston 2003, 5). The large capital inflows in the early phase of the recession in Switzerland increased the Swiss National Bank's gold reserves substantially, so that interest rate increases to counteract speculative attacks in the years 1933 and 1934 were not needed. The discount rate was only raised in connection with the speculations surrounding the devaluation of the Belgian franc in early 1935. This, however, did not turn into a political issue. The only interest rate that was a persistent topic in political debates was the mortgage rate. Complaints about excessive mortgage rates go back to the mid 1920s, reflecting the importance of this type of debt for the ailing agricultural sector. The conditions in the mortgage market were

not seen as an immediate result of monetary policy though. The farmers' resentment targeted commercial banks. The Federal Council and the Swiss National Bank repeatedly tried to coax the banks into concessions for indebted farmers, which eventually led to a Gentlemen's agreement on mortgage conditions in November 1935.

In the context of an analysis of the roots of the strong intellectual commitment to gold chapter 6 also discusses the role of the free-money advocates (Freiwirtschaftsbund). It is argued that their activities contributed to the creation of a taboo around monetary institutions as a topic of political debate in Switzerland. The activities of this party of monetary cranks cover the entire interwar period, where their relative success in receiving recognition was limited to the periods of crisis. Their demand for price-level oriented monetary policies received attention from academic economists who set out to refute the arguments of the free-money advocates. The effects of these debates on the attitudes of Swiss academics on advances in monetary economics, as in the contributions of Fisher and Keynes mentioned above, is analyzed.

Returning to the political debate, chapter 7 shows that after the rejection of the crisis initiative in May 1935 and the parliamentary elections in the fall of 1935, the unanimous support for the gold standard began to break up. This characterizes the third phase in the policy debates in Switzerland. Some of the initiators of the defeated crisis initiative turned into advocates of devaluation. The arguments brought forth resemble those made in connection with the initiative. The devaluation was first and foremost seen as a means to overcome deflation and not so much in light of the impulse it would provide to the export sector. Neither was it expected to be a substitute for expansionary fiscal policies. Expansionary programs would still be necessary but less difficult to finance after a devaluation would bring about more liquid capital markets.

The voices openly demanding devaluation remained few. However, in contrast to the previous years, an open debate about the monetary regime now took place. Currency policies became an issue of public interest. Most of the contributions to this argument can be characterized as attempts at mutual affirmation of the adequacy and desirability of the gold standard. Such a debate nevertheless indicates mounting concern and might be interpreted as a sign of increasing uncertainty and doubts about the adequacy of the currency regime. Among Swiss academic economists the defense of the gold standard prevailed. However, some authors in this period

provided analyses that shed new light on the ingrained perceptions concerning the functioning of the gold standard and the effects of a devaluation. Although professors Eugen Böhler (Zurich) and Paul Keller (St. Gallen) strictly rejected a reduction of the gold parity, their analysis of the effects of devaluation called into question the widespread fears of ensuing high inflation.

The government and the social democratic opposition confirmed the support for the gold parity. The leaders of the Social Democratic Party based their position on experts presenting opposing views in March 1936. The Federal Council documented the adherence to gold on every possible occasion. At the same time, it sought ways out of the stalemate that paralyzed politics. The recent years had not seen any progress in the realization of the adjustment strategy. Price and wage declines, which were still believed to be the precondition for a recovery, had grinded to a halt. The goal of balanced budgets proved unattainable due to falling revenues and increasing expenditures. The government's request for extraordinary powers to implement economic policy measures can be interpreted as an attempt to overcome the deadlock. Not surprisingly, parliament denied a delegation of powers for unspecified purposes in an area where opinions diverged to such an extent in the spring of 1936. The National Council's debate about a modified request for delegated powers took place on September 23, 1936, four days before the government's devaluation decision. It gives insight into the political atmosphere on the eve of this event. Many of the arguments brought forward were simple repetitions of what had been said more than four years earlier and several speakers expressed the need to overcome the political impasse. Under these circumstances, the devaluation offered a way out.

Chapter 8 argues that the French devaluation presented an opportunity to take this step. However, the Federal Council struggled over the decision. It was finally taken by a majority vote overruling the recommendation of the head of the Department of Finance and president of the Federal Council, Albert Meyer, and the unanimous proposition of the directorate of the Swiss National Bank. This part of the Swiss story again deviates from the stylized account presented by Eichengreen and Temin (2000) as summarized above (p. 9). In contrast to the examples they analyze, Switzerland did not see a replacement of government which precipitated the change in economic policies. Two Councillors resigned during the depression, partly in reaction to public pressure. They were, however, replaced by men with similarly orthodox views and almost identical political connections. Despite widespread critique of the government's policies, the parliamentary

elections in 1935 did not lead to a redistribution of power between political parties. Most members of the government that implemented the devaluation had served in their functions for years and were to continue to do so. The devaluation was neither brought about by a replacement of heads nor by a revision of ideas. The gold-standard mentality in Switzerland survived this event.

This is confirmed in the communication of the devaluation decision to parliament. The reduction of the gold parity was presented as Switzerland's contribution to an international restabilization. This, in turn, was interpreted as the restoration of a "sane" international monetary order based on stable exchange rates. Such an interpretation stretched the limits of prudence: the Tripartite Agreement which accompanied the French devaluation entailed little more than a promise by Great Britain and the United States to refrain from retaliatory measures.

Further indications for the survival of the gold-standard mentality are provided by economic policies after the devaluation. The loosening of monetary policies resulted from the reversal of capital flows. Monetary policy in line with gold-standard prescriptions led under these conditions to a relaxation of money and capital markets. Active expansionary fiscal policies were not pursued. Quite to the contrary, balancing the budget remained the central goal in the years immediately following the devaluation. The large-scale, partly credit-financed public works and armament program passed in 1938 falls into a conceptually distinct era. It is not an indication of a policy change either, much less of a change in beliefs. This spending program was seen as part of the reaction to a state of emergency brought about by the German threat of war. Such emergencies could be accommodated well within the gold-standard mentality. As Bordo and Kydland (1995) show, the 19th century gold standard was understood as a contingent rule which allowed for deviations under well-defined conditions, in particular in times of war, without giving up the original commitment. In this sense, devaluation in Switzerland was a "non-event" as Tanner (2000, 46) has pointed out.

2. Macroeconomic developments

The world-wide slump first reached Switzerland through a reduced demand for her exports. Export values had peaked in 1928 and declined rapidly thereafter. However, these effects were overruled by strong domestic demand in the early years of the downturn. In international comparison, losses in output and employment were mild in every single year but severe due to the duration of the depression. When the world economy started recovering in the course of 1933, Switzerland did not participate in the revival. The decline in industries producing for domestic markets gained momentum in this period. The development of price indices followed a similar pattern. Prices declined rapidly in the first years of the downturn and remained constant at low levels until after the devaluation in 1936. While the onset of the recession in Switzerland was export-led, the collapse of domestic industries characterized the second phase of the depression. The paralysis of the Swiss economy was only overcome with the devaluation in September 1936, even though exports had picked up somewhat in the preceding months. The recovery was slow but steady.

This short stylized history of the depression in Switzerland reflects a consensus among Swiss economic historians and echoes contemporaries' perceptions.¹ The unavailability of macroeconomic statistics on the Swiss economy is notorious and has limited research.² However, the compilation of data and estimates in *Historische Statistik der Schweiz* (Ritzmann et al. 1996) has made the existing readily accessible. Most of the material presented here comes from this source.³ The following aims at presenting evidence for and at elaborating aspects of the

¹Kneschaurek (1952) shaped that perception. It is also reflected in Rutz (1970), Weber (1983), Siegenthaler (1987), Bergier (1990), David (1995), Ritzmann-Blickensdorfer (1998), Faber (1997), Tanner (2000), and Müller (2001) to name but a few.

²David (1995, 111-114) discusses the "misère" of Swiss statistics and some reasons for it with respect to the industrial sector. He specifically points out the lack of studies concerning the development of labor and capital productivity, of investment and capital formation. In the context of the interwar developments, the nonexistence of balance of payments data beyond trade statistics is particularly limiting.

³For GDP estimates I draw on Maddison (1995). In part this was suggested by the international comparisons presented in chapter 1. The only figures available from the Swiss statistical office are data for net national income covering the years 1929 to 1938 (Ritzmann et

macroeconomic history outlined in the preceding paragraph.⁴ Particular attention is paid to the development of trade patterns after the onset of the crisis and on the downturn in domestic production in the later phases of the crisis which was accompanied by monetary tightening.

Thus the following account focuses on those parts of the Swiss story which do not conform to the stylized Eichengreen and Temin explanation of the Great Depression presented in chapter 1. The onset of the depression in Switzerland can be described as a Keynesian aggregate demand shock originating in the decline of exports. The government's efforts to maintain exports with countries which had introduced exchange controls, most importantly with Germany, make sense on the background of the loss in competitiveness in the world markets due to the overvaluation of the Swiss franc. The bilateral arrangements allowed for implicit partial devaluation without abandoning gold. It is argued that the government's strategy, though initially successful in preserving export volumes, soon led to high costs for the Swiss economy by severely distorting trade patterns.

The development of monetary conditions in the course of the recession is another part of the Swiss macroeconomic history which is not in agreement with the Eichengreen and Temin hypothesis. The decline in consumer prices in the years 1929 to 1933 was brought about by the collapse in world market prices. Due to large capital inflows in the early years of the world slump

al. 1996, table Q.4a, p. 871). A comparison does not suggest inconsistencies with Maddison's estimates for this period.

⁴For a comprehensive investigation see Kneschaurek (1952), who approaches the issue from a Keynesian perspective by analyzing components of aggregate demand. He has close to nothing to say about monetary conditions. Rutz (1970) provides a detailed analysis of public policy measures and some discussion of the events in currency, capital and money markets. Weber (1983) is a complement to Kneschaurek by analyzing the depression from a monetarist perspective. This Ph.D. thesis remained unpublished and was completely ignored in Switzerland although the Swiss National Bank's library owns a copy. Weber provides an analysis of changes in money supply and demand during the depression years. Although he draws different conclusions, much of Faber's analysis (1997) is anticipated. Aspects crucial to the explanation of Switzerland's macroeconomic development have been analyzed in a number of articles and chapters in books in recent years (e.g. the volume edited by Guex 1998, the articles in *Traverse* 1997, David 1995). Several volumes of the so-called "Bergier Report" (Veröffentlichungen der Unabhängigen Expertenkommission Schweiz - Zweiter Weltkrieg) cover the 1930s (Frech 2001, Meier et al. 2001, Perrenoud et al. 2002).

domestic monetary conditions were loose into the year 1932. It is argued here that the monetary tightening in the following years was neither the result of policy mistakes nor the necessary consequence of the adherence to gold. More precisely, a major banking crisis was averted despite the fact that many banks' balance sheets were burdened by non-performing loans. Apparently golden fetters did not keep the Swiss government from acting expeditiously in this context. Furthermore, it is demonstrated that monetary tightening was only in part due to a declining monetary base. Most importantly, it was provoked by a large shift in demand for liquidity from the public and by the banking sector's increased demand for reserves. As a result, the money multiplier declined markedly. A comparison of pre-crisis levels of the monetary base with those in the later phases of the Swiss depression shows that the monetary base was significantly larger during the crisis than before. This implies that reserve losses as a result of pressure on the exchange rate were not at the root of the monetary tightening as suggested by the Eichengreen and Temin argument. However, this does disprove the insight that the golden fetters were the single most important hindrance to recovery.

The depression of the 1930s in longer-term perspective

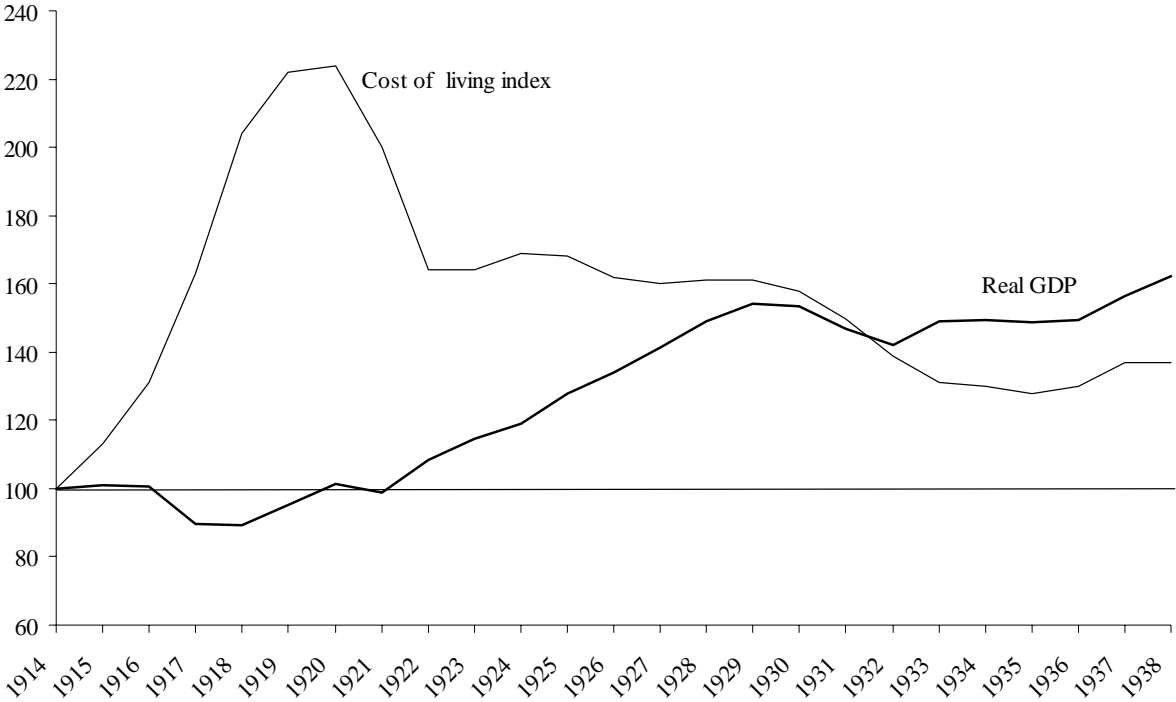
The economic downturn in the early 1930s ended a period of impressive growth with considerable price stability. Siegenthaler (1987, 497) estimates that real output per capita increased by 4 percent p.a. between 1924 and 1930. Industrial production grew at a rate of 6.7 percent p.a. between 1923 and 1929, far exceeding the long-term trend of industrial output growth of 3.2 percent for the period 1852-1912. For the entire interwar period, this outstanding performance was offset by the later downturn and stagnation. When taking into account the decline in industrial production at an annual rate of 1 percent between 1929 and 1937, industrial production grew at 2.2 percent p.a. between 1923 and 1937 (David 1995, 115-16).

Maddison's real GDP figures used in figure 2 conceal the severity of the after-war crisis. Industrial production dropped by 35 percent in 1921, a decline far steeper than for any single year after 1929 (David 1995, 118). Unemployment was especially pronounced in 1922 (see figure 12, below). The war-time inflation turned into rapid deflation, easing the return to the pre-war gold parity of the Swiss franc.⁵ However, a complete reversal of the price increases did not come about. As shown

⁵For details on the stabilization see pp. 156-158 below.

in figure 2, the cost of living index which had peaked at over 220 in 1920 (1914=100) settled around 165 between 1923 and 1929, declining towards the end of this period after. Together with the almost complete disappearance of unemployment after mid-1924 this led to increasing real wages during the phase of prosperity in the second half of the 1920s (Ritzmann et al. (1996), table G.8a, p. 456).

Figure 2: Index of real GDP and cost of living, 1914=100⁶



Hidden behind the impressive growth of the 1920s were deep structural changes. Outstanding is the relative decline in textiles industries and the rise in chemical, metal-processing and machinery industries (David 1995, 125-6). Furthermore, rationalization and concentration processes changed production patterns, a process which was particularly pronounced in the watch-making industries. The agricultural sector was continuously struggling in this period due to the decline in world market prices. The number of self-employed farmers fell by 10 percent during the 1920s (Siegenthaler 1987, 497). Agricultural decline went along with growing demands on the federal

⁶Sources: Real GDP: Maddison (1995), table C-16a, p. 180. Cost of living index: Ritzmann et al. (1996), table H.20, p. 503.

government to assist farmers. By the end of the 1920s an array of support schemes was in place that allowed agriculture to preserve its output during the depression years at the levels attained in 1929 (David and Straumann 2003, 5).

Strong outward orientation

The strength of Switzerland’s interwar growth traces back to the late 19th century. This pertains as much to foreign trade as to the establishment of Switzerland as an international financial center. The growth of the financial sector was based on the long tradition of foreign investment and on a strengthened banking industry in the decades before World War I and during the war.⁷ Switzerland’s history in foreign trade is remarkable. Exports per capita had exceeded those of most European nations all through the 19th century, surpassing even Great Britain (Table 1).

Table 1: Exports per capita 1840-1910 (current prices in US \$, three-year averages)⁸

	Switzerland	Belgium	Germany	France	Great Britain	Sweden
1840	18	7	4	4	10	4
1880	50	43	16	15	30	13
1910	60	85	27	29	48	28
1928	101	108	45	50	77	69
1938	72	86	31	21	48	74

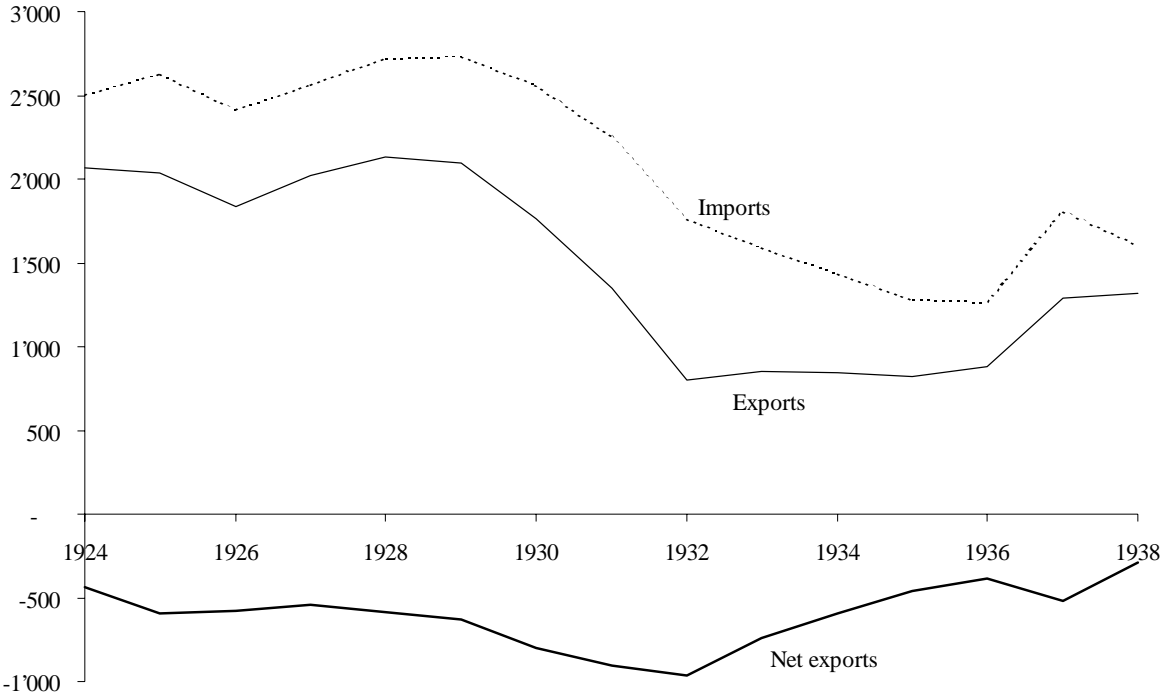
Figure 3 shows that exports declined in 1929 and collapsed in the following years. This development resulted from declining incomes in trading partners (see figure 1, above). Kneschaurek (1952, 123) argues that the bulk of the drop in 1930 and 1931 can be explained by this effect. The repercussions were multiplied by the decline in world market prices following the devaluation of the Pound Sterling in September 1931 which precipitated the collapse of the after-

⁷Siegenthaler (1987, 497) points out that investment by multinational firms reflects the structural changes discussed above. Whereas foreign direct investment before World War I had been dominated by the textiles industries, it concentrated on chemical, electrical and shoe-making production and the food sector in the interwar years.

⁸Source: Bairoch 1990, 106. Sweden’s development is noteworthy: whereas exports per capital fell for all other countries presented here between 1928 and 1938, Sweden managed to increase this figure.

war gold exchange standard. Before Great Britain’s abandoning of gold, a total of 47 countries adhered to the standard. By the end of 1932 only Belgium, France, Italy, the Netherlands, Poland, Switzerland and the United States remained on gold.⁹ Furthermore, trade restrictions were implemented by country after country, the introduction of the Smoot-Hawley Tariff Act in June 1930 marking the end of the interwar endeavors to return to a more liberal trade regime.

Figure 3: Exports, imports and trade balance (nominal, in million SFR) 1924-1938¹⁰



Switzerland’s strong domestic demand, together with the effects of the world crisis, led to increasing trade deficits after 1929. The administration reacted by requesting authorization of the Federal Council to introduce trade restrictions. Parliament passed legislation on December 23, 1931 which led to the introduction of a myriad of constraining measures, mostly in the form of quantitative restrictions. Increasing tariff loads resulted from quantity-based duties at declining

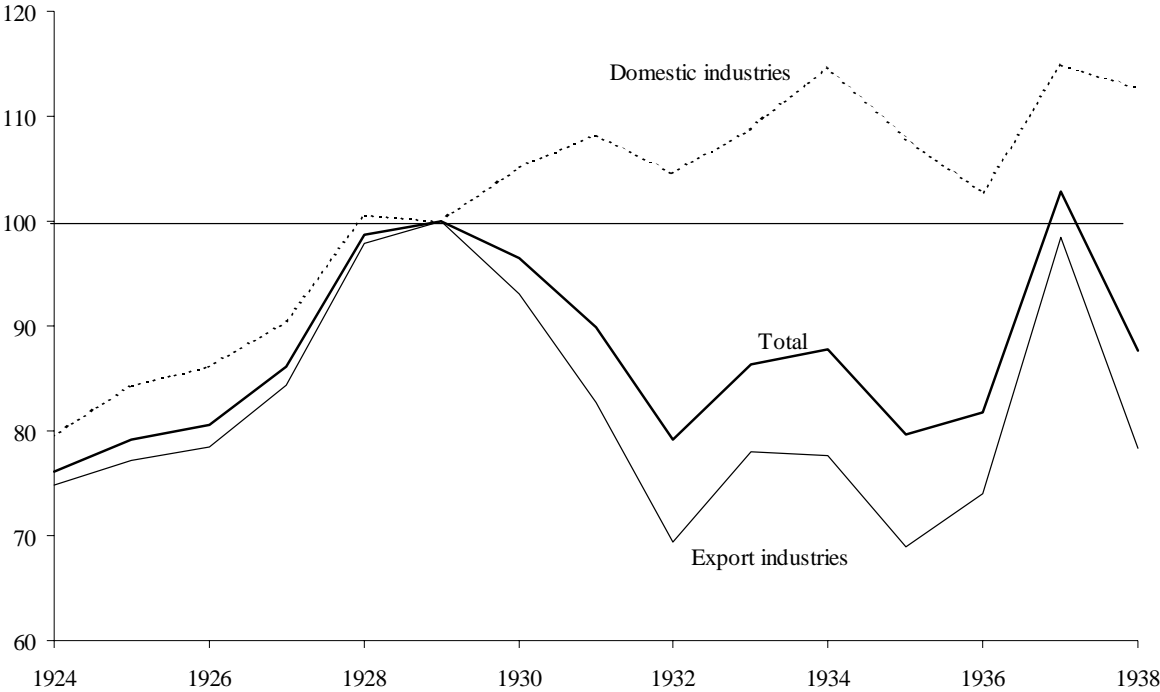
⁹However, Italy had introduced controls on capital account transactions in 1926 and tightened exchange regulations in 1931 (Frech 2001, 68). Smaller countries on gold were Albania, Danzig, the Dutch East Indies, and Lithuania (Eichengreen 1992a, 299).

¹⁰Source: *Statistisches Jahrbuch der Schweiz* (1942).

prices. To constrain the price effects of import restrictions, the Federal Department of Economic Affairs established a price control commission in 1932. Whereas these measures protected domestic production, the sector most affected by the depression - export production - did not receive immediate relief. Only when unemployment began to increase (see figure 12, below) and a timely reversal of the downward trend could no longer be expected, were measures taken.

As figure 4 shows, the performance of overall industrial production was dominated by the export industries. Unemployment was similarly dependent on the development of export production. Overall industrial employment covered 43 percent of the working population in 1930.¹¹ An estimated 30 percent of the industrial work force produced for export in 1929 (Rutz 1970, 54). The export-orientation was particularly pronounced in watch-making (67'000 workers) with 98 percent of output leaving the country and in the machinery industries (65'000 workers) where exports amounted to 70 percent of total sales. Parts of the textile industry were similarly dependent on foreign demand.

Figure 4: Index of the volume of industrial production (1929=100)¹²



¹¹23 percent of the entire working population of 2'035'000 were employed in agriculture and 35 percent in the service sector (Siegenthaler 1987, 494).

¹²Source: Ritzmann et al. (1996), table K.14, p. 629.

Measures in support of the export producers were introduced in March 1932. Under the heading of “productive unemployment relief” (Produktive Arbeitslosenfürsorge) subsidies were granted to exporters who faced losing orders because of elevated production costs as compared to their foreign competitors (Rutz 1970, 191-2). The subsidy was justified as a means to avoid unemployment. Consequently, the amounts granted were supposed to be based on the expenditures saved on assistance to those otherwise unemployed. In fact, subsidies amounted to around 20 percent of export values, thus more or less covering the differences between Swiss and world market prices. Initially, conditions for application were so restrictive that in the first 15 months of the existence of the subsidy only SFR 1.5 million of the provided SFR 2.5 million were called on. After requirements were relieved in June 1934 the use of the subsidy increased. Additional funds were made available in September 1935 and April 1936.¹³ However, overall federal expenditure in support of the export industries remained low. The sum of export subsidies granted from 1932 to 1936 amounted to SFR 21.8 million as compared to support payments to agriculture of SFR 338.5 million in the same time period (Kneschaurek 1952, 182).¹⁴

The introduction of an export risk insurance (Exportrisikogarantie) in March 1934 turned into an effective and cheap means to assist the export industries. This measure resulted from requests of the metal-processing and machinery industries. Increased uncertainty concerning delayed payments were considered a major deterrent to exports. The federal administration committed to payments in cases of exchange rate losses, transfer restrictions or moratoriums, and insolvency of public clients. Exporters did not pay insurance premia. Instead, potential payments were covered by the federal budget. From its introduction in 1934 to the end of 1938 actual payments amounted to all but SFR 39'433.- (Rutz 1970, 193-4).

¹³Of the subsidies granted 83 percent went to firms in the metal-processing and machinery industries and 15 percent to textiles producers (Rutz 1970, 192).

¹⁴Export subsidies thus amounted to 0.5 percent of total exports in this period. As a share of net social product export subsidies came to 0.06 percent and agricultural subsidies to 0.9 percent, again for the entire period (calculations based on the figures in Ritzmann et al. 1996, table Q.4a, p. 871).

Bilateral trading arrangements

The opportunities of Swiss export industries were significantly impeded by exchange controls. In July 1931, Germany, Switzerland's most important trading partner, introduced exchange controls following the banking and currency crisis of the earlier months. As a result, overall German imports declined from Reichsmark 13.4 billion in 1930 to Reichsmark 4.7 billion in 1932 (Frech 2001, 48). The traditional deficit in trade with Germany tripled between 1927 and 1931 as a result of diverging macroeconomic performance (see table 2 below). Beyond the effects on trade, the decline in tourism was also significant for Switzerland's economy and balance of payments as German guests accounted for 25 percent of hotel bookings before the crisis (Frech 2001, 48). Furthermore, exchange controls impinged on the interests of Swiss investors who were Germany's third largest private creditor group, following the United States and Great Britain. Their situation was aggravated by Germany's declaration of a transfer moratorium in June 1933. Whereas Swiss exporters and tourism representatives expected an improvement in business relations with Germany from government intervention, the large banks rejected this approach well into the 1930s.¹⁵ These conflicts pervaded the political reactions to Germany's measures and averted the introduction of unilateral clearing by Switzerland, which was frequently demanded by domestic groups to preserve the interests of exporters and small investors. The fact that Germany, like the other clearing countries, was a net exporter to Switzerland gave Switzerland a strong position in negotiations over payments provisions. Eventually, Germany suggested clearing arrangements to ban the threat of unilateral measures. Treaties were signed on July 26, 1934.

Table 2: Trade in goods with Germany (in million SFR) 1927-1938¹⁶

	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
imports	542	624	698	709	660	500	461	389	338	314	403	373
exports	398	387	355	283	198	111	139	183	170	171	200	206
trade balance	-144	-237	-343	-427	-462	-388	-322	-206	-169	-143	-203	-167

¹⁵Furthermore, the interests of small individual creditors conflicted with those of the large banks, which resisted the inclusion of capital and earnings transfers in public arrangements to protect the anonymity of creditors and debtors (Frech 2001, 60-64).

¹⁶Source: Ritzmann et al. (1996), tables L.18, p. 698 (imports) and L.22, p. 706 (exports).

Most central and eastern European countries followed Germany in implementing exchange restrictions. To preserve export and import channels, Switzerland entered into bilateral agreements with these countries. The first clearing arrangement was negotiated with Austria in 1931 and with Hungary in the same year, a host of similar treaties followed.¹⁷ In quantitative terms, clearing only gained significance once trade with Germany was covered by this regime.¹⁸ Italy entered into bilateral arrangements in December 1935, adding to the growing share of regulated commerce. Between 1931 and 1933 transactions bound by bilateral contracts amounted to around 5 percent of overall Swiss trade. This share rose to almost 40 percent of exports and over 30 percent of imports in 1936. With the devaluation, both figures declined slightly.¹⁹

The clearing arrangement negotiated with Germany differed from other treaties Switzerland had signed. It covered trade in goods and services and the transfer of parts of capital income, whereas most other agreements were limited to trade in goods. As the administration of the German clearing required additional resources, a special department (Schweizerische Verrechnungsstelle) was set up in 1934 within the Swiss National Bank which had also administered the earlier arrangements. Hopes for substantial export increases under clearing did not materialize. Exports increased in 1934 and remained constant until the outbreak of the war when Germany's imports from Switzerland started growing substantially.²⁰ This result was mostly due to Germany's increasing import restrictions after 1934 as part of the efforts to channel trade so as to satisfy food provision and armament goals. Moreover, imports from Germany declined due to increasingly unattractive price relations, an effect which was compounded by the devaluation in 1936.

¹⁷For an overview of durations and partners in bilateral commercial treaties see Hug and Kloter 1999, 56.

¹⁸For a detailed account of clearing arrangements and their development in the 1930s see Frech 2001, 28-98. The following paragraphs draw on this source.

¹⁹During World War II the number of clearing contracts increased significantly. By 1945 almost three quarters of Switzerland's trade went through government-regulated channels (Frech 2001, 29).

²⁰The figures for 1937 and 1938 include price effects of the devaluation which was also applied to the clearing arrangements.

These developments led to limited funds to satisfy the claims from industrial and agricultural exporters, the tourism industry, and creditors. Fierce battles between the representatives of these groups and continuous lobbying with the federal administration accompanied the rounds of renegotiations with Germany. The Federal Council adhered to its original motivation for clearing arrangements as a means of employment policies through export promotion. “Work above capital” (Arbeit vor Kapital) was proposed as the guideline for arrangements favoring the interests of the “workplace” over those of the “financial center.”²¹

The difficulties which developed under the German clearing arrangement were typical for all of Switzerland’s regulated trade. The countries involved were previous net exporters to Switzerland, so that funds initially were abundant to balance Swiss exports. Thus export volumes could be preserved in the early years, as the overvaluation of clearing countries’ currencies matched the Swiss franc’s overvaluation. However, it turned increasingly difficult to sustain the volumes of Swiss imports with increasing differences between clearing countries’ product prices and world market prices. In light of declining clearing funds the Federal Council tightened conditions for the qualification of clearing exports in June 1935. Endeavors to direct imports to clearing countries met with the resistance of Swiss importers who complained about being forced into accepting excessive prices and low quality.

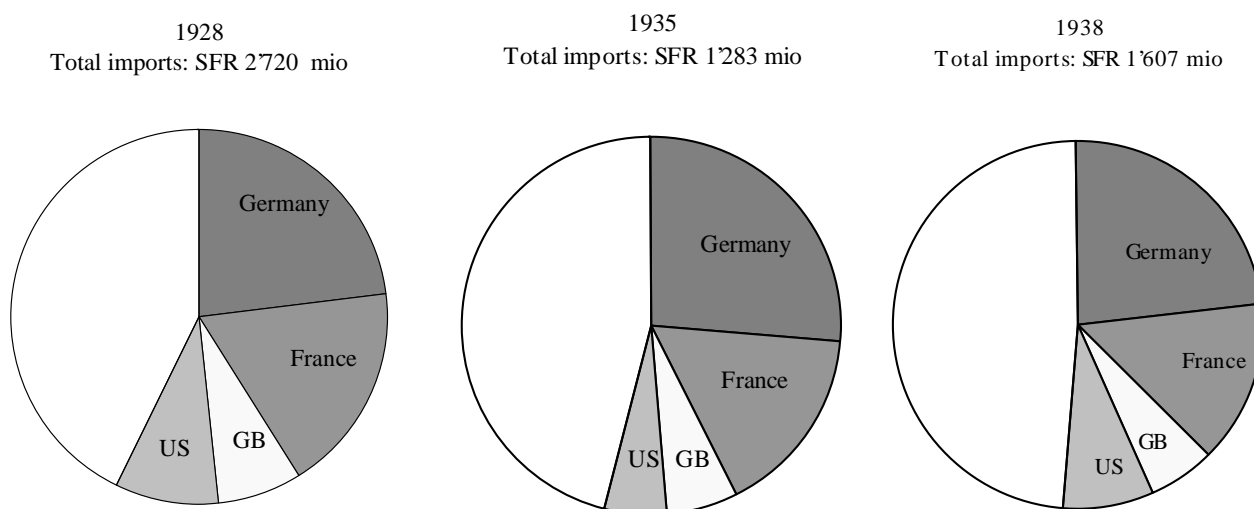
Changes in trade patterns during the depression

Trade with clearing partners as a share of total trade increased in the years up to the devaluation of the Swiss franc unambiguously, a trend which was only temporarily reversed in 1936. The extent of the distortion of trade patterns due to regulated trade under clearing is contended (Frech 2001, 91). Whereas Hug and Kloter (1999, 64-6) argue that biases were significant, Meier et al. (2001, 48-49) claim that overall geographical distortion of trade patterns were limited although they concede significant distortions at the level of individual goods (wheat, corn, raw materials). Figure 5 suggests that export promotion through import regulation significantly biased imports. Noteworthy is the decline in the shares of imports from Great Britain and the United States between 1928 and 1935, despite the competitive advantages gained through the devaluation of

²¹Frech (2001, 76) shows that this situation only changed after 1941.

their currencies.²² France similarly lost out to Germany and other countries, a trend that continued after the devaluation of the Swiss and French currencies. The increase in relative importance of imports from the United States and Great Britain after 1936 can be ascribed to absolute growth in Swiss imports.

Figure 5: Main countries of origin of Swiss imports 1928, 1935 and 1938²³

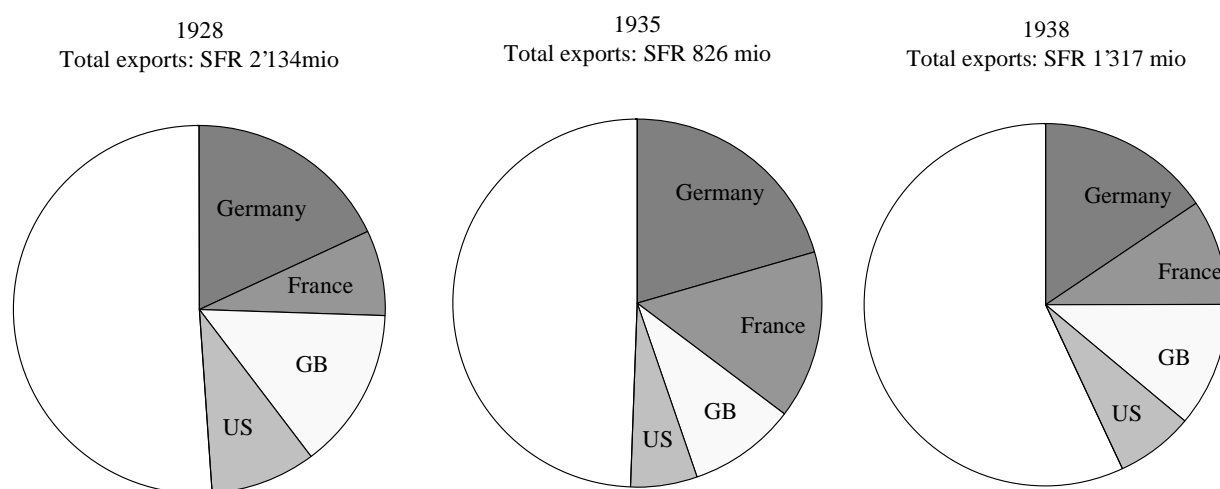


The development of export shares in the course of the 1930s conforms to predictions based on the changes in currency regimes (see figure 6). Exports to the United States and Great Britain declined due to the overvaluation of the Swiss franc up to 1936, after which they started recovering. France gained considerable relative importance as export destination between 1928 and 1935. Germany's increasing import restrictions and the limits given by declining Swiss demand for German goods did not allow the preservation of its share in total Swiss exports after 1936.

²²Currency policies in Switzerland's main trading partners:
 Germany: July 15, 1931: introduction of exchange controls
 Great Britain: September 21, 1931: abandoning of the gold standard led to devaluation of Pound Sterling by 30 percent by the end of the year
 United States: April 19, 1933: abandoning of gold, restabilization at a 41 percent devaluation on January 31, 1934
 France: September 25, 1936: devaluation by 30 percent.

²³Source: Ritzmann et al. (1996), tables L.18-L.21 and L.26, pp. 698-705, 714.

Figure 6: Main export destinations 1928, 1935 and 1938²⁴

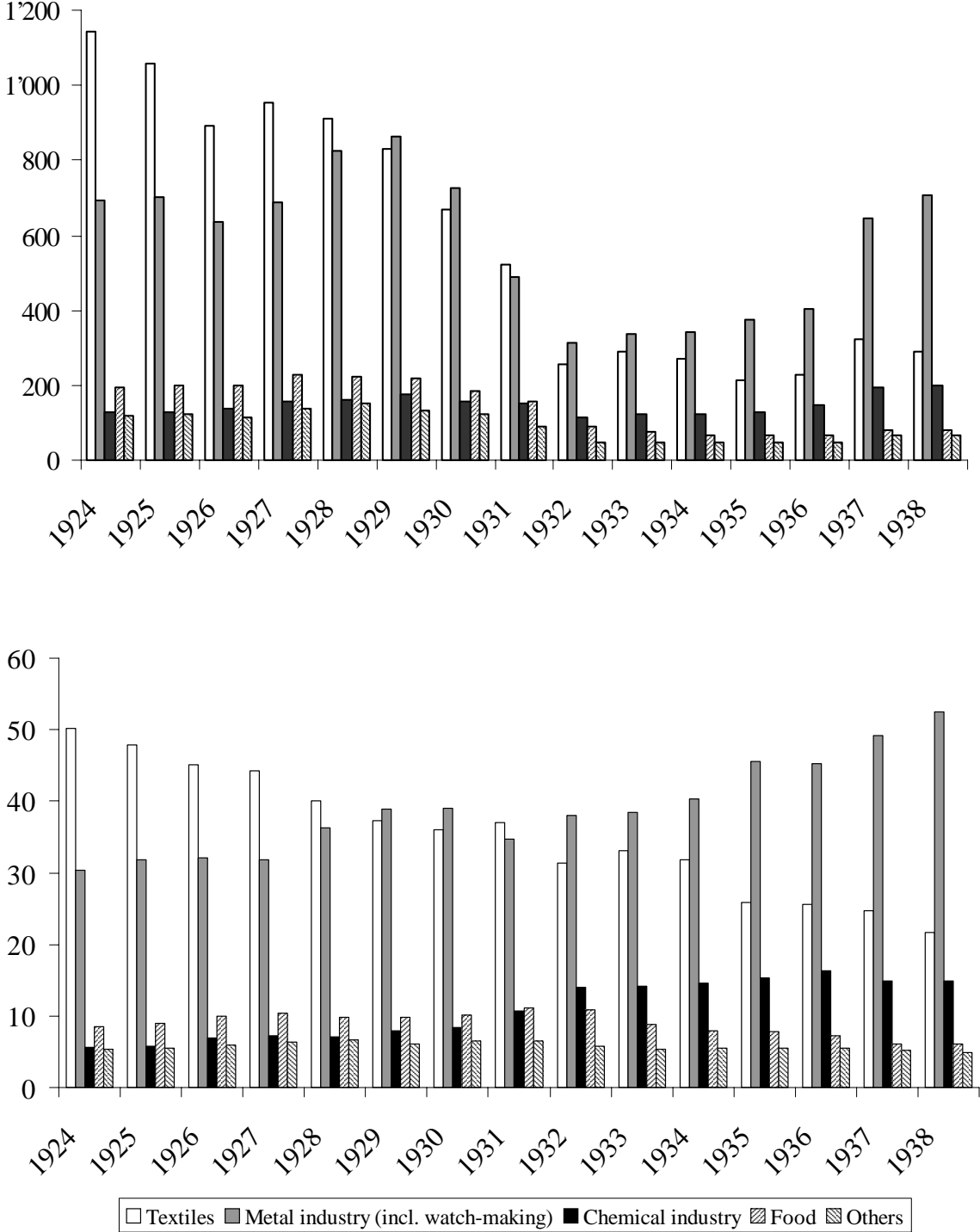


The composition of Swiss exports

The changes in the composition of overall exports can be used to show the structural changes of the post-World War I-era discussed above. Figure 7 shows that the world slump had distinct effects in different sectors. In the textiles industries the depression was superimposed on structural decline. The share of textiles in total exports, which amounted to almost 50 percent in the mid-1920s, declined to little more than 20 percent by 1938. Its place was taken by exports from the machinery and metal-processing industries which came to dominate Swiss exports in this period. The breakdown in exports between 1930 and 1932 translated into a severe crisis in both these sectors. The decline in food exports was less dramatic but resulted in a reduction of its weight in overall exports. The emergence of chemicals as a significant source of export revenues stands out. As this sector suffered less from the downturn than textiles and metal-processing its share in total exports increased during the depression.

²⁴Source: Ritzmann et al. (1996), tables L.22-L.26, pp. 706-14.

Figure 7: Exports by sector 1924-1938 in million SFR and percent of total exports²⁵



²⁵Source: Ritzmann et al. (1996), table L.11b, pp. 683-7. Textiles include confectionary, others comprises leather and leather products, paper, wood and wood products, minerals. Values are nominal.

“Invisibles”

Tourism experienced strong growth in the later decades of the 19th century. Bairoch (1990, 125) estimates that it contributed as much as 5 to 6 percent to gross national product at its peak before the outbreak of World War I, a share which had recovered to 4 to 5 percent by 1927-29 only to decline again to 1 percent by 1936-38. In terms of the contribution to the current account, Bairoch estimates that net receipts from international tourism amounted to a share of export revenues of 23 percent in 1911-13, of 24 percent in 1926-28 and 13 percent in 1936-38. The last figure, however, already reflects the revival after the depreciation, so that the years of deep depression in the tourism industry during the crisis are not covered by these figures. Considering the importance of German guests, the exchange controls after 1931 exacerbated the effects of declined incomes and of the overvaluation of the Swiss franc as compared to the currencies of alternative vacation destinations. For Swiss travelers, foreign destinations similarly became more attractive due to the strong value of their currency thus further aggravating the situation for domestic destinations.

Meier et al. (2001, 54-55) discuss the increasing importance of the insurance business in the interwar years. Although they estimate the foreign share in the volume of premia at about 60 percent, they conclude that, after considering payments on damages, the overall contribution to the current account was still low at SFR 40-50 million at the end of the 1930s. In light of the decline in the tourism surplus, this might still imply a significant gain in relative importance.

Invisibles incomes were, however, dominated by capital income. Perrenoud et al. (2002, 44) estimate pre-crisis net capital revenues at SFR 200 to 240 million per year.²⁶ Capital export had already played an important role in the 19th century, but Switzerland's international financial activities started growing strongly at the turn to the 20th century. Before World War I, Swiss

²⁶Their calculations are based on estimates of foreign assets and on average interest rates on foreign loans. The invisibles part of the current account is little documented. Kellenberger's (1939-1942) estimates of balance of payments figures are considered to provide little more than a benchmark. Baumann and Halbeisen (1999, appendix) present estimates by the Swiss National Bank for the period 1927-1932. They analyze the struggle over the establishment of balance of payments statistics in the interwar period. Whereas the Swiss National Bank considered the information crucial for monetary policy decisions, commercial banks resisted attempts to collect the respective data (Baumann and Halbeisen 1999, esp. 10, 16-18). Official balance of payments statistics are only available since 1985 (Baumann and Halbeisen 1999, 18 fn. 51).

foreign direct investment per capita exceeded that of countries like Great Britain or the Netherlands. Direct investment dominated portfolio investment, underlining the important role Swiss multinational firms played in capital exports. Germany, France, Italy, and Great Britain were the most important European destinations, with Germany leading by far. Foreign direct investment in the United States exceeded that in any single European country and grew substantially in the interwar years (Meier et al. 2001, 56-7).

Table 3: Net capital exports (in million SFR) 1924-1938 ²⁷

1924	1925	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
-165	-249	-278	-479	-489	-447	-186	1916	489	-77	-290	-690	744	-143	449

After World War I, Switzerland extended its role as international financial center.²⁸ Low domestic interest rates and attractive investment conditions in the former belligerents led to net capital outflows after 1924 (see table 3). As pointed out above, capital income consequently contributed markedly to offsetting the traditional deficit in goods trade. But Switzerland also attracted foreign capital most importantly from Germany and France so that international financial intermediation expanded.²⁹ Switzerland's role as international creditor which had substantially grown during World War I was strengthened.

The financial and currency crises in 1931 overthrew this balance. Especially the German moratorium and the ensuing exchange regulations had strong repercussions on Switzerland's banking industry.³⁰ A severe banking crisis was however averted due to expeditious government intervention and the cooperation of the commercial banks under the guidance of the Swiss National Bank (Halbeisen 1998, 76). On several occasions the Federal Government directly

²⁷Data compiled by Baumann and Halbeisen (1999, appendix) from Kellenberger (1939-1942).

²⁸Müller (2001, 50) underlines the importance of the boost Switzerland's financial sector received during World War I when belligerents relied heavily on Swiss credit. Perrenoud et al. (2002, 44) discuss reasons for the strong growth of the sector after World War I.

²⁹Perrenoud et al. (2002, 46-7) discuss the evolution of financial intermediation in the interwar years.

³⁰For a detailed discussion of the accomplishment of transfer agreements with Germany and the changes they underwent see Perrenoud et al. (2002, esp. 42-4 and 154-73).

supplied funds to ailing banks (Rutz 1979, 112-116). In July 1931, a federal loan was granted to a large Geneva bank (Comptoir d'Escompte de Genève) which had become illiquid as a result of the Austrian and German crises.³¹ A large volume of foreign frozen assets also led to the illiquidity of Schweizerische Volksbank, then second largest Swiss bank.³² The bank's reorganization and consolidation in 1933 was supported by massive direct federal aid. Finally, the federal administration provided funds to rescue Neuenburger Kantonalbank from bankruptcy in a joint effort of canton and federation in September 1935.

An institutional solution to the problems of the banking sector, which, however, did not suffice for the more spectacular cases just mentioned, was sought in the establishment of a federal lending institute (Eidgenössische Darlehenskasse) on July 8, 1932. The capital (Garantiefonds) of the institute amounted to SFR 100 million of which the federal administration provided SFR 75 million. The federation furthermore assumed responsibility for the institute's liabilities exceeding this fund. The institute provided liquidity to banks by rediscounting material that was rejected under the strict requirements of the Swiss National Bank, especially by honoring bills drawn on foreign debtors.³³ The banking crisis furthermore gave the impulse to passing legislation on banking supervision, which strengthened the protection of creditors, confirmed banking secrecy and encouraged self-regulation of the banking sector.³⁴

³¹Despite further endeavors to save the bank by a merger and recapitalization, the institute was closed down in 1934. Halbeisen (1998, 68-74) discusses this case in a broader context of the banking crisis and its handling. Faber (1997, 7) mentions that several smaller local banks became illiquid in the summer and fall of 1931.

³²The figures presented by Perrenoud et al. (2002, 81) suggest that more than 15 percent of the bank's assets were covered by transfer restrictions. However, in comparison with the exposure of the other large banks this figure is by no means outstanding.

³³Halbeisen (1998, 68-9) discusses the limited scope of the Swiss National Bank to provide additional liquidity in response to crises.

³⁴Bundesgesetz über die Banken und Sparkassen vom 8.11.1934 and Vorschriften über die Kreditkassen mit Wartezeiten vom 8.11.1934. For details on the debates leading up to the legislation and the scope of the law see Perrenoud et al. (2002, 110-16). Halbeisen (1998, 75) underlines the "liberal" character of the law which minimized government intervention.

The international financial crisis did not only overthrow private balance sheets. The current account effects of declined capital incomes were overruled by the enormous capital inflows that set in with the uncertainty in international capital markets, turning the balance of payments strongly positive.³⁵ Gold reserves of the Swiss National Bank increased dramatically. Between May and September 1931 alone, inflows amounted to over SFR 800 million.

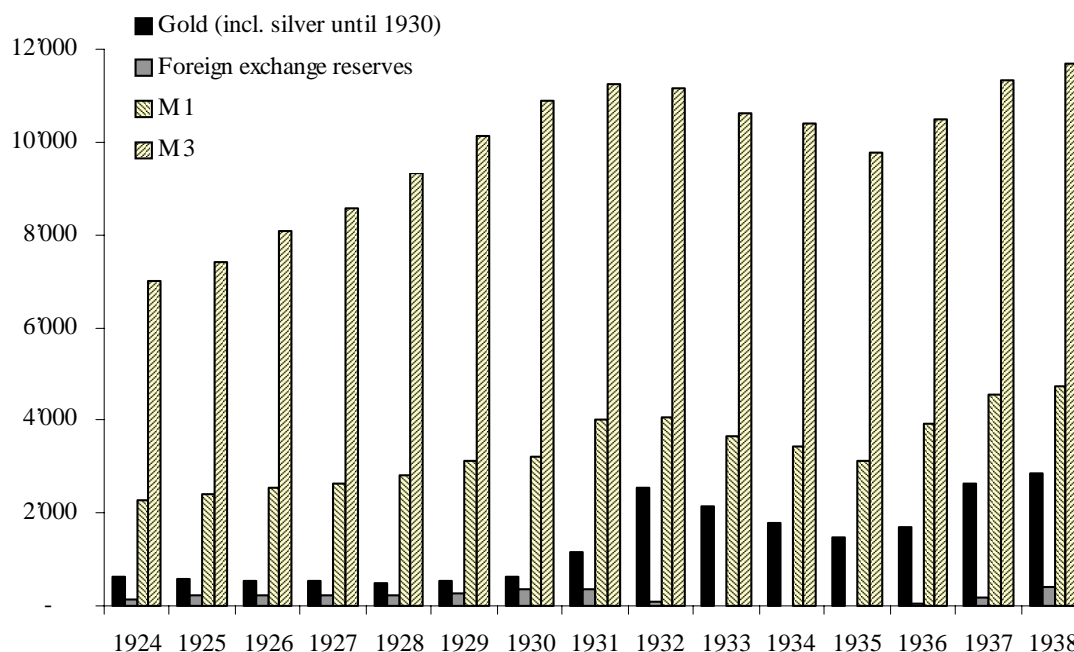
Monetary conditions

These strong capital inflows led to loose money and capital markets in the early years up to 1932. Faber (1997) shows that the marked deflation between 1929 and 1933 did not result from changes in money supply but from the dramatic decline in import prices³⁶. This contrasts sharply with the experiences of the United States, Great Britain and many others, where deflation resulted from tightened monetary conditions. If anything, deflation initially might have added to the expansionary impulses through real balance effects. The large gold inflows of 1931 translated straight into monetary expansion. The Swiss National Bank's means for sterilization had already been employed in the previous years, when the Bank's domestic portfolio had been reduced from SFR 300 million at the beginning of 1928 to less than SFR 50 million by the end of 1930 (Faber 1997, 6). M1 increased by more than 20 percent in 1931. The increase in M3 in the same time period amounted to less than 3 percent, a decisive slow-down in this monetary aggregates' growth rate compared to previous years. M3 declined in 1932 when M1 was still growing, a clear sign for increased demand for liquidity. A further indication for this shift is provided by the soaring note circulation and its changed composition, a development the Swiss National Bank attributed to note hoarding by foreigners (*Geschäftsbericht* 1931, 21-22). The share of notes denominated in SFR 1'000 in overall note circulation increased from 12 percent in 1930 to 20 percent in 1931 and to almost 30 percent in 1932 and 1933 (yearly averages, Schweizerische Nationalbank 1956, 374-5).

³⁵Weber (1983, 46-8) underlines the importance of repatriation of foreign assets and the sharp reduction in short-term foreign lending by Swiss banks in 1931.

³⁶Compare Weber (1983, 17 and 40-53).

Figure 8: Gold and foreign exchange reserves, M1 and M3 (in million SFR) 1924-1938³⁷



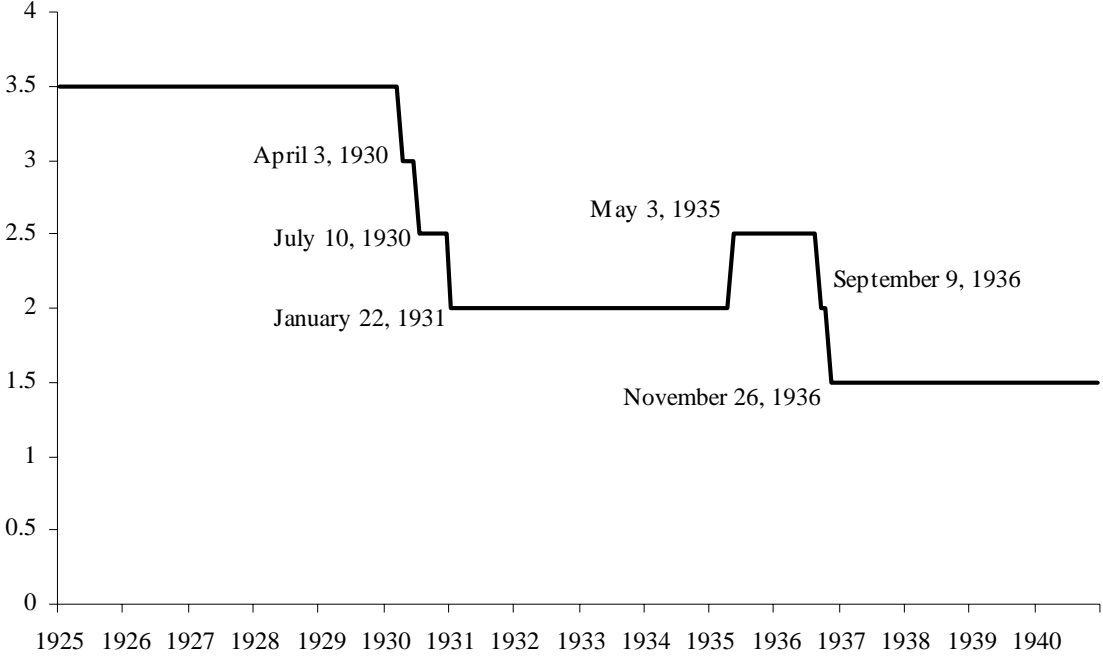
The increases in demand for liquidity went along with declining bank lending. Short-term credit volumes decreased substantially in 1931 whereas mortgage lending expanded (Faber 1997, 7). The uncertainty concerning short-term developments, especially pronounced in foreign capital owners, was initially not matched by a similar uncertainty concerning longer-term domestic economic development. Nominal interest rates reflect this (see figure 10 below). The private discount rate, a short-term market interest rate, declined from 3.3. percent in 1929 to a low of 1.4 percent in 1931, thus trailing the official discount rate which had been lowered twice in 1930 and for a third time in January 1931 (see figure 9). It remained at two percent until the speculative attacks on the Swiss franc in conjunction with the Belgian devaluation set in.³⁸ The Swiss National Bank attributed the decline in returns on Swiss treasury bonds to increased demand for these titles (*Geschäftsbericht* 1931, 14). Although short and long-term nominal rates remained low well into 1934, real interest rates shot up as consumer prices declined sharply in the years 1931 to 1933.

³⁷Source: Ritzmann et al. (1996), table O.2d, p.805: gold and foreign exchange reserves, yearly averages. For 1924 to 1930 the figures for gold reserves include the silver reserves which the Swiss National Bank successively reduced from SFR 94 million in 1924 to zero in 1931. Table O.3, p. 807: M1 and M3 (estimates by Christoph Gruebler, 1958).

³⁸Discounting volume with the Swiss National declined sharply in 1931 accounting for most of the decline in domestic lending (Weber 1983, 93).

After these three years of severe deflation, consumer prices remained fairly constant until the devaluation in 1936. Constant nominal rates thus implied a decline in real rates in 1934, an expectation confirmed by Faber’s (1997, 3) computations.

