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HOUSE OF REPRESENTATIVES

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CURRENT FISCAL ISSUES

FRIDAY, MARCH 2, 2001

HOUSE OF REPRESENTATIVES,
COMMITTEE ON THE BUDGET,
Washington, DC.

The committee met, pursuant to call, at 10 a.m. in room 210, Cannon House Office Building, Hon. Jim Nussle (chairman of the committee) presiding.

Members present: Representatives Nussle, Sununu, Bass, Gutknecht, Collins, Hastings, Culberson, Crenshaw, Putnam, Spratt, Bentsen, Davis, Clayton, Price, Moran, McCarthy, Capuano, and Honda.

Chairman NUSSLE. Good morning. I call the hearing to order. This is the full committee hearing on current fiscal issues. The witness today is the Honorable Alan Greenspan, Chairman of the Board of Governors of the Federal Reserve System. We are honored to have the Chairman with us this morning.

I have a brief statement that I would like to make, and then I will offer Ranking Member Spratt the opportunity as well, and then we would enjoy hearing from our witness.

In town meetings across Iowa, I often hear and have heard throughout my tenure in Congress many different statements from constituents with regard to budget advice. As long as 10 years ago they said balance the budget, pay down the debt, take Social Security off the table, fix Medicare. Wise advice; common sense advice that I know many of my colleagues have heard from their constituents.

This year not only do we hear pay down the national debt, but we also hear, you know, that surplus should not be left in Washington; give us some tax relief.

While the President has presented a budget that does all of those things, and does them in a way that I believe is successful and one that we can work with as a foundation based on the now fifth year that we will go into balanced budgets, having paid down $625 billion of national debt, providing tax relief already, even before we begin this budget process for Americans, and trying to hold as best we can the line on spending for at least 4 of those 6 years, last year, of course, being a grave exception to that, as we go into the budget season this year, it is an honor to have the Chairman here to give us his advice with regard to a number of issues.

I have three questions that I would be interested in covering with the Chairman. First, what is the state of the economy? It is a pretty broad question, but a pretty important question as we look at the budget not only for this year, but as we plan and set the foundation for the next 10 years. Number two is how will tax relief, how will the tax plan, and how will the budget plan provide stimulus or provide assistance in answering the concerns of our current economy? Number three is any recommendations he has with regard to paying down the national debt.

Yesterday we heard from Mitch Daniels, the Director of the Office of Management and Budget, who has written a budget, together with the President, which pays down all of the redeemable debt within the next 10 years using $2 trillion of surplus money over the next 10 years to pay down that national debt. This is what they say is all that we can financially practicably pay down during this 10-year period, and I am interested in hearing from the Chairman his advice with regard to that portion of the plan as well.

We are happy to have the Chairman here, and before I recognize the Chairman for his testimony, I would like to recognize my friend and colleague Mr. Spratt, the Ranking Member of the Budget Committee.

Mr. SPRATT. Mr. Chairman, let me express my admiration also for your work and welcome you once again to our committee. I know you have testified many other places before coming here, but we are glad to have you here, and we have some important questions to put to you today. We are grateful that you have come.

Mr. GREENSPAN. Thank you.

Chairman NUSSLE. Chairman Greenspan, welcome, and your entire testimony, of course, will be made part of the record, as, without any objection, all Member statements will be made part of the record in total.

[The prepared statement of Ander Crenshaw follows:]

PREPARED STATEMENT OF HON. ANDER CRENSHAW, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Thank you, Mr. Chairman, for holding this hearing today. And, thank you, Chairman Greenspan for coming here to share your views on the economy, the budget, and our prospects for significant tax relief this year.

It is my view that the President has laid out a very sound, fiscally responsible course of action in his budget. He uses Social Security surplus for Social Security and Medicare money for Medicare. He proposes continuing to pay down the debt at an historic pace until there is no redeemable debt left to retire without paying tremendous premiums, and then he continues to retire it as it matures. He prioritizes his funding requests to reflect a vision for our nation's future, including improving public education, increasing medical research, and meeting the quality-of-life needs of America's servicemembers.

President Bush also sets aside $1 trillion to establish a sort of "rainy day" fund. Never before has our nation done this—set aside money for unexpected contingencies and long-range reforms. But, now that it has been contemplated, it seems so obvious.

And, even after all that, President Bush makes sure that the American taxpayers get to keep a little more of their hard-earned money, instead of sending it to Washington. When I was President of the Senate in Florida, we passed our first balanced budget without raising taxes. We did it by prioritizing our spending needs and making tough choices. Here, in Congress, with these historic surpluses, we have an opportunity to do still more for the people we represent. Applying the same principles—prioritizing our spending and making tough choices—we can actually reduce the tax burden on American taxpayers and let them use the money for their own household spending needs.

I appreciate your candor, Chairman Greenspan, and look forward to working with you on these important issues.

1. In testimony before the Senate Budget and Banking Committees earlier this year, you indicated your support for a substantial tax relief package. Your statements have also implied tepid support for a trigger mechanism that would slow

down or stop the gradual implementation of tax relief should the surpluses not appear as projected. Senator Kent Conrad, the Ranking Member on the Senate Budget Committee, has rejected the trigger concept out-of-hand, saying, “You would be raising taxes at a time of an economic slowdown. That is exactly the wrong thing to be doing.” Could you please settle the record on whether you support or oppose a trigger mechanism? And, if you do support one, how would you suggest we structure it?

2. I was wondering if you could comment on the President’s proposal for a contingency fund. There comes a point when we retire all of our redeemable debt and to pay it down beyond that would mean paying enormous premiums. So, we accumulate a surplus that the President would set aside to meet unexpected needs, to tackle the kind of long-range reforms in programs like Medicare and Social Security that Congress typically puts off as too daunting, or to act as an economic cushion. Do you have any thoughts on how this contingency fund might affect the broader economy? Do you think its presence could buoy consumer confidence?

Chairman NUSSLE. You may summarize or proceed as you wish. Chairman Greenspan.

STATEMENT OF ALAN GREENSPAN, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. GREENSPAN. Thank you very much, Mr. Chairman and members of the committee. I am most pleased to appear here today to discuss some of the important issues which you raise surrounding the outlook of the Federal budget and the attendant implications for the formulation of fiscal policy. In doing so, I want to emphasize that I speak for myself and not necessarily for the Federal Reserve.

The challenges we face both in shaping the budget for the coming year and in designing a long-run strategy for fiscal policy has been brought into sharp focus by the budget projections that have been released in the past month and a half. Both the Bush administration and the Congressional Budget Office project growing on-budget surpluses under current policy over the next decade. Indeed, growing on-budget surpluses were projected even under the more conservative assumptions of the Clinton administration’s final budget projections.

The key factor driving the cumulative upward revisions in the budget picture in recent years has been the extraordinary pickup in the growth of labor productivity that appears to be causing economists to raise their forecasts of the economy’s long-term growth rates and budget surpluses. This increased optimism receives support from the forward-looking indicators of technological innovation and structural productivity growth, which have shown few signs of weakening despite the marked curtailment in recent months of capital investment plans for equipment and software.

To be sure, these impressive upward revisions to the growth of structural productivity and economic potential are based on inferences drawn from economic relationships that are different from anything we have considered in recent decades. The resulting budget projections, therefore, are necessarily subject to a relatively wide range of uncertainty. CBO, for example, expects productivity growth rates through the next decade to average roughly 2½ percent per year, far above the average pace from the early 1970’s through the mid-1990’s, but still below that of the past 5 years.

The most recent projections from OMB and CBO indicate that if current policies remain in place, the total unified surplus will reach about $800 billion in fiscal year 2010, including an on-budget surplus of almost $500 billion. Moreover, the admittedly quite uncertain long-term budget exercises released by CBO last October maintain an implicit on-budget surplus under baseline assumptions well past 2030, despite the budgetary pressures from the aging of the baby boom generation, especially on the major health programs.

These most recent projections, granted their tentativeness, nonetheless make clear that the highly desirable goal of paying off the Federal debt is in reach and, indeed, would occur well before the end of the decade under baseline assumptions. This is in marked contrast to the perception of a year ago when the elimination of the debt did not appear likely until the next decade at the earliest. But continuing to run surpluses beyond the point at which we reach zero or near-zero Federal debt brings to center stage the critical long-term fiscal policy issue of whether the Federal Government should accumulate large quantities of private or, more technically, non-Federal assets.

At zero debt, the continuing unified budget surpluses now projected under current law imply a major accumulation of private assets by the Federal Government. Such an accumulation would make the Federal Government a significant factor in our Nation's capital markets and would risk significant distortion in the allocation of capital to its most productive uses. Such a distortion could be quite costly, as it is our extraordinarily effective allocation process that has enabled such impressive increases in productivity and standards of living despite a relatively low domestic saving rate.

I doubt that it is possible to secure and sustain institutional arrangements that would insulate Federal investment decisions, over the longer run, from political pressures. To be sure, the roughly $100 billion of assets in the Federal Government's defined-contribution Thrift Savings Plan have been well insulated from political pressures. But the defined contribution nature of this plan means that it is effectively self-policed by individual contributors, who would surely object were their retirement assets to be diverted to investments that offered less-than-market returns.

But such countervailing forces may be greatly attenuated for Federal Government defined-benefit plans, such as Social Security. To the extent that benefits are perceived to be guaranteed by the government, beneficiaries may be much less vigilant about the stewardship of trust fund assets.

Requiring the Federal Government to invest in indexed funds arguably would largely insulate the investment decision from political tampering. But such assets, by definition, can cover only publicly traded securities, perhaps three-fifths of total private capital assets. With large allocations of public funds invested in larger enterprises, our innovative, smaller, nonpublicly traded businesses might find themselves competitively disadvantaged in obtaining financing. To be sure, there is not universal agreement among economists on this point, but it is a consideration that should be kept in mind.

More generally, the problematic experiences of some other countries with large government accumulation of private assets should give us pause about moving in that direction. To repeat, over time, having the Federal Government hold significant amounts of private assets, in my judgment, would risk suboptimal performance by our capital markets, diminished economic efficiency, and lower overall standards of living than would be achieved otherwise.

Private asset accumulation, however, may be forced upon us well short of reaching zero debt. Both CBO and OMB project an inability of current services unified budget surpluses to be applied wholly to repay debt by the middle of this decade. Without policy changes, private asset accumulation is likely to begin in just a few short years.

In summary, then, the Congress needs to make a policy judgment regarding whether and how private assets should be accumulated in Federal Government accounts. This judgment will have important implications for the level of saving and, hence, investment in our economy, as well as for the nature of government programs. If, for example, the accumulation of assets is avoided by eliminating unified budget surpluses through tax and spending changes, public and presumably national savings may well fall from already low levels. If so, over time, capital accumulation and the productive capacity of the economy presumably would be reduced through this channel. Eliminating unified surpluses by transforming Social Security into a defined-contribution system with accounts held in the private sector would likely better maintain national savings levels, but the nature of Social Security would at the same time be fundamentally changed. Alternatively, unified surpluses could be used to establish mandated individual retirement accounts outside the Social Security System, also mitigating the erosion in national savings.

The task before the administration and the Congress in the years ahead is likely to prove truly testing. But, of course, the choices confronting you are far more benign than having to deal with deficits “as far as the eye can see.”

Returning to the broader fiscal picture, I continue to believe, as I have testified previously, that all else being equal, a declining level of Federal debt is desirable because it holds down long-term real interest rates, thereby lowering the cost of capital and elevating private investment. The rapid capital deepening that has occurred in the U.S. economy in recent years is a testament to these benefits. But the sequence of upward revisions to the budget surplus projections for several years now has reshaped the choices and opportunities before us.

Indeed, in almost any credible baseline scenario, short of a major prolonged economic contraction, the full benefits of debt reduction are now achieved well before the end of this decade, a prospect that did not seem reasonable only a year or even 6 months ago. Thus, the emerging key fiscal policy need is now to address the implications of maintaining surpluses beyond the point at which publicly held debt is effectively eliminated.

