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UA36I/29 Gary Ransdell - Federal Reserve Board - Ben Bernanke Town Hall Meeting

St. Louis Federal Reserve Board

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From: Mary.H.Karr@stls.frb.org [mailto:Mary.H.Karr@stls.frb.org]
Sent: Monday, October 04, 2010 2:49 PM
Subject: FedDigest, September 30, 2010: Chairman Bernanke's Town Hall Meeting with Educators (Opening Remarks and Q&A)

Chairman Bernanke's Opening Remarks

This document is not an official transcript. The text is selectively drawn from the original and summarized. Full text:http://www.federalreserve.gov/newsevents/speech/bernanke20100930a.htm

Learning about economics helps students understand how the decisions of millions of people about what to produce and consume determine what Adam Smith called "the wealth of nations"--our living standards. In particular, economics helps students understand both the strengths and the shortcomings of our market-based economic system. The causes and ultimate remedies of the recent financial crisis will continue to be widely debated. The study of economics will allow your students to join the debate in a responsible and informed way.

One of the key lessons of the recent financial crisis is the importance of personal financial literacy. Many of you teach your students the skills necessary to make good financial decisions. Your efforts are of paramount importance in helping students understand how to save for the future and how to invest their money to make it grow. In retrospect, some of the people who were hurt the most during the crisis borrowed money that they should not have borrowed and signed financial contracts they should not have signed. Today, students need a solid understanding of the benefits and risks of borrowing money to buy a car or a home, and of the effect that too much credit card debt can have on their finances. Besides improving their personal financial decisionmaking, teaching students economic principles will help them as citizens understand and make choices about many of the critical issues confronting our nation.

The Federal Reserve works hard to advance financial literacy and economic education--both through our own programs and by working with other organizations. Our financial education website (www.federalreserveeducation.org) provides easy access to free educational materials, a resource search engine for teachers, and games for students of various ages and knowledge levels. Some Reserve Banks offer economic and financial education workshops for teachers, and several Reserve Banks periodically provide lessons in personal finance to middle school and high school students. A number of the Reserve Banks also run academic competitions for middle school, high school, and college students, such as the Fed Challenge, Econ Bowl, and essay contests. And some Reserve Banks have opened learning centers or museums in their lobbies that feature interactive exhibits and related educational programs.

Q&A with Chairman Bernanke

This document is not an official transcript. The excerpts below are selectively drawn from the original unedited transcripts.

Q. What has been the greatest success as well as the greatest failure of the Federal Reserve in the last 100 years?

A. The Federal Reserve was founded in 1913. It has been a tremendous part of U.S. economic history. I would say the greatest failure is no doubt the Great Depression of the 1930s, to which the Federal Reserve made unfortunately an important contribution. The Fed was very slow to expand the money supply

during the Great Depression. As a result it countenanced severe deflation or falling prices during the early 1930s. The Fed was insufficiently proactive in trying to stabilize the financial system. About a third of all the banks in the United States failed during the 1930s, a tremendous collapse of our banking system.

Those two things together were very important in making the depression as deep and as long as it was. As we dealt with the financial crisis in 2008 and 2009 we tried to take those lessons to heart. We tried to make sure that monetary policy was aggressive to prevent deflation and tried to take whatever steps necessary to keep our banking system from collapsing.

Probably the most important success of the Federal Reserve in the past century was after the period of the '70s when we had a lot of inflation. The Federal Reserve under Chairman Paul Volcker conquered inflation and we now have very stable prices. Along the way we achieved economic growth in the United States and it was a very, very important contribution to that period.

Going forward, I think students should understand those two elements of the Fed. The first is financial stability. It's very important for the Fed to contribute to keeping our financial systems stable and productive. And secondly, price stability. Only the Central Bank can affect inflation and keeping inflation low and stable is good for our economy and a very important responsibility for the Fed.

Q. What are the greatest challenges that the Federal Reserve System faces over the medium and long-term?

A. First, even though our economy is stabilized and growing, clearly it is still a very, very difficult time for many Americans. The unemployment rate is still almost 10 percent. Inflation is quite low. We are certainly not the only policy makers that can affect the state of the economy by any means but we need to do our part to help the economy recover and make sure that jobs come back to the United States.

We have another very important responsibility in the short-term, which is the implementation of the new financial regulatory reform legislation. The so-called Dodd-Frank act was signed by the president in July and it is the most ambitious overhaul of our financial regulation since the 1930s.

