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THE ECONOMIC OUTLOOK

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BEFORE THE

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CONGRESS OF THE UNITED STATES

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THE ECONOMIC OUTLOOK

WEDNESDAY, MAY 22, 2013

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to call, at 10:00 a.m. in Room G–50 of the Dirksen Senate Office Building, the Honorable Kevin Brady, Chairman, presiding.

Representatives present: Brady, Campbell, Duffy, Paulsen, Hanna, Maloney, Sanchez, and Delaney.

Senators present: Klobuchar, Casey, Sanders, Murphy, Heinrich, Coats, Lee, Wicker, and Toomey.

Staff present: Corey Astill, Doug Branch, Conor Carroll, Gail Cohen, Sarah Elkins, Al Felzenberg, Connie Foster, Niles Godes, Colleen Healy, Robert O'Quinn, and Sue Sweet.

OPENING STATEMENT OF HON. KEVIN BRADY, CHAIRMAN, A U.S. REPRESENTATIVE FROM TEXAS

Chairman Brady. Chairman Bernanke, welcome again to the Joint Economic Committee. Thank you for your service as Chairman of the Federal Reserve. You deserve great credit for the leadership that calmed America's financial crisis in 2008.

Four-and-a-half years after that crisis, nearly four years after the Recession has ended, the Fed is still engaging in extraordinary monetary actions and may continue doing so well into the future.

Today this Committee will examine how these actions have affected jobs and middle class Americans, and how and when the Fed will exit its current accommodative policies.

America's economy is improving, but faces significant challenges. We are experiencing the worst economic recovery since World War II. The growth gap between this recovery and an average post-War recovery is large and growing.

We are missing 4.1 million private sector jobs, and $1.2 trillion dollars from real GDP. More troubling is that many economists are predicting a new normal for America where long-term growth is diminished.

The Congressional Budget Office recently reduced its estimate for future growth in real potential GDP from 3.2 percent to 2.2 percent. Now a 1 percentage point difference may not sound like much, but it is huge.

A one percent growth gap means a $30 trillion smaller economy in 2062 in today's constant dollars. The unemployment rate has declined, which is very encouraging, but there are red flags that we should not ignore.

Twenty million Americans cannot find a full-time job. Millions more, from recent college graduates to workers in their prime earning years, have simply given up looking for work. Long-term unemployment remains historically high, and the labor force participation rate is at a 35-year low.

While it is encouraging that since the Recession hit bottom over 6 million Americans have found work, more than that—over 8 million Americans—have been forced onto Food Stamps. Regrettably, one in six Americans must now rely on Food Stamps to feed their hungry families.

With strong earnings' reports and the Fed's accommodative monetary policy, there is no question that Wall Street is roaring. But Main Street continues to struggle.

Since the Recession ended, in real terms the S&P 500 Total Return Index has risen by 74.2 percent, while disposable income per person has only advanced a mere 2.3 percent.

That means that over the last four years the real disposable income for Joe Sixpack increased a mere $745. In an average recovery since 1960, he would have $3,604 more in his pocket by now.

Extraordinarily low interest rates have clearly boosted housing prices and housing construction, with positive economic effects. However, these same low rates are punishing seniors, savers, pension funds, and insurance products. Families may now feel more secure about their house, but less secure about their income and job prospects.

As for the Fed's unemployment rate targeting, quantitative easing has run out of steam. Long-term interest rates are already at a near 70-year low. Banks have $1.9 trillion in excess reserves at the Fed, and nonfinancial corporations have $1.5 trillion more sitting on the sidelines. More liquidity and lower long-term rates cannot solve the problems that are holding back job creation in America.

Business investment in new buildings, equipment, and software which drive job creation remains the missing ingredient in this recovery. Monetary policy, no matter how thoughtfully applied, has its limits. It cannot fix poor Washington budgetary and regulatory tax policies that are deterring business investment and the jobs that come with it.

I think my key point today is that I do not question the intention of current Fed policy to fulfill its dual mandate, but I question the policy's effect on employment, and I worry about its future risks.

In the near term, these extraordinary monetary actions become an enabler of bad fiscal policy, allowing President Obama and Congress to avoid the tough and necessary decisions that would clear the roadblocks to a strong economy, such as addressing America's long-term financial sustainability, creating a pro-growth tax code, rebalancing regulation, and addressing the harmful economic effects of the President's Affordable Care Act.

In the long term, the Fed's extraordinary monetary actions pose three risks to our economy.

First, the Fed may be inflating new asset price bubbles.

Secondly, large excess reserves at the Fed could become the fuel for future inflation when economic growth accelerates, unless the Fed acts quickly to contract its balance sheet.

Third, the Fed's expansive balance sheet creates a perverse incentive for future financial repression, an economic term which means channeling domestic savings to the Federal Government to lower its interest costs.

Since 2009, the Fed has purchased the equivalent of 24 percent of all newly issued Treasuries. When growth picks up—and we hope it does—the Fed cannot raise its target rate for Federal Funds and sell long-term Treasuries without recognizing substantial losses on its balance sheet, creating uncertainty.

To avoid that, the Fed will likely boost the interest rate paid to banks on their reserves and increase reserve requirements, which restrict economic growth by limiting bank loans to small businesses and families.

The net effect is financial repression, redirecting credit from the private sector through the Fed to the Treasury to help contain federal interest costs.

Given these risks and the limits to monetary policy in the current economic recovery, the Federal Reserve should begin now to carefully exit from its extraordinary monetary actions and return to a more predictable, rules-based monetary policy that focuses on maintaining the purchasing power of the U.S. dollar over time.

Begin now, with clear communication to the market that will lessen uncertainty and form the best long-term foundation for maximum economic growth for America. Today we intend to explore the Fed's exit strategy and timing in detail.

Chairman Bernanke, I look forward to your testimony and I yield to the Vice Chairman of the Committee, Senator Klobuchar.

[The prepared statement of Chairman Brady appears in the Submissions for the Record on page 36.]

OPENING STATEMENT OF HON. AMY KLOBUCHAR, VICE CHAIR, A U.S. SENATOR FROM MINNESOTA

Vice Chair Klobuchar. Well thank you very much, Chairman Brady. Thank you for putting together this hearing. As you can see, we have very good attendance for you, Chairman Bernanke. And thank you for being here. I look forward to your testimony on the state of the economy and your thoughts on the short-term and long-run issues facing our economy.

As you know, the economy has added private sector jobs for 38 straight months. During that time, 6.8 million private sector jobs have been created. Key economic indicators are also showing some strength. The housing market is recovering.

I had the realtors in my office from Minnesota last week, and it was the first time they had smiles on their faces in a couple of years.

Credit conditions are improving, but we all know—as Chairman Brady has pointed out, that there is a lot more work to do. My hope is that this hearing will allow us to talk about potential solutions that can move our country forward. And because of the Fed's two objectives for the Nation's monetary policy—maximum employment, and stable prices—I am eager to hear your thoughts on what the Fed is doing to stimulate lending and economic activity.

One issue that I know we are all concerned about is what's going on in Congress, and you have testified before about how that would be the best solution, and that we would have more tools to move this economy forward.

I was pleased the immigration reform bill passed with a strong bipartisan vote last night. I think that is just one example, as we look at skilled workers, in addition to our own training we need to do in this country for science, engineering, math, and technology, in addition to the work we have to do on exports which are improving; the work on comprehensive tax reform; as well as bringing down the debt and getting our fiscal house in order.

And I wanted to focus on that for a minute. In the past two years, Congress has made some progress, as you know, in reducing the deficit. We have achieved about $2.4 trillion in deficit reduction. And the goal of $4 trillion, which was one goal that was set out by a number of economists, is within our grasp over the next 10 years.

Last week the Congressional Budget Office reported that the deficit will fall to $642 billion this year, which is $200 billion less than what the CBO projected just three months ago. The better numbers reflect good news in housing and larger-than-expected increases in tax revenues. But I believe that resting on these numbers would be a mistake.

I think we are closer to reaching a new deficit agreement that many people believe, when you look at the numbers at the end of the year when Speaker Boehner and the President were negotiating, when you look at some of the work that is being done on a bipartisan basis in the Senate—and it is as frustrating to me as anyone that we are not reigniting those negotiations. It is only going to happen, I believe, if we work in a bipartisan manner to get a deal done.

I believe that the budget the Senate passed, which I voted for, is a good approach. But I think everyone is open to some compromise. The Senate approach, I would note, is balanced with targeted spending cuts to replace sequestration, and new revenues from closing loopholes and ending wasteful spending in the Tax Code, which would stabilize our debt-to-GDP ratio at around 70 percent.

I feel strongly that we should be doing that—we should be going to conference committee in regular order with these two budgets, the Senate's and the House's, and get this done.

I note that last night Senator McCain and Senator Collins also came out and agreed that these two budgets should go to conference committee.

You have warned, Chairman Bernanke, that cutting too much too soon could lead to a sharp contraction on our economy. I remember that well because for any woman that's been in labor it's a very meaningful phrase, "the sharp contraction," but it is one of the reasons I believe that deficit reduction must be paired with economic growth.

Our ultimate goal is not simply a balanced budget; it is a budget that has balance. As we work towards that goal, we must avoid a repeat of the debt ceiling debacle from the summer of 2011 that rattled financial markets, led to a downgrade of the U.S. credit rating, and unnecessarily harmed our economy.

When I asked you about the debt ceiling showdown at a JEC hearing in the fall of 2011, you answered bluntly that it's no way to run a railroad. I agree. We must do better this time.

We have some breathing room now, because of the change, with the debt but we must continue to press policies that will truly help the economy: the immigration reform I mentioned; a long-term farm bill which helps a significant sector of our economy that I believe will get through the Senate in the next two or three weeks; work-skills training, as I mentioned, for our own students; regulatory reforms; streamlining regulations. Congressman Paulsen and I have worked a lot on the medical device industry trying to make those FDA approvals go quicker. Comprehensive tax reform.

Part of this of course is also smart Federal Reserve policies. Since the financial crisis began in 2007, the Fed has used many tools to bolster our economy. It has kept short-term interest rates near zero since late 2008, and it has taken action to keep longer term interest rates and mortgage interest rates low.

As you and I have discussed, this makes it hard on savers. Yet, in the past three years Americans have saved more than 4 percent of their income. The Fed has also taken steps to open up its policy-making process, expand communication, provide more specific guidance, and enhance the transparency of monetary policy.

Finally, there has to be an ongoing discussion about changing the Fed's goal to focus—there has been an ongoing discussion, and Chairman Brady had a good hearing on this, about changing the Fed's goals to focus solely on price stability.

In my view, now is not the time for the Fed to take its eye off promoting employment. My hope is that Democrats and Republicans can come together to find solutions and put more Americans back to work.

The unemployment rate, while heading in the right direction, remains at 7.5 percent, well above the 6.5 percent level the Fed committed to reaching before changing course on interest rates.

As you may know, the unemployment rate in my State is significantly lower at 5.4 percent. So, again, there are states that have weathered this downturn and are actually expanding the economy.

At the same time, as we know inflation is well below the Fed target of 2 percent. It is at about 1 percent over the past 12 months. Again, we would like to hear your views on how this will all work going out if we see improvements in our economy.

I believe that we have turned the corner and our economy is getting stronger, but I also believe there is so much more work to do. As Congressman Delaney knows from the hearing that we had on long-term unemployment, while the unemployment numbers are getting better there are still many, many people, too many people that have been unemployed for more than six months and are finding it very difficult to get back into the job market.

While this is all somewhat conflicting news in terms of the long-term unemployed and the numbers would show improvement, we all know we have more work to do. I look forward to discussing how we can build on this economic progress.

Thank you for being here and for your testimony this morning.

Chairman Brady. I would like to welcome Chairman Bernanke to our hearing today. Dr. Bernanke is currently in his second term as Chairman of the Board of Governors of the Federal Reserve, and also serves as Chairman of the Federal Open Market Committee.

Prior to his current position, Dr. Bernanke was Chairman of the President's Council of Economic Advisers, and previously served the Federal Reserve System as a member of the Board of Governors, a Visiting Scholar and member of the Academic Advisory Panel. He has a distinguished teaching and educational career.

I welcome Chairman Bernanke and look forward to your testimony. You are recognized, sir.

[The prepared statement of Vice Chair Klobuchar appears in the Submissions for the Record on page 37.]

