economiesuisse DOSSIER POLITIK

11 / 2016
The Empty Promises of the «Sovereign Money Initiative»

11.11.2016

Executive summary

The aim of the «Sovereign Money Initiative» is to introduce a monetary system in Switzerland in which the Swiss National Bank (SNB) has absolute and direct control over the money supply. This would prohibit commercial banks from creating money through lending. They would only be allowed to grant loans that are fully secured via savings accounts. This represents a radical reform of the existing system which would introduce a system that has not been trialled anywhere in the world to date. The initiators want to bring about secure payment transactions, reduce the occurrence of financial bubbles and prevent bank runs. But in their proposal they consistently ignore the associated drawbacks: on the one hand, the money brought directly into circulation by the SNB would not be secured via shares, bonds, or gold, and on the other hand numerous regulations would be required in order to halt efforts to resort to other currencies or create Swiss francs abroad. The initiative also promises an extremely generous annual profit distribution to the government and the population. The proposal thus represents a threat to the autonomy of the SNB's monetary policy.

Positions of economiesuisse

- Money created from nothing is not secured by collateral or securities: it is essentially «empty money» rather than full money.
- Payment transactions would become more expensive: small clients would have to foot the bill.
- Efforts to resort to other currencies or create Swiss francs abroad would have to be suppressed through the introduction of countless new regulations.
- The proposal promises a very generous annual profit distribution by the Swiss National Bank (SNB) to the federal government, the cantons and the general population: this represents a threat to the SNB's autonomy.
- The initiative is irresponsible: while it would prevent bank runs on sight deposits, it would also jeopardise price stability and could give rise to a currency crisis.
- economiesuisse firmly rejects the initiative, which is a high-risk experiment.

Land of milk and honey

The «Vollgeld Initiative»

In Switzerland anyone can propose changes to the constitution by collecting 100'000 signatures. In December 2015, the «Vollgeld Initiative» (full title: «Initiative for crisis-proof money: creation of money by the Swiss National Bank alone!») was submitted. Literally translated, «Vollgeld» means «full money» in English and has the same meaning as «Sovereign Money».

→ **The initiative aims to prevent financial bubbles and bank runs. Tax payers and businesses are to benefit from the seigniorage.**

What are the aims of the initiative?

The authors of the initiative promise a rosy future for Switzerland: sovereign money means that deposits on domestic accounts would at last be absolutely secure. Tax payers and the real economy would benefit from the seigniorage. Financial bubbles and bank runs could be prevented and the government would no longer be compelled to rescue banks that have run into difficulty. The finance sector would again be at the service of society, and the monetary and banking system would no longer be a closed book, but instead would at long last be understandable for everyone again. In other words, the initiative promises to make Switzerland a land of milk and honey again.

→ **The initiative is backed by several well-known critics of the growth system, as well as by a notably large number of people from Germany.**

As is so often the case with moves aimed at radically improving the world, this initiative, too, glorifies the potential benefits while ignoring the associated major drawbacks and risks. It is supported by Monetary Modernisation (MoMo), an organisation based on the ideas of German economist and social scientist Joseph Huber. Its backers include several well-known critics of the growth system, as well as a notably large number of players from Germany. Like the initiative calling for an unconditional basic income which was rejected by a clear majority in June 2016, it appears that, here too, an international organisation wants to put an ideologically-based concept to the test in a direct democracy.

Seigniorage

The term «seigniorage» is derived from the French word «seigneur» (feudal lord). It is a reference to an era in which the right to mint coins – originally granted by the king – was assigned to feudal lords (sovereign right of coinage), who were able to siphon off the gains resulting from the difference between the value of the metal and the nominal value of the coins brought into circulation. Today, it is a more general term that refers to the gains that result from the issue of money by a central bank.

What is sovereign money?

→ **A changeover to sovereign money would result in a radical reform of Switzerland's monetary system.**

Adopting the sovereign money concept would fundamentally change the existing monetary system. But what does the initiative want to change and how would the new system function? This chapter briefly describes the development of Switzerland's monetary system, then explains the changes the initiators want to bring about.

→ **The existing system in which the SNB holds the monopoly on issuing banknotes was only introduced at the beginning of the 20th century.**

Evolution of the existing monetary system

The existing monetary system is relatively young. With the onset of freedom of trade and industry, numerous public and private banks were established in many cantons in order to provide the population with a means for making payments. In addition to the new type of paper money (banknotes) issued by these banks, a large number of different coins were in circulation, including the «batzen» as the unofficial Swiss coin.