Figure 9: The official discount rate 1925-1940³⁹



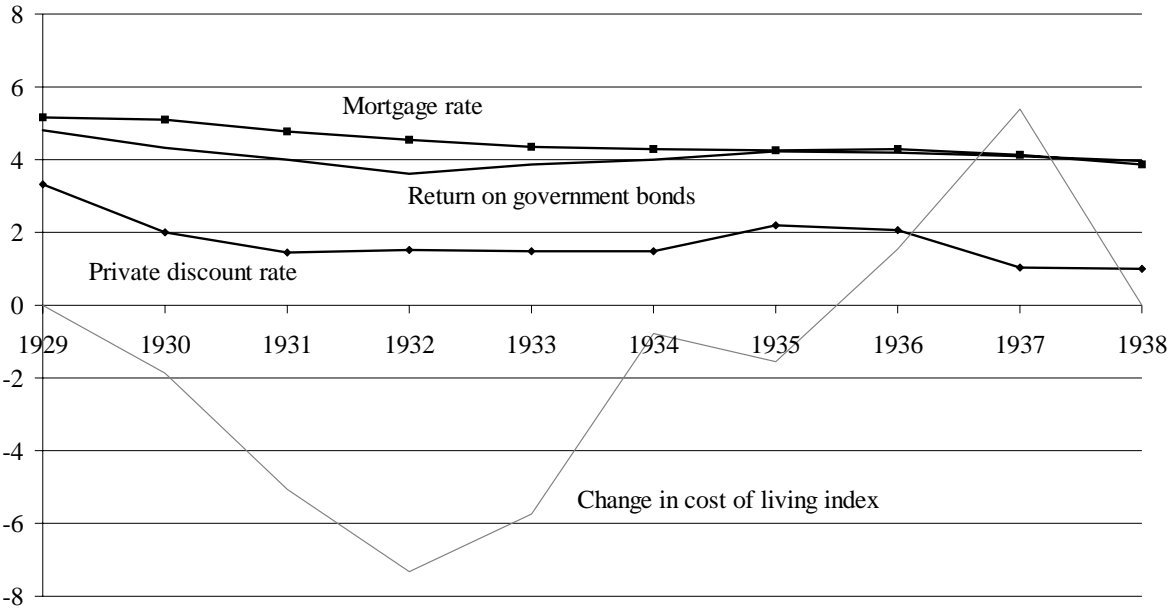
The liquidity of Swiss money and capital markets in the early phase of the world slump was soon reverted. After the explosion of the monetary base (gold and foreign exchange reserves, commercial bank deposits with the Swiss National Bank and currency in circulation) in 1931, it stagnated in 1932 and declined in the following three years, not least due to the reversal in gold flows (Faber 1997, 3). This effect was compounded by the public’s liquidity preference and the banks’ caution, leading to a marked reduction in the money multiplier.⁴⁰ Monetary conditions tightened significantly, a situation that was increasingly deplored by contemporaries since mid-

³⁹Source: Swiss National Bank, *Geschäftsberichte*, several years.

⁴⁰The currency / deposit ratio increased from 0.46 in 1930 to 0.64 in 1931, rising continuously until 1936. The banks’ reserve ratio (short-term deposits) increased from 0.2 in 1930 to 0.52 in 1931 and declined until 1936 (Faber 1997, 6). Weber (1983,41) provides similar figures.

1934. The speculative attacks in spring 1935 provoked the Swiss National Bank to increase interest rates to preserve the gold parity and protect its gold reserves. Monetary aggregates shrank (see figure 8, above). Price levels remained constant in this period, a fact contemporaries do not seem to have appreciated. Complaints about a deflationary environment abounded in this later phase of the downturn. Ex-post real short-term market interest rates calculated by Faber (1997, 3) returned to 3.6 percent in 1934 and 1936, a figure in line with pre-crisis conditions. However, if contemporaries deflation expectations were still high, these calculated rates might underestimate contemporary evaluations. However, the monetary tightness described by contemporaries is also attributable to banks' unwillingness to lend on the background of their endeavors to clean up balance sheets, which were in many cases burdened by non-performing foreign assets.

Figure 10: Market interest rates and inflation 1929-1938, yearly averages⁴¹



The devaluation immediately relaxed money and capital markets. Nominal and real interest rates declined, banks' liquidity increased and the reserves of the Swiss National Bank expanded rapidly. Taking the revaluation gains on the Bank's gold reserves of about SFR 540 million into consideration, gold inflows amounted to over SFR 500 million between October and December

⁴¹Source: Ritzmann et al. (1996), for interest rates: table O.18c, p. 831. Changes of consumer prices index are calculated from Ritzmann et al. (1996), table H.20, p. 503.

of 1936. Foreign exchange reserves, which had been dismantled in the years of the crisis, were rebuilt. The stock exchange boomed, leading to an increase in the values of the large banks' titles far exceeding the adjustment of nominal values in the banks' balance sheets.⁴² Stock prices of bank titles thus doubled between December 1935 and 1936, industrial stocks increased by 45 percent in the same time period (Perrenoud et al. 2002, 66). All this evidence indicates that confidence in Swiss money and capital markets returned quickly after the devaluation.

The development of the domestic sector

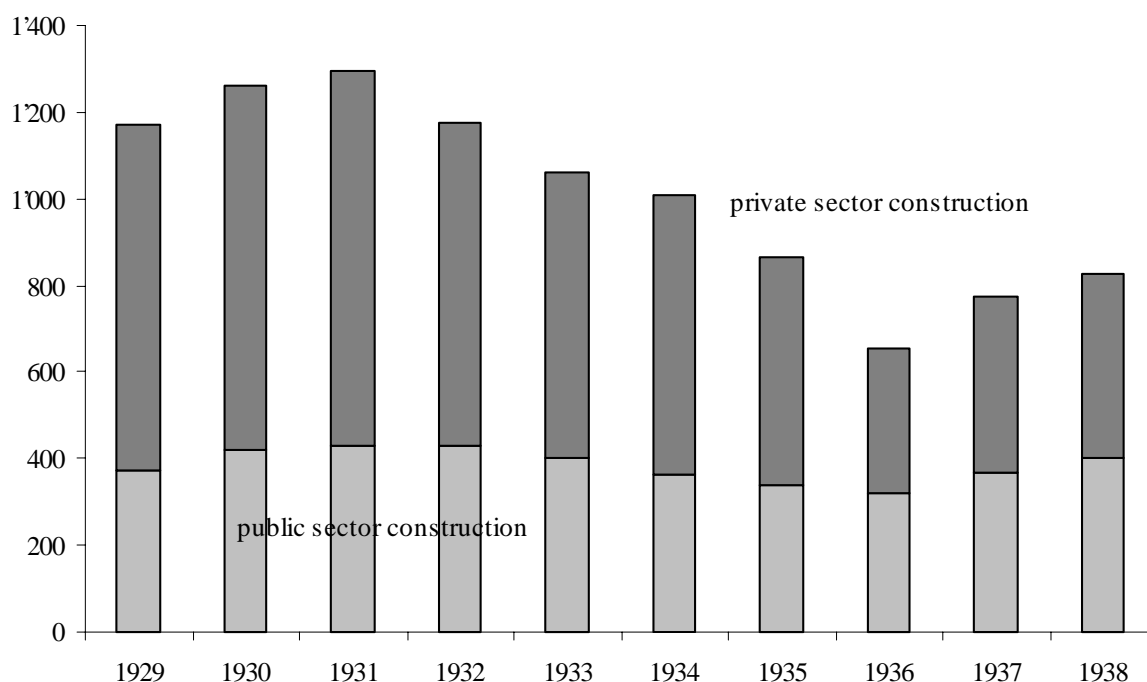
The first phase of the slump in Switzerland was characterized by the decline in exports analyzed in detail above. The second phase with strongly increasing unemployment came about when production for domestic markets turned down. The sharp deflation in 1931-1933 links both these phases. The halt in price decline did, however, neither originate in nor contribute to a recovery.

The decline in domestic industry can partly be explained by monetary conditions. This certainly also pertains to construction (see figure 11). The second half of the 1920s had seen continuously growing private construction. Low mortgage rates had fueled this trend up to 1932. The increase in real interest rates precipitated its decline. Construction spending by the public sector peaked in 1932. The decline in the following years and the recovery after 1936 is in line with the overall pro-cyclical development of federal budgets, which were slightly expansionary up to 1933 and tightened thereafter (Prader 1981, 68 and 84).⁴³ Significant credit-financed spending on employment and defense was only effective in the years after 1938. Up until then fiscal policies were guided by efforts to balance the budget.

⁴²The large Swiss banks clearly benefitted from the devaluation as Perrenoud et al. (2002, 64-5) show, an indication that they were well prepared for the event.

⁴³In line with the efforts to balance budgets, taxes were increased. A multitude of consumption taxes were introduced or augmented and a federal income tax was levied after 1933 along the lines of the "war tax" which expired in 1931. The overall tax burden (federal, cantonal and communal level) as a share of national income increased from 9.92 percent in 1929 to 13.16 percent in 1936 (Kneschaurek 1952, 183).

Figure 11: Yearly construction spending by private and public sectors in million SFR (estimates)⁴⁴



Earlier subsidies to cantonal and communal public works programs (since 1932) were, like the aid payments to the unemployed (since 1931) and subsidies to private unemployment insurances (since 1930), introduced as part of social policy measures aimed at limiting the effects of the crisis.⁴⁵ The large spending programs of the years 1939 and following, justified by defense requirements, were financed by credits from the Swiss National Bank's exchange equalization fund (devaluation gains on gold reserves) and by a turnover tax. The funds provided in these programs for 1939 alone exceeded the sum of federal spending on public works in the years 1932 to 1937 by far (Rutz 1970, 208).⁴⁶ To return to the comparison with the spending on agriculture made above, all expenditures provoked by the industrial crisis (support for exports, public works and aid to the unemployed) in the years between 1930 and 1939 stayed far behind spending on agriculture (Prader 1981, 69).

⁴⁴Source: Ritzmann et al. (1996), table R.4, p. 891.

⁴⁵These are only the more significant federal measures of this sort. Rutz (1970, 147-60 and 199-206) discusses all. Moreover, he analyzes provisions introduced with the aim of protecting industries or sectors through restrictions such as, for example, the prohibition to open chain and department stores (1933).

⁴⁶By including spending of cantons, communities and private entities brought about by the federal programs Kneschaurek (1952, 215) provides a more positive picture of public measures to overcome the crisis.

Multiplier effects initiated by the original negative aggregate demand shock and later autonomous changes fed into the decline in domestic production. However, supply side effects also played a role. Real wages increased between 1930 and 1933 by about 14.5 percent and remained basically unchanged at the elevated level until price level increases in 1936 started lowering them.⁴⁷ This figure probably underestimates real wage increases in the domestic sector as nominal wage adjustments differed markedly between industries.⁴⁸ The desperate situation of export producers had led to wage concessions early on, so that nominal wages declined in comparison to wages in domestic production. High unemployment after 1934 led to only slight declines in nominal wages. The reduction of the foreign work force contributed markedly to controlling domestic unemployment and dampened downward pressure on wages. The number of working permits issued to foreign workers fell from 92'836 in 1931 to 22'197 in 1936.⁴⁹ Considering that the number of job-seekers peaked in January 1936 with 124'000 persons, the rollback of the foreign work force decreased the unemployment rate by far more than 35 percent.

Recovery after devaluation

The recovery that set in after devaluation was slow to reduce unemployment (see figure 12 below). It remained a persistent topic in domestic policy debates eventually and led to the large public spending programs in 1939 and the following years. Output growth was driven by rapid export expansion, especially in 1937 (see figure 3, above). This development was dampened in the following year by the slowdown in the world economy due to the United States' recession. The recovery in domestic production was similarly pronounced in 1937. Relieved monetary conditions contributed their share. The domestic recovery slowed down in 1938. In the following years defense spending and public works provided expansionary impulses.

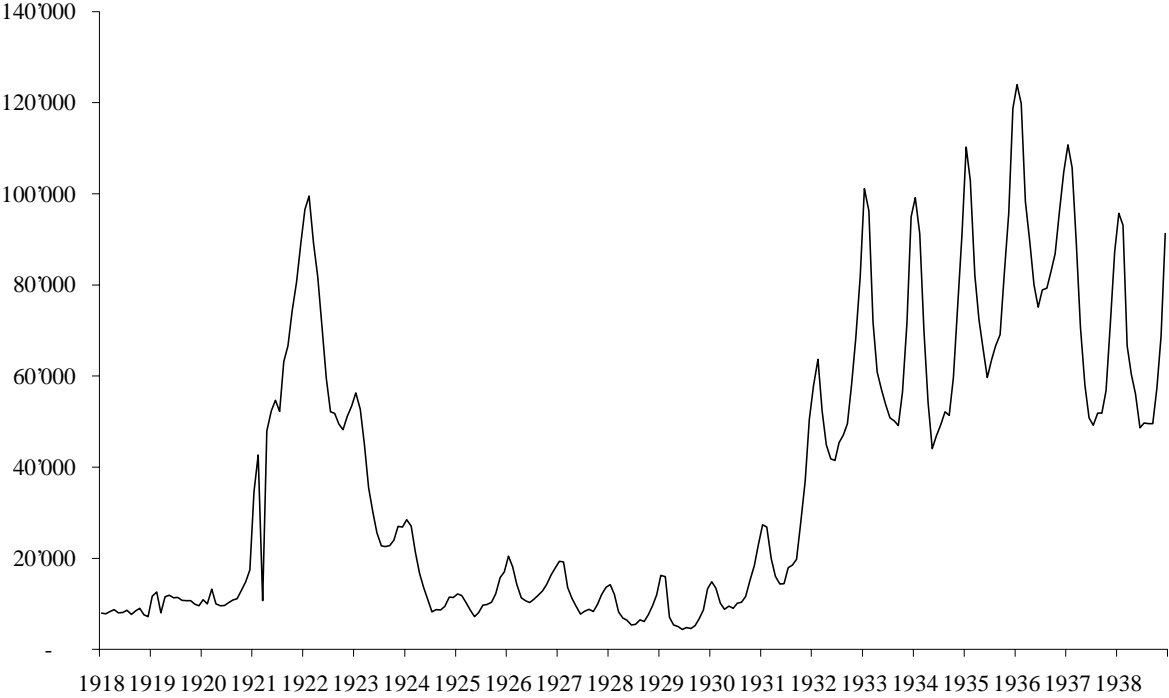
⁴⁷The data these calculations are based on real hourly and weekly wages of workers covered by accident insurance who had met with an accident in the respective period (Ritzmann et al. (1996), table G.8a, p. 456).

⁴⁸Output losses in Switzerland were far lower than projections based on a Cobb-Douglas production function would suggest as a result of these sharp increases in labor costs. The same is true for the remaining gold bloc countries, namely France and the Netherlands. The reasons for this outcome remain yet to be explained. (Eichengreen 2002, 31-2).

⁴⁹*Statistisches Jahrbuch* 1940, 120.

The devaluation led to price increases for imported goods, an effect much feared by contemporaries. Strict federal price controls were implemented. Consumer prices increased by 5.4 percent in 1937 and 1938. The wholesale price index, where import price increases have larger weight, reacted immediately to the devaluation. In 1937 wholesale prices rose by 16.3 percent. Overall inflationary effects were much lower than expected.

Figure 12: Registered job seekers 1918-1938 (month's end)⁵⁰



Concluding remarks

As argued above, the recession in Switzerland falls into two distinct phases. In the first phase from 1929 to 1932 the moderate decline in the Switzerland contrasted with the collapse of the economies of the large industrial countries. The second phase from 1933 to 1936 saw a recovering world economy whereas Switzerland remained in unyielding stagnation. The discussion in the previous sections detailed some of the events underlying these developments, focusing on the

⁵⁰Source: Ritzmann et al. (1996), table F.18, p. 422. As broader measures of unemployment are not available, I will refrain from calculating unemployment rates. Mangold (1934, 5-8) discusses the shortcomings of contemporary Swiss unemployment statistics.

changes in exports in the first part and on domestic monetary conditions in the second part. The development of foreign trade was, like in several open economies during the world depression, disrupted by the decline in trade volumes resulting from currency turbulence and protectionist policies. For Switzerland these effects were compounded by the role Germany played as largest trading partner. The introduction of exchange controls in 1931 in this and other European countries and the efforts to raise autarky markedly curtailed trade opportunities. The federal government tried to protect export interests through clearing contracts, a strategy which proved successful only in its early phases.⁵¹ In time export volumes shrank even within these arrangements. Goods imports were put into the service of export promotion. This led to significant distortions and consequently to high welfare losses for the Swiss economy.

It is pure speculation to argue that more aggressive export promotion aimed at encouraging trade with the recovering economies of countries that had devalued, such as Great Britain and the United States, might have been a more successful strategy in a longer-term perspective. The direct costs in government spending might have been lower than the indirect costs of distortions through government intervention. In the given political context, raising funds for large-scale government subsidies to exporters would have met with resistance. The burden of the indirect costs of intervention on the entire economy went unnoticed. Despite the fact that clearing negotiations and clearing administration absorbed large public and private resources, this type of export promotion was perceived as a costless alternative to financial support. However, the following consideration can be held against this argument: the type of trade regulation introduced during the slump foreshadowed the much more encompassing government-controlled trade regime during World War II. Thus negotiations in those years prepared good relations to partners that gained additional importance under the strains of a war-time economy.

Concerning the development of money and capital markets in Switzerland, two facts are worth underlining. Switzerland avoided a banking crisis despite the high exposure to Germany and other countries that froze assets held by foreigners. Flexible and expeditious government responses to the illiquidity of individual banks prevented a confidence crisis. Such reactions were possible in

⁵¹The conclusion of a trade agreement between Switzerland and the United States on February 15, 1936 can be interpreted as an attempt at reorientation.

a country that had become convinced that its financial sector was vital for the well-being of the entire economy. The expansion of the banking industry in the preceding decades had made its role in balancing the persistent trade deficit visible. A trade deficit was, in turn, perceived as inevitable for the small and resource-poor Swiss economy with its relatively large population and high living standard.

Although by avoiding a banking crisis the severe credit contractions other countries experienced had been prevented, monetary conditions tightened after their initial loosening in 1931. The reversal of gold flows in the following years reduced the monetary base. These effects were escalated by modified behavior of the public reflecting the high uncertainty in this period: money demand rose because of strong liquidity preference and bank's increased reserve holdings. Although the monetary base declined between 1931 and 1935, it always exceeded pre-crisis levels significantly (Schweizerische Nationalbank 1956, 409). The role of monetary policy or, in other words, of Switzerland's "golden fetters" in the tightening monetary conditions is not straightforward. The state of depression, the expectations of actors and their strong liquidity preference generated monetary tightness. All these were closely linked to the monetary regime. To change expectations a marked shift in economic policy was required. It is hard to think of alternatives to devaluation which could have brought about such a result. Especially considering the large share of Swiss economic activity linked to foreign trade, a recovery without strong impulses for the export sector is inconceivable. This leads us to the central question of this study, the analysis of the causes for the delayed devaluation. What guided economic policy makers' perception of the economic realities to preclude this policy option?

3. The dominance of orthodox arguments in the economic policy debate up to 1933

The onset of the recession in Switzerland through declined exports was reflected in contemporary perceptions. The export industries responded to these developments by demanding price and wage reductions, a claim that prompted the trade unions' resistance. Despite the fact that government measures were taken in response to the crisis, the Federal Council was reluctant to acknowledge the recession, much less the unfolding of an extraordinary slump. A statement providing an assessment of the economic conditions and spelling out policy guidelines was published in the spring of 1932. This delay was at least in part due to controversies within the government. The finance minister, Federal Councillor Musy, had jumped ahead with a pronouncement of his own view on adequate crisis policies shortly before the publication of the government position. His proposals agree with the orthodoxy and provide insights into the ingredients of the gold-standard mentality. The government, although following Musy in his demand for adjustment policies, took a more moderate stance and underlined the need for supporting the domestic economy, thus justifying the measures taken in the preceding months. The rapidly growing opposition to the government's approach to the crisis found a platform in the parliamentary debate about the government's statement. However, the tone of the debate changed from conciliatory to confrontational once the government proposed to reduce the wages and salaries of public employees. These developments in the political debate are the topic of the following sections. The arguments used by the Federal Council to substantiate its position and the formation of the oppositions arguments in the parliamentary debates are at the center of attention. Chapter 4 extends this analysis by discussing contributions of academic economists in support of government and opposition.

Early perceptions of the world-wide slump and its effects on Switzerland

In its yearly report on the state of the economy the Swiss National Bank mentioned repercussions of the international economic conditions on the Swiss economy in 1929. Over-production in several countries, sharply falling prices in world commodity markets and the stock exchange crisis in the United States were singled out as influences that were felt in Switzerland, especially by the export industries. Nevertheless, overall domestic economic conditions were judged as satisfactory (*Geschäftsbericht* 1929, 16-17). In 1930, the report (*Geschäftsbericht* 1930, 7-9) spoke of a "wave of depression" (Depressionswelle) that disrupted production and commerce in all countries

to some extent. As background to the crisis, the expansion and rationalization of production and the artificial support of consumer prices in the past years were added to the arguments repeated from the preceding report. Furthermore, the poor performance of agriculture in 1930, political disruptions in several countries, the collapse of a number of banks, protectionist policies, the inter-allied war debts and reparations were mentioned. The report argued that in the second half of 1930 and especially in the last quarter of the year, the Swiss economy had felt the effects of all these events through her trade ties. The increase in unemployment figures was discussed but the report underlined that unemployment had reached only a quarter to a fifth of the figures during the crisis of 1921-22 and was far lower in Switzerland than in many other countries. The reduction in exports to the United States, Germany and Italy and a drop in tourism income were pointed out. In 1931 the report explained that a world credit crisis (*Weltkreditkrise*) had emerged adding to the world economic crisis (*Weltwirtschaftskrise*). Although Switzerland's economy had resisted the downturn during the first half of the year, by the end of 1931 prospects were described as being just as bleak as for the rest of the world (*Geschäftsbericht* 1931, 6-8).

To summarize, in the Swiss National Bank's reports the slowdown in economic activity in 1929 was not seen as of particular significance to the Swiss economy. In the course of 1930 clear signs of an export crisis were acknowledged. By the end of 1931 hope was given up that Switzerland might just escape the effects of the world slump. Commenting on the devaluation of the Pound Sterling in the year the Swiss National Bank called England's abandonment of gold the "most bitter disappointment, especially for central banks" (*die bitterste Enttäuschung, ganz besonders für die Notenbanken. Geschäftsbericht* 1931, 7). It had set off a currency crisis, had caused large financial losses and had undermined central bank cooperation. Needless to say, the Swiss National Bank rejected devaluation of the Swiss franc. Only a short paragraph was devoted to spelling out those arguments which would recur in the Bank's pronouncements in the following years (*Geschäftsbericht* 1931, 20). Dismissing claims that a devaluation would benefit export industries, the Bank argued that production costs would raise as imported raw materials' prices would increase due to the devaluation. Short-term gains in competitive advantage would soon be reverted as the domestic price level would increase. Furthermore, the abandonment of gold would lead to losses on Swiss savings and the devaluation of foreign assets.

The periodicals of industry organizations and unions also reflected the early effects of the world slump. The weekly paper of the Swiss industrial federation (*Schweizerische Arbeitgeber Zeitung*) commented on the downturn in exports. High levels of price and wage indices in Switzerland as compared to those in most other industrialized nations prompted the demand for lowering production costs. This claim was not new, price and wage reductions but been urged repeatedly in the course of the 1920s. *Neue Zürcher Zeitung* took up this perception of the causes of the export crisis and reiterated the demand for price and wage reductions.¹ Downward price and wage adjustment to the world price level was depicted as a question of survival for the Swiss economy. The only alternative was seen in a devaluation of the currency, which would inevitably be forced onto Switzerland if price and wage adjustments were not realized. A devaluation was to be avoided by all means as it was perceived as a “catastrophe” and the “saddest method of economic policy” (die traurigste Methode der Wirtschaftspolitik. *Neue Zürcher Zeitung* January 6, 1932). To consider devaluation as a policy option was impossible for Switzerland, as “international creditor country and shelter for large saving deposits” (internationales Gläubigerland und Hort grosser Sparguthaben. *Neue Zürcher Zeitung* January 6, 1932). Repeatedly, *Neue Zürcher Zeitung* described price and wage reductions on the one hand and devaluation on the other as the only available alternatives. Switzerland was depicted as having reached a crossroads where one or the other path had to be taken. Clearly and early on, *Neue Zürcher Zeitung* came out against devaluation. In the same vein suggestions for a managed currency, for international reflation etc. were forcefully rejected (e.g. *Neue Zürcher Zeitung* January 17, February 5 and February 18, 1932).

The unions countered industry representatives’ demands for wage and price reductions. The February 1930 edition of *Gewerkschaftliche Rundschau* contained a discussion of the negative effects of wage reductions in Germany on the economy: working conditions had deteriorated, labor efficiency had been reduced and purchasing power had fallen. In August the same periodical printed a talk economics professor Fritz Marbach had given at the University of Berne in December 1929. He discussed wage theories and stressed the importance of wages in a

¹Other newspapers gave industry representatives an opportunity to explain their views, e.g. *Neue Glarner Zeitung* with a series of articles by a textile producer in November 1931. *Bund*, a daily newspaper in Berne, published a lengthy article by Alfred Ammon, Professor at the University of Berne, in December 1931 arguing in favor of price and wage reductions.

macroeconomic perspective with wages representing purchasing power. Marbach argued that in light of increased rationalization and expansion of mass production of consumer goods the ability of workers to purchase those goods was crucial. Although he mentioned the role these arguments played in crisis explanations, no reference was made to a contemporary crisis, again reflecting the widespread (non-) perception of events at that early stage. But already in August 1930, the Swiss Federation of Trade Unions (Schweizerischer Gewerkschaftsbund) turned to the federal government with a demand for public works at all levels of government to fight unemployment.² The additional spending, it was argued, could easily be financed at low interest rates through the very liquid capital markets. Furthermore, private firms should be encouraged to follow the lead of public agencies. Beyond the reactions to the immediate crisis, the unions demanded planning and coordination of spending on all levels of government with the aim of systematically reducing public investment during a boom phase and increasing it during a depression. Without introducing the term, a clear concept of counter-cyclical spending was developed.³

The Federal Council (Bundesrat) only reluctantly acknowledged the existence of an economic downturn as can be traced in the communications to parliament, for example. In 1929 no references were made to such developments, a perception that was maintained through the year 1930. In May 1930 a request for an increase in the federal contributions to unemployment insurances of “needy industries” (notleidende Industrien. *Bundesblatt* 1930, 647) was submitted to parliament.⁴ Among the “needy” industries textile and watch-making industries were discussed

²The text was reprinted in *Gewerkschaftliche Rundschau* 1930, 281-8.

³References were made to “several countries” that were trying to institutionalize such policies, especially Germany, and to the International Labour Office that was analyzing the issue. In 1931 the ILO published *Le chômage et les travaux public*. This study was discussed positively in *Gewerkschaftliche Rundschau* (1931, 144-7). The argument in favor of counter cyclical public spending was also made in the statement published by a joint commission of the International Confederation of Trade Unions (Internationaler Gewerkschaftsbund) and the socialist international labor organization (Sozialistische Arbeiterinternationale) on the world economic crisis and unemployment published on January 21/22, 1931 (*Gewerkschaftliche Rundschau* 1931, 95). Clearly, the Swiss unions were in good company within the labor movement concerning the ideas that were promoted.

⁴Bericht des Bundesrates an die Bundesversammlung über die Erhöhung des Bundesbeitrages an die Arbeitslosenkassen notleidender Industrien. (Vom 30. Mai 1930.) *Bundesblatt* 1930, 647-58.

at some length. Concerning textile industries the government argued that “It is generally known, that these industries have been in a severe crisis for years.” (Es ist allgemein bekannt, dass sich die Industrien seit Jahren in einer schweren Krisis befinden. *Bundesblatt* 1931, 652). The structural problems that had emerged after World War I were stressed. Towards the end of 1929 a “severe crisis” had emerged in watch-making (eine empfindliche Krise. *Bundesblatt* 1931, 654). In contrast to textiles, the problems of the watch-making industries were described as a recent issue, but there was no mention of the breakdown in exports nor its roots in a world slump. To sum up, both cases were presented as sectoral problems and not linked to an overall downturn.

When the government turned to parliament with the same issue one year later, in May 1931,⁵ metal processing and machinery industries were added to the list of “needy” industries. The increase in unemployment since the end of 1929 was documented. The government pointed out that the number of people actually out of work was probably underestimated as not all unemployed were registered with unemployment offices or were members of an insurance. The situation in parts of textile industries was denoted as a permanent crisis (Dauerkrisis. *Bundesblatt* 1931, 627). Metal processing and machinery industries had experienced a downturn at the end of 1930 and the situation had deteriorated since then, just as in watch-making industries. There, unemployment had reached “a quite extraordinary extent” (einen ganz ausserordentlichen Umfang. *Bundesblatt* 1931, 627). While the outlook was evaluated as bleak for the traditionally weak parts of textile production and for watch-making, in other parts of the textile industry, in metal-processing and machinery “the employment perspectives for the rest of 1931 could not be assessed yet.” (können jedoch die Aussichten auf Beschäftigung für den Rest des Jahres 1931 im gegenwärtigen Augenblicke nicht abgeschätzt werden. *Bundesblatt* 1931, 629). Still no reference to an overall crisis or a world economic crisis was made.

This had changed by September 1931 when the government proposed the provision of funds in support of a reorganization of the notorious watch-making industry.⁶ By then the crisis in watch-

⁵Bericht des Bundesrates an die Bundesversammlung über die Erhöhung des Bundesbeitrages an die Arbeitslosenkassen notleidender Industrien. (Vom 19. Mai 1931.) *Bundesblatt* 1931, 625-31.

⁶Botschaft des Bundesrates an die Bundesversammlung über die Unterstützung der Uhrenindustrie. (Vom 11. September 1931.) *Bundesblatt* 1931, 189-224.

making was described as result of a “general economic depression,” that had affected this industry early and strongly because of the production of luxury goods (Ihre Ursachen lagen vor allem in der allgemeinen wirtschaftlichen Depression, von der die Uhrenindustrie, weil sie eine Luxusindustrie und als solche sehr konjunkturrempfindlich ist, frühzeitig und heftig getroffen wurde. *Bundesblatt* 1931, 193). The United States’ tariffs enacted in June 1931 and tariffs in other countries were mentioned, but also problems internal to the industry.⁷ Most importantly, at that stage the depression was discussed in the context of a world economic crisis with consequences for the entire economy: “It is obvious, that the Swiss watch-making industry cannot escape the effects of the world crisis, nor can any other part of our national production.” (Es liegt auf der Hand, dass die schweizerische Uhrenindustrie sich so wenig wie irgendein anderer Teil unserer nationalen Produktion den Folgen der Weltkrise entziehen kann. *Bundesblatt* 1931, 195).

The government’s changed assessment of the economic outlook was also reflected in a modified approach to the support of those laid-off by the watch-making industries.⁸ At the end of October the government proposed the introduction of direct federal aid to the unemployed (Krisenhilfe) instead of a further increase in federal contributions to unemployment insurances. The proposal contained a discussion of the relief these measures would bring to the communities in watch-making areas, where budgets had come under enormous pressure through the decline in tax revenues, through aid payments and expenses for public works. Although the government stated that no other industry had so far suffered from the crisis to the same degree, it suggested that this type of support would possibly have to be extended to the unemployed of other industries. In particular, the unemployed in the hotel industry could soon be in need of similar support (*Bundesblatt* 1931, 456). Obviously, at that stage a fast recovery from the depression was no longer expected.

⁷The export of parts and semi-finished watches was blamed in particular for the loss of export markets for finished products in the report of the federal government (*Bundesblatt* 1931, 194).

⁸Botschaft des Bundesrates an die Bundesversammlung betreffend Krisenhilfe für die Arbeitslosen. (Vom 27. Oktober 1931.) *Bundesblatt* 1931, 444-63.

Finally, by the end of 1931, the government explicitly acknowledged the crisis as exceptional. In the introduction to the budget proposal sent to the United Federal Assembly in November, the Federal Council discussed the scope of the world slump:⁹ “The crisis no longer knows any bounds. It has taken on universal character. The world, believing in the permanently growing, but unfortunately artificial, boom of the after-war years, was morally not prepared for this new challenge. She has not succeeded in coming up with the vigorous resistance which would be able to relieve the tension. Our country, with its international economic and banking system, had to stand up to the set-back of these violent disruptions. If the repercussions of the crisis reached us only belatedly, it cannot be precluded that they, for that, will last longer than in other places. We thus have to be prepared for a future that might bring even graver adversities.” (Die Krise kennt überhaupt keine Grenzen mehr. Sie hat heute universalen Charakter angenommen. Die Welt, die an den ständig wachsenden, aber leider künstlichen Aufschwung der Nachkriegszeit glaubte, war dieser neuen Probe moralisch nicht gewachsen. Es ist ihr noch nicht gelungen, den tatkräftigen Widerstand aufzubringen, der die Spannung zu lösen vermöchte. Unser Land mit seinem stark internationalisierten *Wirtschafts*- und Bankenwesen hatte den Rückschlag dieser heftigen Erschütterung auszuhalten. Wenn die Rückwirkungen der Krise bei uns auch erst verspätet eintraten, so ist nicht ausgeschlossen, dass sie dafür bei uns länger dauern als anderswo. Wir müssen uns also darauf gefasst machen, dass uns die Zukunft noch ernsthaftere Schwierigkeiten bringt. Botschaft 1932, 1).

The overall situation of public finances was presented in a positive light as communities, cantons and federation had reduced their debt and accumulated reserves in the preceding years. In 1931, high tariff revenues due to skyrocketing imports had mitigated the effects of the slump on the federal finances. Such effects, as were to be expected in the immediate future, were not yet seen as alarming. For example, the phasing out of the war tax, a temporary income tax, in 1932 was expected to help overcome the crisis by relieving industry and trade. That additional taxes might become necessary to continue the consolidation course of the previous years was not yet considered despite the warnings as to the severity of the crisis.

⁹Botschaft des Bundesrates an die Bundesversammlung zum Voranschlag der Schweizerischen Eidgenossenschaft für das Jahr 1932 vom 6.11.1931.

When comparing the government's budget proposal dated November 6, 1931 with the speech of the finance minister in parliament 6 weeks later, the distinct change in tone is noteworthy.¹⁰ Whereas the introduction to the budget expressed deep concern about the future course of the economy, this concern seems to have turned into anxiety within the short period of time that had elapsed. In his speech Federal Councillor Jean-Marie Musy, as head of the Department of Finance (Finanz- und Zolldepartement) responsible for the budget proposal, emphasized the dire consequences on revenues and expenses if the crisis continued to deepen.¹¹ He complained that even experts could not provide an answer to the question, when the depression would be overcome. The crisis, he repeated, had become universal in covering banking, currency and stock exchange. Beyond that, he stressed, the crisis was a crisis of confidence (*crise moral*. Unveröffentlichtes Protokoll 1931, 153) with catastrophes chasing each other and culminating in the devaluation of the pound Sterling.¹² Musy argued later that the British had sought to solve their financial problems through inflation. Switzerland, however, would stick to the gold parity. Therefore deflation, allowing for a reduction of export prices, was the path for regaining the markets that had been lost to foreign competition in the preceding months. This would increase the purchasing power of the Swiss franc rather than reducing it through inflation

¹⁰Similarly, the proposal on import restrictions dated December 14, painted a much more alarming picture of economic conditions. The government compared the contemporary crisis to the slump of the year 1921-22 (Botschaft des Bundesrates an die Bundesversammlung betreffend die Beschränkung der Wareneinfuhr. (Vom 14. Dezember 1931.) *Bundesblatt* 1931, 804-11). Data were presented to show how exports had deteriorated whereas imports had increased substantially. At the same time, tourism and returns on foreign investment had declined. Here the central argument of the coming debates that industry representatives had put forward since the onset of export crisis was taken up by the government as the trade deficit was explained with the fact that other countries were producing more "cheaply" (Ländern, die billiger produzieren. *Bundesblatt* 1931, 804). The final passage of the report summarized that "This should clearly demonstrate that the economic and commercial situation is grave." (Aus den gemachten Ausführungen dürfte klar hervorgehen, dass die wirtschafts- und handelspolitische Lage eine ernste ist. *Bundesblatt* 1931, 809).

¹¹The national assembly voted not to publish the protocol of its debate on the budget proposal in order to economize on such expenses (Unveröffentlichtes Protokoll 1931, 176). The original *Stenographisches Bulletin der Bundesversammlung* was consulted in the Bundesarchiv.

¹²Janssen (1998, 409) points out that in Germany in the course of 1931, especially in the wake of the banking crisis, the downturn was no longer seen as part of a "normal" business cycle by economists and politicians. A similar change in perception seems to have taken place in Switzerland towards the end of the year.

(Unveröffentlichtes Protokoll 1931, 157). Furthermore, in the long run, the countries which had left gold would stabilize their currencies and return to the gold standard: “Only a healthy currency will provide the global economy with a firm basis from where it can take off again without having to fear renewed stagnation.” (Une monnaie saine seule fournira à l’économie universelle la plateforme ferme d’où elle pourra repartir sans avoir à craindre de nouveaux affaissements. Unveröffentlichtes Protokoll 1931, 156).

Though supporting government’s proposal in principle, conservative parliamentarians demanded budget cuts to preclude future tax increases in light of falling revenues due to the crisis. In contrast, the social democratic opposition considered the budget proposal a declaration of war on workers (Kampfansage an die Arbeiterschaft. Unveröffentlichtes Protokoll 1931, 164) because of the high tariffs and tobacco taxes that particularly burdened low income recipients. Musy was accused of pursuing budgetary policies as class policies in the interest of the ruling classes. In the same session a formal question to the Federal Council (Interpellation) by a social democratic member of parliament similarly concerned Musy’s pressing ahead on another sensitive policy issue. In the parliamentary finance commission, Musy had suggested that reductions in the wages and salaries of public employees would soon become inevitable, a statement which had allegedly attracted considerable attention in the press. The president of the Federal Council, Heinrich Häberlin, responded cautiously to this request: the government was not inclined to commit itself towards future policies in one way or another. He underlined that Musy had expressed his personal opinion in this particular statement (Unveröffentlichtes Protokoll 1931, 528-32).

The preceding paragraphs traced the evolving perception of the effects of the world-wide crisis on the Swiss economy. The repercussions on the export industries led to a downturn and to unemployment in those sectors while other parts of the economy were still prospering. Early on, export industry representatives and unions took the positions that were going to be elaborated in the following debates. Whereas industry demanded price and wage reductions to bring production costs in Switzerland closer to those in trading partners and competitors, the unions countered these demands. On several occasions Federal Councillor Musy pressed forward with distinct policy proposals. The reactions he provoked foreshadowed the policy debates of the following years. Musy clearly sided with the demand for price and wage adjustment and suggested early on that remunerations for public employees should be cut. After the devaluation of the Pound Sterling

he forcefully defended Switzerland's adherence to the gold standard and precluded any other policy options. The opposition soon identified - and vilified - Musy as the driving force behind the government's adjustment approach. The Federal Council was reluctant to acknowledge the development of a slump in Switzerland and even more hesitant to formulate its economic policies in response to the crisis.¹³

On January 14, 1932 *Neue Zürcher Zeitung* openly criticized the government for abstaining from taking a position on the repeated demands for price and wage reductions. "The political circles avoid touching this critical issue and when, for once, they could not evade the question, they were more likely to take a disapproving stance." (Die politischen Kreise hüteten sich dieses heikle Problem anzupacken und wenn sie der Frage einmal nicht ausweichen konnten, so nahmen sie eher eine ablehnende Stellung ein.) Allegedly, the government had been debating its position on the crisis for weeks (*Neue Zürcher Zeitung*, February 28, 1932). The results of these deliberations were expected to be published in time before parliament would convene for its spring session in early March.

“Inflation or deflation”: the policy options presented by Federal Councillor Musy in February 1932

Before the government published a statement on the “economic problems” in March 1932, Federal Councillor Jean-Marie Musy, head of the Federal Department of Finance (Finanz- und Zolldepartement) from 1920 to 1934, presented his views.¹⁴ On February 19, 1932 he gave a talk entitled *Switzerland during the current crisis. Inflation or deflation* at the cantonal economics club in Berne (Volkswirtschaftliche Gesellschaft des Kantons Bern). He discussed the specific problems faced by the Swiss economy at length and laid out policy proposals. The speech was published in a revised and extended version as a brochure in French and German and apparently

¹³Ruffieux (1978, 341) points out that the government's policies up to 1932 resembled the strategy pursued in 1920 to 1922, consisting of interventions in support of sectors particularly affected by the crisis, measures to reduce unemployment and efforts to balance the federal budget.

¹⁴Müller (2001, 70-2) traces Musy's argument back to an expertise by Alfred Ammon, professor at the University of Berne. This expertise is, however, missing in the archives. Ammon's views, as presented in the spring of 1933 at the meetings of the Swiss Statistical Society, will be discussed below p. 97.

circulated widely as it was frequently referred to in the ensuing debate.¹⁵ Musy's outline of the problems, his interpretations and his policy conclusions framed much of the following discussion. Furthermore, Musy's speech reflected the topics that had emerged in the preceding months. The issues raised convey the characteristics of a widespread contemporary perception of causes and effects of the crisis and of adequate policy responses. It will allow us to develop a clearer understanding of the Swiss version of the gold-standard mentality. For all these reasons Musy's speech will be examined in some detail here.

Musy started his analysis with pointing out main features of the Swiss economy. He stressed the high income level in per capita terms despite the poor natural resource base. The background to this, he argued, was the international orientation of economic activities, especially in the export industries, in tourism, banking and insurance. Whereas increasing imports - Musy criticized the import of wine and exotic fruit as luxury consumption - had led to a negative trade balance since long before World War I, the surplus in the invisibles trade had left the overall balance positive. Although this discussion has some mercantilistic overtones, Musy's overall conclusion stressed the interdependence of the Swiss economy with the rest of the world in a more balanced way. The solution to the crisis could not be found in closing the borders and the recent import restrictions were only temporary measures (Musy 1932, 7).¹⁶ This assessment of the vital importance of economic exchange with the rest of the world for the Swiss economy was not seriously challenged by the leading participants in the public debates. Hopes to overcome the crisis by promoting autarky, an important discussion in Germany, did not resonate much in Switzerland.¹⁷ The resort

¹⁵The quotations in the following are my translations from the French version *La Suisse dans la crise actuelle. Inflation ou déflation*. (Musy 1932).

¹⁶In reaction to the enormous increase in the trade deficit in 1931 and the protectionist measures taken by trading partners, the Swiss parliament authorized the Federal Council to introduce import restrictions on December 23, 1931. For details on the measures, see Rutz 1970, 161-6.

¹⁷Ruffieux (1978) discusses the role autarkic tendencies played in Swiss policy debates and actual economic policies during the 1930s. He draws attention to conservative groups that envisioned increased independence of the world economy as part of a corporatist approach to the solution of the crisis. He traces the tendencies back to the experience of food scarcity during World War I which was reflected in the regulation of the cereals market (*vorläufige Ordnung der Getreideversorgung*) of 1927-28 aiming at increased self-sufficiency. Ruffieux (1978, 344-5) discusses this as an example of "voluntary autarky," but the overall reduced importance of

to bilateral arrangements in trade and payments relations was understood as a means to secure markets for Swiss exports, a measure to maintain rather than restrict the openness of Switzerland's economy.

Musy continued with some brief remarks on frequently discussed causes of the “contemporary horrible chaos” (*l’effroyable chaos actuel*. Musy 1932, 8). He mentioned war destruction, the increase in productive capacity beyond the limited possibilities of consumption, the financial crisis, international debt and tariffs which had led to the disruption in the distribution of monetary gold. He stressed the loss of confidence and the prevailing sentiment of insecurity and instability. Musy concluded these considerations with an assessment that would be shared by speakers all across the political spectrum in the years to come. A recovery would depend on international cooperation and coordination, on reciprocal concessions between nations (Musy 1932, 9). As this was not immediately forthcoming, Switzerland would have to expect to suffer from the crisis while her major export destinations and homes to the clientele of the Swiss tourism industry were depressed. But even beyond that, export industries would remain in distress as long as the Swiss price level had not adjusted to the reduced prices on world markets. The rest of Musy's speech developed around this theme, which would dominate economic policy debates in Switzerland for years.

Musy moved on to discuss economic policy options for bringing about a downward adjustment of costs in the export industries, in other words the reduction of domestic prices and wages. The choice he presented was between two alternatives: inflation, i.e. the reduction of the purchasing power of the Swiss franc, the “easy way” as Musy maintained (*c’est la voie facile*. Musy 1932, 10) or deflation, i.e. the reduction in prices. Although this was the obvious path to be chosen according to the speaker, it would demand sacrifice (*c’est la voie du sacrifice*. Musy 1932, 16). Inflation in Musy's understanding would reduce production costs in terms of foreign exchange as increased note circulation would bring about depreciation of the currency. Any positive effects

international trade for Switzerland in the 1930s is seen as a consequence of the economic crisis and not of active Swiss policies. In contrast, in Germany autarky was seen as a potentially viable policy option even before the dominance of national socialist ideology. The importance of this proposal in public debates is indicated by the fact that the Verein für Sozialpolitik devoted an entire day of its two day meetings in 1932 to the topic. Two papers presented opposite views on the issue, a heated discussion followed (Verein für Sozialpolitik 1932, 109-220). On the other day of the meetings “Germany and the world crisis” was debated.

would soon be superseded by increasing domestic prices that would compensate the competitive advantage gained through the depreciated exchange. The dismal consequences of inflation would only start there: small savers would suffer from inflation as they would not have the same means or knowledge as large investors to avoid losses. Debtors, whose burden would be eased by inflation, would thus be relieved at the cost of the “small” saver. Similarly, wage and salary earners would suffer from inflation as their incomes would rise more slowly than prices. Musy stressed the injustice of the redistributive effects of inflation especially on low income groups. Moreover, he argued, inflation undermined economic life by discouraging productive activity and saving.

Devaluation was presented by Musy as just an alternative path to inflation, through the direct means of reducing the exchange rate rather than through the indirect way of inflationary note issue. The effects would thus be the same as those discussed in the preceding paragraphs of his speech. This identification of devaluation and inflation was firmly rooted in the Swiss debate. As will be seen below, it remained largely unchallenged despite evidence from countries that had abandoned gold and not experienced significant price increases.¹⁸ Musy did not bother to take a closer look at that policy option but turned to praising the gold standard as the most secure and stable monetary system. Musy conceded that the gold standard had not worked as well in the recent past as before the war. He again denounced the disproportionate distribution of gold, which had resulted in a shortage of gold reserves for several countries and forced them off the gold standard.

The speaker then turned to commenting on the monetary conditions in Switzerland. He pointed out that commercial banks held extraordinarily large liquid reserves against their obligations. This enabled them to meet liquidity demands at any time under the contemporary circumstances of insecurity and lacking confidence. However, it incurred high costs on the Swiss economy by turning banks into large vaults rather than credit outlets. (...l'inquiétude, le manque de confiance dans l'avenir ont réduit au rôle de coffres-forts les établissements financiers que devraient normalement servir de distributeurs de crédits. Musy 1932, 15). This led Musy on to stress confidence as the central ingredient to a monetary system. The gold standard with its material base

¹⁸See the critique of Böhler and Keller (1935) of this “mistake,” i.e. of treating devaluation as equivalent to inflation, on the eve of devaluation, p. 186.

was in a much stronger position to elicit and sustain confidence than a “manipulated currency” (*monnaie dirigée*. Musy 1932, 15). Therefore Musy expressed no doubt that the gold standard would see a “victorious restoration” (*l’éclatant réhabilitation*. Musy 1932, 16) in those countries that had abandoned it. This, in conjunction with the above-mentioned expectation that the world would return to free trade and international cooperation, was a central argument in the Swiss economic policy discussion where measures incompatible with a liberal international economic regime were seen as a temporary device to survive the unfortunate interim. It was logically concluded that the gold standard that had served Swiss international activities so well in the past would equally be the condition for future success.

With the identification of devaluation and inflation, the argument of their ineffectiveness to solve the problems of the export industries and the demonstration of their undesirable consequences, the initially presented economic policy choices had disappeared. Deflation remained the only possible path for the Swiss economy.

Musy discussed at length the high cost of living in Switzerland as compared to her neighbors. Again, many themes recurrent in the contemporary public debate were raised, among them the elevated (luxurious) living standard in Switzerland as exemplified by the high quality of housing and the perceived abundance of retailing businesses operating at excessive costs. Musy (1932, 18) proclaimed the reduction of the excessive living costs in Switzerland a “national problem” and appealed to each individual to contribute to their reduction. Though not explicitly referring to the German example, he rejected price setting through the administration on the grounds that in a democracy this could only be effective if consistent with public opinion - and in that case dispensable. The following passages of his speech were thus aimed at convincing the public of the necessity to reduce prices. Musy (1932, 19) proposed being content with modest profits and expressed his hope that the adjustment of those prices that had not yet fallen would also bring about the elimination of unjustified profits that had emerged during the war years. This again reflected popular themes of the interwar era, where the discontent with war profiteers lingered on. The price adjustment, if not readily forthcoming, would be supported by pressure brought about through the operation of a permanent federal commission for price control. The commission would regularly collect price information, report to the federal and cantonal governments and make the information available to buyers (Musy 1932, 19).

Musy's argument in favor of wage reductions followed lines similar to his advocacy for reduced prices. He pointed out that Swiss wages were considerably higher than wages in most other countries. As they represented a large cost element, this had led to disadvantages for the export industries. Although market pressure had already decreased wages in these sectors, wage reductions across the entire economy were necessary to effectively reduce costs for export production. As wage indices had increased to even higher levels than the elevated consumer prices, wage reductions would not be aimed at reducing real wages. Even so, Musy (1932, 22) mentioned German and British evidence indicating a "disturbing" correlation between real wages and unemployment. He therefore rejected claims to sustain purchasing power by preserving wages (Musy 1932, 23 and 24) and maintained that the experiments with this approach in the United States had failed.¹⁹ Even if purchasing power of wage and salary recipients in Switzerland was reduced and this decreased demand for domestic products, such a reduction would be less grave than the fall in demand resulting from further losses of jobs and income opportunities for workers in the export industries.

The policy debate on wage reductions in Switzerland followed the pattern of Musy's argument. The question of the adequacy of lowering wages as a means to combat the crisis was posed in the context of the competitiveness of export industries. Controversies developed around the issue whether lower export prices due to lower costs would actually lead to an increase in overall exports, increasing output and employment in Switzerland. The direct link between wage levels and the volume of employment, ardently debated in Germany and Great Britain, was only a sideline in the discussions in Switzerland.²⁰

In a rather short paragraph Musy (1932, 24-5) returned to financial conditions in Switzerland. He explained the prevailing low level of interest rates with large capital inflows and warned that inflation would lead to interest rate increases. Not more than a sentence was devoted to a review

¹⁹Neither case of evidence from other countries was discussed in any detail which might be taken as an indication that the interpretation of these cases were uncontroversial, at least in the audience Musy was addressing.

²⁰*Neue Zürcher Zeitung* (January 28 and February 4, 1932) reviewed Jaques Rueff's study published in *Revue d'Économie politique* on the link between wage levels and unemployment in some detail, but did not discuss the relevance of this argument for the Swiss economy.

of the effects of deflation on financial markets. Musy rejected the opposition to price reductions based on the argument that deflation would increase the burden of debt servicing and repayment by pointing out the inevitability of price reductions (... à la longue, il est impossible de maintenir artificiellement les prix. Musy 1932, 25). The treatment of the issue is in clear contrast to the discussion of the reverse situation earlier in his speech, where the redistribution brought about by inflation was admonished as unjust and the repercussions on incentives for economic activity and saving pointed out. This reflects the traditional high regard for saving and befitting conditions in Switzerland where saving rates were traditionally high.

Musy concluded that lowered prices would clearly make exports easier, improve the balance of trade and stabilize the exchange rate. At the same time, he stressed that the recovery would be slow and difficult. It would have to be supported by the continuation of adequate commercial policies, most importantly by the extension and consolidation of compensation trade. Countries with a trade surplus with Switzerland could thereby be made to import more Swiss goods. Musy went so far as to suggest that such bilateral arrangements would be a useful form of normalizing international economic relations (Ce sera peut-être, dans le domaine des relations économiques internationales, une forme utile de normalisation et de rationalisation, une canalisation provisoire en attendant l'organisation définitive de l'incohérente cohue des producteurs et des consommateurs. Musy 1932, 26). According to the speaker, the experiences so far had shown that the technical problems of this form of trade were surmountable and that it therefore presented a superior solution to the alternative of introducing a state monopoly in international trade, a suggestion that was debated in social democratic circles. The former would be in line with the importance of private initiative and freedom which Musy considered vital elements of the Swiss economic order. He underlined that he opposed any substitution of private activities through the state (Musy 1932, 27). Instead, he argued that a better integration of wage and salary recipients into the existing system would be achieved through a broader distribution of property: if these income groups became capital owners themselves they would be in a better position to understand the essential role of capital in the economy.

The next topic Musy (1932, 28) turned to were public finances. He argued that in parallel to the need for economizing on an individual level, the federal, cantonal and community administrations had to reduce their expenses “courageously.” The repayment of war-time debt had to be continued without allowing deficits to reemerge. Musy rejected a prolongation of the war tax, a temporary federal tax on wealth and income initially accepted by public vote in 1915 and later extended until 1932.²¹ As other possibilities to increase revenues were limited, the consolidation of the budget had to come from the expenditure side. At the same time, Musy promised that the government would assist those most severely affected by the crisis, explicitly mentioning the unemployed and the indebted small farmers. This would bring about additional expenses. Therefore, a “general revision” of the entire budget would be required. Part of the savings would have to come from a reduction in wages and salaries of public employees, a claim he had already made in the December 1931 parliamentary session provoking fervent critique from the social democratic opposition. These difficult adjustments to balance the budget were necessary to preserve the country’s “excellent credit” and would allow to repay debt denominated in Swiss francs “valued at the gold parity” (Musy 1932, 29). “Switzerland should have the legitimate ambition to remain one of the rare, the very rare countries that neither went bankrupt nor imposed the costly settlement of a devaluation on her creditors.” (La Suisse doit avoir la légitime ambition de rester l’un des rares, des très rares pays qui n’ont jamais fait faillite, ni jamais imposé à leurs créanciers l’onéreux concordat de la dévalorisation monétaire. Musy 1932, 29).

This heroic appeal towards the end of Musy’s speech is only one example of the rhetoric he employed. He spoke of the “dangerous cure of a brutal inflation” (un dangereux remède dans une brutale inflation. Musy 1932, 13), the “nobility of our Franc” (la noblesse de notre franc. Musy 1932, 16), the “moral values that are neither quoted at stock exchanges nor submitted to the fluctuations of speculation” (les valeurs morales qui ne sont ni cotées en bourses, ni soumises aux fluctuations de la speculation. Musy 1932, 30) and appealed to the “robust confidence of those who know that they will win because they are resolved to make the necessary sacrifices” (la robuste confiance des hommes qui savent qu’ils vaincront, parce qu’ils sont résolus aux sacrifices nécessaires. Musy 1932, 31). The repeated reference in Musy’s talk to “sacrifices” is subtly

²¹A similar direct tax was introduced in the fall of 1933 as “crisis tax” (Eidgenössische Krisenabgabe), see p. 120 below.

reinforced by the insinuation that those sacrifices might be more adequately seen as a revision of excessive developments in the past, as much in the increase in wages as in the improvement of living standards.²² This language is appropriate in a context where he expected the government to rely on moral suasion rather than intervention to achieve the central goal of lower production costs. From today's perspective, the approach seems naive, in the context of the interwar democracies it was not unusual. President Herbert Hoover's concept of "new economics" similarly relied on the cooperation of businesses, trade unions and lower levels of government. Rational argument and the necessary information were supposed to convince economic actors to make decisions in the long-term interest of the entire economy rather than pursuing their narrowly defined own advantages (Barber 1985, 19, 80-82).

Finally, Musy's use of the terms inflation and deflation deserves some comment. As pointed out by critics and allies alike, his use was not in congruence with traditional definitions.²³ He described inflation as an increase in fiduciary circulation, an over-issue of notes in classical terms (Musy 1932, 11). However, inflation understood as an increase in the price level due to an increase in money supply, is just as possible in a gold standard system when gold inflows translate into an increased domestic money supply as proposed in Hume's specie-flow mechanism, a case not considered by Musy. Instead, he linked inflation inevitably to a depreciation of the currency in terms of gold. He thus alluded to the recent experiences of war and post-war inflations where the suspension of international capital flows had allowed governments to finance their war efforts by issuing notes. Germany and France were daunting examples of inflationary developments and Switzerland herself had experienced substantial price increases during World War I which were largely reversed in the post-war depression. Whereas the entire population suffered from increased prices for all essential goods during the war, low income groups were particularly hard hit. Military pay for the conscripted was low and many workers lost their jobs because of their

²²Eichengreen and Temin (2000, 196) aptly call this the "puritanical strand of the gold-standard dogma" when discussing similar arguments made by President Hoover's treasury secretary.

²³See below, p. 70 for Schulthess. Böhler (1932a, 20) and Marbach (1933, 41) warned that misunderstanding could result from this use of the term deflation, a term that was unambiguously defined within monetary theory.

extended absences due to military service.²⁴ As a result 692'000 persons depended on welfare by June 1918, which amounted to 1/6 of the population (Jost 1983, 136). With these experiences still fresh in their minds, treating inflation as equivalent to devaluation and vice versa was clearly going to convince listeners that any measures leading in the direction of lowering the exchange rate should be excluded from policy options.

Whereas Musy defined inflation in terms of a (fiduciary) increase in circulation, he alleged that deflation was detached from monetary phenomena. Price level decreases in his argument - he did not define the term deflation explicitly - would start from individual price and wage decisions. Deflation was thus put into a context where the actions of each economic agent were depicted as decisive, rather than the policies of the central bank or government. To summarize, Musy's use of the terms inflation and deflation were unconventional not least from contemporary economists' point of view. The definition was asymmetric in that inflation was understood as a monetary phenomenon whereas deflation was seen as the result of price-setting decisions in markets. The equivalence of devaluation and inflation which was insinuated rather than substantiated, was central to the debate on monetary policy choices in later phases of the crisis in Switzerland.