STATEMENT OF HON. BEN BERNANKE, CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, WASHINGTON, DC

Chairman Bernanke. Thank you. Chairman Brady, Vice Chair Klobuchar, and other members of the Committee, I appreciate this opportunity to discuss the economic outlook and economic policy.

Economic growth has continued at a moderate pace so far this year. Real GDP is estimated to have risen at an annual rate of 2½ percent in the first quarter after increasing 1¾ percent during 2012.

Economic growth in the first quarter was supported by continuing expansion in demand by U.S. households and businesses, which more than offset the drag from declines in government spending, especially defense spending.

Conditions in the job market have shown some improvement recently. The unemployment rate at 7.5 percent in April has declined more than ½ percentage point since last summer. Moreover, gains in total nonfarm payroll employment have averaged more than 200,000 jobs per month over the past 6 months, compared with average monthly gains of less than 140,000 during the prior 6 months. In all, payroll employment has now expanded by about 6 million jobs since its low point, and the unemployment rate has fallen 2½ percentage points since its peak.

Despite this improvement, the job market remains weak overall:

The unemployment rate is still well above its longer run normal level, rates of long-term unemployment are historically high, and the labor force participation rate has continued to move down.

Moreover, nearly 8 million people are working part time even though they would prefer full-time work. High rates of unemployment and underemployment are extraordinarily costly. Not only do they impose hardships on the affected individuals and their families, they also damage the productive potential of the economy as a whole by eroding workers' skills and—particularly relevant during this commencement season—by preventing many young people from gaining workplace skills and experience in the first place.

The loss of output and earnings associated with high unemployment also reduces government revenues and increases spending on income-support programs, thereby leading to larger budget deficits and higher levels of public debt than would otherwise occur.

Consumer price inflation has been low. The price index for personal consumption expenditure rose only 1 percent over the 12 months ending in March, down from about 2¼ percent during the previous 12 months.

This slow rate of inflation partly reflects declines in consumer energy prices, but price inflation for other consumer goods and services has also been subdued.

Nevertheless, measures of longer term inflation expectations have remained stable and continue to run in the narrow ranges seen over the past several years. Over the next few years, inflation appears likely to run at or below the 2 percent rate that the Federal Open Market Committee judges to be most consistent with the Federal Reserve's statutory mandate to foster maximum employment and stable prices.

Over the nearly four years since the recovery began, the economy has been held back by a number of headwinds. Some of these headwinds have begun to dissipate recently, in part because of the Federal Reserve's highly accommodative monetary policy.

Notably, the housing market has strengthened over the past year, supported by low mortgage rates and improved sentiment on the part of potential buyers.

Increased housing activity is fostering job creation in construction and related industries, such as real estate brokerage and home furnishings, while higher home prices are bolstering household finances which helps support the growth of private consumption.

Severe fiscal and financial strains in Europe, by weighing on U.S. exports and financial markets, have also restrained U.S. economic growth over the past couple of years.

However, since last summer, financial conditions in the Euro area have improved somewhat, which should help mitigate the economic slowdown there while also reducing the headwinds faced by the U.S. economy.

Also, credit conditions in the United States have eased for some types of loans as bank capital and asset quality have strengthened.

Fiscal policy at all levels of government has been and continues to be an important determinant of the pace of economic growth. Federal fiscal policy—taking into account both discretionary actions and so-called automatic stabilizers—was, on net, quite expansionary during the Recession and early in the recovery.

However, a substantial part of this impetus was offset by spending cuts and tax increases by state and local governments, most of which are subject to balanced-budget requirements, and by subsequent fiscal tightening at the federal level.

Notably, over the past four years state and local governments have cut civilian government employment by roughly 700,000 jobs, and total government employment has fallen by more than 800,000 jobs over the same period. For comparison, over the 4 years following the trough of the 2001 recession, total government employment rose by more than 500,000 jobs.

Most recently, the strengthening economy has improved the budgetary outlooks of most state and local governments, leading them to reduce the pace of fiscal tightening.

At the same time, though, fiscal policy at the federal level has become significantly more restrictive. In particular, the expiration of the payroll tax cut, the enactment of tax increases, the effects of the budget caps on discretionary spending, the onset of the sequestration, and the declines in defense spending for overseas military operations are expected collectively to exert a substantial drag on the economy this year.

The CBO estimates that the deficit reduction policies in current law will slow the pace of real GDP growth by about 1½ percentage points during 2013 relative to what it would have been overwise.

In present circumstances, with short-term interest rates already close to zero, monetary policy does not have the capacity to fully offset an economic headwind of that magnitude.

Although near-term fiscal restraint has increased, much less has been done to address the Federal Government's longer term fiscal imbalances. Indeed, the CBO projects that under current policies the federal deficit and debt, as a percentage of GDP, will begin rising again in the latter part of this decade and move sharply upward thereafter—in large part, reflecting the aging of our society and projected increases in health-care costs, along with mounting debt service payments.

To promote economic growth and stability in the longer term, it will be essential for fiscal policymakers to put the federal budget on a sustainable long-run path. Importantly, the objectives of effectively addressing longer term fiscal imbalances and of minimizing the near-term fiscal headwinds facing the economic recovery are not incompatible.

To achieve both goals simultaneously, the Congress and the Administration could consider replacing some of the near-term fiscal restraint now in law with policies that reduce the federal deficit more gradually in the near term, but more substantially in the longer run.

With unemployment well above normal levels and inflation subdued, fostering our Congressionally mandated objectives of maximum employment and price stability requires a highly accommodative monetary policy.

Normally the Committee would provide policy accommodation by reducing the target for the Federal Funds rate, thus putting downward pressure on interest rates generally.

However, the Federal Funds rate and other short-term money market rates have been close to zero since late 2008, so the Committee has had to use other policy tools.

The first of these alternative tools is "forward guidance" about the FOMC's likely future target for the Federal Funds rate.

Since December, the Committee's postmeeting statement has indicated that its current target range for the Federal Funds rate, 0 to ¼ percent, will be appropriate, quote, "at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored."

This guidance underscores the Committee's intention to maintain highly accommodative monetary policy as long as needed to support continued progress toward maximum employment and price stability.

The second policy tool now in use is large-scale purchases of longer-term Treasury Securities and Agency Mortgage-Backed Securities, or MBS.

These purchases put downward pressure on longer-term interest rates, including mortgage rates. For some months, the FOMC has been buying longer-term Treasury Securities at a pace of $45 billion per month, and Agency MBS at a pace of $40 billion per month.

The Committee has said that it will continue its securities purchases until the outlook for the labor market has improved substantially in a context of price stability.

The Committee also has stated that in determining the size, pace, and composition of its asset purchases, it will take appropriate account of the likely efficacy and costs of such purchases as well as the extent of progress towards its economic objectives.

At its most recent meeting, the Committee made clear that it is prepared to increase or reduce the pace of its asset purchases to ensure that the stance of monetary policy remains appropriate as the outlook for the labor market or inflation changes.

Accordingly, in considering whether a recalibration of the pace of purchases is warranted, the Committee will continue to assess the degree of progress made toward its objectives in light of incoming information.

The Committee also reiterated—consistent with its forward guidance regarding the Federal Funds rate—that it expects a highly accommodative stance of monetary policy to remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens.

In the current economic environment, monetary policy is providing significant benefits. Low real interest rates have helped support spending on durable goods such as automobiles, and also contributed significantly to the recovery in housing sales, construction, and prices.

Higher prices of houses and other assets in turn have increased household wealth and consumer confidence, spurring consumer spending and contributing to gains in production and employment.

Importantly, accommodative monetary policy has also helped to offset incipient deflationary pressures and kept inflation from falling even further below the Committee's 2 percent longer-run objective.

That said, the Committee is aware that a long period of low interest rates has costs and risks. For example, even as low interest rates have helped create jobs and supported the prices of homes and other assets, savers who rely on interest income from savings accounts or government bonds are receiving very low returns.

Another cost—one that we take very seriously—is the possibility that very low interest rates if maintained for too long could undermine financial stability. For example, investors or portfolio managers, dissatisfied with low returns, may "reach for yield" by taking on more credit risk, duration risk, or leverage.

The Federal Reserve is working to address financial stability concerns to increased monitoring, a more systemic approach to supervising financial firms, and the ongoing implementation of reforms to make the financial system more resilient.

Recognizing the drawbacks of persistently low rates, the FOMC actively seeks economic conditions consistent with sustainably higher interest rates. Unfortunately, withdrawing policy accommodation at this juncture would be highly unlikely to produce such conditions.

A premature tightening of monetary policy could lead interest rates to rise temporarily but would also carry a substantial risk of slowing or ending the economic recovery and causing inflation to fall further.

Such outcomes tend to be associated with extended periods of lower, not higher, interest rates as well as poor returns on other assets. Moreover, renewed economic weakness would pose its own risks to financial stability.

Because only a healthy economy can deliver sustainably high real rates of return to savers and investors, the best way to achieve higher returns in the medium term and beyond is for the Federal Reserve—consistent with its Congressional mandate—to provide policy accommodation as needed to foster maximum employment and price stability. Of course we will do so with due regard for the efficacy and costs of our policy actions and in a way that is responsive to the evolution of the economic outlook.

Thank you, Mr. Chairman.

[The prepared statement of Chairman Ben Bernanke appears in the Submissions for the Record on page 38.]

Chairman Brady. Thank you, Mr. Chairman.

If the economy were to accelerate, the Fed would have to start unwinding QE–3. So what is the Fed's exit strategy, the steps it will undertake? And when do you anticipate to begin executing this?

Chairman Bernanke. Mr. Chairman, so the first thing of course would be to wind down eventually the quantitative easing program, the asset purchases.

As I've said, the program relates the flow of asset purchases to the economic outlook. As the economic outlook, and particularly the outlook for the labor market, improves in a real and sustainable way the Committee will gradually reduce the flow of purchases.

I want to be very clear that a step to reduce the flow of purchases would not be an automatic mechanistic process of ending the program. Rather, any change in the flow of purchases would depend on the incoming data and our assessment of how the labor market and inflation are evolving.

So at some point of course we will end the asset purchase program. Subsequent to that, we will follow the guidance that we have provided about interest rates. Our principal tool for raising interest rates will be the interest rate on excess reserves that we pay, which will induce higher money market rates and a higher Federal Funds rate.

And we will complement that with other tools, including tools that we have for draining reserves. We may or may not sell assets. At this point, it does not appear that it is necessary for us to sell any assets, and particularly not any mortgage-backed securities, in order to exit in a way that does not endanger price stability.

So there are a number of steps. We are currently discussing further our exit strategy, and we hope to provide more information going forward. But we certainly are confident that we can exit over time in a way that will be consistent with our policy objectives.

Chairman Brady. Do you anticipate allowing maturing securities to roll off the balance sheet before you begin selling the securities themselves?

Chairman Bernanke. As I said, we could normalize policy by simply letting securities roll off. And I think there are some advantages to doing that. For one, it would not disrupt markets so much. It would avoid irregularity in our fiscal payments to the Treasury. But we will see.

Ultimately, in the very long run, I think there is a desire to get back to a predominantly Treasury Security portfolio. But again, in the exit process allowing assets to roll off would be sufficient to bring us to a more normal balance sheet within a reasonable period.

Chairman Brady. When do you expect this strategy to begin? What are the benchmarks you are looking at to begin this process?

Chairman Bernanke. We are trying to make an assessment of whether or not we have seen real and sustainable progress in the labor market outlook. And this is a judgment that the Committee will have to make.

If we see continued improvement and we have confidence that that is going to be sustained, then we could in the next few meetings, take a step down in our pace of purchases.

Again, if we do that, it would not mean that we are automatically aiming towards a complete wind down. Rather, we would be looking beyond that to seeing how the economy evolves, and we could either raise or lower our pace of purchases going forward.

Again, that is dependent on the data. If the outlook for the labor market improves and we are convinced that that is sustainable, we will respond to that.

If the recovery were to falter, if inflation were to fall further and we felt that the current level of monetary accommodation was still appropriate, then we would delay that process.

Chairman Brady. At the pace we are going, do you think it is likely these actions will begin before Labor Day?

Chairman Bernanke. I don't know. It is going to depend on the data. The key to this program, and in our previous quantitative easing programs, we gave a total amount of expected purchases. And when that total amount was done, we stopped. And in some cases, that stopping was premature because the economy was not yet on a fully self-sustaining trajectory.