The long-term is hard to know. We want to be sure to maintain price stability. We want to learn as much as we can about the economy so we can be even more effective in keeping stability in our economy. I will say one other thing, which is that it's very, very important that the Federal Reserve remain independent; that it remain able to make decisions for the economy based on our views of what the economy needs and not based on short-term political considerations.

Q. As we look at the recession, what role does the media play, do you believe?

A. The question is about confidence and what role does the media play in confidence? When people are confident they are willing to spend, more willing to invest. So that's very important and business confidence is also very important. Firms in order to hire, in order to expand their operations, need to be confident about the economy.

The media is no doubt very important, but I hope your students understand to be a little bit skeptical about the media. If students can learn to develop appropriate skepticism for themselves about where the media is and what is happening, I think we'll avoid some of the echo chamber that can make the good

times seem too hot and the bad times seem too cold.

Q. What fiscal policy measures would you suggest?

A. I first have to say that the Federal Reserve is nonpartisan. So we have to be very careful not to take one side or the other in terms of one fiscal issue or another. Let me just to say how important it is for your kids to understand the difference between fiscal and monetary policy. Fiscal policy, of course, has to do with federal government spending and tax plans. The Federal Reserve has nothing to do with that. What we do is manage the money supply, which helps effect short-term interest rates and, therefore, inflation and also affects growth. There are two very different sets of policies. Fiscal policy is made by the Congress and the Administration. The Federal Reserve independently makes monetary policy.

We have a very difficult situation because in the short run we have an economy which, even though we are in a recovery, is still far from full employment. There is a lot of incentive to provide additional support to the economy and at least not to cut spending or raise taxes in a way that would be bad for recovery. On the other side, we have very serious long-term budget problems. As our society is aging, and as medical costs keep going up, the government's obligations to pay Medicare and Medicaid and Social Security, among other things, mean that we have very long-term debt situations. We are caught between the desire in the short run to be expansive and in the long run to be more frugal. That's a hard combination.

If possible, I think combining those two is the way to go. Whatever we can do to persuade the public as a country that we are serious about tackling our longer term budget issues would give us more flexibility to be more expansionary in the short-term. That's the challenge, to find ways to credibly commit to reducing our long-term debt and give us additional flexibility if we decided to use it to help support the recovery today.

Q. The fiscal and monetary policies moved the economy in the right direction, but growth has remained stubbornly sluggish. What do you see as the major contributing reasons to this?

A. Obviously that's something that we are very interested in, and spending a lot of time investigating. It's not at all uncommon for a recovery that follows a financial crisis to be relatively slow. We have seen that historically in many other countries as well as in the United States. The reasons for that are several. One is that the financial system is so important to our economy that if the banks, for example, have not yet recovered fully to health or the financial markets are not yet functioning at the normal level. That is itself a drag on growth.

Likewise, if you look at household finances, one of the things that happened during the boom that preceded our financial crisis was that people took on a lot of debt. So a lot of people find themselves on the one hand worried about job security and on the other hand finding that they have a lot of debt, a lot of interest payments to make. So they are cutting back.

What we are seeing is that consumer saving rates are going up, which is not a bad thing in itself, but from the point of view of the economy as a whole it means that consumer spending is not there to drive economic growth the way it normally would be. That, combined with the fact that our labor market is not really yet begun to take off, means that there's still an air of caution in the economy, both on the part of households and on the part of businesses that is keeping growth from being as rapid as we would like.

That being said, the National Bureau of Economic Research, as you probably know, declared the recession over in June 2009. What that means, just to make sure what everybody understands, that means as of June of last year, the economy stopped contracting and since then has been growing. That doesn't mean we are back to normal. Doesn't mean that unemployment isn't way too high, doesn't mean that people aren't suffering, doesn't mean any of those things. But we are growing. The economy is not moving as quickly as we would like, but it is moving in the right direction. We want to make sure that progress continues.

Q. What is the most important lesson today's high school students can take away from the financial crisis?

A. At the macro level and the point of view of history and economics, what this crisis shows us is how damaging financial instability can be for the economy as a whole. Your students may think of Wall Street as being pretty far away and pretty irrelevant to their lives. We found out that if our financial system breaks down or is severely damaged, it's like the nervous system in the body not operating properly. You can get very, very bad effects on the economy, as we've seen. So the role of the financial system, the importance of financial stability, I think, are very, very important to understand. That helps us think about the 1930s and other important episodes as well.

