PUBLIC AS OF JANUARY 1, 2009

L.5.2.

RFD. 202

Board of Governors of the Federal Reserve System

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

November 18, 1952

NOT FOR PUBLICATION

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November 18, 1952

Recent Economic Developments in Western Europe 1/ J. Herbert Furth

The continental countries of Western Europe have experienced an interruption in the rapid rise in economic activity but have made some progress toward internal and external equilibrium.

Those optimists who had believed that the rate of increase in production that prevailed during the first four years of the European Recovery Program could be indefinitely sustained, have been greatly disappointed and are talking of "stagnation". The pessimists, however, who for quite some time had expected the boom to be followed by a depression, have been agreeably surprised and are speaking of "high-level stability".

There is more to this difference of opinion than a mere choice of words. Those observers who favor government planning, attribute the economic progress of the postwar period largely to the expansionary financial policies followed by most European governments up to the time when the post-Korean inflation led to a revival of conservative monetary policies. They also attribute the end of the rapid increase in output and employment to the adoption of those conservative policies. They conclude therefore that no further revival can be expected as long as conservative monetary policies are pursued.

Those observers, however, who believe in the adequate working of the market-price mechanism, attribute the levelling off to the reaction of merchants and consumers to the waves of panic buying that swept the free world in 1950-51. They feel that the stopping of inflationary pressure has made it possible for the economies of Western Europe to weather the inevitable process of recovery from inflationary fever without any serious recession. They are therefore confident that the present readjustment will in due time be followed by another period of expansion.

Production and Employment

There is little doubt as to the facts. Production in most countries is still slightly below the peaks reached in 1951. Unemployment has increased moderately, but in most countries the percentage of unemployed is well below the danger level. Most important, the downtrend that was very noticeable in the first half of 1952, does not seem to have continued. Figures for the summer months are distorted by vacation periods; but as far as fall statistics are available, they indicate that the demand situation is not worse, and in some countries much better, than in spring.

In all countries there is a great difference between conditions in light and in heavy industries. The continued armament effort of the

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1/ Paper prepared for the 335th meeting of the National Industrial Conference Board (Detroit, Michigan, November 20, 1952). In view of time limitation, the paper deals only with the members of the European Coal and Steel Community (Belgium-Luxembourg, France, Germany, Italy, and the Netherlands).

free world has virtually guaranteed to heavy industry a continuation of postwar prosperity at peak levels. Everywhere it has been light industry, and in particular textile and leather manufacturing, that has been most severely hit by the decline in consumer demand. Therefore, the over-all industrial production statistics of the various countries must be expected to show some differences: countries in which heavy industries play a major role, such as Germany, will obviously show a greater increase, or smaller decline, in over-all output and employment, than countries in which light industries are most important, such as Italy. The advocates and opponents of conflicting economic policies often compare the experiences of various countries and attribute the differences to divergencies in policy whereas in fact the different composition of the industrial pattern might be decisive.

Under these circumstances it is not surprising that in Germany, whose economy is dominated by the heavy industries of the Ruhr district, total industrial production is substantially higher than a year ago. Unemployment has fallen to a post-stabilization low although due to the inflow of refugees from the East the unemployment ratio is still higher than in most other European countries. It would probably be wrong for the adherents of conservative monetary policies to contend that this development was due primarily to the determination of the German authorities to choose indirect monetary measures rather than direct controls to stabilize the German economy; however, the German example may well be cited to show that economic progress and monetary stability are by no means incompatible.

Similarly, it is not surprising that Italy's position is far less satisfactory although it has pursued monetary policies very similar to those of Germany. Apart from seasonal variations, output has not changed much since early 1951, and in view of the large natural increase in the labor force, unemployment is at a postwar peak.

The Netherlands, which has only recently switched from expansionary to conservative monetary policies, suffered during the first half of 1952 from a decline in output and a rise in unemployment. In the fall, however, there seem to have occurred a distinct turn to the better: output in the third quarter of 1952 was higher than in the same period of 1951, and unemployment, while still larger than a year ago, was substantially lower than in spring. This progress was achieved without in any way endangering the internal or external financial stability achieved in the preceding months.

