S. HRG. 108–852

NOMINATION OF ALAN GREENSPAN

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

ON

THE NOMINATION OF ALAN GREENSPAN, OF NEW YORK, TO BE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

JUNE 15, 2004

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.access.gpo.gov/congress/senate/senate05sh.html

U.S. GOVERNMENT PRINTING OFFICE

22–918 PDF WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

RICHARD C. SHELBY, Alabama, *Chairman*

ROBERT F. BENNETT, Utah
WAYNE ALLARD, Colorado
MICHAEL B. ENZI, Wyoming
CHUCK HAGEL, Nebraska
RICK SANTORUM, Pennsylvania
JIM BUNNING, Kentucky
MIKE CRAPO, Idaho
JOHN E. SUNUNU, New Hampshire
ELIZABETH DOLE, North Carolina
LINCOLN D. CHAFEE, Rhode Island

PAUL S. SARBANES, Maryland
CHRISTOPHER J. DODD, Connecticut
TIM JOHNSON, South Dakota
JACK REED, Rhode Island
CHARLES E. SCHUMER, New York
EVAN BAYH, Indiana
ZELL MILLER, Georgia
THOMAS R. CARPER, Delaware
DEBBIE STABENOW, Michigan
JON S. CORZINE, New Jersey

KATHLEEN L. CASEY, *Staff Director and Counsel*
STEVEN B. HARRIS, *Democratic Staff Director and Chief Counsel*
PEGGY R. KUHN, *Senior Financial Economist*
MARTIN J. GRUENBERG, *Democratic Senior Counsel*
AARON D. KLEIN, *Democratic Economist*
JOSEPH R. KOLINSKI, *Chief Clerk and Computer Systems Administrator*
GEORGE E. WHITTLE, *Editor*

C O N T E N T S

TUESDAY, JUNE 15, 2004

NOMINEE

NOMINATION OF ALAN GREENSPAN OF NEW YORK, TO BE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

TUESDAY, JUNE 15, 2004

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:03 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

This morning, we will consider the nomination of Alan Greenspan to serve his fifth term as Chairman of the Federal Reserve System. If confirmed, and we expect that will happen, Chairman Greenspan will be only the second Federal Reserve Governor to serve beyond his fourth term, equaling the record held by the distinguished William McChesney Martin.

Chairman Greenspan, you have led the Federal Reserve System since August 1987, a period of nearly 15 years. During that time, the U.S. financial system has withstood a number of significant challenges, including economic disruptions in Mexico, Russia, and the currency crisis which engulfed much of South Asia. Your tenure also includes the 1991 to 2001 economic expansion, the longest in American history. This Committee has benefited from your wisdom in crafting a number of significant pieces of legislation, including the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Federal Deposit Insurance Corporation Improvement Act of 1991, and most recently, the Gramm-Leach-Bliley Act. I know that my colleagues will further remark on your successful track record.

Chairman Greenspan, I would like to note your recent remarks at the Federal Reserve Bank in Chicago on financial literacy. In your speech, among other things, you noted that as a young man, it was music that grabbed your interest and that you visualized yourself someday playing with the likes of the Glenn Miller Orchestra or becoming another Benny Goodman. Obviously, your career path ultimately took another direction and for that, Mr. Chairman, the United States and the world financial markets I believe are grateful. The music world will never know what it may have missed, but this Committee and this Senator express our thanks for your extraordinary public service.

Chairman Greenspan, we look forward to your testimony and at the proper time I would get back to you on the oath.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman.

I join you in welcoming Chairman Greenspan back before the Banking Committee this morning as we review his nomination to another term as Chairman of the Board of Governors of the Federal Reserve System.

Let me start by congratulating Chairman Greenspan on his nomination to a fifth term as Chairman of the Federal Reserve Board. If confirmed, as I fully expect he will be, Chairman Greenspan would join William McChesney Martin, as you noted, as the only Fed Chairman to be confirmed for five terms. In terms of longevity of service, he is currently second only to Chairman Martin.

Over the years, I have both agreed and disagreed with Chairman Greenspan over the conduct of monetary and fiscal policy. That is what a democracy is all about, and I understand that. I believe the relationship Chairman Greenspan formed with the then-Secretary of the Treasury Robert Rubin during the 1990's led to the conduct of fiscal and monetary policies which complemented one another and which helped achieve high growth and employment with low inflation and served the country well.

As I look back, I think with respect to monetary policy, my sharpest disagreement with Chairman Greenspan was probably in 1994 when the Fed raised rates in a preemptive manner that I thought was not warranted by inflationary pressures. In regard to fiscal policy, my strongest disagreement with Chairman Greenspan came in the beginning of 2001 when we were told that the debt was being paid down at such a rapid rate that we had to slow the trajectory otherwise we would pay it off too quickly. That took the lid off the punch bowl as far as tax cuts were concerned. Of course, now we are experiencing very large deficits and they are projected well out into the future.

I do want to underscore the agreement I have had with the Chairman and the Fed on issues of bank regulation, particularly in regard to the need for vigorous holding company supervision, and in maintaining the separation of banking and commerce.

Let me say though, Chairman Shelby and my colleagues, that even when I found myself disagreeing with Chairman Greenspan, I have always enjoyed our public exchanges. They have always been focused on the substance of the issues. I found them thought-provoking and informative. Chairman Greenspan has carried out the responsibilities of his office with great skill and dedication, and has sustained the tradition of outstanding economic statesmanship provided by such former Fed chairmen as Marriner Eccles, William McChesney Martin, Arthur Burns, and Paul Volcker.

I would like to take a moment to commend Chairman Greenspan for what I believe will be an important legacy of his chairmanship of the Federal Reserve. That is the movement by the Federal Open Market Committee of the Fed to be more open and transparent in its conduct of monetary policy. That movement began in November of 1993 when the Federal Reserve decided to release all historic transcripts of meetings of the FOMC, and the decision in January 1995 to release transcripts of FOMC meetings going forward with a 5-year lag.

Perhaps most significantly, in February 1994 the Federal Reserve decided that changes in monetary policy by the FOMC would be accompanied by an immediate public announcement of the change with an explanation of a reason for the change. Now that was followed by the decision in January 2000 to release an announcement after every meeting of the FOMC whether or not a change in monetary policy was made, with a brief statement assessing the balance of the risks. And most recently, they have added the recorded votes of the individual members of the FOMC on the conduct of monetary policy.

I also should mention that, in 2000, the Congress, with the support of the Fed, amended the Federal Reserve Act to make the Federal Reserve Chairman's Congressional testimony on the Semi-Annual Monetary Policy report a statutory requirement. Until then the testimony was customary but not required by law.

For those who have followed the conduct of monetary policy by the FOMC over the years and advocated greater transparency in its decisionmaking, these steps taken during Chairman Greenspan's tenure were meaningful and significant changes which have made the deliberations more transparent. I think it has made the members of the FOMC more accountable for the conduct of their responsibilities. Chairman Greenspan deserves great deal of credit for these positive changes.

In fact it has been my perception that members of the FOMC, both Governors of the Fed and the Federal Reserve Bank Presidents have become more open in their public discussions of the work of the FOMC and have made greater efforts to explain their deliberations to the public. I believe the Fed has also developed a greater appreciation of how important communication to the public and to the markets is to the conduct of monetary policy. I regard these as positive developments with lasting consequences.

Finally, let me note, Mr. Chairman, that while this nomination is for a 4-year term as Chairman, Chairman Greenspan has to cease to serve as a governor in February of not next year but the following year, 2006.

Chairman GREENSPAN. January 31, 2006.

Senator SARBANES. We have the date exactly, January 31, 2006—because of the limitation on the length of term a governor can—you can have one 14-year term, but you can have part of a term and then all of a 14-year term, which is the situation Chairman Greenspan would find himself in. At that point he would, of course, have to leave the board. That would help to get the chairmanship and the presidential elections back on what I regard as a more preferable track, which would be a new President would be able to appoint a chairman about a year after he came into office. So you would have some removal from the political process but not a total exception to it. I think that is a better synchronization on which to have the process work.

But again, I close by congratulating Chairman Greenspan on this nomination to a fifth term as Chairman of the Federal Reserve. I look forward, as always, to his testimony this morning and, Mr. Chairman, I look forward to supporting you as you move through this nomination process.

Chairman SHELBY. Senator Bunning.

STATEMENT OF SENATOR JIM BUNNING

Senator BUNNING. Thank you, Mr. Chairman.

Chairman Greenspan, I appreciate your service to our country, especially over the last 12 years, and I have no doubt that you will be reconfirmed as Chairman to serve the last 2 years of your 14-year term. Many are afraid of what will happen when your term expires in 2006. There is much fear and trepidation. But both you and I remember that there was much fear and trepidation when your predecessor, Paul Volcker, left. But our economy survived, and when you step down and decide to play tennis full-time, our economy will survive again.

I think it is obvious to everyone by now that I disagreed with you many times on your monetary policy decisions. As you know, I have already stated that I will not be able to support your renomination. I am quite sure that I will be the only Member this Committee not to support your renomination, and that there is a good chance that I will be the only Member of the U.S. Senate not to support your renomination. But that is okay. This is a democracy. We both know what it is like to take unpopular stands.

There have been many things you have done right in your tenure as Chairman. Since January 2001, I think you have done a pretty good job on monetary policy. I think that the Fed has done a very good a job on working with our financial institutions on combating terrorism. I also think that the Fed, under your leadership, has done a good job about briefing Congress on your antiterrorism activities and other initiatives the Fed has undertaken. And you have let sunshine into the Fed. Though I believe more can be done in that area.

But you know my problems, I have pointed them out to you on many occasions. I do not think that you have always moved aggressively enough to cut rates in the past, especially in 1992 and 2000, and I think you have involved yourself in many things outside the Fed's charter. Believe me, I know that you are asked to comment all the time on things that have nothing to do with monetary policy or banking regulations. Quite often, it is a Member of Congress asking those questions that have nothing to do with your job. I just wish you would be more respectful in declining to answer those type of questions.

Your words matter, Mr. Chairman. You know that. You know what happens when you use the term "irrational exuberance." You know what happens when you use the term "wealth effect." And you know how violent and volatile the markets can be. You knew that deleting the phrase, "for a considerable period" from the FOMC statement back in February, what it would do. I am sure there are times that you wish your words did not matter as much as they did. But people pay attention to what you say. Sometimes that is very good. Sometimes that is very bad. The job of the Fed is to set monetary policy. And I believe that when the Fed strays from that into other areas that we get into trouble.

I look forward to continuing working with you in the future. And hopefully the good people of Kentucky will decide to send me back here so we can work together for the last 2 years of your term. With monetary policy, I hope you will act aggressively. You have over the last three-and-a-half years. I would very much like to see you be the Chairman you have been since January 2001, not the Chairman of the summer and fall of 2000. Remember, if our questions, even today, do not have anything to do with your job, you do not have to answer them.

Thank you for time, Mr. Chairman.

Chairman SHELBY. Senator Schumer.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman. I am pleased to be here. As a New Yorker, I am particularly proud. New York has made countless contributions to our Nation, and you are not the least of them, Mr. Chairman, so thank you for the good work that you do. Your longevity is testament to your excellence. Markets and the Nation breathed a sigh of relief when you agreed to serve another term, and with good reason. Your integrity, your intelligence, and your ability to balance prosperity and inflation, a very difficult thing to do, are second to none. I, for one, am delighted that you are going to serve another term and am enthusiastic about your renomination.

I would just make one point in disagreement, and that is, it seems to mean that as I think your role in the bully pulpit is a good role. I must respectfully disagree with my colleague. I think we have few people who look out for the long-term health of the Nation. If the Federal Reserve Chairman does not do that, who will?

But in those pronouncements, my one concern here is that your voice against too much spending that creates deficits seems to be a lot stronger than your voice against tax cuts that threaten the deficit. I hope that in your next term you will strengthen your voice against unbalanced tax cuts that threaten the viability of our recovery through overwhelmingly large deficits.

Having said that, my view is you have been an A-plus chairman and I am glad you will continue to be.