There's also, though, a micro level, which is more of a personal or family level set of lessons that can be learned from the crisis. I think one of the things that we all talked about but maybe didn't pay enough attention to is financial literacy and financial education. A lot of people who are in trouble today made bad decisions: They borrowed too much or they purchased a home they couldn't afford. They borrowed too much on their credit cards.

Your efforts as teachers to help students understand the importance of financial responsibility, to help them understand what are the basics, the basics of saving and budgeting, those are critical and students need to understand that for themselves as individuals and for the country, good sound practices, good sound behavior in their own financial dealings is really important.

We are learning a lot of lessons about the labor market here. Young people with little experience, as often is the case, are the worst hit by high level of unemployment, particularly minority young people. What does that tell us? Well, among other things it tells us that we need to have kids who are well trained, well educated, who understand, who have a wide variety of basic skills in terms of thinking, writing, math, et cetera, so that they can adapt and change and deal with what could be very unstable situation.

Q. Would you like to see financial education become part of the graduation requirements for high school and in your view what is an effective issue for consumers that could be mitigated with financial education?

A. We don't know as much as we would like about how to teach financial literacy. We have had a number of programs here at the Federal Reserve where we have monitored different approaches to teaching kids about financial literacy. Some work better than others. We haven't really found a magic bullet. We really need to do a better job of integrating financial education into our broader curriculum. So, for example, when you're teaching math instead of just teaching abstract calculation, why not put it in terms of working out an interest payment? Or a budget?

Another way to make this more effective is to tie it directly to kids' own experience in their own lives. We know that people are much more prone to understand and want to learn about say mortgage financing when they are actually in the process of buying a house. So if kids are involved, for example, in opening a savings account or doing other things, saving for college, that's, then those things mean a lot more to them and the training is helpful.

When I was in school we had courses called home economics. It didn't have much to do with economics. It had to do with cooking and other very valuable skills. Well, home economics of the kind that is about knowing how to budget and how to save, that's very important, too. We need to put that into the curriculum so that kids will have the life skills. Even going into college, because we see a lot of kids get into trouble even in the college years with excessive credit card debt and not being able to pay tuition and so on.

Q. Some people say banks should be racing capital to make them stronger and others say they should be spurring the economic by taking on more risk and lending money to small households. What should be the goal?

A. It is our opinion at the Federal Reserve that there is no conflict between those two objectives. What banks do is make loans to good borrowers. That's how they make money. By making loans to good borrowers, that's how they build their profits and build their capital. We think it's good for the economy for banks to lend.

From our perspective, as you know, the Federal Reserve is not only the monetary policy agency, we also have very substantial role in regulating the banking system. So what we tell our bank examiners who go in and look at the books of the banks, we say take a balanced approach. What I mean by that is, you don't want to tell banks: No, no, you can't take any risks.

We don't want them to make loans that won't be paid back. We don't want that either. We want a good balance, good loans to good borrowers and that means loans to small businesses who have been through a lot in this recession; we need them to glow and hire as part of our recovery. There is not a conflict in our policies. What we tell the examiners and the banks is we need the right balance. We don't want to be risky, we do want to make loans to people who can pay back.

Certainly one of the reasons that growth has been sluggish is small businesses not being able to get as much credit as they would like are not being the engine for job creation that they typically are in a recovery. That is one of the things that is holding us back.

Q. How do you propose educating consumers on maintaining a balance between saving and spending?

A. That's a great question. This is often raised as, "you know, in some sense the boom and the crisis came about because people spent too much an consumed too much and borrowed too much. Now we want people to borrow more and spend more, what sense does that make?"

It does to an economist so give me a moment to clarify. (Chuckles.)

First at a micro level, at the level of the individual family or household or individual, we want people to be responsible. We think everyone should live within their means and manage their finances as well as they can. That being said, for the economy as a whole there has to be some source of demand that will put our factories and firms back to work. We need that for recovery. There's a little bit of a contradiction about those two things. There are a couple of ways to resolve that contradiction.

One is to understand that there are components of demand for goods and services in our economy which are not consumer spending. That includes, for example, capital formation. If firms are adding to their high-tech information technology, for example, or if the government is spending on bridges. A very important source of demand, of course, is exports, when selling goods and services to folks outside the country.

