THE ECONOMIC CLUB

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Excerpts from the Signature Event featuring The Honorable Ben S. Bernanke, Distinguished Fellow in Residence, Economic Studies, The Brookings Institute

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What's happening there *[in China]* is that they are trying – as we, the United States, have urged them to – they're trying to make a transition to change their growth model. For a long time their growth model was a very centrist, top-down kind of model focused on heavy industry, exports, construction, and they're trying to move from that to a more services/consumer-oriented type economy, which is difficult to do. I think they're making progress. One of the big problems is that between the fact that their policymakers are not always so transparent about what their objectives and intentions are, and the fact that the data and other information is not at the standard we would see in the United States, a lot of the concerns are rising just because people are very uncertain about what exactly is happening there.

. . . as late as spring of 2007, we did not at that point think that the whole financial system was going to implode. . . . in the fall of '07 the stress in the financial markets began to get much more severe, and at that point – I think it would have been sort of the end of August '07 –our focus was switched away from worrying about inflation, which was a problem, toward trying to address the budding crisis, which was just spreading out from the subprime into the whole credit market.

Europe *[has]* moved into a better policy situation. I do think that it took them many years, but the European Central Bank has adopted some of the unconventional policies that the Fed pioneered six years earlier, and on the fiscal side, the fiscal policy was very, very tight in Europe, much tighter even than the United States because of the austerity and so on that they were running. That austerity period seems to be over, and budgets are more neutral now in Europe. Between less resistance from fiscal policy and a better, more supportive monetary policy, you expect to see a little bit more growth. They are, however, also facing the international concerns that we have in the United States, and if anything their exporters are even more exposed to emerging markets than we are.

Our efforts to support the economy have gone well beyond conventional monetary policy. . . .I have already alluded to the Federal Reserve's close cooperation with the Treasury, the Federal Deposit Insurance Corporation and other domestic and foreign authorities in a concerted and ultimately successful effort to stabilize the global banking system, which verged on collapse following the extraordinary events of September and October 2008. In all of these efforts, our objective has not been to support specific financial institutions or markets for their own sake. Rather, recognizing that a healthy economy requires well-functioning financial markets, we have moved always with the single aim of promoting economic recovery and economic opportunity. In that respect, our means and goals have been fully consistent with the traditional functions of a central bank and with the mandate given to the Federal Reserve by the Congress to promote price stability and maximum employment.

Although the sources of the crisis were extraordinarily complex and numerous, a fundamental cause was that many financial firms simply did not appreciate the risks that they were taking. Their risk-management systems were inadequate and their capital and liquidity buffers insufficient. Unfortunately, neither the firms nor the regulators identified and remedied many of the weaknesses soon enough. Thus, all financial regulators, including the Federal Reserve, must undertake unsparing self-assessments. Although regulators can do a great deal on their own to improve financial oversight, the Congress also must act to fix gaps and weaknesses in the structure of the regulatory system and, in so doing, they must address the very serious problem posed by firms perceived as being 'too big to fail.' No firm, by virtue of its size and complexity, should be permitted to hold the financial system, the economy, or the American taxpayer hostage.

We have a slowing Chinese economy, and the combination of slower China, weak commodity prices, strong dollar is affecting emerging markets around the world, which in turn is creating stress in financial markets. And all the strong dollar, the weak export markets, and financial stress is feeding back on our economy and is becoming a significant headwind. So that's the battle, in some sense, that's going on now.

. . . the domestic U.S. economy looks to be in pretty good shape. It's being driven by a fairly strong household sector. . . . jobs have come back. Wages are beginning to rise. Debts have been paid down. Markets are stronger, certainly compared to a few years ago. You have strengthening consumer spending. The housing sector, of course, has been relatively weak in the recovery, but it's continuing to improve. So overall, you have a domestic U.S. economy which has got some momentum, has been moving forward, creating jobs. There's the issue of very slow productivity growth, which is a somewhat separate issue, but in terms of the cyclical recovery, you're seeing a good dynamic.

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. . . after Lehman failed, that's when the government, when Congress said, OK, we've got to take strong action. And that's ultimately where TARP *[Troubled Assets Relief Program]* came from and so on. . . .Lehman had already put the system into cardiac arrest, I think AIG's collapse would have made things significantly worse. I thought it was a very tough – it was a very tough experience. I remember (Secretary of the Treasury Henry) Paulson and I going to President Bush and . . . say we have to lend $85 billion to a failing insurance company in the middle of a financial crisis. How's that sound? . . .to his credit, President Bush said, you got to do what you got to do and you do it. I'll explain it. But you need to go talk to Congress. So Paulson and I went to an ad hoc meeting of the senior members of the Banking and Finance Committees, from Senate/House leadership. We went over there, and we had about 20 people. We were explaining what was happening, what we thought we had to do, and we were taking questions. Will it stop the crisis? We don't know. Will you get your money back? Well, we hope so. After a while, with questions sort of petered out. Senator Reid, sort of had his face in his hands, he looked at me and Paulson. He said, Mr. Secretary, Mr. Chairman, I want to thank you for coming over here and explaining all this to us – it's been very helpful – and for taking our questions. But he said, I want you to understand one thing. Nothing you've heard here tonight constitutes congressional approval for what you're about to do. He said, this is your decision and your responsibility. And that was a very, very lonely feeling, I have to tell you.

. . . some very terrible things happened – the crisis and the recession – and you always have to ask yourself, what could have been done to avoid it? I have difficulty identifying any obvious action, but I hope at least that we can say that we've learned a lot from what's happened and that we make the system stronger and avoid such crises in the future.

. . . while TARP *[Troubled Assets Relief Program]* is still poison and, on the campaign trail, if you voted for TARP, it's a terrible thing, it was one of the most successful programs the government's ever put in place. It stopped the crisis, it stabilized the financial system, and it made a profit. *[Though TARP]* I think it was on the order of $250 billion" *[that was invested]* in . . . banks. . . . Got every penny back, with interest.