The Federal Council's policy guidelines of March 1932 and reactions in parliament

As mentioned above, Musy's speech on February 19, 1932 just preceded the government's official statement on the economic situation dated March 2, 1932.²⁵ On many issues Musy anticipated the official statement, but in important respects he went far beyond the government's report. Both, the fact that Musy spoke out so shortly before the government and that he went beyond the official proposals, can be taken as an indication of the controversies within the Federal Council. The socialist press had suggested such discord in the preceding weeks. Although this suspicion was rejected for example by *Neue Zürcher Zeitung* (February 28, 1932) the repeated statements

²⁴The daily pay for soldiers covered the cost of 3 glasses of beer and a pack of cigarettes. There were no substitute payments for soldiers' wages nor support schemes for their families (Jost 1983, 135).

²⁵Aus den Verhandlungen des Bundesrates. (Vom 2. März 1932.) *Bundesblatt* 1932, 575-80. Müller (2001, 69-73) reconstructs the debate within the Federal Council preceding the publication.

confirming the unified opinion within the council might be taken as reflecting just the opposite.²⁶ The division was between Musy, head of the Federal Department of Finance and Edmund Schulthess, head of the Federal Department of Economic Affairs from 1912 to 1935 (Volkswirtschaftsdepartement).²⁷ Musy's central policy goal was balancing budgets, not least to strengthen confidence in the Swiss currency. Schulthess' approach was more pragmatic which, at least in part, can be explained by the diverse portfolio of the Department of Economic Affairs, including subsidies for needy industries and for the unemployed, trade policy and the already highly interventionist agricultural policy.

On this background, the government's statement can be seen as a compromise of diverging positions resulting, in part, from differing responsibilities of its members and, in another part, from diverging opinions on adequate economic policy responses to the crisis.²⁸ Compared to Musy's speech, the government's announcement is dry conveys a strive for neutral observation. The

²⁶When the government's announcement was presented to the press it was emphasized that the statement was a product of unanimity (*Neue Zürcher Zeitung* February 28, 1932). In his speech to parliament on March 9, 1932 Schulthess stressed consensus within the Federal Council (*Amtliches Stenographisches Bulletin* 1932, 44).

²⁷Böschenstein (1991b, 324) traces open differences in opinion between Musy and Schulthess back to 1926. In 1931 Musy had opposed a policy proposal of his colleague concerning the financing of the social security system in public, a severe violation of the collegial principle within the Federal Council (Python 1991, 357). Altermatt (1991, 89) relates Musy's resignation in 1934 to the conflicts between these two members of the Federal Council that had been ongoing for years. Furthermore, Jost (1983, 142) argues that Musy's personality made compromises in the Federal Council difficult, since his behavior was "uncooperative and conniving" (unkollegiales und intrigantes Verhalten).

²⁸The conflicting views of Musy and Schulthess also reflect different allegiances. Musy was a member of the Christian Democratic Party, Schulthess of the Radical Free Democratic Party. Before joining the public administration Musy, a trained lawyer, headed a regional bank, the *Crédit gruyérien* and later became a member of the Bank Council of the Swiss National Bank, the supervisory body of the Bank (Bankrat der Schweizerischen Nationalbank). As head of the finance department these ties to the Swiss National Bank were reinforced (Python 1991, 355). Schulthess on the other hand had close connections to industry. He was a personal friend of the founder of Brown Boveri and he had served a short term as director of the company. He was a board member in several industrial companies and some banks. At the same time support from farmer's representatives had been crucial at several junctures in his political career which had lead to a personal friendship with the head of the farmer's party Ernst Laur (Böschenstein 1991b, 321-2).

language is decidedly matter-of-fact. The outline of the policy responses would, elaborated and slightly modified later, dominate official statements until the fall of 1936, when devaluation was accepted as unavoidable.

In its opening passage the government emphasized that the economic policies of recent years had combined a moderate protection of domestic industries with export promotion (p. 27). The introduction of import restrictions in the preceding December of 1931 aimed at supporting domestic production, it should not lead to an increase or stabilization of prices since this would be detrimental to export interests. The often repeated metaphor of the untenability of a Swiss “price island” (Preisinsel. *Bundesblatt* 1932, 575) was used to describe the situation. Price and wage adjustments in Switzerland towards world price and wage levels were deemed necessary but they should take place in small steps rather than through a rapid decline. In contrast to Musy, the government’s statement emphasized reasons other than the elevated costs of Swiss export production for the decline in international trade. It was argued that uncertainties concerning the financial situation of trading partners, high tariffs, import restrictions and convertibility constraints hindered trade.

Nonetheless, a reduction of the Swiss price level was described as necessary, but also as forthcoming as a result of reduced demand. Price setting interventions were rejected since there were no constitutional or legal provisions which could serve as basis for such government activity. Like Musy (p. 60), the government’s statement pointed out that the reduction in consumer prices lagged far behind the decline in the wholesale price index, insinuated excessive profits at the retail level and added an appeal to reduce prices wherever possible.²⁹ Furthermore, negotiations with business organizations and professional associations (Verhandlungen mit den wirtschaftlichen Organisationen und Verbänden. *Bundesblatt* 1932, 576) were mentioned as measures to promote price reductions. The importance of reduced rents for an overall reduction in living costs was pointed out (*Bundesblatt* 1932, 577). Cantonal governments should therefore solicit a reduction

²⁹Despite the claim that retail businesses enjoyed above-average profits in the early phase of the depression, legislature protecting this sector was passed already in October 1933. The federal decree prohibiting the opening of chain-stores, department stores etc. was aimed at large businesses entering the retail sector and competing through low prices (Rutz 1970, 173-5). This provides another example of how actual government policies contradicted the official rhetoric.

of interest rates on mortgages by state owned banks but also by private institutions which would allow the reduction of rents and relieve farmers. Finally, the reduction of wages and salaries in the private sector was addressed. Again, the government's statement indicated that no legal basis for intervention was given, that wage reductions were taking place and would continue to do so given market conditions. In contrast to Musy, the government's announcement pointed out that wage reductions implied reduced incomes and consumer power and demanded that these facts be considered.³⁰

The last point addressed in the government's statement were public finances. A further reduction in revenues was expected and an increase in outlays, "namely for the fight against and the mitigation of the effects of unemployment, the support of agriculture and industry." (...namentlich für die Bekämpfung und Milderung der Folgen der Arbeitslosigkeit, für Stützungsaktionen in Landwirtschaft und Industrie... *Bundesblatt* 1932, 579).³¹ The government stated that it had already asked all departments of the administration to come up with proposals for budget cuts. Like Musy, the government envisioned the reduction of wages and salaries of public employees, but in contrast to him, an increase in revenues was mentioned as possibly inevitable in the future (*Bundesblatt* 1932, 579). The need for sacrifices concluded the government's statement as it did Musy's speech: the living standard, the Swiss had gotten used to, would presumably not be upheld in the future and a return to greater simplicity was foreseen. (Die kommende Zeit wird uns grosse Opfer auferlegen. Das Schweizervolk wird voraussichtlich die Kosten der Lebenshaltung, an die es sich bis jetzt gewöhnt war [sic], nicht mehr dauernd aufbringen und genötigt sein, sich wieder grösserer Einfachheit zuzuwenden. *Bundesblatt* 1932, 580).

Compared to Musy's speech the government's announcement must have appeared defensive. The government rejected the demands, voiced not only in the socialist press, to come up with a comprehensive economic program. Instead it argued that there was no need for a programmatic

³⁰“Man muss sich aber darüber klar sein [sic], dass solche Lohnherabsetzungen zu einer Reduktion des Volkseinkommens und der Konsumkraft führen. Dieser Tatsache ist bei der Preisgestaltung Rechnung zu tragen.” (*Bundesblatt* 1932, 578).

³¹Whereas public finances in 1931 were solid, they rapidly and substantially deteriorated in the course of 1932. Especially the federally owned railway services were running large deficits (*Bundesblatt* 1932, 122).

statement, as it was obvious that the interests of domestic production and of the export industries both had to be considered. Therefore, the distinct economic measures to be taken could not be evaluated in a quest for principles but would have to be judged according to their effects on export and domestic industries on a case by case basis.

The debate on the government's report on import restrictions and the interventions in milk and butter markets in the National Council in early March 1932 turned into a vivid discussion of the recently published government announcement.³² Commenting on the debate *Neue Zürcher Zeitung* (March 3, 1932) stated "In general there is very little talk about import restrictions and also the problems of the dairy industry have moved into the background." (Im allgemeinen ist sehr wenig von den Einfuhrbeschränkungen die Rede, und auch die milchwirtschaftlichen Probleme treten in den Hintergrund.) The government's measures remained a topic in so far as several speakers suggested that import restrictions and the interventions in the dairy market led to price support and were thus openly contradictory to the envisioned price and wage adjustments. This was not only stated by representatives of export interests but also by members of the social democratic party (*Amtliches Stenographisches Bulletin* 1932, 30-31, 35). A representative of the farmers' party (Bauernpartei) rejected the view that the price support schemes for milk stood in the way of adjustment. These interventions, he argued, rather aimed at slowing down a complete collapse in milk prices, they still implied continuously falling prices though. He claimed that agricultural producers had taken a lead in accepting downward price adjustments.

Schulthess, as head of the Federal Department of Economic Affairs responsible for both proposals, responded to these criticisms in the National Council. Like the parliamentarians, he spoke about the government's position as laid out in the recent announcement rather than focusing on the individual measures concerning import restrictions and the dairy industry. He reiterated the premise that both domestic and export industries should be supported by the government's measures. Whereas interventions in favor of the production for domestic markets were effective, the government's "power ceased at the borders." (...unsere Macht hört an den Grenzen auf. *Amtliches Stenographisches Bulletin* 1932, 40). After discussing specific measures such as

³²20 speakers participated in the debate that lasted more than one day and a half. Federal Councillor Schulthess spoke three times on behalf of the government.

clearing arrangements, compensation trade, export risk insurance etc. he turned to price and wage adjustment. In this part of his speech several hints at differences in opinion with his colleague Musy can be found. Schulthess started out with criticizing the use of the term deflation in this context. Appealing to the authority of Federal Councillor Albert Meyer,³³ a trained economist, he rejected the term for the envisioned price and wage adjustment, as these were not driven by restricting the money supply (*Amtliches Stenographisches Bulletin* 1932, 43). Schulthess adhered to a traditional monetary interpretation of the term deflation. He argued that unimpeded imports would drive down prices but at the same time destroy domestic industries. Instead, prices should fall in a controlled manner, but not to the depressed levels of neighboring countries as this would bring about a breakdown in economic activity. Schulthess reiterated the statement that Switzerland could not remain a (high-) “price island” and repeated the appeals for price and wage reductions that were also part of the government’s official statement. The demand for reduced wages and salaries for public employees was paraphrased as well. In his later contribution to the debate, reacting to demands and critique voiced by parliamentarians, Schulthess’ position came out even more clearly. He stated that price and wage reductions alone would not make Swiss exports competitive in world markets or solve the export crisis. But they would be decisive once world markets had recovered. Then competitive cost conditions in Switzerland would allow exports to grow.³⁴ He argued that the debate about wage and price reductions was misconceived as these adjustments would result from market pressure. Furthermore, the adjustments should take place in a controlled manner, a collapse of prices and wages would be disastrous for the functioning of the economy. Finally, he reiterated his viewpoint, a conviction he pronounced frequently, that the power of the government to influence economic processes was rather limited, that the economy followed its own laws instead (*Amtliches Stenographisches Bulletin* 1932, 45 and 80-81).

³³Meyer, like Schulthess a member of the Radical Free Democratic Party, had joined the Federal Council in 1930. Before taking over the Department of Finance after Musy’s resignation in 1934 he headed the Department of Home Affairs.

³⁴A similar argument was made in *Neue Zürcher Zeitung* on April 24, 1932 and on later occasions.

Reviewing this first broad debate over the government's proposed economic policies, several points are worth underlining. First and foremost, a large number of speakers from diverse quarters pointed out inconsistencies in the government's measures of import restrictions and sectoral support with the overall goal of downward price and wage adjustment. Disappointment with the government's statement came out in many contributions. For the left, the goal of further price and wage adjustments was misdirected and government measures taken in support of the economy did not go far enough. An encompassing economic program with a distinct role for the government was demanded.³⁵ Industrial interests deemed the government's declaration timid, not taking a decisive stance on the issue of adjustment, being vague concerning the price controls for the goods of protected industries and offering little to actively promote exports.³⁶ Farmers' representatives defended the government's protective measures, as agricultural prices had collapsed in the recent past. On this background, wage reductions were rejected, as they were expected to further reduce the demand for agricultural products. Despite its contentious nature and the participation of an unusually large number of representatives, the parliamentary debate barely foreshadowed the upcoming controversies.

The government's wage reduction bill submitted in June 1932

It was the government's proposal on the reduction of wages and salaries of public employees which developed into the real battleground over the government's policy.³⁷ The National Council debated the proposal in September 1932 and passed the law with several changes in December of the same year. The core of the government's proposal, which was prepared in Musy's finance

³⁵This demand reflected the debate on economic planning in preceding years. The meetings of the Swiss statistical society (Schweizerische Statistische Gesellschaft 1932, 161-226) in May 1932 had been devoted to this topic (see footnote 58, p. 115 below). The social democratic and unionist suggestions to introduce elements of macroeconomic planning as a means to deal with the crisis would regain prominence in public debates with the presentation of the crisis initiative in 1934 (pp. 125-130).

³⁶The proposal for an increased resort to compensation trade was well received by a majority. The Federal Department of Economic Affairs was going to seek further discussion on these procedures with the representatives of export industries in a first step, then importers should be integrated into the discussion (*Neue Zürcher Zeitung* March 10, 1932).

³⁷Botschaft des Bundesrates an die Bundesversammlung betreffend die vorübergehende Anpassung der Besoldungen, Gehälter und Löhne der im Dienste des Bundes stehenden Personen an die veränderten Verhältnisse. (Vom 20. Juni 1932.) *Bundesblatt* 1932, 101-67.

department, was to reduce wages of public employees by 10 percent during the years 1933 and 1934. The bill would furthermore empower parliament to evaluate a continuation of these reductions for additional two years conforming economic and fiscal conditions. The argument in support of these suggestions was built on budgetary considerations, considerations of fairness across wage and salary recipients and on the need for overall adjustment resulting from the elevated price level in Switzerland as compared to the rest of the world.

After a discussion of the effects of the crisis on revenues and expenses, the importance of wage and salary payments in all parts of the budget was underlined. This pertained not only to the federal administration but just as importantly to federal agencies, in particular the federal railways and the mail, telephone and telegraph services. The proposal aimed at presenting the reduction of wages for public employees as fair by comparing these wages and salaries to wages payed in the private sector. With the same intention the extent of wage and salary reductions for public employees implemented in neighboring countries was documented. The government argued that by taking the year 1927 when the current wage and salary regulations were legislated as point of departure, real wages would be preserved. The proposed reduction of 10 percent was claimed to be lower than the decrease in the consumer price index that had taken place since then.

Finally, the wage and salary reduction was portrayed as inevitable in the context of the depression. Several passages almost literally repeated paragraphs from Musy's February speech. The interpretation of the crisis and need for adjustment to world price and wage levels was reiterated. Wage reductions would allow further price reductions, whereas past price decreases allowed real wage levels to be maintained. As no part of the economy could escape the logic of adjustment, public employees could not stand aside either. The argument, that overall purchasing power in the economy would be lost in light of wage and salary decreases, was countered with a reference to the United States' experience where experiments with growth built on the increase in wages had failed.³⁸ The relationship between the real wage level and unemployment was mentioned in support of wage reductions without substantiating the claim.

³⁸As on earlier occasions, references to the United States' experience are not substantiated by evidence. The argument here and in similar contexts was vague enough to refer to Herbert Hoover's policies as well as to Henry Ford's philosophy.

In a passage on the price level and price controls (*Bundesblatt* 1932, 133-4) it was argued that wage reductions alone would not allow prices to come down sufficiently. Other income components had to fall also, with profits, interest rates and rents mentioned explicitly. An appeal to the “national duty” (nationale Pflicht. *Bundesblatt* 1932, 134) of each and everyone to relinquish unjustified gains followed. At that point a new proposition made its appearance: “If free competition were hindered by price arrangements that fixed the price level once and for all, and if the idea of fairness and professional diligence had lost its valuable moderating influence in the matters of prices and rents, the duty to intervene to regulate prices would accrue to the government.” (Würde der freie Wettbewerb durch Preisabreden, die das Preisniveau ein für allemal festlegen, gehemmt und hätte in der Preis- und Mietzinsfrage der Gedanke der Billigkeit und der beruflichen Gewissenhaftigkeit seinen wertvollen mässigen Einfluss eingebüsst, so erwüchse dem Staate die Pflicht, preisregulierend einzugreifen. *Bundesblatt* 1932, 134). No attention was paid to the suggestion that the government could actually aspire to intervene in price setting at that stage of the debate, maybe simply due to the convoluted form the suggestion was presented in. The Federal Councillors who spoke in parliament did not repeat it. It was to resurface only two years later in Schulthess’ controversial speech (Aarau Reden) of 1934, which will be discussed in due course (p. 137).

In the concluding pages of the proposal the government explained why the time-consuming path of an orderly revision of the laws and regulations of public employees’ remuneration was chosen rather than the expeditious route of an urgent generally binding decision of the Confederation (allgemeinverbindlicher dringlicher Bundesbeschluss) which could arguably also have been resorted to as only temporary changes were envisioned. Whereas the revision of a federal law was open to an optional popular vote (Referendum), this was precluded for urgent generally binding decision of the Confederation. In fact, much of the legislation passed in the following years was based on this type of emergency procedure and on extraordinary delegation of powers to the federal government.³⁹ At this early stage in the debate, when the bitter opposition to the governments’ policies was only just beginning to develop, the Federal Councillors considered the possibility of a popular vote “imperative.” “This serious problem not only concerns the

³⁹The effects of these procedures on the political process will be discussed in more detail below (p. 122).

administration, the civil servants, public employees and workers but the entire economy. Hence the people should be able to decide, if they wish; everybody will have to bow to their verdict.” (Das Referendum erscheint unerlässlich. Über dieses schwerwiegende Problem, das nicht nur Behörden, Beamte, Angestellte und Arbeiter, sondern die ganze Volkswirtschaft berührt, soll das Volk, wenn es dies wünscht, entscheiden können; seinem Verdikt wird sich jedermann beugen müssen. *Bundesblatt* 1932, 135-6). This appeal to the decision of the people was to be repeated by the Federal Councillors in parliament in similarly emphatic terms. Less than a year later such statements had come out of fashion when the government asked parliament to pass a financial program based on emergency procedures. Among other measures to bring about balanced budgets it included the wage reductions that had been rejected in the referendum.

The parliamentary debate on the government’s proposal showed that the positions on the policy of wage and price adjustment were, by now, clearly delineated between the parties represented in the government and the social democratic opposition. During the parliamentary session, the debate in the National Council⁴⁰ continued for two full days (September 21, 22), one afternoon (September 28) and one morning (September 29) session.⁴¹ 29 representatives spoke in the general discussion of the government’s proposal, which was concluded by votes of two members of the Federal Council.⁴² In the debate over the individual articles of the law another 17 contributions were made and both members of the federal government spoke again. The debate was heated, personal attacks abounded, speakers were heckled. Repeatedly, the president of the National Council had to intervene and call the members to order (e.g. *Amtliches Stenographisches Bulletin* 1932, 615). On December 15, 1932, the modified proposal was passed by the National Council

⁴⁰Besides the National Council (Nationalrat) where the population is represented proportionally, the Council of States (Ständerat), constituted of two representatives of each Canton (half-Cantons are represented by one member) debated the proposal and eventually passed the law with modifications.

⁴¹The suggestion of the National Council’s president to close the debate after one and a half days was not supported by a sufficient majority (*Amtliches Stenographisches Bulletin* 1932, 634).

⁴²Jean-Marie Musy, the finance minister, reiterated the need for saving and overall adjustment. Marcel Pilet-Golaz (Federal Councillor from 1928-1944) headed the department responsible for the federal railways and the postal service in the period concerning us here. In his contribution he concentrated on the financial difficulties of these agencies due to the crisis.

with 77 votes in favor of and 57 votes rejecting the law (*Amtliches Stenographisches Bulletin* 1932, 901). Most importantly, the wage reduction was limited to a period of one and a half years and set at 7.5 rather than the proposed 10 percent.

The discussion opened with the reports of the preparatory finance commission. Whereas the majority of its members suggested that parliament should proceed to discuss the articles of the proposed law, a minority of commission members advised not to deal with the matter.⁴³ The majority view was presented by one French and one German-speaking member of parliament. In line with the government's proposal both built their argument around the need to avoid budget deficits in face of reduced revenues. Going beyond the government's justifications, this was set in the context of the Swiss franc's gold parity, which could only be upheld if the state remained solvent and creditworthy (*Amtliches Stenographisches Bulletin* 1932, 569, 572). As well as many of the other speakers, both parliamentarians demanded that the government present an encompassing proposal of budgetary retrenchment.

Most other supporters of the government's bill elaborated on the arguments the government had presented in its proposal. To those the often repeated comparison to good housekeeping was added: just as the prudent pater familias would do, the public administration had to limit expenses so as not to exceed revenues (e.g. *Amtliches Stenographisches Bulletin* 1932, 604). Among the statements made by government supporters, contradictory perceptions of the nature of the ongoing deflation is noteworthy. On the one hand, one speaker pointed out that wage reductions would not lead to real wage cuts as consumer prices had already fallen. On the other hand, he warned of the dangers of imminent inflation if wages were not reduced (*Amtliches Stenographisches Bulletin* 1932, 573). Considering the steep decline in the consumer price index in the previous years (p. 23), it is remarkable that fear of inflation was still pervasive.

⁴³The 1920s had seen a continuous argument over salaries and wages of public employees in parliament. A series of provisional agreements were finally replaced in 1927 with the adoption of a law (*Bundesgesetz über das Dienstverhältnis von Beamten. Vom 30. Juni 1927*) setting general rules for the basis and the adjustment of the compensation of public employees (Bratschi 1967, 42). The refusal of unionist representatives to touch this compromise after it had been in force less than 5 years is at least partly due to its history.

The minority speaker of the preparatory commission, a representative of the social democrats (Robert Bratschi), argued that the wage reductions should not only be seen in the context of balancing the budget, as the government had done in its proposal, but had to be considered in a broader context of their influence on the entire economy.⁴⁴ As the budgetary disequilibrium was a result of the crisis, balancing the budget would only be possible in a recovering economy. Therefore, the question to be asked should be if reducing wages would help to overcome the crisis. The speaker argued that the wage reductions that had taken place in the export sector had not kept exports from falling dramatically. Instead, as exports were increasingly taking place within a framework of compensation trade, the level of imports would have to be maintained if exports were to be kept from falling further. Wage reductions would reduce demand for domestic goods.⁴⁵ Moreover, the decline in demand for imports resulting from reduced incomes would further undermine Switzerland's ability to export. Importing from trading partners was vital for the continuation of exports. The speaker also pointed to the German experience describing it as a "deflation catastrophe" (*Amtliches Stenographisches Bulletin* 1932, 576). The core of the social democratic opposition to the government's policies was thus presented in a nutshell. Underconsumption or purchasing power arguments were used to substantiate these claims.⁴⁶

The speaker continued by criticizing the majority suggestion of the preparatory commission to demand an encompassing plan of reduced expenditure from the government. He expressed doubts about whether the majority expected such a plan to be forthcoming since the minority's recommendation to shelve the proposed wage cuts until the government presented an overall plan

⁴⁴Bratschi's argument followed his detailed discussion in *Gewerkschaftliche Rundschau* (1932 (24), 273-84).

⁴⁵Some representatives of farm interests supported the opposition to the government's proposal taking up this line and arguing that wage reductions would reduce the demand for agricultural products and increase the downward pressure on prices. The majority of the farmers' party, however, stood behind the federal government's proposal (*Amtliches Stenographisches Bulletin* 1932, 608, 9). Since the elections in December 1929, the farmers' party held one of the seven seats in the Federal Council. During the years under consideration, it was occupied by Rudolf Minger who headed the Department of Military Affairs (Militärdepartement) from 1930 to 1940.

⁴⁶In his vote in the parliamentary debate Fritz Marbach elaborated on the ideas. As his contributions represented the opposition view in the academic debate, we will review them in that context, see pp. 89-93.

to balance the budget had been rejected.⁴⁷ In the final passages of his contribution the speaker blamed the government for having provoked the confrontational climate of the current debate by the way the proposal had been prepared (*Amtliches Stenographisches Bulletin* 1932, 580). He accused the government of having neglected consultations with representatives of public employees or their organizations. Moreover, he argued, by publishing the specific suggestions for wage cuts in the press before informing the employees, the government had destroyed any room for negotiations. He declared that the opposition would seek a referendum if the law were passed.⁴⁸

Concluding remarks: the early phase in economic policy debates

The repercussions of the Great Depression on the Swiss economy were concealed by favorable domestic developments into the year 1931. Whereas the press, industry representatives and unions debated the export crisis and necessary reactions to it, the preceding analysis showed that the

⁴⁷In the course of the debate another social democratic speaker suggested considering a general income tax at the federal level, raising a recurring issue in parliamentary budget debates (e.g. *Amtliches Stenographisches Bulletin* 1932, 601).

⁴⁸Some opposition speakers resorted to a Marxist interpretation of events. They accused the government of intending to lower the living standard of a large group of the working population. At the same time, they blamed the more moderate representatives of social democracy of being naive “reformers” when discussing crises explanations and policies with the bourgeois majority instead of perceiving the issue as one of class struggle. In their view, the depression was a systemic crisis of capitalism and the capitalists’ only defense was to increase exploitation (*Amtliches Stenographisches Bulletin* 1932, 596-7). These divisions within the left made their appearance in many votes, be it in this form or in accusations by moderate representatives that the radicals were splitting the workers’ movement. Similar controversies had already broken out in the first broad debate about the government’s economic policies in March (e.g. *Amtliches Stenographisches Bulletin* 1932, 60-61).

The 1930s were a decisive period in the development of Switzerland’s Social Democratic Party away from an opposition force fighting for the overcoming of the (capitalist and bourgeois-democratic) system to an integrated part of the political system of Switzerland. Schmid-Amman (1967, 86-7) points out that already in the 1920s social democrats made up the largest party group in parliament and participated in the governments of several cantons and communities. Even so, the party line was still framed in terms of class struggle and socialist revolution implying a divergence in party program and practical politics. During the 1930s, the debate between radical and reform positions frequently was about economic issues. Policy proposals were compromises. I will concentrate on the reform-oriented wing of the party. Comprehensive analyses of the development of the social democratic party in this period are presented in Scheiben (1987) and Morandi (1995).

government was extremely reluctant to acknowledge the scope of the crisis. Whereas several measures in reaction to the effects of the crisis were taken in the course of 1931, the Federal Council responded only in March 1932 to the increasing demands from the public to issue a general assessment of the economic developments and policy guidelines. In many respects, Federal Councillor Musy anticipated this statement in a speech given in February, but in several points he advanced a less compromising position. The ingredients of his understanding of the crisis and of the necessary policy responses based on the gold-standard mentality were elaborated.

The most important aspects of this world view were spelled out by Musy with reference to the Swiss context. The adherence to the gold standard and more precisely to the given parity was presented as if unquestionable. On the one hand, the system was understood to provide a reliable basis for the international economic ties Switzerland depended upon. The liberal order of which it was part was seen to be only temporarily suspended by the misconceived monetary policies of Great Britain and by trade restrictions. On the other hand, the gold standard provided a sound basis for domestic monetary policies. Any deviations from its imperative would only lead to inflation and chaos. With the fixed parity as cornerstone of the economic regime, changed world market conditions called for a decline in domestic production costs. Therefore, price and wage adjustments were seen as the central mechanism to overcome the disruptions in trade. Furthermore, balancing the budget was indispensable to sustain confidence in the parity of the Swiss franc. The adjustments, both on the individual level of prices and wages and in the public sphere of budget policies, were presented as naturally following from the logic of the economic system. This was contrasted to the arbitrariness of a manipulated currency. Both parts of the adjustment strategy would help overcome alleged excesses of the past and lead to healthier and sustainable conditions. Apart from the traditional liberal faith underlying the world view, it thus also entailed a claim on principles of modesty and morality.

It had taken the Federal Council months to come up with a joint statement on the crisis. Among other, this was an indication for differences in the opinions within the Council. Whereas the government's statement reflected the world view underlying Musy's talk, in many details it deviated from his argument. The assessment of recent developments was overall more realistic, conceding circumstances that counteracted the functioning of automatic adjustments in the international arena. Import restrictions by trading partners, convertibility constraints, etc. impeded

Swiss exports at least as much as production cost differences. Thus, the argument and the conclusions were more cautious and the demand for adjustment more moderate than Musy's. Moreover, the government confirmed its approach to supporting domestic production.

The unions had reacted without delay to the export industry's demands for wage reductions. Their rejection rested on purchasing power arguments, suggesting losses to domestic industry as demand from wage earners declined. The trade unions had also approached the government with demands for employment programs. However, in the early phase of economic policy debates these suggestions were unable to draw public attention. The debate was dominated by the demand for adjustment policies, the opposition was forced into the defensive. When the Federal Council presented a bill to parliament in June 1932 proposing wage reductions for public employees it met with the fervent resistance from social democrats. In the brief period between the spring and the summer of that year, the tone of the debate between government supporters and opposition had changed dramatically. The protocols of the parliamentary debates analyzed in the previous sections prove that point. The confrontation reached a first peak when the opposition took the federal law mandating the reduction of wages and salaries of public employees to a referendum in the spring of 1933.

Devaluation of the Swiss franc was not an important topic in these early debates. Although Britain's departure from the gold standard provoked comments, these were short and straightforward. Few words were devoted to rejecting devaluation as a policy option for Switzerland, an indication that consensus on the issue made an extended debate unnecessary. The central counter arguments to devaluation were, however, spelled out. They were to gain importance in later stages of the debate.

4. The demand for adjustment on the background of contemporary business cycle theory

The fierce and confrontational debate that raged through parliament and the press was taken up by academic economists. The supporter of the government's agenda drew on overinvestment theories to substantiate the demand for price and wage adjustment. His opponent a member of the social democratic party employed underconsumption arguments in his critique of the government's approach to crisis policies. Both sides thus relied on theories that played important roles in the policy debates in other European countries. These theories will be presented and confronted with each other. Additional aspects were brought into the debate at the annual meetings of the Swiss Statistical Society in May 1933, taking place just a few days before the referendum on the federal government's wage reduction bill. Finally, the perspective on the theoretical arguments is broadened by discussing their relation to the classical framework of analysis from which they emerged and by contrasting them with the framework of Keynesian macroeconomic analysis dominant in the second half of the twentieth century.

Overinvestment arguments and the case for adjustment

Eugen Böhler, Professor at the Federal Technical Institute Zurich, was the first Swiss economist to contribute an extended discussion of economic policy options from an academic perspective.¹ Böhler picked up the theme which had concluded the speech of Federal Councillor Edmund Schulthess in parliament in March 1932 (see p. 70 above). Schulthess had pointed out the inherent logic of events to justify the government's abstention from presenting an encompassing program of crisis policies: "According to our understanding, the crisis we are experiencing today leads perforce to certain consequences, which are inevitable and there are no means to make them disappear. Whether we want to lower wages, whether we want to lower prices or not, does not matter. It is not us who command. Events have taken the floor and we are only executors of this will." (Wir fassen die Dinge so auf, ... dass die Krise, die heute besteht, zwangsläufig zu gewissen Konsequenzen führt, die unvermeidlich sind und die wir durch kein Mittel aus der Welt schaffen können. Ob wir die Löhne, ob wir die Preise herabsetzen wollen oder nicht, darauf kommt es nicht an. Nicht wir befehlen.... Die Ereignisse haben das Wort, und wir sind nur die Vollstrecker dieses

¹Contributions of academics in newspapers and magazines predate Böhler (1932a). E.g Alfred Ammon in *Bund* December 12, 1931.

Willens. *Amtliches Stenographisches Bulletin* 1932, 45 as cited by Böhler 1932a, 6). Böhler reinforced this view by adding that there existed no simple and straightforward causal links within the complex interrelations of the economy which could be used to bring about recovery through government policies. Instead, adjustment would be necessary so as “to generate the conditions that precede revival according to experience” (... um diejenigen Voraussetzungen zu schaffen, die erfahrungsgemäss der Wiederbelebung vorangehen. Böhler 1932a, 7).

Böhler’s argument was a contribution to economic policy debates, he avoided purely theoretical discourse. On the one hand, he sought to substantiate the government’s adjustment policies and on the other, he aimed at refuting alternative policy suggestions. The theoretical framework of his argument is clearly discernible. Read on the background of the contemporary debates over business cycle explanations, his analysis of the cycle and his policy conclusions resembled arguments widely held in contemporary Europe. At the time often referred to as monetary business cycle theories, Gottfried Haberler (1963 [1937], 29) united the different branches of the argument under the title overinvestment theories. He thus stressed the common ground rather than the differences between authors like Friedrich A. Hayek² and Ludwig Mises³ who saw monetary causes at the root of business cycles and Joseph A. Schumpeter⁴ for whom credit expansion was a necessary concomitant of a boom, though not its ultimate cause.⁵ Mises, in a contribution to the discussion at the yearly meetings of the Verein für Sozialpolitik in 1928, claimed them to be the “prevailing view” (herrschende Auffassung. Verein für Sozialpolitik 1929, 326). Even if this statement would not have been subscribed to by all in his audience, it is certainly fair to argue that, by this time, a broad consensus had emerged that monetary factors played a central role in the business cycle.⁶

²*Preise und Produktion*. (1931)

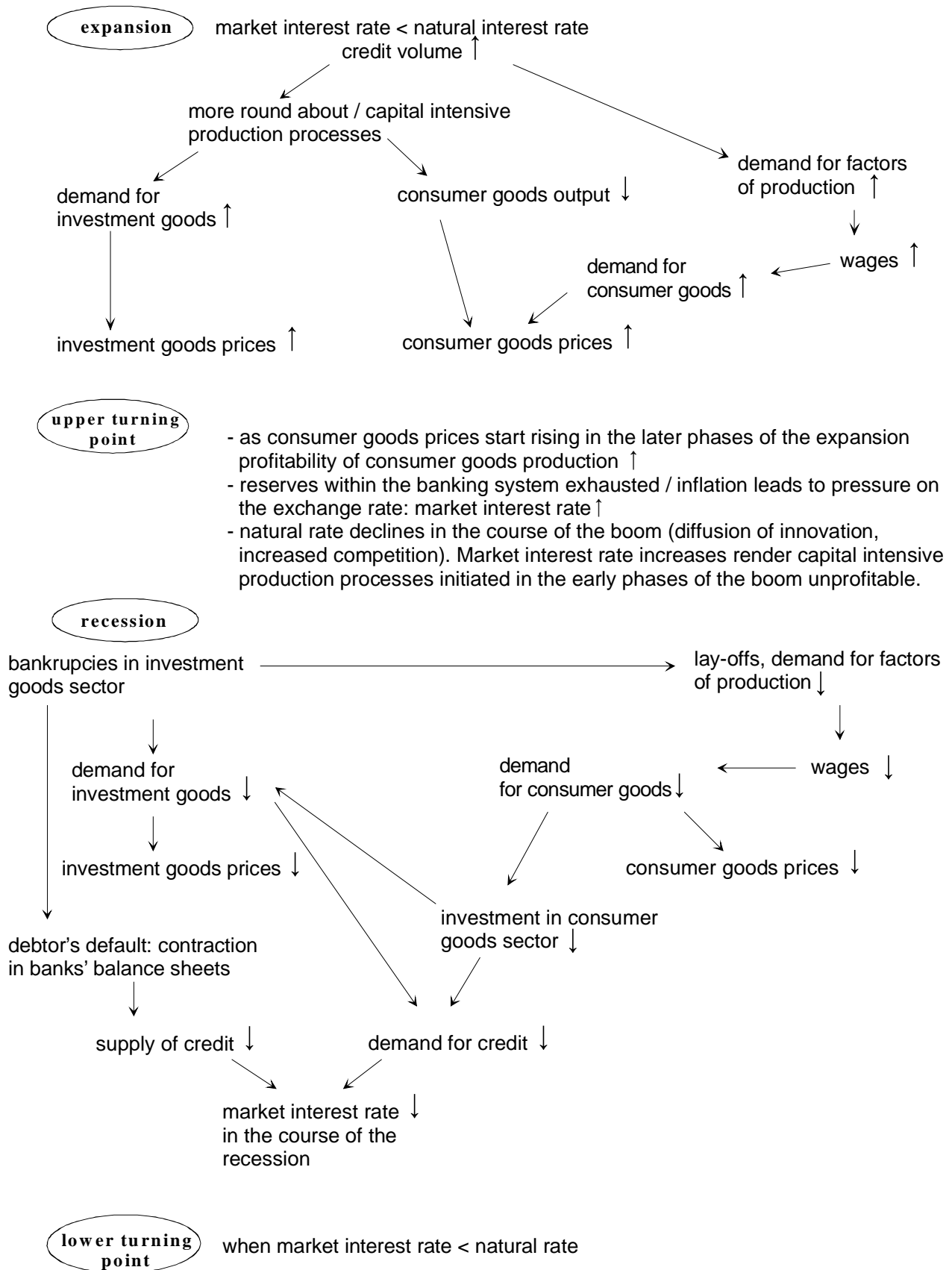
³*Theorie des Geldes und der Umlaufsmittel*. (1912)

⁴*Theorie der wirtschaftlichen Entwicklung*. (1911)

⁵Austrian business cycle theory also influenced the English speaking world. Decisive for the spread of ideas was Lionel Robins who invited Hayek to the London School of Economics in 1931 (Laidler 1999, 27).

⁶See also Spiethoff’s influential entry on crises in *Handwörterbuch der Staatswissenschaften* where he identified credit as “the indispensable aid” (das unentbehrliche Hilfsmittel) of the expansion (Spiethoff 1925, 74).

Figure 13: The main chain of arguments in overinvestment theories



Central to overinvestment theories is the empirical observation that during the business cycle fluctuations in investment goods industries are more pronounced than in consumer goods industries.⁷ This development is initiated by a credit expansion. Its effects are discussed in terms of Wicksell's cumulative process, putting his analysis of price and quantity dynamics at the core of overinvestment theories. Wicksell (*Geldzins und Güterpreise*. 1898) distinguished the market rate from the natural rate of interest. The market rate is determined in the loanable funds market from investors' demand for funds and the supply of credit by commercial banks. In contrast, the natural rate is not observable. It is the rate where the supply of voluntary saving and investment demand would meet. In other words, if the natural rate of interest prevails, goods markets clear at constant prices, i.e. the economy is in real and monetary equilibrium (Leijonhufvud 1981b, 155-6).⁸ If the market rate falls below the natural rate investment demand rises and initiates an expansion.

Figure 13 provides a schematic overview of the main mechanisms that explain the cycle according to overinvestment theories. The low market interest rate renders more round about or capital intensive production processes profitable. Additional investment demand is financed through bank credit. As it is not made possible by additional voluntary saving consumption does not decrease to free up factors of production. Excess demand in goods markets leads to price increases, further fueling profit expectations of investors. Increased demand for labor raises employment, drives up wages and through this venue increases consumer goods demand in the later phases of the boom.

The expansion lasts as long as commercial banks are willing to expand the volume of credit. Eventually the banking system's reserves will be absorbed. Within the gold standard price level increases may furthermore drive down the exchange rate and force the central bank to raise the

⁷Böhler (1932a, 8) stressed this observation as a critique of "popular" purchasing power explanations of the crisis that pointed to a lack in demand for consumer goods as leading to the breakdown of the boom. He thus insinuated that purchasing power arguments claimed that the recession emerged from consumer goods industries in contrast to the actual argument of Swiss underconsumptionists (see below p. 92).

⁸This equilibrium definition led to a search for the principles of "neutral money" or, in other words, for monetary policies aimed at avoiding disturbances of economic equilibrium. For the contemporary debates on monetary theory and policy and their links to overinvestment arguments see below, pp. 164- 175.

discount rate. The resulting increase in the market interest rate ends the boom. The crisis is triggered by “overinvestment” in the sense that credit-financed investment exceeds the volume sustained by voluntary saving.⁹ It is not a shortage in consumers’ demand that leads entrepreneurs to cut investment. Quite to the contrary: following the logic of the model, too much is consumed and too little is saved to sustain the capital-intense or round-about structure of production built up during the boom period.¹⁰ The crisis spreads to the entire economy through real and monetary channels. The adjustment process will lead to a structure in real capital corresponding to the real savings of the economy. Lower costs and falling interest rates will restore profitability. As investment expands, a recovery sets in.

The depression follows the boom as a necessity. Its function is to “purge” the economy from the excesses of the boom period. As interest rates, wages, and prices fall a recovery ends the depression just as naturally as the crisis terminates the boom. Business cycles are understood as deviations from the long-term equilibrium or equilibrium growth path to which the economy is returned by market forces (Klausinger 1994, 112). Therefore, the only economic policy that is desirable in the depression is one that accelerates the adjustment process (Röpke 1931, 427). Following the logic of the model adjustment implies a reduction of consumption in favor of savings. Public spending has to be curbed and the budget has to be balanced so that savings are not diverted from private sector investment. Expansionary economic policy would be counterproductive. A prerequisite for recovery is the realignment of prices and costs offsetting the inflationary increases of the boom.

⁹Forced saving, i.e. the reduction in desired (real) consumption through reduced purchasing power of recipients of those incomes that do not increase as fast as prices, will relieve the pressure in goods markets and free up resources for accumulation only to a limited extent.

¹⁰The original proponents of overinvestment theories argued on the background of Austrian capital theory stressing the temporal nature of production processes (Laidler 1999, 27-36). More capital-intense production is understood to go along with an increase in the subsistence fund allowing investors to start more round-about processes. The crisis implies that such “longer” production processes cannot be brought to conclusion, thus leaving the economy with a capital stock whose structure does not correspond to the intertemporal preferences of its subjects. This point is retained by authors who otherwise do not strictly adhere to Austrian capital theory.

This explanation of the business cycle was the background to Böhler's argument. Thus he was able to take up the demands of the export industries for a reduction in domestic costs in face of fallen prices of export goods, a demand that must have seemed plausible to a general audience perceiving the crisis in Switzerland as resulting from the spill-over of the world depression. The price collapse on international markets had been aggravated by the devaluation of the Pound Sterling and had destroyed the competitiveness of Swiss products in world markets. The Swiss government backed the export industries' demand as the revival of exports was considered a precondition for the recovery of the entire economy.

Böhler added to this argument justifications for price and wage reductions taken from the overinvestment view of the cycle. He pointed out the role of bank credit in bringing about the boom (Böhler 1932a, 8-10) and described the crisis as a result of the lack in capital necessary to conclude the expansion of the production capacity (Böhler 1932a, 28 and 36). Böhler argued that the causes of the crisis could be found in the fact, "...that sufficient capital was not available to finance the expansion of the production capacity in the economy which would allow to fully employ what already existed." (...dass nicht genügend Kapital verfügbar war, um den weiteren Ausbau des Produktionsmittelapparates der Volkswirtschaft zu finanzieren, der eine Beschäftigung des bereits vorhandenen ermöglicht hätte. Böhler 1932a, 36). Thus Böhler argued in loosely Austrian terms by suggesting that the capacity created in production goods industries could not be fully utilized as the capital necessary to build up the later stages of the production process was not available. He concluded from this argument that, as precondition to recovery, investment demand had to increase so that the capacities in the investment goods sector could be employed. Additional demand for consumer goods, as called for by his opponents, would not lead to this effect. Despite the Austrian "spirit" of his argument, Böhler did not explicitly refer to the temporal structure of production as stressed in Austrian capital theory or use the vocabulary familiar from authors like Hayek, Mises and other Austrians.

Along the lines of the overinvestment theory, he argued that the boom period of the 1920s had brought about new industries, new goods and improvements in production methods.¹¹ These

¹¹Böhler (1932a, 10-12) pointed out that the cyclical development was eclipsed by structural changes as in the case of the textiles industries brought about by the appearance of new

changes had been accompanied by inflation. Declining prices in the recession were therefore a result of this progress and a natural part of adjustment (Böhler 1932a, 20). Reduced costs were furthermore seen as necessary to allow investment to recover and bring about a reversal of the depression.¹² Böhler (1932a, 21) continued that the spontaneous adjustment of prices as implied by the theoretical argument had been uneven. Certain prices and wages had been kept artificially high by cartels and government intervention, such as tariffs, import restrictions and subsidies (Böhler 1932a, 26). Product prices had fallen more rapidly than wages, interest rates and taxes, prices of raw material had declined more than prices of finished products and prices determined in free markets were lowered more than prices determined in oligopolistic markets. Therefore, Böhler argued, what was necessary was a “differentiated reduction in wages, salaries and prices, i.e. a reduction in those prices and wages, which have so far not participated in the adjustment.” (... ein differenzierter Lohn- und Gehaltsabbau und ein differenzierter Preisabbau, d.h. ein Abbau derjenigen Preise und Löhne, die bisher die Anpassung nicht mitgemacht haben. Böhler 1932a, 22). As the aim would be to restore the competitiveness of the export industries, prices and wages in most other sectors had to fall.¹³ Böhler (1932a, 22) concluded that “the more general the reductions in costs, the lesser they will need to be in each individual line of business, since they then add up in the costs of the export industry.” (Je allgemeiner die Kostensenkung, desto geringer muss sie beim einzelnen Erwerbszweig sein, weil sie sich dann bei der Exportindustrie summiert...). Finally, Böhler (1932a, 25) argued that the cost reduction should be implemented as quickly as possible so as to shorten the period of stagnation. Just as argued by the government, Böhler (1932a, 24) stressed that wage earners had experienced an increase in purchasing power in recent times, an increase that was unjustified and should be reversed through the adjustment process.¹⁴

industrial producers on world markets.

¹²Böhler did not address the problem that falling prices dampen profit expectations and that this effect could outweigh the effects of reduced production costs.

¹³Böhler (1932a, 23) excluded agricultural prices from the need for immediate further reductions since they had already fallen substantially. In this sector price decline could wait until overall wages and prices had adjusted.

¹⁴Böhler (1932a, 32-4) discussed devaluation as an alternative to price and wage adjustment. However, discussing the effects he arrived at a clear rejection of this policy option, stressing inflationary impulses, the loss of confidence and increased uncertainty.

Böhler and the Federal Councillors who expounded the government's economic policy goals shared the lack of well-defined suggestions on how price and wage adjustment could be brought about. Böhler repeatedly stressed the importance of the price mechanism as key to the functioning of a market economy. He pointed out government interventions and cartel organizations as hindrances to the working of the price mechanism. But he did not come up with concrete policy proposals on how these interventions should be reduced to allow for the necessary adjustment, i.e. he did not demand an abolition of tariffs or import restrictions (to take up his examples). Thus, like the politicians, all he offered was the rejection of expansionary policies which would lead to further intervention (Böhler 1932a, 45). He left his readers with an appeal that each and every one participate in the necessary adjustment: "... whoever wants to contribute effectively to shortening the crisis will bring about, as soon as possible, those cost reductions he can control." (... wer wirksam dazu beitragen will, die Krise abzukürzen, der wird so rasch wie möglich diejenigen Kostensenkungen in die Wege leiten, die in seiner Macht stehen. Böhler 1932a, 47).

Underconsumption arguments and the demand for expansionary policies

The government's adjustment policy was sharply criticized by unions and the social democratic opposition, as shown in chapter 3. The majority of these critics advocated expansionary policies to induce a recovery.¹⁵ Their argument drew on the long-standing tradition of underconsumption explanations of crises. In face of an abundance of unused factors of production and excess stock on the one hand, poverty and unsatiated needs on the other, the intuitive appeal of these arguments explain their popularity during the Great Depression.

The core of the arguments used date back to the early 19th century when Lord Lauderdale and Thomas Robert Malthus in Great Britain and Jean Charles Sismondi on the continent explained crises as disequilibria between (aggregate) supply and demand for consumer goods. Their contentions focused on the effects of saving. One line of reasoning, often associated with Malthus and Lauderdale, contends that high savings diminish the demand for consumption and, as investments, increase production capacity and future supply. In this process the incentive for

¹⁵For the divisions within the social democrats see footnote 48, p. 77 above and the literature cited there.

further saving and investment disappears.¹⁶ Schumpeter (1954, 740 fn. 4) labeled this argument the oversaving type and distinguished it from the mass-poverty type of underconsumption theory. Proponents of mass-poverty reasoning saw income distribution at the root of underconsumption. Sismondi argued that the share of capital owners' receipts in national income grew systematically over time. The expansion of consumer goods output financed by their savings was not matched by an increase in the income of the masses who would be willing to buy the goods. Schumpeter (1954, 740 fn. 4) singled out a third type of underconsumption arguments, "the nonspending type that emphasizes disturbances which arise from saving decisions that are *not* offset by decisions to invest." All three types of 19th century underconsumption arguments made their appearance in the 20th century and figured, to a smaller or larger extent, in the debates over the Great Depression.

David Ricardo and James Mill unconditionally dismissed the underconsumptionists' case which led to its disappearance from the theoretical discourse. The concepts addressed in underconsumption theories, such as aggregate demand or aggregate production, were of no significance in the classical vision of the economic system. Instead, the classical analysis focused on the system of individual markets for goods and factors of production interrelated through the price mechanism. Excess supply in individual markets would be eliminated by price adjustment, the resulting redistribution of purchasing power, redirection of demand and reallocation of resources. This argument was summarized in Say's law of markets which was seen as a refutation of general glut arguments. Underconsumption theories survived "below the surface" (Keynes 1973[1936], 32), especially in the labor movement and popular explanations of the recurring crises of the last quarter of the 19th century.¹⁷ In the 1920s and 1930s they played an important role in the critique of orthodox crisis policies in several countries. In the United States, William T. Foster and Waddill Catchings gained considerable public attention with their monetary explanation of the

¹⁶In this line of reasoning it is particularly obvious that the original debate over the possibility of general gluts emerged in the context of growth and development. The long-term framework of the underconsumption concerns in the 19th century debates differs fundamentally from the 20th century analysis aiming at explanations for short-term cyclical unemployment and goods market disequilibria (Baumol 1977, 160). See also fn. 55, p. 114 below.

¹⁷Kadish (1994) shows for Great Britain that over-production and underconsumption arguments dominated the debates over depressions in production and trade in the last quarter of the 19th century. He explains that these arguments were not used exclusively by labor representatives but were also brought forward and supported by business men.

crisis based on underconsumption arguments (Barber 1985, 55-7). In Great Britain, Major Douglas similarly found a sizeable audience with his arguments about the deficiency of purchasing power (Gaitskell 1933, 281-303). John A. Hobson advocated his underconsumption explanation of cycles within the Labour Party. Even though Labour provided a minority government in 1929 and was part of the “National Government” between 1931 and 1935, the expansionary policy prescriptions advanced by Hobson were not implemented.¹⁸ The common sense appeal of underconsumption arguments gave their proponents a big audience. They entered the debates over the adequate government responses to the Great Depression with clear-cut remedies of expansionary policies and were successful in shaping public opinion.

In Switzerland, the academic representative of underconsumption arguments was Fritz Marbach, professor of economics at the University of Bern and social democratic member of parliament until 1934.¹⁹ He built his business cycle analysis around underconsumption reasoning. The rejection of wage and price cuts followed as an obvious conclusion. Instead, he demanded an increase in purchasing power through government spending. He summarized his explanation of the crisis and policy conclusions in a booklet published in a union series under the title *The current problem of wages* (*Das aktuelle Lohnproblem*, 1933a) in April 1933, in time for the upcoming vote on the government’s wage reduction proposal.²⁰

¹⁸Hutchison (1966 [1953], 129) argues that, although Hobson was not able to convince Labour leaders in the interwar years, his ideas strongly influenced Labour policies after 1945.

¹⁹He resigned as representative because he found academic and parliamentary work incompatible under the given circumstances (Marbach 1969, 1).

²⁰The other Swiss author expounding purchasing power arguments to a wide audience was Max Weber, from 1926-1940 economist with the Swiss Federation of Trade Unions (*wissenschaftlicher Mitarbeiter des Schweizerischen Gewerkschaftsbundes*). I refrain from a systematic comparison between the positions of Marbach and Weber on business cycle explanations and the resulting policy recommendations but will refer to Weber occasionally. Hohl-Slamova (1983) provides an overview of the development of Weber’s economic policy analysis. Weber played an important and independent role in the debate about the devaluation of the Swiss franc as will be discussed below, see p. 183.

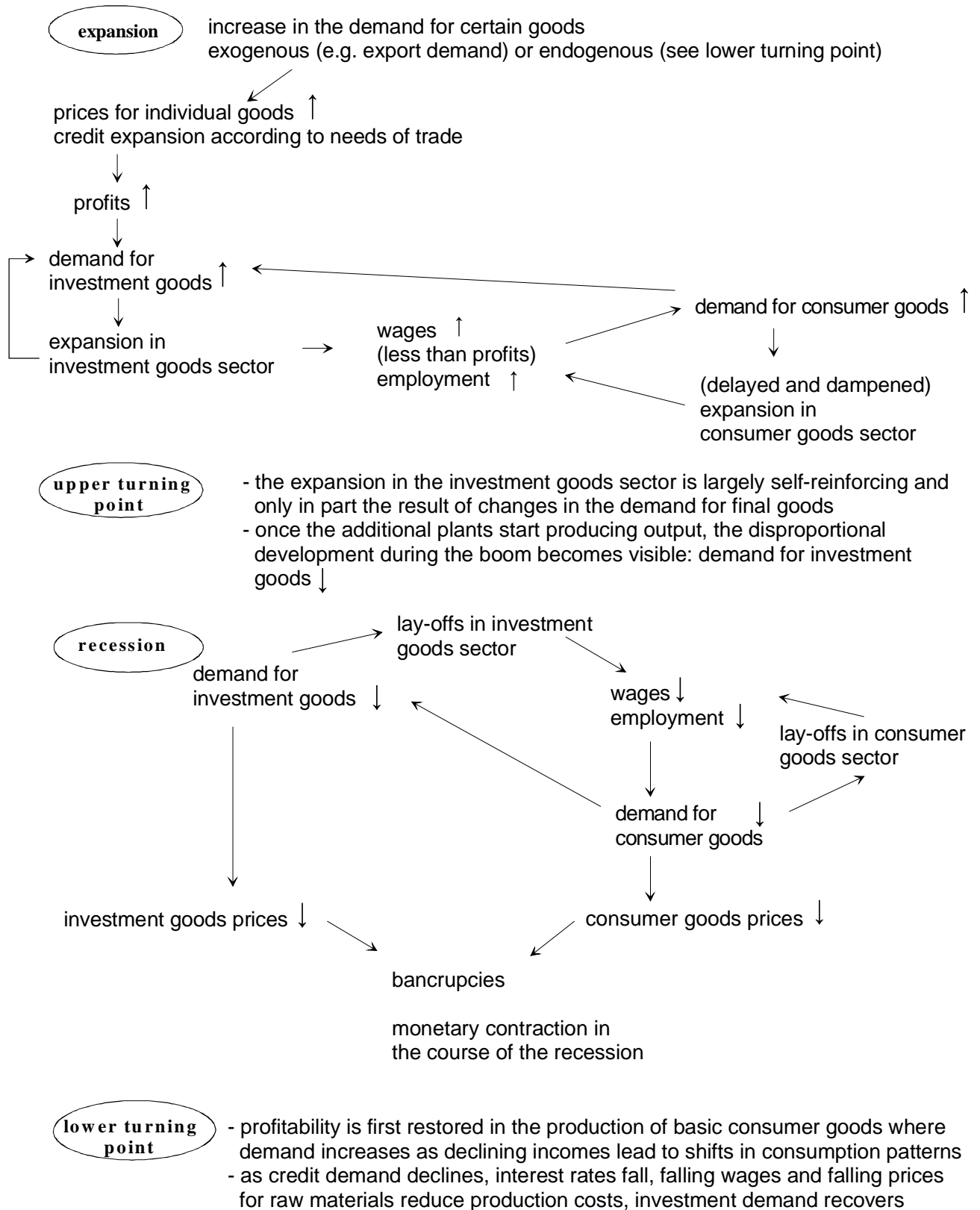
Marbach's starting point was a critique of the scarcity assumption of orthodox economics. He argued that technical progress had made it possible to overcome the want of the past so that a potential abundance of goods relative to effective demand existed. The concern with production and the supply of goods in economic theory should therefore be replaced by a concern with consumption and demand. Under contemporary circumstances, where large stocks and overcapacity existed, economic activity depended on the organization of the distribution of goods, the sale of stocks and the utilization of existing capacity. Only once these capacities were fully employed would additional investment and production be forthcoming. In Schumpeter's terms, Marbach thus adhered to a variant of the oversaving type of underconsumption theory, where the effect of savings on aggregate supply as described by the earlier authors is multiplied through technical progress.²¹ Both other types of underconsumption arguments mentioned by Schumpeter make their appearance in Marbach's writings but do not play a separate role in his explanation of the business cycle.

Marbach concluded that consumption and not production was at issue in the contemporary capitalist economy and continued that "[t]he undisputable core statement of economics 'no consumption without production' can be modified today: no production without consumption." (Der umstreitbare [sic] Zentralsatz der Nationalökonomie: "Keine Konsumtion ohne Produktion" kann heute variiert werden: keine Produktion ohne Konsumtion. Marbach 1933a, 9). Income distribution, Marbach's argument and policy conclusions implied, was central to bringing about adequate aggregate demand, thus resorting to aspects of mass-poverty types of underconsumption reasoning.

In the business cycle analysis that rested on these considerations, Marbach relied heavily on Erich Carell (1932). Figure 14 gives an overview of the chain of reasoning underlying Marbach's arguments. The increase in demand which marked the beginning of the expansion could originate from different sources leading to price increases which augmented profits. Profit increases, in turn, led to an expansion in investment demand. Capital goods industries expanded reacting to the increased demand for their products. Once the boom was underway, high profits induced high savings and an increased investment.

²¹Sismondi had pointed to labor-saving machinery as a cause of unemployment which aggravated the distortion in income distribution (Schumpeter 1954, 741).

