

Can monetary policy alone promote growth?

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Central bankers are in the news again, not because of IMF's annual meeting in Lima, Peru last week.

It is because of the 600- page book just released this week by its author, the former US Federal Reserve (the Fed) chairman Ben Bernanke.

A common impression is central bankers are aloof and they prefer not being heard. They feel any word they might utter can be misinterpreted and fear it would spell a disaster for the markets.

It is something similar to the old saying, a rule traced to Aristophanes of 423 BC. He wrote in his *The Clouds*: "Children should be seen and not heard".

The central bankers are cool headed thinkers. They are known for reviewing each minute the happenings in financial markets. They evaluate their long-run impact. They are not bothered by stratagems of the politicians, who are more concerned with short-term gains, retaining or seizing power.

No wonder, politicians dislike central bankers, accusing them of taking cover behind "independence". Unable to manipulate monetary policy, whining politicians accuse them as heartless.

Are they humourless too?

Thanks to Joe Weisenthal of *Business Insider* and Morgan Stanley economist Joachim Fels, we have a story. It was narrated by a central bank chief at a dinner at Frankfurt's Senckenberg Museum a few years ago.

A man needs a heart transplant.

Says the doctor: "I can give you the heart of a five-year old boy."

"Too young."

"How about that of a forty-year old investment banker?"

"They don't have a heart."

"A seventy-five year old central banker?"

"I'll take it."

"But why?"

"It's never been used!"

That was the favourite joke of Mario Draghi, European Central Bank President, now facing a situation what Ben Bernanke faced and muddled through, and got the US out of what would have become Great Depression of last century.

This millennium, it will be known as Great Recession.

In the process, Bernanke he had to incur the wrath of his own party Congressmen and Senators.

He announced his resignation from the Republican Party as he released this week his 600-page book: *The Courage to Act: A Memoir of a Crisis and Its Aftermath*.

Appointed by the Republican President George W. Bush, and retained for another term by the Democrat President Obama, Bernanke was a member of the Fed Board from 2002 until 2014 and Chairman from 2006 to 2014. He was the right man at the right time, when America had to face deflation, unlike his predecessors who were experts in anti-inflationary economics.

Bernanke's doctoral research was on the *Great Depression*. He knew what should be done this time. Students of monetary economics would remember the US Fed failed in its duty: it allowed the banks in distress to die instead of rescuing them as "lender of last resort". That was the charge held against the Fed by monetarist Milton Friedman.

The courage to act

Aside from saving financial institutions, Bernanke had to revive domestic demand. He was keen to do Friedman's suggestion of helicopter money that is, cash transfers to households. He could not do it. It was disliked by Republicans. On the other hand, quantitative easing (QE) was resorted to for adding to reserves of the bank by buying their bad debts, hoping that they would lend out and step up demand.

It did not happen.

On the other hand, as the *Economist of London* wrote, cash transfers of 2% of GDP would have boosted the economy by 2.6% (using a multiplier of 1.3) rather than fiscal stimulus, which takes its own time for implementation. Consumer spending acts faster than government investment. That was hated by conservatives.

With a hostile legislature, imposing debt limit and against government spending, Bernanke had to contend with QE. Banks, though awash with liquidity, were reluctant to lend under deflationary conditions.

Bernanke knew monetary policy alone could not buy growth. The "animal spirits" had to be kicked in," a Keynesian remedy through fiscal spending. He was not a Keynesian, though. The Republicans pictured him so.

He writes in his book: *"It's the stupid (the Republican) economics ...[they] saw inflation where it did not exist and, when the official data did not bear out their predictions, invoked conspiracy theories.*

They denied fiscal policy could support job growth, while still working to direct federal spending to their own districts”.

As he lost patience, he says in his book: “I didn’t leave the Republican Party. I felt that the party left me.”

A Democrat, John Kennedy before becoming President, wrote in his *Profiles in Courage*:
“A man does what he must — in spite of personal consequences, in spite of obstacles and dangers, and pressures — and that is the basis of all human morality.”