

Allan Meltzer and Swiss and European Monetary Policy

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It is a great pleasure to be here and to talk a little bit about the contribution of Allan Meltzer and his late friend Karl Brunner on European monetary policy in general and on Swiss monetary policy in particular.

After the changeover to a system of flexible exchange rates the Swiss National Bank – and it was not the only Central Bank – had no concept for monetary policy. But at least the Swiss National Bank was fortunate, it employed a young researcher, Alex Galli, who spent a year in Pittsburgh with Allan Meltzer writing his Ph.D thesis on the money supply process in Switzerland. Back in Switzerland, Alex was advocating inside and outside the Bank a money stock policy. At the same time he developed the money supply statistic for Switzerland. When I joined the Swiss National Bank in autumn 1974 I could benefit from his statistical and ideological foundation for a money stock policy. The president asked me to make a proposal for a monetary policy concept for Switzerland within three weeks. That Allan's student was favoring a money stock concept does certainly not come as a surprise. My position was - at least for outsiders – more ambiguous because I had a different background. Before joining the bank I was building a large econometric model for Switzerland at the Wharton School which in Karl Brunner's view was the worst place you could go to. I learned later that Allan Meltzer spent some time at the Wharton School as well. Karl Brunner was not aware of the fact that he convinced me a few years earlier that inflation was a monetary problem. Once I tried to convince Karl over a coffee that trade unions, cartels, import and raw material prices were primarily responsible for inflation. Instead of giving me a lecture on monetarism or his and Allan's papers on monetary policy or monetary theory, he simply said, inflation is a monetary problem and if you can show me one country which has inflation without a permanent big increase in the money supply you can have all my savings. As you know , money is a good incentive. Therefore I was trying hard to find such a country. As you can guess, I ended up with no money but with the conviction that the control of the money supply is essential for controlling inflation. Therefore I was favoring a money stock concept as well.

In 1976 I was invited to present a paper on “Monetary Policy under Flexible Exchange rates: The Swiss Case” at the “Konstanzer Seminar on Monetary Theory and Monetary Policy”. Allan and Karl organized the Konstanz Seminar together with Manfred Neuman in order to give young European economists an opportunity to meet American economists, and to present papers being discussed by American professors and researchers. The list of economists who started their academic career in Konstanz and who became interested in monetary policy issues is long. The ideas of monetarism were spreading out all over Europe and have made its marks in many Central Banks. Over the years the Konstanz Seminar became also an informal meeting place for leading people from Central Banks and academics. It is therefore not surprising that Allan Meltzer had so many friends in Central Banks and that those who are still active are keen to get Allan’s advice. His ability to combine theory and policy and to understand the political process within Government institutions makes his advice so valuable.

Let me also give you a none European example as well. In the late seventies Yoshio Suzuki, who later on became an executive director of the Bank visited me in Zurich. He was on a trip around the world to study the question how the Bank of Japan could bring its huge inflation under control. How times can change in thirty years. But that is an other story. Yoshio Suzuki was interested to learn about the Swiss approach to fight inflation. During our discussion we talked about Allan’s and Karl’s contribution and I asked him whether he met Karl and Allan on his trip. He said that he had not met them but he would be keen to meet them. As we went out for lunch we were running into Karl Brunner. Karl invited Yoshio Suzuuki to give a paper in Konstanz. A few years later, Allan became one of the two foreign honorary advisers of the Bank of Japan, succeeding Milton Friedman. Allan and Karl, what is less known, also played a crucial role in changing the monetary policy approach of the Bank of England in the early eighties, in particular in giving advice to Mrs. Thatcher. I still remember the meeting we had a Downing Street 10 on the eve of the war between Iraq and Iran.

