

# Opinion

Tackle child obesity: teach mums to eat

Susie Orbach, page 36



## Forget hard choices. We need pampering

Central banks are right to flood the world economy with newly printed money – so long as they know when to stop

Anatole Kaletsky



At long last, the world's economic leaders are swinging into action. The US Federal Reserve could have done what it did on Tuesday night — slashing US interest rates to absolute zero and announcing that it would print money without limit — two months ago, when the collapse of Fannie Mae and Lehman Brothers turned a localised financial problem into a life-threatening convulsion threatening the entire global economy. But better later than never.

The world's most important economic policymakers now have the bit between their teeth and their counterparts in Britain, Japan, Switzerland and the eurozone will find it impossible not to follow.

Politicians all over the world must now stop talking about hard choices — and start taking soft options. That may sound sardonic, but it isn't supposed to be. The political rhetoric of "hard choices" may sound more appropriate than "soft options", but a medical analogy makes it clear why pampering, not punishment, is what the world economy now requires. To recuperate from the post-Lehman heart attack, bankers and borrowers needs cossetting in the soft eiderdown of zero interest rates, while consumers and businesses need the emotional reassurance of tax cuts and government guarantees.

Without such tender care from central bankers and politicians, the year ahead could easily bring the death-throes of the globalised capitalist economic system. By cutting interest rates from 1 per cent to zero, the Fed opened the door to a completely new world of possibilities where many traditional rules vanish or go into reverse — a sort of economic Wonderland in which money can be distributed free to citizens and where governments can spend and borrow at will, without any increase in borrowing costs.

Now that the Fed has blazed the trail, other central banks are likely to follow. The sooner they do this — for the Bank of England it should be at its January monetary policy committee meeting — the greater the chances of averting a depression.

Specifically, the Fed's decision to impose zero interest rates was accompanied by a commitment to "unconventional" monetary measures.

### Bankers and borrowers needs cossetting in the eiderdown of zero rates

In layman's terms this means a promise to print and distribute money — and to keep printing it — until the US economy has pulled out of its recessionary spiral.

This is something that no central bank in any advanced economy has before promised so explicitly. But what, in practice, does it mean? In a modern economy there are three ways to "print money".

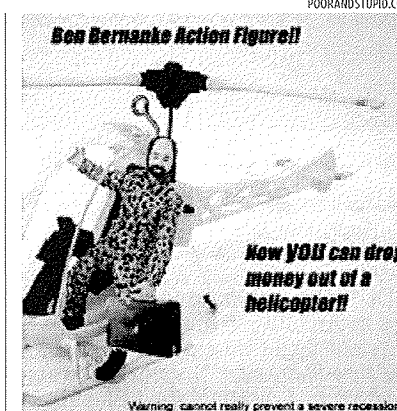
The first, most cautious, approach is for the Fed to buy safe assets, such as government bonds, mortgages,

student loans and other guaranteed debts that are now owned by private banks, investment institutions or individuals. The Fed will pay for them simply by making electronic transfers into the bank accounts of the people or institutions selling. For every \$1 million worth of assets bought, the Fed will transfer \$1 million of new money into private bank accounts. This "money" will come literally out of nowhere. It will simply be an electronic blip on the Fed's computer. Because electronic deposits at the Fed are the ultimate form of legal tender in the US system, the result will be that the US economy has \$1 million more money.

The problem is that for every \$1 million of new money thus "printed" the private sector must give to the Fed \$1 million in some form of wealth, such as mortgages or bonds. As a result, the private sector does not feel any richer and might not increase consumption or investment. Because of this, the Fed has promised to go much further.

The next option is to buy risky assets — commercial mortgages, bundled-up credit-card loans, perhaps even houses or shares. By making new money available for private sector mortgages, shares or other risky assets, the Fed would be able to drive up their prices making the private sector genuinely richer. Even more importantly, it could make new credit available directly to businesses and homeowners, bypassing the paralysed private banks — an example that the Bank of England and British Government should soon emulate if they have any sense.

The most radical option is to send the newly-minted money directly to the US Government. It could then be



American fiscal hero: Helicopter Ben

handed out to citizens via tax relief. This form of monetary expansion would be equivalent to printing money and dropping it from helicopters for people to pick up — a graphically extreme proposal that earned the Fed chairman, Ben Bernanke, his nickname of Helicopter Ben.

If there were doubts over whether private citizens would spend the newly-minted dollars, the Fed could agree with the Government on a programme of direct public spending financed by free electronic money, instead of taxes or bond issues. The Fed can literally guarantee that any new money created by this "ultra-Keynesian" approach will increase economic activity and employment. But such certainty comes at a cost.

A central bank that prints money to finance large-scale government spending is, in theory, moving into territory occupied by Zimbabwe and Weimar Germany. The Fed can take this risk at present, and is right to do so. Banks, businesses and consumers

are so convinced today about the prospect of falling prices — for houses, shares, commodities, cars, washing machines and all kinds of other assets — that far from losing confidence in paper money, they are too eager to keep all their savings in government-guaranteed paper.

As a result they refuse to invest in productive assets — and this refusal to invest is causing the slump. Until investors, businesses and consumers regain enough confidence to start spending, the Fed and other central banks can print money with abandon — and must do so. But once private spending resumes they must turn off the printing presses — or risk an inflationary boom that could be worse than the present deflationary crisis.

Contrary to conventional wisdom, inflation is much harder and more painful to deal with than deflation. Deflation can always be reversed — all it takes is a central bank willing to print money, supported by politicians who cut taxes, increase public spending and support banks instead of putting them into liquidation.

These are politically easy options. It was only because policymakers were so unpragmatic and moralistic, especially in their attitudes to bank regulation and accounting, that the crisis deteriorated so disastrously two months ago. Dealing with inflation is a different matter. Inflation really does demand tough choices — harsh public spending cuts, tax increases and high interest rates.

Today the threat is deflation, not inflation. The measures needed to deal with it are relatively painless and cost-free. Central bankers and politicians deserve to be praised when they take these easy options — provided they know when to stop.