Belgium seems to have been less fortunate. In recent months, industrial production was lower, and unemployment higher, than in any year since 1949. This development is the more surprising since Belgium has a strong heavy industry, which in 1951 was even able to export substantial quantities of steel to the United States. Apparently the severe depression in the Belgian textile industry has more than offset the prosperity in the heavy industrial sector.

France stands in a category by itself. As the only one of the "big five" industrial countries of Western Europe, it continued to suffer from rampant inflation until the spring of 1952, largely because of the unsettled situation of its public finances. The inflationary boom therefore did not come to an end until April, and production kept at a level substantially higher than in 1951 at least until the summer. It remains to be seen whether the stabilization, accomplished for the time being by the Pinay administration, will result in a decline from the level of output reached under the stimulus of inflation.

Balance of Payments

Turning to the problems of international economic relations, we find that three of the five countries under consideration have achieved virtual equilibrium in their balance of current payments.

Germany had reached equilibrium as early as in the spring of 1951 and has maintained this position ever since. Its gold and official dollar holdings increased by about 50 per cent during the first nine months of 1952 despite a substantial payment made as Germany's capital subscription to the International Monetary Fund. This increase was due largely to U. S. troop expenditures and especially to Germany's receipts of gold and dollars from EPU settlements, mainly at the expense of France and the sterling area.

Success in the Netherlands was as dramatic in 1952 as the improvement in the German situation had been in 1951. A trade deficit of $600 million in 1951 was gradually reduced until it completely disappeared in the third quarter of 1952. The country's gold and dollar reserves increased by 40 per cent in the first three quarters of 1952.

Belgium has maintained a strong international position throughout the postwar period; since the spring of 1952 it has succeeded in substituting virtual balance for its huge surplus within the European Payments Union which had put a heavy strain on the EPU mechanism.

In contrast to the experience of these three countries, the foreign trade of Italy has been deteriorating ever since 1950. In 1951, its trade deficit was nearly twice as large as in 1950, and in the first nine months of 1952 it was almost twice as large as in the same period of 1951. The country's gold and dollar balances were saved from serious depletion only by the receipt of US aid. Moreover, while the rise in the deficit between 1950 and 1951 was accompanied by a large increase in both imports and exports, the rise in the deficit this year was due primarily to a fall in exports.

The situation in France is similar. French trade was in virtual balance in 1950. A moderate trade deficit reappeared in 1951, but in the first nine months of 1952 the deficit was about twice as large as in the comparable period of 1951. Again as in the case of Italy, the deterioration is due primarily to a fall in exports. Moreover, a large part of French exports has been diverted to the protected market of the French colonies, and therefore fails to produce foreign exchange proceeds.

There is, however, an important difference between the French and the Italian situation. French imports have been kept from rising by very strict import controls, contrary to the liberalization policy of the European Payments Union and the Organization for European Economic Cooperation. Italy, on the other hand, has so far faithfully adhered to the principles of liberalization and virtually abolished quantitative controls in intra-European trade. Since France is a very important market for Italian produce, Italian exports have been badly hurt by the French restrictions, and a large part of the deterioration in Italy's trade position might be traced to events in France rather than to domestic events in Italy.

Despite this growing trade deficit, France has so far managed to keep its gold and dollar reserves from shrinking by the receipt of large amounts of US assistance, primarily in the form of advances on off-shore purchases, i.e., U. S. orders placed in France for the armed forces of the members of the North Atlantic Treaty Organization. In fact, France is unique among continental European countries in that it finances a sizeable deficit in the European Payments Union by means of its net receipts of dollars. This practice would greatly contribute to multilateralism and international trade equilibrium if the dollar earnings resulted from a surplus in commercial transactions. However, they merely reflect Government actions due to political rather than economic conditions, which can hardly be expected to continue indefinitely.

Conclusions

If we try to form a tentative opinion of the present economic trend in continental Western Europe, we may conclude that there are no signs indicating either a dramatic upswing nor a dramatic downswing in the near future. Heavy industry will probably continue to prosper, and light industry may well pick up somewhat, bringing over-all production back at least to the level of 1951. In most countries, internal financial stability is reasonably well established. In the field of international trade, however, two conflicting tendencies can be observed. On the one hand, the rise in foreign exchange reserves should enable most countries to continue, and perhaps to expand, intra-European trade liberalization. On the other hand, the continuation of French import restrictions, together with the uncertain future of the sterling area, may well induce some countries to retaliate and to reimpose import controls.

