THE STATE OF THE U.S. ECONOMY

HEARING

BEFORE THE

COMMITTEE ON THE BUDGET
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, FEBRUARY 9, 2011

Serial No. 112–2

Printed for the use of the Committee on the Budget

Available on the Internet:
http://www.gpoaccess.gov/congress/house/budget/index.html

U.S. GOVERNMENT PRINTING OFFICE

64–726 PDF WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
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THE STATE OF THE U.S. ECONOMY

WEDNESDAY, FEBRUARY 9, 2011

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

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

Members present: Representatives Ryan, Garrett, Campbell, Akin, Cole, Price, McClintock, Chaffetz, Stutzman, Lankford, Black, Ribble, Flores, Mulvaney, Huelskamp, Young, Amash, Rokita, Guinta, Woodall, Van Hollen, Schwartz, Kaptur, Doggett, Blumenauer, McCollum, Yarmouth, Pascrell, Honda, Ryan of Ohio, Wasserman Schultz, Moore, Castor, Shuler, Tonko, Bass

Chairman RYAN. Before we begin I want to welcome Representative Rob Woodall from Georgia, to the House Budget Committee. We have a number of caucus and conferences ending right now, so a number of members are going to be coming in. But Mr. Woodall will be officially on board this afternoon with the adoption of the House Resolution. I ask unanimous consent that Representative Woodall be permitted to participate in this morning's important hearing. He is our new Rules Committee Member. Without objection, it shall be done.

Thank you, Chairman Bernanke, for coming to our committee today to talk about the state of our economy. The U.S. economy continues to suffer from slow growth, and unemployment remains unacceptably high. Continued uncertainty about our economic future is hindering job creation today. Washington is creating much of this uncertainty. All one has to do is go home and talk to a businessman, a businesswoman, and that is exactly what you will hear. The explosive growth in our federal debt is by far the biggest source of this uncertainty. By sowing doubt about future taxes, interest rates, and price stability, government is hindering business' ability to plan and invest, creating a drag on economic growth today.

The purpose of today's hearing is to discuss the fiscal and monetary policies that have led us here. On the fiscal side, CBO projects a $1.5 trillion deficit this year with publicly held debt raising to 69 percent of GDP by the end of the year: that is up from 40 percent in 2008. In a few short years, the CBO projects government spending to drive our debt to crisis levels, overwhelming the entire economy and drowning the next generation in red ink. Endless borrowing is not a strategy. We must restore the foundations of economic growth: low taxes, spending restraint, reasonable regulations, and sound money. To help restart the engines of economic growth and job creation, that is so essential. We must not neglect the sound money part of the equation.

The Federal Reserve is undertaking another round of quantitative easing, purchasing Treasury bonds in an attempt to lower borrowing costs and stimulate the economy. My concern is that the cost of the Fed's current monetary policy, the money creation and massive balance sheet expansion, will come to outweigh the perceived short-term benefits. I hope that is not the case. These costs may come in the form of asset bubble and price pressures. We are already witnessing a sharp rise in a variety of key global commodity and basic material prices, and we know that some producers and manufacturers here in the United States are starting to feel the cost pressure as a result.

According to the Core Price Indexes the Fed closely watches, these cost pressures have not been yet passed along to consumers, but the inflation dynamic can be quick to materialize and painful to eradicate once it takes hold. The steepening of the yield curve this week adds to these concerns and fuels some of this speculation.

I'm concerned that normalizing monetary policy, when the time comes, may be difficult, not only for the pure technical challenges of shrinking the Fed's substantial balance sheet or correctly judging economic turning points, but also for political reasons. It's hard to overstate the consequences of getting this wrong. The dollar is the world's reserve currency and this has given us tremendous benefits in the global economy. For the sake of our economy in particular, and the global recovery as a whole, it is vital that we focus on dollar stability if we are to prevent the kind of beggar-thy-neighbor currency conflicts that can ultimately destroy a worldwide economic recovery. Our currency should provide a reliable store of value. It should be guided by the rule of law, not the rule of men. There is nothing more insidious that a country can do to its people than to debase its currency.

Chairman Bernanke, we know that you know this. We know that you are focused and concerned about this. The Fed's exit strategy and its future policy will determine how all of this ends. Many of us fear that our monetary policy is on a difficult track. We are very concerned about our fiscal policy here, and we know that it is on a very, very dangerous track, that is a very, very well-established fact.

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

Thank you for your indulgence, thank you for your time in coming here, we understand that you have to be out firm by about 12:30, so we will ask our members to stick within the time limit, and at this time I'd like to yield to our Ranking Member, Mr. Van Hollen.

[The statement of Mr. Ryan follows:]

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

Before we begin, I want to welcome Rep. Bob Woodall from Georgia to the House Budget Committee. He will be officially on board this afternoon after the adoption of the House resolution. I ask unanimous consent that Rep. Woodall be permitted to participate in this morning's important hearing. Without objection.

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

The U.S. economy continues to suffer from slow growth and unemployment remains unacceptably high.

Continued uncertainty about our economic future is hindering job creation today.

Washington is creating much of this uncertainty, and the explosive growth of our federal debt is by far the biggest source of this uncertainty.

By sowing doubt about future tax rates, interest rates, and price stability, government is hindering businesses' ability to plan and invest, creating a drag on economic growth today.

The purpose of today's hearing is to discuss the fiscal and monetary policies that have led us here.

On the fiscal side, the CBO projects a $1.5 trillion deficit this year with publicly-held debt rising to 69 percent of GDP by the end of the year—up from 40 percent at the end of 2008.

In a few short years, the CBO projects government spending to drive our debt to crisis levels, overwhelming the entire economy and drowning the next generation in red ink.

Endless borrowing is not a strategy. We must restore the foundations of economic growth—low taxes, spending restraint, reasonable regulations, and sound money—to help restart the engines of economic growth and job creation.

We must not neglect the "sound money" part of the equation. The Federal Reserve has undertaken another round of quantitative easing—purchasing Treasury bonds in an attempt to lower borrowing costs and stimulate the economy.

My concern is that the costs of the Fed's current monetary policy—the money creation and massive balance sheet expansion—will come to outweigh the perceived short-term benefits.

These costs may come in the form of asset bubbles and price pressures. We are already witnessing a sharp rise in a variety of key global commodity and basic material prices, and we know that some producers and manufacturers here in the United States are starting to feel cost pressures as a result.

According to the core price indexes that the Fed watches closely, these cost pressures have not yet been passed along to consumers—but the inflation dynamic can be quick to materialize and painful to eradicate once it takes hold. The steepening of the yield curve this week certainly adds to these worries.

I'm concerned that normalizing monetary policy when the time comes may be difficult—not only for the pure technical challenges of shrinking the Fed's substantial balance sheet or correctly judging economic turning points, but also for political reasons.

It is hard to overstate the consequences of getting this wrong. The dollar is the world's reserve currency and this has given us tremendous benefits.

For the sake of our economy in particular and the global recovery as a whole, it is vital that we focus on dollar stability if we are to prevent the kind of beggar-thy-neighbor currency conflicts that can destroy economic recoveries.

Our currency should provide a reliable store of value—it should be guided by the rule of law, not the rule of men.

There is nothing more insidious that a country can do to its citizens than debase its currency.

Chairman Bernanke: We know you know this. The Fed's exit strategy and future policy—it will determine how this ends.

We know you are concerned about this nation's fiscal trajectory. We have asked you to come here today because our fiscal policy is on a dangerous track. That is well established.

But, many of us fear our monetary policy is on a similar track as well.

I firmly believe that a course correction here in Washington is sorely needed to help get us back on the right track. While it won't be easy, Americans have risen to greater challenges and prevailed in the past.Thank you for your indulgence and at this time, I would like to yield to the Ranking Member, Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you very much, Chairman Ryan, and welcome, Chairman Bernanke. I want to thank you for your service to our country during a period of great economic turmoil. And I think we have been fortunate as a nation to have a student of the Great Depression to help us avoid a second Great Depression.

When you appeared before this committee two years ago, President Obama had just recently been sworn in. He inherited a terrible situation: the economy was in free-fall, spiraling downward at a negative growth rate of six percent; Americans were losing their jobs at the rate of 700,000 every month.

Two years later, things have improved substantially. The economy grew at an annual rate of 3.2 percent in the last quarter, and more than 1.3 million private sector jobs have been created since the start of 2010. As you indicated in testimony before this committee last year, the measures taken by the Federal Reserve, the TARP solicitation by the Bush Administration, and the Recovery Act by the Obama Administration, averted, and I quote, "An extraordinarily severe downturn, perhaps a great depression."

But we know that, while the economy has improved, millions of Americans are still out of work, and the unemployment rate, while coming down slightly, remains stubbornly and unacceptably high. We must use all the tools at our disposal to help businesses put people back to work, and I hope at some point this Congress, through its legislative agenda, will stop re-litigating Health Care Reform and start focusing on jobs. I commend you and your colleagues at the Fed for using various forms of monetary policy to promote maximum employment and stable prices.

I find it astounding that at a time when millions of Americans are out of work, some of our Republican colleagues have introduced legislation to strip the Federal Reserve of that part of its mandate that focuses on full employment and putting people back to work.

Obviously the Fed must not waver in its commitment to price stability, but to deprive you of the tools necessary to grow the economy would be a huge mistake. People need to pay attention to these proposals, and people need to know, at a time when millions of Americans are out of work, some are proposing that the Fed ignore the unemployment rate part of its mandate. That would be taking us backwards, not forwards, on a jobs agenda.

I also commend you for speaking out about the need to put our country on a fiscally sustainable path. The President's bipartisan Fiscal Commission and the Bipartisan Rivlin-Domenici Commission have demonstrated that such plans are difficult, but achievable. In his State of the Union Address, the President indicated that his budget would include cuts of $400 billion in non-security discretionary spending as a down-payment on that effort. Clearly, other measures must be taken, including, I believe, comprehensive tax reform.

But both bipartisan commissions also indicated that it would be a big mistake to put our fragile recovery at risk by slashing outlays too early in the short-term when millions of Americans are still out of work, and the demand for goods and services is still relatively weak. That commission indicated, and I quote, "In order to avoid shocking the fragile economy, the commission recommends waiting until 2012 to begin enacting programmatic spending cuts." The Rivlin-Domenici Commission gave us the same advice.

Mr. Bernanke, this Congress will have to make difficult decisions to put our nation on a fiscally sustainable path. We must make those decisions in a responsible manner. One upcoming decision involves dealing with the nation's debt ceiling. Nobody in this Congress should be playing political games when it comes to the full faith and credit of the United States. As Speaker Boehner observed recently, the debt ceiling vote requires an "adult moment."

Chairman Bernanke, you stated last week that the implications of not raising the debt limit would be "catastrophic" for our financial system and our economy. You urged the Congress, and I quote, Not to focus on the debt limit as being a bargaining chip in this discussion, unquote. I hope our colleagues heed your advice and don't engage in reckless conduct that puts the entire economy at risk. I have been surprised by the number of proposals put forward by some in the House and the Senate that would not only jeopardize the credit-worthiness of the United States, but would extend the full faith and credit of the United States Government to China and other foreign countries, but not to American businesses and our servicemen and women.

Let's not gamble with the full faith and credit of our nation; that would be a recipe for financial and economic chaos and would destroy any hope of putting Americans back to work. Thank you, Mr. Chairman, and thank you, Chairman Bernanke.

[The statement of Mr. Van Hollen follows:]

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

Thank you Chairman Ryan and welcome Chairman Bernanke.

Thank you, Chairman Bernanke, for your service to our country during a time of great economic turmoil. We have been fortunate to have a student of the Great Depression at the helm of the Federal Reserve to help prevent a second great depression.

When you appeared before this Committee two years ago, President Obama had just recently been sworn in. He inherited a terrible situation. The economy was in freefall, spiraling downwards at a negative growth rate of 6 percent. Americans were losing jobs at the rate of over 700,000 every month. Two years later, things have improved substantially. The economy grew at an annual rate of 3.2 percent last quarter and more than 1.3 million private sector jobs have been created since the start of 2010.

As you indicated in testimony last year before this Committee, the measures taken by the Federal Reserve, the TARP solicitation by the Bush Administration, and the Recovery Act by the Obama Administration, averted 'an extraordinarily severe downturn, perhaps a great depression.'

But while the economy has improved, millions of Americans are still out of work and the unemployment rate—while coming down—remains stubbornly high. We must use all the tools at our disposal to help businesses put people back to work. I hope at some point this new Congress will stop re-litigating the health reform law and start focusing on jobs.

I commend you and your colleagues at the Fed for using various forms of monetary policy to promote maximum employment and stable prices. I find it astounding that, at a time that millions of Americans are out of work, a number of our Republican colleagues have introduced legislation to strip the Federal Reserve of that part of its mandate that focuses on full employment and putting people back to work. Obviously, the Fed must not waver in its commitment to price stability, but to deprive you of the tools necessary to grow the economy would be a huge mistake. People need to pay attention to these proposals. The American people need to know that, at a time that millions of Americans are out of work, these proposals say that Fed policies should ignore the unemployment rate. That would be going backwards, not forwards, on a jobs agenda.

I also commend you, Chairman Bernanke, for speaking out about the need to put our country on a fiscally sustainable path. We must put in place a responsible plan to bring down and then eliminate the primary budget deficit. The President's Bipartisan Fiscal Commission and the bipartisan Rivlin-Domenici Commission have demonstrated that such plans are difficult but achievable. In his State of the Union address, the President indicated that his budget would include cuts of $400 billion in non-security discretionary spending as a down payment on that effort. Clearly, other measures must also be taken, including comprehensive tax reform. But both bipartisan commissions also indicated that it would be a big mistake to put our fragile economic recovery at risk by slashing outlays too deeply in the short-term when millions of Americans are still out of work and the demand for goods and services remains weak. The President's Bipartisan Commission stated that 'in order to avoid shocking the fragile economy, the Commission recommends waiting until 2012 to begin enacting programmatic spending cuts.' The Rivlin-Domenici Commission rendered the same advice. Deep cuts now will not create a single job; in fact, Mark Zandi and other economists have indicated that they will put thousands of American jobs at risk.

I am also pleased that your testimony today calls upon the Congress to promote research and development, provide necessary public infrastructure, and invest in the skills of our workforce. Some of our Republican colleagues have tried to make 'investment' a dirty word, but, as you indicate, such investments can help build a more productive economy.

This Congress will have to make difficult decisions to put our nation on a fiscally sustainable path. We must make those decisions in a responsible manner. One upcoming decision involves dealing with the nation's debt ceiling. Nobody in this Congress should be playing political games when it comes to the full faith and credit of the United States. As Speaker Boehner observed recently, the debt ceiling vote requires an 'adult moment.' Chairman Bernanke, you stated last week that the implications of not raising the debt limit would be 'catastrophic' for our financial system and our economy. You urged the Congress 'not to focus on the debt limit as being the bargaining chip in this discussion.' I hope our colleagues heed your advice and don't engage in reckless conduct that puts the entire economy at risk. I have been amazed at a number of proposals put forward by Republicans in the Senate and the House that would not only jeopardize the creditworthiness of the United State, but would extend the full faith and credit of the United States government to China and other foreign governments, but not to American businesses and our service men and women. Let's not gamble with the full faith and credit of our nation. That is a recipe for financial and economic chaos that would destroy any hope of putting America back to work.

Chairman Bernanke, I look forward to your testimony of these and other pressing issues.

Chairman RYAN. Chairman Bernanke.

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

Mr. BERNANKE. Thank you very much. Chairman Ryan, Ranking Member Van Hollen, and other members of the Committee, thank you for inviting me. I am pleased to have this opportunity to offer my views on the economic outlook, on monetary policy, and on issues pertaining to the federal budget.

The economic recovery that began in the middle of 2009 appears to have strengthened in the past few months, although the unemployment rate remains high. The initial phase of the recovery, which occurred in the second half of 2009 and in early 2010, was in large part attributable to the stabilization of the financial system, the effects of expansionary monetary and fiscal policies, and the strong boost to production from businesses rebuilding their depleted inventories.

But economic growth slowed significantly last spring, and concerns about the durability of the recovery intensified as the impetus from inventory building and fiscal stimulus diminished, and as Europe's fiscal and banking problems roiled global financial markets. More recently, however, we have seen increased evidence that a self-sustaining recovery in consumer and business spending may be taking hold. Notably, real consumer spending rose at an annual rate of more than four percent in the fourth quarter. Although strong sales of motor vehicles accounted for a significant portion of this pick-up, the recent gains in consumer spending appear reasonably broad-based.

Business investment in new equipment and software increased robustly throughout much of last year, as firms replaced aging equipment and as the demand for their products and services expanded. Construction remains weak, though, reflecting an overhang of vacant and foreclosed homes, and continued poor fundamentals from most types of commercial real estate.

Overall, improving household and business confidence, accommodative monetary policy, and more supportive financial conditions, including an apparently increasing willingness of banks to lend, seem likely to result in a more rapid pace of economic recovery in 2011 than we saw last year.

While indicators of spending and production have been encouraging on balance, the job market has improved only slowly. Following the loss of about eight and three-quarter million jobs from 2008 through 2009, private sector employment expanded by little more than one million in 2010. However, this gain was barely sufficient to accommodate the inflow of recent graduates and other new entrants to the labor force, and therefore not enough to significantly erode the wide margin of slack that remains in the labor market.

Notable declines in the unemployment rate in December and January, together with improvement in indicators of job openings and firms' hiring plans, do provide some grounds for optimism on the employment front. Even so, with output growth likely to be moderate for a while, and with employers reportedly still reluctant to add to payrolls, it will be several years before the unemployment rate has returned to a more normal level. Until we see a sustained period of stronger job creation, we cannot consider the recovery to be truly established.

On the inflation front, we have recently seen increases in some highly visible prices, notably gasoline. Indeed, prices of many industrial and agricultural commodities have risen lately, largely as a result of the very strong demand from fast-growing emerging market economies, coupled in some cases with constraints on supply. Nonetheless, overall inflation is still quite low, and longer-term inflation expectations have remained stable. Over the 12 months ending in December, prices for all the goods and services consumed by households increased by only 1.2 percent, down from 2.4 percent over the previous 12 months.

To assess underlying trends in inflation economists also follow several alternative measures of inflation. One such measure is so-called core inflation, which excludes the more volatile food and energy components, and therefore can be a better predictor of where overall inflation is headed. Core inflation was only 0.7 percent in 2010, compared with about two and a half percent in 2007, the year before the recession began. Wage growth has slowed as well, with average hourly earnings increasing only 1.7 percent last year. These downward trends in wage and price inflation are not surprising given the substantial slack in the economy.

Although the growth rate of economic activity appears likely to pick up this year, the unemployment rate probably will remain elevated for some time. In addition, inflation is expected to persist below the levels that the Federal Reserve policy makers have judged to be consistent over the longer term with our statutory mandate to foster maximum employment and price stability. Under such conditions, the Federal Reserve would typically ease monetary policy by reducing its target for the Federal Funds Rate; however, the target range for the Federal Funds rate has been near zero since December 2008, leaving essentially no room for further reductions. As a consequence, since then we have been using alternative tools to provide additional monetary accommodation. In particular, over the past two years, the Federal Reserve has further eased monetary conditions by purchasing longer-term securities, specifically Treasury Agency and agency mortgage-backed securities on the open market. These purchases are settled through the banking system, with the result that depository institutions now hold a very high level of reserve balances with the Federal Reserve.

Although large-scale purchases of longer-term securities are a different monetary policy tool than the more familiar approach of targeting the Federal Funds Rate, the two types of policies affect the economy in similar ways. Conventional monetary policy easing works by lowering market expectations for the future path of short-term interest rates, which in turn reduces the current level of longer-term interest rates and contributes to an easing in broader financial conditions. These changes, by reducing borrowing costs and raising asset prices, bolster household and business spending and thus increase economic activity.

By comparison, the Federal Reserve's purchases of longer-term securities do not affect very short-term interest rates, which remain close to zero, but instead put downward pressure directly on longer-term interest rates. By easing conditions in credit and financial markets, these actions encourage spending by households and businesses through essentially the same channels as conventional monetary policy, thereby strengthening the economic recovery.

Indeed a wide range of market indicators suggest that the Federal Reserve securities purchases have been effective at easing financial conditions, lending credence to the view that these actions are providing significant support to job creation and economic growth.

My colleagues and I have said that we will review the asset purchase program regularly in light of incoming information and will adjust it as needed to promote maximum employment and stable prices. In particular, we remain unwaveringly committed to price stability, and we are confident that we have the tools to be able to smoothly and effectively exit from the current, highly accommodative policy stance at the appropriate time.

Our ability to pay interest on reserve balances held at Federal Reserve Banks will allow us to put upward pressure on short-term market rates, and thus to tighten monetary policy when needed, even if bank reserves remain high. Moreover, we have developed additional tools that will allow us to drain or immobilize bank reserves as needed to facilitate the smooth withdrawal of policy accommodation when conditions warrant. If necessary, we could also tighten policy by redeeming or selling securities.

As I am appearing before the Budget Committee, it is worth emphasizing that the Fed's purchases of longer-term securities are not comparable to ordinary government spending. In executing these transactions, the Federal Reserve acquires financial assets, not goods and services; thus these purchases do not add to the government's deficit or debt. Ultimately at the appropriate time, the Federal Reserve will normalize its balance sheet by selling these assets back into the market or allowing them to run off. In the interim, the interest that the Federal Reserve earns through its securities holdings adds to the Fed's remittances to the Treasury. In 2009 and 2010, those remittances totaled about $125 billion.