Though special care must be taken not to conclude that wraps on fiscal discipline are no longer necessary, at the same time we must avoid a situation in which we come upon the level of irreducible debt so abruptly that the only alternative to the accumulation of private assets would be a sharp reduction in taxes or an increase in expenditures. These actions might occur at a time when sizable economic stimulus would be inappropriate. Should this Congress conclude that this is a sufficiently high probability, it is none too soon to adjust policy to fend off such potential imbalances.

For reasons I have testified to previously, if long-term fiscal stability is the criterion, it is far better, in my judgment, that the surpluses be lowered by tax reductions than by spending increases. The flurry of increases in outlays that occurred near the conclusion of last fall's budget deliberations is troubling because it makes the previous year's lack of discipline less likely to have been an aberration.

As for tax policy over the longer run, most economists believe that it should be directed at setting rates at the levels required to meet spending commitments while doing so in a manner that minimizes distortions, increases efficiency, and enhances incentives for saving, investment, and work.

In recognition of the uncertainties in the economic and budget outlook, it is important that any long-term tax plan, or spending initiative for that matter, be phased in. Conceivably, it could include provisions that, in some way, would limit surplus-reducing actions if specified targets for the budget surplus or Federal debt levels were not satisfied. Only if the probability were very low that prospective tax cuts or new outlay initiatives would send the on-budget accounts into deficit, would unconditional initiatives appear prudent.

The reason for caution, of course, rests on the tentativeness of our projections. To be sure, unless the current economic weakness reveals a less favorable relationship between tax receipts, income, and asset prices than has been assumed in recent projections, receipts should be reasonably well maintained in the near term, as the effects of earlier gains in asset values continue to feed through with a lag into tax liabilities. But the longer-run effects of movements in asset values are much more difficult to assess, and those uncertainties would intensify should equity prices remain significantly off their peaks.

In the end, the outlook for Federal budget surpluses rests fundamentally on expectations of longer-term trends in productivity, fashioned by judgments about the technologies that underline these trends. Economists have long noted that the diffusion of technology starts slowly, accelerates, and then slows with maturity. But knowing where we now stand in that sequence is difficult, if not impossible, in real time. Faced with these uncertainties, it is crucial that we develop budgetary strategies that deal with any disappointments that could occur.

That said, the changes in the budget outlook over the past several years are truly remarkable. Little more than a decade ago, the Congress established budget controls that were considered successful because they were instrumental in squeezing the burgeoning budget deficit to tolerable dimensions. Nevertheless, despite the sharp curtailment of defense expenditures under way during those years, few believed that a surplus was anywhere on the horizon, and the notion that the rapidly mounting Federal debt could be paid off would not have been taken seriously.

But let me end on a cautionary note. With today's euphoria surrounding the surpluses, it is not difficult to imagine the hard-earned fiscal restraint developed in recent years rapidly dissipating. We need to resist those policies that could readily resurrect the deficits of the past and the fiscal imbalances that followed in their wake.

Thank you very much. I look forward to your questions, Mr. Chairman.

Chairman NUSSLE. Thank you, Mr. Chairman.

[The prepared statement of Alan Greenspan follows:]

PREPARED STATEMENT OF HON. ALAN GREENSPAN, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

I am pleased to appear here today to discuss some of the important issues surrounding the outlook for the Federal budget and the attendant implications for the formulation of fiscal policy. In doing so, I want to emphasize that I speak for myself and not necessarily for the Federal Reserve.

The challenges you face both in shaping a budget for the coming year and in designing a longer-run strategy for fiscal policy have been brought into sharp focus by the budget projections that have been released in the past month and a half. Both the Bush Administration and the Congressional Budget Office project growing on-budget surpluses under current policy over the next decade. Indeed, growing on-budget surpluses were projected even under the more conservative assumptions of the Clinton Administration's final budget projections.

The key factor driving the cumulative upward revisions in the budget picture in recent years has been the extraordinary pickup in the growth of labor productivity experienced in this country since the mid-1990's. Between the early 1970's and 1995, output per hour in the nonfarm business sector rose about 1½ percent per year, on average. Since 1995, however, productivity growth has accelerated markedly, about doubling the earlier pace, even after one takes account of the impetus from cyclical forces. Though hardly definitive, the apparent sustained strength in measured productivity in the face of a pronounced slowing in the growth of aggregate demand during the second half of last year was an important test of the extent of the improvement in structural productivity. These most recent indications have added to the accumulating evidence that the apparent increases in the growth of output per hour are more than transitory.

It is these observations that appear to be causing economists to raise their forecasts of the economy's long-term growth rates and budget surpluses. This increased optimism receives support from the forward-looking indicators of technical innovation and structural productivity growth, which have shown few signs of weakening despite the marked curtailment in recent months of capital investment plans for equipment and software.

To be sure, these impressive upward revisions to the growth of structural productivity and economic potential are based on inferences drawn from economic relationships that are different from anything we have considered in recent decades. The resulting budget projections, therefore, are necessarily subject to a relatively wide range of uncertainty. CBO, for example, expects productivity growth rates through the next decade to average roughly 2½ percent per year—far above the average pace from the early 1970's to the mid-1990's, but still below that of the past 5 years.

Had the innovations of recent decades, especially in information technologies, not come to fruition, productivity growth during the past five to 7 years, arguably, would have continued to languish at the rate of the preceding twenty years. The sharp increase in prospective long-term rates of return on high-tech investments would not have emerged as it did in the early 1990's, and the associated surge in stock prices would surely have been largely absent. The accompanying wealth effect, so evidently critical to the growth of economic activity since the mid-1990's, would never have materialized.

In contrast, the experience of the past 5 to 7 years has been truly without recent precedent. The doubling of the growth rate of output per hour has caused individuals' real taxable income to grow nearly 2½ times as fast as it did over the preceding 10 years and has resulted in the substantial surplus of receipts over outlays that we are now experiencing. Not only has taxable income risen with the faster growth of GDP, but the associated large increase in asset prices and capital gains has created additional tax liabilities not directly related to income from current production.

The most recent projections from OMB and CBO indicate that, if current policies remain in place, the total unified surplus will reach about $800 billion in fiscal year 2010, including an on-budget surplus of almost $500 billion. Moreover, the admittedly quite uncertain long-term budget exercises released by the CBO last October maintain an implicit on-budget surplus under baseline assumptions well past 2030 despite the budgetary pressures from the aging of the babyboom generation, especially on the major health programs.

These most recent projections, granted their tentativeness, nonetheless make clear that the highly desirable goal of paying off the Federal debt is in reach and, indeed, would occur well before the end of the decade under baseline assumptions. This is in marked contrast to the perception of a year ago, when the elimination of the debt did not appear likely until the next decade. But continuing to run surpluses beyond the point at which we reach zero or near-zero Federal debt brings to center stage the critical longer-term fiscal policy issue of whether the Federal Government should accumulate large quantities of private (more technically, nonfederal) assets.

At zero debt, the continuing unified budget surpluses now projected under current law imply a major accumulation of private assets by the Federal Government. Such an accumulation would make the Federal Government a significant factor in our nation's capital markets and would risk significant distortion in the allocation of capital to its most productive uses. Such a distortion could be quite costly, as it is our extraordinarily effective allocation process that has enabled such impressive increases in productivity and standards of living despite a relatively low domestic saving rate.

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But such countervailing forces may be greatly attenuated for Federal Government defined-benefit plans such as Social Security. To the extent that benefits are perceived to be guaranteed by the government, beneficiaries may be much less vigilant about the stewardship of trust fund assets.

Requiring the Federal Government to invest in indexed funds arguably would largely insulate the investment decision from political tampering. But such assets, by definition, can cover only publicly traded securities, perhaps three-fifths of total private capital assets. With large allocations of public funds invested in larger enterprises, our innovative, smaller, non-publicly traded businesses might find themselves competitively disadvantaged in obtaining financing. To be sure, there is not universal agreement among economists on this point, but it is a consideration that should be kept in mind. More generally, the problematic experiences of some other countries with large government accumulation of private assets should give us pause about moving in that direction. To repeat, over time, having the Federal Government hold significant amounts of private assets would risk suboptimal performance by our capital markets, diminished economic efficiency, and lower overall standards of living than would be achieved otherwise.

Private asset accumulation may be forced upon us well short of reaching zero debt. Obviously, savings bonds and state and local government series bonds are not readily redeemable before maturity. But the more important issue is the potentially rising cost of retiring long-maturity marketable Treasury debt. While shorter-term marketable securities could be allowed to run off as they mature, longer-term issues could only be retired before maturity through debt buybacks. The magnitudes are large: As of January 1, for example, there was in excess of three quarters of a trillion dollars in outstanding nonmarketable securities, such as savings bonds and state and local series issues, and marketable securities (excluding those held by the Federal Reserve) that do not mature and could not be called before 2011. Some holders of long-term Treasury securities may be reluctant to give them up, especially those who highly value the risk-free status of those issues. Inducing such holders, including foreign holders, to willingly offer to sell their securities prior to maturity could require paying premiums that far exceed any realistic value of retiring the debt before maturity. Both CBO and OMB project an inability of current services unified budget surpluses to be applied wholly to repay debt by the middle of this decade. Without policy changes, private asset accumulation is likely to begin in just a few short years.

In summary, the Congress needs to make a policy judgment regarding whether and how private assets should be accumulated in Federal Government accounts. This judgment will have important implications for the level of saving and, hence, investment in our economy, as well as for the nature of government programs. If, for example, the accumulation of assets is avoided by eliminating unified budget surpluses through tax and spending changes, public and presumably national saving may well fall from already low levels. If so, over time, capital accumulation and the productive capacity of the economy presumably would be reduced through this channel. Eliminating unified surpluses by transforming Social Security into a defined-contribution system with accounts held in the private sector would likely better maintain national saving levels. But the nature of Social Security would at the same time be fundamentally changed. Alternatively, unified surpluses could be used to establish mandated individual retirement accounts outside the Social Security system, also mitigating the erosion in national saving.

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Indeed, in almost any credible baseline scenario, short of a major and prolonged economic contraction, the full benefits of debt reduction are now achieved well before the end of this decade—a prospect that did not seem reasonable only a year or even 6 months ago. Thus, the emerging key fiscal policy need is now to address the implications of maintaining surpluses beyond the point at which publicly held debt is effectively eliminated.

But, though special care must be taken not to conclude that wraps on fiscal discipline are no longer necessary, at the same time we must avoid a situation in which we come upon the level of irreducible debt so abruptly that the only alternative to the accumulation of private assets would be a sharp reduction in taxes or an increase in expenditures. These actions might occur at a time when sizable economic stimulus would be inappropriate. Should this Congress conclude that this is a sufficiently high probability, it is none to soon to adjust policy to fend off such potential imbalances.

In general, for reasons I have testified to previously, if long-term fiscal stability is the criterion, it is far better, in my judgment, that the surpluses be lowered by tax reductions than by spending increases. The flurry of increases in outlays that occurred near the conclusion of last fall's budget deliberations is troubling because it makes the previous year's lack of discipline less likely to have been an aberration.

As for tax policy over the longer run, most economists believe that it should be directed at setting rates at the levels required to meet spending commitments, while doing so in a manner that minimizes distortions, increases efficiency, and enhances incentives for saving, investment, and work.

In recognition of the uncertainties in the economic and budget outlook, it is important that any long-term tax plan, or spending initiative for that matter, be phased in. Conceivably, it could include provisions that, in some way, would limit surplus-reducing actions if specified targets for the budget surplus or Federal debt levels were not satisfied. Only if the probability were very low that prospective tax cuts or new outlay initiatives would send the on-budget accounts into deficit, would unconditional initiatives appear prudent.

