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NATIONAL ECONOMIC OUTLOOK

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BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

FIRST SESSION

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NATIONAL ECONOMIC OUTLOOK

THURSDAY, JANUARY 30, 1997

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:20 a.m., in room SD–215, Dirksen Senate Office Building, Hon. William V. Roth, Jr. (chairman of the committee) presiding.

Also present: Senators Chafee, Grassley, Nickles, Jeffords, Mack, Moynihan, Rockefeller, Conrad, Moseley-Braun, Graham, Bryan, and Kerrey.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The committee will please come to order. I thought, in the interest of conserving time, we would have the Ranking Member and myself make our opening statements, as brief as I hope they will be. But we do have to take a vote on the confirmation of the USTR as the first order of business, so we will break in whenever we have the necessary quorum.

But, first, let me indeed welcome our Chairman of the Federal Reserve. I think you are serving in your tenth year at the helm of the Federal Reserve, and certainly you are not only widely respected on Wall Street and Main Street, but most importantly on both ends of Pennsylvania Avenue.

Clearly, your views on the national economic outlook are particularly important to our committee, given our jurisdiction over all major entitlement and tax policies. I am not going to read my entire statement. I would ask that it be included as read.

[The prepared statement of Chairman Roth appears in the appendix.]

The CHAIRMAN. But I would like to point out that earlier this week the Wall Street Journal detailed the importance of accurate economic statistics as policy makers such as yourself and the members of the Congress work toward a better economy.

And, as you know, Dr. Michael Boskin and his commissioners studying the accuracy of the consumer price index have found that this important statistic has overstated the rate of inflation by about 1.1 percentage points. So, Mr. Chairman, we are, indeed, looking forward to your comments on his findings.

I might say that the recent news reports have also suggested that some other important economic statistics may not be as accurate as possible: productivity numbers, trade numbers, wage growth, increased debt, to name a few. Clearly, this is, indeed, troubling.

Mr. Chairman, we are looking forward to your testimony. I understand that you will be emphasizing CPI and the problems with that, but that you will be open to questions in the many other areas in which this committee is interested.

So at this time I would like to call upon my distinguished colleague, Senator Moynihan.

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. Thank you, Mr. Chairman. Welcome to Dr. Greenspan. It is a notable event, Mr. Chairman, that you began this week with testimony from the full membership of the Boskin Commission on CPI. One of the members, Robert Gordon of Northwestern University, wrote in 1981 that it is probably the most cited statistic in the world and so much derives from it, including a number of the things that you mentioned, productivity, wage growth, and such.

Now, for the most distinguished Chairman of the Federal Reserve of this age to come before this committee and devote the whole of his written prepared testimony to this subject suggests that the time is at hand. We have a rare moment. Dr. Greenspan suggests that, as a proxy for a cost of living index, the CPI overstates the increase in the cost of living by between a half a percentage point a year and 1.5 percentage points a year. That is very close to the estimate of the Boskin Commission.

Commentators on the commission report at the economic meetings in New Orleans this year thought that the Boskin Commission estimate of the overstatement was too low, but said it is in a perfectly legitimate range. What is at issue here if we were to make this correction, if we fail to do, it would cost the Treasury $1 trillion in the next 12 years.

If we do it, we can move out of this protracted fiscal crisis that is so draining to the country. We can establish Social Security on actuarially sound basis, just with that one event. We will start getting our numbers in order.

The issue is not really whether you raise revenue or lose revenue, the issue is trying to get the numbers right. That is what you have spent your life doing, and we are immensely pleased that you are going to address this subject and we look forward to your testimony.

The CHAIRMAN. We will pause for a moment. We have, I think, nine. We need 11 to vote on the confirmation.

Yes, Senator Nickles.

Senator NICKLES. I would just ask the committee members, and also to accommodate Dr. Greenspan's schedule, would it be possible for us to maybe have a rolling quorum? Can we do this and vote when we arrive?

The CHAIRMAN. Well, I think we will have a real quorum here. We have a question of a waiver as well. I think it would be best.

Senator MOYNIHAN. Does the Open Market Committee have problems like this? [Laughter.]

The CHAIRMAN. And if so, what do you do about it? [Laughter.]
The CHAIRMAN. Find them.

Senator CHAFEE. The most indefinite statement in Washington is, he is on his way.

