

to other investors and the use by banks of the proceeds to make loans will shift the ownership of deposits and may increase the activity of existing deposits, but such sales will not increase total bank reserves so as to permit an increase in total bank credit and deposits" (1954, p. 126).

1961: The tone of the 1961 edition is much less sanguine than the above quotation. In its place is substituted the following: With yields on short-term securities now more attractive, "nonbank investors may use temporarily idle balances" to buy them, "or they may even be induced to economize on cash balances held for current payments. When banks sell short-term paper to other investors and use the proceeds to make loans, ownership of deposits may shift from holders of idle balances to borrowers who are spenders and will shortly disburse the proceeds. To the extent that this occurs, the velocity of existing deposits will increase. Total bank reserves and total bank credit and deposits do not increase in this process, but the volume of money transactions increases as the existing supply of money is used more actively" (1961, p. 127).

4. 1954: The sale of short-term securities soon depletes bank liquidity, so that the banks become increasingly reluctant to reduce their short-term holdings further. They are also by now reluctant to sell longer-term issues as well. The rise in short rates has exerted an upward pressure throughout the yield curve, bringing about lower capital values on longer issues.¹⁵ "Many banks . . . are reluctant to sell securities at a loss. As the potential loss becomes greater, this reluctance

deepens" (1954, pp. 126-27). In addition, monetary restraint has injected a note of caution and uncertainty into the business outlook. Because of these factors, banks start to conserve their liquidity and stop selling securities in order to make loans.

1961: The 1961 edition reproduces the concept of the erosion of bank liquidity, with consequent reluctance of the banks to continue their sales of short-term issues. However, the "uncertainty effect"—the dampening influence of a restraining monetary policy on expectations regarding future business conditions—is not mentioned at all and the so-called "lock-in effect" is sharply downgraded: "Banks are influenced *to some extent* by potential capital losses on the securities in their portfolios and they hesitate to sell securities at a loss. Income tax considerations and strict earnings calculations, however, may moderate *or even negate* the deterrent effect of such losses on continued sales of such securities" (1961, pp. 127-28).

5. Both the 1954 and 1961 editions stress that this process of monetary restraint leads to credit rationing by banks as well as to higher interest charges. The credit rationing takes the form of more careful screening of loan applicants and greater over-all selectivity in lending practices and standards. One of the reasons for this mentioned in the 1954 edition, however, is not in evidence in 1961, namely, the effect of a tight money policy in inducing a reassessment of prospective business developments.

6. 1954: Non-bank financial institutions have not escaped unscathed. In the first place, the prospect of continued monetary tightness also tempers their optimism about future business trends. In addition, rising interest rates and concomitant lower capital values of the

¹⁵ Neither edition makes any serious attempt to argue that only *small* changes in interest rates will suffice to lock lenders into their existing portfolios (cf. Tobin, *op. cit.*), although there is some suggestion of this in the 1954 edition, pp. 44 and 145-46.