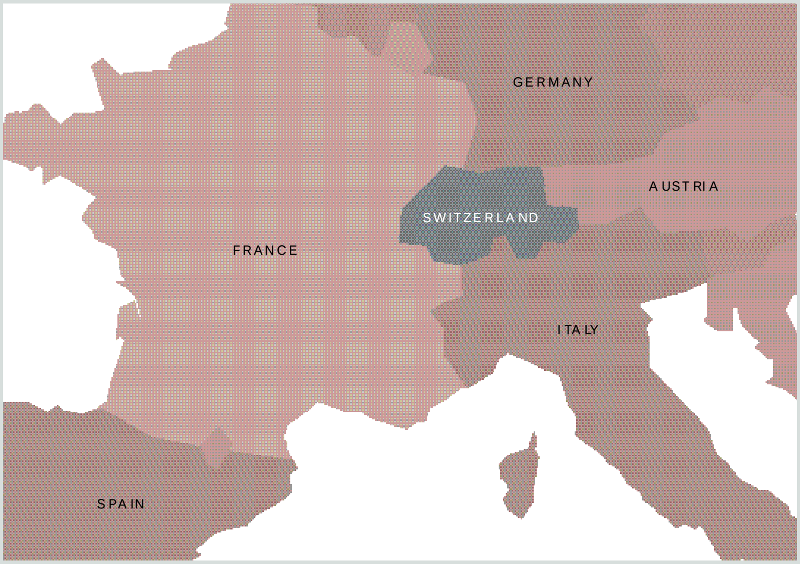
Switzerland's Gold

WORLD GOLD COUNCIL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Ten key questions about Switzerland’s gold

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Why should we care about Switzerland's gold?

The reason is simple. With 2,590 tonnes of gold in its official reserves[1] Switzerland is the world's fourth biggest individual official holder of bullion, after the Eurosystem[2], the US and the IMF. As of April 1999, gold forms 38.3 per cent of the reserves of the Swiss National Bank (SNB). For many people, both inside and outside Switzerland, there has long been an assumption that the strength of the country's currency and its economy owes much to its considerable reserves of gold. The link between gold and the Swiss currency has been enshrined in the country's constitution for more than a century.

The media outside Switzerland were therefore taken aback when, on 24 October 1997, a joint group of the Swiss Finance Ministry and the SNB produced a report on reform of the country's currency laws which, among other matters, recommended that some 1,400 tonnes of the gold reserves should be sold.[3] The price of an ounce of gold fell from the London morning fix of almost $322 to $316 in the afternoon and then later to $308.25 in New York. By Monday 27 October, the London afternoon fix was $311.80, then the lowest since 8 July 1985.

To put the scale of this potential sale into context, consider proposals made in the first half of 1999 that the IMF should sell 5-10 million troy ounces of its gold reserves, to fund debt relief programmes. At the upper level, this would mean IMF sales of 311 tonnes, just 24 per cent of the disposal contemplated by the Swiss Government.

The Swiss Government is now proposing to mobilise some of the country's gold reserves for budgetary and philanthropic purposes. The SNB itself has, since October 1997, emphasised that if the sales go ahead they will happen in an orderly and transparent fashion, and be phased over perhaps as long as a decade. Sales by the SNB of 130 tonnes a year over 10 years can easily be absorbed by the market. The market's response to the news from the SNB has thus been exaggerated. It is easy to see how this process could have been picked up, partially understood, given wide media coverage, and ultimately distorted. Nevertheless, something important is happening to Switzerland's gold reserves. The aim of this document is to give the full facts.

1 As of April 1999 **2** This includes, besides the ECB, the national central banks of Austria, Belgium, Finland, France, Germany, Italy, Ireland, Luxembourg, the Netherlands, Portugal and Spain **3** 1,400 tonnes was the figure first mentioned. However, in Switzerland, the discussion has since been firmly fixed on 1,300 tonnes. For consistency we have followed Swiss practice

What is the background?

2

There is a complex legal background to the October 1997 announcement by the SNB and it is part of an evolutionary process in the SNB's handling of its gold reserves.