Figure 14: The main chain of arguments in underconsumption theories



Marbach underlined that the incentives for an increase in investment goods production did thus not originate in an expansion in consumer goods demand and production, but the investment goods sector grew in a self-reinforcing expansion (Marbach 1933a, 31). As the wage sum rose due to an increase in employment, consumer goods demand strengthened. However, growth in the capital goods industries exceeded the capacity necessary to sustain the expanded consumer goods demand (Marbach 1933a, 32). As the additions to plant and equipment went into production, the disproportionality became apparent with the demand for capital goods falling short of their supply. Thus, a crisis would start in the production goods sector. Through lay-offs the wage sum declined and the demand for consumer goods was reduced correspondingly. Compared to the situation before the boom, an increased supply of consumer goods now faced a reduced demand. A cumulative recession would result.²²

Marbach concluded that government intervention to increase consumer goods demand was necessary to overcome the crisis (Marbach 1933a, 47) and rejected orthodox economic policy prescriptions. Specifically, he attacked the wage and price adjustment strategy supported by the Swiss government. In the case of German price level reductions could be explained as necessary because of the inadequacy of gold reserves. The abundance of gold in the Swiss National Bank's possession made this argument inapplicable to the situation in Switzerland (Marbach 1933a, 43).

Furthermore, Marbach argued that simultaneous price and wage adjustments were practically impossible: whereas wages could be reduced administratively, prices would not follow in a market economy with decentralized pricing. The fall in real wages would aggravate the underconsumption crisis by further reducing the consumer goods demand of wage recipients. Purchasing power would also be reduced by cutting public employees' wages. Marbach conceded that the reduction in the wage bill would be compensated by lowered tax payments. But this "redistribution of income" would reduce the demand for consumer goods (Marbach 1933a, 62-4): the wage cuts would fall on low income recipients and predominantly reduce consumption whereas the tax relief would mainly benefit the wealthy who would save the additional income. Under normal conditions

²²Carell (1932, 97) argued that the downturn was necessary to correct the disproportionalities between the sectors and adjust the structure of production. This argument, reminiscent of the claims of overinvestment theories, does not appear in Marbach.

savings would be invested. But because of lacking profit expectations due to the crisis, savings would be left unexploited (Marbach 1933a, 38). Hoarding might not be a burning issue on an individual level. But, Marbach (1933b, 164) argued, it was relevant on an aggregate level. The banking sector was holding large reserves. Thus an increase on the asset side of a bank's balance sheet did not automatically lead to an increase in the volume of credit.²³ The same logic stood behind Marbach's call for tax-financed public spending. Progressive taxes would liquefy hoarded income and unexploited savings; public works would provide work and income to formerly unemployed who would purchase consumer goods. The non-spending type of underconsumption arguments thus appears in the context of lacking incentives for further investment. It does not play a separate role in Marbach's argument or reach the importance it has e.g. in the argument of Silvio Gesell or in Irving Fisher's endorsement of stamped money schemes. Hoarding is seen as a concomitant of the crisis but not as a separate cause.

Marbach concluded that "The central problem of the modern economy is the *demand-deficit*." (Das Kernproblem der modernen Wirtschaft ist das *Nachfrage-Defizit*. Marbach 1933a, 39, emphasis in the original). The solution had to be sought in the creation of demand and, since production capacities were already idle, it had to be demand for consumer goods. Marbach (1933a, 39) suggested this to be the government's responsibility, similar to the central bank's responsibility to provide the economy with adequate credit.

The controversy between overinvestment and underconsumption views

Both, Böhler and Marbach, devoted the larger parts of their contributions to the critique of the opposing view.²⁴ Whereas the position on the government policy of wage and price adjustment was the primary dividing line, several other points in their arguments and conclusions were

²³Marbach's support for a "crisis tax" as demanded by the left as early as 1931 rested on the same reasoning. Progressive taxes would liquefy hoarded income or unexploited savings; public spending would transfer these incomes to recipients who would spend on consumer goods. The crisis tax (*Krisensteuer*), a tax on income and wealth, was introduced with the government's first emergency fiscal program of 1933. To a large extent it met the demands of the social democrats (Bratschi 1933, 349).

²⁴The authors expounded their critique also on other occasions, e.g. Böhler 1933. Marbach had explained his views in a detailed contribution to the parliamentary debates in September 1932 (*Stenographisches Bulletin* 1932, 585-9).

controversial. Debate evolved around the question of whether wages should be primarily perceived as a cost element, as Böhler maintained, or as a component of aggregate demand, as envisioned by Marbach. In Böhler (1932a, 10), a reduction in wages was precondition to restoring profitability of firms and thus precondition to renewed investment. Marbach (1933a, 26-7) countered that wages, though a large cost element, had lost importance in the course of the rationalization and mechanization investment of the inter-war period. Due to large fixed costs, production costs per unit increased as output declined. This would more than offset savings that could be achieved through reduced wages. Instead, the wage reductions would translate into a reduction in demand for final goods, which, in turn, would drive cost progression. A vicious circle would set in if wages were reduced, driving firms out of business rather than restoring profitability.

Whereas both authors (Böhler 1932a, 10, Marbach 1933a, 33) agreed that the crisis originated in the investment goods industries, they parted company on the question of which sector of the economy could provide the impulse for recovery. From Marbach's perspective, the diagnosed over-capacities in production goods industries made additional investment undesirable from a macroeconomic perspective. Instead, an increase in consumption was necessary to absorb excess stock and thus provide incentives for renewed production. In contrast, Böhler argued that the impulse for recovery could only come from the sector that lay at the root of cyclical volatility. His opponents, he argued, did not realize that employment, income and thus aggregate demand could only increase as a result of renewed investment. As long as profitability was not restored, firms would not be able to re-invest to keep up capacity, much less to expand. Böhler (1932a, 14) nonetheless rejected interventions aiming at increasing investment demand. He expected a credit expansion to be useless as long as investors' confidence was not reestablished. A government-financed investment program, expected by many to be able to provide an impulse for recovery, was also rejected by Böhler (1932a, 14-15).²⁵ As construction investment, the main form government investment would take, had been high in Switzerland well into the depression, there was no backlog of investment projects. Furthermore, the building boom had led to excess capacity in this sector and government intervention to protect such unsustainable structures was

²⁵Röpke (1931, 447) demanded such an impulse ("Initialzündung") on the background of the overinvestment theory, see fn. 40, p. 104 below.

undesirable. In a more general sense, according to Böhler (1932a, 40-41), increased public expenditure would be detrimental to a fast recovery. The government's borrowing would keep interest rates from falling below the profit rate and government spending would prop up demand, preventing price adjustments for raw materials, etc. and a decline in wages. Most importantly, budget deficits would undermine the return of confidence. Böhler's argument thus resulted in a wholesale rejection of expansionary government policies.²⁶

Finally, Böhler and Marbach disagreed on the effect of cost reductions on a recovery of exports. Marbach (1933a, 57-8) rejected Böhler's and the export industry's claim that cost reductions would lead to a revival of exports. He argued that exports were impeded by trade barriers and not by price differences, that Switzerland being a (high) "price-island" was of minor importance in this context. Marbach (1933a, 36 and 59) argued that a recovery could be brought about by international cooperation in an effort to reduce tariff and furthermore in coordinated expansionary policies.²⁷ In contrast, Böhler (1932a, 10 and 29-30) considered price and wage adjustment as precondition for the recovery of Swiss exports.²⁸ Going beyond that, in the context of his business cycle explanation, each country seen individually had to bring about adjustment in order to create conditions conducive to renewed growth. This process could not be circumvented by artificially increasing demand through expansionary public policies.

²⁶In this context, Böhler (1932a, 39) referred to two letters by a "number of well-known English economists" to *The Times* (October, 17. and 21. 1932) and singled out Keynes as the speaker of this group, whom he claimed to be "the spiritual father of the monetary theory which underlies the contemporary disastrous British currency policy." (...der geistige Urheber der Geldtheorie ist, die der heutigen verhängnisvollen englischen Valutapolitik zu Grunde liegt. Böhler 1932a, 40). These letters (reprinted in Moggridge (1982, 138-40) develop an argument in favor of private and public consumption spending, based on the contention that additional savings would not be turned into investment considering existing idle capacities. Next to Keynes, Pigou was the most prominent signer of these letters.

²⁷Marbach's argument might refer to W. L. Woytinsky's 1931 proposal on "the international raising of prices as a way out of the crisis." (*Die Hebung der Preise als Weg aus der Krise*. Leipzig: Buske) Woytinsky, head of the statistical office of the German trade union federation, suggested internationally coordinated efforts. His book "argued for price reflation - a policy goal he soon dropped - and contained an articulated plan for public works on an international scale...." (Garvy 1975, 399).

²⁸Frequently in the debate contributors acknowledged that trade impediments were the primary problem for exporters in the current situation but that once trade barriers were reduced, an adjustment of the Swiss to the world price level was decisive for exporters' competitiveness. See e.g. Schulthess as cited p. 70 above.

Despite the controversy, the arguments of the opponents also shared crucial features. One of them is the repeated reference to the fact that in the years after World War I the working of the capitalist economy was disrupted.²⁹ Market responses were impeded by tariffs, monopolistic firms or monopolistic industry organizations (Marbach 1933a, 20 and Böhler 1932a, 11 and 26, see also p. 86, above).³⁰

Furthermore, it is important to note that in both business cycle explanations the primary cause of the contemporary recession in Switzerland, the breakdown of exports, could not be analyzed explicitly. Böhler used the overinvestment explanation of the business cycle to substantiate the claims for price and wage reduction that had emerged from the export industries, but he did that by adding an additional argument rather than by integrating the existing claims into his theory. The overinvestment as much as the underconsumption theory are analyses of a closed economy. Neither author discussed explicitly how they could be applied to Switzerland's situation or whether they should be understood as explanations of the slump in the world economy as a whole. Nevertheless, the conclusions of the theoretical examination were translated into policy prescriptions for Switzerland. Böhler supported the adjustment approach of the government and agreed that price and wage reductions would help the export industries. Marbach concluded that the domestic crisis could be fought actively. In his 1933 argument no references to the problems of trade were made. In the political debate the critics of the adjustment policies supported the government's subsidies to the export industries and other efforts to increase exports through clearing arrangements, risk guarantees etc. The support for the export industries was aimed at "bridging" the gap until exports recovered (Überbrückungspolitik). In a similar vein, expansionary policies were demanded to keep the industries producing for the domestic market going.

Concerning the export sector, both sides of the debate acknowledged the importance of exports for the Swiss economy and the dependency of Switzerland on the world economy. They shared the view that the world would eventually return to liberal trade which would allow the recovery

²⁹Furthermore, both authors stressed structural changes and accelerated rationalization.

³⁰For Germany, James (1986, 327) claims that "[t]he view that the crises of the 1920s were "crises of interventionism" was widely held by economists." Similarly, Barber (1985, 102) mentions Alvin Hansen's critique of the interventionism of the 1920s as cause for the depression and the delayed recovery in the United States.

of the export sector. Opinions diverged on how this recovery could best be prepared domestically. But both authors stressed that domestic policies were crucial in preparing an expansion. Considering this shared faith in a return of the international community to economic cooperation based on principles that had guided post-World War I policies, it is not surprising that the adherence to the gold standard was not questioned at this stage of the debate by either side.

Additional arguments: the Swiss Statistical Society's annual meeting in May 1933

At the annual meetings of the Swiss Statistical Society in 1933 the conflicting business cycle theories and the respective policy conclusions were fiercely debated (Schweizerische Statistische Gesellschaft 1933). The meetings took place on May 19-20, the weekend just before the referendum on the government's plan to cut wages of public employees which was scheduled for May 28. The topic of the meetings - the influence of price and wage reductions on the business cycle - had been set well in advance of the political developments which led to the referendum (Schweizerische Statistische Gesellschaft 1933, 167).³¹

The opening statement was given by a proponent of wage and price reductions, Alfred Ammon, Professor of international standing at the University of Berne since 1929 and thus a colleague of Marbach's. Ammon (1933) did not present a business cycle explanation but argued on the

³¹In May 1928 the Swiss Statistical Society's annual meetings had been devoted to business cycle research (Konjunkturforschung) and to economic policies in the cycle (Konjunkturpolitik) with speeches by Karl Pribram (University of Geneva) and Manuel Saitzew (University of Zurich) respectively (for further details see p. 162). Both speeches were characterized by deliberate caution towards the enthusiasm in the United States concerning the possibility of prediction as well as the abolition of the cycle through adequate policies. The participants' contributions to the debate mostly reflected that caution though some speakers criticized Saitzew's pessimism concerning the scope of economic policy. Two points are worth mentioning. First, the possibility of price and wage reductions as a means to overcome the crisis were not part of the policies mentioned by Saitzew. On the background of a business cycle explanation building on the arguments of Albert Aftalion and of Arthur Spiethoff he discussed a wide array of possible measures. Influencing decision makers through adequate information on macroeconomic and market developments, monetary policy, adequate timing of public spending, public works and unemployment insurance were the areas he covered. Although he stressed the limited scope of each of them, he conceded that endeavors to moderate the cycle had been successful in so far as cyclical fluctuations since the 1880s had become less violent (Saitzew 1928, 191). Secondly, no reference to this debate, which had taken place only 5 years earlier, can be found in the protocols of the 1933 meetings although many of the participants had also attended the earlier meetings.

background of a static and comparative-static analysis of supply and demand and an application of the quantity equation. He diagnosed distortions of relative prices brought about by price adjustments in some cases and rigidities in others as the central problem of the depression. Only a realignment of prices could restore a functioning market economy and thus bring about a revival in production. Ammon hence characterized a situation where some prices could be described as “too high,” others as “too low,” implying that a realignment would either be brought about by increasing the low or by lowering the high prices (Ammon 1933, 151-3). Assuming a given quantity of money, Ammon concluded that a reduction in those prices that had not yet fallen would allow a *ceteris paribus* increase in the volume of transactions. This argument not only applied to goods prices but also to wages. Ammon (1933, 156) cautioned that during the adjustment process “restraint in purchases” (*Zurückhaltung im Kaufen*) might take place. But such transitional effects would be limited in extent and duration. In any case, they should be considered negligible as compared to the positive long-term effects. Ammon (1933, 157) concluded with a reference to the German example of wage and price adjustments in the winter of 1931-32. He argued that this experience could not be taken as a counter argument to the effectiveness of such policies in speeding up recovery. Ammon underlined that he would not judge the German experiment a failure, but he emphasized that several interferences prevented the measures from being entirely successful. Price and wage adjustments were - mostly for political reasons - not pursued consistently. Besides, trade barriers impeded the expansion. But most importantly, the effectiveness of an individual countries’ policies was limited by the state of the world economy. This should, however, not keep countries from doing what was in their command to contribute their share in the effort to overcome the world crisis.

Although Ammon’s argument differed substantially from Böhler’s, both authors shared the conclusion on the need for price and wage adjustments and both stressed the disruptions in the functioning of free markets as the reason for the disturbance in relative prices. Thus, price and wage adjustments should not be even across the economy but should be focused on those that had not fallen yet.³² Furthermore, like Böhler Ammon emphasized that each individual country had to go through adjustment as a precondition for the recovery of the world economy. Compared to

³²“ein differenzierter Lohn- und Gehaltsabbau und ein differenzierter Preisabbau” in Böhler’s words, see p. 86 above.

Böhler's contributions, Ammon's reasoning appears mechanical and abstract. At no point did he explicitly refer to the situation in Switzerland, only adding to the rather sterile nature of his statement.

The second speaker at the meeting was Fritz Marbach, whose criticism of the adjustment strategy was presented above. In the introduction to his statement Marbach (1933b, 158) challenged the abstract character of Ammon's contribution by suggesting that, although it might be tempting to treat the issue on a completely theoretical plane, he would expect the audience to prefer such a discussion to be linked to the practical issues at hand. Therefore, he organized his argument around two topical questions central to the ongoing public debate. First, he addressed whether simultaneous price and wage reductions would lead to economic revival, then he asked what effects could be expected if the decrease in wages were not matched by an equivalent decrease in prices. In his statement he resorted to the reasoning discussed above, leading him to reject the government's adjustment policies.

As president of the society, Eugen Grossmann, Professor at the University of Zurich, chaired the meetings. In his introductory remarks he underlined that the aim of the discussion should be in particular to evaluate "the accuracy of the sum of considerations which are advanced as the so-called purchasing power theory." (... insbesondere über die Richtigkeit der Erwägungen, die als die sogenannte Kaufkrafttheorie geltend gemacht werden. Schweizerische Statistische Gesellschaft 1933, 168). Clearly, Marbach's critique of adjustment policies was seen as controversial and scrutiny needed to be concentrated on his argument rather than on the "orthodoxy" presented by Ammon, the background to the government's policy proposals. Ammon's reasoning received little attention, possibly due to its abstract nature. Böhler contributed to the debate with an extended criticism of Marbach's views along the lines outlined in his booklet. In the discussion his statement was repeatedly referred to, confirming the impression that he had positioned himself in public as an expert spokesman in favor of adjustment.

As was common in those days, the meetings were not only attended by academics. Although a large number of the economics professors at (German speaking) Swiss universities contributed

to the debate,³³ the discussion was also shaped by the active participation of bankers, business men, and public employees (Schweizerische Statistische Gesellschaft 1933, 169-207).³⁴ The most prominent participant at this particular meeting was a member of government, Federal Councillor Albert Meyer, a trained economist, then head of the Federal Department of Internal Affairs, after 1934 responsible for the Federal Department of Finance.

Issues raised in the discussion included the difficulties surrounding the adherence to the Swiss franc's gold parity when currencies of trading partners had devalued which resulted in an elevated price and wage level in Switzerland. A recurring theme was the evaluation of the German experience with adjustment policies. Critics of adjustment stressed the differences between the Swiss and German starting points, emphasizing that the gold shortage had forced Germany to adopt such policies, an argument also made by Marbach (1933b, 159, see p. 92 above). They maintained that the effects of price and wage adjustment in Germany were disappointing. Proponents countered that the policy was implemented only half-heartedly, as Ammon had maintained, and that additional difficulties going back to the war and its aftermath had interfered. Accordingly, general conclusions about the policy's efficacy could not be drawn. The president of the German Statistical Society, Professor Friedrich Zahn (also president of the Statistical Bureau of the state of Bavaria), had been involved in implementing the adjustment strategy. He added to this debate by providing information on the actual measures taken in Germany.³⁵ This led to a discussion of practical difficulties in administering price and wage adjustments. The interventionist character of such policies and the danger of the emergence of black markets were pointed out. The fact was emphasized that a statistical basis to evaluate price distortions and implement measures comparable to the German interventions was missing in Switzerland. As an

³³Eugen Böhler (Zurich, Federal Technical Institute), Albert von Mühlenfels (St. Gallen), Manuel Saitzew (Zurich, University), Edgar Salin (Basel).

³⁴This is also a feature of the annual meetings of the Verein für Sozialpolitik in this era as can be concluded from the protocols.

³⁵Zahn (Schweizerische Statistische Gesellschaft 1933, 182) referred to the positive effects of returned confidence that resulted from the recent "political calmness" (politische Ruhe). It is peculiar to read this statement made some four months after Hitler's seizure of power and the Gleichschaltung of unions and other organizations repressing all activities not in line with the government's goals.

important issue, which was claimed to have been neglected in the public debate despite its importance to the Swiss economy, the asymmetric effects of price reductions on debtors and creditors was debated.³⁶

Several speakers discussed whether the current crisis was comparable to crises of the past and pointed out aspects that made it an extraordinary event. Ample debate surrounded the questions of the extent of excess capacity resulting from overinvestment in Switzerland as compared to other countries, of the industries, where this was of particular importance and their representation in Switzerland. The structural adjustment in textile and watch-making industries was discussed as an issue to be clearly distinguished from cyclical problems.

The discussion was animated, it was definitely controversial and at times it seems to have gotten somewhat out of control.³⁷ Although matter-of-factness and objectivity were appealed to, the protocol contains many polemical and personal remarks. As the brief overview of the issues discussed makes clear, the controversy did not center on the theories underlying the policy recommendation. No attempts were made to clarify possible relations between the arguments or to specify the reasons for their contradictory conclusions. The speakers were more interested in practical policy conclusions than theoretical scrutiny. The question of how price and wage reductions could be implemented received ample attention in contrast to the silence of the advocates of such policies on practical issues. The contradiction between government intervention to influence prices and wages on the one hand and the recourse to market prices as the central coordination mechanism within the economy on the other was emphasized by several speakers. Whereas only three of the twelve speakers in the discussion were sympathetic to Marbach's views,

³⁶It is noteworthy that in this context no reference was made to the concept of a "secondary deflation" as discussed by Röpke in Germany and e.g. by Hawtrey and Keynes in Great Britain (Haberler 1963 [1937], 59). In the United States Fisher (1933) had described "debt deflation" as a process independent of the necessary adjustment in the production capacity which leads to a perpetuation of the depression through monetary contraction.

³⁷The chair jokingly threatened to introduce a downward adjustment of his own by cutting short the speaking time of contributors (Es kommt noch eine andere Senkungsaktion: die Senkung der Redezeit. Schweizerische Statistische Gesellschaft 1933, 197). Later in the discussion, a contributor remarked that at some points in the discussion three and four speakers had been talking simultaneously (Schweizerische Statistische Gesellschaft 1933, 201).

it cannot be concluded that the majority was in favor of price and wage adjustment. Only three of the contributions can be counted as clear votes in favor of government induced adjustment. Reasons why speakers hesitated to subscribe to this view were diffuse. They covered a wide spectrum with the belief, at one extreme, that such measures could or should not be implemented even though in principle downward price and wage adjustment was desirable. At the other extreme stood the suspicion that the multitude of disruptions that characterized the current depression, in contrast to past “normal” crises, could not be solved easily. Instead, interventions could lead to unforeseeable outcomes within the complexities of a real rather than a model economy. Just as in the political debate over adequate economic policies to fight the depression, unanimity was expressed only concerning the gold parity of the Swiss franc: a devaluation was rejected by all speakers who touched on the subject.

Swiss overinvestment and underconsumption arguments in the context of contemporary business cycle analysis and Keynesian macroeconomics

This section presents two difficulties. The first is that the attempt to position the interwar debate on business cycle theory in the history of economic thought merits a separate book rather than a view pages. These years, which cover a part of what Shackle (1967) called *The years of high theory*, brought about shifts in economic analysis with far-reaching consequences for future theoretical developments. The paragraphs here try to bring to light some of the issues at the core of these changes. Only those questions are treated that have some relation to the issues debated in Switzerland, thus leaving aside central international developments such as the increasing importance of empirical research and the beginnings of econometrics.³⁸ The following touches upon substantive matters in the theoretical debates of the time but also on methodological issues which might be of interest only to a specialized audience. Nonetheless, an attempt is made to hint at the overall scope of the issues raised in the debates.

The second difficulty is due to limitations of space, which keep me from developing my comments in more detail. Considering the immense literature on the issues addressed here, I draw on concepts and labels developed in the debate. In this context it is important to note that the term “Keynesian macroeconomics” is used to refer to the set of ideas developed from the impulses

³⁸Aspects of this story are taken up in chapter 6.

given with Keynes's *General Theory* as distinct from "the economics of Keynes," i.e. Keynes's very own contributions. "Classical economics" is employed in the sense typical of modern history of thought to refer to the body of ideas that dominated the 19th century orthodoxy as developed prominently by Adam Smith, David Ricardo and John Stuart Mill. Thus the term is not reserved to the meaning Keynes (1975 [1936], 4-22) gave it.

The predominant "gold-standard mentality" and the emergence of alternative policy proposals
Interwar economic policy debates in the industrialized countries all followed somewhat similar patterns. At the onset of the crisis, governments resorted to "traditional" economic policy responses to a down-turn: budget deficits emerging with the slowdown in economic activity from declining revenues were countered with budget cuts and tax increases. Balancing budgets was perceived as good housekeeping and as decisive for the protection of exchange rates. These policies agreed with the conclusions drawn from contemporary business cycle analysis which was firmly rooted in the same set of ideas. Importantly, the state was not given any distinct role to play in the economy.³⁹ Quite to the contrary, it was expected to behave like any other prudential economic entity. As argued above (p. 96), the interventionist policies of the interwar years were considered an important cause of the depression on this background.

With the crisis developing into an as yet unparalleled economic catastrophe, the orthodox policy prescriptions came under increasing pressure. Objections were not only voiced by the political opposition, which in many cases represented labor interests. In several countries a critique of the effectiveness of such policies emerged from within the majority. Similarly in the academic debate, the orthodoxy was not only challenged by outsiders such as underconsumptionists or monetary

³⁹The patterns of debate in Great Britain do not fully conform to this simplified picture. Continuously high unemployment rates during the 1920s had put this problem on the top of the agenda of economic policy debates in Great Britain much earlier than in other countries. The Minority Report of the Royal Commission on the Poor Laws of 1909 had played a pioneering role in advocating systematic public works programs to combat cyclical unemployment. It provoked a debate on adequate measures to overcome unemployment where many of the arguments that would gain importance in the debates during the Great Depression were already developed (Hutchison 1966 [1953] 414-23). The vehement rejection of public spending programs was restricted to the representatives of "Whitehall, the City, and Westminster." This opposition waned in the course of the 1930s but not until 1937 was public spending significantly increased with the launch of a rearmament program in face of the threatening war (Hutchison 1978, 192-4).

cranks. The longer the crisis lasted, the more mainstream economists joined in the efforts to develop new perspectives on the explanation of contemporary developments and to seek alternatives to the passive role prescribed for the government by traditional economic theories. In many respects, these efforts paved the way and anticipated the reorientation of macroeconomics towards the Keynesianism of the post-World War II era.

According to the review of the academic debate in Switzerland contributors were not aiming at an advancement of business cycle theory as such. Their resort to earlier and contemporary economic thought was aimed at explaining the crisis phenomena they observed and at substantiating the economic policies they deemed adequate. Nonetheless did contributions on both sides of the Swiss debate reflect, if only implicitly, the contemporary controversies especially in the German language area. The authors took up arguments and adjusted them, to some extent, to the conditions as perceived in Switzerland. In contrast to the developments of economic policy debates in Germany, Great Britain or the United States, critics of orthodox policy proposals in Switzerland came from the margins. Critique from within the political or academic mainstream developed only late and mostly in the form of claiming a moderation of orthodox policies rather than suggesting new approaches. Alternative policy proposals, as provided for example in Germany in the second report of the Brauns-Kommission by mostly liberal members (Röpke 1931) and supported in the United States by Chicago economists (Barber 1985, 156), did not exist in Switzerland.⁴⁰ Here, the opposition to the government's policy rested on the limited political

⁴⁰Early in 1931 Brüning's government had appointed a commission chaired by Heinrich Brauns to suggest measures to overcome the crisis. It is noteworthy that the expansionary policy proposals of the Brauns-Kommission were developed from the "prevailing" business cycle explanation, i.e. the overinvestment theory (Röpke 1931, 443). The report argued that the necessary adjustment of the economy had already taken place. The paralysis in the state of depression due mainly to the severe banking and financial crisis should be overcome through the impulses of government spending financed through an international loan (Initialzündung. Röpke 1931, 447). In January 1932, Ernst Wagemann, head of the German statistical office, presented a plan to overcome the paralysis of money and credit markets by a reform of the monetary system. The unions' public works program based on Wladimir Woytinski's ideas followed in April of the same year. In addition to these suggestions based on business cycle analysis and theoretical debate, a number of reform plans inspired by the perceived urge for action and contempt for theoretical economics were published. See Bombach (1976b) for a documentation of a selection of the vast number of alternative policy proposals originating from a broad spectrum of political orientations in Germany in the early 1930s. Korsch (1976, esp. pp. 91-113) provides an overview over the arguments and Jansen (1998) a critical analysis. The situation in the United States

influence of the Social Democratic Party and the unions. At that time Swiss social democracy was not yet part of the federal executive, whereas e.g. Great Britain and Germany had seen Labour and Social democratic governments.⁴¹ In Switzerland, the establishment remained rather unified in adhering to orthodox strategies, at least in principle.

Drawing on the contemporary literature

The following is devoted to determining the position of the contributions analyzed in the previous sections within the history of contemporary and later macroeconomic thought. As discussed above (p. 81), Böhler's argument in support of government policies rooted in the "prevailing view" of the overinvestment explanation of the crisis, which had been shaped by Austrian business cycle analysis. The importance given to monetary influences in the explanation of fluctuations was not specific to these views. It goes back to classical economists and can also be found in authors like Spiethoff who built on the heritage of the German Historical School. Böhler presented the argument in a form lacking the theoretical rigor the Austrian authors pursued. He used it merely as a framework to be supplemented with a variety of additional observations and added a personal flavor by stressing the complexities of the modern economy. According to Böhler, this complexity rested to a large extent on the fact that men were driven by a multitude of motivations, some of which rooted in irrational urges rather than rational goals. Therefore, the working of the economy could not be understood to follow simple causal links and, more importantly, such links could not be used to determine economic policies (Böhler 1932a, 6-7).⁴² As argued above, Böhler, like Marbach, was neither interested in theoretical progress per se, nor in an interpretation or evaluation of contemporary theories. Thus, he neither referred to individual authors as sources for

differed in so far as the main aim of President Herbert Hoover's "new economics" program of the 1920s had been to avoid or at least moderate business cycles. Anticyclical government spending had been advocated as an important tool to achieve this goal. The strategy unraveled in the course of 1931 in the face of the deepening crisis. After the banking crisis of 1931 Hoover rejected government borrowing. He argued it would further destabilize the financial system by putting additional downward pressure on bond prices (Barber 1985, 135).

⁴¹On the level of cantons and in several cities social democrats successfully participated in governments since World War I.

⁴²Böhler developed this theme in later work, where he strove to understand economic phenomena on the background of the psychology of Carl G. Jung (Ritzmann 2002).

his argument, nor did he hint at the ongoing debates within the orthodoxy he drew on.⁴³ The nature of his contribution is in large parts descriptive rather than analytical. This style of argument is reminiscent of Spiethoff (1925) and pervaded German language economic writing of the time. It is also characteristic of Marbach's contributions.

Like Böhler, Marbach loosely drew on the contemporary literature. He explicitly cited Erich Carell (1932) and in other contexts he referred to Emil Lederer and Lederer's students Jakob Marschack and Karl Massar.⁴⁴ He explicitly positioned himself in the tradition of underconsumptionist or purchasing power arguments. The outstanding feature of underconsumptionist contributions is that their authors strove for a vision of economic activity as ultimately determined by the demand for consumer goods. This set underconsumption theories apart from the classical tradition where production, and therefore supply, was analyzed as the driving force of economic activity while demand was seen as a logical consequence as implied by Say's law of markets. Instead, underconsumptionists directed their attention to the role aggregate demand for consumption goods played in regulating aggregate employment and income. This is where underconsumption theories pointed in the direction of Keynesian economics.

Underconsumptionist concepts of aggregate demand

In contrast to Keynesian economics underconsumptionists narrowly focused on consumer goods demand as the ultimate incentive for production though. This concentration included a relative neglect of all aspects involving investment goods production. Investment was seen only as serving the production of consumer goods. Its role in creating employment and income, central to Keynesian economic theory, was not perceived. Furthermore, multiplier effects emerging from investment in the same way as they emerge from other types of aggregate spending were not

⁴³The contributions in Schefold (1989) provide insights into the many facets of the interwar debates on business cycle theory in the German language area.

⁴⁴With his repeated references to the fact that labor saving technical progress and rationalization dominated post-World War I investment, Marbach took up the central theme of Lederer's 1931 contribution on technical progress and unemployment. Similar to Lederer, Marbach (1933a, 27) argued that modern capitalist production was characterized by an increase in fixed relative to variable capital. According to Marbach this put additional pressure on the profitability of firms as output fell, thus intensifying the crisis, an observation that reminds of similar arguments in Lederer.

acknowledged. This is remarkable as the demand for increased government spending was often supported by descriptions of second round effects brought about by the increase in incomes in public works programs (e.g. Grimm and Rothpeltz 1934, 115. See also fn. 44, p. 143 below).⁴⁵

These crucial differences to Keynesian economics resurface in the description of the underemployment situation and the policy conclusions drawn. In Keynes, it is aggregate demand that is insufficient to fully utilize production capacity, in underconsumptionists' writings, inadequate demand for consumer goods characterizes the crisis. An increase in investment demand, which solves the problem in a Keynesian perspective, aggravates the disequilibrium described by underconsumptionists.

Classical roots of underconsumption theories

Notwithstanding their criticism of traditional economics, modern underconsumption theorists retained a central classical assumption by positing a direct link between saving and investment.⁴⁶ Although the authors usually also addressed hoarding, they considered it an abnormality and inessential in explaining the crisis. As argued above (p. 93), Marbach stood out in this respect. Even though he did not describe hoarding as a cause of the recession, he argued that it played a significant role in keeping the economy depressed. Since incentives for investment were lacking in the depression, aggregate savings would not be automatically turned into investment. Instead, savings would be left unexploited and e.g. used to increase the banking sector's reserves. This argument entails a break with the classical assumption of ex ante equality between savings and investment, an assumption upheld by the underconsumptionist authors, as mentioned above, and an assumption they shared with the theories they criticized, namely overinvestment theories. Marbach did not develop the consequences of this changed perspective though. Although he emphasized expectations in investment decisions, he did not introduce the independent investment

⁴⁵Marbach's argument on the spreading of the crisis from export industries to sectors producing for domestic consumption built on similar considerations (*Die Nation*, 22.6.1934).

⁴⁶I refer to Hobson, Lederer, Foster and Catchings as "modern" underconsumptionists following Haberler (1963 [1937], 118) who singles them out as those "authors who have done most in recent times to re-state and propagate the under-consumption theory in a scientific way." The relevant contributions are Mummery and Hobson 1956 [1889], Hobson 1896 and 1909, Lederer 1925 and Foster and Catchings 1925. As to the adequacy of the label "underconsumptionist" for Lederer's business cycle explanation see Allgower 2003.

demand function central to the Keynesian system based on investors' expectations of returns.⁴⁷ The accelerator model of investment, implicit in Marbach's argument about the upper turning point in the business cycle, focuses narrowly on demand for consumer goods. This limits the potential for expansionary government policies to such policies that increase consumer goods demand and only through this channel generate incentives for additional investment.

Supply vs. demand side explanations of economic activity

Therefore, the notion of a demand-driven economy that Keynes developed in *The General Theory* was only partially anticipated by underconsumptionists and Marbach did not get beyond them. In underconsumption theories, the increase in production capacity during the boom period was described as being brought about by the automatic investment of increased profits and aggregate savings, i.e. in the boom period ex ante savings determine investment. Eventually, it was typically argued, this led to the disequilibrium between aggregate supply and aggregate demand for consumer goods. The crisis was thus not seen as being brought about by autonomous changes in aggregate demand, as in Keynesian economics, but by the realization on the part of investors that production capacity had outgrown consumers' demand in the course of the expansion. Savings and investment would therefore break down once the production facilities built up by excessive saving during the boom went into production. At this point, the increased supply of consumption goods would meet with insufficient demand. The incomes that could be realized in such circumstances would fall short of the value of total output (Schneider 1987, 742). Whereas aggregate demand for consumer goods was thus essential in explaining the upper turning point in underconsumption theories, the development during the boom was described as dissociated from an expansion of aggregate demand and instead driven by the ex ante equality of saving and investment. This perception differs fundamentally from the Keynesian. On the one hand, ex ante investment depending on expectations of profitability can differ from ex ante saving in Keynes. On the other hand, according to Keynes's income flow model, savings and investment are necessarily equal ex post, the equilibrium being brought about by income adjustment. In sum, the

⁴⁷Shifts in expectations of profitability have of course long figured as an argument in the explanation of crises. In Keynes they receive a new significance, though, in that they determine the short-term equilibrium of the economy. Marbach can be interpreted similarly as suggesting that a change in expectations could reduce the extent of hoarding and thus change the short-term outcome in terms of employment and output.

different nature of underconsumptionist and Keynesian models can be traced back to fundamental differences in the respective concepts of macroeconomic equilibrium and the role of savings and investment play in determining equilibria.

Notwithstanding these qualifications, underconsumptionists explain the onset of the crisis with reference to aggregate demand conditions. In contrast, overinvestment theories argue that changes on the supply side bring about the crisis. More precisely, the increase in interest rates renders investment projects initiated in the past unprofitable, i.e. supply conditions change. Changes in aggregate demand follow. According to overinvestment theories the reduced demand for investment goods leads to the propagation of the crisis to all parts of the economy.

Intertemporal models

As argued above (p. 84), overinvestment theories of the business cycle raise the issue of general or macroeconomic disruptions in the context of a growing economy. They discuss intertemporal coordination, i.e. the coordination of consumption, saving, and investment decisions. The business cycle was understood as a deviation from an equilibrium growth path determined by saving and consumption decisions on the one hand, and by production technology on the other.⁴⁸ The disruptions characterizing the business cycle distort the structure of the economy's capital stock. Therefore, short-term cycles cannot be analyzed independently from long-term growth and development perspectives. The effects of the business cycle are effects within an intertemporal model of the economy, not just departures from a short-term equilibrium.

Most contemporary authors using underconsumption arguments, prominently among them Hobson and Lederer, shared this perspective with overinvestment theorists. They developed their business cycle analysis in an intertemporal framework. Just as in overinvestment theories, intertemporal coordination failures were at the heart of the argument. Whereas the early phase of the business cycle might provide incentives for the expansion of production capacity, they argued, this did not guarantee that the facilities could be employed profitably in the future, given

⁴⁸In Austrian business cycle theory, based on temporal production functions, the rigid production technology in terms of the time path of the availability of output of final goods is particularly visible.

insufficient demand for their output resulting from the uneven development of income shares in the course of the boom. With such considerations authors like Hobson and Lederer shared the classical roots of contemporary mainstream business cycle theories by analyzing fluctuations in the context of a long-term growth model.⁴⁹ Marbach's argument differed from these authors in that long-term considerations were absent. He made no references to an intertemporal equilibrium framework which would provide the background to his argument.⁵⁰ In contrast, Marbach's writings focus on short-term effects, which brings him closer to a Keynesian perspective. But as argued above in the context of the importance of investor's expectations in investment demand (p. 107), Marbach abandoned the orthodox vision without developing the consequences of this step. Therefore, even if he stressed issues central to Keynes's departure from the classical system, he did not anticipate the conclusions Keynes drew.

Information and coordination failures

Even without developing an intertemporal framework, Marbach described the causes of the disruptions that lead to the crisis in terms of information and coordination failures of consumption, saving and investment decision. This is a feature shared by overinvestment and underconsumption theories as pointed out in the preceding paragraphs: information and coordination failures are the background to the misallocations during the boom period which eventually lead to the upper turning point in the business cycle. The theories differ, though, in their explanation of how the information, which leads to the corrections of the preceding mistakes and thus to contraction, is revealed. In overinvestment theories the reduction of market interest rates below the level of the natural rate explains the expansion of investment in the boom period. If the divergence was initially brought about by technical progress, i.e. an increase in the natural rate, this change may

⁴⁹In Lederer the classical "trait" is particularly pronounced. He rejected most contemporary expansionary policy proposals with the argument that they would reduce aggregate savings and investment and thus lower the long-term growth path of the economy. His classical concern with saving and investment as the driving forces of economic development clearly outweighed underconsumptionist aspects in his argument. The effects on growth are put at the center of the argument (Lederer 1925, 407). In contrast, Hobson expected positive effects of avoiding crises through redistribution to soon exceed the reduction in the rate of accumulation due to diminished aggregate savings. For details see Allgoewer 2002, 7-8.

⁵⁰See also fn. 22, p. 92. Carell's contribution is somewhere in between. Even though he did not develop an intertemporal model explicitly he made several references to intertemporal issues in the course of his argument.

not have been perceived by individual banks. They increased their credit supply in response to increased credit demand to preserve or increase their market shares. Firms increase credit demand in response to the perceived profit opportunities resulting from the low market interest rate as compared to the natural rate. They do not realize that the credit expansion has inflationary effects, which reduce the real rate of return on investment. As reserves within the banking system are absorbed in the course of the boom and / or the exchange rate comes under pressure, refinancing rates increase, revealing the information that was initially lacking.

Underconsumptionists argue that profit increases in the early boom phase provide incentives for additional investment. As entrepreneurs seize profit opportunities they invest in plant and equipment, irrespective of the development of demand for final goods. Once the additional capacities enter the production phase, entrepreneurs realize that demand is insufficient to absorb the increased supply. If we compare the arguments about the information problems, certain differences are noteworthy. Overinvestment theories provide an explanation of why the information problems arise (banks perceive the change in demand for their credit but not the overall market development) and explain the mechanism by which the information is revealed (change in refinancing rates). Underconsumption theories postulate erroneous profit expectations which break down later. Why entrepreneurs are misguided is not substantiated, in particular, it remains open why they do not include expectations of the development of final demand. A clear-cut mechanism which brings about the break-down of investment as described by overinvestment theories is thus missing, the argument about the upper turning point remains vague in underconsumption theories.

A sectoral model of production

After analyzing differences between underconsumption and overinvestment arguments we now return to some common characteristics. One of them is the distinction between different sectors of production. Böhler and Marbach both set the consumer goods sector apart from the investment goods sector. Based on this distinction, Böhler described the crisis as a result of intertemporal coordination failures. They surface as voluntary savings are insufficient to complement investment projects and thus lead to insufficient demand for the output in the investment goods sector.⁵¹

⁵¹As argued above, Böhler did not strictly apply the concept of the production process developed from Austrian capital theory with its emphasis on the temporal structure of production.

Similarly, the distinction allowed Marbach to describe the increasing disproportionality between the sectors during the boom and to identify this development as leading to the turning point in the business cycle. In Keynesian economics the distinction between investment and consumer goods sectors disappears. Whereas different components of aggregate demand are distinguished, no such distinction is made for the supply side of the economy. This implies that production capacity is flexible enough to adjust to shifts in the composition of demand even in the short run.⁵² The causes for crises analyzed by both overinvestment and underconsumption theories cannot be addressed in the framework developed by Keynesian macroeconomics.

Say's law of markets

The 19th century debate about general glut arguments was resolved with reference to the adjustment mechanisms existing in a system of markets as implied by Say's law: overproduction in one market would, by necessity, be matched by excess demand in another market. Relative price changes and the resulting adjustments in production could easily eliminate such disruptions.⁵³ The 19th century underconsumptionists questioned the adequacy of the underlying vision of the macroeconomy as a system of interrelated individual markets. Instead, they presented an alternative vision by aggregating the demand for a range of goods, i.e. final goods for consumption, and confronting this aggregate demand with the respective supply of the same range of goods. Within the classical logic it could be countered that disequilibria within the aggregate can be traced back to individual markets and are thus matched by corresponding disequilibria in other aggregates of markets. Adjustment processes would set in to eliminate them. Crucial to the argument within the aggregate perspective is the implicit assumption that whatever mechanisms for adjustment exist between those groups of markets, they will not bring about equilibrium in the simple way postulated by Say's law. This premise is accepted by modern underconsumptionists. For the sake of illustration, it could be summarized in claiming that corresponding disequilibria in the markets for shoes and for tractors cannot be eliminated in the same way as in the case where

Neither did his argument build on the rigidity of an economy's capital structure that follows.

⁵²The neoclassical production function embodies the same notion of malleable capital.

⁵³The other set of arguments usually referred to under the heading of "Say's law" is equality between planned saving and planned investment: hoarding leading to leakages from the circular income flow was considered an abnormality. Though they conceded that it existed, it was deemed insignificant by classical authors. This aspect of classical economics was not questioned by the underconsumptionists considered here. See the discussion above p. 107.

the disequilibria entail the markets for shoes and for boots. Whereas demand would react through substitution in the case of shoes and boots, the same could not be expected in the example of shoes and tractors. Sectoral disproportions would therefore not be eliminated through such adjustment mechanisms.

In contrast to the controversy in the 19th century, the departure from the vision of the macroeconomy as a system of interrelated markets dominating classical economics is shared by underconsumption and overinvestment theorists. Both present an argumentative logic outside the classical system underlying the law of markets by distinguishing groups of goods and aggregating across their supply and demand. No references to Say's law of markets can be found in the controversies of those years.⁵⁴ The renaissance of the debate about Say's law came after Keynes's attacks in the *General Theory*. From the perspective presented here, which follows Schumpeter (1954) and Leijonhufvud (1981a), Keynes's critique and much of the literature it provoked is misconceived. With regard to the business cycle theories relevant to the Swiss debates, both sides of the argument had clearly departed from the classical vision of interrelated markets to a macroeconomic perspective based on aggregates. This change in perspective anticipated important aspects of Keynesian macroeconomics. It had its origins in the classical quantity theory. Schumpeter (1954, 1117 fn. 1) credits Wicksell with a central role in the adoption of aggregate demand analysis, calling him "...the patron saint of all those economists who renounce Say's law at present." In sum, both sides of the interwar debate on business cycle theory relevant to the controversies in Switzerland shared a vision of the macroeconomy distinct from 19th century classical economics. This vision anticipated aspects of the framework of aggregate analysis as developed in Keynesian macroeconomics.

Harmony vs. anarchy in a market economy and the scope for macroeconomic planning

After discussing these more narrowly substantive and methodological issues uniting or separating the two sides of the debate, we now turn to a fundamental dividing line between them: the overall perception of the capitalist economic system. The underconsumptionists of the 19th and 20th

⁵⁴Thus, a more thorough discussion of the issue, even if tempting, can be left aside in the context of the argument pursued here. For syntheses of the different stages of the debate see Becker and Baumol (1952), Sowell (1972), and Leijonhufvud (1981a). Blaug (1997) provides brief but lucid comments on the most controversial contributions to the 20th century debate on Say's law.

centuries have in common the rejection of the classical assumption of a natural harmony between the interests of individuals and society, a perception underconsumptionists share with Keynesian economics. The proposition, that market forces bring about prosperity and growth, was questioned. Systematic shortcomings in the functioning of the market system leading to underconsumption were made responsible for cyclical or secular decline in growth (Schneider 1987, 741).⁵⁵

Overinvestment theories built on the classical orthodoxy and the belief in the harmony of a market economy (Burchardt 1928, 142). As stressed above (p. 84), business cycles were perceived as disrupting the harmony, where the disturbances were seen as originating outside of the system or in contradiction to it.⁵⁶ But market forces would ensure adjustment and the return to equilibrium conditions eliminating the disturbances and their effects. However, interference with market forces could prevent an automatic recuperation.⁵⁷ Therefore, the government's role in the economy should be minimized and brought as close as possible to the role of any other market participant. Underconsumptionists, instead, argued that government intervention should be used to overcome the shortcomings of the market system. This would increase the "wealth of nations" beyond the level brought about by markets alone. The concern with the possibilities and virtues of

⁵⁵Bleaney (1976, 11) claims that a tendency towards stagnation of the capitalist economy is at the core of underconsumption arguments. This might be true for most 19th century authors. Schumpeter (1954, 740) similarly argues that Malthus's and Sismondi's are theories of stagnation rather than theories of crises. In contrast, underconsumption arguments in the late 19th century and in the 20th century are central to non-orthodox and widespread popular business cycle explanations. In these underconsumption is usually described to emerge in the later phases of the boom period and to bring about the upper turning point of the cycle.

⁵⁶Technical progress played the central role among exogenous causes. Disruptions could moreover originate from elements alien to the market system. The monetary system with a monopolistic central bank at its core was seen as the principal cause of disturbances in this set of arguments.

⁵⁷Monetary business cycle theory "anchors the business cycle not within the market system but in economic policies acting in contradiction to market tendencies." (Nicht im Marktzusammenhang, sondern in einer zu den Markttendenzen gegensätzlich handelnden Wirtschaftspolitik verankert sie (die monetäre Konjunkturtheorie, EA) den Zyklus. Burchardt 1928, 142).

macroeconomic planning followed from there.⁵⁸ The debate about planning in the 1930s was overshadowed by the actual developments in the USSR, so that ideological rather than theoretical considerations soon dominated. Even though these fundamental issues surfaced in the controversies during the interwar years (see below p. 127 for Switzerland), the debate over the government's role in the economy during the Great Depression focused on government spending, on interventions in price and wage setting, etc. The socialist alternative model of economic organization, though a continuous theme in the debates about the depression, never won enough support to be seriously considered.

⁵⁸The 52nd annual meeting of the Swiss Statistical Society in 1932 discussed free versus planned economies (Schweizerische Statistische Gesellschaft 1932). Three contributions treated the topic from different perspectives. Böhler (1932b) presented an “enlightened” liberal view, discussing both the model of a pure market economy and the model of an entirely planned economy as idealizations. Existing economies embodied aspects of both. He argued that the classical liberal vision of free markets was imbedded in strong ethical and religious constraints. As these had disappeared with enlightenment and secularization government regulations had to take their place. He thus rejected a celebration of the 19th century economy as a realization of a pure market economy and argued that towards the end of the century government interventions became increasingly important to the point of hindering the play of market forces. Referring back to the classical liberal vision as he had presented it, he advocated a free market system based on moral and ethical rules. Max Weber (1932), the economist of the unions' federation, presented a vision of a planned economy that resembled the German contributions by Emil Lederer, Eduard Heimann and others. The central supervision of investment decisions, possibly through industry organizations, would reduce misguided investment and the ensuing crises. The planned economy these authors pictured was not aiming at a complete replacement of markets. Quite to the contrary, markets' function of coordinating needs and production would be embedded in a system that would avoid the anarchy inherent in a pure market economy. Like Böhler, Weber described the existing system as a mixed economy, where elements of a planned economy entered in the form of cooperatives, state run enterprises etc. The last talk at the meetings was by an industry representative Hermann Henrici. He rejected all aspects of planning as inconsistent with a market economy and vehemently criticized the interventions after World War I as causes for the grave crisis. Consequently, he demanded a much reduced role for the government in the economy. The plenary discussion at the meetings was dominated by non-academic speakers. Although repeated references to the current crisis were made, the debate remained rather abstract in confronting the alternative economic models discussed by the speakers. Clearly, the majority of speakers sided with a liberal model, whereas the degree of government involvement and the functions industry organizations could take over varied. Overall it is remarkable, how little the discussants referred to concrete policy options in view of the crisis. Rather, the aloofness of the debate can be taken as indication that the actual crisis in the Swiss economy and even on the worldwide level was not yet perceived as an outstanding and disquieting situation as it would be in later years. This would reflect, here in the realm of the academic debate, the reluctance of Swiss political authorities to perceive the contemporary developments as extraordinary and act accordingly, as argued in detail in chapter 3 above.

Some appraisals

John Stuart Mill's (1987 [1848], 557) assessment of underconsumption arguments characterized the reception they obtained from traditional economics over more than a century: "The doctrine appears to me to involve so much inconsistency in its very conception, that I feel considerable difficulty in giving any statement of it which shall be at once clear, and satisfactory to its supporters."⁵⁹ Keynes (1973 [1936]) challenged this view in chapter 23 of *The general theory of employment, interest and money*. In his "Notes on mercantilism, the usury laws, stamped money and theories of under-consumption" he argued that these strands of economic reasoning had been unduly criticized and rejected by classical economists. He offered reinterpretations on the background of his own theory and found praise for authors who had developed reasoning that paralleled arguments used in the *General Theory*. At the same time, he belittled their contributions by using language that implied that the rank and file of the "brave army of heretics" should not be taken too seriously.⁶⁰

The preceding section provided perspectives on these claims and evaluations. Most importantly, underconsumptionists challenged the classical trust in the harmony of the market system and concluded that government spending should be used to overcome crises. They can thus be claimed to have foreshadowed Keynes's argument in the *General Theory* in these respects. At the same time, it was demonstrated that underconsumptionists' theories firmly rooted in classical economics.

Furthermore, I argued that both overinvestment and underconsumption theories departed from the vision of the decentralized market system on which Say's law of markets builds and which was key to the classical stance on general or macroeconomic crises. Both types of business cycle theories developed visions of the macroeconomy based on the aggregation of markets. Demand and supply for certain groups of goods, namely consumer and investment goods, were

⁵⁹Schneider (1987, 744) confirms the view that "Underconsumption theories have never been acceptable to orthodox economists, perhaps partly because underconsumptionists in general have lacked rigour in the exposition of their ideas..."

⁶⁰A similar rhetorical strategy was used by Schumpeter (1954, 1130) when introducing Hobson as someone who seemed to stand "in something that to many looks very like a halo of glory."

distinguished. Whereas Keynesian macroeconomics perfected aggregate analysis, the sectoral differences central to pre-Keynesian business cycle analysis were lost. The older theories analyzed the crisis in conjunction with an explanation of all phases of the business cycle and in both cases the recession was explained as a result of disequilibrating processes in the expansion. Keynesian macroeconomics, in contrast, placed the crisis at the center of a short-term analysis, thus severing the link between the analysis of cyclical developments and intertemporal theories of growth.

In sum, the business cycle explanations that shaped the contemporary perception of the Great Depression represent an intermediate stage in the development from classical to Keynesian macroeconomics. On the one hand, central classical traits are retained that Keynes abandoned. On the other, characteristics of Keynesian analysis are foreshadowed. Underconsumptionists were close to Keynes in their policy conclusions, several methodological features were also shared by overinvestment theories.

Concluding remarks: the academic debate and the gold-standard mentality

The place of the business cycle arguments central to the academic debate in Switzerland in the development of macroeconomics or, more broadly speaking, in the history of economic thought was the topic of the preceding sections. To return to the core of the issues pursued in this study a few remarks conclude the chapter which relate the academic debate to the gold-standard mentality that dominated the understanding of the economic developments and policy options in the Swiss public as argued in chapter 3. Both sides of the debate explicitly supported the adherence to the gold standard at the given parity of the Swiss franc. The taboo of a devaluation or the abandoning of the gold standard was not questioned by any of the participants in the academic debate. Furthermore, the overinvestment theory of the business cycle built on the gold-standard mechanisms. In many authors the upper turning point of the cycle was explicitly related to the limitation of reserves within the banking sector. The pressure of the exchange rate resulting from the inflation of the boom phase would force interest rates up and truncate investment demand. Beyond the explicit reference to the gold standard, the overinvestment argument is anchored in the classical liberal tradition which is a central ingredient of the gold-standard mentality. Market mechanisms were relied upon to eliminate the disruptions that had resulted from the boom, they were expected to ensure the return to equilibrium. Government policy could, if anything, support the market forces. Attempts to moderate the downturn was seen as equivalent

to preventing the purgation which was seen as necessary in this phase of the cycle. Such government policy would thus be counterproductive and aggravate the situation.

Marbach and other proponents of underconsumption arguments questioned this part of the gold-standard mentality. They claimed that market forces could not be relied upon to bring about recovery. They suggested an active role for the government instead. Yet, these authors departed only halfway from the traditional liberal vision. Especially in this early phase of the debate the imperative of balanced public budgets was not questioned. In part, this is only the logical consequence of the support for the gold parity, thus the gold-standard mentality prevailed over the insight that expansionary policies would help overcome the crisis. Marbach, in line with his uncompromising support for the gold standard, was reluctant to support the demand for credit-financed public spending that soon emerged in the opposition. However, even the supporters of expansionary government policies would reject any contradiction between such policy measures and the adherence to gold, a position which will receive more attention below.

To summarize, the prevalence of the gold-standard mentality in Switzerland applied to the academic debate as well. Critics of the government's policies questioned only some aspects of the dominating view in the early phases of the debate. The following chapters will show how these first inroads into this encompassing set of beliefs eventually allowed its proponents to question the taboo of the Swiss franc's gold parity.

5. The turning tide: the opposition's demand for expansionary policies leading the headlines 1934-1935

This chapter returns to the development of the political debate on responses to the crisis, taking up the thread laid out in chapter 3. The government's orthodox policy proposals and adjustment rhetoric analyzed above had dominated the public debate in the early phases of the recession. When the government resorted to emergency legislation to pass the federal budget in the fall of 1933 and implemented the wage cuts earlier rejected by the population, resistance mounted. As the social democrats' influence in parliament was curtailed, the opposition resorted to a people's initiative to present a policy program entailing expansionary measures. The debate about the policy alternative, analyzed in this chapter, dominated in the years 1934 and 1935. Although the Federal Council reiterated its original approach to crisis policies in response to the initiative, government and opposition seemed to seek ways to overcome the confrontation towards the end of this period. Signs of conciliatory moves were, among others, the resignation of two Federal Councillors, Musy and Schulthess, who had been identified with the adjustment strategy and, on the side of the opposition, the Social Democratic Party's declaration in support of military defense in January 1935. However, the Federal Council's moderation, especially with regard to the adjustment rhetoric, cannot be interpreted as indicating a change in beliefs, as is argued in the following.

Government by emergency legislation

The referendum on the federal law mandating the reduction of wages and salaries of public employees on May 28, 1933 resulted in a rejection of the proposal.¹ This did not, however, discourage the government from pursuing an adjustment strategy. In September 1933, the Federal Council sent a proposal to parliament advancing "extraordinary and temporary measures to re-establish budget balance."² On October 13, 1933 both chambers of parliament passed the bill

¹In a voter turn-out of over 80 percent 505'190 votes were cast against, 411'536 votes in favor of the law, 15 cantons rejected and 10 accepted the proposal.

²Botschaft des Bundesrates an die Bundesversammlung betreffend die ausserordentlichen und vorübergehenden Massnahmen zur Wiederherstellung des Budgetgleichgewichts. (Vom 2. September 1933). *Bundesblatt* 1933, 197-294.

which contained the measures of the first emergency fiscal program.³ “...in view of the severe economic crisis and the large sacrifices that are imposed on the country, in preserving the highest interests of the country and the solidarity between all parts of its people, in view of the urgency to take the necessary measures ...” parliament authorized the government to introduce all regulations that were deemed imperative to implement the extraordinary measures contained in the fiscal program (... angesichts der schweren Wirtschaftskrise und der grossen Opfer, die dadurch dem Lande auferlegt werden, in Wahrung höchster Landesinteressen und der Solidarität aller Volksteile, angesichts der Dringlichkeit, die hiefür notwendigen Massnahmen zu treffen... *Eidgenössische Gesetzsammlung* 1933, 839).