The CHAIRMAN. It is in the mail.

[Whereupon, at 10:27 a.m., the hearing was recessed.]

[After recess.]

The CHAIRMAN. I apologize to you, our most distinguished Chairman, for this delay, but you know better than anyone how we perform here in the Congress. We are looking forward very much to your remarks. Please proceed.

STATEMENT OF HON. ALAN GREENSPAN, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM, WASHINGTON, DC

Chairman GREENSPAN. Thank you very much, Mr. Chairman. I very much appreciate your kind opening remarks, as well as those of the Ranking Member. Mr. Chairman and members of the committee, I very much appreciate the opportunity to appear before you today.

The committee is faced with a number of complex policy issues that will have an important bearing on the fiscal health of the Nation and the welfare of our people well into the next century. I will be happy to respond to questions relating to any of those issues, but in my formal comments this morning, as Senator Moynihan indicated, I intend to focus on the accuracy of the consumer price index.

I would like to begin by commending this committee for having done so much to bring the issue of possible bias in the CPI to the attention of the Congress and of the Nation in general. The hearings conducted by this committee in 1995, as well as the report produced by the advisory commission that was sponsored by this committee, have advanced the discussion considerably.

These efforts, along with the continuing contributions of the Bureau of Labor Statistics research staff, have added importantly to our understanding of the sources of measurement error in the CPI.

Any index that endeavors to measure the cost of living should aim to be unbiased. That is, a serious examination of all available evidence should yield the conclusion that there is just as great a chance that the index understates the rate of growth of the target concept as there is that it overstates the truth.

The present-day consumer price index does not meet this standard, in my judgment. In fact, the best available evidence suggests that there is virtually no chance that the CPI, as currently published, understates the rate of growth of the appropriate concept.

In other words, there is almost a 100 percent probability that we are overcompensating the average social security recipient for increases in the cost of living and almost 100 percent probability that we are causing the inflation-adjusted burden of the income tax system to decline more rapidly than I presume that Congress intends.

A major reason for this is that consumers respond to changes in relative prices by changing the composition of their actual market basket. At present, however, the market basket used in constructing the CPI changes only once every decade or so. Moreover, new goods and services deliver value to consumers even at the relatively elevated prices that often prevail early in their life cycle; currently, that value is not reflected in the CPI.

For that and other reasons outlined in the Boskin Commission report and other studies, we know with near certainty that the current CPI is off. We do not know precisely by how much, however. There is, nonetheless, a very high probability that the upward bias ranges between a half a percentage point a year, and 1.5 percentage points a year.

Although this range happens to coincide with the one I gave 2 years ago at this committee, it does reflect both the improvements in the index that the BLS has implemented since then, and the emergence of evidence suggesting that the initial problem was of a slightly greater dimension than had previously been estimated. This estimate is consistent with a number of microstatistical studies, as well as an independently derived macroevaluation by the staff at the Federal Reserve Board, which I will discuss shortly.

In judging these evaluations, it is incumbent upon us to resist the evident strong inclination to believe that precision is the equivalent of accuracy in price bias estimation. If we cannot find a precise estimate for a certain bias, we should not implicitly choose zero, as though that was a more scientifically supportable estimate. There is no sharp dividing line between a pristine estimate of a price and one that is not. All of the estimates in the CPI are approximations, in some cases, very rough approximations.

Further, even very rough approximations can give us a far better judgment of the cost of living than holding to a false precision of accuracy. We would be far better served following the wise admonition of John Maynard Keynes that, "It is better to be roughly right than precisely wrong."

Estimates of the magnitude of the bias in our price measures are available from a number of sources. Most have been developed from detailed examinations of the microstatistical evidence. However, recent work by staff economists at the Federal Reserve Board has added strong corroborating evidence of price mismeasurement using a macroeconomic approach that is essentially independent of the exercises performed by other researchers, including those of the Boskin Commission.

In particular, employing the statistical system from which the Commerce Department estimates the national income and product accounts, the research finds that measured real output and productivity in the service sector are implausibly weak, given that the return to owners of businesses in that sector apparently has been well-maintained.

Taken at face value, the published data indicate that the level of output per hour in a number of service-producing industries has been falling for more than two decades. In other words, the data imply that firms in these industries have been becoming less and less efficient for more than 20 years.

