

Funding the Future

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Martin Sandbu wrote two articles in the [FT last week](#) (very paywalled) that look at issues arising from this weekend's referendum in Switzerland on banking reform.

Let me be clear: I oppose the proposed reform because I think it embraces all the worst features that Positive Money propose for the banking system and if adopted this would, firstly, be harmful to the Swiss economy and, secondly, be prejudicial to the necessary real monetary reforms that are required in most countries at present. I explain why in some detail, [here](#).

Bizarrely, Sandbu has, despite his obvious overall sympathy with reform, managed to write the pieces without the slightest reference to modern monetary theory. It is as if he, like so many economists, thinks that money exists as a phenomenon separate from the economy as a whole. I've already noted similar traits from [The Economist](#) and [John Kay](#) in the last few days. And it is as if he, like they, thinks, quite erroneously, that money can have a value as if it is a commodity in its own right.

Sandbu gets this wrong. Money has no value of its own, and it never has. Both physical cash and ancient and modern intangible forms of money (to cover all forms of ledger based monetary creation - which are in essence identical however the record has been maintained) get their value from recording debt. A currency achieves that by being issued into existence by a government that accepts it back in settlement of legally due tax obligations. Bank created money, which because it is always denominated in a government created currency is always a derivative of it and so of secondary standing, exists because of the debt that exists from a lender to the bank that extended them credit.

Sandbu, and those suggesting banking reform in Switzerland, ignore this reality. Alternatively, they are saying that a central bank must decide the quantum of monetary debt denominated in a state's currency that should exist in an economy. This is deeply dangerous for three reasons.

First, it assumes that the central bank is capable of accurately forecasting this. I have to say I have absolutely no such confidence.

Second, it assumes that the market will adapt and that there will be no resulting shortages or excesses of available credit money for settlement of obligations due within an economy. Again, I do not share that confidence.

But, most importantly, and third, this assumes that recourse will not be had to alternative currencies. I can think of no better way of promoting their use than the adoption of this reform. Far from a central bank, and so a government, having control of their macroeconomy as a consequence of this reform they would instead, I suggest, lose it as a result: no country where two currencies are in widespread common usage can ever be subject to effective macroeconomic management in my opinion.

Sandbu seems to recognise the issues he is addressing, saying:

The most generous way to interpret this objection is as a worry that a full-reserve system will not, in practice, generate as much credit as the fractional-reserve system. (This worry is expressed by the Swiss central bank head in his opposition to Vollgeld.) Even this is not obviously bad for growth if credit supply is only moderately more tight-fisted but much less volatile. But the broader point is that there is no inherent reason why a full-reserve system should lead to less credit creation (over time) than the status quo. That depends entirely on the policies pursued by the central bank in the new system.

What those policies should be deserves its own debate. One thing that is clear is that central banks would have a wider range of tools – and so the range of possibly policies is correspondingly broader (including policies that would mimic today's system). It would be surprising if something better than the status quo could not be found.

It's hard to disagree with the conclusion: we all know the status quo is not working. But complete credit control is no solution at all. I have no problem with directing credit, and controlling its excesses. But handing all credit creation to the central bank is not only technically impossible in a modern economy, it's a dangerous folly. Modern monetary theory provides a better answer (so long as tax is a fully integrated policy issue). It's time the world's economists woke up to that.