The fiscal program spelled out measures aiming at across-the-board expenditure cuts and revenue increases. Noteworthy was the reduction in wages and salaries of public employees by 7 percent for the years 1934 and 1935, implementing an only slightly smaller reduction than the one contained in the bill rejected by popular ballot less than 4 months earlier. Furthermore, a crisis tax (*Eidgenössische Krisenabgabe*) was introduced as a progressive tax on income and wealth. The tax on returns of bonds and savings accounts (*Stempelabgabe*) was increased, as were taxes on tobacco and beverages. The validity of these extraordinary measures, and the authorities granted to the federal government to decree all regulations necessary to implement them, were limited to a four-year period starting on January 1, 1934. They were amended on January 31, 1936 and extended on October 28, 1937 for an additional year (until December 31, 1938).⁴

³Bundesbeschluss über die ausserordentlichen und vorübergehenden Massnahmen zur Wiederherstellung des finanziellen Gleichgewichts im Bundeshaushalt. (Vom 13. Oktober 1933). *Eidgenössische Gesetzsammlung* 1933, 839-47. This package of measures was usually referred to as the “fiscal program,” later as “fiscal program I” (*Finanzprogramm I*) once adjustments and extensions were passed in January 1936 as a second fiscal program, see following footnote 4.

⁴Bundesbeschluss über neue ausserordentliche Massnahmen zur Wiederherstellung des finanziellen Gleichgewichtes im Bundeshaushalte in den Jahren 1936 und 1937. *Finanzprogramm 1936*. (Vom 31. Januar 1936.) *Eidgenössische Gesetzsammlung* 1936, 17-39. Consumption taxes were increased significantly, whereas the increase in direct taxes covered only a small part of the envisioned additional revenues (Morandi 1995, 173). Across-the-board budget cuts included further reductions in wages and salaries of public employees. For further discussion see below, p. 201.

In October 1933, the Federal Council justified the measures by arguing that balancing the budget was “imperative” (unerlässlich. *Bundesblatt* 1933, 198). It was maintained that a deficit had to be avoided at all cost so as to safeguard the excellent credit Switzerland enjoyed and to keep the Swiss franc “unshakably” (unerschütterlich) at its gold parity. Therefore, Switzerland had to prove immediately “that she had the situation under control” (... dass die Schweiz Herr der Situation bleibt... *Bundesblatt* 1933, 199). It would be a grave mistake to cover deficits by debt-financing, as advocates of this “easy policy” (bequeme Politik) suggested, since it was not clear how long the crisis would last and since Switzerland was already burdened by a large public debt inherited from World War I and its aftermath. All these arguments had appeared in the government’s earlier statements. Balancing the federal budget had been the centerpiece of the adjustment strategy. What had changed was the assessment of the crisis: whereas the government had hesitated to acknowledge a recession in Switzerland well into 1931 as argued above, it now considered economic conditions “entirely extraordinary” (ganz ausserordentliche Wirtschaftsverhältnisse) and maintained that “probably it is rather a transition to a new state, likely to be different from the conditions that existed before 1914 in all possible respects.” (Wahrscheinlich handelt es sich eher um den Übergang zu einem neuen Zustande, der von den Verhältnissen, wie sie vor dem Jahre 1914 bestanden haben, in jeder Beziehung abweichen dürfte. *Bundesblatt* 1933, 198).

Despite the restrictive measures of the fiscal program, some representatives of the unions considered the compromises it entailed as proof of their successful opposition to the government’s adjustment strategy.⁵ Robert Bratschi, a union leader and social democratic member of parliament, went so far as to claim that “a fundamental change in the economic policy” (eine grundsätzliche Schwenkung in der Wirtschaftspolitik) had taken place, that the rejection of the wage reduction bill in the referendum earlier that year had dealt a “decisive blow to the deflationary adjustment policy” (der entscheidende Schlag gegen die deflationistische Abbaupolitik. Bratschi 1933, 351). The introduction of the crisis tax was considered a victory for the opposition. In March 1932, a similar proposal had been presented to the federal government which was then attacked ardently by the conservative press: the tax would worsen the crisis, destroy private property and lead to

⁵The fact that the Swiss Federation of Trade Unions (Schweizerischer Gewerkschaftsbund) had expressed support for the government’s fiscal program increased the already existing tensions between this organization and the leadership of the Social Democratic Party (Scheiben 1983, 176).

a wholesale redistribution of income and wealth (Marbach 1933b, 154-5). After the government suggested a similar tax, union leaders argued the additional revenues would allow the government to provide the funds necessary to mitigate the effects of the crisis especially on the unemployed. Moreover, they maintained that the fight against the reduction of wages and salaries had been successful in so far as the reductions that were implemented with the fiscal program were less than half the reductions originally envisioned by the government (Bratschi 1933, 351).

If some unionist social democrats might have found it possible to interpret parts of the fiscal program as a victory in their fight against adjustment policies, it was much harder to find a positive interpretation for the legislative form in which the fiscal program had been passed and for the sweeping authorities granted to the Federal Council.⁶ These procedures were based on emergency legislation as provided by Art. 89 of the Federal Constitution.⁷ Within the constitutional framework emergency measures could take the form of an “urgent” generally binding decision of the Confederation (allgemeinverbindlicher dringlicher Bundesbeschluss), a form of legislation at the same level with federal laws but with a limitation on the period in force. In contrast to formal federal laws (Bundesgesetze) regulations decreed as generally binding decision of the Confederation were withheld from an optional referendum through declaring them “urgent.” The issues raised by this form of legislation have to be considered within the context of Switzerland’s constitution which combines elements of direct democracy with parliamentary representation. Whereas in a pure parliamentary democracy members of the legislature truly represent their electorate, a Swiss parliamentarian is only delegated by her voters: the final decision on federal legislation rests with the sovereign.⁸ This implies that constitutional changes are subject to a mandatory referendum (obligatorisches Verfassungsreferendum) whereas federal

⁶Both had encountered fierce resistance in the National Council (*Stenographisches Bulletin* 1933, 391-616) and had been heavily criticized in the press (e.g. *Die Nation* 29.9.1933).

⁷The Federal Constitution of 1874 prescribed (Artikel 89 Abs. 2 BV): “Bundesgesetze, sowie allgemein verbindliche Bundesbeschlüsse, die nicht dringlicher Natur sind, sollen überdies dem Volke zur Annahme oder Verwerfung vorgelegt werden, wenn es von 30'000 stimmberechtigten Schweizerbürgern oder von acht Kantonen verlangt wird.” The article implied that “dringliche Bundesbeschlüsse” were exempt from this provision.

⁸This explains why the Swiss constitution does not provide for full judicial review of federal laws. Since the people as the sovereign have the final word on federal legislation there is no need for an institution evaluating federal laws on the basis of the constitution.

laws are submitted to an optional referendum (fakultatives Gesetzesreferendum) if required by a given number of signatories (30'000 in the period of interest here). Thus legislation decreed in the form of “urgent” generally binding decisions of the Confederation excluded the sovereign from the legislative process.

Historically, emergency legislation first gained importance with the outbreak of World War I, when parliament granted extended authorities to the federal government (Giacometti 1937, 46). After the war, standard procedures were reintroduced to a large extent, but repeatedly government and parliament resorted to declaring generally binding decisions of the Confederation as urgent. During the crisis years of the 1930s the appeal to emergency became the rule. Out of the 293 pieces of legislation passed on the federal level between 1914 and 1939 a total of 148 were based on emergency procedures.⁹ Between 1930 and 1938, the period of interest here, 91 decrees took the form of emergency legislation (Mäusli 1960, 17).

Viewed from the perspective of the formation of political will, these procedures significantly reduced the influence of the opposition on legislation. Within parliament, the threat to submit bills to popular vote has traditionally given opinions that are not represented within the government coalition leverage in the bargaining process. Therefore, it is not surprising that only 10 of the 49 social democratic representatives supported the proposal to declare the fiscal program as urgent (Bratschi 1933, 352).¹⁰ During the 1930s, a series of people’s initiatives from the whole range of the political spectrum aimed at limiting the scope of emergency legislation (Mäusli 1960, 19-27). Academic critique claimed the practice to be in violation of the constitution. Giacometti (1937, 46) contended that the emergency legislation promoted an authoritarian type of state along two lines. The first he circumscribed drastically as “parliamentary dictatorship” (Parlamentsdiktatur,

⁹Parliament decreed 114 federal laws (Bundesgesetze), 31 generally binding decisions of the Confederation (nicht dringliche Bundesbeschlüsse), which are also subject to an optional referendum, and 148 urgent generally binding decisions of the Confederation (dringliche Bundesbeschlüsse) (Mäusli 1960, 17).

¹⁰In part, Bratschi (1933, 351-2) justified his consent by referring to the fact that in the years after World War I important union concerns had been legislated in this form, such as the federal support for the unemployed and cost of living supplements for public employees. This justification is less than convincing since in both these cases narrowly defined measures were concerned. This was definitely not the case with the fiscal program.

Giacometti 1937, 46) referring to the exclusion of the sovereign from the legislative process through emergency procedures as discussed above (Dringlichkeitspraxis). The second criticism focused on the delegation of legislative authority from parliament to government and administration (Giacometti 1937, 63 and 66) as violating the constitutional division of power (Vollmachtenregime).

Giacometti (1937, 49-50) argued that, according to the constitution, urgency had to be understood in a strictly temporal sense as not allowing the delay entailed in constitutional legislative procedures. He concluded that perceived exigency, in the sense of a higher interest of the state, was not sufficient grounds to exclude legislation from the referendum. He maintained that, in many cases during the 1930s, urgency had been construed as a pressing necessity to legislate on a certain issue rather than in the temporal sense where the issue was so imperative that legislation could not be decided upon according to time-consuming constitutional rules. Given the evidence, Giacometti (1937, 56) contended, the Federal Council used the urgency clause instead to prevent proposals from being submitted to popular ballot because the government distrusted the people. Thereby the federal administration “conjured a crisis of direct democracy and created tensions between the people and their representatives and the executive respectively.” (Die Bundesbehörden misstrauen somit dem Volke; sie beschwören auf diese Weise eine Vertrauenskrise gegenüber der Referendumsdemokratie herauf und erzeugen damit eine Spannung zwischen Volk und Volksvertretung bzw. Exekutive. Giacometti 1937, 56). All in all, Giacometti concluded that the emergency practice as it had developed since the beginning of World War I was unconstitutional by violating the constitutional political rights of citizens.¹¹

Besides being heavily criticized for its controversial constitutional nature, the practice of emergency legislation limited the opposition’s influence within the parliamentary process as argued above. This forced the critics of the government’s policies to resort to legislative channels outside parliament, most importantly to people’s initiatives, to promote its policy proposals. On the

¹¹Furthermore, he argued that the several decrees materially violated the constitution by limiting economic freedom and changing the constitutionally prescribed division of authorities between federation and cantons (Giacometti 1937, 58-61). The federal government was aware of this critique as is apparent from the defenses offered on several occasions (e.g. Schulthess 1934, 9 and *Bundesblatt* 1935, 301).

federal level, initiatives are limited to constitutional amendments. The proposed amendments, once supported by a given number of signatories, are submitted to a popular vote. Thus, this channel opened up a path for opposition forces to present alternatives to the government's policies directly to the sovereign.

The opposition's crisis initiative of spring 1934

The "crisis initiative" (Kriseninitiative)¹² was the most successful and most controversial of such initiatives during the 1930s. It was launched in 1934 by a political alliance (Aktionskomitee zur Bekämpfung der Wirtschaftskrise) including representatives of trade unions, the employees' organizations (Angestelltenverbände) and a group of reform-oriented farmers (Jungbauern). In order to provide the proposal with broad support and to avoid political trench warfare, the initiators deliberately built on the cooperation of professional organizations rather than political parties as sponsors of the initiative (*Die Nation* 18.5.1934).¹³

Die Nation, a weekly "independent paper for democracy and community of the people" (Unabhängige Zeitung für Demokratie und Volksgemeinschaft) as its subtitle claimed, became a central voice for the development of the ideas of the initiative. The first issue of the paper was published on September 1, 1933. Its aim, as stated in the declaration signed by 74 individuals (at least 3 of them women) and published in the first issue, was to provide a free forum where "citizens of different professions, different origins, different views, farmers and workers, merchants and craftsmen, scholars and artists jointly prepare the way for a spiritual, political and economic recreation of the Confederation." (Bürger verschiedener Berufe, verschiedenen Herkommens, verschiedener Anschauung, Bauer und Arbeiter, Kaufmann und Handwerker,

¹²"Volksbegehren zur Bekämpfung der wirtschaftlichen Krise und Not." The text of the initiative was reprinted in *Bundesblatt* 1935 (I), 277-8. The initiator's presentation was published as Schweizerisches Aktionskomitee (1935). In the summer of 1934, *Die Nation* published a series of articles explaining the goals of the initiative.

¹³Although the ideas for a proposal were initially developed by a working group within the Social Democratic Party, the union leaders soon circumvented that forum and approached representatives of trade (Gewerbeverband) and farmers (Bauernverband) without informing the working group (note that neither organizations ended up participating in the alliance). Their next step was to suggest the strategy of building the support for the initiative on professional organizations, de facto excluding the leadership of the Social Democratic Party from any further direct influence on the initiative (Scheiben 1983, 179-187).

Gelehrter und Künstler gemeinsam *den Weg bereiten zur geistigen, politischen und wirtschaftlichen Neugestaltung der Eidgenossenschaft*. *Die Nation* 1.9.1933, emphasis in the original). In many ways the paper was a reaction to the emergence of ultra-conservative and fascist “fronts” and the flood of propaganda papers started by them which had reached its high point in the spring of 1933.¹⁴

The initiators of *Die Nation* can be loosely described as a cross-section of progressive and reform-oriented circles. Different political parties were represented and some well-known names of moderate social democrats, union leaders and progressive farmers stood out.¹⁵ It was clearly a movement of intellectuals: 32 of the signatories had doctor titles, another 11 signed their names as professors. The support for democracy, the rejection of violence, the respect for minorities and justice in their treatment included in *Die Nation*'s program set the paper in evident opposition to those of the radical fronts.¹⁶ Beyond these ingredients of a traditional liberal consensus the declaration of *Die Nation* also formulated - if vaguely - social goals: “As much as Switzerland embodies ... a *national community of people*, it has to become an example of a *social community of people*.” (Wie die Schweiz ... den Sinn *nationaler Volksgemeinschaft* verkörpert, so muss sie ein Beispiel *sozialer Volksgemeinschaft* werden.) Further on in the text, the “social strengthening” (*soziale Stärkung*) of democracy was appealed to. *Die Nation* frequently criticized the government's adjustment policies and demanded expansionary measures and an end to price and wage reductions. Finally, on May 18, 1934 the crisis initiative was announced in *Die Nation* and

¹⁴The emergence of *Die Nation* must also be seen in the context of the power struggles within social democracy. Scheiben (1983, 175) points out that the social democratic leadership had tolerated the launch of the paper only reluctantly and considered it an instrument of the right-wing opposition within the party. Morandi (1995, 43 and 64 ff.) argues that *Die Nation* turned into an important forum for the debates over social democratic policies and the eventual reorientation of the party in the course of the 1930s.

¹⁵Robert Bratschi, Konrad Ilg and Max Weber from the Swiss Federation of Trade Unions (Schweizerischen Gewerkschaftsbund), Fritz Marbach and Emil Klöti from the social democrats, and Andreas Gadiant a democrat. Among the initiators there were also conservatives and traditional liberals like Eugen Grossmann and William Rappard.

¹⁶Contributions regularly discussed and criticized the activities and proposals of the nationalist circles. The success of the fronts was interpreted as an effect of unemployment and increasing disorientation brought about by the economic crisis and the government's passive stance on it.

a week later, the full text was published in the paper. Presented as an alternative to the government's contradictory policies, it was also, true to the initial impetus of *Die Nation*, seen as an attempt to integrate the population into a broad-based debate over crisis policies.

The proposal was supported by 334'940 signatories from all parts of the country, a large number considering the constitutional requirement of 30'000 signatures necessary to submit a people's initiative.¹⁷ The crisis initiative contained proposals to fight the depression with expansionary measures as an alternative to the government's adjustment policies (*Bundesblatt* 1935 (I), 277-8).¹⁸ In contrast to the official government strategy, the initiative demanded that the decline of prices and wages should be controlled by government intervention. The government would provide adequate support for the unemployed. Systematic public works programs and the organization of employment exchanges by the federal government were foreseen. Over-indebted farmers and small entrepreneurs should receive debt reduction. Support of exports and tourism were proposed. Furthermore, the initiative advanced the regulation of capital markets and capital export and the control of cartels and trusts. Elements of macroeconomic planning were proposed in the provisions concerning the banking and insurance sectors.¹⁹ To implement these measures

¹⁷*Die Nation* (7.12.1934) presented an overview over the geographical distribution of the signatories' places of residence which demonstrated the broad basis of support.

¹⁸As pointed out above, see fn. 13, p. 125, the leadership of the Social Democratic Party had been bypassed in the preparation of the crisis initiative which reflected the positions of the moderate union representatives within the party. At the same time as the initiative was prepared the Social Democratic Party developed a "plan for work" (Plan der Arbeit) along the lines pursued by the Belgian economist Henrik de Man. It proposed the transition to a mixed economy (Scheiben 1983, 216). The socialization of key industries, the large banks and insurance companies was demanded, and an encompassing industrial policy aimed at the creation of employment and income opportunities was envisioned. The government's authority to plan and control the economy was to be substantially increased. Whereas the crisis initiative had aimed at temporary measures, the "plan for work" projected permanent changes in the economic system (Ruffieux 1974, 214). For the union leaders who had orchestrated the crisis initiative, Robert Bratschi, Konrad Ilg and Max Weber, these suggestions went too far in the direction of centralization and intervention (zu etatistisch-zentralistisch. Schmid-Ammann 1967, 90. See also Weber 1934). The "plan for work" was discussed and accepted at the Social Democratic Party convention in January 1935.

¹⁹Not surprisingly this turned the banking sector's representatives into determined opponents of the crisis initiative. Baumann and Halbeisen (1999, 29-31) discuss the activities developed by the Swiss Bankers Association (Schweizerische Bankiervereinigung) in the

the proposal included provisions that would authorize the federal government to elicit the cooperation of cantons and of professional and business organizations and to restrict economic freedom. Furthermore, the expenses of the suggested measures would be covered by credit financing and by regular revenues, but the proposal explicitly suggested that the government raise additional funds by issuing bonds and taking out loans. The proposal limited the validity of this constitutional amendment to five years, the Federal Assembly (made up of both chambers of parliament) would have been authorized to extend this period for the maximum duration of another five years. With these measures, the authors of the proposal sought to implement a systematic approach to crisis policies as an alternative to the government's allegedly inept efforts to balance budgets and mitigate the effects of the crisis by ad hoc interventions and selective social policies.²⁰

campaign against the initiative. The organization did not hesitate to enter into alliances with the far right to increase the effectiveness of the resistance and came up with an enormous budget for this crusade. The insurance sector also took strong action to influence the campaign, a fact explicitly discussed in *Die Nation* (June 7, 1935).

²⁰The crisis initiative bears the handwriting of Max Weber, economist at the Swiss federation of trade unions (Schweizerischer Gewerkschaftsbund). He was an advocate of counter-cyclical government spending in Switzerland, arguing that government investment projects should be postponed during the boom and concentrated in the recession. By adequately timing public expenditure according to business cycle needs, additional job creation projects (Notstandsarbeiten) would become unnecessary (Hohl-Slamova 1983, 107). Weber's argument reflected the contributions of the German economist Eduard Heimann whose influence on the Swiss union movement is also documented by Morandi (1995). In a minority opinion to the Brauns commission's report in 1931, Heimann had advocated the adequate timing of government expenditure and rejected additional unproductive projects as wasting the limited supply of savings (Röpke 1931, 447). This view, which was also central to Hoover's conception of "new economics" developed in the early 1920s, had become widely accepted in the course of this decade. For Switzerland, it had for example been discussed uncontroversially by Saitzew in 1928 (fn.31, p. 97). However, in the debates during the crisis, only social democrats demanded counter-cyclical public spending. Certainly, the priority of budgetary balance was seen as limiting the scope of such policies by conservative economists. Weber, who had supported the social democrats' proposal for a crisis tax to finance additional government spending in the earlier stages of the crisis, in later years demanded credit-financed public spending. He argued that budgets should be balanced over the business cycle rather than in every individual year. He thus departed from Marbach, who was very reluctant to support deficit financed public spending programs. The different standpoints of these intellectual leaders of the reform-oriented wing of social democracy which emerged in this context fully developed into opposing views on the issue of devaluation which will be discussed below, p. 182 ff.

Die Nation provided a forum to advance and explain the suggestions of the crisis initiative in the following months. Whereas proponents of the proposal clearly dominated, the occasional critical voice also got printed (e.g. *Die Nation* 18.1.1935). In March 1935 the editors published an open letter to the Federal Council, restating the aims of the proposal and defending it against the charges of its critics (*Die Nation* 1.3.1935). In this context, the initiators' critique of adjustment policies was reiterated, reflecting the experiences of the recent years and the economic situation at the beginning of 1935.²¹ Among the economic effects, even the pronouncement of adjustment was claimed to lead to an "adjustment psychosis" (Abbaupsychose) which was responsible for the paralysis of trade and production as potential buyers or producers postponed activities awaiting further price and wage reductions. Moreover, it was argued, deflation had devastating effects on credit and capital markets. As indebted farmers and small businesses saw the real burden of their obligations increase, default was becoming inevitable. This would endanger banks, a fact that was already reflected in investors' decisions. Instead of investing their funds, they withdrew them from markets by holding gold or cash. This argument reflected the tightening of credit markets in Switzerland increasingly deplored by contemporaries since mid-1934 (see p. 39 above).

Besides pointing out the economic effects of deflationary policies, the initiators argued that they also had political effects. Whereas farmers, craftsmen, workers and employees were the basis of Switzerland's successful democracy, they would lose confidence in the state's institutions as the crisis kept deepening. Without the support of these masses, Switzerland's existence as an independent state would soon be threatened. By arguing that the proponents of adjustment policies burdened themselves with the responsibility for future political events, the government's critics implicitly suggested comparisons with Brüning's policies and the developments in Germany. Thus, as in other pronouncements by the opposition, the political aspect of the economic crisis

²¹*Die Nation* argued that in the last four years the federal government and parliament had swayed. Whereas downward price and wage adjustments had been proclaimed, at the same time prices had been supported by a variety of measures, suggesting that one part of the government did not know what the other was doing. (Bundesrat und Parlament schwanken aber seit vier Jahren hin und her, verkünden programmatisch den Abbau, stützen und schützen gleichzeitig durch verschiedenste Massnahmen die Preise, suchen also die durch den Abbau geschlagenen Wunden mit Pflasterchen wieder zu überkleben, und erwecken den Eindruck, dass die eine Hand oft nicht weiss, was die andere tut. Andreas Gadiant in *Die Nation* 18.8.1934). These remarks allude to the differences within the Federal Council discussed repeatedly in chapter 3.

was underlined and economic measures were portrayed as effective means to undermine the support for fascist circles.²²

The government's response

The federal government took the debate about the initiative as an opportunity to restate its own position.²³ The lengthy report started with an overview of the measures taken so far and a discussion of recent economic developments. Schulthess's statement from 1932 (p. 80, above), claiming that price and wage declines were inevitable since the developments within an economy followed certain almost law-like principles, was repeated. In light of the fact that the drop in the price level had come to a halt after 1932, this is remarkable. Whereas Schulthess commented on what he had observed in the previous years, under the conditions of 1935 the statement turned into a claim on a reality which did not conform to these expectations. The difficulties in Switzerland were described as the result of fundamental changes in the world economy: Europe that used to be the main supplier of industrial products with a "monopolistic supremacy" (monopolartige Vormachtstellung. *Bundesblatt* 1935 (I), 290), was now confronted with the competition of the United States and Japan as large exporters. Formerly agricultural countries and

²²Since the late 1920s nationalistic and conservative circles demanded a corporatist organization of the economy to overcome the confrontation between employers and employees and the different interests of industry and agriculture in favor of national unity (Ruffieux 1974, 208). These demands were taken up by the emerging "fronts," the nationalistic movements built on ideology, forms of organization and agitation drawing on the example of the Nazis in Germany and the Italian fascists. Although the corporatist ideas on economic organization were also voiced, e.g. in the parliamentary debates over the government's crisis policies, the movement did not come forward with specific suggestions for alternative crisis policies. Their demands went much further, as the initiative for a complete revision of the constitution in 1935 demonstrated. They argued in line with, for example Jakob Lorenz, that the increasing influence of economic interests in the political process (Verwirtschaftlichung der Politik) was central to the economic crisis. Their suggestions thus aimed at a form of government that was less dependent on parliament and its perceived special interest representation (Morandi 1995, 168). The initiative for a revision of the constitution was rejected in the referendum of September 8, 1935 (511'578 votes against, 196'135 votes in favor with 21 cantons and half-cantons against, 4 in favor of the proposal and a low voters' turnout of 60.9 percent. Ruffieux 1974, 246). This defeat weakened the support for the fronts and their activities, which were at their high point in the spring of 1933 (Frontenfrühling). For a discussion of the activities and their influence on the political climate in Switzerland see Ruffieux (1974, 216-46).

²³Bericht des Bundesrates an die Bundesversammlung über das Volksbegehren zur Bekämpfung der wirtschaftlichen Krise und Not. (Vom 6. März 1935.) *Bundesblatt* 1935 (I), 277-347.

importers of manufactured goods had started to produce industrial goods themselves. All in all, that implied a shift of economic power away from Europe and a stronger inward-orientation of each country's economy. These changes were aggravated by the results of the war, which had led not only to the impoverishment of entire nations but also of groups within the population, especially in the middle classes. The outlook for Switzerland was particularly bleak: "Those people will suffer most from these developments who rely most heavily on selling their products. And amongst them, again, the blow will be particularly severe for those whose exports do not consist of essential food stuff and raw materials, but to a large extent embody luxury items." (Von diesen Verhältnissen werden jene Völker am schwersten getroffen werden, die am stärksten auf den Absatz ihrer Waren angewiesen sind. Und unter diesen ist der Schlag wieder für jene besonders hart, deren Export nicht aus lebensnotwendigen Nahrungsmitteln und Rohstoffen, sondern in hohem Masse aus Luxuswaren besteht. *Bundesblatt* 1935 (I), 291).

The report went on to lament the decline in exports and industrial employment resulting from the changes in the world economy. The often-repeated arguments were reiterated once more: excessively high production costs in Switzerland and import barriers and export subsidies in the rest of the world undermined trade. Accordingly, "the reconstruction of our export business will therefore take long decades of privation, if it will be possible at all." (Der Wiederaufbau unseres Auslandsgeschäftes wird daher langer, entsagungsvoller Jahrzehnte bedürften, wenn er überhaupt je wieder möglich ist. *Bundesblatt* 1935 (I), 295). Since the outlook for a recovery in tourism income on the one hand, and returns from exported capital on the other were just as bleak, the Swiss economy was also deprived from these important sources of income. Although the conditions in the industries producing for domestic markets were less desperate in comparison, the contemporary economic situation was judged as "extraordinarily grave," it could become even more severe in the future. "Crisis and unemployment have become a world problem and have taken on the character of a permanent phenomenon." (Krise und Arbeitslosigkeit sind zu einem Weltproblem geworden und haben den Charakter einer Dauererscheinung. *Bundesblatt* 1935 (I), 298). This statement, quoted from the expertise of Grimm and Rothpelz (1934), closed the section on the economic conditions in Switzerland.

Based on these remarks, the government took up the line of argument developed in 1933 for the presentation of the fiscal emergency measures to parliament. Then, the "transition to a new state" in economic conditions had been referred to rather vaguely (p. 121), whereas now this "new state"

was described as one of a worldwide redistribution of economic activity and wealth resulting in permanent crisis and unemployment in Switzerland.

Concerning exports, the government thus shared the outlook implicit in its critics' initiative that, although the outward orientation remained a central pillar of the Swiss economy, a recovery starting from this side could not be expected in the near future. The onslaught on the initiative thus needed a different starting point. It set out with an ideological attack: the suggestions were characterized as yielding a socialist form of economic organization, a fact many supporters were claimed not to be aware of and would most certainly not want to advance. The government suggested that the initiative aimed at placing the responsibility for the individual's well-being in the hands of the state. Instead, in the liberal order defended by the government, the state should only come in "subsidiarily" in those situations where the individual's strive encountered unsurmountable difficulties (*Bundesblatt* 1935 (I), 299). The government thus took up the wording introduced by the papal Encyclical *Quadragesimo Anno* (1931). The perceived socialist outlook of the crisis initiative was underlined by arguing that the proponents' aim was to prepare the ground for the introduction of a planned economy, as entailed in the social democrats' "plan for work." This plan, it was maintained, was part of an international coordination of similar initiatives aimed at the realization of an ideology that had grown on "international soil" (...einer auf internationalem Boden gewachsenen Ideologie. *Bundesblatt* 1935 (I), 300). This statement insinuated that such international concepts could not be appropriate, considering the country's distinct history and present state.

The government's accusation that the crisis initiative was interventionist cannot be questioned. Still, the line of argument presented was misleading. The reference point to evaluate the interventionist character of the initiative could, under the given circumstances, hardly be an ideal liberal economic order or even the rules entailed in the Swiss constitution. The actual regime that had developed in the course of the crisis was itself highly interventionist. A large part of the legislation passed in those years had been based on emergency procedures as argued above, many of them limited (constitutional) economic freedom severely and intervened heavily in individual

markets.²⁴ At the same time, the federal government had taken over functions from the cantons by regulating e.g. support payments to the unemployed who could not or no longer rely on unemployment insurance. In many respects, the regime introduced by the emergency legislation did not differ fundamentally from the one entailed in the crisis initiative.²⁵ The initiators even argued that the suggested constitutional amendment would legitimate many of the government's measures taken in the past which lacked a constitutional basis (*Die Nation* 1.3.1935). As pointed out above, the provisions of the initiative were limited to the expected duration of the crisis. They were designed as an "emergency regime" albeit, in contrast to the government's approach, on a constitutional basis.

Turning to the initiatives' distinct proposals for expansionary government policies, the differences in the government's and the initiators' outlook becomes obvious, a disagreement that goes beyond the ideological differences emphasized in the government's report. The central discrepancy between both sides concerned the economic understanding of the effects of public spending. Discussing the demand for increased expenses, the government defended its own measures aimed at supporting production such as the export subsidies or agricultural price support schemes as pursuing exactly the goals envisioned by the initiative. The report argued that a further increase in such measures was impossible: "The state can well provide for the individual or for entire trades as long as the state herself has the necessary means or as long as the economy as a whole is in a

²⁴Examples are the restrictions on hotel construction, on the establishment of department stores, and on the opening of shoe repair shops or the price support schemes in agriculture (see Rutz 1970: 152-179 for an overview of the interventions introduced in the course of the depression). Another example was the ongoing debate about the government's endeavors to be granted authority to enforce downward price adjustment. The Federal Council's aim was to broaden the scope of the institution established in 1932 which oversaw the price effects of import restrictions so as to include a wider range of goods and to introduce sanctions. These suggestions met with bitter resistance from parliament. Eventually and with considerable delay a decision on price control was passed in June 1936. It extended the provisions of federal price control that had so far been reserved to goods covered by import restrictions to goods which were produced with government support or under the supervision of cartels. (Bundesbeschluss betreffend die Überwachung von Warenpreisen. (Vom 20. Juni 1936.) *Eidgenössische Gesetzsammlung* 1936, 504-5). For details see Rutz 1970, 180-4).

²⁵The aspects of macroeconomic planning envisioned in the crisis initiative through increased control of the financial sector had, of course, no correspondence in the crisis policies of the government.

position to supply these funds.” (Der Staat kann wohl dem einzelnen und ganzen Ständen helfen, solange er selbst über die nötigen Mittel verfügt oder die Wirtschaft in ihrer Gesamtheit in der Lage ist, sie zu liefern. *Bundesblatt*, 1935 (I), 304). Implicitly any expansionary effects of government spending were thus rejected without making an explicit argument about this contention. Possibly the authors of the report were not even aware of this fundamental difference in the aims pursued by the government’s interventions and the initiative’s suggested expansionary policies. The government’s argument showed that it expected nothing more than a conservation of economic structures from the measures introduced so far. That government spending could have positive effects on the entire economy was not perceived.

The report repeatedly insisted that, given the importance of exports to national income, the domestic economy would inevitably contract as long as this source of revenue had not recovered. The proponents of the crisis initiative by no means denied the importance of the export sector for the Swiss economy. Marbach (*Die Nation*, 22.6.1934), for example, argued that there was no disagreement concerning this point between the initiative and the government. Differences existed, though, on how best to promote exports: whereas the government’s strategy of price and wage adjustment had severe repercussions on the sectors producing for domestic markets, the initiative suggested additional export subsidies to make up for the differences in production costs. Furthermore, the argument made previously by the government’s critics that trade barriers were much more important hindrances to an increase in Swiss exports than price competition was repeated.

From the limited scope of government spending implied by the Federal Council’s argument, and the eventual exhaustion of means to finance government interventions, the report moved on to the need for adjustment to the conditions in the rest of the world. As on earlier occasions, the inevitability of adjustment was conjured. The pessimistic tone of the entire report is reflected in the revised expectations as to the need for sweeping adjustment: whereas the protection of certain sectors through government intervention might be possible temporarily, they would eventually also face contraction (*Bundesblatt* 1935 (I), 305). The government’s outlook had thus changed significantly. From this new perspective, interventions to mitigate the effects of the crisis could only provide a “break” in the adjustment pressure. In the past, they had been expected to allow the respective sectors to get through the (temporary) crisis until recovery would make them viable

again. Under this general outlook, it is not surprising that an argument that had been present all through the debate over the crisis policies now gained additional weight. The report discussed in detail the excessive increase in living standards during the 1920s and suggested the reductions necessary under the given circumstances be understood as an adjustment to a healthier or normal situation rather than as sacrifice (*Bundesblatt* 1935 (I), 310).²⁶

This argument is part of a discussion and rejection of purchasing power arguments as misconceived,²⁷ and as particularly misconceived in an open economy. The reasoning built on a popular interpretation of Say's law, not least popular because of its apparent incorporation of sound economic thinking on the household level: income first had to be earned and only then could it be spent on consumption. Thus, both the purchasing power argument and its rejection are depicted here in simplistic terms, without doing justice to either side of the debate. Considering earlier, more sophisticated contributions by members of the government, by the administration and expert speakers in favor of the government's position, this over-simplification can only be understood in light of the increasing pressure the government was exposed to and the changed tone in a heated political debate.

In its concluding remarks (following a detailed discussion of the individual proposals of the initiative) the government restated its own approach to the crisis.²⁸ The claim of the authors of the crisis initiative that the government's policy aimed at the "reduction of wages, the reduction of prices, the reduction of the living standard of all professions" was fervently rejected. Instead, it was argued that the government's measures had led to a slow-down and moderation of the decline

²⁶In this part of the argument, mercantilistic overtones, also familiar from earlier announcements, reappeared. It was, for example, argued that the recently developed "want" (Bedürfnis) for individual mobility had left Switzerland even more dependant on her trading partners as vehicles and gasoline needed to be imported. This aggravated a situation where it was increasingly difficult to finance the "requirement" (Bedarf) of food imports through exports (*Bundesblatt* 1935 (I), 309).

²⁷The report even resorted to citing Marx's critique of purchasing power arguments to give its own rejection authority (*Bundesblatt* 1935 (I), 307).

²⁸Note that the government did not comment on the political justification for expansionary policies as a means to undermine support for the fascist "fronts," an argument stressed by the proponents of the crisis initiative.

in prices and wages (*Bundesblatt* 1935 (I), 341). Even so, the report claimed it to be inevitable to realign the Swiss with the world economy. At the same time, it promised a continuation of the measures introduced so far. The need for balanced budgets was underlined and the initiative's suggestion to resort to credit-financing rejected as irresponsible. The government's final verdict on the proposal was not to be mistaken: the initiative aimed at "building a small, socialist utopian state in the heart of Europe" and the initiators believed "with incomprehensible arrogance to be able to eliminate the effects of the developments in the world economy in our country." (... das im Herzen Europas einen kleinen, sozialistischen Zukunftsstaat schaffen will und in unverständlicher Überheblichkeit glaubt, die Wirkung weltwirtschaftlicher Vorgänge in unserem Lande ausschalten zu können. *Bundesblatt* 1935 (I), 347).²⁹

In sum, the Federal Government's response to the crisis initiative underlined reflected the same contradictions that had characterized its pronouncements since the early years of the crisis. On the one hand, the need for orthodox policies inspired by the gold-standard mentality was underlined and adjustment was presented as inevitable. This was contended with more urgency than ever in view of the structural changes in the world economy and conditions in Switzerland that were depicted as desperate. On the other hand, the report pointed out that the government's policies had been successful in supporting price, wage and income levels in Switzerland, policies to be continued in the future. The forceful rejection of the crisis initiative's claim that the government's policies had been guided by the principle of downward price and wage adjustment has to be seen in light of the turmoil that had been created by a speech delivered by Federal Councillor Schulthess on November 29, 1934 (Schulthess 1934) to a meeting of business representatives (Kaufmännische Gesellschaft) in the town of Aarau in his home canton.³⁰ His argument, a fierce attack on the policy proposals of the crisis initiative and a demand for government-enforced adjustment, are reviewed in the following section.

²⁹The Federal Council refrained from presenting an alternative to the crisis initiative to popular vote thus underlining its categorical rejection of the proposal. Thereby the government deliberately relinquished an opportunity to provide a constitutional basis for its own policies.

³⁰Böschenstein (1991b, 325) makes the critical reactions to Schulthess's speech from quarters that had supported him in earlier conflicts responsible for Schulthess's resignation in the following spring of 1935.

Federal Councillor Schulthess's "Aarauer speech" of November 1934

After an overview of the deplorable economic situation, the "Aarauer speech" (Aarauer Rede) argued that the Swiss people were confronted with a fateful decision between two alternative policy paths. The first, the path of the crisis initiative, was - not surprisingly - forcefully rejected. Apart from the arguments that later appeared in the government's report that we just reviewed, Schulthess (1934, 17) insinuated that the public budget deficits resulting from the increased expenses could only lead to "the ruining of our currency." The alternative path was the adjustment to the world economy. Schulthess (1934, 22) claimed that all options for increasing employment in the production for domestic markets had been exhausted. Hence recovery could only start in the export sector - a claim so often repeated by the government that it must have resounded like a mantra in the ears of the listeners.

Did Schulthess have anything new to say about such a recovery? In contrast to the government, Schulthess (1934, 23) pointed to the revival in world trade and argued that if production costs in Switzerland were lower, her economy could participate in the revival. Schulthess repeated the demand for adjustment of prices and wages in all those areas where reductions had not taken place yet. Beyond them, a decline in overall prices and wages was necessary, so that production costs could fall by 20 percent, as demanded by the export industries and as based on the administration's experience with export subsidies.³¹ Although an elimination of all measures taken in support of the production for domestic markets would quickly bring about such an adjustment, Schulthess conceded that a sudden change in this regime was not desirable since it could lead to the collapse of agricultural production and of the industries supplying domestic markets. Still, the gradual demolition of the system of protection should soon set in as production was increasingly distorted (Schulthess 1934, 26-7).

Just as controversially, Schulthess (1934, 27) suggested that government intervention to enforce price reductions and a decline in rents might be the only solution to the "contemporary paralysis" (gegenwärtige Verkrampfung) of the economy. He justified his claim by arguing that such

³¹On January 28, 1935 the industry organizations (Schweizerischer Handels- und Industrieverein and Zentralverband schweizerischer Arbeitgeberorganisationen) formally presented the proposal for an adjustment of 20 percent to the federal government. At the same time, reductions in social spending and subsidies were demanded. (*Die Nation* 1.3.1935)

intervention was aimed at returning the economy to normal conditions. Schulthess pointed to the existing price controls for imported goods and the pricing commission which overlooked domestic prices (Preisbildungskommission). These institutions could effectively take over the additional functions if they were provided with adequate authorities to enforce their decisions.³² Whereas Schulthess (1934, 29) deemed wage and salary reductions just as necessary as price adjustment, he rejected government intervention in their determination and appealed to the insight of the contracting parties in the inevitable necessities and their own long-term interests. If price and wage adjustments would not take place, Schulthess warned that a further decline in employment and a further worsening of the public finances would bring about the devaluation of the currency, which would inevitably be followed by inflation (Schulthess 1934, 30-34).³³ After a lengthy plea presenting price and wage adjustment not only as inevitable but also as desirable once a long-term view was taken, Schulthess ended his talk with the appeal: “Away with demagoguery and catch phrases! Responsibility and sacrifices are the call of the moment.” (Weg mit der Demagogie und den Schlagworten! Verantwortungsbewusstsein und Opferwilligkeit fordert die Stunde. Schulthess 1934, 40).

Not just this final emphatic appeal must have reminded listeners and readers of Schulthess’ former adversary Musy. It seemed as though Schulthess had taken over the crusade for adjustment policies from his former colleague.³⁴ As Musy before him, Schulthess became the target of the critique expressed by the unions and social democrats who perceived Schulthess’ Aarau speech as an assault on the crisis initiative and as particularly biased and polemic (Bratschi 1967, 46-7). Even the rhetoric he employed has more similarities with Musy’s talk of February 1932 than with his own moderating contributions in the earlier phases of the political debate. Especially in

³²In June 1936, the supervision of prices was somewhat extended, see fn. 24, p. 133 above.

³³The lengthy description of the abhorred effects of a devaluation on all parts of society concluded with the remark that “never would anybody be willing to take the responsibility for a deliberate devaluation” (Ich glaube nicht, dass jemals bei uns irgend jemand bereit wäre, die Verantwortlichkeit für eine gewollte Währungsentwertung zu übernehmen, ... Schulthess 1934, 33-4). This contrasts with Schulthess’ later claim, that he had already become convinced of the inevitability of devaluation by the time he gave this speech (Schulthess 1936, 463).

³⁴Musy had stepped down in April 1934 see p. 145 below.

presenting the vote on the crisis initiative as a fateful crossroads for Switzerland Schulthess took up Musy's argumentative strategy. Now the alternatives were presented as short-sighted, irresponsible budgetary policies leading to inflation and devaluation on the one hand, forward-looking and conscientious adjustment on the other. Schulthess, in contrast to Musy, avoided the term deflation, possibly because it had become the catch-word to characterize the government's policies in the opposition's attacks.

The government's official statement on the crisis initiative, reviewed above, dispensed with some of the attacks on the opposition that Schulthess had made a few months earlier. In particular, the argument that the crisis initiative inevitably led to devaluation was dropped. Even so, Schulthess' arguments had been repeated in the campaign so that the initiators' open letter to the Federal Council took them up (*Die Nation* 1.3.1935).³⁵ The claim that the initiative would lead straight to devaluation was rejected forcefully. Instead, it was argued that public finances were sound despite the crisis and would not be threatened by the additional debt suggested in the initiative. Currency policies as such, and the capacities of the Swiss National Bank, would not be changed by the provisions of the constitutional amendment. Its proponents explicitly rejected the interpretation that the initiative presented a choice between adjustment and devaluation, a rhetoric that had already been central to the fight over the government's wage reduction bill in the winter and spring of 1932-33. This line of attack gained importance as the Swiss franc got under increasing speculative pressure in the wake of the devaluation of the Belgian franc in March 1935. The critics of the crisis initiative argued that these pressures reflected investors' worries about the pending economic policy decision in Switzerland.³⁶ In view of these arguments, Weber went so far as to claim that the crisis initiative was the last attempt to stop the deflation and a further

³⁵Müller (2001, 128-9) shows that the industry organization Vorort des Schweizerischen Industrie- und Handelsvereins drew arguments for the rejection of the crisis initiative from the dangers it entailed for the maintenance of the Swiss franc's parity. He provides further details on the arguments brought forward by the initiative's critics and the coalitions formed by them during the campaign. According to him the currency question became the central topic in the campaign in the course of April 1935 (Müller 2001, 150-56).

³⁶This view was repeated by the government in its proposal for adjustments to the emergency fiscal program in November 1935 (*Bundesblatt* 1935 (II), 777).

deepening of the crisis without having to resort to devaluation.³⁷

Schulthess' talk must also be seen in the context of increasing criticism of the government from within the coalition parties. One problem was the loyalty of the farmers whose party was represented in the Federal Council since 1930. Influential parliamentarians of the farmers' party, most importantly the president of the farmers' organization, Ernst Laur, openly rejected wage and price adjustment as being detrimental to his constituency's interests. The other problem for the government coalition was the increasing critique from the conservative end of the political spectrum. They argued that the liberals had gotten into a routine of government practice based on uneasy compromises rather than the pursuit of clear-cut policy goals. The conservative press argued that economic policies were a case in point and accused the government of having given in to the pressure of social democrats instead of implementing the economic and fiscal policy program of adjustment that had been considered the correct response to the crisis by the members of the Federal Council (Morandi 1995, 195-8). The failure of the government's policies to bring the Swiss economy onto a path to recovery was attributed in those quarters to the half-heartedness with which the government pursued adjustment, to insufficient price and wage decline. Not surprisingly, industry representatives, *Neue Zürcher Zeitung* and other conservative newspapers welcomed Schulthess' speech. *Die Nation* (7.12.1934), in contrast, published an adamant critique focusing on Schulthess' suggestion to enforce price reductions through federal agencies. On the one hand, the realization of such a project was ridiculed through a listing of goods and services whose prices the agency might strive to regulate. On the other hand, the suggestion was likened to Brüning's policy and it was insinuated that his adjustment policies had directly led to the empowerment of national socialism.

As these examples show, the debate around the crisis initiative was bitter and both sides resorted to all available means to discredit the opponent. The government's supporters painted a simplified picture of a fateful choice between two policy options presented by the crisis initiative and a continuation of the strategy pursued so far. The government's supposedly tested policy mix of

³⁷“Die Kriseninitiative bringt keine Gefährdung für den Schweizerfranken. Im Gegenteil, sie ist für weite Kreise der letzte Versuch, ohne Abwertung die Deflationspolitik und damit die weitere Krisenverschärfung aufzuhalten.” (“Was will die Kriseninitiative?” *Mitteilungen der Neuen Helvetischen Gesellschaft*, XXI, 2).

adjustment, balanced budgets and supportive measures, was confronted with the opposition's crisis initiative as leading to inflation and devaluation.³⁸ The initiative was defeated in the referendum on June 2, 1935. With a record voter turn-out of 84.4 percent 567'425 votes rejected the initiative as compared to 425'242 votes of acceptance, 20 cantons voted against and 5 in favor of the initiative (Ruffieux 1974, 213). The government took the result as support for its policy stance. This was confirmed by the outcome of the parliamentary elections in the fall of 1935, which left the distribution of power between the government coalition parties and the opposition basically unchanged. The opposition, at the same time, interpreted the result of the vote on the crisis initiative as a clear sign of the discontent with the government's economic policies. Most importantly, the initiators prided themselves in having generated a broad debate on economic policy issues that involved all parts of the population. Its proponents claimed that the rejection of the initiative was only possible because the government had adopted core demands of the initiative and had given up its adjustment strategy (*Die Nation* 7.6.1935). To a large extent, this was still wishful thinking. Even so, there is truth to the claim that the government had not pursued adjustment as claimed by official rhetoric.

Looking back at the development of the economic policy debates between 1931 and 1935, major events have been singled out to characterize the different stages of the debate. The government's bill on the reduction of wages and salaries of public employees of June 1932 opened the debate about the government's economic policies to a broad audience. The opposition's success in the public vote on the bill drove the government to resort to emergency legislation to implement its policy proposals. Under this legislative regime, the opposition resorted to an offensive against the government by proposing an alternative approach to economic policy in the crisis initiative of 1934. Whereas in the first round of the debate in 1932-33 the government had taken the lead and the debate had centered on its policy proposals. In 1934-35 the opposition's alternative proposal was under scrutiny.

Even if the debates were very confrontational, this should not hide the fact that the government had made several concessions to the opposition in the course of the years. Social policy measures

³⁸The fact that the campaign of the crisis initiative's opponents emphasized the dangers of devaluation was later blamed for the failure of the initiative by its supporters (Sozialdemokratische Partei 1936, 78).

to mitigate the effects of the crisis on the unemployed had been part of the government's strategy from the early phases of the crisis and took up the approach that had been employed in the post-war crisis of 1921-22. Public works programs, on the other hand, had been rejected by the government in the early debates about crisis policies not least because of their alleged failure in the early 1920s.³⁹ Furthermore, it had been argued that due to the construction boom of the late 1920s and the built-up of public infrastructure in the same period there were no projects left that could be usefully promoted through public works. Last but not least, it was argued that there were no funds available for large-scale public works programs in view of the fiscal crisis and the need to balance the budget.⁴⁰

Indications for a rapprochement between government and opposition?

The commissioning of an expertise on "Fighting the crisis. Job creation." (*Krisenbekämpfung. Arbeitsbeschaffung. Gutachten dem Eidgenössischen Volkswirtschaftsdepartement* erstattet. Grimm and Rothpelz 1934) can be seen as a sign that the line of defense against the demands of the social democrats was breaking up. As head of the Department of Economic Affairs, Schulthess had engaged Robert Grimm, president of the Social Democratic Party, member of parliament and director of the public utility companies in the city of Berne, and Ferdinand Rothpeltz with this task.⁴¹ The expertise was presented in May 1934. The above-cited judgement (p. 131), that the contemporary crisis differed from past cyclical downturns, reflected Grimm's Marxist interpretation of the depression as a systemic crisis of the capitalist economy (Scheiben 1983, 115). In the course of the crisis, this pessimistic view had developed into a broadly accepted opinion across the political spectrum, although the explanations for the situation differed. In

³⁹Federal Councillor Schulthess argued in the parliamentary debates in March 1932 that Switzerland's situation concerning public works was distinct: railroads, roads and the utilization of water for the production of electricity had all been amply developed. There were no building projects left after the rapid growth period of the previous half-century. According to him, construction projects with no immediate productive uses had turned out to be the most expensive means of supporting the unemployed during the economic crisis of the early 1920s (*Stenographisches Bulletin* 1932, 42).

⁴⁰As pointed out above (p. 42), communal and cantonal public works schemes had been subsidized by the federal administration since the early phase of the recession (see Rutz 1970, 201-5 for details).

⁴¹Dr. Ferdinand Rothpeltz was an engineer in Aarau and not a socialist (Imhof 1993, 315).

Grimm and Rothpeltz it was explained in the context of the technical changes, especially the development of mass production, the development of international trade, in particular the selling of mass products in overseas markets that had now collapsed, the tremendous increase in production capacity, competition on the one hand and limitations of markets on the other. The scope to fight the crisis in Switzerland was thus limited not only by the fact that the Swiss were part of the international economic problems but by the conclusion that the crisis had become a permanent condition and the hope of a return to the normality of the past was misconceived (Grimm and Rothpeltz 1934, 12).⁴²

On the background of this interpretation of the crisis, the measures proposed in the expertise were designed to provide a quasi-permanent basis for government supported job creation. Acknowledging the importance of the export sector, propositions to increase exports were treated first, giving priority to measures that would reintegrate Swiss production into the world economy. Then government-financed projects to increase employment opportunities and finally social policies were discussed. The expertise came up with suggestions to provide employment for 50'000 workers for a period of three to five years.⁴³ This would imply that unemployment could be made to disappear at least during the summer months, a statement based on the figures of the preceding years, which would not hold up to the increasing unemployment of the following two years.⁴⁴ The measures would imply spending an additional SFR 500 million to be raised by issuing debt. Thus, the financing proposal of the expertise was at odds with the strategy pursued by the government so far. Furthermore, the authors suggested organizational measures to improve the administration of crisis policies on the federal level. Finally, it was argued that these measures should be based on a constitutional authorization to end the emergency regime on which the majority of the crisis policies had so far been based.⁴⁵

⁴²The judgement of the permanency of the crisis was frequently repeated throughout the expertise (e.g. on pages 7, 9, 12, 29, 58, 59, 66, 108, 121, 124).

⁴³Employment opportunities through secondary effects were mentioned, but no estimate was made concerning their extent (Grimm and Rothpeltz 1934, 115).

⁴⁴The number of registered job seekers reached 65'400 in 1934, 82'470 in 1935 and peaked in 1936 at 93'000 (yearly averages, Ritzmann et al. 1996, table F.18, p.422).

⁴⁵A suggestion for a constitutional amendment was included. It contained some, but by no means all, of the demands of the crisis initiative (Grimm and Rothpeltz 1934, 120).

Although the expertise came up with a long list of proposals to increase employment, it broadly stayed, apart from the envisioned debt financing, within the boundaries of the government's approach to the crisis, systematizing and increasing the scope of the measures that had been taken in the past. Particularly remarkable is the consensus concerning the support of the export industries through consolidating and extending the compensation and clearing arrangements. Thus, as much as the government's commissioning of these authors for an expertise can be interpreted as a concession to the left, the endeavor to provide suggestions in line with the government's past policies can be seen as an accommodation towards the center on the part of the leading social democrat.⁴⁶ The expertise is not the only sign indicating such a development. The rhetoric of class struggle and confrontation had, to a large extent, given way to a cooperative tone as it was pursued in *Die Nation*.⁴⁷ In part, this could be ascribed to a shift in power from the traditional left-wing forces to the more moderate parts in social democracy and a clear marginalization of radical sections. But it was also a change in opinions and political strategy of traditional social democratic leaders.⁴⁸ The explicit declaration of belief in democracy and of support for the Swiss

⁴⁶On the other hand, it can be argued that the more traditional parts of social democracy represented by Grimm had all along been closer to the government's position than to those of progressive social democrats in the union movement. Whereas these circles expected impulses for the entire economy from expansionary policies aimed at sectors producing for domestic markets, the government and traditional social democrats expected little more than a preservation of employment opportunities from such measures. Morandi (1995, 171) goes even further by arguing that Grimm and Rothpeltz presented a list of "long envisioned and little controversial job creation proposals" (längst vorgesehenen und wenig umstrittenen Arbeitsbeschaffungsmöglichkeiten) in contrast to the measures entailed in the crisis initiative that were part of a coherent concept. Thus, Morandi concludes, Grimm and Rothpeltz's expertise can be interpreted as an "informal counterproposal" to the crisis initiative (informeller Gegenvorschlag).

⁴⁷Still, even in *Die Nation* attacks against "financial capital" (Finanzkapital) and "export industries" (Exportindustrie) as determining government policies can be found.

⁴⁸A paragraph from *Die Nation* (28.6.1935) exemplifies the readiness for change expressed by social democrats. The comment, however, also reflects satisfaction on the part of the moderate circles as represented by *Die Nation* over the coming around of the party to their positions. "We all have to learn to adjust to the new facts and revise dated views.' Who said that in parliament? No less a person than the parliamentarian Grimm, who openly declared that social democracy had to change her ideas, but that the bourgeois majority had to change as well." ('Wir müssen alle lernen uns zu neuen Tatsachen neu einzustellen und alte Anschauungen zu revidieren.' Wer sagte das im Parlament? Kein geringerer als Nationalrat Grimm, der überdies offen erklärte, dass die Sozialdemokratie Verschiedenes habe umlernen müssen, dass aber auch die Bürgerlichen umzulernen hätten. Emphasis in original).

Confederation brought the social democrats closer to the political center. Looking beyond the economic policy debate, an important step in this development of the Swiss social democrats was taken in January 1935, when the party convention agreed to include the acknowledgment of the legitimacy of military defense of Switzerland's neutrality into the party program.⁴⁹ All these changes, of course, have to be seen in the larger context of the party's development from an opposition force to a participant in the Swiss system of political consensus.

On the side of the government, there were indications for a departure from the proclaimed adjustment strategy in view of the resistance it encountered from large parts of the population, the business world and farmers. The resignation, effective end April 1934, of Jean-Marie Musy, the head of the Federal Department of Finance and adamant proponent of adjustment, could be interpreted as a step in this direction. He had tried to force the Federal Council to take a clear position in favor of adjustment by threatening to withdraw from the Council unless its members signed his proposals for economic and financial policy, among them strict prescriptions for balanced budgets and increased authorities for the government to implement price and wage adjustment.⁵⁰ These endeavors were rejected by the Council, leading Musy to step down (Python 1991, 359). After Musy's resignation, Albert Meyer, so far head of the Department of Home Affairs, took over the finance ministry. He was an economist, formerly editor of *Neue Zürcher Zeitung* and president of the Radical Free Democratic Party (FDP). As finance minister he could be expected to pursue a clearly conservative course. But, being a thoughtful and conciliatory personality, he would never become as controversial a figure as Musy (Cattani 1991, 382).

⁴⁹Scheiben (1983, 198-209) analyzes the change in the social democratic party's position on military defense in detail and concludes that although the party program was adjusted only in 1935, the transition had already been concluded by the end of 1933. He points out the importance of the perceived fascist threat from Switzerland's neighbors and from the Swiss nationalistic "fronts" as driving forces, a point also made by Schmid-Amman (1967, 88). Furthermore Scheiben (1983, 237-8) discusses the seeming contradiction between the acceptance of military defense on a principal level and the rejection of a military bill coming up for popular vote on February 24, 1935, a contradiction heavily criticized in the moderate and conservative press.

⁵⁰Besides, proposals to reconsider the treatment of unemployment with the aim to keep the unemployed "occupied," suggestions to overcome class confrontation along corporatist lines and the demand to expedite foreigners who threatened national security were included in Musy's proposals (Python 1991, 359).

To the surprise especially of the moderate left, the position of Federal Councillor Schulthess, head of the Department of Economic Affairs, seemed to have become more radical after Musy's resignation. Where before he had been perceived as moderating Musy's uncompromising adjustment proposals within the Federal Council, he now came forward as their proponent. The outburst of critique after his "Aarau speech" of November 1934 led Schulthess to resign on April 15, 1935 after almost 23 years of holding office. He was replaced by Hermann Obrecht who took over the Department of Economic Affairs as a newly elected member of the Federal Council with a broad experience as member of governments on cantonal and communal levels, as former parliamentarian on the federal level but also as business man. Though, like Schulthess, also a member of the Radical Free Democratic Party (FDP), he was perceived as a fresh face, not burdened with past controversies and not tired out by past years of responsibility like his predecessor (*Die Nation*, 28.6.1935).

