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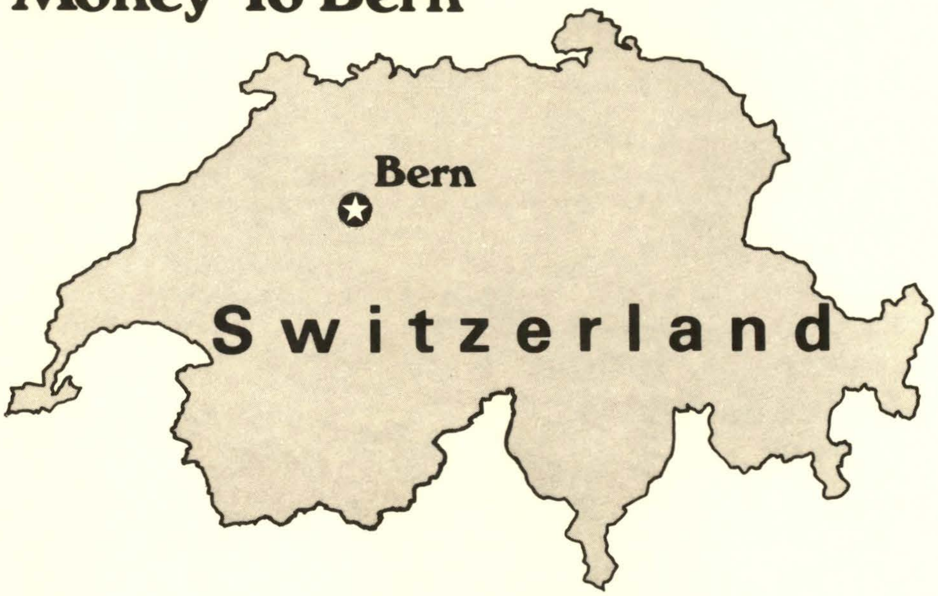
the LEDGER

economic education newsletter

Money To Bern



When Egypt's King Farouk abdicated his throne, he also gave up his yacht, his art collection, and his cherished coin collection. Nevertheless the renowned playboy enjoyed his years in exile because he had the foresight to divert millions of dollars into Swiss bank accounts. Money from those accounts more than met Farouk's needs, and he died at thirty-eight from the strain of living too well.

On New Year's Day 1959, Fidel Castro's revolutionaries chased President Fulgencio Batista out of Cuba. Batista had little time to pack, but he had prepared for just such an emergency by stashing $3 million in a Swiss bank.

In 1979, Iran's revolutionary government claimed that the Shah had transferred $15 billion out of the country during the final months of his reign. Much of the money reportedly went to Switzerland, but such reports were impossible to verify. Swiss bankers are notoriously tight-lipped.

Monarchs and dictators have long favored Swiss banks, but so have merchants, manufacturers, celebrities, aristocrats, and political figures from around the globe. They have usually been motivated by adverse conditions in their home countries: fear of war, social unrest, political instability, economic uncertainty, or high taxes. The money they transfer to Switzerland is insurance against an unpredictable future.

Most foreign deposits originally came to Switzerland from neighboring Italy and France. Huguenots (seventeenth century French Protestants) were among the first to seek a Swiss haven for their money. More than a hundred years later, the French Revolution and the Napoleonic Wars forced French aristocrats to flee across the Swiss border with their money. After World War I, economic chaos prompted wealthy Europeans to engage the services of Swiss bankers. When Hitler rose to power, German Jews transferred money to Switzerland. Nazis did the same when they realized Hitler's days were numbered.

Since the Second World War, money has poured into Switzerland from the developing world, especially the Middle East and Latin America. Middle Eastern kings, sheiks, and merchants deposit vast sums in Swiss banks because they are keenly aware that Middle Eastern governments all too often rest on shifting sands. Well-to-do Latin Americans, who once kept most of their money in Miami, New Orleans, and New York, are also turning to Switzerland. Many feel that Swiss bankers are less vulnerable to political pressure than bankers in the United States.

At the same time, European money still flows to Zurich, Geneva, Basel, and Bern. When France elected a Socialist president in 1981, monied Frenchmen hastily moved their capital into Switzerland. "Fright capital" from Italy crosses the Swiss frontier after each new attack or kidnapping by Red Brigade terrorists. "It's a safe bet," notes *Business Week,* "that trouble anywhere in the world means more money for Swiss banks."

