THE STATE OF THE U.S. ECONOMY

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET HOUSE OF REPRESENTATIVES

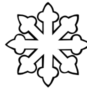
ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

HEARING HELD IN WASHINGTON, DC, FEBRUARY 2, 2012

Serial No. 112–18

Printed for the use of the Committee on the Budget



Available on the Internet:
www.gpo.gov/fdsys/browse/committee.action?chamber=house&committee=budget

U.S. GOVERNMENT PRINTING OFFICE

72–573 PDF WASHINGTON : 2012

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON THE BUDGET

PAUL RYAN, Wisconsin, *Chairman*

SCOTT GARRETT, New Jersey
MICHAEL K. SIMPSON, Idaho
JOHN CAMPBELL, California
KEN CALVERT, California
W. TODD AKIN, Missouri
TOM COLE, Oklahoma
TOM PRICE, Georgia
TOM McCLINTOCK, California
JASON CHAFFETZ, Utah
MARLIN A. STUTZMAN, Indiana
JAMES LANKFORD, Oklahoma
DIANE BLACK, Tennessee
REID J. RIBBLE, Wisconsin
BILL FLORES, Texas
MICK MULVANEY, South Carolina
TIM HUELSKAMP, Kansas
TODD C. YOUNG, Indiana
JUSTIN AMASH, Michigan
TODD ROKITA, Indiana
FRANK C. GUINTA, New Hampshire
ROB WOODALL, Georgia

CHRIS VAN HOLLEN, Maryland, *Ranking Minority Member*
ALLYSON Y. SCHWARTZ, Pennsylvania
MARCY KAPTUR, Ohio
LLOYD DOGGETT, Texas
EARL BLUMENAUER, Oregon
BETTY McCOLLUM, Minnesota
JOHN A. YARMUTH, Kentucky
BILL PASCRELL, JR., New Jersey
MICHAEL M. HONDA, California
TIM RYAN, Ohio
DEBBIE WASSERMAN SCHULTZ, Florida
GWEN MOORE, Wisconsin
KATHY CASTOR, Florida
HEATH SHULER, North Carolina
PAUL TONKO, New York
KAREN BASS, California

PROFESSIONAL STAFF

AUSTIN SMYTHE, *Staff Director*
THOMAS S. KAHN, *Minority Staff Director*

CONTENTS

	Page
Hearing held in Washington, DC, February 2, 2012	1
Hon. Paul Ryan, Chairman, Committee on the Budget	1
Prepared statement of	2
Hon. Chris Van Hollen, ranking member, Committee on the Budget	3
Prepared statement of	5
Hon. Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System	6
Prepared statement of	10
Response to questions submitted for the record	51
Hon. Mike Honda, a Representative in Congress from the State of California, questions submitted for the record	49

THE STATE OF THE U.S. ECONOMY

THURSDAY, FEBRUARY 2, 2012

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The Committee met, pursuant to call, at 10:00 a.m., in room 210, Cannon House Office Building, Hon. Paul Ryan, [Chairman of the Committee] presiding.

Present: Representatives Ryan, Garrett, Simpson, Campbell, Cole, Price, McClintock, Lankford, Black, Flores, Mulvaney, Huelskamp, Young, Rokita, Van Hollen, Doggett, Blumenauer, McCollum, Pascrell, Honda, Wasserman Schultz, Moore, Castor, Tonko.

Chairman RYAN. The committee will come to order. Thank you, Chairman Bernanke, for coming to our committee today to talk about the state of the economy. You have been here a number of times and we appreciate your time. We know that your schedule is tight, so we will proceed quickly so we can get you back on your schedule.

Nothing is more critical to today's economy than restoring real job and business growth in America. Yet, for almost three years the U.S. economy has remained mired in a slow growth, high unemployment trap. The president and his party leaders say things are getting better. Yet we continue to hear from families and businesses in our districts who tell us this kind of talk is completely disconnected from reality.

The fact is that this administration told us stimulus plan would keep unemployment from ever rising about 8 percent, and that the economy would have grown at 4 percent last year. In reality, unemployment climbed as high as 10 percent and today it stands at 8.5 percent. Worse, CBO confirmed just yesterday that it is projecting economic growth to remain sluggish, and that the unemployment rate might hover near 9 percent through 2014. So the obvious question is why did these policies fail? I think when you get out and talk to families and businesses, the answer becomes quite clear. The president's policies added hundreds of billions of dollars to our annual deficits. As a result, the explosive growth of our debt created tremendous uncertainty about our physical and our economic future. When government shows doubt about future tax rates, interest rates, and price stability, it undermines that feeling of future security that businesses and families need in order to plan and invest, and this puts a drag on economic growth.

There is a monetary side to this uncertainty, as well. The Fed announced that it is going to continue to hold interest rates at ex-

tremely low levels through 2014. I think this policy runs the great risk of fueling asset bubbles, destabilizing prices, and eventually, eroding the value of the dollar. The prospect of all three is adding to uncertainty and holding our economy back in many of our judgments. And I fear that normalizing monetary policy when the time comes will be incredibly difficult, not just technically difficult, but politically difficult as well.

For instance, I was greatly concerned to hear that the Fed recently announced that it would be willing to accept higher than desired inflation in order to focus on the other side of its dual mandate, which is promoting employment. This is not because unemployment is a lesser concern, far from it. It is because the Fed's tools for promoting employment are limited, imprecise, and could have highly undesirable, unintended consequences.

By contrast, the Fed is uniquely positioned to protect the currency, the value of our money. And I would find it very disturbing if that role were to be diminished. The inflation dynamic can be quick to materialize and painful to eradicate once it takes hold. For the sake of our economy in particular, and the global recovery as a whole, it is vital that we focus on stability and certainty, especially when it comes to the value of the dollar. I firmly believe that a course correction here in Washington is sorely needed to help us get back on the right track. While it will not be easy, Americans have risen to greater challenges and have prevailed in the past, and we hope to provide a plan to do just that. With that, I would like to yield to the ranking member, Mr. Van Hollen.

[The prepared statement of Chairman Paul Ryan follows:]

PREPARED STATEMENT OF HON. PAUL RYAN, CHAIRMAN, COMMITTEE ON THE BUDGET

Thank you, Chairman Bernanke, for coming before our Committee today to talk about the state of the economy.

Nothing is more critical to today's economy than restoring real job and business growth. Yet for almost three years, the U.S. economy has remained mired in a slow-growth, high-unemployment trap.

The President and his party's leaders say things are getting better. Yet we continue to hear from families and businesses in our districts who tell us that this kind of talk is completely disconnected from reality.

The fact is that this administration told us its stimulus plan would keep unemployment from ever rising above 8 percent. In reality, it climbed as high as 10 percent, and today it stands at 8.5 percent.

Worse, the CBO confirmed just yesterday that it is projecting economic growth to remain sluggish and the unemployment rate to hover near 9 percent through 2014.

So the obvious question is this: Why did the President's policies fail?

I think when you get out and talk to families and businesses, the answer becomes clear: The President's policies added hundreds of billions to our annual deficits. As a result, the explosive growth of our debt created tremendous uncertainty about our fiscal and economic future.

When government sows doubt about future tax rates, interest rates, and price stability, it undermines that feeling of future security that businesses and families need in order to plan and invest—and this is puts a drag on economic growth.

There is a monetary side to this uncertainty as well. The Fed has announced it's going to continue to hold interest rates at extremely low levels through 2014.

I think this policy runs the great risk of fueling asset bubbles, destabilizing prices, and eventually eroding the value of the dollar. The prospect of all three is adding to uncertainty and holding our economy back.

And I fear that normalizing monetary policy when the time comes will be incredibly difficult—not just technically difficult, but politically difficult as well.

For instance, I was greatly concerned to hear the Fed recently announce that it would be willing to accept higher-than-desired inflation in order to focus on the other side of its dual mandate, which is promoting employment.

This is not because unemployment is a lesser concern—far from it. It is because the Fed's tools for promoting employment are limited, imprecise, and can have highly undesirable unintended consequences.

By contrast, the Fed is uniquely positioned to protect the currency, and I would find it very disturbing if that role were being diminished. The inflation dynamic can be quick to materialize and painful to eradicate once it takes hold.

For the sake of our economy in particular and the global recovery as a whole, it is vital that we focus on stability and certainty—especially when it comes to the value of the dollar.

I firmly believe that a course correction here in Washington is sorely needed to help get us back on the right track. While it won't be easy, Americans have risen to greater challenges and prevailed in the past.

With that, I would like to yield to the Ranking Member, Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. Welcome, Dr. Bernanke. We must use all the tools at our disposal to help put people back to work, and I commend you and your colleagues at the Fed for using various forms of monetary policy to promote stable prices and higher levels of employment. I do find it troubling at a time when millions of Americans are still out of work, many of our Republican colleagues want to strip the Federal Reserve of that part of its mandate that focuses on full employment and putting Americans back to work. Obviously, the Federal Reserve must not waver in its commitment to price stability, but to deprive you of the tools necessary to boost employment would be a big mistake. Indeed, without those tools, the economy today would be in much worse shape.

Dr. Bernanke, as you testified previously before this committee, the measures taken by the Federal Reserve, the politically unpopular, but economically necessary TARP legislation, engineered by the Bush Administration, and the Recovery Act, by the Obama Administration, averted, and I quote what you said earlier, "an extraordinarily severe downturn, perhaps a Great Depression." And indeed, we have averted a Great Depression.

And it is important to remember that the day President Bush left office, the day President Obama was sworn in, the economy was collapsing at an even faster rate than originally thought. The gross domestic product was plummeting at a rate of 8.9 percent. In other words, negative 8.9 percent GDP, and we were losing 840,000 jobs every month. Three years later, conditions have improved. The economy grew at an annual rate of 2.8 percent in the last quarter, and 3.2 million private sector jobs have been created since March 2010. Reports and findings by the Congressional Budget Office confirm your earlier assessments, that the passage of the Recovery Act, coupled with the actions by the Federal Reserve and others, did help end the free fall, and it helped begin the climb upward toward economic growth.

Indeed, the Congressional Budget Office has told us that the Recovery Act helped save or create up to 3 million jobs in the year 2010, and lowered unemployment by up to 1.4 percentage points in 2011, compared to what it would have been if Congress had not acted. Those are not my facts, those are from the Congressional Budget Office.

It is clear that we were on a huge, vast downhill slide, and action taken by the Federal Reserve, President Obama, and the Congress

at the time helped end the economic free fall and begin to turn the corner. Still, we know, that while the economy has improved, millions of Americans still remain out of work, unemployment remains unacceptably high, and American families around the country are still hurting. Our economy is still very vulnerable to outside shocks, whether it is the Japanese tsunami, to the brewing European debt crisis. That is why our first priority has to be nurturing this fragile economy, and making sure we do what we can to help small businesses and other businesses help put people back to work.

So I commend you, Chairman Bernanke, in articulating in your prepared testimony that in pursuing medium and long-term fiscal sustainability, which we absolutely must do, we ought take care not to slash investments too quickly because those would impede the economic recovery. In fact, some policy makers in Europe are coming to this notion a little late. The British economy, for example, contracted by .2 percent last quarter, due in part to the severity of government spending cuts, according to the January 31 article in "The Wall Street Journal." Of course, the British model was much heralded just a few years ago by some of our colleagues as an example of how austerity could work. Severe austerity is now coming back to bite them.

Christine Lagarde, director of the IMF, was quoted by BBC just recently saying, "The IMF is not suggesting there should be fiscal consolidation across the board." She went on to point out that you need to look at this on a case by case basis, and rating agency standards in poor, in a quote explaining the rationale behind their January 13 downgrade of nine Eurozone nations noted, and I quote, "a budgetary reform process based on a pillar of fiscal austerity alone risks becoming self-defeating, as domestic demand falls in line with consumer's rising concerns about job security and disposable incomes, eroding national tax revenues * * *" and by the way, of course, then, also contributing to long-term deficits.

These are reasons why we should take immediate actions, to take up the president's job plan, which he presented in September, including important investments in our national infrastructure. It is also why we should finish the job with respect to extending the payroll tax cut to 160 million working Americans, and make sure that unemployment insurance is there for millions of others who were out of work through no fault of their own.

Dr. Bernanke, I apologize to you in advance; the conference committee on the payroll tax cut also begins at 10:00, so I am going to have to leave before I want to.

Let me just close by saying that as we nurture the very fragile economy, we should also take immediate steps to enact a plan to reduce our out year deficits and debt. We should do it in a stable, predictable, and balanced way. The question is not whether we should do that. The question is how we do that. And I believe that the bipartisan commission, Simpson-Bowles, Rivlin-Domenici, provide the overall framework to the approach for doing that, if not every specific recommendation they make.

So with that, Dr. Bernanke, again, thank you and your colleagues for your work. Mr. Chairman.

[The prepared statement of Chris Van Hollen follows:]

PREPARED STATEMENT OF HON. CHRIS VAN HOLLEN, RANKING MEMBER, COMMITTEE ON THE BUDGET

Thank you very much, Chairman Ryan, and welcome, Chairman Bernanke.

We must use all the tools at our disposal to help put people back to work, and I commend you and your colleagues at the Federal Reserve for using various forms of monetary policy to promote higher levels of employment and stable prices. I find it troubling that, at a time when millions of Americans are still out of work, some of our Republican colleagues want to strip the Federal Reserve of that part of its mandate that focuses on full employment and putting people back to work.

Obviously the Federal Reserve must not waver in its commitment to price stability, but to deprive you of the tools necessary to boost employment would be a huge mistake. Indeed, without those tools, the economy today would be in much worse shape.

Chairman Bernanke, as you testified previously before this Committee, the measures taken by the Federal Reserve, the politically unpopular but economically necessary TARP legislation engineered by the Bush Administration, and the Recovery Act by the Obama Administration, averted "an extraordinarily severe downturn, perhaps a great depression."

Indeed, the day that President Bush left office, the day that President Obama was sworn in, the economy was collapsing at an even faster rate than originally thought. The gross domestic product was plummeting at a rate of 8.9 percent, in other words negative 8.9 percent GDP, and we were losing more than 840,000 jobs a month. Three years later, conditions have improved. The economy grew at an annual rate of 2.8 percent in the last quarter, and 3.2 million private sector jobs have been created since March of 2010. Reports and findings by the Congressional Budget Office confirm your earlier assessments—that the passage of the Recovery Act, coupled with actions to save the auto industry and efforts by the Federal Reserve, helped end the free fall and began the climb upward toward economic growth.

Indeed, the Congressional Budget Office has told us that the Recovery Act helped save or create up to 3 million jobs in the year 2010 and lowered unemployment by up to 1.4 percentage points in 2011, compared to what it would have done if the Congress had not taken action. It is clear that we were on a huge downhill cascade and action taken by the Federal Reserve and President Obama helped end the economic freefall and turn the corner.

Still, we know that while the economy has improved, millions of Americans are still out of work, and the unemployment rate remains unacceptably high. Our economy is still vulnerable to outside shocks, from the Japanese Tsunami last year to the brewing European debt crisis, which has been ongoing. That is why our first priority has to be nurturing this fragile economy and making sure we do what we can to help small business and put people back to work.

So I commend you, Chairman Bernanke, for articulating in your prepared testimony that in pursuing medium- and long-run fiscal sustainability, we ought to take care not to do so much budget-cutting in the short-term that we impede the current economic recovery. In fact, you note that the two objectives—long-run fiscal sustainability and short-run stimulus—are mutually reinforcing.

Clearly, some policymakers in Europe are coming to this notion a little late. The British economy, for example, contracted 0.2 percent last quarter due in part to the severity of government spending cuts, according to a January 31 article in the Wall Street Journal. Christine Lagarde, Director of the International Monetary Fund, was quoted by BBC News in Davos, Switzerland as saying "[The IMF is] not suggesting there should be fiscal consolidation across the board." Ratings agency Standard & Poor, in a note explaining the rationale behind their January 13th downgrade of nine Eurozone nations, noted, "A [budgetary] reform process based on a pillar of fiscal austerity alone risks becoming self-defeating, as domestic demand falls in line with consumers' rising concerns about job security and disposable incomes, eroding national tax revenues."

These are all reasons why we should take immediate action in this House on the jobs plan the President submitted to the Congress last September, including his significant infrastructure investments to help rebuild our infrastructure around the country.

We should also finish the job with respect to extending the payroll tax cut for 160 million Americans and making sure that unemployment insurance is there for people who have lost work through no fault of their own. And, Mr. Chairman, I'm going to apologize to both you and Chairman Bernanke, because after this statement I'm going to have to go to the conference committee on that issue and I hope that conference committee will move forward quickly and without delay to get that job done.

As we nurture the fragile economy, we should also take immediate action to enact a plan to reduce the out-year deficits and debt in a stable, balanced, predictable way. The question is not whether we do that, but how. I support the kind of balanced framework proposed by bipartisan commissions like Simpson-Bowles and Rivlin-Domenici.

Chairman RYAN. Thank you. Chairman Bernanke, the floor is yours.

