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FED CHAIRMAN WARNS ABOUT DEFICITS, DEBT

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In his testimony to the House Budget Committee today, Federal Reserve Chairman Benjamin S. Bernanke gave special attention to the need for Congress to control spending, deficits, and debt; and he warned that long-term economic health depends on this. Here are several key quotes from the Fed Chairman.

From Prepared Remarks

- "The administration recently submitted a proposed budget that projects the Federal deficit to reach about $1.8 trillion this fiscal year before declining to $1.3 trillion in 2010 and roughly $900 billion in 2011. As a consequence of this elevated level of borrowing, the ratio of Federal debt held by the public to nominal GDP is likely to move up from about 40 percent before the onset of the financial crisis to about 70 percent in 2011. These developments would leave the debt-to-GDP ratio at its highest level since the early 1950s, the years following the massive debt buildup during World War II."

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- "[E]ven as we take steps to address the recession and threats to financial stability, maintaining the confidence of the financial markets requires that we, as a nation, begin planning now for the restoration of fiscal balance."

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- "The recent projections from the Social Security and Medicare trustees show that, in the absence of programmatic changes, Social Security and Medicare outlays will together increase from about 8½ percent of GDP to 10 percent by 2020 and 12½ percent by 2030. With the ratio of debt to GDP already elevated, we will not be able to continue borrowing indefinitely to meet these demands."

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- "In particular, over the longer term, achieving fiscal sustainability – defined, for example, as a situation in which the ratios of government debt and interest payments to GDP are stable or declining, and tax rates are not so high as to impede economic growth – requires that spending and deficits be well controlled."

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- “Unless we demonstrate a strong commitment to fiscal sustainability in the longer term, we will have neither financial stability nor healthy economic growth.”

From Question and Answer

- *Concerning growing deficits in the current budget path – reaching 5.7 percent of GDP in 2019 – and debt rising to 82.4 percent of GDP just as the baby boomers are retiring, expanding the burdens on Social Security and Medicare*: “I think we face a double challenge. One is that we have to restore ourselves to a more balanced fiscal path after addressing the financial and economic crises that we current are facing. But in addition, that’s complicated by the fact that with the retirement of the baby boom and the increase in medical costs that we are facing, rising entitlement costs – this is no longer a long-term consideration; this is something that is going to happen in the next 5 or 10 years. . . . We cannot allow ourselves to be in a situation where the debt continues to rise; that means more and more interest payments, which then swell the deficit, which leads to an unsustainable situation.”

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- *On dealing with the debt, which is slated to triple in the next 10 years under the President’s budget*: “You can’t have a debt-to-GDP ratio which continues to rise indefinitely.

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- *Asked whether the Federal Reserve will monetize the debt*: The Federal Reserve will not monetize the debt. . . . At some point you have to have a path of spending and taxes that will give you a stabilization of the debt-to-GDP ratio. If you don’t, then fear that the debt will continue to rise will make it very difficult to finance it; and at some point you’ll hit a point where you’ll have to have both very draconian cuts and very large tax increases, which is not something we want. So in order to avoid that outcome down the road, we need to begin now to plan how we’re going to get the fiscal situation into better balance.”

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- *Asked whether the $56 trillion in unfunded liabilities, and the currently growing debt, is the government’s most serious fiscal problem*: “I would say that’s right. . . . It’s a very hard problem to solve, but it is critical that we address that.”

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- *Regarding how the $100 million in savings the President recently called on his Cabinet officers to identify stacks up against current fiscal challenges*. “Well, $100 million obviously by itself is not a very big amount of money relative to these problems. I think the important thing is the commitment that the administration and Congress have both talked about, and need to put into play. . . . A lot of the budget that was presented was placeholders, and broad plans and themes. . . . The proof will be in the pudding, as they say, or how Congress and the administration actually implement health care reform or climate change policy. Those details about how the spending and revenues will be matched will be the critical issue."

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- *Expressing concern about projected deficits in relation to the economy. [In the President's budget, the deficit never falls below 4 percent of GDP, and rises to 5.7 percent of GDP by 2019]*: "We can't expect to continue to borrow even 4 to 5 percent of GDP."

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- *Asked whether it makes sense to add a third government health care entitlement to the already unsustainable Medicare and Medicaid Programs*: From a fiscal perspective, the reforms to health care need to address the cost issue. . . . If you don't get control of the cost of health care, then the fiscal issues are very serious. In particular, for example, Medicare trustees assume that health care costs are going to grow at only 1 percent faster than per capita income. In fact they have been growing at 2½ percent faster than per-capita income. So we need some substantial cost controls just to get down to the trustees' projections."

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Chairman Bernanke's prepared remarks can be found at:
http://budget.house.gov/hearings/2009/06.03.2009_Bernanke_Testimony.pdf

A webcast of the hearing can be found at:
http://budget.house.gov/hearings.aspx#06032009