Fed Chairman Bernanke signals more bank bailouts, calls for cuts in social programs

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In two days of testimony before Congress, Federal Reserve Board Chairman Ben Bernanke defended the multi-trillion-dollar bailout of the banks while seeking to allay fears on financial markets of a potential eruption of inflation.

Bernanke's testimony before the House Financial Services Committee on Tuesday and the Senate Banking Committee on Wednesday underscored the commitment of both the central bank and the Obama administration to defending the profits and wealth of the financial elite. His reception by the Democratic-controlled committees made clear that, whatever minor criticisms Congress may offer, it shares this overriding goal.

Bernanke published a lengthy commentary in the *Wall Street Journal* on Tuesday, timed to coincide with his appearance before the House committee, arguing that the Fed had an "exit strategy" to unwind the massive injections of capital into the banking system and avoid an inflationary spiral once business activity begins to rebound from the deepest recession since the 1930s.

In his prepared statement, Bernanke cited the rally on Wall Street and the renewed profitability of major banks as signs that the financial crisis had abated. At the same time, he made clear that unemployment and home foreclosures would continue to rise and remain at near-record rates for at least the next two years, and warned that consumer spending would remain depressed.

The Fed chairman forecast a slight growth in the US economy by the end of 2009 and a gradual acceleration in 2010 and 2011. But he said the central bank, which cut its key interest rate to near zero last December, would continue to hold interest rates at record lows "for an extended period."

Bernanke acknowledged that "financial conditions remain stressed, and many households and businesses are finding credit difficult to obtain." In response to a question about the prospects for a jobs recovery, he said, "We have a very long haul here. Unemployment is going to stay high for quite a while, and so it's not going to feel really like a strong economy."

However, he called a second economic stimulus package "premature" and proposed no measures either to provide immediate relief for the millions hit by plant closures, layoffs, and the collapse of home values and savings, or to allocate government funds to create new jobs. Nor did he propose any measures to compel the banks, which have received more than $200 billion in taxpayer cash and trillions more in low-interest loans, subsidies and government backing for their debt, to increase their lending and make credit available to working families.

On the contrary, he reiterated earlier demands that Congress and the Obama administration agree on plans to slash the budget deficit by cutting basic social programs such as Medicare and Medicaid. In his prepared statement, he said "...maintaining the confidence of the public and financial markets requires that policymakers begin planning now for the restoration of fiscal balance. Prompt attention to questions of fiscal sustainability is particularly critical because of the coming budgetary and economic challenges associated with the retirement of the baby-boom generation and continued increases in the costs of Medicare and Medicaid. Addressing the country's fiscal problems will require difficult choices, but postponing those choices will only make them more difficult."

In the course of his testimony, he endorsed the drive by the Obama administration, in the name of health care "reform," to reduce the costs to business and the government of health insurance for workers. "I do believe," he said, "for the broad economy's health or fiscal health, we do need to address the problem of increasing cost. And so any program that is undertaken should look to how we're going to get control of costs..."

An exchange on Wednesday with Jim Bunning, the right-wing Republican senator from Kentucky, highlighted the priorities of the Federal Reserve. Citing the role of former Fed Chairman Paul Volcker, who, under presidents Jimmy Carter and Ronald Reagan, raised interest rates above 20 percent and precipitated a wave of plant closures and layoffs, Bunning asked, "But do you have the will as former Chairman Volcker did to tighten even if the economy is still weak?"

Bernanke replied, "We will absolutely do it, so long as we are not forced to do something different by Congress."

At the same time, Bernanke made clear that the Fed would continue to allocate whatever funds were needed to prop up the banks. In response to the plea from Senate Banking Committee

Chairman Christopher Dodd, Democrat from Connecticut, Bernanke said he was prepared to extend one bailout program, the Term Asset-Backed Securities Loan Facility (TALF), beyond its December 31 expiration date.

Much of the discussion at both hearings focused on fears of an impending avalanche of commercial real estate defaults. Trends Research Institute Director Gerald Celente, who forecast the subprime mortgage crisis, has predicted that defaults will turn into a commercial real estate collapse that will "dwarf the subprime problem."

Moody's Investor Services reported that the number of commercial properties in default, foreclosure or bankruptcy in June was more than twice the number six months earlier and almost twice the value.

Bernanke at one point acknowledged that "Many banks will be facing mountains of CRE (commercial real estate) challenges going forward." He told the Senate Banking Committee that it "may be appropriate" for the government to guarantee commercial mortgages, an allocation of government funds that could run into the hundreds of billions of dollars.

In a further indication of the character of the "recovery" touted by Bernanke, the Fed chairman said, "The American consumer is not going to be the source of a global boom by any means. On that very topic, we are continuing to encourage our trading partners in Asia and elsewhere to understand—and I believe that they do—that they need to substitute their own domestic spending, their own domestic demand, for American consumers as the engine of growth in their economies." He cited China's stimulus program as a positive example.

Bernanke used the hearings to oppose an Obama administration proposal to establish, as part of a revised bank regulatory system, a largely token consumer protection agency, a measure that is fiercely opposed by Wall Street. He also denounced a pending bill in Congress that would expand the powers of the Government Accountability Office, an arm of Congress, to audit the Federal Reserve.

The hearings, known as the semi-annual Monetary Policy Report to Congress, came in the wake of bumper profit reports by bailed out banks, most notably Goldman Sachs and JPMorgan Chase, and record set-asides by Wall Street firms for executive salaries and bonuses. Public anger is rising over the windfalls for bankers and big investors, some of it coming from predatory hikes in credit card rates and fees and huge penalties being charged for bank overdrafts.

This sentiment found no genuine reflection in the hearings. Massachusetts Democrat Barney Frank, the chairman of the House Financial Services Committee, devoted his opening remarks to absolving Bernanke of any wrongdoing in last year's Bank of America takeover of Merrill Lynch.

A number of congressional hearings have been held into charges that Bernanke and then-Treasury Secretary Henry Paulson pressured Bank of America CEO Kenneth Lewis to go through with the takeover even though it had become clear that Merrill's debts and toxic assets were far higher than the failing bank had acknowledged. Shareholders have filed suits alleging that Lewis, under pressure from Bernanke and Paulson, concealed the real state of Merrill from shareholders and the public.

Within weeks of the January 2009 completion of the merger, the government awarded Bank of America $20 billion in bailout cash under the Troubled Asset Relief Program (TARP) over and above the $25 billion that had been given the bank in October of 2008. The government also agreed to guarantee over $300 billion on Bank of America assets.

Frank declared that he saw "no villains" in the takeover deal.

On the Senate side, Chairman Dodd used his opening statement to posture as an advocate for laid off workers and families facing foreclosure, praising the progress in stabilizing the banks but complaining that the recovery was one-sided. There should be more balance, he said, so that the "other half"—namely, the broad mass of the American people—also benefitted.

He took pains, however, to combine this criticism with a testimonial to Bernanke's service to the country. "Mr. Chairman," he said, "all of us understand the importance of the work you are doing—and that's not just a platitude or a generous comment. And we all look forward to continuing to partner with you in this effort."

No one at either hearing raised the charges leveled Monday by the special inspector general for TARP, Neil Barofsky, that TARP funds were being misused by the banks. Nor did any congressman or senator cite his denunciation of the Obama administration for refusing to compel the banks to reveal how the bailout funds are being used. In his report, Barofsky estimated the total in government funds allocated for the various bailout programs at $23.7 trillion.