STATEMENT OF BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BERNANKE. Thank you. Chairman Ryan, Vice-Chairman Garrett, Ranking Member Van Hollen, and other members of the committee, I appreciate this opportunity to discuss my views on the economic outlook, monetary policy, and the challenges facing federal fiscal policy makers. Over the past two and a half years, the U.S. economy has been gradually recovering from a deep recession. While conditions have certainly improved over this period, the pace of the recovery has been frustratingly slow, particularly from the perspective of the millions of workers who remain unemployed or underemployed.

Moreover, the sluggish expansion has left the economy vulnerable to shocks. Indeed, last year, supply chain disruption stemming from the earthquake in Japan, a surge in the prices of oil and other commodities, and spillovers from the European debt crisis risked derailing the recovery. Fortunately, over the past few months, indicators of spending, production, and job market activity have shown some signs of improvement, and in economic projections just released, the Federal Market Committee participants indicated that they expected somewhat stronger growth this year than in 2011. The outlook remains uncertain, however, and close monitoring of economic developments will remain necessary.

As is often the case, the ability and willingness of households to spend will be an important determinant of the pace at which the economy expands in coming quarters. Although real consumer spending rose moderately last quarter, households continue to face significant head winds. Notably, real household income and wealth stagnated in 2011, and access to credit remained tight for many potential borrowers. Consumer sentiment has improved from the summer's depressed levels, but remains at levels that are still quite low by historical standards.

Household spending will depend, in turn, heavily on developments in the labor market. Overall, the job situation does appear to have improved modestly over the past year. Private payroll employment increased by about 160,000 jobs per month in 2011. The unemployment rate fell by about 1 percentage point, and new claims for unemployment insurance declined somewhat. Nevertheless, as shown by indicators like the rate of unemployment and the ratio of employment to population, we still have a long way to go before the labor market can be said to be operating normally.

Particularly troubling is the unusually high level of long-term unemployment. More than 40 percent of the unemployed have been jobless for more than six months, roughly double the fraction during the economic expansion of the previous decade.

On certain job prospects, along with tight mortgage credit conditions continue to hold back the demand for housing. Although low

interest rates on conventional mortgages and the drop in home prices in recent years have greatly improved the affordability of housing, both residential sales and construction remain depressed. A persistent excess supply of vacant homes, largely stemming from foreclosures, is keeping downward pressure on prices and limiting the demand for new construction.

In contrast to the household sector, the business sector has been a relative bright spot in the current recovery. Manufacturing production has increased 15 percent since its trough, and capital spending by businesses has expanded briskly over the past two years, driven in part by the need to replace aging equipment and software.

Moreover, many U.S. firms, notably in manufacturing, but also in services, have benefited from strong demand from foreign markets over the past few years. More recently, the pace of growth in business investment has slowed, likely reflecting concerns about both the domestic outlook and developments in Europe. However, there are signs that these concerns are abating somewhat. If business confidence continues to improve, U.S. firms should be well-positioned to increase both capital spending and hiring. Larger businesses are still able to obtain credit at historically low interest rates, and corporate balance sheets are strong. And though many smaller businesses continue to face difficulties in obtaining credit, surveys indicate that credit conditions have begun to improve modestly for those firms as well.

Globally, economic activity appears to be slowing, restrained in part by spillovers from fiscal and financial developments in Europe. The combination of high debt levels and weak growth prospects in a number of European countries has raised significant concerns about their fiscal situations, leading to substantial increases in sovereign borrowing costs, concerns about the health of European banks, and associated reduction in confidence and the availability of credit in the Euro area. Resolving these problems would require a concerted action on the part of European authorities. They are working hard to address their fiscal and financial challenges. Nonetheless, risks remain if developments in Europe or elsewhere may unfold favorably and could worsen economic prospects here at home. We are in frequent contact with European authorities, and we will continue to monitor the situation closely, and take every available step to protect the U.S. financial system and the economy.

Let me turn now to a discussion of inflation. As we had anticipated, overall consumer price inflation moderated considerably over the course of 2011. In the first half of the year, a surge in the prices of gasoline and food, along with some pass through of these higher prices to other goods and services, had pushed consumer inflation higher. Around the same time, supply disruptions associated with the disaster in Japan put upward pressure on motor vehicle prices. As expected, however, the impetuous from these influences faded in the second half of the year leading inflation to decline from an annual rate of about 3.5 percent in the first half of 2011 to about 1.5 percent in the second half, close to its average pace in the preceding two years. In an environment of well-anchored inflation expectations, more stable commodity prices, and substantial

slack in labor and product markets, we expect inflation to remain subdued.

Against that backdrop, the FOMC decided last week to maintain its highly accommodative stance on monetary policy. In particular, the committee decided to continue its program to extend the average maturity of its securities holdings, to maintain its existing policy of reinvesting principle payments on its portfolios of securities, and to keep the target range for the federal funds rate at 0 to .25 percent. The committee now anticipates that economic conditions are likely to warrant exceptionally low levels to the federal funds rate, at least through late 2014.

As part of our ongoing effort to increase the transparency and predictability of monetary policy, following its January meeting, the FOMC released a statement intended to provide greater clarity about the committee's longer term goals and policy strategy. The statement begins by emphasizing the Federal Reserve's firm commitment to pursue its Congressional mandate to foster stable prices and maximum employment.

To clarify how it seeks to achieve those objectives, the FOMC stated its collective view that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate. And it indicated that the central tendency of FOMC participants' current estimates of the longer run, normal rate of unemployment is between 5.2 and 6 percent. The statement noted that these statutory objectives are generally complementary, but when they are not, the committee will take a balanced approach in its efforts to return both inflation and employment to their desired levels.

In my remaining remarks, I would like to briefly discuss the fiscal challenges facing your committee and the country. The federal budget deficit widened appreciably with the onset of the recent recession, and it has averaged around 9 percent of GDP over the past three fiscal years. This exceptional increase in the deficit has mostly reflected the automatic cyclical response of revenues and spending to a weak economy, as well as the fiscal actions taken to ease the recession and aid the recovery. As the economy continues to expand and stimulus policies are phased out, the budget deficit should narrow over the next few years. Unfortunately, even after economic conditions have returned to normal, the nation will still face a sizable structural budget gap if current budget policies continue. Using information from the recent budget outlook by the CBO, one can construct a projection for the federal deficit assuming that most expiring tax provisions are extended, and that the Medicare's physician payment rates are held at their current level. Under these assumptions, the budget deficit would be more than 4 percent of GDP in fiscal year 2017, assuming that the economy is in close to full employment.

Of even greater concern is that longer run projections, based on plausible assumptions about the evolution of the economy and the budget under current policies, show the structural budget gap increasing significantly further over time, and the ratio of outstanding federal debt to GDP rising rapidly. This dynamic is clearly unsustainable. These structural imbalances did not emerge over-

night. To a significant incident, they are the result of an aging population and especially fast rising health care costs, both of which have been predicted for decades. Notably, the CBO projects that net federal outlays for health care entitlements, which were about 5 percent of GDP in fiscal year 2011, could rise to more than 9 percent of GDP by 2035. Although we have been warned about such developments for many years, the time when projections become reality is coming closer.

Having a large and increasing level of government debt relative to national income runs the risk of serious economic consequences. Over the longer term, the current trajectory of federal debt threatens to crowd out private capital formation, and thus, reduce productivity growth. To the extent that increasing debt is financed by borrowing from abroad, a growing share of our future income would be devoted to interest payments on foreign held federal debt. High levels of debt also impair the ability of policy makers to respond effectively to future economic shocks and other adverse events. Even the prospect of unsustainable deficits has costs, including an increased possibility of a sudden fiscal crisis. As we have seen in a number of countries recently, interest rates can soar quickly if investors lose confidence in the ability of a government to manage its fiscal policy.

Although historical experience and economic theory do not indicate the exact threshold at which the perceived risks associated with the U.S. public debt would increase markedly, we can be sure that without directive action, our fiscal trajectory will move the nation ever closer to that point.

To achieve economic and financial stability, U.S. fiscal policy must be placed on a sustainable path that ensures that debt relative to the national income is at least stable, or preferably, declining over time. Attaining this goal should be a top priority. Even as fiscal policy makers address the urgent issue of fiscal sustainability, they should take care not to unnecessarily impede the current economic recovery. Fortunately, the two goals of achieving long-term fiscal sustainability and avoiding additional fiscal head winds for the current recovery are fully compatible; indeed, they are mutually reinforcing. On the one hand, a more robust recovery will lead to lower deficits and debt in coming years. On the other hand, a plan that clearly and credibly puts fiscal policy on a path to sustainability could help keep longer term interest rates low and improve household and business confidence, thereby supporting improved economic performance today.

Fiscal policy makers can also promote stronger economic performance in the medium term through the careful design of tax spent policies and spending programs. To the fullest extent possible, our nation's tax and spending policies should increase the incentives to work and save, encourage investments in the skills of our work force, stimulate private capital formation, promote research and development, and provide necessary public infrastructure.

Although we cannot expect our economy to grow its way out of our fiscal imbalances, a more productive economy will ease the trade-offs that we face and increase the likelihood that we leave a

healthy economy to our children and grandchildren. Thank you, Mr. Chairman.

[The prepared statement of Ben S. Bernanke follows:]

PREPARED STATEMENT OF HON. BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Chairman Ryan, Vice Chairman Garrett, Ranking Member Van Hollen, and other members of the Committee, I appreciate this opportunity to discuss my views on the economic outlook, monetary policy, and the challenges facing federal fiscal policymakers.

THE ECONOMIC OUTLOOK

Over the past two and a half years, the U.S. economy has been gradually recovering from the recent deep recession. While conditions have certainly improved over this period, the pace of the recovery has been frustratingly slow, particularly from the perspective of the millions of workers who remain unemployed or underemployed. Moreover, the sluggish expansion has left the economy vulnerable to shocks. Indeed, last year, supply chain disruptions stemming from the earthquake in Japan, a surge in the prices of oil and other commodities, and spillovers from the European debt crisis risked derailing the recovery. Fortunately, over the past few months, indicators of spending, production, and job market activity have shown some signs of improvement; and, in economic projections just released, Federal Open Market Committee (FOMC) participants indicated that they expect somewhat stronger growth this year than in 2011. The outlook remains uncertain, however, and close monitoring of economic developments will remain necessary.

As is often the case, the ability and willingness of households to spend will be an important determinant of the pace at which the economy expands in coming quarters. Although real consumer spending rose moderately last quarter, households continue to face significant headwinds. Notably, real household income and wealth stagnated in 2011, and access to credit remained tight for many potential borrowers. Consumer sentiment has improved from the summer's depressed levels but remains at levels that are still quite low by historical standards.

Household spending will depend heavily on developments in the labor market. Overall, the jobs situation does appear to have improved modestly over the past year: Private payroll employment increased by about 160,000 jobs per month in 2011, the unemployment rate fell by about 1 percentage point, and new claims for unemployment insurance declined somewhat. Nevertheless, as shown by indicators like the rate of unemployment and the ratio of employment to population, we still have a long way to go before the labor market can be said to be operating normally. Particularly troubling is the unusually high level of long-term unemployment: More than 40 percent of the unemployed have been jobless for more than six months, roughly double the fraction during the economic expansion of the previous decade.

Uncertain job prospects, along with tight mortgage credit conditions, continue to hold back the demand for housing. Although low interest rates on conventional mortgages and the drop in home prices in recent years have greatly improved the affordability of housing, both residential sales and construction remain depressed. A persistent excess supply of vacant homes, largely stemming from foreclosures, is keeping downward pressure on prices and limiting the demand for new construction.

In contrast to the household sector, the business sector has been a relative bright spot in the current recovery. Manufacturing production has increased 15 percent since its trough, and capital spending by businesses has expanded briskly over the past two years, driven in part by the need to replace aging equipment and software. Moreover, many U.S. firms, notably in manufacturing but also in services, have benefited from strong demand from foreign markets over the past few years.

More recently, the pace of growth in business investment has slowed, likely reflecting concerns about both the domestic outlook and developments in Europe. However, there are signs that these concerns are abating somewhat. If business confidence continues to improve, U.S. firms should be well positioned to increase both capital spending and hiring: Larger businesses are still able to obtain credit at historically low interest rates, and corporate balance sheets are strong. And, though many smaller businesses continue to face difficulties in obtaining credit, surveys indicate that credit conditions have begun to improve modestly for those firms as well.

Globally, economic activity appears to be slowing, restrained in part by spillovers from fiscal and financial developments in Europe. The combination of high debt levels and weak growth prospects in a number of European countries has raised significant concerns about their fiscal situations, leading to substantial increases in

sovereign borrowing costs, concerns about the health of European banks, and associated reductions in confidence and the availability of credit in the euro area. Resolving these problems will require concerted action on the part of European authorities. They are working hard to address their fiscal and financial challenges. Nonetheless, risks remain that developments in Europe or elsewhere may unfold unfavorably and could worsen economic prospects here at home. We are in frequent contact with European authorities, and we will continue to monitor the situation closely and take every available step to protect the U.S. financial system and the economy.

Let me now turn to a discussion of inflation. As we had anticipated, overall consumer price inflation moderated considerably over the course of 2011. In the first half of the year, a surge in the prices of gasoline and food—along with some pass-through of these higher prices to other goods and services—had pushed consumer inflation higher. Around the same time, supply disruptions associated with the disaster in Japan put upward pressure on motor vehicle prices. As expected, however, the impetus from these influences faded in the second half of the year, leading inflation to decline from an annual rate of about 3½ percent in the first half of 2011 to about 1½ percent in the second half—close to its average pace in the preceding two years. In an environment of well-anchored inflation expectations, more-stable commodity prices, and substantial slack in labor and product markets, we expect inflation to remain subdued.

Against that backdrop, the Federal Open Market Committee (FOMC) decided last week to maintain its highly accommodative stance of monetary policy. In particular, the Committee decided to continue its program to extend the average maturity of its securities holdings, to maintain its existing policy of reinvesting principal payments on its portfolio of securities, and to keep the target range for the federal funds rate at 0 to ¼ percent. The Committee now anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate at least through late 2014.

As part of our ongoing effort to increase the transparency and predictability of monetary policy, following its January meeting the FOMC released a statement intended to provide greater clarity about the Committee's longer-term goals and policy strategy.[1] The statement begins by emphasizing the Federal Reserve's firm commitment to pursue its congressional mandate to foster stable prices and maximum employment. To clarify how it seeks to achieve these objectives, the FOMC stated its collective view that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate; and it indicated that the central tendency of FOMC participants' current estimates of the longer-run normal rate of unemployment is between 5.2 and 6.0 percent. The statement noted that these statutory objectives are generally complementary, but when they are not, the Committee will take a balanced approach in its efforts to return both inflation and employment to their desired levels.

FISCAL POLICY CHALLENGES

In the remainder of my remarks, I would like to briefly discuss the fiscal challenges facing your Committee and the country. The federal budget deficit widened appreciably with the onset of the recent recession, and it has averaged around 9 percent of gross domestic product (GDP) over the past three fiscal years. This exceptional increase in the deficit has mostly reflected the automatic cyclical response of revenues and spending to a weak economy as well as the fiscal actions taken to ease the recession and aid the recovery. As the economy continues to expand and stimulus policies are phased out, the budget deficit should narrow over the next few years.

Unfortunately, even after economic conditions have returned to normal, the nation will still face a sizable structural budget gap if current budget policies continue. Using information from the recent budget outlook by the Congressional Budget Office, one can construct a projection for the federal deficit assuming that most expiring tax provisions are extended and that Medicare's physician payment rates are held at their current level. Under these assumptions, the budget deficit would be more than 4 percent of GDP in fiscal year 2017, assuming that the economy is then

[1] Board of Governors of the Federal Reserve System (2012), "Federal Reserve Issues FOMC Statement of Longer-Run Goals and Policy Strategy," press release, January 25, *www.federalreserve.gov/newsevents/press/monetary/20120125c.htm.*

close to full employment.[2] Of even greater concern is that longer-run projections, based on plausible assumptions about the evolution of the economy and budget under current policies, show the structural budget gap increasing significantly further over time and the ratio of outstanding federal debt to GDP rising rapidly. This dynamic is clearly unsustainable.

These structural fiscal imbalances did not emerge overnight. To a significant extent, they are the result of an aging population and, especially, fast-rising health-care costs, both of which have been predicted for decades. Notably, the Congressional Budget Office projects that net federal outlays for health-care entitlements—which were about 5 percent of GDP in fiscal 2011—could rise to more than 9 percent of GDP by 2035.[3] Although we have been warned about such developments for many years, the time when projections become reality is coming closer.

Having a large and increasing level of government debt relative to national income runs the risk of serious economic consequences. Over the longer term, the current trajectory of federal debt threatens to crowd out private capital formation and thus reduce productivity growth. To the extent that increasing debt is financed by borrowing from abroad, a growing share of our future income would be devoted to interest payments on foreign-held federal debt. High levels of debt also impair the ability of policymakers to respond effectively to future economic shocks and other adverse events.