European imports from the United States are still almost everywhere strictly controlled, and the volume of import licenses is mainly governed by the volume of dollar earnings by means of exports plus US aid. Continued prosperity in the United States should keep dollar export proceeds from falling. Moreover, since most US aid is being given in the form of defense support, there is no reason to expect this source of dollar funds to decline substantially in the near future. Some countries such as Germany and the Netherlands have been able to accumulate reserves to such an extent that they may be willing to forego future accumulation or even, to some small degree, permit drawing on their dollar holdings in order to pay for increased US imports.

In one sector, however, dramatic developments might conceivably occur. The trend towards unification of Europe, and especially towards closer ties between the members of the Coal and Steel Community which we have been discussing, might lead to an attempt at creating a preferential trade system, with discrimination against the outside world. This trend recently found expression in a resolution of the Consultative Assembly of the Council of Europe, which called for freedom of intra-European trade with protection against the dollar area. If such a tendency gained momentum, trade with the United States might indeed be hampered. However, the leaders in the movement have stated expressly that they wanted to lower intra-European trade barriers, not to raise barriers against the rest of the world. Moreover, as long as Europe is dependent on US aid it would hardly pursue a policy that would inevitably lead to swift retaliation. It seems therefore unlikely that the words of the Consultative Assembly would soon be reflected in action.

All in all, as long as the United States does not make it more difficult for the European countries to earn dollars by exports of goods and services, there does not seem to be much reason to expect a drop in European imports from the United States from their present level, and on the contrary there may be some hope of an increase.

November 18, 1952

RECENT MEASURES OF ECONOMIC POLICY IN SWITZERLAND

Rosa Ernst

Switzerland alone of all European nations has been able to maintain both a fully convertible currency, with internal financial stability and equilibrium in its balance of international payments, and a maximum level of economic activity and employment. To a large extent, this state of affairs is due to Switzerland's good fortune -- not unrelated to its management of foreign policy and defense preparedness -- of having escaped participation in the two world wars. However, the difficulties experienced by other neutral countries prove that Switzerland was able to maintain the advantages gained from having been spared the ravages of war only by having followed appropriate postwar economic policies.

In 1951, Swiss national income reached an all-time peak of $4.5 billion, or about $1,000 per head of the population; unemployment stood at less than 1 per cent of all insured workers, and in June, 1952, less than 1,500 individuals were totally unemployed. This record low was reached although the country's important textile industry had felt the repercussions of the world-wide slackening of demand for textile goods. Wholesale prices and the cost of living both have been virtually unchanged since the middle of 1951 at a level barely 10 per cent higher than at the time of the Korean outbreak. The money supply (currency plus bank deposits) has shown a similar stability. The Federal budget for 1951 showed a small surplus, but a deficit is forecast for 1952 since the Swiss electorate rejected in July 1952 a proposal to pay additional taxes for the increased rearmament expenditures (about $65 million per year). There is no danger, however, that this deficit would have to be financed by inflationary means.

Swiss economic policy has traditionally avoided interference with the market forces except under extraordinary circumstances and consistently has used indirect monetary and fiscal measures rather than direct controls in safeguarding its internal and external balance. In the sphere of domestic policy, the Swiss authorities have, therefore, relied to a large extent on voluntary cooperation and the sponsorship of private agreements, furthered by financial inducements, and have restricted their direct intervention to the maintenance of stand-by control authorizations. In its international relations, the country has maintained equilibrium not by curtailing imports, but by permitting a substantial excess of commodity imports over exports to be balanced by its net receipts on "invisible" account. It has, therefore, played the role of a creditor nation according to the classical tradition. However, it has shown its regard for cooperation with the rest of the free world by refraining from expanding its trade with the Soviet Empire and by participating in the European Payments Union.

Switzerland has virtually eliminated the remnants of its wartime restrictions. It has reached agreements on the treatment of German assets in Switzerland and on Swiss claims against Germany. Finally, it has taken a decisive step toward putting the Swiss currency formally back on a gold standard by removing all obstacles to gold transactions and by establishing a new legal gold parity for the Swiss franc.

Domestic policy

Swiss authorities have taken certain precautionary measures to keep the economy stabilized in case of unfavorable developments.