Chairman SHELBY. Senator Crapo.

STATEMENT OF SENATOR MICHAEL CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman.

Chairman Greenspan, I welcome you back. I am one of those who will be supporting your confirmation. I appreciate the visit that we had when we discussed your confirmation. And frankly, I appreciate your strong leadership in the country.

There are a number of issues on which your voice has helped people to gain the confidence to take very important steps we needed to take. I am sure you do not appreciate it, but you are always going to get pulled into this tax cut fight. I appreciate the voice you have had in that tax cut debate with regard to the question of whether we should focus on spending. I think we all agree with your strong comments about not spending ourselves into deficit. Those of us up here on the Hill will probably continue to debate forever the question of whether tax relief is helpful and stimulative to the economy, or whether it is harmful, and the circumstances in which it should be utilized and which it should not be.

But I frankly just wanted to let you know that you have taken some shots here today from different perspectives. You are used to taking those shots, but you are universally recognized as one of those who has made a difference in America and I appreciate your service. Thank you.

Chairman SHELBY. Senator Bayh.

STATEMENT OF SENATOR EVAN BAYH

Senator BAYH. Mr. Chairman, welcome. I must remark upon the differences among our institutions of governance. Your 17 years as head of the Fed rank you second in the history of our republic, and yet I look around the Senate and you would be a relative newcomer in this institution, or at least it seems to me that way. But I compliment you on your years of devotion to our country and your capable service and would only add—I am going to save most of my remarks for our question period. But I would only add that I think the only potential stumbling block to your reconfirmation is the victory margin I would anticipate and the professional jealousy that might engender in some of us up here.

So, I thank you for your service and look forward to its continuation.

Chairman SHELBY. Senator Dole.

STATEMENT OF SENATOR ELIZABETH DOLE

Senator DOLE. Thank you, Mr. Chairman.

Today, I certainly want to lend my voice in strong support of the renomination of Alan Greenspan. Senators on both sides of the aisle have long admired the wisdom, the leadership, the integrity of Alan Greenspan since he first took office under President Reagan in 1987.

He has repeatedly demonstrated that a cool head and keen understanding of the markets can lessen the dangers when events panic the markets and capital crisis ensues. While it may seem obvious today, Chairman Greenspan has repeatedly had to remind us all that the fundamentals of the U.S. economy remain strong. Within 2 months of assuming the chairmanship of the Board of Governors, Alan Greenspan reassured investors and brought the necessary liquidity into the market when a panic caused the loss of more than 23 percent of the stock market value in October 1987. Then again, Chairman Greenspan demonstrated his considerable skills in the 1987–1988 global financial crisis when, with considerable finesse and three rate cuts, he was able to avert problem after problem as the world markets panicked. It is for these reasons, and many more, that I have full confidence in Chairman Greenspan's ability to continue as the head of the Federal Reserve System.

While many would expect an economist to simply see the numbers before him, Chairman Greenspan is also keenly aware of the people most affected by the numbers he analyzes. For example, he understands the growing wage difference between skilled and unskilled labor, and for that reason he has been a strong advocate for the continuing education of our workforce.

I share Chairman Greenspan's admiration for the excellent work of our community colleges, which is so important to North Carolina as we strive to retrain displaced workers due to enormous job losses in manufacturing. I am proud to be working with my colleagues Senators Enzi and Alexander to write legislation which provides additional assistance to our community colleges and other institutions of higher learning for training and retraining students in high-growth job markets. We are currently working on this bill with the Senate HELP Committee and I look forward to its introduction later this year.

In the past year, we have witnessed an economy that continues to grow stronger. Over 1.1 million jobs have been added since last August, with 8 consecutive months of gains. The Nation's unemployment rate is 5.6 percent, below the average of the 1970's, the 1980's, and the 1990's. Economic growth over the last three quarters has been the fastest in 20 years. American companies are reporting record productivity with growth between the years 2000 and 2003 at the fastest 3-year rate in half a century. All of this is thanks to both the excellent efforts of Chairman Greenspan and tax relief that clearly works.

I look forward to the swift consideration of Chairman Greenspan's nomination and its quick passage by the full Senate.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Miller.

STATEMENT OF SENATOR ZELL MILLER

Senator MILLER. Thank you, Mr. Chairman.

Mr. Chairman, thank you for your years of service to this country. Thank you for being willing to continue to serve and work in the arena; not always the quietest and most comfortable place to work. But your wisdom and your integrity are especially needed today. Thank you for your willingness to serve and thank you for your long and distinguished career.

Chairman SHELBY. Senator Hagel.

STATEMENT OF SENATOR CHUCK HAGEL

Senator HAGEL. Mr. Chairman, thank you. I too welcome Chairman Greenspan and I strongly support his leadership and his renomination. I do that, Mr. Chairman, because I think Chairman Greenspan has been one of the most effective leaders in monetary policy that we have had in this country, during some very difficult and challenging times. He has provided steady, common sense, and strong leadership. I have particularly appreciated his wider lens view of these issues, understanding that the fabric is a weave of many dynamics: trade, monetary and fiscal policy, foreign policy, and geopolitical issues. He has done that extremely well and I think has presented his case in that wider lens context which has been helpful to this country and to the world.

Mr. Chairman, thank you.

Chairman SHELBY. Senator Stabenow.

STATEMENT OF SENATOR DEBBIE STABENOW

Senator STABENOW. Thank you, Mr. Chairman.

I also would begin by welcoming Chairman Greenspan. I appreciate your leadership, your service to the country over the past 16 years, and I am proud to support your efforts and willingness to continue to do that.

Chairman Greenspan has clearly steered monetary policy for our country through good times and bad, as colleagues have indicated today on the Committee. He has seen difficult recessions and boom times, and he has been an outspoken voice for question and reason when we have needed it.

For example, he warned us, when many did not want to hear it, that the dot.com boom period could be fueled in part by irrational exuberance, and the subsequent correction in the market proved him right. Exponential growth in many market stock portfolios was indeed not based on sound market pricing.

Chairman Greenspan has also not been afraid to aggressively fight off inflationary pressures when he thought the economy was overheating. During my time in the House and the Senate, I have appreciated his willingness to warn policymakers about the danger of out-of-control deficits. I believe that we should be more responsible about both how we spend money and how we approach our revenue needs and our tax policy.

I had the opportunity to visit with Chairman Greenspan a few weeks ago and we discussed many important issues. I reiterated my concern to him at the current difficult economic environment with the Federal deficit is simply not sustainable or responsible. We are going to have to rethink our current fiscal policies if we are going to honor our promise to the baby-boom generation as they retire. I am glad that as we consider how to take care of our aging population, Chairman Greenspan has been willing to repeat his support for budget triggers.

Chairman Greenspan and I also recently discussed the important issue of financial literacy, and the Federal Financial Literacy Commission that I worked with Senator Sarbanes, Enzi, and Chairman Shelby to set up. I know of the Chairman's personal commitment to financial literacy, which I appreciate. Financial literacy creates more efficient markets. It also helps people to make financial decisions that are in their personal best interests, and I am glad that we have a Federal Reserve Chairman who believes financial literacy should be a priority.

Chairman Shelby, thank you for calling today's important nomination hearing. I intend to support Chairman Greenspan's nomination to another term. And, again, I thank you for your service, Mr. Greenspan.

Chairman SHELBY. Senator Chafee.

STATEMENT OF SENATOR LINCOLN D. CHAFEE

Senator CHAFEE. Thank you, Mr. Chairman, and congratulations on your nomination for a fifth term. You are one of the few in this town that has served under Presidents of both political parties. I particularly want to salute the work you did prior to coming to the Federal Reserve in the early 1980's on the Social Security Commission. Successful at raising the age of eligibility on a slow glide path from 65 to 67; something we have not been able to do on Medicare. So congratulations.

Chairman SHELBY. Senator Sununu.

STATEMENT OF SENATOR JOHN E. SUNUNU

Senator SUNUNU. Thank you, Mr. Chairman.

Mr. Greenspan, my staff was hoping that I would ask you upon which piece of U.S. currency you would most like to see your portrait, but I pointed out to them that your modesty and sense of fairness would preclude you from singling out one denomination over another.

[Laughter.]

So instead I simply want to welcome your testimony, of course, and your appearance here, but ask that in your testimony and any written submissions to the Committee you focus on those areas that I think are most pertinent to the Fed, areas of capital market regulation, and banking regulation, and monetary policy. As I look through the issues that we dealt with this year, just this session of Congress, whether it is regulatory issues or legislative issues, market structure, mutual fund regulation, terrorism risk insurance, the structure of public boards and their liability, hedge fund regulation, GSE legislation, all of these issues I think have the potential to really change the structure of our capital markets, their operation, their efficiency, and public confidence in the capital markets.

I would very much like to see, whether it is a resubmission, a restatement, or clarification of the guiding principles that you believe should shape both regulation and legislation in these areas affecting the efficiency of the capital markets and public confidence in the capital markets, because most of the issues that I just mentioned are not going to go away at the end of this year. We are going to be taking them up again next year, and I think any perspective that you can provide to us to help guide and shape our views as policymakers would be welcome. Thank you very much.

Chairman SHELBY. Senator Allard.

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. Mr. Chairman, again I would like to thank you for holding this hearing on the renomination of Dr. Greenspan to be the Chairman of the Board of Governors of the Federal Reserve System. I look forward to his testimony and the opportunity to have the Chairman come before this Committee and share his expertise on economic issues and factors that are driving and hindering economic growth.

Today, I want to extend my appreciation for his unfettered commitment to analyzing and interpreting the peaks and valleys of our U.S. economy. His contribution to this country has been exemplified by his constant vigilance to the factors that play such an influential role in the direction and success of our economic system. Dr. Greenspan has served on the Board of Governors of the Federal Reserve System since August 1987 and as Chairman of the Board of Governors since June 2000. He has witnessed, obviously, a great deal of uncertainty and change in those years as the heightened impact on our economy of technological advances, competition, and robust productivity have become evident.

Accordingly, Dr. Greenspan and the other members of the Board of Governors have altered the framework in which they analyze the economic system so that they may gain a more accurate depiction of what the economy looks like and how better to formulate monetary policy in light of those changes.

Dr. Greenspan, I appreciate your commitment to this Committee and to this country, and look forward to supporting your nomination for a fifth term as Chairman of the Federal Reserve Board.

Thank you, Mr. Chairman.

Chairman SHELBY. Chairman Greenspan, I ask now that you stand and take the oath. Would you raise your right hand?

Do you swear that the testimony that you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Chairman GREENSPAN. I do.

Chairman SHELBY. Do you agree to appear and testify before any duly-constituted committee of the Senate?

Chairman GREENSPAN. Mr. Chairman, I do.

Chairman SHELBY. Chairman Greenspan, we welcome you to the Committee. You may proceed as you wish.

STATEMENT OF ALAN GREENSPAN, OF NEW YORK, TO BE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Chairman GREENSPAN. First I want to express my gratitude to President Bush for his confidence in me, and to you, Mr. Chairman, and Members of the Committee, for expeditiously holding this hearing on my renomination for a fifth term as Chairman of the Board of Governors of the Federal Reserve System. The Federal Reserve has had a close and productive relation with this Committee over the years. If you and your Senate colleagues afford me the opportunity, I look forward to working with you in advancing our shared goal of strengthening the firm foundation upon which the American people have built a prosperous economy and a sound and efficient financial system.

The performance of the U.S. economy has been most impressive in recent years in the face of staggering shocks that in years past would almost surely have been destabilizing. Economic policies directed at increasing market flexibility have played a major role in that solid performance. Those policies, aided by major technological advances, fostered a globalization which unleashed powerful new forces of competition, and an acceleration of productivity, which at least for a time has held down cost pressures.

We, at the Federal Reserve, gradually came to recognize these structural changes and accordingly altered our understanding of the key parameters of the economic system and our policy stance. But while we lived through them, there was much uncertainty about the evolving structure of the economy and about the influence of monetary policy.

