Hating on Ben Bernanke

By Paul Krugman, The New York Time

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Last week Ben Bernanke, the Federal Reserve chairman, announced a change in his institution's recession-fighting strategies. In so doing he seemed to be responding to the arguments of critics who have said the Fed can and should be doing more. And Republicans went wild.

Now, many people on the right have long been obsessed with the notion that we'll be facing runaway inflation any day now. The surprise was how readily Mitt Romney joined in the craziness.

So what did Mr. Bernanke announce, and why?

The Fed normally responds to a weak economy by buying short-term U.S. government debt from banks. This adds to bank reserves; the banks go out and lend more; and the economy perks up.

Unfortunately, the scale of the financial crisis, which left behind a huge overhang of consumer debt, depressed the economy so severely that the usual channels of monetary policy don't work. The Fed can bulk up bank reserves, but the banks have little incentive to lend the money out, because short-term interest rates are near zero. So the reserves just sit there.

The Fed's response to this problem has been "quantitative easing," a confusing term for buying assets other than Treasury bills, such as long-term U.S. debt. The hope has been that such purchases will drive down the cost of borrowing, and boost the economy even though conventional monetary policy has reached its limit.

Sure enough, last week's Fed announcement included another round of quantitative easing, this time involving mortgage-backed securities. The big news, however, was the Fed's declaration that "a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens." In plain English, the Fed is more or less promising that it won't start raising interest rates as soon as the economy looks better, that it will hold off until the economy is actually booming and (perhaps) until inflation has gone significantly higher.

The idea here is that by indicating its willingness to let the economy rip for a while, the Fed can encourage more private-sector spending right away. Potential home buyers will be encouraged by the prospect of moderately higher inflation that will make their debt easier to repay; corporations will be encouraged by the prospect of higher future sales; stocks will rise, increasing wealth, and the dollar will fall, making U.S. exports more competitive.

This is very much the kind of action Fed critics have advocated - and that Mr. Bernanke himself used to advocate before he became Fed chairman. True, it's a lot less explicit than the critics would have liked. But it's still a welcome move, although far from being a panacea for the economy's troubles (a point Mr. Bernanke himself emphasized).

And Republicans, as I said, have gone wild, with Mr. Romney joining in the craziness. His campaign issued a news release denouncing the Fed's move as giving the economy an "artificial" boost - he later described it as a "sugar high" - and declaring that "we should be creating wealth, not printing dollars."

Mr. Romney's language echoed that of the "liquidationists" of the 1930s, who argued against doing anything to mitigate the Great Depression. Until recently, the verdict on liquidationism seemed clear: it has been rejected and ridiculed not just by liberals and Keynesians but by conservatives too, including none other than Milton Friedman. "Aggressive monetary policy can reduce the depth of a recession," declared the George W. Bush administration in its 2004 Economic Report of the President. And the author of that report, Harvard's N. Gregory Mankiw, has actually advocated a much more aggressive Fed policy than the one announced last week.

Now Mr. Mankiw is allegedly a Romney adviser - but the candidate's position on economic policy is evidently being dictated by extremists who warn that any effort to fight this slump will turn us into Zimbabwe, Zimbabwe I tell you.

Oh, and what about Mr. Romney's ideas for "creating wealth"? The Romney economic "plan" offers no specifics about what he would actually do. The thrust of it, however, is that what America needs is less environmental protection and lower taxes on the wealthy. Surprise!

Indeed, as Mike Konczal of the Roosevelt Institute points out, the Romney plan of 2012 is almost identical - and with the same turns of phrase - to John McCain's plan in 2008, not to mention the plans laid out by George W. Bush in 2004 and 2006. The situation changes, but the song remains the same.

So last week we learned that Ben Bernanke is willing to listen to sensible critics and change course. But we also learned that on economic policy, as on foreign policy, Mitt Romney has abandoned any pose of moderation and taken up residence in the right's intellectual fever swamps.