Fiscal policymakers also face significant challenges. Our nation's fiscal position has deteriorated appreciatively since the onset of the financial crisis and the recession. To a significant extent, this deterioration is the result of the effects of the weak economy on revenues and outlays, along with the actions that the administration and the Congress took to ease the recession and steady financial markets. However, even after economic and financial conditions return to normal, the federal budget will remain on an unsustainable path, with the budget gap becoming increasingly large over time unless the Congress enacts significant changes in fiscal programs.

For example, under plausible assumptions about how fiscal policies might evolve in the absence of major legislative changes, the CBO projects the deficit to fall from its current level of about nine percent of GDP to five percent of GDP by 2015, but then to rise to about six and a half percent of GDP by the end of the decade. In subsequent years, the budget situation is projected to deteriorate even more rapidly, with federal debt held by the public reaching almost 90 percent of GDP by 2020 and 150 percent by 2030, up from about 60 percent at the end of fiscal year 2010.

The long-term fiscal challenges confronting the nation are especially daunting because they are mostly the product of powerful underlying trends, not short-term or temporary factors. The two most important driving forces behind the budget deficit are the aging of the population and rapidly rising health care costs. Indeed the CBO projects that federal health spending will roughly double as a percentage of GDP over the next 25 years. The ability to control health care spending while still providing high quality care to those who need it will be critical for bringing the federal budget onto a sustainable path.

The CBO's long-term budget projections, by design, do not account for the likely adverse economic effects of such high debt and deficits, but if government debt and deficits were actually to grow at the pace envisioned, the economic and financial effects would be severe. Sustained high rates of government borrowing would both drain funds away from private investment and increase our debt to foreigners, with adverse long-run effects on U.S. output, incomes, and standards of living.

Moreover, diminishing investor confidence that deficits will be brought under control will ultimately lead to sharply rising interest rates and government debt and, potentially, to broader financial turmoil. In a vicious circle, high and rising interest rates would cause debt service payments and the federal debt to grow even faster, resulting in further increases in the debt-to-GDP ratio, and making fiscal adjustment all the more difficult.

In thinking about achieving fiscal sustainability, it is useful to apply the concept of the primary budget deficit, which is the government budget deficit excluding interest payments on the national debt. To stabilize the ratio of federal debt to the GDP, a useful benchmark for assessing fiscal sustainability, the primary budget deficit must be reduced to zero. Under the CBO projection that I noted earlier, the primary budget deficit is expected to be two percent of GDP in 2015, and then rise to almost three percent of GDP in 2020, and six percent in 2030. These projections provide a gauge of the adjustments that will be necessary to attain fiscal sustainability.

To put the budget on a sustainable trajectory, policy actions, either reductions in spending, increases in revenues, or some combination of the two, will have to be taken to eventually close these primary budget gaps.

By definition, the unsustainable trajectories of deficits and debt that the CBO outlines cannot actually happen, because creditors would never be willing to lend to a government with debt relative to national income that is rising without limit. One way or the other, fiscal adjustments sufficient to stabilize the federal budget must occur at some point. The question is whether these adjustments will take place through a careful and deliberative process that weighs priorities and gives people adequate time to adjust to changes in government programs or tax policies, or whether the needed fiscal adjustments will come instead as a rapid and painful response to a looming or actual fiscal crisis.

Acting now to develop a credible program to reduce future deficits would not only enhance economic growth and stability in the long run, but could also yield substantial near-term benefits, in terms of lower long-term interest rates and increased consumer and business confidence.

Plans recently put forward by the President's National Commission on Fiscal Responsibility and Reform and other prominent groups provide useful starting points for a much needed national conversation. Although these proposals differ in many details, they demonstrate that realistic solutions to our fiscal problems do exist.

Of course, economic growth is affected not only by the levels of taxes and spending but also by their composition and structure. I hope that in addressing our long-term fiscal challenges, the Congress and the Administration will undertake reforms to the Government's tax policies and spending priorities that serve not only to reduce the deficit, but also to enhance the long-term growth potential of our economy: For example, by reducing disincentives to work and to save, by encouraging investment in the skills of our workforce as well as new machinery and equipment, by promoting research and development, and by providing necessary public infrastructure.

Our nation cannot reasonably expect to grow its way out of our fiscal imbalances, but a more productive economy will ease the trade-offs that we face.

Thank you, Mr. Chairman, Ranking Member. I'd be very pleased to take your questions.

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

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

Chairman Ryan, Ranking Member Van Hollen, and other members of the Committee, I am pleased to have this opportunity to offer my views on the economic outlook, monetary policy, and issues pertaining to the federal budget.

THE ECONOMIC OUTLOOK

The economic recovery that began in the middle of 2009 appears to have strengthened in the past few months, although the unemployment rate remains high. The initial phase of the recovery, which occurred in the second half of 2009 and in early 2010, was in large part attributable to the stabilization of the financial system, the effects of expansionary monetary and fiscal policies, and the strong boost to production from businesses rebuilding their depleted inventories. But economic growth slowed significantly last spring and concerns about the durability of the recovery intensified as the impetus from inventory building and fiscal stimulus diminished and as Europe's fiscal and banking problems roiled global financial markets.

More recently, however, we have seen increased evidence that a self-sustaining recovery in consumer and business spending may be taking hold. Notably, real consumer spending rose at an annual rate of more than 4 percent in the fourth quarter. Although strong sales of motor vehicles accounted for a significant portion of this pickup, the recent gains in consumer spending appear reasonably broad based. Business investment in new equipment and software increased robustly throughout much of last year, as firms replaced aging equipment and as the demand for their products and services expanded. Construction remains weak, though, reflecting an overhang of vacant and foreclosed homes and continued poor fundamentals for most types of commercial real estate. Overall, improving household and business confidence, accommodative monetary policy, and more-supportive financial conditions, including an apparently increasing willingness of banks to lend, seem likely to result in a more rapid pace of economic recovery in 2011 than we saw last year.

While indicators of spending and production have been encouraging on balance, the job market has improved only slowly. Following the loss of about 8¾ million jobs from 2008 through 2009, private-sector employment expanded by a little more than 1 million in 2010. However, this gain was barely sufficient to accommodate the inflow of recent graduates and other new entrants to the labor force and, therefore, not enough to significantly erode the wide margin of slack that remains in our labor market. Notable declines in the unemployment rate in December and January, together with improvement in indicators of job openings and firms' hiring plans, do provide some grounds for optimism on the employment front. Even so, with output growth likely to be moderate for a while and with employers reportedly still reluctant to add to their payrolls, it will be several years before the unemployment rate has returned to a more normal level. Until we see a sustained period of stronger job creation, we cannot consider the recovery to be truly established.

On the inflation front, we have recently seen increases in some highly visible prices, notably for gasoline. Indeed, prices of many industrial and agricultural commodities have risen lately, largely as a result of the very strong demand from fast-growing emerging market economies, coupled, in some cases, with constraints on supply. Nonetheless, overall inflation is still quite low and longer-term inflation expectations have remained stable. Over the 12 months ending in December, prices for all the goods and services consumed by households (as measured by the price index for personal consumption expenditures) increased by only 1.2 percent, down from 2.4 percent over the prior 12 months. To assess underlying trends in inflation, economists also follow several alternative measures of inflation; one such measure is so-called core inflation, which excludes the more volatile food and energy components and therefore can be a better predictor of where overall inflation is headed. Core inflation was only 0.7 percent in 2010, compared with around 2½ percent in 2007, the year before the recession began. Wage growth has slowed as well, with average hourly earnings increasing only 1.7 percent last year. These downward trends in wage and price inflation are not surprising, given the substantial slack in the economy.

MONETARY POLICY

Although the growth rate of economic activity appears likely to pick up this year, the unemployment rate probably will remain elevated for some time. In addition, inflation is expected to persist below the levels that Federal Reserve policymakers have judged to be consistent over the longer term with our statutory mandate to foster maximum employment and price stability. Under such conditions, the Federal

Reserve would typically ease monetary policy by reducing its target for the federal funds rate. However, the target range for the federal funds rate has been near zero since December 2008, leaving essentially no room for further reductions. As a consequence, since then we have been using alternative tools to provide additional monetary accommodation. In particular, over the past two years the Federal Reserve has further eased monetary conditions by purchasing longer-term securities—specifically, Treasury, agency, and agency mortgage-backed securities—on the open market. These purchases are settled through the banking system, with the result that depository institutions now hold a very high level of reserve balances with the Federal Reserve.

Although large-scale purchases of longer-term securities are a different monetary policy tool than the more familiar approach of targeting the federal funds rate, the two types of policies affect the economy in similar ways. Conventional monetary policy easing works by lowering market expectations for the future path of short-term interest rates, which, in turn, reduces the current level of longer-term interest rates and contributes to an easing in broader financial conditions. These changes, by reducing borrowing costs and raising asset prices, bolster household and business spending and thus increase economic activity. By comparison, the Federal Reserve's purchases of longer-term securities do not affect very short-term interest rates, which remain close to zero, but instead put downward pressure directly on longer-term interest rates. By easing conditions in credit and financial markets, these actions encourage spending by households and businesses through essentially the same channels as conventional monetary policy, thereby strengthening the economic recovery. Indeed, a wide range of market indicators suggest that the Federal Reserve's securities purchases have been effective at easing financial conditions, lending credence to the view that these actions are providing significant support to job creation and economic growth.market expectations for the future path of short-term interest rates, which, in turn, reduces the current level of longer-term interest rates and contributes to an easing in broader financial conditions. These changes, by reducing borrowing costs and raising asset prices, bolster household and business spending and thus increase economic activity. By comparison, the Federal Reserve's purchases of longer-term securities do not affect very short-term interest rates, which remain close to zero, but instead put downward pressure directly on longer-term interest rates. By easing conditions in credit and financial markets, these actions encourage spending by households and businesses through essentially the same channels as conventional monetary policy, thereby strengthening the economic recovery. Indeed, a wide range of market indicators suggest that the Federal Reserve's securities purchases have been effective at easing financial conditions, lending credence to the view that these actions are providing significant support to job creation and economic growth.market expectations for the future path of short-term interest rates, which, in turn, reduces the current level of longer-term interest rates and contributes to an easing in broader financial conditions. These changes, by reducing borrowing costs and raising asset prices, bolster household and business spending and thus increase economic activity. By comparison, the Federal Reserve's purchases of longer-term securities do not affect very short-term interest rates, which remain close to zero, but instead put downward pressure directly on longer-term interest rates. By easing conditions in credit and financial markets, these actions encourage spending by households and businesses through essentially the same channels as conventional monetary policy, thereby strengthening the economic recovery. Indeed, a wide range of market indicators suggest that the Federal Reserve's securities purchases have been effective at easing financial conditions, lending credence to the view that these actions are providing significant support to job creation and economic growth.[1]

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[1] For example, in August 2010 we announced our policy of reinvesting principal payments on agency debt and agency-guaranteed mortgage-backed securities in longer-term Treasury securities and signaled that we were considering additional purchases of longer-term Treasury securities. Since then, equity prices have risen significantly, volatility in the equity market has fallen, corporate bond spreads have narrowed, and inflation compensation as measured in the market for inflation-indexed securities has risen from low to more normal levels. Yields on 5- to 10-year Treasury securities initially declined markedly as markets priced in prospective Fed purchases; these yields subsequently rose, however, as investors became more optimistic about economic growth and as traders scaled back their expectations of future securities purchases. All of these developments are what one would expect to see when monetary policy becomes more accommodative, whether through conventional or less conventional means. Interestingly, these developments are also remarkably similar to those that occurred during the earlier episode of policy easing, notably in the months following our March 2009 announcement of a significant expansion in securities purchases.

My colleagues and I have said that we will review the asset purchase program regularly in light of incoming information and will adjust it as needed to promote maximum employment and stable prices. In particular, we remain unwaveringly committed to price stability, and we are confident that we have the tools to be able to smoothly and effectively exit from the current highly accommodative policy stance at the appropriate time. Our ability to pay interest on reserve balances held at the Federal Reserve Banks will allow us to put upward pressure on short-term market interest rates and thus to tighten monetary policy when needed, even if bank reserves remain high. Moreover, we have developed additional tools that will allow us to drain or immobilize bank reserves as needed to facilitate the smooth withdrawal of policy accommodation when conditions warrant. If necessary, we could also tighten policy by redeeming or selling securities.

As I am appearing before the Budget Committee, it is worth emphasizing that the Fed's purchases of longer-term securities are not comparable to ordinary government spending. In executing these transactions, the Federal Reserve acquires financial assets, not goods and services; thus, these purchases do not add to the government's deficit or debt. Ultimately, at the appropriate time, the Federal Reserve will normalize its balance sheet by selling these assets back into the market or by allowing them to run off. In the interim, the interest that the Federal Reserve earns from its securities holdings adds to the Fed's remittances to the Treasury; in 2009 and 2010, those remittances totaled about $125 billion.

FISCAL POLICY

Fiscal policymakers also face significant challenges. Our nation's fiscal position has deteriorated appreciably since the onset of the financial crisis and the recession. To a significant extent, this deterioration is the result of the effects of the weak economy on revenues and outlays, along with the actions that the Administration and the Congress took to ease the recession and steady financial markets. However, even after economic and financial conditions return to normal, the federal budget will remain on an unsustainable path, with the budget gap becoming increasingly large over time, unless the Congress enacts significant changes in fiscal programs.

For example, under plausible assumptions about how fiscal policies might evolve in the absence of major legislative changes, the Congressional Budget Office (CBO) projects the deficit to fall from its current level of about 9 percent of gross domestic product (GDP) to 5 percent of GDP by 2015, but then to rise to about 6½ percent of GDP by the end of the decade.[2] In subsequent years, the budget situation is projected to deteriorate even more rapidly, with federal debt held by the public reaching almost 90 percent of GDP by 2020 and 150 percent by 2030, up from about 60 percent at the end of fiscal year 2010.

The long-term fiscal challenges confronting the nation are especially daunting because they are mostly the product of powerful underlying trends, not short-term or temporary factors. The two most important driving forces behind the budget deficit are the aging of the population and rapidly rising health-care costs. Indeed, the CBO projects that federal spending for health-care programs will roughly double as a percentage of GDP over the next 25 years.[3] The ability to control health-care spending, while still providing high-quality care to those who need it, will be critical for bringing the federal budget onto a sustainable path.

The CBO's long-term budget projections, by design, do not account for the likely adverse economic effects of such high debt and deficits. But if government debt and deficits were actually to grow at the pace envisioned, the economic and financial effects would be severe. Sustained high rates of government borrowing would both drain funds away from private investment and increase our debt to foreigners, with adverse long-run effects on U.S. output, incomes, and standards of living. Moreover, diminishing investor confidence that deficits will be brought under control would ultimately lead to sharply rising interest rates on government debt and, potentially, to broader financial turmoil. In a vicious circle, high and rising interest rates would cause debt-service payments on the federal debt to grow even faster, resulting in further increases in the debt-to-GDP ratio and making fiscal adjustment all the more difficult.

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[2] This alternative fiscal policy scenario, which assumes, among other things, that most of the tax cuts enacted in 2001 and 2003 are made permanent and that discretionary fiscal outlays rise at the same rate as gross domestic product, is presented in Congressional Budget Office (2010), The Long-Term Budget Outlook (Washington: CBO, June (revised August)), available at *www.cbo.gov/doc.cfm?index=11579&zzz=40884.*

[3] See the two long-term scenarios for mandatory federal spending on health care shown in figure 2-3, p. 39, in CBO, The Long-Term Budget Outlook, in note 2.

In thinking about achieving fiscal sustainability, it is useful to apply the concept of the primary budget deficit, which is the government budget deficit excluding interest payments on the national debt. To stabilize the ratio of federal debt to the GDP—a useful benchmark for assessing fiscal sustainability—the primary budget deficit must be reduced to zero.[4] Under the CBO projection that I noted earlier, the primary budget deficit is expected to be 2 percent of GDP in 2015 and then rise to almost 3 percent of GDP in 2020 and 6 percent of GDP in 2030. These projections provide a gauge of the adjustments that will be necessary to attain fiscal sustainability. To put the budget on a sustainable trajectory, policy actions—either reductions in spending, increases in revenues, or some combination of the two—will have to be taken to eventually close these primary budget gaps.

By definition, the unsustainable trajectories of deficits and debt that the CBO outlines cannot actually happen, because creditors would never be willing to lend to a government with debt, relative to national income, that is rising without limit. One way or the other, fiscal adjustments sufficient to stabilize the federal budget must occur at some point. The question is whether these adjustments will take place through a careful and deliberative process that weighs priorities and gives people adequate time to adjust to changes in government programs or tax policies, or whether the needed fiscal adjustments will come as a rapid and painful response to a looming or actual fiscal crisis. Acting now to develop a credible program to reduce future deficits would not only enhance economic growth and stability in the long run, but could also yield substantial near-term benefits in terms of lower long-term interest rates and increased consumer and business confidence. Plans recently put forward by the President's National Commission on Fiscal Responsibility and Reform and other prominent groups provide useful starting points for a much-needed national conversation. Although these proposals differ on many details, they demonstrate that realistic solutions to our fiscal problems do exist.

Of course, economic growth is affected not only by the levels of taxes and spending, but also by their composition and structure. I hope that, in addressing our long-term fiscal challenges, the Congress and the Administration will undertake reforms to the government's tax policies and spending priorities that serve not only to reduce the deficit, but also to enhance the long-term growth potential of our economy—for example, by reducing disincentives to work and to save, by encouraging investment in the skills of our workforce as well as new machinery and equipment, by promoting research and development, and by providing necessary public infrastructure. Our nation cannot reasonably expect to grow its way out of our fiscal imbalances, but a more productive economy will ease the tradeoffs that we face.

Thank you. I would be pleased to take your questions.

Chairman RYAN. Thank you, Mr. Chairman. First, let me lead off with what you have concluded. Just to summarize, you do believe that one of the best things we can do for short-term economic growth is to put out a plan that actually stabilizes our fiscal picture, that actually gets our liabilities under control, and shows with confidence that we have a right trajectory because we've addressed the programs, which are the spending programs that are getting us out of control. Is that the case?

Mr. BERNANKE. That's correct.

Chairman RYAN. Okay. I want to talk to you about QE2. Last time you came to the Committee to testify, you said that QE2 is not an exercise in monetizing the debt. Now, the question basically is this. I understand from your perspective you can say that QE2 is not monetizing the debt because it is not causing runaway inflation because the money you are creating is not yet circulating in the broader economy, it is being held as excess bank reserves. But isn't this sort of a distinction without a difference? It seems to me that the argument here is that the intention of QE2 is what we ought to be focusing on, because the intention is to bring rates

[4] This result requires that the nominal rate of interest paid on government debt equals the rate of growth of nominal GDP, a condition that might plausibly be expected to hold over time. If the interest rate on government debt is higher than the growth rate of nominal GDP, as might happen if creditors become wary of lending, then a primary budget surplus rather than primary balance would be needed to stabilize the ratio of debt to GDP.

down to promote economic growth, and therefore the intention is what should matter here, but this is debt monetization, so isn't that really a distinction without a difference?

Mr. BERNANKE. No, sir. Monetization would involve a permanent increase in the money supply to basically pay the government's bills through money creation. What we are doing here is a temporary measure which will be reversed so that at the end of this process, the money supply will be normalized, the amount of the Fed's balance sheet will be normalized, and there will be no permanent increase, either in money outstanding, in the Fed's balance sheet, or in inflation.

Chairman RYAN. So if we get this wrong, and if credibility is diminished because of these moves, and if expectations form around price increases, then we do have a big interest rate problem. And if you look through our fiscal side of it, just raising interest rates under normal, average predictions would just be vicious to our balance sheet. The interest payments alone in the current budget window, which assumes extremely low interest rates for the decade, go from $200 billion this year to a trillion at the end of the budget window. If interest rates move up from their current projections, which I think long bonds are about four to five percent throughout the budget window, that is about one to anywhere from $6 trillion in extra interest payments. So basically, this is all based on confidence that what you are doing and saying will actually be done, and confidence and credibility is just critical in all of this.

What I'm trying to get at is, and just take a look at today's Wall Street Journal: Inflation Worries Spread. You've got, basically, inflation jitters spread through emerging markets. In Brazil, Latin America's largest economy, the government reported Tuesday that inflation is accelerating. You know, we've got inflation popping up in other parts of the world, after all, many countries peg their currencies to the U.S. dollar, and my basic question is, to what extent do you think the Fed's monetary policy stance has contributed to these global inflationary pressures? Has this contributed to the hot money flows abroad that have led to some of these global imbalances that are not fully appreciating when we examine the costs and benefits of your current QE2 monetary policy stance?

Mr. BERNANKE. Mr. Chairman, your first sentence under the headline was very revealing. The inflation is taking place in emerging markets because that is where the growth is, that is where the demand is, and that is where, in some cases, the economy is overheating. It's the responsibility of the emerging markets to set their monetary and exchange rate policies in a way that will keep their economies on a stable path. The increases in oil prices, for example, are entirely due, according to the International Energy Agency, to increases in demand coming from emerging markets; they are not coming from the United States. So the bulk of the increase in commodity crisis is a global phenomenon.

In the United States, inflation made here in the U.S. is very, very low. Now, of course, that is a serious problem, but monetary policy can't do anything about, for example, bad weather in Russia, or increases in demand for oil in Brazil and China. What we can do is try to get stable prices and growth here in the United States.

