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NEGATIVE INTEREST RATES - ABSOLUTE DESPAIR IMPROVISES THE ECONOMY

Maria NEGREPONTI-DELIVANIS[1]

Abstract. *This article deals with a timely issue, the recent EU decision to implement an unprecedented economic measure. This consists of the application of negative interest rates on bank deposits, which in principle, represents an incomprehensible measure for economists. In particular, European citizens, who will put their savings in commercial European banks, not only will not be rewarded with a positive interest rate, as was the rule until now, but they will have to pay a negative interest to the banks for safeguarding their money. This incredible measure abolishes the quintessence of savings and causes turmoil and an unprecedented review of the entire monetary theory and policy, as well as the content of basic concepts and principles of economic science. It is a measure of despair and improvisation, moving away from the fundamentals of the economy and trying to overcome the failure of low and very low interest rates to yield the desired results, ie the revitalization of the European economy. This paradox measure is an extension of the famous statement by Mario Draghi, the ECB president, on January 2016, that "there are no limits" to what he will do in order to achieve the objectives he has set for his term. The ECB is the first bank implementing this measure for a year already. It is therefore necessary to investigate the meaning, the causes and consequences of this European*

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1. Which is the Meaning of this unconventional financial measure which punishes savings, and aims at encouraging total expenditure, i.e. consumption and investment?

Negative interest rates, from a theoretical viewpoint, aim at making borrowing cheaper, thus leading to an increase in demand and reviving the economy. Savers are discouraged to save as they are required to pay a price to the banks for keeping their savings. The initiators of this measure hope, moreover, that those who are discouraged to save because of negative interest rates will shift to consumption or investment.

This however is by no means certain. Chances are that under the deep recession prevailing in European economies they will prefer hoarding, awaiting more favorable developments. This is because hoarding will bring about a zero interest rate, while depositing their savings in the bank will result in negative interest rates.

[1]Prof. Ph.D., Honorary member of the Academy of Romanian Scientists (delimar@uom.gr).

Apart from the fact that the measure of negative interest rates is directed against savings, it also turns against the banks which are penalized for accumulating and not lending enough, while it is hoped that, as a result of negative interest rates, they will increase loans for investment and consumption. This hypothesis however, requires both sufficient bank deposits in spite of the negative interest rates the depositors will be required to pay, as well as the willingness of banks to increase lending to individuals and its fulfillment is by no means certain, for two main reasons:

-Firstly, because private savers will most probably prefer inexpensive hoarding over depositing their money in the banks, even at a low cost, they will decrease their deposits which form the basis for lending and

-Secondly, because banks will probably be less willing to lend compared to before the adoption of the measure of negative interest rates, in case they face decreased profits between what they gain through reduced deposits and what they lose from granting loans [4]. The profit of commercial banks will also be lower because they will now be obliged to pay negative interest rates to the Central Bank for the percentage of their deposits there exceeding the required level. This additional measure is also aimed at encouraging lending by commercial banks to individuals, as opposed to maintaining cash deposits at the Central Bank.

Apart from the negative interest rates on government bonds, the unorthodox measure extends to private European debt securities, worth EUR 65 billion [1]. What can possibly be the aim of individuals placing their savings in securities which require them to pay a price for safekeeping? Safety? Even more important is the relevant question, whether they think of this as a temporary or permanent condition.

1.1. The causes for the imposition of negative interest rates

What are the causes behind the imposition of such an absurd, in principle, financial measure? These are mainly:

A. The failure of the EU and the eurozone

Given the fact that this unnatural measure apparently started essentially in Europe[1], it makes sense that any attempt at investigating its causes should stem from the situation prevailing there. The reason is that this is a desperate measure, seeking even unconventional salvation solutions, a measure chosen by institutions and individuals in order to ensure their savings, even by resigning from a positive interest rate, even through their consent to accept a negative interest rate.

[1]The measure was imposed for a short period in the USA in 2008, and since 2012 has spread to Europe. Japan adopted it as well in 2016.

