A summary of

The Sovereign Money Initiative in Switzerland: An Assessment

Philippe Bacchetta

University of Lausanne
Swiss Finance Institute
CEPR

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An Academic Assessment

- The paper reviews some of the main arguments behind the initiative and assesses its potential implications.
- It takes an academic and macroeconomic perspective.
- Complementary to other analyses.
- The sovereign money reform is complex and requires a detailed analysis. Mostly for specialists.

Overall Assessment: No Scientific Support

- There is no scientific support behind the precise text of the initiative.
- The complexity of the initiative allows its defenders to use imprecise or misleading arguments.
- The initiative committee mentions academic studies on issues related to the initiative, but none of these studies deals precisely with the reform proposed for Switzerland.
  - Their results are therefore not relevant.

No Scientific Support

- The initiative basically ignores current economic knowledge.
- In contrast, the reasoning behind the initiative and several arguments used to defend it are inconsistent with empirical evidence and basic economic logic.
- There is extensive scientific work illustrating the potential negative impact of a sovereign money reform.
- This paper will give some numerical estimates.

Overall Assessment: A Negative Impact

- The arguments for the initiative give a role for sight deposits that is partly inconsistent with the facts.

- Consequently, controlling sight deposits will not provide the promised benefits.

- In particular, this does not avoid financial crises or large credit expansions.

Overall Assessment: A Negative Impact

- On the other hand, the sovereign money reform has several negative macroeconomic implications.

- In particular, depositors will suffer from the reform (more than banks).

- It would increase both financial instability and macroeconomic instability.

- There is also high uncertainty at two levels.
    1. The text of the initiative is not precise and there is uncertainty about how it could be implemented.
    2. Since such a system has never been implement anywhere, there is high uncertainty about the reaction of economic agents to the reform.

Four Elements of the Sovereign Money Reform

1. Sight deposits in Swiss francs (included in M1) would be transferred outside commercial banks' balance sheets and would be fully backed by reserves at the SNB.

2. The SNB would control the quantity of sight deposits.

3. The SNB distributes funds to the state or directly to households.
   - These funds would come from new money creation and from selling SNB existing assets.
   - Money is not considered a liability.

4. It would also impose restrictions on minimum holding periods for non-monetary financial assets (e.g. saving deposits).

- Element 1 implies 100% reserve requirement on sight deposits and is related to the “Chicago plan”.
- Several studies analyze this system, with pros and cons.
- But the sovereign money initiative departs significantly from the Chicago plan.
  - Chicago plan does not have elements 2, 3 and 4.
  - Also does not necessarily impose zero interest rate on money.
  - Includes all deposits and not only sight deposits.
- This is why the existing studies do not apply.
- Analyses specific to the Swiss initiative are required.

- But even if we focus on the Chicago plan only, the decade-old analyses are no longer relevant.

- Most analyses were written by dead economists in a different era.

- The banking sector has dramatically changed after WWII.
  - In particular, the link between money and credit has weakened.

- The reasons behind financial crises have also changed.
  - Not caused by demand deposits as in bank run models.

Section 2: Reviews some of the arguments behind the reform

- Bank credit is unrelated to money creation at the macroeconomic level
  - No correlation between changes in money and changes in credit.
  - Sight deposits only represent about 25 percent of credit.
  - Controlling money would not prevent credit booms.

- Increases in money do not precede financial crises. On the contrary.
  - Controlling money would not avoid financial crises.

- Claiming that money is not a liability is puzzling. Using this perspective to allow the SNB to sell its assets is dangerous.
  - It would bias fiscal policy.
  - It would make the SNB less credible.

Section 2

- The widely cited paper of Benes and Kumhof (2012) does not apply to the sovereign money initiative for Switzerland.
  - It focuses on the Chicago plan, but considers an experiment very different from the sovereign money initiative.
  - It uses a model that does not fit the Swiss economy.

- Moreover the paper does not represent the views of the IMF (as falsely claimed by the initiative committee).

Section 3: examines quantitatively the impact of the reform's first stage

- First stage: all sight deposits are backed by reserves at the SNB, but the SNB lends these funds back to banks. Reserves do no bear any interest.

- Uses a simple model of monopolistic competition in the banking sector. Measures the impact on the state, on banks and on depositors.

- In the current situation the impact is negligible: interest rates are around zero and reserves at the SNB are approximatively equal to sight deposits.

- The paper uses data for the 1984-2006 period.
  - A period with higher interest rates (4% average for government bonds) and lower reserves at the SNB.

- The overall impact is negative: the state gains, but banks, and especially depositors lose.

- Impact in annualized percentage of GDP:

SNB + Government	0.53
Banks	-0.50
Depositors	-0.82
Total	**-0.79**

- SNB + government gain 0.53% (about CHF 3.5 billion)
  - SNB gets the interest rate margin on sight deposits.
  - Takes into account the decrease in taxes paid by banks on these margins.
  - But does not take into account potential increase in costs in dealing with these deposits at SNB.

- Depositors lose because of zero interest rate on reserves.
  - Sight deposits would offer zero interest + some fixed costs (as currently).
  - Higher opportunity cost of holding money.
  - The quantity of sight deposits would be smaller as they are more costly.

- Banks lose their interest margin.
  - Impact not so large as sight deposits represented only 15% of their balance sheets and would even be smaller with zero interest.
  - Banks also pay smaller taxes.
  - Limited impact on credit.

Section 4: Other macroeconomic implications of the reform

1. The alternative sources of funding by banks would slightly be more costly, but more importantly would endanger financial stability.
   - Replace relatively stable source of funding, sight deposits, by more unstable funding.
   - Increase in non-deposit bank liabilities raises probability of financial crises.

2. The precise use of SNB additional income and existing wealth can have very different macroeconomic implications.
   - Buying additional assets or buying Swiss government debt would have little impact.
   - But distributing funds by selling existing assets can have disastrous effects and lead to macroeconomic instability.

Section 4

3. Leads to suboptimal monetary policy
   - Constraints monetary policy strategy by imposing the control of sight deposits.
   - The control of monetary aggregates was abandoned for good reasons some decades ago.
   - Limit the flexibility of monetary policy to react to unexpected events.
   - Periods of more restrictive monetary policy would be particularly problematic. How does the SNB reduce the amount of sight deposits?

Conclusion

- The foundations for sovereign money reform are shaky, its benefits are questionable, and its drawbacks can be serious.
- It ignores and even despises current knowledge in monetary economics. Several of the arguments made are inconsistent with this knowledge and with basic economic logic. Some of the claims are misleading or demagogic.
- It is to be hoped that all these costs and potential risks will be well understood by Swiss voters.