So the difference in this program is that we are buying a flow rate. We are buying a certain amount of assets each month. And the amount that we purchase will depend on how the data come in, and how the outlook for the labor market goes over time.

Chairman Brady. How much notice will you give the market before you start executing the strategy?

Chairman Bernanke. Well we have explained the strategy. And again the market can see the data as well as we can. And what we are looking for is increased confidence that the labor market is improving, and that that improvement is sustainable.

And as we see that, we will, in steps, respond to that by reducing the amount of accommodation in a way that is appropriate and maintains an appropriate level of accommodation given the economic outlook.

Chairman Brady. It is frustrating. Here we are nearly four years after the Recession ended, and this economy is in such a weak state, fragile state. At this point, the patient ought to be out of the hospital, done with rehab, and playing baseball with its kids. I feel like the economy is in the outpatient room and the Fed continues to feed it medicine on a daily basis, asking are you getting better?

But my worry is that the Fed does not have the prescription for what ails our economy. A year ago, the Fed made clear that it would not set an employment target rate because it is generally affected by nonmonetary factors; but your unwinding of QE is based on the employment areas that you have the least control of.

What do we make of that?

Chairman Bernanke. Well, Mr. Chairman, first of all the slowness of the recovery can be explained by a number of important headwinds, including the after-effects of the financial crisis, developments in Europe, the problems with the housing market, and very importantly the fact that fiscal policy for the last few years has actually been a significant headwind to recovery rather than a supporting tailwind.

So I would submit that without monetary policy's aggressive actions, that this recovery would be much weaker than it has been. And indeed, if you compare our recovery to that of Europe and other advanced industrial economies, it looks relatively good.

With respect to employment, monetary policy as a general rule cannot influence the long-run level of employment or unemployment, and that is certainly correct. What we are trying to address here is the short-run cyclical gap.

We are seeing currently the economy operating at a level below what it is capable of operating at, and many people out of work who normally would have work; and monetary policy can help to put people back to work in the short run.

In the longer run, increasing the potential growth of the economy, as you mentioned earlier, that is not really the Fed's job. That is the private sector's job and Congress's job in terms of things like the Tax Code, investment in infrastructure, training, all those things that help create more growth potential.

Chairman Brady. And I'll just thank you and conclude with this point. I think monetary policy has limits, and QE, quantitative easing, has run its course. I have yet to meet a business who tells me that if those lower long-term rates were just lower and there was more liquidity, I'd be hiring more.

That is just not happening. It really is fiscal issues, from higher tax increases, regulation, extraordinarily I think burdensome to them. The President's new health care law is creating a great deal of uncertainty and impacting job hiring today. Those I think are the main roadblocks. That is why I think the earlier the Fed can begin communicating and announcing that it's unwinding, I think the more onus is put on Congress and the White House to actually address some of these critical fiscal issues.

With that, I recognize Vice Chairman Klobuchar.

Vice Chair Klobuchar. Thank you very much, Mr. Chairman. Thank you.

I was going to take the analogy the Chairman just made about the hospital, and I was thinking: Well, we are out of intensive care, thanks in part to the Fed's actions. And we are probably out of the hospital. But one of the problems is, because of this brinkmanship that goes on on the Hill here, we keep having to go back to the emergency room. And I do not think that helps. We also just are not in that kind of long-term healthy way that we want to be. And so I want to start with that.

Right now the Fed is working to spur the economy, as you just discussed with the Chairman, at the same time that Congress is implementing across-the-board spending cuts. And I am one that believes that we have to have a mixture of cuts and revenue.

But some policymakers are pushing for even deeper cuts than we are seeing with sequestration. What effect do you think sequestration—you addressed this in your opening statement—what effect do you think it is having on economic growth? And do you think it would be better to have a long-term budget in place?

Chairman Bernanke. Well as I talked about in my testimony, sequestration is only part of an overall pattern by which there has been considerable fiscal restraint in the short term not involving just sequestration but tax increases, and elimination of the payroll tax cut, and numerous other things which collectively according to the CBO are creating quite a bit of headwind for the economy.

Now I fully realize the importance of budgetary responsibility, but I would argue that it is not responsible to focus all of the restraint on the very near term and do nothing about the long term, which is where most of the problem exists.

So I do not take a view on past cuts versus budget spending. That is really Congress' prerogative. But I do think that we would all be better off with no loss to fiscal sustainability or market confidence if we had somewhat less restraint in the very near term—this year and next year say—and more aggressive action to address these very real long-term issues which threaten, within a decade or so, to begin to put our fiscal budget on an unsustainable path.

Vice Chair Klobuchar. So having a more long-term approach with a long-term budget, with spending reductions as well as revenue changes, would be better?

Chairman Bernanke. It is a long-term problem, and I would advocate looking at it from a long-term perspective. I worry sometimes that the 10-year window may artificially constrain the thinking about the appropriate horizon for budgetary discussions.

Vice Chair Klobuchar. Well we are not even at the five-year window. So I would note again that there are many of us here in the Senate, including now Senator McCain and Senator Collins, that would like to see a budget conference committee so we can really work on these things and try to work them out.

You were talking with Chairman Brady about the Fed's work. There have been proposals to change the Fed's dual goals of maximum employment and price stability to a single focus on price stability. How would that change the Fed's policymaking?

Chairman Bernanke. Well first let me say that of course Congress sets the mandate for the Federal Reserve, and so Congress has the right to set the mandate of course any way it likes. My own personal view is that we have been able to help on the employment side, and that the dual mandate has served us well since the mid-1970s when it was first incorporated. So I would recommend that you stay with that. But again, Congress certainly is able to make that decision if it wishes.

I would point out that even though we have a dual mandate, that inflation if anything is a little bit too low. Inflation has been very low. The dollar has been strong. We have not in any way failed on that responsibility.

So I think it is consistent with our mandate and with our current policy to maintain price stability, and that is what we have been achieving.

Vice Chair Klobuchar. In fact, do central banks in other countries that just have a single goal and not the dual mandate, do they have a better track record in terms of inflation and other things?

Chairman Bernanke. No, I don't think so. I think in practice they do respond to cyclical conditions, as well as to inflation. That is certainly the case in a number of major central banks. But again, I think our inflation record is as good as really any major central banks. So it has not really been a sacrifice in that respect.

Vice Chair Klobuchar. Last month we held a hearing here examining the persistently high rates of long-term unemployment during the Recession and the recovery. Close to 4 in 10 unemployed workers have been without a job for 6 months or longer. You made reference to it in your testimony.

Long durations of unemployment of course have lasting adverse impacts on earnings, health, and even the achievement of the children of the unemployed. Are you seeing signs of rising structural unemployment? And is the high long-term unemployment rate a sign of structural challenges?

Chairman Bernanke. Well it is a significant concern, and we are seeing evidence, for example, that employers are reluctant to look at people who have been out of work for a long time, even if they appear to be qualified, just on the assumption that if you have not had a job for six months there must be something wrong with you.

Vice Chair Klobuchar. Actually, the former advisor to Mitt Romney, who spoke here, who did a very good job, talked about that as a scar on these workers; that it is so difficult for them to go out there with this record at this point.

Chairman Bernanke. That's right. So we think at this point that this is not an irreversible problem. But we are concerned about the long-run effects on employability of people who have been out of work for a long time. And if they are employed again, what will their wages be? Likely much lower.

Vice Chair Klobuchar. Is the Fed equally able to address cyclical and structural unemployment? Or are structural unemployment problems different, and are they better addressed through job training, education, things we should be doing in Congress?

Chairman Bernanke. Monetary policy—and this again relates to my answer to Chairman Brady—is not able to address long-run employment issues very well. I mean, our goal is to address cyclical unemployment primarily.

That being said, cyclical unemployment that lasts long enough becomes structural unemployment as people lose skills and so on, and that is one reason for the urgency of trying to get people back to work as quickly as possible.

Vice Chair Klobuchar. I mentioned how low interest rates have helped spur the economy by promoting investment by businesses and households, and low mortgage interest rates have helped with this growing housing market for the first time in many years, but lower interest rates as you and I discussed have also hurt older Americans who live off fixed incomes and are relying on the safe return they can get from the savings they keep in government bonds.

Could you talk about the impact you think low interest rates are having on U.S. households?

Chairman Bernanke. Well generally I think that low interest rates are helping households. I am very aware of the return issue you just mentioned, and I will come back to that in just a second. But it is also true that low interest rates are making it easier for people to buy homes, are increasing the price of homes, are increasing construction jobs and other jobs related to housing, have supported automobile purchases, and manufacturing, and are generally adding both to employment and to the wealth of Americans. And so in that respect I think that this is very much a Main Street policy. That is certainly our intention.

With respect to savers, savers have many hats. They are workers. They may own a small business. A healthy economy helps them in those capacities. And as I said in my testimony, what we would like to do is get higher returns in a sustainable way.

A weak economy will not produce high returns. In Japan, for example, interest rates have been 1 percent or lower for 15 years. The only way to get interest rates up is to get the economy growing again so that returns will be adequate, not just for fixed income instruments but for other kinds of assets as well.

Chairman Brady. Thank you, Vice Chairman. The time is expired. Mr. Campbell is recognized for five minutes.

Representative Campbell. Thank you, Mr. Chairman, and Mr. Chairman.

You mentioned in your opening remarks about financial stability concerns driven by the quest for higher yields, and some of the risks that that could cause given the low yields in fixed-income instruments.

Has your concern about these financial stability concerns increased recently?

Chairman Bernanke. I would say that it has increased a bit. We have greatly increased our monitoring and our attention to these issues, and we pay very close attention to essentially all asset classes and all major types of financial institutions, even those we don't regulate. We are trying to ascertain both whether there is a sign of frothiness or bubbles and, moreover, what exposure there is in the sense of high leverage or other kinds of vulnerabilities that would mean that if a frothy asset price were to reverse, what implications would that have for the broader economy.

So we are paying close attention to that. And we are doing our best, both through monitoring but also through our supervision/regulation/coordination with other agencies and so on to address these problems. Some of these issues were discussed in the FSOC's annual report, which Secretary Lew has been testifying about.

So this is an issue, and it is something that we take into account. As was mentioned in the statement, we look at the costs and the efficacy of our program. And I think the most significant cost is probably financial stability concerns.

On the other hand, it is a very difficult tradeoff because, as I mentioned, a weak economy means lower interest rates, which creates some of the same problems. And, more over, a weak economy means worsening credit quality, for example. And that too has financial stability implications.

So there are tradeoffs and difficult judgments to make. But I just want to assure you that we are quite aware of this issue and are watching it very carefully. And it does factor into our thinking about the appropriate amount of accommodation and the appropriate exit strategy.

Representative Campbell. Speaking of exit strategy, yesterday Federal Reserve Bank President William Dudley said that the Federal Reserve should consider holding on to mortgage-backed securities until maturity rather than selling them at whatever point an exit strategy might be necessary.

Maybe I read wrong, but I thought I heard in your responses to Chairman Brady's questions that perhaps you agree with that viewpoint? And if so—because when the Fed entered the QE a couple of years ago that was not the plan for the exit strategy. The plan for the exit strategy was to begin selling these securities at some point.

Where are you? Where is the FOMC on this?

Chairman Bernanke. Well, you are correct that we have not updated the exit strategy we put out two years ago, which included sales of MBS. And as I said, we've not done that yet and so the Committee has not officially communicated our plans there. But I will say that we have done a lot of work on this, and I personally believe that we could exit without selling any MBS because most of them will run off in a reasonable period.

But that decision has not yet been taken, and we will certainly let people know it when it is taken.

Representative Campbell. If you do that, aren't you subject to an argument that that is outright monetization, in that that debt will never have been sold to the public effectively? That you are increasing the monetary base this way?

Chairman Bernanke. No, because monetization means that we permanently finance the government using money. What we plan to do is ultimately to get our balance sheet back down to a more normal level, and, in particular, to get excess reserves which are currently nearly $2 trillion back to a more normal $25 billion or so at some point. It seems like the likely outcome there.

My point is that we can do that by allowing assets, and particularly MBS, simply to run off and mature, rather than selling them. Either way, it gets them off our balance sheet.

Representative Campbell. In my final 45 seconds here, Bank of Japan yesterday reiterated their QE, if you will, and there is significant buying. The yen has been depreciating about 5 percent against the dollar. How do you see this in terms of the potential currency war, the race to the bottom, our QE, their QE; are all world central banks leaning towards trying to—in a war here of depreciating currencies?

