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# Fed Liquidity Programs Hurt, Worked

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WASHINGTON — Though President Obama last week said the spate of government programs helping banks was comparable to a "root canal," there can be little doubt that a key part of those efforts — the Federal Reserve Board's multiple liquidity facilities — was vital in staving off economic collapse.

As the central bank begins today to end several of those programs, including those that purchased commercial paper and gave money to big Wall Street firms, most observers agree the moves were both creative and effective.

"The Fed was very agile and was able to meet the needs of the markets very well," said Song Won Sohn, a lecturer in business and economics at California State University Channel Islands. "This is one of the responsibilities the Fed has, and they performed it perfectly."

By the time the financial crisis was in full swing, the Fed was running nearly a dozen facilities and lent billions to investment banks, corporations and commercial banks.

The programs, which were largely authorized by Section 13-3 of the Federal Reserve Act, crystallized for the world just how much power resides in the Fed. But the aggressive lending nearly derailed Chairman Ben Bernanke's bid for a second term running the central bank. And as the Fed begins its most significant pullback from financial markets to date, there are likely to be some long-term costs. When another crisis surfaces sometime in the future, even if it does not match the depth of the current turmoil, investors, banks and others will expect similar actions from the Fed, observers said. "We've created a huge moral-hazard issue from this crisis," said Kevin Jacques, who chairs the finance department at Baldwin-Wallace College. "The moral hazard is effectively never going away."

The Fed did not comment for this story, but Mark Calabria, the director of financial regulation studies at the Cato Institute, said the central bank created a bad precedent by essentially usurping Congress and creating programs that amount to fiscal policy.

"This was an inappropriate use of the Fed's power," Calabria said. "These were all things that Congress could have and should have done."

It is difficult to pinpoint which programs were most successful. The Primary Dealer Credit Facility, which made loans through the discount window to investment banks, lent nearly $134 billion in the middle of October 2008 but has rested at zero for the past several months. The commercial paper facility, which helped companies roll over their short-term debt, topped out at $350 billion but rested at $8.6 billion on Wednesday.

Meanwhile, the Money Market Investor Funding Facility, a form of support for money market mutual funds, never attracted a dime of business and was allowed to expire last year.

"On aggregate, there's no question the programs were successful in moving us away from the brink of disaster," said Robin Lumsdaine, a professor at American University's Kogod School of Business and a former Fed official. "In retrospect, one might be tempted to look back and say, 'This one was more popular,' or

'This one had greater effect,' but that is the benefit of hindsight. At the times these programs were introduced, there were enormous and urgent liquidity challenges coming from all directions. It required a multipronged approach."

Though financial markets remain skittish, most observers said the Fed's pullback would not panic Wall Street, especially since many of the programs have fallen into disuse in recent months. In its first policy statement of the year, the Fed said Wednesday that it stands "prepared to modify these plans if necessary."

"It's appropriate that these programs are winding down," Lumsdaine said. "Many of them were initiated under 13-3 and hence were always intended to be temporary."

As of today, four programs are shutting down: the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, the Primary Dealer Credit Facility and the Term Securities Loan Facility.

The Fed still has two major programs running. It plans to end its purchases of debt and mortgage-backed securities from the government-sponsored enterprises by the end of March. The Term Asset-Backed Securities Loan Facility will expire at the same time.