Even the prospect of unsustainable deficits has costs, including an increased possibility of a sudden fiscal crisis. As we have seen in a number of countries recently, interest rates can soar quickly if investors lose confidence in the ability of a government to manage its fiscal policy. Although historical experience and economic theory do not indicate the exact threshold at which the perceived risks associated with the U.S. public debt would increase markedly, we can be sure that, without corrective action, our fiscal trajectory will move the nation ever closer to that point.

To achieve economic and financial stability, U.S. fiscal policy must be placed on a sustainable path that ensures that debt relative to national income is at least stable or, preferably, declining over time. Attaining this goal should be a top priority.

Even as fiscal policymakers address the urgent issue of fiscal sustainability, they should take care not to unnecessarily impede the current economic recovery. Fortunately, the two goals of achieving long-term fiscal sustainability and avoiding additional fiscal headwinds for the current recovery are fully compatible—indeed, they are mutually reinforcing. On the one hand, a more robust recovery will lead to lower deficits and debt in coming years. On the other hand, a plan that clearly and credibly puts fiscal policy on a path to sustainability could help keep longer-term interest rates low and improve household and business confidence, thereby supporting improved economic performance today.

Fiscal policymakers can also promote stronger economic performance in the medium term through the careful design of tax policies and spending programs. To the fullest extent possible, our nation's tax and spending policies should increase incentives to work and save, encourage investments in the skills of our workforce, stimulate private capital formation, promote research and development, and provide necessary public infrastructure. Although we cannot expect our economy to grow its way out of our fiscal imbalances, a more productive economy will ease the tradeoffs that we face and increase the likelihood that we leave a healthy economy to our children and grandchildren.

Chairman RYAN. Thank you. We agree completely with the last part of your statement, which is if we do not get our fiscal house in order, it is going to get ugly pretty fast.

Also, I want to salute you for having more transparency on the operation of the Federal Reserve. The latest FOMC statement

---

[2] The Congressional Budget Office (CBO) reported an "alternative fiscal scenario" (Table 1-7, p. 22) that assumed that most expiring tax cuts and the Medicare "doc fix" would be extended and also that the automatic spending reductions required by the Budget Control Act (BCA) would not take effect; under this scenario the deficit would be about 5 percent of GDP in fiscal 2017. If the automatic spending cuts from the BCA, however, are assumed to be put in place (the effects of which are shown in Table 1-6, p. 18) then the deficit would be more than 4 percent in fiscal 2017. See Congressional Budget Office (2012), The Budget and Economic Outlook: Fiscal Years 2012 to 2022. Washington: Congressional Budget Office, January, *www.cbo.gov/doc.cfm?index=12699.*

[3] This projection is under the alternative fiscal scenario developed by the Congressional Budget Office, which assumes most current policies are extended. See Congressional Budget Office (2011). The Long-Term Budget Outlook. Washington: Congressional Budget Office, June, *www.cbo.gov/doc.cfm?index=12212.*

clearly was an attempt to put your policy on the table and let the country see it. But it is in that policy that I have a couple of questions.

Early on, you put out an inflation target rate of 2 percent. That puts, certainly, more clarity. But at the end of the statement, I am just going to quote it, "In setting monetary policy, the committee seeks to mitigate deviations of inflation from its longer term goal, and deviations of employment from the committee's assessment of its maximum level. These objections are generally complementary, however, under circumstances in which the committee judges that objectives are not complementary, it follows a balance approach in promoting them. Take into account the magnitude of the deviations and the potentially different time horizons over which employment and inflation are projected to return to levels judged consistent with its mandates."

Here is what I do not get. It seems as if you are moving away from an inflation target with that kind of a statement, and at best, it is ambiguous; at worst, it says that if a deviation is higher on unemployment, which clearly it is, then it is on inflation, is follows, in my interpretation, that the Fed is willing to accept higher levels of inflation than your preferred rate in order to chase your employment mandate. Is that not what we should interpret out of this?

Mr. BERNANKE. No, Mr. Chairman, I would not say that is correct. So, 2 percent is our definition of price stability. As part of our mandate we want to achieve that 2 percent inflation rate in the medium term. Obviously, monetary policy works with a lag. We cannot achieve it every day, every week, but over a period of time, we want to move inflation always back towards 2 percent.

We will not actively seek to raise inflation or to move away from the target. We are always trying to bring inflation back to the target. The only sense in which there is a balance, of course, is that, in looking at the two sides of the mandate, the rate of speed, the aggressiveness, may depend, to some extent, on the balance between the two objectives. But we are always trying to return both objectives back to their mandate. We are not seeking higher inflation. We do not want higher inflation, and we are not tolerating higher inflation.

Chairman RYAN. The core mission of every central bank is stable prices. It is a necessary precondition for economic growth, and therefore, then, full employment, at least in some of our judgment. And you and I talked about mandates, single versus double, a lot. But if we were to say that we are now going to look at the deviations between the two, and if we are saying that we think that full employment is 5.2 to 6 percent, we are clearly way above that, but at your PCE we are closer to where your inflation target is. I do not know how other else to interpret this, that the result of this balanced approach is that higher than preferred inflation may be tolerated, not that it is desired, but that it will be tolerated. And I will simply just quote Paul Volcker, who said in the late 1970s, "Central bankers who are willing to tolerate a little more inflation usually end up getting a whole lot more than they expected."

My concern is that this appears less to be an inflation targeting statement than an inflation equivocation statement, because we are now targeting deviations and that is the concern. When this

statement was released we saw a buildup of commodity prices, even though, I think you said fairly recently that demand is down, therefore commodity prices should be low. So my basic question is if this is our interpretation, and we have a spike in commodity prices that occurred after the statement released, is that not the market's interpretation of this statement?

Mr. BERNANKE. Mr. Chairman, first of all, as we say, the two sides of the mandate are generally complementary. I mean, we agree that low, stable inflation is good for the economy, and it is goof for growth, it is good for employment, and we think most of the time that there is a complementary relationship between those two.

You discussed earlier the responsibility of the central bank for the dollar and for the price level. Inflation, currently, looks to be very well-controlled. Our expectation, of course, we will adjust policy as needed, but our expectation is that inflation will be below target over the next couple of years. Of course, unanticipated events can happen. The dollar has been pretty stable since the crisis. I do not think you should read into this any unwillingness to keep price stability as a critical goal of the central bank. All central banks, including those with the price stability mandate, take into account, to some extent, the overall state of the economy, but over the medium term they seek to return inflation to its objective, and that is what we are intending to do.

Chairman RYAN. So let me turn to quantitative easing. The Federal Reserve has applied an unusual and unprecedented amount of monetary easing for a long period of time. Not just during the crisis moments, but well after that, and now, apparently, through 2014. And by buying down Treasury rates, is it your view that this is putting an artificial cap on price discovery in the treasury markets, and is that not lulling policy makers, fiscal policy makers, into a false sense of security, when true price discovery in our treasury market, like it has in other countries, might give us the wakeup call we need to get our act in order, to fix our problem? Are we not lulling ourselves in a false sense of security by this intervention in the treasury markets?

Mr. BERNANKE. Mr. Chairman, first, quantitative easing is very analogous to the usual monetary policy of cutting short-term interest rates. I mean, basically, that also lower longer term rates. It is basically a way of trying to provide more support for the economy. Our policies are hardly unusual. At this point, almost every major industrial central bank, excluding Canada, which had less of a recession than we did, has a large balance sheet and low interest rates, including the ones with single mandates, again, as I mentioned, not having any signs of higher inflation or declining dollar.

In terms of the issue relating to distorting the bond market, again, it is the objective of the policy to get rates somewhat lower to provide more support for the economy, and to bring inflation up to target, if necessary. But I think the basic reasons for low long-term rates, which are also a feature of every other major industrial economy, are low inflation, slow expected growth, and the fact that the dollar is a safe haven. And with problems in the world, people are investing in U.S. treasuries, because they are attractive.

I think it is important for me to say that if Congress is being lulled, they should not be lulled. I think we agree that the attention needs to be paid to these issues. As the case of some of the countries you are referring to, like Greece and Portugal, suggests, if investors lose confidence in the fiscal policy of a country, the rates are going to go up, and there is nothing the central bank can do about that. And so, obviously, it is important for Congress to address these problems, and I have spoken out about it quite consistently, as you know.

Chairman RYAN. I think we would agree that we think sustainable long run economic growth derives from savings and investments, and therefore, increased productivity instead of borrowing and consumption. I know you well enough to know that we more or less agree with that. But do you measure the effects that these policies have on savers, on people living on fixed income, living on CDs? Are you concerned at all about the very low interest payments that these savers are getting from these kinds of fixed incomes assets, which are hitting our savings and investments side of the economy, in exchange for helping the borrowing and consumption side of the economy?

Mr. BERNANKE. We are quite aware of that issue. We hear a lot about it. We consider it, we think about it, and I recognize that for people on a fixed income whose main income is interest on a CD, I think I recognize that imposes a hardship. The purpose of our policy, though, is to create a stronger economy. And savers, collectively, hold all the assets, all the capital in the economy, and if you do not have a strong economy, if you have a weak economy, you are not going to get good returns on all the other assets.

Chairman RYAN. My time is running out, let me give you just a sense of this. A lot of us believe that the Federal Reserve was too loose for too long in the 2003 to 2005 period, and that is what, in part, led to the asset bubble and the malinvestment that occurred, and the problems we have today. I know you do not agree with that, but because you do not agree with that, our fear is that you are just going to repeat these same mistakes again, but by orders of magnitude that we cannot even comprehend right now. And that the Federal Reserve, whose primary goal is to manage our money, is involving itself in fiscal policy. It is sort of bailing out fiscal policy because the branch of government in charge of fiscal policy, this branch, is not going its job. I mean, a budget has not passed Congress in two years. We are going to pass a budget, we did one last year, but there is nothing in the Senate.

So fiscal policy is not being done the way it needs to be done, but that is not an excuse for the Federal Reserve to step in and try and bail us out, because that could be done at the expense of the priority, which is unique to the Federal Reserve, of maintaining our currency as a reliable store of value; and we fear that these exercises and these new ambiguous statements will compromise that. That is the point I am trying to make. Mr. Van Hollen?

Mr. VAN HOLLEN. Thank you, Mr. Chairman. Dr. Bernanke, thank you for your testimony, and you laid out what I think is a very clear two-track strategy for dealing with economic growth as we move forward. The first is recognizing the fiscal and budgetary challenge that we have got, and I think there is agreement on this

committee that we need to come up with a predictable, stable way to reduce our deficits and debt. We have had disagreements over how we do it, but not whether we do it.

There are two lessons, I think, from what we see happening here. One, of course, is the debt crisis, that if you wait too long to address these issues, you are right, your borrowing costs are going to go up, people are going to lose faith, and we should heed that as an early warning and not delay putting in place those predictable changes. But your testimony also pointed out that there is a danger in overreacting to that in the near term, in terms of the negative impact it could have on economic growth. And the other strategy that you have laid out is the need to nurture this very fragile economy we are in right now.

So if you could just briefly talk about some of the lessons we have learned from the European experience, recognizing the debt crisis and early warning system, but the austerity only and immediately approach. Some countries cannot avoid it, like Greece, because they have got themselves in a fix, but talk about the fact that an austerity only and immediate deep cuts, whether or not that can have a negative impact on the very fragile recovery that we are having now.

Mr. BERNANKE. Well, the European situation is complicated. Among other things, of course, they have a monetary union and a fiscal disunion. They do not have the same kind of situation we have here. And you are correct, also, that there are some countries, like Greece, obviously, and others that have very difficult fiscal sustainability issues, and they have tried to address those in the near term. I hesitate a bit to advise my colleagues in Europe, but I would cite the IMF and others to point out that very slow growth, or recession, makes fiscal improvement more difficult, because tax revenues fall, and spending automatically rises if there are social safety nets and the like. So it is important to try to figure out what the right balance is there.

I want to be very clear; I do not want anyone to interpret me saying anything other than that this Congress has a very difficult and important job to address the long-term fiscal sustainability of our federal budget. That is a critical thing. I think that even more aggressive strategies than have been pursued recently are warranted over the longer term, but I also think that that can be done in a way which is persuasive to markets and achieves those objectives, but does not quite jolt the recovery, and it does not do it at once. I think that as long as there is a credible, strong plan over a period of time, and we move into that plan, then we will achieve most of the objectives of fiscal sustainability. We need to at least avoid doing harm. I would say, "do no harm" is an important piece of advice I would offer you. So there is a balancing act there that I think is important for us to pay attention to.

Mr. VAN HOLLEN. Thank you, Dr. Bernanke. As you point out, those two goals are totally consistent. Sometimes they get muddled in the message, and I understand that sometimes people interpret the need to prevent doing harm to the fragile economy now as meaning we should not move ahead on long-term deficit reduction. Of course we should, as you said. You can do things at the same time, but if you undermine the fragile economy, as the IMF, as you

indicated, has warned is being done with certain fiscal policies in Europe, that just creates an even bigger hole.

And again, I apologize, I have to leave to go to the conference on the payroll tax extension, if you could just comment on whether or not failure to extend the payroll tax cut for 160 million Americans, whether failure to extend unemployment compensation for millions of Americans who are out of work through no fault of their own, whether failure to do that would be a drag on what is already very fragile economic growth.

Mr. BERNANKE. Congressman, I know you appreciate that I do not endorse individual tax and spending policies, and I think that is a good approach for me to take. Obviously, you need to look at the whole picture. I agree with what you said before, that you cannot do one and not the other, you know? You cannot say we have got to protect the recovery, and therefore, we just completely put aside all of fiscal approaches to fiscal sustainability. You have got to do both simultaneously, and you have to got to do both credibly." So I think it is the question of balance, which is important.

Mr. VAN HOLLEN. Just to follow up, as I look at your GDP numbers, your projected growth numbers, it seems pretty clear that they assume some extension of current policy, for example, an extension of, at least through the end of the year, payroll tax. I am not saying specific numbers, but there are differences between those and CBO, and CBO had to assume current law. They had to assume we do not extend the payroll tax cut, and they have to assume that all the tax cuts at the end of the year, including middle income tax cuts lapse. That is one of the reasons the CBO economic forecast GDP projections are lower than yours.

Mr. BERNANKE. Yes.

Mr. VAN HOLLEN. Thank you, Mr. Chairman. I thank my colleagues.

Chairman RYAN. Should we just yield the rest of the time to Mr. Doggett?

Mr. VAN HOLLEN. Yield the time, and I think he also has a little time of his own, as well. So thank you, Mr. Chairman.

Chairman RYAN. So members he is leaving, so we are going to allow Mr. Doggett to finish his time, and then we will go back in order. Mr. Doggett.

Mr. DOGGETT. Thank you, Mr. Chairman. And thank you, Mr. Chairman, for your testimony. Just continuing along the same line of questioning Mr. Van Hollen was raising, Chairman Ryan has expressed some concern that under certain circumstances the Fed pursues a balanced approach. Do you believe that the Fed is having any difficult in achieving the goals of both employment and price stability?

Mr. BERNANKE. Well, I think it is evident that, particularly on the unemployment side, we would like to see greater progress than we have seen. On the inflation side, I am very cognizant of Chairman Ryan's concerns, but at least for now we appear to be pretty close to target. I think what I would say about that is, of course, we are going to have to continue to evaluate monetary policy as the new data come in, as we see how the outlook changes, and so on, but I said before, and I think it is important to emphasize that monetary policy cannot do everything; it is not a panacea. And this

body, and others, need to think about the troubled parts of the economy, places where improvements can be made in the tax code or in other areas.

Again, to answer your question, we are obviously not satisfied with where we are, and while we will continue to do all we can to meet our dual mandate, which is what Congress has given us, we hope that all of you, and the administration and like, will look for alternative ways to strengthen our economy.

Mr. DOGGETT. And you certainly have the capacity to recommend to the Congress that it alter that mandate if you thought it was interfering with the objectives of the Fed.

Mr. BERNANKE. I think that the dual mandate has worked fine. We have as good an inflation record as any other central bank. I do not think it has been a major problem, so I think it has served us well. That being said, Congress created the Fed, Congress gave us our mandate. If you determine that you want to change it, we will, of course, do whatever you assign us to do.

Mr. DOGGETT. And you, of course, determine how to implement that mandate, and you have said, with reference to price stability, a goal of about 2 percent is your goal. And with reference to unemployment, did I hear you say 4.5 to 6 percent?

Mr. BERNANKE. 5.2 percent.

Mr. DOGGETT. 5.2 to 6 percent?

Mr. BERNANKE. The difference, Congressman, between inflation and unemployment is that the Fed can control inflation in the long run. We cannot control unemployment in the long run; that is determined by many other factors in labor markets and other policies that we do not control. So we cannot set an arbitrary target, but what we can do is try and make our best guess of what level of unemployment the economy could sustain over a period of time, and we do not have an official number, but the 5.2 to 6 percent is the central tendency of the estimates provided by the members of the FMOC.

Mr. DOGGETT. And while we would certainly be delighted to be at that range today, or at the end of this year, that is still a substantial amount of unemployment, is it not?

Mr. BERNANKE. Certainly. We have a very high level of unemployment; we have not come remotely close to replacing the jobs that were lost in the recession. We have a very high level of long-term unemployment. I think we all agree that unemployment, and underemployment, and people leaving the labor force, and all those things, are a serious problem. I mean, we may disagree about remedies, but the problem is certainly there.