Chairman Bernanke. The G–7 has given a statement with which we agree, which is that monetary policies which are directed primarily at the domestic economy and are not specifically designed to affect relative exchange rates, are acceptable because whatever effect they may have on exchange rates they also affect domestic demand in Japan which is good for the global economy because it creates more trade and more activity around the world.

So we are supportive of Japan's policies, and I would make two observations. One is that under their current plan the Bank of Japan's balance sheet as a share of GDP will be three times larger than the Fed's. Just to give you a sense of proportion.

And secondly, though, that the actions they have taken seem to be having fairly dramatic effects both on financial markets but also on—so far as we can tell—on some aspects of the real economy. And I take that as a bit more evidence that these policies do have effects on the economy.

Representative Campbell. Thank you.

Chairman Brady. Thank you.

Representative Delaney is recognized for five minutes.

Representative Delaney. Thank you, Chairman Brady.

And thank you, Chairman Bernanke, not only for your leadership, which was really incomparable across the financial crisis in particular, but also for your testimony today which I thought was very well crafted in terms of laying out the limits on the economic recovery we can see absent certain actions from Congress and the Administration.

In other words, the cost of this inaction is not nothing, and we are seeing that in the results in the economy. And it seems to me you were fairly specific with the two things we should do.

The first thing is we should focus on the long-term fiscal challenge—the years, what I'll call 2011 through 2020 challenges—which can only be addressed through appropriate but comprehensive reforms to our entitlement programs, and reforms to our tax systems.

But then also in the short term, to be more intelligent about the cuts that we make, about our tax policy, and about the investments we make as a country.

And then, absent our doing that, you face challenges, and the country faces challenges. Your challenges are you have to continue to use monetary policy to make a difference against unemployment.

And so, while I agree with Chairman Brady that monetary policy has limits, it seems to me its limits have to always be defined in the context of what else is going on and what other actions are taken.

In other words, the limits I would think of your monetary policy would be different if Congress was acting in a different way. And so my question really ties into what Senator Klobuchar was talking about with employment.

Because if we deconstruct our employment challenges between cyclical unemployment and structural unemployment, how do you think about the effects of monetary policy? Obviously monetary policy can be more responsive to cyclical unemployment than it can to structural unemployment, which requires policy initiatives—true long-term policy initiatives it seems to me—how do you think about the target for unemployment in light of what you are seeing between cyclical unemployment and structural unemployment?

Chairman Bernanke. Well, to respond to your first comment, I think a more balanced monetary fiscal mix would be better. Monetary policy cannot offset what is happening in the fiscal sphere, and it would be better if there was a more equal burden sharing between the different parts of the government in that respect.

It is very difficult to assess exactly what the long-run natural, or structural rate of unemployment is. As I said before, for the most part the Federal Reserve cannot influence the long-run structural rate of unemployment except insofar as cyclical unemployment becomes structural unemployment. So we are focused primarily on our estimates of cyclical unemployment, and, in particular, our forward guidance gives a way station of 6.5 percent which is a point at which we will consider beginning the tightening process. That does not mean we think that is the lowest rate that can be achieved, but we have to begin a process before we get to that lowest rate or else we will risk overheating the economy.

We have a protection, which is a second condition, which is that if we see inflation beginning to rise, which would suggest that structural unemployment is higher than we estimate, then we would perhaps raise rates earlier. So that is how we protect ourselves.

Representative Delaney. And then as we think about the unwinding question, and if we look at some of the external factors that we are observing—rates obviously low, as we all know; markets quite strong without any observation that there's a bubble because price-to-earnings ratio, et cetera, are at historical averages; corporate balance sheets in very good shape; consumer balance sheets in much better shape than they've been for a long time; opportunity to have low-cost energy over the long term—if we were to actually do something significant in terms of the fiscal condition of the country, in your opinion how much would that improve the fundamentals around employment that would allow you to have more flexibility in your ability to unwind?

So if a grand bargain were to happen, how much greater flexibility do you think that provides you?

Chairman Bernanke. Well, you addressed in that last comment the point I wanted to make. Which is, I view this as a two-handed thing, a two-part policy. Which is, on the one hand slowing the pace of tightening in the very near term, but at the same time doing things that will create greater confidence about fiscal sustainability in the long run.

I think that combination would be confidence-inspiring in the public and markets. It would help strengthen the economy certainly. And it would take some of the burden off of monetary policy. And I agree with Chairman Brady that monetary policy is not omnipotent. We are pushing pretty hard at this point, and there are a lot of headwinds. And it would make it certainly easier for us to unwind.

Representative Delaney. Great. Thank you, Mr. Chairman.

Chairman Brady. Representative Hanna is recognized for five minutes.

Representative Hanna. Thank you, Chairman.

Chairman Bernanke, all jobs are not equal. In fact, in the last 20 or so years about 98 percent of the jobs that have been created have been service-oriented jobs, not STEM—science, technology, engineering, and math.

We have a skills gap. We have a growth gap. We have what seems to be an intractable employment gap, a shrinking middle class, and on top of all of that a lack of real growth in real income.

In a speech you gave the other day at BARD—and I don't attribute this to you, you are attributing it to someone else—you said: The IT revolution, as important as it surely is, likely will not generate transformative economic effects that flow from the earlier technological revolutions. As a result, these observers argue, economic growth and change in coming decades will likely not be noticeably slower than the pace to which Americans have become accustomed.

Apparently Dr. Kevin Hassett agrees with you, or agrees with that statement of the American Enterprise Institute. Though the structural factors such as mismatch between skill sets, arguably STEM, that the employed have in the skills that employers need also plays a significant role, which leads us back to education.

My question is in three parts. How much of today's unemployment is cyclical, and how much is structural?

If a significant portion of today's unemployment is structural, then how does a highly accommodative monetary policy that the Fed is pursuing boost employment, cyclically or structurally over the long term?

And if a significant portion of today's unemployment is structural, do we expose ourselves to significant risk of price inflation in the near term by continuing a highly accommodative monetary policy until the employment rate drops below 6½ percent?

Chairman Bernanke. So on the first question, how much is structural, again nobody knows precisely. It has to be estimated. The FOMC makes its own estimates, and the numbers we have come up with are between 5.2 and 6 percent.

So if we have 7½ percent unemployment now, we are saying there's still probably a couple of percentage points of cyclical unemployment which can be addressed by monetary policy. The rest probably cannot be addressed by monetary policy, except to the extent that cyclical unemployment left untreated will become structural unemployment.

In terms of longer run growth, the comments that you read were pessimistic comments about the IT revolution. Let me be clear that I laid out this view that, as you mentioned, of pessimism, and I was agnostic about that. I think that there are a lot of differences between the world today and the world in the 19th Century when other inventions were being made.

And what is important about the difference, the most important differences have to do with the amount of research and development funding, the skills available, the markets that make it very profitable to be first to market with a new innovation. And since research, development, and technological progress are the engines of long-term growth, I think that as a country we need to think about our policies in that area and try to do what we can to address shortages of STEM workers, mismatches, assure that talented people from all over the world can come to the United States and participate in technical innovation.

So I think this is a very important area, and I am the first to admit that it is outside the realm of what the Fed can do. It is really something that only Congress can address.

Representative Hanna. Thank you very much. I yield back.

Chairman Brady. Thank you.

Senator Sanders is recognized.

Senator Sanders. Thank you, Mr. Chairman.

And, Mr. Chairman, thanks for being with us. There are three or four issues that I have been working on that I would appreciate your commenting on.

Number one, I continue to worry about the growing inequality of wealth and income in this country. We have the absurd situation where the top 1 percent now owns 38 percent of the wealth in America. The bottom 60 percent own 2.3 percent. And in the last recent years, almost all new income went to the top 1 percent.

Now as part of that, I also worry about concentration of ownership, particularly with what is going on in Wall Street. We bailed out the large financial institutions because they were too big to fail, and yet all 10 of them today are larger than they were when we bailed them out.

There is a growing feeling among many economists, including the president of the Dallas Fed, that maybe the time is now to start breaking up these large financial institutions, the top six of which have assets equivalent to two-thirds of the GDP of the United States of America.

So I would like you in a second to comment: Is now the time to break up large financial institutions which have an unbelievable amount of assets and are, in my view, in danger at some point in the future of once again being in a position of having to be bailed out?

Issue number two deals with the structure of the Fed, laws that the Fed did not make but Congress made. As you know, we have 12 regional Feds, Reserve Banks, which have 9 members each. Many of my colleagues may not even know this, but as a result of Congressional law: of the 9 members, 3 come from the financial institutions themselves, 3 others are appointed by the financial institutions, and 3 come from appointments by the Fed.

We have had absurd situations where Jamie Dimon, the CEO of the largest financial institution in America, sat on the New York Fed whose job is supposedly to regulate Wall Street, and many of us think that is the fox guarding the henhouse.

I will be introducing—reintroducing—legislation to end what I consider to be an absurdity of having 6 out of 9 members of Regional Feds coming from the financial institutions.

The last question that I would like to ask is the fact that from the end of 2007 until April of 2013, financial institutions have increased the amount of excess reserves held at the Fed from $1.5 billion to more than $1.7 trillion. And one of the reasons why that has occurred is that, since 2008 the Fed has provided interest to financial institutions to keep this money at the Fed.

So what we see is huge financial institutions parking huge amounts of money at the Fed getting a small amount of interest. I think it would be much more productive for our economy if that money was out going to small businesses and into the productive economy, rather than sitting at the Fed.

And the legislation that I am working on would address this problem by prohibiting the Fed from providing interest to banks on their excess reserves, and require the Feds to impose a 2 percent fee on the excess reserves of the largest banks in America, those with more than $50 billion in assets. In other words, get the money out rather than parking it in the Fed.

So those are three issues that I am working on that I would love to have your comments on. Thank you, very much.

Chairman Bernanke. Senator, on the last one, the amount of excess reserves in the banking system is completely out of the control of the banks. The Fed puts those reserves in the system. The banks can pass them around from each other, but the total is just given. They can't do anything about that. It's like a hot potato.

The quarter percent interest that we're paying them, which we're doing for technical reasons, is not preventing money from going out to small business or any other business. After all, CNI loans are paying about 4 percentage points now. Prime rate is I think about 3½. So if they can find—if banks can find attractive loans, they are certainly going to make those loans rather than hold the excess reserves.

In addition, getting rid of the interest in excess reserves capacity would force us, when we come time to tighten, it would force us to sell assets very quickly in a very disruptive way instead of using that tool to tighten interest rates and avoid inflation. So it would be very counterproductive. And we can discuss that I'm sure at more length.

Senator Sanders. Yes. Breaking up the large banks?

Chairman Bernanke. That is a very complex question. I think that many of the suggestions to break them up have either involved relatively small changes, or a form of Glass-Steagall. I think Glass-Steagall is not the solution because, as we saw in the crisis, investment banks, commercial banks separately got into serious trouble.

I would support—so I think that we are doing a lot of things, which I don't have time to go through, through Dodd-Frank, through Boswell III, through Orderly Liquidation Authority, and other authorities to move in the right direction towards addressing too-big-to-fail.

And as I have said, if we do not feel after some additional work here that we have addressed that problem, I would certainly be supportive of additional steps. I think the best direction is probably requiring the largest firms to hold more capital proportionally, and that would force them both to be safer, to have a more level playing field, and if their economic returns did not justify the higher capital costs to induce them to break themselves up.

Senator Sanders. Structure of the Fed, the Regional Fed.

Chairman Bernanke. Structure of the Fed, I am very open to discussing those with you. I just want to assure you as strongly as I can that the primary role of the board members is, first, to give us market insight, business insight, let us know what is going on in the economy.

They are also helpful on some operational issues. But there is a complete and utterly impermeable wall between the board members and any supervisory matter. And I assure you of that. And so there really is no conflict.

That being said, I can see why you might want to have different people represented on that board—more union members, for example, and I think that is a perfectly reasonable thing to talk about.

Chairman Brady. Thank you. All time has expired.

Representative Paulsen.

Representative Paulsen. Thank you, Mr. Chairman.

Chairman Bernanke, I wonder if you can just comment on what are the primary factors that you are monitoring to gauge the economic risks of your current policies? In other words, given that the effectiveness of Federal Reserve policy has been at least somewhat muted over the last few years by a strong deleveraging cycle, how important do you consider the expansion of bank lending, or the results of the Fed's own senior loan officer opinion survey as a gauge of future inflation?