Coming back to the Konstanz Seminar, I have to admit that I was nervous when I had to present my paper. Allan and his friends had a reputation of being extremely sharp and aggressive discussants. But as you can see, I survived

and the Seminar was the starting point for long and stimulating friendship with Allan. May be I was treated in a rather friendly way because the Swiss National Bank adopted as one of the first Central Banks a M1 money stock target and was using the adjusted monetary base to control the money stock (For an excellent description of Swiss monetary policy see: George Rich: Swiss Monetary Targeting 1974-1996: Central-Bank Analysis and Communication. Mim. 27. November, 2002). The monetary base approach was unique in the world (see: George Rich and Kurt Schiltknecht: Targeting the Monetary Base – The Swiss Approach, in BIS: The Monetary Base Approach to Monetary Control, Basle 1980) and of course based on Allan's and Karl's work. The only disagreement we had, was the flexible response in the money supply policy to large fluctuations in the exchange rates.

Karl and Allan had a preference for a rigid money stock approach. We at the Swiss National Bank had to take into account that Switzerland was an extremely open economy and therefore vulnerable to big exchange rate fluctuations. Therefore we were for many years in favor of abandoning the monetary policy target temporarily in order to dampen exchange rate fluctuations. Karl and Allan forced me to explain and to justify whenever we deviated temporarily from the money stock target. Karl was the spokesman of the two. He called me at least twice a week. If I had a question regarding a policy issue, he came back a few days later saying that he discussed the problem with Allan and that they were of the opinion that this would be a solution or that the approach which we had taken at the Bank was inappropriate. Whenever Karl or Allan learned about an interesting paper on monetary policy issues they informed and mailed me the papers. So we had access to many papers ahead of their publication. Allan and Karl invited me and my colleagues to participate and present papers at various conferences all over the world. The result of the permanent discussion with Karl and Allan over the years can best be seen from the conclusion of a paper which we presented at the Carnegie-Rochester Conference in 1983 (H.J. Büttler and Kurt Schiltknecht: "Transitory Changes in Monetary Policy and Their Implications in Money-Stock Control" in Carnegie-Rochester Conference Series on Public Policy 19 (1983)). We concluded "that central bank should abstain from fine tuning or fixing short-term money-stock targets. Instead, central banks should control the trend of the money supply."

Looking back to the 10 years I was in charge of formulating the monetary policy strategy of the Swiss National Bank I have to say that Karl and Allan were extremely crucial for the success of the Swiss monetary policy. First of all the policy concept laid down in 1974 was based to a large extent on Allan's and Karl's work. But it was not only the theoretical work and the stringent policy concept which was of big importance, it was also the intellectual comfort we had at the Swiss National Bank by having the opportunity to exchange and check out ideas and concepts with Allan, Karl and their friends. If you have no experience in running a money stock approach, if you are the only central bank using a monetary base approach to control the money supply and if inflation is reacting with a lag of almost three years to a change in the money supply you need people who tell you that you are doing things right. A stable intellectual environment is in my view very important for policy makers, in particular if you are under pressure from the export industries due to a strong appreciation or from the politicians who always want to see quick results regarding growth or inflation. I still remember the hour long discussion we had in 1978 during a conference on econometric model building in An Arbor. Just before going to the conference, we decided at the Swiss National Bank to temporarily abandon the money stock target in favor of an exchange rate target. Over lunch and dinner and in the evening and later on in Rochester I got the opportunity to explain the reasoning behind decision of the Swiss National Bank, the difficulties of forming expectations in the forex market if there are exogenous shifts in the demand for Swiss Francs. We also discussed the risks of the policy shift and how and when the Bank could return to a money stock policy. The results of the discussions with Allan and Karl - which of course continued over the phone after returning to Switzerland - were reflected in the proposals for monetary policy in 1979. However the recommendations were for first time not accepted by the Governing board. The board was in favor of sticking to an exchange rate policy for the foreseeing future. The price of this decision was high. Switzerland returned for a short period to high rates of inflation. I am mentioning this because I do not want that somebody might blame the monetary base concept or Allan and Karl for this temporary increase in inflation. The Swiss National Bank has to take the blame alone. Allan and Karl on the other hand deserve our gratitude for their contributions to monetary policy in general and Swiss monetary policy in particular.

