Lecture and Discussion Question Assignment 5 (Do what you can to answer LDQ-1 and LDQ-2 but not LDQ-3 —*alas, some of these questions have no answers*!) due October 24th or 25th on turnitin.com)

LDQ-1 Helicopter Ben? Ben Bernanke has been extremely innovative during his term at Federal reserve chairman, see New York Times profile, the Audacious Pragmatist. (a) Briefly, discuss the traditional of monetary policy, open market operations, setting reserve requirements and change the Federal Funds rate (as discussed in Chapter 16 of Mankiw). (b) Listen to Bernanke discuss the ways he has expanded interventions of the Federal Reserve to support the economy, briefly describe how and why balance sheet operations or quantitative easing works (see also lecture notes posted on web page and here). (c) How did Bernanke get the name Helicop Ben? (see the illustration from the text below, and this paragraph from his 2000 presentation at the AEA meetings in Boston). Has he been as aggressive as he urged the Bank of Japan to be? What did he urge the bank of Japan to do? (d) To be fair, why did CEA head Christine Romer "start clapping in the car" in 2009 when Time Magazine named Ben Bernanke "man of the year." Did the Federal Reserve do "exactly" what the sage of central banking Walter Bagehot, said to do in 1873 (compared to what the ECB did, for example, see page 94-96 in Blinder, 2013. *After the Music Stopped*? (start listening to Christine Romer's "oral history" at "The Fed did exactly what a Central Bank is supposed to do" How fast was the economy falling (at an annual rate) in the 4th quarter of 2008 (the Lehman quarter) vs. Fall 2009? EC. *Why was CEA head Romer pushing for more stimulus? Why did she lose this fight? What are her regrets and what was she most disappointed with in Washington (e.g. re housing, & writing down 1st mortgages, what are the pros and cons of changing the "sacred" status of 1st mortgages, or private student loans?).*[1]

To quote Bernanke, 2000: "Suppose that the yen depreciation strategy is tried but fails to raise aggregate demand and prices sufficiently, perhaps because at some point Japan's trading partners do object to further falls in the yen. An alternative strategy, which does not rely at all on trade diversion, is money-financed transfers to domestic households—-the real-life equivalent of that hoary thought experiment, the "helicopter drop" of newly printed money. I think most economists would agree that a large enough helicopter drop must raise the price level. Suppose it did not, so that the price level remained unchanged. Then the real wealth of the population would grow without bound, as they are flooded with gifts of money from the government—-another variant of the arbitrage argument made earlier. Surely at some point the public would attempt to convert its increased real wealth into goods and services, spending that would increase aggregate demand and prices. Conversion of the public's money wealth into other assets would also be beneficial, if it raised the prices of other assets.[2]

LDQ-2 September Employment Report: Generally the employment report is released on the first Friday of the month (for the prevous month). But since the government shut down for a a few weeks, the September report was just released today (Tuesday October 22, 2013). Viewing the press release and the employment situation (http://www.bls.gov/news.release/empsit.a.htm) see in particular the last column showign the change for August to September 2013. How much did the number of employed increase? Why is this number different from the headline number "nonfarm employment rose by 148,000"? (see the FYI on Page 306, "The Jobs Number"). Why was this number a bit of a dissapointment (see NewYork Times or other news report)? Did unemployment fall for men or women? Did the number working increase (or did people just stop looking for work?). Did the number of discouraged workers or those "marginally attached" to the labor forces increase August to September (see the last few lines of summary Table A). Mention two encouraging and two discouraging aspects of this report. *Why did stock markets rise following this report (hint: date of the next "clean" employment report?).*

---

[1] PBS Frontline special on the financial crisis, Christine Romer interview, http://www.pbs.org/wgbh/pages/frontline/oral-history/financial-crisis/christina-romer/

[2] . Bernanke, Ben, 2000, "Japanese Monetary Policy: A Case of Self-Induced Paralysis?, page 21, ASSA meetings, Boston MA, January 9, 2000, Princeton University, also published in the Peterson Institute for International Economics, special report 13 *Japan's Financial Crisis and Its Parallels to US Experience,* 149-66, page 162 .http://www.piie.com/publications/chapters_preview/319/7iie289X.pdf or

LDQ-3: Super Mario Brother Mario "the Dragon" Draghi "changed the ECB's course virtually overnight" saving Greece (and Italy) from a potentially disastrous downward debt spiral using a Central Bank, the ECB, that really had not authority to save any country. How did he do it? B) For the U.S. (and New York) the "music stopped" when Lehman collapsed, PBG (Paulson, Bernanke, and Geithner) decided not to save because they thought *"saving Lehman with a loan from the Fed was illegal."*[3] Mario "the Dragon" on the other hand, knew it was illegal for the ECB to buy the sovereign debt of Greece and Italy, however he not only found a way to do this (with 3 year 1% loans to banks) but he promised to buy debt more "without limit" to using OMT (outright monetary transactions) if necessary.[4] While Germany's high court will make a decision on the legality of the OMT later this year, it is clear that Draghi bent the rules and pulled back from the cliff, while Bernanke et al. let Lehman go dark in Times Square, at enormous cost (millions of jobs, thousands of homes lost to foreclosure, though this may not have been clear at the time). Perhaps Bagehot's famous dictum for Central banks needs to be modified, to "lend without limit," at very low rates, legal or not…" (a) Was Lehman "to big to fail?" Blinder says this entire "to big to fail" argument is a red herring, why?). C) In retrospect, was Lehman illiquid or insolvent (consider AIG, which everyone thought was totally insolvent, has the TARP investment in AIG paid off?). D) Why did PBG let Lehman fail (was it mainly P, B or G? See for example the BBC radio play, "the day Lehman Died") What should they have done? [Mario Monti, Jesuit Professor and Mario Draghi are actually not brothers at all, they just have the same first name] *C) How did Mario Draghi earn his other nickname "the dragon" (two ways actually).*

