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Federal Reserve Chairman Ben Bernanke faces tough economic decisions in his 2nd term

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Before Ben Bernanke starts another term as Federal Reserve chairman, he'll have to win confirmation from a restive Senate determined to vent.

He'll almost certainly hear angry accusations about how he used his expanded powers to bail out Wall Street fat cats while letting consumer protection flag.

No matter: Renominating Bernanke is the smart move, at least according to a fellow economist who saw the banking chief in action during the peak of the crisis last fall.

Randall Kroszner was a Fed governor until he resigned in January, and he's convinced that Bernanke's "amazing and steady" leadership helped the nation avoid another Great Depression. Bernanke is the best choice to finish what he started, said Kroszner, who has returned to his post at the University of Chicago. "The president made the right decision."

No one can be happy about the economic disaster of the past year, and deficit projections unveiled by the White House on Tuesday underscore the astronomical cost.

Some critics say Bernanke embodies an easy-money mentality that will hurt in the long run. His renomination "sends the worst possible message," said Mark Calabria, a policy scholar at the libertarian Cato Institute, who wants him ousted.

Yet even many of those who nurse doubts about unprecedented Fed action view Bernanke as a safer bet than anyone else for the central bank's top job, particularly now that the economy and financial markets have stabilized.

"Love him or hate him, there's strength in continuity," said money manager Douglas Nardi of Legg Mason Investment Counsel. "Things are going pretty well, and you don't want to rock the boat."

As of now, Bernanke is considered a shoo-in for confirmation, especially if the questions focus, as expected, on the past. The Fed chairman is sure to be ready.

Take the decision to let Lehman Brothers fail, after bailing out Fannie Mae, Freddie Mac, Bear Stearns and American International Group. That single event arguably did more than any other to put the financial system into cardiac arrest.

It's not that saving Lehman would have been too big a job, Bernanke said in a speech last week at the Fed's annual economics conference in Jackson Hole, Wyo. Lehman, he said, was too sick to save.

"Concerted government attempts to find a buyer for the company or to develop an industry solution proved unavailing, and the firm's available collateral fell well short of the amount needed to secure a Federal Reserve loan of sufficient size to meet its funding needs," said Bernanke, a former Princeton University professor.

"As the Federal Reserve cannot make an unsecured loan, and as the government as a whole lacked appropriate resolution authority or the ability to inject capital, the firm's failure was, unfortunately, unavoidable."

Expect similarly long-winded explanations for other iffy calls, such as the shotgun marriage of Merrill Lynch and Bank of America.

The more crucial question is, what's coming next?

At some point, maybe within a few months, Bernanke will have to pull money out of the system that he flooded with cash last fall. It's a judgment call, fraught with political peril, because it may involve putting the brakes on economic growth even with unemployment still around 10 percent -- or else risking runaway inflation.

To hear Kroszner tell it, the process is much further along than most Americans realize. The Fed provided roughly $1.5 trillion in short-term lending as of late last year, which helped keep swaps, commercial paper and a host of other institutional markets from shutting down entirely.

Since the peak, those short-term facilities have contracted by a trillion dollars "without anyone really noticing," Kroszner said.

In addition, banks hold $700 billion in excess reserves that they could lend out "if they see good opportunities," he noted. That's a potential source of inflation.

But Congress gave the Fed new authority last year to provide interest on those reserves, which will help it manage that process better than in previous recoveries, he said.

Eventually, the Fed will start raising interest rates, though Kroszner would not predict when.

"The key is that the central bank will be forward-looking," he said. "Where is inflation likely to go? Where is employment likely to go? There is no magic number."

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