After the foundation of the Swiss Confederation in 1848, the sovereign right of coinage was initially assigned to the federal government, which then defined and minted Switzerland's coins. Then in the early 1880s, the still relatively young Swiss Confederation made a further move in the direction of centralisation when it introduced regulations governing the issuance of banknotes, which was still more or less organised on the basis of market-economy principles.

It was only at the beginning of the 20th century that cantonal and private banks were prohibited from issuing banknotes, and the right to do so was assigned to the newly established Swiss National Bank (SNB).

→ **Today the SNB primarily controls the money supply by buying currencies or carrying out repo transactions.**

Who creates money?

Since 1907, the SNB has been responsible for creating central bank money. The central bank money supply, which comprises banknotes in circulation and current account deposits of banks at the SNB, is referred to as M0 and currently amounts to approximately 500 billion Swiss francs. The SNB puts money into circulation by, for example, buying currencies from the commercial banks against Swiss francs or concluding repo transactions [1] . In view of the euro crisis, buying foreign currency is the SNB's most important instrument today, whereas under normal market conditions, repo transactions are the leading instrument. Table 1 shows the respective balance sheets of the SNB and a commercial bank. In this example, the SNB buys foreign currencies from the commercial bank amounting to 50 million Swiss francs and thus extends its balance sheet by the same amount. At the commercial bank the transaction results in an asset exchange, with lower foreign currency holdings offset by an increase in current account deposits.

Table 1

SNB creates central bank money by buying foreign currencies

SNB balance sheet

Assets	Million Swiss Francs	Liabilities	Million Swiss Francs
Other assets		Other liabilities	
Gold		Sight deposit accounts	+50
Foreign exchange investments	+50	Circulation of banknotes	
		Equity	

Commercial bank balance sheet

Assets	Million Swiss Francs	Liabilities	Million Swiss Francs
Other assets		Other liabilities	
Foreign currencies	-50	Equity	
Sight deposit accounts	+50		

Source: economiesuisse analysts

→ **Commercial banks also create Swiss francs by issuing credit facilities, though these are subject to clear limitations.**

In the existing system, in addition to the SNB, commercial banks also create money. They bring book money into circulation through the issuance of credits (cf. Table 2). If a bank issues a credit in the amount of 900,000 Swiss francs, it credits the corresponding amount to the client's account in the form of a sight deposit. Together with cash at non-banks, these form money supply M1 and are available for payment purposes. M1 currently amounts to around 600 billion Swiss francs.

The creation of money by commercial banks is subject to clear limitations. In order to prevent themselves from getting into difficulty, these banks have to ensure that borrowers are in fact able to repay their loans. This means that most loans have to be adequately secured, for example in the form of real estate or securities. Commercial banks are also obliged to cover a certain portion of customer deposits with reserves, as well as to comply with liquidity and capital regulations. Finally, with its range of monetary policy instruments the SNB is able to steer interest rates on the money market and thus indirectly control the money supply via credit demand.

Table 2

Creation of book money by commercial banks through lending

Commercial bank balance sheet

Assets	Million Swiss Francs	Liabilities	Million Swiss Francs
Other assets		Other liabilities	
Credits	+0.9	Sigth deposits	+0.9
		Equity	

Balance sheet of client

Assets	Million Swiss Francs	Liabilities	Million Swiss Francs
Other assets		Other liabilities	
Current account	+0.9	Credits	+0.9
		Equity	

Source: economiesuisse analysts

→ **The Sovereign Money Initiative wants to prohibit commercial banks from creating money. Furthermore, it calls for the SNB to distribute created money to the government and the population instead of investing it.**

The sovereign money system

The Sovereign Money Initiative aims to change the existing monetary system in two ways. Firstly, it wants to prohibit commercial banks from creating money in that it would assign the book money monopoly to the SNB. In this way, the SNB would be the sole institution permitted to put money into circulation. Commercial banks would only be allowed to grant loans on the basis of savings that cannot be withdrawn for a certain period of time. These banks would have to book this money outside their balance sheet on a newly created payment account that is similar to a custody account. And secondly, the initiators want to change the way in which money is brought into circulation and are calling for the SNB to create sovereign money without buying anything and without receiving a countervalue. It is to be permitted to define sovereign money as an asset, and to pay it out debt-free to the government and the population, and thereby control the monetary circulation.

Table 3 shows the balance sheet mechanism. Because the SNB is authorised to issue legal means of payment, it is able to credit debt-free money to itself to the tune of 10 billion Swiss francs on the assets side, and thus increase its equity by the same amount. It can now distribute this money, which has been created out of nothing, to the government and the population. Its assets and equity then decrease again as shown in Table 4, and the government and population now possess an additional 10 billion Swiss francs.