Chairman RYAN. So, as you look at some of the leading indicators: the yield curve, for instance, commodity prices, do those not send you a warning that inflation is building in America? Or are you still looking at core inflation as your main guidepost measuring whether or not our monetary policy is keeping prices in check? My basic question is, and my concern is, using your output gap model, my fear is that you are going to catch it before the cow is out of the barn. You are going to see inflation after it has already been launched. And given that you have a huge balance sheet, given that we are basically in uncharted territory with respect to the Great Recession and the responses that you put out there, that we are going to catch this after it is too late.

Could you please give us a sense of what else you are looking at to gauge inflation in America, other than core inflation, which, as you know, there's a big debate as to whether or not that is the proper tool we use or not. Even the ECB uses broader definitions of inflation. So where are you looking, outside of your core deflation, to give you a gauge as to how to set monetary policy to prevent inflation from actually getting unhinged here in America?

Mr. BERNANKE. Mr. Chairman, let me say first, that there be no doubt that we are unwaveringly committed to maintaining price stability; that is a very, very strong goal and objective, we will do so. In terms of what we are looking at, first of all, overall inflation, including food and energy is still very low, about one percent. But looking forward, you asked about credibility and the yield curve, if you look, for example, at inflation breakevens, which are a measure in the inflation index bond market of what the markets think inflation is going to be. The five year breakeven is about two percent, 2.1 percent last I looked. So there is not really any indication in our financial markets that in the United States there's an expectation of inflation.

That being said, we will look very carefully not only at output gaps and those things that you mention, but also at commodity prices, at interest rates, and all the other indicators that will help us assess when inflation is becoming a problem. It is always an issue, as you know, Mr. Chairman, that in the recovery period you have to pick the right moment to begin removing accommodation, taking away the punch bowl, and we, of course, face that problem, as the Central Bank always does, but we are committed to making sure that we do it at the right time.

Chairman RYAN. So when you see the steepening of the yield curve that has taken place recently, do you see that as market participants showing some concerns about future inflation, or do you see that as signs that an economic recovery is beginning to take root?

Mr. BERNANKE. The inflation breakevens have risen since we began the QE2 program in August, but they have moved from very low levels to about normal levels. The bulk of the increase in interest rates has been, in the real side of the interest rate, which means that, like the stock market, the bond market is expecting greater future growth and is more optimistic about the U.S. economy, and I think that is a good thing, obviously, and I think our policies have contributed to that.

Chairman RYAN. So we obviously have a bigger punch bowl than we normally have in these times, and if we were in a cyclical situation, I don't think concerns would be as great as they are right now. But I think part of our problem, as you mentioned, on the fiscal policy side, is structural. We have a tidal wave of debt we are running into. If interest rates begin to leave the current projections, we have a serious problem on our hands. And it just gets to a vicious cycle, like you have described.

The punch bowl, your asset, your balance sheets: Have you done a stress test on the Fed's balance sheet assets as an exit strategy occurs with higher interest rates that perhaps result from what has been going on? So, have you done a stress test on your balance sheet? And what level of losses do you think are acceptable as you withdraw?

Mr. BERNANKE. We have done multiple stress tests. Under most likely scenarios, the fiscal implications of the balance sheet are positive. We've already turned in, in the last two years, $125 billion to the Treasury, and given our low level of cost, our low cost of financing, under most plausible scenarios this policy will continue to be profitable. Of course, that is not the main objective of it; the objective is to strengthen the economy.

If short-term interest rates were to rise exceptionally high, much more than we anticipate, then it could be that the remittances to the Treasury would go down for a time, but in that case, it would probably also be the case that the economy was much stronger than expected, and tax revenues would more than compensate for that loss. So our sense is that the net expectation from a fiscal side is that this will actually be constructive and reduce the federal deficit.

Chairman RYAN. I'd go on for a long time, but I want to be fair to my colleagues. Mr. Van Hollen.

Mr. VAN HOLLEN. Thank you, Mr. Chairman, and again, Chairman Bernanke, thank you for your testimony. Now, obviously the United States as part of a global marketplace, but your job, your mandate at the Fed is to watch out for the American economy, is that right?

Mr. BERNANKE. Yes, sir.

Mr. VAN HOLLEN. And your testimony, as I understand it, is that you are vigilant about looking out for inflation pressures but your assessment right now is that we do not have an inflation problem in the United States, is that correct?

Mr. BERNANKE. We do not now have a problem, but I do want to repeat that we are extremely vigilant, we will be very careful to make sure that we don't wait too long.

Mr. VAN HOLLEN. Right. And your policy known as QE2, you had QE1, and QE2 was referenced, by your assessment how many American jobs has that saved or created?

Mr. BERNANKE. It is obviously very difficult to know precisely. There have been a number of studies which have tried to assess, using macroeconomic models and so on. A very careful study done by Federal Reserve System economists suggests that the total job impact of all of the QE programs, including QE1, including the reinvestment, including QE2, could be up to three million jobs. It could be less, it could be more, but the important thing to understand is that it is not insignificant; it is an important contribution to growth and to job creation. And we are in a situation where we have almost half of the unemployed being out of work for more than six months. And the longer that people stay out of work, the more difficult it is going to be for them to come back and rejoin the labor force at a decent wage, and to return to their previous employment.

Mr. VAN HOLLEN. Right. So as I understand you, that was a credible study in your view, was it not?

Mr. BERNANKE. It is, and there have been other studies as well, which are comparable.

Mr. VAN HOLLEN. Okay. And just focusing on QE2, my understanding is that, just with respect to that, those monetary decisions that created or saved between 600,000 and 700,000 jobs, is that correct?

Mr. BERNANKE. The same study attributed, again perspectively, in part, to the $600 billion QE2 about 700,000 jobs. Again, let me just emphasize that these are simulation studies, but they do indicate that the potential impact is significant.

Mr. VAN HOLLEN. Right, but Mr. Chairman, simulation studies are what the Feds, the OMB, the CBO, we all do, right?

Mr. BERNANKE. Correct.

Mr. VAN HOLLEN. Okay. With respect to that policy, if you did not have those tools at your disposal and you were not able to use them, I assume that would mean that you would not be able to take action to save or create three million jobs, is that correct?

Mr. BERNANKE. That's correct because our interest rate is essentially down to zero.

Mr. VAN HOLLEN. Thank you. Now, I want to turn briefly to the question of debt ceiling because this Congress is going to face a very important decision coming up, and last week at the National Press Club, you indicated that failure to raise the debt ceiling would be, quote, Catastrophic for our economy and financial system. I assume you have the same opinion today.

Mr. BERNANKE. Yes, sir.

Mr. VAN HOLLEN. Okay. You also indicated at the National Press Club that it would be a mistake for, in your view, for the Congress to use the debt ceiling as a, quote, Bargaining chip, with respect to decisions on spending and tax, that we should address those as part of our normal discussion but not hold the debt ceiling hostage to that. I assume you still have that view today.

Mr. BERNANKE. To be clear, it is very important to address these issues, but the risk of not raising the debt ceiling is that interest would not be paid on outstanding government debt, and if the United States defaulted it would have extraordinarily bad consequences for our financial system, and it would mean that we would face higher interest rates essentially indefinitely because creditors wouldn't trust us to make our interest payments.

Mr. VAN HOLLEN. I mean it would be reckless from an economic and financial perspective to allow, to essentially default on our debts and question the creditworthiness and full faith credit of the United States, correct?

Mr. BERNANKE. We do not want to default on our debts; it would be very destructive.

Mr. VAN HOLLEN. Have you had an opportunity to look at some of the legislative proposals that have been introduced on the Senate and the House side that would purport to try and delay those payments, and have you seen Secretary Geithner's comments in a response?

Mr. BERNANKE. We have just begun to look at the issue of whether or not you could reorder, re-prioritize payments so that the debt interest would be paid, but other things not paid. This has not been done before and our early assessment is that there would be some difficulties from just a purely operational point of view. For example, you would have to differentiate between Social Security payments, which presumably would not be going out, versus interest payments to individuals holding savings bonds, which would be going out, and that might cause some operational issues, so we do have some concerns on that score.

Mr. VAN HOLLEN. Some of these proposals would actually allow the full faith and credit of the United States to extend to some of our foreign creditors, like China and other governments, but not to U.S. businesses and American citizens. Let me ask you a quick question on the fiscal policy, because I think we all agree that the Congress should act now to put in place a plan to get our deficit and debt under control. We need to come up with a plan to put this country on a sustainable, fiscal path.

And, as you indicated, you referenced the bipartisan commission, the President's Commission, in your remarks. The authors of that plan observed, and I quote, In order to avoid shocking the fragile economy, the Commission recommends waiting until 2012 to begin enacting programmatic spending cuts. Let me just ask you this, Mr. Chairman: If you were to take a lot of investment out of the economy at this particular point, when it is fragile, could that create a drag on the economy and have a impact on jobs?

Mr. BERNANKE. If it were large enough, it could, but on the other side, I just want to emphasize that the deficit-reduction approach should be one that takes a long-term perspective, that you are looking at a long-term window and addressing the whole trajectory of spending, rather than looking only at the very short-term.

Mr. VAN HOLLEN. Okay. And I agree with that, Mr. Chairman. Last question is I was pleased to see in your testimony that you believe that certain investments, national investments in our economy, can in fact lead to productivity and growth. There are some who are trying to turn investment into a dirty word, but as you indicate here, investments in our public infrastructure, investments in education, and investments in science and research can in fact have a positive, productive impact on economic growth. Is that correct?

Mr. BERNANKE. If they are well done, yes.

Mr. VAN HOLLEN. Thank you, Mr. Chairman.

Chairman RYAN. Something tells me we are going to have a big debate over the definition of investment over the next two years. Mr. Garrett.

Mr. GARRETT. There we go. And thank you, Mr. Chairman. Following up on a couple of those questions, before I get to some other ones. So, Mr. Ryan was asking an initial question to your response back, with regard to monetary policy, whether monetizing the debt and the like. You said your actions right now have been short-term in nature, as opposed to permanent actions, which, if I understand you, would be effectively monetizing the debt. I guess, then, the question becomes, if you had implemented permanent, there's nothing that would have precluded the Fed, somewhere down the road, undo their actions later on. You're not bound by your decisions today. So, anything that is actually permanent is also changeable by the Fed. Correct? There's nothing permanent that you would do today, that you couldn't undo.

Mr. BERNANKE. What's key here is expectations. And the markets don't expect inflation, which means they expect us to undo this process at the appropriate time.

Mr. GARRETT. Right. And effectively what you have is a difference between one's interpretation of what is permanent and what is temporary. And I imagine that no Fed Chairman would ever come to this witness table, and say, I am engaging in permanent monetizing of the debt. That no matter how they would describe it to us, they would describe it as, I'm only taking a temporary action to get over this period that we are in right now. Isn't that correct?

Mr. BERNANKE. That's what we are doing. It's a temporary action. But, of course, the Fed always buys securities for various reasons. For example, that is how we create the currency that Americans use every day.

Mr. GARRETT. But this is obviously outside the norm as far as your balance sheet.

Mr. BERNANKE. That's right.

Mr. GARRETT. And part of your opening comments was the fact that one of the good signs we are in right now is that consumer spending is going along, which is sort of pulling the economy going forward, right?

Mr. BERNANKE. Yeah.

Mr. GARRETT. Is that in part because of exactly what you are doing, whether we call it permanent or temporary, it is because of that, basically, cheap money that is out there that is encouraging all of us to say that, Hey, it is cheaper to borrow right now, so I can actually increase my consumer spending?

Mr. BERNANKE. That's how monetary policy works all the time. Not just now.

Mr. GARRETT. Right. But in the area of housing, however, you had said, not just last year with regard to housing policy and the age old question of what caused us to get into this situation. And you said, Well, I don't think it was really monetary policy, I'm paraphrasing, here, that got us into this situation. And I know the old line, that if you get three economists in a room, you will come up with four different definitions on what economic policy should be. When you were saying that, about three-quarters of business economists were just saying the opposite of that. They said that it was a cheap monetary policy that was bringing us into this situation. So you disagree on that point with a number of other economists, as whether it was the low cost of money that actually exacerbated the housing problem. Right?

Mr. BERNANKE. Right.

Mr. GARRETT. But now, you are basically, on the other hand, saying, We're going to use that exact same policy, of basically cheap money, to do what? To try to drive up the cost of the housing, in order to pull us out of this economic morass. Right?

Mr. BERNANKE. The price of housing isn't responding at all to the policy. It's going——

Mr. GARRETT. But that is your ultimate goal here, isn't it? Basically, if we have the cheap money, that people will be able to start buying houses again, that it'll hit the bottom and the housing prices will go back up again. Right?

Mr. BERNANKE. Again, that is the way the monetary policy works: by lowering rates of returns, so people will be more willing to spend.

Mr. GARRETT. I'm in this quandary here. On the one hand, you are saying that, in the past when you had, not you but your predecessor, had a cheap monetary policy, that really didn't cause the problem because monetary policy really wasn't driving the cost of the housing and causing the problems that we have here. Now, however, you are going to use that exact same formula to say, Yeah, well, actually it does have as significant impact, or we should hope it has a significant impact on the monetary policy. So I am at a quandary as to which is it from the Fed: whether it had an impact in the past, or will it have an impact in the future? If you don't think it had an impact in the past, why do you think it is going to have an impact now on housing?

Mr. BERNANKE. It should have an effect that is proportionate to the interest rate change. Now, the housing bubble we saw earlier in this decade was far greater than can be explained by the monetary policies of that time, which is one of the reasons why I don't think that the monetary policy was a major source of that bubble.

Mr. GARRETT. Okay. Very quickly, last minute and 15 seconds, with regards to spending. Wouldn't significant reductions, or addressing the short-term spending aspects, be good for the market and the economy, despite some of the critics on the other side that say this might be detrimental to overall growth?

Mr. BERNANKE. Well, again, I think it is really a question of convincing the market that there's a long-term plan here, and to the extent that that was part of a long-term plan, it could be helpful, yes.

Mr. GARRETT. Okay. Well, Moody's looking at what we are doing in Washington. I guess they're optimistic about what we will do, because they came out a month ago with their report looking at the fiscal health, looking at three categories: the debt to GDP, the debt to revenue, and the interest payment revenue, and they said that the U.S. exceeds the median level of AAA rated nations for all these other categories, and concludes that it would expect to see, quote, Constructive efforts to reduce the current deficits, as well as constructive efforts to control long-term growth of entitlement spendings. I guess they're optimistic as to what Washington does, making those statements. Are you optimistic that we are going to be able to make those hard choices, even if they make some significant cuts in spending right now?

Mr. BERNANKE. Well, I'm not certain. And that is why I'm making this case. I hope that people will listen and take seriously the responsibility to address this problem.

Mr. GARRETT. I appreciate that. Thank you.

Chairman RYAN. Mr. Doggett.

Mr. DOGGETT. Thank you very much for your service, Mr. Chairman. While it may be true that there are only two certainties in life, death and taxes, I would think that a close third would be gigantic bonuses for many at gigantic Wall-Street financial enterprises. When you were here to testify last, you responded to my question about that by indicating that the Federal Reserve, under your direction, was preparing a public report to the American people on bank compensation structures that would be available at the end of last year or early this year. About four months ago, your general counsel testified here in the House, also, about the importance of making that report public to the American people. When can we expect to see the report?

Mr. BERNANKE. I believe that will be soon. We certainly are working in that direction. As you know, we put guidance out in June 2010, and we are working to follow the requirements of the Dodd-Frank Act to put out additional restrictions.

Mr. DOGGETT. I know there's been some discussion that the public report that you testified to us about, and that your general counsel testified about, would now be kept secret. But it is your intent to make it fully public to the American people.

Mr. BERNANKE. That's my understanding, yes.

Mr. DOGGETT. And you think that will happen very soon.

Mr. BERNANKE. I believe so, but I'd like to get back to you, if I might, on the exact date.

Mr. DOGGETT. Please do, especially if any part of it will be kept secret, as some have suggested. I think that kind of reversal would be very troubling. Thank you, though.

Moving to the issue of the Consumer Financial Protection Bureau, created in the Wall Street Reform Law, you are very familiar with it, to arm the American people with information that they need to make informed financial decisions. Many question whether that Bureau should be located within the Federal Reserve, given its traditional mission, and given concern about the independence of the Bureau and the ability to fulfill its mandate. With it set to begin full operations shortly, in July, and with no Consumer Financial Protection Bureau Director yet nominated, can you provide us assurances that it will be sufficiently strong and independent to fulfill its mandate, to offer consumer protection to the American people, from the many credit abuses that they have faced in the past?

Mr. BERNANKE. Congressman, the CFPB is located in the Federal Reserve, only in the narrow sense that the Federal Reserve pays the bills. But we have no oversight or control. The control really is coming from the Treasury, and I think they are the ones who would be most appropriate to respond to you about the nature of the Bureau.

Mr. DOGGETT. You and the Fed have no involvement in the operation of the Bureau? You're just kind of the landlord and the paymaster?

Mr. BERNANKE. We're doing our best to help them get set up. Obviously, there's a lot to be done, in terms of just hiring people and setting up an IT system, and so on, but in terms of policymaking, they are completely independent of the Federal Reserve. We have no say whatsoever.

Mr. DOGGETT. And you are making no recommendations about who the director should be, or how the Bureau will operate in any way from a policy standpoint?

Mr. BERNANKE. No sir, that is not part of our responsibility under Dodd-Frank.

Mr. DOGGETT. Another major issue that perhaps involves the Treasury some, and it involves you some, is the future of Freddie Mac and Fannie Mae. Some are concerned that perhaps most, if not all, of their functions would, again, be turned over to a few large financial enterprises. What is your general approach to the future of these two institutions?

Mr. BERNANKE. Well, as you know, the Treasury is promising us a set of proposals very soon, and it will be interesting to see what they provide. There are various possibilities that we could do, including making them a government utility, or privatizing them, which would be two alternatives. One suggestion, which I have made in previous remarks, is that if the government is involved in providing credit guarantees, it should do so only as a deep backstop. That is, the first losses should be borne by the originators of the mortgages, or by the securitizers. The government, if it does provide backstop insurance, should do so for an actuarially fair premium, and that would essentially allow the government to provide a backstop in situations like we had in the last few years, where the housing market came under enormous stress.

Mr. DOGGETT. Thank you. Thank you, Mr. Chairman.

Chairman RYAN. Mr. Campbell.

Mr. CAMPBELL. Thank you Chairman Ryan and Chairman Bernanke. Some things in economics are cyclical and others are structural. You mentioned earlier today that you feared that unemployment would remain elevated for an extended period of time. How much of our current high unemployment, in your view, is cyclical, and how much is structural?

Mr. BERNANKE. I don't have a precise number, but we have done a lot of work looking at this. And I would say that the bulk of it is still cyclical. The risk is that if it goes on long enough, it will start becoming structural as people lose their skills and their connection to the labor force.

Mr. CAMPBELL. Is it fair to say that you have control only over monetary policy, not fiscal policy and government policy, and that to the extent that unemployment is structural, that that is something that is really out of your purview to deal with, be it QE2, or any other form of monetary policy?

Mr. BERNANKE. That's correct.

Mr. CAMPBELL. I'd like to talk about what Mr. Ryan referred to a minute ago, about this thing of spending and investment. There's a lot of talk these days that what we need to grow the economy is spending: government spending, spending by individuals, spending by consumers. To me, there's a great distinction. And the term investment is thrown around a great deal, but investment means that someone puts money to work, expecting a monetary return. And that is very different from spending. In order to achieve long-term growth, stable employment growth, isn't investment, from a true definition, and savings where we should be trying to head, rather than just focusing on consumer spending or government spending? You mentioned earlier today that we should remove the disincentives to saving and would. Shouldn't we be removing disincentives to saving and investment, to get this long-term growth, rather than all this focus on spending in both the public and private sector?

Mr. BERNANKE. Congressman, I mentioned, improving the tax code to reduce disincentives for productive activity. I think it is very important, for individuals and for businesses and for investment. The government does have some role in providing infrastructure and education and so on, obviously, but the way that is done and the level which it is done is a matter for Congress to decide.

Mr. CAMPBELL. Do you believe that we currently, since you mentioned disincentives to saving, have disincentives in place, that block savings or investment from the private sector that could add to growth?

Mr. BERNANKE. I think there would be a lot of agreement that our tax code is very complex, and is not conducive to the most productive activities in many cases.

Mr. CAMPBELL. Switching to QE2, the flavor of the day, as it were, have you fully implemented QE2 yet?

Mr. BERNANKE. No sir. We announced an intention to purchase six-hundred-billion, between November and June, and so we are about halfway through.

Mr. CAMPBELL. About halfway through. When QE2 finishes, presumably in June, and you mentioned that you could reverse it or whatever, what are the metrics that you are following that would lead you either to believe that you should have QE3 or that you should reverse QE2?

Mr. BERNANKE. Well, first, there's the question of efficacy, and we are seeing the intended results in terms of financial markets and in terms of financial conditions. So, in that respect, we think that it is being successful. In terms of looking forward, we will be trying to assess whether the recovery is on a sustainable track. And things have moved in that direction, which is encouraging. And we will be trying to assess whether inflation is low and stable, at around two percent or a bit less, which we think is about the right level, and most other central banks think is about the right level. And looking forward, if that appears to be the trajectory we are on, then additional action would not be necessary. If we are still in a situation where the recovery does not seem established, and deflation risk remains a concern, then we would have to think about additional measures.

