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Doing It Again

By PAUL KRUGMAN

Eight years ago Ben Bernanke, already a governor at the Federal Reserve although not yet chairman, **spoke** at a conference honoring Milton Friedman. He closed his talk by addressing Friedman's famous claim that the Fed was responsible for the Great Depression, because it failed to do what was necessary to save the economy.

"You're right," said Mr. Bernanke, "we did it. We're very sorry. But thanks to you, we won't do it again."

Famous last words. For we are, in fact, doing it again.

It's true that things aren't as bad as they were during the worst of the Depression. But that's not saying much. And as in the 1930s, every proposal to do something to improve the situation is met with a firestorm of opposition and criticism. As a result, by the time the actual policy emerges, it's watered down to such an extent that it's almost guaranteed to fail.

We've already seen this happen with fiscal policy: fearing opposition in Congress, the Obama administration offered an inadequate plan, only to see the plan weakened further in the Senate. In the end, the small rise in federal spending was effectively offset by cuts at the state and local level, so that there was no real stimulus to the economy.

Now the same thing is happening to monetary policy.

The case for a more expansionary policy by the Fed is overwhelming. Unemployment is disastrously high, while U.S. inflation data over the past few years almost perfectly match the early stages of Japan's relentless slide into corrosive deflation.

Unfortunately, conventional monetary policy is no longer available: the short-term interest rates the Fed normally targets are already close to zero. So the Fed is shifting from its usual policy of buying only short-term debt, and is now buying long-term debt — a policy generally referred to as “quantitative easing.” (Why? Don't ask.)

There's nothing outlandish about this action. As Mr. Bernanke tried to explain Saturday, “This is just monetary policy,” adding, “It will work or not work in much the same way that ordinary, more conventional, familiar monetary policy works.”

Yet the Pain Caucus — my term for those who have opposed every effort to break out of our economic trap — is going wild.

This time, much of the noise is coming from foreign governments, many of which are complaining vociferously that the Fed's actions have weakened the dollar. All I can say about this line of criticism is that the hypocrisy is so thick you could cut it with a knife.

After all, you have China, which is engaged in currency manipulation on a scale unprecedented in world history — and hurting the rest of the world by doing so — attacking America for trying to put its own house in order. You have Germany, whose economy is kept afloat by a huge trade surplus, criticizing America for running trade deficits — then lashing out at a policy that might, by weakening the dollar, actually do something to reduce those deficits.

As a practical matter, however, this foreign criticism doesn't matter much. The real damage is being done by our domestic inflationistas — the people who have spent every step of our march toward

Japan-style deflation warning about runaway inflation just around the corner. They're doing it again — and they may already have succeeded in emasculating the Fed's new policy.

For the big concern about quantitative easing isn't that it will do too much; it is that it will accomplish too little. Reasonable estimates suggest that the Fed's new policy is unlikely to reduce interest rates enough to make more than a modest dent in unemployment. The only way the Fed might accomplish more is by changing expectations — specifically, by leading people to believe that we will have somewhat above-normal inflation over the next few years, which would reduce the incentive to sit on cash.

The idea that higher inflation might help isn't outlandish; it has been raised by many economists, some regional Fed presidents and the International Monetary Fund. But in the same remarks in which he defended his new policy, Mr. Bernanke — clearly trying to appease the inflationistas — vowed not to change the Fed's price target: “I have rejected any notion that we are going to try to raise inflation to a super-normal level in order to have effects on the economy.”

And there goes the best hope that the Fed's plan might actually work.

Think of it this way: Mr. Bernanke is getting the Obama treatment, and making the Obama response. He's facing intense, knee-jerk opposition to his efforts to rescue the economy. In an effort to mute that criticism, he's scaling back his plans in such a way as to guarantee that they'll fail.

And the almost 15 million unemployed American workers, half of whom have been jobless for 21 weeks or more, will pay the price, as the slump goes on and on.



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