Mr. DOGGETT. Right, and all I am saying is that the objective you set is not an overly demanding objective as far as employment, the 5.2 to 6 percent.

Chairman RYAN. We will let you answer that in his next five minutes. Mr. Garrett.

Mr. GARRETT. Mr. Chairman, thank you. So I heard your answer to Mr. Van Hollen and you said you normally do not like to comment on fiscal policy, in particular, tax bills and the like. I thought, really, Mr. Chairman? Is that still your opinion? I was truly taken aback, just recently, as you know, the Fed issued an unsolicited white paper, if you will, on housing policy, where if you did not ad-

vocate for, you certainly mirrored much of the positions of this administration. So I do not know how the two go together. On the one end, you say you do not get involved in these areas, but here you had a white paper that was not solicited from us. I know you are protective of your independence, but when you advocate for a position like that, why would you issue such a paper, when we do not ask for it?

Mr. BERNANKE. Well, Congressman, first, the Fed has a lot of interest in housing. It is important for the economy, it is important for monetary policy. We are bank supervisors, so we are interested in mortgage and lending.

Mr. GARRETT. So let me ask you this, then. Congress has a lot of interest in monetary policy. I guess the comparable would be for us to do a House resolution with regard to monetary policy. Is that an invitation now to Congress that we should be issuing resolutions to what the monetary policy that the Fed should be doing? If so, I am sure there is a lot of members who would like to engage in it.

Mr. BERNANKE. Well, I hear lots of advice from congressmen, but let me say that the bottom line here, though, is that we have done a lot of work on this, we have gotten a lot of requests from individual congressmen for our views and for our analysis. It was not the intent of that white paper to provide a set of recommendations. There is not a list of recommendations at the end of the white paper. We were trying to provide pros and cons, analysis, background. I am sorry if you think we went too far, but we tried to provide that information.

Mr. GARRETT. But within 24 hours after that paper went out, the New York Fed president was out there basically advocating for some of the positions in there. Governor Elizabeth Duke was out there basically advocating for positions out there. So you cannot be on both sides of the issue, where you are just saying this is what we think, and then the Governor is coming out there advocating.

And if it is because you are saying that members were asking your opinion, well, we were asking your opinion and we would have certainly have liked to see a white paper back when the president's colossal failure with the stimulus was going through, and we certainly would have liked a white paper at that time from the Fed to say just how that would have all worked out. Why did we not see a white paper at that time, spelling out whether this would work, and whether you advocate or did not advocate.

Mr. BERNANKE. Well, again, I know you are skeptical, but we are trying very hard to avoid encroaching on Congress' fiscal responsibilities. With respect to the points you made about Governor Duke and President Dudley, they are not representing any official position of the Board. They are speaking on their own recognizance. If you pay attention to the speeches that Reserve bank presidents give, you know there is a wide variety of opinion even on monetary policy. So there was no official endorsement of those positions. We are, again, trying to provide useful background. I apologize if it was misinterpreted. Again, our goal was just to be helpful.

Mr. GARRETT. Well, I guess I would just sort of take off of what the Chairman was talking about. You have two mandates, in the

area of employment, the area of monetary policy, and that is obviously a lot for the Fed to be responsible for. We have a mandate in the area of fiscal policy, and we would like to retain that.

Let me then go to another area. You do have a responsibility, as others may have, where you are the owner of about $1 trillion right now in mortgage back securities. In that position of the owner, wearing that hat, can you comment, then, on the president's new proposal on the Refi plan? What have you looked into that, what would the impact be, as far as realized losses to the balance sheet, if that plan was to go through?

Mr. BERNANKE. No, we have not done that specific calculation, and once again, I am not going to endorse or not endorse his program.

Mr. GARRETT. What is the cost if we were to do that?

Mr. BERNANKE. There are costs, as the president acknowledged, there are costs to it, and they would have to be raised somehow, whether it is from a bank tax, or some other way. He mentioned $5 to $10 billion; we have not looked at that number, we do not know if it is correct or not. There would also be costs to investors, including the Federal Reserve.

Mr. GARRETT. Right, you are the investor in this situation.

Mr. BERNANKE. Yes.

Mr. GARRETT. You bought these things, some would say, at a premium, so not what it costs to the taxpayer, but your costs. Have you begun to look to see what your costs would be as the loss realized on those?

Mr. BERNANKE. No, we have not, although we acknowledged, or I think it should be acknowledged, that the rates of refinance have been extremely low, lower than expected, over the last couple of years, and so in some sense that is reversing a gain that we got. But you are right, there are costs to the program, there are costs, potentially, to investors, and those costs to the government, potentially. Yes.

Mr. GARRETT. So that would be one area that we would like to have a specific information back on, and also as a regulator, what the impact would be for the banks that you regulate, what the impact would be if you increased the fees on that. And I see my time is up.

Chairman RYAN. Thank you, Mr. Garrett.

Mr. GARRETT. Thank you, Mr. Chairman.

Chairman RYAN. Back to Mr. Doggett.

Mr. DOGGETT. Let me just return to the last question, and that is, many economists would think that unemployment of 5.2 to 6 percent leaves many people out there hurting badly in an economy. It is a fairly substantial rate of unemployment, even though it is much, much better than where we are today. In setting your goals of trying to avoid excessive price instability and inflation, you have not taken a drastic position on unemployment. You have tried to have some, as you said, balance between the two, have you not?

Mr. BERNANKE. Well, there is nothing in our statement which suggests that we think that 5.2 to 6 percent unemployment is desirable or is a good outcome. We are just saying that given where the economy is today, that is what we think it can sustain under more normal conditions. There are many policies that Congress

could consider, work force skills and other things that might affect that long-run unemployment, and if that unemployment rate is changed, then we will respond to that.

Mr. DOGGETT. And on your estimates of what type of growth we will see in the near term in the economy that are in your testimony and the reports of the Fed, what assumptions do those estimates make concerning fiscal policies and where the Congress will be? I understand you are not getting into specific bills, pro and con.

Mr. BERNANKE. Well, in order to make forecasts, we make guesses about what Congress will actually do. There is no endorsement; there is no endorsement involved in that. Basically, the CBO presented, sort of, two kind of extreme proposals: one is the current law proposal, which assumes, for example, that all the tax cuts are ended, and that the doc fix is not adopted and so on; and then there was a alternative scenario, which assumed that there was no sequestration, and that all the tax cuts were extended, and sort of took the opposite approach. Our numbers, obviously, are based on an intermediate level, assumes that some of these policies are undertaken, but not all of them, and we try to make our best guess, but it is only staff guesses about what they think Congress may do. And I do not think those forecasts, or the details of that, are particularly helpful to you. I mean, obviously, you are going to be trying to figure out what the right thing to do is.

Mr. DOGGETT. With regard to an issue we have discussed when you have been here in the committee before on whether the policies of the financial community concerning rewards and compensation for taking excessive risks remain a problem. You finally issued a report in October dealing with that. It indicated that there had been some improvement, but among the largest banks there continued to be a number of problems with regard to risk-taking and how that leads to rewards from some of those that are taking the risk with other people's money. Could you give us an assessment of what has happened since that report came out, in terms of what progress is being made to deal with this issue that many of us are concerned could lead to another financial meltdown?

Mr. BERNANKE. The Federal Reserve undertook, even before financial reform was passed by the Congress, we undertook to look at this as a safety and soundness matter, and very early on we began working with the Boards and the compensation committees of the major institutions to try to structure their compensation in ways that did not lead to more or excessive risk taking. And I think, as the report suggested, we have made a good bit of progress. It is really sort of about that time of year when a lot of this information is finalized, in terms of what the compensation packages are going to look like. We continue to make progress on that, we continue to work with the banks. I think, as I said, that a lot of the major institutions are taking serious steps in this direction.

I would point out, in addition, that beyond the actions that the federal reserve took independently, Dodd-Frank requires the Fed and other bank regulators to establish incentive compensation standards, and that rulemaking process is underway, and so that will augment and add to the guidance that we have already provided. So we have seen progress, and we continue to work actively

with the banks, I think, in everyone's interest, to make the bank safer and reduce the risks to the tax payer.

Mr. DOGGETT. Does more need to be done?

Mr. BERNANKE. Well, we continue to work on it. As we said in our report, we do not think that we are where we need to be necessarily. I think that there are a lot of interesting questions. This is actually an active topic of academic research about how best to structure pay packages, what role should options, and stock, payments, and so on, play? So more does need to be done, but I think part of the process will be learning in our consultations with the institutions, and with academics, and others about what works best. And of course the Europeans are doing similar things in this interchange there as well.

Chairman RYAN. Thank you. Mr. Simpson?

Mr. SIMPSON. Thank you, Mr. Chairman, and thank you, Mr. Chairman, for being here today and for your testimony and comments. You know, I have been a member of this committee, and I think the Chairman has also, for eight years now. And for eight years, we have had economists and other experts come and tell us that we have a structural deficit problem that is unsustainable, and we need to do something about it. So far we failed to heed the warning. We are now at a situation where I think if we do not heed the warning, there is going to be consequences to paythat nobody is willing to accept. And the sad thing about it is that both parties, Republicans and Democrats, sit and demonize one another no matter what we try to do to address this problem. We call the Democrats "just tax and spend Liberals" that do not care about the economy, and they show us pictures of Paul Ryan pushing Grandma off the cliff.

Unfortunately, that does not solve the problem when everyone in this room, everyone listening to us, and everyone on this committee knows what has to be done. We have had several commissions that have looked at what needs to be done. They all say, almost universally, that you have got to get the $4 to $6 trillion in savings if you are going to have an impact on the long-term deficit of this country, whether it is Simpson-Bowles, Domenici-Rivlin, the Gang of Six, or whatever. We all know that we have got to restrain discretionary spending. We all know that we have got to get entitlements under control. And we all know that we need a pro growth tax policy in this country instead of a 19th century tax code, one that fits the 21st century. We all know that. We might have some differences of exactly how to do some of these things, but we all know that the problem exists, and we all know we have got to come together. What we need is an armistice between Republicans and Democrats to solve this problem, because if we do not, all of these other things we have talked about are not really going to matter, are they?

Mr. BERNANKE. That is correct. It is, I think, striking that when the U.S. debt was downgraded by SNP last summer, it was more about what they cited was the political concerns about the ability of the Congress to work effectively to make progress. So it is easy for me to say and, obviously, I recognize that politics is a tough game and that there are a lot of disagreements in Congress, but obviously the more that can be done to show cooperation and col-

laboration on this very important issue. I think we all agree on the issue, as you say.

Mr. SIMPSON. The 1st of January I was in New Zealand, Australia, and the Philippines, and talking with officials there and businesses there, I was surprised that they are really watching Congress. There are worried about Congress' inability to get together to solve this problem because they know the problem is going to extend to them if we do not solve our problem here. And I was surprised that they follow us as closely as they do.

Let me ask you, do you believe that the general assumption that we have to get to $4 to $6 trillion in savings is the right number or a number that will stabilize our deficit and get us headed in the right direction? Could you paint a picture for us because it is sometimes hard for us to explain to the public what could potentially happen if we do not do anything? Could you paint a picture for us of what you think will happen to this economy if we do not take the steps necessary to stabilize our debt, and if we put it off for another year or another year after that as we have been kicking that can down the road forever?

Mr. BERNANKE. The $4 to $6 trillion, Congressman, was a number that was talked about for the next decade; and the idea was that achieving that would stabilize the debt GDP ratio, and maybe get some progress there, and I was supportive of going big, so to speak, when we, we the country, were discussing these issues last summer. So yes, I think a very substantial additional tack on the deficits is needed.

The other point I would make is that the 4 trillion, the 6 trillion number is, again, about the next decade. The biggest problems we have are beyond the next decade. They stretch out into the next 20 or 30 years, as entitlement costs, in particular, begin to rise further, and as our demographics begin to move, I guess some would say, adversely. So one thing I would urge you, as you think about these issues, is not just to focus only on the 10 year official budget window, but to think about the longer term, beyond 10 years, because what we have seen, an example would be the Social Security reform that was done in the early 1980s, which is still phasing in; it is not even all phased in yet, 30 years later. The more time you give people, the slower the process, the more warning, the more likely it is going to be successful, both politically and economically. So you need to look beyond 10 years.

In terms of the implications for the economy, I think the good scenario is that when the economy recovers that we have higher interest rates, we have higher borrowing abroad, we have a slower growing economy, slower productivity gains, et cetera, as I discussed in my testimony. The bad case scenario, which, ultimately, will happen if we do not change this trajectory, is that, analogous to what we have seen in some countries in Europe, that investors will begin to lose confidence that we can manage our long-term fiscal situation, and we will see sharp movements in interest rates or loss of confidence in U.S. debt, in which case, changes would have to be made, but in a much more chaotic, rapid, and disruptive way than by doing it in a long-term, thoughtful way.

Chairman RYAN. Thank you. Mr. Blumenauer?

Mr. BLUMENAUER. Thank you. Thank you, again, sir, for joining us. I cringed a little when my good friend from New Jersey's portrayal. It seems to me that you are independent of Congress. You are not CBO; you are managing the monetary system and you are purposefully an independent agency trying to insulate the notion that somehow you are at all the beck and call of a particular administration or Congress. My understanding is that is the structure that is in place to try and give you that independence. Am I missing something here?

Mr. BERNANKE. Well, the Fed was created by Congress, but Congress did set up in a way, for example, 14 year terms for governors and so on, to try to create independence in making monetary policy decisions. We have a number of roles, including supervisory roles and so on, which bring us into contact with issues related to housing, and mortgages, and so on. Again, I just want to be clear to this committee, that our intention was to try to provide useful background, and we, in all cases, looked at both sides of the issue, and we recognize, we have no doubt whatsoever, that it is Congress that has to make those decisions.

Mr. BLUMENAUER. And I appreciate that. Having been here through some of the stormy weather, I think there are lessons to be learned by all of us. I think you, some of your governors, looking at the events, I hope Congress is looking at what we did or did not do, hopefully people in the private sector. The notion that somehow we might ask the Fed to come up with a report on the Recovery Act, I mean, there is an independent agency; it is called the CBO, which we set up to give us that, who produced such a report that said that it raised real inflation adjusted GDP between .3 tenths of a percent and 1.9 percent; that it lowered the unemployment rate between .2 of a percent and 1.3 percent; it increased the number of employed between 400,000 and 2.4 million; it increased the number of full-time equivalent jobs by between half a million and 3.3. That is an independent agency that Congress set up. You may not like the answer, but asking somebody else, an independent agency, to do it, I think is not going to get us any further down the line.

I am personally struck by what my good friend from Idaho said, because as usual, he is making sense, get to it, deal with the notion, and I have opined in this committee and elsewhere that we know what to do; it is not that hard, that we could do things to reign in military spending without putting us at risk. We could reform agricultural spending. We could, in fact, move to have a health care system that rewards value instead of volume that meets Mr. Bernanke's test, which is not just in 10 years. The real test is 20 and 30 years, that potentially sinks it.

And I am hopeful that we are able to focus on the big picture, that this Budget Committee, in the course of our deliberation, can look at things that actually enjoy bipartisan support, and that could make a difference over the next quarter century, and not have the picture that is being portrayed today and yesterday by independent experts become a fulfilling prophecy.

I just feel from the bottom of my heart that this is something we ought to be focusing on, and in particular, the notion that we are looking at the longer term. We live with a 10-year budget window.

But the real challenges are beyond that, and that is where the savings have to occur, that is where it actually gets easier, not harder. And for us to bludgeon the Fed, I think you have done an extraordinary job trying to balance being more transparent in what you are doing, but not spooking people, not adding fuel to one fire or the other. I appreciate your continued patience coming here, although I know it is probably a statutory duty, but you do it with good humor. I do not know that we have subpoena power, but I am hopeful that we can focus on the lessons that we learned or should have learned, and get to the work that Mr. Simpson talked about, in terms of getting to it.

Chairman RYAN. Sounds like an endorsement of our budget.

Mr. BLUMENAUER. I will yield back. I am with you on agriculture.

Chairman RYAN. Okay, thank you. You are.

Mr. BLUMENAUER. I have only started on military.

Chairman RYAN. Your gentleman's time has expired.

Mr. BLUMENAUER. I hope we build on what used to be bipartisan approaches to controlling Medicare.

Chairman RYAN. Agreed. Mr. Campbell?

Mr. CAMPBELL. Thank you, Mr. Chairman and Dr. Bernanke. A suggestion was made earlier that you make policy pronouncements on housing, and I am very deeply, as you know, involved in trying to restructure housing finance and housing market. And as much as I personally wish that were true, and that you would weigh in on the side of the proposals that I have made versus others, you and the Fed have been, I think, quite judicious in not doing that. But what you have opined on, and I would like to ask you to say in your own words, is the importance of the housing market and a housing recovery, if we wish to have a robust economic recovery and job growth. Would you care to comment on that?

