

Pope, Robin

Working Paper

Quantitative Lending Directives are Needed

Bonn Econ Discussion Papers, No. 13/2009

Provided in Cooperation with:

Bonn Graduate School of Economics (BGSE), University of Bonn

Suggested Citation: Pope, Robin (2009) : Quantitative Lending Directives are Needed, Bonn Econ Discussion Papers, No. 13/2009, University of Bonn, Bonn Graduate School of Economics (BGSE), Bonn

This Version is available at:

<https://hdl.handle.net/10419/37034>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

Bonn Econ Discussion Papers

Discussion Paper 13/2009

Quantitative Lending Directives are Needed

by

Robin Pope

July 2009



Bonn Graduate School of Economics
Department of Economics
University of Bonn
Kaiserstrasse 1
D-53113 Bonn

Financial support by the
Deutsche Forschungsgemeinschaft (DFG)
through the
Bonn Graduate School of Economics (BGSE)
is gratefully acknowledged.

Deutsche Post World Net is a sponsor of the BGSE.

Quantitative Lending Directives are Needed

Robin Pope, University of Bonn*

Housing booms and busts have been a recurrent feature of developed economies for well over a century. They not infrequently lead into severe banking and general economic crises as in 2007-2009 with recovery impaired by bank reluctance to lend out the excess reserves that they in due course start to accumulate. In the US, this bank reserve excess skyrocketed from under \$2 billion in February 2008, to over \$600 billion a year later, Aaron Edlin and Dwight Jaffee observe. They endorse trying the Scott Sumner's proposal of price incentives to entice banks to lend out this excess. Keynes however was pessimistic about such price incentives operating on bankers once their animal spirits have fallen into fear. In his later years, Keynes' proposal of the remedy was for the government to tax the public and for the government itself to dole out the money to those entrepreneurs who yet had courage. Keynes' educated Nugget Coombs, head of Australia's World War 2 Reconstruction Committee, and then governor of its central bank 1960-1968, found a way to order the bankers to lend, instead of the government needing to do the lending in situations he discerned as market failure. Admittedly Coombs quantitative lending directives were not for the sort of entrepreneurial venture capital projects that Keynes may have envisaged, but for conventional sectors such as housing and rural industries. Coombs deemed that since central bankers understand imprecisely how bankers react to particular price incentives in booms and busts, to adequately expand loans in cyclically depressed sectors, and to adequately curtail loans in boom phases price incentives need to supplement price incentives.

It is a hubris, unsubstantiated by any shred of evidence, for economists to propose that today we have acquired such a clear understanding of financial markets that central bankers can sufficiently rapidly fine tune price incentives on hitherto non-price-incentivized magnitudes like excess reserves, to seek to do everything by price incentives alone. By all means let us implement Scott Sumner's proposed excess reserves price incentives and start seeking to estimate their effects. But let us also go in for more secure methods in the current emergency of requiring banks to reduce their excess reserves by a given percentage each month if they are to continue to reap the benefits of taxpayer guarantees of the security of public deposits lodged with them. In this respect a sensible complement to price incentives is Swapan Dasgupta's proposal to effectively ban excess reserves via prohibitive penalties, a proposal also endorsed by Aaron Edlin and Dwight Jaffee.

It may also be desirable for central banks to issue sectoral lending directives to direct some quantitative amount of bank lending toward social desirable projects and long term projects, such as environmental, educational and public transport infrastructure improvements. When taxpayers indirectly bolster the banking system even in normal times, and are directly funding it a present, it is entirely appropriate for its official sector representatives to "interfere" to enhance the social return reaped from bank loans.

* Experimental Economics Laboratory, ZEIfb, Walter Flex Str 3, D-53113 Bonn, Germany
Tels +49 (228) 73 18 87, 7, +49-228- 446 2880, Fax +49-228-446-2881 Robin.Pope@uni-bonn.de
http://www.zei.de/zei_english/mitarbeiter/pope.htm; <http://www.bonneconlab.uni-bonn.de/econlab/>

REFERENCES AND FURTHER READING

Aaron S. Edlin and Dwight M. Jaffee, Show Me The Money, *Economists' Voice*, April 6, 2009

Swapn Dasgupta, Comment on Luigi Zingales: Why not Consider Maximum Reserve Ratios? *Economists' Voice*, March, 2009

Evan Jones, Nugget Coombs and his place in the postwar order, *The Drawing Board: An Australian Review of Public Affairs*, Volume 4, Number 1: July 2003, 23–44.

Scott Sumner. Comment on Brad Delong: Can We Generate Controlled Reflation in a Liquidity Trap? *Economists' Voice*, March 2009