

## **What Chairman Bernanke Should Have Told Congress**

**Scott E. Hein**

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**On February 24, 2010, Chairman Bernanke addressed the Committee on Financial Services of the U.S. House of Representatives. Here is what I wish he had said:**

The Federal Reserve has been exceedingly accommodating for some time now, in response to the financial crisis that engulfed not only the U.S., but also much of the world. There are signs, today, that this accommodation has provided needed stability, as risk premiums in financial markets, which sky rocketed in the crisis, have decreased to their pre-crisis levels. Additionally, the U.S. economy grew at a 4% annual rate in the second half of 2009. While there remain signs of constraint on the economic front (many caused by our U.S. Congress), and no one can be fully pleased with the current state of the U.S. economy, forward looking financial markets are indicating that now is the time to begin tightening monetary policy, moving toward a neutral stance, especially when we recognize the significant lag between monetary policy changes and the impact they have on the economy. We know that the financial crisis was spawned, in part, by keeping monetary policy too easy for too long, and we cannot repeat this past mistake.

In today's economy, it would be wrong to continue to encourage consumers and businesses to borrow, when all are trying to reduce the amount of debt they have, not borrow more. The primary part of our economy that is made better off by the current stance of monetary policy would be you, in the Congress, and the President, since the U.S. Treasury is essentially the only large part of our economy that is borrowing at these low rates. Consumers and businesses, as a whole, are trying to save monies these days, not borrow, to improve their financial positions in light of the huge losses associated with the U.S. housing bubble that spilled into commercial real estate, as well. Having short-term interest rates as close to zero, as humanly possible, does not allow a saver to benefit from their actions.

As such, I am today asking the Federal Open Market Committee members to follow my advice and begin immediately to move the current target of the federal funds rate to a neutral stance, as opposed to an expansionary policy. Our economy will return to an equilibrium situation sooner by helping consumers and businesses start to feel confident about their financial situations. The aggressive encouragement of borrowing and spending in the current economic climate, by continuing to keep rates unduly low, is truly counterproductive to this goal. Raising short-term interest rates today will actually help consumers and businesses increase their savings and net worth. Our goal should be to quickly bring our target for short-term interest rates to the current level of consumer inflation, which is running between

1.5% and 2.0%. Short-term investors today should at least be compensated for the damage done to their purchasing power by inflation.

Financial markets are not expecting such a policy move to neutral this soon. As such, I suspect that there might be some wild swings in these markets in the short-term. However, Congress has charged the Federal Reserve with stabilizing the economy and not financial markets. Moreover, I am confident that these short-term financial market swings will not have a long-term damaging effect on the economy. I should also mention that it is entirely possible that longer-term interest rates fall on this policy move, as market participants become more assured that future inflation is less of a threat.

Now, let me further explain that there is much that the Congress itself can do immediately to put the economy on a better course. Congress needs to fully understand the uncertainty that it has created as a result of the discussion of sweeping legislation, such as healthcare and “cap and trade” legislation. Undoubtedly, there are things to do to improve the delivery and financing of healthcare, as well as our environment. But to propose legislation as big and financially costly as being discussed today is unsettling to everyone throughout the economy. It is imperative that Congress recognize that one of the unintended consequences of any increased federal government spending is that the public asks itself how this will be financed.

Today, Congress seems to be comfortable with the answer that the Treasury will finance this with deficit borrowing. On the other hand, John and Jane Q. Public are not satisfied with this solution, recognizing that this means that either their taxes, or their children's taxes, or their grandchildren's taxes, will have to be higher at some point to finance this debt. As such, John and Jane now feel less wealthy, and naturally are thinking of ways to save more to offset this financial pain. While it is understandable that a federal deficit occurs in an economic crisis, it is not acceptable to plan for large deficits for the next ten years. Congress must help return the economy to a more stable footing by eliminating, not increasing, projected federal government deficits.

An unintended consequence of what Congress has done regarding unemployment also deserves mention. While Congress has done much recently to encourage firms to hire new employees with tax incentives and the like, many have forgotten that for every person hired there is someone who voluntarily accepts the job. And ironically, what Congress has done by extending the duration of unemployment compensation, on three separate occasions, is counter to the goal of getting people back to work. We are now incentivizing unemployed individuals to not take jobs they are offered, and to be more selective in these choices. Is it any wonder that we are in the midst of another "jobless recovery," with such policies in place?

**I wish Chairman Bernanke had said these things. In contrast to my wishes,** he once again refused to acknowledge that the “easy money” policies of 2003-2005 were responsible in part for the housing bubble and the subsequent financial crisis, or to recognize the lag between changing policy and impacting the economy. As such, he sees no downside to “easy money” now; he said the Fed would continue to keep the target for the federal funds rate between 0% and 0.25% for “an extended period,” to foster borrowing and spending. Finally he failed to mention savings, or to link today’s fiscal uncertainties to the current economic malaise in our country.

You can find out exactly what Chairman Bernanke said at:

<http://www.federalreserve.gov/newsevents/testimony/bernanke20100224a.pdf>

Scott E. Hein, Ph.D.

Robert C. Brown Chair of Finance, Texas Tech University, and former senior economist Federal Reserve Bank of St Louis

Director, Texas Tech School of Banking and Faculty Member, Graduate School of Banking at Colorado

*The 60<sup>th</sup> Anniversary School Session at the Graduate School of Banking at Colorado will take place July 11-23, 2010 on the University of Colorado campus in Boulder, Colorado. For more information, please visit [www.GSBColorado.org](http://www.GSBColorado.org) or call 800-272-5138.*