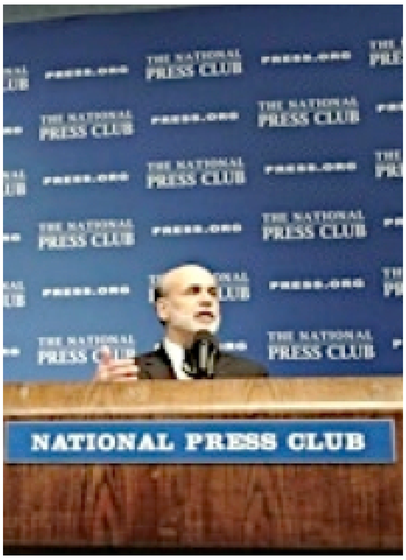
Bernanke Issues Warnings, Accepts No Blame



Federal Reserve Chairman Ben Bernanke's address to the National Press Club on Thursday was a remarkable blend of hubris, claimed innocence, and warnings.

His opening remarks were condescending and patronizing to the journalists assembled:

> Contemporary economic issues can be highly complex, and few nonspecialists have the time or the background to master these issues on their own. The public must therefore rely on the diligent reporting, clear thinking, and lucid writing of reporters [like you]…to help people understand what they need [to know] to make good decisions…

Claiming responsibility for rescuing the economy at the start of the Great Recession, he made no mention whatsoever of the Fed's role in enabling the creation of the housing bubble in the first place, nor his failure to see it coming before it imploded. Instead, he said, "The early phase of the recovery, in the second half of 2009 and in early 2010, was largely attributable to the stabilization of the financial system [by the Fed], the effects of expansionary monetary and fiscal policies, and a strong boost to production from businesses rebuilding their depleted inventories." Despite a decline in the economy in the latter part of 2010, Bernanke now claims he can see "increased evidence that a self-sustaining recovery … may be taking hold."

However, he said, that recovery isn't having much if any impact on jobs. With 8½ million jobs lost in the Great Recession, unemployment remains high, still sturdily resistant to the efforts of the Fed and the current administration to bring it down. "Until we see a sustained period of stronger job creation," Bernanke advised, "we cannot consider the recovery to be truly established."

He then commented on the recent extraordinary rises in commodity prices, just reviewed here, but avoided any claim of responsibility through the actions of the Fed. Instead, Bernanke blamed such increases as "largely … a result of the very strong demand from fast-growing emerging market economies, coupled, in some cases, with constraints on supply." He failed to name specifically any of those emerging market economies, however, and proceeded instead to talk about how "core" inflation in the U.S. was only 1.2 percent last year, well below the Fed's perceived target and "mandate" from Congress to inflate the economy to at least 2 percent a year. That mandate, he reminded his student/journalists, was for the Fed "to foster maximum employment and price stability." With unemployment, based upon government calculations, remaining above 9 percent, and inflation (when food and energy is included) rising to well above 5 percent annualized, the Fed has failed on both counts.

And so, since past and current efforts to stimulate the moribund economy have largely failed to work, the best thing to do, intoned the chairman, is to do more of the same: “[Since] the target range for the [Fed] funds rate has been near zero since December, 2008…the Federal Reserve has indicated that economic conditions are likely to warrant [maintaining] an exceptionally low target rate for an extended period.” Without directly referring to “quantitative easing” by name, he said that the Fed will continue with its latest plan by buying still more Treasury securities, “with the result that depository institutions [banks] now hold a very high level of reserve balances with the Federal Reserve.” It was hoped, he noted, that this new round of QE would work, without noting that those in the past have failed: “These [purchases], by reducing borrowing costs and raising asset prices, bolster household and business spending, and thus increase economic activity.” He naturally failed to estimate when such additional “stimulus” would be expected to begin working.

He obliquely noted the dangers of continuing to pump money into the economy, and mentioned repeatedly that he had an “exit plan” if prices became too frothy. He said, “In particular, it bears emphasizing that we have the necessary tools to smoothly and effectively exit from the asset purchase program at the appropriate time.” He failed to indicate when that time would be but he did say that some of those tools would involve raising short-term interest rates, “immobilizing” [his word] bank reserves as required “to facilitate the smooth withdrawal of policy accommodation when conditions warrant. If needed, we could also tighten [monetary] policy by redeeming or selling securities.”