This negative interest rate is required to face circumstances of abnormally low inflation, deflation and recession, combined with a fall in the general level of prices, phenomena that prevail in Europe on a long-term basis. The aim is mainly to convince commercial banks to lend to individuals rather than to accumulate their assets to the ECB, to which they are also obliged, as mentioned above, to pay a negative interest rate. Some form of logic inherent in the imposition of negative interest rates refers to periods where the general level of prices drops, with the result that the debtor who borrowed at a positive interest rate records losses, while the lender has an extra gain beyond the positive nominal interest rate, through the rise of the effective interest rate he enjoys. Therefore, in times of falling prices, depositors, even if required to pay the banks a negative interest rate, eventually reap the gain from the increase in purchasing power their deposits have acquired in the meantime. This is precisely the case of the EU, which has sunk into recession and failing prices. Negative interest rates also aim at reversing deflation to inflation in Europe. Please observe that the entire structure of the EU, and especially that of the Eurozone is organized so as to protect the common currency from inflation, while its founders obviously considered that it was not threatened by deflation, while Europe already wishes for more inflation.

The adoption of this unprecedented measure, i.e. negative interest rates, on the part of the E.U., certainly testifies to its inability to address the numerous and accumulating problems, using traditional financial measures. Europe’s problems can be summarized as referring to the consequences of a complete failure to fulfill all initial promises given to European citizens, consisting of ensuring rapid growth rates, the convergence of the less developed countries to more developed ones, full employment and more equitable distribution of the European income. The convergence of the economies, which would be automatic, according to the unfounded tenets of neoliberals, not only did not materialize, but furthermore, the gap between the rich North and the poor South is constantly widening. Moreover, the EU failed to fulfill promises concerning full employment and rapid growth. It also breached the promise of Europe for a more equitable income distribution, since disparities are peaking due to the concentration of wealth in the ever fewer hands of oligarchs. However, in the highly globalized EU environment, which simultaneously combines extreme doctrinal views of liberals and the consequences of the chaotic activity of financial capitalism, what is of prime importance for the evaluation of its economic effects are the numbers, not the data of the real economy. The profits of stock markets and other financial institutions were sending a message of illusory success for many years, while there was an obvious disregard for the degree of prosperity of European citizens, the emaciation of applied democracy, for increasing Euroscepticism and the progressive reduction of solidarity and cohesion in Europe. The introduction of the common European currency, not only did not contribute to the functioning of the economies of its member states, but on the contrary aggravated their condition and brought on the full realization of a deadlock in Europe.

Europe tried to react to the gloomy state of the economy with the adoption of monetary policy measures which were however unsuccessful. The European economy is constantly sinking into chronic depression, which at times intensifies with signs of deflation and falling commodity prices. Unemployment remains high, or very high, especially in many southern European economies, while the propensity to invest is weak and therefore insufficient to revive the economy. Annual growth rate estimates are being constantly revised, as actual values are lower compared to forecasts.

Please note in this regard that only in 2008 the income of the 19 Eurozone economies reached the corresponding level of the first months of 2008 [6].

The dominant reason for the long-term failure of the EU-Eurozone at recovery is undoubtedly the imposition of austerity, which turned from a short-term measure into a long-term one with no closure date. Additional reasons have emerged recently, which hamper European recovery, such as low oil prices, declining growth in China and other emerging economies, the appearance of numerous indications of fatigue in Germany which operates as the growth engine of Europe, as well as the rise of far-right parties in Europe, fueling pessimistic predictions about the future.

Within the gloomy European scenery one should take into account the constant failures of meeting its objectives. Although one of the main objectives was to limit public debt in Europe, the latter is constantly increasing, in spite of the throttling austerity permanently imposed.

It is therefore hard, based on the disappointing European economic situation, to interpret Mario Draghi's optimism that negative interest rates would "cause a miracle." Moreover, he is not the only one who seems to believe in the effectiveness of this measure as implied by the fact that several economies have already implemented it[1].

J**ustified doubts as to the success of negative interest rates in reviving the European economy, have fueled rumors that the secret objective of negative interest rates is not the one officially stated, but the path towards the abolition of money and its replacement by plastic [11].** This view is supported by the fact that: France has banned all cash transactions exceeding EUR 1000; Spain has banned all cash transactions exceeding EUR 2,500; Uruguay has banned all cash transactions in excess of EUR 5,000[11].

[1]Eurozone, Denmark, Switzerland, Sweden and Japan.

B. Zero growth forecast

Apart from austerity which would be theoretically possible to modify following a decision of the member states, in spite of the fact that it represents Europe's permanent macroeconomic policy, condemning it to deep recession, there seems to be something even more serious, not limited to Europe the solution to which is extremely difficult if not impossible. This is the international revival of Alvin Hansen's theory [13], updated by Larry Summers[1] and focusing on the heavily burdened already European plane[2]. This theory totally justifies the market forecasts of very low inflation and very low interest rates for many years to come: 1% inflation and 1% interest rate. This is the theory of chronic depression, stating that apart from the consequences of the 2007 crisis, the developed economies are likely to suffer as a result of a significant imbalance between the propensity to save in excess of the propensity to invest. This imbalance pushes interest rates downwards and when the latter reach very low levels monetary policy is no longer able to influence them, with the result that the economy enters a long period of recession[3].