Mr. CAMPBELL. What's the trigger that causes reversal?

Mr. BERNANKE. If the economy begins to grow very quickly and inflation risk begins to rise, then we would reverse it.

Mr. CAMPBELL. Okay. Final question. I think Mr. Ryan alluded to this earlier. There's been fairly significant moves in the 10-year and 30-year Treasury yields, just recently. What do you think's causing that? And are you concerned? Or, what is your opinion?

Mr. BERNANKE. No, I'm not concerned. I think it reflects, primarily, increasing optimism about the U.S. economy, and it is natural for the term structure to move in that way when investors become more optimistic about growth.

Mr. CAMPBELL. Thank you.

Chairman RYAN. Mr. Blumenauer.

Mr. BLUMENAUER. Thank you, Mr. Chairman. Thank you for joining us again. You come at a time when there are lots of people, including in Congress, who are very interested in helping you do your job better: critiquing it, maybe undertaking some things that would constrain direct control. But I got from your message that there are a couple of things that Congress should be focusing on, and our primary job. One, I guess we are all in the business of making sure there is confidence in the United States Government, meeting its obligations, not putting an undue cloud over it. Then you referenced the aging population and health care, which, again, is within our purview. There have been, it is no secret, a lot of suggestions as we approach the debt ceiling and it is widely acknowledged, no one disputes the need to extend it. There are discussions about conditions and terms, under which some of it might happen where we will change the scheduled debt repayment. Has this been, in your experiences, both as head of the Federal Reserve and as an economist and a scholar, has this been the routine? Has Congress done this regularly in the past?

Mr. BERNANKE. Well, there have been, in the past, political battles, and both parties have done this, over whether or not to raise the debt limit.

Mr. BLUMENAUER. Excuse me. I'm talking about, has Congress ever, in the past, established conditions on limitations on the debt ceiling, or the sequencing, changing the order of business so we do not just honor our obligations and make sure that there's adequate head room?

Mr. BERNANKE. If you are talking about the prioritization of payments, no, that is not happened, to my knowledge.

Mr. BLUMENAUER. Or have there been conditions attached to debt ceiling increases in the past?

Mr. BERNANKE. I don't know if there have been direct conditions. Obviously, there have been negotiations about budgetary matters which have preceded those decisions.

Mr. BLUMENAUER. Setting that aside. We will always do that. That's our job. I think that is appropriate. And we will get down into cases, in terms of cutting, and I think there may be actually some bipartisan initiatives that would implement some of the recommendations, for example, that came from the President's Debt Commission. I'm just very interested in the perception. If we are going to do something for the first time that changes the repayment, or we are going to have some sort of onerous conditions, or we are actually seriously threatening not to raise the debt ceiling, to what extent does that impact global perception, market confidence in the United States as being a good repository for their investments?

Mr. BERNANKE. We want to address our fiscal issues, but my argument is that we don't want to cast any doubt or uncertainty on the fact that the United States will make good its obligations. I think that is critical.

Mr. BLUMENAUER. And I think it is clear if, well, I will just say, I appreciate you have some limitations in terms of what you say, but I think it is obvious that if we are going to start playing games with something as routine as this, holding out the prospect that we are not going to actually meet our obligations, and even if it is seriously considered, not negotiations, not disagreeing about some elements, but considering that as the nuclear weapon. That has got to shake that confidence.

You mentioned health care. And that is something that is within our purview. There are some differences of opinion, some are not interested particularly in advancing the reforms that are in place as opposed to, perhaps an opportunity to accelerate, to actually put teeth into what we are doing and get down to cases to actually change that health care curve.

From your perspective, are we better off actually following through on the commitment to deal with health care reform and dealing with long-term costs or making this just one of these areas that we continually talk about, push back and forth, and make no progress?

Mr. BERNANKE. It's out of my purview to support or not support a specific plan, but I do think it is very important and essential to the long-term fiscal situation that we address the costs, both for the private economy, but also for the federal budget, which are going to be increasingly a dominant part of our spending.

Mr. BLUMENAUER. Thank you, sir.

Chairman RYAN. Mr. Chaffetz.

Mr. CHAFFETZ. Thank you, Mr. Chairman. Mr. Chairman, thank you for being here. In January, you said that the Federal Reserve would not bail out state and local governments. Is that because you have no intention of bailing out the local governments or that you physically can't do it because the law precludes you from doing that?

Mr. BERNANKE. I would say both.

Mr. CHAFFETZ. You mentioned that in page 8, at the very end of your testimony here, you said you mentioned that enhancing long-term growth potential of our economy, quote, by reducing disincentives to work. What are the disincentives that you see to work? What are the disincentives to work that you mentioned?

Mr. BERNANKE. Well, I'm speaking generally about the tax code and also transfer programs that create, essentially, a very high marginal tax rate on earned income. And to the extent that we can simplify our tax code, reduce rates, broaden the base, eliminate the complexity, et cetera, in ways that would make it more financially attractive for people to work, save, invest, and so on; it is obviously good for our economy.

Mr. CHAFFETZ. Anything above and beyond the tax treatment that you have looked at that fall into that category from your perspective?

Mr. BERNANKE. Again, tax and transfer policies would be the ones. I don't know what else are you thinking of, but those are the two that I would focus on.

Mr. CHAFFETZ. Thank you. The CBO records Fannie, and Freddie, and Budget, and uses fair-value accounting to measure the financial impact of the two GSEs. Moreover, not only does the CBO consider Fannie and Freddie as federal government entities, but it also treats the mortgages they guarantee as obligations of the government, scoring them on a market-risk adjusted present value basis. Do you agree with this budgetary treatment?

Mr. BERNANKE. It's important that we take into account, in our budgetary planning, the cost and the prospective costs of Fannie and Freddie. Now, there are different ways to do that. As I understand it, the Fannie and Freddie are not fully consolidated with the federal budget and that is a decision that is been made to try to keep some separation between the government and those two institutions. But clearly, as we think about our budgetary situation, the costs that have already been incurred and may still be incurred for Fannie and Freddie are obviously something important to keep in mind.

Mr. CHAFFETZ. The Fed's been the biggest buyer of treasuries over the last several months. And the reports are that the Fed is now past China as the biggest owner of treasuries. Does that distort the bond markets and create dependency, and is this something that the Fed should be worried about?

Mr. BERNANKE. We've been very careful to not distort the bond market. We've paid a lot of attention to that issue. We've monitored the market function. We've made sure that we don't own too high a fraction of any particular issue of government bonds, and our clear sense is that the treasury markets are functioning very normally, very liquid, and we don't see our policy, which again, is a temporary policy, as creating any particular problems for the market itself.

Mr. CHAFFETZ. There have, Mr. Chairman, there have been discussions out there in the newspapers and whatnot, other countries talking about pegging oil and whatnot to something other than the dollar. What type of concern do you have about this? Do you see this as a reality?

Mr. BERNANKE. The currency in which goods are invoiced is really of not much consequence. Another question, though, a broader question is what currency is the reserve currency? The currency that countries hold their international reserves in? And the fact is that the U.S. dollar share of 60 percent plus has been pretty stable, and I really don't see much likely change in that. In fact, lately, given the problems of the Euro, et cetera, the dollar and the perspective growth in the U.S. economy, the dollar has actually been looking a little bit more attractive relative to some of the other currencies in the world.

Mr. CHAFFETZ. Thank you, Mr. Chairman. I yield back.

Chairman RYAN. Ms. McCollum.

Ms. MCCOLLUM. Thank you, Mr. Chairman. Chairman Bernanke, thank you for being here. I believe that we have a lot of work ahead of us, and I want to thank you for the work that you did in stabilizing our economy in the past, and I look forward to hearing some of your advice, suggestions, and ideas on how we move forward with getting out of the Great Recession. And I want to be part of the solution, and we hear a lot of talk here in Congress about spending, but I'm also concerned about a lot of the tax perks that lobbyists have been very successful in getting for special interests in our tax code, and I think that we need to put everything on the table.

But having said that, today, we've focused on spending quite a bit, as some of the questions have come through. And in fact, I'm going to paraphrase a popular Tea Party slogan; it goes something like, quote, The federal government doesn't have a revenue problem, it has a spending problem.

Now last week, Chairman Ryan put forward his best effort to reduce the deficit with spending target cuts, that is $41 billion from the fiscal year 2011 budget. The Republican target reduces the fiscal year 2011 projected deficit by about 2.5 percent. That leaves 97.5 percent of the deficit intact.

Now, in an extreme scenario, if all 176 Republican Study Committee members were able to have their way and take control, they would be allowed to cut four times what Chairman Ryan's best effort is. But that would only then still only represent 10 percent of the federal budget deficit for fiscal year 2011, still leaving more than 1.3 trillion.

Chairman Bernanke, it seems clear to me that the deficit is not just a spending problem. Is it possible to reduce the federal deficit to responsible levels without capping or cutting defense spending and without looking at the tax perks that many corporations and lobbyists have been successful in getting?

And my second question is: With the type of cuts that are being discussed, do you think that we need to be insightful when making these spending decisions on what to cut, on the impact of jobs as well as U.S. competitiveness, and the global economy? I think we need to be careful of gutting domestic investments in education, infrastructure, and R&D in the next decade, because we might see reverses that would put us at a competitive disadvantage.

Mr. BERNANKE. Well, on your second question, I'm hoping to, obviously, it is very important that the deficits be brought under control, but it is not just a matter of total spending and total revenues, it is also how smart is the spending and how are we using it? And the tax code, are we doing it in a way that is constructive for growth and for competitiveness?

So, I would urge the Congress not only to talk about total budget numbers, but also to think hard about the various programs and tax provisions to make sure that they are growth friendly, and that is a very important part of your job.

In particular, you mentioned perks, et cetera. I think one direction that at least should be considered would be, in the corporate tax code, for example, to reduce a lot of loopholes, to broaden the base, and therefore be able to lower the tax rate, which is now soon going to be the highest in the industrial world so that the decisions made by corporations are based, you know, not on tax distortions, but rather on the economics of where, for example, they should locate their plants, and so on.

So, I do think that growth friendliness is a very important part of this and that lower rates and broader base is something that most economists would agree is a good direction to go in the tax code.

On short-run versus long-run, I, again, I understand there's a lot of focus on this year's budget. Without commenting directly on that, I do think that in order to be credible, given that the budgetary problems get worse over time, that is as the baby boomers retire, as health care costs rise, and so on, given that the prospective deficits are rising over a long period of time, I would hope that a good bit of your discussion will be about the long-term over the 10, 15, 20 year horizon and to the extent that you can change programs that will have long-term effects on spending and revenues. That will be a more effective and credible program than one that focuses only on the current fiscal year.

Ms. MCCOLLUM. Thank you, Mr. Chairman. As you know, we are setting the budget. We're setting the spending and Ways and Means does its issues with the tax code and addressing what I hope will be any tax perks. But I can't make a decision in isolation, so I look to all of us to put everything on the table so that we make a well-rounded decision as we move forward with the budget. So, Mr. Chairman, I'll be looking to see what your comment is.

Chairman RYAN. Thank you, Ms. McCollum, and I can only say what we are doing right now is our best; it is our first effort at getting fiscal control under this place. Mr. Ribble.

Mr. RIBBLE. Thank you, thank you, Chairman Ryan, and thank you, Chairman Bernanke, for coming in today. I'm one of the new freshman members. I have spent the last 30 years working in the private sector owning my own business. My questions today are going to relate around kind of two central areas. One is the debt ceiling that will hopefully get some understanding there, and then also, your take on lending a small business and inside businesses. But first of all, and I understand it too, that it might be reckless for the U.S. government to default on this debt. Would you agree that that is a true statement?

Mr. BERNANKE. Certainly.

Mr. RIBBLE. Okay. Is it not also reckless to have the level of uncontrolled spending that the American people are witnessing by this Congress in the last 20 years or so?

Mr. BERNANKE. Absolutely, and I don't mean to imply you shouldn't be addressing that, I just think you should do it as a separate measure.

Mr. RIBBLE. Yeah, okay. Understood. As a business owner, often, the lenders would impose their own debt limit on many companies. If we were reckless in our spending and our balance sheets didn't look very good, at some point they impose their own debt limits. Is it not likely at some point that the lenders to the U.S. Government are going to impose a debt ceiling of their own?

Mr. BERNANKE. The bankers' debt limit is really a spending limit, it says you can't spend any more.

Mr. RIBBLE. Correct.

Mr. BERNANKE. And you have already made decisions about what the government is going to spend and what revenues it is going to collect. That implies a deficit, and that has to be financed. If you set a limit that is too low, that just means basically that you can't borrow money that you have already spent. So, it is really an extraneous thing, once you set spending and once you set taxes, you essentially are, by definition, defining how much you have to borrow.

And if you don't allow the government to borrow that, then, again, the only way to do that is not to make the required interest payments, which, your banker wouldn't like that, I'm sure.

Mr. RIBBLE. Correct, sure. Or the other alternative would be to either increase revenue or decrease spending so that you didn't exceed the debt. Correct?

Mr. BERNANKE. If that can be done before the debt limit.

Mr. RIBBLE. Sure, sure. And my point is going back to the discussion of long-term because you just mentioned moments ago that it is important for us to look at a 10 or 20 year horizon. The American people are cynical that we are able to actually do that in such a way that in 20 years from now, we are still having this same discussion over again. And I think the fear that the American people have is that at some point, lenders are going to say to us, That's all we are going to lend, or We're going to price this at such a place that would be catastrophic to the economy.

Mr. BERNANKE. That's a risk, yes.

Mr. RIBBLE. Do you see that as a legitimate risk over the next decade?

Mr. BERNANKE. Yes.

Mr. RIBBLE. Okay. Thank you for that comment. There is almost a constant stream of constituents coming into my office since I have arrived here in Washington, D.C., discussing the difficulty that they're having finding, financing, and lending; their ability to borrow has been greatly restricted in the last 24 months.

Can you talk to us a little bit about what it might take for local, medium, and national banks to begin to, once again, to loan money? What's causing the restriction?

Mr. BERNANKE. Well, first, part of it came from the fact that banks, after the crisis, were deleveraging and cutting back themselves. Part of it came from the fact that the economy was very weak, and therefore, borrowers didn't look as attractive in their cash flows, their collateral values were less attractive than they were before the crisis.

So, there's both a supply and demand element to that. Now, I think that both of those things are looking better. Banks have increased their capital. They're feeling much more stable; they're much more liquid. And our sense, and we do surveys, is that banks, while they still have quite tight standards, are at least beginning to ease those standards and beginning to look more actively to find good borrowers. And so I think that is improving somewhat.

And likewise, as the economy strengthens, and we are seeing for example, increases in the prices of commercial real estate, which is what many small businesses use as collateral, that there'll be more small businesses that can qualify for credit. So we think things will be getting better slowly. The Federal Reserve is working very hard with both banks and small businesses to try to make sure that, at least from a regulatory point of view, that we are not preventing banks from making loans that they should make. We want them to make good loans. And we have been very clear about that in our instructions to banks and our training of our examiners.

Mr. RIBBLE. Okay. Thank you very much. Thank you, Chairman Ryan.

Chairman RYAN. Mr. Honda.

Mr. RIBBLE. Thank you, Mr. Chairman.

Mr. HONDA. Thank you, Mr. Chairman. Welcome, Mr. Chairman. In your speech to the National Press Club on February 3, you noted that unemployment, which is, to me, the key economic indicator for the well-being of American people, will remains stubbornly high and that these conditions will improve gradually.

You also noted that the trajectories of our national deficit and debt are unsustainable. You went on to state that among the course of corrections needed to address these problems are investments in the skills of the workforce, which I am going to simply call education, and policy changes to reduce our deficits and debt.

I have two questions. My first question is in regard to the latter. The current rules of the House have taken the War on Terror off-budget, meaning that the costs of our conflict in Iraq and Afghanistan and other actions associated with the so-called War on Terror can be financed with debt.

Afghanistan alone represents the costs of approximately $10 million per hour, 325 million per day, and $150 billion per year. Disturbingly, this is our country's largest long-term investment. So my question is will the savings that resulted from ending combat operations associated with the War on Terror reduce projected deficits?

Mr. BERNANKE. If those expenditures were not necessary, of course they would reduce deficits, but I'm not qualified to comment on whether or not we should be engaging in that conflict.

Mr. HONDA. But the budgetary action that we've taken, that we put it aside as, in the past we call supplements. What impact does that have on our debt and our deficits?

Mr. BERNANKE. Well, clearly, additional spending for military or any other purpose, all else equal will add to the deficit.

Mr. HONDA. So, if there's no revenue with sustaining that, and we take it off budget, we are essentially creating an automatic deficit and then a debt.

Mr. BERNANKE. That's right.

Mr. HONDA. Thank you. My second question, Mr. Chairman, is that I think it is very important to note that among other investments, including encouraging the scaling up of U.S. manufacturing by incentivizing purchasing new machinery and investment, promoting R&D, rebuilding public infrastructure, you single out education as an area of public investment that will promote economic growth. Would you explain to this Committee how public investment in education promotes economic growth?

Mr. BERNANKE. Well, one of the key elements in economic growth that a lot of economists have identified is the skills of the workforce. And I would like to say that there are a lot of ways to impart skills. There is K though 12 education and college, certainly, but there's also junior colleges, community colleges, technical schools, on the job training, a variety of different ways, and that is always been a strength of the United States, that we have a diverse set of ways to help people get training. But I think that should be something we should be at least paying some close attention to.

It may or may not be a matter of money. It may or may be a matter of spending more wisely, but clearly, one of the concerns we have about our society is the increase in inequality between the richest and the poorest. There are many reasons for that, but no doubt the largest reason is that there's a part of our society which is not receiving the training that they need to get good paying jobs, and that is going to be a problem for us and it is a problem for our economy.

Mr. HONDA. With the education, I would probably call that an investment. And, making that investment into education would be something that we can count upon as far as a return on our investments. And if we have an education system that is been completely decimated, what kind of impact do you think it would have on our investments, relative to the entire picture that we have before us today?

Mr. BERNANKE. Well, it is very important to have a good education system, and we are not doing well on that count, and to help people get skills, there's a lot of dispute about exactly how to accomplish that, and you know, we could talk about that for quite a long time. So, I think we need to think, as a country, about how we can both increase the quality of our training and also make sure that it is broadly spread, so that everyone has a chance to get the skills they need.

Mr. HONDA. Okay, and I understand that. Education comes in a lot of forms. In our investment in R&D, and investment in the other kinds of programs that we have, but the system of education and the Department of Education would seem to be one place where we can focus on this very complex problem of equity and equal distribution resources. Would you agree on that or do you have other comments on that?

Mr. BERNANKE. Well, the Department of Education is certainly one place that can help review, and understand, you know, what's working, what's not working. I think, as a country, we are having a sort of a crisis of confidence, so we know how to provide broad based skills. So, I think that is really part of the problem; it is not just resources, it is also, you know, how do we do this better? And it is not clear that our models are working very well right now.

Mr. HONDA. I appreciate your response. Thank you, Mr. Chairman.

Chairman RYAN. Mr. Huelskamp is next.

Mr. HUELSKAMP. Thank you, Mr. Chairman; I appreciate Mr. Chairman being here today. And I had a couple questions, particularly on the issue of job creation, and I'm a little confused from the testimony. On one hand, you do indicate, in your opinion, we are in a period of economic recovery. Is that correct?

Mr. BERNANKE. Yes.

Mr. HUELSKAMP. On the other hand, you do indicate that the unemployment rate is apparently not where you would like it to be. A couple questions on that. What is the targeted unemployment rate that you would be comfortable with?

Mr. BERNANKE. Well, the FOMC, the Federal Open Market Committee, makes projections on what the long run sustainable unemployment rate is, and currently those projections are between five and six percent of the labor force. That would be a more or less, a more normal level. That being said, I want to be clear that that doesn't mean that we would maintain maximum monetary policy accommodation until we reach that level. We have to withdraw that accommodation at some point before we get there, but that would be the area where we hope we could get back to.

Mr. HUELSKAMP. So, five to six percent. Is there a projected time period where that might occur?

Mr. BERNANKE. At the rate we are going, it takes about two and a half percent real growth just to keep even because you need about that much growth just to make jobs for the new entrants to the labor force. So, if we were to average, just thinking hypothetically, four and a half percent growth, which is quite ambitious, it would still take us another four years or so to get down to the five to six percent range, so it could take quite a long time.

Mr. HUELSKAMP. And at the two and a half percent level, how many years would it take to reach?

Mr. BERNANKE. It would take, essentially, I don't want to say infinite, but it would be very, very slow.

Mr. HUELSKAMP. Okay. And our current rate of growth is what for the last quarter?

Mr. BERNANKE. In the last quarter, it was 3.2 percent, and we are looking for 2011 to be somewhere between three percent and four percent, so that should bring unemployment down over the year, but not very quickly.

Mr. HUELSKAMP. And at 3.2 percent, how long would it take to reach the five to six percent goal?

Mr. BERNANKE. Well, that would lower unemployment by about three to four tenths a year. So that would be about 10 years.

Mr. HUELSKAMP. Ten years, but you still think your policies are promoting success if we are still projecting 10 years until we reach a decent unemployment level.

Mr. BERNANKE. I am not projecting them. You asked about the fourth quarter, and that was 3.2 percent. We think that it is going to pick up in 2011 and possibly even further in 2012, depending on a variety of circumstances.