This evolution started in 1971, when – following the demise of the Bretton Woods system – legal obligations to convert the Swiss franc to gold were suspended, due to the ‘currency turbulence’ of a floating exchange rate system. That same year, a government decree set the value of the Swiss franc at SFr142.90 ($96.40) per troy ounce of gold. While that was thought an appropriate level at the time, this is obviously considerably below current market prices.[4] Since 1971, the SNB has been legally permitted to buy and sell gold only within +/-1.5 per cent of this officially-set price. With the collapse of the dollar-gold exchange standard in the early 1970s, the international price of gold has been well above this official fixed rate; no Swiss sales or purchases of gold have been possible since that time.

In 1996, it became apparent to Swiss Government officials that this paralysis needed action. For one thing, the law requiring a 40 per cent gold cover for currency in circulation was soon going to be breached; by late 1996, the proportion of the money supply covered by gold had reached 43 per cent. With money supply growing at about two per cent a year, the constitutional requirement would probably have been broken within two years if the Government did nothing. While this would perhaps have been no more than a technical difficulty, it would nevertheless have been strictly unconstitutional.

To resolve this, the Federal Ministry of Finance and the SNB, in June 1996, formed a joint ‘Working Party’. This Working Party recommended the passage of temporary legislation – pending a necessary revision to the constitution – lowering the gold-currency ratio from 40 per cent to 25 per cent. This legislation came into effect on 1 November 1997. The passage of this legislation itself caused another ripple in the gold markets, where the reasons for the move were either poorly explained or inadequately understood. The negative sentiment based on the mistaken belief that the Swiss were thereby declaring a loss of confidence in gold as a reserve asset still hangs over the market. The truth is that this temporary legislation was passed to achieve three things:

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• to avoid a possible legal problem (breaching the constitutional requirement of the 40 per cent backing of the money supply with gold)
• to free some gold for leasing purposes (thereby gaining some revenue)
• and to work towards compliance with the terms for membership of the IMF.

Simultaneously to the Working Party analysing this aspect of the constitutional underpinning of Swiss monetary affairs, an Expert Group was established to consider more specifically what should be done with Switzerland's gold reserves, effectively mothballed since 1973.

This Group concluded that Switzerland should have about one third of its reserves in gold; in specific terms, SFr10.7 billion in gold and SFr29.4 billion in foreign currency. It also suggested an upward revaluation of the existing gold stock, from $96.40 an ounce to $189 an ounce, roughly 60 per cent of the then prevailing market price. This valuation would make the total value of the gold on the SNB's asset sheet worth SFr23.3 billion. The conclusion was that, with a revalued gold stock, some 1,300 tonnes of gold (SFr12.6 billion) was above the amount deemed necessary for monetary policy (which was about 1,300 tonnes). This 1,300 tonnes could be declared 'excess', said the Expert Group.

Since then, what has exercised the minds of everyone in the international gold business is what the Swiss might do with this so-called 'excess'.

What has happened does not constitute a rejection of gold as a reserve asset, but a political and economic recognition that Switzerland could, by valuing these reserves closer to market prices, use some of the gold for budgetary and pressing social needs. In other words, it is equally arguable that what the Swiss are doing is re-emphasising gold's historic role as an asset to be used for large-scale, nationally important tasks.

How has this come about? It is a response, partly, to a growing perception within Switzerland itself that the country's long tradition

2 continued

of international humanitarian aid, through such organisations as the International Red Cross, has recently come under closer examination. Intense media scrutiny of the country's role during the Second World War has engendered within many Swiss citizens a wish to reinvigorate the country's historic claim to assisting the world's less fortunate peoples. The genesis of the SNB's plans for its gold reserves owes much to this intangible but real national self-questioning. On 5 March 1997, Arnold Koller, Federal Councillor and the then President of the Swiss Confederation, advanced the idea of creating a long-term Solidarity Foundation for humanitarian aid at home and abroad. Kaspar Villiger, Finance Minister, also backed this proposal.

Outside Switzerland, this evolution has erroneously been translated into the view that Switzerland will inevitably and rapidly sell its 'excess' gold so that 1,300 tonnes will soon begin to flood the market. But this apparent 100-metre dash is much more like a marathon – and the race has only just begun.

