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Paying for Bank Deposits

Hyman P. Minsky Ph.D.

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I thought it over pretty carefully and then, with some regrets, spent the remainder of that job striding about in flat heels and full skirts.

JUDY B. GILBERT

Mountain View, Calif.

Paying for Bank Deposits

Editor, *The Wall Street Journal*:

Mr. George Shea's article of October 21 took up the possibility of commercial banks once again being allowed to pay interest on demand deposits. One of the arguments, that "an interest return might attract additional funds into the banks, tending somewhat to ease the credit strain," is fallacious. As I believe that the proposed change has some merit, I feel that correct rather than fallacious arguments should be used in examining it.

The error lies in confusing a "bank" and the "banking system." The ability of a bank to lend or invest depends upon the deposits it attracts: hence each bank offers inducements in order to attract depositors. However, the ability of the banking system as a whole to lend or invest depends upon the volume of reserve balances that is made available to the banking system by the Federal Reserve System.

In the present situation, with commercial banks not paying interest on demand deposits, an individual or a corporation with excess deposits can earn a return only by purchasing a security or by making a loan. As pointed out in the article, since 1954 the holdings of Treasury bills (and of other short-term government debt) by non-bank investors has increased at the same time as bank holdings of short-term government debt has decreased. The effect of these changes has been the same as if the banks sold some of their investments to their depositors; bank holdings of government debt and deposits decrease simultaneously.

However, the total reserves of the banks are not affected by these changes, so that banks now have more funds available to lend to other business enterprises. As a result a given quantity of reserve balances and hence of demand deposits can support more business activity—in technical jargon, velocity increases.

Such velocity increases tend to offset the efforts of the Federal Reserve System to restrain expenditures by not allowing commercial bank reserves to increase. Hence, in order to prevent such velocity-increasing substitution of non-bank assets for deposits from being the general reaction of large holders of demand deposits during tight money periods, it is desirable that interest should be paid on large deposits.

The payment of interest on demand deposits by commercial banks would tend to stabilize velocity by fixing the large, which are the volatile, deposits in the banks.

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Art of Government

And there was an element of luck, as well as of merit, in the fact that Eisenhower escaped the frozen aloofness which a position of high command develops in some military officers. His warm and folksy personality, his infectious grin, communicated an unusual sense of fellowship to the men under his command, down to the lowliest private.

When there was a suggestion that General John J. Pershing, a somewhat withdrawn personality and a stern disciplinarian, might be nominated for the Presidency after World War I, one hostile comment remarked that this would be a sure way to lose four million ex-soldier votes. Just opposite was the case with Eisenhower's strong movements in his favor developed in both major parties.

Favorable Winds

After winning the Republican nomination in a close contest with the politically sophisticated Robert A. Taft, Mr. Eisenhower again enjoyed good fortune in the circumstances of his first political battle with the Democrats.

Public reaction was high in 1952 against a frustrating war in Korea which the Truman Administration could neither win nor lose. So was disgust with evidences of Communist infiltration into Government service and deep freezes, mink coats and other symbols of petty corruption in Washington. The party hero was swept into office on a tide of demand for change and became the first Republican to be elected President since 1928.

And, while the President was faced with some difficult situations, the rather squalid row between McCarthy and the Army, the Eisenhower luck held pretty well during his years of high office. The death of Stalin paved the way for a break in the stalemate over the Korean War. It proved possible a few months after Eisenhower's inauguration to end the fighting and the casualty lists on a basis of restoring essentially the *status quo*, and without any humiliating compromise of principle, such as the release of unwilling prisoners would have been.

Mr. Eisenhower was fortunate in so many of his economic aides, notably former Secretary of the Treasury George M. Humphrey, former Chairman of the Council of Economic Advisers Arthur Burns. But the element of luck in the fact that in his first years of his Administration the living was virtually stabilized, with inflation in food prices offsetting some increase in prices of manufactured goods and services. Far from facing unemployment times, industrial workers, who had seen wages were rising while prices were stationary, "never had it so good," and the public swing in many industries in 1956 proved.

That Eisenhower had become

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