In view of the replacement of two proponents of adjustment policies in the Federal Council within one year Ruffieux (1974, 216) maintains that "The substitution of men also marks a change in crisis policies." (Le changement d'hommes marque bien une mutation dans la politique de crise.) In fact, the policies of the Federal Council had all along been a mix of endeavors to balance the budget on the one hand, measures to mitigate the effects of the crisis on the other. This strategy would be continued for some time. before an effective break with the past doctrines could be brought about. What seemed, at least for the time being, to have disappeared with the change in faces was the ideology of adjustment. Obrecht's first speech to parliament issues in June 1935 entailed no single use of the words "Abbau" or "Anpassung," which had been employed to characterize adjustment policies. Moreover, Obrecht appealed to cooperation on crisis policies across party lines. This was not yet coming about. With the pressure on public finances as a result of the crisis and the adherence to the conviction that balancing the federal budget was imperative, the next confrontation between government and opposition was just around the corner. On this occasion Obrecht turned out to be just as convinced of the need for adjustment as his predecessors, as we will see below (p. 200).

Concluding remarks: changing weights in the economic policy debates

The rejection of the government's proposal to cut the wages of public employees in the referendum of May 1933 marked a turning point in the debate about economic policy options. Notwithstanding, the government adhered to the orthodox strategy discussed in detail in chapter 3. The Federal Council strove to balance the budget by increasing revenues and reducing expenditures, implementing the wage cuts earlier rejected by the voters. By passing the budget under emergency procedures the government limited the influence of the opposition in the legislative process. Not surprisingly, the government's critics turned to extra-parliamentary paths to propagate their alternative policy proposals of expansionary government measures to overcome the crisis. By presenting a people's initiative in the spring of 1934, the opposition thus managed to set the agenda of the public debate. Whereas in the early phase up to 1933 the government had defined the issues - wage and price adjustments - and the opposition had found itself in the defensive, the roles were now exchanged.

The opposition's crisis initiative advanced expansionary government policies financed by bond issues. Furthermore, the proposal included provisions for government intervention suspending constitutional individual rights and federal divisions of power for the duration of the crisis. Arguably, the constitutional amendment suggested in the initiative would have served to provide a constitutional basis for many of the crisis measures taken by the government in the preceding months. However, it also entailed suggestions for government intervention going far beyond those already implemented during the crisis.

The government's reactions to the initiative was analyzed as entailing contradictory elements. Not surprisingly, the initiative was forcefully rejected in the Federal Council's official statement. At the same time, the argument made in this statement was much more moderate than the critique advanced by Federal Councillor Schulthess a few months earlier. It was argued that the expertise on employment policies commissioned by the Federal Department of Economic Affairs could be interpreted in a similar vein as conciliatory concession to the social democratic opposition. At the same time, the Social Democratic Party took an important step towards becoming a reliable partner in the democratic process in the perception of the majority parties of the center by acknowledging the legitimacy of Switzerland's military defense. Thus, despite the aggressive tone in the debate about the crisis initiative, in other respects this time period also saw signs of a

reconciliation between government and opposition. The resignation of those Federal Councillors, who in the public mind, had become the representatives of the infamous adjustment policies in spring 1934 (Jean-Marie Musy) and in spring 1935 (Edmund Schulthess) helped ease the tensions. It was argued, though, that the exchange of heads did by no means entail a fundamental change in policies. The politicians who came in as replacements were less profiled than their predecessors, but no less orthodox in their views on crisis policies. Furthermore, the government felt confirmed in its approach as the crisis initiative was rejected in June 1935, although significant parts of the population supported the government's critics. However, the parliamentary election in the fall of the same year confirmed the distribution of power and the joint majority of the parties represented in the Federal Council. Thus, even though the rhetoric of price and wage adjustment had, for the time being, lost prominence in the government's pronouncements, the understanding of the crisis and the policy conclusions based on the gold-standard mentality were not abandoned. The policy priority of maintaining the gold parity of the Swiss franc and balance budgets was not questioned, despite the fact that the gold bloc had shrunk to an exclusive club with France, the Netherlands and Switzerland as the remaining members. By the fall of 1935, the numbers of those questioning the taboo around gold in Switzerland had increased and received support from wider circles.

A final word will be added on a remarkable change in the period analyzed in this chapter: it is the pronounced pessimism that dominated the government's statements in 1935, reflecting the pronounced downturn in 1934 and the increases in the level of unemployment. The crisis was now attributed to a fundamental change in the world economy. Thus its effects could no longer be treated as a temporary challenge. It was concluded that adjustments were necessary in all parts of the economy. The protective and supportive government interventions originally supposed to help those sectors particularly under pressure from the crisis to survive until the recovery would set in, were now interpreted as temporary relief in a painful but inevitable process of adjustment.

6. Swiss views on money in the interwar years

The corner stone of the gold-standard mentality is, of course, the gold standard itself. Little has been said about contemporaries' understanding of it so far. It provided the background to and justification for the policy proposals of the political majority. The opposition, though criticizing those policies, did not question the adherence to gold. Social democrats and union representatives repeatedly underlined their support for the government in this area. Only in 1935, and outspokenly only after the parliamentary elections in October of that year, parts of the opposition started raising the topic. Before we turn to the political debate about the gold standard in chapter 7, the background to the attitudes on money that dominated the interwar period is sketched out. Several factors, which influenced the views on monetary theory and policy in Switzerland, will be brought to attention in the following sections. The activities of a splinter party of Silvio Gesell followers that had advocated price-level stabilization in the early 1920s influenced the Swiss perception of proposals for a reorientation of monetary policies made by Anglo-Saxon economists. It will be demonstrated that the aggressive stance of this group weighed upon the already tense domestic political atmosphere of the crisis years and caused ostensible over-reactions by the establishment. The return to the pre-war parity of the Swiss franc had been achieved with relative ease once the immediate after-war deflation and depression was overcome. The gold standard provided the background to a period of growth and political stability. Furthermore, the positions held in Switzerland on matters of monetary theory and policy will be evaluated in the context of the German-language academic debate about these issues. In sum, this chapter approaches the sketch of the monetary aspects of the Swiss gold-standard mentality from three angles. By discussing the activities of Gesell followers political influences are central, historical arguments are stressed in the overview of the experience of the post-war return to gold and an academic side of the story is developed in the analysis of the evolution of economists' thinking on monetary issues.

The demand for monetary reform by Gesell followers

The large degree of unanimity between majority and opposition in Switzerland concerning the adherence to gold was disturbed by the small party Schweizerischer Freiwirtschaftsbund. While the activities of these proponents of monetary reform during the depression years of the 1930s are of interest here, their effects can only be understood on the background of their development after World War I.

The constitution of the party goes back to 1915 when an organization was formed to propagate the ideas of the German social reformer Silvio Gesell whose name is familiar to this day thanks to John Maynard Keynes's generous discussion of his teachings in *The General Theory of Employment, Interest and Money* (1973 [1936] 353-8).¹ At the center of Gesell's writings is a monetary explanation of business cycles. He argued that fluctuations arose from a disequilibrium between supply and demand, where supply in Gesell consisted of goods and services and demand was equal to the supply of money narrowly defined as currency in circulation (Gesell 1929 [1916], 168-70).² The quantity equation thus interpreted played a central role in the presentation of Gesell's ideas by his followers. Gesell concluded that supply and demand, defined as aggregates by him, determined the price level. The price level would fall if the supply of money fell short of the supply of goods and services at given prices. Price level changes would induce real fluctuations. As prices declined expectations of further price reductions would keep firms from investing and producing, consumers would postpone purchases, a crisis would follow. Price level increases resulting from money supply exceeding the supply of goods and services similarly would induce a boom. Gesell concluded that changes in the price level disturbed the development of a market economy. He argued that continuous growth depended on adequate money supply (Gesell 1929 [1916], 190). Since the supply of gold was determined by factors independent of the real economy he demanded that the gold standard be abandoned. Instead, Gesell argued for a fiat money system where a government agency would control the money supply with the aim of stabilizing the price level.

¹German-born Gesell had gained some wealth as a businessman in Argentina during the last quarter of the 19th century. His thinking on monetary issues was shaped by his observation of the Argentinian crisis of the 1880s which was accompanied by severe deflation (Chick 1987, 520). He lived in Switzerland between 1900 and 1919. His first attempts to influence public decisions led to a pamphlet during the preliminary discussions about the establishment of the Swiss National Bank which started taking over central bank functions in 1907. After his brief commitment in the Bavarian revolutionary government of 1919 Gesell was not allowed to settle in Switzerland again. By then his followers were well organized and tried to win political influence with his teachings.

²Gesell's book *Natural Economic Order* was translated into English in 1929 from the German *Die natürliche Wirtschaftsordnung* (1916). The references are to the English edition.

Guaranteeing sufficient money supply would not necessarily provide for adequate aggregate demand though.³ Gesell considered hoarding a central problem of an advanced monetary economy. Since money could be used as a store of value it offered an alternative to real investment of savings. With growing production and accumulation returns to investment would fall, the attractiveness to store wealth instead of investing it would increase. The possibility to hoard money and thus withdraw funds from capital markets provided a floor to profits according to Gesell. He argued that for money to work well as a means of exchange it would have to be useless as a store of value (Gesell 1929 [1916], 192). Money therefore had to be forced into circulation by a negative interest rate: bills should be void unless periodically validated by a stamp. Gesell considered a toll on the value of bills amounting to 5 to 6 percent p.a. as adequate to ensure the circulation of money. The low return on investment resulting from advanced capital accumulation would be turned from vice into virtue by negative interest rates on money. Instead of deterring capital from being invested, an abundance of real capital would lead to increased consumption and improved living standards. Gesell did not expect savings to fall as a result of low interest rates. He considered the individual's desire to accumulate reserves as the primary motive for saving. Therefore, he predicted that once free money was introduced, nothing more was needed "... to reduce commercial profits to the rank of a wage and in a short space of time to drown capital interest in a sea of capital" (Gesell 1929 [1916], 214).

An evaluation of Gesell's writings must remain ambiguous. They are imbued with missionary zeal, pervaded by his belief that he had disentangled complex phenomena which had preoccupied many before him, and that his insights could turn the world into a better place, or rather, into paradise. He celebrated a practical man's contempt for academic speculation, for intricate arguments and specialists' language. He emphasized that all his insights could be explained in the most simple terms to anybody. This rhetoric and his frequent repetitions make his writings tedious. Despite the obvious fallacies in his argument he can astonish with keen observation as for example in his

³Gesell identified money supply with currency in circulation. He had a limited understanding of the functions of banks, which was not untypical of the time though (see the discussion below, p. 168). He was not aware of the credit creation process, but thought of banks as turning deposits into credit, thereby passing the notes depositors had brought to the bank on to debtors who would use them for payment. He concluded that currency in circulation covered all means of transaction (Gesell 1929 [1916], 369).

discussion of price level stability (Gesell 1929 [1916], 147-9). He may have also been appealing to his readership because he not only offered his insights but translated them into practical policy advice down to institutional details. Gesell did not develop his thought in reaction to the numerous and serious criticism he received, an attitude he shared with other cranks. His book went into several editions without major changes.

Keynes (1973 [1936], 353-8) devoted ample space to the discussion of Gesell. He praised Gesell's "flashes of deep insight" despite the "palpable defects in the argument" which had led Keynes himself to treat Gesell as a crank before he had reached his own conclusions in his own way (Keynes (1973 [1936], 353). Nonetheless, the viewpoints Keynes and Gesell shared were few. Most importantly, both explained the interest rate as a monetary phenomenon to be distinguished from the real return on capital, the marginal efficiency of capital in Keynes. Hence, the interest rate was explained as determined independently of the real rate. Furthermore, both argued that the (money) interest rate set a floor to returns on real investment, thereby limiting investment, employment, and accumulation.

This is where the common ground ends. Keynes's friendly tone in discussing Gesell's stamped money proposal should not keep the reader from discerning the wholesale rejection his arguments amount to (Keynes (1973 [1936], 356-7). It is first and foremost the explanation of the monetary interest rate where Gesell differed fundamentally from Keynes. In Keynes, liquidity preference was central to the decision on how to hold wealth: individuals would only forego liquidity if compensated. This compensation, Keynes argued, was interest. In other words, interest arises as reward for giving up a liquid position when money is exchanged for other financial and real assets.

In contrast, Gesell argued that interest stemmed from transactions involving money on one side, goods and services on the other. Goods and services could only be stored at carrying costs whereas money could be hoarded at no cost. Therefore, money commanded a premium in such exchanges. Interest in his logic represented the "power" money allegedly had in goods and services markets, the advantage of costless storage as compared to the costs of storing goods (basic interest in the English translation, *Urzins* or *Tribut* in the German original). Also note that Gesell did not distinguish between the decision between consumption vs. saving and the decision between different forms in which to hold wealth. The only decision Gesell considered was the one

between spending (on goods and services for consumption or investment purposes) and hoarding. From the perspective of traditional economic thinking Gesell's concept of saving was muddled.

In sum, Gesell's explanation of a monetary interest rate has nothing in common with liquidity preference as Keynes introduced it. Referring to Gesell, Keynes pointed out that "the notion of liquidity-preference had escaped him" (Keynes 1973 [1936], 356). This is also the basis for Keynes's fundamental critique of the stamped money proposal. Keynes argued that an array of liquid assets was considered in the decision over holding cash, so when retaining money would become costly as in the stamped money proposals other assets would take its place. As alternatives Keynes (1973 [1936], 358) mentioned "bank-money, debts at call, foreign money, jewellery and the precious metals generally, and so forth."

The activities of the Swiss party of Gesell followers evolved around Gesell's main proposals concerning "free money."⁴ They included the demand for a fiat money system independent of a metallic standard. Negative interest rates in the form of stamps to validate bank notes would keep money in circulation, i.e. prevent hoarding. Last not least, monetary policy aimed at price level stability would end the business cycle.

The debate during the economic crisis after World War I

The party grew substantially in the immediate post-war years in terms of members and public influence.⁵ The contemporary developments provided ample ground for an argument with Gesell's ideas. The suspension of gold with the onset of the war had left Swiss monetary policies devoid of clear guidelines. The financing of government deficits by discounting treasury bills (Reskriptionen) was justified with the real bills doctrine. Interest rates were kept low so that the burden of the accumulating debt on public budgets would remain manageable. Monetary aggregates grew accordingly. Consumer prices doubled between 1915 and 1919. Wage increases

⁴Gesell's reform scheme included land reforms. They were also part of the program of the Swiss party but drifted to the background in the political debate as the party concentrated on the propagation of abandoning the gold standard and stabilizing the price level.

⁵Schärrer (1983) analyzes the development of the Swiss organizations propagating Gesell's reform plans between 1915 and 1952 in great detail. Rickli (1939, 455) documents their success in elections.

had not kept this pace so that real wages declined significantly. As a result the Swiss National Bank had to face strong critique for its monetary policy in early 1918. In addition to the attacks by Gesell followers which had already accompanied the war-time inflation, several newspapers published articles claiming that the central bank was responsible for the inflation by having substantially increased note circulation. The Swiss National Bank dismissed this view and held against it that the inflation had been brought about by the increased prices of imported raw materials and agricultural goods as a result of the war.⁶ A link between an increase in circulation backed by real bills and the rise in prices was denied, thus rejecting any responsibility of the central bank for the inflation.

Nonetheless, measures were taken to reduce note circulation in April 1918. The increase in the discount rate by a full percentage point to 5.5 percent in October was explained, like in the pre-war years, with the necessity to protect the gold reserves. On this occasion, the Swiss National Bank underlined that this measure would not lead to a reduction in prices. However, consumer prices started declining in early 1920. By October this turned into deflation and recession (Ruoss 1992, 110-16). The discount rate was reduced by one half percentage point in 1919 and lowered to 3 percent in successive steps of one half percentage points in the crisis years of 1921-22 (Schweizerische Nationalbank 1957, 396). Moreover, the Swiss National Bank made concessions to the financing needs of the federal government during the after-war crisis.

In her assessment of the monetary policies in the immediate after-war years, Ruoss (1992, 150-1) comes to the conclusion that the Bank's policies in the two years before the crisis had been restrictive. Based on a comparison of short-term interest rates in Switzerland, Great Britain and the United States she argues that the Swiss National Bank's mild monetary tightening prevented a post-war boom in Switzerland which both other countries had experienced. The crisis of 1921-22 is then understood as part of the world-wide recession which led to an enormous drop in Swiss exports. The decline in the price level by far exceeded the decline in economic activity. Falling imported prices and deflationary expectations in line with the expected return to the pre-war gold parity explain this fact according to Ruoss.

⁶In the following I draw on Ruoss (1992) who provides a thorough analysis of the Swiss National Bank's monetary policy from its foundation in 1907 to 1929.

The deflation and recession in 1921-22 provided the basis for the Gesell followers' renewed critique of the Swiss National Bank. The Bank was accused of having induced the downturn by restricting the money supply. The demand for a reorientation of monetary policy followed. Instead of seeking to stabilize the exchange rate with the intention of returning to the gold standard, the Swiss National Bank should pursue price-level stability. This issue was intensely debated under the heading "absolute" or "indexed currency" (Absolute Wahrung, Indexwahrung). A number of articles were published in Swiss academic journals.⁷ The association succeeded with its request for a conference with representatives of the Federal Department of Finance, the Swiss National Bank and commercial banks on its policy proposals in 1923 (Kellenberger 1937, 313-14).

All these debates resulted in the unanimous rejection of the policy proposals based on Gesell's ideas.⁸ The arguments used for this rejection reveal considerable differences in method and substance of the economic analysis applied by the respective authors.⁹ Paper currencies were rejected altogether as inherently unstable and prone to inflation (Diehl 1920), the use of mathematics in economics, as e.g. in the quantity equation, was deemed inappropriate (Gygax 1920), real versus monetary causes of business cycles were stressed (Liefmann 1920), it was questioned whether a stable price index implied stable prices (Diehl 1920). Kellenberger (1917, 1920), who underlined the benefits of price-level stability in theory, stressed practical difficulties with defining a price index, with measurement and with influencing money supply and the price level.¹⁰ He argued that fluctuating exchange rates would be the most important downside of

⁷Among them: Kellenberger (1917), Ellenberger (1923), Reichesberger (1923), Bohi (1926). The editors of the *Zeitschrift fur Schweizerische Statistik und Volkswirtschaft* (today the *Swiss Review of Economics and Statistics*) asked several academic economists for statements on Gesell's ideas. The survey on the "absolute currency" (Enquete uber die "absolute Wahrung.") published in 1920 contained articles by seven German and Swiss economists.

⁸Bohi (1926, 314) stands out in that he stressed that rejecting the policy proposals of Gesell should not be taken as a wholesale rejection of all monetary reform proposals aimed at price-level stability.

⁹Reichesberger's (1923) main interest was to prove the incompatibility between socialist economic analysis and Gesell's ideas. His report to the Social Democratic Party in the same vein was the basis for the party's hostility towards the Gesell followers who tried to win social democrats for their cause in the early 1920s (Scharrner 1983, 56).

¹⁰As economics editor of the Berne newspaper *Bund* he had been one of the mainstream critics of the Swiss National Bank's monetary policy during the war years.

monetary policy aimed at price-level stability in a gold-standard world. Since Switzerland's economy was tied into the world economy, stable exchange rates were vital according to Kellenberger.

The stabilization of the Swiss franc

This was also the conviction of the federal government and the Swiss National Bank. The suspension of gold with the economic disruptions of the World War was seen as a temporary affair. Alternatives to a return to the gold standard at the pre-war parity were not considered. Swiss market participants obviously shared this belief: the increases in long-term interest rates during the war years were negligible as compared to the high inflation rates (Ruoss 1992, 108). The expectation that price increases would be reverted after the war was confirmed by the deflation of 1921-22, even though prices were not completely brought back to pre-war levels (see figure 2, p. 23).

Whereas the directors of the Swiss National Bank and the Federal Council agreed on a return to gold in principle, the government repeatedly put pressure on the Bank to speed up the process.¹¹ The Bank, in turn, favored a slow adjustment so that market forces could ultimately be relied on to bring about the desired exchange rate. The consolidation of federal finances and the reduction of the outstanding short-term debt, parts of which were still held by the central bank, were seen as prerequisite for the exchange rate stabilization. Furthermore, a return to more restrictive discounting principles, comparable to those pursued before the war, were considered necessary (Ruoss 1992, 162). These preconditions were finally fulfilled in the course of 1924. Although the stabilization was achieved rather smoothly, the instability of the international monetary system of the post-war years was reflected in the developments on Swiss currency markets in the years in between.

¹¹This, of course, touched on the issue of central-bank independence granted in the statutes of the Swiss National Bank. Accordingly, the directors reacted hostile to repeated open pressure by Federal Councillors in the following years. Another reason for tensions between the Bank and the government were federal finances and the government's debt management (Ruoss 1992, 163).

During the post-war crisis the depreciation of the Swiss franc against the US dollar which had reached the low point in November 1920 at a rate of SFR 6.49 per US \$ (5.18 marked the parity) was reverted. Although parity was approached in early 1922 the Swiss National Bank considered stabilization as premature. Until the end of 1923 the Swiss franc depreciated while output and employment recovered. Whereas the Bank had abstained from interventions in the foreign exchange markets in the turbulence of the earlier years US dollars were sold in support of the Swiss franc in June 1923. After the private discount rate had already been pushed up through open market interventions in April 1923, the official discount rate was raised in July of the same year. These interventions proved sufficient to prevent a further depreciation of the currency. Finally, in the spring of 1924 the dollar exchange rate started declining, reaching parity in July. In November 1924, the Swiss National Bank declared that it would now stand ready to support the dollar exchange rate within the gold points. In comparison to 1922 the conditions for the sustainability of the parity were favorable now. Federal finances had been consolidated, with the Dawes plan and the stabilization of the Mark international monetary conditions were given a sound basis and Great Britain's speedy return to the gold standard was expected after the election of a conservative government (Ruoss 1992, 165).

All in all, the return to the gold standard in Switzerland went smoothly. Whereas the Swiss National Bank had tightened monetary conditions in 1918-19 to offset the inflation of the previous years and had done little to counteract the deflation and recession of 1921-22, the stabilization of the currency was achieved without causing unemployment (Ruoss 1992, 153). This contrasted sharply with the experiences of other countries, for example Great Britain and France, where the return to gold was perceived as a struggle and made responsible for the unfavorable development of their economies in the early 1920s. The currency stabilization in Switzerland introduced a period of prosperity (see figure 2, p. 23). The increase in employment and output was accompanied by slightly falling prices which resulted from declining world market prices for raw materials and agricultural products rather than monetary policies. The Swiss National Bank concentrated on keeping the exchange rate at par, on ensuring the gold backing of the note circulation and on stable and low interest rates. Whereas the discount rate had been the main policy instrument in the classical gold standard, in the immediate post-war years (domestic) open market interventions had taken this place, to be in turn replaced by interventions in foreign exchange markets. The favorable development of the economy and the unwavering confidence in

the stability of the Swiss franc turned the “golden fetters” during this period into a rather comfortable bind. The attractiveness of Switzerland’s financial markets induced capital inflows. The Swiss National Bank was able to isolate domestic economic conditions from short-term volatility in the international arena.¹²

The successful stabilization ended the years of recurring critique of the National Bank’s policies. The return to a monetary policy guided by the bounds set by the gold standard and by the real bills doctrine protected the central bank from critique and demands on its policy. This contrasts with the development in several European countries, where monetary policies became politicized in the interwar years, which in turn undermined the credibility of the commitment to gold. This argument, which is part of the Eichengreen-Temin explanation for the dysfunctional quality of the interwar gold standard in the early years of the depression, does not apply to Switzerland. Stable price levels despite the adherence to gold had also taken the wind out of the Gesell followers’ sails.¹³ Once the economic crisis in the aftermath of the World War was overcome, their organization lost many followers and almost disappeared from the political scene. This development was reversed in the depression of the early 1930s, the party reemerged.

The revival of Gesell’s following with the onset of the Great Depression

The approach of the party Schweizerischer Freiwirtschaftsbund was unchanged. Like in the 1920s, aggressive publicity campaigns were initiated with widely distributed pamphlets, letters to newspapers, petitions to the government and the Swiss National Bank. The arguments were unchanged, too. Gesell’s system of free money was presented as a solution to the depression in Switzerland, the abandoning of the gold standard in favor of price-level stabilization would end the business cycle. If we compare the interpretation of crises and the policy conclusions of Gesell’s

¹²In contrast to the pre-war gold standard, where the Swiss National Bank had usually traced international interest rate changes, Swiss interest rates were stable and below those in Great Britain and the United States in the interwar years. In addition to the reasons discussed above, Ruoss mentions political stability as explaining these conditions (Ruoss 1992, 192).

¹³This development fulfilled the expectations of the Federal Council that the gold standard would provide not only for stable exchange rates but also for stable prices, an expectation expressed in 1924 (Kellenberger 1937, 315). According to the Federal Council the United States’s price-level oriented monetary policies, which dominated the system, would, via fixed exchange rates, stabilize prices in the system’s members.

followers with those of the political majority and their social democratic critics, the central difference is that the supporters of Gesell's ideas implicitly suggested that the crisis could be overcome independently of the world economy. The introduction of price-level oriented monetary policies would open the path for the Swiss economy to prosperity.¹⁴ This contrasted sharply with the consensus on the importance of the gold standard for a revival of international trade as precondition to a full recovery of the Swiss economy. Mainstream critics of the free money proposals did not separate the different parts of the argument, namely the pursuit of price-level stability instead of exchange-rate stabilization, the introduction of stamp scrip and a recovery independent of the world economy. Therefore the support for the gold parity came off as the central conclusion in discussions of the ideas of the Gesell camp.

Before we turn to an analysis of the arguments made to undermine the Gesell followers' claims at this stage of the debate, some reactions to the revival of their party will be briefly discussed, since the changes in the political atmosphere during those years are reflected in the academic contributions. The return of the Schweizerischer Freiwirtschaftsbund went along with the recruiting of new members, public lectures, especially in German-speaking rural areas, and the dissemination of propaganda material. The party was set up as a grass roots organization with a strategy to win supporters through almost missionary activities (Schärrer 1983, 158-74). In the politically unsettled atmosphere of the depression it was increasingly perceived as a potentially dangerous force by the establishment. From today's perspective the reactions seem excessive. The board of directors of the Swiss National Bank demanded prosecution of Gesell's followers in 1933 and again in 1934 depicting them as disturbing law and order. This request was rejected by the Federal Council, but the administration gave in to the pressure of the Swiss National Bank on other occasions. In 1933 several German and Austrian advocates of Gesell's ideas were not allowed to enter the country and the government canceled a conference with the party Schweizerischer Freiwirtschaftsbund on monetary issues (Schärrer 1983, 248-51). At the same

¹⁴Schärrer (1983, 92-3) claims that by propagating the stabilization of the price level without demanding the introduction of a stamped-money scheme the followers of Gesell actually neglected his main concern, the elimination of hoarding. The incentives for hoarding are, of course, sharply reduced if price-level stability replaces deflation, a point Schärrer does not seem to appreciate. In the immediate after-war years, Gesell adherents had similarly advocated price-level oriented monetary policies with the argument that this could prevent a crisis brought about by deflation expectations.

time the Swiss National Bank started activities to counter those of the advocates of Gesell's ideas. In 1934 an "organization for sound money" (Vereinigung für gesunde Währung) was set up under her auspices. The initiators' aim was to bring together all leading groups of society to demonstrate consensus concerning the rejection of free money and to inform the population about the flawed arguments.¹⁵ Some of the contributions we turn to now originated with these endeavors and were published and distributed by the organization for sound money.¹⁶

Eugen Grossmann, Professor at the University of Zurich and president of the government's business cycle commission, was an important voice in the formation of public opinion. In a 1934 article on the free-money proposals he interpreted the crash of 1929 as proof for the impossibility to create continuous prosperity by stabilizing the price level (Grossmann 1934, 3). He argued that the United States' Federal Reserve had contributed to the depression by the monetary policies of the interwar period. He criticized Fisher and Keynes for supporting "similar experiments"

¹⁵Invitations for the founding meetings were sent out in November 1933 to economists and representatives of government, parties, unions, and the business community. Eugen Böhler, Professor at the Federal Technical Institute in Zurich and supporter of the government's adjustment strategy, was the most profiled of the three academics among the founding members. The organization was primarily financed by banks and insurances. Their and the Swiss National Bank's representatives dominated the organization, using it to propagate the gold parity and conservative monetary policies (Baumann and Halbeisen 1999, 21-2, 27-8). During the discussions about the organization's statutes it became clear that the initiators had more in mind than a counter-offensive to the propaganda of the Gesell followers. The rejection of a devaluation of the Swiss franc was to be an important part of the information of the public. The union representative Max Weber (Schweizerischer Gewerkschaftsbund) withdrew from the organization in May 1934. Schärer (1983, 261) interprets this as a sign that the unions at that stage were no longer willing to exclude devaluation from policy options. In contrast, Tanner (2000, 66) argues that Weber's withdrawal did not result from a difference in opinion on the currency question but should rather be seen in the context of the conflicts between trade unions and the Social Democratic Party concerning the crisis initiative and the party's more radical alternative proposal of a "plan for work". The question can remain open here. Weber's public statements in favor of devaluation starting in the fall of 1935 will be analyzed in detail below (p. 183).

¹⁶The following occurrence is another curious example for the overreactions to the activities of the Gesell adherents. Theo Keller, then secretary of the "organization for sound money" and later professor at the Trade School and later University of St. Gallen, used his ties to the catholic church to get Switzerland's episcopal conference to issue a statement condemning the Schweizerische Freiwirtschaftsbund in 1935 (Schärer 1983, 263-5).

(ähnliche Experimente), and reproached the League of Nations for sympathizing with such ideas.¹⁷ Grossmann's argument built on a rejection of economic theory that aimed at establishing formal regularities, though not explicitly mentioning neoclassical theory.¹⁸ He argued that economic events had to be understood as the "result of singular historical incidents" (eine Folge von einmaligen historischen Ereignissen. Grossmann 1934, 5), in line with the tradition of the Historical School. Furthermore, he questioned the possibility to measure the quantity of money, the volume of transactions etc. as the necessary empirical basis for monetary policy based on the quantity equation, thus repeating arguments brought forward by Ernst Ackermann (1933), the head of the statistical office of the Swiss National Bank. Grossmann supported his argument in favor of the gold standard by pointing out that it provided for monetary conditions independent of political influences. Arbitrary changes in the price level that would be possible in a fiat money system would undermine confidence and thus the basis for production and growth (Grossmann 1934, 12). Grossmann praised the Swiss population's preference for a metallic currency as reflecting a cautious mentality and considered the gold standard one of the few firm pillars left to hold on to in a frenzied world (Grossmann 1934, 16).¹⁹

Bosshardt (1933) questioned the link between a stable price level and economic equilibrium. He argued that this link was only valid in a stationary economy. In a changing environment, price-level stability could come with underlying inflation or deflation. Like Grossmann, he turned to the recent developments in the United States to exemplify his argument: the price-level stability of the 1920s brought about by Federal Reserve policy prevented the price-level reduction that would have followed from cost-saving technological change (Bosshardt 1933, 359-60). The monetary policy had produced an inflationary impulse which set off a business cycle as suggested by

¹⁷Grossman might have referred to the work done at the International Labour Office, see fn. 38, p. 172.

¹⁸He asked cunningly whether Gesell's followers should be blamed for simplistic views of the economy when academic economists used equally simplifying models and singled out the contemporary business cycle theories (Krisentheorien) as target for his critique (Grossmann 1934, 5). Levi (1934) criticized the use of mathematics in economics explicitly. Note though, that this critique was provoked by the formal statement of the quantity equation.

¹⁹Grossmann's decision to resign from the government's business cycle commission after the devaluation revealed how strong his belief in the gold standard was.

overinvestment theories and thus ultimately caused the depression. This view was widely held at the time. Amongst economists Hayek, who had been an early critic of United States' monetary policies, was its most prominent proponent. His reasoning will be reviewed below (p. 170).

It is worth noting that in all these contributions the gold standard was discussed as a mechanism to regulate domestic money supply which was superior to the alternative of a "manipulated currency." The working of the gold standard as an international monetary regime, which provided the context in which the regulation of domestic monetary conditions took place, was not addressed. The neglect of this aspect is remarkable: by the time, the contributions just reviewed were written, the gold standard had all but ceased to exist.

To summarize, the issues raised in the debate about monetary policies aimed at price-level stability ranged widely. On one end of the spectrum stood the question whether price-level stability in itself was desirable, on the other end issues of price-level measurement and of implementation were discussed. The same range of issues had been raised in the debates of the early 1920s. Like in the statements made in this earlier period, authors did not distinguish between Gesell's proposals and contributions of e.g. Keynes or Fisher to the debate about price-level oriented monetary policy.²⁰ The common denominator was the rejection of any "experiments" with the monetary regime, in other words, the support for the gold-standard regime. These conclusions were clear-cut. They were unambiguously, and at times stubbornly, stated. Even if it would be hard to find outright advocates of monetary policies aimed at price-level stability in the intervening years amongst Swiss economists, several of the contributors to the debate at the meetings of the Swiss Statistical Society in 1928 seemed fairly open-minded when commenting on the contemporary developments in monetary economics.

The meetings had been introduced by two invited speakers, both presenting conservative positions. Karl Pribram (University of Geneva) discussed "business cycle observation" (Konjunkturbeobachtung), focusing on the development of empirical analysis and presenting a rather cautious view of its scope. Manuel Saitzew (University of Zurich) discussed "business cycle

²⁰In part this was the result of the fact that the contributions of these authors were translated by the Gesell followers, who distributed them as pamphlets in support of their own proposals (Schärker 1983, 90-91). Mühlenfels (1933) stands out in that he distinguished the debate about monetary policy aimed at price-level stability from the one about Gesell's ideas.

policy” (Konjunkturpolitik). His remarks on the possibility of dampening the cycle by adequate monetary policy are of interest here. Although he conceded that the influence of monetary conditions in the cycle were undisputed, he argued that not all business cycles could be traced back to monetary causes. Referring to monetary business cycle theories, he rejected the claim that excesses of the boom could be prevented by credit restriction in the early phases of the cycle: firms could always resort to alternatives to the credit market for financing investment if profit expectations were high.²¹ His conclusion, that credit policy would never lead to economic growth free from fluctuation, was not contradicted in the debate. But several contributors admonished Saitzew’s rather pessimistic judgement of the scope of economic policies aimed at dampening the cycle. Monetary policies did not dominate the debate about crisis policies though, alternative means received similar attention. In conjunction with Pribram’s cautions against empirical research, issues of implementation were also raised.

In reviewing the debate of 1928 several observations can be made. First, there were no outright proponents of a monetary business cycle explanation at the meetings. Böhler, who used overinvestment arguments five years later, did not come out in their defense. This “vogue” had obviously not infected Swiss economists, although the participants in the debates were familiar with the main arguments and policy conclusions. Nonetheless, the pessimistic views expressed by the invited speakers on the new developments in economics were questioned by several contributors. Secondly, the debate about price-level oriented monetary policies made no references to Gesell or his Swiss followers in the *Freiwirtschaftsbund*. The tone of the argument about such policies was objective, although they were evaluated cautiously. None of the emotionality and self-righteousness could be found here which characterized the publications on the proposals of the Gesell followers as much in the early 1920 as in the 1930s. The debate about credit policies in the business cycle did not evoke the knee-jerk reactions typical of the earlier and the later years. This reinforces the argument made above: the professional contributions on the arguments of the Gesell followers were tainted by the political tensions of the time.

Finally, the incompatibility of price-level oriented monetary policies with the exchange-rate stabilization in the gold standard was not discussed at the meetings in 1928. This argument ranged in the very first place in the rejection of the arguments of the Gesell followers. One interpretation

²¹For comments on other parts of Saitzew’s contribution see footnote 31, p. 97 above.

could be that the proposals for price-level stabilization were discussed as a purely theoretical matter. Their merits were evaluated on an abstract level, although the proposal as such was of limited relevance given the institutional setting. Furthermore, exchange rate stability and price level stability went hand in hand before the onset of the Great Depression. In contrast, when the Gesell followers demanded price-level stabilization as an alternative to the gold-standard regime in the early 1930s, deflationary conditions prevailed. Price and wage declines were now considered a necessary part of the downturn on the basis of the prevailing business explanation, but more importantly as indispensable for a recovery of Swiss exports.

In reviewing the contributions of Swiss economists on issues of monetary theory and policy in this period, the pervading skepticism towards the more recent ideas is surprising to the modern reader. Even authors who supported new strands of analysis did that rather cautiously. As will be seen in the following section, it is not surprising that Swiss economists turned to monetary conservatism in this period. The interwar years saw vivid debates about monetary economics despite the fact, that many of the theoretical contributions, which are accepted wisdom today, had been made much earlier. In the years of interest here, they were controversially debated and consensus, even on fundamental issues, was not yet reached.

Swiss economists' monetary thinking in the context of the contemporary debate

The suspension of gold convertibility with the onset of World War I provided the historical background to the interwar controversies on monetary theory and policy and explains the broad interest in the subject. National monetary authorities faced enormous challenges as the monetary-policy rules developed within the gold standard provided little guidance under these new circumstances. This problem was compounded by the demands from administrations for support in financing war efforts and the disruptions in domestic production and international trade.²² The lack of a conceptual basis for and experience with managing a fiat money system augmented by the strains of war had led to inflation of varying degrees in the countries concerned. At the same time these experiences proved how powerful monetary policies, cut loose from their “golden fetters,” were in influencing economic conditions.²³

²²It should also be remembered that most central banks were still fairly young institutions.

²³These perceptions were matched in the sphere of government intervention with the insight into the effectiveness of war-time economic organization and control. Similar to the debate

This section focuses on issues raised in the interwar debates about monetary theory and policy that were taken up by Swiss authors. The approach is selective. In other words, in the context of this study an encompassing overview of the wide-ranging topics of the debates in those years will not be provided.²⁴ The reference point for the evaluation of the debate in Switzerland is the German-language area, where the developments of monetary economics in the Anglo-Saxon world were in general viewed with some suspicion in the interwar era. Though on first sight the Swiss authors may seem to be hopelessly lagging behind the theoretical progress in this period, their contributions reflect the state of disagreement in the profession. The Swiss economists can be seen as siding with the more cautious and conservative parts of the German-language debate. Admittedly, individuals boldly taking a progressive stance cannot be found in Switzerland at the time, although several, especially younger economists seem to have been well aware of the international debate.

As a background to the concerns in Switzerland the following interrelated issues are of interest. The possibility of stabilizing the business cycle through monetary policies should be mentioned in first place.²⁵ The developments in business-cycle analysis were crucial to this debate, as the role

about monetary economics the discussion of economic planning received inspiration from the war-time experience.

²⁴For an overview see Schumpeter's chapter on "Money, credit, and cycles. From 1870 to 1914 (and later)" (Schumpeter 1954, 1074-1135). The relevant chapters in Laidler (1991 and 1999) provide detailed analysis, especially of the lines of thought developed in the Anglo-Saxon world. In contrast, Schumpeter renders the multitude of influences and the dissent within the profession comprehensible. The views held by those economists who were torn between received wisdom and modern thought are of interest for our discussion, since they can be taken as an indication for the thinking of larger parts of the profession. Laidler disentangles the confusion and presents an account of theoretical progress. Ellis (1934) provides an analysis of *German monetary theory. 1905-1933* from the perspective of contemporary Anglo-Saxon understanding. Like Laidler, he was interested in the vanguard and not in the bewildered (professional) masses.

²⁵This debate, of course, goes back to well before World War I. Irving Fisher's 1911 *The purchasing power of money* had fueled it. Fisher demanded monetary policies aimed at price-level stability and provided guidelines for their implementation with his analysis based on the quantity equation. He argued that the velocity of circulation was determined by technical conditions and thus fairly constant. Therefore, the price level could be controlled by adequate money supply and fluctuations could be dampened. In his *Tract on monetary reform* (1923) Keynes advocated price-level stabilization as a guideline for monetary policy. He thus opposed the majority conviction just confirmed at the Genoa conference in 1922 that the post-war reconstruction of the world

of credit fluctuations in the course of the cycle was increasingly acknowledged despite continued controversy about other aspects of business-cycle explanation. Overinvestment theories, to which a credit expansion in the boom phase was central, had contributed to the acceptance among German-language economists.²⁶ The debate was fed by the development of the United States' economy in the after-war years. In the 1920s, the prosperity had been seen as proof for the manageability of an economy by enthusiasts. The critics, who considered the policies of the after-war years interventionist gained the upper hand after the crash of 1929.²⁷ The United States provided the plane for another set of issues tightly linked to the claim of the manageability of the economy. The usefulness of an "economic barometer," based on the statistical analysis of time-series data, as presented by economists at the Harvard University and soon imitated by several other agencies, was fervently debated (Pribram 1928, 158-9).²⁸ These controversies culminated in the conflicts between empirical and theoretical business-cycle analysis in the interwar years. Understood as a broader methodological issue, the role of quantitative empirical research within economics was yet to be clarified.

economy should be based on a restoration of the gold standard (Laidler 1999, 106-12). The empirical business-cycle research, especially in the United States, was perceived as providing the empirical basis for price-level stabilization. These ideas had attained considerable popularity among Anglo-Saxon economists whereas continental Europe remained rather critical.

²⁶The issues debated above in the context of overinvestment theories are obviously intimately linked to monetary theory and policy on a theoretical plane. These links will be taken up now whereas the relations to growth theory, theories of economic equilibrium etc. were discussed above. Although overinvestment theories played a role in defending the government's economic policy proposals especially in the academic sphere, the Swiss debate of the early 1930s completely eschewed questions of monetary policies. Therefore, the analysis of these different sets of issues raised by overinvestment theories are separated in this study.

²⁷The United States' experience was also seen as undermining purely monetary business cycle theories and their policy conclusions. Price-level stability had obviously not been sufficient to prevent a crisis (Haberler 1933, 95).

²⁸This type of research had received critical comments by German-language economists from its inception. It experienced a serious blow with the crash of 1929. None of the barometers had been able to provide warnings as to the coming events and the onset of the depression. European economists saw their reservations confirmed (e.g. Haberler 1933, 92 and Röpke 1933, 243).

The contributions made at the meetings of the Verein für Sozialpolitik in September 1928 provide valuable insight into the state of monetary thinking in the German-language area before the onset of the Great Depression. The following analysis of these contributions with some references to related contemporary discussions focuses on the issues singled out above, namely the potential of monetary policy in controlling the business cycles, the interpretation of the United States' experience, and the scope of empirical research. The theme of the meetings, which were held in Zurich, was "credit and the business cycle" (Kredit und Konjunktur). This was a matter of "great topicality" (grosser Aktualität) according to the first speaker Karl Diehl (University of Freiburg) "... since it is known that this topic is at the center of interest for the economists of most countries." (...denn dieses Thema steht bekanntlich im Mittelpunkt des Interesses der Nationalökonomien der meisten Länder. Verein für Sozialpolitik 1929, 276). Diehl's contribution provided a broad overview of the issues contemporarily discussed under this heading.²⁹ The theoretical contribution by Walter Eucken (University of Freiburg) summarized the basic tenets of the monetary business-cycle explanation, discussed under the heading of overinvestment theories above (p. 81 ff.). Eucken did not draw policy conclusions from his argument. The question, whether adequate monetary policies could moderate the business cycle, was not addressed.

This concern was at the center of the contribution of the third invited speaker at the meetings. Adolf Jöhr, at the time director of the largest Swiss bank Schweizerische Kreditanstalt, had been a long-time employee of the Swiss National Bank and a member of its board of directors from 1915-1918.³⁰ His discussion of the links between monetary conditions and the business cycle from the "practitioner's point of view" is of particular interest here, as it certainly reflected positions held within the Swiss National Bank, even if Jöhr had departed from there 10 years earlier. Jöhr discussed the function of the banking sector in the economy at length. He argued that banks collected the funds generated by real saving and passed them on to investors in the form of credit.

²⁹For some more detailed comments on his talk see p. 175.

³⁰Jöhr had been head of the III. Department of the Swiss National Bank, the division of the Bank responsible for the discount, foreign exchange and lombard business and for giro transactions. From 1939 to 1951 he was a member of the Bankrat, the body entrusted with the supervision of the Swiss National Bank.

“In this respect, the extent of credit granted is not the cause but the consequence, not the stimulus but a concomitant of the business cycle.” (Insofern ist der Umfang der von ihnen gewährten Kredite nicht Ursache, sondern Folge, nicht Erreger, sondern Begleiterscheinung der Konjunktur. Verein für Sozialpolitik 1929, 310). Furthermore, the development of the banking sector and its increasing importance in executing payments had allowed the reduction of overall cash balances in the economy, as banks held them on behalf of individual firms. The centralization of liquidity management allowed converting parts of the means formerly bound up in cash balances into productive capital. This, Jöhr maintained, had been a slow process taking place over decades and could hardly be responsible for variations in the volume of credit in the short term. He concluded that the extent of credit creation by the banking sector was grossly overestimated and in fact negligible as compared to the transformation of deposits (Verein für Sozialpolitik 1929, 312).

Is it possible that a former central bank director and head of a large commercial bank expressed such views in 1928 at the meetings of the leading organization of the German-language economics profession - and was basically not contradicted?³¹ Schumpeter (1954, 1110-16) discusses the slow acceptance of the ideas concerning the link between bank credit and deposit creation by the profession. He argues that “...it proved extraordinarily difficult for economists to recognize that bank loans and bank investments do create deposits. In fact, throughout the period under survey³² they refused with practical unanimity to do so. And even in 1930 when the large majority had been converted and accepted that doctrine as a matter of course, Keynes rightly felt it to be necessary to re-expound and to defend the doctrine at length ...” (Schumpeter 1954, 1114-5). Another indication for the state of theoretical understanding of the process of credit creation is the fact, also mentioned by Schumpeter, that *Economica* published an article by F. W. Crick on “The genesis of bank deposits.” in 1927, an article devoted to explaining the process of deposit creation and annihilation. On this background Jöhr’s views appear less antiquated. To the modern reader they are still striking since we are used to thinking that the analysis of the monetary economy as

³¹Whereas most contributions disregarded Jöhr’s reservations concerning the scope of credit creation, one speaker set out to refute his argument by explaining the process of credit multiplication through the banking system (Verein für Sozialpolitik 1929, 355-6).

³²“1870 to 1914 (and later)” is the title of part V of Schumpeter’s *History*, from which this quotation is taken.

a credit economy had been established since Wicksell's contributions.³³

Finally, Jöhr's comments on the areas of responsibility of a central bank are noteworthy. He listed the management of the currency and the provision of circulating notes.³⁴ However, he decisively rejected any obligation to control the credit supply. To the modern reader it is curious to see that Jöhr mentioned this rejection in the same breath with the central bank's financing of public sector debt (Notenbanken sind ... ausschliesslich Anstalten für die Regulierung der Währung und für die Versorgung des Verkehrs mit den nötigen Geldzeichen. ... Die Kreditversorgung der Wirtschaft ist grundsätzlich so wenig Sache der Notenbank als die Kreditversorgung des Staates. Verein für Sozialpolitik 1929, 314). Today, the central bank's role in shaping credit-market conditions would be treated as an issue fundamentally different from the monetizing of budget deficits. Jöhr's conclusions concerning the scope and desirability of influencing the business cycle through credit policies follow. The suggestion to burden the central bank with responsibility for the business cycle reflected, according to him, a misjudgement concerning the nature of the economic system. Furthermore, he argued the capacity to regulate the volume of credit and the possibility of actually influencing the course of the economy through this channel were grossly overestimated. Thus, Jöhr rebuffed all demands for monetary policy aimed at the stabilization of the business cycle. His talk still ended on a positive note (Verein für Sozialpolitik 1929, 316): the most violent economic and credit crises had probably been part of the childhood diseases (Kinderkrankheiten) of capitalism, as the system had built up resistance over the years. Needless to say, this widely shared optimism was soon to be defeated.

Jöhr's outright rejection of monetary policies aimed at price-level stability was not the dominant view at the meetings of the Verein für Sozialpolitik. However, support for such policies was in most cases cautious. Among the reservations voiced, difficulties in the implementation ranged prominently. We have seen above that this topic was also frequently raised in Swiss debates. Mises (Verein für Sozialpolitik 1929, 325) saw a central obstacle to price-level stabilization in the

³³Ellis (1934, 396-7) draws attention to institutional characteristics of German (and Swiss) banking to explain "a certain backwardness on the part of the German students of banking" as compared to their Anglo-Saxon counterparts.

³⁴ Jöhr explicitly acknowledged the lender-of-last-resort function in this context.

impossibility to define an uncontroversial price index which could provide the central bank with a guideline for monetary policies. Schumpeter (1954, 1089) claims that the Austrian economists in general “distrusted index numbers.” He adds that “[t]hey were, of course, not the only ones to do so. ... Generally speaking, index numbers imposed themselves upon the profession as a whole by a slow process of infiltration which wore out opposition rather than convinced it.” (Schumpeter 1954, 1089 footnote 10). The recurrent doubts expressed by Swiss economists concerning the reliability of price indices and the information they actually contained were hardly extraordinary at the time.

Even if Mises did not doubt that the stabilization of the business cycle was feasible in principle, he rejected the view that central banks could target the price level as a simple rule to bring about such results. He concluded that the assessment of whether increases in credit would lead to inflation or misguided investment had to be left to commercial banks. To resist the demands from public and politicians to lower interest rates was the only general guideline he provided concerning credit policies (Verein für Sozialpolitik 1929, 325-6).

In contrast to Mises, Hayek rejected the possibility to stabilize business cycles by regulating the money supply in principle.³⁵ His analysis started from the equilibrium conditions Wicksell had formulated in the context of the cumulative process. Wicksell’s contention, that “neutral money” would “leave the real process of the barter model uninfluenced,” set off a “hunt for the conditions in which money is neutral. And this point eventually led to the discovery that no such conditions can be formulated, that is, that there is no such thing as neutral money or money that is a mere veil spread over the phenomena that really matter - an interesting case of a concept’s rendering valuable service by proving unworkable.” (Schumpeter 1954, 1088) Hayek had been central to this discovery. He questioned Wicksell’s contention: whereas stable prices characterized monetary equilibrium in a stationary economy, this would not be the case in a growing economy. If the price level was kept constant in a growing economy, so the argument went, money supply would have

³⁵Hayek’s argument, as it is presented here, is contained in Hayek 1931, although elements of it had been advanced earlier. In his contribution to the debate at the meetings of the Verein für Sozialpolitik in 1928, Hayek discussed reasons for the recurrent differences in market and natural interest rates, pointing out information and coordination problems within the banking sector (Verein für Sozialpolitik 1929, 369-75).

to be increased. Hayek argued that such increases had effects on the structure of relative prices, an argument he traced back to the pre-classical economist Richard Cantillon.³⁶ According to Hayek, increases in money supply did not lead to an even increase in all prices, instead their effects on prices depended on the channels through which the additional funds entered into circulation. A stable price level, implying increases in money supply in a growing economy, could, consequently, not be neutral. Only falling prices, resulting from a constant money supply, were consistent with neutrality.³⁷ The practical conclusion from this analysis was an outspoken pessimism concerning the hope that monetary policy could lead to the elimination of the business cycle.

Hayek had been an early critic of the Federal Reserve's monetary policies in the years after World War I. He pointed out that the policies of price-level stabilization were pursued on the background of a rapidly growing economy and enormous technical progress. The increases in efficiency compressing production costs should have reduced prices considerably. Therefore, the combination of technical progress and price-level stabilization actually provided for inflationary conditions (Hayek 1965 [1932], 13-14). Those observations had led Hayek to predict a severe crisis in the American economy before the events of 1929-1933 as Laidler (1999, 44) points out. Hayek took the downturn as confirmation for his explanation of the business cycle (e.g. Hayek 1933, 112), but he certainly also took them as support for his policy conclusions.

To return to the debate at the meetings of the Verein für Sozialpolitik in 1928, further issues concerning the practicability of price-level oriented monetary policies were raised, beyond the ones discussed above in the context of Mises' critique. Among other things, Theodore E. Gregory (London School of Economics) argued that the transmission of monetary-policy changes, more precisely the effect of an increase in interest rates on prices, was not fully understood (Verein für Sozialpolitik 1929, 329). Although he considered price-level stabilization possible in principle, he argued that monetary policy under the guidelines of the gold standard were preferable. A central

³⁶For a detailed discussion see Hagemann and Trautwein 1998.

³⁷A constant money supply is not the only condition for neutrality as Klausinger (1997, 199-200) shows. For comments on the contemporary critique of Hayek's proposals and references to the literature see Klausinger (1997, 199) and Laidler (1999, 44-6).

bank charged with the task of stabilizing prices would hardly be able to withstand the political pressure it would face. To achieve credibility and confidence in the business world under such conditions would be impossible. Gregory's was the only comment at the meetings of the Verein für Sozialpolitik that addressed the incompatibility of monetary policies aimed at price-level stability with the existing fixed-exchange-rate regime, reflecting a neglect of this issue which had been discussed above in the context of the debate at the Swiss meetings earlier in the same year (p. 163).

Outright support for monetary policy aimed at moderating fluctuations in economic activity came from an industry representative at the meetings of the Verein für Sozialpolitik. He argued that the stable growth in the post-war United States had resulted from monetary policies aimed at price-level stability. Although he conceded that other factors might have contributed, he underlined the importance of the Federal Reserve's strategy and demanded that European central banks paid more attention to the business-cycle effects of discount rate and credit policies (Verein für Sozialpolitik 1929, 364).

Also commenting on the United States' economy, Adolph Löwe had criticized this widely held view. He pointed out that the remarkable performance of the American economy was generally attributed to credit policy, "which in accordance with the monetary business cycle theories regulates monetary movements and endeavors to once and for all abolish the normal business cycle ... and provide for continuous high employment levels for any chosen duration." (...die im Einklang mit monetären Konjunkturlehren die Geldbewegungen reguliert und den normalen Konjunkturzyklus ... endgültig durch einen gleichmässigen hohen Beschäftigungsstand für einen beliebig langen Zeitraum ablösen will. Löwe 1928, 357).³⁸ This monocausal explanation of the

³⁸The relationship between price-level stability and unemployment had been studied by economists at the International Labor Office (ILO) in Geneva in the early 1920s (Endres and Fleming 1998). On the background of "economic barometers," i.e. the statistical analysis of the path of indicator variables considered central to the business cycle, active monetary policy targeting price stability was recommended. There, "the US Federal Reserve was presented as an exemplar because it closely followed the ILO conception of a monetary policy strategy..." (Endres and Fleming 1998, 379). Although this work was done in Switzerland interchange with "local" economists seems to have been minimal. The economists at the International Labor Office did not contribute to the debates in their host country nor did they participate, for example, at the meetings of the Swiss Statistical Society.

business cycle forwarded by the purely monetary theories was rejected by Löwe. At the meetings of the Verein für Sozialpolitik he argued that it was necessary to analyze the complexities of the causes of fluctuations where the credit expansion in the boom was a regularity which was neither necessary nor sufficient to explain the cycle (Verein für Sozialpolitik 1929, 341-2). Accordingly, his interpretation of the American growth experience underlined the importance of other aspects of American economic policies in this period. Labor market policies, especially the control of immigration, policies in support of purchasing power i.e. wage levels, agricultural policies and the “imperialist expansion” (imperialistische Expansion) were mentioned as adding to the effects of credit policies (Verein für Sozialpolitik 1929, 346).

Another topic, also repeatedly surfacing in the Swiss debates over price-level oriented monetary policy, was the availability and reliability of the necessary index numbers. Empirical business cycle research had grown enormously after World War I. The Harvard barometer served as prototypical example of this type of analysis in the European debates. The newly founded research institutions in the German language area similarly tried to provide topical information on the economy.³⁹ Indicators were published not least in the hope that by providing information to private-sector decision makers an altogether more rational and efficient course of the economy could be brought about and business cycles dampened. The need for a corresponding institution was also discussed in Switzerland. At the annual meetings of the Swiss Statistical Society in 1928 the head of the Swiss National Bank’s statistical office, H. Schnebeli, contributed a lengthy statement on the difficulties of business cycle research in Switzerland (Schweizerische Statistische Gesellschaft 1928, 209-18). The insufficiency of available statistical data was an important argument, the fact that no output statistics existed in Switzerland was underlined.⁴⁰ The possibility of constructing

³⁹In 1925 the “Institut für Konjunkturforschung” (today: Deutsches Institut für Wirtschaftsforschung) was founded in Berlin with Ernst Wagemann as president (who at the same time headed the administration’s statistical service, Statistisches Reichsamt). In 1926 Adolph Löwe came to the “Institut für Weltwirtschaft an der Universität Kiel” and built up a soon renown research group concentrating on international business cycle analysis (Hagemann 1997). The “Österreichisches Institut für Konjunkturforschung” in Vienna was founded in 1927, first headed by Friedrich A. von Hayek (1927-1931) and later by Oskar von Morgenstern (1931-1938).

⁴⁰This topic was taken up in several contributions to the discussion. The need for an output statistic was repeatedly underlined. The reservations concerning the availability of data were rejected by one speaker. He maintained that the existing material, especially the data

a “barometer” for Switzerland in the near future was therefore rejected. Nonetheless, the importance of systematic business cycle analysis was endorsed. Schnebeli discussed whether such analysis could take place under the auspices of the Federal Statistical Office, the Swiss National Bank or in a private research institute. He rejected all these possibilities and suggested cooperation among existing interested groups instead. Apart from those already mentioned, he named industry and trade organizations, the farmers’ association and the universities. This cooperation could in time lead to the foundation of an institution entrusted with the task of systematic business cycle analysis.⁴¹ For the time being, the monthly information brochure, *Wirtschaftliche und Sozialstatistische Mitteilungen*, published by the Federal Department of Economic Affairs could fulfill the needs of the Swiss economy. Some speakers supported Schnebeli’s reservations concerning the setting up of a Swiss institute for business cycle research. The dangers of influencing public opinion through predictions were pointed out, dangers which were seen as particularly grave if - in the case of Switzerland - only one institution was brought into existence which could claim authority in the field. But several contributors contradicted Schnebeli and demanded the foundation of a research institute, among them Pribram (*Schweizerische Statistische Gesellschaft* 1928, 236).