Mr. HUELSKAMP. And Mr. Chairman, I appreciate that. And we are all hopeful it does that, but one thing you do note is that you said, ultimately, at the appropriate time, the Federal Reserve will normalize its balance sheets by selling these assets back into the market.

A couple questions about that. If you believe it is a thriving economic recovery, can you provide information why you apparently believe that a sell-off would not have the opposite effect?

Mr. BERNANKE. Well, it is the same pattern that we always see with monetary policy, which is that low interest rates help stimulate the economy. Once the economy has a self-sustaining, you know, once it sort of reached escape velocity, so to speak, then that monetary fuel can be withdrawn. And usually, with raising short-term interest rates, in this case it would involve both raising short-term interest rates and reducing the size of the balance sheets. So yes, as the economy begins to get stronger and develops its own momentum, then it needs less monetary policy support, and we have to begin to withdraw it, otherwise we would risk inflation, as Chairman Ryan was concerned about.

Mr. HUELSKAMP. So, even though we are kind of looking at four percent growth, maybe three, and you are comfortable that it won't take 10 years to return to normal employment levels; you are not certain. Is it more like five years we might have those normal employment levels?

Mr. BERNANKE. It could be four or five years. I hope it is less than that.

Mr. HUELSKAMP. Yeah, I do too, and so do my constituents, Mr. Chairman, and my concern that if on one hand, you claim the policy is driving economic growth, even though it is very, very slow, from what would be the target, my fear would be that the reverse policy would potentially have that other effect.

Last thing, a quick question. I know you picked $600 billion. Can you tell us again why you picked $600 billion versus $500 billion or say, $750 billion for the target?

Mr. BERNANKE. We tried to make an assessment. We asked a hypothetical question: If we could lower this federal funds rate, how much would we lower it? And a powerful monetary policy action at normal times would be about a 75 basis point cut in the federal funds rate. We estimate that the impact on the whole structure of interest rates, from $600 billion, is roughly equivalent to $75 basis point cut, so on that criterion, it seemed that that was about enough to be a significant boost, but not one that was excessive.

Mr. HUELSKAMP. Thank you, Mr. Chairman.

Chairman RYAN. Ms. Moore is next.

Ms. MOORE. Thank you so much, Mr. Bernanke. I have seen you many times on the Financial Services Committee, but I have had such a low ranking that it is been such a hard time getting an opportunity to actually ask you a question.

I do want to thank Mr. Huelskamp for his last question, because I was very curious about how you say in your testimony on page four that exit from the current, highly accommodative policy, at an appropriate time, would be very easy, and I think you may have answered my question when you spoke with him.

QE1 and QE2 have been very important, I think, in terms of preventing a financial catastrophe, and QE2 has been supported by a lot of economists. The Chamber of Commerce has endorsed it, American manufacturing is grateful for it. As a matter of fact, the manufacturer in my district, Harley Davidson, is really grateful for a QE2 in terms of boosting their exports.

But, you have been accused of everything from creating an environment for inflation with this QE2 policy. Everything from that to causing the riots in Tunisia and Egypt, so I guess I would like for you, because commodities are traded on dollars, and they say that food prices, commodities have gone up and the speculation on commodities have risen. So this QE2 policy really has been very inflammatory with respect to destabilizing the region. Can you please respond to that?

Mr. BERNANKE. I'll be glad to. First of all, it doesn't matter what commodities are priced in; what matters is the currency of the country that is making the purchases, and they don't use dollars in Egypt. They use Egyptian pounds, and when the dollar weakens, which it has done very slightly, that would make the pound stronger, make them better able to buy commodities.

But I think the real issue in Egypt, for example, is the fact that Egypt is the world's leading importer of wheat, and we've just seen very bad harvests in Russia and Eastern Europe, which are their primary sources of wheat. And that is what's really happening, is that there are, on the agricultural side there have been droughts and other problems around the world that have affected crops.

Monetary policy can't add one bushel of corn to the world. I mean, basically, that is determined by agricultural productivity, and by the weather, and those factors. And we've just seen on the agricultural side that a combination of supply issues, like weather, crops, and increased demand from the rapidly growing emerging markets has put pressure on those supplies, and that is where that is coming from. I think monetary policy in the United States has really very little to do with the price of wheat in Egypt.

Ms. MOORE. Good. And with respect to your creating an environment for increased inflation with QE2 and creating an inflation bubble here in the United States and traders being leery over these inflation threats. I am wondering what your response is to QE2. Because you say that you can exit this monetary accommodation; because eventually you are going to have to raise interest rates. Walk us through how you will exit this without creating inflation.

Mr. BERNANKE. Well first, both actual inflation and expected inflation currently are low in the United States. Markets are not expecting high rates of inflation. Like I said before, the five year tips break even, which is a measure of market expectations of inflation: it is a little bit over two percent, which is about where we'd like it to be.

Obviously, we can't continue this level of monetary accommodation indefinitely because at some point, it would begin to create inflation concerns. And so, at some point, we do have to unwind some of this stimulus. In terms of how we would do it, of course, the usual question, the difficult question is choosing the right moment. But once we've decided when to do that, we can raise short-term interest rates as normal. We would do that by raising the interest rate paid on excess reserves to banks, which in turn would make them unwilling to lend in short-term money markets below that rate, so we can raise the short-term interest rate pretty much as we always do when we tighten monetary policy.

In addition, we have a number of tools, which I have talked about in great detail before the House Financial Services Committee that can help us drain bank reserves out of the system and reduce the liquidity in the system. For example, we had just recently been testing a time deposit program, whereby banks lock up their reserves with the Fed for a period of time instead of having them liquid and available whenever they want them.

So we do have the tools to do it. As always, we have to make the right call about when, you know, when the balance of risk is starting to shift, and we think the economy is strong enough and inflation has risen, and it is time to take action to avoid problems down the road, but it is really not all that different from normal monetary policy, in that respect.

Ms. MOORE. Thank you very much, sir.

Mr. BERNANKE. Thank you.

Mr. MCCLINTOCK. Turns out I'm next. Mr. Chairman, thank you for being here. Earlier today, you testified before the Committee that not raising the debt ceiling would be a very bad thing because, and you specifically singled out, it would mean that interest would not be paid on the debt. In January, you told the Senate Budget Committee that we are not seeing extraordinary stress in the municipal markets, which suggests that investors still are reasonably confident that there won't be any default among major borrowers. One reason they might believe that is because most states have rules, which put debt repayment and interest payment at a very high priority above many other obligations of the state and locality. Wouldn't it be a good idea if the federal government did the same thing?

Mr. BERNANKE. Well, it would reduce the risk with the debt limit, that is for sure. We haven't done that yet, of course. This comment that it would take some time to change our systems and computers, and so on, to make sure that we could change that prioritization in an appropriate way, but doing that would, I think, reduce some of the risks associated with the debt limit. But again, let me just be clear that we would need some notice to make that practical.

Mr. MCCLINTOCK. But would you recommend it as a long-term reform?

Mr. BERNANKE. Frankly, I, again, I would just prefer that you put the debt limit issue aside and just address directly the long-term fiscal problems, which I admit, and I agree, and in fact, I have been emphasizing, are very serious and need to be addressed. I'm not in any way saying that you don't need to address these problems; what I'm just saying is that that particular device, you know, at least under current law, has some risks in terms of the possibility that we would default on debt.

Mr. MCCLINTOCK. What is the percentage of U.S. debt held by the public, that is held by American investors?

Mr. BERNANKE. Less than half, I think.

Mr. MCCLINTOCK. Roughly half.

Mr. BERNANKE. Yeah.

Mr. MCCLINTOCK. And what's the percentage of U.S. debt held by China?

Mr. BERNANKE. About a quarter.

Mr. MCCLINTOCK. A quarter of the total debt held by the public, my understanding is about 9.5 percent.

Mr. BERNANKE. If you have the numbers there, you may be right. But I think they hold more than two trillion of U.S. Treasury, and that would be closer to 20, 25 percent.

Mr. MCCLINTOCK. Okay. Well, nevertheless, giving priority to debt repayment, we are still, apparently, overwhelmingly favor American investors to Chinese, would it not?

Mr. BERNANKE. Well, certainly. But, more importantly, the financial markets globally are where we borrow and if investors lose confidence in us, they won't lend to us in the future, which means that we will have a fiscal crisis almost immediately.

Mr. MCCLINTOCK. Right, which means guaranteeing our debt service would provide greater confidence to those investors, would it not?

Mr. BERNANKE. It would, again, subject to technical ability to make that reprioritization effective in a short-time.

Mr. MCCLINTOCK. Mr. Chairman, you also testified today that as the economy begins to grow rapidly and inflation begins to rise, the

Federal Reserve would then reverse the qualitative easing. And I'm just wondering how does the Fed intend to drain $1 trillion in excess reserves.

Mr. BERNANKE. Well first, we can raise interest rates without even draining reserves, as I mentioned, by raising the interest rate paid on excess reserves to banks. But we have released three other tools for draining reserves.

Mr. MCCLINTOCK. If I could just pause right there. How much would you have to increase?

Mr. BERNANKE. What we would do is we want to raise the, say, we wanted to raise the short-term interest rate to one percent. Then if we paid one percent on excess reserves to banks, they would not be willing to lend money to the money market at less than one percent, and that would essentially achieve our objective right there. But there are other tools we have to drain reserves, including time deposits, reverse repos, asset sales, and perhaps others.

Mr. MCCLINTOCK. As you do that, what's the impact on the economy?

Mr. BERNANKE. Well, it'll be a tightening monetary policy, again, as interest rates will go up. And that will slow the economy, but that is what taking away the punch bowl always does. It means that the accommodation is no longer needed, the economy can move forward on its own, and so the point there is to try to normalize interest rates, normalize financial conditions so that you can get back to a healthy growth path without inflation.

Mr. MCCLINTOCK. There are some of us long enough of tooth to remember a day when we had, not only double digit unemployment, but double digit inflation and interest rates at 21 percent. What can you tell us to allay our fears?

Mr. BERNANKE. Well, I can also mention that since the early 1980s, between the early 1980s and 2007, when central banks began to understand the critical importance of keeping inflation low and stable, that the U.S. economy not only had low inflation, but it also had a much more stable economy, and that was a 25 year experience. So the difference is that we have no illusions about it being not so bad to let inflation rise. We are strongly committed to keeping inflation low and stable, and we will do so.

Mr. MCCLINTOCK. Next is Ms. Castor.

Ms. CASTOR. Thank you very much, and welcome, Chairman Bernanke. Not unlike many places in the country, my home state of Florida was hit particularly hard by the Great Recession. It seemed like it started earlier in Florida, in 2007, because the housing bubble burst, and we were so tied to real estate development. And the job losses happened so quickly, at the end of 2008 and early 2009, and we are still in the double digits in Florida. You say in your testimony that there is some optimism for on the unemployment front, but we need more.

I think folks at home look at the economic indicators, and they see there is plenty of hope out there; corporate profits are way up, consumer spending is up, we've had six straight quarters of economic growth, but the bottom line for families, it is that job. And they need the swifter job growth.

The economic drivers in my area, the port, the airport, the universities, and research centers, the public schools, and small businesses, and tourism, and businesses; and all of them benefited by the Recovery Act investments. The Recovery Act investments are coming to an end now and business owners and others in the community are torn; they're hearing this schizophrenic message from Washington.

They understand that we've all got to live within our means, and they do it every day. But they also understand that those infrastructure investments and keeping the colleges and universities healthy and able to do the research, simply attracts private investment and allows them to hire, in the long run. So they're hearing a lot of talk about, We've got to cut spending, cut spending, cut spending, but they are also, at the same time, clamoring for additional public investment. It is only government that can dredge the ports so that the oil tankers can come in, the cruise ships can come in, all the private businesses can continue there.

What can you share with them on this schizophrenia between investment and living within our means and where we should be headed here in future budget years?

Mr. BERNANKE. Well, it is not an easy problem. Of course, you know, the reason that the Federal Reserve is doing what we are doing is to try to promote job creation, which we think is a very serious concern. But Florida, like California, Nevada, and a few other kind of States, were particularly hard hit because of the real estate decline.

We do have to live within our means. The Congress needs to try to find ways to make sure that, over the longer term, that our revenues and our expenditures are close enough that debt does not grow without limit. You know, we just really don't have any choice about that; that is just something we have to do. But as I tried to indicate in my remarks, at the end, that doesn't mean we can't think about the money that we are spending. Can we do it better? Can we use the money more effectively? Can we do it in ways that will be more growth promoting? And, you know, one way to do that, for example, is to think hard about health care costs, which are so very high, and see whether there are savings there that could be, for example, that could be put into, sort of more growth friendly types of investments.

But I appreciate your quandary. You know, we'd like to be able to undertake all these different projects, but we have to, at least in the longer term, we have to have a budget that will be reasonably in balance.

Ms. CASTOR. So, it would be helpful for me and others to explain back home what you have said in your testimony regarding the long-term fiscal challenges confronting the nation. The two most important driving forces behind the budget deficit are the aging of the population; they'll like that in Florida. And rapidly rising health care costs. And the CBO projections of federal spending for health care programs will roughly double as a percentage of GDP over the next 25 years, and may be explained to business owners there that rely on certain infrastructure investments, investments in education, and innovation that the strategy is working together to continue to make those strategic investments, but look at the long-term issues, especially surrounding health care and the aging population.

Mr. BERNANKE. Yes.

Ms. CASTOR. Thank you very much. I yield back.

Chairman RYAN. Mr. Flores.

Mr. FLORES. Thank you, Chairman. Mr. Chairman. Chairman Bernanke, thank you for joining us today. I appreciate your service to the country and to the Federal Reserve.

My first question starts with two principles. The first principle is there's a natural debt level for any organization, be it a country, a company, a family, whatever. They cannot be exceeded without substantial turmoil, and I think you talked about that in the past, about the turmoil our country will face if we continue to live beyond our means.

The second principle is that interest rates are made up of two components. The first component is expected inflation; the second component is a risk premium, which investors in that instrument want to receive for the perceived risk, the instrument.

Treasury rates have gone up quite a bit in the last few months. Your testimony today says that expected inflation is going to be low, so that implies a substantial increase in risk premium, which further implies that we are getting close to a natural debt limit. So my question for you is: What is the natural debt limit of the United States government? And you can answer it in one of a couple forms, either an absolute number, which would mean you ought to be in Las Vegas gambling, or as a percentage of GDP. So, I'd like some help with that, please.

Mr. BERNANKE. Well first, on interest rates, there is a third component also, which is the expectation of future short rates, which in turn, is tied to growth. So, one important reason that rates have gone up so much, and stock market had also gone up so much, is that markets are becoming more optimistic about growth in the U.S. economy, so that is a good thing.

Now, there may be part of the increase, I don't know how much, maybe a little bit, that is related to concerns about government fiscal policy, which is the other part of your question. There's no magic number for what ratio of debt to GDP is the limit. If we look around the world, we see that countries in the 60, 70 range, which is where we are now, are generally pretty comfortable.

If you look at Greece, which is 120 or Japan, which just got downgraded, because it is at 200, you know, numbers above 100 then are certainly very concerning. Of course, you always want to leave some space for a recession, or a war, or some other kind of emergency. So, I hope that we can stabilize the debt-to-GDP-ratio somewhere not too much higher than we are now, would be the ideal thing. But, I don't think there's a magic number, but the higher it gets, the more of your annual appropriations are going to pay the interest on the debt. And that is in a way, a drain on what the government could otherwise be doing.

Mr. FLORES. Thank you. Question number two is: You said today that we are on an unsustainable path, but in testimony, or in interviews you gave back in June of last year, you indicated that you felt like it was inappropriate to reduce spending or to increase taxes at that point in time.

But still, on the deficit, you said we need to reduce the deficit. So, you put us, let me rephrase that. If you are in our seat, there are not many tools left. So, which direction do you go first? Do you reduce spending? Do you raise taxes? What's the recommended approach?

Mr. BERNANKE. Well, the spending versus taxes or the composition of spending and taxes is a congressional prerogative, a congressional responsibility. But what I think is the right way to do this, which on the one hand, doesn't put too much pressure on the recovery, which is still ongoing, but at the same time, makes credible progress towards a balanced budget and a sustainable fiscal trajectory, is to talk about longer term windows and look at the 10 year window, for example, and take actions which are credible, that will cut spending, perhaps in the near term, but will cut spending more as you go forward in time, or raise taxes, if that is the decision that Congress makes.

So, this is a long-term problem. The numbers that we are looking at go out to 2035, 2050, that is when the problem really gets, basically, just unbearable. So anything that can be done now to change that path, change that trajectory going forward over the next decade or two decades, those are the kinds of things that will be effective and will have good impact on the current economy and current interest rates, as well as restore confidence in our fiscal policy.

Mr. FLORES. Thank you.

Chairman RYAN. Mr. Tonko.

Mr. TONKO. Thank you, Mr. Chair. Dr. Bernanke, thank you for your expertise that you lend to this economic recovery. When you came before this Committee last June, you predicted that the economic growth rate, our GDP, would rise to an annual rate of just over three percent for the last month of 2010, and that it very well could increase over the course of 2011. That's nearly a double digit turnaround from the six percent downturn that we witnessed under the end of President Bush's administration. Has your forecast, in your opinion, proven accurate in terms of how you calculated it and its bottom line result?

Mr. BERNANKE. Well, we were disappointed over last summer, as the economy slowed down, and that is why in August, essentially, we basically began to take the steps towards this second round of so-called quantitative easing. Since we've done that, the markets have strengthened again and the outlook has improved, and so the numbers you gave, the fourth quarter was 3.2 percent, and now, looking forward into 2011, you know, most forecasters think between 3 and 4 percent is about right. And of course, these things are very uncertain, but that does seem to be about where we, at this point, were predicting.

Mr. TONKO. We hear on the Hill here in Washington, in Congress, and certainly within the microcosm of the Budget Committee in the House, different philosophical approaches or programmatic responses to best grow the recovery of our economy. That being said, some of our colleagues, from friends across the aisle, have been very enthusiastic about these numbers, claiming that the growth that we've seen in the last three months is related to the outcome of the November elections.

I would ask, is there, within your calculus for these projections, was there a result in the November elections that guided whatever your forecast would be? In other words, did you need to know who would win the elections?

Mr. BERNANKE. We don't take election results into account in our forecasting, but I couldn't really make a judgment on that.

Mr. TONKO. I agree with you, that it is more policy-driven than politics. And so, can you cite for us, what did go into your calculation, your forecast, on growth and employment? And specifically, can you emphasize the main elements that we need to focus on in order to best drive numbers to help the economy improve and become more stable?

Mr. BERNANKE. Well, in terms of what happened since the late summer, there have been two policy initiatives at the Federal Reserve, QE2, which really came into effect in August, because that is when we began to re-invest our maturing securities and we announced, at least we indicated that we were seriously considering additional securities purchases. The other step that is been taken, of course, is the agreement that took place during the lame duck session about extending tax cuts and creating a payroll rebate, tax rebate, and so on.

So those two things have, I think, been positive in terms of near-term growth. Going forward, it is much more difficult because the fiscal space and the monetary space, and both sets of policies have much less room to operate than they would have under normal circumstances. So, as I was saying before to Ms. Castor, I think it is very important to think about the composition of what you are doing. Is it growth friendly? Is it going to increase confidence? And look for things that will, you know, increase productivity, for example.

Mr. TONKO. Thank you. I appreciate your expertise and would hope that, within the spirit of bi-partisanship and the growth of consumer investor confidence, we can move forward with a progressive bit of policy that will bolster this economic recovery and lead to the best way to move forward.

Just a final question out of the median annual wage for American workers, fall into some $26,000, means that just about that half of our workforce is making less than that $26,000 figure. And at the end of 2010, we okayed a tax plan that actually raised taxes on those individuals who make under $20,000 per year, while relieving the tax burden on our wealthiest families. Since those first payments came home in mid-January, I have been hearing from dismayed and outraged constituents on that outcome. If we continue to finance tax breaks for the top 1 percent, at the expense of our bottom 50 percent of wage earners, how would that impact on the consumer spending out there, that you noted is necessary to help lead us out of the economic woes?

Mr. BERNANKE. The distributional aspects of taxes are very contentious. I am sorry I'm not going to be able to really give you the answer you want, because I think, ultimately, there is both decisions about equity and decisions about efficiency that go into those tax code decisions.

So, I am going to leave that particular decision to the Congress, only note that you have to pay attention to the overall revenue collection as part of the plan for restoring budget balance over time.

Mr. TONKO. Why, thank you very much.

Chairman RYAN. Mr. Lankford.

Mr. LANKFORD. Thank you, Mr. Chairman. Chairman Bernanke thank you for coming. I'm sure it is your favorite day of the week, every time that you come up to the Hill and get a chance to spend the morning with us, so thank you for doing this.

In Oklahoma, where I represent, there have been a very large community banks that I have chatted with, that are very frustrated with the regulatory environment that is coming down. They feel like some of the largest banks in America made some mistakes, and they're being punished for it. Lending has slowed down dramatically, and they look at a single element for that. They look at the regulatory environment that is surrounding them.

Personal perspective from you: Where do you think the community banks stand, as far as any need to circle around in capital requirements and change the rules from discretionary to now? That is really what the rule is on areas. How do we free up the flow of money and the lending in smaller community banks in rural communities?