The reason for caution, of course, rests on the tentativeness of our projections. What if, for example, the forces driving the surge in tax revenues in recent years begin to dissipate or reverse in ways that we do not now foresee? Indeed, we still do not have a full understanding of the exceptional strength in individual income tax receipts during the latter years of the 1990's. To the extent that some of the surprise has been indirectly associated with the surge in asset values in the 1990's, the softness in equity prices over the past year has highlighted some of the risks going forward.

To be sure, unless the current economic weakness reveals a less favorable relationship between tax receipts, income, and asset prices than has been assumed in recent projections, receipts should be reasonably well maintained in the near term, as the effects of earlier gains in asset values continue to feed through with a lag into tax liabilities. But the longer-run effects of movements in asset values are much more difficult to assess, and those uncertainties would intensify should equity prices remain significantly off their peaks. Of course, the uncertainties in the receipts outlook do seem less troubling in view of the cushion provided by the recent sizable upward revisions to the 10-year surplus projections. But the risk of adverse movements in receipts is still real, and the probability of dropping back into deficit as a consequence of imprudent fiscal policies is not negligible.

In the end, the outlook for Federal budget surpluses rests fundamentally on expectations of longer-term trends in productivity, fashioned by judgments about the technologies that underlie these trends. Economists have long noted that the diffusion of technology starts slowly, accelerates, and then slows with maturity. But knowing where we now stand in that sequence is difficult—if not impossible—in real time. Faced with these uncertainties, it is crucial that we develop budgetary strategies that deal with any disappointments that could occur.

That said, the changes in the budget outlook over the past several years are truly remarkable. Little more than a decade ago, the Congress established budget controls that were considered successful because they were instrumental in squeezing the burgeoning budget deficit to tolerable dimensions. Nevertheless, despite the sharp curtailment of defense expenditures under way during those years, few believed that a surplus was anywhere on the horizon. And the notion that the rapidly mounting Federal debt could be paid off would not have been taken seriously.

But let me end on a cautionary note. With today's euphoria surrounding the surpluses, it is not difficult to imagine the hard-earned fiscal restraint developed in recent years rapidly dissipating. We need to resist those policies that could readily resurrect the deficits of the past and the fiscal imbalances that followed in their wake.

Chairman NUSSLE. I would like you, if you would, to highlight from your testimony and from your opinion what you believe the state of the economy is as we speak and in the near future. The concern of markets, our constituents, consumers throughout the country is something that is certainly on the minds of all of us as we begin the job of writing the budget for this year. And, in fact, it certainly was on the mind of the President as he made his first proposal.

I am particularly interested in your views about what would be the greatest assistance that we could provide from this budget; what is the greatest assistance to the economy from our budgetary decisions; and what would be the greatest threat to the economy as you see it today from the decisions we are about to make on the budget.

Mr. GREENSPAN. Well, Mr. Chairman, I outlined in some detail my views of the short-term outlook at the House Financial Services Committee recently, and I will not go into detail on that, but just let me say that the crucial issue that I think confronts you is the fact that the projections that we are looking at are being driven to a very substantial extent by longer-term considerations, in part because a large part of the receipts that we are observing, that are coming on stream in a manner which are well above expectations, seem to be to a significant extent the result of the huge rise in asset values, especially in households, and the rise in asset values that has reflected itself in increased tax liabilities, especially in individual tax returns.

There is a long lag in the translation of capital asset values into their realization and taxation, whether it be literally the capital gains tax itself or, just as importantly, the effect of capital gains on taxable incomes. Because there is a very long lag in that process, the actual short-term budget outlook is not going to be as closely aligned to what economic forces are as it always has been in the past because of these significant differences. So the crucial issue is really going to have to emphasize more the longer-term view.

And in response to your last question, Mr. Chairman, I think that the most important thing that the budget should do is to create a sense of stability and long-term coherence in budget policy. That, in my judgment, can create the most effective backstop for economic decisions in this country. And I would hope that what we do is get on a path of budget policy which we do not back and fill from too readily, because that creates uncertainties in the marketplace. And, presumably, if it occurs to a substantial extent, then I think it will induce negative effects on capital investment.

But above all, as I said in my closing remarks, these are extraordinary times. These surpluses have done extraordinarily positive things for our economy. Let us remember that deficits for a very protracted period of time dominated the discussions of this committee. Hopefully we will not get back and should not get back into those types of discussions again.

Chairman NUSSLE. One of the advantages that I believe we have had in forecasting and putting our budgets together is that we have been relatively pessimistic with regard to the economic growth potential that we anticipate within the current budget, let alone for the 10-year forecast that we put into play, and that has resulted in as much as $80 billion increases in overforecast of our revenues.

Do you have any opinion with regard to the forecasts or with regard to the growth figures that are being contemplated for this budget? We are using what many are suggesting are pessimistic views, certainly below the blue-chip averages that are being suggested right now. That, to me, appears to be not only pessimistic, but realistic with regard to your concerns. If that is true, then that should, to some extent, alleviate some of the concern you have with regard to our budgeting.

Mr. GREENSPAN. Well, Mr. Chairman, we have looked at the various projections of both OMB and CBO and the previous administration's OMB. They are all very close. And they are all close not because the outlook is so sharply in focus that it is very difficult to deviate, but what tends to happen in periods such as this is you try to get a sense of what the various probabilities are out there, and while the range of probabilities may be rather wide, there is sort of a maximum likelihood estimate that is pretty much convergent around the types of numbers that we have seen in these various projections. So it is reasonable to do that.

Let me just say that being conservative for conservative's sake is a mistake, because that, by definition, means you have a suboptimal forecast, and you don't want to do that. You want to get the best estimate you can and then focus on the obvious problems of how accurate that forecast is. But one doesn't solve that problem by taking an especially either overly optimistic or overly pessimistic view. That doesn't help you make projections, it just helps you make mistakes.

So the question should not be whether you are conservative or not, but what is the most likely outcome and what is the range, the realistic range, that one can expect when you are dealing with 5- and 10-year forecasts.

Chairman NUSSLE. It seems to me what you are telling us is that these forecasts that we are using from OMB and CBO appear to be at least realistic within our current understanding of where the economy is going.

Mr. GREENSPAN. Mr. Chairman, let me just say that the crucial factor, as I pointed out in my prepared remarks and in other testimony, is the increasing evidence that the underlying structural productivity growth of this economy has picked up to levels quite significantly above where it was, for example, in the 20 years preceding 1995. To be sure, it's likely to be coming down, as indeed the data do show for the third and the fourth quarters, and certainly will show for the first quarter. The productivity, the actual output-per-hour growth rates, are going to come down quite significantly, but that is to be expected and not inconsistent with the general view that the longer-term productivity numbers are going to be running at rates of increase above where they have been in the past.

If that assumption is made, a whole series of other calculations fall into place. Of all the assumptions we make about the deliberations on the budget, that is the critical one. If that one is right, you can be wrong on a large number of other things. If that one turns out to be wrong, then the outlook is really quite fundamentally different from anything we have seen in the numbers of projections that you have been exposed to.

Chairman NUSSLE. Because there is a certain level of uncertainty with regard to projections, the President has put together a plan which suggests that we can pay down all of the redeemable debt between now and 2011, as part of the plan, $2 trillion; that another substantial portion of that, $1.6 trillion, should be returned from that tax surplus to the people that pay the taxes in the form of tax relief. The Ways and Means Committee just yesterday moved the first piece of that legislation. Finally, that there should be approaching a $1 trillion reserve fund for a contingency. And I suppose to some extent that contingency may be that some of those surpluses may not be realized to their fullest extent.

Does this general matrix appear to be wise within the counsel that you are providing us today, cautioning us about the surpluses actually coming to fruition in years to come?

Mr. GREENSPAN. Mr. Chairman, I would like to respond by repeating what I have said many times in the past. These judgments are fundamentally political judgments in the best sense of the term; they are based on value judgments made by our elected representatives, and the issues that I would raise relate to the macroeconomic effects and the broader issues. But I hesitate to raise issues on the very details of any particular program because they are very difficult decisions, and there are pluses and minuses on both sides.

At the root, these are value judgments and judgments about where the future of this country is going and what type of budgetary processes we want. And if I may, I would like to eschew giving personal opinions. Even though I am a voter with one vote, it is out of a rather large voting population, and I don't think I want to put more weight on it than I think it deserves.

Chairman NUSSLE. I appreciate that.

One final question, then, to just zero in on one of the pieces I think you might be willing to comment on, and that is your consistent advice over the years with regard to paying down as much of the publicly held debt as possible. That appears to be a goal that can be accomplished. You mentioned it as a highly desirable goal.

It appears to be a goal that we can achieve by probably the midpoint in this 10-year process, if not $2 trillion by the end of 2011.

Do you believe that at least meets, to your satisfaction, the goal that you believe is highly desirable?

Mr. GREENSPAN. When I originally raised the issue of the first priority that we should have with respect to lowering the debt from an economic point of view, and I emphasize, I made that issue not as a judgment on values, but on a judgment as to what my view was when asked with respect to the effects of a lowering of debt on real interest rates, on the cost of capital and, therefore, on rising productivity and standards of living.

I think that it is a very rare event—that policies which endeavor to do something, like effectively reduce and, at the end of the day, eliminate, for all practical purposes, the Federal debt, are very likely to be achieved except if something extraordinarily unforeseen occurs. And that is a major achievement in this country, and it has had and will continue to have as it goes forward a very positive effect.

But once we get down to the irreducible minimum, no further benefits are possible. So in that sense, we declare victory and go on to the next issue that is relevant to deliberations.

Chairman NUSSLE. Thank you, Mr. Chairman.

Mr. Spratt.

Mr. SPRATT. Mr. Greenspan, when you mentioned that you had one vote, I was reminded of George Orwell's comment that sometimes some voters are more equal than others. I think your vote is a very important one.

Mr. GREENSPAN. I believe in democracy; one vote per person.

Mr. SPRATT. I do, too.

You have described the path we are trying to find as a glidepath, the Greenspan glidepath. To establish that glidepath, we need to know where we are and where we are going, and that means we need to have some kind of fix on what is the irreducible amount of debt within the foreseeable future.

I never thought we would have this dispute, but the administration suggests that there is as much as $1.288 billion of Treasury debt that is unredeemable, not callable; CBO developed a figure to arrive at $818 billion; as I read your testimony here, you have a figure close to $750 billion; and Gary Ginsler, who used to be the Under Secretary of the Treasury, responsible for debt management, said perhaps we could get the debt down to $410 billion or $500 billion over the same period without paying prohibitive penalties.

Could you give us an idea of, within the next 10 years, what is the lowest point that we should try to achieve on this Greenspan glidepath?

Mr. GREENSPAN. First of all, let me just say the reason for the glidepath, as I hope I was able to elaborate, is basically my concern that if we were to come up to a very large surplus and choose to eliminate it because we were fearful of accumulating private assets in government accounts, an abrupt change at that point would be highly undesirable. And, therefore, the glidepath I was talking about was a mechanism which would reduce the probability of our coming up against that sort of phenomenon and having to very rapidly adjust, in an inappropriate manner, the fiscal policy of this country.

The question of what is the irreducible level has a number of variables in it. It depends on how you calculate it and, most importantly, at what time you are indicating the actual level is breached. There is no ambiguity whatsoever about what the debt is. There are certain elements in our debt which would be very difficult, and indeed, inappropriate probably to reduce. One, obviously, is savings bonds. Two is the State and local government savings which facilitates the capacity of State and local governments to take moneys they raise in debt issuance and escrow them into a particular Federal Government debt facility. These are valuable things that are extremely unlikely to be reduced, or should not be reduced.