With reference to the development of empirical research in the United States, a confrontation between theoretical and empirical business cycle analysis was conjured by several European economists. These issues were also raised at the meetings of the Verein für Sozialpolitik in 1928, some of the aspects of the debate have already made their appearance in the contributions discussed above. The comments of Diehl in his introductory speech reflect the still mixed attitude

collected by the Swiss railway, provided timely information on the level of economic activity. Longer time series extending to the pre-war era were of no use for the analysis of post-war developments as economic organization had fundamentally changed with the war (*Schweizerische Statistische Gesellschaft* 1928, 218-20).

⁴¹This suggestion was taken up. In 1932, the Federal Department of Economic Affairs set up a commission mandated to comment on the development of the economy and on the methods of its observation. The members of the so-called Kommission für Konjunkturfragen included civil servants from several parts of the federal administration, a representative of the Swiss National Bank, the employers, the unions and the farmers (*Die Volkswirtschaft* 1932, 54). An institute devoted to business cycle research was founded in 1938 at the Federal Technical Institute in Zurich (today: Swiss Institute for Business Cycle Research).

which prevailed among most economists. He praised the contribution of empirical research to a more detailed understanding of the facts of cyclical development. At the same time he cautioned against exceeding expectations concerning the value of such information. Diehl explicitly rejected claims that an understanding of cyclical phenomena could be reached directly from the analysis of empirical regularities or that they could lead to a useful prediction of future developments, a position often associated with Wesley C. Mitchell or the Harvard Institute (Verein für Sozialpolitik 1929, 283). Instead, he called for the cooperation of empirical and theoretical business cycle research (Verein für Sozialpolitik 1929, 287). This had also been the tenor of the debate at the Swiss Statistical Society's meeting earlier in the year (see also p. 162 above). Saitzew, who had discussed business cycle policy there, had advocated a synthesis of empirical and theoretical methods. He had favored empirical analysis inspired by theoretical models, thus presenting a forward-looking approach widely defended by European economists at the time (Saitzew 1928, 187).

Concluding remarks: influences on the Swiss views on money

It is probably fair to claim that attitudes on monetary policy are among those most difficult to change. Historically, monetary thought and theory has usually developed in reaction to disruptions or the breakdown of existing regimes. Rarely have events taken the opposite direction, in the sense that theoretical treatment preceded institutional change. Therefore, monetary theory and policy are an arena for conservatism in the literal sense.

As the disruptions in the Swiss economy resulting from World War I were mild compared to those of the belligerents, the return to the pre-war gold parity went smoothly. An alternative to the policy goal of restoring the gold standard was not considered, as Switzerland's vital international economic ties had prospered under the pre-war system and were supposed to depend on the soundness of gold and the reliability of fixed exchanges. Critique came only from the margin. The small party of adherents to Gesell's teachings demanded monetary policy oriented at price-level stability in the deflation years during and after the war and again with the onset of the depression in the early 1930s. The party attracted the authorities' attention with its aggressive political course. Especially the Swiss National Bank's representatives seemed to have quickly tired from the encore of relentless attacks by the Gesell followers during the depression years, who for

example used the shareholders' meetings of the Bank as a forum for the propagation of their ideas (Schärrer 1983, 88-9, 247). In the contributions repudiating the arguments of the Gesell followers adherence to gold as an "unmanipulated" monetary system came off as the central conclusion.

The academic debate in the German-language area did not contribute much to undermining this consensus. Whereas Anglo-Saxon economists had intensely discussed monetary policies aimed at price-level stability as a means to moderate fluctuations in positive light, these arguments met with reservation on the continent. However, the popularity of overinvestment theories of the business cycle had led to a widespread acceptance of the proposal that fluctuations in the volume of credit were an important factor in business cycles. Policy conclusions were drawn only cautiously from this insight. The attitudes among Swiss economists resembled the more conservative parts in the German-language debate, but they did not stand out in any respect. It was argued that many issues raised in the interwar years in the context of monetary theory and policy were by no means settled in these debates. Conservatism, that is adherence to received wisdom, does not seem like an unwise strategy in such circumstances.

7. A golden calf? The debate about devaluation 1935-1936

Even though the small party advancing Gesell's monetary reform proposals had been arguing for an abandonment of the gold standard all along, a devaluation was considered as a policy option only in the year before the devaluation actually took place. Nonetheless, it was suggested by very few members of the political mainstream. Those openly demanding devaluation, mostly the reform-oriented circles around Max Weber, initiated a public debate on the benefits and drawbacks of the adherence to gold. Although this discourse was dominated by the arguments of those rejecting devaluation, it contrasted sharply with the earlier phases of the Swiss economic policy debates when the adherence to gold was considered beyond discussion. It is conspicuous that no Swiss economist supported those proposing devaluation. It took some skill to analyze the evidence from the countries that had experienced recovery after devaluation and still conclude that Switzerland was better off remaining on gold, as Böhler and Keller did in 1935. The export industries' staunch support for the adherence to the gold parity is similarly remarkable. Although price and wage adjustment remained the sole acceptable policy in the public pronouncements of the industry organization's leaders, attitudes towards devaluation changed in this time period. The Federal Council confirmed the adherence to the Swiss franc's gold parity on every possible occasion up to the very event of the devaluation. The adjustment strategy of the earlier years had by no means been abandoned and was now presented in the slightly modified demand for differential adaptation (*differentielle Angleichung*) in the government's programmatic statements. However, the parliamentary debates on the eve of the devaluation show that resistance to translating this strategy into action was as determined as ever. Speakers from across the political spectrum agreed that the positions on policy prescriptions had remained basically unchanged despite years of discussion. The political deadlock had resulted in a collection of individual snapshots at symptoms of the crisis, measures upon which the opponents had more or less reluctantly agreed in the early phase of the crisis. However, a majority for one of the proposed policy approaches had not emerged. The Federal Council's ability to act was undermined and its attempts to overcome the paralysis by delegation of powers to the government were consistently rejected in parliament.

***Die Nation* as spearhead of a mainstream advocacy of devaluation after October 1935**

Whereas the opposition to the government's deflationary policies was united behind the demand for an expansionary program as presented in the crisis initiative, the unanimity in support of the Swiss franc's gold parity would eventually begin to wane.¹ A first sign that the open deserters would come from the progressive opposition was an article published on April 27, 1934 in the weekly journal *Die Nation*.² The author, one of the initiators of the paper, argued - in the very last paragraph of his contribution - that "lowering the exchange rate" should not be excluded from policy options. Instead, he claimed that the issue should be examined "calmly and thoroughly while there is still time." (Wir fordern, dass man in aller Ruhe und Gründlichkeit, solange es noch Zeit ist, die Frage einer Senkung des Wechselkurses prüfe.) Nonetheless, this was a premature opening to a debate which would only take place much later. For more than a year *Die Nation* kept silent on the issue. This was in part a result of the campaign over the crisis initiative where the critics had argued that the suggested measures would lead straight to devaluation (see p. 139 above). The proponents of the crisis initiative not only wanted to keep away from the delicate issue of currency policies. They (still) believed that expansionary policies would allow the Swiss economy to overcome the stagnation without changes in the monetary regime. It was only after the parliamentary elections in the fall of the same year, that the discussion gained momentum.³ The editors of *Die Nation* seemed to have been anxiously awaiting the closing of the polling stations to open the debate. The paper, true to the impetus of the founders, provided a forum for the discussion over adequate monetary policies.

¹There had always been individuals who came out in favor of devaluation namely from the export industries, tourism and the farmers. Their arguments had, however, been easily ignored on the background of the encompassing support for the adherence to the Swiss franc's gold parity.

²Within the industry organization Vorort des Schweizerischen Handels- und Industrievereins (today's economiesuisse) devaluation was also discussed in the early months of the year 1934. Like on later occasions, the issue was raised by Albert Pictet, a private banker, who argued that it should be examined within the organization as the government's policies offered nothing but palliatives in the treatment of the crisis. For further comments on the industry organization's position on devaluation see pp. 190-195 below.

³Schärrer (1983, 266-7) mentions that starting in November 1935 opinions concerning the desirability of devaluation diverged within the organization for a sound currency (*Vereinigung für gesunde Währung*). That standpoints were modified even in the former stronghold of gold-standard defenders can be taken as an indication for the changed atmosphere.

Even before the elections *Die Nation* presented a theme which was going to recur in the following months (*Die Nation*, October 4, 1935). It was argued that the gold bloc, reduced to France, the Netherlands and Switzerland, was a crisis area (Kriseninsel) in a recovering world economy. The reason for these contrasting paths of economic development were seen in diverging price levels. These differences could be overcome either by devaluation or by systematically subsidizing exports to absorb price differences. The editors presented this as matter-of-fact analysis. No explicit relation to Swiss policy debates was established, nor was an argument made in favor of one or the other of the proposed policies.

Furthermore, four statements on economic policy were published shortly before the parliamentary elections by *Die Nation* (October 18 and 24, 1935). The journal had approached the authors with a request for opinions on the current state of the Swiss economy, on future developments and on the path leading out of the depression (*Die Nation*, October 18, 1936). William Rappard (Graduate Institute of International Studies, Geneva) and Alfred Ammon (University of Berne) advocated the continuation of adjustment policies, Swiss prices had to be brought down to the world price level.⁴ Devaluation was rejected. Switzerland with its poor natural resources had been economically successful because of its reliability which would be destroyed by devaluation, argued Rappard. Ammon rejected devaluation because Switzerland depended heavily on imported raw materials and agricultural products. As they would become more expensive any other advantages of the measure would be outweighed.

Fritz Marbach and Max Weber, both proponents of the reform-oriented wing of the Social Democratic Party, had fought together against deflationary measures advocating expansionary government policies. Now they parted company. Marbach continued to reject devaluation. His arguments reflected a belief in the return to a liberal international economic order as basis for a recovery of the Swiss economy, an opinion he had already expressed in the earlier phases of the crisis (p. 96 above). He argued that he was convinced, “that a return to liberal practices in international economic relations (international stabilization of currencies, gradual restoration of convertibility, gradual reduction of international barriers to trade) would bring about a recovery, which would also substantially assist the Swiss economy.” (Ich zweifle nicht daran, dass eine

⁴Ammon had been an early advocate of price and wage reductions (p. 97 above).

Rückkehr zu liberaleren Gepflogenheiten im weltwirtschaftlichen Verkehr (Internationale Währungsstabilisierung, sukzessive Wiederherstellung des freien Zahlungsverkehrs, sukzessiver planmässiger Abbau der internationalen Handelsschranken) einen konjunkturellen Aufschwung herbeiführen würde, welcher auch der schweizerischen Wirtschaft entscheidend zugute käme. *Die Nation*. October 24, 1935). He rejected devaluation as he considered its consequences to be equivalent to those of deflation.⁵ He argued that a reduction in the value of the currency would have particularly negative effects in Switzerland, as everybody in the country saved, not only the rich. He implied that savings would be lost in a devaluation but did not explain how.

Max Weber was the fourth expert to state his views on economic policies which would lead out of the recession in *Die Nation*. According to him, the reversal of deflation was urgently needed to prevent a further deepening of the crisis. He singled out the gold-bloc countries as the only ones still trying to bring their price levels down by deflationary measures. While the rest of the world economy was recovering, they suffered from depression. He presented two alternatives to overcome the deflation without favoring one over the other: consistent price and wage support or devaluation. The change in parity would not suffice to bring about a recovery, expansionary policies would just become less difficult and less expensive.

A week after these experts' statements were published, the editors of *Die Nation* came out with their opinion on the matter and provided a clear statement in favor of devaluation. It was the first issue of the paper after the parliamentary election on October 27, 1935. The editors had obviously let these events pass, hoping to find a more open-minded atmosphere. In part this reflected the crisis initiative's proponents' interpretation of the vote. The claims of the initiative's opponents, that the measures proposed would lead straight to devaluation, were seen as a decisive tactic in the campaign. The rejection of the initiative was thus understood as a result of the population's deep-seated disapproval of devaluation. Not surprisingly, the reformers did not want to hamper the social democrats' chances in the election. With the latter over, the time seems to have finally

⁵A similar argument was later made in a communication of the Federal Council, see p. 206 below.

been considered ripe for an open discussion of the issue.⁶

In their full page article, dressed by a quotation from Keynes's *Tract on monetary reform* (1923), the editors of *Die Nation* argued that a devaluation would help export industries by making them competitive on world markets and by improving the profitability of the firms producing export goods. Furthermore, the fear that devaluation would lead to price increases was countered by the argument that not all imports would become more expensive as trade restrictions and tariffs would become superfluous and be dismantled. Effects on consumer prices would be further mitigated as agricultural prices in Switzerland already far exceeded world prices for those goods. Therefore, the only obvious disadvantage of devaluation identified was the effect on Swiss assets denominated in Swiss francs in the rest of the world. Their value and their returns would decline in terms of gold.⁷ The overall effect and its importance would, of course, depend on the ratio of foreign assets to foreign debt, a figure which could not be ascertained for the Swiss economy as a whole. The authors concluded that the decision on devaluation had to weigh the advantage of overvaluation for Switzerland as creditor (den Vorteil, welchen die Schweiz als Gläubigerland aus der relativen Ueberbewertung ihrer Währung zieht) against the disadvantage that Switzerland as a producer suffered from the economic decline (den Nachteil, welchen sie als Produzent durch die Schrumpfung ihrer Wirtschaft erleidet). The "dozen millions" in asset values which would be lost to devaluation were compared to the "hundreds of millions" in national income foregone due to deflation. A clear vote in favor of devaluation followed.

Die Nation consistently upheld this editorial position in favor of devaluation in its statements, in comments on publications, and in articles criticizing government policy. Opponents to devaluation

⁶Hohl-Slamova (1983, 113) argues that after the rejection of the crisis initiative and the confirmation of the division of power between parties in parliamentary election, Max Weber had become convinced that the chances of introducing expansionary measures had disappeared. Therefore he started advocating devaluation as a means to overcome domestic deflationary pressure. This he considered the most important effect of devaluation. His expectations as to a recovery of exports were rather cautious, as will be shown below.

⁷When *Die Nation* returned to these issues on May 28, 1936 it was claimed that the importance of the argument about losses on Swiss assets in the rest of the world through devaluation declined month after month as similar losses were brought about by measures of the debtor countries such as transfer moratoria and exchange restrictions.

were also given space and letters criticizing the editors' opinion were published. The position in favor of devaluation was underscored repeatedly in discussions of the world recovery and gold bloc stagnation. Detailed statistical material was used to illustrate the upswing in Great Britain, the United States and Germany and to contrast it with the recession in France, the Netherlands and Switzerland (*Die Nation*. November 28, 1935, January 1, May 7, and June 11, 1936). The rhetorical question, how the world could overcome the crisis, was answered unambiguously: "Not by sitting back and doing nothing. Monetary policy and public works have brought about recovery." (Wie konnte die Welt die Krise überwinden? Nicht indem sie die Hände in den Schoss legte. Monetäre Krisenpolitik oder staatliche Arbeitsbeschaffung haben den Wiederanstieg bewirkt. *Die Nation*. November 28, 1935). In February 1936 a lengthy article by Fernand Baudhin (Professor at the University of Leuven and one of the few advocates of devaluation among continental economists) discussed in positive light the effects of the devaluation of the Belgian franc in the previous year.⁸ In April and May 1936 a series of articles by the Dutch economist G. M. Verrijn Stuart (University of Utrecht) was published. Based on the experiences in the Netherlands with a policy mix very similar to Switzerland's, he advocated devaluation.⁹ After an extensive analysis of possible effects he concluded that the outcome could be expected to be positive (*Die Nation*. April 4, 23 and 30, May 14, 1936).

The social democrats' continued support for the gold parity

Despite the advocacy of devaluation by *Die Nation*, representing parts of the reform-oriented wing of social democracy, the official party line remained unchanged. But the debate between diverging opinions of social democrats that had been initiated under the auspices of *Die Nation* was taken up within the party. In an expertise drawn up on request of the leaders of the Social Democratic Party, Weber and Marbach had the opportunity to explain their positions on devaluation in more detail. After evaluating the arguments of both authors, the party leadership

⁸Eichengreen (1992a, 360) points out the important role he played in the economic policy debates in Belgium.

⁹Stuart was a member of a pro-devaluation coalition which had lobbied for the consideration of this policy option since 1934. Several members of the group were economics professors, most of them teaching at commercial colleges (Economische Hogescholen) (Griffiths 1987, 27).

decided to uphold its opposition to devaluation in March 1936.¹⁰ This corresponded to the positions of most European socialist and communist parties. Devaluation was often portrayed as a policy in the interest of capital owners and at the cost of workers. As inflation was expected to usually follow devaluation workers would loose in the process.

Marbach's rejection of devaluation was not built on a plea for the gold parity. Instead, his aim was to undermine the arguments of the proponents of devaluation (Sozialdemokratische Partei 1936, 12-63). He denied any positive influences on the Swiss economy, referring unspecifically to experiences of countries that had already devalued.¹¹ He maintained that exports would not increase since they were primarily restricted by trade barriers, that problems of over-indebtedness would not be solved and public finances not improved. Marbach attributed positive effects of devaluation to a change in the atmosphere brought about by government propaganda and not by devaluation per se. Furthermore, Marbach saw the danger of renewed competitive devaluations and retaliatory trade measures. He expected considerable increases in domestic prices to worsen the situation of the working population. He stressed that a devaluation would undermine confidence. This would be particularly harmful in a country like Switzerland where basically everybody saved and would loose in terms of purchasing power of their savings. On the other hand, he downplayed the extent and importance of the overvaluation of the Swiss franc, arguing that international comparisons of price indices were no reliable measure and that exchange rates played a negligible role in a situation where economic relations between countries were not dominated by market forces anyway. Marbach confirmed his previously expressed view that there was no lasting solution to the problems of the Swiss economy unless supported by a joint effort of expansionary policies on an international level.

Max Weber (Sozialdemokratische Partei 1936, 67-101) agreed that the devaluation would probably not lead to an immediate increase in exports. Nonetheless, it would restore profitability to the export industries and free up public funds that so far went into export subsidies for

¹⁰Nonetheless, both sides of the argument were published (Sozialdemokratische Partei 1936).

¹¹Böhler and Keller (1935, 25-53), in contrast to Marbach, did not deny positive effects in their analysis of countries' devaluation experiences but attributed them to exceptional circumstances (see below, p. 185)

measures to rebuild domestic industries. The most important effect Weber expected from the devaluation was a reversion of deflation. He argued that the deflationary pressure had paralyzed the economy. Especially the tightened credit and capital markets would loosen. The devaluation would produce favorable conditions as a basis for expansionary policies. Weber also drew attention to the experiences of countries which had devalued their currencies. His conclusions were cautious but positive: in all cases the downward price trend was reverted and in no case had conditions deteriorated. While Weber also expected price increases, he argued that they could be curbed by reduced import tariffs and price controls. To fend off the argument that purchasing power would be lost on savings, he maintained that this would only partly offset gains in purchasing power made during the preceding years of deflation. The opposition to devaluation on grounds that it would violate creditors' confidence, he countered with pointing to debtors' problems brought about by continued deflation.

Swiss economists and the defense of the gold standard

No Swiss economist spoke out in favor of devaluation. In 1935, the Swiss National Bank's organization for sound money (Vereinigung für gesunde Währung) published a 100-page booklet by University of Zurich professor Eugen Grossmann. He fervently opposed a lowering of the exchange rate and painted the effects on the Swiss economy in the darkest colors. But there was also cautious criticism of the governments' unconditional support for the gold standard. Alfred Bosshardt (Trade School and later University of St. Gallen) is an example. In a piece published in 1935, he discussed the foundations of a functioning gold standard as spelled out in the final report of the League of Nations' gold delegation in 1932. He reproached the Swiss public for having welcomed the recommendation to return to the gold standard without taking into consideration the necessary conditions. Bosshardt analyzed the working of a gold exchange standard in the first half of his contribution (Bosshardt 1935, 1-33). He stressed the importance of the *international* gold standard as regulator of international trade and capital flows and contrasted this with the widely discussed advantages of a gold-based currency in an individual country (Bosshardt 1935, 34). He also criticized popular beliefs that particular qualities of gold made it a suitable monetary metal.

In the second half of the publication, Bosshardt analyzed the developments since World War I. He emphasized the problems created by reparations and inter-allied debt, by capital flight, and

protection. He argued that the idea of a “world economy” (Weltwirtschaft) had been closely tied to the international gold standard and to free trade. This system was replaced by “excessive economic nationalism” (überspannter wirtschaftlicher Nationalismus) with protectionism and national paper currencies as particular characteristics (Bosshardt 1935, 46). These changes were compounded by increasingly inflexible prices due to stronger unions and to market concentration, the higher volatility of gold prices and the sterilization of gold inflows by France and the United States. Bosshardt concluded that a return to a functioning international monetary system based on gold would only be possible if all countries were willing to cooperate and accept the changes necessary to rebuild the foundations of such a system. He concluded that for such cooperation to be effective, intergovernmental treaties would be necessary to spell out principles for common credit policies aimed at business cycle stabilization (Grundsätze einer gemeinsamen Kredit- und im weiteren Sinne Konjunkturpolitik). He argued that this could be much more effectively achieved in a supranational organization (überstaatliche Organisation). In contrast, in a world of hostile nations preconditions for a cooperation on international monetary affairs were not given and even if a gold standard were restored, under such conditions it would not be long-lived (Bosshardt 1935, 64).

Bosshardt did not draw conclusions for Switzerland’s monetary policy concerning the gold standard under the circumstances he had described so drastically. They seemed obvious, though, as he clearly maintained that the advantages of adherence to gold could only be reaped in a truly international system. Since the gold bloc had shrunk to an insignificant group of countries, there was no good argument to stick to the parity. Bosshardt did not, however, suggest that Switzerland should abandon the gold standard.

Another academic contribution of 1935 helped to undermine one of the central arguments against devaluation, the argument with its inflationary effects. It was part of the analysis Professors Eugen Böhler (Federal Technical Institute, Zurich) and Paul Keller (Trade School and later University of St. Gallen) undertook in their book on crisis policies (*Krisenbekämpfung. Ergebnisse der Krisenpolitik des Auslandes. Grundlagen eines positiven Programms für die Schweiz.* 1935). They contributed a detailed review of policy options and evaluated them on the background of the experiences of the countries which had applied them. More than 50 pages were devoted to a discussion of devaluation. Although the authors did not allow as much as the emergence of a

doubt about their favorite policy option - adherence to the gold standard and adjustment policies - they assembled overwhelming evidence for the favorable development of the devaluation countries' economies.

Böhler and Keller (1935, 21-5) started out with an evenhanded review of the arguments made in favor and against devaluation. According to them, proponents of devaluation argued that it would free the economy from deflationary pressure and lead to an increase in the credit volume, that it could be used in active reflation policies, that it would rectify distortions between the prices of agricultural and industrial products. Furthermore, that debts would decline in real terms, that excessive real wages would be corrected thus reducing production costs, that exports would rise and imports fall and all effects together would eventually lead the economy out of the depression were reported as potential positive consequences of devaluation. As arguments against devaluation the authors cited the much-feared inflation, a renewal of downward pressure on gold prices, the initiation of a round of competitive devaluations, increased strive for autarchy, trade policy retaliation and the need to introduce exchange controls.

In this initial listing of arguments the authors withheld comments. They did, however, point out that the remaining two arguments against devaluation were of particular importance for Switzerland: wage increases as a reaction to inflation would revert initial positive effects on exports, furthermore, the values of foreign assets would be reduced (Böhler and Keller 1935, 25). Nonetheless, the authors criticized the wide-spread misconception that devaluation and inflation were one and the same thing (Böhler and Keller 1935, 31 and 156).¹² They argued that the expectation that devaluation would reduce domestic asset values and purchasing power depended on inflation. They continued that in most of the countries that had recently devalued such effects were negligible as consumer price levels had not changed dramatically. Moreover, in their estimate of possible price level effects in Switzerland, they came to the conclusion that prices would increase by a maximum of 20 percent in the wake of a hypothetical devaluation of the Swiss franc of 40 percent (Böhler and Keller 1935, 64). The calculation that price-level increases would be far smaller than devaluation rates provided an important argument in the political debate.

In the eyes of a modern reader, the most striking part of Böhler and Keller's contribution is their

¹²This perception traces back to Federal Councillor Musy's speech early on in the Swiss controversies over adequate crisis policies (see p. 56 above). However, it was widespread at the time as the inflation experiences of the war and after-war years were seen as intimately linked to the suspension of convertibility at the beginning of World War I.

debate of the overall effects of devaluation. They presented statistical evidence for the years 1930 to 1935 on industrial production, on construction, on unemployment, on commercial banks' activities and on wholesale prices (Böhler and Keller 1935, 43-50). A comparison of the countries with devalued currencies with the gold-bloc countries, made obvious the differences in developments.¹³ The authors did not, however, interpret these differences as unequivocal evidence for devaluations' positive effects. They argued that, so far, only short-run effects could be observed and that the positive outcomes could well have been traded for long-term drawbacks (Böhler and Keller 1935, 43).¹⁴ More importantly, Böhler and Keller (1935, 51) warned that the increase in output and employment could have "inflationary character," citing the post-war boom in Germany as an example for similar effects. Furthermore, the increases were possibly achieved at the cost of those countries that had remained on the gold standard. Last but not least, exceptional circumstances were pointed out, such as increases in military expenditure and increased trade barriers.

Whereas Böhler and Keller allowed for ambiguity concerning potential positive effects of devaluation on a national level, they described the outcome for the world economy in plain negative terms (Böhler and Keller 1935, 52-3). The wave of devaluations had increased the pressure on international gold prices, had amplified the loss of confidence in international capital markets, had led to competitive devaluation and a surge in trade barriers. Moreover, the authors argued that any advantages individual countries could temporarily achieve through devaluation would disappear as soon as all other countries had followed suit.¹⁵

¹³Most tables contain figures for England, the United States, Sweden, Canada, Belgium and Japan. Besides the remaining gold-bloc countries France, Netherlands and Switzerland, the figures for both Germany and Italy are listed. However, in the text the authors questioned to which extent these countries could still be considered to be on the gold standard (Böhler and Keller 1935, 44).

¹⁴When discussing the unemployment figures, Böhler and Keller (1935, 47) pointed out that despite the reversal of unemployment trends in the countries that had devalued, unemployment rates in Switzerland in March 1935 were still lower than in any of the countries discussed.

¹⁵ The only positive effect of devaluations, Böhler and Keller (1935, 53) saw, was the relative increase in agricultural prices.

Not surprisingly, Böhler and Keller concluded: “In general, devaluation is not the means to lead the economy out of the crisis, and in particular, devaluation is not the means to increase international trade in the long run.” (Generell ist die Abwertung kein Mittel, um die Wirtschaft aus der Krise zu lösen, und insbesondere auch kein Mittel, um den weltwirtschaftlichen Verkehr auf die Dauer zu steigern. Böhler and Keller 1935, 53). This conclusion was reiterated in the later parts of the book in the context of the discussion of the authors’ specific policy proposals for Switzerland. However, the authors did concede the advantages of devaluation as an instrument of adjusting the Swiss price and wage levels to world market conditions (Böhler and Keller 1935, 156-7). Böhler and Keller contended that both sides to the debate, proponents as much as opponents of devaluation, exaggerated in their claims of disadvantages and benefits. Nonetheless, devaluation could only be justified in a context of a restabilization of the international monetary system and a dismantling of trade barriers. Furthermore, it would by no means make further adjustment on the national level unnecessary. As competitive conditions would be restored, Switzerland would be submitted to its pressures. Although Böhler and Keller took a clear position of adherence to the gold parity, they still provided a scenario under which devaluation appeared as an acceptable policy option. We will reencounter their argument in the Federal Government’s justification for the devaluation decision (p. 216, below).

The export industry’s position on devaluation: some comments

Due to the devaluations in the early 1930s, the severe overvaluation of the Swiss franc had repercussions on export and tourism industries. They aggravated the negative demand shock on these sectors, which had been the first to suffer from the effects of the world economic crisis. The question arises why the professional organizations representing these sectors did not consider devaluation in their best interest and why they did not lobby for the corresponding policy. This puzzle has since received considerable attention by Swiss economists.¹⁶ Most recently, Philipp

¹⁶As argued in the introduction, the banking sector’s position on the adherence to gold has also been the subject of analyses interpreting Switzerland’s belated devaluation as a result of policy guided by economic interests. Baumann and Halbeisen (1999) present the argument and evidence to refute Arlettaz’s (1982) claim of a primacy of financial interest as an explanation for Switzerland’s gold policies. Perrenoud et al. (2001, 58-65) add to their case. They show that the banks’ precautions in anticipation of devaluation had led to conflicts with the Swiss National Bank as early as May 1933. The commercial banks’ gold purchases had repeatedly provoked the central bank’s scorn. Furthermore, the fact that the banking sector, and particular the large banks, benefitted from the devaluation provides evidence for their being prepared for the event.

Müller (2001) contributed to the debate in an analysis of the Swiss policy decisions during the depression. He traces the development of the monetary policy debate through several phases, focusing on the strategies of the Federal Council, the Swiss National Bank and the major economic organizations. He then analyzes the political economy of their respective policy positions. The export industry as special interest representation receives particular attention.

Müller's starting point is Sébastien Guex's arguments on why export industry representatives did not advocate abandoning the gold standard. Guex (2001) presents several arguments, which are relevant to the purported interests of the export industries. The large degree of specialization of the main exporters had caused competition over prices to be replaced by competition based on quality. Furthermore, an increasing share of exports was channeled outside of markets as they took place within clearing arrangements and compensation trade. Under these circumstances exporters did not expect devaluation to improve their position in world markets.

Margrit Müller's (2002) research on internationalization strategies of Swiss firms in the interwar period provides evidence along similar lines. She argues that export-oriented firms reacted to the disintegration of world markets by adjusting to the circumstances rather than by attempts to influence public policies. In case studies she shows how firms tried to overcome the difficulties generated by trade barriers and devaluations through price agreements with the competition, through licensing arrangements and foreign direct investment. Müller (2002, 249) concludes that "...from the perspective of the firms there were sound economic reasons for the little interest taken in devaluation. It increased uncertainty with regard to sales in the clearing countries and export subsidies were canceled; it was expected to raise import prices for raw material and intermediary products and put a strong pressure on wages. Further more, cartel agreements or sales policies adopted before the devaluation restricted the possibility to lower the prices for exports to foreign countries." Although she is keen to explain the export industries' "little interest ... in devaluation" by their economic interests, she also points out that "devaluation was strictly rejected"¹⁷ and that "the rapid increase [of exports, EA] after the devaluation came as a surprise" (Müller 2002, 249). On the background of my analysis, these comments can be taken as an indication that decision

¹⁷This is reinforced in comments on the attitudes of top executives and members of the board (Müller 2002, 254, endnote 86).

makers in the export industries, just like the majority of participants in the political debate in Switzerland, conservative and progressive alike, were not aware of the possibility that devaluation could bring about overall improvement. In other words, the conceptual framework of the actors limited the perception of their own economic interests.¹⁸

Philipp Müller (2001), as mentioned above, sets out to explain the export industries' rejection of devaluation based on their political interests. He argues that the political dimension of the monetary policy debate in the early 1930s is essential (Müller 2001, 9). The symbolic value of the Swiss franc as a gold currency propagated by the ruling circles served their interests in their fight against the left. More precisely, the demand for a reduction of wages was an attempt to revert the gains made by the labor movement after World War I.¹⁹ In this interpretation, the defense of the gold parity is nothing more than a pretext to utilize the crisis in the interest of capital owners (Müller 2001, 10).

In line with the approach pursued in this study, some light might be shed on the debate by examining the conceptual framework of the actors. Did industry representatives perceive devaluation as a policy choice which could render, in any way, beneficial effects? The protocols of the regular meetings of the industry organization Vorort des Schweizerischen Industrie- und Handelsvereins (the precursor of today's *economiesuisse*) give some insight into the thinking of leading figures in this interest group, which also represented major exporters.²⁰ According to meeting records, devaluation was briefly discussed in early 1934, then completely disappeared

¹⁸Another example for this point is the argument about the effect of devaluation on production cost. Both Margrit Müller (2002) and Guex (2001) point out that export industry representatives presumed that inflation would follow devaluation. This leads beyond manifest economic interests into the sphere of decision makers' expectations. These, however, reflect an implicit economic model. The conceptual framework thus shapes expectations (in this case concerning the development of production costs) and determines what actors perceive as their economic interest.

¹⁹This interpretation echoes the arguments made by left-wing and communist members of parliament in the debates over adjustment policies.

²⁰I would like to thank Tobias Straumann for giving me access to the archival sources he has collected from the Archiv für Zeitgeschichte, Zurich, and for his comments and discussion.

from the agenda and returned as a recurring topic in the meetings in the first half of 1936.²¹ These debates were never mentioned in the Vorort's public pronouncements.²² The organization deliberately remained a staunch proponent of price and wage adjustment as will be seen below.²³

In the context of a discussion of export subsidies in January 1934 Albert Pictet, representative of a private bank, suggested that the organization should internally examine "the question of the Swiss franc" (la question du franc. *Protokoll*. January 12, 1934).²⁴ He argued that the measures pursued so far were only palliatives, which were not sufficient to stop the economic decline. By taking the form of government interventions, crisis policies moved the economy forward on a path to socialism. A devaluation would, among other things, bring about a reversal of this trend. He thus implied, although he did not make this explicit, that a devaluation would help overcome the crisis and make interventionist policies superfluous. His suggestion to scrutinize the position on devaluation was not taken up. Several speakers rejected the view that lower exchange rates could contribute to a solution of the problems of the economy.²⁵ On this and on later occasions the arguments brought forward against changing the parity were the ones used across the political spectrum by proponents of the gold standard: devaluation would lead to a catastrophe, to the ruin of the middle classes. The breaking of contracts implied by a debasing of the currency would damage Switzerland's reputation. Moreover, devaluation was an "adventure" with uncertain

²¹For a review of the organization's debates on devaluation preceding this period see Müller (2001, 98-100 and 157-9).

²²In the following I will abbreviate the name of the organization to Vorort, the title under which it was usually referred to.

²³This is not to deny that individual exporters were unambiguously in favor of devaluation. E.g. *Schweizerische Handelszeitung* reported in the fall of 1935 that a survey of owners and managers in the export industries had revealed widespread support for devaluation. Bebié (1939, 142-4) also reports that increasing numbers of representatives of tourism came forward with positive statements on devaluation.

²⁴By this time the government's immediate crisis measures were implemented. The first financial program had just been passed by parliament and the debate on the crisis initiative had not yet started. No pressing policy issues were on the table. For the time being, the government's approach to the crisis was defined and put into action. Hence, it might have seemed a good time for a more fundamental debate of policy options.

²⁵Bebié (1939, 137-8) cites further examples of industry organizations' and individual industry representatives' rejection of devaluation.

outcome, as the government could start a depreciation by abandoning gold, but had no means to stop it. Furthermore, inflation would be unavoidable because of the importance of imported raw materials and foodstuffs for the Swiss economy. The resulting struggle over wage increases would lead to social unrest. As a result of inflation all assets would decline in value, so large and small savers alike would lose.

Within Vorort it was argued that Switzerland would eventually be forced to devalue the currency if adjustment failed. In this case the outlined disastrous consequences of devaluation would have to be faced. This was a recurrent argument brought forward by proponents of adjustment in public debates, an argument which played an important role in the campaign over the crisis initiative as argued above (p. 139). In sum, the voice of Pictet demanding a rethinking on the issue of devaluation was lost in a flood of repetitions of familiar arguments. The position of the organization remained firmly rooted in the conviction that price and wage reductions were the adequate response to the disruptions in the world economy.²⁶ If adjustment along this line was not achieved, devaluation would be inevitable. It is noteworthy that Pictet, in his January 1934 position, did not argue that devaluation would reduce the competitive disadvantage of Swiss producers in world markets. The advantage of devaluation as opposed to a continuation of the current regime was seen in making superfluous government intervention through export subsidies and other measures. The economy would be freed from some of its burgeoning “socialist” chains.²⁷

²⁶Not only prices and wages but capital values as well needed to be corrected downward. This adjustment was not forthcoming to the extent considered necessary and resistance was deemed particularly strong (*Protokoll*. February 14 and April 24, 1936). Adjustment of capital values was, of course, not an openly debated issue. In public, the proponents of deflationary policies from the ranks of the export industries addressed workers or their representatives in the unions and demanded wage reductions. In contrast, the correction of capital values concerned the proponents themselves, they would have been entrepreneurs' contribution to overall adjustment.

²⁷State socialism was also one of the topics that Hans Sulzer, new president of Vorort, raised in a contribution on the situation of the export industries to *Zeitschrift für schweizerische Statistik und Volkswirtschaft* in 1935. In Sulzer's argument in favor of adjustment increasing government intervention was a recurring topic. Devaluation was only briefly mentioned in the article and as usual rejected referring to the losses in foreign assets and to large damages for the Swiss economy.

It took two years for the issue of devaluation to be raised again. Under the heading “monetary issues” in the Vorort meetings of February 1936. Carl Köchlin, representative of the chemical industries, called on members of the organization to take a clear position on the issue (*Protokoll*. February 14, 1936). The earlier preconceived positions presented above were critically discussed and qualified on this occasion. Whereas the majority of the speakers confirmed their rejection of devaluation, Albert Pictet, who had raised the issue in 1934, again pointed to advantages of devaluation. He argued that the sacrifices to maintain the Swiss franc’s parity were large and hardly forthcoming. Therefore, as soon as favorable circumstances to realign the value of the currency presented themselves, the opportunity should be seized. A general restabilization of world currencies was identified as such an opportunity, though Pictet did not expect it to arise any time soon.

Hans Sulzer of the large multinational machinery producer in Winterthur (since 1935 president of Vorort) contributed a long statement where he questioned some of the traditional arguments against devaluation. In particular, he pointed out that in several countries devaluation had not been followed by a proportional increase in domestic prices. He rejected as irrelevant the claim that devaluation was in effect a breaking of contracts after most of the world had taken this step. However, devaluation continued to be presented in a negative light as the inevitable consequence of failing to adjust domestic price and wage levels outside the export industries. The increased taxation to finance export subsidies - an “indirect” way of adjustment as opposed to the direct path of price and wage reduction - led to economic planning and socialism. Because devaluation would be forced onto Switzerland one way or the other, Vorort should not come forward as proponent of devaluation. Such a statement would be “inappropriate and dangerous” (inopportun und gefährlich). Instead, the organization should continue to demand price and wage adjustment as the “sane” path of adjusting to the world economy and not pronounce any opinion on the currency issue. Nonetheless, the speaker clearly stated that he had lost confidence that adjustment could be achieved. (Ich habe allerdings jede Hoffnung auf einen wirksamen Abbau verloren. *Protokoll*. February 14, 1936).

In the following weeks and months this view took hold of the organization. When the Federal Council’s proposal on economic emergency measures (p. 202 below) was discussed in a meeting on April 24, 1936, several speakers expressed their disappointment with the government’s

communication. Above all, the lack of decisive action on price and wage adjustment was lamented. Hans Sulzer expressed surprise, that the Federal Council, in contrast to the past categorical rejection, presented devaluation as an “exit option” (Ausweg). For Sulzer this was a sign that the government no longer believed in the possibility of adjustment through price and wage reductions. He repeated the argument, also found in the government’s communication (p. 206 below), that devaluation would not supersede the downward correction of living standards. Furthermore, he again pointed to the uncertain consequences of devaluation.

Sulzer saw his interpretation confirmed in a subsequent meeting with Federal Councillor Obrecht to discuss the organization’s position on the government proposal (*Protokoll*. May 16, 1936). Obrecht had apparently given up on price and wage adjustments according to another speaker, he appeared to share the Vorort’s conviction that a continuation of current policies was impossible. Despite the resignation concerning the chances of implementing their favored economic policy strategy, the leaders of the industry organization decided to uphold their demand for adjustment and their warnings that a failure to implement such policies would lead to devaluation. An official statement confirming this position was issued.

Despite this public position demanding the implementation of uncompromising adjustment policies, the heads of the industry organization seem to have accepted the inevitability of devaluation. By June 1936, monetary issues were discussed solely in terms of lowering the parity of the Swiss franc.²⁸ The consequences of the event were debated, the useful extent of the devaluation and measures to prevent price increases were discussed.²⁹ Several speakers underlined that the organization should be cautious in its pronouncements on the issue. By all means, the

²⁸The recommendation to commission a study on the effects of devaluation from Professors Eugen Böhler and Paul Keller was made in this context. In a later meeting it was suggested that they be sent on a mission to Belgium for this purpose at the cost of the industry organizations (*Protokoll*. July 3, 1936).

²⁹Industry representatives were concerned about finding an alignment with the Sterling and Dollar trading areas (*Protokoll*. June 20, 1936). This consideration also provided the background to the Federal Government’s decision on the extent of the devaluation. It sheds additional light on the argument that exporters had adjusted to conditions as provided for example by clearing arrangements. Whereas trade with clearing countries declined the Dollar and Sterling export markets had begun to grow after 1933. Swiss exporters must have become increasingly interested in participating in this growth.

impression should be avoided that Vorort was supporting devaluation, otherwise it would be burdened with responsibility for its effects after the event.

This review of the debates on monetary issues in the meetings of the Vorort helps to clarify the apparent puzzle about the export industries' position on devaluation. Certainly on the background of the experiences with the Swiss devaluation in 1936, and much more so from a modern perspective, the Vorort's staunch support for the gold parity must be interpreted as contradicting the interests of the members. But as the arguments of the leaders of the organization show, devaluation was not expected to solve the problems of the export industries. Firmly rooted in the gold-standard mentality, price and wage reductions were seen as the only "sane" path to adjust to changed world market conditions. Devaluation was seen as clouded by uncertainties. This was aggravated by the conviction that living standards had to be lowered in Switzerland: inflation, following devaluation, would renew distributional conflicts as unions would fight for wage increases. Thus, devaluation alone would not lead to the necessary adjustment to world market conditions, the reduction in living standards could not be circumvented.

Despite maintaining this opinion, industry proponents increasingly realized that downward adjustment was not forthcoming and Switzerland would eventually be forced to devalue. This insight took hold of the organization in the course of the first half of 1936. It did not provoke public surrender. Quite to the contrary, the facade of the demand for adjustment policies and the opposition to devaluation was upheld. Behind the scene, though, the consequences of an adjustment of the Swiss franc's parity and necessary precautions were discussed. Therefore, the devaluation did not come unexpected or even unwelcome in these circles. The public pronouncements and the internal debates were clearly at odds.³⁰ Nonetheless, devaluation was never considered a policy option preferable to adjustment. Rather it came to be viewed as superior to the regime of export subsidies and government interventions in foreign trade which was perceived as leading straight to socialism.

³⁰From a contemporary's perspective, Bebié (1939, 146-7) suggests that a large number of those actually concerned with the currency question might have behaved similarly.

The Federal Council's position in the fall of 1935: the gold parity, balanced budgets and adjustment policies again

The elections for parliament in the fall of 1935 had not only postponed the debate on devaluation, it had also put a break on the implementation of measures to balance the budget. Resolutions on budget cuts were postponed until after the elections. In November 1935, the government's proposal for a renewal of and an amendment to the emergency fiscal program of 1933 was presented to the United Federal Assembly.³¹ Only 2 weeks earlier a proposal on "economic emergency measures" had been submitted.³² As in preceding years, the government took these proposals as an opportunity to present an assessment of Swiss economic conditions and to draw policy conclusions.

The communication on the fiscal program began with a contradictory appraisal of the state of the world economy. The conviction, first expressed in 1933 (p. 121 above), that the world economy had entered a phase of decline and was undergoing permanent changes was repeated, and the opinion, that Switzerland had to participate in these adjustments, was confirmed (Wir stehen mitten in einem weltwirtschaftlichen Schrumpfungs- und Anpassungsprozess, dem wir uns in der Schweiz nicht entziehen können. *Bundesblatt* 1935 (II), 758).³³ However, just one page further down in the proposal, it was pointed out that the world economy was slowly heading for recovery. Whereas the situation in Switzerland was still deteriorating, the government maintained that with some time lag Swiss exports of industrial and agricultural products would also begin to rise. The Federal Council added that the developments in Switzerland usually followed the world economy with some delay as had been the case at the beginning of the crisis and also in the 1920s. To be able to hold out for this recovery it was necessary to keep public finances and the currency in good order and to avert any disruptions which could originate from these sources. Maintaining

³¹Botschaft des Bundesrates an die Bundesversammlung über neue ausserordentliche Massnahmen zur Wiederherstellung des finanziellen Gleichgewichtes im Bundeshaushalt in den Jahren 1936 und 1937. (Vom 22. November 1935.) *Bundesblatt* 1935 (II), 757-904.

³²Botschaft des Bundesrates an die Bundesversammlung über die wirtschaftlichen Notmassnahmen. (Vom 12. November 1935.) *Bundesblatt* 1935 (II), 533-64.

³³The Federal Council saw proof that its economic policies could not have been as mistaken as some of the critics maintained in the fact that overall unemployment in Switzerland was lower than in "comparable countries" (vergleichbare Länder. *Bundesblatt* 1935 (II), 758).

the gold parity of the Swiss franc remained the cornerstone of the government's policies and the need to balance the budget followed (*Bundesblatt* 1935 (II), 759).

In the introduction to the fiscal program, the Federal Council commented on several issues relevant to its position on monetary and exchange rate policy. The development of domestic savings and their influence on money and capital markets was one of them. The government lamented the decline in domestic savings as a fateful consequence of the crisis, a decline which was considered larger but also more significant than the decline in consumption. The government's financing needs, the argument continued, reduced further the means available for investment. On top of this, losses in the industrial sector and in agriculture diminished overall savings. Last but not least, savings were hoarded and no longer made available on money and capital markets. All these influences added up to the effect that hardly any means were left for productive investment. The tightness of capital and money markets was thus traced back to the reduced supply and the absorption of savings by unproductive uses (*Bundesblatt* 1935 (II), 766 and 769).³⁴ Monetary conditions, such as the impact of the increase in the official rate to preserve the gold parity earlier in the year or the effects of deflation on money demand, were not mentioned. The argument reflects a classical interpretation of saving as abstention from consumption providing the real resources necessary to finance investment. Certainly this view, which was highly contested at the time, can be considered an integral part of the gold-standard mentality.³⁵

Furthermore, the communication contained comments on the "current account, the balance of payments and the currency." (Ertragsbilanz, Zahlungsbilanz und Wahrung. *Bundesblatt* 1935 (II), 775-7). The deficit in the trade balance, the break-down in tourism revenues, and the decline in returns on foreign assets were discussed as was the resulting reduction in capital exports. Based on the development in these areas during the 1920s, the fact that Switzerland had become "Europe's banker" was highlighted (der Bankier Europas. *Bundesblatt* 1935 (II), 776). This

³⁴Illiquid capital markets were also made responsible for the decline in construction since early 1935. This was seen as cause for the aggravated state of domestic production and for the significant increase in unemployment (see figures 11 and 12 in chapter 2).

³⁵Compare the debate referred to in the letters to *The Times* in October 1932, footnote 26, p. 95 above.

entailed, according to the federal government, dangers for Switzerland: depositors could, just as in the case of a commercial bank, abruptly withdraw their funds. However, the argument continued, the Swiss National Bank had prepared for this danger by accumulating gold reserves (Zum Glück hatte sie beizeiten einen gewaltigen Kassenbestand geüfnet: Der Goldvorrat der Schweizerischen Nationalbank war noch nie zuvor so gross gewesen. *Bundesblatt* 1935 (II), 776). This had enabled Switzerland to maintain the convertibility of her currency in face of the large withdrawals in 1933 and early 1935.³⁶ Domestic economic conditions (die innern, volkswirtschaftlichen Verhältnisse der Schweiz. *Bundesblatt* 1935 (II), 777) had not triggered these withdrawals, the government argued and concluded that it was crucial to strengthen federal finances so that no reasons for a loss in confidence on the side of investors could emerge.

With a reiteration of its firm support for the gold parity of the Swiss franc, the 20-page general introduction to the detailed discussion of the individual measures of the fiscal program was concluded. The Federal Council rejected devaluation against the suggestion, allegedly made repeatedly at the time, that export opportunities would increase as a result. Although the proposal confirmed that the recovery of exports was key to the revival of the economy (der Schlüssel zur Wiedergesundung unserer Volkswirtschaft. *Bundesblatt* 1935 (II), 759) it was argued that no such effect could be expected from devaluation. Instead, debasing the currency would lead to retaliation and eventually to another round of competitive devaluations, events which would only prolong the world economic crisis. Furthermore, devaluation under contemporary circumstances of stable world market prices, in contrast to the declining prices of 1931, would inevitably lead to inflation (*Bundesblatt* 1935 (II), 777). The Belgian experience, which was discussed controversially at the time, was cited as proof for this contention.

Apart from stressing the importance of a recovery of exports and rejecting the view that devaluation could initiate such a development, the government's statement on the fiscal program contained no hints on how the Federal Council expected the Swiss economy to overcome the continuing depression. The proposal on economic emergency measures, drawn up at roughly the same time, indicated that the government held on to price and wage adjustments as complements

³⁶Apart from the devaluation of the Belgian franc, the government mentioned the uncertainty generated by the campaign over the crisis initiative as reason for speculative attacks (*Bundesblatt* 1935 (II), 777).

to the policies of supporting the gold standard and balancing the federal budget. In the introduction to the suggested parliamentary decision on an across-the-board prolongation of the crisis measures decreed in the preceding years, the proposal reiterated the need for the reduction in those prices and wages that had not been lowered so far, taking up the argument of former Federal Councillor Schulthess in his infamous “Aarau speech” (p. 137 above).³⁷ It was conceded that the demand for a general price reduction had met with fervent resistance. Nonetheless, the government argued, an adjustment to the conditions of the world economy would eventually be unavoidable. Moreover, the fact that many wages had been reduced called for price reductions to accommodate the reduced budgets of households (*Bundesblatt* 1935 (II), 548). The proposal continued with a discussion of the price effects of the policy measures taken to support agriculture and other sectors of domestic production. In this context an extension of the price controls for those goods covered by import restrictions or other support through government measures and for goods produced or sold in organized sectors was proposed, taking up another proposition from the “Aarau speech.”³⁸

The concluding statement of the communication on economic emergency measures summarized the government’s general outlook after 4 years of economic decline and stagnation: “We cannot count on an impending return to the conditions of the pre-war or pre-crisis era. To the contrary, the insight has finally to be accepted that we have to rebuild on an economically weakened and narrowed basis, that each and every one has to adjust ... to the general setback of the economy, that this process ... of alteration results inevitably for us, too, from the changes in the world.” (Mit einer baldigen Wiederkehr der Verhältnisse der Vorkriegs- oder Vorkrisenzeit können wir nicht rechnen. Im Gegenteil muss endlich die Erkenntnis durchdringen, dass wir auf einer ökonomisch geschwächten und verengerten [sic] Grundlage neu aufbauen müssen, dass jeder sich dem allgemeinen Rückschlag der Wirtschaft ... anpassen muss, dass dieser Prozess ... der Umstellung sich aus der Veränderung der Welt zwangsläufig auch für uns ergibt... *Bundesblatt* 1935 (II), 560-1). Adjustment was out of the closet again, where it had been hidden for most of 1935, especially

³⁷The argument goes back to Böhler (1932) as discussed above, p. 86. It was reiterated in Böhler and Keller (1935, 157-9).

³⁸An increase in the scope of price control as envisioned in the proposal was decreed in June 1936, see fn. 24 p. 133 above.

during the debate on the crisis initiative and in the election campaign. Federal Councillor Obrecht turned out to be just as resolved a proponent of this policy as his predecessor Edmund Schulthess, who had taken the torch after Federal Councillor Musy's resignation. Obrecht had been cautious in professing this conviction in the early phases of his office in view of the impending votes.³⁹

The proposal on economic emergency measures contained a request for an authorization of the Federal Council to enact additional measures as deemed necessary to protect the economy and the country's credit.⁴⁰ This proposal met with immediate resistance as many argued that the government pursued the authorization only in order to be able to decree price and wage adjustment, by-passing parliament. With very limited prospects that parliament would decide on the proposal within a reasonable time frame, the Federal Council included a request for more narrowly defined authorities concerning the protection of the currency and the country's credit in the fiscal program of 1936.

The fiscal program including the authorization was passed by the United Federal Assembly under emergency procedures on January 31, 1936.⁴¹ Budget cuts were resumed in an effort to counteract the deterioration of public finances that had undermined the intended balancing of the budget

³⁹Considering Obrecht's career, it is not surprising to find his convictions firmly rooted in the prevailing gold-standard mentality. He had joined the liberal party as a young teacher and advanced quickly first as finance minister on the cantonal level (Solothurn) and later as parliamentarian on the cantonal and federal levels. At the age of 35 he left government services and became a successful businessman. Respected as an expert in financial and broader economic issues, he served on the board of several banks and industrial firms, among them the Schweizerische Bankverein and the Allgemeine Schweizerische Uhrenindustrie AG (ASUAG). He was thus close to the concerns of the financial and exporting sectors. His biographer points out that Obrecht's military career, namely as a member of the general staff (as Brigadier), was highly significant for his political success (Böschenstein 1991a, 395-6). *Die Nation* described these links somewhat more critical. The subscript to a caricature published in the spring of 1935 read: "The newly elected Federal Councillor Dr. Obrecht, so far member of 20 boards of directors and middleman of the international armament industry." (Der neue Bundesrat Dr. Obrecht, bis jetzt Mitglied von 20 Verwaltungsräten und Mittelsmann der internationalen Rüstungsindustrie).

⁴⁰Art. 2 in the draft of the decree on economic emergency measures (*Bundesblatt* 1935 (II), 563).

⁴¹Bundesbeschluss über neue ausserordentliche Massnahmen zur Wiederherstellung des finanziellen Gleichgewichtes im Bundeshaushalte in den Jahren 1936 und 1937. (Finanzprogramm 1936.) (Vom 31. Januar 1936.) *Eidgenössische Gesetzsammlung*, Neue Folge 52, 17-39.

already in the course of 1934. In contrast to the decision on the first fiscal program, the social democrats now solidly opposed the government's bill, which included further reductions in expenses, in particular another round of substantial cuts in wages and salaries of public employees. The opposition saw revenue increases, among them a rise in the crisis tax but also the augmentation of several consumption taxes and tariffs, as having regressive effects by the opposition. The decree authorized the Federal Council to take measures considered necessary and pressing to protect the country's credit. (Der Bundesrat ist ermächtigt, Massnahmen zu treffen, die er zur Erhaltung des Landeskredits als notwendig und unaufschiebbar erachtet. *Eidgenössische Gesetzsammlung*, Neue Folge 52, 34). This article would eventually provide the legal basis for the Federal Council's decision to devalue the Swiss franc.⁴²

The proposal on economic emergency measures mentioned above was not only sharply criticized in public but also met with resistance in the preparatory commission of the Council of States, before it was debated either in this chamber or in the National Council. This meant that the wholesale prolongation of earlier crisis measures envisioned by the government would not be granted in time. The Federal Council resorted to presenting these proposals individually to parliament, where they were passed without major changes in the following months of late 1935 and early 1936. The Federal Council's request for an authorization concerning economic policy measures deemed too urgent to be presented to parliament remained an open issue.⁴³

⁴²A first decree based on these authorities was issued in April (Bundesratsbeschluss über die Sanierung von Banken (Vom 17. April 1936.) *Eidgenössische Gesetzsammlung*, Neue Folge 52, 185). In June 1936, a prohibition under threat of penalty was introduced for acts of speculation especially for the buying and selling of gold and foreign exchange in forward contracts - i.e. hedging - in order to protect the currency and the country's credit (Bundesratsbeschluss über den Schutz der Landeswährung. (Vom 19. Juni 1936.) *Eidgenössische Gesetzsammlung*, Neue Folge 52, 485-6.). Furthermore, the spreading of false information suitable to threatening the currency or undermining the country's credit were put under threat of fines and prison.

⁴³Apart from the time-consuming process of a regular treatment of government proposals by parliament, delays resulted from parliament postponing their discussion, i.e. government proposals could be shelved for extended periods of time as the example of the government's proposal on economic emergency measures shows. When the sense of urgency differed between government and legislature, the Federal Council had no means to force parliament to deal with an issue. With delegated authorities, the Federal Council would have been able to act. The government's decrees would have been presented to parliament only after the fact.

The Federal Council's quest for delegated powers

In April 1936, the government turned to the United Federal Assembly with a renewed request for a delegation of powers.⁴⁴ The government took up the critique its earlier suggestion had provoked and attempted, in particular, to provide a more detailed justification based on a broad hearing of the large organizations of Swiss industry, commerce and agriculture and the Swiss Federation of Trade Unions. The original proposal of November 1935, while covering a much broader set of measures, had been presented on 31 pages in the *Bundesblatt*. The “supplementary” communication of April 1936 was laid out on 63 pages. Contrary to the hopes of its authors the critique seems to have grown just as much as the volume of the proposal, despite the more cautious formulation and diminished scope of the proposed decree.

The government's communication provided an overview of the statements the organizations of the Swiss economy had provided on the administration's request to deliver an assessment of the economic conditions and to present economic policy options deemed adequate (*Bundesblatt* 1935 (II), 623-31). The majority of the responses, most of them dated February 1936, supported the government's approach to crisis policies. However, the Federal Council's critics demanded measures in contradiction to the government's adjustment strategy. Just as in the preceding years an unbridgeable gap divided the demands on the government. Both large organizations of industry and trade (Vorort des Schweizerischen Handels- und Industrievereins and Schweizerischer Gewerbeverband) explicitly applauded the endeavors to balance public budgets. The demand for downward adjustment of production costs were adamantly supported by Vorort and the association of tourism (Schweizerischer Fremdenverkehrsverband, the precursor to today's Schweizer Tourismus-Verband). The position of the federation of trades (Schweizerischer Gewerbeverband) on deflation was ambiguous.⁴⁵ Even though the policy of downward price and

⁴⁴Ergänzungsbotschaft des Bundesrates an die Bundesversammlung über die wirtschaftlichen Notmassnahmen. (Vom 7. April 1936.) *Bundesblatt* 1936 (I), 617-80.