These circumstances simply are not credible. On the reasonable assumption that nominal output and hours worked and paid of the various industries are accurately measured, faulty price statistics are almost surely the likely cause of the implausible productivity trends. The source of a very large segment of these prices is the CPI.

For this exercise, the study used the GDP chain-weight price measures. Although these price measures are based on many of the same individual price indexes included in the CPI, they do not suffer from so-called upper-level substitution bias. Hence, the price mismeasurement revealed by this data system largely reflects shortcomings in quality adjustment and in the treatment of new goods and services.

If, instead of declining, productivity in these selected service industries was flat, to up a modest one percentage point a year, the implicit aggregate price bias associated with these service industries alone would be on the order of a half a percentage point or so per annum in recent years, very similar in magnitude to the Boskin Commission estimate of total quality adjustment and new products bias.

Some observers who are skeptical that the bias in the CPI could be very large have noted that the evidence on the magnitude of unmeasured quality change and the importance of new items bias is incomplete and inconclusive. Without a doubt, quality change and new items are among the most difficult of the problems currently confronting the BLS.

But since I raised this issue 2 years ago in my testimony before this committee, a number of studies have documented significant new examples of cases in which the current treatment in the CPI results in an overstatement of the rate of growth of the cost of living.

There doubtless are certain components of the CPI that are biased downward because quality change is handled inappropriately. We should be prepared to embrace credible new research on quality adjustment, regardless of whether that research points to additional sources of upward bias or previously undetected instances of downward bias.

Nonetheless, currently available evidence very strongly supports the view that, on balance, the bias is decidedly toward failing to appropriately capture quality improvements in our price indexes. There is little reason to believe that this conclusion will change unless we alter our procedures.

A more difficult quality-related issue is whether to reflect changes in broad environmental and social conditions in price measures that are used for indexing various components of Federal outlays and receipts. That is, should the CPI reflect the influence of factors such as the level of crime, air and water quality, and the emergence of new diseases which are not specifically related to products that consumers purchase?

There is little in the record to suggest, when it enacted the indexation of Social Security benefits in 1972, that Congress intended for the beneficiaries of that program to be compensated for changes in such environmental and social factors, nor do these issues appear to have been raised when Congress debated the indexation of various tax parameters during the 1980s.

Taking account of such conditions, particularly those that lie outside of the markets for goods and services, would be an interesting exercise in its own right, but would appear to extend well beyond the original intent of the Congress.

A considerable professional consensus already exists for at least two actions that would almost surely bring the CPI into closer alignment with a true cost of living. First, we should move away from the concept of a fixed market basket at the so-called upper level of aggregation and move toward an aggregation formula that takes into account the tendency of consumers to alter the composition of their purchases in response to changes in relative prices.

There is a somewhat more difficult issue as to whether the concept of a variable market basket can be applied in so-called real time, that is, with the same degree of timeliness that characterizes the current CPI. It is not possible to implement the textbook versions of any of the so-called superlative index formulas in real time because these formulas require contemporaneous data on expenditures and those data are not presently available until about a year after the fact. However, this hardly forecloses the possibility of implementing an approximation to a superlative formula, and work should continue on the development of such an approximation.

A second area that will require attention is the aggregation of prices at the most detailed level of the index. This is a highly technical area, and an important example of how research by the staff at the BLS has advanced our knowledge. Without going into the details of the matter, it is sufficient to say that a selective move away from the current aggregation formula is warranted and would probably make a modest further contribution to bringing the index more in line with the concept of a cost-of-living index.

Beyond these rather limited steps, most of the needed developments will require time, effort, and quite possibly additional resources. It is important that the Congress provide the Bureau with sufficient resources to pursue the agenda vigorously.

Where will this longer-term effort be required? One of the key areas, by all accounts, is quality adjustment. As the Bureau has rightly noted, they do indeed already employ a variety of methods to control for quality change. But available evidence suggests that these are not sufficient to the task. Unfortunately, making improvements on this front will be difficult. Each item will have to be considered on its own, and there may well be limited transfer of knowledge from one item to the next.

In addition to quality change, the longer-term agenda should also include concentrated attention to the methods for introducing new items into the index, the development of new sources of data such as the information collected by bar code scanners, and the analysis of time use, the latter being important in understanding the value of time-saving and convenience-enhancing innovations.