In January 1952, a Federal law went into effect designed to forestall a sudden collapse of the Swiss economy in case of serious disturbances in the international economy, upon which Switzerland is highly dependent. The law encourages the private sector of the economy to lay aside on a voluntary basis reserve funds for the creation of employment, should the need arise. The law provides tax refunds to those firms which comply with the provisions of the law; these refunds will not actually be paid out, however, until the time when the reserve funds are put into use in times of an emergency. The Federal Council (Cabinet) is to decide whether or not such an emergency exists in any branch of the industry or in the nation as a whole, but business has a voice in these decisions through the various business and economic organizations. The law prescribes that 60 per cent of the reserve funds are to be invested, until needed, in non-negotiable interest-bearing bonds of the Confederation. Thus funds are syphoned off as an antidote to inflationary pressures and over-expansion in boom times and are ready to be spent in times of local or national depression. The various States have enacted separate legislation in support of the Federal Government's plan. The law has also been received favorably by the private sector of the economy; it is reported that so far 370 such reserve funds with a total of about 65 million Swiss francs 1/ have been set up.

In order to prevent excessive expansion in the building industry a "Gentlemen's agreement" was entered into on August 1, 1951 and was later extended to July 31, 1953. The agreement (to which about 1,600 financial enterprises such as banks, insurance companies, pension funds, have adhered) is aimed at keeping available housing credits and mortgages for new buildings within specified limits. On the whole, the agreement seems to have worked out quite well, although the building trades showed more than usual activity in the past twelve months.

The Federal Government, as a stand-by measure, has decided to propose the retention of price control until the end of 1956. It explained that boom conditions still were prevalent in the economy; if all controls were lifted at the end of 1952 (the end of the emergency decrees enacted at the outbreak of the war), the economic equilibrium of the country might be seriously upset. The Government expressed the hope that it would not be necessary to introduce new price regulations and stressed the fact that

1/ The Swiss franc is currently quoted at about 23 U. S. cents.

its liberal economic policies would be continued. The measure has been submitted to the voters for a referendum.

Balance of international payments - imports and exports

Switzerland is a creditor nation, but at the same time it is largely dependent upon the importation of foodstuffs, raw materials, and manufactured products. The country has, therefore, been able to use its net receipts on service account to pay for its deficit on merchandise account. Since 1886, when trade statistics were introduced, the country has had a trade deficit in every year with the exception of the war years 1916 and 1945. In the postwar period, this deficit averaged about $230 million annually, but was fully covered by net receipts from tourist traffic and foreign investments.

Swiss economists have estimated that Switzerland would need a yearly trade deficit of about 1.2 billion francs if it wanted to offset completely its balance of payments surplus on current transactions other than merchandise trade. In 1952, however, the trade deficit will probably remain well below that figure.

During the first half of 1952, imports showed a marked decrease, amounting to 2,731 million francs as compared with 3,140 million in the same period last year. Exports were slightly higher, amounting to 2,251 million as against 2,245 million in 1951. The trade deficit was, therefore, 480 million as compared with 895 million in the first half of 1951. The decrease in imports was particularly noticeable in textiles and foodstuffs; imports of machinery, metals, and woodpulp showed an increase. The small rise in exports was merely the result of higher export prices; the index of export volume declined by more than 5 per cent.

The United States is Switzerland's most important customer at the present time, with exports to this country amounting to about 13 per cent of total exports. During the early postwar years, the United States was also Switzerland's largest supplier, but it has now been surpassed by Germany. In recent years, Switzerland had an annual trade deficit with the United States averaging about $80 million, but its annual net receipts from American tourist traffic, investments, and other "invisible" items have been estimated at an average of nearly $60 million; its balance of payments deficit with the United States amounts thus to about $20 million annually and is easily covered by net receipts in convertible currencies from third countries.

The largest export item by far during the first six months of 1952 was watches (and parts); the volume (16.9 million pieces) was slightly smaller, the value (about 500 million Swiss francs) somewhat higher than in the first six months of 1951. The watch industry is one of the most important industries in the Swiss economy; in 1950 (latest figures available) it employed over 47,000 persons, or almost 10 per cent of the industrial workers. About 35 per cent of this industry's output is destined for export to the United States, and much satisfaction and relief was expressed when it was announced that President Truman would not consent to increase by one-half the U. S. import duties on watches. The present scale of duties was established by trade agreement in 1936.