The Federal Reserve's experiences over the past two decades make it clear that such uncertainty is not just a pervasive feature of the monetary policy landscape; it is the defining characteristic of that landscape. As a consequence, the conduct of monetary policy in the United States has come to involve, at its core, crucial elements of risk management. This conceptual framework emphasizes understanding the many sources of risk and uncertainty that policymakers face, quantifying those risks when possible, and assessing the costs associated with each of the risks.

This framework entails devising, in light of those risks, a strategy for policy directed at maximizing the probabilities of achieving, over time, our goals of price stability and the maximum sustainable economic growth that we associate with it. In designing strategies to meet our policy objectives, we have drawn on the work of analysts, both inside and outside the Fed, who over the past half century have devoted much effort to improving our understanding of the economy and its monetary transmission mechanism. A critical result has been the identification of key relationships that, taken together, provide a useful approximation of our economy's dynamics. Such an approximation underlies the statistical models that we at the Federal Reserve employ to assess the likely influence of our policy decisions.

However, despite extensive efforts to capture and quantify what we perceive as the key macroeconomic relationships, our knowledge about many of the important linkages are far from complete and, in all likelihood, will always remain so. Every economic model, no matter how detailed or how well-designed, conceptually and empirically, is a vastly simplified representation of the world that we experience with all its intricacies on a day-by-day basis. Policymakers have needed to reach beyond models to broader, though less mathematically precise, hypotheses about how the world works.

A central bank needs to consider not only the most likely future path for the economy, but also the distribution of possible outcomes around that path. The decisionmakers then need to reach a judgment about the probabilities, costs, and benefits of the various possible outcomes under alternative choices for policy.

As the transcripts of the Federal Open Market Committee meetings attest, faced with these abundant challenges, we find the making of monetary policy to be an especially humbling activity. In hindsight, the paths of inflation, real output, employment, productivity, stock prices, and exchange rates may seem to have been preordained, but no such insight existed as we experienced these developments at the time.

Yet, during the past quarter-century, policymakers managed to defuse dangerous inflationary forces and to deal with the consequences of a stock market crash, a large asset price bubble, and a series of liquidity crises. These developments did not divert us from the pursuit and eventual achievement of price stability and the greater economic stability that goes with it.

Going forward we must remain prepared to deal with a wide range of events. Particularly notable in this regard is the fortunately low, but still deeply disturbing, possibility of another significant terrorist attack in the United States. Our economy was able to absorb the shock of the attacks of September 11 and to recover, though remnants of the effects remain. We, at the Federal Reserve, learned a good deal from that tragic episode with respect to the impact of policy and, of no less importance, the functioning under stress of the sophisticated payment system that supports our economy. Our efforts to further bolster the operational effectiveness of the Federal Reserve and the strength of the financial infrastructure continue today.

Each generation of policymakers has had to grapple with a changing portfolio of problems. So while we importantly draw on the experiences of our predecessors, we can be sure that we will confront different problems in the future.

The Federal Reserve has been fortunate to have worked in a particularly favorable structural and political environment over the past quarter-century. But we trust that monetary policy has contributed meaningfully to the impressive performance in our economy in those year. I have been extraordinarily privileged to serve my country at the Federal Reserve during most of these years and would be honored if the Senate saw fit to enable me to continue this service.

Thank you very much, Mr. Chairman.

Chairman SHELBY. Thank you, Chairman Greenspan.

Chairman Greenspan, this morning the Commerce Department reported that the business inventories climbed 0.5 percent in April to $1.212 trillion, a record high and the eighth straight monthly increase. What do these increases tell us about any potential inflationary pressures?

Chairman GREENSPAN. At the moment not too much, Mr. Chairman. The reason is that even though, as you point out, inventories have risen to record high levels, as a ratio to sales or production they are close to, and probably are at, record lows. Indeed, there is a very significant path of inventory reduction over the last couple of decades, the so-called just-in-time inventory process. So, I would perceive that that is going to continue on, but there is no evidence at this stage that I can unearth that suggests to me that recent inventory patterns are contributing either to inflation or deflation.

Chairman SHELBY. Mr. Chairman, what can we expect, in your judgment, in terms of job growth in light of these heavy inventory numbers? Is there any correlation there at all?

Chairman GREENSPAN. Strangely enough, I would reverse it and say that the fact that inventories in a general context of the level of sales being quite low leads me to conclude, indeed to those purchasing managers who try to evaluate the inventory position of their customers, that the next change in inventory policy, at least for the short-run, is probably going to be some element of either accumulation or at least, at a minimum, a temporary stabilization of the inventory-sales ratios before the long-term trend continues.

What that suggests is that even flattening out of inventory-sales ratios creates a significant increase in the rate of increase in inventories during any particular period. And since inventory accumulation adds to final demand to get production and employment, I would presume that, if anything, the inventory picture today is probably more likely to be helpful in expanding employment than in contracting it.

Chairman SHELBY. The Federal Open Market Committee, you referenced that a minute ago, will be meeting at the end of this month. It is widely anticipated that the Federal Open Market Committee will move to increase short-term interest rates. You have noted any upward movement will be, your word "measured" although you also noted that, "the FOMC is prepared to do what is required" to maintain price stability, which is important to everybody. In other words, to pursue a more aggressive interest-rate strategy there.

What factors will you be looking at between now and the end of this month to determine whether or not a measured or an aggressive response is necessary?

Chairman GREENSPAN. Mr. Chairman, as I said in the remarks which you are quoting from, our best judgment is that the economy is growing in a solid fashion. To be sure, underlying unit costs, having gone down for quite a long period, have now started to turn up modestly. But our general view is that inflationary pressures are not likely to be a serious concern in the period ahead.

Therefore, we concluded in our policy statements that the removal of an increasingly unnecessary degree of accommodation in monetary policy is very likely to be measured over the quarters ahead. But clearly, this is our general view of the outlook and forecasts are subject to error. If our judgment as to how the economy is going to evolve and how inflation is going to evolve turns out to be mistaken we will change, because our fundamental goal is, as you point out, to maintain price stability over the longer-run as a means of creating maximum sustainable growth.

Chairman SHELBY. Do you believe that the economy will continue each month to add a significant number of jobs as we have seen in recent months?

Chairman GREENSPAN. So far the pace of economic activity, and a slightly lessened pace of productivity increase compared to what it had been, numerically creates job growth, if I may put it in those terms. We see nothing in the immediate outlook to suggest any major change in the path of employment growth going forward.

Chairman SHELBY. Thank you.

Senator Sarbanes.

Senator SARBANES. Thank you very much, Chairman Shelby.

Chairman Greenspan, the economy has now 1.9 million fewer private-sector jobs than it had when the recession began 38 months ago in March 2001. Now in every other recession since World War II, the economy has recovered all of the private-sector jobs that had been lost by this point in the cycle; generally well before this point. In fact when compared to a typical recovery, our economy has 5 million fewer private-sector jobs at this point in the recovery period than under a typical recovery.

Let me just show you this chart to make this point. The red line is the average of nine recessions since World War II in terms of the recovery of private-sector jobs. This dark line here is what has happened in this recovery. The thing that is interesting is that it started off and they pretty well tracked the same course going down. But then in previous recessions we got an upswing and we came back up here, then we pass the point of—now we are getting net gain in jobs. But this time we stayed down here on this trajectory so there is a gap here of 5 million private-sector jobs short of a typical recovery.

I find obviously that is a matter of great concern. What is your explanation for that? These are the amount of months. So we are out here now. We are at 37, 38 months out here in the period and we have not come back up. We are not even back up to recovering. We are still 1.9 million short, and we are 5 million short of—when you compare it with the average of the nine recessions since World War II. What is your explanation for that or your theory on that?

Chairman GREENSPAN. Senator, I think there are two explanations. First, and most important, is the extraordinary increase in the rate of productivity growth, which has been very unusual for a period of economic weakness such as prevailed since the peak of economic activity in the year 2000. Productivity growth has never, in my recollection, grown anywhere near as rapidly as it has grown during the period of comparable weakness that has been experienced in the last several years.

What this means is that even though demand picked up, that increasing efficiencies have enabled businesses to meet that demand without hiring new people. This has been a fairly pronounced and significant trend over a large number of quarters.

Second, the size of the upswing that you show in your chart is, in many respects, a function of the size of the downswing that preceded it. The fact that we have had a very shallow recession most recently, indeed, the shallowest recession that has occurred in the post-World War II period, means that even if the productivity gains were not there, or let us put it more exactly, with the same average of the nine recessions that you are pointing out on your chart, we would still have had a lag in employment, largely because there is not enough of a bounceback that ordinarily occurs out of a shallow recession as one which is far more deep. Indeed, I recall, for example, the 1975 recession most vividly when we had an extremely sharp decline. That was the spring of 1975. And by the first quarter of 1976 the economic growth rate was almost 10 percent at an annual rate and employment had come back very substantially.

This is the other extreme that we are looking at today.

Senator SARBANES. On that second point, the job loss pretty well parallels. I think the GDP drop was shallower in comparison with previous recessions.

Chairman GREENSPAN. Excuse me, what is the first date? Is that March 2001? I believe productivity was increasing fairly significantly at that point.

Senator SARBANES. Let me ask you this question in view of that answer. The long-term unemployed workers has not substantially improved over these last several months even though we are getting some job growth. There are 1.8 million long-term unemployed workers who constitute 22 percent of all unemployed workers today. That percentage has remained elevated above 20 percent for the past 20 months, the longest such streak with respect to a recovery. The average duration of unemployment today remains 20 weeks and 80,000 workers lost their benefits in April.

It seems to me that this chart and what we are discussing here—and let us accept the hypothesis about productivity, but that still leaves us with the fact that workers have lost their jobs and we are not creating jobs and they are not getting back to work. Yet the unemployment insurance system is geared to expire after 26 weeks unless you make extensions. It seems to me that poses a real problem for us, because workers run out of their benefits. The labor market has not strengthened sufficiently that they can move back into jobs. It seems to me to cry out for an extension of unemployment insurance benefits, which of course, we have done in the past. In fact, we have done it in the past in a more responsive way than I think we are doing it in this recession, even though we have this added factor that you have just detailed which has inhibited job growth.

What is your view on temporarily extending unemployment insurance further?

Chairman GREENSPAN. Senator, I have testified before that I thought that the extraordinarily high degree of exhaustions out of the unemployment insurance fund, which indeed is a reflection of the point you are making, namely, the fairly significantly longer average duration of unemployment in this period, creates a problem because, as I pointed out previously, these people in this type of labor market have lost their jobs through no fault of their own. And we have constructed an unemployment insurance system which is closely geared to the issue of trying to take care of those who lose their jobs from no fault of their own, and to a concern many people who construct such programs that a fairly generous unemployment insurance program will tend to create unemployment, as indeed the evidence does suggest.

I think our system is very well-balanced and that is the reason why I have argued in the most recent past that under these conditions it is presumably appropriate to extend employment insurance.

But I would say that given the increase in job growth that is in process, and my suspicion, although I do not have the evidence, that exhaustions most recently are beginning to fall away, should you go ahead with the extension of unemployment insurance I think you will find that a short-term extension will probably serve your concerns with respect to the exhaustees.

Senator SARBANES. The extension we are talking about is 13 weeks, which is not a very lengthy period under the circumstances.

Chairman GREENSPAN. I agree with that.

Senator SARBANES. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Bunning.

Senator BUNNING. Thank you, Mr. Chairman.

You have ventured into some unusual places again. Thank you. Would you agree or disagree with this statement, a recent statement that has been made, that "this economy is the worst economy since the Great Depression?"

Chairman GREENSPAN. Senator Bunning, I would strongly disagree with that statement.

Senator BUNNING. Thank you.

Have the high energy prices acted as a brake on the economy? In the absence of the high cost of energy, do you believe the Fed would have already been forced to raise the discount rate?

Chairman GREENSPAN. I am not sure the energy changes that have occurred, while important and having fairly broad impacts on the world economy and the United States, are a material factor in monetary policy at this point. They could become a problem.

