The Phenomenon of Negative Interest Rates*

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One is witnessing the emergence of a strange and unprecedented phenomenon in the advanced capitalist world, namely the charging of negative interest rates. The European Central Bank reduced its deposit rate to -0.1 percent in June 2014, and since then it has reduced this rate further, to-0.2 percent in September 2014, -0.3 percent in December 2015, and to -0.4 percent in March 2016. And apart from the ECB, four other national central banks, those of Switzerland, Japan, Denmark, and Sweden, have also reduced interest rates on certain parts of their deposits to negative levels. In addition the ECB has also announced that if banks borrow from it to increase the amount of loans they give by more than 2.5 percent of the prevailing level, then it would charge -0.4 interest rate on all such borrowings at the margin. (In any case the interest rate it charges on its loans to banks is zero at present).

This phenomenon, it should be noted, is still confined only to transactions between the central bank and its constituent banks, and does not affect transactions between the "public" and the banks. But even this shift to negative interest rates has already had one visible effect: if banks can get loans at negative interest rates then they will also be willing to hold assets which give negative interest rates, provided the latter rates are even marginally higher, and provided these latter assets are otherwise attractive in the sense of being risk-free. Government bonds are generally considered risk-free, and we find that government bond rates in Germany and Japan have also entered into the negative territory.

To understand why interest rates have entered the negative region, we must look at the context provided by the world recession. A recession entails low investment, which basically means that wealth-holders are not very keen to hold reproducible physical capital assets; what they are interested in holding instead is money. A recession therefore entails an increase in what economists call "liquidity preference", namely a greater desire on the part of wealth-holders to hold their wealth in the form of money rather than in the form of capital goods (or claims on capital goods, such as bonds and equity).

One way of nullifying the effects of this increased "liquidity preference" on the part of private wealth-holders, is to get banks to show the opposite preference, for capital goods (or claims on capital goods) instead of money, i.e. to get them to run down excess cash reserves, or even to borrow money from the central bank, to buy equity and bonds which would then indirectly raise the demand for goods in general. It would do so by making investment more attractive (because finance for it has become cheaper) and by raising consumption through the "wealth effect" (since the holders of bonds and equity feel wealthier when the prices of these assets go up because of banks' demand).

This is what monetary policy has been trying to do ever since the beginning of the world recession in 2008. The Federal Reserve Board of the U.S.A., and the ECB, had brought down the interest rate at which they make funds available to banks to virtually zero. Even so however banks were unwilling to lend to corporations and households, because of their bitter experience with being saddled with "toxic assets"

earlier. In other words it is not just the "public" but even the banks, which had been afflicted with "excessive liquidity preference" in the current crisis. Everybody, whether banks or the "public", simply wanted to hold money and nobody wanted to lend, which is why the recession persisted.

This situation could be overcome, if instead of all this rigmarole of making the banks give larger loans to the private sector so that this sector's demand for goods could increase (which is what monetary policy tries to do), the government just directly bought more goods. The government could simply borrow from the banking system (which is what an increase in the fiscal deficit amounts to) to finance its larger demand for goods, and the recession would be ameliorated. But a larger fiscal deficit is unacceptable to finance capital, which always insists on "sound finance". (Earlier such "sound finance" had meant balancing the budget, while these days it means a cap on the ratio of the fiscal deficit to GDP, usually at 3 percent; but in either case the fiscal deficit route for overcoming a recession is avoided). But if the fiscal route for overcoming the recession is avoided, then all that the system has, by way of policy instruments at its command, is monetary policy. And if monetary policy is unsuccessful in causing a revival, even when the interest rate has been pushed down to zero, then the system is forced to push the interest rate even lower, i.e. to the negative region.

The pushing of certain interest rates to the negative region therefore indicates a number of things: first, that the crisis of the capitalist world, whose end, we are repeatedly told, is imminent, continues to persist; second, that the worry over this persistence is so serious that capitalist countries are desperate to use whatever instrument they can to end it, even to the point of having negative interest rates which are unprecedented in the history of capitalism. There have of course been negative real interest rates (when the rate of inflation exceeds the nominal interest rate), but not negative nominal interest rates.

