



What Ben Bernanke could learn from Margaret Thatcher

Iron Lady and her cabinet pointed out the 'economic facts of life' to British in 1979; U.S. Fed chairman should do the same for Americans

BY KEVIN CARMICHAEL

WASHINGTON

It's reasonable to assume Ben Bernanke was too preoccupied to notice the release late last week of a batch of Margaret Thatcher's cabinet papers by the British National Archives. That's because the U.S. Federal Reserve chairman is preparing to oversee a two-day meeting of the Fed's policy committee that ends Wednesday.

With the legislative branch paralyzed by Tuesday's midterm elections, the Fed is under serious pressure to breathe life into a depressingly slow recovery. This will be no easy task because there is serious doubt about what appears to be Mr. Bernanke's preferred course of action: creating hundreds of billions of dollars to buy financial assets, a controversial policy called quantitative easing, or QE.

But the controversy over QE is precisely why Mr. Bernanke could do worse than spare a few minutes to flip through the correspondence between Ms. Thatcher's economic team after their election in the summer of 1979. The documents talk of the need to teach citizens the "economic facts of life" as a prelude to the government's plan to dramatically reduce government spending. The Thatcher cabinet recognized that the jolting changes they were contemplating would work only if the public had a basic understanding of why the rules were being rewritten. With understanding comes acceptance, which leads to confidence in the economy. As Mr. Bernanke contemplates further unorthodox policy, acceptance of his prescription is lacking, presenting a significant risk to its potential success.

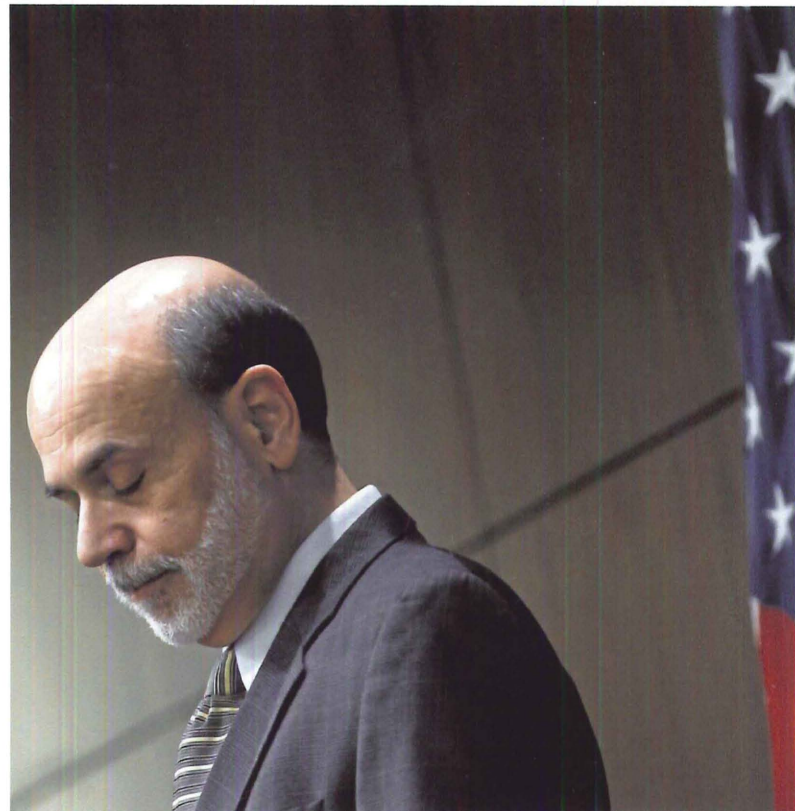
Virtually everyone with an opinion on U.S. monetary policy expects the Federal Open Market Committee to bridge its internal divisions over QE and launch a second round of asset purchases.

Analysts predict the FOMC

will adopt a program of between \$500-billion (U.S.) and \$1-trillion that would be spread over six to nine months. The unanimity over what the FOMC will do belies a contentious debate over what it should do. A legion of critics assault the wisdom of Mr. Bernanke's apparent inclination to resume QE almost daily. The dispute threatens to undermine broader confidence in the Fed's ability to act as steward of the economy. To avoid that outcome, Mr. Bernanke and others on the FOMC must find a way to clearly explain their strategy in order to win over, or at least quiet, the doubters. "The words they choose are critical and that's what they have to be good at if they are going to be effective," said Daniel Bain, chief investment officer at Toronto-based Thornmark Asset Management.

The case for further stimulus lies in the latest report on U.S. gross domestic product. The Commerce Department said in the first of three estimates that the U.S. economy expanded at an annual rate of 2 per cent in the third quarter, not nearly fast enough to lower the unemployment rate from 9.6 per cent. The Fed's preferred gauge of inflation, the core personal consumption index, rose at a 0.8-per-cent pace, the slowest in two years and uncomfortably close to signalling a deflation.

But the case against QE is equally strong, if more hypothetical. Borrowing costs already are low, suggesting that consumers remain too freaked out by the financial crisis to spend, and would rather save. The strategy has been so rarely used, little is known about its longer-term effects. Cheap money could lead to asset-price bubbles or inflation. Adding to the supply of dollars could further weaken the U.S. currency, stoking political tensions over exchange-rate policies that risk igniting a trade war. According to Marvin Goodfriend,



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an economist at Carnegie Mellon University and a former policy adviser at the Federal Reserve Bank of Richmond, the Fed is facing so much doubt because it has done a poor job explaining how it would implement a QE program and why it should do so. Prof. Goodfriend said Mr. Bernanke should release a "framework" that would describe, among other things, that the Fed's main objective is to achieve inflation of 2 per cent and therefore must do what it can to lift prices. Mr. Bernanke acknowledged in his Boston Fed speech that the risk of losing the public's confidence is risk that argues against QE. Perhaps with that in mind, Mr. Bernanke delivered one of his most transparent speeches on monetary policy yet, saying the Fed uses targets for employment and inflation to guide policy and that both are crying out for the Fed to take action. Opting against further stimulus would mean ignoring the

Fed's mandate to achieve "maximum" employment and price stability, Mr. Bernanke said.

It was a good tutorial by the former Princeton University professor. Expect more of them soon.

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