According to the initiators, this solution will result in a crisis-proof payments system because bank runs would then be a thing of the past. The banking system would be more secure and the «too big to fail» problem would be greatly eased. Furthermore, the population would benefit from the distribution of seigniorage by the SNB.

Table 3

Sovereign money «printed» via a balance sheet extension

SNB balance sheet

Assets	Billion Swiss Francs	Liabilities	Billion Swiss Francs
Other assets		Other liabilities	
Inventory		Equity	+10
Coins			
Banknotes			
Book money	+10		

Outside the balance sheet: Coins in circulation
Banknotes in circulation
Book money in circulation

Balance sheet of government and population

Assets	Billion Swiss Francs	Liabilities	Billion Swiss Francs
Other assets		Other liabilities	
Sovereign money		Equity	

Source: economiesuisse analysts

Table 4

Distribution of book money to government and population

SNB balance sheet

Assets	Billion Swiss Francs	Liabilities	Billion Swiss Francs
Other assets		Other liabilities	
Inventory		Equity	-10
Coins			
Banknotes			
Book money	-10		

Outside of balance sheet: Coins in circulation
Banknotes in circulation +10
Book money in circulation

Balance sheet of government and population

Assets	Billion Swiss Francs	Liabilities	Billion Swiss Francs
Other assets		Other liabilities	
Sovereign money	+10	Equity	+10

Quelle: eigene Darstellung

→ **The sovereign money system should not be confused with the Chicago Plan, which calls for banks to hold 100 percent reserves on sight deposits.**

The Chicago Plan

The sovereign money concept is often confused with a monetary system that calls for banks to hold 100 percent reserves. The most widely known draft for a 100 percent reserve system (also referred to as 100 percent banking, 100 percent money or full reserve) is the Chicago Plan dating from the 1930s. Despite certain similarities, the two monetary systems differ in terms of their fundamental concept. Whereas sovereign money itself is a financial asset and is listed outside the bank's balance sheet, the 100 percent money system obliges the bank to fully cover its sight deposits with central bank money. Sovereign money can only be created by the central bank, whereas with the 100 percent money system banks can still bring money into circulation in the form of loans against interest. Thus under the Chicago Plan, money remains a debt and not a financial asset.

A radical experiment with an uncertain outcome

→ **The initiative envisages advantages that are by no means a foregone conclusion, and ignores drawbacks associated with the proposed reform.**

Switzerland as guinea pig

The advantages the initiators attribute to the sovereign money system are by no means a foregone conclusion, and the initiative largely ignores the risks and drawbacks associated with the proposed changeover. If the initiative were to be accepted, Switzerland would effectively become a large-scale test laboratory in which the population would collectively function as test subject. The consequences of the changeover to the sovereign money system are difficult to predict and threaten both growth and prosperity in Switzerland. No other country has introduced this system and it has never been trialled anywhere to date. As guinea pig, Switzerland would face a highly uncertain future.

→ **The comparison that is often made with the monetary system that was in place in Louisiana in the mid-19th century is flawed. At that time it was competing banks that issued banknotes, not a monopolist in the form of a central bank.**

Inappropriate comparison between Louisiana and coinage

The initiators cite Louisiana and coinage in Switzerland as evidence that sovereign money functions very well. But this comparison is unable to withstand close scrutiny: it is tantamount to comparing apples with pears. Following the US banking crisis of 1837, Washington delegated banking regulation to the individual states. While Texas and Iowa prohibited banks altogether, other states – and in particular New York – favoured «free banking», i.e. a system without any banking regulation at all. With the adoption of its Free Banking Act in 1853, Louisiana also favoured a market economy solution, but had already imposed an obligation on banks in 1842 to cover their deposits and banknotes with cash (one-third) and short-term securities (two-thirds). The system adopted in New York proved highly successful, and the Louisiana solution was also relatively successful and stable from the 1850s onwards [2] .

But the example of Louisiana is not suitable for making a genuine comparison. At that time there was no central bank that brought money into circulation as monopolist: banks issued banknotes in competition with one another. That system essentially is a combination of the free banking period in Switzerland in the 19th century and the Chicago Plan, and thus functioned in an entirely different way to the sovereign money concept proposed by the initiators.