Switzerland is the only Western European country that does not receive assistance from the United States and that is therefore not bound by the Battle Act's restrictions on trade with the Soviet Empire. Nevertheless, its trade with Soviet countries was smaller during the first six months of this year than during the six months preceding the outbreak of the Korean War. Imports dropped from 4.9 per cent of total imports in 1950 to 2.8 per cent in 1952 and exports decreased from 6.0 per cent of total exports in 1950 to 3.5 per cent in 1952.

European Payments Union

On June 18, 1952, the Swiss Parliament recommended to the Federal Council that Switzerland's membership in the European Payments Union be prolonged for a term of not more than two years; that additional credits be granted by Switzerland to the EPU in the amount of 50 per cent of any payments surplus in excess of the Swiss EPU quota, which might arise before June 30, 1953; and finally that an additional pro-rated contribution be granted to the EPU if and when additional working funds might be called for. This decision was in response to a message sent to Parliament by the Federal Council in which the Federal Council had noted with satisfaction that Switzerland's membership in the EPU had reacted favorably on the development of Swiss trade; travel allotments had been liberalized, thus enabling more foreign tourists to travel in Switzerland, and measures had been taken to facilitate financial transfers. These transfers are of special concern to Switzerland because of the country's considerable volume of business in international banking and insurance.

In the 20 months from Switzerland's adhesion to EPU (November 1950) to the end of the second quarter of 1952, Switzerland accumulated a surplus totalling 738 million Swiss francs (about $170 million) within the EPU. On the other hand, Swiss press reports indicate that in this period Switzerland had a deficit with the other member countries on merchandise trade account, amounting to nearly 1,500 million francs. It would thus appear that the Swiss surplus on non-trade account in this period reached about 2,230 million francs (about $515 million). However, this surplus included not only current items such as tourist expenditures, insurance, and investment income, but also capital transactions such as the repayment of foreign loans granted in the immediate postwar period by the Federal Government, and changes in the balances of foreigners with Swiss banks.

It has been reported that talks are under way to channel Swiss loans through the EPU. Such a step would make Swiss funds available to all EPU members rather than only to individual countries; at the same time, it would ease Switzerland's permanent creditor position within EPU. In the past, however, the United Kingdom and France have invariably opposed all such multilateral loans.

German assets and claims

On August 29, 1952, the Western Allies and Switzerland signed an agreement which abolished most of the provisions of the "Washington Accord" of 1946 on German assets in Switzerland. Under the new agreement the Allies are to renounce all their claims to German assets in Switzerland, in return for a lump sum payment of 121.5 million Swiss francs. However, articles IV and VI of the "Washington Accord" will continue in force. Article IV states that "1. The Government of the United States will unblock Swiss assets in the United States. The necessary procedure will be determined without delay. 2. The Allies will discontinue without delay the 'black lists' insofar as they concern Switzerland." Article VI reads: "In case differences of opinion arise with regard to the application or interpretations of this Accord which cannot be settled in any other way, recourse shall be had to arbitration."

Differences of opinion have arisen with particular reference as to what constitutes blocked "Swiss" assets in the United States, and also with regard to the exchange rate to be applied in compensating German owners of assets in Switzerland. Since both parties are insisting on a divergent interpretation, this matter still is not settled.

At the same time, Switzerland concluded two agreements with the Federal Republic of Germany; all three treaties are to go into effect simultaneously. The first of these agreements concerns the disposition of German assets in Switzerland. Germany is to reimburse Switzerland for the 121.5 million francs to be paid to the Allies and will acquire the necessary Swiss francs for this transaction by asking German nationals, whose assets in Switzerland amount to more than 10,000 Swiss francs, to relinquish one-third of their holdings. German nationals who comply with the request may freely keep and dispose of the remainder; the others will be obliged to turn over their entire holdings to the German Government (which will reimburse them in German marks) and will also be subject to payment of back taxes and other penalties.

This agreement does not apply to Germans in the Soviet zone and in the Saar territory. No settlement with the Soviet zone has been reached; with regard to the Saar, Switzerland has agreed to release at once all blocked assets, which are reported to amount to less than 2 million Swiss francs.