And also what other factors, other than just pure inflation measures, do you look at as potential precursors to an expansion of economic risks due to these policies?

Chairman Bernanke. Well we have seen a number of things which are suggestive that the effects of the financial crisis are being mitigated to some extent.

As you mentioned, consumers are deleveraging. Their debt burdens and their interest burdens are going down, and their balance sheets are healthier than they have been. A smaller number of people are underwater on their mortgages, for example.

Banks are much healthier. In our regulatory role, we have been doing these stress tests and we found that the largest banks have now roughly doubled the amount of capital that they had four years ago. And as that survey you mentioned indicates, their willingness to lend is improving in many areas, not in all. There are still issues in mortgage lending. But credit availability is improving.

So a number of factors related to the financial crisis do seem to be moderating, and that is hopeful for further progress in the real economy.

On inflation, you know, we use econometric models. We look at market data. We look at commodity prices, commodity futures prices. We simply don't see at this point much sign of inflation. In fact, inflation is a little bit on the low side historically.

And if you look at market indicators, the very fact that the United States can borrow at 30 years at under 3 percent is indicative of the idea that investors are not anticipating a major inflation problem in this country.

So we are very attentive to that. That is half our mandate. But at the moment inflation, if anything, seems a little bit on the low side.

Representative Paulsen. And knowing that's the case, why do you think businesses are not investing so much in the economy? Interest rates are at really low rates, especially long-term interest rates. And so I don't talk to any businesses, again in Minnesota, that are saying interest rates need to be lower for us to invest. But at what point—you know, can you comment, like whether it's the tax increases. You talked about the payroll tax in your testimony expiring. You talked about the tax increases maybe at the end of the year having an effect.

But at what point are the tax hikes, do you believe, on high-end earners or as a part of the new taxes associated with the implementation of the Affordable Care Act, and in Minnesota Senator Klobuchar and I, we both see the effects of the Medical Device Tax, at what point do you think those taxes are having an impact now in terms of a drag on the economy?

Chairman Bernanke. Well firms had been investing in hiring. In a way, that is consistent with the overall slow pace of growth. I mean, they are not seeing the rapid growth that would induce them to expand capacity quickly.

Given the amount of growth that they see, they have been investing, and employment growth, as unsatisfactory as it is, is probably a little stronger than you would have guessed given how much GDP growth there is, how much output growth there is.

Firms do not respond very strongly to interest rates directly in their investment decisions. A lot of literature suggests that. But they do respond to final demand. How many orders they have. And so indirectly the way monetary policy stimulates capital investment is by generating more consumer demand through the fact that lower interest rates do affect consumer spending, or raise house prices, or other asset prices. And we have been seeing the last few reports on consumer spending have been surprisingly strong, and we have seen improvement.

Just the other day we saw a very substantial improvement in consumer optimism. So that is where the monetary policy's best channel for affecting investment. If firms see more demand coming in the door, then they will expand capital and labor.

Representative Paulsen. And do you see a drag on the economy with some of the tax hikes that have happened at the end of the year?

Chairman Bernanke. I mentioned a list of things, including tax increases, elimination of the payroll tax cut, other things. I am not pronouncing on the desirability of any one of those specific policies. I am just saying, taking them all together they have the effect of being a drag on economic growth, perhaps more than necessary.

Representative Paulsen. I yield back, Mr. Chairman.

Chairman Brady. Thank you. Senator Coats is recognized for five minutes.

Senator Coats. Thank you, Mr. Chairman.

Chairman Bernanke, sometime earlier you and I had a conversation and I asked you the question about why the United States was doing relatively better than its neighbors across the seas than others. And you said, well, it's because we have the best-looking horse in the glue factory.

I am wondering where that horse is now. Is our horse still in the glue factory? Is he in the pasture just outside the glue factory? Or is he back on the farm?

Chairman Bernanke. Well it is clearly the case that we are not yet where we want to be. We have 7½ percent unemployment. We have a very low ratio of employment to population, and a lot of people leaving the labor force. GDP growth has exceeded now where we were before the crisis, but we are still well below the trend of growth.

That being said, I was struck at the latest meetings of the IMF and the G–20 in Washington recently when the IMF economists were talking about a three-speed global recovery, by which they meant the fastest growth still taking place in some of the emerging markets like China, but the United States now breaking away to some extent from the pack—notably from Europe and Japan—and we have had better performance.

In the case of Europe, it was about less than four years ago that the U.S. and the Euro area had the same unemployment rate. Today, our unemployment rate is 7½ and the European unemployment rate is above 12. So we really have done better than some other countries, for a variety of reasons, not just monetary policy or any single factor.

But we are moving in the right direction but, you know, I don't think we can be yet satisfied given where the labor market is, and given that we still have unused capacity in this economy.

Senator Coats. You cautioned in your statement that too much restraint too quickly continues to be the headwind that we may not want to get into, but we have not addressed our longer term problems.

Then you mentioned that you thought the 10-year window might be too short to do that. Some of us are looking now at something like more than 30 years, relative to where our growth will be relative to our debt. And particularly the enormous spike in mandated mandatory spending and the impact of that on interest rates and the economy and so forth.

You suggested before that you have used a lot of the tools, most of the tools that the Fed has to get us through this period of time, but ultimately that responsibility falls here and with the Administration. And we have yet to I think summon the political will to address that long-term problem.

My take is that that begins in earnest in a relatively short period of time, maybe two or three or four years. And so to me it would make sense that we begin to address it now.

Chairman Klobuchar Vice Chair mentioned some of that earlier. Could you expand a little bit more on that about what you think our responsibility is? Because I am starting to hear things like the Fed is buying us time, so therefore we do not need to take action right now.

Is the Fed being an enabler for an addiction that Congress cannot overcome?

Chairman Bernanke. Well the Fed is doing what Congress told it to do, which is we are doing our best to try and promote maximum employment and price stability.

Congress needs to take a longer view. It is true that interest rates are quite low today, and therefore the interest burden today is quite low. But when the CBO scores budget plans out for a decade or two decades, it assumes that interest rates are going to rise, which we hope they will because that will be a suggestion that the economy is recovering and coming back to normal.

So in looking at those 5, and 10, and 20 year budget plans, they assume higher interest rates. And you are going to have to deal with higher interest rates at some point, we hope, as the economy strengthens. And so I very much support your suggestion of having a longer horizon.

I would note the 1983, or whatever it was, Social Security Commission that my predecessor chaired, that the reforms that were introduced then are still now being phased in. So 30 years later. So for some of these changes with very long lead times, they will make them much easier to achieve.

Senator Coats. And lastly, your concern about the low amount of interest return and the risk taking, or the reaching for yield, is this creating another potential bubble? There is a big surge in the market here that seems to be not in force by underlying fundamentals, but I would like your take on that.

Chairman Bernanke. Well we are watching it carefully, and of course nobody can ever say with certainty what an asset price should be. But to this point, our sense is that major asset prices like stock prices and corporate bond prices are not inconsistent with the fundamentals.

For example, it was mentioned earlier that price/earnings ratios and the like are fairly normal in the stock market.

In addition, in thinking about risk to financial stability, you also have to look at things like leverage, credit growth, and other indicators that suggest not only is there some mispricing going on, but that mispricing has the possibility of greatly damaging the broader financial system. And we are not seeing that at this point.

So at this point, of course it is always again dangerous to predict, but our sense is that those issues are still relatively modest. But they require very close attention, and we will continue to do that.

Senator Coats. We are glad you are doing that because we do not want a repeat of what happened before.

Chairman Bernanke. Absolutely not.

Senator Coats. Thank you, Mr. Chairman.

Chairman Brady. Thank you. Representative Sanchez is recognized for five minutes.

Representative Sanchez. Thank you, Mr. Chairman.

And, Mr. Chairman, thanks again for being before us. I think we have had many years when you were the President's economic advisor, and now as Chairman.

So I know that now you are sitting as the Chairman, but I have questions overall about our economy and I would really like to get your idea on something in particular.

I remember when Chairman Greenspan was before us, and I talked to him about—I spoke to what I saw at the time, a frenzy in the housing market, and right around the time he called it just a "frothing" in a particular set of markets. And of course since having left said, "I completely missed what was going on."

So I want to go back to housing, because I think housing is such an incredible piece of the American's budget, the American family's budget, their sense of wealth creation. Because in many ways it is the first step, and it is traditionally what we have used to make small businesses, or to put kids through college, et cetera.

So this is what I see going on now. Around the Nation in a lot of markets, in particular in California, housing prices are going up. So everybody is cheering and everything. But what I see is foreign money coming in. Money is being bought as investments. Banks sloughing off large amounts of homes and putting them into hedge funds. These funds are holding on to these and renting them out, anticipating at some point I'm sure, 5 or 10 years down the road, to get appreciation out of those assets.

Rental markets are tightening. Rents are going through the roof. And your average working family, at least where I live, is not able to buy a home because of these, if you will, "haves" who have the money and the cash to come in and buy the home, and in return not flip it as we saw in the last speculation housing market, but actually hold it at a higher rate for rent to these families who now are becoming, unless we change something, permanent renters.

So the housing market is getting better, but not for the middle class or the higher lower income class. And it's almost chaining them, I would say, into the inability to find their way to home ownership.

So do you see that going on? Do your people see that going on in the different markets? And secondly, what can the Congress do to ensure not the other way where we went wrong that too many people who should not have been buying in bought in, but that what we would normally call the middle class, and people who should be attempting to buy a home, not get caught in this cycle of "I didn't get in and I didn't get a home"?

Chairman Bernanke. Well just a few comments.

First, with prices having fallen about 30 percent and with very, very low mortgage interest rates, affordability right now is the highest it has been in decades. So there are people who are able to buy now who could not have bought under other circumstances—although mortgage lending, I agree, is tight for the people in the lower part of the cycle distribution. I agree with that.

On the rent side, many people who have lost homes or otherwise not become home owners, stopped being homeowners, have gone to renting. And rents have gone up, as you said. So it is probably a good market response that houses that were previously owned are now being available for rent. That is adding supply to the rental market and will probably take some pressure off of rents and reduce the rents that people have to pay who are forced to rent.

Representative Sanchez. Well excuse me a minute, Mr. Chairman. Those people who had mortgage rates who were paying mortgages and, you know, we know that a good amount of these people lost their job, and that is why they were not able to continue their payments. But in most cases, what I see in my markets are lower mortgage payments that they were making, versus higher rental payments that are now being caused again because the family is not getting credit, or the family cannot get credit, or even those who qualify with credit, you know, cash offers in particular foreign markets, are, you know, wiping them off from being able to own them.

So what I see for a family unit is a higher cost of housing, effectively, than what they had pre this whole problem.

Chairman Bernanke. Well again, if you can get a mortgage—which I understand your question—the payments are low, and affordability is high. I agree with you—if this is your question, I agree with you that mortgage lending is still too tight.

There are a number of reasons for that: excessive conservatism on the part of the banks; some uncertainty about regulation. You know, there is still work to be done to clarify the securitization rules, for example. The need for GSE reform, and other things. Fear of put-backs that the banks still have.

So I think over time, particularly as house prices go up a bit, that mortgage lending will become a little bit more accessible to a broader range of people. But right now it is still relatively tight. So I agree with that.

Chairman Brady. Thank you, Chairman. All time has expired. Senator Lee.

Senator Lee. Thank you very much, Mr. Chairman.

And thank you, Chairman Bernanke. Mr. Bernanke, does quantitative easing on the margin tend to encourage private sector debt? Or does it at least tend at the margin to discourage private sector deleveraging?

Chairman Bernanke. Well on the one hand with low interest rates, we do want people to spend normally. We want them to be able to afford a house or a car, and that is part of what puts the economy back to work.

But on the other hand, as the economy strengthens, jobs are created. They get more income. And interest rates are lower. So those factors overall help people deleverage. And as you look at the data, you will see that consumers have deleveraged quite a bit over the past few years.

Senator Lee. Does quantitative easing facilitate or otherwise promote the accumulation of government debt?

Chairman Bernanke. By whom?

Senator Lee. At least at the margin?

Chairman Bernanke. By private citizens?

Senator Lee. No, no. Does quantitative easing have an impact on the accumulation of government debt? Does it at least at the margins make it easier for government to acquire a lot of debt?