Then there is a very large component of marketable Treasury securities, to a large extent held by foreign central banks and foreign businesses and individuals, who hold those assets because they perceive them to be an extraordinarily valuable, risk-free, dollar-denominated obviously, asset which, even though they may get, say, 5 percent on them annually, they would be willing to hold them at 3 percent or less, meaning, to get them to disgorge those securities prior to their maturity would be extraordinarily expensive and obviously undesirable to do. The level of what that number is, is a judgmental factor, and it can vary. The first two I don't think really vary in the slightest. That Treasury marketable securities is an issue, what can be bought back and what cannot, is an open question.

Finally, there are obviously but not explicitly stated different assumptions about what is going to be happening to 5- and 10-year note issuance and 30-year bond issuance, because, clearly, to the extent that those issues are expanded between now and, say, 2006 or 2008 or 2010 will pretty much determine what the level of unredeemable debt is without a very significant amount of premium paid for outstanding debt. So there is an issue of indeterminacy here which, in part, will reflect to a very substantial extent the particular year in which we run into a point when surpluses can no longer redeem debt and, two, what Treasury policy is with respect to the issuances of 5-, 10-, and 30-year coupon securities.

Mr. SPRATT. Well, am I reading your testimony correctly to indicate you think it might be as low as $700 billion, though?

Mr. GREENSPAN. Well, the number I wrote down there is actually a different number from what others are using because it is calculated differently. I was merely referring to what the number was as of January 1 of this year, but that is not a relevant number in that regard. I was using it merely as an example of what the size and order of magnitude is, because we will not get to a point of irredeemable debt for a number of years, and as a consequence, the calculation must be made as of that forward point.

Mr. SPRATT. Let me ask you about the projections, which are pretty phenomenal if you have been around here as long as I have and grappled with the deficit and wondered if we would ever see the budget in surplus.

You stressed in your testimony the "tentativeness" of these projections because primarily of the fact that they rest upon assumptions about productivity growth that is going on in the economy now.

The question, I guess, is, is this systemic and sustained, or is it something episodic, or, indeed, are we even reading the evidence wrong?

CBO, when it did its book here, its latest forecast, to emphasize the primacy of these factors in its forecast put it on its cover. They show the productivity in the economy between 51 and 73, which was 2.7 percent. They show that productivity dropped to 1.5 percent between 1974 and 1995, and now they are assuming that it will continue at a level of about 2½ percent.

Now, they say in their report, however, on page 100, that if this factor doesn't obtain, and if we revert to the productivity growth rate of the previous 25-year period, and if the cost assessment of Medicare and Medicaid is off by 1 percent, and if tax revenues don't grow faster than underlying incomes that are taxed, then we are not on an ascending path of higher and higher surpluses. Indeed, we will have an on-budget deficit by as early as 2003, 2004.

Would you share that view? Have you read the budget estimate yourself to include that particular chapter?

Mr. GREENSPAN. Well, I don't know about the 2003-2004 issue. Let me say this: The issue of productivity is beyond 2003 and 2004, because the period immediately ahead is far less relevant than the more deep-seated question of what the broader productivity patterns are going to be in, say, 2005 and forward. If it turns out that productivity has only a 1.5 percent annual growth rate leaving out Medicare and all the other issues, you have a fundamentally different issue.

But remember that there are two sides to this. That is, what both CBO and OMB are trying to do is give you a middle estimate, and they can just as easily be wrong by being too low as being too high.

So we have to confront the possibility of both types of problems, and I think they are problems in the sense that having very large chronic surpluses, while obviously a far more benign phenomenon than having large deficits, nonetheless do create significant economic problems in the allocation of capital. We ought to be aware that allowing either side—either extremely large surpluses or extremely large deficits—both have significant negatives.

So one of the real issues that confronts us is to get a sense of where we are in all of this. That is why I think, as CBO and indeed OMB point out very correctly, the crucial issue here is these long-term productivity growth numbers. And we will not get a truly effective fix on them, one that creates a good deal of confidence, until we have been through this full cycle, which we are now working our way through, and see where we come out when we are back to normal.

The data to date, as I indicated in my prepared remarks, are quite encouraging in that regard, but we are not there yet, and there are considerable possibilities that the numbers that are being projected can turn out to be significantly off.

Mr. SPRATT. Well, in light of that, you have recommended some caution on our part in not going too far with the policy actions that we take that would be irreversible. And yet you were saying today you are concerned about instability in the marketplace. You would like to see a stability of fiscal policy.

I infer from that, then, that you are being a little skeptical of triggers that would turn off and turn on tax cuts and leave the market wondering what may happen?

Mr. GREENSPAN. If you put on triggers, there is no question that you do create an element of uncertainty with respect to economic decisionmaking that is based upon presumptions of longer-term tax cuts or, for that matter, expenditure increases.

The trigger by itself, wholly from the point of view of looking at the certainty issue and its effect on economic decisions, is a negative. In my judgment, however, the ability to have a far more calibrated pattern of unified surpluses and a more balanced system, which triggers help to achieve to a considerable extent, is a more important value, from my point of view, than the question of how the tax system is affecting economic activity.

The reason I say that, Congressman, is that we have at this moment an extraordinary productive set of incentives in our economy in the sense that we are clearly only part way through this major technological revolution which has been creating very high long-term rates of return on new facilities. The problem is not the long-term earnings expectations, which are currently creating problems. It is the discount factor, as best I can judge, namely, a very high degree of uncertainty and risk.

As I indicated in comments before the House Financial Services Committee, it is that sharp increase in the discount factor which has brought the present value of assets down and curbed capital investment in the short run. But that is an issue which relates to the short run, and I don't perceive that what we are missing at this point are long-term incentives.

I did also say in previous testimony, and indeed I have commented on occasion, that if you think of the Tax Code and potential tax cuts as a stimulus to the economy, it is very unlikely that in the short run you can really significantly affect the evolution of what is going on in the economy now, unless you moved extraordinarily rapidly. It would have a value only if the adjustment process we are now undergoing stretched out inordinately, in which case having lower taxes rather than having higher taxes undoubtedly would be helpful.

So it is a very complex set of decisions that are involved here, and a lot rests upon forecasts which we can make only tentatively.

Mr. SPRATT. Thank you, Mr. Chairman. Let me yield to others. I may have some questions when we get to the end. Thank you very much, though.

Chairman NUSSLE. Mr. Sununu.

Mr. SUNUNU. Thank you very much.

Welcome, Mr. Chairman.

If I were an economist, I would be very focused on the issues and the statistics and assessments of productivity and economic growth, and I would go back to my office and maybe make adjustments on the economic model I had on my computer. But I am not an economist, and I don't have such a model. I am a budgeteer right now working on the Budget Committee. And rather than focus on productivity, I am focused on revenue growth, on projecting revenue growth, and I know the economy plays into that.

But there are other factors, in particular the assumption one makes about the percentage of the national economy that is consumed or collected at the Federal level on taxes. On that point, both the Budget Office and the OMB assume a reduction, a declining level of tax collection as a percentage of our Nation's economy. That confuses me a little bit. But more to the point, it results in an assessment of revenue growth that is significantly below historic averages.

If you go over any 10-year period, say, in the second half of the 20th century, look at the 1950's, the 1960's, look at the decade of the 1970's even, when productivity was low, the decade of the 1980's or 1990's, in each of those decades revenue growth ran between 7 and 9 percent per year. Now, we are putting together a 10-year budget. If I was putting together a 1- or 2-year budget, I might be more inclined to look at the statistics you look at, inventories, productivity, unemployment, et cetera. But over a longer period, I think that the historic average does bear some importance.

Over the 10 years of this budget, we forecast a nominal revenue growth of 5 percent per year, and that is markedly less than the minimum of 7 percent per year over the decade periods I have spoken about. You indicated it doesn't make sense to be conservative just to be conservative, but my question is, doesn't that strike you as too great a refutation of the historic record or what might be different that would justify thinking that the next 10 years would be so different than any 10-year period in the country's modern history?

Mr. GREENSPAN. Well, Congressman, you are quite correct that the ratio of receipts to gross domestic product and nominal value are projected down. And the reason they do that relates to the issue I raised earlier; that in the most recent period, a significant proportion of tax revenues are coming directly or indirectly from capital gains either realized or unrealized. And if you add that to the receipts that come directly from taxes on earned income, you will end up with a higher ratio relative to nominal GDP, which excludes capital gains.

As a consequence of that, and I don't think they exactly do it this way, but if you were able to strip out of the receipts the parts that were not related to capital gains or changes in asset values, and you took that as a projection, as a ratio to the GDP, my impression is it would be pretty flat and, indeed, would look very much like earlier periods.

So what is happening is this huge bulge in asset values is distorting the ratio, and, implicitly or explicitly, both CBO and OMB are taking those asset values and they are bringing them down so that a smaller proportion of aggregate receipts will be capital gains related. And, hence, since the GDP doesn't include capital gains—that is the denominator—then the ratio will fall.

And in that regard, I suspect they are correct in that it is just a shorthand way of going through a more sophisticated and very difficult calculation. But you are certainly correct, there is no reason to project less than we have seen in the past, after you adjust for a presumed capital gains bulge and then some slowing down in that asset set of values.

Mr. SUNUNU. Slowing down in the asset values or declining in the asset values?

Mr. GREENSPAN. I frankly don't know what their actual estimates are. My presumption is that they probably have adjusted for the decline in asset values in equities. Remember, equities are only part of the issue here.

Mr. SUNUNU. Not that I don't have great respect for your presumption, but you are presuming that this is the way they have structured the model? It is not necessarily the way you have analyzed economic growth. They do not send the model over to you for your thumbs up, do they?

Mr. GREENSPAN. No. What I am trying to do is to infer why they might have done it that way. I haven't had a chance to look at the detail. But what I'm really saying is that if I want to just summarize, it doesn't necessarily follow that taking the projection as a ratio to the GDP and lowering it is an incorrect assumption. But you are correct, I don't know that firsthand.

Mr. SUNUNU. I want to address the issue that Mr. Spratt raised, not to get into it in too much detail, but on the irredeemable debt—the savings bond, and State issues you talked about—is today about $360 billion. The longer-term notes, 10 to 30 years, is roughly $790 billion. You had a number as of January 1 this year of $750 billion.

I assume you took a portion of the 10-to 30-year securities, roughly half, and said half of it might be held by foreign banks, where there is a much greater reluctance to sell without a significant premium, and that half might be purchased in the open market at a modest or insignificant premium. Is that a reasonable way of describing how the calculation is made?

Mr. GREENSPAN. The number is calculated in a somewhat different way from the way it should be if one is endeavoring to get at the irredeemable debt. I calculated the number as what basically was in the existing set of liabilities which were not either matured or callable prior to the year 2011. Now, the reason I did that was that no one had been discussing this irredeemable debt previously, and I am just trying to give an example. But I wouldn't use my numbers as being that calculated.

Mr. SUNUNU. Aside from the issue of the premium that has to be paid, as we approach that level, whatever it might be in 6 or 7 years, are there any other concerns or issues that we should be aware of that will be raised by the capital markets; in other words, the treasuries that are used by our banking system and financial services system for collateral or that play a role in other transactions?

Aside from the premium issue, are there going to be some concerns raised by those elements of the capital markets as these securities become more and more scarce?

Mr. GREENSPAN. Congressman, I think not. There is no doubt that our Treasury issues have been an extraordinarily useful benchmark security for not only our domestic financial markets, but really for the rest of the world. And the question basically is can we do without them if we have to? And the answer is yes.

We at the Federal Reserve, for example, who hold over $500 billion in U.S. Treasury issues, are, as I have indicated previously, undergoing a fairly extensive examination of how we would operate an open market policy without this very substantial amount of debt. It is obviously a little more difficult to do it that way, but the advantages of reducing the debt are such that this should be our first priority, and the markets will adjust.

New benchmarks will arise. You will get the private markets creating near riskless securities, quadruple-A securities, so that while it clearly would be better, other things equal, to have that Treasury debt out there, other things are not equal. And the other things that are not equal is the value of having very negligible amounts of U.S. Treasury debts outstanding.

