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Fed Turns Out To Be Enabler of Debt Binge

By MIKE COSGROVE

The U.S. economy is in the ditch, growing slowly as an anti-growth fiscal and regulatory policy portfolio prevents it from climbing back onto the growth highway. Federal Reserve Chairman Ben Bernanke and other Fed leaders have become enablers of allowing the U.S. economy to underperform.

Bernanke had it exactly right in his April 7, 2010, speech when he said: "To avoid large and unsustainable budget deficits, the nation will ultimately have to choose among higher taxes, modifications to entitlement programs such as Social Security and Medicare, less spending on everything else from education to defense, or some combination of the above."

His talk's timing coincided with President Obama's creation of the Bowles-Simpson commission whose first meeting took place on April 27, 2010. Mr. Bernanke's talk outlined some of the choices facing Bowles-Simpson.

"But," he added, "unless we as a nation demonstrate a strong commitment to fiscal responsibility, in the longer run we will have neither financial stability nor healthy economic growth." The Bowles-Simpson report, released on Dec. 1, 2010, outlined a path toward fiscal responsibility.

The administration ignored Bowles-Simpson and instead continuing its large and unsustainable budget deficits, a huge new entitlement — ObamaCare — and subpar economic growth.

Bernanke may have been assured by the administration that the Bowles-Simpson outline of moving the nation toward fiscal responsibility would be followed.

Why? The Fed implemented QE2 in November 2010. That program bought $600 billion of Treasury debt. That would have been the ideal time to move the U.S. toward fiscal responsibility — easy money in conjunction with much tighter fiscal policy.

Instead Bernanke was likely snookered by the administration. The timing of QE2 should have coincided with the Bowles-Simpson parameters of restructuring of entitlements and the tax code. That would have let businesses, households and capital markets know what tax rates and entitlement levels would be for perhaps years.

Instead, $5 trillion has been added to our Federal debt, along with more years of underfunded entitlements. Entitlements are currently underfunded by at least $60 trillion, a number that escalates each year.

Entitlements need to be restructured, and the increase in entitlement outlays needs to dramatically slow toward the pace of economic growth.

Now the U.S. financial system has been flooded with $1.4 trillion of excess reserves from QE1 and QE2, and everyone is stuck with Bernanke's 2010 longer-run concerns of having neither financial stability nor healthy economic growth. Total non-farm employment is currently 133.1 million, below where total employment was in January 2000 and still 5 million below the January 2008 level.

Meanwhile the U.S. population has increased by 30 million since 2000.

That defines a very unhealthy economy that is burdened under the weight of unsustainable fiscal deficits, entitlement liabilities that won't be paid and a tax system that needs to be revised to generate more tax revenue.

The failing European economies have chosen a similar road of unsustainable fiscal deficits, entitlements that can't be paid and an increasing tax burden. Those countries all had choices years ago — reform or fail. Greece, Spain, Italy, Portugal all chose failure.

The U.S. had the same choice in 2010 — reform entitlements and the tax code and steer the federal budget toward balance or allow the economy to sink under the weight of federal debt and federal debt obligations.

The Obama administration, by deciding to ignore the Bowles-Simpson guidelines for fiscal responsibility, placed the U.S. on the path toward unemployment and underemployment.

Bernanke enabled the administration to do that by flooding the financial system with excess reserves.

As I said, Bernanke may have thought the administration would move ahead with Bowles-Simpson in 2010, but that did not happen. In fact, it's been the opposite. Perhaps the largest unintended consequence of QE2, to date, is that it let the Obama administration weigh the U.S. economy down with more federal debt.

A QE3, if enacted, would create the same unintended consequence — allow the U.S. economy to slide further into the ditch following the path of the failing European economies.

The sooner entitlements and the tax code are reformed, the sooner the economy can drive out of the ditch.

Bernanke could hasten that process by shutting the door now on QE3 and bringing a halt to Operation Twist, Jr.

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