Switzerland offers political and economic stability in a strife-torn world. The Swiss have a long democratic tradition and a strong economy. They settle internal disputes peaceably and reasonably. (The highly unionized Swiss labor force staged only three strikes in 1981. The longest lasted one day and involved only fifteen workers.) The Swiss take an equally sensible approach to foreign affairs. They maintained neutrality in both world

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wars. (During the Second World War they traded with Germany and shipped their national gold reserves to New York for safekeeping.)

In short, Switzerland inspires confidence among foreign depositors. Anxious foreigners take particular comfort in the deep Swiss respect for private property. Swiss law forbids government confiscation of private property without full and prior compensation. Furthermore, the Swiss do not consider tax evasion a criminal offense, and bankers are not obliged to cooperate with foreign or domestic tax collectors. On the contrary, Swiss law and an unwritten code of ethics encourage Swiss bankers to pursue a client's business interests to the utmost. (Swiss bankers will sometimes work with law enforcement officials, but the case must involve an act defined as criminal under Swiss law.)

A certain mystique surrounds Swiss banking

A certain mystique surrounds Swiss banking, and secret numbered Swiss bank accounts figure prominently in novels of international intrigue. Banking secrecy, however, is one of the least understood aspects of Swiss banking. (For example, most Swiss banks offer customers the opportunity to open an account that is identified by number only, but no bank will open an anonymous account. Two or three bank officials always know an account holder's identity.)

The Swiss are deeply committed to banking confidentiality. Article 47 of the Swiss Federal Banking Law (1934, revised 1971) reads in part:

> *Whoever divulges a secret entrusted to him in his capacity as officer, employee, authorized agent, liquidator or commissioner of a bank, as a representative of the Banking Commission, officer or employee of a recognized auditing company, or whoever has become aware of such a secret in this capacity and whoever tries to induce others to violate professional secrecy, shall be punished by a prison term not to exceed six months or by a fine not exceeding SF50,000.*

Developments leading to the adoption of Article 47 could have come straight from the pages of a spy thriller. During the 1920s, wealthy Germans shifted large amounts of capital to Switzerland. They were trying to protect themselves against the severe inflation and political turmoil that plagued Germany after World War I. When Hitler took power, the Nazis ordered every German with foreign holdings to declare those holdings or face a possible death sentence. Some Germans quickly complied with the order. Others, especially German Jews, feared the mounting Nazi persecution and maintained or added to their foreign holdings.

In 1933, Hilter's agents filtered into Switzerland. They employed bribery and deception to ferret out information that often led to the identification and subsequent death of German depositors who defied the Nazis. Swiss officials quickly realized that even an inadvertent breach of confidentiality threatened the integrity of Swiss banking, so Switzerland adopted the banking secrecy law in 1934.

The Swiss commitment to banking secrecy is so strong that it has even led to occasional friction between Switzerland and the United States. From time to time, U.S. authorities allege that Swiss banks are a haven for money from the American underworld. The allegations usually culminate in Congressional hearings that ruffle Swiss feathers but have little actual impact on the way Swiss banks do business.

In one instance, however, banking confidentiality sparked an uncharacteristically bitter dispute between the two countries. The issue erupted on the eve of America's entry into World War II. It centered around a U.S. Treasury Department request that Swiss banks with branches or affiliates in the United States reveal the identities of Nazi depositors. The Swiss steadfastly refused on the grounds that cooperation with the T-men would violate the 1934 banking secrecy laws. Treasury officials responded with a freeze on Swiss assets in the United States (including the gold reserves Switzerland had shipped to New York for safekeeping).

Courtesy of Swiss National Tourist Office

Swiss assets remained frozen until well after the Nazi surrender. In fact, tension between Switzerland and the United States reached its height after the fighting ended. The two countries could not agree on the disposition of German assets held by Swiss banks. (During the war, German industrial interests formed Swiss corporations and used Swiss banks to conduct global operations. Individual Nazis shipped stolen art treasures and other war loot to Switzerland for safekeeping.) The Swiss promptly returned war booty to its rightful owners, but Swiss bankers balked at helping the Allies find and liquidate German corporate assets. Finally, Switzerland and the United States compromised on a limited and voluntary breach of Swiss banking secrecy. The compromise left Swiss banking law intact and ended an unusual dispute between two essentially friendly countries.

On paper the "Big Five" Swiss banks (Union Bank of Switzerland, Swiss Bank Corporation, Credit Suisse, Volksbank, and Bank Leu) appear to be little more than successful commercial banks. Their balance sheets are unspectacular. Balance sheets, however, don't entirely reflect a Swiss bank's activity.