Even if the BLS moves aggressively, some upward bias will almost surely remain in the CPI, at least for the next several years. Two years ago in testimony before this committee, I suggested that a workable structure for dealing with this situation might involve a two-track approach. That suggestion still seems to me to make sense.

The first track would involve action by the BLS to address those aspects of the bias that can be dealt with in relatively short order, say within the next year. The second track would involve the establishment of an independent national commission to set annual cost-of-living adjustment factors for Federal receipt and outlay programs.

The commission would examine available evidence on a periodic basis, and estimate the bias in the CPI taking into account both the latest research on the sources and magnitudes of the bias, and any corrective actions that had been taken by the BLS.

This type of approach would have the benefit of being objective, nonpartisan, and sufficiently flexible to take full account of the latest information. Moreover, there is no reason why the two tracks could not proceed in parallel.

Without the second track, we are implicitly assuming, contrary to overwhelming evidence, that the most accurate estimate of the bias is zero. There has been considerable objection that such a second-track procedure would be a political fix. To the contrary, assuming zero for the remaining bias is the political fix. On this issue, we should let evidence, not politics, drive policy.

We have an over-arching national interest in building a better measure of consumer prices and in implementing more rational indexation procedures. Through these efforts, we are most likely to ensure that the original intent of the relevant pieces of legislation will be fulfilled in insulating taxpayers and benefit recipients from the effects of ongoing changes in the cost of living. At present, this objective is not being met.

Mr. Chairman, I have excerpted from my prepared remarks, and request the latter be included for the record.

The CHAIRMAN. Without objection.

[The prepared statement of Chairman Greenspan appears in the appendix.]

The CHAIRMAN. Well, thank you, Mr. Chairman. We will now move to questions. Let me start out, if I may, with a couple of questions not related to CPI, but then I will turn to the subject matter of your opening statement, a most important one, in my opinion.

Dr. Greenspan, Secretary Robert Rubin said a week or so ago that a rising dollar is good for America because it slows inflation. Last summer, you mentioned this concept in your Humphrey-Hawkins testimony to Congress.

What is the relationship between the stronger dollar and the Federal Open Market Committee monetary policy decisions? Basically, Mr. Chairman, is a stronger dollar enough to make, for example, an interest rate hike unnecessary?

Chairman GREENSPAN. Mr. Chairman, I will not comment on specific actions which may or may not be implemented by the FOMC. But, very clearly, since the exchange rate of any country has an important impact on its whole financial structure as well as its level of economic activity, we invariably, at all meetings, are evaluating what the interface between the domestic and international economies is, and the exchange rate plays a very major role in that evaluation.

It is certainly the case that when the dollar rises relative to other currencies, other things equal, import prices tend to be less expensive. That does impact on our overall price structure, but it is only one of many, many items which the Federal Open Market Committee must consider in judging its policy stance. Sometimes the exchange rate is negligible in its impact on any policy, sometimes it has an effect, but almost never is it the determining effect.

The CHAIRMAN. Mr. Chairman, there is a significant tax on investment in the form of a capital gains tax. There is a proposal to cut the capital gains tax in the Senate Republican leadership tax bill. Do you agree that a reduction in the capital gains tax would spur investment and economic growth?

Chairman GREENSPAN. Mr. Chairman, as I have said before this and other committees of the Congress over the years, I do not believe that capital gains tax is a useful means of raising revenue or a means, for that matter, of doing anything else of a constructive nature.

One of the reasons is I believe that even though we cannot document in great detail precisely what the relationship is between the tax and capital investment, I do not think that the issue of what the sign of that relationship is, is ambiguous.

Senator MOYNIHAN. Would you mean it is negative?

Chairman GREENSPAN. Yes. Thank you, Senator. I appreciate your previous history coming to bear on this question.

One issue I do think we ought to confront, even aside from the question of whether or not there should be a capital gains tax and what the tax rate should be, is that it strikes me that we should be very careful, if there is a negative effect, and we should avoid embodying in that tax the effects of actions which reduce the purchasing power of the dollar caused basically by the broad economic policy of government.