⁴⁵The president of the organization, August Schirmer, had opposed deflationary policies from the beginning arguing that devaluation should be considered an alternative path of adjustment already in early 1934 (Müller 2001, 100). He sought options which could replace the economic policies pursued by the Federal Council and got in touch with the progressive parts of the farmers' organization and moderate trade unionists for this reason (Müller 2001, 122). However, the prospect of a joint policy proposal disappeared in the spring of 1934 (Müller 2001, 125. See also above fn. 13, p. 125).

wage reductions was not altogether rejected, it was claimed that within-sector adjustments were already far advanced. Further price reductions would only be feasible if costs declined.⁴⁶ A demand for an increase in the support for the export industries united all three furthermore with the trade unions (Schweizerischer Gewerkschaftsbund) and the farmers' organization (Schweizerischer Bauernverband). Demands for alternatives to the government's approach to crisis policies came from the trade unions and the farmers. Price and wage adjustments were rejected, a position both organizations had taken early on in the debate. Instead, expansionary measures through credit-financed government spending and expansionary credit policies were demanded.⁴⁷ None of the organizations included in the government hearing explicitly demanded devaluation. On the surface, the unanimous support for the gold standard policy had remained intact and the differences between the large economic organizations concerning other areas of economic policies were similarly unchanged.⁴⁸

The communication, prepared in Obrecht's Federal Department of Economic Affairs, aimed at rejecting the opposition's demands for decisive action in support of domestic markets. To this end, a peculiarly erratic argument was developed where agricultural production and exports were portrayed as the original sources of Switzerland's wealth, whereas the domestic sectors were depicted as basically unproductive and only drawing on these riches (*Bundesblatt* 1935 (II), 631-3).⁴⁹ As exports had declined, the basis for industrial and service production directed at domestic

⁴⁶Wages, rents, taxes, transportation fees of the railway services and other public utilities were explicitly mentioned. The implicit critique that the government expected price adjustments from the private sector but did not reduce the prices of services produced by government-owned companies was frequently made by trade and industry representatives.

⁴⁷The representatives of import and wholesale trade not surprisingly focused on criticizing the government's trade policies and advocated a return to a liberal trade regime (*Bundesblatt*, 1936 (I), 629-31).

⁴⁸We have seen that Max Weber, economist at the Swiss Federation of Trade Unions had become an outspoken advocate of this policy option. Even though his views were spread by the union press, a unified position in favor of devaluation had not emerged. The Vorort which had arrived at a more open-minded stance on devaluation in internal debates, adhered to its previous rejection of an adjustment of the gold parity in public as outlined above p. 190-195.

⁴⁹Whereas earlier statements of the government could be traced back to popular versions of classical beliefs, this perspective can only be interpreted as a combination of physiocratic and mercantilistic views. But possibly it is best to abstain from an attempt at finding sources in the

markets had been reduced. Promotion of agriculture, which was also genuinely productive, would replace some of the losses. Even so, there were limits to the increase in activities aimed at domestic markets, especially since these had already been extended disproportionately in the after-war years. On the background of the influence of powerful unions wages had been raised leading to improvements in living conditions. However, the Federal Council was convinced that these living standards could not be upheld permanently (Wir halten das gegenwärtige Niveau der Lebenshaltung nicht für dauernd tragbar. *Bundesblatt* 1935 (II), 635). Therefore, the argument continued, the production facilities that had been built up on the expectation of continued growth far exceeded the extent of domestic markets. The proposal suggested that output capacity would suffice to provide for a population of 7-8 rather than the 4 million people living in Switzerland at the time (*Bundesblatt* 1935 (II), 636) thus indicating a tremendous over-capitalization of the economy. The argument continued that this situation was aggravated by the over-indebtedness of the entire economy. The need for restructuring liabilities added to the challenges of adjusting production capacities to actual needs.

The government expressed the belief that a return to the pre-war order of international economic relations could no longer be expected. Now the altered nature of the economic system was seen as permanent and entailing not only protection and the strive for autarky but also changes in domestic institutions: the increased power of government over the economy would remain a preeminent feature (Die beiden angeführten Wesenszüge der neuen Wirtschaft: Nationalisierung des Wirtschaftslebens (Abschluss und Streben nach möglicher Selbstversorgung) und wachsende Macht des Staates über die Wirtschaft müssen als dauernd und bestimmend betrachtet werden. *Bundesblatt* 1935 (II), 645-6). The proposal concluded that Switzerland could be no exception to these developments. Therefore the demands for a reduction of government intervention, which had risen with every measure decreed in the course of the crisis, were rejected. Instead, it was

history of economic ideas. For some opinions expressed by politicians no “defunct economist” can be made responsible. *Die Nation* called the report “an inorganic conglomerate, that is made up of the work of a secretary, a Federal Councillor, a liberal professor (Prof. Keller) and an outspoken opponent of liberalism (Prof. Lorenz), a pieced together monster, which is full of contradictions...” (Sie ist ein anorganisches Konglomerat, das sich aus den Arbeiten einer Sekretärin, eines Bundesrates, eines liberalen Professors (Prof. Keller) und eines dezidierten Gegners des Liberalismus (Prof. Lorenz), zusammensetzt, ein zusammengestoppeltes Monstrum, in dem es von Widersprüchen wimmelt ... *Die Nation* June 11, 1936).

argued, cooperation between the private sector and the government were pivotal to well-being and prosperity (*Bundesblatt* 1935 (II), 652).

On the background of this general assessment and expectations for future developments, the proposal proceeded to justify the government's demand for a delegation of powers for cases of economic emergency by giving general guidelines concerning the policy fields where such emergency measures could become necessary. In line with the argument in the proposal's introduction, where support for domestic markets had been rejected and exports had been depicted as a source of wealth, the discussion over means to improve export possibilities made up the larger part of the argument. However, the government did not come forward with new proposals. It reconfirmed its previous approach to the support of the export industries and rejected the demands for general export subsidies oriented at the price-level differences between Switzerland and her trading partners. Such subsidies would amount to a gift to the trading partners, they would help to consolidate the price differences and last not least, funds to finance such subsidies could not be raised without serious repercussions on the confidence in the Swiss franc and the country's credit. Again, adjustment was presented as the only way out of these dilemmas. "Differential adaptation" (differentielle Anpassung. *Bundesblatt* 1935 (II), 664) was necessary. Prices and wages that had remained at their pre-crisis levels would have to come down. Apart from the reduction in production costs, which would provide for a recovery of exports, this was also called for out of considerations of justice.

The proposal went to great lengths to make sure this suggestion would not be confounded with much-dreaded deflation. Deflation was defined as the "sudden and forcible" reduction of wages and prices by government decree, "as it has taken place in countries, where the government holds unrestricted powers. This path is out of the question for Switzerland according to the Federal Council's conviction." (... Deflation: die durch behördliche Vorschriften gewaltsam und plötzlich durchgeführte Senkung der Löhne und Preise, wie es in Staaten geschehen ist, in denen die Regierung unbeschränkte Machtbefugnisse in Händen hat. Dieser Weg kann nach Dafürhalten des Bundesrates für die Schweiz nicht in Frage kommen. *Bundesblatt* 1935 (II), 663). Thus, by redefining the meaning of deflation, the proposal attempted to overcome - at least rhetorically - the resistance to this policy path, which not only prevailed in the social democratic opposition but also in large parts of the government coalition parties.

Devaluation, it was argued, would not preclude the necessary downward adjustment so elaborately presented in the government's communication (*Bundesblatt* 1935 (II), 667-70). The price increases on imported goods would reduce real wages and therefore lead to the same effect as nominal wage reductions at gold parity. Devaluation, according to the proposal's logic, eventually had deflationary effects. Moreover, these effects would exacerbate the injustice incurred by those who had already made sacrifices by accepting downward price and wage adjustment. Most importantly, however, the devaluation could not avert the downward adjustment of overall living standards.

The loss in the value of foreign assets would aggravate the decline in wealth the crisis had already brought about. Moreover, the confidence in Switzerland's capital markets would be undermined, which would lead to further tightening and interest rate increases. All in all, the proposal reconfirmed that "[w]e consider the devaluation a cowardly solution to affairs which would require other decisions and insights. The Federal Council is convinced that the majority of the Swiss people share the judgement that the imitation of ill examples would not conform to the nature of the Swiss nor be in his best interest. The Swiss can maintain his Swiss franc, if he remains faithful to it... The Swiss does not give up his Swiss franc unless he is forced from the outside (Wir halten die Abwertung für den wenig mutvollen Ausweg aus einer Lage, die andere Entschlüsse und Einsichten erfordern würde. Der Bundesrat ist der Überzeugung, dass die grosse Mehrheit des Schweizervolkes mit ihm den Standpunkt vertritt, dass diese Nachahmung ungueter Beispiele dem Wesen des Schweizers, aber auch seinen Interessen nicht entsprechen würde. Der Schweizer kann seinen Schweizerfranken halten, wenn er treu zu ihm steht... Der Schweizer gibt seinen Schweizerfranken nicht preis, wenn er nicht von aussen her dazu gezwungen wird. *Bundesblatt* 1935 (II), 669). This emotional appeal made any further discussion of the issue unnecessary and tied over to the government's request for the delegation of authorities to take economic emergency measures.

The parliamentary economic policy debate on the eve of the devaluation

After the Council of States had debated the government's April 1936 proposal on economic emergency measures in the parliamentary spring session, the National Council took it up only in September. The discussion turned into a debate over the government's economic policies, the first debate of such general scope since the controversies over the crisis initiative, as one contributor

pointed out. It took place in the week before the Federal Council's devaluation decision on September 26, 1936. Individual opinions and the political atmosphere at this point in time are conveyed in the parliamentary debate and the contributions of Federal Councillor Obrecht, the head of the Federal Department of Economic Affairs.

The debate was opened, as usual, by contributions of one member of the preparatory commission who supported the government's proposal and by one opponent. The supporting vote underlined that the authorities requested were narrowly circumscribed and that the decisions made under the authorities were only provisional and needed the consent of parliament, thus preserving democratic rights. Furthermore, the government's economic policy guidelines were supported, especially the need for differential adaptation as opposed to deflation was underlined and the adherence to the gold standard was seen as ever more important in a world where the breaking of contracts had become pervasive. Last but not least, the Federal Council's opinion on the permanency of government's increased role in the economy was upheld. The speaker concluded that the request for a delegation of powers would allow the government to actually fill this role.

Not surprisingly, the opposition to the government's request was fervent. An undermining of democracy was conjured as even the amended proposal was vague as to what the authorities would be used for. The speaker concluded that the Federal Council demanded powers to be in a position to finally implement the adjustment policies it had pursued all along, policies which had to a large extent been defeated by the resistance from parliament (*Stenographisches Bulletin* 1936, 1161). However, the continuation of adjustment would lead straight to devaluation, in contrast to the choice between adjustment and devaluation presented by the government. The social democratic speaker rejected devaluation: the costs of this option would, in the end, be levied on the workers. The categorical rejection of devaluation was shared by most speakers across the political spectrum. Nonetheless, the government's adjustment strategy was also rejected by many. Several speakers referred to a "third way," beyond deflation and devaluation. They alluded to a flood of proposals that had been published in the preceding months seeking ways out of the policy dilemma presented by adjustment vs. devaluation (Bebié 1939, 196-9). The proposals for across-the-board export subsidies to make up for the differences between Swiss and world market prices were considered even more promising. By creating conditions which would allow the export industries to compete, they seemed to go straight to the roots of the Swiss depression. Gottlieb

Duttweiler, the founder and head of the successful retailing cooperative “Migros” and independent member of parliament, had advanced this idea. He suggested to submit imported goods to tariffs so as to bring up their prices to the domestic price level and use the proceeds for subsidizing exports. The price-level differences with the rest of the world would thus be neutralized at the borders of Switzerland.

Federal Councillor Obrecht, whose Department of Economic Affairs had prepared the communication on economic emergency measures, defended the government’s position in parliament. Obrecht argued that “the prevalent confidence crisis in the area of money” (epidemische Vertrauenskrise auf dem Gebiete des Geldes. *Stenographisches Bulletin* 1936, 1194) could only be overcome by sound public finances and the adherence to the gold standard. The problems of the export industries called for differential adaptation, thus Obrecht reiterated the argument of the communication and reinforced it with wage rate comparisons with other exporting countries.

Concluding remarks: policy positions on devaluation

Comparing the parliamentary debate on economic policy principles on the eve of the devaluation in September 1936 with the one in spring 1932, analyzed in detail above (p. 69) it is striking how little had changed in the more than four years of crisis. With some variation, the same arguments were brought forth. The demand for adjustment from the Federal Council was now more cautiously framed, the resistance to this policy had, however, hardly changed. The opposition had become much less emotional, in part because the government’s rhetoric had not resulted in decisive action as objections even within the coalition parties were grave. Instead, a patchwork of support measures had emerged out of the attempt to mitigate the worst effects of the crisis. Like other speakers, Federal Councillor Obrecht expressed his disappointment that the debate had only brought a reiteration of long determined positions. Undeniably, a political deadlock had developed over the years. The government as much as the opposition, seems to have sought ways out of this standstill. Speakers from all parts of the political spectrum underlined the need for cooperation across party lines.

Whereas the arguments in favor and against downward adjustment still dominated the debate, devaluation was discussed at length. This had not been a topic at all in the debates in 1932. Without any doubt, the clear majority of the members of the National Council still firmly rejected changing the parity, not a single speaker openly advocated devaluation. However, contributors seem to have felt impelled to take up the issue, to reaffirm each other and to counter the voices demanding devaluation outside of parliament that had grown somewhat stronger. Obviously, the adherence to the gold parity was no longer taken as self-evident in the same way as in the debates a few years earlier.

As was argued in earlier sections of this chapter, the weekly journal *Die Nation* had taken a leading role in propagating positive aspects of devaluation beginning in the fall of 1935. On the other hand, we have seen that the leaders of the industry organization Vorort became convinced in the course of the first half of 1936 that devaluation had become inevitable and started preparing for the event. This was not a result of changed convictions concerning adequate economic policies but rather a resignation to the fact that price and wage adjustment policies could not be implemented. Most likely, Federal Councillor Obrecht had reached similar conclusions. The political stalemate, which the government tried in vain to overcome by requesting a delegation of powers from parliament, had undermined the hopes for an eventual success of adjustment. There are parallels between these transformations of opinions and Max Weber's conversion to an advocate of devaluation. After the parliamentary elections in the fall of 1935 had basically confirmed the division of power Weber saw no further chances for finding a majority in support of the expansionary policies he considered necessary to overcome the crisis.⁵⁰ To him, devaluation offered a way out of the deflation that paralyzed domestic production. His hopes for recovery based on devaluation alone were cautious though. Max Weber did not convince the social democratic party leaders with his arguments. They remained steadfast in their support for the gold parity.

⁵⁰When *Die Nation* (August 20, 1936) surveyed the opinions of 18 fairly well-known politicians and academics in August 1936, the voices of those opposing devaluation clearly dominated. Even among the critics of the government's deflationary approach devaluation was seen only as the smaller of two evils by most, whereas expansionary policies were depicted as an alternative superior to both devaluation and deflation.

However, on both sides of the political spectrum tactical consideration also played their part in the public adherence to gold.⁵¹ Even after the respective opinion leaders had become convinced that devaluation was inevitable, they kept silent on the issue. Nobody wanted to burden himself with the responsibility for the negative effects expected from devaluation. Furthermore, both sides had argued in earlier phases of the debate that if their policy prescriptions were not followed, the parity of the Swiss franc could not be upheld. Supporting devaluation now, it was argued, would have been interpreted as a reversal of original positions and played into the hands of the political opponent. In conclusion, it seems likely that by the fall of 1936 a large number of opinion leaders had become convinced that devaluation was inevitable. Still, few seemed to have been prepared for the swift decision of the Federal Council to follow France in devaluing the currency on the last weekend of September.

⁵¹Müller (2001, 192) shows this for the Social Democratic Party. Above, it has been pointed out for proponents of adjustment with the example of the industry organization.

8. Gold-standard continuity despite devaluation

The Federal Council came to the devaluation decision only reluctantly and against the recommendations of the Swiss National Bank and its own president. However, once the decree was passed, the government was anxious to downplay its importance. The reduction in the par-value of the Swiss franc was interpreted as Switzerland's contribution to the reestablishment of orderly international monetary relations on the background of the Tripartite Agreement. Thus continuity, rather than change, was insinuated. The French devaluation had offered the pretext to take a step the necessity of which had become accepted by many. Just as importantly, it presented a way out of the political stalemate that had paralyzed economic policies at least since the rejection of the crisis initiative. The gold-standard mentality was not discarded. Even the large-scale credit-financed public spending programs passed in 1938 are no indication for such a change in beliefs. The exceptional circumstances of rearmament in the neighboring countries and the increasing threat of German warfare presented a contingency that allowed for a departure from the strict adherence to the prescriptions of the orthodoxy. The gold-standard mentality survived the depression intact.

The devaluation decision

The decision to devalue the Swiss franc was taken on Saturday, September 26, 1936. The events leading up to it had happened in a rush.¹ Late on Thursday night (September 24) the French Minister of Economic Affairs Charles Spinasse had arrived in Berne and informed the Swiss government about the French devaluation decision. The president of the Swiss Confederation, Albert Meyer (also head of the Department of Finance), the president of the Swiss National Bank, Gottlieb Bachmann, and a high official of the Department of Foreign Affairs were present at this meeting. Spinasse explained that the French government envisioned lowering the value of the currency by 30 percent and that the step would be taken in agreement with the British and the United States' governments. He inquired whether Switzerland would participate in the

¹The succession of events follows from the documents reprinted in *Diplomatische Dokumente der Schweiz 1848-1945* (1989, 861-8), which mainly consist of summary protocols of the meetings of the Federal Council in the days around the weekend of September 26, 1936. Müller (2001 200-2) provides additional details on the debates of these days from his archival research.

devaluation, referring to the Netherlands from where he had “good news” (gute Nachrichten. *Diplomatische Dokumente* 1989, 863). On the following evening of September 25 the French government made its decision public, on September 26 the Tripartite Agreement between France, Great Britain and the United States was published.

On Saturday, the day following the publication of the French devaluation, the Swiss government still struggled over a decision.² Bachmann intermittently took part in the meetings of the Federal Council. He reported that all the directors of the National Bank opposed a devaluation and explained that the French decision in no way called for Switzerland’s following suit since the Bank’s reserves were solid, the Swiss banking system was stable and the federal budget in no immediate danger.³ Furthermore, in contradiction to the information received from the French, he maintained that the Netherlands would not reduce the parity of the Guilder. Therefore Bachmann pleaded with the Federal Council to abstain from devaluation and instead resort to temporary measures like closing the stock exchange and restricting gold exports.

Meyer, the president of the Federal Council, shared Bachmann’s assessment. However, he failed to convince the Council. Only Johannes Baumann, the Head of the Department of Home Affairs, backed him, the other five Councillors argued in favor of devaluation. Whereas Meyer repeated the conviction that a devaluation would result in unforeseeable damage to the Swiss economy, would undermine the confidence in the government and destroy savings, he could not persuade them. They argued that the decision could not be based on technical considerations alone, such

²On Friday, September 25, the Federal Council met in the morning and evening to debate the issue. The directors of the Swiss National Bank also met during the day, in the evening Bachmann returned to Berne (Müller 2001, 198-9).

³The gold coverage of the currency far exceeded the statutory requirement of 40 percent all through the crisis as can be seen from the table below. Even in its annual report for 1936 the Swiss National Bank felt compelled to confirm that the gold parity could have been defended after a French devaluation (*Geschäftsbericht* 1936, 18).

Gold coverage of currency in circulation in percent, year averages. (Source: Schweizerische Nationalbank 1956, table 13, p. 380)

1929	1930	1931	1932	1933	1934	1935	1936	1937	1938
59.2	67.9	102.1	168.8	147.2	132.5	113.6	130.6	191.5	183.2

as the sufficiency of currency reserves to withstand speculation against the Swiss franc. Concerns of the entire economy, they claimed, should be at the center of attention. The French devaluation would increase the difference between Swiss and world market prices and would further reduce export opportunities. On the other hand, a devaluation of the Swiss together with the French franc would provide an opportunity to adjust to world market conditions, an opportunity which should not be allowed to pass (...nun sei es höchste Zeit für die Schweiz, den Anschluss an die Weltwirtschaft nicht zu verpassen und ebenfalls mitzumachen. *Diplomatische Dokumente* 1989, 864). The majority of the Councillors therefore concluded that, as devaluation had become inevitable, it should be taken in a situation where its effects seemed manageable and damages would not be exceeding.

Eventually, the decision to devalue was taken by majority vote in the Federal Council against the recommendations of the experts namely Meyer, the head of the Department of Finance, and Bachmann, the president of the Swiss National Bank (*Diplomatische Dokumente* 1989, 865). After the explicit plea to help implement the Federal Council's decision, Bachmann and Meyer expressed their willingness to remain in office and to do their duties as best they could. It was Meyer's task as president of the Federal Council to communicate the devaluation decision. A press release was passed in the Saturday meeting and published by two o'clock in the afternoon, stating the devaluation by circa 30 percent and informing the public that stock exchanges would remain closed on Monday and Tuesday of the following week.⁴ The Council agreed that Meyer would explain the devaluation decision to the public in a short radio-broadcasted speech on Sunday (*Diplomatische Dokumente* 1989, 865-6).

⁴Bebić (1939, 209-10) reproduced the text of the press release: "Nach Kenntnisnahme des Beschlusses der französischen Regierung, den französischen Franken um 30 % abzuwerten, hält der Bundesrat dafür, dass das Interesse der nationalen Wirtschaft auch die Schweiz zwingt, ihre Valuta den führenden Weltvaluten anzunähern. Er wird am Montag den eidg. Räten seinen Bericht unterbreiten. Die Börsen werden an diesem Tage, sowie am Dienstag geschlossen sein."

On Sunday afternoon the Federal Council met again to discuss the details of devaluation and the necessary legal measures. Two decrees were passed as “decision of the Federal Council” (Bundesratsbeschluss).⁵ The decree on the currency measures absolved the Swiss National Bank from the obligation to convert notes into gold. At the same time, the Bank was instructed to keep the value of the Swiss franc within a band defined in terms of gold values so that on average a devaluation of 30 percent was implemented.⁶ The decree on “extraordinary measures concerning the living costs” provided the Federal Department of Economic Affairs with broad authorities to take steps aimed at preventing inflation at the threat of penalty.⁷

On Monday morning, September 28, the Federal Council discussed and passed the report to parliament on these measures. The rest of the day was filled with meetings with the heads of the parliamentary parties, with the presidents and vice-presidents of both chambers of parliament, and with the respective finance commissions. The Council of States had been called in to hold an extraordinary meeting on Monday evening, on Tuesday morning the National Council would treat the Federal Council’s report. An issue that caused some controversy in the run-up and much more so in the actual parliamentary debates was the government’s aim to ask parliament for “approving attention” (zustimmende Kenntnisnahme) rather than simply for “attention” (Kenntnisnahme) of the Council’s devaluation decision. The majority of the Councillors considered an expression of parliamentary approval pivotal to back the authority of the government in this critical moment. If parliament remained indifferent or silently opposed to the decision a successful implementation of the devaluation would be impeded. As the adjustment in the value of the currency had far-

⁵Furthermore, an order with technical guidelines was issued instructing the National Bank to transfer the devaluation gains on the gold reserve to a exchange equalization fund (Währungsausgleichsfonds) to provide for currency interventions. By preventing the devaluation gain from being included in the monetary base the expansionary effect of the devaluation was reduced (Weber 1983, 91).

⁶Bundesratsbeschluss betreffend Währungsmassnahmen. (Vom 27. September 1936.) *Eidgenössische Gesetzsammlung*, Neue Folge (52), 741. Art. 3 of the decree states that “The Swiss National Bank is ordered to keep the gold value of the franc between 190 and 215 milligram of fine gold...” (Die Schweizerische Nationalbank ist angewiesen, den Goldwert des Frankens zwischen 190 und 215 Milligramm Feingold zu halten...).

⁷Bundesratsbeschluss über ausserordentliche Massnahmen betreffend die Kosten der Lebenshaltung. (Vom 27. September 1936.) *Eidgenössische Gesetzsammlung*, Neue Folge (52), 742-3.

reaching implications such an explicit backing of the Federal Council was deemed necessary and the report was passed to parliament with the broader request (*Diplomatische Dokumente* 1989, 868).⁸

The Federal Council's interpretation

The report to parliament⁹ opened with a description of the events that had driven the Federal Council to the devaluation decision. In the opening paragraphs the miserable economic conditions were invoked, the developments of the previous years were reiterated. The stock market crash as a turning point, the declining demand from commodity exporting countries, the effects of trade restrictions on Swiss producers, and the depression of the Swiss economy which had been aggravated in the passed year were pointed out. The “true epidemic of currency devaluations” (*wahre Epidemie der Währungsabwertungen. Bundesblatt* 1936 (II), 694) was discussed at some

⁸The Federal Council legally based the devaluation decision on the extraordinary authorities included in the fiscal program of January 1936. These powers were granted to the government to take measures considered necessary and pressing to protect the country's credit (*Eidgenössische Gesetzsammlung* 1936, 34. See above, p. 201). When the delegation of powers was passed in parliament the intention of the legislature did not extend to devaluation. Quite to the contrary, repeatedly in the debate and specifically in the votes of Federal Councillor Meyer, the special authorities were discussed on the background of a possibly arising need to take measures aimed at preserving the gold parity of the Swiss franc. It was explicitly excluded that the Federal Council sought the authorities to carry out “currency experiments,” a term used at the time to circumscribe any policies implying the abandonment of the gold standard (*Stenographisches Bulletin* 1936, 558). Giacometti (1937, 69-72) discusses the legal form the government chose for the devaluation decision at length as part of his critique of the emergency legislation employed during the depression of the early 1930s (see above, p. 123). He attacked the Federal Council for basing the devaluation decision on the authorities of the fiscal program and argued that the government had exceeded the discretion entailed in this parliamentary delegation of powers. Although he conceded that emergency conditions had unambiguously existed in this case, he maintained that the Council should rather have taken a provisional decision and asked parliament for approval, a path that had been taken in France and Czechoslovakia. Thus a sound legal basis for the government's actions would have been provided (Giacometti 1937, 72). The insistence of the majority in the Federal Council for parliament's “approval” instead of simple “attention” is an indication that the government was, as in other cases, aware of the insufficient legal basis for its decision (see above footnote 11, p. 124). In parliament the issue was also raised when one speaker pointed out that the authorities had been granted for the protection of the currency, whereas the government had used them for its ruin, a claim effectively presented in a pun (... statt zum Schutze der Währung hat der Bundesrat die Vollmachten benützt zum Sturze des Frankens. *Stenographisches Bulletin* 1936, 1339).

⁹Bericht des Bundesrates an die Bundesversammlung über seine Beschlüsse vom 26. und 27. September 1936 über die Abwertung des Schweizerfrankens. (Von 28. September 1936.) *Bundesblatt* 1936 (II), 693-700.

length. “The abandonment of orderly monetary relations, which had provided for security, is downright terrifying in its variance and had fateful consequences for the international exchange of goods and capital...” (Dieses in seiner Vielfältigkeit geradezu erschreckende Verlassen geordneter und Sicherheit gewährender Geldverhältnisse hat seinerseits wieder den verhängnisvollsten Einfluss auf den internationalen Verkehr der Waren und Kapitalien ausgeübt... *Bundesblatt* 1936 (II), 694). Other negative effects such as the deterioration in payment behavior and the creation of “disloyal advantages” in trade were pointed out. In the introduction, Switzerland and the Netherlands were described as standing out “... in a world of devalued or otherwise damaged currencies.” (...inmitten einer Welt mit abgewerteten oder sonstwie beschädigten Währungen. *Bundesblatt* 1936 (II), 693).¹⁰ It is peculiar to find such condemnation of devaluation in a statement which was designed to evoke approval for the equivalent measure in Switzerland from its addressees.

On page three the report finally turned to explaining and justifying the Federal Council’s decision. It was underlined that Switzerland was by no means forced to follow France considering the strength of the Swiss National Bank’s reserves.¹¹ However, the government continued, it feared the repercussions of this event on the Swiss economy: France would have been lost as a customer of Swiss goods; moreover, she would have turned into another unequal competitor on world markets. This would have implied additional declines in the tourism industry, increases in unemployment and a further deterioration of public finances. Eventually, Switzerland would have been forced into devaluation under unfavorable circumstances and at the cost of great losses to the National Bank’s reserves.

Finally devaluation was presented in positive light: the Federal Council portrayed the French devaluation as part of a far-reaching effort to destabilize on an international level. The agreement with Great Britain and the United States was interpreted to include a commitment of both countries to maintain stable exchange rates and to ease the quantitative restrictions and exchange controls. Thus the French devaluation took a form, “which could command quite extraordinary

¹⁰France, the other remaining gold-bloc country, was not included in this list as the stabilization in 1928 had fixed the value of the franc at a reduced parity as compared to the pre-war standard.

¹¹The wording of this argument is basically identical with Bachmann’s vote as reported in the protocol of the Federal Council’s session of September 26, 1936 (see above, p. 212).

significance in view of currency policies.” (... die in währungspolitischer Hinsicht ganz besondere Bedeutung beanspruchen konnte. *Bundesblatt* 1936 (II), 695). The Federal Council had therefore taken the opportunity to “participate in the reformation of international relations und to relieve Switzerland from the pressure that had resulted from the latent antagonism between the large world-trading nations and herself.” (...um die Einordnung in eine Erneuerung der internationalen Verhältnisse mitzumachen und sich damit eines Druckes zu entledigen, der in den letzten Jahren durch den latenten Gegensatz der grossen Welthandelsstaaten gegenüber der Schweiz auf unserem Lande gelastet hatte. *Bundesblatt* 1936 (II), 696). The devaluation was thus presented as Switzerland’s contribution to rebuilding an international monetary order aimed at stability and predictability, offering an account of the Tripartite agreement that stretched the limits of prudential interpretation.

The obvious argument, that the devaluation allowed Switzerland to realign price and wage levels to world market conditions, appeared only much further down as explanation for the extent of the devaluation and as justification for the proposed authorities to permit the introduction of price controls. Furthermore, the report stated that the stabilization in terms of a band of gold values would give the Swiss National Bank some flexibility in allowing the adjustment of the Swiss currency in line with the “world currencies” Pound Sterling and Dollar.

Devaluation in parliament

The opening statement in the session of the National Council on Tuesday, September 28 supported the government’s devaluation decision (*Stenographisches Bulletin* 1936, 693). The speaker’s argument reproduced the weights the Federal Council had given to the different arguments in justifying the devaluation, underlining the role it played in the international restabilization. Within the logic of this argument, the fact that the Federal Council had confirmed its support for the gold parity just a few days earlier would not seem so odd. A devaluation under such circumstances had presented itself as a result of developments beyond the Federal Council’s influence. The government’s critics, of course, highlighted the contradiction between the government’s decision and the recent statements on the currency question. Furthermore, they pointed out the incongruence in the pronouncements of Councillors Meyer and Obrecht in the several meetings with groups of parliamentarians on the preceding day.

A social democratic representative spoke for the critics of the government who rejected the

request for parliamentary approval of the devaluation decision. He repeated many of the familiar arguments against devaluation which had dominated the discussions in the previous months and pointed to the damages that resulted from the step. Several speakers argued along similar lines. Again and again the astonishment over the government's quick shift of opinion concerning devaluation was pointed out. The government's critics even triumphed that their warnings had come true: the deflationary policies of the Federal Council had left devaluation as the only retreat. In conclusion, speakers insisted that adjustment policies be completely abandoned to compensate for "the disadvantages and strains of the devaluation" (die Nachteile und Belastungen der Abwertung. *Stenographisches Bulletin* 1936, 1319). Instead, policies conducive to recovery were demanded by the social democratic fraction. Measures to combat inflation and to preserve real wages and unemployment payments were suggested. The abolition of import restrictions, the taxing of private devaluation gains and the transfer of the Swiss National Bank's devaluation gains to the federal administration as a fund to finance public works and transfers to cantons and communities were proposed. Most of these suggestions were uncontroversial between opposition and majority, especially the endeavors to prevent inflation and to reduce import restrictions. However, the utilization of the National Bank's devaluation gains would be contended in the following months until it would be designated to back the large-scale program of defense and employment for the years 1939 and following (see p. 225).

Meyer, as president of the Federal Council, expounded the government's decision in parliament. He conceded the differences in opinions within the Council but argued that such disagreement should not come unexpected considering the controversial nature of the topic. He reiterated the argument in the government's report and underlined the importance of a Swiss contribution to the international restabilization. Nonetheless, his reservations against the devaluation decision shone through.¹² For example, he commented in detail on the loss in asset values which resulted from the devaluation. He found some comfort in the fact that these reductions were at least smaller than those incurred in Great Britain and the United States where the devaluation had amounted to 40

¹²This must have also been the case in the radio broadcast on Sunday, September 27, 1936. *Neue Zürcher Zeitung* reported on the following day, that Meyer had recalled the history of currency devaluations. Referring to the time period between the pound and the dollar devaluation, he said that "35 gold currencies had gone bankrupt" (... haben 35 Goldwährungen bankrott gemacht. *Neue Zürcher Zeitung*, September 28, 1936).

percent. However, he also pointed out that the wealth of a country rested not only in its assets but also “in the productive forces of the people” (in den produktiven Kräften des Volkes. *Stenographisches Bulletin* 1936, 1312). If devaluation actually led to an increase in production the loss in asset values could be compensated. Meyer’s chain of reasoning is noteworthy as a reflection of his deep-seated conviction of the adequacy of a currency based on gold where gold provided the foundation for measures of value. The argument, that a loss in asset values resulted from devaluation alone, is only consistent on the background of this presumption. That Meyer did not perceive of inflation following devaluation as the source of the reduction in asset values follows from his argument that the losses in Britain and the United States with devaluation rates of 40 percent were higher than those Switzerland was about to experience.

Meyer’s comments on the political background to the devaluation decision is revealing: “A fierce battle between two groups of representatives of different approaches to combating the crisis has developed in our country. One side claims one thing imperatively, the other side claims exactly the opposite. The Federal Council with its policy is right in between, attacked and criticized from both sides ...” (Wir haben in unserem Land den heftigen Streit der beiden Gruppen von Vertretern der verschiedenen Modalitäten der Krisenbekämpfung. Die einen stellen imperativ dieses, die andern ein entgegengesetztes Verlangen. Dazwischen steht dann der Bundesrat mit seiner Politik, die von beiden Seiten befehdet und kritisiert wird... *Stenographisches Bulletin* 1936, 1311). This confirms the interpretation advanced above. The devaluation presented itself as a means to overcome the political stalemate on the issue of crisis policies that had developed over the preceding years.¹³

Federal Councillor Obrecht as head of the Department of Economic Affairs was challenged to justify the incongruence between his vehement rejection of devaluation in parliament just three days before the Federal Council’s decision to adjust the value of the currency was made public (see above, p. 208). He argued that he had not seen any dangers for the Swiss franc in the preceding week and that the news from France had been “the greatest surprise” (die allergrösste

¹³Morandi (1995, 214) argues similarly that the devaluation helped restore the government’s ability to act which had been lost as a result of the mounting critique from all sides of the political spectrum. He points out that the real breakthrough was only achieved with the overcoming of the emergency legislation regime with the financial program passed in 1938.

Überraschung. *Stenographisches Bulletin* 1936, 1348). However, he conceded that the controversial parliamentary debate of the previous week had demonstrated to him that it would be basically impossible to come up with a consensus on the provision of additional funds for export subsidies. This substantiates the interpretation that, with regard to domestic policies, the devaluation was seen as a solution to the paralysis of the political process. The reconstruction of the changes in the views within the industry organization (see pp. 190-195 above) can be taken as indication for the development of Obrecht's thinking. As pointed out above (fn. 39, p. 200), he had close ties to industry through his several board memberships. The protocols of Vorort also show that he held regular meetings with the organization's leadership. There are good reasons for assuming that Obrecht, like the industry representatives, had given up faith in the possibility to enforce of downward price and wage adjustment by the summer of 1936. The delegation of powers requested from parliament in the government's proposal on economic emergency measures which was prepared in Obrecht's Department of Economic Affairs might or might not have been originally aimed at providing the Federal Council with greater authority to implement its favored policy. It was certainly an attempt to restore some ability to act to the government. However, after the proposal had been discussed controversially in the Council of States and in public in the spring of 1936, chances for a positive parliamentary vote on the bill were dim. Under these circumstances devaluation seemed to become inevitable. In public and in parliament the unfaltering support for the gold parity of the Swiss franc had, of course, to be upheld so as to prevent the emergence of even the slightest doubt in the government's position which would have set off speculation.

Further indication for Obrecht's belief in the inevitability of devaluation can be found in the fact that steps had been taken quietly in his department to prepare for the event of a devaluation. In his speech in parliament, Obrecht revealed that a "man of confidence" had been sent to Belgium in early June to gather information on the measures that had been taken there in the wake of the devaluation (*Stenographisches Bulletin* 1936, 1350).¹⁴ The extension of the price control

¹⁴Whether this initiative was inspired by the proposal of the industry representatives mentioned above (fn. 28, p. 194) cannot be reconstructed from the sources consulted for this study. Neither do they allow an answer to the question whether the entire Federal Council was aware of these preparations. Müller (2001, 196-7) provides more detail on the information that was gathered in Belgium. Furthermore, he reports that the opportuneness of preparing for the event of a devaluation had been discussed in the Federal Council in the spring of 1935 when

commission, which had taken place in the previous months, had been inspired by the need that would arise for its work after the adjustment of the currency value. However, Obrecht added, these measures could not have been discussed in public, as this would have fed speculation against the Swiss franc.

In his concluding remarks, Obrecht confirmed the interpretation the government had offered for its step. “The Federal Council resolved to devalue, not because the current situation forced it into this step, but rather, because it could no longer be assumed that we would be able to maintain our currency as the last or the last-but-one gold currency for any length of time. After this step has now been taken it is our duty and also our intention, to turn the misfortune which has reached us from France as far as possible into the best, into a cure for our ailing economy.” (Die Abwertung ist vom Bundesrat beschlossen worden, nicht weil die momentane Lage dazu gezwungen hätte, sondern weil man nicht mehr daran glauben vermochte, dass wir unsere Währung als letzte oder vorletzte Goldwährung auf die Dauer würden halten können. Nachdem dieser Schritt einmal getan ist, ist es unsere Aufgabe und auch unsere Absicht, das Unheil, das uns von Frankreich her erreicht hat, nach Möglichkeit zum Guten zu wenden, zu einem Heilmittel für unsere kranke Wirtschaft auszuwerten. *Stenographisches Bulletin* 1936, 1353).

All in all, little enthusiasm came up in parliament over the Federal Council’s devaluation decision.¹⁵ Even on the side of the government’s supporters, contributions articulating anxieties over the uncertain effects of devaluation prevailed. As exemplified by the quotations presented above, the Federal Councillors’ addresses could hardly be called convincing in their efforts to resolve these doubts. Not surprisingly, the late-night vote in the National Council on the government’s report was not overwhelmingly positive: 96 representatives expressed approval for the Federal Council’s decision, 60 representatives denied such support and granted mere attention.

speculation against the Swiss franc resumed after the Belgian devaluation. Edmund Schulthess, then still head of the Department of economic affairs, suggested that preparations in view of a possible Swiss devaluation should be taken. This was rejected with the argument that such preparations would feed doubts about the adherence to gold (Müller 2001, 143).

¹⁵Immediate press reactions to the government’s decision give a similar impression. Bebié (1939, 232-7) provides an overview of the commentaries which reflect the reactions across the political spectrum as expressed in the National Council.

After devaluation

Despite the earlier opposition to devaluation the government's decision was soon to be applauded by many. The immediate positive effects were widely acknowledged. Earlier opponents to devaluation were quick to praise the government's decision and reinterpret their earlier objections.¹⁶ The implementation of the decision was acclaimed as beyond any critique.¹⁷ Commentators confirmed the government's interpretation that the devaluation was not equivalent to abandoning the gold standard. Quite to the contrary, Schulthess (1936, 464), the former head of the Department of Economic Affairs, argued that devaluation had restored the gold currency on a sound basis.¹⁸ Saitzew (1936, 154) similarly pointed out that despite the band in which the Swiss franc was allowed to fluctuate after the devaluation the central characteristic of the gold standard regime, convertibility in the international context, had been continuously upheld.

As a result of devaluation liquidity returned to money and capital markets, speculative capital outflows were reversed, short and long-term interest rates fell. Bond and stock markets recovered spectacularly within the first trading day after the devaluation (Saitzew 1936, 154). The considerable over subscription of a federal bond issue to finance armament spending (Wehranleihe) in mid-October 1936 was taken as unambiguous proof for the recovery of capital markets (Cattani 1991, 382). Furthermore, the fact that the gold reserves of the Swiss National Bank had increased after the devaluation, was pointed out as a sign that confidence in the Swiss

¹⁶From the authors cited in the following paragraphs only Saitzew (1937, 163) remained critical of the devaluation as such. He conceded that under the circumstances it might have been the only option Switzerland had, but in a global and longer-term perspective he considered the devaluations of the early 1930s insane. Böhler (1936, 18-19) similarly argued that the devaluation of the gold bloc was necessary to restore the exchange rates between the trading nations' currencies at pre-crisis levels, which he claimed to reflect the developments and the experiences of the 1920s. This contrasts with the widespread view, which goes back to Gustav Cassel, that the devaluations were a necessity to salvage the gold standard as the stabilization of the 1920s had taken place at overall inflated rates. Thus gold had lost purchasing power as compared to the pre-war era which was eventually restored by the devaluations (Bosshardt 1946, 101).

¹⁷Schulthess (1936, 474), Bebié (1939, 240).

¹⁸Schulthess had changed his position on the issue earlier. In January 1936 he presented his arguments in favor of devaluation in a mimeographed memorial allegedly on request of members of the federal government. Böschenstein (1966, 189) summarizes Schulthess' case which centered around the thought that the destruction of wealth and the decline in its returns in the course of the depression needed to be reflected in a reduced gold content of the Swiss franc.

currency had returned (Schulthess 1936, 467; Kellenberger 1937, 319; Saitzew 1937, 155). The danger of a large-scale banking crisis disappeared (Schulthess 1936, 475). The most important effect of devaluation was seen by many in its contribution to overcoming the deflation mentality of the depression years (Bosshardt 1946, 102; Saitzew 1937, 158).

However, the need to balance the budget was underlined again and again. Even the phrasing of this demand had remained unchanged, the rhetoric of adjustment of the previous years survived in this context. Böhler (1936, 26) and Schulthess (1936, 473 and 476) argued that, unless spending was cut, the new parity would soon come under pressure again. Concerning the government's role in the economy, Böhler (1936, 12) took up the argument that had played an important part in the debates of the industry organization Vorort. Devaluation made a reduction of government intervention possible by rendering export subsidies and import restrictions unnecessary.

Böhler stressed that the devaluation alone would not induce recovery but government policies and adequate monetary conditions were necessary (Böhler 1936, 9-15).¹⁹ Saitzew (1937) argued similarly in his comparison between the effects of the devaluation in France and Switzerland, pointing to the sound basis of the Swiss economy as compared to the French.²⁰ Both authors repeated the old theme that a full recovery would depend on the recovery of the world economy and the establishment of a stable international regime, suggesting international cooperation between governments (Böhler 1936, 27; Saitzew 1937, 163). In line with the arguments made earlier in the debate, it was emphasized that lowering the exchange rate was not a sign of any fundamental change in monetary policy in the direction of "manipulating" the currency (Schulthess 1936, 464). Furthermore, all authors argued that the advantages of the devaluation would be endangered by excessive price level increases.

¹⁹Böhler had allegedly begun to question the defense of the gold parity earlier in the year, although not in public (Schärrer 1983, 266-7).

²⁰Kellenberger (1937, 318) argued more generally that devaluation did not automatically lead to recovery, pointing to Great Britain and the United States for examples.

The overall recovery of the Swiss economy was, however, only in part seen as a result of the direct and indirect effects of devaluation. Saitzew (1937, 160) was not alone in arguing that the worldwide increase in armament expenditure on top of the recovery of demand for non-military purposes had led to increased demand for Swiss goods, an effect which was compounded by Switzerland's increased military spending.

Concluding remarks: the gold-standard mentality endures

The analysis in this and the preceding chapters has focused on the ingredients of the gold-standard mentality in Switzerland. At its core was the conviction that Switzerland as a small country depended vitally on its international economic ties which were best served by a stable and predictable monetary system. The restrictions in international trade and capital flows were seen as temporary measures and hopes were high that a liberal regime would soon be rebuilt based on an international gold standard. Under such circumstances Switzerland would be able to benefit from having held on to its gold parity. The high esteem for the gold standard was also traced back to the successful and rather effortless return to gold in the years after World War I. The positive experiences of economic stability and growth while the gold standard was enforced as opposed to monetary instability, recession and unemployment in the years off gold during the World War and its aftermath must have been deeply ingrained in public memory. The strong preference for a gold-standard may also have reflected a staunch belief in the value of gold per se, a belief that was considered widespread in the Swiss population by contemporaries (Grossmann 1935, 12).²¹ Finally, Switzerland's proverbial conservatism could be mentioned in this context.²²

On this background it is not surprising that the decision to devalue in September 1936 was framed in terms of a continuation of time-proven institutions. Tanner (2000) shows that the significance of this interpretation goes beyond the economic sphere. He presents the efforts to transform the

²¹ The population's alleged desire to rely on gold as a safeguard for the currency was again referred to by Swiss politicians in December 1998 when the revision of the respective articles in the constitution were debated in parliament (*Neue Zürcher Zeitung* 294, 18.12.1998).

²² Other examples from the sphere of monetary institutions are the belated acceptance of bank notes in the last quarter of the 19th century or the time span of more than 15 years between the formal decision in favor of a note issuing monopoly and the actual setting up of the Swiss National Bank.

devaluation into a heroic and forward-looking act as part of a larger effort at constructing national consensus.²³ These efforts provided the backdrop to the political events and their digestion in the second half of the 1930s preparing the ground for Switzerland's "spiritual national defense" (*geistige Landesverteidigung*) during World War II. According to Tanner (2000, 47), the strong, convertible currency is one ingredient in the actually more encompassing concept of national defense extending to military, economic and social aspects.

However, the government's presentation of the devaluation as a non-event was by no means only a rhetorical strategy. The gold-standard mentality was not discarded with devaluation. The government's decree instructed the Swiss National Bank to conduct currency policies oriented at reduced gold values. It did not float the Swiss franc, as Great Britain and the Netherlands among others had chosen to do. Although convertibility of notes was suspended, all other ingredients of a gold-based monetary regime were upheld. As argued above, the balancing of budgets was the guideline for fiscal policies corresponding to the support of the gold parity that guided monetary policies. Prudential budgetary policies were considered necessary to bolster the currency's parity. In view of unemployment, which remained high despite the recovery, the opposition's demand for public spending on employment programs persisted. The Social Democratic Party presented concrete proposals in their "national public works program" in March 1937 and suggested to finance substantial additional expenditure by the Swiss National Bank's devaluation gains (*Nationales Arbeitsbeschaffungsprogramm*. Prader 1981, 110). These suggestions were eventually incorporated in the budget proposal for budget years 1939 and following, linking employment and defense policies. The funds to finance the program were provided by credits drawn from the exchange equalization fund.²⁴ With this compromise, the government finally reached an understanding with the social democratic opposition to overcome the regime of emergency legislation of the preceding years (Prader 1981, 85-6).²⁵ Finally, the

²³The process of national consensus building has been repeatedly alluded to in the preceding chapters. It proved particularly difficult in the sphere of budgetary policies.

²⁴The turnover tax, which was introduced in this context, was expected to provide for interest and amortization payments (Rutz 1970, 208).

²⁵Müller (2001, 213) underlines the importance of these developments in preparing the ground for the "peace agreement" between unions and employers' organizations in July 1937, where both sides agreed to abstain from industrial action. This agreement is considered a

budget would again be passed according to constitutional procedures. Although these measures implied a retraction from the goal of balanced budgets, it can not be interpreted as a repudiation of gold-standard principles. The circumstances in which credit-financed spending was acceptable to the Swiss government conformed to the contingencies allowed for within the interpretation of the classical gold standard (Bordo and Kydland 1995).²⁶ Germany's threat of warfare permitted to suspend strict adherence to the prescription of balanced budgets. The gold-standard mentality survived the turbulence of the depression years.

milestone in the establishment of social stability in Switzerland.

²⁶The arguments provided by Swiss economists conformed to this interpretation. Public finances were the topic of the annual meetings of the Swiss Statistical and Economics Society in 1937 (Schweizerische Gesellschaft für Statistik und Volkswirtschaft, renamed from the former Schweizerische Gesellschaft für Statistik). Böhler's argument in favor of credit-financed public spending rested on the observation that the functioning of the economy was severely disrupted since World War I. He described these changes as a move to a "permanent war economy" (permanente Kriegswirtschaft. Böhler 1937, 497). The argument implied that under such extraordinary circumstances traditional fiscal policy guidelines had to be suspended. His views were confirmed by the contributions to the discussion (Schweizerische Gesellschaft für Statistik und Volkswirtschaft 1937).

Appendix I: Dates and events

Switzerland	World
	1922 Genoa conference of League of Nations recommends return to gold on a gold exchange standard
July , de facto stabilization of Swiss franc	August , stabilization in Germany, introduction of Reichsmark.
	1925 April 28 , Great Britain returns to gold at pre-war parity
June 17 , Swiss National Bank declares commitment to supporting the Swiss franc's pre-war gold parity (convertibility legally reestablished on December 20, 1929)	
December 25 , confirmation of the constitutional amendment concerning the institution of old age insurance (AHV, Alters- und Hinterlassenenversicherung) and a later introduction of invalidity insurance (IV, Invalidenversicherung) Legislation regulating the implementation of the insurance is only confirmed in the referendum of July 6, 1947 (Ausführungsgesetz)	
	1926 December , de facto stabilization of French franc at a parity reduced by 80 percent compared to the pre-war standard
	1927 Gentlemen's agreement between Swiss National Bank and commercial banks on information exchange concerning bond issues on foreign account.
	1928 June 25 , official restoration of the French franc's convertibility.
	1929 October 24 , "black Thursday": New York stock market crash

1930

June 17, Smoot-Hawley Tariff Act

1931

July 11, insolvency of Comptoir d'Escompte de Genève. On July 17, the Federal Council supports the bank with a loan. (Despite these efforts the bank goes out of business on April 30, 1934)

December 1, clearing arrangement with Hungary in force

December 10, clearing arrangement with Austria in force

Most central and eastern European countries enter clearing arrangement in the following years, most importantly Germany on July 26, 1934.

December 23, introduction of

- import restrictions
 - direct federal aid to the unemployed (Krisenhilfe)
 - subsidies to communal and cantonal public works
-

May 11, run on Österreichische Creditanstalt

July 13, run on Darmstädter Nationalbank, two bank holidays follow

July 15, introduction of foreign exchange controls by Germany

June 20, Hoover moratorium

September 21, Great Britain abandons gold

December 8, Brüning emergency decrees lowering wages, interest rates and prices of cartelized industries

1932

February 18-June 30, discount rate of Bank of England reduced from 6 to 2 percent

March 18, introduction of export subsidies in the form of "productive unemployment relief" (Produktive Arbeitslosenfürsorge)

July 8, a federal lending institute is set up to provide liquidity to commercial banks by discounting material which does not conform to the Swiss National Bank's requirements (Eidgenössische Darlehenskasse)

July, the Federal Department of Economic Affairs appoints a committee assigned with the task of business cycle observation (Kommission für Konjunkturbeobachtung)

September 9, support for the hotel industries introduced

November 9 and 10, military forces are deployed to control workers' demonstrations in Geneva (13 killed and 60 injured)

February 27, Glass-Steagall Act

June-July, Lausanne conference: cancellation of reparations

November, election of Franklin D. Roosevelt

1933

March to May, “Frontenfrühling:” right-wing organizations are founded and strengthened in Zurich and Berne

May 28, legislation prescribing the reduction of wages and salaries of public employees rejected in a referendum

October 13, first fiscal program passed by parliament based on emergency procedures (Finanzprogramm)

Reorganization of Schweizerische Volksbank with government support.

January 30, Hitler appointed Reichskanzler

February - March, bank panics in the U.S. lead to bank holidays in several states

March 1, Roosevelt assumes office

April 19, U.S. abandon gold

June 9, German transfer moratorium

June 12 to July 27, World Economic Conference in London

July 3, Roosevelt’s “bombshell message”

July 3, Gold Bloc established (Belgium, France, Italy, Netherlands, Poland, Switzerland)

July 27, Sterling Bloc established

December 18, German restrictions on foreign exchange transactions

1934

January 31, stabilization of US \$ (parity reduced by 40 percent from pre-crisis level)

March 11, legislation for the protection of the public order (Schutz der öffentlichen Ordnung) rejected in a referendum. This result led to the resignation of Federal Councillor Heinrich Häberlin on March 12.

March 28, introduction of export risk insurance (Exporttrisikogarantie).

April 30, resignation of Federal Councillor Jean-Marie Musy

May, crisis initiative presented

July 26, clearing arrangement with Germany

November 11, Federal Councillor Edmund Schulthess reinforces the demand for adjustment: “Aarau Reden”

1935

January 27, Social Democratic Party convention passes a moderate party program including a qualified commitment to national defense and a “plan for work” (Plan der Arbeit)

March 1, banking legislation in force (Bundesgesetz über die Banken und Sparkassen, Vorschriften über die Kreditkassen mit Wartezeiten). Introduction of banking supervision through a federal body (Bankenkommission)

March 31, devaluation of Belgian franc by 28 percent.

April 25, resignation of Federal Councillor Schulthess

June 2, the crisis initiative is rejected in a referendum

June 20, Gentlemen’s agreement between Swiss National Bank and commercial banks aimed at reducing gold and foreign exchange transactions (i.e. controlling domestic speculation against the Swiss franc)

June 28, Federal Council tightens conditions for the admission to the clearing trade as imports from clearing countries decline

September 8, the right-wing initiative for a complete revision of the federal constitution (Totalrevision) is rejected in a referendum. This ends the influence of fascist circles on home affairs.

October 27, elections to the National Council confirm the previous distribution of power

November 21, Gentlemen’s agreement between Swiss National Bank and commercial banks concerning the mortgage market

1936

January, number of registered job seekers peaks at 124'000

January 31, second fiscal program passed by parliament, including the delegation of powers to protect the country’s credit to the Federal Council

June 19, Federal Council passes a decree aimed at protecting the currency by prohibiting forward contracts in currency markets (Bundesratsbeschluss über den Schutz der Landeswährung)

June 6, Popular Front government (Léon Blum) assumes office in France

September 25, devaluation of French franc by 30 percent. The Tripartite Agreement between France, Great Britain and the United States is announced on the same day (Switzerland joined on September 28).

September 27, devaluation of the Swiss franc by circa 30 percent

September 27, Dutch guilder off gold. A new parity is not fixed, devaluation amounts to 20-25 percent.

1937

March 24, the Social Democratic Party presents an initiative proposing public works financed by the devaluation gains on the Swiss National Bank's gold reserves (Nationales Arbeitsbeschaffungsprogramm)

Britain announces a five-year program of increased armament expenditure

July 19, unions and employers' organizations in the metal and watch-making industries agree to resolve future conflicts in negotiations, renunciation of industrial action (Friedensabkommen der Schweizerischen Metall- und Uhrenindustrie)

1938

November 11, parliament passes a federal spending proposal linking employment policies and defense (SFR 415 million), confirmed in a referendum on June 4, 1939 (Landesverteidigungs- und Arbeitsbeschaffungsprogramm)

November 27, provisional fiscal legislation is confirmed in a referendum replacing the fiscal emergency regime of the five previous budget years. (Übergangsordnung für den eidgenössischen Finanzhaushalt)

1939

January 22, partial revision of the Federal Constitution reforming emergency legislation

September 1, World War II begins with the German attack on Poland

Appendix II: The members of the Federal Council 1929-1936²⁷

	Department of Foreign Affairs (Politisches Departement)	Department of Home Affairs (Departement des Innern)	Department of Justice and Police (Justiz- und Polizeidepartement)	Department of Defence (Militärdepartement)	Department of Finance (Finanz- und Zolldepartement)	Department of Economic Affairs (Volkswirtschaftsdepartement)	Department of Post and Railway Services (Post- und Eisenbahndepartement)
1929	Motta	Pilet-Golaz	Häberlin	Scheurer	Musy	Schulthess	Haab
1930		Meyer		Minger	Musy		Pilet-Golaz
1931			<i>Häberlin</i>				
1932	<i>Motta</i>						
1933						Schulthess	
1934		Meyer Etter	Häberlin Baumann		Musy Meyer		Pilet-Golaz
1935				<i>Minger</i>		Schulthess Obrecht	
1936					Meyer		

Radical Free Democratic Party (Freisinnig-Demokratische Partei)

Christian Democratic People's Party (Christlichdemokratische Volkspartei)

Swiss People's Party (Schweizerische Volkspartei)

Italic = President of the Federal Council

The Federal Councillor's lifespans and overall terms of office²⁸

Baumann, Johannes (1874-1953): 1934-1940

Etter, Philipp (1891-1977): 1934-1959

Haab, Robert (1865-1939): 1918-1929

Häberlin, Heinrich (1868-1947): 1920-1934

Meyer, Albert (1870-1953): 1930-1938

Minger, Rudolf (1881-1955): 1930-1940

Motta, Guiseppe (1871-1940): 1912-1940

Musy, Jean-Marie (1876-1952): 1920-1934

Obrecht, Hermann (1882-1940): 1935-1940

Pilet-Golaz, Marcel (1889-1958): 1929-1944

Scheurer, Karl (1872-1929): 1920-1929

Schulthess, Edmund (1868-1944): 1912-1935

²⁷Based on Altermatt (1991, 627-28). Party names in their current form. Translations are from Swiss Federal Chancellery, Information Service (2003). The names of departments have been changed repeatedly in the past (Altermatt 1991, 32). The German terms used at the time are in brackets, the translations follow the terms used today.

²⁸Based on Altermatt (1991, 611-7).

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