→ **Coinage, too, is unsuitable for comparison with a functioning sovereign money system. Historically speaking, the intrinsic value of a coin was close to its nominal value. Today, however, coins account for less than one percent of the overall money supply.**

Coinage, too, is an unsuitable example for comparison purposes. At the time of its inception in 1851/52, the composition of the Swiss franc was defined as five grams of silver 900 per thousandth, fine. The five franc coin was currency money, i.e. its intrinsic value was equivalent to its nominal value. Banknotes were not widely distributed until the 1870s, and at that time book money was also not as widely used as it is today. Swiss franc coins were widely distributed alongside foreign coins and were used intensively. However, the first Swiss franc coins were not sovereign money: with the exception of coins with a nominal value below 20 cents, their intrinsic value was equivalent to their nominal value. Thus seigniorage resulting from the minting of coins was only possible to a very limited extent.

Today, the metal value of Swiss coins is only a fraction of their nominal value. This means that the federal government is able to obtain seigniorage from the minting of coins. However, a comparison with the sovereign money system is not appropriate. On the one hand, the federal government forms reserves equivalent to 65 percent of the coins in circulation. Because experience has shown that a shrinkage rate of 35 percent has to be anticipated, even in the case of a full return flow of the coins the government is able to exchange them on a profit-neutral basis for banknotes or book money by drawing on its reserves. And on the other hand, coins meanwhile account for less than one percent of the overall money supply. Consumers have largely substituted coins with banknotes and book money.

Due to the lack of meaningful comparisons, sovereign money would be a high-risk economic experiment for Switzerland.

Two major risks due to lack of comparisons

It is therefore clear that the Sovereign Money Initiative aims to introduce a fundamentally new monetary system that has never existed anywhere to date in the proposed form. Although other monetary systems indicate certain similarities with the sovereign money concept, it is not possible to draw direct comparisons. This gives rise to two major risks: firstly, it is by no means certain that the transition from the existing system to the proposed sovereign money concept will take place without severely harming the Swiss economy. And secondly, it is not at all clear whether in the sovereign money system the desired effects can be achieved and at the same time the negative effects will not outweigh the positive ones. In view of this, the proposed sovereign money system has to be regarded as an economic experiment with a highly uncertain outcome.

The transition from the free banking system to the banknote issuance monopoly of the SNB took place relatively smoothly in 1910. A three-year transitional period was declared for this purpose.

Transition to banknote issuance monopoly

The handover of the banknote issuance monopoly to the newly established Swiss National Bank (SNB) meant that around three dozen private and cantonal banks had to cede their issuing rights. In 1907, the proportion of notes in circulation to the balance sheet total was around twelve percent on average. In order to give the banks sufficient time to create the necessary liquidity, a three-year transitional period was specified. By the end of June 1910, the banks had to deliver a minimum of 40 percent of the equivalent value of their issued banknotes to the SNB in legal tender and the remainder in the form of cash, bills of exchange or securities. Because the banknotes were covered to around 50 percent by coinage and the option was available to hand over securities – an option that some banks utilised to a very great extent – the transition took place relatively smoothly.

For some banks, however, this move resulted in far-reaching consequences. Private issuing banks were either liquidated or merged with other banks because their business activity was now prohibited. And for the cantonal and other private banks the loss of a financing option had a negative effect on profitability [3] . The elimination of banknotes meant that they had to replace non-interest-bearing resources, which in most cases was implemented via share capital increases. This accelerated the process of consolidation in Switzerland's banking sector.

Empty promises mean greater uncertainty

→ **If sovereign money were to be defined as an asset and given away by the SNB, confidence in the Swiss franc could be quickly eroded.**

Risk of loss of confidence in the Swiss franc

Instead of comparing the Louisiana case and coinage with sovereign money – i.e. apples with pears – apples should be compared with apples in order to be able to at least roughly sketch the uncertain outcome of the sovereign money experiment with the aid of various scenarios. Here, one indicator would be the apparently strongest argument put forward by the initiators: the security of the Swiss franc.

Because payment transaction accounts are managed outside the balance sheet, sovereign money is no longer affected by banking crises. Issued Swiss francs would always be available on the clients' own account and could therefore be withdrawn at any time. Even if all clients decided to withdraw their money simultaneously, this would not give rise to any difficulties for the bank.

While this means that bank runs would be eliminated, a significantly greater risk would arise, namely that of a run on the currency. At present, the SNB books central bank money under liabilities and a mix of forex investments, securities, gold and bonds under assets. Although the SNB is currently being criticised to some extent for maintaining securities denominated in euros on its books, the situation under sovereign money conditions would be a great deal worse. In a sovereign money system the central bank no longer books any assets on its balance sheet. Sovereign money would be defined as an asset and subsequently given away to the government and the population. This means that no assets are acquired in order to put sovereign money into circulation. Instead, sovereign money is simply defined as an asset.