If the rate of inflation overall is rising and that clearly has an impact on assets which are involved in a capital gains tax, then at a minimum I believe we should strip out of the base of the valuation of the asset which is being taxed, those changes which result not from the action of the person who has purchased and is selling the asset, but actions of government which affect the purchasing power of the currency. So I would argue, at a minimum, Mr. Chairman, that we index in some appropriate manner the price change which is in the underlying base of the tax itself.

The CHAIRMAN. Let me now turn to the CPI, as important a matter as any that will come before the Congress this year. Now, Mr. Chairman, as you well know, correcting the CPI would lower our annual deficits very, very substantially.

It has been estimated that if we lower it 1.1 that it would save over $1 trillion in the next 12 years. Also, recent estimates have shown that the insolvency date of the Social Security Trust Fund would be pushed back another 20 years.

You were head of a commission several years ago to save Social Security. Do you feel that further reforms to the Social Security system should be undertaken now, even with a correction in the CPI?

Chairman GREENSPAN. As Senator Moynihan has indicated in an op-ed piece a few weeks ago, if no changes were made but the CPI was adjusted to a proper cost-of-living basis, a substantial part of what strikes me as a major problem for this country—namely the Social Security System, or OASDI—would remain. If we do nothing, we are going to find it very difficult subsequently to handle the funding problems that become apparent starting 10 years from now when the so-called baby boomers start to retire. The arithmetic is very daunting. The retirement of the baby-boom generation creates a very large increase in benefit payments under existing law and existing means of indexation. Some significant actions, in my judgment, are going to have to be implemented to come to grips with that problem.

I might say, parenthetically, Senator, that we currently estimate that the presumed shortfall is only 2.2 percent over a 75-year horizon as a percent of covered payrolls. It is, I might add about 4.5 percent, if we go beyond the proscribed 75-year horizon and project out forever.

The problem with that estimate is that it requires that the underlying assumptions that are now being employed for the Social Security System over the next 75 years, be correct. As you know, under the existing set of estimates, the Social Security Trust Fund is supposed to go broke in the year 2029.

That number, when Senator Moynihan and I were completing the Social Security Commission, among other members, was somewhat beyond the year 2057. In other words, we knew it was solvent as of the end of that 75-year projection horizon. The date of insolvency has been coming down virtually every year, monotonically, as we say, meaning it does not go up and down, it just keeps going straight down.

Implicit in the fact that there is a funding shortfall of only 2.2 percent in the OASDI system is that this estimate remains flat beyond 75 years and that is what previous evidence has suggested is a rather peculiarly inapt assumption. It is not only incorrect economic assumptions, incidentally, which have created increasing estimates of the funding shortfall. We have apparently misestimated the underlying disability liabilities, and we have a number of other technical issues which have fallen short.

I do not know whether or not there is a bias in our current estimates that needs correction, but all I can tell you is that the burden of proof is on those who say that, having missed long-term projections now for 13 years, all of a sudden we got smart. I find that a bit tough to assume.

The CHAIRMAN. I will ask you one more question my first round, then I will turn it over to Senator Moynihan.

In your view, how important is the work that BLS is now developing with regard to the experimental indexes, such as the new cost of living index for the elderly?

Chairman GREENSPAN. I think that the work that the BLS is doing is exceptionally important in the sense that there is no other institution with that many qualified people who are expert in index number analysis available to do a number of these other types of activities.

What they do not have at this stage, even though they have an experimental index for the elderly, is an appropriate pattern of expenditures for that group in the sense not only of the amount spent, but the types of outlets and the types of things they do to get the aggregate.

As you probably are aware, Mr. Chairman, the so-called experimental elderly index runs a shade higher in annual rate of change than does the CPI. The reason for that has been, to a large extent, the increased weight of medical expenses in that index.

There is a serious question, however, of how much bias is in that index because a disproportionate amount of the bias in the CPI probably is in medical prices as they are estimated by the CPI.

The CHAIRMAN. I might comment, Senator Moynihan, there was an article in the paper the other day that said the Chairman, after carefully reviewing all types of figures and statistics, in essence relied upon his intuition or crystal ball.

I think I should ask you, Mr. Chairman, is that correct?

Chairman GREENSPAN. I certainly hope not.

The CHAIRMAN. Senator Moynihan.

Senator MOYNIHAN. I would bet his crystal ball against most statisticians.

Mr. Chairman, just to say again, it is extraordinarily helpful that you should come forward and speak about our indexation and price indexes at this juncture. Just to make the connection, if we are to index capital gains so that inflation is not taxed, we want that to be an accurate index.

