Congressional Democrats defer to Fed Chairman Bernanke on Wall Street bailout

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Federal Reserve Chairman Ben Bernanke testified before the Joint Economic Committee of the US Congress on Wednesday, stating for the first time that "a recession is possible" and suggesting that the US economy is likely to stagnate or contract in the first half of the year.

In his opening remarks, Bernanke highlighted the generally dire prospects facing the US economy—rising unemployment, falling consumer spending and stagnating home values—and concluded, "[I]t now appears likely that real gross domestic product will not grow much, if at all, over the first half of 2008 and could even contract slightly." He added, "The uncertainty attending this forecast is quite high and the risks remain to the downside."

Bernanke also noted that "uncertainty about the inflation outlook has increased," and made passing reference to the depreciation of the dollar as a factor contributing to rising prices.

The Fed Chairman was noncommittal in his signals regarding interest rates. While his economic prognosis was grimmer than those he has previously given, he asserted that "much necessary economic and financial adjustment has already taken place," hinting that the Fed may slow the pace of interest rate cuts.

Bernanke made no reference in his opening remarks to the regulatory overhaul proposed by Treasury Secretary Henry Paulson on Monday. When asked his opinion on the proposal, he merely called it an "interesting and useful first step."

The plan would further deregulate the financial system, stripping the Fed of its longstanding role as regulator of commercial banks, while giving it new powers to intervene throughout financial markets to prevent a "systemic" crisis, presumably by engineering bailouts such as that carried out earlier this month at the investment bank Bear Stearns.

Stock indexes closed down slightly after Bernanke's testimony, following a nearly 400-point rise in the Dow Jones Industrial Average on Tuesday. That day's rally came despite announcements by the Swiss banking giant UBS and Deutsche Bank that they would write down billions more in debt, and news that the International Monetary Fund (IMF) had significantly reduced its forecast for US economic growth.

The IMF now estimates the chance of world recession in the coming period to be around 25 percent, and that US growth is likely to be in the neighborhood of only 0.05 percent in 2008 and 0.06 percent in 2009. This latter figure is at odds with comments made Wednesday by Bernanke, who predicts growth to return to normal next year. Three months ago, the IMF said it expected the US economy to grow at 1.5 percent in 2008.

Bernanke, in contrast to his usual central banker's stolidity, was visibly unnerved by questions raised by committee members about the March 14 Fed-assisted sale of Bear Stearns to JPMorgan Chase. At several points, Bernanke found himself unable to answer relatively simple questions about the operation, deferring to congressional testimony slated for Thursday by the heads of the New York Fed, the Securities and Exchange Commission, and JPMorgan Chase.

Bernanke said he was not sure whether the $30 billion in Bear Stearns debt taken onto the Federal Reserve's balance sheets had been independently evaluated, and said he could not comment on the details of how the transaction unfolded.

This barely raised an eyebrow among the Democrats and Republicans on the Joint Economic Committee. No one commented on the fact that Bernanke, who can cause a stock market crash with the wag of his tongue, was either unable or unwilling to answer rudimentary questions about an unprecedented action that took place under his supervision.

Most significant was the fact that none of the congressmen and senators went on record as opposing the Fed's actions. No one even asked Bernanke whether the Federal Reserve was within its rights to take Bear's securities onto its own books. As a whole, the discussion revealed the prostration of both parties before the top representative of the US financial elite, and their lack of opposition to bailing out Wall Street with taxpayer funds.

A number of Democratic members of the committee made a show of berating the Fed chairman for refusing to recommend specific fiscal measures to Congress.

After noting that an economic downturn would put pressure on state budgets, forcing states to either raise taxes or cut spending, Senator Edward Kennedy asked, "What can we do to assist our constituents, especially those who are closer to retirement?" Bernanke avoided answering the question, in response to which Kennedy theatrically removed his glasses and began raising his voice, demanding, "Are you going to provide help and assistance to the states?"

Bernanke replied that he has authority only over monetary policy, and that Congress would have to make fiscal decisions. To this, Kennedy replied, "You have to have some position." Bernanke answered, "No, sir, I do not. I'm all in favor of helping people, sir, but that's up to the Congress."

The absurdity of Kennedy's show of displeasure was underscored by the fact that Democratic Senator Charles Schumer, the committee's chairman, said in his opening remarks that Bernanke was not testifying in order to recommend policies to Congress, and that this was not his job.

Congressman Elijah Cummings continued in a similar vein, substituting Kennedy's bluster for pathos. He said, "There are people in my district who can't even afford the gasoline to get to their jobs. These people will be watching now to try to understand what's going on." The congressman added plaintively, "You're the expert, you're the one that we depend on, you're the superstar, you have to tell us what to do."

The Democrats' criticisms were intended to obscure the fact that they propose no serious measures to aid struggling homeowners or workers facing the loss of their jobs, falling wages and crushing debt burdens. At the beginning of the hearing, Schumer proposed a derisory program that would allocate $200 million for "pre-foreclosure counseling" and another $4 billion in "community development block grants." To put the proposal in perspective, the war in Iraq is estimated to cost $12 billion every month, and the Fed has already allocated nearly a trillion dollars in cheap loans to bail out Wall Street.

When questioned about the precedent set by the Fed's actions, Bernanke replied categorically, "We did not bail out Bear Stearns," arguing that the bank's shareholders suffered significant losses as a result of the buyout.

None of the committee members even hinted that multi-millionaire executives at Bear Stearns and other Wall Street firms that created and profited massively from the housing bubble based on shaky subprime loans should be held accountable for the economic and social disaster their policies have produced.

They know full well that involved in the speculative binge that has now collapsed were deceptive and fraudulent practices, combined with reckless risk-taking on an unprecedented scale.

Bernanke denied that more bailouts were in the offing, stating that "we are nowhere near the condition for a government bailout of the financial system." But the reality is quite different. The front page of Tuesday's *Financial Times* reported that plans for "temporary suspension of capital requirements, taxpayer-funded recapitalization of banks and outright public purchase of mortgage-backed securities" are currently under discussion among central banks and governments.