Mr. BERNANKE. I certainly would, and this is the reason that we have a housing committee, basically, at the Fed with a bunch of staff and some governors who were looking at this almost all the time. I would say that one of the main reasons that the recovery has been as disappointing as it has been is that usually housing provides an important amount of the impetus to growth. Not just construction, but all the related industries and services that are tied to housing. In this case, housing has been very weak. In fact, we have seen a few small positive indicators, but generally it remains at a very low level. So the recovery in housing would be a very important boost to the overall recovery. It works through a number of different ways, not just through construction but by affecting the wealth of consumers and their financial well-being. The mortgage market, the problems with a access to credit, for example, mean that the Federal Reserve's monetary policies are less effective than they otherwise would be, because not as many people as could be are taking advantage of the low mortgage rates that we have tried to create.

There is a lot of other implications for both borrowers and lenders. Clearly, continued poor conditions in housing markets imply losses on mortgages, imply foreclosures, imply people underwater who cannot move or sell their houses. So there are a lot of costs at the neighborhood and the household level, as well. But I do

think that the lack of a housing recovery is one of the big reasons that recovery has not been stronger than it has.

Mr. CAMPBELL. So without advocating a specific solution, kind of like on the budget deficits, you are saying it is something to which we should be paying policy attention?

Mr. BERNANKE. I think it would repay your efforts to think about ways to remove some of the barriers to recovery and housing. I do not think it is superiorly a market phenomenon. I think there are a number of legal and administrative and regulatory barriers to housing being as strong as it should be.

Mr. CAMPBELL. Thank you. Shifting gears for a second and going to Europe, in the last 30 days or 60 days, has a recovery or a positive solution in Europe, is it closer or farther away, in your view? And while we cannot control this, but if they were to have a failure of some sort over there which was not well-constructed or whatever, that would affect us. Could you comment on where you think Europe is today and what impact it would have on us, even though we cannot control it, if they were to have some form of failure or collapse?

Mr. BERNANKE. Certainly, Congressman. So there have been a couple of positive developments. The European Central Bank has provided extensive financing to the European banking system, and will provide another round of financing at the end of this month. That has had the benefit of reducing some of the stresses in the banking system. It has even gone so far as to bring down, to some extent, the borrowing costs of some of the more fiscally troubled countries, as well. So that has taken away some of the financial stress, and has given a little bit more breathing space.

There has also been progress made, and in terms of an international agreement within the Eurozone to have mutual surveillance of fiscal policies, to try and get long-term agreement on fiscal stability within the Eurozone and within individual countries; and that is a necessary condition for a full solution, so those are positive things.

There is an awful lot that remains to be done. The Greek negotiations are still ongoing; we do not know how those are going to come out. The banking system remains undercapitalized. It has been contracting its credit, which has been contributing to a weakening economy in many countries in Europe. And I think the back stops that are needed to protect if one country has problems, to protect other countries from contagion, the Europeans have been setting up financial backstops to do that. There is still a lot of uncertainty about the size of those backstops and how they would be used, and so on; more work needs to be done there.

I think it is important, finally, just to conclude, that there are some really deep fundamental problems, not just fiscal issues, slow growth issues, but also issues of competitiveness. Countries on the periphery, like Greece and Portugal, are not at all competitive to Germany. They have big current account deficits; they cannot change the value of their exchange rate because they are tied to the Euro, so it is going to be a very difficult process for them to get to a more competitive situation. All those things put together mean that you could have very slow growth in some European countries for quite a while.

Chairman RYAN. Ms. Castor?

Ms. CASTOR. Thank you, Mr. Chairman. Good morning.

Mr. BERNANKE. Good morning.

Ms. CASTOR. Dr. Bernanke, the economy is creating jobs. We have had 22 months of private sector job growth. The unemployment rate is at its lowest level for three years, and it is very noticeable at home in Florida. In 2007 and 2008, the headlines in the newspaper were devastating about companies closing and people losing jobs. And it is noticeably different; it was noticeably different last year, with stories about companies hiring. It is pretty steady right now, but obviously, we can do better. In your testimony, you said a more robust recovery will lead to lower deficits and debts in coming years. So here is the frustration, and our colleague who gave us the list of ways to reduce the debt and deficit, it was very noticeable that he did not include job creation in that list. It was cuts, spending, we are doing that; in the Budget Control Act, we did that. We need to do more entitlements. There is some common ground we could find there. But he left off that very important list job creation. And Dr. Elmendorf, from the CBO, testified yesterday that yes, if we had a lower unemployment rate we would have a lower deficit, and that followed up on his letter of October, where he used technical language, says the underutilization of capital and labor resources in the economy. If we had better utilization, if we had more people working, the projected federal deficit under the current law in fiscal year 2012 would be about one-third lower. That deficit would be equal to about 4.0 percent of gross domestic product compared with 6.2 percent projected for 2012 in the CBO's baseline. If the economy were operating at its potential, the deficit would be lower because incomes, and therefore revenues, would be higher, while the rate of unemployment, and therefore outlays for certain government programs, would be lower.

So here is our frustration, and the frustration of folks back home. They know we can be doing more to reduce the deficit and put people back to work, but the Congress has not been able to get off the dime and come to common agreement on ways we invest in infrastructure, and research and development. So give us some words of wisdom on this. Going forward, what do you believe are the most effective policy options that all of us can pursue to speed job creation and thereby lower the deficit?

Mr. BERNANKE. Well, Congresswoman, first of all, I am glad to hear that the tone is a little better in Florida. That is good. There has been some progress, obviously, but it is still very slow. In my testimony, I made, I think, three related points about fiscal policy. The first is that whatever we do for confidence purposes and for long-run sustainability; we have got to keep our eye on the long-term. We have got to make sure that we have a credible plan put in place that will be moving us towards stability and sustainability in our fiscal policies over the next few years and into the subsequent decade. So I think we have got to keep that part always on the table. I think that is really important.

Secondly, I think we can avoid, if we can, unnecessary disruption to the recovery. I think that is important. Mr. Elmendorf, I am sure, pointed out that under current law there is going to be a massive fiscal contraction in 2013. Without addressing any of the spe-

cific policies involved, I think Congress should be aware of that and try to avoid having too big a hit on the recovery in 2013.

And then finally, again, without taking the side of specific policies, I think, my third point was that fiscal policy is not just about total spending and total taxes. A lot of it is the quality of the budget. I mean, are the things we are spending on going to help our economy? Do they support RND, or work force skills, or other things that will help the economy grow in the long run?

On the tax side, are we moving towards more efficient, more effective tax codes, simpler, fairer, and the like? So I think you want to look at the top lines, total spending and total taxes to deficit, but obviously, and it is easy for me to say, but it makes a difference, the quality of the programs, the way the money is spent, the way the money is collected, makes a difference in terms of jobs and growth.

Chairman RYAN. Mr. Cole?

Mr. COLE. Thank you very much, Mr. Chairman. And before I get to my questions, I just, I want to thank you for the role you played during the TARP situation, which I think was a critical point for the country, and I want to thank you for the transparency and the efforts since then. I think to try and restore a measure of public confidence in the Fed. In the history of the periods written, I think, a lot of people, Fed, SEC, the GSE, Congress, they are going to have a lot to answer for in the lead-up, but at the moment of crisis, I think you did a really terrific job for the country, and I appreciate it very, very much.

Mr. BERNANKE. Thank you.

Mr. COLE. You laid out pretty compellingly the fiscal challenge that we face going forward, and I think that is what we wrestle with on this committee more than almost anything else. And let me pause at a couple things, and then try and get your opinion on it, if it is appropriate.

First you mentioned spending restraint, and that is actually beginning to happen. The Appropriations Committee has actually cut discretionary spending two budget years in a single calendar year. We have an agreement in the Budget Control Act going forward that is going to let out the belt a little, but honestly, in the context of the federal budget, not a lot. We can argue about whether it was a good policy or not, but we did tie long-term spending cuts in some fashion to the debt ceiling increase. So there is lots of signs, at least on the discretionary side, we are beginning to see some discipline, and it is likely to stay here for a while.

Second, on the revenue front, our president obviously extended all the tax cuts for two years. He had the ability not to do that; he could have knocked all of them out or any of them that he wanted to knock out, because we could not have possibly overridden the veto, and frankly, he had the majorities until January to do pretty much what he wanted. He told us pretty clearly then that he thought we needed those tax cuts for another two years, and he bargained, in exchange for that, an extension of unemployment, and obviously, payroll tax holiday. But he signaled that come January next time, we are going to have a revenue increase for high income earners, if I am still the President of the United States. And he will have the ability to impose that, if he chooses. So let's just

pause it for a minute, hate to do this as a Republican, but he is in the position to do that. So that will be a revenue increase of some sort.

Are those two things, in and of themselves, spending restraint and revenue increases of the kind that we are talking about, sufficient to deal with the long-term structural deficit that you describe?

Mr. BERNANKE. No, I do not think they are, and I think standard CBO calculations would support that discretionary spending is not particularly high, as a share of GDP, relative to history. I think you could cut discretionary spending pretty close to zero, and not solve the problem in the long-term. So focusing only on discretionary spending is probably not going to be, by itself, sufficient on the spending side.

Mr. COLE. Or, and I do not mean to put words in your mouth, or only on the revenue side, or only on the tax side.

Mr. BERNANKE. Well, I was going to say, on the other side there are many arguments for and against changing the taxes on higher income individuals, but that, by itself, is not going to close the budget deficit either. We need a much broader set of policies. I think the elephant in the room is really health care costs. As I mentioned in my testimony we are heading towards 9 or 10 percent of GDP just from federal spending on health care, and then another 8 or 9 percent eventually in private sector health care spending. So that is a broad issue that affects the budget and affects the efficiency of our economy. I do not think we are going to get a real solution there without some kind of way of addressing that problem.

Mr. COLE. I agree very much with that, and obviously, we had an effort in this committee to do exactly that, in the so-called Ryan budget. I suspect we will have something very similar again this year. I hope we look at Social Security as well; I know that decision has not been made, because I think that is the crux of the issue. We have a lot of commissions that have put out a lot of ideas. Are you aware of any other elected officials that have actually passed, or proposed, has the president laid out, a set of long-term reforms and entitlement spending, or anybody else other than my friend, the Chairman, here?

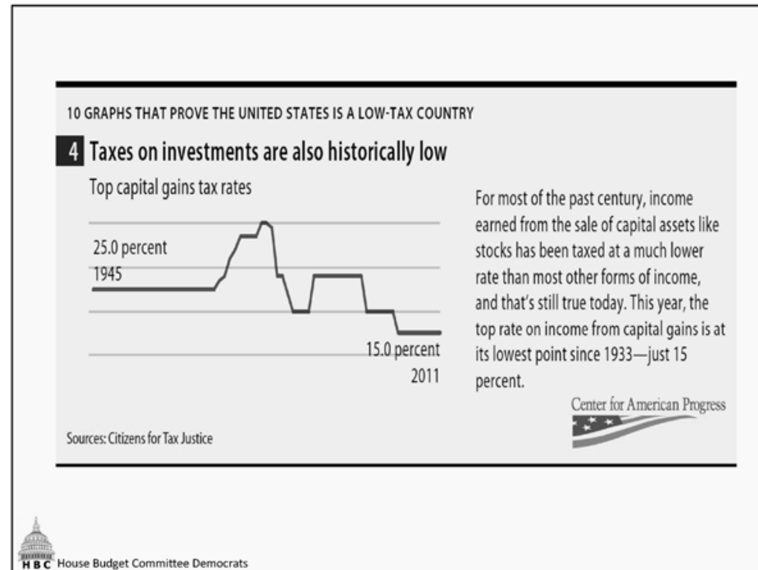
Mr. BERNANKE. I do not know of any comprehensive plan. Again, as you point out, there have been a number of commissions, but even those commissions are not fully detailed. I mean, for example, I do not think Bowles-Simpson had a lot to say about health care and how to control that spending. I think that is where a lot of the serious work has been done, in think tanks and the like.

Mr. COLE. Thank you very much. Thank you, Mr. Chairman.

Chairman RYAN. Mr. Pascrell?

Mr. PASCRELL. Thank you, Mr. Chairman, for bringing us together today. Chairman, I want to associate myself with the comments of Mr. Cole, as to keeping a steady head through this real, financial crisis, economic crisis, and I can appreciate that it is not a very easy task, nor is it an easy task for this committee.

First chart up there, Mr. Chairman.



We have heard a lot about how some people can pay 15 percent, a tax rate around 10 percent to 13 percent lower than firefighters, teachers, and police officers, as an example, particularly in North Jersey. I understand you can use the 15 percent rate on investment income rather than the higher 35 percent top rate on wage income. We have been told that increasing the rate on capital gains will discourage investment. Warren Buffett said that he had worked with investors for 60 years, and he is yet to see anyone, not even when capital gains rate were at 39.9 percent back in the mid-1970s, shy away from a sensible investment because of the tax rate on the potential gain. "People invest to make money, and potential taxes have never scared them off," unquote. Now according to the National Income and Product Accounts tables, the top tax rate on investment income significantly changed over the past 80 years, which you are very familiar with, which I have heard you speak about many times. It was as high as 39.7 percent in 1976, and now today it is 15 percent. Yet investment grows with the cycle. Chairman, in your opinion, do changes in the capital gains tax rate mainly affect investments already made, rather than new investments being considered? And the latter is what drives growth. What is your opinion?

Mr. BERNANKE. Well, you are pulling me into a complex topic. The economic theory says that you should tax consumption, rather than saving or investment, and that is the rationale for lower rates on capital gains and capital income. That is the theoretical results; there is a variety of estimates about how strong the affect is, which is what you are alluding to. It is hard to pin it down exactly. There are many other issues related to this, I do not want to be pinned down on a simple response, because on the one hand, tax and investment income, as I said, can be justified by economic theory, it can be justified by arguments to the need for personal corporate tax integration and so on, but I think Congress has an appropriate

task to try to balance whatever benefits that low taxes on capital income have against considerations of equity, considerations of implementation. Can people convert regular income into interest income or capital gains income, and thereby evade taxes? So there are some complex issues on both sides.

To try to answer your questions, I think while there is some disagreement in the literature, I think there is some effect of after tax rate of return on investment decisions, but there is a lot of disagreement about how strong it is.

Mr. PASCRELL. Do you see the problems, as it is, not just that the rate on capital gains is so much lower than the rate on earnings? And we could discuss that at length, because we have seen a real turnaround in the last 50 to 70 years on what we do tax. And one that feeds those who say that income earners are at a disadvantage in terms of what we make, how we taxed the profits of investments. The problem amplified, and we debated this, the carried interest loophole that encourages capping the difference. What is your opinion about that?

Chairman RYAN. Time of the gentleman has expired.

Mr. PASCRELL. Can he answer the question?

Mr. BERNANKE. I am going to punt anyway, I think. It is a complicated question.

Chairman RYAN. Let's try to get to everybody else here. Dr. Price?

Mr. PRICE. Thank you, Mr. Chairman. I do want to comment about Warren Buffet. Warren Buffet, peculiarly, has become kind of a financial guru making recommendations for some peculiar reason, I am not quite certain. He is a gentleman, who, as I understand it, will not release his tax returns, who pays himself an income of 100,000, who has never contributed any more to the federal government. In fact, he is doing all he can not to pay taxes, to skirt his responsibility. But that is a complete aside, and I apologize for it.

Mr. Chairman, I think you for coming. I want to turn our attention to the European situation. The European situation, to quote your testimony, is quote "leading to substantial increases in sovereign borrowing costs, concerns about the health of European banks, and associated reductions in confidence in the availability of credit in the Euro area. Resolving these problems will require concerted action on the part of European authorities." My first question is do you believe that loans to European countries today carry a greater risk than they did two or three years ago?

Mr. BERNANKE. When you say "to countries," do you mean to the governments?

Mr. PRICE. Yes.

Mr. BERNANKE. Surely they do, and you can see it in the interest rates that they have to pay.

Mr. PRICE. And would you please explain what the exposure of the United States, the American tax payer, is to that credit challenge that they have?

Mr. BERNANKE. Well, in the official sector, the United States is 15 percent shareholder of the IMF. The IMF is involved in programs for the three small countries: Greece, Portugal, and Ireland. The IMF does have a very good record of being paid back. They

have a senior position in the debt of those countries, and they are very much engaged in making sure that those countries are taking appropriate policies. As I have explained in previous venues, the Federal Reserve has a swap line with the European central bank. That is not an obligation of any European government directly. The European Central Bank is highly credit worthy. It is owned by the central banks of all the countries in the Eurozone. And moreover, they give us Euros as collateral, so it is swap of currency rather than a loan, per se. They lend the proceeds on to their banking system in dollars, and there is some important reasons for that. But just from an exposure point of view, they take all the credit risks, all the interest rate risks, and all the exchange rate risks, and I think it is a good bargain for us.

Mr. PRICE. Are you able to quantify the exposure of the U.S. tax payer to the risks, through the IMF and elsewhere?

Mr. BERNANKE. Through the IMF? I do not have the number exactly, but it would be in the tens of billions.

Mr. PRICE. It may even be higher than that, I think. Do you believe that it is appropriate for the United States, for the Fed, and hence the United States tax payer, to have a greater exposure through the IMF, or are we at about where we ought to be, or should we decrease our exposure?

