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MARKETS

A Vote to Upend Banking as We Know It

A country synonymous with finance is holding a referendum that has voters wondering: What is money, anyway?



A member of the sovereign money initiative, a referendum campaign that would abolish traditional bank lending and allow only money created by the Swiss National Bank (SNB), offers flyers to travelers at the central railway station in Zurich on May 3. The poster reads, 'Who should produce our money? Sovereign money yes—Swiss francs from National Bank only.' PHOTO: ARND WIEGMANN/REUTERS

By *Brian Blackstone*

June 1, 2018 2:00 p.m. ET

A decade after the collapse of Lehman Brothers, the world is still debating the causes of the financial crisis—down to the meaning of money itself.

In buttoned-down Switzerland, that debate is taking the form of a nationwide referendum set for June 10. Voters are being asked to consider fundamental questions rooted in the crisis: what is money; who creates it; and how safe is it? And they'll have a chance to blow up one of the foundational features of global finance: the ability of banks to create money with just a few keystrokes.

That's right, if a bank gives you a loan, it can pretty much create the money on the spot. It's something that banks do every day around the world. It means that all money isn't created equally, and the cash that pops out of an ATM machine isn't the same as the numbers on a bank statement.

But if the Swiss referendum passes, all money creation there would have to be done directly by the country's central bank.

Supporters say this is how most of the public assumes that all money is created already so their idea isn't that radical. Yet some opponents compare the idea to the gold standard, something that they contend might sound good in theory but is entirely unworkable in practice.

Behind the initiative is Hansruedi Weber, a former schoolteacher turned financial reformer. He is a founder of the Vollgeld Initiative, known in English as Sovereign Money. The group amassed enough signatures to put the proposal on the ballot. Under the current system, he says, "money is debt." Vollgeld would "separate money from credit," he says, leading to a more stable economy.

When banks create electronic money, it becomes a liability on their balance sheet while the loan is an asset. If the borrower can't repay the loan, the bank's profit takes a hit. If this happens on a large scale, as it did in the U.S. subprime crisis a decade ago, the bank could be wiped out. Even if customers only fear this, then they might start withdrawing their money en masse.

Under Vollgeld, banks could still go bust but the money wouldn't disappear because it would no longer be on the balance sheet of the bank the way electronic money is.

Similar ideas to Vollgeld stretch back at least to the 1930s and are American in origin. In the midst of the Great Depression, a group of U.S. economists presented what became known as the "Chicago Plan" of banking reforms that would have required all lending to be backed by central-bank created money. It was never adopted. After the 2008 financial crisis, the idea gained traction among campaigners in Iceland and the U.K. Next month's Swiss referendum has given the idea of sovereign money its biggest public airing yet.

It's an unlikely proposal in a country synonymous with finance. Under Vollgeld, the Swiss central bank would directly control the money supply. Electronic deposits—basically the money people see in their bank statements instead of their wallets—would be converted to central bank money issued by the Swiss National Bank.

Opponents of Vollgeld say Switzerland would be going it alone if it upended its money-creation system, weakening its competitiveness while making it harder for banks to extend credit and overburdening the central bank with decisions on who should be getting loans and who shouldn't. Their most effective argument may simply be that the current system isn't broken—Switzerland's economy is doing well—and doesn't need fixing.

Under the current system, when a borrower is approved for a mortgage, the bank doesn't take existing money from a vault. Instead, it creates an electronic deposit for the borrower, which the borrower transfers to the seller's bank account.

Much of the growth in money in circulation is through these bank-created deposits. Regulatory limits, such as capital ratios, keep banks from endlessly making loans.

Of the 645 billion Swiss francs (about \$652 billion) in circulation, only about 85 billion francs are notes and coins.

Under the Vollgeld proposal, banks would have to actually have money before they lend it out. The central bank would extend loans to banks to keep the supply of available money sufficient for the economy. But the onus would be on the central bank to determine the amount of lending available, a form of monetary policy that was more common in the early days of central banks in the 19th and early 20th centuries.

The one-time schoolteacher and his allies are up against some powerful opponents. Switzerland's central bank chief, whose powers would expand greatly under Vollgeld, has slammed it as a "dangerous experiment" that would "inflict great damage" by raising borrowing costs and damaging investment. The plan is also opposed by parliament, the executive branch and the country's commercial banks. "I don't expect the Swiss people to be suicidal and approve it," UBS Group AG Chief Executive Sergio Ermotti said recently, without going into details. Indeed, recent polling suggests the Swiss are solidly opposed to it.

Switzerland's direct-democracy system creates these types of David versus Goliath scenarios whereby citizens like Mr. Weber—whose organization MoMo (for Monetäre Modernisierung) took its name from a little girl's character in a Michael Ende novel—can take on the elites of politics and finance.

Vollgeld enthusiasts have campaigned for the referendum with flyers, sandwich boards and a giant piggybank touring Swiss cities to argue that electronic deposits are nothing more than glorified vouchers for money that might or might not exist.

EXCHANGE

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"It would be like creating your money and going shopping with it. Everyone would like to do this. But it is only the banks that have the ability," said Joseph Huber, professor at Germany's Martin-Luther-Universität, whose writing on the topic inspired Mr. Weber to launch Vollgeld. "Central banks have lost control, and the whole idea is to regain control of money creation."

Supporters say that the Vollgeld plan would limit destabilizing credit booms and busts while protecting the economy from costly bailouts. Bank runs and capital controls would be a thing of the past. “In a sovereign-money system there could be no bank run because the money would exist,” said Mr. Huber.

Aleksander Berentsen, professor at University of Basel, sees the vote as an abuse of Switzerland’s direct democracy system, under which people can obtain a referendum by gaining 100,000 signatures. In the past, the country has gone to the polls to decide on ending television fees (no), phase out nuclear power (no), or purchase military jets (no, but stay tuned for another vote by 2020).

“It has become a game, like kindergarten, but this is going to radically affect the way we live,” he said, by making Switzerland a laboratory for untested economic theories.

But Mr. Weber said the referendum was the only practical way for Vollgeld to get a public debate. He said he’s “not an utopist” and knows he faces challenging odds.

Even if Vollgeld is rejected, Mr. Weber thinks he has planted the seeds for future success. He sees parallels with another long-shot referendum two years ago: Basic Income. The plan, which would have guaranteed each Swiss resident a minimum income, was soundly defeated but got a lot of exposure. The idea has gained steam in Switzerland and elsewhere since then.

“It’s the same with Vollgeld, you can’t anymore put Vollgeld aside,” Mr. Weber said. “If we change this here, everyone will know that it’s not necessary to have a debt-accumulating system that will inevitably crash.”

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