There are several complicated legislative and political hurdles before any gold can be sold. The SNB and the technical experts have made their recommendations but how they are practically implemented will be a political decision, and one fraught with uncertainty.

For example, a big question mark hangs over the use to which any proceeds from gold sales may be put. Since late 1997, Swiss politicians have been struggling to arrive at a formula which they are confident the Swiss public will happily embrace. One suggestion has been that the proceeds from 500 tonnes be put into the proposed Solidarity Foundation[5], while the remaining 800 tonnes be divided between the Confederation and the Cantons. Only the interest from such disposals will be used; the capital will be left intact. But this Solidarity Foundation has yet to be approved, both by the parliament and the people, and its purpose has yet to be defined. Parliamentary opinion was, in April 1999, still divided over the allocation of the profits from the other 800 tonnes, 18 months after the proposal was first aired, if indeed they were eventually to be sold.

But this is still far from certain. According to Peter Klauser, Director of the SNB, any sale of gold could only follow a political decision as to what to do with the proceeds. In Switzerland, where political

2 continued

decisions are conventionally dependent upon the achievement of a prior consensus, the date for the sale of the first ounce of the so-called 'excess' gold appears to be fast receding into an indeterminate point in the future.

Still, the ball has started rolling. The 18 April 1999 referendum on a total revision to the Swiss constitution represents a further step towards the possibility of gold sales.

4 In 1971, the average market price established by the London pm fix was $40.82 per troy ounce
5 This is distinct from the Holocaust Foundation: see question 9

Is the 18 April 1999 referendum important?

3

As the object of the 18 April referendum is the first total revision of the country's constitution since 1874, it is clearly an important political event within Switzerland. However, it has aroused no controversy as it does no more than give the constitution a long-needed facelift, mostly by integrating all the accrued amendments into the body of the text. To approve this change, a majority vote is required both from voters on a national basis and voters in a majority of the 26 Cantons. Our document was prepared before the referendum, but all sources inside Switzerland forecast a low turn out, with a healthy majority in favour of the proposed revision.

The *Neue Luzerner Zeitung* newspaper on 18 March 1999 carried an analysis of the new constitution by Stefan Inderbitzin, under the headline "New constitution leaves one cold". The piece anticipated a poor voter turn out for the 18 April referendum on the constitution for several reasons, including the fact that the Swiss parliament had worked very hard to establish a maximally broad consensus on all issues and formulations in the constitution. The article quotes René Rhinow (FDP, Baselland), president of the Council of Cantons, as saying: "*Voter participation would be greater if the object of the vote had some direct effect on personal finances or was politically very controversial such as a vote on the army or heavy transit traffic.*"

4

What does the old constitution say about gold?

The parts of the outgoing constitution concerning the country's monetary and currency affairs, including gold, are a small element of the whole package: there are two relevant Articles, with a total of 10 sections. These contain the basic rules concerning the operation of the SNB. They can be summarised as follows:

- Article 38, section 1: sets out the Federal monopoly over the issue of coins and its right to issue coins
- Article 38, section 2: deals with the Federal right over coining
- Article 38, section 3: describes the Federal right to fix the value of the coins and to enact regulations on tariffs of foreign coins
- Article 39, sections 1-5: these describe the role of the SNB and set out its monopoly over the printing of bank notes
- Article 39, section 6: this stipulates that the State "may not remove the duty of exchange of banknotes into gold...except in time of war or under conditions of international currency turbulence."
- Article 39, section 7: this sets out that the issued bank notes and coins have to be covered by gold and short-term claims.

In other words, on paper the monetary regime still links the Swiss franc to gold, according to section 7 of Article 39.

5

And what does the new constitution say?

Article 38 will be abolished, and Article 39 becomes Article 99.