People can spend responsibly if they have the income. So what we would like to see is a labor recovery. The labor market has been growing, it's been recovering, but too slowly. To the extent that economic policies or the decisions being made by employers across the country will help our labor market grow, and jobs be created, that's going to increase incomes. That will allow people to spend more, create more demand for products, create more growth in our economy, but without being irresponsible on the part of the individuals.

Q. What do you believe would or could have happened if the Fed in collaboration with the government had not taken the very aggressive steps it took during the financial crisis?

A. This is one of the very difficult areas. A lot of your students and people in the country say "well, they bailed out Wall Street – it has nothing to do with me." The reason we got involved [was that] we knew from history that the financial is so essential to our economy, that the collapse of the financial system would have been catastrophic. That's what happened in the 1930s. We know that a financial crisis can be very, very damaging to the real economy.

In September and October of 2008, we came extraordinarily close to a complete collapse of the global financial system. Not just the United States, but the whole global financial system. We had a meeting in, here in Washington in October of the G-20 -- 20 of the largest countries in the world. We developed coordinated plans whereby in each country around the world we took strong steps to try to prevent the financial system from melting down. We didn't succeed entirely, obviously. We had at least one major firm collapsed. We had other firms that required government bailouts. Those things were very distasteful to us.

I can only say that if the global financial system melted down and many firms had failed, if the ability to make loans had essentially dried up, if people had lost most of their investments, their savings accounts, their retirement accounts, we would not be today at least on a recovery path. We would still be in a much deeper hole, something much closer to the Great Depression of the 1930s.

I do hope that while your students will understand that not everything that the government did during the recession and the crisis was right, that stepping in to prevent the collapse of the global financial system was something that was necessary and it affected every single American in a very important way.

I guess the final thing I would say is, while there was a lot of money made available to address the problems of the financial system, at this point it looks like we are going to get it all back, pretty much all

of it. Not something we would ever want to do again, but we are getting our money back on top of everything else. So I would have to say that this was a successful policy. Not a popular one, but a successful one.

As an economic historian, somebody who has spent much of their career looking at economic history both in the United States and other countries, I firmly believe that we really had to stop that collapse of the financial system or the consequences for everybody would have been much more severe than what we did in fact see.

Q. Can you describe what you see going forward as the strength and failings of the Dodd-Frank legislation and what safeguards have been put in place for the future?

A. I spent the morning in the Senate Banking Committee giving testimony on the implementation of the Dodd-Frank Act. This was the omnibus financial reform passed in July of this year. It's very, very comprehensive, certainly by far the most comprehensive financial regulatory reform since the 1930s.

It makes a lot of fundamental changes in our financial system. To name just a few of them, it creates a financial stability oversight council which brings together the heads of all the regulatory agencies and says: Let's all work together to see if we can identify any risks that might be arising in our financial system. One of the problems that happened before the recent crisis was that everybody had their own little responsibilities, but there wasn't really anybody in charge of looking at the system as a whole. What this legislation does is greatly strengthen the provisions to require regulators not just to look at their individual fiefdom but to look at the whole financial system and identify risks that might be arising in the financial system changes. That by itself is a major change.

In addition the Dodd-Frank act closes a lot of gaps that existed. We were just talking about bailouts. AIG, which took important steps today to begin to pay back the government, was essentially not regulated by anybody. Nobody really was paying attention to what was going on there. The investment banks like Lehman Brothers had very limited regulation. So the Dodd-Frank act closes a lot of gaps and creates new oversight responsibilities for the Fed and for the other agencies.

Let me mention two other things it does. One, it is going to create a consumer protection agency. We have been talking today a lot about financial literacy, about people who got into trouble on their mortgages or credit cards. Some of that is the fault of the borrower. Some of it, of course, is bad disclosures or bad practices on the parts of the financial institutions. The Federal Reserve has been working hard on consumer protection under my chairmanship and this new Bureau, which will be within the Fed but independent, will also be responsible for trying to provide those protections.

There are provisions now in the law that will make bailouts both unnecessary and illegal. That is, should we ever come to a situation where big financial firm is about to collapse and its collapse poses dangers to the U.S. economy, we now have a set of rules that would allow the Federal Deposit Insurance Corporation to come in and seize that institution and wind it down in a safe way that will not cost the taxpayers any money and that will not create chaos in the financial system. If we had that two or three years ago, we could have avoided a lot of what happened.