Mr. BERNANKE. Well, I think the IMF plays a really important role in helping to stabilize countries that are in stress. The administration, the treasury secretary is our director, and he has the most direct responsibility for the IMF, and he has been very clear that he is not supportive of any increase in U.S. contribution to the IMF, and so I would leave that to his judgment. His view, as I understand it, you should speak to him, of course, his view is that it is up to the Europeans, first, to take the necessary actions to stabilize the situation.

Mr. PRICE. Let me switch very quickly in the brief moments that I have left to the comments that you made about health care and Medicare/Medicaid. Our discretionary budget is about a trillion dollars. The amount of the deficit is greater than a trillion dollars. So one could do away with all discretionary spending is that not correct. You could do away with all discretionary spending and not even get to a balanced budget without addressing Medicare, Medicaid, Social Security.

Mr. BERNANKE. Well, part of the trillion dollar deficit is due to the fact that the economy is in very weak condition, and the CBO suggested that if the economy returns to normal, say by 2017, that the deficit would be more in the order of 4 to 5 percent, which would be in the order, in today's terms, 60 to 75 billion. So the balance it is not quite what you said. What I said before is true, that discretionary spending cannot bear the entire brunt of deficit closing. It is just not arithmetically possible.

Mr. PRICE. Thank you, Mr. Chairman.

Chairman RYAN. Mr. Tonko?

Mr. TONKO. Thank you, Mr. Chair. Chairman Bernanke, thank you for appearing before the committee. I represent a part of upstate New York that hosts the third fastest growing high-tech jobs hub in the country, and we have a higher share of our work force in green power jobs than anywhere else in America. And the inno-

vation economy in our region is not just a talking point; it is a reality that is paying bills for many families. It came about with a huge bit of planning, and the investment from both public and private sectors in providing the industrial clustering that is currently underway. So I am interested in your comments about the investments that need to be part of the response to a troubled economy, that encourage investments in RND, in the development of skills of a labor force that is essential for an ideas economy, and also the requirement of sound public infrastructure. After 20 years of investment through work in the policy development and the state assembly, and when I served at the State Energy Research and Development Authority, we saw what happened when people brought it all together, and now enabled us to experience this comeback.

Interestingly, when I arrived here I saw a lot of tug against investment in these given dynamics that you made mention of. Can you develop further for us the benefit, the value added, that comes with this focus on RND, on skill set, and on infrastructure?

Mr. BERNANKE. Yes, there is a lot of evidence that clustering can be beneficial, as you described. If you have a number of high-tech industries, for example, close together, they can share ideas, and suppliers, work force, and the like. The public sector has a role there. One of the great strengths of the United States is our university system. Many of the high-tech clusters, I do not know about the one you are speaking of, have grown up in the context of a strong university where there is a lot of exchange between scientists or other professionals in the university and in the private sector. And of course the U.S. Government supports university education in many direct and indirect ways. Of course, it also supports public education for younger people, and the high-tech industries require skilled workers. A range of people, but certainly people who are conversant with math and science, is very important. So there is some important roles.

Infrastructure, while that is certainly a topic of debate, about how much and what kind, I think most people agree that there is certain kinds of infrastructure that the government has a role in providing, from roads, to airports, to public crime and firefighting services, and a variety of things, to the extent that can support activity that is useful.

Research and development is an interesting question. I recently gave a speech on this topic and talked about some of the considerations about what role, if any, the government should play there, and I think that, again, it is an issue debated among economists, but there is some argument to the fact that without any government intervention, that purely basic research may be underprovided because the people who are doing that do not share in all the benefits from that. So there may be some case for government encouragement of basic research; of course, you have an RND tax credit. That is certainly one way; there are other ways as well, to support National Science Foundation, and so on, or to support research and development. So I think the lessons of experience is that industrial policies which attempt to dictate exactly what companies, exactly what products are not, generally, very successful. There often is a role for government partnerships to help create the

basis where a private sector can be very productive, particularly in high-tech areas.

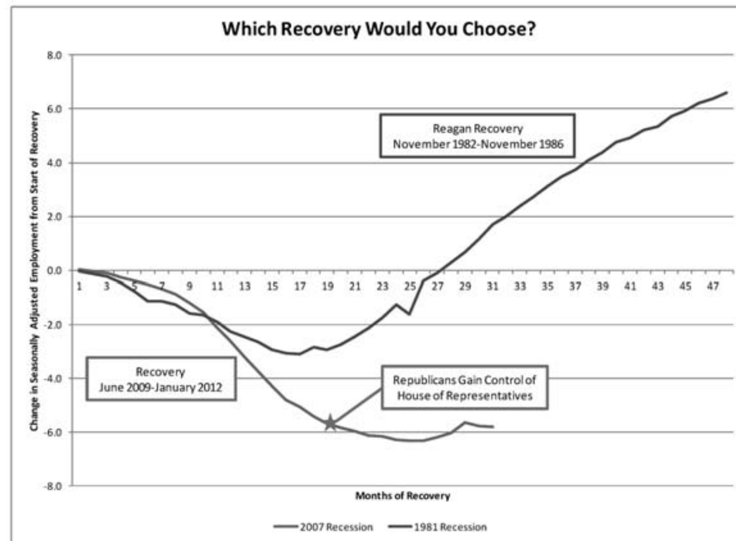
Mr. TONKO. Do you have any sense of how we might fare with the international community in terms of RND investment?

Mr. BERNANKE. We do pretty well, including both public and private. We certainly have the biggest amount, in absolute terms, of research and development investment, and we have a pretty high percentage of GDP as well. Some emerging markets like China are beginning to approach us, at least in terms of share of GDP, but we remain an RND leader.

Mr. TONKO. Thanks.

Chairman RYAN. Mr. Flores?

Mr. FLORES. Thank you, Mr. Chairman. Thank you, Chairman Bernanke, for joining us today. I want to follow up on some of the questions we have had earlier today, and to talk about policy responses. As you said, you are worried about the federal government's fiscal sustainability as we move forward, and it looks to me like we do not really have to reinvent the wheel when it comes to policy responses. If you look at this chart that we have on the screen, you can see the differences in recoveries during the 2006-2011 timeframe versus 1982 to 1986.



There was an op-ed in The Wall Street Journal this morning by Phil Gramm and Mike Solon that said that if we had just followed the same policies that Reagan followed when he inherited a really bad economy, that we would have about 17 million more Americans working today, and that our GDP per family would be about 23,000 higher. We all recognize that the Constitution says the federal government has certain basic responsibilities. It is explicit that we have to provide for national security. Some people feel like we need to provide for basic research funding, and I agree with that particular idea, but then everything else is really sort of on the table when looking forward. So my questions are fairly simple. I would like you to give me the abbreviated, abridged, Reader's Digest bed

response, if you can. Who is a better allocator of capital to the greater public good: is it the private sector or the federal government?

Mr. BERNANKE. Well, as I was saying earlier, there are some areas where the federal government is really the only provider, it is very hard to get the private sector to provide roads, but for innovative industries and those sorts of things, I think it is generally agreed that the private sector is better. China is an example of a country which has a Communist party running the show, but they allow private sector activity a very large role in the development of new industries.

Mr. FLORES. Right. You have got the difference between private sector investments, like the Keystone pipeline, versus public sector investments like Solyndra. I mean, that one is pretty obvious at face value that the federal government does a pretty poor job of allocating resources? Do you see anything that should dissuade us from thinking that it would be better for the private sector to allocate resources instead of the federal government?

Mr. BERNANKE. Well, again, the private sector, because of the profit motive and so on, is often better in innovating. But again, I do not want to get into the Keystone situation. I do not know enough about it, but I do know it involves in a multi-state, right of way, and all those environmental issues, and so forth.

Mr. FLORES. I was not trying to get into the weeds on Keystone. I am just saying, as an example, you have got, on one hand, you have got a private investment of $7 billion and thousands of jobs created, on the other hand, you have got a half a billion tax payer dollars to spend and no jobs today.

Mr. BERNANKE. To be fair, you can point to situations where government investments, in the space program or in the Internet, have paid off, you know, they paid off for the public, but clearly, we have a market economy and we want to use the market wherever appropriate.

Mr. FLORES. Good, exactly. Looking at the stimulus plan, if you use the most aggressive, optimistic numbers of jobs created or saved that have been promulgated, the cost of the stimulus plan divided by the number of jobs is about $400,000 per job. Would you say that the private sector could have done better than that, if we had just said, "Okay, private sector, through some sort of tax reform or tax reduction, we are going to leave those stimulus dollars in the hands of the tax payers to start with, instead of cycling them through Washington." Would that have created a better economic outcome for the United States?

Mr. BERNANKE. Well, it is hard to say. I mean, we were in a deep recession, and one of the differences between this recession and the 1982 and 1986 was that the Fed's tightening to reduce inflation was one of the main reasons for the 1982 recession, and so when the Fed relented and cut interest rates, that was a big reason for the recovery. In this case, rates are zero; we cannot do as much as they did in the mid-1980s. The other thing, I would comment is that dividing the total cost by the number of jobs is, to me, not exactly the right way to think about it, because the total cost also involved the provision of whatever was built or constructed.

Mr. FLORES. I was not trying to get into the knacks like that. I am just saying, at a macro level, what would have been a better policy response? What would have produced a better economic benefit for the average American? A, you know, $800 billion in the hands of the tax payers.

Mr. BERNANKE. If I could just quickly respond, I think there are times when monetary and fiscal policy can help to create better employment, but the private sector, clearly, is where the decisions about what industries, what products, and so on, should take place.

Mr. FLORES. Very good, thank you.

Chairman RYAN. Ms. McCollum?

Ms. MCCOLLUM. Thank you, Mr. Chair. Mr. Chair, back to the chart that we just had, could I ask to have that put up again, even though it was not my chart?

[Chart]

Chairman Bernanke, some of my colleagues are talking about the Reagan recovery a lot more. But I think when you talk about recoveries you also have to talk about how you got into the position you are in. You talked about how the Fed had interest rates to work with during the recovery; we did recover during the recession, that was pointed out. But I think it is important, historically, to point out that with what we are facing right now, we had two wars that went on credit cards. We had a housing collapse, which really, it broiled us into, as you pointed out, housing being the last leg, maybe, of this recovery moving forward. So you really cannot compare the two and say that the same solutions would have worked for this recovery. And then the other question I might ask you is would you say that 2007 is a fair starting point for talking about where the recovery started on this chart?

Mr. BERNANKE. No, December 2007 is beginning of the recession. The recovery began, according to the NBER, in June of 2009. I think this has been a unique experience, this last crisis. We have never had a housing boom and bust, and such an impact on the financial system, as this particular example. The financial crisis was extraordinarily severe. We did come very close to a total global meltdown. And while people can disagree about how much that has held back the recovery, I am sure that tight credit, and mortgages, and small businesses, and some other areas has been part of that. And I think the monetary policy issue is an important one. I mean, mortgage rates in the early 1980s were 18 percent, or something like that, and letting interest rates come down as the Fed lightened up, as inflation came down, was certainly part of what the economy bounced back as quickly as it did, and housing was one of the areas that bounced back. Obviously there is some comparability of all recessions, but there is some important differences as well.

Ms. MCCOLLUM. Thank you, Mr. Chairman. Mr. Chairman, in my remaining time, I would like to go back to some of the discussion that we have had about our interaction with the economies on an international market. And we are facing some decisions, and I believe that we need a balanced package of revenue, spending cuts, and that as a robust discussion about how we move forward. But there are many in Congress, some of my colleagues who want to implement deep cuts. Going back to some of the discussions that you were having with Mr. Tonko, I had an interesting meeting with

Ford Motor Company a couple years ago, and they said if we had an energy plan that would allow Ford to determine to go gang busters, whether it is going to be electric, whether it is going to be bio fuels, whatever, if we have an energy policy that countries like Japan have an energy policy, the EU came out deciding to go diesel, that that would really help our business sector be part of global competition in the way forward with competitives. Could you maybe talk about energy policy and a determinist for our country to really embrace one, to allow our businesses to kind of move forward together? Ford really said, when they knew that they had to build diesel, they could build the best diesel car, they were totally competitive in Europe, but the lack of us having an energy policy for a nation as large as ours really left them up in the air.

Mr. BERNANKE. Well, I think companies would like to have clarity about what energy sources are going to be used, how the government is going to tax or subsidize different types of energy. I think the main issues there, frankly, are environmental, as much as anything else. Japan, for example, has decided to phase out its nuclear power because of the safety concerns. The EU decision on diesel, I think, was generated primarily by environmental issues, so those are the kinds of issues that is an area where government may make some decisions about energy policy because certain types of energy may be judged or better for the environment.

Putting that aside, we do need to maintain a role for energy markets, and we were talking about this before. There is a remarkable increase in the supply of natural gas, for example, in the United States, and that is a good thing, as long as we can manage it in a safe and environmental, sound way.

Chairman RYAN. Thank you. Mr. Mulvaney?

Mr. MULVANEY. Thank you, Mr. Chairman. Dr. Bernanke, I want to drill down a little bit on something you have talked about in general here today, which is Europe, and I want to go into some detail on the Central Bank liquidity swaps, what some folks call “the dollar swap agreements.” Since you have been here last time, the agreements with very central banks have grown from roughly $2.8 billion to about $103 billion, as of last week. And my first question is where does that money come from? Is that money that you have existing reserves, is that new money, where does that $103 billion come from that we participate in those agreements?

Mr. BERNANKE. It becomes both a liability and an asset on the Federal Reserve’s balance sheet. I mean, it is, in some sense, paid for by greater excess reserves in the banking system, and on the other side, we have an asset, which is the money given in exchange to the European Central Bank.

Mr. MULVANEY. But to the extent it is “greater excess reserves,” that would be in laymen’s terms, new money. It is not money that you took out of a maturing treasury, and then moved over to a swap agreement. This is money that you have set aside for this purpose.

Mr. BERNANKE. We chose to do it that way because monetary policy currently has rates very close to zero, but it would not be difficult to sterilize that to a number of different methods.

Mr. MULVANEY. Fair enough. You stated earlier that it is your current intention, with all of your maturing securities, to reinvest

those. As these securities mature, I think 90 percent of them are less than 90 days; actually, all of them are less than 90 days, is your intention to reinvest those in domestic securities, reinvest them in swap agreements? What is your current intention with that?

Mr. BERNANKE. Well, it is the ECB and the Bank of Japan, the two main counter parties who would determine what their request is, and then we would decide whether or not to grant the request. So it is not our choice; we are not looking to invest there. If the swaps run out then that will just be extinguished. It will mean a comparable drop in our liabilities and in our assets.

Mr. MULVANEY. Fair enough. And to the extent that part of this $103 billion goes over to Europe in the swap agreements, comes back within the term of the agreements, and are reinvested in domestic securities, does that have an expansionary effect on the domestic monetary supply?

Mr. BERNANKE. It does increase the high powered money supply a little bit. In this case, it would be about 4 percent, 3, 4 percent. It does not have, in practice, have much effect on money and circulation, only the amount of excess reserves that the banks are holding with the Fed; and it does not affect interest rates. So what we see it as doing is reducing financial stress, strengthening the role of the dollar in international markets, improving funding for both U.S and foreign banks. We do not see it as having any major implications for inflation, for example.

Mr. MULVANEY. How is that different from what you have just described, from what you were trying to accomplish with QE1 and QE2?

Mr. BERNANKE. Well, the difference being that with QE1 and QE2, first of all, they were much bigger. Secondly, we were buying medium to long-term securities on the open market. In this case, the money is going via the ECB, who are our counter party and take all the risks, are going to help finance the dollar assets of European banks, which is then put back, basically, in the ECB.

Mr. MULVANEY. So I understand the first half of the transaction, but when the money comes back from Europe, and you reinvest it, how is that different from QE1 and QE2?

Mr. BERNANKE. There is no change. This does not involve any change in our holdings of securities. We have an asset, which is the obligation of the ECB, and we have a liability, which is increase in excess reserves. Unless banks are lending those reserves out, it is not going to be turning into more money supply.

Mr. MULVANEY. You have got the option, as you exercised in 2008, to lend this money directly to the European banks. You could do it to domestic subsidiaries of European banks. Why are you not doing that? Why are you using the swap agreements instead of lending directly to domestic subsidiaries of overseas banks?

Mr. BERNANKE. Well, if subsidiaries, domestic subsidiaries, of overseas banks came to the discount window, by law, we have to treat them on an even playing field with U.S.-only banks. We do not have any lending right now through the discount window. From our perspective, and an economic perspective, from the U.S. tax payer's perspective, doing it through a swap is much better because it is the responsibility of the ECB to take the collateral, to decide

on who can qualify for the loan, to decide how much is needed to address the money market problems, and so on and we are totally protected that way. And we are protected, also, in discount window through collateral, but I think this is a better way to do it.

Mr. MULVANEY. Lastly, and very quickly, we established, I think, you have got the ability to lend directly to domestic subsidiaries, you have the ability to do these swaps, but you told my colleague from South Carolina in December that you had neither the intention nor the authority to bail out European banks. Do you still stand by that statement? You do not have the intention or the authority to do that?