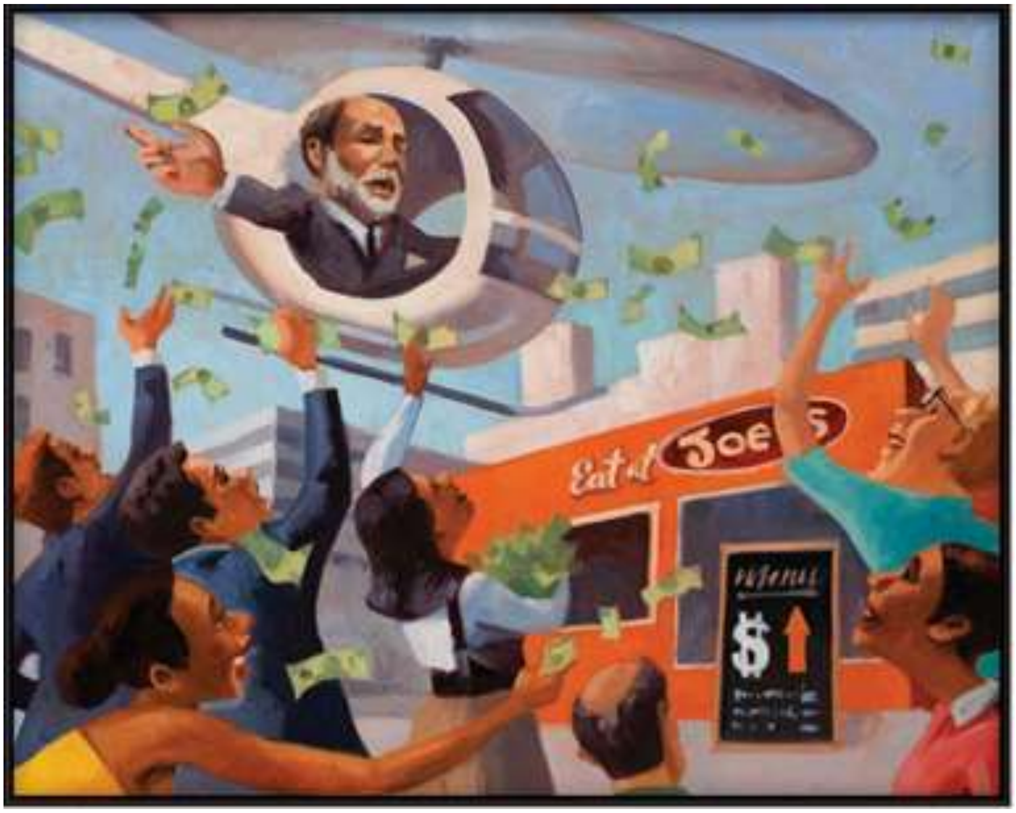
Ben Bernanke introduces QE_3 on PBS:

http://www.pbs.org/newshour/rundown/2012/09/qe3-fed-launches-third-attempt-to-stimulate-economy.html

---

[3] See Blinder, 2013, page 127-28 of Blinder, 2013, "Mostly for this reason, Paulson, Bernanke, and Geithner had made a fateful decision even before the last possible private buyer (Barclays) dropped out: If no private-sector solution could be found, they would let Lehman Brothers fail and deal with the consequences, because saving Lehman with a loan from the Fed was illegal. *This critical judgment will reverberate for years.* Bernanke, Geithner, and the Fed's legal staff decided that lending to Lehman—against collateral that few could honestly characterize as "good"— would stretch the law beyond its breaking point. They believed they had no choice. The consequences of letting Lehman go down turned out to be more severe than probably anyone imagined. The financial system literally started to fall apart. Why? We'll be in a better position to answer that question after the next chapter, which examines the cascade of failures and near failures that followed the Lehman bankruptcy. But a large part of the answer is staring us right in the face already. Bear Stearns— and to a lesser extent Fannie and Freddie—had, indeed, established a precedent. Call it moral hazard if you wish, though not many financial companies aspired to go the way of Bear. But whatever you call it, the market had acquired the view that the government was not going to let any financial giant fail messily. Blinder, Alan S. (2013). After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead (pp. 127-128). Penguin Group US. Kindle Edition.

[4] See Blinder, 2013 page 425, "A month later, the markets were getting jittery again and the euro was sagging. Talk of a euro-area breakup was in the air. Draghi reacted again, this time with words, telling a conference in London that the ECB would "do whatever it takes to preserve the euro," and "believe me, it will be enough." It was tough talk, and markets immediately began to speculate that the ECB would soon restart, and probably enhance, its suspended program of buying sovereign debt. They were right. In early September, Draghi announced a new bond-buying program, called "Outright Monetary Transactions" (OMT), that went well beyond the ECB's previous efforts. While restricted to bonds with maturities of three years or less, the volume of sovereign debt purchases under OMT is in principle unlimited. So the ECB's wallet is wide open."



Video: [Ben Bernanke on 60 Minutes – Quantitative Easing & Economic Outlook](http://www.clipsandcomment.com/2010/12/05/video-ben-bernanke-on-60-minutes-quantitative-easing-economic-outlook/)

http://www.clipsandcomment.com/2010/12/05/video-ben-bernanke-on-60-minutes-quantitative-easing-economic-outlook/

December 5, 2010

http://www.wallstreetdaily.com/2012/01/26/world-economic-forum-year-of-the-draghi/

http://www.bls.gov/news.release/empsit.a.htm