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Easing is Fine, but the Exit May Not Be a Happy One

By: William Poole - March 17, 2013

How much confidence can we have in an op-ed whose author makes an elementary mistake? Alan Blinder makes such an error in his next-to-last paragraph. He says, "As I have argued for some time, the Fed should reduce the interest rate it pays on . . . banks' excess reserves. If it did, banks would keep less cash on deposit at the Fed. The liberated funds would probably flow mainly into the money markets."

In fact, when banks use reserves to buy money-market instruments or to make loans, the reserves do not disappear. They end up in some other banks' reserve accounts at the Fed. The only way for the Fed to reduce bank reserves is to proactively sell some of its assets or let them run off. Nothing that banks can do changes this basic proposition.

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