Mr. BERNANKE. Well, first, community banks have really shown their worth in this lending crisis. As many larger banks withdrew from small communities or from small business lending. A lot of community banks stepped up and began to make more loans, and that just shows the value of their personal connections and their knowledge of the local community, and so on.

I absolutely agree with you that small banks should not bear, and cannot bear, the same burden of regulation that the largest banks bear. They certainly don't pose the same risk to the financial system, for example. So what the Federal Reserve is doing there is several parts. I mean, first, we have added new committees and advisory groups to our regular routine, where the board meets with outside committees to create special roles for community banks. So, we have a new subcommittee on community banking; we have a counsel of community bankers that comes three times a year to meet with the board and talk about their issues; and we want to make particularly sure that as we implement the Dodd-Frank regulations, for example, which are mostly aimed at large, systemically critical banks, that we are very attentive to the possible implications for small banks. And we do want to do that.

The other thing that we've tried to do, and this is for all banks, is that we recognize that in some cases after a crisis, that bank examiners can become very conservative, because they don't want to see their bank, you know, fail, and be responsible for that. And as a result, they may put pressure on banks not to make, what would otherwise be potentially good loans.

We've done all we can to fight against that by issuing guidance to our examiners and to the banks, that we want loans to be made to credit-worthy borrowers by training our examiners, by having meetings all across the country with small businesses and small banks. So we are very focused on that issue, and I think we've made some progress and what I'm hearing and what we are seeing from surveys is some modest improvement now, in terms of the lending environment for small business, and some growth among community banks.

Mr. LANKFORD. Well, let me just say to you, from the Oklahoma perspective, there has been growth in that area. It has been very modest, because there's continued frustration with individuals that are saying, I need to lend and have plenty of folks that want to be able to borrow, but I'm tapped out in all these areas and my regulators are telling me this, and I'm stuck. And companies in the local areas are saying, I'd like to borrow, I'd like to expand, I'd like to hire more people, but currently the bank is hiring more compliance officers and we are doing less lending. And that is a very bad formula for what is actually functional for us.

Mr. BERNANKE. I agree with you.

Mr. LANKFORD. Let me mention a couple things. Right now, you mentioned the high priority for you is dealing with unemployment, which great on that. Then I'm sure there are times in different quarters you deal with inflation. How do you balance out what formula do you work through to say, I am going to balance, this quarter is going to be more on inflation, this quarter is going to be more on unemployment numbers. How do you all make that decision?

Mr. BERNANKE. We do it based on a variety of models and other things that help us project forward, where we think the economy is going to go. And right now, our models are showing that unemployment is likely to stay high for some time, as I was discussing earlier, and inflation, notwithstanding, we know about the commodity price increases, of course we are paying close attention to that, but notwithstanding that, underlying inflation looks to be still pretty low. And so, based on that, we think accommodative policies are still warranted.

We are very committed to price stability. We are not buying into any idea that we can get some more employment by letting inflation get higher than normal. We're not going to do that. We want inflation to be somewhere around 2 percent, or a bit less. So, as our models begin to suggest that the economy is moving towards those desired levels, then, you know, just like a quarterback has to lead a receiver, we have to begin to move before the economy gets there because we've got to withdraw that stimulus in advance of the point to where we get to where we want to be. So, even though models, and projections, and forecasts are obviously not always accurate, they are really our best tool to try to analyze at what point we need to begin to pull back on that support and begin to worry more about the inflation side and less about the employment side.

Mr. LANKFORD. Okay, thank you, Mr. Chairman, I yeild back.

Chairman RYAN. Mr. Ryan.

Mr. RYAN OF OHIO. Thank you, Chairman Ryan. I appreciate it. Thank you, Dr. Bernanke. One of the mandates for the Fed is to keep unemployment low. There are some folks in town who think that that should no longer be the role of the Fed. How would you have negotiated this crisis, and where would we be today if you didn't have that mandate?

Mr. BERNANKE. Well, our policies would probably have been somewhat similar, because from both sides, I mean, we had both high unemployment and low inflation, so both of those things have moved us to be accommodative. That being said, in situations like this, where unemployment is very high, and inflation is low, I think that monetary policy does have some scope to support recovery, and therefore, to help on the employment side. So, I say that, but again, re-emphasizing that just like other central banks, the Federal Reserve is very committed to price stability, and we will make sure that that happens as well.

Mr. RYAN OF OHIO. Would we have the unemployment numbers today if you didn't have the ability, or the mandate to look out for unemployment and try to keep it low?

Mr. BERNANKE. It is really very hard to tell, because again, inflation is also very low, so we might have been, we certainly would have had very easy policies anyway because of the need to keep inflation away from the deflation zone, to keep inflation away from zero. That being said, maybe it would have been somewhat less accommodative.

Mr. RYAN OF OHIO. Well I'm just concerned that if we get in this situation again and the Fed doesn't have that ability, that we could be in a worse scenario to recover and come out of this stuff. One of the things that struck me, one of the gentlemen from the other side asked you about, you said ambitiously four and a half percent growth, and if we had that ambitious growth, it would still take five years, and if we had three-plus growth percent a year, we would take 10 years to get out of here. That's a lost decade, as far as I can tell. We're in the same position Japan was in during the 1980s. I mean, that is unacceptable to me. I'm from Ohio; we have cities in my district that are 10, 15 percent unemployment. Crime is going up; we have all these social problems that are happening because people are out of work. What else could we do here, from the legislative side that could help drive that number down quicker?

Mr. BERNANKE. It's very difficult and no easy answers given where we are. The one suggestion I have, and I have been trying to reiterate this, is that even as you are looking at budget cuts and balancing the budget, all of which is very important, it is also important to be thinking about the composition. Can you, for example, can you make the tax code more growth-friendly? Can you improve the way your spending is allocated?

Mr. RYAN OF OHIO. Put additional investments in infrastructure, like you mentioned, you know, $50 billion, $100 billion in the next year or two for infrastructure that needs to get done anyway in education, in job retraining that would put people directly back to work. Is that something that would help drive down this unemployment rate quicker?

Mr. BERNANKE. What I would like to see it combined with a longer-term perspective that maintains budget discipline over the next few years. Otherwise, a risk might be that interest rates would go up and that would undo some of the benefits.

Mr. RYAN OF OHIO. I think we are all in agreement that the long-term demographics and health care costs, and that is what we tried to deal with the Health Care Reform Bill, which CBO says will save us a $1 trillion in the second decade and almost $200 billion in the first decade, that is what CBO is saying. And also some disincentives to work that were mentioned earlier. One of the disincentives to work I experience with folks in my district is, they're better off being on Medicaid because they have health care for their kids. Health care reform is now an incentive to go back to work, because you will be rewarded with health care. So I think those are two things that need to be addressed. So I think we need additional fiscal stimulus to drive unemployment down, we shouldn't be so worried about inflation in places outside of our country so much, and I think we've got to worry about jobs here at home.

One final question on Chinese currency, do you still believe that the Chinese are manipulating their currency, and if they are, is that fueling the inflation in China? And how is the manipulation of Chinese currency affecting our ability to recover here in the United States? So I just wrapped three into one there.

Mr. BERNANKE. Their currency, the renminbi is undervalued; it would be both in our interest and in Chinese interest for them to raise the value of their currency, and it would help them with their inflation problem. One of the things that is happening, which is a little surprising in a way, is that they have an inflation problem and the way they are addressing it is not by raising their currency value, which would reduce the demand for their exports. Rather, they are leaving it where it is, and they are instead trying to reduce domestic demand through higher interest rates. And it would seem like a better strategy would be to let domestic demand be what it is, and let people enjoy a higher standard of living in China, and reduce their exports via a higher exchange rate. So yes, it is a counterproductive policy both for them and for us, and it is contributing to the still-large global imbalances in terms of current accounts that we see around the world. Thank you.

Mr. RYAN OF OHIO. Thank you, Dr. Bernanke.

Chairman RYAN. Mr. Mulvaney.

Mr. MULVANEY. Thank you, Mr. Chairman. Dr. Bernanke, it is a privilege to be here and to bring you greetings from Dillon, South Carolina, which I have the honor to represent. Thanks for doing this. Very quickly, I'm going to try and bring us back to the budget process because we are getting ready to start that here right away. And one of the things that obviously we look at, I know you have looked at, is the CBO baseline projections, which were made available to us, I think, last week. And I'm comparing it to what I'm seeing happen in the bond market, we saw I think the 10-year Treasury go through 3.5 percent on Monday, 3.7 yesterday, I understand as recently as 11:30 it was still trading above 3.7. When you look at the CBO's projections for what the interest rates will be over the course of this year, they assume a 3.4 percent rate for the 10-year Treasury for the balance of this year. Is it fair to say, sir, that the CBO may have underestimated the interest-rate environment that we are going to see for the balance of 2011?

Mr. BERNANKE. I would say that since we are at 3.7 now, that reflects anticipation of higher growth. Of course, as you know, the rates change pretty radically. I don't happen to know what the CBO expects for next year. I think for the longer-term horizon, it is the whole path that matters. But as the economy recovers and normalizes, you would expect interest rates to go up.

Mr. MULVANEY. It's 3.8 percent for next year and roughly 3.5 percent over the course of the next several years. My concern, obviously, is something that you referred to earlier, which is that we are so exposed on our debt at roughly $14 trillion that they even admit, by the way, the CBO does, that if they are off by just 1 percent on their estimates for interest rates, it translates into an additional 1.3 trillion dollars worth of debt over the next decade.

Brings me to the next issue which you have heard discussed a couple times, which is the debt ceiling. And I have heard the back-and-forth, and you said something that caught my attention, which is that you were concerned, obviously, that some of the proposals that may have been offered, including Senator Toomey's, you had some questions about the workability of that. About trying to prioritize spending amongst debt repayment, interest repayment, and various benefit programs. Given our fiscal situation, if we were able to figure out a way to work through those workability problems, if we were able to figure out a way to prioritize, would that assuage your concerns about using the debt ceiling as an environment to have some discussions about changing our fiscal policy?

Mr. BERNANKE. Well, my concern, since I'm mostly involved in the financial side, my concern is about, you know, not defaulting on the debt, and I think that for me is a very high priority. So that would help, on that count, very much. You still would be in a position, of course, where you would be not paying contractors, for example, you would be not putting out Social Security and Medicare checks and those things, and if you think that is something you are willing to do, that is really up to Congress to decide.

Mr. MULVANEY. That's fair enough. Last question, we have talked about your plans to exit this expansionary policy when you see the need to do so, and you have talked about raising rates, talked about redeeming some of the securities that you hold. Are you satisfied that you will be able to do that quickly enough to react to inflationary concerns?

Mr. BERNANKE. Yes, we can raise short-term interest rates, which are the main tool we have, essentially as quickly as we like. Because we can raise the interest rate we pay on excess reserves to banks. So yes, we don't have to sell off all our assets to tighten policy. We can do it via our control over short-term interest rates.

Mr. MULVANEY. Have you given serious consideration to not completing the QE2 program?

Mr. BERNANKE. We review that program at every meeting. We have another meeting coming up in the middle of March. And we will, as we always do, we are going to look at the outlook for both employment and inflation, and it is certainly possible. We take very seriously that this is a program that needs to be looked at every meeting, and in light of however the economic news comes in.

Mr. MULVANEY. Given that QE2 is more of the unusual and extreme, extreme is not the right word, but the more unusual tool that you are using this period. Would it be fair to say that you would consider ending QE2 before raising short-term rates?

Mr. BERNANKE. Yes, I think that will be the most likely outcome, yes.

Mr. MULVANEY. And the last question I have got; maybe it is not a question, it is a point. There's another $1.4, $1.5-trillion gorilla in the room, isn't there, in terms of the amount that gets dumped in the system, the expansionary policies that we are talking about, which is our fiscal policy.

You have no control over our fiscal policy and you could do everything possible to tamp that inflation, to restrict monetary expansion policy, and if we continue to spend a bunch of money we don't have, we will be contributing to the inflationary pressures, won't we?

Mr. BERNANKE. Yes, but I think even more severely, you will be contributing to financial problems, stress in the financial markets.

Mr. MULVANEY. Thank you, sir.

Mr. BERNANKE. And say hello to my friends in Dillon for me.

Mr. MULVANEY. I'd be happy to. Thank you.

Mr. MCCLINTOCK. Mr. Pascrell is next.

Mr. PASCRELL. Thank you Mr. Chairman, Dr. Bernanke, thank you for laying bare some of the myths for us on both sides of the aisle, about the financial situation that we face today and the financial situation we actually faced a few years ago, and hopefully, we will learn and move on.

I want to thank both Chairman Ryan and Ranking Member Van Hollen because of this civil tone that the questions have taken. I think it is struck me, maybe it is normal for all of you. So, I will try to continue on that avenue. I will try my best.

For the past several months, some folks have been promoting the myth of a Europe, with an overrun health care system, overbearing government, and economic stagnation. But not long ago, some of these same people had nothing but praise for the same country's low taxes, low spending economies. So, the problem of this theory is that it is incorrect, I think.

Ireland ranked near the top of the Heritage Foundation's so-called Economic Freedom Index, while sitting on a property bubble, fueled by banks that had run wild. Then the bubble burst, and the revenue dropped, and the public debt exploded.

We need to remember, my good friend, the mayor of New York, who said a year and a half ago when he was running, that what we need to do, it won't be too long before a return, it'll take us four or five years before we return to where we were in 2006.

The point is, we don't want to return to what it was in 2006, because that is the problems that we did not address, and we see the systemic and we see the results of not addressing them. So, these countries are relying on the same theories of slash-and-burn budgeting that is being talked about here, not just today. The problem is it doesn't work.

For instance, Britain: its gross domestic product fell 0.5 percent in the last quarter of 2010, widespread losses in construction, widespread losses in transportation, and in services rendered to the public. So, I think we are all here to roll up our sleeves, with your direction and advice, address our long-term deficit. But we cannot pull the legs out from under the recovery, and I think this is your message. Correct me if I'm wrong. By taking a slash-and-burn approach to government operations, or hold the full-faith credit of the country hostage.

Mr. Chairman, what do you see as the results of the immediate and drastic cuts to the federal budget? What would be the result, in your view?

Mr. BERNANKE. Well, I think if that is all that was done, that the costs to the recovery would outweigh the benefits, in terms of fiscal discipline. I think we really need to take a long-term view. Now, maybe a little bit of a down payment is needed, but we need to show that we have a plan that will carry us forward for the next decade at least, that will produce consistent reductions in that deficit over time, and it has the benefit of allowing us to think it through, and to take the time needed to change programs, et cetera. So, again, my message is that, I think, that the best approach is to take a longer term perspective.

Mr. PASCRELL. This is not just the one or two year solution.

Mr. BERNANKE. It is not a one or two year thing. Nothing we can do this year will serve this long-term problem.

Mr. PASCRELL. I think folks on both sides of the aisle have to understand that. On our side of the aisle as well. So, there has to be cuts to the budget; there's no two ways about it. We cannot continue, and we cannot continue to have tax cuts that are not paid for, where we have no offsets, like we did in 2001, 2003. We were warned in those years; we were warned in 1999, before those things ever happened.

And obviously, we did not heed them. My last question is: Is it your opinion that whatever deficit savings, we would find an immediate and drastic slash approach to the budget, would be lost to an economic downturn or stagnation? Do you agree with that?

Mr. BERNANKE. I don't know quantitatively, but I do think there is a concern about only focusing on short-term cuts, because of the recovery, which is, obviously, still not complete. I think cuts, combined with a long-term perspective, will be both less painful for the current recovery and also more credible in the bond markets.

Mr. PASCRELL. Thank you, I do appreciate it. Thank you, Chairman.

Mr. MCCLINTOCK. Our time is fleeting and the staff has suggested and the minority has agreed that we go to three minutes, if there's no objection, on the remaining questions. So, without objection, we will next go to Mr. Akin.

Mr. AKIN. Thank you, Mr. Chairman. It seems like when we talk about dealing with the budget deficit, it reminds me a little bit about these all kinds of imaginative weight-loss programs, you know? It seems like when you get down to the bottom line, you can either eat less or you can exercise more. You're only given two alternatives. It seems like we are in the same way, we can try and sugar-coat it, but the problem is that either we are spending too much or we've got to tax a whole lot more. The comment was made earlier, which I thought was an amazing quotation from Ms. McCollum, The budget deficit is not a spending problem. I found that amazing, because it seemed like to me it sure is a big spending problems. We're just on different planets, I suppose, but let's just assume, instead of you are going to cut spending, that you are going to try to increase taxes.

Now, my understanding is, I take a look at historic data, our tax revenues run somewhere in that 18 percent range. My understanding is if we were to double the tax rate on everything across the board, we couldn't assume that we are going to get double in revenue, federal revenue.

In fact, we may well do what you are saying, crash the economy and get even less. I do recall, we did dividends, capital gains, and death text in May 2003, and the Congressional Budget Office said, Well, now you are going to have less revenue, but in fact, there was more revenue because the economy kind of got going.

So, my question is, when I take a look at this overall problem that we are, you know, too heavy, in terms of like a weight loss thing, it is pretty spooky to me because you add all of the entitlements, the main ones, Medicare, Medicaid, Social Security, and then the other kinds of entitlements, and add debt service to that, and it seems, when I looked at the numbers, it was looking like about 2.3, roughly, trillion. And our revenue is about the same thing. So that says you get zero defense, zero discretionary non-defense, and you are right now just a parody. So, I don't understand. I guess my question to you is, first of all, don't we have to, essentially, deal with the entitlements, just by definition, or can you actually make it up by just doubling taxes and hope there's going to be a ton more revenue?

Mr. BERNANKE. Well, I think that, as you point out, I mean, that in the long run, the way we are going, entitlements plus interest would basically be the entire government budget, and so, unless you raise taxes considerably. Now it is up to Congress to find the right balance between taxes, and cuts, and so on, of course. But I think you need to look seriously, particularly at the health care costs, which is of course, part of what has been going on the last couple of years here in Congress, but I think a focus on the cost side is important.

And, it would be difficult, I think. I'm very loath to prescribe exactly how to address these issues; I do think that it would be very difficult to leave health care programs untouched and still achieve budgetary balance in the next 15 years.

Mr. AKIN. Thank you. I think what I heard you saying is, is you really got a deal with that rate of spending, and particularly, in the entitlement, the health care piece is such a big part of that, that has to be dealt with. And that raising taxes, just to finish the question.

Mr. MCCLINTOCK. I am sorry, we are out of time.

Mr. AKIN. Thank you.

Mr. MCCLINTOCK. Ms. Schwartz is next.

Ms. SCHWARTZ. Thank you, and thank you, Chairman Bernanke, for your good work over the last few years in helping the economy begin to grow and to do your part; not easy decisions on any of our parts, so, I appreciate what you have done.

And, some of your comments this morning were really very important to us as we see this beginning of a recovery. And some of your comments about your optimism may be too strong, but your sense that we are growing and growing out of this.

You also made some comments I want to follow up on, which was really about the debt ceiling and the recklessness of there being politics played with raising the debt ceiling. None of us want to raise the debt ceiling, I mean, we would much rather not have be in this situation, but the two consequences of not raising the debt ceiling, as you have pointed out, and I want to confirm, the harm it would do to the United States and our ability to borrow in the future, interest rates, and really, defaulting on our not paying. It is just a huge consequence to our economy, so I did want you to talk about that again, if you would.

And secondly, as I think it is been pointed out and President of the Chair, Mr. McClintock and Senator from Pennsylvania, our new senator, Senator Toomey, have proposed legislation that would make debt payment to our creditors, our foreign creditors, the priority over paying, instead of paying, our Social Security beneficiaries possibly not getting checks, or our veterans not getting payments, U.S. contractors not getting payments, so it would put the U.S. in a different position of no longer having faith with American seniors, American veterans, and of course, U.S. companies or creditors.

So, could you comment on both of those, and I think you have commented very much on the first piece about how reckless it would be. But of course the second one, to put us in a position of losing faith with the American people who have counted on us do that and leaving that prioritization, making a statement very clearly that we would rather pay our foreign creditors than actually pat the American people.

Mr. BERNANKE. On the first, defaulting on the debt would create probably an immediate financial crisis, a very severe one, and would have very deep consequences for our economy. And, even assuming that we were able to get through that, it would probably lead to much higher interest rates for the United States for many years to come, and that is been pointed out by a couple of folks, that applying a higher interest rate to our existing debt means that will be a very big step backward, in terms of trying to balance our budget.

On the prioritization, that might help address the default problem, which is very important. It is up to Congress, I suppose, whether you think it is worth doing what you say, which is you would be stopping Social Security checks and those sorts of things. I just wanted to make the very narrow point, but still important point, that there are operational problems as well.

I mean, even if we were instructed, the Federal Reserve is the agent of the Treasury. We make a lot of the payments on behalf of the Treasury, and we would have to figure out how to tell that this check is Mr. Jones is a payment on his interest, and this check is the Social Security check. There would be some practical, operational problems that we would like to bring up, if we move in this direction.

Ms. SCHWARTZ. So, you were saying, it is reckless. Thank you very much. I appreciate your comments.

Mr. MCCLINTOCK. Mr. Woodall is next.

Mr. WOODALL. Mr. Chairman, hi.

Mr. BERNANKE. Hi.

Mr. WOODALL. I appreciate you are willing to spend this two and a half hours, with us as a junior member and a tardy member, I am the real beneficiary of your commitment to give us that time. So, I'm grateful.

