Clarifications to the SNB’s FAQ about the Sovereign Money Initiative

The SNB has published a document “Swiss sovereign money initiative (Vollgeldinitiative): frequently asked questions” dated 5th March 2018. The link to the original is [here](#).

There is some information in this document which is based on misunderstandings, and other information which is merely opinion. Our aim here is to add clarification.

Below we reproduce (cut and paste) the SNB document with our clarifications added.

**General**

**Why has the SNB become involved in this political discussion in the first place?**

- It is true that the SNB does not usually make pronouncements on political issues. However, it has decided to take a position on this matter as acceptance of the Swiss sovereign money initiative (*Vollgeldinitiative*) would fundamentally change Switzerland’s monetary system, create new tasks for the SNB and have a direct impact on its monetary policy.

- Generally speaking, the SNB bears a responsibility when it comes to political discussions that directly concern the monetary system and the fulfilment of the SNB’s statutory mandate. In such cases, it acts on its duty to provide information to ensure that voters can make an informed decision.

Sovereign Money Initiative Committee:

Agree absolutely that voters should be provided with information to make an informed decision. Our air here is to differentiate between facts and opinions, and to correct misunderstandings.

**Why is the SNB opposed to the initiative?**

- The SNB shares the concerns expressed by the Federal Council in its dispatch on the initiative.

Sovereign Money Initiative Committee:

We do not agree with the main points in the Federal Council’s dispatch on the initiative. Our response is [here](#).
Sovereign Money Initiative Committee:

We are already currently living in a huge financial experiment with central banks enacting “unconventional measures”: 20 years ago who would have dreamed that negative interest rates would be in place and the SNB would be buying billions in shares in foreign companies? Central bankers the world over will tell you in private that it is not a question of if there will be another financial crisis, but when (see e.g. quote from Annelise Riles). Next time central bankers will have fewer tools to cope – for instance, they can no longer lower positive interest rates to zero.

It shows a biased understanding when calling today’s fractional reserve system “tried and tested” when in reality the SNB is navigating in unchartered waters. Ironically, historically it is actually this sovereign money reform that has been tried and tested. In Switzerland in the 1800s banks could print their own banknotes. This resulted in financial crises and instability. In 1891, there was a referendum (notably initiated by the Swiss government and the parliament) in which people voted to prohibit private banks printing banknotes, and to set up the SNB to issue bank notes in the interest of Switzerland as a whole. This did not result in problems back then, and suggesting that banks should be allowed to print banknotes again would be viewed as ridiculous.

Back at the end of the 19th century most people used banknotes and coins for their transactions. Now 90% of the Swiss money supply for transactions is electronic rather than banknotes and coins. The Sovereign Money referendum is just extending the accepted idea that it is the SNB which should create Swiss francs to also cover the Swiss francs in our current accounts at banks.

We believe the implementation of a sovereign money reform would be a much lower risk path for Switzerland than continuing on the current path with “unconventional measures”.

Regarding raising costs for banking customers:

It is true that when the interest rates were positive, the banks could profit directly from creating electronic money (See NEF report). This will no longer be possible for “Sovereign Money” accounts after implementation of a sovereign money reform.

However, with zero or negative interest rates – as now - the banks do not profit from creating money any longer. Therefore, today there is no financial impact through the introduction of Sovereign money. Many banks in Switzerland charge fees for their current account services to cover their costs – which they can continue to do after a sovereign money reform. Market forces and competition should limit the amount banks can charge, as now.

After a sovereign money reform, banks can make money from being intermediaries between savers and borrowers due to the interest rate spread. Again, the costs to customers should be limited by competition.
Moreover, a switch to sovereign money would entail moving away from the tried-and-tested distribution of tasks between the central bank and commercial banks. The initiative calls for the SNB to guarantee the supply of credit to the economy by financial service providers. Such a concentration of tasks would expose the SNB to political ambitions.

Sovereign Money Initiative Committee:

The SNB would have no influence as to which of the banks’ customers receive loans after a switch to sovereign money. That is a matter for only for the banks. The banks must have the funds available to lend in advance of making a loan. The SNB can offer banks loans (for which it can set the interest rates) to ensure that banks always have the funds they need available to lend into the economy. Further to that, banks can get loans from other banks and use the savings deposits of their customers. There is no means by which the SNB can tell the banks which individual customers should receive loans, neither can the SNB force any bank to grant any loans. There may be political pressure to raise or lower these interest rates the SNB sets – as there is now. The SNB must act in the best interest of Switzerland as a whole.

It is true to say that the philosophy of the SNB would change. Today it has the philosophy of being the bank for the banks, and a lender of last resort. After the sovereign money reform it would be the bank for the people of Switzerland by providing the legal tender for everyone. The change of the paradigm would be away from the thinking of the “British banking school” back to the Central Bank’s role as sole issuer of sovereign money as proposed by the “British currency school”.

