

BOOK REVIEW

21ST CENTURY MONETARY POLICY: THE FEDERAL RESERVE FROM THE GREAT INFLATION TO COVID-19

BEN S. BERNANKE

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Previous works by Federal Reserve System officials acknowledge the central bank's role in creating inflation and recession (Francis 1969, Willes 1977, Greenspan 2007). Bernanke also makes numerous admissions that individuals working in the Austrian school tradition should find of interest. He admits U.S. presidents Lyndon B. Johnson, Richard M. Nixon and Donald Trump pressured three Fed chairs to pursue inflationary policies, roles they acquiesced in despite the bank's alleged "independence." He admits the Fed's role in the Great Recession (December 2007–June 2009), writing, "I don't absolve the Federal Reserve from its share of blame-and, after August 2002, that includes me personally." (p. 102) He admits "yield curve control" is a potential tool in the Fed's 21st

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century toolkit. Finally, Bernanke provides evidence he was more interested in the stock market than jobs creation.

Bernanke reviews Fed history, including his chairmanship (2006–14), and examines how the central bank may evolve in the future. He contends “the Fed responded hesitantly and inadequately” to the Great Inflation of “the mid-1960s until the mid-1980s” when policymakers demanded “guns and butter.” Political pressure played a role. Fed Chair William McChesney Martin (1951–70) publicly expressed concern about the possible consequences of “perpetual deficits and easy money.” But Johnson pressured Martin during a 1965 visit to his Texas ranch and the Fed chair became “an unwilling co-conspirator,” in Bernanke’s words. Fed Chair Arthur Burns (1970–78) did not believe inflation was primarily caused by monetary forces. Yet he was pressured by Nixon, whose 1971 wage and price controls Bernanke terms “analogous to dealing with an overheating engine by disabling its temperature gauge.” Bernanke contends Chair Paul Volcker (1979–87) restored the “Fed’s anti-inflation credibility.” Inflation peaked at 13.5 percent in 1980. Later, Trump called on the Fed to “get our interest rates down to ZERO, or less” in 2019. Bernanke writes, “It is hard to overstate how jarring Trump’s tactics were, particularly compared with his predecessors’ assiduous respect for Fed independence.” He is less critical of current Fed Chair Jerome Powell, who took over in 2018.

Bernanke disputes the idea that easy monetary policy stimulated housing prices that crashed into the Great Recession. He blames mass psychology, financial innovation, and inadequate regulation. Consumers panicked and lost confidence. Runs forced fire sales of troubled assets and led to price declines. Insolvencies extended the spiral. Regulators “underestimated the potential for peril since they thought” collateralization “would reassure investors.” Bernanke points to shadow banking, which “provided more credit to U.S. banks and households than the traditional banking sector.” He claims the sector avoided many of regulations applied to traditional commercial banks, such as minimum capital requirements, leading to risky lending.

The Fed failed at oversight, assuming more mission creep power, though Bernanke admits its “insufficient understanding” of risks pre-crisis. “To control the panic,” he writes, “we needed

to serve as lender of last resort to this broader set of firms and markets." Doing so meant "moving well beyond Bagehot's dictum." The Fed "became the *lender of last resort for nonfinancial borrowers as well.*" It relied on the Federal Reserve Act's Section 13(3), added in the Great Depression (1929–33), a Fed monetary failure. The new lending authorities included the Commercial Paper Funding Facility and Troubled Asset Relief Program. The Fed also gave a controversial loan to Bear Stearns, an investment bank that failed in the crisis.

The recession ended in mid-2009, but the Fed pursued radical monetary policies for the rest of Bernanke's tenure. Intended fed funds remained 0-to-0.25 percent until December 2015. The FOMC's "official embrace of large-scale securities purchases as a policy tool" were among actions. "Inside the Fed we would call it 'LSAPs,'" he writes, "short for large-scale asset purchases. Everyone else called it 'QE,' short for quantitative easing." The radicalism occurred at the zero bound. The two main approaches were "forward guidance and large-scale securities purchases." The Fed established a 2.0 percent PCE inflation target. It also pursued multiple QE rounds. Bernanke writes, "QE3 would soon dwarf QE2. . . unlike our previous securities-purchase programs, QE3 was *open ended*, with no total purchase amount or end date given." He admits "there was a lot we didn't know" when discussing QE. "We had no definite answers to many questions." Bernanke concedes the eventual monetary tightening "would have to be more gradual and finely calibrated than the easing had been." He admits no central bank "had succeeded in reversing zero-rate policies" at the time Janet Yellen, his successor (2014–18), replaced him. Can the U.S. economy stand on its own through a business cycle without stimulus? Describing turmoil in the repo market late in the last expansion (Fall 2019), Bernanke admits, the Fed "miscalculated." He writes, "Measures of bond-market volatility reached their highest levels since the financial crisis, while the heavily used markets for derivatives linked to Treasuries nearly ceased functioning."