Mr. SUNUNU. Thank you very much.

Chairman NUSSLE. Mr. Bentsen.

Mr. BENTSEN. Mr. Chairman, always good to see you. I want to follow up briefly on the point you were just getting on, and I will ask a couple of questions for the record on that.

I did read your testimony from a couple of weeks ago before the Senate Banking Committee where you talked about the study that is going on at the Fed for its open market activities.

And, in fact, the Fed is engaging in using agency debt, some of the GSE debt, and other types of securities, and you are exploring, as I understand it, even going beyond State and local debt. I am curious as to what other types of debt or collateral you would be looking at. So I would like to hear for the record, to the extent you could provide me where you are on your study and the types of debt you are looking at, because the Fed is facing the same problem that the general government is facing—for different reasons, but nonetheless the same problem.

I also would like for the record, because I don't think we want to engage too much in this back and forth—and I have asked the Chairman of the Financial Services Committee to hold a hearing on this issue, the possibility of why—and the efficiency or lack thereof of the Federal Government, the Treasury Department in its debt management using unexpended balances to decrease to maturity otherwise irreducible debt, because I think it is interesting and we ought to discuss it.

If there is anyplace that you can earn arbitrage, legal arbitrage, it is through the Federal Government. So I would ask that your staff, if they could prepare a response to that, whether or not that would be a feasible opportunity for us in the future as a way of debt management and to get after this trillion, 700 billion, 400 billion, whatever it is, that there might some other market mechanisms that we might use.

[The information requested follows:]

CHAIRMAN GREENSPAN'S RESPONSE TO QUESTIONS POSED BY MR. BENTSEN

As you noted, in my testimony before the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate on February 13, I stated that, at its late January meeting, the Federal Open Market Committee announced additional study of the possibility of moving beyond current practice by expanding the scope of eligible assets for open market operations or enhancing the role of the discount window. The minutes of that meeting, which were released on March 22, provided further elaboration of the content of the FOMC's discussion.

The FOMC decided to proceed cautiously and has asked Federal Reserve staff to review a broad range of alternatives recognizing that relative to investments in Treasury securities, all of the options could entail significant drawbacks, including increases in credit risk in the Federal Reserve's portfolio, reductions in its liquidity, and potentially distorting effects on relative prices in financial markets.

In the near term, the FOMC asked the staff to investigate the option of authorizing the Desk to engage in repurchase transactions using assets that could be purchased under existing legal authority but are not currently permitted by the FOMC—specifically, certain debt obligations of U.S. state and local governments and of foreign governments. Before the FOMC could decide on such an additional diversification of the System's temporary holdings of financial assets, a number of issues would need to be resolved that would necessitate consultation with the Congress and market participants.

From a somewhat longer-term perspective, the FOMC also requested the further study of certain other issues. One involved the appropriate reliance on outright purchases versus temporary short-term transactions that would be undertaken through intermediaries—such as repurchase agreements with securities dealers and discount window loans to depository institutions. The role of the discount window might be expanded by auctioning such credit to financially sound institutions.

Another issue involved adding new assets not currently allowed by law either to the permanent Federal Reserve portfolio or on a temporary basis through a still wider range of underlying collateral for repurchase agreements. Such use of private securities would have a number of risk management and accounting implications that would need thorough examination. The appropriate speed and extent of diversifying the Federal Reserve's portfolio also would have to be carefully considered. The Committee did not specify particular types of assets it wanted to study further. Rather, it is still at the stage of looking at broader issues of strategy relative to approaches to diversification, liquidity, and risk should it need to utilize assets beyond those currently authorized by the Federal Reserve Act.

You also asked about the merits of defeasing Federal debt that cannot readily be paid down. Private borrowers typically defease debt in order to remove it from their balance sheets, which may help them gain access to credit on more favorable terms. The U.S. Treasury, of course, already can borrow on very favorable terms, because the long-term health of the U.S. economy and the strengths of its political system provide investors with an extremely high level of assurance that the Federal Government will have sufficient revenues to repay its debt obligations. Thus, defeasing its debt is unlikely to improve the terms on which the Treasury can borrow. You seem to be suggesting, however, that the Treasury also could make an arbitrage profit by investing funds in the liabilities of private issuers at a higher interest rate than it pays on its debt. But the higher interest rate on such private instruments importantly reflects higher risks that investors must bear. Moreover, as you know, I am deeply concerned about the potential for distorting financial markets if the Federal Government were to become a major investor in private assets. I believe it would be virtually impossible to shield investments by the Treasury's general fund from political influence, and the resulting override of the market's allocation of credit would lead to financial and economic inefficiencies.

Mr. BENTSEN. Let me go further to your testimony. I do want to highlight for the record—some of the points you hit, and I think it is important that we go through them again. On page 7, you say limit surplus, reducing actions of specified targets for the budget surplus, or Federal debt levels were not satisfied. The reason for caution, of course, rests on the tentativeness of our projections, but the risk of adverse movements and receipts is still real. The probability of dropping back into deficit as a consequence of imprudent fiscal policies is not negligible. With today's euphoria surrounding the surpluses, it is not difficult to imagine the hard-earned fiscal restraint developed in recent years rapidly dissipating.

Those are notes of caution as I read it. I would further ask, I think the laws of economics are fairly clear that a dollar today is worth a lot more than a dollar tomorrow. Yet it seems that we are moving in a path, with the President's budget, of treating a dollar 10 years from now as a dollar that we have in hand today, with no discounting at all. Except I read your testimony to be a little different. I would like you to comment on that.

The second thing I would like to ask you relates to the President's budget and the treatment of the trust fund surpluses. And I won't engage in the debate over the Medicaid Trust Fund surplus that we had yesterday because that is an intergovernmental function. But more to the point, and you testified on this many times before this committee and other committees, with respect to Social Security Trust Funds and Medicare Trust Funds, there is a fiscal gap in both the Social Security Trust and the Medicare Trust. In the past, I believe you have testified that the best thing the government could do would be to use surplus funds to pay down debt because in the future we will have to regain debt that is held by the trust funds and pay out the benefits. To spend that money—to take surpluses and try and use those to paper over that fiscal gap would not work because those funds are already obligated. And yet it would appear from looking at the President's budget that in some cases they are contemplating using perhaps $600 billion from projected Social Security Trust Fund receipts for privatization of the Social Security System. Would that not be exacerbating the fiscal gap that is there already, or does that mean that you have to make up that $600 billion by making structural changes in the program as it relates to benefits in the future?

The same would be said for the Medicare program. You have trust fund assets that are obligated funds for future retirees, but the administration seems to be poised to use those funds on hand to restructure the program. Don't we have to make those moneys up somewhere down the line? Those are not unencumbered assets, in my reading of what I think you have said in the past. Is that correct? And you, of course, have great expertise in this area.

Mr. GREENSPAN. The problems arise because of the way we keep the books in the unified budget system. If we try to separate the issue of what the budget would look like on an accrued basis as distinct from a unified cash basis, which is what it is, we would still have a small deficit. And the reason that would be the case is if you take Social Security by itself, we are still increasing the net contingent liabilities which are in the program, which now represent roughly $9 trillion or thereabouts. What that basically means is if you are going to move part or indeed all of the Social Security Trust Fund into the private sector, you move the obvious receipts out of the unified budget, and you put them in the private sector. But you also remove the obligations—the government's obligations—and one way you can do that is by creating what is called recognition bonds, the way the Chileans did, in which what you pick up is the liability which each individual worker has created for the Federal Government, meaning the benefits that have accrued to that worker on the basis of the existing Social Security benefit rules. And if you even assume at this particular point that you are asking what is the liability to that individual worker when he or she retires, that is not on our books in the unified budget at this time. And that is what that $9 trillion, $10 trillion number is.

If you move part of Social Security to the private sector, you move the receipts and you move the contingent liability, meaning instead of a contingent liability which presumes the Congress could change it, you hard-wire those liabilities and make them indistinguishable from liabilities that the government now must pay, the $3.4 trillion, for example. What you then do is you increase the debt to the public by the amount of recognition certificates that move into the private sector.

So the issue here really relates to, when you make these decisions, you have to take into consideration exactly what the obligations of future benefits are going to be. And the standard model that most people use, the Chilean model, which is the one which is the cleanest one in that regard, is that what they did is that they moved a significant part, in fact virtually all, as I recall, of their contingent liabilities, made it official debt of the government, created recognition certificates, in a sense privatized Social Security.

Now, nobody is arguing to do that at this particular stage. They are all arguing one form or another of whether you move part of Social Security. The crucial issue here is in that process do you move the benefit obligations to the private sector as well, or do you increase the total benefits by adding new benefit calculations that are coming from, say, the defined contribution plan, which occurs as you move part of the Social Security receipts over, or do you basically move the requirement to pay benefits to the private account as well?

The crucial question that must be asked here: Are aggregate Social Security benefits being increased or left the same?

Mr. BENTSEN. Mr. Chairman, if I could ask for just an English translation from the Chairman on this because I know my time is up. On the issue of when you make that transfer, it is not necessarily a dollar-for-dollar transfer of benefits. I believe what you were saying, is when you transfer the benefits from the government obligation to the private sector obligation, the question then is, is the safety net which existed in the government obligation, does it still exist in the private obligation, or is the private obligation solely contingent upon market value?

Mr. GREENSPAN. That is correct, Congressman. Implicit in all of these discussions is usually some form of safety net imposed not as part of the Social Security structure itself, but an endeavor to catch those, who would be a small minority, who invest poorly and as a consequence find themselves at the point of retirement in some dire straits.

Mr. BENTSEN. So that is not free.

Mr. GREENSPAN. Correct, it is not free.

Mr. BENTSEN. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Bass.

Mr. BASS. Thank you, Mr. Chairman, and thank you, Chairman Greenspan, for being here today. I have three—peer between these two heads here—three questions for you. First is relevant—first two are relevant to Mr. Bentsen's comments, or first one is at least.

Ultimately, what happens to the unredeemable surplus? You talked in your testimony about not wanting to have private investment. Maybe index funding is an interesting option. You just talked about the possibility of privatization of Social Security. I am not going to put words in your mouth. You certainly don't support spending it, I don't think. So ultimately from cash flow as well as a money management standpoint, what happens to this surplus if it occurs? It is a delightful debate, but we really don't know what to do with it.

My second question refers to the Goldilocks statement of the President the other night. If you were economic emperor for a day, and some might say you already are, would you agree with the President that his tax cut is just about right?

The third question, and I will be quick here, which is a different one, but we are going to be considering the reintroduction of fast-track trade. It has got a new name now. It is called trade promotion authority. Don't you believe that this is an important economic priority for this country, and the President, having been without fast track promotion authority for over 7 years, needs it, and it needs to enacted as soon as possible?

Mr. GREENSPAN. Congressman, let me go backwards. The authority to enable the President to negotiate in an effective manner on trade issues is a very crucially important requirement if we are going to maintain open and expanding markets. I think the evidence is highly impressive that trade during the post-World War II period has been extraordinarily beneficial to all parts of the world, especially the United States. And it would be really tragic if we, who have led the world in openness, don't continue to be the leader in opening up markets, creating competition, and raising standards of living everywhere.

So I think it is a very important issue, and hopefully I will be able to expand on it. I have been invited by another committee to discuss this issue, and I will try to be as expansive as I can because it is a terribly important issue.

I am not going to comment on the Goldilocks issue. That is an issue which the President and the Congress have to decide, and I don't have anything useful to add, but would you just give me a quick review? I have forgotten the first question.

Mr. BASS. Ultimately what happens to that unredeemable surplus, the ultimate bottom line, after everything—we actually have more money, Social Security, everything is paid, is accounted for, there is still more cash coming in, what could happen?