Chairman Bernanke. To issue a lot of debt, you mean?

Senator Lee. Yes.

Chairman Bernanke. Well it does keep interest rates a bit lower in the short term, although again what we are trying to do is get a stronger economy which will support higher interest rates going forward.

And as I have mentioned, any kind of budgeting process that looks ahead even more than one year has to take into account the CBO's estimates that interest rates will be rising over the next few years and factor that in when you make your budgetary calculations.

So I don't see how raising interest rates prematurely and causing the economy to relapse back into recession would be helpful to fiscal policy. I think it is important for Congress to look at the 5- and 10-year window and look at how interest rates are expected to move, and make decisions based on that.

Senator Lee. To the extent quantitative easing does have these impacts that I've described, it does so basically by way of encouraging consumption. Isn't that sort of the aim of it?

Chairman Bernanke. Right. There's not enough demand in the economy, so it does encourage consumption, yes.

Senator Lee. Okay. Was net equity extraction from homes and increased leverage a problem the last time the Fed had very low rates for a really prolonged period of time, let's say in the mid-2000s?

Chairman Bernanke. There was a lot of equity extraction from homes during that period. How much was due to the Fed policy, how much was due to lax lending policies, how much was due to regulation, is a debated question.

Senator Lee. And did the excessive leverage, whatever its cause, tend to exacerbate the crisis that arose in 2008?

Chairman Bernanke. Yes.

Senator Lee. Did the Fed identify the weakness in housing in the mid-2000s and react to it?

Chairman Bernanke. Well, we saw—we saw, and this goes back to my discussion with Representative Sanchez—we saw that the relationship between house prices and rents was very—that house prices were very high relative to rents. House prices were historically very high.

And so therefore it was always considered a possibility that house prices would come down. And in fact when I became Chairman in 2006, house prices were already coming down. So, yes, we certainly saw that as a possibility. What we did not anticipate was how much damage that would do to our core financial institutions, as it did. And that led to the crisis.

Senator Lee. Yes. These things are hard to anticipate.

Chairman Bernanke. Yes.

Senator Lee. Would it be fair to say that debt can create risks that are, by their very nature, difficult to anticipate? And once they arise, also are difficult to address?

Chairman Bernanke. Excessive leverage can create instability; that's correct. But as I said, what we are seeing in households, and particularly in corporations, is a lot of deleveraging. Much stronger balance sheets. More equity in the case of banks and firms than we saw prior to the crisis.

Senator Lee. So what would you say to those who might be concerned that we could be facing a similar crisis coming up as we saw in the mid-2000s?

Chairman Bernanke. Well first, again the indicators like asset prices, house prices, leverage, credit growth, all those things look very different today than they did before the crisis.

Secondly, there is a whole lot of reform going on. Very bad mortgages were being made, as you know. And there has been a considerable amount of tightening up of the laws protecting consumers.

There have been considerable increases in the amount of capital that banks have to hold, and so on. So a lot has been done. And

I am not saying that this work is completely done, but we have certainly done a lot to make the system more resilient.

Senator Lee. Thank you very much. I see my time has expired. Thank you, Chairman Brady.

Chairman Brady. Thank you. Senator Toomey is recognized for five minutes.

Senator Toomey. Thank you, Mr. Chairman, and thank you, Chairman Bernanke for joining us again.

Just a quick sort of follow up on the nature of very accommodative monetary policy. Isn't it true as a general matter that very accommodative monetary policy has the tendency, to the extent that it is successful at all, to bring economic activity that would otherwise occur in the future closer to the present day, rather than to increase the total amount of economic activity that occurs over the long run?

Chairman Bernanke. To some extent that is correct. But we have a situation now where, for example, home building is well below what can be sustained in the longer term. And so the more quickly we can get back to that more normal level, the more quickly our economy will be at something close to full employment.

Senator Toomey. Be that as it may, I just think it is an important point to consider that accommodative monetary policy is not really a net growth strategy. It probably has a bigger impact on the timing of economic activity than the total amount.

Chairman Bernanke. We are trying to mitigate the effects of the Recession, but we cannot affect long-term growth very much. That's right.

Senator Toomey. Right. Another point, just a quick follow up on Senator Coats and Senator Lee who alluded to asset bubbles that have occurred in the past. I think it is clear to virtually everyone that we had a residential housing bubble in the last decade, and I just worry that this extremely accommodative and unprecedented policy can manifest itself in unpredictable ways.

And when we see the recent surge in housing prices, extraordinarily low yield on junk bonds, huge rally in equities, high agricultural land prices, it is not—as you point out, it is very hard to know at any point in time exactly what an asset ought to be worth, but it worries me that this is going to manifest itself in unpredictable ways.

The last point I would just want to raise is you have discussed the general strategy for exiting when that day comes, but always with an implication that there will be this orderly transition. And I just know you're aware of this, but I think it is important to underscore that it is hard to predict how the markets will respond when the biggest holder of fixed-income securities in the history of the world decides it has to sell them. And you might decide you have to sell them. I know you may decide you can just let them run off, but that may not be enough. And I just think there are very significant risks that we are taking by accumulating a portfolio of this scale.

Do you want to just comment on that briefly?

Chairman Bernanke. Well, I do not disagree that this is not easy and requires good communication. We have improved our communication——

Senator Toomey. By the way, I would like to commend you for that. You have provided I think more transparency, more communication, and more guidance than the Fed has, to my knowledge, ever provided certainly in recent history and I do think that is constructive.

Chairman Bernanke. Thank you.

I guess I would just say that there is no risk-free strategy here. I mean, inflation is 1 percent. Unemployment is still high. So we could tighten monetary policy and address some of the issues that you have in mind. I think it would also include a big market correction if we moved very quickly and unexpectedly.

Senator Toomey. Which might suggest that the reason the market is where it is is because of the monetary policy rather than the underlying fundamentals.

Chairman Bernanke. Well, but it may be because the market thinks that monetary policy is creating more profits and growth.

Senator Toomey. That is possible. A quick follow up to comments you have made in the past about the swaps push-out provision in Dodd-Frank. I have legislation to allow that, much but not all, much of that activity that is currently required to be pushed out to the curb back in the banks, which I think is a better way for financial institutions to manage risk and a better way for end-users to be able to use these products.

Do you still share the view that it is a good idea to repeal parts of the swap push-out?

Chairman Bernanke. Yes. The Federal Reserve had concerns about this prior to the enactment of the law, and we still have concerns about it.

Senator Toomey. The last thing I want to mention is, there are August 9th, 2011, minutes of an FOMC meeting that contain notes on an August 1 videoconference in which there is a reference—and I am going to read. I will quote from a portion of it. It refers to, quote:

“Plans that the Federal Reserve and the Treasury have developed regarding the processing of federal payments, potential implications for bank supervision and regulatory policies, and possible actions that the Federal Reserve could take if disruptions to market functioning posed a threat to the Federal Reserve’s economic objectives.”

Of course this was in the context of the debt-limit impasse. So clearly there were plans regarding how to deal with the processing of Fed payments, for instance, and other things. Could you give us a sense of what those plans consist of, and what you can tell us about those plans?

Chairman Bernanke. Well my memory won’t be complete, but we looked at our systems and our ability to make payments to principal and interest holders. For the most part, we found that we were able to do that, with a few possible exceptions, people holding savings bonds and a few things that are not as easily connected to the system.

We also had some discussion of the kind of policy we would have with banks—for example, discount window lending; would we accept defaulted Treasury; and all kinds of things that were contingency planning in case that this were to happen.

What we did not do was directly engage the private sector for any contingency planning. We were mostly looking at our internal systems. We are the agent of course of the Treasury, and it is our job to do whatever they tell us to do. And we were just working through our capacity both as an agent managing the payment system, and also as a bank supervisor to deal with a possible default if the debt ceiling was not raised.

Senator Toomey. Okay, I see my time has expired. Thank you, Mr. Chairman.

Chairman Brady. Thank you. Former Chairman, Senator Bob Casey is recognized for five minutes.

Senator Casey. Mr. Chairman, thank you. Vice Chair Klobuchar, thank you for making this opportunity available to us.

And Chairman Bernanke, we are grateful for your presence here and your testimony and, I have to say, as well, for the work you have done to deal with a set of economic circumstances that we have rarely faced in American history. So you brought not just a lot of focus, but also a lot of passion, and we appreciate that.

I really wanted to focus just on one issue. I am not sure it has been raised yet, but if it has I think it always bears even more examination. The issue is tax reform.

If there is one area of real consensus in Washington and across the country, there is a lot of consensus—and here it happens to be bipartisan—that we have got to simplify the Tax Code. We have got to make it a much more workable tax system for individuals and for businesses; all kinds of ways to do that.

The hard part is getting consensus in order to move forward. The good news here—I do not want to overstate this but it is important to assert it—is that we have had two chairmen, Chairman Baucus in the Finance Committee the last several years, and Chairman Camp, the House Ways and Means, working together individually and their staffs to try to tackle this, and processes or mechanics are underway in both places.

For example, every Thursday in the Finance Committee we sit down around the table and for at least an hour or more go through elements of the Tax Code. That is all the good news. And I think it is moving in the right direction.

The challenge is getting consensus. The question I have for you—and maybe one or two—the basic question is: Can you give an opinion, or assess the impact, I am assuming it will be positive but I would like to hear about this, on passage of a substantial bipartisan reform of the Tax Code?

Chairman Bernanke. Well first I would just make the observation that such a major action taken in a bipartisan basis would itself be confidence-inspiring.

I think most everybody on both sides of the aisle agrees that the Tax Code is extremely complex and distorts economic decisions in a lot of ways. So I think if it were done in a way that simplified it, made it more economically efficient and rational, I think that would be very positive. And I hope that you and your colleagues can make progress on that.

Senator Casey. Is there any one part of the Tax Code that is of particular significance in terms of the adverse impact it has on either business activity or economic growth? I realize there may be more than one, but if there is one that you think is particularly difficult to manage?

Chairman Bernanke. Well the very difficult problem you face is the following: Most economists would argue that an efficient Tax Code is one that has a relatively broad base and low marginal rates.

But low marginal rates is easy, but "broad base" means restricting or limiting popular deductions and credits. So that is the goal. But the political challenge is to figure out how to do that.

And as you know, in the income tax, for example, the personal income tax, the biggest deductions are housing, charitable, state and local government, and the health care exemption, which are all obviously very popular and have their own purposes.

So finding a way to deal with that issue I think is the most challenging part but has the biggest payoff, if you can find ways to again broaden the base and lower the tax rate.

Senator Casey. And I hear about it a lot, and I know we all do, this sense that businesses have that there are various, or I would say a big measure, or substantial areas of uncertainty: one is the Tax Code, another is the economy generally. Frankly, one of the areas of uncertainty is what the Congress will or will not do, or hasn't done.

And it is my belief if we can get a bipartisan tax reform agreement, it would remove at least one element of uncertainty. I know my time has almost expired, and as a former Chair I want to be on the right side of Chairman Brady.

[Laughter.]

Chairman Brady. Thank you, sir. Representative Duffy is recognized for five minutes.

Representative Duffy. Thank you, Mr. Chairman.

To follow up on Mr. Casey's questioning just briefly, not only are we here to hopefully get bipartisan support for reform of our Tax Code but hopefully we will have bipartisan support for fair implementation of our Tax Code. But that is not this hearing.

Thanks for coming, Mr. Chairman. You testified with regard to the need to in essence keep the spigots going with regard to monetary and fiscal policy; that you are going to continue to print money, drive interest rates down; that we should continue to borrow and spend on our end in the short term to help grow the economy and work on our debt in the long term.

I am sure you are well aware of these numbers, but if you look at how much we have spent since 2008, the Federal Government in 2008 spent $2.9 trillion. In 2009, during the course of the Stimulus Bill, we spent $3.5 trillion. So the year of the Stimulus Bill, $3.5 trillion, a half a trillion dollar jump.

This year, the CBO projects us to spend $3.4 trillion. So we are almost spending this year the same amount we spent in the year of the $800 billion Stimulus Bill. But your testimony today is that the cuts have been too significant. We need to actually spend more in conjunction with your printing.

Could you explain that a little further for me? Why do we need to spend more when we are already a half a trillion dollars more in spending from fiscal year 2008?