Mr. BERNANKE. So in that particular conversation, off-the-record conversation, I was asked, and I said, well, first of all, let me be clear, we have done these swaps, and I explained it to him and talked about them; and they had been done well before that conversation. And then the question was were we going to do additional things, were we going to make loans to the IMF, or something like that, and the answer is no.

Mr. MULVANEY. Thank you, sir.

Chairman RYAN. Ms. Wasserman Schultz?

Ms. WASSERMAN SCHULTZ. Thank you, Mr. Chairman. Chairman Bernanke, it is good to see you. Our friends on the other side of the aisle, since the debate over the Recovery Act ensued, have furiously tried to insist that it had no impact, that it created no jobs, and that it was not necessary. According to CBO, the Recovery Act lowered the unemployment rate by up to 1.8 percentage points in calendar year 2010, up to 1.4 percentage points in 2011, relative to what it would have been had Congress not acted at all. Since that time, actually since 2005, we have created more jobs in last year than we have since 2005. Since March of 2010, 3.2 million jobs have been created in the private sector. So my question to you is had we not acted and passed the Recovery Act, would that recovery have happened as soon, or even at all? Mr. Flores seemed to be pressing the notion that it is only private market investment that we should use to help an economy or a recession turnaround, are there times when you think public investments, like the Recovery Act, is necessary?

Mr. BERNANKE. Well, to answer your question directly, as you say, the CBO calculated some effects on GDP and employment. Obviously, that requires some assumptions about the counterfactual, what would have happened otherwise, but the Fed, in our analysis, in our modeling, we are basically pretty comfortable with the CBO's conclusions. We think it did have some positive effects on growth and employment, so, yes.

Ms. WASSERMAN SCHULTZ. Thank you. Then just shifting gears, there has also been a pretty raging debate over the course of the last year over what is the best way to reduce the deficit? Clearly, we all share the goal of reducing the deficit as significantly and as quickly as possible. Would you agree, though, because our friends on the other side of the aisle believe, and have tried to enact, only spending cuts, that they deem wasteful, as a strategy towards deficit reduction. Would you agree that wasteful spending also exists and is created in the tax code?

Mr. BERNANKE. Well, you are pushing me into areas which are at the province of Congress. I think the law that I would support is the law of arithmetic. So if you believe that the government should be doing more and spending more, then you should be willing to collect the taxes to do that. And if you want to cut taxes and keep revenues low, then you have to find the spending cuts that match that. So I think that balance is what is critical. People have different visions of what the role of government should play, and I do not think I am the one to adjudicate that. Clearly, it is a big issue.

Ms. WASSERMAN SCHULTZ. I know, and I am not asking you to make a political judgment, because that is our job. Would you agree with CBO, who has said that tax cuts, like the 2001-2003 tax cuts for the wealthiest, provide the least bang for our buck in terms of job creation and reducing unemployment?

Mr. BERNANKE. I think that is a debatable point. They provide some demand from the point of view of putting more income in people's pockets. I think the other issue, though, is to ask the question of, how do they play into the long run efficiency of the tax code. I have not talked about it much today, but I think there would be a lot of benefit, without much budgetary cost, of thinking about our corporate and personal income tax codes, and improving those, reducing inefficient exemptions, broadening the base, and so on. So from a purely demand side perspective, tax cuts do provide income, do provide a source of spending. They may be less in some cases than spending on a purely demand side perspective. But you also have to think about the role of the tax code in promoting growth in the long-term.

Ms. WASSERMAN SCHULTZ. And just one other quick question before my time expires. Would you say that deficit finance tax cuts tend to pay for themselves?

Mr. BERNANKE. No, expect in very rare circumstances. I do not think many people, including many good friends of mine on both sides of the aisles, would argue that tax cuts fully pay for themselves. The question is whether or not they improve efficiency and growth, but not whether they fully pay for themselves.

Ms. WASSERMAN SCHULTZ. Thank you, Mr. Chairman, I yield back.

Chairman RYAN. Thank you. Mr. Young?

Mr. YOUNG. Thank you, Mr. Chairman. Thank you, Dr Bernanke, for visiting with us today. Clearly, this economic recovery has been long delayed. It remains fragile. My constituents are frustrated, as are so many of us serving them, that we are not doing some things here on the fiscal side of the ledger to get the economy moving more quickly. 2011, real GDP growth was 1.7 percent. Private sector forecasts indicate that in the coming year, we are going to be at 2.2 percent. That is well below the 3 percent growth that trends in recent history.

We have a jobs deficit, 8.6 million jobs lost in the 2008, 2009 recession, less than a third of those recover. I am really concerned about our country tipping back into recession at this point, maybe as a result of Europe. We spent some time discussing Europe here today, in your interaction with ECB officials and others. But what I would like to hear from you, doctor, is what preparation our Fed

has made for a disorderly default by Greece or some of these other countries within Europe? I have not heard any specifics there. You have indicated that the Fed was prepared to use all the different levers that you have, all policy options.

So that is the general question. But specifically, I would also like you to speak to the money market mutual fund market. Right after Lehman, there was a bail-out of the money market mutual funds, because of panic over so-called breaking the buck. That is, the investment income would not cover all operating expenses, it would not cover all the investment losses, and so there was an intervention by the United States into that market. Could that also be something that people begin demanding, right here in Washington? We bail out the money markets as a result of a disorderly default in Europe?

Mr. BERNANKE. So in terms of preparations, other than beyond the swaps, which we just discussed, the Federal Reserve has been operating in a supervisory capacity, working with other bank supervisors to understand the exposures of banks to European nations, to European banks, European economies, trying to help them manage the risks, and reduce the risks wherever possible. We have been doing that.

The other set of tools that we have in the event of a crisis, which I think, if it was severe enough, would have very adverse effects for our economy and our financial system, no matter how well prepared we are, is the modified 13-3 authorities that Dodd-Frank left us. We can, of course, refuse the discount window, as we always do, as a backstop liquidity provision for banks that come under pressure from funders, and if necessary, we could use the 13-3 authority to provide additional programs to lend to other institutions that are under funding pressure. So we would try to mitigate any resulting contagion from the problems in the banking sector, or in the economies of Europe.

We pay close attention to money market mutual funds. Of course the SEC is a primary regulator there. They, too, like our banks, have been working to reduce their exposure to Europe. They have substantially reduces their exposure to the Eurozone countries, and all of that is to the good.

Mr. YOUNG. If I could interject briefly, is there a reason why the Financial Stability Oversight Council, created by Dodd-Frank to monitor systemic risks, has not characterized the money market mutual funds as a systemic risk, in this case?

Mr. BERNANKE. Well, I think it did, actually, in July. It did point to money market mutual funds as an area that needed more work. You mentioned the bailout. The things that were done in 2008, such as the Treasury using exchange stabilization fund to guarantee money market mutual fund deposits, were outlawed by Dodd-Frank, and so those things are not available. So it is very important that the money market mutual funds take the necessary actions to be safe in the event of some kind of problem. As I said, one thing they are doing is reducing the risks and their exposures, but the SEC, which has already imposed some improvements in the regulation of these funds, is considering additional steps and consulting with the Federal Reserve, and we are quite sympathetic to

the idea that more might need to be done in order to ensure that we do not see another run like we did in 2008.

Mr. YOUNG. I will yield back my remaining two seconds. Thank you.

Chairman RYAN. Mr. Rokita?

Mr. ROKITA. Thank you, Mr. Chairman. Mr. Chairman, thanks for coming back again. It is good to talk to you. As I said yesterday to the other witnesses, it is about this time in the day that we always seem to talk to each other. And trying to synthesize everything that has been said, I have several distinct questions, and if we could be succinct in our answers as much as possible. You may be repeating, and if so, just say so.

First of all, this discussion about the inflation, and we talked about this the last time we talked via microphone here, when you say you are not worried about the increase in inflation, my laymen's way of looking at this is that when you are effectively printing money for the quantitative easing, and the money is piling up, the inflation may be measured by the lack of velocity when that money changes hands. And so it is my perception that the banks are holding out on the money, to make sure the sheet is balanced for the regulators, and for fiscal soundness. People might be stuffing money in their mattress because they are so uncertain, or putting it somewhere. They are not using the money. And are you not worried that when they start, when we get this government believing again, for example, in a true, free market system, and people start having confidence, and the money starts picking up velocity, are you not worried that you are not going to be able to stop that runaway train?

Mr. BERNANKE. No, we are not concerned. We have two broad sets of tools to remove the money at the appropriate time. One is simply to sell assets, which extinguishes the money. The other is to use a variety of tools we developed to sterilize, or essentially remove that, either lock up or remove those excess reserves in the banking system. So at the time it comes we have to raise interest rates to fight inflation, we have made explicit what our inflation goal is now: 2 percent. The markets seem very confident in our forecast. The private sector forecasters, even surveys of consumers all feel that inflation is well controlled and will be well controlled, and we do have the tools to withdraw that money.

Mr. ROKITA. Thank you, Chairman. Many baby boomers are retiring, we know, 10,000 per day. It traditionally has been the strategy to have the more elderly in our society be able to rely on the less riskier investments, like bond interest, and the kind of things like that. And it seems with the interest rate so low that we may be forcing our most vulnerable citizens into risky investments. Do you have a comment on that?

Mr. BERNANKE. Well, I did talk about it before. We do take that into account. We understand it is an issue for many people. That being said, our savers, collectively, have to hold all the assets in the economy, and a strong economy produces much better returns in general.

Mr. ROKITA. Fair enough. Kevin Warsh was a former Federal Reserve governor; I am sure you know him. He wrote an article in The Wall Street Journal December 6, 2011, and if you do not mind,

I will quote from it, and then have you comment on it. "However well intentioned, the Federal Reserve's continued purchase of long-term treasury securities risk camouflaging the country's true cost of capital. Private investors are crowded out of the market when the Fed shows up as a large and powerful bidder."

Mr. BERNANKE. Private investors are not being crowded out; they have the best access to capital they have had in a long time, at low interest rates, bond markets are open. I think the people who have trouble are small businesses and others who cannot access bank credit to the extent we would like.

Mr. ROKITA. Okay, and then you mentioned Canada earlier on, and you indicated that they had less of a recession than we did. Why do you think that is?

Mr. BERNANKE. Well, there were several reasons, but the main reason, I think, is that they have a small number of large banks, which has plusses and minuses, but in this case they had probably better regulation. The banks did not get involved in sub-prime mortgages and the like. So some of the things that created our housing boom and bust in our financial crisis, were not as severe there, and that is why they did not have as deep a recession.

Mr. ROKITA. Would you personally favor a model more like Canada's in terms of quote unquote "better regulations"?

Mr. BERNANKE. Well, I do not think I want to go to just a small numbers of large banks. I think community banks, medium-sized banks play an important role in our economy, but I think they were right in being tougher and making sure that banks were not taking excessive risks. Our system is much more complicated, and therefore, some of the steps have been taken to provide a more systemic or macro-oriented approach, I think, is a plus here, and it was less necessary in Canada with a slightly less complicated financial system.

Mr. ROKITA. And finally, if you had to choose between one of the mandates, which would you rather pursue?

Chairman RYAN. Please answer the question.

Mr. BERNANKE. You said you had subpoena power, was that right? Ultimately, as far as central banks, in the long run, they only control inflation, so obviously price stability is a critical function of central banks, and that provides a healthier economy in the long term. You know, that being said, in the short term, I think that some benefits can be had in terms of supporting a weak recovery, like the one we have now.

Mr. ROKITA. I thank both the Chairmen.

Chairman RYAN. Ms. Black, will you yield for just a moment?

Ms. BLACK. Sure.

Chairman RYAN. To tack on to what Mr. Rokita is saying with this new statement, we know there were deliberations whether or not to have an employment mandate, and that is not in there, but you reference specifically 5.2 to 6 percent. In the next paragraph, you talk about focusing on deviations. We have an incredible, unprecedented expansion of the monetary base. And so when velocity turns back on, that is when paying higher interest on reserves must occur to sop up the money supply, which is your plan. But I would argue that this is made more complicated now, less certain from us as to whether that is going to occur on time, because what

if the employment deviation is greater than the inflation deviation at that time? And with that kind of monetary base running through a system with faster velocity, it is like putting a cruise missile through goal posts. The question is are you going to do this? Are you going to be able to mop it up on time, now that you have, perceptibly, more emphasis based on the employment mandate? And that is why these things are made more ambiguous.

Mr. BERNANKE. No, I am sure we can do it. We have the technical ability, of course, as always. As always, in any situation, there is always the question of whether or not you have tightened too early or too late, but that is a judgment you always have to make. But in terms of technically, we have no difficulty in doing it. I would point out that the Bank of England and the ECB, both of which are a single mandate banks, currently have larger balance sheets than we do, as a share of GDP.

Chairman RYAN. I hope you are right. Ms. Black?

Ms. BLACK. Thank you, Mr. Chairman. Thank you, Mr. Bernanke, for being here and giving us so much time. I want to turn to your testimony on Page 6, and because I am a visual learner, I did a little diagram here that helps me to work through what you are saying here, and I think you make some very good points. And you start out by saying in that second full paragraph that having a large and increasing level of government debt relative to national income runs the risk of serious economic consequences. So I started out here with increased debt, and then I go down here, and what you say is it crowds out private capital, and then, therefore, reduces productivity growth, which then results in more borrowing, i.e. from foreign governments, from abroad, which then increases our future income devoted to interest payments, which then comes back full circle to increasing the amount of debt. So I think that cyclical piece there, in a diagram, really would help my constituents to see how this is so important that we take care of this issue.

I am also intrigued by your results that you say here impairs the ability of the policy makers to respond effectively to future shocks or adverse events, which is our role and our responsibility, then ultimately unsustainable deficits increase the possibilities of sudden fiscal crisis, which, as we look at what has happened in Europe, certainly can happen here. I think you have diagrammed that well for us.

And then finally, my point is that you make here that investors lose confidence in the ability of the government to manage its fiscal policy. So the fiscal policy piece of that is our role and responsibility. Would you agree that the economic growth flows from investments and savings in the long term, and not borrowing? We can agree with that?

Mr. BERNANKE. Well, sometimes you have savers who want to provide funds to invest. If you are a startup firm and you do not have enough of your own money to invest, and you have got savers over here, then borrowing could be part of the process by which the money from the savers goes to the investors. So I do not think you want to get rid of borrowing in general. Mortgagees help people own homes, et cetera. But certainly, from the federal point of view, if borrowing is so large that the deficit relative to the size of the economy continues to grow, then that feedback loop you were talk-

ing about, higher interest rates, bigger deficits, and bigger debt are a significant concern, and bond markets can bring that forward, and anticipation of that can bring that forward. So if your question is should the federal government have a long-term plan to keep its fiscal situation sustainable and stable, obviously, the answer is yes.

Ms. BLACK. Okay, so that given, then can you help me with how did the policies of the Fed on setting the interest rates affect the investors and the savers?

Mr. BERNANKE. Well, my comment a moment ago about investors having access to capital, currently, the economy is not in a recession, but it is far from full employment. So there are plenty of unused resources available to be put to work by firms, and we are not seeing any evidence that either monetary or fiscal policy is crowding out private sector activity. To the contrary, to the extent that we can support growth and lower rates for borrowers, we can facilitate investment spending. But clearly when the economy is at full employment, deficits raise interest rates, and they, therefore, reduce investment. Monetary policy, which is too easy, distorts the economy and leads to inflation pressures. So clearly it is a function of where the economy is.

Ms. BLACK. And on the other hand, does a zero interest rate encourage savers to save?

Mr. BERNANKE. It may because there is both what economists call substitution effects and income effects. You may need to save more in order to get the same return.

Ms. BLACK. I am not sure that, for me, and maybe I am just abnormal, but I am not sure that putting my money into accounts where I am going to get a zero return is probably what I want to do, especially in an economy that is so uncertain.

Mr. BERNANKE. So let's just think this through.

Ms. BLACK. I will put it underneath my mattress.

Mr. BERNANKE. Suppose in order to solve, savers' problems, suppose the Fed raised interest rates sharply. That would almost certainly throw the economy back into recession. It would mean the stock market would decline, it would mean returns on other investments would go down, and it might mean that increased deficits might lead to more concerns about our federal government. So, again, we understand the concern that savers have, but we are trying to deal with a bad situation and this is one of the tools we have to try to get the economy back to full employment.

Ms. BLACK. I know my time is out, but I am not advocating a sharp increase. I am just saying that there is not an incentive there right now if there is zero percent interest. Thank you.

Chairman RYAN. There is a case for normalizing policy. Mr. Langford?

Mr. LANKFORD. Chairman, thank you for being here very much, and I also appreciate your open communication that you have started: more press conferences, more communication, any time you get the Federal Reserve ideas and thoughts out there, it is obviously helpful, and I know that is part of strategy as well, so I appreciate you taking that on, allowing some more sunshine into your thoughts and the plans here.