Mr. GREENSPAN. The simplest thing to do, leaving aside the obvious issues of spending it or reducing taxes, because one of the things you want to be careful about is not to reduce national savings when you begin to move, is you take the unified surplus and you try to bring it down to zero. A simple way to do it, and it sounds a lot simpler than it probably is, is to take individual retirement accounts, take them from the government account, and put them in the private account. You reduce the unified budget surplus by exact dollar for dollar of what you take out. You put mandated individual retirement accounts in the private sector. The presumption is that, one, you don't have the problem which I am concerned about, namely the issue of the Federal Government investing in private securities, and, two, you don't have a material change in the national savings rate. All you have done is move savings from the government sector to the private sector, and that, frankly, is probably highly desirable if you can do that.

So whether or not you do it through the Social Security Trust Funds or IRAs or other mechanisms of that nature is a matter of choice, but the ideal choice is to try to move the unified budget surplus to the private sector with as minimum an impact as you can get on overall national savings.

Mr. BASS. Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Davis.

Mr. DAVIS. Thank you, Mr. Chairman.

Chairman Greenspan, one of the points you have highlighted in your testimony are the benefits of increased productivity associated with technology. My first question is what would you recommend that Congress do by way of tax policy or spending to contribute to continued short-term and long-term benefits in productivity associated with technology?

Mr. GREENSPAN. The first thing I would do is to try to find a general view from those who are the innovators, or have been the innovators in recent years, and try to ask them and get some insight from them as to what various different tax policies and actions by the American Government would enhance their incentives to do the types of things they have been doing.

It is very easy for an economist to sit here and hypothesize on how people will respond. There is a far simpler way of finding out: You ask them. And I don't know what they are going to say, but I would listen closely to their recommendations because they may tell you that taxes don't matter all that much, or they may tell you they are very crucial. They may tell you that the capital gains tax is a great inhibition to what they are doing, or they may not. But it is important to find out from the people who are on the firing line rather than from commentators who try to make inferences about what makes people behave.

Mr. DAVIS. Chairman Greenspan, this is our second day of hearings on the budget, as you know. Yesterday, the House Ways and Means Committee passed a tax cut that is estimated between $950 billion and $1 trillion. You have gone out of your way to highlight the fearful pattern that is developing in terms of last-minute bloated spending in this Congress. I think it is fair to say that the failure of the budget resolution process has certainly contributed to that. We are starting back down that road again now.

Would you offer us any caution about the process we ought to use in terms of developing the budget resolution in relation of taking up and passing tax cuts?

Mr. GREENSPAN. Congressman, I thought that the whole set of rules that you set up following the 1974 act on endeavoring to contain the budget, in my judgment, had very little chance of working. I was wrong, it really did matter, much to my surprise. The PAYGO rules, the whole issue of how various different programs were handled, which theoretically could have been overthrown by a majority of the Congress and wasn't, and the reason it wasn't is there obviously was something that was happening which the American public thought was very important.

As I indicated in my prepared remarks, I thought that the appropriations process of the last couple of years which essentially breached all of those various constraints has been most unfortunate, and unless and until we can get back to some form of budget discipline, I don't care what type of surplus projections you have, they won't happen.

Mr. DAVIS. Would you care to comment in that regard on what the appropriate sequence of events would be for us to take up with regard to the budget resolution and tax cuts?

Mr. GREENSPAN. Well, I don't want to get specifically into any individual programs because I suspect you will know the answer to that far better than I, Congressman.

Mr. DAVIS. Chairman Greenspan, if we are to preserve the opportunity to increase general revenue funding to preserve the solvency of Social Security and Medicare as the baby boomers are getting ready to retire, how should that factor into our decisions about the magnitude of the tax cut to proceed with over the next few years?

Mr. GREENSPAN. Again, Congressman, I can't really comment on it. Those are the key decisions which are really fundamentally deep and very important value judgments about the future of our Nation, and I think the elected representatives are the most qualified people to reflect the values of the population as a whole. This type of debate which we are now seeing is, I think, an extraordinarily valuable picture of democracy in action, and it credits the Congress, and it credits the administration, I think, very effectively.

Mr. DAVIS. Chairman Greenspan, there has been a proposal to set up a contingency fund that is estimated to amount to $1 trillion. There are also a number of spending proposals by the President that many of us support in defense and education and others that are yet to be costed. If the cost of those proposals were to exceed the amount of this contingency fund, and we had to choose between reducing the rate of proposed debt retirement and the size of the tax cut, which should we choose, in your judgment?

Mr. GREENSPAN. Well, again, Congressman, I said that from my point of view I thought that debt reduction was the highest priority; that is, as best I can judge, through virtually every particular evaluation of the potential uses of the unified surplus, the debt does get paid down to an irreducible minimum. So in that regard, I don't have a horse in this race, if I may put it that way.

Mr. DAVIS. One last question, Mr. Chairman. The National Conference of State Legislators has recently indicated that approximately 25 States are now beginning to experience some serious problems in their revenue streams. Does that give you any pause as you look at how optimistic the projections are that we are relying upon as we proceed with the surplus we have discussed today?

Mr. GREENSPAN. I think not, Congressman. Each individual State has handled its significant improvement in revenues differently. Remember, early on, the big surge in receipts showed up in State and local governments as well as the Federal Government. There has been, I think, a far greater spread of alternate uses of those funds, and a number of States have cut taxes substantially, and a number of States have increased expenditures substantially, far more than the Federal Government has in either case.

And in that regard, there is very little to be learned about the Federal Government revenue outlook from what we are seeing in the States. In other words, it has not added anything to our knowledge because they are all coming off the same income base, and they are just handling it differently. So I wouldn't say that one learns very much what the Federal budget outlook is from what is happening to the States.

Mr. DAVIS. Thank you.

Thank you, Mr. Chairman.

Chairman NUSSLE. Mr. Gutknecht.

Mr. GUTKNECHT. Thank you, Mr. Chairman.

Chairman Greenspan, it is always delightful to have you here even though you tend to speak in cryptic tones, which we all tend to interpret depending on our own particular political philosophy.

Let me just review, at least from my perspective, what you have told us so far today. One of the most important things you have said is that essentially you believe that we are moving into an era of surpluses. And you suggested that perhaps by the year 2010, we could see a $800 billion on-budget surplus.

Mr. GREENSPAN. Under current services. I don't expect that to happen because what is going to occur are changes in policy which will alter that path. But I think the crucial issue, as you point out, quoting me and my quoting CBO, is that there are very large surpluses under what we call current services budget.

Mr. GUTKNECHT. And you have also told us one of the real key factors is rising productivity, and I think that is important. We need to watch that as we go forward. I think the most important thing you have told us, and this is for the benefit of all the members of the committee, is that tax reductions will be much preferred over spending increases. And I think that is going to be the real critical task not only for this committee, but for the Congress in the next several years because the temptation to dip into this growing surplus—if we get back on an economic growth path, I think the temptations are going to be enormous.

To that extent I strongly support what the President is trying to do to limit the growth in the Federal budget, to lessen the growth in the average family budget.

I want to come back to a question that is really more directed to you as Chairman of the Federal Reserve. Benjamin Franklin said, "I know no lamp by which to see the future than that of the past." We know now looking backwards in the last 6 months or so that the economy began to slow in the September-October period. Do you think that perhaps the Fed waited a little long to lower interest rates? And you have already indicated that there won't probably be another action by the Fed until your March meeting, but do you believe that you may have waited a little too long to lower interest rates?

Mr. GREENSPAN. Well, first of all, I hope I was sufficiently ambiguous not to have indicated the timing of when or if we would move. I was peculiarly adept—I hope I was adept—at what we termed Fedspeak on that issue at the House Financial Services Committee a couple of days ago.

The answer to your first question is no, meaning that remember when you are involved, as we were, in confronting a period where from early 1999 through the early spring of 2000, we had a major acceleration in underlying investment demand, real capital asset demand, relative to underlying savings in the economy. The effect of that was to put very significant pressure on real long-term corporate interest rates. In other words, their cost of capital from the debt side was rising quite significantly.

We at the Fed in such an environment always join the markets in endeavoring to contain those saving-investment imbalances. Because were we not to increase interest rates as we did from June 1999 forward, it could have been done only by holding down the interest rates and thereby accelerating money supply growth and liquidity. And so we would have created a much different environment as we moved into the year 2000 than indeed occurred. We would have had a highly buoyant economy with rapidly increasing imbalances.

We had significant imbalances as it was, and they started to adjust, actually, probably quite visibly by the spring of 2000. Indeed that was the peak in long-term interest rates. Had we moved too soon, in our judgment, we would have altered the path of adjustment and conceivably created a higher level of economic activity than we are currently seeing, but inducing far greater imbalances and a far greater correction of adjustment than we are now undergoing.

So the timing of when one moves on monetary policy is a very crucial issue with respect to trying to get to a glidepath in economic activity, which is what we would call the maximum sustainable economic growth. In my judgment and the judgment of my colleagues, had we moved sooner, we would have threatened that adjustment process. It is a very difficult judgment to make. But in retrospect I see nothing that we did which strikes me as inappropriate as far as policy is concerned.

Mr. GUTKNECHT. One final follow-up. You don't disagree, it is more than possible—and I don't want to—yes, I do want to put words in your mouth—but the President is really talking about and the CBO and OMB are all talking about getting back to an economic growth rate of roughly 3 to 3.1 percent average over the next 10 years. You don't think that is an unreasonable target, do you?

Mr. GREENSPAN. It presupposes about a 2½ percent annual productivity increase, which, considering that we have been running 3 percent over the last 5 years, adjusting for cyclical change and a variety of other technical problems, no, it is not an unreasonable estimate.

Mr. GUTKNECHT. Over the long term, you told us 5 years ago, I remember when you testified before the committee, that if the Congress was serious about balancing the budget and if we would continue to apply a certain level of fiscal restraint, that ultimately long-term interest rates would come down. That pretty much has been true. Can we expect then at least long term—and I don't want to get into March's meeting or what may happen in the next 6 months. I do think we have to think long term. But long term it is fair to say if we continue to pay down debt, exercise fiscal restraint by this Congress, that long-term interest rates will be relatively lower than they would have been, right?

Mr. GREENSPAN. Absolutely.

Mr. GUTKNECHT. Thank you.

Chairman NUSSLE. Mrs. McCarthy.

Ms. MCCARTHY. Thank you, Mr. Chairman, and thank you, Chairman Greenspan. It has been a pleasure listening to you. I am new on this committee, and so I am sitting here and I am absolutely fascinated the last 3 days of everything that I have heard.

Here are my concerns. Since I have been in Congress, and I am just going on my third term, in 1997 we did the balanced budget amendment, which I thought was terrific. I voted for it. I think the majority of people here believe in fiscal restraint. One of the things that we did do, though, was unfortunately hurt our health care system, hurt certainly our hospitals, because we didn't take in the amount of money that we were giving back to our hospitals. And we have spent the last 2½ years now trying to correct that. So we here in Congress sometimes make mistakes.

To be here at this point to see that we have a surplus I think is terrific. But I am like you, I believe in paying down the debt. When I had a mortgage, twice a year I tried to double the payments so I could reduce it. I don't believe in having a heck of a lot of debt. I don't like it. It is something that is holding over me.

My concern is the class of 1946. They would be our baby boomers. They are going to be retiring. Now we are hearing that an awful lot of people will probably continue to work because they are healthier. Some might. I also know that those that have done very well economically will probably retire early so they can enjoy their later years.

Here is what my problem is: With this development wouldn't that suggest that we need an extra margin of safety in our budget policy, because when we see our baby boomers starting to retire, whether it is Social Security or whether it is Medicare, we are going to see great outlays of money unless we correct it between now and then, which is 7½ years away. I don't know if the will of Congress will do what it has to do for Social Security and Medicare, and this is why I get scared.