To review his remarks before moving on then, Bernanke patronized his audience with his (and their) expertise in these complex matters, and then reviewed the flat-lined economy the Fed has been trying unsuccessfully to stimulate for two years, claiming victory over inflation and imminent victory over stubborn unemployment. And if things get out of hand, he noted that he has all the tools needed to withdraw those failed stimuli “smoothly” without damaging the economy further.

At that point, Bernanke went on the offensive, noting that the government’s fiscal policies faced “significant challenges.” He noted, accurately (!), that the federal deficit averaged only about 2 percent of GDP prior to the Great Recession, but has expanded to a frightening 9 percent. None of this was his fault, of course: “The extraordinarily wide deficit largely reflects the weakness of the economy along with the actions that the Administration and the Congress took to ease the recession and [to] steady financial markets.” While failing to mention that the prime results of those actions were to make some insiders extraordinarily rich and to save the major banks in the banking cartel headed by the Fed from the consequences of their own bad decisions, he said that “even after the economic and financial conditions have returned to normal [no date offered – Ed], the federal budget will remain on an unsustainable path, with the budget gap becoming increasingly large over time, unless the Congress enacts significant changes in fiscal programs.”

Bernanke then trotted out the usual demographic and economically seismic shifts taking place, including the aging of the American population putting Social Security and the other government healthcare entitlement programs increasingly at risk, and the inevitable increases in interest rates that will be demanded by those purchasing government debt to offset the increasing risk of default. At this point, Bernanke was honest about the country’s fiscal difficulties:

> By definition, the unsustainable trajectories of deficits and debt…cannot actually happen, because creditors would never be willing to lend to a government with debt, relative to national income, that is rising without limit. The economist Herbert Stein succinctly described this type of situation: “If something cannot go on forever, it will stop.”

And then he offered the “fatal alternatives” to the country’s difficulties:

> The question is whether these adjustments will take place through a careful and deliberative process that weighs priorities and gives people adequate time to adjust to changes in government programs or tax policies, or whether the needed fiscal adjustments will be a rapid and painful response to a looming or actual fiscal crisis.

Prior to taking questions from his students, Bernanke gave lip service to what is needed to save the country:

> Reducing disincentives to work and to save…encouraging investment in the skills of our workforce as well as in new machinery and equipment, by promoting research and development, and by providing necessary public infrastructure. Our nation cannot reasonably expect to grow its way out of our fiscal imbalances, but a more productive economy will ease the tradeoffs that we face.

During the Q & A, Bernanke was asked about rising commodity prices and the implicit responsibility through the Fed's excessively loose and continuing monetary policy. He denied any of it and instead *blamed peoples' diets*:

> As peoples' diets are becoming more sophisticated and as they eat more beef and less grains and so on, the demand for food and energy rise [sic], and that's the primary long-term factor affecting the real price of commodities and food…

I think it's entirely unfair to attribute excess demand pressures in emerging markets to U.S. monetary policy because emerging markets have all the tools they need to address excess demand in those countries.

When asked if the United States would ever default on its debt, Bernanke admitted that "unless the debt limit is not extended…the United States could conceivably…be forced into a position of defaulting on its debt," adding,

> And the implications of that on our financial system, our fiscal policy and our economy would be [to use Treasury Secretary Geithner's word] catastrophic. I would very much urge Congress not to focus on the debt limit as being a bargaining chip in this discussion, but rather to address directly the spending and tax issues that we have to deal with in order to make progress on this fiscal situation.

In summary, Bernanke neatly exculpated himself and the Fed from any responsibility for the Great Recession, characterized his position as that of a simple bystander watching the flow of economic history from on high, and offering wise and sage suggestions on how to fix things based upon his long years of successful experience in such matters. That any of this is in no way related to current economic reality is irrelevant. After all, Bernanke and his students must provide "the diligent reporting, clear thinking, and lucid writing" to help educate the poor struggling masses and to leave things in the capable hands of Bernanke and his experts at the Federal Reserve.

Photo: Federal Reserve Chairman Ben Bernanke answers questions during a luncheon at the National Press Club in Washington, Feb. 3, 2011: AP Images