I have appreciated your comments about the economic impacts of simplifying the tax codes, lowering rates, eliminating those distortions that are there. I wanted to talk specifically about those dollars that are overseas. I think back to the Wall Street Editorial that the Cisco President and Oracle CEO put together $1 trillion overseas that want to come back home, for whatever odd reason. I'm new to this body: We'll tax you if you try to bring that money and invest it in America but we will let you invest it overseas for free. What do you think the economic impact would be of having that tax holiday, to allow those American companies who want to bring invest those dollars in America?

Mr. BERNANKE. Well, we've done that before, a few years ago. And a lot of money did come back. Some of it went to dividends and that sort of thing. Some of it probably went to investment; it is a little hard to tell how much would go in each direction. I think if you were going to do that, you might want to consider the sort of more permanent alternative, which is to do what other countries do, most other countries, and tax on a territorial basis in the first place. But you certainly would get a lot of repatriation if you did a holiday, no question.

Mr. WOODALL. And you have talked a lot about low long-term bond rates. I think, when we did it back in 2003, the rate was five and a quarter that you could repatriate it. Would we see a substantial difference if that rate was zero and without those limitations that we placed on that repatriation back in 2003, or would it be substantially the same?

Mr. BERNANKE. Either one is probably a good bit less than the normal rate, so I think any low rate would create a lot of repatriation. I don't really have more to add on that.

Mr. WOODALL. There was a lot of discussion, back at that time, about how many of those dollars went to dividends. Now, you have talked a lot about the importance of consumer spending, in terms of getting us out of our current situation. Having those dollars go to dividends, is that a bad thing? Is that just different from investment, but it is still going to contribute.

Mr. BERNANKE. Yes, dividends can be spent by consumers, that is right.

Mr. WOODALL. You also have talked about the importance of asking the question of how smart is the spending. Is there any spending out there that you would say is sacrosanct and should not be examined? Or should we be looking at everything as we are asking the question about how smart is the spending?

Mr. BERNANKE. I hope you will look at everything.

Mr. WOODALL. Thank you very much.

Mr. MCCLINTOCK. Ms. Wasserman Schultz is next.

Ms. WASSERMAN SCHULTZ. Thank you. Chairman Bernanke, it is good to be with you. When you testified before the Senate Budget Committee last month, you observed that the Recovery Act funds will run out in 2011, and you acknowledged at that time, that the expiration of those stimulus fund would worsen the fiscal outlook of States and localities, and in your words, present a headwind for the overall economy.

In addition, with the announcement of Chairman Ryan's spending caps for Fiscal Year 2011, our colleagues on the other side of the aisle are intending to further cut some types of discretionary spending, that was such a critical component in the Recovery Act. And so essentially, that is like an anti-Recovery Act.

Given this headwind, what would you say the impact would be, coupled with the inevitable cuts in state and local budgets because of the deficits that they are now going to face, because of the Recovery Act hole, combined with the draconian spending cuts proposed by our Republican colleagues, is there any way that solely cutting discretionary funding spending in 2011, which is Mr. Ryan's plan, is going to create jobs on its own? And what impact is that going to have?

Mr. BERNANKE. For state and local governments specifically, their tax revenues have improved somewhat as the economy's gotten better, which is obviously a help, but they are still under considerable strain, and that reduction in employment and spending at that level is going to be a negative for growth.

I can only come back to the point I have made a couple of times, which is that I think it is very important to address the deficit, but I hope that rather than doing a one-off kind of thing, that you will look at a longer term window, a longer term horizon, and in thinking about it, and keep in mind that we are still coming out of the very deep recession right now, but that doesn't, in any way, reduce the need to address these long-term structural budget problems, and I hope that you will do that in a very serious way.

Ms. WASSERMAN SCHULTZ. Acknowledging that we do need to address the deficit, but taking, by themselves, which is what is proposed, draconian cuts from the Chairman of the Budget Committee, combined with the impact of the Recovery Act funds being phased out and no longer being available, what is that likely to do to the jobs, our potential for creating jobs, and the continued pace of the recovery?

Mr. BERNANKE. Well, it would depend on the details, but again, I just would like to re-iterate that it is better, I think, to think about this in the context of a longer term plan, a longer term trajectory for fiscal spending.

Ms. WASSERMAN SCHULTZ. And, on health care, the Affordable Care Act included numerous provisions to contain costs by moving from a payment system that rewards quantity to one rewards quality, and value and efficiency. Would you agree that by giving providers incentives to coordinate care and reduce wasteful spending, that we have the potential to generate real savings there?

Mr. BERNANKE. I'm not really able to make estimates. I know there are some measures in the health care plan that are intended to reduce costs. I don't know how effective they are going to be. I think that is something that the Congress ought to monitor very closely, and look for any additional ways that you can find to control wasteful spending, which, of course, there is a great deal, I think, in the health care industry.

So, since, as we were discussing earlier, since health care spending is going to be an enormous part of the federal budget in coming decades, finding anything you can do to reduce unnecessary spending will be very, very helpful.

Chairman RYAN. Thank you, Chairman. Mr. Rokita.

Mr. ROKITA. Thank you. I love it, how in Washington, D.C., cutting 2.5 percent of a budget deficit is draconian. I also appreciate your thoughts about long-term reform, because it is just the beginning, and I can't wait to get to some long-term reforms. When you say you are going to be vigilant about watching for inflation, can you name one time in your agency's history where you got it right? Where you got on the brakes in time to correct runaway inflation, do you have any track record at all?

Mr. BERNANKE. Absolutely. Ever since Paul Volcker conquered inflation in the early 1980s, inflation has come down very steadily.

Mr. ROKITA. I feared that you were going to mention Paul Volcker. I don't think you got to it in time.

Mr. BERNANKE. Well, I'm saying after.

Mr. ROKITA. Your goal is two percent or less.

Mr. BERNANKE. By the time Chairman Volcker left office, he came in with a 13 percent inflation rate. He left office with a four percent inflation rate.

Mr. ROKITA. After it went to

Mr. BERNANKE. Thirteen percent was the highest. Then it came down, over about eight years, under his stewardship, to about four percent. Then, from there, under Chairman Greenspan, until the late 1990s, it came down gradually, to about two percent, and it is been there ever since.

Mr. ROKITA. I don't think the agency got to inflation on time, as you are proposing.

Mr. BERNANKE. It has. It has, except in the 1970s, which, of course, we've learned from.

Mr. ROKITA. Okay, well, maybe we will beg to differ there. The banks: there's a lot of government products on the street to support this borrowing that we are doing. Doesn't it make sense, at least, it does to me, that when banks have one of your products to invest in on their balance sheets, versus the small business down the street, they're going to go to your product. And, so, couldn't you argue, then, to Mr. Lankford's point that, my Lord, if we just stop these products from being offered and let banks invest in the private sector, where you get a better return on your money, that that could be a solution? At least to Mr. Lankford's question?

Mr. BERNANKE. No, I don't think so. First of all, we pay 25 basis points, one fourth of one percent. So, if there's any attractive lending opportunity out there, banks would certainly prefer to do that than put money with us.

Secondly, the existence of those reserves is the counterpart to the purchase of securities that we are doing, which, in turn, is lowering rates, and making it easier for borrowers to get credit. So, you can't look at one side, and not look at the other side. So, I think that is not correct. I think it does help credit extension.

Mr. ROKITA. Okay, thank you. Over the last three years, you advocate over $1 trillion in government spending. Considering, when government gets a dollar, we make 60 cents I think the private sector record is for every dollar the private sector makes $1.20 or $1.30. Can't you at least argue that taxing and borrowing, and bigger government is not the most effective way to grow the economy?

Mr. BERNANKE. It's certainly true that taxation, in particular, has what's called a dead-weight loss. And, so the loss to the private sector is greater than the taxes actually paid because of the distortions that are caused. And, as I have said, I think anything that can be done to make the tax code more efficient, fairer, lower rates, and so on, would be good for the economy.

Mr. ROKITA. I agree with you there. Thank you, sir.

Chairman RYAN. Commissioner Yarmuth?

Mr. YARMUTH. Thank you, Mr. Chairman. Chairman Bernanke, thank you very much for your testimony. I want to return to this issue of the possibility of not extending, or raising, the debt ceiling, and focus on the economic consequences. The American people, I think, would be repulsed by the idea that we would default on our debt, just as a concept, and you have called it catastrophic, we call it reckless, all in all, not a good idea. But, the idea of prioritizing payments is frightening to me, because wouldn't this essentially have the effect of we would be paying China before we would be paying our troops in Afghanistan?

Mr. BERNANKE. Yes.

Mr. YARMUTH. It's a pretty scary concept. Talking about, again, the impact on the economy, if we were to not raise the debt ceiling, and we didn't do it for six months, in that period of time, absent that, we would be spending about a $1.8, $1.9 trillion, in the current levels, something like that, during that six months. Wouldn't that be about right? Just short of $4 trillion, overall, we'd be spending close to $2 trillion. And we are now borrowing 40 to 50 cents of every dollar we spend. So, essentially, wouldn't we be taking somewhere close to a trillion dollars out of the economy during that six-month period? Which, essentially, is more than the entire Recovery and Reinvestment Act?

Mr. BERNANKE. Well, first of all, as you point out, some of that money would be going overseas, and so on, but, I think that effect would be just dwarfed by the financial crisis that you would be engendering.

Mr. YARMUTH. All in all, pretty, draconian, is the word that is been thrown around here, pretty draconian, and negative impacts all around.

I wanted to clarify one thing that Mr. Akin raised about my colleague, Ms. McCollum's, statement. I don't think she said that it was not a spending problem. She said it is not solely a spending problem. And, just recently, there was a report out that we are at the lowest tax rate in this country in 60 years, could you square the concept that we don't have at least somewhat of a revenue problem, in terms of the budget deficit?

Mr. BERNANKE. Well, we have a revenue problem right now, in part, because we haven't recovered. And, so, the share of GDP that were getting revenues is way below the historical average. So, that is a temporary situation, we hope. And, we hope that we will go back more towards the sort of 19 percent GDP that is been normal. But, in the longer term, basically, Congress is just going to have to decide where its values are, whether it wants to raise taxes, whether it wants to cut spending, or wants to make a combination. I hope you look at the whole set of options, and try to think about what's best for the economy.

Mr. YARMUTH. I just want to make one comment, because you referenced taxes that are growth-friendly. My brother is in the barbecue business. He's done extremely well, paid a lot of taxes. And, he said, when we were talking about whether to extend the tax rate for the people making over a quarter of a million dollars, which certainly includes him, he said, "I don't care what my tax rate is. I care that people can afford barbecue. Because, if they can't afford barbecue, it doesn't matter what my tax rate is." Thank you very much.

Chairman RYAN. Mr. Guinta.

Mr. GUINTA. Thank you very much, Mr. Chairman. And, thank you, Dr. Bernanke, for being here. I want to stay a little bit on the subject matter of debt ceiling, and then I want to move into state pension reform and state debt and deficit, and how that may impact the decisions that Congress has to make.

Earlier, during the hearing, someone had referred to our debt ceiling vote as quote "routine." I happen to be one of the people that believes that is part of the problem that we are having. This notion that we are going to continue, as the federal government, to borrow beyond our means, I think has a direct impact to the global markets, to our markets here, and to the consumers and employers and small business owners, that are trying to have some predictability, who are the ones who are going to really help us emerge stronger as a nation, and as an economy. I also was concerned about some of the comments you had made, or phrases that you had used; some, I appreciated and agree with, and some concern me.

One was unwind some of this stimulus. I agree with that. I think what you are saying is we should be stopping the use of stimulus, and returning some of those dollars. But, you also said, future spending must be quote "smart" spending. When you say, future spending must be smart spending, how would you categorize the spending up to this point, in the last two years?

Mr. BERNANKE. I was only making a point. What I'm afraid of is that Congress will look only at the total spending, the total revenue numbers, and then try to worry about how to make those equal, which is important. But, it is also important to look at the programs, look at the tax code, and make sure that it is as effective as possible. I wasn't claiming that I could identify waste, fraud, and abuse. But, clearly, whatever changes you can make.

Mr. GUINTA. It's a multi-pronged approach, then.

Mr. BERNANKE. Yes.

Mr. GUINTA. We have got to reduce our spending. We've got to simplify the tax code, which I think I had heard you said earlier. And we've got to sort of restore, or I would argue, reduce some of the regulatory environment that is going to get some of that private sector money, that is on the sideline, back into the economy, which I think would replace the federal spending that is being suggested as required for this economy to move forward.

The second question I have, or concern I have, is according to Census Bureau data, this is fiscal year 2008, we have four percent of interest on debt as the share of state and local expenditures, and we have fiscal year 2008 debt outstanding as a share of GSP 18.2 percent. Can you comment briefly on those levels? If they're appropriate, if they're high, if they're low, and then compare it to our levels at the federal level?

Mr. BERNANKE. Well, they're clearly lower than the federal. I mean, it 18 percent versus 69 percent, and most of that debt is associated with capital projects as well. So, in that respect, the states are not as bad off, in some sense, as the federal government.

On the other hand, they have a very difficult short-term situation, because they do have balanced budget amendments, and with the fallen tax revenues, they're having some very difficult cuts they've had to make on spending and employment.

But, I would say, also, that 18 percent number doesn't take into account some long-term issues, I think you have referred to already, with pensions and health care; unfunded liabilities, which are potentially much more significant.

Chairman RYAN. Thank you, sir. Ms. Kaptur?

Ms. KAPTUR. Thank you, Mr. Chairman, very much. And, thank you, Chairman Bernanke, for your long suffering today. I apologize. I had to leave for another hearing. I have three simple questions, that are probably just one-word answers, and then a little bit longer one. Have you ever seen a recovery in modern history that has not been led forward by housing and construction?

Mr. BERNANKE. It is normal for housing and construction to be an important part of the recovery.

Ms. KAPTUR. Thank you very much. Its absence is particularly troubling to this member.

Number Two. With the instability in the Middle East, and rising gas prices, could I ask you, at what level of gas prices in our nation would we trigger a deep recession again? I put that number about $4 a gallon. Where would you put it?

Mr. BERNANKE. I don't think there's a single number. But, it is absolutely true that as we move up above four that you are beginning to take a significant amount of disposable income away from people, and that acts like a tax, essentially, and makes it more difficult for the economy to grow.

Ms. KAPTUR. Thank you. I don't know if you have any ideas about helping to put to work the unemployed you so aptly identified in your opening statement; those who've been out of work for more than six months. Thank you for recognizing that. That lost productivity is of deep concern.

What, in your opinion, would be the most effective means to reemploy them in the short-term, and to gain productivity in this economy?

Mr. BERNANKE. I don't have any good answers. As you know, the Fed is trying to do our best to help improve the employment situation. I guess one area to look at would be the unemployment insurance system. Maybe there might be ways to use some of the money to give training, for example, rather than just simple income support.

Ms. KAPTUR. Thank you very much for that. Longest question, last December, Congress and the courts forced the Federal Reserve to release its report on what it had done during the financial crisis, and which financial institutions received money through the Federal Reserve. You had opposed compiling and releasing that report, claiming that making Federal Reserve activities public would disturb the financial markets.

What we have learned is that the Federal Reserve really wanted to keep secret that it had bought back, from German and Swiss banks, more than a half of a trillion dollars of bad mortgage-backed securities that Wall Street's megabanks had pawned off to those banks. Clearly, this was something that the Fed apparently didn't want the Congress and the public to know. We now also know that private gains provided to Wall Street and foreign banks were at the expense of massive social costs, forced on our public in the form of growing debt from historic levels of unemployment. Why shouldn't Congress and the public know what the Fed is doing, especially when it puts onto the U.S. financial system, and public system, such burdens as buying back bad bonds from foreign banks?

And my questions are: Did you defend secrecy for the sake of secrecy? Or, did you defend secrecy to protect the Fed from the public's view of mistakes made by the Fed and its member institutions?

Mr. BERNANKE. There is no longer any secrecy. The discount window, where there is some case to have secrecy during the period of the crisis, all that information is now revealed, with a two-year lag, under the Dodd-Frank Act. So, there is no aspect of the Fed's operations now, which is permanently secret. I have no idea what you are talking about with the Swiss. We have not purchased mortgage bonds from anybody, other than Fannie and Freddie, and we lent money to only banks that had, through their U.S. operations, which is required by law, that we treat all domestically operating banks the same. And we'd lent against collateral, and we were paid in every single case.

Ms. KAPTUR. Thank You.

Chairman RYAN. I ask unanimous consent that all members questions be included in the record and that the chairman respond to them. Mr. Young.

Mr. YOUNG. Mr. Chairman, thank you for visiting with us. It's my privilege to be with you on behalf of my Southern Indiana constituents. As you know, Japan recently had its credit rating downgraded, in light of its fiscal situation. Part of the justification for Standard & Poor's downgrade was the fact that Japan has no coherent plan to deal with its unsustainable fiscal situation.

Here in this country, like Japan, we have very low interest rates, as compared to recent history. Our own deficits are adding to our national debt at a remarkable rate. And, we too, have no coherent plan to deal with this; at least in the long term.

You have indicated that there is no magic number. I think that is fair. I think history proves it out. There's no magic debt to GDP number. That said, you no doubt, have some sense of when we are getting close to unsustainable debt dynamics.

When are we getting close, and what are the main indicators that we need to monitor, we, as members of Congress, you as the Federal Reserve, to avoid a crisis?

Mr. BERNANKE. We already have a considerable increase in our debt-to-GDP-ratio, and we are heading towards ninety percent by the end of 2020, I believe. I'm not sure. So, as we move up beyond 90, as we move to a hundred, we are approaching the levels of where some of the countries in Europe are now that are having very serious problems. So, again there's not a magic number. And problem is that you can't tell in advance when the bond markets might begin to become worried.

I think the bond markets are looking not only, anyway, at the debt to GDP number. They are looking, as you mentioned, at the plan. Does the country have a plan? Does it have the political will, and so on? I think if we demonstrate that we have the political will, I think the markets will be quite forgiving.

Mr. YOUNG. I suspected that you would say that. So, it is the very fact that this Congress does not implement a bipartisan, coherent plan, to deal with that situation. To that end, one of the things that is, no doubt, driving our debt to GDP is our federal spending. Things like Medicare. And, I was encouraged to hear my friend on the other side of the isle indicate earlier, she wants to put everything on the table, as we deal with this.

Medicare, why don't we take that, and put that on the table as one example? Because you have recently indicated that we have a choice. In your National Press Club comments, you said we can either make adjustments, through a careful and deliberative process, or, when this crisis hits, we are going to have to do things very quickly, in a hasty way that maybe most of our country is uncomfortable with. Do you agree that Medicare is on an unsustainable path, and that it must be addressed fairly quickly here?

Mr. BERNANKE. It's going to be a very, very big share. Medicare, Medicaid, all health care spending programs will be a very big share of government spending, and of GDP over the next 10, 15, 20 years. And I think long-term budgetary stability, and economic health of the United States in general, requires us to look very, very hard at ways to save costs on health care.

Mr. YOUNG. Thanks so much. I regret my time is up.

Chairman RYAN. Ms. Bass.

Ms. BASS OF CALIFORNIA. Thank you. Thank you, Mr. Chairman. I'd like to ask you questions about the consequences of not lifting the debt ceiling I wanted to know if you could paint a picture of the consequences?

Coming from the State of California, and in the State Legislature, we were having to manage our budget crisis. When I was first there a couple of years ago, our budget was a hundred and $10 billion dollars. We cut it to $83 billion. And, now my colleagues, that are still there, are left with a $23 billion deficit. And, so, if we didn't lift the debt ceiling, what would that do to the States? Would States be able to refinance their debt?

Mr. BERNANKE. Well, I think it is important to note that California always paid its interest. I mean, it used Scrip, and so on, for some employees, and for some payments, but it is paid its interest. Even so, I think the risk premium on California debt went up for a while; at least following that.

It's clear that the failure to pay interest on U.S. debt would just create enormous crises of confidence in the financial markets, and in the bond markets. It would, as a practical matter, cascade through the system because banks and other institutions who are counting on receiving the interest in order to make their payments would not be able to make their payments, and so you have a seizing up of the financial system that could be quite detrimental to our economy. Even if that was worked through somehow, and say for example, the debt ceiling was raised for a few hours, the long-term consequences in terms of the interest rate that the United States Government would have to pay could be quite serious, which in turn would make our debt payments, interest payments much higher, and make the deficit all that much worse. On the States, I think there will be some indirect effects because, after all, the Federal Government does provide a good bit of income, revenue sharing, et cetera, to the states, would make this situation worse as well.

Ms. BASS OF CALIFORNIA. Would they have access to alternative funding sources if it wasn't raised?

Mr. BERNANKE. No doubt the bond markets would be very disrupted, so if they were able to borrow at, very possible, they would be at much higher rates than they are borrowing today. But whether they would have access, I don't know.

Ms. BASS OF CALIFORNIA. What about intergovernmental transfers from the Federal to the State Government, you might have, you were addressing that a couple of seconds ago, but could you elaborate?

Mr. BERNANKE. Well, it depends on the prioritization. If all payments are shut down other than interest payments on the debt, which again, I think, has some serious technical concerns associated with it, but then that would mean, presumably, that payments to Social Security, Medicare recipients, contractors, and to the States, would all be interrupted until such time as the limit was raised.

Chairman RYAN. All right, thank you, just in the interest of the Chairman's time, we have two more. Mr. Stutzman.