I do not think we are there yet, but we are watching the situation, obviously, fairly closely because the cost of energy is a very important element in the underlying cost structure of American business, but also extraordinarily important amongst our trading partners. Because imports as a share of our economy and exports are very large relative to where they were a decade ago, and obviously even earlier, our interaction with the international economy is increasingly important to our prosperity. Therefore, anything which undermines the world economy, and very high oil prices would do that, would be a concern to us, and indirectly, should it impact on our economy, would therefore affect monetary policy. But it is the impact on our economy, not the energy prices changes themselves, which would induce us to respond.

Senator BUNNING. Mr. Chairman, if energy per barrel cost would escalate beyond $42 a barrel and maintain that cost over a year, or 2 years, would that not directly impact our economy?

Chairman GREENSPAN. It would certainly have some impact. The question I think at issue, which we do not know the answer to, Senator, is how significant the impact would be. It is the answer to that question which essentially would determine how monetary policy would or would not respond.

Senator BUNNING. The Chairman of the Committee asked you about inflation and evidence of inflation in the economy. I always ask you the question when you come, besides energy costs and energy prices, are there other factors, like commodity prices and things, that are indicating to the Fed that we do have an escalation of inflation in the economy?

Chairman GREENSPAN. Senator, I think the issue which would concern us most is the slowdown in the extraordinarily rapid rate of productivity, which I mentioned before. Because average hourly compensation has been edging up in recent months, the effect of the combination of a decline in the rate of increase of productivity growth and the slightly quickening pace of wage increase has caused unit labor costs, which had been going down for quite a number of quarters, to have turned up in most recent quarters. On a consolidated basis, that accounts for more than two-thirds of the costs of nonfarm, American business. While at the moment those increases are still modest, it is there where our central focus is likely to be because it is such a large part of the total cost area.

But certainly, as you point out, commodity costs, prices of imported goods, capital costs, interest costs, and the like, all have impact on the underlying cost structure. It is essentially the package of costs which we focus on most closely, and on our ability to try to forecast in the direction in which they were going. In that regard, we spend a good deal of time trying to make judgments about what is the trend of average hourly earnings, what causes it to change, for example, the underlying depreciation cost is another item. It is in that pattern that we try to focus on the whole structure of prices and costs and profitability in making judgments as to whether individual price changes are significant and are expressing an underlying trend. It is the underlying trend which monetary policy endeavors to address.

Senator BUNNING. Thank you very much.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Schumer.

Senator SCHUMER. Thank you, Mr. Chairman. And I thank you, Chairman Greenspan, for your good work. My concern is the deficits. It is interesting that when we get new economic news, the stock market does not go up, but goes down sometimes in the last few months. And even if we have a very strong recovery in the next several months, my worry is about longevity because of the large deficits that we have.

Given the fact that the deficits are at large levels, we can debate how they compare historically. It is high, historically, some people say higher than in other times, some people say, well, about the same or a little less, but they are high or certainly higher than you thought or anyone thought they would be in 2001.

Do you think we should make the tax cuts that were temporarily extended in the last tax bill permanent, as the President is seeking to do?

Chairman GREENSPAN. Senator, let me answer that in two parts. First, I have always been strongly supportive of the elimination of the double taxation of dividends largely because I have always considered it a type of tax which probably impeded capital expansion and economic growth as a consequence. So, I was very strongly supportive and remained supportive of those types of tax cuts, including marginal tax-rate cuts. Second, I also have been consistently supportive of maintaining PAYGO and discretionary caps on spending, and I was very much concerned in September 2002, when the fairly effective caps and PAYGO were allowed to lapse.

I would hope that the Congress will put them back in place as they were before. And, in that context, obviously, I am stipulating that, because the individual tax cuts which I found very important would lapse, they would, under the rubric which I am discussing, be required to go through a PAYGO evaluation in order to be passed.

Senator SCHUMER. And as you know, we are debating this right now in the budget resolution, and there are many who want PAYGO for spending, but not for tax cuts. And my question to you is twofold: One, should PAYGO be enacted for both spending and for tax cuts; and, two, if Congress should fail to enact PAYGO legislation in this budget resolution, so we would be faced with the choice of making the tax cuts permanent without offsets in spending or in other taxes, would you be for making those permanent?

Chairman GREENSPAN. Let me just say this. I believe that the legislation, which was in place prior to September 2002, in my judgment, was the correctly balanced legislation. As I have often stated, I think the real problem over the longer-term is constraining spending because I think there is a bias in the way our system functions. But I think, looking at the issue from the point of view of fiscal policy, a symmetry is required in the way one looks at that.

So, I am not willing to acknowledge the fact that PAYGO would not be put back in place.

Senator SCHUMER. Right. But if it was not? Because I will tell you the odds, and there are some people sitting around this room who are under big pressure not to do it. If it was not, would you—and this is an important question because of what was mentioned—if we did not enact PAYGO, the way we had it in 2002 on the tax side, should Congress enact permanent tax cuts without offsets on either the spending or tax side? Because that will increase the deficit even further if we do that.

Chairman GREENSPAN. I am aware of that. I am reluctant to answer that question largely because I do not want to get involved into the details of negotiations beyond the positions that I have taken. There are lots of hypothetical questions which——

Senator SARBANES. Some of us think you have already answered it by your answer on the PAYGO question.

Chairman GREENSPAN. Well, the Senator presumes otherwise.

Senator SCHUMER. Yes. I just think this is an important issue, and your words are very important. They get interpreted in many different ways, and I am looking for as clear an answer as possible. I think I can read the same thing that Senator Sarbanes did, but there are going to be many who say, no, that is not the case. And if we end up at the end of this Congressional session with a further increase in the deficit, I think that will bode real trouble for the recovery. I guess you would agree with that.

Chairman GREENSPAN. I actually am somewhat less concerned about the short-term budget deficit because I think, given what appears to be a fairly solid recovery, which seems to have legs to it, revenues are going to be reasonably good over the next fiscal year, and I think that that will contain the deficit. However, there is no way to look at the longer-term trends of our fiscal system without concluding that we will run into fairly serious difficulty in the next decade, say, 2011 and forward, as the very large numbers of baby-boom retirees leave the labor force and join retirement.

The numbers I find very disturbing, and while I appreciate that that is seemingly a number of years off, it is not far enough into the future to say we can handle it at another time. The time for addressing the size of the commitments made for the next generation of retirees, relative to the economic resources we are likely to have to finance them, I find deficient and disturbing.

Senator SCHUMER. I thank you, Mr. Chairman. My time has expired. I would just note that a lot of these permanent tax cuts would take effect in that 2010, 2011, 2012 timeframe when the crunch will occur.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Dole.

Senator DOLE. I would like to follow-up, Chairman Greenspan, on the response to Senator Bunning, when you spoke about wage growth. Let me ask about the reports of the stagnation of wages. In past years, we witnessed strong productivity growth, but that has not resulted in a real increase in wages. My question is do you believe that is a trend that will be corrected in the short-term or do you see that as something that will continue?

Chairman GREENSPAN. Senator, I think it is in the process of changing. If you would just look back from an accounting point of view, the very significant increase in productivity from, say, the first quarter of 2003 to the first quarter of 2004 is reflected wholly—almost wholly—in rising profit margins. In other words, very little spilled over into real wage increases.

Now, the evidence suggests that is beginning to turn, as it always does in this regard, meaning that profit margins are now flattening out or are likely to flatten out, and the catch-up invariably is in real wages. This is a very typical pattern, where productivity gains are first picked up in rising profits and then, essentially, in part, are given back in the way of real wages because of competitive pressures that invariably occur when profit margins are large. In other words, companies try to increase production in a sense to harvest those profits, and by so doing, they bid up the wage structure. That seems to be occurring at this particular stage, although as I pointed out to Senator Bunning, not at a pace which, in our judgment, looks to be moving unit labor costs to an inflationary plateau.

But I think that the sharp decline in the share of national income going to compensation of employees over this most recent period is now in the process of turning and is likely, through the next year or two, to go back to its normal level after this adjustment. It is not a long-term trend.

Senator DOLE. I have read recent reports stating that real disposable income is rising, up 11 percent since December 2000. In fact, Americans' real disposable income is at its highest level ever, I believe, and some have said that, well, this is because a lot of the new jobs that are being created are in industries that are paying higher-than-average amounts. Others have said it is due to the tax relief, putting more money in the pockets of Americans.

I would be interested in what you attribute this rise to, this impressive rise in disposable income, and is this a trend that you believe is going to continue?

Chairman GREENSPAN. It is very difficult to tell whether, in fact, the rise is attributable to differential gains within the wage and salary area. You can look at it in two ways. Let us go back to wages and salaries, from the beginning.

If wages and salaries are growing per hour, as they are now, is it pretty broad-based? And the answer appears to be, yes, but we are not sure for the following reasons. It is certainly the case that the rise in wages that would have occurred, if the industry structure had frozen, is about exactly the wage rise we have actually perceived which suggests that the increases are across all industries. What we do not know, however, is that within industries, whether the trend of highly skilled versus lesser skilled is continuing to open up.

My suspicion is that when we finally get the data, which are quite delayed in this respect, we are going to find that. But it is not an issue of industry, because we have those data, and there is no evidence, at least in the last 4 months, when the significant increase in disposable income has occurred, there is no evidence that it is the industry mix that is doing it. In other words, it looks that the gains are across the board in industry.

With respect to the tax cut, that was very significant last year. It is a lesser issue this year. Most of the rise in income is that the economy is beginning to move, and as I indicated before, profit margins are no longer taking the lion's share of the big increase.

Senator DOLE. Mr. Chairman, my time has expired, but I have a number of other questions that I would like to submit for the record, if I could.

Chairman SHELBY. You may do that.

Senator DOLE. Thank you.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you.

Senator SARBANES. Mr. Chairman, could I be very clear on one thing, on the answer to this question? As I understand it, real disposable income could rise very substantially on the basis of tax cuts at the top end of the scale because that would bring very large increases in disposable income. That figure alone does not show what is happening to ordinary workers. Would that not be the case?

Chairman GREENSPAN. I think that is correct. But I am saying that in the last 4 months of increase, it is basically the underlying economy which is moving the real wage rate.

Senator SARBANES. But before that.

Chairman GREENSPAN. Before that, a significant part of the increase in disposable income was the result of tax cuts.

Chairman SHELBY. Senator Bayh.

Senator BAYH. Mr. Chairman, I appreciated your focus in your statement about the importance of risk management and the inherent difficulty, ambiguity, "unknowability" of many of the forces that we must anticipate or contend with. You listed several things that have helped to reduce the level of systemic risk with which we have to contend. And then you said, going forward, we must remain prepared to deal with a wide range of events, and you specifically mentioned terrorism. I would like to ask you what other events you are concerned about or that we need to prepare for.

Chairman GREENSPAN. We, at the Fed Reserve, as a general rule, obviously try to make an evaluation of where we think the most probable trend of events is going and construct our preliminary policy programs with respect to that path. But we also try to consider a whole series of alternates. I do not want to list them because one sounds scarier than the next. And even though the probabilities are very low, I am always hesitant to mention something.

Senator BAYH. Let me suggest a couple then. I am not asking you to tell us what, if anything, keeps you up at night. I hope you sleep soundly, but a couple of things.

There was a headline today, I am sure you saw, about the current figures in the balance of trade and the fact that the recent figures were not good, although there is some debate about whether they overstate the situation, in fact. What about the risk of some event triggering, rather than an orderly, a disorderly fluctuation in our currency?

Chairman GREENSPAN. That is obviously one of the issues which we have focused on. We have done a number of studies of how developed countries have handled very large current account deficits, which is the larger version of the trade deficit. And what we have concluded is that international financial markets are sufficiently flexible to allow the inevitable adjustment of those outsized deficits to gradually lower in such a way which is not disruptive to economic activity.

We have done a great deal of work in trying to evaluate how the current one is going to change. You cannot know, for certain, but what is reasonably clear, at least in my mind, is that if we maintain a high degree of flexibility in our economy and in the international economy, which indeed we have today, then market forces will gradually adjust the imbalances, but we cannot tell at this stage or in advance whether it is relative prices in various economies, whether it is the exchange rate, whether it is the relative different growths in various economies which will do it. But what these various studies of developed countries suggest is that those adjustments will, in some form or another, take place.