The institutions that create the money supply have power, and – it is true - may be exposed to political ambitions. We believe that the people of Switzerland would be better served if the SNB has this power, rather than private companies with a duty of maximising their profits for their shareholders. The SNB has the mandate to act in the interest of Switzerland as a whole.

The reform would entail constitutional changes with respect to monetary policy implementation that would make it more difficult for the SNB to fulfil its mandate.

Sovereign Money Initiative Committee:

A sovereign money reform would give the SNB more tools in its toolkit, making it easier to fulfil its mandate. Its existing tools would remain in force.

The initiative raises unrealistic expectations, particularly with regard to financial stability and profit derived from the note-issuing privilege (‘seigniorage’).

Sovereign Money Initiative Committee:

With respect to financial stability – clearly we can’t control what happens outside of Switzerland. If there is a global recession, Switzerland will be affected. However, we can make sure that people’s Swiss francs are completely safe in their bank accounts – something which is not the case at the moment. This is the focus of the initiative: make money (the means of payment) safe and independent of the financial system, rather than fixing the shortcomings of today’s system.

We have especially tried not to promote the potentially enormous profits from seigniorage, as we realise it will be prudent for the SNB to only gradually bring debt-free money into circulation. (Further, in view of a balance sheet of over 800 bn CHF, it is clear that there will be more profit
distribution (2018: 2 bn CHF) in the future, irrespective of Sovereign money). As the implementation date of a sovereign money reform will be at least two years after the referendum, the SNB will have ample time to set expectations. (Reminder: the SNB creates Swiss francs which can be either spent into circulation – with seigniorage profit – or lent into circulation with much less associated profit).

Sovereign Money Initiative Committee:

The SNB could continue to set the interest rates at which banks can borrow money from it after a sovereign money reform. This will influence the interest rates that banks offer their customers, and therefore the demand for bank loans, as it is the case today. After a sovereign money reform the SNB creates Swiss francs which can be either spent into circulation or lent into circulation. It would clearly be prudent for the SNB to first learn about its new “tools” by lending most of the money into circulation for which it can directly set the interest rate. By increasing the interest rate it offers, more loans are likely to be repaid than taken out – thereby reducing the money in circulation.

Furthermore under the sovereign money system - just the same as now - the SNB can bring new money into circulation by the purchase of foreign currencies, securities, Gold or other assets and at any time the money supply can be reduced by the sale of these assets.

Over time the SNB could increase the amount of money spent into circulation by distribution to the Confederation, the cantons or citizens, but never to 100% of M1 (note M1 is currently approximately 640 bn CHF). One cannot imagine circumstances whereby the SNB would want to, for instance, halve the money supply M1 – so one can easily imagine that up to half of M1 could be spent into circulation in this way (but slowly – over years, not months). Eventually this figure might rise further, still with absolutely no risk that the SNB would need to reclaim money from the Confederation, the cantons or citizens. It has always been made clear by the advocates of Sovereign Money that only the part of the money in circulation that never ever needs to be taken back shall be issued debt free. Reviewing historical data shows there are hardly any years in which the money in circulation had to be reduced, and, on the occasions that it was reduced, it was only by very small percentages. Usually the money supply has increased far beyond GDP growth.

The SNB can continue to fine tune the monetary system through open market operations, as it does now.

Sovereign Money Initiative Committee:

The SNB can signal that, immediately after the changeover to a sovereign money system, it will continue to organise the monetary system exactly as it does now – targeting interest rates and offering banks the funds they need to do everything they do now. From the banks’ perspective, their
IT systems would have to “fetch” funds from the SNB before lending them further (if they don’t have the funds already available) – in much the same way as they can create money out of thin air now, with a few clicks in their computers. Customers will not notice any immediate change (except being sent legal documents notifying them that their terms and conditions with the bank are changing in their favour, as they will legally “own” their money for the first time).

**It is wrong and unhelpful** for the SNB to take the position that the initiative “would plunge the Swiss economy into a period of extreme uncertainty”. The SNB’s statement itself puts the Swiss financial system at risk: if a central bank makes such a statement it can become a self-fulfilling prophecy.

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The Sovereign Money Initiative Committee:

This is an important misunderstanding. After a sovereign money reform the SNB has the full flexibility from targeting interest rates through to targeting the monetary supply. For more information see “Would a sovereign money system be flexible enough?” published by Positive Money. It is absolutely possible for the SNB to continue to pursue a policy of targeting interest rates.