Medical technology is advancing rapidly, which I think is wonderful, but that means that our constituents are obviously going to want that medical care. What I am trying to get at, if we pay down the debt—and by the way, all of us want tax cuts. This side of the aisle, that side of the aisle, no one is disputing that. It is just probably how much should a tax cut be so that we can have a rainy day. I come from an up bringing, I guess, where you always try to have a nest egg. You always try to save some money for that day when my furnace breaks down or my car breaks down. I am trying to apply that here.

So we hear both sides of the aisle saying we are going to have the money. I don't know if I believe that. And I guess I got to go that way. Do I want a tax cut? Yes. And I do. Certainly would help my son, my brothers and sisters and everybody else. But it is really—and this is my problem—there is such a considerable measure of uncertainty in the projections of the course of the baby boomers' retirement that how are we going to prepare for this?

Mr. GREENSPAN. This is an issue which I think was very much of a concern as recently as a year ago because the Trustees' report for Social Security indicated significant problems as we moved beyond 2010 or 11 and ultimate exhaustion of the fund in 2037.

Those estimates were made with relatively low productivity growth projections. We will have another estimate next month or late this month. It isn't clear as to whether or not they are going to include in those estimates the type of productivity increases which we now see in both CBO and OMB. If they did, then the receipts for Social Security, OASDI in total, for example, would be enough under existing benefit formulas to essentially maintain a continued gap between receipts and benefits even without interest accumulation. So that I should say through a good part of the next decade what that implies is that despite the fact that there is a very dramatic rise, as you point out, in the number of the 1946 generation going into retirement, the effect of this acceleration in productivity is such that it just turns out that the receipts, especially including interest, are more than adequate to meet that big surge through a goodly part of a decade subsequent to 2010.

In the health care area, it is a different issue, and it is highly indeterminate. As you pointed out very importantly, the degree of technology that is coming on is truly awesome. There is pharmacology on the one side and the electronic technologies that brought us MRI and CAT scan and a whole variety of other medical advances, just altering the path of medical care in a dramatic way which we really cannot forecast. And so we don't know whether a lot of this technology is going to reduce costs or whether it is going to significantly make available so much potential health care that the effect of rationing that goes on today would become far more widespread. In other words, you bring on MRI, and the number of people who want to use that machine right at that point is far in excess of what you have available. So a rationing process is implicit in our system, which works remarkably well. It is the physicians who basically do the rationing.

As a consequence of these factors, estimating the costs of health care is a serious problem because we don't know what the outlook is out there. Just parenthetically I was talking to the Secretary of the Treasury, who has got some very interesting ideas on this issue. I don't know if he raised them with you.

Ms. MCCARTHY. I talked to him yesterday about them.

Mr. GREENSPAN. Did he raise with you the issue of changing the way we do prescriptions for drug purposes?

Ms. MCCARTHY. No, we actually didn't get into that.

Mr. GREENSPAN. He was involved with the Pittsburgh operation, which I thought was really quite unusual.

But the bottom line here is, whereas Social Security seems to be moving in a less concerned path than we thought a year ago, largely because of the productivity numbers we have been looking at, medical outlays are a whole different issue. They are going to require some very thoughtful insights on the part of both the Congress and the administration.

Ms. MCCARTHY. Thank you, Mr. Greenspan.

Chairman NUSSLE. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Greenspan, it is always interesting to listen to your comments. Some of them are very direct and easy to understand. Some of them remind me of a squirrel trying to cross the road with an oncoming high speed automobile looking down at him. He zigzags back and forth and many times winds up laying dead in the road.

You know, your comments about productivity, productivity has been up, we have seen it in business, and I am a small business person, have been for 38 years, actually a little longer than that. We have been going through a correction period. And we do this.

I saw it early in 1974 and almost bit the dust as a small business person then. And I saw it again in the 1980's. Several things contribute to that correction. One is the interest rates in which the Federal Reserve has a hand in. Another was fuel costs, which affects all consumer products. I am in the transportation business. Another one is the cost of energy during the winter months. But I fully believe, as you do the bottom line of that correction period, it will still leave productivity higher than it was in 1995. But in my opinion, neither the Federal Reserve nor the Congress can micromanage the economy.

I think there are three things that play a principal role in what happens to the economy from this day forward. One you are very much involved with interest rates, and I appreciate the fact that you are moving interest rates downward. And I understand why you moved them upward; because of the corporate—the heavy corporate capital investments. And most of those corporations borrow on prime rate, fixed rates.

But I think you need to increase the downward movement of interest rates because there are a lot of small business people who borrowed money on floating rates, and as those corporates tightened up because of the change in interest rates and those investments that they want to continue to make, they begin to shift their cash flows, and oftentimes it was at the expense of a lot of their suppliers and the small business people in the form of their payables, receivables to those small businesses, which has put those small business people, many of them, in kind of a tight situation. Credit is tight, interest rates are up. They are on floating rates. They go to the banks to borrow operating capital. It is difficult to do, and it has forced many of them to go under. We need to take that into consideration between now and your next meeting in March, the later part of this month.

Another area that we must look at is tax relief and the budget. I think the President of the United States is on the right track. As you told us 2 years ago, January 20, 1999, before the Ways and Means Committee, that marginal rates is an area that we should look at and make adjustments in.

Budget discipline. This President has put forth a budget with a 4 percent increase. What bothers me, that I am already hearing Members of Congress, chairmen, even the chairman of our committee here, talk about how there are certain areas that we must have more money for. I heard them—that the Chairman of the Senate Budget Committee says we don't need to look at 4 percent, we need to consider more like 6 percent. That is not good budget discipline.

When it comes to the Medicare and Social Security, you have said, too, in that same presentation to the Ways and Means Committee if you are ever going to solve the problems of Social Security, you have got to end the pay-as-you-go system. The Congress has got to have the backbone to do so. The President ran on the campaign to do so. Because once you lay it out as to how you are going to reform and end those pay-as-you-go systems, which is both Medicare and Social Security, then you can tell the American people exactly what it is going to cost them from the general funds to sustain those programs which will make them self-sustaining after a long period of time.

It bothers me, too, that when it comes to tax relief, we have a sizable group of people in the Congress who are not looking at the cash flow of the individual wage earner or the individual person, they are singling out and targeting just certain ones to try to enhance their cash flow at the expense of others. I call it transfer of paycheck receipts, because when you take from one's paycheck and you enhance another's income, that is just a transfer of paycheck money. That is wrong.

The third area that we must look at, and I believe the President has also campaigned on this and put forth a group to address this problem, it is called energy policy, a domestic energy policy, how we are going to overcome our dependency on others and yet still provide the energy we need.

I was given a question to ask you. In a paper from the National Bureau of Economic Research called, quote, What Ends Recessions, end of quote, Christina and David Romer argued that tax cuts in the past failed to deliver the economy from recession because the cuts passed were generally too small and too late. They found that the small cuts that did occur, however, did provide a noticeable economy boost.

I am not going to ask you to answer whether they were right or wrong, because, Mr. Greenspan, I think it is wise that you tend to interest rates and you leave the tax policy up to the Congress. Thank you.

Chairman NUSSLE. Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman.

Chairman Greenspan, the other day I had the pleasure of listening to you at the Financial Services Committee, and we had a brief discussion about productivity. I am very glad today that you came back with what I consider to be reassurances about what the potential for productivity increase is, though I still have to tell you I sit here with some reservations and some doubt, which you have expressed, but your reassurances overwhelm my concern, and I am glad to say that today.

I also particularly like the suggestion that you have made in your statement today relative to a trigger. I heard your concerns. I share them. I think that any trigger for any tax cuts on spending proposals does bring some problems with it, but I also share your comments that a trigger might probably be a very good way to go. Just rereading it, it could include provisions that in some way would limit surplus reduction actions if specified targets for the budget surplus or Federal debt levels were not satisfied. Only if the probability were very low that prospective tax cuts or new outlay initiatives would send the on-budget accounts into deficit would unconditional initiatives appear prudent. I agree with that statement 100 percent. I thank you for making it. I hope that this Congress pursues the concepts. Hopefully we can draft something—first of all draft then adopt something that would work that would address as many of the concerns that you mentioned as we could possibly do.

I also want to talk a little bit about the surpluses that you have discussed. Today you seem to concentrate a lot on government investment in private assets. I kind of wonder where that came from, because up until just yesterday when we had the Budget Director here, I hadn't heard anybody concerned about that issue. It is a fair issue. We did have that discussion last year relative to Social Security. It hasn't really been brought up. I guess it is a very fair point to raise.

But I also—I guess I want to make sure that most people were listening and people who were asking me have a very good understanding that as we speak right now, right this very minute, probably the largest investor in the private market, the one if not the largest investor, is government. Now, that is not the Federal Government, but it is State and local governments through their retirement accounts and other such trust funds, and they are huge investors in the private market.

I was vehemently opposed to privatizing the Social Security System last year for this very reason. I agree with you, but I don't think the Social Security System should be in the private market. At the same time, government investment in private accounts is not new, and, therefore, I think we are already beyond the question, unless either you or somebody wants to start raising the issue of whether or not the California retirement system, the Florida retirement system, the Texas retirement system, et cetera, et cetera, whether anybody wants to raise that issue as to whether they shouldn't be in the private markets. But on the presumption that no one has raised that thus far that I am aware of, we all accept that as reasonable and probably not capable of moving the market in and of itself.

But on that presumption that we all take that as an acceptable fact, that some government involvement in the private market is not necessarily bad, and as we get to surpluses, I hope that some people start wondering and questioning and discussing whether we should have some government involvement in private things, such as mortgage-backed securities.

One of the biggest problems in my district is people can simply not afford to buy or maintain their homes, just can't do it. That is true in the general Washington area as well. Most working-class people cannot afford to move into many housing markets. I think there would be some legitimate question as to whether some Federal money or Federal trust fund money should be put into helping reduce mortgage rates or down payment assistance at some point; not now, not today, I know that. But I hope that when the time comes when we get to that position, that those issues are at least fully discussed and not just dismissed out of hand. I don't think I heard that from you today, but I just hope that others don't hear it as well.

I do want to ask you a couple of questions. I want to talk particularly on the current circumstances. I understand and I actually respect that you prefer tax cuts to spending increases as a general proposition. You said that before, you are consistent on it, and I appreciate it. I don't want to get into specifics of the tax cut because I do agree that is the prerogative of Congress, and I accept that, but I also want to make a statement as well that every time we do a tax proposal, every single time we do a tax proposal, somebody wins, somebody loses.

The current tax proposal we have in front of us has 40 percent of the tax cut going to people that only pay 20 percent of the taxes.

That is a fair judgment. You can make the argument if you believe it, that is fair, but that is a judgment. It is not dollar for dollar the money that you pay in taxes that get back with a tax cut or any tax cut I have ever seen.

I don't want to talk to you about the specifics. I also don't want to talk to you about the specifics about many of the spending proposals, because I agree it is not your role to discuss social issues such as health care, such as K-through-8 education, such as whether we want to get into prescription drugs. I understand and respect your decision that that is our proper role, and I agree with it.

I also think it is important to get your opinion on as to whether it should be 4 percent increases, 6 percent increases, 2 percent increases. Again, that is a fair argument. But once we get to a decision, a political decision, that says we are going to have X percent of increase or even a decrease in spending, there are some Federal Government spending programs that strike me as having a direct impact on the economy. And there were two in particular that I want to talk to you about, one of which I talked to you about the other day at the Financial Services Committee, and the other one I talked to the Budget Director about yesterday.

First one is the unemployment. You said consistently, I assume nothing has changed since the other day, but your expectation at the moment is unemployment is going to rise over the foreseeable future, next year or so, regardless of any tax proposal we currently have on the table.

Given this, I have two questions: First one on the unemployment, isn't it reasonable, or do you think it is reasonable, for government spending to have as a priority retraining programs to take those newly or soon to be unemployed American citizens to retrain them into new jobs that they will be able to have a better market value with and help improve the economy in the future?