Senator BAYH. A high degree of flexibility, Mr. Chairman, you said is a key to trying to deal with the unanticipated event? Is it not true that our twin deficits reduce our margin for error, reduce some of the flexibility that we have?

Chairman GREENSPAN. Well, the flexibility is mainly institutional. In other words, for example, we have very flexible financial markets which adjust very quickly, and we have extraordinarily broad labor markets which are quite flexible as well, better than in most of the rest of the world. So, yes, indeed, the budget deficit and the current account deficit are problems, but I am saying there is a difference. The current account deficit is largely going to be adjusted one way or the other by market forces. The Federal budget deficit will be adjusted partly by market forces——

Senator BAYH. Policy decisions.

Chairman GREENSPAN. —but mainly policy.

Senator BAYH. Before my time expires, Mr. Chairman, let me mention one of the risks that is popularly thrown out there, and we have asked you about it before, and you have responded, but things have changed some since your last response, and that is with regard to housing and the fact that housing prices have outstripped the growth incomes over the last several years.

Now, the effect of that was ameliorated by the lower interest rates, which enabled people to afford these higher prices. Interest rates may now be in the process of adjusting some. And your response previously had been that immigration and that land scarcity would help to sustain these higher prices.

Are you concerned about housing prices at this point and perhaps the effect that that will have on consumer spending if prices prove not to be justified at current levels?

Chairman GREENSPAN. It is certainly the case, as you point out, Senator, that prices have been moving up faster than they had been. But remember that because productivity growth in residential construction has historically been moving more slowly than the average over the longer-run, largely because there is a good deal of custom house building—in other words, we would like our own idiosyncratic house—this means you cannot have mass production such as you can have in the general area of manufacturing, mainly. So that there is a gradual long-term updrift in the price of homes relative to the price of everything else, but to be sure, there has been a faster pace today, but not enough, in our judgment, to raise major concerns.

It could become a problem if it were to accelerate further. We see little evidence that that is likely to happen, largely because we perceive that the very strong expansion in new and existing home sales is now flattening out, and the really quite unexpected boom in home sales over recent years is unlikely to be continued. Our forecast is generally flat in aggregate volumes. Where house prices go, I am not sure, but I would be quite surprised if they showed continued acceleration on the upside.

Senator BAYH. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Chafee.

Senator CHAFEE. Thank you, Mr. Chairman.

Chairman Greenspan, you were hopeful that with the improving economy, the added revenues would help address the deficit, but there are also some unknowns, particularly on the prescription drug benefit, what exactly that is going to cost and also what we are going to have to invest in stabilizing Iraq and the region there. If the deficits do continue to grow, I know there are some concerned that could produce a sharp devaluation of the U.S. dollar, something that did happen in 1985, which would, in turn, undercut European exports, and that would affect European economies.

Is that of a concern to you?

Chairman GREENSPAN. Senator, it is an issue which a number of people have raised, and obviously we have looked at it. And there is very little evidence, at this particular stage, that the size of the Federal budget deficit and the point, or indirectly, relating to the fairly significant amount of our Government issuances to finance that deficit, which would be purchased by foreign central banks and, indeed, by others.

We look at it fairly closely. The markets seem to be adjusting remarkably well, and a good part of those securities which are purchased by foreign central banks are shorter term. So that there is no real basic concern that a lot of people have argued in favor of, namely, that a major endeavor to disgorge those holdings could have a destabilizing effect back here. We do not think so.

In other words, we think, as I pointed out earlier, that the degree of flexibility in our financial system is sufficient to absorb very considerable amounts of change. Remember that our financing system is huge relative to the rest of the world, and the demand to hold U.S. dollars by foreigners is a very high propensity which continues irrespective of these deficits which we are looking at.

So could it become a problem in the future? It could, but there is no evidence of which I am aware which suggests any such problems are on the horizon.

Senator CHAFEE. Last year, I believe we sold $208 billion of Treasury securities just to Japan, China, and other Asian countries, $208 billion just last year. But you are saying that is short term and not of concern?

Chairman GREENSPAN. Well, $200 billion is not a small number, obviously. It is a big number. And as I think the Treasury pointed out the other day, that of marketable securities foreigners own somewhat more than half, currently.

I think that if it were a significant problem, we would be seeing the forward edge of the problem already, but we do not. There is an unquenchable demand to hold claims against American residents largely because they are presumed to be safe, and they are presumed to have significantly higher rates of return adjusted for risk in most other areas in the world.

Senator CHAFEE. I have heard some people rail against the fact that it is not in our best interests to have the Chinese buying our T-bonds, and that is all the fault of the deficit. If we did not have this deficit, the Chinese would not be buying our T-bonds. I guess that is the point I am making.

Chairman SHELBY. Thank you, Senator Chafee.

Senator Stabenow.

Senator STABENOW. Thank you, Mr. Chairman.

Chairman Greenspan, we have talked a little bit about PAYGO today. I am a very big supporter of PAYGO, both in terms of tax policy and spending policy. But when you were in my office a couple of weeks ago, we talked about another way of trying to keep that balance, which is a budget trigger. And as you know, Senator Bayh, Senator Snowe, and I, and others proposed back during the original debate on tax cuts earlier that we should have a trigger that covered both spending and tax cuts. And I believe we would not be where we are now if we had, in fact, been able to put that into place.

Could you speak about your support for the notion of a trigger on these kinds of major tax and spending policies?

Chairman GREENSPAN. Senator, 20, 30 years ago, certainly 50 years ago, nobody was concerned about long-term budget problems in the United States because we never had commitments that lasted very long. Our Social Security system, for example, was relatively small at that point. The commitments in the military were sometimes for 3 to 5 years on some weapons system, but we never had any ability nor need to worry about what the budget deficit would look like 5, 8, or 10 years in the future, and we always had the capacity to adjust as time went on.

As entitlements, specifically retirement entitlements, have grown to an ever-larger proportion of our budget, our ability and our necessity to have a sense of where fiscal balances will be 10 years from now have all of a sudden become a very crucial issue for determining what current fiscal policy should be.

Because our ability to forecast 10 years out is very marginal, at best, I have always believed that we have to make the best judgment we can, but also put in place some mechanism in which, if our path of budget balance, whether surplus or deficit, goes significantly off-track that we have fiscal mechanisms to get us back on track. That is essentially what a trigger is. It is a vehicle which stipulates that if a particular program is not doing what it was projected to do, then certain adjustments would occur automatically or certain adjustments would require that the Congress revisit the program.

There are lots of different triggers. But the main concept is to recognize that we no longer have year-by-year budget-making as the process of fiscal policy. We are in a wholly different world, and part of that world, in my judgment, requires triggers because our capacity to forecast is so limited as we get out that far.

Senator STABENOW. Thank you. I could not agree with you more, and I am hopeful, as we go forward, that we will have the opportunity to debate again and hopefully put in place some kind of a trigger.

One other question, Mr. Chairman, that is particularly important to my home State of Michigan. I am extremely concerned about currency manipulation and how it is effectively creating an artificial tax on U.S. goods exported abroad and giving the Chinese and the Japanese an unfair advantage when they ship goods into our country. We know this is happening.

The Chinese pegging of their currency to the dollar prevents an appropriate float of their currency, and the Japanese have been very aggressive and willing to intervene in currency markets when they feel that it is warranted, to their advantage.

I have raised this issue with Treasury Secretary Snow in the past. The Administration, up to this point, has not been willing to take concrete steps to end the currency tax. I am wondering, Mr. Chairman, do you agree that currency manipulation is going on and is it having a detrimental impact on U.S. goods, in particular, in the manufacturing sector, which hits my State so heavily?

Chairman GREENSPAN. Senator, first, the Japanese ceased their intervention in the yen-dollar market a while back, and they have not been involved since mid-March. In mid-March, they announced that intervention had ceased and that is indeed the fact.

Senator STABENOW. And I would just say that we hope that they will not return to that policy.

Chairman GREENSPAN. I think one issue here is that it is not to the advantage of foreign central banks to accumulate very large amounts of foreign currency after a certain point because it creates domestic problems of monetary stability. The issue is most relevant in this regard to China because they are acutely aware of the fact that their stabilization of the renminbi versus the dollar has required very large accumulations of dollar assets on the balance sheet of the People's Bank of China, the central bank, and this creates problems that are obviously exaggerating the difficulties they are currently having with respect to underlying inflationary pressures and boom conditions, which they are endeavoring and, apparently successfully, beginning to constrain.

I think that over the longer-run it will become very apparent, as indeed it is increasingly becoming apparent, to the Chinese financial authorities that intervention of the type that they had been doing has not been helpful to them. So, I think in their own interest that is going to change, and I think that issue that you are concerned about will go away.

Senator STABENOW. Mr. Chairman, I hope you are correct, because in the short-run, certainly in my State, we are seeing what I believe to be unfair incentives on the exporting of American jobs. So, I am hopeful that you are accurate and correct on that.

Chairman SHELBY. Senator Sununu.

Senator SUNUNU. Thank you, Mr. Chairman.

I have a number of areas of capital market regulation that I mentioned in my opening statement, and I will probably submit a list, hopefully not too long of a list, for the record. But, Mr. Greenspan, I did want to ask you about a couple of items, one of which you have addressed before, one which you may have not.

First, we have had a series of hearings and discussion here in the Committee about market structure and market structure reform, and I would be curious to hear your assessment of what the impact on cost of capital, access of capital, or the efficiency of the capital markets would be of a modification or an elimination of the trade-through rule.

Chairman GREENSPAN. Senator, which rule?

Senator SUNUNU. The trade-through rule on the New York Stock Exchange.

Chairman GREENSPAN. This is a highly complex issue which, as you know, is being debated up in New York, and it is a problem concerning trading procedures on the New York Stock Exchange and the large institutional investors who are endeavoring to get the best type of execution they can get.

I have, as you pointed out, stayed out of this, largely because of rare good judgment on my part.

[Laughter.]

And I think I will probably endeavor to maintain that position.

I do think it is a very interesting issue. I am not certain that it is not being properly handled in the debate, and I think the right issues are on the table and the people who are involved I trust will come to the most reasonable solution.

Senator SUNUNU. Well, that is not a great deal of consolation to me, for a number of reasons, not least of all, you know, we have spent an hour here talking about PAYGO and housing prices and a whole list of Jim Bunning's pet peeves.

[Laughter.]

And this is obviously an issue that does, I think, have a direct impact on issues of capital market stability and access to capital and cost of capital and underlying economic performance.

Chairman GREENSPAN. Let me cut through it. I will be very straightforward in this respect. I do not think that we at the Fed know as much as the participants involved in the negotiations to have a firm opinion which we think should override those of the Exchange and some of the major players on the Exchange. We are in contact with them. I have spoken to both sides at considerable length, and I am learning something from them, but I do not think that I have—and I am not sure my colleagues have—a great deal to present with respect to this issue.

I would say that our real problem is we know where we would like it to all come out, namely, in a system which is stable, and has efficient execution. I am not sure we at the Fed know how to get there. If we did, I probably would find a way to communicate that to the parties involved.

Senator SUNUNU. This is not by design, but that does provide a nice segue to my second and final question, which is about hedge fund regulations. You have spoken out against further regulation of hedge funds in the past. There are obviously some proposed rules and modification to existing regulation that have been put on the table. Has your thinking on this issue changed in any way substantively over the last 6 or 12 months?

Chairman GREENSPAN. It has not, Senator. Let me just repeat why I think it is so important that these types of organizations are left free to supply the extent of liquidity that they are, in fact, supplying to our financial markets. I have made a special point in my prepared remarks and in earlier questions that the degree of flexibility in our economy has been instrumental in enabling us to absorb the shocks which have been so extraordinary in recent years. And one of the most flexible parts of our system is financial and our ability to absorb financial shocks.

If you start to inhibit the number of types of unregulated participants in the financial market from taking the types of risks and supplying the liquidity, I am fearful that we will remove some of the flexibility that we have in our overall system. I am certainly of the opinion that should hedge funds accept capital from retail investors, they should go under the same regulations as a mutual fund. But so long as their sources of equity funds are professional or large investors with net worths, say, exceeding $1 million or more, I see no purpose in regulation, and I see very significant potential loss in doing so.