The relevant sections of the new Article 99 stipulate:

- Article 99, section 1: this deals with the legislative competence of the Confederation in all money and currency matters. It grants a monopoly to issue coins and notes.
- Article 99, section 3: this obliges the SNB to accumulate sufficient reserves to fulfil its mandate, and says a part of these reserves must be in gold.
- Article 99, section 4: this gives a breakdown as to how the profits of the SNB be distributed, with "at least" two-thirds to be given to the Cantons, the other third to the Confederation.

With the end of Article 39, section 7, it is clear that the link between the Swiss franc and gold will be severed. However, within Switzerland itself little importance is attached to this move. The reason is because this link has not been in effect for many years, as Switzerland's Society for the Promotion of the Swiss Economy (a body which represents the country's employers) recently pointed out:

"In reality, this linkage to gold ceased a long time ago. The last time the SNB's redemption obligation was actually honoured was in 1936. Gold has for a long time been a normal commodity and the Swiss franc the legal means of payment. As part of the review of the Constitution, therefore, the franc's linkage to gold is also to be abolished in law. This will allow for a more realistic market valuation of the SNB's gold reserves and greater flexibility in their use."[6]

Article 99 is widely perceived by parliament as insufficient to form the legal basis for gold sales. It is regarded as being too general in terms of the mandate for the SNB and provides an unacceptable division of the profits from a one-off sale of those reserves now deemed to be surplus for the policy requirements of the SNB. It is already the subject of various legislative initiatives for amendment. Under the proposed draft, passed by both houses of parliament, the new Article 99 will eventually disappear and be replaced by a new Article 39.

5 continued

A question arises: why introduce this stepping-stone of Article 99 – why not go straight from the old Article 39 to a new version?

It was considered vitally important to pass the total revision of the constitution as quickly as possible. The political parties decided that argument over the definition of possible 'excess' reserves in the SNB and how to spend the profits from their sale would endanger the timetable for passage of the entire constitution. They therefore agreed a compromise in Article 99 for passage on 18 April.

This new Article 39 principally addresses two issues. Specifically it mandates the SNB to target inflation as a priority policy goal, but it also provides for changing the traditional distribution of profits from activities of the SNB with regard to sales of 'excess' gold reserves.

When Switzerland joined the IMF in 1992 (following a national referendum) it promised to bring its laws into compliance with the IMF's Articles, including those which allow a country to set the exchange value of its currency through any means other than tying it to gold. It is not clear that the partial gold backing for the Swiss franc is a breach of the IMF's Articles forbidding countries to peg their currencies to gold, but it is seen as contrary to their spirit. The proposed amendments to the monetary Articles of the constitution are designed partly to fulfil this pledge.

6 Press release, 1 March 1999, from Gesellschaft zur Förderung der schweizerischen Wirtschaft

A new constitution - what next?

6

As well as acceptance of the new constitution, there will have to be a Bill, containing the enabling legislation for currency and monetary matters. As a general election will take place on 24 October 1999, there will be a delay in the Swiss parliament's consideration of this Bill. In fact, both Daniel Eckmann of the Finance Ministry and Peter Klauser of the SNB said, in March 1999, that passage of this enabling legislation could be delayed until spring 2000 in order to correspond with an approval in March 2000 of the new Article 39. On 18 March 1999, the Swiss newspaper *Le Temps* said: *"The Solidarity Foundation cannot be established before the electorate has accepted the [new finance] article of the constitution which cannot now occur, because of the autumn elections, before March 2000."*

The need for this Bill is a direct consequence of the 18 April referendum. This draft Bill is a piece of 'housekeeping' legislation, ratifying in law what has been approved for the new constitution.

The Bill contains the following salient points:

• it ratifies the Swiss franc as the country's official means of payment
• it sets out the areas of competence of the Federal Council, the department of finance, and the SNB
• it contains a number of details concerning the issuing and withdrawal of bank notes
• it does away with Article 19 of the law concerning the SNB, which stipulates that 25 per cent of money in circulation must be backed by gold
• it does away with Articles 20-22 of the law concerning the SNB, which imposed a duty to exchange banknotes and coins with gold.

The new legislation concerning currency and means of payment makes no mention of gold at all.