This is the well-known liquidity trap [5], which occurs during periods of intense depression when the interest rate has dropped to such a low level that the relative expectations of individuals exclude any further reduction. A recent study [14] proves that over the last 30 years real interest rates have decreased by approximately 4.5 percentage points both in developed and developing economies. This decrease is the result of many factors, some acting as vicious circles, such as low growth rates and especially changing preferences for savings and investment caused by an overabundance of savings combined with reluctance to invest. The factors causing this imbalance are expected to have an impact on interest rates, keeping them low and possibly negative, for many years to come.

The prospect of a world with no growth is frightening [2] and negative interest rates can be seen as "the price of fear" [1]. It is a reflection of societies, in which the next generation will enjoy a lower degree of prosperity than the previous one.

1.2. Negative interest rates and economic theory

The introduction of negative interest rates in the context of general economic theory, especially when they are perceived as a permanent and not temporary phenomenon, encounters insurmountable difficulties. This is because the interest rate is a monetary phenomenon, which is determined by four factors [3]:

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[1] IMF, November 2013.
[2] As well as Japan and almost all developed economies.
[3] "Secular depression" in the term used by Alvin Hansen.

* Time preference: people do not attach equal importance to present and future consumption. Time preference indicates their displeasure when forced to postpone for the future, a satisfaction that could be carried out without delay, and this delay is rewarded by the interest rate. **In the case of a negative interest rate, the above logic is reversed and is no longer rational: people prefer future over present consumption, and to ensure it they are willing to pay a price: the negative interest.**

* Marginal productivity of capital, which is the return on an additional unit invested. **In the case of negative interests, an individual will probably expect a negative marginal return on capital because of the recession and low demand for consumption, and therefore will not invest (the imbalance between savings exceeding investment will increase).**

* The increase in the quantity of money in circulation provided by seignior age banking **(increasing the amount of money in case of negative interest rates will not further decrease their level and will not revive the economy).** * The preference of people for liquidity (which does not occur in case of negative interest rates, given the fact that this indicates an excessive liquidity).

Maintaining negative interest rates for long is a case that cannot be interpreted by general economic principles (along with many other cases that are no longer subject to rules because of the incompatible consequences of the almost simultaneous invasion of globalization, extreme neoliberal views and the stock market development stage) [9].

***2.* Will the desired objectives be achieved by the imposition of negative interest rates?**

As pointed out already in the preceding analysis, resorting to the unorthodox measure of negative interest rates was mainly aimed (at least as officially stated) at revitalizing the economy, both European and global.

2.1. The erroneous practice of fiscal policy exclusion

The anxiety as to the success of the attempts at revival of the world economy and the European one in particular, brings up a very important omission of the macroeconomic policy, adopted in the EU. This consists of the EU's decision in the late 70s to only apply monetary policy, almost completely rejecting fiscal policy. This unilateral EU choice contradicts the fact that the inability of monetary policy to effectively help the economy in the Great Depression of 1929-1933, had generally been recognized since 1936, the importance of increased expenditure in the economy for the control of depressions had been realized thanks to the General Theory of J.M. Keynes, and the constant increase in government spending as a share in the GDP of modern economies imposed the complementation of fiscal and monetary policy as an absolute necessity. However, what has radically changed the operating mode of individual national economies in the late 70s, is the absolute predominance of the neoliberal vision, which downplayed demand, attributing an excessive importance to supply, with the result that resorting to fiscal policy was deemed unnecessary. However, it was not unnecessary [10]. That decision proved not only wrong but also extremely dangerous, as the adverse factors that led the European economy into a long term recession cannot be dealt with only through monetary policy. In the case examined here in particular, resorting to low and already negative interest rates, does not promise to be an effective solution, especially as these are imposed on economies that have suffered the adverse effects of chronic austerity and are thus extremely problematic. In order to get back on their feet, these economies require a radical review and restructuring of their entire economic system. More specifically, their accumulated problems can only be solved through the widespread use of properly selected measures, measures available in the arsenal of fiscal policy. Recognizing the abandonment of fiscal policy as a major mistake, many economists now argue that if governments had attributed sufficient importance to demand since the 70s, their economies would now be witnessing low underemployment, high income and low inflation [12]. Concerning in particular the problem of inflation, please note that since the mid-80s, inflation has caused widespread panic, in spite of the fact that it did not contribute significantly to the decaying structure of the EU-eurozone.