This is not a panacea. It is not complete. Passing the law is only the first step. The regulators have to implement these laws, which means we have to devise a whole set of rules and regulations that will make

specific and concrete for the financial firms and other regulated entities what those laws mean specifically. We have to enforce those laws. That means we have to strengthen our supervisory arm and make sure we have all the resources and talents we need to enforce those rules.

One last thing. Part of what made this crisis so difficult is that it was a global crisis, particularly in the industrial countries in Europe. That required a great deal of coordination. That is going to be necessary also as we impose new rules in the financial marketplace. We don't want to have one set of rules in the U.S. and another set of rules in France and a third set of rules in Japan.

There are a lot of challenges ahead. We are not home free by any means, but I think this legislation which I, as I said is the most sweeping since the 1930s will give us a fighting chance to set up a system that will prevent what happened in 2008 and 2009 from happening again.

Q. Chairman Bernanke, does the FOMC hold divergent views? And what do you recommend to students to reconcile the differences in their own opinions?

A. Good question. As I'm sure you know, but to provide some context, the Federal Open Market Committee is the group of people who [meet] eight times a year to decide what we should do about monetary policy. People have different views on the committee. That's always the case. It may be more the case today because we have such a complex situation.

My attitude about that is if two people agree on everything all the time, one of them is redundant. (Laughter.) It's good to have different views. That's why you want to have a committee. One of my ex-colleagues at Princeton wrote some very nice papers showing that committees for certain kinds of complex decisions can actually do a better job than a single person. Ultimately the committee finds the consensus and we work together to figure out what the right thing is for the country. Again, we try to do that in a way that is independent of any political considerations. It's important that we hear both sides of the story. We listen to all points of view. We use critical thinking to try to figure out what we believe and what's right. We investigate, we do research. We get the facts. That's the way forward.

So disagreement is a good thing. It creates new ideas. It forces people to look at all sides of a question. That's one of the most challenging things[for students]. While I know it's really important to get good test scores, thinking for yourself, that's something people will have for their whole life if you can get there.

Q. What do you believe the role of education will be in our future economy and how can we better prepare our students for financial success?

A. I would say it is the most important element of both our national future success and individual success. Just think about how the world is changing. First of all, technology is changing radically. One of the key explanations that economists give for the increasing inequality of income in the United States and in the world has to do with technology. That people who are capable with ease of using sophisticated technologies earn high incomes and are productive. People who do not have those skills do not do nearly so well. That's part of the reason why income inequality has increased in America.

What other trends are there? New forms of energy, new forms of climate related industries [require] technology, creativity, scientific and engineering training. All those things are going to be critical for economic success and for personal success.

We all compete globally now. So if we want America to remain the place where the best jobs are, we have to make the best workers. Although there are some weaknesses in the American educational system, we have some important strengths. One is our very strong university system. Another, as I already mentioned, is that we have such a diversity of ways for people to get skills and training.

In the current economy there are people who have been out of work now for a period of time. Maybe the job they had is never going to come back. There are ways in America to get retrained, to get new skills. It's strength of our economy and our country. If you want to be successful having the skills to get a good job or to launch a business are important, but you also need to manage your money well. That's where financial literacy and financial education comes in.

Q. Recently I had a banker as a guest speaker in my classroom. He stated that there are two areas that he would not lend to and they are manufacturing and agribusiness.

A. Agriculture always has ups and downs and parts of the country may be doing well and other parts may be doing poorly. Generally speaking agriculture is one of the most productive sectors of the United States economy. There was a time when half the population was involved in growing food. Now it's two or 3 percent. Not only they feed the whole country but they have enough left over to be major exporters to people around the world. This is an area where the United States has been very, very competitive for a long time.

The other question was about manufacturing. There, I think, the popular perception may be a little bit too pessimistic. It remains a very strong sector in the United States and very important source of exports to other countries. Another observation to make is that in this recovery that we are watching unfold, manufacturing has been a big part of that.

That being said, there is one dimension which is important, which is that because manufacturing has been so productive the number of workers with manufacturing jobs has gone down even as the output of the manufacturing sector has gone up. So there are far fewer manufacturing jobs than there used to be and there are particularly fewer sort of low skilled manufacturing jobs than there used to be. Manufacturing in the United States is a growing industry and important part of our economy. It is not as big an employer as it used to be, but it does play a very important role in our recovery and in our international trade.