How to lend it

A referendum on the way money is created

Switzerland votes on Vollgeld

TO ITS opponents, the Vollgeld initiative is “suicidal” and a “dangerous experiment”. To its supporters, it is the ticket to a “fairer and more stable banking system”. Swiss voters will decide for themselves on June 10th, when the proposal for sovereign money, which would rewire the country’s banking system, are put to a referendum that, in theory, would be binding.

The heart of the argument is whether private-sector banks should be able to create money. In modern economies, most money takes the form of deposits in commercial banks, rather than the cash in circulation and the reserves determined by the central bank. And bank deposits are mainly created through bank lending. Lenders can thus lend far more than they hold in central-bank reserves.
Vollgeld supporters want to take such money-creating powers away from banks. Bank deposits are not as safe as sovereign money, they say. If a bank collapses, depositors lose uninsured funds. Instead the public should hold current accounts directly with the Swiss National Bank (SNB), the central bank. Banks’ lending should be funded entirely by time deposits (savings accounts) or by borrowing of their own. Vollgeld’s backers say that bank runs would be much less likely and there would be no need for taxpayer-funded bail-outs. Similar ideas floated among economists in America in the 1930s, but have never been put into practice.

The initiative’s opponents, which include the Swiss government, the SNB and the banks, say sovereign money would incur large costs for little gain. The transition to Vollgeld would be expensive and unpredictable as banks reorganised themselves and sought alternative, dearer, sources of funding. Interest rates would rise, at great cost to the Swiss economy.

Daniel Kalt, an economist at UBS, a bank, believes that sovereign money would not stop financial crises. In 2007-08 a seizure in interbank funding, rather than bank runs, toppled financial institutions with no retail deposits, such as Lehman Brothers. Thomas Jordan, the head of the SNB, has argued that sovereign money would not prevent banks from granting risky loans or overestimating future returns. Today’s macroprudential rules will do more to avert a crisis than tearing down the system.

Sovereign money could also complicate monetary policy. Rather than setting interest rates to influence bank lending, the SNB would have to control inflation by regulating the amount of cash in circulation directly. The SNB also frets that, if
granted the power to distribute money and credit, it will become embroiled in politics.

With opinion polls suggesting that only a third of respondents will vote in its favour, the radical initiative is unlikely to pass. But authorities in several countries are contemplating the merits of digital currencies, which could allow the public to hold deposits with the central bank. Vollgeld might not pass, but some more cautious monetary experiments may well be on their way.

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