2.2. The causes of long-term recession or zero growth

The fundamental cause for this long term recession, which particularly affects Europe and not only, is, besides austerity, probably the non-implementation of fiscal measures in the economy, for about 45 years. This lack of budgetary measures can be summarized in the minimization of state intervention in the economy, which gradually led to the new zero-growth model for Europe and the world, characterized by an overabundance of savings. This dangerous overabundance[1] with its many abnormal aspects is the focus of current imbalances in the world and is especially manifest in Europe, as a result of the austerity policy. These imbalances are largely the result of widening income inequalities and wealth distribution on many levels.

In the first place, although, the share of wages in GDP is perceived as constant in the long term, it is nevertheless subject to a significant decline during the period 1983-2006, according to relevant IMF estimates[2], which is considered dangerous

[1]Identified initially in 2005 by the director of the FED Ben Bernanke in his speech "The world over-abundance of savings and the current deficit of the USA", cited in The *Economist,* 24.9.2005.
[2]March 2008.

for the system, since in many cases it has exceeded what is considered a crucial point in the context of the prevailing theory[1]. Specifically, the share of wages in the G7 member countries decreased by 5.8% in the period 1983-2006, namely by 8.8% in the countries of the EU, 9.3% in France and 13% in Greece respectively. At the same time, the share of profits is obviously constantly increasing as a share in the GDP of developed economies, as income shares are changing hands and are channeled from wage-earners to financiers, from labor to capital. This anomaly is due to the fact that, since the 80s, wages constantly fall short of labor productivity, which means that employees not only do not reap the fruits of progress, though their productivity is rising and rising fast, but witness in many cases a decrease in their real earnings.

Let me remind you that, according to the prevailing economic theory, the equation of wages with labor productivity is a sine qua non for the smooth functioning of the economy. However the neoliberal State remains inactive, so that the alleged state neutrality essentially favors profits at the expense of wages.

An additional aspect of creating uncontrollable inequalities refers to personal income distribution, where developments have been exponential since the imposition of globalization and neo-liberalism: 1% of the Earth's richest residents is in control of about 45% of global wealth ... and 50% of the poorest inhabitants of the planet is called to share 1% of global wealth. In the future it is expected that the share of wealth in the hands of the global elite will increase further.

These uncontrollable inequalities fuel the overabundance of savings which, on one hand reduce demand, resulting in crises of overproduction and, on the other hand, are not channeled into productive investment which remains weak, but in the hoarding of or demand for luxury goods and services. It is indeed well known that the creation of savings is the prerequisite for the generation of investment, but does not guarantee the latter. While savings depend on the level of income and are enhanced by unequal distribution, the propensity to invest is a function of the profits expected in return. During a period of decreasing prices which is expected to continue, the elasticity of business forecasts is equal to -1, which means that entrepreneurs not only do not expect a profit from their investment, but fear further losses, in which case they will not invest. The overabundance of liquidity on the other hand, is no longer primarily directed to the acquisition of financial assets, as long as their returns are too low.

Regarding the demand for consumption, the drastic reduction of wages, insecurity prevailing everywhere, the reduction of the welfare state services and high unemployment maintain it at low and inadequate levels as far as encouraging development is concerned.

[1]As defined in the wage/profit ratios in the neoclassical Cobb-Douglas function.

The oligarchs on their part have accumulated about half of the world income, have long met their basic needs and the kind of luxurious goods and services they buy, and their preference for hoarding do not contribute to stimulating the deeply recessionary economy through active demand.

Conclusion

The critical situation in Europe, as well as the failures of macroeconomic policy, which is entirely based on monetary policy measures, necessitates its supplementation with fiscal policy measures.

The most urgent among the latter is the immediate effort to redress the totally unregulated mode of income distribution. The explosive and extremely dangerous income distribution inequalities prevailing over the last 30 years are the dominant cause hindering the smooth operation of the European economies. It is naturally obvious that consolidation should start by substituting this paranoid permanent austerity system with an automatic correction mechanism of the economic cycle.

The analysis shows that without a revision of European macroeconomic policy as a whole, the measure of imposing negative interest rates has no chances of achieving its objectives.

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