Banking system and customers

Nowadays banks can create money by granting loans. Does the SNB believe banks should enjoy this privilege?
- It is correct that banks can create money (deposits) by granting loans, but not without constraints. When a bank provides a loan, it credits the amount in question to the borrower’s account. The bank then has a claim on the assets side of its balance sheet and a liability (deposit) vis-à-vis the borrower on the liabilities side (balance sheet expansion). It is through this liability in the form of a deposit that money is created.
- An individual bank cannot use the granting of loans to ensure a lasting increase in the deposits it holds, since payment transactions lead to an outflow of these deposits. However, as these deposits are transferred to an account at another bank, they remain within the banking system.

The Sovereign Money Initiative Committee:

We are very happy that, since the start of our activities bringing about the Sovereign Money Initiative, the SNB have changed their explanation of how money comes into circulation from the incorrect money-multiplier model to the correct explanation that banks create money by granting loans.

The question not answered by the SNB is why banks are the only players in the economy who should be allowed to create money to begin with, while everybody else needs to find the funding before spending.
Sovereign Money Initiative Committee:

Experts are divided between believing that interest rates are an effective tool for the demand for credit, and believing that human psychology has a much stronger influence on the demand for credit with “irrational exuberance” dominating in the good times and pessimism in the bad times.

Money creation is rarely constrained by the regulatory framework: by the time the next version of the “Basel rules” has come out, big banks have already worked out how to get round them.

**What economic function do the banks’ lending activities fulfil?**

- A bank’s balance sheet typically contains comparatively illiquid, long-term claims such as loans on the assets side and comparatively liquid, short-term liabilities such as sight deposits on the liabilities side. Savers want secure and readily available deposits, while investors need long-term loans to finance projects, which tend to be illiquid. The bank therefore engages in liquidity and maturity transformation, mediating between the diverging requirements of savers and investors.

- The bank thus bears both credit risk and liquidity risk. Due to the large number of depositors and borrowers, these risks can be diversified. Moreover, banks have an advantage over individual savers in that they are better able to assess and monitor borrowers. This also opens up access to loans for parts of the economy that cannot raise funds on the capital market and would hardly be able to finance their projects without a bank, i.e. households and SMEs.

- Under the present system, banks charge higher interest on loans than they grant on deposits. But this is not synonymous with risk-free profits. The interest spread compensates banks for the credit and liquidity risks assumed, for services linked to customer deposits, and for the assessment and monitoring of borrowers.

Sovereign Money Initiative Committee:

The idea that banks are intermediaries between savers and lenders in the current system is wrong, however after a sovereign money reform banks would do just that, and they would earn money on the spread of interest rates between savers and borrowers which would compensate them for their costs of the assumed risks, customer services and the assessment and monitoring of borrowers. They would also charge fees (as they do now) for managing customers’ current accounts.

After a sovereign money reform banks would have no immediate liquidity risk as their customers would own the money in their current accounts. However, savers (with term accounts) could
demand their money back at the end of the term. If the banks were unable to fund this they would have to borrow funds from the SNB (at the going rate).

**Would the costs for bank customers be higher or lower under a sovereign money system?**

- They would be higher – for two reasons. First, no interest would be paid on sovereign money accounts. However, the banks would have to continue providing services for payment transactions and would pass these costs on to their customers.

Sovereign Money Initiative Committee:

Fees would not be higher. The situation is exactly the same as the situation today, as under the negative interest regime no interest is payable on current accounts.

- Second, the credit supply would tighten and become more volatile, and thus more expensive. Mortgage interest paid by households would therefore rise.

Sovereign Money Initiative Committee:

The SNB could decide to target interest rates (as they do now), so there would be no change whatsoever from the situation today. However, they could target the money supply, in which case the statement above would be true. They would have the flexibility to do either, but they must act in the interest of Switzerland as a whole.

**The SNB has a legal mandate to contribute to the stability of the financial system. The initiative’s backers claim that sovereign money would prevent bank failures and thus enhance financial stability. From this perspective, would sovereign money not be beneficial?**

Sovereign Money Initiative Committee:

We do not claim that sovereign money would prevent bank failures – rather the opposite: banks should be able to go bankrupt like any other poorly performing private company, but this should not have catastrophic repercussions on the economy as it would under today’s system.

- If banks no longer had sight deposits available to finance lending, they would either grant fewer loans or look for other sources of finance, such as the interbank money market, that are less stable. And yet, bank financing via the interbank money market proved to be particularly vulnerable during the global financial crisis. Shadow banks could also play a bigger role in financing loans.