Chairman GREENSPAN. Absolutely, Senator.

Senator MOYNIHAN. Not larger, not lesser, but as near as you can get, which is always an approximation. But roughly right is better than precisely wrong.

It seems to me, sir, that the most important thing you said to us this morning was that, to leave matters as they are is the political fix. We have been told, do not touch CPI. Do not let political hands get on the CPI. If we do not change it in the face of the overwhelming evidence and the consensus, then that is a political choice. That is the political decision. The nearest you could come to a nonpartisan, technical response would be to make the adjustments that seem to be in order.

It, perhaps, cannot be too often stated that when you are establishing CPI, you are not establishing an atomic weight, or something. We have two CPIs; one adjusts benefits, the other adjusts revenues. I believe, in 15 years, they have only been the same three times. That is the nature of it. Once you get inside that world, you understand it.

But I believe your proposal of a two-track arrangement, to keep working on the existing number, improve it as you can, knowing you are never going to get all of the upward bias out, and have a commission to make the remaining adjustment once a year, or whatever accurately reflects what the BLS can and cannot accomplish. That is almost precisely what the Boskin Commission proposed; is that not right?

Chairman GREENSPAN. It is, Senator. Yes.

Senator MOYNIHAN. So we now have from the Federal Reserve Board its own independent study coming out, in fact, about where these studies come out.

Chairman GREENSPAN. Let me just correct myself, slightly. They have got a "best practices" index which they argue should be published once a year.

Senator MOYNIHAN. Yes.

Chairman GREENSPAN. That is not exactly the same thing I am recommending. I am, in a sense, saying that even that would not fully get the bias out. It is, unquestionably, a very major step forward to come far more closely to the, I presume, intent of the Congress to protect beneficiaries from rises in the cost of living. But it does not fully give us what I would perceive to be what a consensus of experts in this field would tell you is the most likely full bias in that index.

Senator MOYNIHAN. Right. And could I say, sir, among those experts we are talking about are the esteemed career civil servants in the Bureau of Labor Statistics. That is why, in response to the question "Is the CPI a cost-of-living index?" the BLS replies "No."

Chairman GREENSPAN. That is correct. There are great disputes about what the various biases are, how to correct them, and there has been, as a consequence of these disputes, I think, an enhancement of our knowledge of what the problems are.

We have made very considerable progress in moving the index forward to a status that I would suspect could become far more useful as a measure of what is going to be a terribly difficult issue in the 21st century: measuring prices. Fifty years ago we had steel, copper, aluminum, and broad-woven cotton fabrics. Today we have got software, units of legal opinion, various different types of surgical techniques which vary from one six-month period to the next.

The price estimating procedures that we are going to have to get involved with are going to be really increasingly awesome. It is important that we get ahead of the curve. This process is under way, and the people best capable of doing it are in the BLS.

Senator MOYNIHAN. Yes. I wonder if I could ask if you might give some thought to the question of who might be on a commission such as you suggest.

Chairman GREENSPAN. I would tend to choose academics who clearly have no evident interest in the outcome. It is very tough, because the CPI is indexing a large number of private contracts, not only the labor union contracts. It is used for a wide variety of purposes and it is terribly important that we get it as right as we can.

Having said that, I do think that we have to distinguish between the issue of the CPI, which is a monthly index which we do not revise, and get that as good as we can. But, failing to have the ability to revise it, which has become, I guess, a fundamental requirement of something which is built into contracts the way it is, we lose a lot of the accuracy that one gets by being able to go back and change things. The "best practices" index, which the Boskin Commission recommends, endeavors to do that.

Senator MOYNIHAN. Yes.

Chairman GREENSPAN. I think running both side-by-side, having an up-to-date, important, and improved CPI—not cost of living, as you point out, Senator—as well as something far more closely approaching a cost-of-living index which is employed only on an annual basis for government indexing purposes, I think, is a major advance forward.

Senator MOYNIHAN. Thank you very much, sir.

The CHAIRMAN. Senator Grassley.