The second question has to do with research and development. You said repeatedly in the past you think it is a fair thing for the government to have a spending priority relative to research. If I remember correctly, and I won't put words in your mouth, but what the heck, everybody else does, I may as well try, that basic research is a particularly important government priority. I agree with you, if that is an accurate statement. I agree with that statement whether you agree with it or not, particularly when it comes to the things right now, some of the comments have been made as well that energy prices are driving everything up. How are we going to get those energy prices down? There is only so much oil in the ground; there are only so many ways to get it out. We have to have more efficient fuel economies. We have to do all kind of things to heat our homes smarter and better, and that only comes through research.

My two questions to you, sir, are relative to retraining unemployed workers in this current situation and continuing, if not increasing, government support for research, particularly basic research.

Mr. GREENSPAN. Well, Congressman, first let me say that the crucial question that has to be answered before you can draw a conclusion is to make judgments of how successful the types of training programs we have had over recent years have been. As I am sure you know better than most, the record is rather mixed.

Mr. CAPUANO. I agree.

Mr. GREENSPAN. But what we do learn from a number of the studies that one has seen is that the training programs that work most effectively are those as close as you can get to a specific job. On-the-job training is very clearly the most effective mechanism that we have. And those types of governmental-sponsored programs which effectively enhance on-the-job training, as far as I understand it, have been the most effective.

There is no question, as you point out, that you get significant increase in the market value of a person if they have skills which are required and usable elsewhere, and anything that one can do with respect to transitions is a very valuable thing to do. And I have argued this with respect specifically to trade policy; that is, we have a number of areas where individuals, through no fault of their own, get laid off because they are in industries which are caught up in very competitive prospects. And I do think, as I have said in the past, that endeavoring to build new training capabilities into those programs rather than go to a protectionist mode is a very valuable policy with respect to enhancing the capability of individuals to work and earn a living.

So I think that training programs have a role, unquestionably. I do, however, wish to caution that merely expanding programs that we have done in the past is a mistake. And I hope we are willing to move as indeed periodically governments have done, to consolidate previous programs and the like.

On the issue of research, there is just no question that if you are going to have technology as the base of your economy, which we do, research is crucial. It is another issue to make a judgment as to where that research should take place, and that, again, is really a fundamental judgment of the Congress. And it is a tricky question of how much applied research should government do, how much basic research and where. As you know, there are large discussions and debates on that. But that we should in some way or other enhance the incentives to do research in this economy, there is just no question. If we don't, we are going to find that we are in position where we may have awesome technologies, but if you don't continuously nurture them, they won't continue to exist.

Mr. CAPUANO. Thank you very much.

Chairman NUSSLE. Mr. Chairman, we have come to the 2-hour mark. You asked if we could try and get you out of here by noon, and I guess what I would ask from the other Members, are there any other Members that have a quick question in the last couple of minutes that we have?

Mr. Hastings, you would be recognized for a quick question. Real quick.

Mr. HASTINGS. Thank you very much.

Mr. Greenspan, good seeing you again. There has been a lot of talk to questions a number of times regarding productivity, and even in your statement you talked about productivity, but you specifically said nonfarm productivity. I come from an agriculture State, agriculture district, the State of Washington. We have Boeing, Microsoft, Starbucks, but when you put all of the total economy together in Washington State, agricultural is the biggest portion of that economy. I am not talking about major crops. We do have wheat, but we have apples, and potatoes, and cherries, and asparagus, and so on.

Would you talk about, number one, the productivity of agriculture and how that rates to the overall economy. And as a follow-up to you—Congressman Bass' question to you regarding trade, fast-track authority, and maybe the global economy in general as it relates to agriculture.

Mr. GREENSPAN. Well, as you imply, Congressman, the productivity rate of increase in agriculture has matched that in the nonfarm area, and indeed in certain periods has actually exceeded it, as you know better than anyone. Yields have gone up extraordinarily on crops. The technical capabilities we have in maximizing the way we move livestock to market is really quite a different agricultural system than we had 50 years ago.

The problem that occurs as a consequence, however, is that we produce significantly more than the American people can consume, and, as you know, in wheat we export half of our crop. We export huge proportions of a whole series of other crops and, indeed, livestock. And for farm prices and farm income to hold up in the United States, in my judgment, it is essential that we have an enlarged export market, and one of the ways which I think we can do that is to find ways to break down barriers abroad where, as you well know, the restraint on American products is increasing. And fast track, or whatever we now want to call it, is clearly a mechanism which would give our trade people the capabilities of initiating a broadening or opening up of markets, which, in my judgment, is absolutely crucial for American agriculture.

Mr. HASTINGS. Thank you very much.

Chairman NUSSLE. Mrs. Clayton, do you have a question?

Mrs. CLAYTON. Yes, I do, Mr. Chairman.

Mr. Chairman, I was struck by your consistency in terms of the debt reduction, constraint, taxes versus spending. All of those are issues that the Committee on the Budget must consider. You have also emphasized the uncertainty both for revenue and uncertainty in terms of unforeseen costs.

I just want you to comment on the health issue. We have already commented on the Medicare. In the report coming from the Federal Reserve in February, you indicated the one cost that was causing more uncertainty was not Medicare, but the uncertainty of Medicaid, and the substantial amount of moneys being spent on Medicaid that have never been spent before.

If you couple that with the undercount possible in the census projection, those people do not have eligibility that is not accounted for, how would you advise us in the Committee on the Budget to prepare for that uncertainty of that health cost?

Mr. GREENSPAN. Well, Congresswoman, the reason we know or suspect there are certain undercounts is we do certain types of samples. And when you are dealing with trying to make judgments as to what type of costs there will be in various different types of populations, all of these data are subject to error. And, indeed, the sampling materials which the Census has employed and which are usable have ranges of error in them as well.

But what I think is necessary to do is to get the best estimates that you can of various different types of populations in various different areas and try to make judgments as to what the underlying costs of those various programs are.

We have not been successful, as you know better than anyone, in really projecting Medicaid data effectively. Forecasts have been awful, if I may put it that way, and we have to improve them. And any additional data that can come on to help that be done, I think, is an extraordinarily important thing for this committee and for the Congress in general to engage in.

Mrs. CLAYTON. Thank you.

Chairman NUSSLE. Mr. Culberson.

Mr. CULBERSON. Thank you, Chairman Nussle.

Chairman Greenspan, in the interest of time, I want to reduce all my questions to one. I am John Culberson; I was elected to succeed Mr. Archer from west Houston, and I am particularly interested in identifying some procedural institutional changes that we can implement in Congress to restrain our institutional instinct to increase spending in the years ahead. As you have correctly identified, that is a real problem.

I want to ask you, sir, if you could tell us, recommend to us, any specific institutional and procedural changes that this Committee on the Budget should consider implementing for the years ahead to restrain spending that in your opinion have worked effectively either in State constitutions or in previous sessions of Congress. What do you recommend to us that we should adopt?

Mr. GREENSPAN. Well, Congressman, as I indicated before, I was quite surprised at how well some of the various measures that have been implemented by the Congress have essentially constrained discretionary spending over a number of years, until the last couple. And merely moving back to some version of those earlier very specific vehicles strikes me as the type of thing that ought to be done. And my impression is that if you succeed, it will be very helpful.

Mr. CULBERSON. I am a freshman Member. Can you tell me specifically which reforms are you referring to?

Mr. GREENSPAN. The PAYGO, for example, has always been very useful. There are a whole series that come out of the 1974 Budget Impoundment Act and that have been developed over the years. Some have been changed, some have been altered, but what is clearly quite remarkable is a very large number of them have worked.

And I think you will find the staff of this committee is very well versed on which of the particular ones the committee has found most useful over the years.

Mr. CULBERSON. One quick follow-up on that.

Chairman NUSSLE. I apologize, but I am going to have to move on.

Mr. Moran, do you have a question to finish up the hearing?

Mr. MORAN. Thank you, Mr. Chairman. There is so much context and so many questions I have to ask, but out of consideration of all the time you have spent, let me focus on one.

The equity markets have pretty well factored in what Wayne Angell has suggested; that there may be as much as a 90 percent chance that you are going to make a dramatic reduction in interest rates in the short term. But I remember back in 1988, you were under similar pressure, and have been any number of times since, to reduce interest rates and stimulate the economy, and your response at that time was that you wanted to keep focused on the law; that the law says that the Federal Reserve's role is to maintain stable prices, or low inflation, and economic growth that could be sustainable year after year.

What I would like to know, because we don't hear so much of what the other side of the picture is, what do we need to fear on the other side of the equation in terms of inflation, energy and food prices? Some of the latest economic statistics show that inflation may be increasing again. We don't know whether this is long term or just a blip. But, also, if we make this substantial tax cut and make it retroactive so that it is immediately available, that is a significant stimulus to the economy. The President has said that is one of the principal motivating factors for it.

What other considerations are in your mind in terms of maintaining that stable rate of noninflationary economic growth, Mr. Chairman?

Mr. GREENSPAN. Well, Congressman, let me address the issue of where we view the inflation problem is. As I indicated in my remarks to the Financial Services Committee, we think inflation at the moment is very well contained. The specific blip that we saw in the Producer Price Index and the CPI don't appear anywhere else on our radar screens, which suggests that unless something is happening which we have not yet captured, pricing restraint is really quite broad and deep, so that the problem that we see at this particular point is not an immediate emergence of inflationary pressures.

What we are concerned about generally is to maintain a stable, long-term environment. And, indeed, as you put it, the term we actually use is maximum long-term sustainable economic growth. And while we obviously are aware of what various different fiscal policies do to the economy, we don't respond to fiscal policy per se. What we do respond to is how various different budgetary policies impact on the economy, and it is the economy to which we respond.

And so I can't say in any specific detail what we will or will not do, but there are a whole series of forces, both in government and out of government and in the marketplace and internationally, which have fairly dramatic impacts on what our economy is doing, and it is that to which we generally respond.

Mr. MORAN. Thank you very much, Mr. Chairman. We are all very interested to know whether you think the irrational exuberance of the stock market has been pretty much squeezed out. But unless you want to volunteer an answer, we thank you very much.

Chairman NUSSLE. Mr. Putnam, do you have a question?

Mr. PUTNAM. Thank you, Mr. Chairman, very briefly.

And thank you, Chairman Greenspan, for your patience.

Much has been made and discussed of the impacts that will occur in this country and on this Congress arising from the opportunities to rapidly reduce our debt. But considering the high volume of debt that is held by foreign nations and foreign businesses, what are our friends and neighborhoods around the world doing to prepare for the change that will be coming sooner than is expected? Where will those resources flow, and what type of destabilizing impact would our economic prowess have on their decisions?

Mr. GREENSPAN. My impression is that foreigners are investing in U.S. Treasury securities for two reasons: One is the riskless nature of those securities, and, two, it is the dollar.

Now, to be sure, you cannot replicate the degree of risklessness in U.S. Treasury securities fully in the private market. You can get very close, and, indeed, a number of foreign accounts of which I am aware, when U.S. Treasury interest rates began to fall in part because the size of the outstanding debt was declining, shifted from U.S. Treasuries into other dollar-denominated securities in order to enhance their rate of return, and I think that process will continue.

I do think that the overall propensity to hold U.S. dollars will continue, and, hence, to the extent that the available Treasury issues decline, the switch will be substantially into other dollar-denominated private or State and local-type assets. It is a shift that should not have any material effect of which I am aware.

Mr. PUTNAM. Thank you, Mr. Chairman.

Chairman NUSSLE. Thank you, Mr. Greenspan, for indulging us an extra 10 minutes there. We appreciate your attendance today.

I ask unanimous consent that all Members have 7 legislative days to submit statements and questions for the record.

Without objection, that is so ordered.

And with that, we are adjourned.

[Whereupon, at 12:15 p.m., the committee was adjourned.]

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