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FEDERAL RESERVE'S FIRST MONETARY POLICY REPORT FOR 2001

HEARING
before the
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS
FIRST SESSION

ON

OVERSIGHT ON THE MONETARY POLICY REPORT TO CONGRESS
PURSUANT TO THE FULL EMPLOYMENT
AND BALANCED GROWTH ACT OF 1978

WASHINGTON, DC

FEBRUARY 13, 2001

Senater Allard. I think if you have a couple of questions, I think that is acceptable.
Senator Carper.

OPENING STATEMENT OF SENATOR THOMAS R. CARPER

Senator Carper. Thank you, Mr. Chairman.

Chairman Greenspan, as we come to the end of this hearing, first of all, let me just thank you for being here today, for your testimony again.

And maybe more important, thank you for your service to the people of our country.

One of the values for me of a hearing of this nature is to find some areas where we agree on some things. And I just want to kind of go back over what I have gleaned from your testimony today and see if I have gotten it right.

One of the things that I have understood you to say is that the direction of our Nation's debt and turning deficits into surpluses is something that has been a real positive for economic growth in this country.

I understand you to say that economic growth in this country has slowed, but it has not tanked.

And I think, to quote you, you said that the central tendency for real gross domestic product growth over the four quarters of this year is 2 to 2 ½ percent.

I can remember a time not long ago when 2 to 2 ½ percent GDP growth was actually considered pretty darn good.

I have gleaned from your testimony that productivity growth continues, albeit, at a somewhat slower rate than it did over the last several years.

And that the long-term prospects for economic growth over the next decade or so are actually quite encouraging.

I have sensed from your testimony today that you believe inflation remains at bay. And while we always want to be cognizant of it, mindful of it, it is not now an imminent threat to our economy.

I understand from your testimony today that the surplus forecasts, while they are robust in the years to come, are not always written in stone. And I think you mentioned at one point that the difference between what was forecast for deficits in 1995 and what we actually realized in surpluses in 2000, I think, the swing was about $500 billion.

Chairman Greenspan. That is what I commented on at the Budget Committee, that is correct.

Senator Carper. Okay. And I think I have understood you to say that, given the fact that we have some extra money on the table, extra revenues on the table, that one of the good ways to make sure that we spend money prudently, which is left for spending, is to return some of it to the taxpayers of this country.

Those are very helpful things for us to know, as we in this Committee and the Congress and the President attempt to fashion a budget, a fiscal policy for our country, budget policy for our country, and adopt changes in taxes.

Where we don't agree is in the following area.

If you could give me a little bit of further guidance on this, it would be helpful.

First of all, if real GDP growth for the year actually turns out to be 2 or 2 ½ percent, the issue of whether or not we need to cut takes at this point in time in order to stimulate the economy, or whether or not the Fed, the Federal Open Market Committee, is perfectly capable of using monetary policy, interest rate cuts, to help us ease through this slowdown and to return to a stronger growth, that is the question before us.

And we are going to go from here, and the Democrats, we are going to meet over lunch and try to figure out which way to go.

There is some who say, no, that is not appropriate. Let's let the monetary policy work and make tax cuts phase in a bit further down the line.

Any help you can give us on that point?

Chairman Greenspan. Well, Senator, the position I have taken, on the basis of the experiences I have had over the years, is that recessions, when they occur, tend more often than not to be over reasonably quickly, and that the timeframe for enacting tax legislation almost invariably is longer than that. But there are some cases in which, when recessions take hold, they extend themselves. They sit there for a while and are more prolonged than you anticipate. Under that condition, which I submit is a relatively low probability, a tax cut having been in place for a period of time is a good rather than bad.

So what it is, as I indicated before, is it is an insurance policy. It is basically doing something against a relatively low probability outcome- that is, the protracted nature of a recession. And the usefulness of that will basically depend on what is the size of the tax cut, where it is located, and what the economic outlook is.

I haven't raised that as a crucial issue because I think that the particular point that I was raising as to why I believe tax cuts are important, is to address this technical problem with respect to the accumulation of assets in the Federal government. So my argument is really quite independent of the issue of economic stimulus, though I recognize that it has certain obvious relationships to it.

Senator Carper. Thank you. My only other question is this.

In my little State of Delaware, we cut taxes 7 years in a row during my time as Governor, sometimes rates at the top, sometimes rates at the bottom, sometimes in between. We cut taxes for businesses and individuals.

We had a four-part litmus test for tax cuts that we adopted.

One of the things that we are wrestling with within our own caucus, and I presume my Republican friends are as well, is a set of core principles on which tax cuts should be based.

If you will, a litmus test.

The four that we used in my State were the following:

One, the cuts should be fair; Two, they should promote or enhance economic growth; Three, to the extent that they can, we should simplify the Tax Code, not make it more complex; And the fourth is that the cuts should be consistent with the balanced budget and sustainable throughout the full business cycle.

But those four things- fairness, promoting econominc growth, simplicity, and sustainability throughout the full business cycle and consistent with a balanced budget.

Really, the litmus test that we used.

Can you just give us a little guidance, I know my time is expired, but just a little guidance on the kind of principles, whether Democrats or Republicans, that our tax cut policy should be based on?

Chairman Greenspan. Well, I think in a very interesting way, it depends on where one starts.

Going back from, say, the purview of 1995, for example, with what appeared at that point to be about a 1 ½ percent trend growth rate in productivity, it appeared as though the level of taxation was essentially consistent with a balanced budget over the longer run at full employment.

And what has happened is that productivity growth has accelerated quite significantly, and so, the existing set of tax rates has engendered a very much more rapid rise in revenues. As I said at the Senate Budget Committee, that productivity over the past 5 to 7 years has risen at about a 3-percent rate, which is twice what it had been previously, and revenues have gone up 2 ½ times, the difference being that the rise in the productivity has elevated earnings, expectations, and created a permanent, higher level of asset values, which spilled over into tax liabilities when realized gains were involved, or even when they weren't.

And so that what you have got at this point is, as a consequence of the acceleration in productivity, a much higher rate of receipts than one had anticipated. And so, I think the Congress is confronted with the choice of whether in fact you give back what in retrospect turned out to be an unintended excessive level of receipts, or whether those are employed for other purposes these are the key judgments which I think in this particular debate are critical, and these are political judgments. These are judgments which only the Congress can make.

Senator Carper. Thank you so much.