In some respects, Swiss banks differ sharply from American commercial banks. American banks make most of their money from loans because American law, particularly the Glass-Steagall Act, defines separate roles for commercial banking and investment banking. Swiss bankers are under no such constraints. They eagerly invest a customer's money and then reap a custodial fee (usually $^1/_2$ of 1% of the money managed) plus part of the brokerage fees. Money deposited in Swiss banks often ends up on Wall Street.

Fiduciary (trust) accounts afford anxious depositors an extra measure of protection. A Swiss bank invests a depositor's money in such things as securities, certificates of deposit, or precious metals. The transaction, however, is carried out in the bank's name. Such an arrangement makes life difficult for foreign tax collectors or anyone else who wants to trace money to its source.

Switzerland is a small, landlocked country with few natural resources. Banking is important to Switzerland's economic well-being and, for the most part, Swiss bankers are highly successful. Success, however, sometimes makes Swiss banking the target of critics both at home and abroad.

Switzerland's textile and watch manufacturers often complain that Swiss bankers are too cautious in providing capital for factory modernization. Other sectors of the Swiss economy charge that money flowing into Switzerland makes the Swiss franc ''artificially'' strong in comparison to currencies of other industrialized nations. The franc's strength in turn, leads to an exchange rate that makes Swiss goods and services more expensive and less competitive on world markets. Tourism is particularly hurt by a strong Swiss franc because vacationers, who once flocked to Switzerland for the skiing and the breathtaking scenery, now look for less expensive destinations.

Criticism from abroad usually focuses on two areas: 1) the Swiss banks' lucrative dealings in foreign exchange, and 2) the Swiss bankers' reluctance to provide backing for projects in developing nations.

The foreign exchange departments of large Swiss banks do a brisk business swapping currencies for Swiss and foreign customers who seek to profit from the fluctuation of one currency against another. Because Swiss banks are so heavily involved in foreign currency transactions, critics sometimes accuse them of manipulating foreign exchange. During the mid-1960s, for example, members of Britain's Labor government accused Swiss bankers of deliberately trying to sabotage the British pound. As the pound declined, Britain's Economic Minister, George Brown claimed in a now-famous quote that, ''The gnomes of Zurich are at work again.'' (The term ''gnomes'' reflects the popular characterization of Swiss bankers as secretive people whose only allegiance is to money.)

An even more sensitive issue is the Swiss bankers' reluctance to make loans in developing countries. Critics charge that Swiss banks draw capital from Asia, Africa, and Latin America only to invest it in the already rich industrialized world. If Swiss bankers respond to such criticism at all, they say simply that investments in Europe and North America are generally less risky than investments in the developing countries. From the bankers' point of view, the question of whether or not to make loans in developing countries is not a political or social issue. Their primary responsibility is not to foster the economic development of poor nations, but rather to manage a customer's money wisely. A Swiss banker's ''moral'' obligation is to the customer; not the world's poor. Such an attitude is likely to keep foreign money flowing into Swiss banks as long as wealthy people fear economic uncertainty and political instability in their home countries.

They Don't Give Away Clock Radios or Toaster Ovens

Swiss bankers aren't very interested in small foreign deposits, because Swiss banks make much of their profit from commissions and service fees. The big banks prefer foreign depositors who have lots of money to invest.

Most small savers would do better to keep their money in the United States. An American with $10,000 can earn a much higher yield at home, despite federal and state taxes on unearned income.

Wealthy Americans, who seek to diversify their investments and keep a percentage of their portfolios outside Wall Street, might consider a Swiss bank account, and so might those with children in Swiss boarding schools. Otherwise, even upper-bracket Americans are usually better off with a good tax lawyer than a Swiss bank account.

FOLLOW-UP QUESTIONS

1) Swiss banks attract sizable deposits from customers in poor nations that desperately need capital for development. To what extent are Swiss banks obligated to make loans or foster economic development in those countries?

2) People from outside Switzerland often deposit money in Swiss banks. How does the influx of foreign money affect the strength of the Swiss franc? How does the value of the Swiss franc affect the rest of Switzerland's economy?

3) Hypothetical Situation: A corrupt dictator skims money from the national treasury, extorts money from private citizens, and regularly deposits his/her ill-gotten gains in a Swiss bank. Finally, the people get fed-up and force the rascal into exile. The new government feels the money in the Swiss account rightfully belongs to the ex-dictator's country. They demand the money's return. To what extent should the Swiss bankers cooperate with the new government?