This practice could shatter confidence in the Swiss franc. As Voltaire pointed out, paper money eventually returns to its intrinsic value – zero. Sovereign money would sooner or later suffer the same fate if the SNB were to no longer possess any foreign currencies, securities, gold and bonds on the assets side. Confidence in the Swiss franc could rapidly diminish and culminate in a frantic flight from the currency. Based on historical comparisons, this is unfortunately a realistic scenario.

→ **Examples from the past (e.g. the Byzantine Empire and Japan) have shown that money without an intrinsic value sooner or later causes the collapse of the currency concerned.**

The historical balance of «asset-based money» with no intrinsic value

All over the world, the devaluation of coins was always a popular means of supposedly generating revenue at no cost. The intrinsic value of a coin was reduced with the aid of various methods and thus resulted in the creation of seigniorage. In the Byzantine Empire, silver was added to coins originally made of pure gold while the nominal value was retained. The proportion of silver was constantly increased until in the end the coin consisted entirely of silver, which resulted in a loss of confidence in the currency and ultimately caused it to collapse. In Japan, the weight of coins was periodically reduced until they were worth only a fraction of their original value. The Japanese population then used rice as a means of payment.

Unlike coins, sovereign money – which is also an asset-based concept [4] – does not possess any intrinsic value at all. In view of this it is likely that the loss of confidence in such a currency would be at least as drastic as was the case in the above historical examples.

→ **The advantages that Switzerland has built up over the long term thanks to a stable currency would be severely jeopardised by the introduction of a sovereign money system.**

A currency crisis would have far-reaching consequences for the Swiss population. The purchasing power of the Swiss franc – and thus the country's prosperity – would be eroded. This would mean that all the advantages that Switzerland has built up since the nineteenth century thanks to its stable currency would practically vanish overnight.

While the risk of bank runs would be eliminated through the introduction of a sovereign money system, Switzerland would merely be exchanging that risk for the much greater risk of a flight from the Swiss franc.

→ **Sovereign money only protects payment accounts. As before, savings would still be jeopardised in the event of the bankruptcy of a bank and covered by deposit protection up to the value of 100,000 Swiss francs.**

Sovereign money cannot protect savings

It is an undisputed fact that bank runs and banking crises can cause a great deal of harm to the economy. But the sovereign money system only prevents the former. A bank run occurs when a large number of clients simultaneously decide to withdraw their money from their bank. Due to the money multiplier, the bank is not able to cover all the withdrawals at the same time. This means it becomes illiquid and could drag down other banks in the resulting turmoil, thus potentially jeopardising the entire banking system. This kind of bank run cannot occur in the sovereign money system. By contrast, a bank can become bankrupt if its borrowers are no longer able to repay their debts. Because only payment accounts are secured in the sovereign money system, if the bank becomes bankrupt, savers would lose their money as in the past. But the existing deposit protection ensures that a client's deposits at the domestic and foreign branches of a bank are secured up to the amount of 100,000 Swiss francs.

Small clients will have to foot the bill

→ **The initiative not only poses the threat of a currency crisis for the population, it also forces them to choose between risky savings accounts and non-interest-bearing sovereign money accounts for which charges apply.**

Restricted freedom of choice

The Swiss population not only has to anticipate the risk of a currency crisis, but in the sovereign money system would also have to pay a very high price in that bank clients would then only be able to choose between a secure, non-interest-bearing sovereign money payment account for which they would also have to pay charges, and a savings account that, while bearing interest, would remain exposed to a certain degree of risk and cannot be used for payment purposes. The current account that is preferred by clients today would be prohibited. The initiators welcome this prohibition, but in doing so are overlooking the fact that the choice of a current account can in fact be a conscientious and rational decision. Security is not the sole criterion associated with the choice of a bank account. For example, clients favour a current account because they are able to withdraw their money at any time and as a rule simultaneously receive interest as compensation for the risk they enter into, namely that in an extreme situation they may not be able to withdraw all their money. The fact that bank clients do not choose to hold a current account without being aware of the associated risk was confirmed in a survey in which 88 percent of the respondents answered this question accordingly. Despite this, by bringing about a prohibition of the current account the initiators want to force bank clients to waive the benefits of such an account.