Chairman Bernanke. Well first I did not say "spending." I talked about the whole package, which included tax increases and elimination of the payroll tax cut. I'm saying put all that together and it is a drag on the economy. Since the stimulus the government has been tightening its belt pretty significantly. I mentioned in my testimony that there are 800,000 fewer government employees today than there were a few years ago. And I am not advocating. I am not here to advocate a major new stimulus program.

I am simply saying that a rebalancing between a somewhat slower tightening in the near term, and more aggressive and systematic attempt to address the longer term imbalances where the big problems really are, I think that would be better.

And please don't misunderstand me. I am not in any way denying the importance of fiscal responsibility. I just think it is not the best way to go about it to focus entirely on the short term and ignore the long term.

Representative Duffy. And I would agree with you on that point. One of the problems in this town is that we see the long-term implications of the course that we are on. And you are well aware of the politics in these two chambers and with the White House. And you have seen our side.

I think aggressively talking about the long-term implications of our aging population and the impact on Medicare, and that I think you would agree is the driver of our debt. Yes? You would agree with that, right?

Chairman Bernanke. On the spending side, health care costs and aging are very important, yes.

Representative Duffy. And what program does that spending come from?

Chairman Bernanke. Medicare and Medicaid.

Representative Duffy. Right. So you know that on our side of the aisle we are trying to actually reform it and make it sustainable. And one of the frustrations is we are not able to get buy-in with others to actually join us in that effort.

It is one thing to say, listen, I don't like the Republicans' plan, but then the other side has to put out a plan that actually makes it sustainable, too. Wouldn't you agree?

Chairman Bernanke. I'm sorry?

Representative Duffy. That makes Medicare sustainable in the long term.

Chairman Bernanke. We certainly want to do that, yes.

Representative Duffy. Yes. And both sides should put out plans that make Medicare sustainable so they can negotiate. Correct?

Chairman Bernanke. Well I don't want to get into negotiations, but——

Representative Duffy. I'm talking policy-wise.

Chairman Bernanke. From a policy perspective, yes, we want Medicare to be sustainable and we want the budget overall to be sustainable.

Representative Duffy. And we want two sides to put out plans that make Medicare sustainable, right?

Chairman Bernanke. There needs to be, obviously, some bipartisan way of negotiating whatever it is you're going to do.

Representative Duffy. And to negotiate that, both sides put out plans. One of my concerns with your testimony, when you talk about the headwinds, is you didn't talk about regulations. When I talk to my small business owners, people back in Wisconsin, they are concerned about the things you mentioned but they are also concerned about the rules, the regulations, the red tape. Government is getting in their way when they're looking at expanding and growing their business.

When you have someone who is looking at starting a business, they will cite rules and regulations, and government interference as a problem. And I guess I see that as one of the headwinds as well, and that wasn't referenced. I wonder if you see that as a concern?

Chairman Bernanke. It is a concern. Smart regulation is very important. I wonder, though, whether these regulations are ones that have just been imposed, or whether they are things that have been in place for a long time?

And talking about headwinds, I was looking at factors that were specific to this recovery as opposed to the longer term growth issues.

Representative Duffy. And just quickly, I know your term is up in January?

Chairman Bernanke. Right.

Representative Duffy. If offered a second term by the President, would you accept?

Chairman Bernanke. I'm not prepared to answer that question now.

Representative Duffy. Okay. Some of us are concerned about the policies that have been implemented and the long-term impacts that won't take effect in the next six months but will impact us three, four, five, and six years down the road.

Thanks for your testimony.

Chairman Brady. Thank you, Representative Duffy, for waiting till the very last moment to slip that question in.

[Laughter.]

Vice Chair Klobuchar. Yeah.

Chairman Brady. Chairman Bernanke, thank you for being here. I think the Fed played a critical role in calming the financial crisis. I do not know that I agree with the assertion that everything good in the economy, including corporate earnings, has occurred because of adroit monetary policy. I think the economy is more complex in the private sector, more resilient on its own. I just believe that at this point in the recovery, while it is very fragile, it really is the fiscal roadblocks, aside from Europe and some other issues, are really key to getting this economy going.

We are going to continue to explore monetary policy, exit strategy, timing, and other issues in future hearings. Mr. Chairman, thank you for being here today.

Chairman Bernanke. Thank you, sir.

(Whereupon, at 11:45 a.m., Wednesday, May 22, 2013, the hearing was adjourned.)

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF HON. KEVIN BRADY, CHAIRMAN, JOINT ECONOMIC COMMITTEE

Chairman Bernanke, welcome again to the Joint Economic Committee.

Thank you for your service as Chairman of the Federal Reserve. You deserve great credit for the leadership that calmed America's financial crisis in 2008.

Four and half years after that crisis and nearly four years after the recession ended, the Fed is still engaging in extraordinary monetary actions and may continue doing so well into the future. Today, this Committee will examine how these actions have affected jobs and middle class Americans, and how and when the Fed will exit its current accommodative policies.

America's economy is improving, but faces significant challenges. We are experiencing the worst economic recovery since World War II. The "growth gap" between this recovery and an average post-war recovery is large and growing. We are missing 4.1 million private sector jobs and $1.2 trillion from real GDP.

More troubling is that many economists are predicting a "new normal" for America where long-term growth is diminished. The Congressional Budget Office recently reduced its estimate for future growth in real potential GDP from 3.2 percent to 2.2 percent. A one-percentage point difference may not sound like much, but it is huge. A one-percent growth gap means a $30 trillion smaller economy in 2062—in constant dollars.

The unemployment rate has declined, which is very encouraging, but there are red flags that we shouldn't ignore.

Twenty million Americans cannot find a full-time job. Millions more—from recent college graduates to workers in their prime earning years—have simply given up looking for work. Long-term unemployment remains historically high, and the labor force participation rate is at a 35-year low.

While it's encouraging that since the recession hit bottom over 6 million Americans have found work, more than that—over 8 million Americans—have been forced onto food stamps. Regrettably, one-in-six Americans must now rely on food stamps.

With strong earnings reports and Fed's accommodative monetary policy, there's no question that Wall Street is roaring, but Main Street continues to struggle. Since the recession ended, in real terms, the S&P 500 Total Return Index has risen by 74.2 percent, while disposable income per person has only advanced a mere 2.3 percent.

That means that over the last four years the real disposable income for Joe Sixpack increased a mere $745. In an average recovery since 1960, he would have $3,604 more in his pocket by now.

Extraordinarily low interest rates have clearly boosted housing prices and housing construction with positive economic effects. However, those same low rates are punishing seniors, savers, pension funds and insurance products. Families may now feel more secure about their house, but less secure about their income and job prospects.

As for the Fed's unemployment rate targeting, quantitative easing has run out of steam. Long-term interest rates are already at a near 70-year low. Banks have $1.9 trillion in excess reserves at the Fed, and non-financial corporations have $1.5 trillion sitting on the sidelines. More liquidity and lower long-term rates cannot solve the problems that are holding back job creation in America.

Business investment in new buildings, equipment and software—which drive job creation—remains the missing ingredient in this recovery.

Monetary policy, no matter how thoughtfully applied, has its limits. It cannot fix poor Washington budget, regulatory and tax policies that are deterring business investment and the jobs that come with it.

I don't question the intention of current Fed policy to fulfill its dual mandate, but I question the policy's effects on employment and worry about its future risks.

In the near term, these extraordinary monetary actions have become an enabler of bad fiscal policy: allowing President Obama and Congress to avoid the tough and necessary decisions that would clear the roadblocks to a stronger economy: such as addressing America's long-term financial sustainability, creating a pro-growth tax code, re-balancing regulation, and addressing the harmful economic effects of the President's Affordable Care Act.

In the long term, the Fed's extraordinary monetary actions pose three risks to our economy:

- First, the Fed may be inflating new asset price bubbles.
- Second, large excess reserves at the Fed could become the fuel for future inflation when economic growth accelerates unless the Fed acts swiftly to contract its balance sheet.

- Third, the Fed's expansive balance sheet creates a perverse incentive for future financial repression, an economic term, which means channeling domestic savings to the federal government to lower its interest costs.

  Since 2009, the Fed has purchased the equivalent of 24 percent of all newly issued Treasuries. When growth picks up, the Fed cannot raise its target rate for federal funds and sell long-term Treasuries without recognizing substantial losses on its balance sheet, creating uncertainty.

  To avoid that, the Fed will likely boost the interest rate paid to banks on their reserves and increase reserve requirements, which restrict economic growth by limiting bank loans to small businesses and families. The net effect is "financial repression"—redirecting credit from the private sector through the Fed to the Treasury—to help contain federal interest costs.

Given these risks and the limits to monetary policy in the current economic recovery, the Federal Reserve should begin now to carefully exit from its extraordinary monetary actions and return to a more predictable, rules-based monetary policy that focuses on maintaining the purchasing power of the U.S. dollar over time.

Begin now with clear communication to the market, that will lessen uncertainty and form the best long-term foundation for maximum economic growth for America.

We intend to explore the Fed's exit strategy in detail today.

Chairman Bernanke, I look forward to your testimony.

PREPARED STATEMENT OF HON. AMY KLOBUCHAR, VICE CHAIR, JOINT ECONOMIC COMMITTEE

Chairman Bernanke, thank you for being here. I look forward to your testimony on the state of the economy and your thoughts on the short-term and long-run issues facing the U.S. economy.

The economy has added private-sector jobs for 38 straight months. During this time, 6.8 million private-sector jobs have been created. Key economic indicators are also showing strength—the housing market is recovering, and credit conditions continue to improve. But we know there is more work to do.

My hope is that this hearing will allow us to talk about potential solutions that can move the country forward. And because of the Fed's two objectives for the nation's monetary policy—maximum employment and stable prices—I'm eager to hear your thoughts, Chairman Bernanke, on what the Fed is doing to stimulate lending and economic activity.

One issue that I know we are all concerned about is getting our fiscal house in order.

In the past two years, Congress has made some progress in reducing the deficit. We've already achieved $2.4 trillion in deficit reduction and the goal of $4 trillion is within our grasp.

Last week, the Congressional Budget Office reported that the deficit will fall to $642 billion this year, $200 billion less than what the CBO projected just three months ago. The better numbers reflect good news in housing and larger than expected increases in tax revenues. But I believe that resting on these numbers would be a mistake. I think we're closer to reaching a new deficit agreement than many people believe.

There is bipartisan agreement on this. At a hearing this Committee held in March, former Republican Senator Judd Gregg shared a quote from the Foreign Minister of Australia, who said, "The United States is one debt deal away from leading the entire world out of [its] economic doldrums." I think that's exactly right.

But, it's only going to happen if we work in a bipartisan manner to get a deal done. I believe that the budget the Senate passed, which I voted for, is the right approach.

It's balanced—with targeted spending cuts to replace sequestration and new revenues from closing loopholes and ending wasteful spending in the tax code that would stabilize our debt-to-GDP ratio at around 70%.

You have warned, Chairman Bernanke, that cutting too much too soon could lead to a sharp contraction. I quote you a lot on that because for any woman who has gone through labor it is a highly memorable description. It is one of the reasons I believe deficit reduction must be paired with economic growth.

Our ultimate goal isn't simply a balanced budget; it's a budget that has balance. As we work towards that goal, we must avoid a repeat of the debt ceiling brinkmanship in the summer of 2011 that rattled financial markets, led to a downgrade of the U.S. credit rating and unnecessarily harmed our economy.

When I asked you about the debt ceiling showdown at a JEC hearing in the fall of 2011, you answered bluntly that it's "no way to run a railroad."

I agree. We must do better this time. And we must continue pressing policies that will help the economy: immigration reform, a long-term farm bill, work-skills training for our own students, regulatory reform and comprehensive tax reform. Part of this is, of course, smart Federal Reserve policies.

Since the financial crisis began in 2007, the Fed has used many tools to bolster the economy. It has kept short-term interest rates near zero since late 2008, and has taken action to keep longer-term interest rates and mortgage interest rates low.

As you and I have discussed, this makes it hard on savers, yet in the past three years, Americans have saved more than 4 percent of their incomes.

The Fed has also taken steps to open up its policy-making process, expand communication, provide more specific guidance and enhance the transparency of monetary policy.

Finally, there has been an ongoing discussion about changing the Fed's goals to focus solely on price stability—and we held a good hearing on this issue.

In my view, now is not the time for the Fed to take its eye off promoting employment. My hope is that Democrats and Republicans can come together to find solutions that put more Americans back to work.