Senator SUNUNU. Thank you very much, Mr. Chairman. I see the time has expired, and I appreciate your patience.

Chairman SHELBY. Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Thank you very much, Mr. Chairman. And, Chairman Greenspan, welcome.

You spoke earlier with great insights about productivity growth and its impact on the economy, but one of the things that is interesting and, indeed, troubling is that even with this rapid growth in productivity, we have not seen a rapid growth in labor compensation to the extent we have seen in other periods of expanding productivity, which leads me to the conclusion that the expansion is now driven more by debt than by income. People are buying things not from increased wages in their paycheck but credit cards, which is not sustainable over a longer period of time.

And I suspect there are some structural reasons for this, or let me just pose the question: Why is labor compensation not keeping up? Why is this expansion, as a result, a result of debt and credit cards rather than wages being devoted to consumption?

Chairman GREENSPAN. First of all, I think that as I indicated to Senator Dole, a very substantial part of the increase over the last year in productivity has ended up in increasing profit margins. But that seems to have come to an end as margins have gone from a very low level to a very high level and, historically, they have stabilized at this point. And there is evidence that that is occurring.

This will mean that productivity growth will feed into a fairly pronounced up-trend in real wages, and indeed, there is evidence that that is already in the process of occurring.

The amount of income that is now moving into consumer markets is becoming an ever important factor in consumption, and even though it is the case that credit card debt has moved up significantly, it is not large enough to be a serious concern, and indeed, the delinquencies and the defaults are not particularly large relative to what one ordinarily expects in that type of business. And, indeed, delinquencies generally have been exceptionally low across the board in the consumer area, especially, for example, in mortgage and in home equity loans.

So, I am not actually concerned at this point that we are looking at a really serious consumer debt problem, especially when one of the major factors in the growth of mortgage debt. In fact, 10 percent of the level of mortgage debt occurs: As a consequence of the fairly significant increase in the ratio of households who are homeowners, because if we had the 64-percent homeownership ratio that we had 10 years ago rather than the current 68, 69 percent, we would not have had a very significant number of renters buying homes, which has had two effects: One, it obviously increases the asset side of their balance sheet by the value of the home, but two, it increases almost to the same extent the liability side, which is mortgage debt. And as a consequence of that, what you have is a very significant part of the population which have gone from renter to homeowner, and in the process have statistically increased the amount of household debt, mortgage debt in this case, very substantially. But I would never argue that the renters by becoming homeowners had their financial situation significantly deteriorated.

So part of this ratio of debt-to-income is not evidence of deterioration in household finances. It is the case, however, that if we continue to get very significant increases in the ratio of household debt-to-income, the debt service charges obviously will be going up. And there is a conceivable point out there which I would consider worrisome. I just do not think that we are anywhere near there yet, and I doubt if we will get there.

Senator REED. Mr. Chairman, you suggest that the wages are improving a bit, yet in May, according to the Labor Department, real wages fell by about 0.4 percent. And according to the Economic Policy Institute, over the past year hourly wages are up about 2.2 percent, just about the rate of inflation.

Part of my question was the notion that there might be structural reasons here, the outsourcing of jobs, the threat of outsourcing putting pressure on the ability of employees to ask for money, decline of labor union participation, fewer and fewer workers are organized, they have, therefore, less ability to negotiate.

Are any of these factors structural factors that will mitigate increases in wages going forward?

Chairman GREENSPAN. I do not think that they are related to the average increase in wages. They are a problem on the distribution of wages. As I have pointed out many times in recent months, we are seeing, and probably are continuing to see even to this day, a continuing opening up of the wage spread between highly skilled and lesser skilled workers; and that this is in my judgment largely an educational problem that is confronting us, which I think has to be addressed. But the consequence is that the real wage below the median has been flat to declining, whereas in the upper quartile it has been rising. And that is largely reflected in skill differentials, but on average, what we are observing is now a fairly across-the-board increase industry-by-industry, as I indicated to Senator Dole, but I suspect that within industries, we are getting this more skilled/lesser skilled spread continuing.

So in that sense, it is a problem caused basically by our skill mix not keeping up with the technology that our capital stock requires. I guess that is a structural problem. But it is one that can be and must be addressed because I think that it is creating an increasing concentration of incomes in this country. And for a democratic society, that is not a very desirable thing to allow to happen.

Senator REED. Thank you, Mr. Chairman.

Chairman SHELBY. Senator Carper.

Senator CARPER. Chairman Shelby——

Chairman SHELBY. Senator Carper, if I could go vote, and I do not know how long the Majority Leader will indulge us here, but if you will go ahead and if no one comes back, then Senator Corzine. Will that be okay?

Senator CARPER. Yes, sir.

Chairman SHELBY. Thank you.

STATEMENT OF SENATOR THOMAS R. CARPER

Senator CARPER. Mr. Chairman, just a real quick question, and I will ask for a very brief response because I still have not voted either. But I want to ask this question. We are probably going to take up legislation on class action reform later this month, something that a number of us have pushed hard for for the last several years. And there will be a number of amendments offered to our class action bill. Some will be germane; some will be nongermane. One of the nongermane amendments that is likely to be offered to the bill is one dealing with an increase in the minimum wage, which you may recall has not been raised I think since 1997 at the Federal level. And I would appreciate it if you just take a minute or two and give us some things that we might want to keep in mind as we address that issue. I think there is a good likelihood that it will be raised, probably phased in over several years, I think it should be, but some things that we should keep in mind as we approach this decision.

Chairman GREENSPAN. I am the wrong person to ask, Senator, because I am one of probably a few people whom you talk to who does not think the minimum wage is a good idea to begin with. And the reason is I think it destroys jobs. I think it prevents people who are of the lesser skill and are trying to work their way up the ladder of skill, from working because they cannot earn the minimum wage. I think that is a mistake.

This is a very large and big debatable issue, and I think you are aware of both sides of the issue. So, I just want you to know I have nothing to suggest at this stage because I am not one of those who considers it a desirable policy.

Senator CARPER. Well, that was certainly a brief answer—not the one I expected, but a brief one. Thank you very much.

Senator Corzine.

STATEMENT OF SENATOR JON S. CORZINE

Senator CORZINE. Thank you, Senator Carper. It seems like we have control over here on the other side of the aisle for a change.

[Laughter.]

Maybe it is only temporary.

Let me recommend that I put a statement in the record. I apologize for not being here for your opening statement, Mr. Chairman.

In that statement, I give testimony to your tenure and efforts in leading us in one of the most important roles in our Nation, and I think our economy and our country is a lot better off because of your service, and I congratulate you on your nomination and I expect that I will be voting in the affirmative.

That said, I have some concerns that a number of my colleagues—I was watching some of the questions and responses. Many of these come down to definition of statistics. We seem to focus on macro statistics and GDP growth, and we talk about averages as opposed to means and distributions. I am particularly pleased to hear you talk about the differential that it is occurring between highly skilled and low-skilled workers. But it does cover a lot of impact for middle-class America, in particular. We hear and will hear, I suspect, during the campaign about the middle-class squeeze. And it has some merit. I think it actually ties to this underlying issue that you have identified, skilled versus lower-skilled workers.

Do you consider an auto worker at a Ford Motor plant in my home State who loses a job after 20 years a low-skill worker?

Chairman GREENSPAN. I think it is relative to the demands of the job structure itself. I would put it this way: The requirements for the level of skills increase year on year because, as we get ever more sophisticated capital stock, the skills that are required to staff that structure are going up, on average. And if a certain person, say, 20 years ago had a specific skill which at that point in time was a highly skilled job, but did not change at all over a 20-year period, it is conceivable that in today's environment that could be considered a medium- or even a lower-skill job, which is the reason why I have argued the necessity for continuing education throughout one's life. You cannot stop. We have to have means by which skills are continuously upgraded.

So the answer is, yes, it is possible that somebody who was high-skilled in an earlier period, did not lose any of those skills, could in a later context be designated as medium- or low-skilled.

Senator CORZINE. It might even be the pace at which they picked up those skills. They may even have trained themselves for an advancing economy, but not stayed with the pace.

I think that there is concern—I certainly have concern about the erosion of the industrial base in the context of this. And I think you see that in these low-real-wage increases, whether it is 2.2 percent or other measurements that show jobs lost versus the job that replaces it for those individuals being sharply lower. And I think that has ended up undermining the broad health that is covered by the term "averages." I do not know whether the number is 400 times or 500 times that corporate executives are receiving relative to lowest wage earners. There are different surveys and different statistics. But, quite obviously, if those numbers are very high and they are added together with those workers who are in these newly defined low-skill wages, we can have averages that are moving up and, in fact, broad swaths of our society are not where they are. I think this is one of the most important issues for us to debate. It does get to the long-term issue of education and retraining, which gets to the second element that I would like to talk about. That gets to having the ability for society to have the resources to be able to invest in education to help create that skill set as we go forward, whether it is investing in community colleges or it is investing in Pell grants that allow for many of those people who come from low-skill families to access higher education.

We have a serious budget problem in the country, and we are about to impose on ourselves or at least some think we are about to impose on ourselves PAYGO rules that work against spending but do not work against taxes. And I heard your response to Senator Schumer that you do not like answering hypotheticals. But this does not seem like a hypothetical. We have proposals on the table that would suggest that we must have PAYGO rules apply to spending and not with regard to making permanent tax cuts.

How are we going to be able to deal with these most important broad social issues that I think you have talked about, high-skill, low-skill workers, and still deal with what I think is appropriately identified? You said we are okay. You can live with current deficits maybe in the immediate horizon, but you talked about 2011. How can we do that when all of these permanent tax cuts come at a later time and we still have great social needs in this country?

Chairman GREENSPAN. Senator, I have indicated earlier in this testimony that I think because of the longer-term structural problems that are emerging in our budgets, we need new tools in order to make certain that we appropriately allocate our resources in a manner through the Federal budget in a way which we cannot do today. I have cited three sets of rules which I believe will be very helpful—I assume they may even be sufficient—which are a symmetrical PAYGO rule, discretionary caps, and triggers on both spending and on taxes.

I think that it was a mistake to allow the fairly effective PAYGO rules, in place in September 2002, to expire. And in my judgment it would be very wise to take that structure which existed back then and reenact it.

Senator CORZINE. If the logical extension of that is dealing with the permanent tax cuts, then that is the logical extension.

Chairman GREENSPAN. That is for the Congress to decide.

Senator CORZINE. But I am taking the logical extension.

Chairman GREENSPAN. Okay, fine.

Senator CORZINE. You do believe, though—and I just reiterate—that we have a very serious structural fiscal problem in the outyears as we evolve.

Chairman GREENSPAN. I do. As I have said on numerous occasions, Senator, I am most concerned because of our inability specifically to make a judgment of what resources will be required for Medicare in the next decade and beyond. Given the very large increase in retirees, because of the uncertainty, I think we have to be quite cautious because I am fearful we are on the edge of the possibility—I do not know what the probability is, but the possibility— that we are making promises in real terms to the next generation that we may not be able to fulfill.

Senator CORZINE. Just one quick follow-up, and then I will have used up more than my fair share of time. Was it by choice that you left out Social Security when you said that our future obligations that we are laying down are ones that—you have primarily focused—you did focus on Medicare as opposed to Social Security, and then we just saw a recent CBO analysis that makes us feel at least somewhat more comfortable with——

Chairman GREENSPAN. Social Security is a defined benefit program. There are ranges over which long-term estimates can occur, but relative to Medicare, they are extremely narrow.

As CBO indicates, as the Social Security trustees indicate, Social Security is currently long-term unstable and requires adjustments. The adjustments, however, are far clearer and the size of the problem is far easier to get our hands on because it is a defined benefit program than is the case with Medicare. So there are lots of ways of solving Social Security, and we are not doing any of them, I must say, because every time somebody raises a way to do it, that is unacceptable.

