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Bernanke: Baby boomers threaten economy

Fed chief says failure to deal with aging population could hurt economy.

January 18 2007: 3:14 PM EST

WASHINGTON (Reuters) -- Federal Reserve Chairman Ben Bernanke bluntly warned the U.S. Congress Thursday that failure to act soon to deal with the budgetary strains posed by an aging U.S. population could lead to serious economic harm.

"We are experiencing what seems likely to be the calm before the storm," Bernanke told the Senate Budget Committee as he acknowledged projections that the U.S. budget deficit could hold steady or even narrow in the near-term.

"However, if early and meaningful action is not taken, the U.S. economy could be seriously weakened, with future generations bearing much of the cost," he added, citing worrisome long-term projections on the cost of programs such as Social Security and Medicare.

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"The longer we wait, the more severe, the more draconian, the more difficult the adjustments are going to be," Bernanke cautioned as he answered questions before the panel.

The Fed chairman did not discuss the outlook for interest rates in his

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testimony, the first he has delivered since Democrats took control of Congress after November elections. He is expected to testify on Fed policy on Feb. 14-15.

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Bernanke also hewed closely to a previous pledge to remain neutral in Washington budget policy debates, steering clear of specific advice on how Congress might meet or lower the projected costs of retirement and health-care programs even as he warned of the risks of inaction.

"Dealing with the resulting fiscal strains will pose difficult choices for the Congress, the administration, and the American people," Bernanke said.

'Vicious cycle'

Bernanke cited projections by the Congressional Budget Office that showed spending on entitlement programs would reach about 15 percent of U.S. gross domestic product by 2030, nearly doubling today's levels, a size he said risked fueling an ever-growing mountain of debt.

"A vicious cycle may develop in which large deficits lead to rapid growth in debt and interest payments, which in turn adds to subsequent deficits," Bernanke said.

"Ultimately, this expansion of debt would spark a fiscal crisis, which could be addressed only by very sharp spending cuts or tax increases, or both," he added.

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The Fed chief said whatever budget decisions were taken, tax rates would need to be set at a level that achieved "an appropriate balance of spending and revenues in the long run."

Bernanke said advocates of lower taxes would have to accept lower spending on entitlement programs. Likewise, proponents of more-expansive government programs must recognize the need for higher taxes brought about by higher spending, he added.

"Unfortunately, economic growth alone is unlikely to solve the nation's impending fiscal problems," he said.

President Bush has also warned of the risks of inaction but a plan he offered to shore-up Social Security by allowing workers to invest retirement accounts in stocks and bonds was rejected by Democrats, who



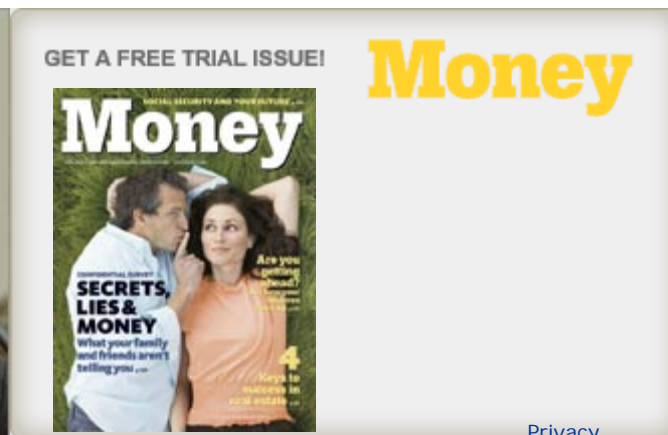
DENNIS DOOK/AP

Fed chief Bernanke warns the financial strain of the aging population could imperil the economy if Congress doesn't act soon.



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argued it would undermine retirement security.

Trustees for the retirement program said last year Social Security would exhaust its assets in 2040, while the trust fund for Medicare, which covers retiree health-care costs, would run dry in just 12 years.

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