The Federal Council – Switzerland's seven-person supreme governing body – wants to enact this Bill at the same time that the new Article 39 is accepted by referendum, i.e probably spring 2000. To achieve that, both houses of parliament – the National Council (Nationalrat) and the Council of Cantons (Ständerat) – must discuss and approve it in the second half of 1999 at the latest.

Surely there will still be gold sales?

7

As of April 1999, it remains unclear as to precisely what will happen. The initiative to revalue Swiss gold reserves and declare some 1,300 tonnes of it ‘excess’ was taken by the Swiss Finance Ministry. At the time, this seemed to indicate that such sales would inevitably happen. But this whole topic has now entered the political arena where the situation is much more fluid and quite unresolved.

Indeed, such is the current state of flux that it is no longer even self-evident that the disposal will be in the form of sales. It might conceivably be in the form of lending, or the issuing of gold-backed bonds. Nor is it clear how the resulting capital will be invested, if the disposals take the form of outright sales. Furthermore, as we have stated, in April 1999 there was still no political decision as to how either the Confederation/Cantons or the Solidarity Foundation would use the proceeds from such disposals.

Without a decision on these matters, there will be no disposals.

The case of the Solidarity Foundation illustrates the difficulties which have delayed and will probably continue to slow any disposals of gold reserves. Under Swiss law, any new public foundation can only come into being following a national referendum. It is far from clear that a majority of the Swiss voting public will support the establishment of the Solidarity Foundation in such a referendum. Influential national newspapers, such as the *Neue Zürcher Zeitung*, *SonntagsBlick* and *Tages-Anzeiger*, are likely to support the establishment of the Solidarity Foundation, but only if it has a clearly defined agenda, a far distant prospect in April 1999.

On 15 March 1999, the Federal Council issued a statement stipulating that the Solidarity Foundation’s international charitable work would be preventative and gave three bases for its work. It would combat:

- suffering, and
- violence, and would
- operate through communal structures rather than individuals.

For a number of influential Swiss journalists, this vague statement was seen as a serious failure to pay sufficient attention to a potentially sceptical Swiss public who will be called upon to back the

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establishment of the Solidarity Foundation in a national referendum. If the Swiss voters are not presented with a clear and eminently appealing cause to which the proceeds of the sale of 500 tonnes of gold will be put, then it is entirely plausible to expect them to reject the Foundation.

Although there is a determination among some senior Swiss politicians and within the SNB to sell some gold, it is evident that the debate as to the purposes of the proceeds from such sales is at a very early stage. If no political consensus emerges as to what the proceeds of any sale should be, it is conceivable that the impetus to sell may grind to a complete halt. If, as many anticipate, the 24 October 1999 election increases the polarisation between left and right parties in parliament, the tussle over the sales of gold, the establishment of the Solidarity Foundation, and the desire to make an international humanitarian gesture versus the impulse to conserve the wealth of the country for domestic purposes, may well create further paralysis in any move to sell gold.

8

Does gold still function as a reserve asset?

Even if the proposed sales go ahead, they will take time and be carefully phased. The Swiss newspaper *Tribune de Genève* reported on 18 March 1999: *"Sales will have to be carefully measured because, as Kaspar Villiger lamented, the price drops each time someone speaks of possible Swiss gold sales."* It is equally evident that the date at which such sales may start is highly approximate, the earliest being mid-2000.

In any case, there have been a number of statements by senior political figures and SNB officials reinforcing the view that Switzerland still regards its gold as a vital component of its reserves. In a letter to the World Gold Council[7] Hans Meyer, president of the SNB, said, in the context of the planned revisions of Switzerland's currency and reserve laws: *"...we remain convinced that gold has an important role to play. By offering a useful diversification to foreign exchange reserves, gold will remain a useful asset in the portfolio of the Swiss National Bank."*

Moreover, the Swiss people and many Swiss politicians still remain wedded to the SNB's holding of gold. In the National Council on 17 December 1998, Rudolf Keller, of the Swiss Democrats, said in a debate on monetary questions: *"We should hold the largest possible amount of our reserves in gold. The value of gold should be seen from a long-term perspective. Gold will continue to be very important in the future."*

The conclusion to be drawn from this episode is that Switzerland wants to mobilise a portion of its gold on behalf of socially compelling causes. This could be argued to be one of the traditional reasons why governments hold gold – to be used in times of pressing need.