Social Security is far less of a problem than is Medicare. Medicare is the one that has the very large uncertainties associated with it. But even in the CBO report that came out yesterday, it has a range of probabilities for what the Social Security outlook is over the next 100 years, and it is a very wide range.

Senator CORZINE. Of course.

Chairman GREENSPAN. But it still——

Senator CORZINE. A soluble problem.

Chairman GREENSPAN. Yes, exactly.

Senator CORZINE. Thank you.

Thank you, Mr. Chairman.

STATEMENT OF SENATOR ROBERT F. BENNETT

Senator BENNETT. [Presiding.] Thank you very much.

Chairman Greenspan, I will be mercifully brief so you can get to lunch and the rest of us will as well. You said in your response to Senator Corzine that we cannot wait and we should be working on this long-term structural problem now. I felt we should be working on it when I came to Congress 10 years ago, and, unfortunately, we have not been able to do that.

I think we have a cautionary tale for us in what is happening in Europe. Is it not true that their problems are substantially greater than ours with respect to these two, retirement pay and medical for the aged?

Chairman GREENSPAN. I think that certainly the demographics in Europe are far more formidable a barrier to fiscal balance than in the United States. It varies by country, obviously. It is not the same everywhere. But I would say, in general, their problems are more difficult than ours, as you point out.

Senator BENNETT. Yes, that is my concern. One overall question—and, by the way, being unable to be here for an opening statement, let me just for the record thank you for your splendid service to the country, not only in your tenure as Chairman of the Federal Reserve but also your previous service in a variety of preparatory assignments. It is not everyone who is willing to give as much time to public service as you have, give as large a percentage of one's life to public service as you have. And the Nation should be very grateful, and expressions of appreciation are never too many. So let me add mine to those that you have received and make the record clear that I will vote for you with enthusiasm but, more importantly, with gratitude for the work that you have done.

Chairman GREENSPAN. Thank you very much, Senator.

Senator BENNETT. Isn't it true—well, that is not the way to start it. That is the way lawyers start. I am not a lawyer.

It is my conviction that the next President, whoever he may be, will enter office at a time of extremely strong economic growth and very robust—it will be almost too late speaking of it in terms of a recovery, because I think it will happen throughout all of 2004. I would like your reflections on that, if I am overly optimistic or if you think there are some soft spots we should worry about. But as I look forward, whoever the next President might be, he will be fortunate enough to take office at a time of extremely strong economic performance.

Chairman GREENSPAN. I think that is right, Senator. The reason I hesitate is that forecasting even 6 months out is slightly precarious. But as I indicated in a presentation I made last week, there is something about this recovery which does not have underlying destabilizing momentum, in other words, of going too fast. And the way we know that is that, despite the fact that capital investment has been rising fairly appreciably, it has fallen behind the very significant rise in cashflow. And it is very rare in a recovery that you will find that capital investment at this stage of the recovery is not running well ahead of cashflow and that borrowing requirements accordingly are very significant.

That is not the case today. The corporate bond markets are very slow. Indeed, in the month of May, the last time we had data, actual net bond issuance—that is, gross issuance minus retirements—was negative. So that is yet another shoe to drop in the expansion, if I may put it that way, which is an increasing sense of confidence in the business community to start moving up capital investment to still higher levels. And that is the reason why I think that this particular recovery has some momentum in it and does not look to be short-lived.

Obviously, numbers of things can happen adversely, the oil price or any of a number of destabilizing events. But right now I tend to be fairly much in the same camp that you are with respect to the outlook.

Senator BENNETT. Thank you very much.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Chairman, I have a number of questions for the record, but I will submit those for the record, a couple of things, and maybe we can go into the early afternoon—get out of here, in other words.

Mr. Chairman, you have previously testified before this Committee about your concerns on the unrestrained growth of debt by the GSE's. With the current rise of long-term interest rates and the possibility of the Federal Reserve raising short-term rates within the year, the housing market has seen a dramatic fall in mortgage refinancing. What effect, if any, would a potential slowdown of the housing market and asset-backed securities industry have on the current health of Freddie Mac and Fannie Mae? Does that concern you at all?

Chairman GREENSPAN. No, that doesn't, in the sense that I have no problem with the way they manage their structure, both their portfolio and the securitization parts of their business. I think it is rather well done. They do a fairly impressive job.

My concern is the issue which I raised before this Committee previously namely, the subsidy. The size of the subsidy is debatable, but I am sure there is one. The subsidy creates the problem of expanding assets, mortgage assets—or, indeed, any set of assets—in a way which could become destabilizing if it continues on very much beyond where they are, because they have become very large financial institutions, and because of the subsidy, they do not have the automatic market adjustment forces constraining their growth.

Now, to be sure, they have slowed their rate of growth fairly recently, and I trust that is the beginning of a conscious trend to slow things down. But if you have a subsidy, the initiation of which is wholly up to you—remember, this is not a subsidy that the Congress has given them. It is the market's perception that in the event of a serious problem, the U.S. Government will bail them out and that, therefore, the debentures should sell close to U.S. Treasuries. But there is no limit to how far that debt can expand because it is up to the companies, Fannie and Freddie, to determine how much. That is what concerns me.

Chairman SHELBY. Mr. Chairman, I do not have the exact figures before me now, but if you put Freddie Mac and Fannie Mae's debt together, they are way up there. They are approaching the public debt of the country, are they not?

Chairman GREENSPAN. Indeed they are.

Chairman SHELBY. And that has to be——

Chairman GREENSPAN. And in certain of the measures, they exceed it.

Chairman SHELBY. Yes. Thank you.

Mr. Chairman, under your tenure at the Fed, what particular changes have been made in the system as an institution that you think were the most significant?

Chairman GREENSPAN. You mean changes in the Federal Reserve System?

Chairman SHELBY. Yes, sir, while you have been there. As you reflect back.

Chairman GREENSPAN. Yes. It is a very interesting question because you tend not to think in those terms. You are usually thinking above what have we done recently.

I think that our technique of evaluating how the economy is functioning and our ability to understand how markets are operating and, most specifically, how we interface with the rest of the world are new initiatives in the last decade or so, in fact, being driven by the world economy, essentially.

In response, we have built up technical capabilities that enable us to evaluate these things far better than I think we were able to earlier on.

Technology has created a major improvement in the payment system in the United States and, indeed, in the world, and our interface with that payment system and our oversight of it has increased very significantly. And looking back at the overall efficiency of the American financial system and the extent where we, at the Fed, have been helpful along the way I think has been very important from our point of view.

Then as Senator Sarbanes indicated very early on, we have also found that we interface with the markets better as we disclose more. There are limits to how far we can go. If we were to televise our FOMC meetings, I think we would find that disclosure became absolute, but our efficiency would not. So we have to trade off the ability of knowing how best we can manage our deliberations to fulfill the Congress' mandate, and I think we are gradually moving in that direction. I think we have a way to go. We are not there yet. But we have come a good way on the issue of getting optimum transparency.

Chairman SHELBY. What particular reforms or measures are you interested in achieving during your fifth term as Chairman? If you are at liberty to talk about it now. Maybe you are not. What would you like to do?

Chairman GREENSPAN. The major focus that we are involved with is, as I have indicated earlier, the elimination of the increasingly unnecessary level of accommodation in monetary policy in order to restore financial balance in a manner which essentially leaves the American economy and financial system in a degree of stability. We seem to be on track, but as we duffer golfers like to say, it is not a gimme putt.

Chairman SHELBY. Sure. Mr. Chairman, we appreciate your patience here today, your appearance. We will move your nomination as expeditiously as possible, you can be assured. Thank you very much.

Chairman GREENSPAN. I thank you very much, Mr. Chairman.

Chairman SHELBY. This hearing is adjourned.

[Whereupon, at 1:16 p.m., the hearing was adjourned.]

[Prepared statement, biographical sketch of the nominee, response to written questions, and additional material supplied for the record follows:]

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: Greenspan (Last) Alan (First) (nmn) (Other)

Position to which nominated: Chairman of the Board of Governors of the Federal Reserve System

Date of nomination:

Date of birth: 06 (Day) 03 (Month) 1926 (Year)

Place of birth: Bronx, NY

Marital Status: married

Full name of spouse: Andrea Mitchell

Name and ages of children: none

Education:

Institution	Dates attended	Degrees received	Dates of degrees
George Washington HS	1940-43	diploma	
New York University	1945-48	B.S.	1948
New York University	1948-50	M.S.	1950
New York University	1977	Ph.D.	1977

Honors and awards:

List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships and any other special recognitions for outstanding service or chievement.

see page S-1 attached

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates

see pages S-2 and S-3 attached

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and inclusive dates of employment.

see page S-4 attached

Government experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part time service or positions.

see page S-5 attached

Published Writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

For list of representative articles written since 1980, see page S-6 attached

Political Affiliations and activities: List memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

none

Political Contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify specific amounts, dates, and names of recipients.

none

Qualifications: State fully your qualifications to serve in the position to which you have been named. (attach sheet)

see page S-7 attached

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

no

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

no

3. Has anybody made you a commitment to a job after you leave government?

no

4. Do you expect to serve the full term for which you have been appointed?

By law, my term as a governor of the Federal Reserve Board, a prerequisite of being Chairman, expires January 31, 2006.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

none

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

none

3. Describe any business relationship, dealing or financial transaction (other than tax paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

none

4. List any lobbying activity during the past ten years in which you have engaged in for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

none

5. Explain how you will resolve any conflict of interest that may be disclosed by your responses to the items above.

none

Civil, criminal and investigatory actions:

1. Give the full derails of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

none

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

none

HONORS AND AWARDS:

Gerald R. Ford Medal for Distinguished Public Service, 2003

Knight Commander of the British Empire, 2002

decorated Legion of Honor (Commander) france, 2000

Harvard University, Doctor of Laws (honorary), 1999

Yale University, Doctor of Humane Letters (honorary), 1999

University of Pennsylvania, Doctor *Honoris Causa* (honorary), 1998

Catholic University of Leuven (Belgium), Doctor Honoris *Causa* (honorary), 1997

University of Notre Dame, Doctor of Laws (honorary), 1995

Wake Forest University, Doctor of Laws (honorary, 1989

Colgate University, Doctor of Humane Letters (honorary, 1987

Hofstra University, Doctor of Humane Letters (honorary), 1984

Pace University, Doctor of Commercial Science (honorary), 1981

Fellow of the American Statistical Association, 1989

Thomas Jefferson Award for the Greatest Public Service Performed by an elected or appointed official, presented by the American Institute for Public Service, 1976

MEMBERSHIPS:

Organization	Office held (if any)	Dates
Gerald R. Ford Foundation	Board of Trustees	1981-1987
The Economic Club of NY	Vice Chairman, Board of Trustees	1984-1987
Council on Foreign Relations	Board of Directors Member	1982-1987 1987-present
Committee For a Responsible Federal Budget	Director	1981-1987
Institute For International Economics	Board of Directors	1981-1987
Hoover Institution	Board of Overseers	1973-1974 1977-1987
The Ronald Reagan Presidential Foundation	Board of Governors	1986-1987
The Trilateral Commission	Member, Executive Committee	1982-1987
Century Country Club Purchase, NY	Member	1979-2001
Hillcrest Country Club Los Angeles, CA	Nonresident Member	1975-present
City Midday Club New York, NY	Member	1983-1987
Harmonie Club	Member Nonresident Member	1971-1987 1987-present
The University Club New York, NY	Member	1979-1989

Conference of Business Economists	Member Past Chairman	1963-present 1974
National Association of Business Economists	Member, Fellow Past President	Early 60s-present 1969-1970
National Economists Club Washington, DC	Member Past Director	1969-present
Brookings Panel on Economic Activity Washington, DC	Senior Adviser	1970-1974 1977-1987
Chevy Chase Club Chevy Chase, MD	Resident guest Resident member	1991-1996 1996-present

EMPLOYMENT RECORD:

Research Associate, National Industrial Conference Board, New York, NY, 1948-53

Economic consultant, Townsend-Greenspan & Co., Inc., New York, NY, 1953-54; Chairman and President 1954-74, 1977-87; Chairman only June 1987-July 31, 1987