The second agreement with Germany has no connection with the "Washington Accord," but concerns Swiss war claims on Germany. These claims include a war-time clearing balance of 1,012 million Swiss francs, about 300 million for defaulted interest payments, 250 million for a gold payment made by Switzerland to the Allies in 1946, and a sum of 177 million under various other titles; all in all, the claims amount to about 1,750 million Swiss francs ($403 million). Out of this total, the German Government has expressed a willingness to make restitution in an amount of 650 million francs ($150 million). Payments are to be arranged over a period of 32 years. The agreements require approval by the Swiss Parliament, but no delay is expected in this ratification.

Gold policy

Beginning July 1, the Swiss National Bank ceased all control over imports and exports of monetary gold (including gold bars and coins). This step was the last in a series which aimed at the gradual lifting of restrictions imposed in December 1942 by the Federal Council under its war emergency powers. At that time, every individual transaction in gold required a license by the National Bank; only authorized banks were permitted to buy and sell gold; and a maximum buying price of 4,869.80 Swiss francs per kilogram of fine gold was established. Moreover, in 1947 sales of gold by the National Bank to the public were suspended entirely and at the end of 1948, the gold transit trade was put under the control of the Bank. Switzerland, although not a member of the Bretton Woods Agreement, thus observed the rules promulgated by the International Monetary Fund.

In September 1951, the International Monetary Fund decided to permit its member countries to sell industrial gold on the free market at premium prices. This change in policy, together with the fact that the emergency measures of 1942 were to expire at the end of 1952, brought the question of the continuation of gold restrictions into sharp focus. In December 1951, the National Bank abandoned its control over the price of gold coins and bars. As a result, the price of monetary gold rose by the end of that month to 5,425 Swiss francs per kilogram or an equivalent of $38.65 per fine ounce. The existing tax of 4 per cent on the purchase price, however, was not lifted and this may have been one of the reasons why the expected rush to buy gold did not materialize. Since January 1952, the gold price has fluctuated, dropping from 5,460 francs per kilogram at the end of February to 5,200 francs (or $37.04 per ounce) at the end of August. In April 1952, the Swiss National Bank ceased to exercise any supervision over the transit business in gold and, as the latest step, it liberated the import and export of gold.

The amount of gold held by the Government under its sterilization program has been held constant since March 1951 at the equivalent of 278 million Swiss francs. The gold holdings of the National Bank have decreased slightly since the first of the year from 6,004 million to 5,799 million Swiss francs on September 30, but the foreign exchange reserves, practically all in U. S. dollars, have increased from 218 to 418 million francs. Thus the total official gold and dollar holdings have remained virtually constant at almost 6,500 million francs ($1.5 billion). During the same period, the note circulation dropped from an all-time high of 4,927 million to 4,747 million francs; demand deposits of the National Bank and all commercial banks remained with little change at approximately 7,000 million.

On September 16, 1952, the Swiss National Council (Lower House of Parliament) discussed and passed a new monetary law. This decree does not introduce any fundamental changes with regard to the Swiss currency, but it defines anew the parity of the Swiss franc. When Switzerland went off the gold standard, the Swiss National Bank, by a decree effective September 28, 1936, was instructed to maintain the gold parity of the franc at a value ranging between 190 and 215 milligrams of fine gold per franc. Thus the Swiss franc was allowed to fluctuate within a range of 4.133 and 4.677 francs to the dollar. Actually the exchange ratio never went to either extreme. The yearly averages of the official dollar quotation in Switzerland between the years 1936 and 1951 ranged between a high of 4.44 francs per dollar in 1939 and a low of 4.28 during 1946-48.

The new law fixes the gold content of the franc at 203.2258 milligrams of fine gold per franc. This corresponds to an exchange ratio of 4.373 francs per dollar, or 22.87 U. S. cents per franc.

At the same time, the Lower House authorized the striking of two new gold coins of 25-francs and 50-francs. The present gold coins are in denominations of 10, 20, and 100 francs. The law has not yet been put into effect and it has not yet been decided whether (or when) the new gold coins will be put into circulation.

Conclusion

The political and economic position of Switzerland is so different from that of most other countries that it would be futile to expect the Swiss example to be taken as a guide for the policies of other nations. However, a case study of Swiss economic policy may provide a useful object lesson on the relation between stability and prosperity and may well help to refute the views of those pessimists who believe that economic freedom and full-employment equilibrium, or economic progress and financial stability are incompatible with each other.