The unemployment rate, while heading in the right direction, remains at 7.5 percent, well above the 6.5 percent level the Fed committed to reaching before changing course on interest rates.

At the same time, inflation is well below the Fed target of 2 percent. It's at about 1 percent over the past 12 months.

I believe we've turned the corner and our economy is getting stronger. We have had almost three and a half years of private-sector job growth.

While this is good news, we have much more to do. I look forward to discussing how we can build on this economic progress. Chairman Bernanke, thank you for being here and for your testimony this morning.

Prepared Statement of Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System

Chairman Brady, Vice Chair Klobuchar, and other members of the Committee, I appreciate this opportunity to discuss the economic outlook and economic policy.

CURRENT ECONOMIC CONDITIONS

Economic growth has continued at a moderate pace so far this year. Real gross domestic product (GDP) is estimated to have risen at an annual rate of 2½ percent in the first quarter after increasing 1¾ percent during 2012. Economic growth in the first quarter was supported by continued expansion in demand by U.S. households and businesses, which more than offset the drag from declines in government spending, especially defense spending.

Conditions in the job market have shown some improvement recently. The unemployment rate, at 7.5 percent in April, has declined more than ½ percentage point since last summer. Moreover, gains in total nonfarm payroll employment have averaged more than 200,000 jobs per month over the past six months, compared with average monthly gains of less than 140,000 during the prior six months. In all, payroll employment has now expanded by about 6 million jobs since its low point, and the unemployment rate has fallen 2½ percentage points since its peak.

Despite this improvement, the job market remains weak overall: The unemployment rate is still well above its longer-run normal level, rates of long-term unemployment are historically high, and the labor force participation rate has continued to move down. Moreover, nearly 8 million people are working part time even though they would prefer full-time work. High rates of unemployment and underemployment are extraordinarily costly: Not only do they impose hardships on the affected individuals and their families, they also damage the productive potential of the economy as a whole by eroding workers' skills and—particularly relevant during this commencement season—by preventing many young people from gaining workplace skills and experience in the first place. The loss of output and earnings associated with high unemployment also reduces government revenues and increases spending on income-support programs, thereby leading to larger budget deficits and higher levels of public debt than would otherwise occur.

Consumer price inflation has been low. The price index for personal consumption expenditures rose only 1 percent over the 12 months ending in March, down from about 2¼ percent during the previous 12 months. This slow rate of inflation partly reflects recent declines in consumer energy prices, but price inflation for other consumer goods and services has also been subdued. Nevertheless, measures of longer-term inflation expectations have remained stable and continue to run in the narrow ranges seen over the past several years. Over the next few years, inflation appears likely to run at or below the 2 percent rate that the Federal Open Market Committee (FOMC) judges to be most consistent with the Federal Reserve's statutory mandate to foster maximum employment and stable prices.

Over the nearly four years since the recovery began, the economy has been held back by a number of headwinds. Some of these headwinds have begun to dissipate recently, in part because of the Federal Reserve's highly accommodative monetary policy. Notably, the housing market has strengthened over the past year, supported by low mortgage rates and improved sentiment on the part of potential buyers. Increased housing activity is fostering job creation in construction and related industries, such as real estate brokerage and home furnishings, while higher home prices are bolstering household finances, which helps support the growth of private consumption.

Severe fiscal and financial strains in Europe, by weighing on U.S. exports and financial markets, have also restrained U.S. economic growth over the past couple of years. However, since last summer, financial conditions in the euro area have improved somewhat, which should help mitigate the economic slowdown there while also reducing the headwinds faced by the U.S. economy. Also, credit conditions in the United States have eased for some types of loans, as bank capital and asset quality have strengthened.

FISCAL POLICY

Fiscal policy, at all levels of government, has been and continues to be an important determinant of the pace of economic growth. Federal fiscal policy, taking into account both discretionary actions and so-called automatic stabilizers, was, on net, quite expansionary during the recession and early in the recovery. However, a substantial part of this impetus was offset by spending cuts and tax increases by state and local governments, most of which are subject to balanced-budget requirements, and by subsequent fiscal tightening at the federal level. Notably, over the past four years, state and local governments have cut civilian government employment by roughly 700,000 jobs, and total government employment has fallen by more than 800,000 jobs over the same period. For comparison, over the four years following the trough of the 2001 recession, total government employment rose by more than 500,000 jobs.

Most recently, the strengthening economy has improved the budgetary outlooks of most state and local governments, leading them to reduce their pace of fiscal tightening. At the same time, though, fiscal policy at the federal level has become significantly more restrictive. In particular, the expiration of the payroll tax cut, the enactment of tax increases, the effects of the budget caps on discretionary spending, the onset of the sequestration, and the declines in defense spending for overseas military operations are expected, collectively, to exert a substantial drag on the economy this year. The Congressional Budget Office (CBO) estimates that the deficit reduction policies in current law will slow the pace of real GDP growth by about 1½ percentage points during 2013, relative to what it would have been otherwise.[1] In present circumstances, with short-term interest rates already close to zero, monetary policy does not have the capacity to fully offset an economic headwind of this magnitude.

Although near-term fiscal restraint has increased, much less has been done to address the federal government's longer-term fiscal imbalances. Indeed, the CBO projects that, under current policies, the federal deficit and debt as a percentage of GDP will begin rising again in the latter part of this decade and move sharply upward thereafter, in large part reflecting the aging of our society and projected increases in health-care costs, along with mounting debt service payments. To promote economic growth and stability in the longer term, it will be essential for fiscal policymakers to put the federal budget on a sustainable long-run path. Importantly, the objectives of effectively addressing longer-term fiscal imbalances and of minimizing the near-term fiscal headwinds facing the economic recovery are not incompatible. To achieve both goals simultaneously, the Congress and the Administration could consider replacing some of the near-term fiscal restraint now in law with policies that reduce the federal deficit more gradually in the near term but more substantially in the longer run.

[1] See Congressional Budget Office (2013), The Budget and Economic Outlook: Fiscal Years 2013 to 2023 (Washington: CBO, February), available at www.cbo.gov/publication/43907.

MONETARY POLICY

With unemployment well above normal levels and inflation subdued, fostering our congressionally mandated objectives of maximum employment and price stability requires a highly accommodative monetary policy. Normally, the Committee would provide policy accommodation by reducing its target for the federal funds rate, thus putting downward pressure on interest rates generally. However, the federal funds rate and other short-term money market rates have been close to zero since late 2008, so the Committee has had to use other policy tools.

The first of these alternative tools is "forward guidance" about the FOMC's likely future target for the federal funds rate. Since December, the Committee's postmeeting statement has indicated that its current target range for the federal funds rate, 0 to ¼ percent, will be appropriate "at least as long as the unemployment rate remains above 6½ percent, inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal, and longer-term inflation expectations continue to be well anchored." This guidance underscores the Committee's intention to maintain highly accommodative monetary policy as long as needed to support continued progress toward maximum employment and price stability.

The second policy tool now in use is large-scale purchases of longer-term Treasury securities and agency mortgage-backed securities (MBS). These purchases put downward pressure on longer-term interest rates, including mortgage rates. For some months, the FOMC has been buying longer-term Treasury securities at a pace of $45 billion per month and agency MBS at a pace of $40 billion per month. The Committee has said that it will continue its securities purchases until the outlook for the labor market has improved substantially in a context of price stability. The Committee also has stated that in determining the size, pace, and composition of its asset purchases, it will take appropriate account of the likely efficacy and costs of such purchases as well as the extent of progress toward its economic objectives.

At its most recent meeting, the Committee made clear that it is prepared to increase or reduce the pace of its asset purchases to ensure that the stance of monetary policy remains appropriate as the outlook for the labor market or inflation changes. Accordingly, in considering whether a recalibration of the pace of its purchases is warranted, the Committee will continue to assess the degree of progress made toward its objectives in light of incoming information. The Committee also reiterated, consistent with its forward guidance regarding the federal funds rate, that it expects a highly accommodative stance of monetary policy to remain appropriate for a considerable time after the asset purchase program ends and the economic recovery strengthens.

In the current economic environment, monetary policy is providing significant benefits. Low real interest rates have helped support spending on durable goods, such as automobiles, and also contributed significantly to the recovery in housing sales, construction, and prices. Higher prices of houses and other assets, in turn, have increased household wealth and consumer confidence, spurring consumer spending and contributing to gains in production and employment. Importantly, accommodative monetary policy has also helped to offset incipient deflationary pressures and kept inflation from falling even further below the Committee's 2 percent longer-run objective.

That said, the Committee is aware that a long period of low interest rates has costs and risks. For example, even as low interest rates have helped create jobs and supported the prices of homes and other assets, savers who rely on interest income from savings accounts or government bonds are receiving very low returns. Another cost, one that we take very seriously, is the possibility that very low interest rates, if maintained too long, could undermine financial stability. For example, investors or portfolio managers dissatisfied with low returns may "reach for yield" by taking on more credit risk, duration risk, or leverage. The Federal Reserve is working to address financial stability concerns through increased monitoring, a more systemic approach to supervising financial firms, and the ongoing implementation of reforms to make the financial system more resilient.

Recognizing the drawbacks of persistently low rates, the FOMC actively seeks economic conditions consistent with sustainably higher interest rates. Unfortunately, withdrawing policy accommodation at this juncture would be highly unlikely to produce such conditions. A premature tightening of monetary policy could lead interest rates to rise temporarily but would also carry a substantial risk of slowing or ending the economic recovery and causing inflation to fall further. Such outcomes tend to be associated with extended periods of lower, not higher, interest rates, as well as poor returns on other assets. Moreover, renewed economic weakness would pose its own risks to financial stability.

Because only a healthy economy can deliver sustainably high real rates of return to savers and investors, the best way to achieve higher returns in the medium term and beyond is for the Federal Reserve—consistent with its congressional mandate—to provide policy accommodation as needed to foster maximum employment and price stability. Of course, we will do so with due regard for the efficacy and costs of our policy actions and in a way that is responsive to the evolution of the economic outlook.

QUESTIONS FOR THE HONORABLE BEN BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM FROM SENATOR DANIEL COATS (R–INDIANA)

1. Chairman Bernanke, I want to follow up with you concerning the Federal Reserve's plans with regard to adopting Basel III capital rules for the insurance sector, an action that I believe could lead to unintended results. Specifically, as you know, concerns have been expressed over the fact that those capital rules are not an appropriate fit for insurance companies.

Are you at the Fed able to appropriately tailor capital standards for insurers, and in so doing utilize the long-established state risk-based capital regime designed for the insurance business model?

Do you believe federal regulators fully understand the impact Basel III capital rules would have on insurance companies, consumers of insurance products, and our economy? I strongly urge the Federal Reserve to consider those impacts through a thorough Quantitative Impact Study. Basel III has been developed over the years for the bank model, not for insurers. Insurance consumers—and our economy—deserve no less than a full and public understanding of the impact these bank-like capital rules would have on the life insurance industry prior to finalization of the Basel III rule.

Section 171 of the Dodd-Frank Act, by its terms, requires the appropriate Federal banking agencies to establish minimum capital requirements for bank holding companies (BHCs) and savings and loan holding companies (SLHCs) that "shall not be less than" "nor quantitatively lower than" the generally applicable capital requirements for insured depository institutions. Section 171 does not contain an exception from these requirements for an insurance company that is a BHC or an SLHC, or for a BHC or an SLHC that controls an insurance company.

To allow the Board an additional opportunity to consider prudent approaches to establish capital requirements for SLHCs that engage substantially in insurance activities within the requirements of the terms of section 171, the Board, on July 2, 2013, determined to defer application of the new Basel III capital framework to SLHCs with significant insurance activities (i.e., those with more than 25 percent of their assets derived from insurance underwriting activities other than credit insurance) and to SLHCs that are themselves state regulated insurance companies. After considering the concerns raised by commenters regarding the proposed application of the proposed regulatory capital rules to SLHCs with significant insurance activities, the Board concluded that it would be appropriate to take additional time to evaluate the appropriate capital requirements for these companies in light of their business models and risks. Among other issues, commenters argued that the final capital rules should take into account insurance company liabilities and asset-liability matching practices, the risks associated with separate accounts, the interaction of consolidated capital requirements with the capital requirements of state insurance regulators, and differences in accounting practices for banks and insurance companies. The Board is carefully considering these issues in determining how to move forward in developing a capital framework for these SLHCs, consistent with section 171 of the Dodd-Frank Act.

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