Interest Rates and the Use of Cash*

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Finance capital is always opposed to the use of fiscal measures for stimulating an economy. This is because any such fiscal stimulation undermines the social legitimacy of capitalism, and especially of that segment of it which constitutes the world of finance and which is peopled with "functionless investors" in Keynes' words or of "coupon clippers" in Lenin's words, i.e. of entities that play no role in the production process. If State intervention comes to be seen as necessary for stimulating the economy, then the question may arise in the public mind: why do we need all these entities? Why does not the State itself take over and run the economy through instituting public ownership?

The fear of this question being raised makes finance capital oppose fiscal intervention and support only such State intervention that does not destroy the mystique of capital, and of finance capital in particular. It only wants that form of State intervention for stimulating the economy which either boosts capitalists' "inducement to invest", or operates through lowering the cost of credit to the capitalists.

It is for this reason that the use of monetary policy for reviving a capitalist economy is preferred by finance capital over the use of fiscal policy. And since in the current era of globalization we have finance capital that is international, confronting States that are nation-States, the latter willy-nilly have to accede to the demands of finance, which is why most countries even have "fiscal responsibility" legislations that rule out the provision of a fiscal stimulus, while monetary policy everywhere enjoys centrality.

In the current capitalist crisis however a peculiar situation has arisen. Despite interest rates in most advanced countries being pushed down close to zero, so gloomy has been the capitalists'outlook on the growth of demand that very little investment has been forthcoming, and hence the crisis has continued to persist. And yet instead of accepting the need for fiscal stimulation in the current juncture, spokesmen of finance have argued that monetary policy should be persevered with, but that interest rates should be driven down below zero for reviving the system.

Negative interest rates however require two things, one of which is easy to achieve but not the other. Banks access funds in two ways, from deposits made by the public, and from loans made by the central bank. If there are to be negative interest rates on the credit they give out, then they must have access to funds at even more negative rates (otherwise they would not make profits). Now, central banks can charge negative interest rates to banks on the loans they make; that is a matter of policy-decision. And in countries where central banks are State-owned (like in India for instance) and central bank profits simply accrue to the government budget, any losses incurred by the central bank through charging negative interest rates, at least on certain types of loans it makes to banks, come out of the budget as a consequence. (This only illustrates incidentally that the opposition of finance capital is to fiscal means of directly stimulating the economy, not to placing the budget in the service of capital).

The European Central Bank has been charging negative interest rates for some time on loans to banks that the latter use for certain specific kinds of credit disbursement. Though it has scarcely had any impact by way of reviving the economy, the very fact of its being instituted shows that negative interest rates in this sense are not difficult to achieve.

But if negative interest rates are to be more widely charged on bank credit, then there must be negative interest rates on bank deposits as well. A hurdle however arises here: why should anyone deposit cash with banks if such deposits fetch negative interest rates? It would be better to hold on to cash itself than to put it in banks which give negative interest rates.

True, holding cash carries some risk, of theft, or of loss in other ways, that banks deposits avoid (except in situations where banks themselves run the risk of failing); but this can at the most make people accept a tiny negative deposit rate to compensate for such risk. On the whole therefore cash can be said to have almost a zero interest rate, so that if bank deposits fetch negative rates then nobody would hold bank deposits. Put differently, the use of cash puts a floor to the bank-deposit rate at zero; and this rules out negative lending rates by banks, which conservative economists, echoing finance capital's opposition to fiscal stimulation, have come to accept as being necessary for the revival of capitalism.

The difficulty of having negative interest rates on bank deposits is illustrated by the case of Sweden. While Swedish banks have introduced negative deposit rates, the Swedish government allows advance tax payments on which it gives a small positive interest rate (of around half a percent). Because of this there is a sudden swelling of the tax revenue of the Swedish government which it does not quite know what to do with. People have simply switched from holding bank deposits to holding claims upon the government in the form of advance tax payments. And since the whole purpose of having negative deposit rates is to enable banks, to whom such deposits accrue, to lend also at negative rates in order to stimulate investment in the economy, if bank deposits themselves dry up then this purpose is clearly defeated.

The Swedish case only illustrates the more general point, namely that negative deposit rates, and hence negative lending rates by banks on a pervasive scale, are impossible as long as alternative ways of holding purchasing power are available that yield a non-negative rate. Even if advance tax payments to the government, fetching some positive rate, did not exist, the sheer holding of cash which fetches a zero rate, would prevent any revival of the economy through a regime of negative deposit rates.

Some conservative economists therefore have now started arguing for an abolition of cash altogether. Prominent among them is a Harvard economist Kenneth Rogoff who was at one time the Chief economist of the IMF and who has written a book called The Curse of Cash arguing precisely this. He is of course not asking for an abolition of cash overnight; he sees it as something that should occur over a fairly prolonged period of time. But the reason it should occur, according to him, is not just the usual one that is advanced, including by the Indian government, namely that the abolition of cash eliminates unrecorded transactions and thereby reduces the scope for "black money"; an important reason, apart from this, is that it makes negative interest rates possible. If cash is simply eliminated from the system and everyone is forced to hold and deal in bank deposits, then negative deposit rates can be imposed on people without their being able to do anything about it.

Three points should be noted about this argument. The first is its sheer authoritarianism. What it amounts to is that for the revival of the capitalist economy today, a massive shift of income distribution must occur from the people at large to the capitalists, so that the latter are "induced" to make investments. Not only must we have capitalists, and investment by capitalists as the sole means of stimulating the economy (and not public spending), but to make the capitalists undertake such investment, the people must undergo whatever suffering in the form of income losses is necessary!

This is reification with a vengeance. The abolition of cash is advocated in the "social interest", i.e. for the betterment of the people. For their own "betterment", therefore, the people, according to this argument, must make whatever sacrifice is necessary, so that the reign of the capitalists remains undisturbed and undisputed.

The second point is that even with negative interest rates any revival of the world capitalist economy today is unlikely. Since modern capitalism is dominated by oligopolies which invest only in accordance with the expected growth of the market and whose investment is insensitive to the interest rate, as long as the market remains stagnant (precisely because of the crisis), very little investment would occur, even if there is a lowering of the interest rate to the negative region; and this very fact would perpetuate the crisis.

The third point to note is that even the abolition of cash will not push interest rates to the negative region. This is because there would be other circulating mediums that would be used if cash is unavailable, which share with cash the property of having very little "carrying costs", i.e. whose value relative to their volume is enormous (so that the cost of storage is minimal) , and which do not suffer much wear and tear through storage. One obvious such medium is gold; and if cash is sought to be abolished then people would simply switch to gold, which, like cash, has virtually a zero interest rate if purchasing power is held in its form, and which therefore puts a floor to the bank deposit rate at zero.

Mankind had begun its journey into the realm of money by first using gold as money. It is ironic that demands are being made under the most advanced form of capitalism today which would only push us back into the age of gold-money.

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