US Fed chief demands austerity plan

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In testimony Wednesday before the Joint Economic Committee of Congress, Federal Reserve Board Chairman Ben Bernanke made a pointed call for the Obama administration and Congress to quickly adopt a plan for austerity measures to reduce soaring deficits.

The Fed chief underscored his demand for austerity policies by concluding his opening remarks with a section on fiscal policy, in which he said "the confidence of the public and financial markets requires that policymakers move decisively to set the federal budget on a trajectory toward sustainable financial balance."

He stressed that agreeing to a plan to rein in federal deficits and the public debt would have short-term as well as long-term benefits, arguing that such a plan would immediately encourage lower long-term interest rates.

While Bernanke was deliberately vague about what such an austerity plan should consist of, he said it would "require difficult choices"—a euphemism for major cuts in social programs.

Last week in a speech in Dallas, Bernanke warned of the fiscal implications of the aging of the US population, strongly suggesting that he favors major cuts in entitlement programs for the elderly such as Social Security and Medicare.

This is in line with the policies of the Obama administration, which has set up a bipartisan deficit commission to recommend reductions in spending for Social Security, Medicare and Medicaid, as well as possible tax increases.

Bernanke reiterated his call for austerity in an exchange with Republican Senator Sam Brownback. Warning that the government's debts and deficits could undermine investor confidence and raise the cost of US borrowing, he said, "At some point, the markets will make a judgment about really not our economic capacity, but our political ability, our political will, to achieve longer-term sustainability. At that point interest rates could go up…"

When Brownback asked if that could happen now, Bernanke replied, "It's absolutely possible, certainly."

Later, Bernanke told Democratic Senator Amy Klobuchar that the markets presently were "signaling a lot of confidence that our political system will deliver a sustainable trajectory of fiscal policy." However, he continued, "If we don't do it, or we give a strong indication that we're not going to be able to do it, then it would not be something we have to worry about in 2040; it could be something we have to worry about on Wednesday."

Translated from central bank jargon into plain English, this means that the political system has to agree on massively unpopular cuts that will have severe consequences for the living standards of tens of millions of people.

Bernanke warned that the ratio of US public debt to gross domestic product, presently projected to soar to 70 percent by the end of fiscal 2012, could go above 100 percent by 2020. He omitted to note that a key reason for the explosive growth of the national debt is the multi-trillion-dollar bailout of the banks.

The Fed chairman claimed that the US was undergoing a "moderate" economic recovery, but indicated unemployment would remain extremely high for an extended period. He said it would take "a significant amount of time" to "restore the 8.5 million jobs that were lost during the past two years."

He also noted that while bank profits continued to rise, their lending to both households and businesses continued to fall.

In response to a question from Democratic Senator Charles Schumer, a leading advocate of trade war measures against China, Bernanke made his most direct criticism to date of Beijing's currency policy. He told

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Schumer that "most economists agree the Chinese currency is undervalued and has been used to promote a more export-oriented economy." He added, "I think it would be good for the Chinese to allow more flexibility in their exchange rate."

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