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Ben Bernanke: Supernanny?

By Dean Baker

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We all know the story of the "nanny state." That is what conservatives call a government that ensures people have basic necessities like decent childcare and decent health care. Conservatives deride the idea the government should have to provide such services to people, because people really should be able to look out for themselves. In the view of conservatives, people don't need the government to act like a nanny to ensure they are protected.

If a government that acts to protect ordinary people can be dubbed a "nanny state," then a government that protects the superrich certainly deserves the title of a "super nanny state," making its top officials "supernannies." The question for the moment is whether Federal Reserve Board Chairman Ben Bernanke now qualifies as a "supernanny."

His immediate claim to this title stems from his decision to have an emergency cut of 0.75 percentage points in the Federal Reserve Board's overnight loan rate. This rate cut came in response to the financial panic that had descended on Asian and European financial markets. It seems the sophisticated traders in these markets had finally discovered the \$8 trillion housing bubble in the United States and realized its collapse would throw the US economy into a recession.

This knowledge sent these markets plummeting. The fear was about to spread to the US markets when Chairman Bernanke announced the dramatic rate cut. This cut spurred a turnaround, stabilizing financial

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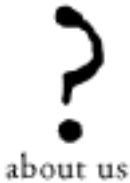
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markets for at least a few more days.



The Fed has no business using its interest rate policy to prop up financial markets. High prices in financial markets redistribute wealth from people who don't own large amounts of stocks and bonds to people who do. That is not the job of the government or an agency of the government, like the Fed.



In this particular case, Bernanke's decision was also the right decision for the economy as a whole. After ignoring the housing bubble as it expanded to ever more dangerous levels, the Fed is now trying to counteract the harm that will come from its collapse. Lower interest rates can be part of the story (aggressive fiscal stimulus is another part).

However, there is a limit to what the Fed can accomplish through lower rates. First, it can't bring its overnight rate below zero. Thus far, Bernanke has lowered the rate by 1.75 percentage points from 5.25 percent to 3.5 percent, that doesn't leave much more room to go down.

More importantly, the overnight rate has very little direct impact on the economy. The interest rates that most directly affect the economy are longer-term rates, like the 30-year mortgage rate. Typically long-term rates move together with the overnight rate set by the Fed and other short-term rates, but this is not always the case. If investors begin to anticipate higher inflation rates, then it is possible lower short-term rates could actually lead to higher long-term rates. This could already be happening. Long-term rates actually rose the day after the Fed's rate cut. If the Fed cuts rates further, and this leads to higher long-term rates, then we will know Bernanke is playing the role of supernanny. The logic of this is simple: Banks borrow short-term; they lend long-term. If the gap between short-term rates and long-term rates increases, then this will allow the banks to make back some of their big losses in the mortgage markets. This would be good news for the banks, but bad news for the economy.

Of course, Bernanke has not yet pushed rates to levels that clearly raise this spread. However, the public should be wary of this possibility.

In the same vein, it should also be concerned about the Fed's decision to create a new mechanism, the "term auction facility (TAC)," through which banks can secretly borrow reserves from the Fed. Ordinarily, banks have to disclose their borrowing, but due to the extraordinary crisis facing the banking system, Bernanke thought it best to create a mechanism through which the banks could conceal their

borrowing.

While there may be nothing illicit about the conduct of these banks, there is little reason to have confidence in the integrity of the financial markets and the major actors within them. At the least, the TAC offers the opportunity for insiders to make large gains at the expense of those who rely only on publicly available information. To eliminate this possibility, the Fed should open the TAC. Too much transparency is not the cause of the current crisis.

Ben Bernanke may not have yet earned the title of "supernanny," but the public is right to be wary. A "nanny state" provides real benefits for the vast majority of its people. A "supernanny state" only benefits the rich at the expense of the vast majority.

Dean Baker is the co-director of the [Center for Economic and Policy Research \(CEPR\)](#). He is the author of [The Conservative Nanny State: How the Wealthy Use the Government to Stay Rich and Get Richer \(www.conservativenannystate.org\)](#). He also has a blog, "Beat the Press," where he discusses the media's coverage of economic issues. You can find it at the [American Prospect's web site](#).

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