4) American law precludes the possibility of commercial banking and investment banking ''under the same roof.'' Swiss banks are not similarly restricted. What is the rationale behind the American regulations? Behind the Swiss lack of regulation? What impact is the trend toward deregulation having on American banking?

5) What circumstances, if any, justify one country freezing the assets of another country?

6) What circumstances, if any, justify government confiscation of private property?

MULTI-MEDIA

The Story of Checks and Electronic Payments, published by the Federal Reserve Bank of New York

Originally published as **The Story of Checks,** this longtime favorite is changing with the payments system. The newly revised comic-style booklet chronicles the development of checks and explores the concept of an electronic payments system. Copies of the new edition are available from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, NY 10045. (Appropriate for high school students. Charges for some bulk orders.)

Key to the Gold Vault, published by the Federal Reserve Bank of New York

The world's largest known accumulation of gold lies approximately eighty feet beneath Manhattan's Nassau Street in the Federal Reserve Bank of New York's gold vault. **Key to the Gold Vault** offers a fascinating look at vault operations. The 12-page booklet also describes the alluring metal's physical properties and recounts gold's glamorous past. Copies of **Key to the Gold Vault** are available from the Public Information Department, Federal Reserve Bank of New York, 33 Liberty Street, New York, NY 10045. (Appropriate for general public, high school and college students. Charges for some bulk orders.)

GIVE & TAKE

The people who brought you **Trade-offs,** the successful economic education video series for fifth and sixth graders, are hard at work on a project called **Give & Take.** The Joint Council on Economic Education, the Canadian Foundation for Economic Education, Agency for Instructional Television, and a consortium of state and provincial education agencies are developing the new video series to help eighth, ninth, and tenth graders approach every day decisions in economic terms.

Twelve 15-minute programs will focus on personal, real-life situations and events. According to Phillip Saunders, chief consultant and head of the **Give & Take** Design Team, ''We want to emphasize the kinds of economics that can be used by individuals — what economists call microeconomics. Budgeting, career choices, things like that.''

Each **Give & Take** program is designed to be an open-ended lesson, and each lesson is ''independent'' or ''self-contained.'' Teachers need not use the programs in sequence, nor will they have to use all twelve programs. The new series will provide teachers with a great deal of flexibility because ''the Design Team identified certain instructional objectives that are to be achieved by viewing the program alone as well as other, more ambitious objectives that will require supplementary classroom materials and/or teaching activities to achieve.''

Give & Take is scheduled to be available for classroom use in September 1982. The series' designers feel the programs will be appropriate for use in economics, consumer education, social studies, business education, and home economics classes. For more information on **Give & Take,** contact the Joint Council on Economic Education, 1212 Avenue of the Americas, New York, NY 10036; phone (212) 582-5150.

New England Update

CONNECTICUT

The **Center for Economic Education, Central Connecticut State College,** is arranging a one-day bus tour to the General Motors Assembly Plant in Tarrytown, New York and Unimation, Inc. (industrial robots), in Danbury, Connecticut. The trip is scheduled for Saturday, June 25, 1982. Its theme is ''Technological Change in the '80s and '90s.'' The cost is $12.00 per person (including coffee and light refreshments on the bus). Space is limited to forty people. For more information and reservations, please contact the Center for Economic Education, Marcus White Hall, Room 103, Central Connecticut State College, New Britain, CT 06050.

VERMONT

Vermont has joined with the other forty-nine states by affiliating with the Joint Council on Economic Education.

The **ECON TREK** summer workshop will be held at the University of Vermont, June 28–July 2, 1982. It will provide teachers with classroom materials, teaching ideas, and background on the Vermont economy. The full week of work will include field analysis of Vermont businesses and industries; guest speakers from government, business, labor; viewing of **ECON TREK** television shows on Vermont economic issues; demonstration lessons; and seminars on economic principles. Malcolm F. Severance of UVM's Business Administration Department leads the economic instruction for the workshop. A fellowship to cover all tuition costs, plus room and lunch costs as necessary, will be granted to the first 25 qualified applicants.

FED UPDATE

Upcoming exhibitions:

South Shore Art Center: **The Intuitive Eye.** Monday, May 17 through Friday, July 9.

Artists Foundation: **Images of Preservation and Development in the Fort Point Channel and the Leather District.** Scheduled to open on or about July 22.

Both exhibitions are open to the public, at no charge, Monday through Friday from 10:00 am to 4:00 pm. The Display Area is located on the ground floor of the Federal Reserve Bank, 600 Atlantic Avenue, Boston.

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