If in the sovereign money system an investor chooses the option of a savings account that is exposed to certain risks, he or she has to leave the money in the hands of the bank for a specified period of time, during which the money remains unavailable. This is because the current standard practice, according to which a withdrawal limit of several tens of thousands of Swiss francs applies, and thus a portion of the client's savings is available at any time, would no longer be constitutional: in order to ensure that payment and savings accounts remain clearly separated, the initiative calls for the SNB to specify a minimum holding period for savings deposits (for example, three months). This would mean that, in order to avoid getting into financial difficulties, more and more liquidity-intensive companies would have to choose a non-interest-bearing payment account that is also subject to bank charges. In the future, an unexpected, short-term liquidity requirement would place companies and private individuals in a difficult situation. If, for example, my car is a write-off as the result of an accident, and I do not have enough money on my payment account, I would only be able to buy a new one by taking out a loan. This means that, in order to be prepared for any such contingency, it would be necessary for me to form reserves on my payment account in order to ensure that I can remain solvent at all times.

→ **If banks are not permitted to use sovereign money accounts as a source of financing, they will have to pass on numerous charges to the account holders for services for which the latter currently do not have to pay.**

Sovereign money as a cost trap

A bank is required to book its clients' sovereign money outside its balance sheet. This means it is not permitted to use payment accounts as a source of financing for credits. Under these circumstances, how can the bank cover the account management costs? It would have to pass on numerous costs that currently do not have to be borne by its clients. Costs associated with general account management, transfers, invoices or withdrawals from ATMs would have to be charged to clients. We can obtain a picture of how costs in a sovereign money system would be structured over the long term by examining the current low-interest policy of the SNB. Existing charges are being periodically increased, or new ones are frequently being introduced, and these are hitting small clients particularly hard.

There is another increase in costs that the banks, and ultimately their clients, will have to bear on the financing side. Although it is to be anticipated that banks will finance themselves in other ways, for example via the capital market or savings deposits, it is likely that borrowing costs will increase on average, especially for smaller lending institutions and those with a regional orientation for whom access to the international capital market is more difficult. Adolf Jöhr, who was the first Secretary General of the SNB, already drew attention to this as the logical consequence of a banknote prohibition for private banks. Due to similar circumstances, the same effects have to be anticipated for a book money prohibition.

Due to the higher costs and in some cases the difficulty of passing them on, it is possible that some banks will no longer offer payment accounts. Because the management of these accounts goes hand in hand with high fixed costs, small clients in particular are likely to find themselves facing a reduction in choice. Thus the most plausible scenario is that small clients will have to foot the bill. They will either have to leave their capital in the hands of the bank for a minimum period as specified by the state, or will have to pay high charges for their payment account, for which they even have a reduced choice of providers.

→ **The federal government has to guarantee the provision of financial services to the economy. In an extreme case, the sovereign money system could even give rise to the nationalisation of the banking sector.**

If, as the result of state intervention, banks are only able to offer their services to wealthy clients, then they would be left holding the baby, so to speak. Since in accordance with the wording of the initiative the federal government would be required to guarantee the provision of financial services to companies, and thus could deviate from the basic principle of economic freedom, at the political level it is possible that pricing regulations could be defined and finance institutions would have to manage a sovereign money account for everyone. And what would be even worse is the fact that such a development could even pave the way for the complete nationalisation of the banking sector.

Potential tidal wave of regulation

→ **If confidence in the Swiss franc is lost, this could trigger a flight into other currencies. For example, the euro could establish itself in Switzerland.**

Suppression of the Swiss franc by foreign and alternative currencies

In the past few years, the banking sector has been subjected to an increased quantity of stringent state regulations. The initiators argue that this flood of regulations could be restrained in a sovereign money system because various regulations would become superfluous. While it is a fact that some banking regulations such as the federal deposit insurance on sight deposits, state guarantees and even some of the regulations of the Basel Committee on Banking Supervision (BCBS) could be repealed, these would be replaced by far-reaching interventions that would affect not only the banks, but also the entire economy and the population. This would mean that a local flood would be replaced by a global tidal wave.

In view of the conceivable flight from the Swiss franc, we would have to anticipate the establishment of other currencies – e.g. the euro – in Switzerland. In the view of the initiators this scenario is unlikely because in Switzerland there is no euro payment transactions system as such and this would result in currency risks, and no one would give preference to the «unstable euro» over the «stable Swiss franc». But firstly, the presumed stability of the sovereign money Swiss franc clearly has to be relativised as outlined above, and secondly this is not the sole reason for deciding for or against a given currency. The population and business sector could attach greater value – as they do today – to the additional benefits of interest payments than to the minor residual risk of a bank run, and thus give preference in the future to the common European currency over the Swiss franc. Employees and employers could then agree on salary payments in euros, and companies would also accept the latter currency as is already the case today in border regions. Euro payment transactions would set in and the currency risk would also be reduced following the loss of confidence in the Swiss franc. But this would contradict the proposed constitutional wording, because the SNB would no longer be able to fulfil its constitutional mandate, namely to pursue a currency policy in the overall interests of the country.