Mr. STUTZMAN. Thank you. Thank you, Mr. Bernanke, for being here as well. I have really enjoyed the discussion and the dialogue today. As a small business owner from back in northern Indiana, for the last 15 years I have seen a lot of fluctuations in several different sectors that we've been involved in. And I guess I want to touch on just one thing, real quick, because as a business owner, kind of going back to what Ms. Bass was talking about with the debt.

Currently we do not prioritize debt, is that correct? Why can't we change that, why can't we focus on making sure that our current debt, our primary obligations be taken care of, and then start, you know, basically by process of elimination, moving down that ladder and saying, We're going to make sure that we don't default, because I don't believe that we should default either. Even though I'm a freshman Congressman, I think that we do have an obligation for doing that.

Mr. BERNANKE. The only point I make there is that there are some technical difficulties. Because the Federal Reserve, as the agent of the Federal Government, makes many of these payments, including interest payments and other kinds of payments as well. And we would have to find ways to make sure that we were making the interest payments and not other kinds of payments. So I think there would be some serious operational concerns, particularly if this came with very short notice. So I do raise that point for your attention. Beyond that, Congress again has to make the determination whether you are willing to stop Social Security payments and the like, as a temporary measure.

Mr. STUTZMAN. But I think if we make that one of our priorities, because people have paid into that for years, making sure that is a priority, making sure military's a priority, making sure that our interest is a priority. Can't we then say to those that carry our debt, that we are going to make sure that they're taken care of in moving down the ladder and making sure our priorities are first and foremost at the top of the list? It seems like, coming to Washington so far, it is just a foregone conclusion that, well we've got to raise the debt ceiling. Well, are we taking measures and steps to say long-term, not just with a short-term notification that you all would have to change operational infrastructure and things, but long-term, wouldn't we be better off having some flexibility like that?

Mr. BERNANKE. Well, first, the amount of borrowing the government has to do was already determined when you agreed on how much you were going to spend and how much you were going to tax. So it is like this debt was incurred already. The question is, are we just going to make the payments that we owe or not. That's what this is about. In terms of the prioritization, given enough time I'm sure that that could be worked out, but I really do want to make sure people understand that, if this is a short-term thing, it might not be technically possible to carry out.

Mr. STUTZMAN. Right. But long-term, you think it would be a good thing?

Mr. BERNANKE. I would just prefer, instead, that, again, I'm sorry, I mean I think that this whole issue is very, very important, but I think the best way to do it is to just sit down and look at the long-term situation, look at each part of the budget, and try to come to some decisions about how you are going to address these imbalances.

Chairman RYAN. Ms. Black.

Ms. BLACK. Thank you. Thank you. And Mr. Bernanke, I apologize for not being here during the entire hearing, but I had another meeting, so, it seems to me that I continue to hear over and over since I have come in, that you do agree that there needs to be a long-term plan. And certainly looking at more than half of our budget is not subject to the annual approval by Congress, and it is on automatic pilot. As you talk about there needs to be an overall plan, do you have an idea about how we might reform the budget process to help us to consider all of the expenses on a yearly basis?

Mr. BERNANKE. Well, I think it is sensible to, and particularly over a long-term plan, to drop the somewhat artificial distinction between discretionary and mandatory spending. You want to look at everything on the budget over a longer term. In a speech I gave a few months ago, I talked about fiscal rules. And a lot of countries around the world have set up fiscal rules which describe, and this goes back to Mr. Stutzman's question a little bit, that these rules, some of them for example, would impound or sequester part of the government's spending if the deficit exceeded a certain level, for example.

So there are ways to set up rules that would force Congress, essentially, to meet certain targets. Something similar to that was the Gramm-Rudman-Hollings approach that was used some time ago. So I don't have real specific suggestions here, but I do think that thinking hard about your framework and recognizing that the current approach, when you try to find an offset, that is basically saying we are satisfied with the deficit where it is. You need to have something that is better than an offset. You need something that is going to allow for the deficit actually to shrink over time relative to where the current projections are, so it is very challenging to do that, I understand. But, again, creating some kind of long-term overall plan and then, within the context of that plan, fitting in various programs, that is essentially what has to be done in order to get us back on stable path.

Ms. BLACK. I know there has been a lot of talk about us having a Balanced Budget Amendment, and of course that takes a very long time to get there. What would you think, in the meantime, about having a spending cap that we could only spend to a certain level?

Mr. BERNANKE. Well, that is up to Congress to do that, if you want. I assume that that would be just a legislative action as opposed to a Constitutional action. You could do that, but then you would have to have a mechanism. This is similar to a fiscal rule; I mean basically it says that you'd have to not be allowed to appropriate more than a certain level. If more was spent because, say, Medicare payments were higher than anticipated, you'd have to find a way to deal with that. But that is a form of rule that you could apply. And along with consideration of how revenues are going to evolve, that could help you structure the plan for reducing the deficit over time.

Ms. BLACK. Thank you, thank you, Mr. Chairman, I yield back my time.

Chairman RYAN. Chairman, you have been very generous, we've gone over your time, we know you are running late, and we appreciate your indulgence. This hearing is adjourned.

Mr. BERNANKE. Thank you, Mr. Chairman.

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

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

In your speech to the National Press Club on February 3, you noted that unemployment, which is to me the key economic indicator for the well being of the American people, will remain stubbornly high and that these conditions will only improve gradually.

You also noted that the trajectories of our national deficit and debt are unsustainable.

You went on to state that among the course corrections needed to address these problems are investments in the skills of the workforce, which I am going to simply call education, and policy changes to reduce our deficits and debt.

1. AFGHANISTAN

My first question is in regards to the latter. The current rules of the House have taken the "War on Terror" off-budget, meaning that the costs of our conflicts in Iraq and Afghanistan and other actions associated with the so called "War on Terror" can be financed with debt. Afghanistan alone represents a cost of approx. 10 million dollars per hour, 325 million dollars per day and 150 billion dollars per year. Disturbingly, this is our country's largest long-term investment. So my question is:

Would the savings that resulted from ending combat operations associated with the "War on Terror" reduce projected deficits?

2. EDUCATION

I think it was very important to note that among other investments including encouraging the scaling up of US manufacturing by incentivizing purchasing new machinery and investment, promoting R&D, and rebuilding public infrastructure, you singled out education as an area for public investment that would promote economic growth.

Can you explain to the Committee how public investment in education promotes economic growth?

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

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

BEN S. BERNANKE
CHAIRMAN

April 1, 2011

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

Dear Congressman:

Enclosed are my responses to the written questions you submitted following the February 9, 2011, hearing before the House Budget Committee. A copy has also been forwarded to the Committee for inclusion in the hearing record.

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

Sincerely,

Enclosure

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

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Would the savings that resulted from ending combat operations associated with the "War on Terror" reduce projected deficits?

Any reduction in future spending would, all else being equal, reduce projected deficits. More broadly, I have highlighted on many occasions the significant fiscal challenges faced by our nation and the risks of not addressing this issue. In particular, if government debt and deficits were actually to grow in coming years at the pace envisioned in the Congressional Budget Office's long-term projections, the economic and financial effects would be severe. Accordingly, in my view, it is very important for policymakers to act now to develop a credible program to reduce future deficits. Such a plan would not only enhance economic growth and stability in the long run, but could also yield substantial near-term benefits in terms of lower long-term interest rates and increased consumer and business confidence. That said, the particulars of such a plan with respect to the mix of changes to spending and taxes are for the Congress and the Administration to determine.

2. EDUCATION

I think it was very important to note that among other investments including encouraging that scaling up of U.S. manufacturing by incentivizing purchasing new machinery and investment, promoting R&D, and rebuilding public infrastructure, you singled out education as an area for public investment that would promote economic growth.

Can you explain to the Committee how public investment in education promotes economic growth?

- 2 -

In the testimony, I expressed my hope that, in addressing the nation's long-run fiscal challenges, the Congress and the Administration will undertake policies that serve not only to reduce the deficit, but also to enhance the long-term growth potential of the economy. I highlighted a number of ways in which policies could contribute to longer-term growth, including encouraging investment in the skills of our workforce. A standard economic framework for identifying the sources of overall economic growth focuses on increases in capital and labor inputs as well as technological progress. To fully capture the role of labor in this process, it is important to account for the skill level of those in the labor force. This skill component--the accumulation of knowledge embodied in the workforce--often is referred to as human capital, and continued increases can contribute importantly to economic growth in the longer run as a more-skilled workforce can produce more and as more-skilled workers tend to earn higher wages. The nation's human capital can be increased in many ways, including through formal and informal education, experience gained over time on a job, and training in the workplace.

[Questions submitted for the record by Mr. Calvert follow:]

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

Question #1: One area that I believe has a major impact on our nation's economic recovery is the stability of the commercial real estate industry. A healthy commercial real estate market provides more than 9 million jobs and generates billions of dollars in federal, state and local tax revenue. However our commercial real estate market continues to suffer and this has a direct and lasting impact on the stability of tens of thousands of small businesses and small and mid-size banks.

Despite the October 2009 interagency guidance on Prudent Commercial Real Estate Loan Workouts, anecdotal evidence shows that bank regulators/examiners are still being inconsistent with regards to commercial real estate workouts. Regions such as my area of southern California continue to suffer as property owners seeking to refinance existing loans find access to credit nearly nonexistent. I continue to hear stories where capital calls on loans are occurring on property that is near full capacity and where owners are paying their bills.

What else can be done to ensure that creditworthy borrowers, who have the willingness and capacity to repay their debts, obtain the necessary refinancing or term extension to stay afloat?

Question #2: The Financial Accounting Standards Board and International Accounting Standards Board have proposed new accounting rules that would force companies of all sizes to capitalize commercial real estate leases onto their balance sheets, which could significantly reduce the credit capacity of many borrowers. Are you concerned with this proposal, especially in light of the current commercial real estate credit crisis?

[Responses to Mr. Calvert's questions follow:]

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

BEN S. BERNANKE
CHAIRMAN

March 18, 2011

The Honorable Ken Calvert
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the written questions you submitted following the February 9, 2011, hearing before the House Budget Committee. A copy has also been forwarded to the Committee for inclusion in the hearing record.

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Sincerely,

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What else can be done to ensure that creditworthy borrowers, who have the willingness and capacity to repay their debts, obtain the necessary refinancing or term extension to stay afloat?

The Federal Reserve has conducted significant training for its examiners on this guidance to ensure that it is carefully implemented. In addition, we continue to strongly reinforce the guidance with our examiners and are focusing on evaluating compliance with the guidance as part of our regular monitoring of the examination process, which includes local management vettings of examination findings in the district Reserve Banks, review of a sample of examination reports in Washington, and investigation of any specific instances of possible undue regulatory constraints reported by members of the public.

Our monitoring to date suggests that examiners are appropriately considering the guidance in evaluating supervised institutions. However, to the extent that a banking organization in your state is concerned about supervisory restrictions imposed by Federal Reserve examiners, they should feel free to contact Reserve Bank or Federal Reserve Board supervisory staff with their concerns. Bankers may also confidentially discuss these concerns with the Federal Reserve Board's Ombudsman; information on the Ombudsman is available by phone at 1-800-337-0429 or on the Federal Reserve's website at:
<u>http://www.federalreserve.gov/aboutthefed/ombudsman.htm</u>.

The most important step we can take to improve credit availability to businesses both large and small in addition to potential home buyers is to achieve a sustainable economic recovery. Over the course of the past two years, the Federal Reserve has taken aggressive action in response to the financial crisis to help improve financial market conditions and strengthen U.S. banking organizations. We have acted on multiple fronts, instituting accommodative monetary policy, providing market liquidity, and issuing additional supervisory guidance to our bank examiners.

The Financial Accounting Standards Board and International Accounting Standards Board have proposed new accounting rules that would force companies of all sizes to capitalize commercial real estate leases onto their balance sheets, which could significantly reduce the credit capacity of many borrowers. Are you concerned with this proposal, especially in light of the current commercial real estate credit crisis?

The standard setters have proposed a change in accounting that would require entities to record lease commitments on the balance sheet using a: "right-of-use" approach. The Federal Reserve and the other federal regulatory agencies (FDIC, OCC, OTS, and NCUA) provided a comment letter to the FASB in December 2010 on the proposal. The comment letter provided support for the objective of providing improved transparency related to leasing activities, but noted specific concerns related to the proposal. For example, we expressed concern that the application of the new standard could lead to technical defaults on debt covenants or similar contractual requirements. Please refer to the attached comment letter for more details about our view on the proposal.

Federal Deposit Insurance Corporation
Board of Governors of the Federal Reserve System
National Credit Union Administration
Office of the Comptroller of the Currency
Office of Thrift Supervision

December 16, 2010

Technical Director
Financial Accounting Standards Board
401 Merritt 7
Post Office Box 5116
Norwalk, Connecticut 06856-5116

RE: *File Reference No. 1850-100 – Proposed Accounting Standards Update, Leases (Topic 840)*

Dear Sir or Madam:

The five federal regulatory agencies responsible for supervising the safety and soundness of U.S. financial institutions (the Agencies) appreciate the opportunity to comment on the *Proposed Accounting Standards Update, Leases (Topic 840)* (the Exposure Draft). The Exposure Draft would improve the transparency of leasing activities and address concerns that existing accounting standards for leases permit some entities to achieve a particular accounting outcome by the careful structuring of lease transactions. Under existing rules, the bright-line distinction between operating leases and capital leases can result in leases that have similar economics receiving different accounting treatment while leases having dissimilar economics can receive the same accounting treatment. Moreover, the existing lease accounting standards permit lessees to accumulate substantial amounts of off-balance-sheet leverage. The Exposure Draft would enhance the comparability of companies that own and finance property to companies that obtain rights to use similar property and incur payment obligations through leasing.

We support the FASB's objective of providing financial statement users with more transparency into companies' leasing transactions and reducing structuring opportunities available under U.S. generally accepted accounting principles (GAAP). However, we have several specific concerns with the Exposure Draft, the most significant of which is the complexity of measurement, which we expand upon in the following comments and observations.

Recognition

We support the accounting recognition of a right-of-use asset and an associated liability for future lease payments by lessees. We concur with the Board's determination that a lessee's right to use leased property represents an asset of the lessee and a performance obligation (or a derecognition event) of the lessor. Similarly, future lease payments are an obligation that should be recognized as a liability of the lessee (and as an asset of the lessor).

We also support the two proposed accounting approaches for lessors: derecognition and performance obligation. We believe these two approaches would appropriately represent the different business strategies that exist among lessors. For example, financial institutions, as financers, typically offer leases and loans as different financing options to commercial customers to fund the acquisition of assets to be used in their businesses. When the financing option is in the form of a lease, the leasing activity would typically align with the derecognition model.

We concur with the comments in the Basis for Conclusions regarding lessee presentation that a right-of-use asset has traits in common with tangible assets such as property, plant, and equipment, more so than intangible assets. We request the FASB clarify in its final standard that a right-of-use asset is not an intangible asset.

Measurement

In developing the Exposure Draft, the FASB considered a number of measurement approaches; we support its decision to use amortized cost for initial measurement based on present value, with estimated cash flows discounted using either the lessee's incremental borrowing rate or the lessor's implicit lease rate. However, we believe the proposed measurement method is overly complex for many leases and a simpler approach could be allowed with minimal sacrifice to the relevance of information provided financial statement users.

In our view, the Exposure Draft's probability-weighted present value technique to measure contractual conditional elements[1] is unduly complex for many leases and would provide little if any net benefit over a simpler, more straightforward approach to measurement. We see significant merit to the position the FASB took during an earlier stage of the project to base the measurement on management's best estimate of conditional elements for purposes of estimating future cash flows. We are skeptical that probability-weighted present values will provide information that is materially more decision-useful to financial statement users than present values of best-estimate cash flows. Any difference between the estimates from the two approaches should be reduced by the Exposure Draft's requirement for subsequent reassessment when facts and circumstances indicate a significant change in a lease's estimated cash flows.

[1] Conditional elements to a lease include (1) options for term extensions and termination and (2) variable lease payments that reference indices, such as a consumer price index; external non-index events, such as performance by tenants other than the lessee in a multi-tenant retail center; events within the lessee's control or influence, such as the lessee's sales in leased retail premises; or equipment usage, such as hours or distance. In many leases, conditional elements can span many years with consequential effects on estimated cash flows.

With regard to the comparative cost of the two measurement techniques, best-estimate present value is less costly and more straightforward to apply than probability-weighted present value. Cost considerations that favor best-estimate present value include its wide use as an analytical technique in business and finance and its flexibility to be adapted to different approaches among companies when analyzing buy-or-lease situations. It is also less quantitative and can be applied more readily where data are not available or objectively determinable or the use of probability-based present value analysis would not materially alter a buy-or-lease decision.

We consider a standard that factors conditional elements into the measurement of leases to be an improvement over existing accounting rules, which are focused on contractual minimums. This aspect alone should inhibit structuring opportunities and increase the transparency of leasing in financial statements. Although it may be attractive from a theoretical perspective, we do not believe the incremental benefit to financial statement users of requiring probability-weighted cash-flow analysis exceeds its additional costs to preparers. Therefore, we encourage the FASB to allow both the probability-weighted present value and the best-estimate present value in its final standard. A final standard that permits both present value techniques could be seen as a practical expedient that reduces burden and complexity, in particular for small public and privately held companies that have more limited resources for accounting compliance. We also believe that permitting both techniques would be consistent with FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, as amended,[2] and also would be consistent with the FASB's goal to issue principles-based accounting standards.

Lessor's Impairment Recognition Under the Performance Obligation Approach
In the discussion of financial statement presentation in the Basis for Conclusions, the FASB noted that the leased asset, the lease receivable, and the performance obligation are interdependent. We agree with this observation; however, we believe the existing standards on asset impairment and measurement of liabilities like the performance obligation do not reflect this relationship. In many leases, the risk of impairment (due to such factors as functional obsolescence) is shared in varying degrees between the lessor and the lessee. However, the Exposure Draft does not address the accounting from the lessor's perspective for the portion of risk that has been transferred to the lessee.

Given the acknowledged interdependency between the assets (both the leased property and the lease receivable) and the performance obligation, it seems reasonable that the risk transference should reduce the amount of any impairment loss measurement to be recognized by the lessor or reduce the performance obligation. We encourage the FASB to consider addressing the accounting for such risk transference in the final standard.

[2] For example, see paragraph 51 of Concepts Statement No. 7 regarding cost-benefit considerations.

Transition and Effective Date

We encourage the FASB to take into consideration the following issues when it evaluates the timeframe under which companies will adopt a final standard. First, leasing is widespread and, in some industries, is extensive. Among financial institutions supervised by the Agencies, an institution can be both a lessor and lessee and may also lend to companies that have extensive lease arrangements with third parties. We are concerned that the application of the new standard could lead to technical defaults on debt covenants or similar contractual requirements. Since leasing is a common means of financing, the FASB should consider this potential consequence, in addition to the typical record-keeping and systems issues, when deciding how soon to require the adoption of a final standard.

We also note that the FASB has numerous projects on its agenda. Some, such as a final standard on financial instrument accounting, may result in substantial differences from current practice that would require extensive changes to accounting systems. Resources available to preparers are not unlimited. The effective date of a leasing standard should take into account other changes to accounting standards that the FASB plans to issue. The FASB should weigh carefully comments from both users and preparers when assessing the needs of the former versus the capacity of the latter to accommodate extensive change. These comments should help inform the FASB about how to coordinate the effective dates of its new standards so as to balance the benefits gained with the disruption caused by changes.

The FASB also should consider the tradeoffs between the longer lead time necessary for companies to implement the simplified retrospective treatment required in the Exposure Draft, in some cases for leases that will have expired or will have been terminated before the standard's effective date, and an earlier application of a final standard under which outstanding leases would be recognized in accordance with the new accounting requirements, but need not be recast for prior comparative periods.

Lastly, we encourage the FASB to reflect on the information needs of financial statement users with respect to organizations that are not investor owned or are privately held. Financial institutions of this type are generally small companies for which the costs of applying new accounting standards can be disproportionately high. We encourage the FASB to consider whether a delayed effective date is warranted for these kinds of organizations.

Convergence

The efforts of the FASB and the International Accounting Standards Board (IASB) to issue closely aligned leasing proposals for review and comment by a worldwide audience should help to improve the quality of financial reporting, which bodes well for eventual harmonization. We believe that when the two standard-setting bodies issue similar proposals, as in this instance, it reduces uncertainty among preparers and allows them to better focus resources to comment on the proposals and plan for their efficient implementation. The FASB and the IASB should strive to achieve such close collaboration when formulating all accounting standards on their convergence agenda.

Although the FASB and the IASB are closely aligned on this project, we acknowledge their different approaches to revaluation of the right-of-use asset. We encourage the FASB and the IASB to address the difference. We support the current treatment of property, plant, and equipment under U.S. GAAP that would not permit a company to revalue a right-of-use asset other than to recognize an impairment loss.

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The Agencies appreciate your consideration of our comments. We would be pleased to discuss in more detail our views on the Exposure Draft.

Sincerely,

Robert F. Storch

Robert F. Storch
Chief Accountant
Federal Deposit Insurance Corporation

Arthur W. Lindo

Arthur W. Lindo
Senior Associate Director and Chief Accountant
Board of Governors of the Federal Reserve System

Melinda Love

Melinda Love
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Randall J. Black

Randall J. Black
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Jeffrey J. Geer

Jeffrey J. Geer
Chief Accountant
Office of Thrift Supervision

[Whereupon, at 1:03 p.m., the committee adjourned subject to the call of the Chair]

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