Central bankers hear plea: Turn focus to government spending

By Binyamin Appelbaum
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Central bankers who gathered here to discuss better ways of jump-starting slow economic growth received a surprising message from their lunchtime speaker on Friday: Stop. You're making things worse.

Christopher A. Sims, a Nobel laureate in economic science, told the annual conference that increased government spending was required to lift the world's major economies from stagnation. The pursuit of innovations in monetary policy, he said, is diverting needed attention from the inaction of fiscal policy makers.

"So long as the legislature thinks it has no role in this problem, nothing is going to get done," said Mr. Sims, a professor at Princeton. The best hope, he said, "is that people at central banks are willing to say publicly that this is what is necessary."

Developed nations have leaned heavily on their central banks since the 2008 financial crisis. The United States, Europe and Japan have all relied on low interest rates to encourage increased spending by businesses and consumers even as government spending has remained relatively austere. Mr. Sims is among a growing number of experts who warn that this experiment has reached its limits.

The central banks have pushed rates to historically low levels. The European Central Bank and the Bank of Japan have even imposed negative interest rates, effectively taxing savings to encourage spending. Yet job growth and inflation remain stubbornly weak. Benoît Coeuré, a European Central Bank official, drew laughter from the audience when he noted the "good news" that eurozone inflation had doubled last month — from an annual rate of 0.1 percent up to 0.2 percent.

In the United States, the Federal Reserve responded to the crisis more forcefully than other central banks, and the federal government initially spent more freely. Yet here, too, growth remains slow, inflation remains weak and millions of middle-age people are no longer working.

Mohamed A. El-Erian, the chief economic adviser at Allianz, warned in a recent book, "The Only Game in Town," that time was running out. If developed nations do not increase spending and pursue structural reforms in the next few years, Mr. El-Erian predicted, they will be locked into a new reality of slower growth.

Moreover, he said central banks would be handicapped in fighting future crises — they have little room to cut rates should economic conditions deteriorate.

"It is dangerous to continue to focus the debate on what central banks can do," Mr. El-Erian, who is also the head of President Obama's Global Development Council, wrote Saturday in an email. "What is needed — not only in the U.S. but even more in Europe and Japan — is a policy pivot away from excessive dependence on central banks."

Central bankers profess to regard this pessimism as overstated. Janet L. Yellen, the Fed's chairwoman, and the heads of other major central banks have repeatedly urged lawmakers to lend a hand — albeit with considerable diffidence.

However, they also describe their own efforts as effective even without fiscal support. They are increasingly resigned to slower growth and lower interest rates, yet they insist they still have the means — by buying government debt,

for instance — to help reverse future downturns.

"Even if average interest rates remain lower than in the past," Ms. Yellen said at the conference, "I believe monetary policy will, under most conditions, be able to respond effectively."

The annual meetings here, hosted by the Federal Reserve Bank of Kansas City in the shadow of the Grand Tetons, often mix technical discussions and loftier debates. This year, as academics presented proposals for minor improvements in the mechanics of monetary policy, some in the audience suggested that monetary policy makers should be spending less time talking about themselves.

Peter Blair Henry, the dean of the Stern School of Business at New York University, asked a panel of central bankers whether they were doing enough to explain the limits of their own powers, to focus the public on the importance of fiscal policy.

"Everyone is sort of waiting for the next pronouncement about monetary policy when that's really not the central issue," Mr. Henry, an expert on international development, said in an interview. "I think it's important to communicate the limitations of what central bank policies can actually do to drive long-run growth. Central banks have done a real good job restoring stability, and we're at a point now where most of what needs to happen, needs to happen through structural reform."

Ms. Yellen and other central bankers do make this point with some regularity, but they also tend to do it with considerable circumspection. On Friday, Ms. Yellen waited until the final paragraphs of her speech to mention that "fiscal policies and structural reforms can play an important role in strengthening the U.S. economy."

Both Donald J. Trump, the Republican presidential nominee, and his Democratic opponent, Hillary Clinton, have called for increased government spending in areas including infrastructure. Those plans, however, would require support from Congress, where Republicans, worried about the federal debt, have prevented spending increases in recent years.

The debt already is large by historical standards. And running up the tab during a period when the economy is growing, if slowly, may make it harder to spend freely during a future recession, when the need for government stimulus is more acute.

But Douglas W. Elmendorf, the dean of the Kennedy School at Harvard, argued in a recent paper written with Louise Sheiner, a senior fellow at the Brookings Institution, that the sensible solution is to spend money now and deal with the debt later.

"A rush to reduce budget deficits after 2010 was the biggest error in this downturn," Mr. Elmendorf, former head of the Congressional Budget Office, said in a May presentation on the nation's economic woes.

Mario Draghi, the head of the European Central Bank, chose this conference two years ago to declare that European governments should increase fiscal spending even as the bank expanded its own stimulus campaign. (Such spending would be "helpful," he said, in the understated language of a central banker.)

But that speech and subsequent pleas have not produced any noticeable effect on Germany, the country whose trade surplus is at the heart of Europe's problems.

At this year's conference, Mr. Coeuré described the efforts of European governments as "half-baked and halfhearted." But he made clear that the E.C.B. would press on by itself.

"I would argue that this fundamentally doesn't impair our ability to achieve our objective, but it has a strong impact on the way we do it," he said.

Haruhiko Kuroda, the governor of the Bank of Japan, expressed a similar mix of helplessness and optimism. Japan has struggled with low inflation and slow growth for decades, and the bank's recent campaign to address the problem is perhaps the most aggressive of any developed nation. Yet the Japanese government has undermined those efforts, for example by imposing a large tax increase.

"I agree that monetary policy cannot do all things without the help of fiscal policy and structural policies," Mr. Kuroda said on Saturday. Asked what could be done to secure such help, he said that he met with the prime minister once or twice a month.

"In that sense," he said, "the Bank of Japan is provided the opportunity to speak up."