→ **In order to rescue the Swiss franc as a means of payment, the federal government would have to issue numerous regulations.**

The initiators are harbouring the expectation that in the event of a positive decision in Switzerland, other countries would soon follow suit and switch to a sovereign money system. If the federal government does not also want to commit to the principle of expectation, it would have to intervene in the market with numerous regulations in order to take the euro out of circulation again and force the Swiss population to return to the Swiss franc. But even if the expectations of the initiators were to be fulfilled, namely that other countries would introduce sovereign money shortly after Switzerland, and thus that the euro would no longer represent an alternative, due to the changed framework conditions we would have to anticipate that other alternative currencies such as WIR money or Bitcoin could experience a strong surge in demand. The initiators are not baulking at this possibility and are trying to sell the fact that the libertarian wording of the initiative expressly permits the creation and use of other currencies. But as already noted, this only applies as long as the SNB is able to fulfil its mandate. As in the example of the euro, the federal government would have to intervene with regulations and prohibitions as soon as demand for the alternatives reaches a certain level. So the initiative in no way facilitates competition among currencies. As soon as a given currency gains acceptance among the population thanks to its more attractive qualities, the government would have to either greatly restrict or completely prohibit its use in order to prevent an infringement of the Federal Constitution. This is not exactly what a libertarian project looks like.

→ **The creation of Swiss francs abroad that could be used for domestic transactions is also a possibility. And this, too, would have to be counteracted through the introduction of regulations.**

Creation of Swiss francs abroad

If sovereign money has suppressed the other currencies in Switzerland due to prohibitions and restrictions, other options become available. Here, for example, the creation of Swiss francs abroad is conceivable. Although the initiators regard this as possible in theory, they consider it as irrelevant in practice because few people are likely to hold sight deposits in Swiss francs outside the country. This static view ignores the dynamic that would accompany a changeover to sovereign money. As the SNB noted in a letter to the initiators, it is by all means conceivable that, under changed conditions, Swiss franc deposits abroad could be used to an increasing extent for domestic transactions. In order to prevent this, the government would again have to intervene, for example by carrying out capital flow controls, and pass on the associated costs to the economy and the population. Regardless how clients in the sovereign money system behave, i.e. whether they turn to alternative currencies or to Swiss francs created abroad, the government would have to immediately intervene. The consequence would be a massive tidal wave of regulations.

→ **Switzerland's monetary policy system may not be perfect, but it has been relatively successful. Targeted improvements make sense – but not if they are enforced with the aid of the sovereign money sledgehammer.**

Targeted measures instead of a sledgehammer approach

While the present-day system may not function perfectly, it nonetheless works fairly well. Switzerland has not experienced a bank run since the collapse of Spar- und Leihkasse Thun in 1991. It has been able to absorb bankruptcies in the banking sector without undue difficulty, and was also not hit too hard by the financial crisis. Should a bank nonetheless have to declare bankruptcy in the future, clients' deposits are insured up to 100,000 Swiss francs through federal deposit insurance. Instead of adopting a sledgehammer approach, it would be better to resort to measures wherever they make sense. In the past few years, the density of regulation in the financial sector has increased sharply. In the future, what is required is not more, but better, regulation. (Various studies have shown that the current flood of regulations in the banking sector can have a negative effect on its stability, and that fewer but better regulations are more expedient [5] .

The sovereign money system is a burden and an obstacle for the Swiss National Bank

→ The initiators predict annual payouts by the SNB to the tune of around 10 billion Swiss francs.

Die SNB als Spielball von Partikularinteressen

In order to render the costs, risks and restriction of freedom of choice more digestible, the initiators are trying to make their concept attractive to the general public by citing annual payouts of around 10 billion Swiss francs to the federal government, the cantons and the population. But such a bonanza would be accompanied by major risks. The existing system already creates an attitude of entitlement: the federal government and the cantons budget the anticipated annual payouts by the SNB at around a billion Swiss francs as future revenue, and plan their expenditure accordingly. When in 2014 the SNB was unable to make these payouts due to a record loss, some cantons reacted aggressively and thus exerted pressure on the SNB.

You do not need to be a prophet in order to predict how this pressure would increase in the sovereign money system with payouts in the double-digit billion range. If 10 billion Swiss francs a year were to be distributed, this would be equivalent to around seven percent of the current expenditure of the federal government and the cantons. As past experience has shown, a surplus of this nature does not give rise to a reduction of the tax burden, but rather to short-term financing of all sorts of special wishes. So in the future, the SNB would have to solve problems which should in fact be tackled through economic policy: deficits in the pensions scheme, exploding healthcare costs and inefficiencies in the agriculture sector are just a few of the potential problem areas. It would be illusory to believe that the creation of a «Fourth Estate», namely a monetary monopoly, could somehow suppress these demands. On the contrary: new demands would be formulated in the belief that they would be easy to finance.