In 2023, Americans live with the worst inflation since the early 1980s. Yet Bernanke appears incapable of comprehending radicalism's role in the process. He praises predecessor Alan Greenspan (1987–2006) for "his ability to see beyond standard economic data" but criticizes his "overconfidence in the power

of market forces to discipline risk-taking in financial institutions and markets.” More importantly, Bernanke disagrees with Greenspan’s seeming willingness “to reward with lower interest rates politicians who accomplished deficit reduction.” Bernanke terms this “analytical error” because “the economic risks of moderate government deficits are low.” He does not define “moderate,” claiming U.S. debt levels are sustainable. He writes favorably of the CARES Act, enacted in the 2020 COVID pandemic. Fuzzy math: based on the \$454 billion Treasury allocation, the Fed estimated it could provide at least \$2.3 trillion in loans. It also expanded eligibility to corporations, medium-sized businesses, and state and local governments. Bernanke acknowledges “no one really knew the level of reserves that would satisfy banks’ needs under most circumstances,” admitting the “ideal” balance sheet level has “to be determined by trial and error.” Americans needn’t worry. Bernanke assures us “scientific, rational policies” underscore Fed policymaking.

One sentence illustrates Bernanke’s state of denial. With “inflation near 2 percent on average,” he writes, “the new approach should help keep the inflation expectations of households and businesses well anchored near target.” (271) Instead, it topped 5% in 2022.

Bernanke’s future view asks, “Is the Fed’s Toolkit Enough?” He criticizes MMT, arguing it “would eliminate central-bank independence and institutionalize fiscal dominance.” In a fiat-money system, he claims “it is not possible for a central bank to leave asset prices and yields entirely to the free market.” Bernanke views negative interest rates and yield curve control as possible tools. Central bankers will apparently learn on the job. “Our understanding of the links between monetary policy, regulatory policy, and financial stability,” he writes, “remains much more limited than we would like.” Monetary students will find his explanations of the portfolio-balance and signaling channels of practical interest. On forward guidance, he explains, “I often liked to say that monetary policy is 98 percent talk and 2 percent action.”

There are several odd claims in the book.

- Bernanke equates libertarianism with the Efficient Market Theory, though securities arbitrage is a challenge to the EMT framework. (Kaza, 2000)

- Bernanke criticizes institutional groupthink, declaring, “The need to hear a range of views is another argument for central banks to be transparent about their thinking and open to exchange with outsiders.” Presumably this includes Fed critics, so why did ABCT references peak in member bank reviews in the *pre*-Bernanke era?

By contrast, it isn’t odd to learn Bernanke developed “mutual trust” with U.S. Rep. Barney Frank, D-Massachusetts, not U.S. Rep. Ron Paul, R-Texas, author of a Fed-critical book that earned a *New York Times* Best Seller list spot.

The Humphrey-Hawkins Act (1978) added *full employment* as a national economic policy objective. Bernanke cites unemployment rates a few times, but not with the frequency of stock market references on the following pages:

- “markets jumped on the announcement but ended down for the day.” (133)
- “Conditions brightened a bit over the next few months. The stock market bottomed in March (2009) and began what would become a long bull market.” (149)
- “The stock prices of the major banks rose sharply in 2009, and lending began to recover.” (151)
- “Financial conditions had eased considerably. . . with a 25 percent increase in stock prices suggesting growing optimism.” (168)
- “stocks fell about 2 percent on the day.” (194)
- “... the Dow had fallen more than 10 percent in the prior five trading days.” (209)
- “stock market decline” (235)
- “with the Dow jumping 3.3%” (236)
- “brought down the Dow” (244)
- “stock prices fell sharply” (255)

This is an area for further research, given Bernanke’s anemic jobs creation record. BLS data shows U.S. total payroll employment grew at an annualized 0.16% rate (February 2006, 135,737,000; January 2014, 137,548,000) during the ex-Fed chair’s eight-year tenure.

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