You mentioned earlier about small business access to capital, and that is a concern, and that is something we actually talked

about the last time that you were here. And the fact that you had mentioned bank examiners were becoming more conservative in this time of instability, and that is an issue. I can tell you in the community banks that I deal with, and I represent Oklahoma, community bankers are still very concerned with the approach on compliance. Safety and soundness, they have no issue with. Compliance becomes a big issue, and especially with the number of rules that are coming down now and the number of regulations. Let me just give you one example.

The new Volcker was intended to only affect big banks. Our community banks have to prove that they are exempt from it, and so you have got a bank of 40 people, total employees, going through pages, and pages, and pages of documents to prove they do not apply to this. It is adding a tremendous amount of workload that is not into lending, and that is forcing them to second guess. When we talked about this last year, you said there have been some modest improvements on that. I would like to follow up and say, what improvements can we still expect in the coming days? Because the community bankers that I have talked to still are not actively lending and are still second guessing every bit of risk, not sure if someone is going to come in and second guess them.

Mr. BERNANKE. So I will not go into the safety and soundness part, because your question was about compliance.

Mr. LANKFORD. Right.

Mr. BERNANKE. So it is certainly true that many of the provisions of Dodd-Frank are aimed at the biggest banks, and the small banks, it is irrelevant to them. And I agree with you that they should be spared even the need to demonstrate to their small banks, we know they are small banks.

Mr. LANKFORD. But they currently do have to demonstrate it.

Mr. BERNANKE. So what we are doing at the Fed, we have a subcommittee of two governors, Governor Duke, who was a community banker, and Governor Raskin, who was, besides being a Senate staff person, was also the head of supervision in Maryland; so they are both very knowledgeable about small banks. Their job working with staff is to try to first make sure that rules that do not apply to small banks are not put in force, and that in addition to that we provide as much clarity as we can to what the small banks need to worry about and what part they can just throw away. To help us on that we have created a advisory council of community depository institutions that we meet with, and get their feedback. I appreciate your point, and I think it is progress that we are moving away from the safety and soundness, but we are working on that.

Mr. LANKFORD. Do you feel like it is getting better the next year, because community bankers that I am talking to are getting more frustrated, and to them, it is death by 1,000 paper counts.

Mr. BERNANKE. Right.

Mr. LANKFORD. It is not any one single piece, it is just the frequency of how many small pieces are coming at them, and with the bank again, 35, 40 people in total employees, they cannot keep up with the frequency of things that are coming out.

Mr. BERNANKE. We have already begun a process whereby we will try to provide instructions and guidance to smaller banks, about what part they can just throw away without looking at.

Mr. LANKFORD. Okay. That would be very helpful and I will continue to press on that. Obviously that is the highest number of banks that we have out there, and not the highest systemic risk, but they are getting the brunt of a lot of this.

Separate question for you, and it is a broader issue that I personally struggle with in trying to watch across the world. We have so much sovereign debt worldwide, and we are continuing to add more and more sovereign debt worldwide. At what point do we reach the definition of unsustainable worldwide, that we reach some kind of limit where we do not have enough liquid capital sitting out there for all the borrowing that has happened in the sovereigns? Not just us, obviously we are the largest of that, but there has to be some point that would be defined as unsustainable. There is not enough liquid capital to manage this, and we are pulling it out of the markets, and we have hit that cycle.

Mr. BERNANKE. Well, at the moment private borrowing is way down because of the weakness of the economy; so there is money out there. As we get to full employment, then you are going to start seeing the crowding out, and that people are going to have to pay higher rates, and that is going to have the adverse effects I discussed on capital formation and productivity. I do think, though, that from our perspective in the United States, I think we are the premier economy, we are the safe haven, we have a strong interest in maintaining that status, and so I guess I would worry less about the global supply of capita and just really think about managing our own need for capital, going forward.

Mr. LANKFORD. I understand that, but there is a limited amount of liquid capital at any moment worldwide, and every country is competing for it at a higher rate.

Mr. BERNANKE. Well, there is a supply and demand. Interest rates will go up until supply equals demand. So the money will be there is some sense, but if the rate is so high, that will be bad both for the fiscal borrowers and for the private sector.

Mr. LANKFORD. That would be the definition of unsustainable, that we suddenly cannot get the money at the rate that we need it for in other countries, and obviously that affects us and then the contagion beings. The sense is, are we even close to that kind of point? I mean, that is predicting, that is crystal ball type stuff, but you have got to be watching that as well.

Mr. BERNANKE. Well, again, for countries like the United States, and the U.K., and others, rates remain very low, government bond rates. Again, the bond market is very forward looking; a lot of the bonds of 30 years, right? So a lot of this depends on what the bond markets expect the sovereign financing needs to be over the next few decades. And so, once again, it is really, to some extent, a country by country issue. If we can take a strong set of policies to ensure the sustainability of our fiscal situation, I am sure that the funding for the United States will be there.

Mr. LANKFORD. Okay, thank you. I yield back.

Chairman RYAN. Queue is closed, last question? Mr. Huelskamp.

Mr. HUELSKAMP. Thank you, Mr. Chairman, and Dr. Bernanke, I appreciate your time today. I remember our discussion last year. And one thing I asked my staff in the last few days was to read through transcripts of the 2006 Federal Open Market Committee

meetings, and looking at those comments and the transcripts, is it fair to say that the Fed did not see the severity of the housing crisis coming in 2006?

Mr. BERNANKE. I think the mistake was a little different than that. House prices were already falling in 2006, and we were aware of that. What we did not know was what the impact going to be, and in particular, we did not have a sufficient understanding of how the falling house prices, the resulting effects on mortgage quality and so on, would affect the financial system. That was the linkage that we did not see in 2006. Obviously, we did not see the crisis coming, but we certainly were aware in 2006 that the housing market was cooling, and we talked about that quite frequently, and I talked about it in testimony.

I have to emphasize that we have learned a lot of lessons from that experience and we have radically changed the way we do our supervision, and also, in particular, we now focus very much on the interactions between different parts of the system, looking at it from a systemic point of view, not just from individual institutions. So while I can never promise that we will not have another financial crisis, I think we have made a lot of progress in our ability to monitor those situations.

Mr. HUELSKAMP. And Mr. Bernanke, looking at the economic projections from last January, if I had the right ones here, you projected growth of 3.4 to 3.9 percent for GDP for this past year. It came in at 1.7. What happened, why were you so far off, and what kind of expectations do you have, or will you potentially be that far off in your projections for the coming year?

Mr. BERNANKE. I would like to look at those numbers. I do not recall what our projection was, but I would say two classes of things. One is that there was some developments that were impossible to anticipate, like the tsunami in Japan, and simplications for global supply chains, and the like, or the effects of the Arab spring on oil prices, a few things like that. I think, more generally, it is fair to say that since the recession ended that we have, until recently at least, been too optimistic about the pace of recovery, and as I go back and look at the reasons for it, I think the two main areas I would point to, one is the housing sector, which I have talked about today, which is not recovered the way we had hoped and expected, and continued pressure in financial markets, part of which is related to Europe, which, again, we did not fully anticipate in 2010.

Mr. HUELSKAMP. But you believe those factors were the primary reasons you were about a 100% over the actual growth we achieved this last year, which was an anemic 1.7 percent. Again, these are your figures: 3.4 to 3.9 percent was the range. You projected for 2012, 3.5 to 4.4 percent. Now you are back, I guess, more reality, you projected roughly 2 percent growth. But pretty far off, and pretty rosy, and we sat in this room here and thought we had some difficulties. I am just concerned with how comfortable and confident you are on how long we will stick at the two point whatever percent growth.

Mr. BERNANKE. Well, you know, macroeconomic forecasting is very difficult. We do not pretend that we have the crystal ball. What we try to do is set our projections at a level where we think

the chances of being too optimistic are roughly equal to the chances of being too pessimistic. So we will see what happens.

Mr. HUELSKAMP. Well, I understand. That is the range.

Mr. BERNANKE. We could be better than we expect.

Mr. HUELSKAMP.: Well, I would hope it would be, but seeing those figures that have been talked about earlier, how we have such an anemic recovery, the worse one since the war. We are 13.7 jobs short of where we would be on average recovery. From your estimates, I have not seen that coming out that is getting that flavor for that.

One other thing I want to mention about the transcripts, and others have talked about thanking you for being a big supporter of transparency, but is there a reason you have to wait five years to release transcripts of your meeting, for transparency purposes?

Mr. BERNANKE. Well, that was the agreement that was made with Congress. I think it was a reasonable compromise. No other central bank, virtually, releases transcripts ever. The Bank of Japan does after a 10 year lag. As far as we are aware, no other government agency releases the transcripts of confidential meetings. It adds a real cost to our deliberation process. When the transcripts began to be released, the meetings became much more scripted, much less free interchange. So I think it would inhibit the discussion process and the free exchange of ideas. Five years seems just to be an appropriate compromise. It certainly satisfies the needs of history, and again, it is a more aggressive transparent policy than other agencies or other central banks.

Mr. HUELSKAMP. Okay, and Mr. Chairman, if I might, 15 more seconds, just to close on that comment.

Chairman RYAN. Go fast.

Mr. HUELSKAMP. Thank you. Doctor, I appreciate this, but this is America, and we are responsible for fiscal policy, and the impacts, particularly in proposals you have made on housing policy, suggest an incredibly bigger role than in other countries. So I appreciate the transparency; I wish we would step that up so the American people feel more comfortable with decisions that have been made. So thank you, Mr. Chairman.

Chairman RYAN. Thank you. Chairman, you have indulged us for two and half hours. I appreciate your patience, and the hearing is adjourned. Thank you.

[Questions submitted for the record from Mr. Honda follow:]

QUESTIONS FOR THE RECORD SUBMITTED BY HON. MIKE HONDA, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

UNEMPLOYMENT BENEFITS

Mr. Chairman, I was reading through your comments from the press conference on January 26th following the FOMC meeting, and your thoughts on the long-term unemployed particularly caught my eye. To quote from your remarks,

"We're concerned that the large amount of long-term unemployment may be causing some workers to lose skills or lose labor force attachment, which at least for awhile will also likely increase the so-called natural rate or sustainable rate of unemployment."

Mr. Chairman, I'm also very concerned about the long-term unemployed, and making sure we get these people back in the workforce as soon as possible.

With this in mind, can you comment on a recent Congressional proposal that would pare back unemployment benefits from 99 weeks to 54 or less weeks? This

bill would cut off unemployment benefits for more than 3 million Americans—more than half a million Californians.

Would this hamper demand for goods and services, and stifle our economic recovery?

VOLCKER RULE & VENTURE CAPITAL INVESTMENTS

I'd like your comments on the well-known proposed Volcker Rule. I am an ardent supporter of the Dodd-Frank Act and the Volcker Rule, as intended. The intent of Congress was to limit the ability of commercial banking institutions and their affiliated companies to engage in risky trading unrelated to customer needs. However, it was NOT intended to restrict properly conducted venture capital investments.

Throughout the Dodd-Frank legislation, Congress addressed private equity funds and venture capital funds separately. This consistency, in my belief, should remain in the Volcker Rule.

Congress intended to keep this consistency, as confirmed by a colloquy on the floor of the Senate, when Senator Dodd responded to an inquiry from Barbara Boxer specifically on this issue. The text of this exchange is below:

From proceedings in the United States Senate on July 15, 2010

Mrs. BOXER. Mr. President, I wish to ask my good friend, the Senator from Connecticut and the chairman of the Banking Committee, to engage in a brief discussion relating to the final Volcker rule and the role of venture capital in creating jobs and growing companies.

I strongly support the Dodd-Frank Wall Street Reform and Consumer Protection Act, including a strong and effective Volcker rule, which is found in section 619 of the legislation.

I know the chairman recognizes, as we all do, the crucial and unique role that venture capital plays in spurring innovation, creating jobs and growing companies. I also know the authors of this bill do not intend the Volcker rule to cut off sources of capital for America's technology startups, particularly in this difficult economy. Section 619 explicitly exempts small business investment companies from the rule, and because these companies often provide venture capital investment, I believe the intent of the rule is not to harm venture capital investment.

Is my understanding correct?

Mr. DODD. Mr. President, I thank my friend, the Senator from California, for her support and for all the work we have done together on this important issue. Her understanding is correct.

The purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment in hedge funds and private equity for that reason. But properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section 619, I would expect the appropriate Federal regulators to exempt it using their authority under section 619(J).

Chairman Bernanke, could you comment on the potential affects that an overly expansive Volcker Rule on sound investments?

[Response to Mr. Honda's questions follow:]

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

May 16, 2012

The Honorable Michael Honda
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the written questions you submitted following the February 2, 2012, hearing before the House Budget Committee. A copy has also been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I can be of further assistance.

Sincerely,

Enclosure

Questions for The Honorable Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, from Representative Honda:

Unemployment Benefits

Mr. Chairman, I was reading through your comments from the press conference on January 26th following the FOMC meeting, and your thoughts on the long-term unemployed particularly caught my eye. To quote from your remarks,

> **"We're concerned that the large amount of long-term unemployment may be causing some workers to lose skills or lose labor force attachment, which at least for a while will also likely increase the so-called natural rate or sustainable rate of unemployment."**

Mr. Chairman, I'm also very concerned about the long-term unemployed, and making sure we get these people back in the workforce as soon as possible.

With this in mind, can you comment on a recent Congressional proposal that would pare back unemployment benefits from 99 weeks to 54 or less weeks? This bill would cut off unemployment benefits for more than 3 million Americans – more than half a million Californians.

Would this hamper demand for goods and services, and stifle our economic recovery?

The Emergency Unemployment Compensation program has likely affected the U.S. economy in many ways. First, the program has mitigated the financial hardship felt by many families in which a member has lost a job by replacing a portion of lost income. Second, by increasing the incomes of these families, the program has added to consumer spending. The net effect of the program on aggregate demand depends upon many factors, including the financing of the program, but the net effect is likely to have been a substantial positive for aggregate demand. The program has likely increased employment as a result of this extra aggregate demand. Third, on the margin the program has likely increased unemployment by giving job-seekers the wherewithal or incentive to extend the length of their job searches, largely by increasing participation in the labor force. To the extent that longer search offsets the increase in employment generated by the additional aggregate demand, that may have its good as well as bad points, because in some cases the extra time allows people to find a more appropriate job with a higher wage, instead of taking the very first thing that they see.

Volcker Rule & Venture Capital Investments

I'd like your comments on the well-known proposed Volcker Rule. I am an ardent supporter of the Dodd-Frank Act and the Volcker Rule, as intended. The intent of Congress was to limit the ability of commercial banking institutions and their affiliated companies to engage in risky trading unrelated to customer needs. However, it was NOT intended to restrict properly conducted venture capital investments.

Throughout the Dodd-Frank legislation, Congress addressed private equity funds and venture capital funds separately. This consistency, in my belief, should remain in the Volcker Rule.

Congress intended to keep this consistency, as confirmed by a colloquy on the floor of the Senate, when Senator Dodd responded to an inquiry from Barbara Boxer specifically on this issue. The text of this exchange is below:

<u>From Proceedings in the United States Senate on July 15, 2010</u>

> **Mrs. BOXER. Mr. President, I wish to ask my good friend, the Senator from Connecticut and the chairman of the Banking Committee, to engage in a brief discussion relating to the final Volcker rule and the role of venture capital in creating jobs and growing companies.**
>
> **I strongly support the Dodd-Frank Wall Street Reform and Consumer Protection Act, including a strong and effective Volcker rule, which is found in section 619 of the legislation.**
>
> **I know the chairman recognizes, as we all do, the crucial and unique role that venture capital plays in spurring innovation, creating jobs and growing companies. I also know the authors of this bill do not intend the Volcker rule to cut off sources of capital for America's technology startups, particularly in this difficult economy. Section 619 explicitly exempts small business investment companies from the rule, and because these companies often provide venture capital investment, I believe the intent of the rule is not to harm venture capital investment. Is my understanding correct?**
>
> **Mr. DODD. Mr. President, I thank my friend, the Senator from California, for her support and for all the work we have done together on this important issue. Her understanding is correct.**
>
> **The purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment in hedge funds and private equity for that reason. But properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section 619, I would expect the appropriate Federal regulators to exempt it using their authority under section 619(J).**

Chairman Bernanke, could you comment on the potential affects that an overly expansive Volcker Rule on sound investments?

Relevant to venture capital investments, section 619 of the Dodd-Frank Act contains two separate prohibitions. One generally prohibits banking entities from engaging in proprietary trading for the purposes of profiting from short-term price movements. The second prohibits banking entities from acquiring or retaining interests in, or having certain relationships with, hedge funds and private equity funds. The statute also explicitly provides certain exemptions from these prohibitions, as well as limitations on permitted investments.

The joint proposal issued by the Federal Reserve, OCC, FDIC, and SEC requested comment on a wide variety of issues, including regarding whether venture capital funds meet the statutory definition of a hedge fund or private equity fund and whether any investment activity, such as investment in a venture capital fund, meets the statutory standard for exemption from the requirements of section 619. The agencies received a significant amount of comment on the joint proposal and the Federal Reserve is carefully reviewing and considering these comments as we work to finalize implementing rules.

[Whereupon, at 12:33 p.m., the Committee was adjourned.]