→ Gratuitous money creates greed. This threatens the autonomy of the Swiss National Bank and its most important objective: price stability.

In the past 20 years, the Swiss National Bank has very effectively fulfilled its primary mandate (to maintain price stability), and thus provided the economy with ideal framework conditions. For the SNB, as a result of the strong pressure in favour of its second objective (to provide a stable economic situation), fulfilling the primary mandate would be pushed into the background to an increasing extent. If it were to give in to this enormous pressure, the Pandora's box would be well and truly opened. Everyone would claim an entitlement to the presumed gratuitous money from the SNB. Thus the sovereign money experiment would emulate historical examples that have their origins in precisely this issue: if monetary policy is used for financing government duties, this inevitably leads to significant increases in the money supply, and thus to high inflation rates. Experience has shown that a pronounced currency devaluation has dire consequences for the business sector, the population and the entire national economy.

Interfering with the autonomy of the SNB is therefore playing with fire. Here the assurance on the part of the initiators that the SNB is to continue to guarantee price stability is of little comfort. A central bank that is exposed to this kind of pressure can no longer act largely independently of political and economic players. Sooner or later it will no longer be able to fulfil its mandate of providing a stable currency.

→ **You cannot ask for gifts to be returned – the SNB would hardly have any options for reducing the money supply.**

Restricted room for manoeuvre

The proposed sovereign money system would prevent the SNB from fulfilling its core mandate of pursuing a monetary policy that is in the interest of the entire country. Because sovereign money is paid out to the government and the population without consideration, reducing the money supply becomes increasingly difficult. If you offer something as a gift, you can hardly ask for it to be returned to you. Although the SNB would still have the possibility to effect short-term credit transactions, reducing money demand (for example due to technological innovations) could prove to be an impossible task.

In the sovereign money system, the SNB would no longer be able to reduce the money supply as it can today by selling foreign currencies or raising the minimum reserve ratio. Instead, the federal government would have to come to its aid with a sovereign money tax in order to take the money out of circulation that was originally distributed gratuitously. This would be difficult to implement over the long term. Here, too, there is a risk of high inflation rates with accordingly high costs for the economy and society.

→ **In the future, the ideal money supply would no longer be determined by a large number of players, but by the central bank on its own. This would enhance the risk of forecasting errors.**

Departure from decentralised information acquisition

It is not only the restricted scope for manoeuvre for the SNB, but also the fact that a monopoly is to be created with the sovereign money system that will drastically reduce the quality of Switzerland's existing monetary policy. For both the economy and the population it is important that money supply and demand are harmonised to the greatest possible extent. As sole provider of the money supply, the SNB therefore depends on precise estimates of money demand so that it can provide an appropriate supply. In the sovereign money system, only the SNB would estimate the demand for money, which in contrast to the present-day situation in which this is the responsibility of the banks would be a disadvantage for two important reasons.

On the one hand, according to the law of large numbers the accuracy of a forecast tends to increase in line with the number of players. Estimates by the SNB alone would tend to result in less accurate forecasts, an inappropriate money supply and thus harmful impacts on the economy. And on the other hand, banks do business on site and are constantly in contact with their clients, which enables them to estimate the future demand for money more accurately and in a more timely manner than the SNB, which can only base its own forecasts on historical data. In view of this, a departure from decentralised information acquisition is something that should be avoided.

1. Repo transactions have a limited duration ranging from one day to one year. They enable the SNB to increase or decrease liquidity in the financial system and the economy, depending on monetary policy requirements. In the former case the SNB purchases securities from a counterparty and credits the corresponding amount to the counterparty's current account at the SNB. Upon expiry of the transaction the counterparty's securities are re-sold and the corresponding amount is debited to the current account.
2. Dowd, Kevin (1992): The experience of free banking
3. Jöhr, Adolf (1914): Die Schweizerischen Notenbanken 1826–1907
4. in the past, this usually took the form of gold or silver coinage
5. Gropp, Reint et al. (2010): The Impact of Public Guarantees on Bank Risk Taking: Evidence from a Natural Experiment | Gropp, Reint et al. (2011): Competition, Risk-Shifting, and Public Bail-Out Policies | Davies, Richard / Tracey, Belinda (2014): Too Big to Be Efficient? The Impact of Implicit Subsidies on Estimates of Scale Economies for Banks