7 Dated 21 November 1997

9

What has this got to do with the Holocaust?

Nothing, although it is easy to see how the issues have become linked. Indeed, for many Swiss the two separate issues have become intertwined in a spirit of wishing to be seen to make amends for past presumed failures. Yet while both foundations stem from Switzerland's current reappraisal of its place in the history of the Second World War, there are significant differences between them.

The Swiss Fund For Needy Victims of the Holocaust (Stiftung "Fonds für Menschlichkeit und Gerechtigkeit")[8] was established in February 1997 and has been active since 1 September 1997. It is financed by the private sector, including the SNB acting in a private capacity. It operates under an international executive, and its SFr280 million funds eventually will be exhausted (about one-third of the funds had been distributed by April 1999). This fund was set up to help victims of Nazi injustice and was independent from any government activity in the same area.

The Solidarity Foundation – if it ever gets off the ground – will operate under Swiss leadership, the principal will remain intact, and the programme will be designed (on thinking prevalent in April 1999) for purposes other than relief of victims of the Holocaust.

8 Literal translation: Fund for Humanity and Justice

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How can I find information in Switzerland about this issue?

This is a list of some important Swiss public figures and officials.

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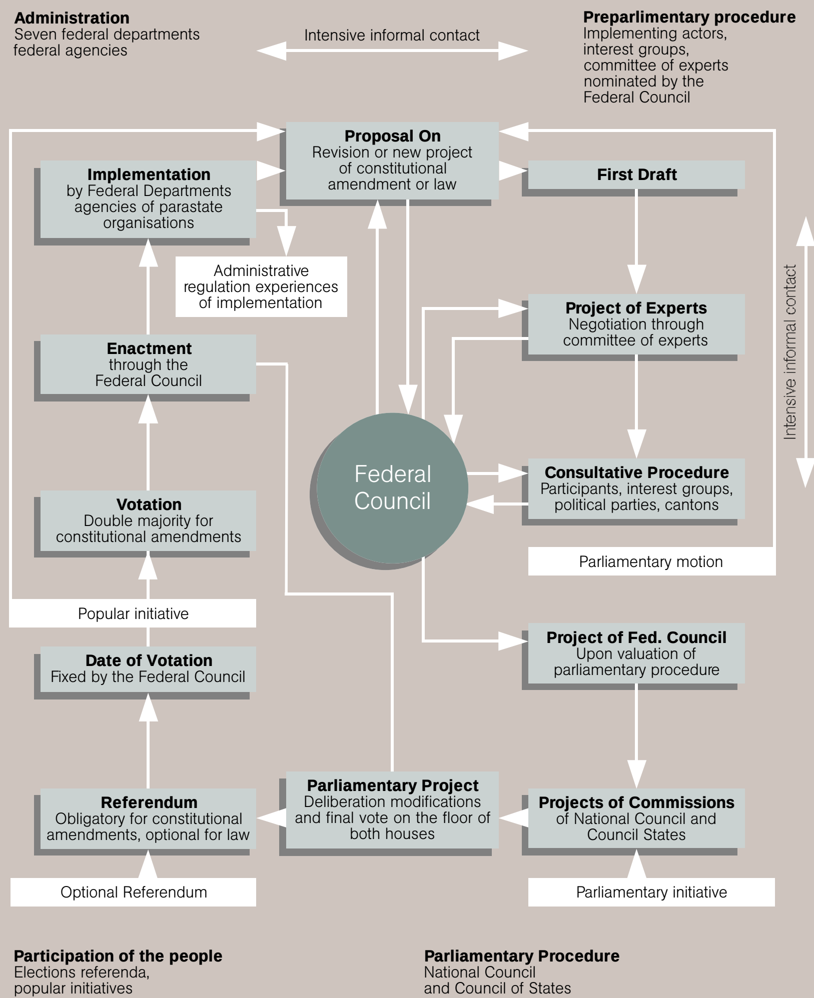
The power-sharing legislative process in Switzerland



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