Sovereign Money Initiative Committee:

After a sovereign money reform, banks can borrow money from the SNB. This will be as stable as the SNB chooses to make it. All businesses – financial, bank, shadow bank or otherwise, must first get hold of sovereign money before it can lend it.
It is not the aim of the Sovereign Money Initiative to solve financial stability problems, however, it is the aim that, should there be a financial crisis, money in current accounts would be completely safe, thus normal transactions in the economy would not be jeopardised. Further a sovereign money reform:

- would solve the liquidity risk as sovereign money accounts hold “liquidity”, and banks can borrow funds from the SNB to pay back savers if required;
- if banks make poor decisions when granting credit and get into solvency problems, they can go bankrupt like any other business (but sovereign money accounts would be completely safe);
- and therefore the ‘to-big-to-fail’ problem is solved: banks can fail without any direct consequences such as a standstill of the payment system of the whole country.

We believe that current regulatory measures are both inadequate in that big banks can circumvent them, and bad for the economy in that the costs of compliance are mushrooming. This is especially burdensome for smaller banks, which is likely to lead to more consolidation in the banking industry and, in the long run, SMEs who thrive on good relations with their bank managers being less well served by the banking sector.

However, should a crisis occur after a sovereign money reform, money in people’s current accounts is absolutely safe as it belongs to the bank account holder, not the bank. Banks (or other institutions) that have misjudged credit risks might suffer or go out of business without dire knock-on effects in the real economy.

**Would sovereign money not prevent bank runs and thus strengthen financial stability?**

- Under the current system, banks promise to convert customers’ sight deposits (deposits at commercial banks) into central bank money at any time. However, the volume of customer deposits is in fact greater than the volume of banknotes and sight deposits that the banks hold at the SNB. This is not generally a problem because it is rare for all customers to withdraw money at the same time. Banks can therefore finance long-term loans via short-term sight deposits.
It is not the intention of the Sovereign Money Initiative to prevent bank runs from happening, but rather to make the Swiss francs in people’s current accounts (i.e. sight deposits) completely safe. Yet, as stated by the SNB above, bank runs on such accounts would not be possible under a Sovereign Money system. A bank run on savings accounts (where savers converted their savings into sovereign money accounts) could only happen if the bank did not borrow sovereign money from the SNB. As savings accounts would have a minimum term set by the SNB, any potential bank run would happen in “slow motion”, giving ample time for the bank to go to the SNB to borrow enough sovereign money.

If a bank was heading towards a solvency problem (rather than a liquidity problem) it would be possible for a bank run on savings to occur, and some savers might lose their money. The fact that poorly performing private businesses can fail is part of our capitalist system. People putting money into savings accounts will be putting their funds at risk (knowingly and out of free choice), for which they will be compensated by the interest they earn on these savings. Banks may well want to pay into an insurance scheme like Esisuisse to encourage customers to put their funds into savings accounts.
Seigniorage

Sovereign money means that seigniorage could be distributed in its entirety to the general public, i.e. the state and its citizens. What’s wrong with that?

- Already in today’s two-tier system, a large proportion of seigniorage is generated at the SNB. The SNB earns this seigniorage because, thanks to its note-issuing privilege, it can finance assets on highly favourable terms via banknotes in circulation and sight deposits, and these assets generate income. A large share of seigniorage is absorbed by the profit distribution to the Confederation and the cantons and therefore benefits the general public.
- The proponents of the initiative believe that the SNB could pay out an additional CHF 5–10 billion to the Confederation and the cantons. They argue that seigniorage under a sovereign money system would be based on a much larger amount of central bank money.

- However, it is difficult to estimate how much public demand there would be for sovereign money and therefore how much central bank money there would be. Since it involves a fundamental change in the system, it cannot be assumed that customers would hold all their existing sight deposits at commercial banks as sovereign money, particularly if it earns no interest.
- Moreover, the SNB’s profit opportunities would diminish. The SNB currently earns income on its assets and passes this on to the Confederation and the cantons through its distributions. Since a growing economy demands more money, under the current system both the cash liability item (specifically sight deposits held by banks and banknotes in circulation) and asset items (foreign currency investments or repo balances) at the SNB increase over time.
- If the SNB were to put money into circulation ‘debt-free’, that is without purchasing foreign exchange or increasing liquidity via repo operations, the cash liability item would grow and the equity liability item shrink – and ultimately turn negative at some point. Assets would no longer increase, thus compromising the ability of the SNB to make a profit.

Sovereign Money Initiative Committee:

Currently only 10% of the money supply for transactions is provided by the SNB. This is lent or spent into the economy. The profits from spending money into the economy are one-off, for the face value of the money (less production costs which are particularly relevant for coinage) whereas profits for lending money into the economy (i.e. the interest payable) are much lower but on-going.

After a sovereign money reform, 100% of this money supply would be provided by the SNB, ten times more than today. Whether this is lent or spent into the economy, it is hard to envisage a scenario in the next few decades in which the SNB would have less profit to distribute than it does now.

The SNB can continue to hold assets (e.g. foreign currency investments or repo balances) after a sovereign money reform.