Chairman, Council of Economic Advisers, Washington, DC, 1974-77

Chairman, Board of Governors of the Federal Reserve System, Washington, DC, 1987-present

Director	Trans World Financial Co., Los Angeles, 1962-1974
Director	Dreyfus Fund, New York, 1970-1974
Director	Dreyfus Special Income Fund, New York, 1971-1974
Director	General Cable Corp., New York, 1973-1974, 1977-1978
Director	Sun Chemical Corp., New York, 1973-1974
Director	Dreyfus Liquid Assets, Inc., New York, 1973-1974
Director	Standard & Poor's InterCapital Income Securities, Inc., 1973-1974
Director	Bowery Savings Bank, New York, 1974
Director	General Foods Corp., White Plains, 1977-1985
Director	J.P. Morgan & Co., Inc., New York, 1977-1987
Director	Morgan Guaranty Trust Company of New York, New York 1977-1987
Director	Mobil Corporation, New York, 1977-1987
Director	Aluminum Company of America, Pittsburgh, 1978-1987
Director	Automatic Data Processing, Inc., Roseland, NJ, 1980-1987
Director	Capital Cities/ABC, Inc., NY -- (ABC) 1984-1986, (CC/ABC) 1986-1987
Director	The Pittston Company, Greenwich, CT, 1985-1987
Director	The Rand Corporation, Los Angeles, 1986-1987
Member	Board of Economists -- Time Magazine, New York, 1971-1974, 1977-1987

GOVERNMENT EXPERIENCE:

1969	Member, Task Force on Economic Growth
1969-70	Member, Commission on an All-Volunteer Armed Force
1970-71	Member, Commission of Financial Structure and Regulation
1977-87	Consultant, Congressional Budget Office
1981-83	Chairman, National Commission on Social Security Reform
1981-87	Member, President Reagan's Economic Policy Advisory Board
1983-85	Member, President's Foreign Intelligence Advisory Board

PUBLISHED WRITINGS:

"The Great Malaise," Challenge (March/April 1980) pp. 37-40.

"Economic Policy," in Peter Duignan and Alvin Rabushka, eds., The United States in the 1980s (Board of Trustees of the Leland Stanford Junior University, 1980).

"Weekly GNP," Roundtable of GNP Users, Studies in Income and Wealth, No. 47 (University of Chicago Press, 1982).

"Competition Means Better Service," At Home With Consumer [The Direct Selling Education Foundation, volume 5, number 3 (September 1984)].

"Risk, Safety and Bank Deregulation," The Sears Sounding Board (Sears Financial Network, 1985).

The Wall Street Journal (New York):

"Can the U.S. Return to a Gold Standard?", September 1, 1981.

"The Collapsing World of OPEC," March 11, 1983.

"Onward The Revolution in Financial Services," September 16, 1983.

"Payment Setup Can't Ensure Medicare's Fit," September 4, 1984.

"Takeovers Rooted in Fear," September 27, 1985.

"Coordination Could Be Washed Out," July 10, 1986.

The Washington Post, "Alan Greenspan:," December 4, 1983.

QUALIFICATIONS:

I have been an economist for more than a half-century, first as an analyst, and later as a consultant. My work has covered both industrial and financial sectors of the United States and, to an increasing extent, the rest of the world. I have considerable knowledge of American financial structure (I served on the President's Commission on Financial Structure and Regulation, 1971) and monetary theory. I have served on the boards of directors of a savings and loan holding company (Trans-World Financial, 1962-1974) and a bank holding company (J.P. Morgan, 1977 to 1987). My service as Chairman of the Council of Economic Advisers (1974-1977) offered opportunities to broaden my experience beyond the private sector. Finally, I have served as Chairman of the Board of Governors of the Federal Reserve System since August 1987.

RESPONSE TO A WRITTEN QUESTION OF SENATOR SARBANES FROM ALAN GREENSPAN

Q.1. The Federal Reserve recently issued for public comment proposed regulatory revisions to address concerns about bounced check protection programs. Rather than specify disclosures as required for all other extensions of credit by the Truth-in-Lending Act (TILA) and Regulation Z, the Board instead proposes to make changes to Regulation DD which implements the Truth-in-Savings Act. It is my understanding that the Board has referred to bounce protection loans as credit. In your letter to me explaining your reasons, you stated you exempted these programs from TILA, despite the fact that they are credit. The Board's action appears inconsistent with statutory requirements for exempting credit transactions from TILA coverage. Section 105 of TILA appears to require the Board to go through an analysis before exempting credit transactions from coverage. Please explain why the Board did not undertake the evaluation outlined in subsections (a) and (f) of Section 105 before issuing proposed regulations that implicitly exempt such bounced transactions from TILA.

A.1. In recent years, some institutions have begun to market courtesy overdraft protection by disclosing the dollar limit that consumers may be allowed to overdraw their account if it is in good standing. Under these programs, when an institution pays an overdraft, a fee is imposed and the consumer is informed that the overdraft must be covered within a specified period, typically 5 to 30 days. You have asked for an explanation of how such transactions are exempt from Truth-in-Lending Act (TILA) coverage if they constitute credit.

The Board's Regulation Z, which was originally issued in 1969, has never covered overdrafts on a deposit account when the institution has not previously agreed, in writing, to pay such items. Accordingly, banks' historical payment of overdrafts on an ad hoc basis has been exempt from TILA's coverage, while traditional overdraft lines of credit, which are generally subject to a written agreement, have been covered under TILA.

Regulation Z applies only to a consumer credit transaction that is subject to a finance charge, or is payable by written agreement in more than four installments. In adopting Regulation Z in 1969, the Board determined that fees imposed by a financial institution for paying items that overdraw an account should not be deemed "finance charges," unless the payment of such items and the imposition of the charge were previously agreed upon in writing. The Board's determination that such fees should not be disclosed as "finance charges" under TILA is consistent with the Board's general rulemaking authority under Section 105 of the statute. The Board's classification of overdraft fees under Regulation Z was designed to facilitate depository institutions' ability to accommodate consumers on an ad hoc basis.

Although some depository institutions market courtesy overdraft protection as a feature of their deposit accounts, these institutions generally reserve the right to exercise discretion and to not pay any particular overdraft. Because there is no written credit agreement to cover overdrafts, the fees imposed are excluded from the finance charge that would be disclosed under Regulation Z (*see* 12 CFR

§ 226.4(c)(3)). Institutions' overdraft protection programs generally do not provide for repayment in installments. Accordingly, these overdraft protection programs typically are not covered by Regulation Z.

On May 28, the Board issued for public comment proposed revisions to Regulation DD, which implements the Truth-in-Savings Act, to address concerns about disclosures for overdrawn accounts generally and, in particular, concerns about overdraft protection services. The proposed improvements in the disclosures provided to consumers under the Truth-in-Savings Act are intended to aid consumers in understanding the costs associated with overdrawing their accounts, and promote better account management. The Board's issuance of proposed revisions to Regulation DD did not entail any determination to issue an exemption under Section 105 of TILA. The proposal does recognize, however, that fees imposed in connection with overdraft protection services that do not involve written agreements have never been considered finance charges, and thus have never been subject to disclosure under Regulation Z. Accordingly, the Board's proposal under Regulation DD represents a decision not to amend Regulation Z to cover these transactions, although the Board also expressly noted that further consideration of the need for such coverage may be appropriate if concerns about these programs persist.

RESPONSE TO A WRITTEN QUESTION OF SENATOR CARPER AND SENATOR MILLER FROM ALAN GREENSPAN

Q.1. Chairman Greenspan, you last appeared before the Senate Banking Committee on April 20 to discuss the "Condition of the Banking Industry." During that hearing you entered into a discussion with Senator Carper regarding the dual banking system and you said . . . "The dual banking system is a very unusual competitive structure for regulation, and it has served us well, and I am concerned that however we develop issues in the years ahead, that we be careful to be certain that we maintain the appropriate balance of regulation between State and Federal agencies."

It has also been reported to us that you have recently said that you believe that there is an imbalance in the dual chartering system right now particularly for larger multistate operators. This issue is a concern for several institutions in our States as well as our State banking commissioners.

Do you think there is an imbalance between the charters currently? Can you clarify for us what your concern is? What should be done?

A.1. Under our "dual" banking system, banks may elect to be chartered by either the States or the Federal Government (acting through the Office of the Comptroller of the Currency). Congress historically has sought to maintain a competitive dual banking system, that is one in which both national and State-chartered banks may compete effectively. Over time, a healthy dual banking system promotes diversity, flexibility, and inventiveness in the banking system. For these reasons, the Board has long supported the dual banking system and efforts to ensure the viability of both the State bank and national bank charters.

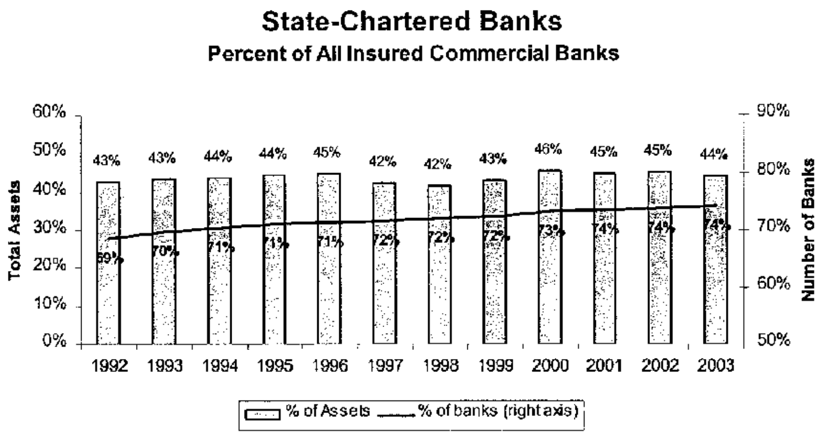
For many years, there has been a rough equilibrium in the banking system between State-chartered and nationally chartered institutions as measured by both the percentage of banks that are State chartered and the percentage of banking assets controlled by State-chartered banks. As reflected in Table A, the percentage of insured commercial banks that are State-chartered fluctuated only slightly between 1992 and 2003, rising from 69 percent in 1992 to 74 percent in 2003. Moreover, the percentage of banking assets held by State-chartered banks also remained relatively constant over this time period.

Recently, a number of State-chartered banks have converted, or have announced their intention to convert, to a national charter. As a result, the percentage of banking assets held by all State-chartered banks is forecast to decline from 44 percent to 33 percent and the percentage of banking assets held by State member banks, which are directly supervised by the Federal Reserve, would decline from 25 percent to approximately 15 percent.

Although this projected shift in assets controlled by State banks is significant and larger than seen in some time, it is too early to tell whether it reflects a temporary anomaly or an underlying imbalance between State and Federal charters that should be of concern to the Congress. Regarding the implications of these changes for supervision, the Federal Reserve has adapted and refined its supervisory programs and practices regarding bank and financial holding companies in response to changes in the financial industry and the statutory requirements established by the Congress. The Board believes that the Federal Reserve should continue to play a meaningful role in the supervision of banking organizations to assist in fulfilling its broader responsibilities for conducting monetary policy and managing and containing risk within the financial system.

At this point, we do not believe that the recent developments have hampered the Federal Reserve's ability to maintain a "hands-on" role in the supervision of large banking organizations through our role as umbrella or consolidated supervisor of bank holding companies, financial holding companies, and the U.S. operations of foreign banks. Looking ahead, if these developments adversely affect the Federal Reserve's window into the banking system over time, the Board will bring the matter to the attention of the Congress to ensure that it retains the authority and access necessary to carry out the full range of its central bank responsibilities.

Table A


State-Chartered Banks
Percent of All Insured Commercial Banks
60%
50%
40%
30%
20%
10%
0%
Total Assets
90%
80%
70%
60%
50%
Number of Banks
43%
43%
44%
44%
45%
42%
42%
43%
46%
45%
45%
44%
69%
70%
71%
71%
71%
72%
72%
72%
73%
74%
74%
74%
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
% of Assets
% of banks (right axis)