A slight digression is in order here. Bourgeois theory holds that investment entails a sacrifice of consumption. It entails that some goods which could have been consumed today are set aside from today's consumption but are added to capital stock so that society becomes more productive tomorrow, and an even greater amount of consumption goods than what is sacrificed today is obtained tomorrow because of this addition to capital stock. All capital stock, which is simply the cumulative total of such investments, is thus based on "sacrifice"; and profit (or surplus) as a category of income constitutes a "reward for sacrifice".

A necessary condition for the validity of this view is that the economy should always be operating at full employment, i.e. that all resources are always fully utilized. But this has never been the case under capitalism, which instead has always had unutilized resources (except during wars, but these do not reflect the "normal" functioning of the system). It follows therefore that an increase in investment, instead of requiring a fall in consumption, actually leads to a concurrent increase in consumption. This is always the case (except during wars); but it becomes particularly visible in situations like the present.

Now, if profits and, by inference interest rates, were a reward for sacrifice, then negative interest rates could never arise. They would simply be impossible to explain.

The fact that the system has to have such negative rates points yet again to the vacuity of bourgeois theory.

Even with negative interests rates however there is unlikely to be any significant recovery from the crisis. If investment was not getting stimulated at zero interest rates, it is unlikely that a slightly lower (i.e. negative) interest rate will change the situation all that much. It is not as if a whole stock of investment projects have been waiting in the wings, which would suddenly become worthwhile because of the slight fall in interest rate; on the contrary such desperate measures, which underscore the gloomy economic scenario, will take away whatever euphoria the capitalists may have acquired of late, make them more "edgy", and hence further dampen their "animal spirits". Negative interest rates could mean at best a substitution of high-cost debt of firms by lower-cost debt within their existing portfolio, but not an expansion in the overall capital stock, or even much enlarged consumption.

A fall in the interest rate no doubt can weaken the currency of the country, and hence work in the direction of snatching demand away from other countries even within a generally stagnant world market. But even this route to recovery is unlikely to be of much help in a situation such as now, where all countries are lowering their exchange rates vis-à-vis the U.S. dollar, i.e. all countries other than the U.S. The U.S. itself however is increasingly resorting to protectionism as is evident from firms being penalized for outsourcing services to countries like India.

Even if perchance there is some recovery caused by the negative interest rates through the creation of a new "bubble", since the continuation of the "bubble" would require that the negative interest rates should be allowed to persist, when such a "bubble" does collapse, the rates would have to be pushed into a further negative region for bringing about a recovery from that situation.

Negative interest rates in other words, even assuming that they do work to stimulate a revival, i.e. in the most optimistic scenario for capitalism, are likely to end up being analogous to providing drugs to a drug-addict whose need for the stuff keeps increasing over time.

The reason why such measures, notwithstanding their unconventionality, are both unlikely to work and push the system towards greater dysfunctionality even in the event of their working, is because capitalism today is caught within a deep structural crisis.

For a very long period, right until the first world war, the system had the prop of a colonial arrangement which ensured that recessions were brief and were ensconced within an overall long boom. In the post-second world war period, State intervention in demand management played a similar role and came to the rescue of the system, even after the prop of the colonial arrangement had ceased to be effective as a stimulus (which is not the same as saying that imperialism had become irrelevant). Capitalism today however has no such props: the colonial arrangement not only cannot be revived but would also be inadequate as a stimulus for a long boom (because of the limited relative size of the colonial markets in the present context); at the same time, State intervention in demand management cannot work as a stimulus because of finance capital's insistence upon "fiscal responsibility".

Measures like monetary policy, which really amount to tweaking the system here and there, work only if there is some basic underlying prop that keeps the system going. But in the absence of such a prop, as is the case now, such tweaking, even if it takes unconventional forms like negative interest rates, is unlikely to work.

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