Senator GRASSLEY. Mr. Chairman, if I could first have the attention of the committee on a matter that I was quoted on after the Boskin Commission report, a fairly favorable review of committee members, feeling we ought to move very quickly to do the things that are suggested by the Boskin Commission because of the $1 trillion figure, and if you do not move quickly we lose a lot of valuable time. I was accurately quoted in there, but I think I left the impression that maybe I felt we should not be moving when I urged caution.

My point about caution is related to making sure that there is a firm understanding that there is the unanimity that we were hearing, among economists. But even if there is unanimity among economists, we still have this terrible problem that we have to deal with on a lot of issues in Washington of the cynicism of the public towards us manipulating things for political purposes or trying to cloud an issue that ought to not be political with political discussion that leads it to be more political than technical.

So my caution is that we take quick action to do those things that educate the public, as much as we can do that from Washington, about what the problem is and to get a consensus. And it is not as simple as just having the President say, well, I agree with the Republicans and the Congress, or I agree with the Congress. That helps an awful lot, but there is still so much cynicism in the American public.

We have got to move cautiously as we do this. It is not that I think we ought to put this off for 5 years, or maybe even a year, but we have got to move very deliberately in this direction. And that is what I was commenting on that may have made it appear that I did not think the problem was as serious as Chairman Roth and Ranking Minority Member Moynihan feels it is, because I see it as a serious problem.

My question to you would be this, because you refer on page three that your staff economists have done a lot of work and verify some of the things that the Boskin Commission has decided.

In your policy determinations through the Federal Open Market Committee or anything the Reserve Board does, do you take what your economists might acknowledge is wrong with the CPI and use a revised CPI index in your calculations, in your policy determinations?

Chairman GREENSPAN. In a sense, yes, Senator. However, as best we can judge, the biases that we are finding in the index have not been changing dramatically in recent years. They seem to be pretty much the same for the most recent period.

This means that the changes that one would create if you merely put in a more appropriate price index would give you a faster rate of growth of economic output. It would also give you a faster rate of growth in the capacity of the economy.

The evidence that we now see, which is what we tend to view as critical in evaluating what the economy is doing, would not significantly change in our evaluation because even if we perceive that we are misestimating the rate of growth of productivity, which I certainly think we are, even if we are misestimating the growth in real incomes, which we are, it does not change the types of relationships and the evidence of imbalances that we seek to ferret out in making judgments about monetary policy. But, clearly, in the back of our minds, indeed, in the data we employ, we do make the mental adjustment that the CPI is upward biased.

Senator GRASSLEY. You may have just answered my second question, but let me ask it anyway because this is how I was thinking about this whole process. Through your policymaking you make some accommodations for the fact that the CPI overstates inflation. Your policy decisions have a dramatic impact upon the economy, as they are intended to have. Then you have other branches of government, the Executive Branch, and particularly Congress, making policy decisions that are made on a flawed CPI.

Having a very powerful organization like yours use a more precise estimate and ours using one that is not so precise, would that tend to compound any problems that we have, with one part of government making very bad policy that has to be overcompensated then by you?

Chairman GREENSPAN. That is an interesting question, Senator. I think not. I do not know if this is an apt analogy, but it is probably saying the same thing in two different languages. But we do have a good translator. So I don't think that there are any actions that we take, or any actions that the Congress or the administration takes, which create an inadvertent mismatching of views. I think we are all aware of the context with which we are working. I do not think that should create a problem for us.

Senator GRASSLEY. It may be because you have the ability to be a counterweight to bad fiscal policy by the Congress that that is the case, and you can act in a more nonpolitical way. But if you could not act in a nonpolitical way and be that counterweight, then there could be tremendous problem.

Chairman GREENSPAN. I certainly agree with that, Senator.

The CHAIRMAN. Senator Bryan.

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

Mr. Chairman, you have offered some powerful and compelling testimony, added to the testimony that we received earlier this week from the Boskin Commission, that this Congress must act, and failure to act would be fiscally irresponsible.

I have read your testimony and heard your testimony this morning, and much of what you recommend parallels the thrust of the testimony that we heard earlier this week. I would like to pursue with you for a few moments this two-track concept that you have outlined. As I understand, the independent national commission and our distinguished Ranking Member made inquiry about how that commission might be constituted. The other, I presume, is the BLS taking some short-term measures.

My first question would be, what direction should the Congress give to the BLS with respect to the short-term measures that you contemplate that they could take?

Chairman GREENSPAN. Senator, I do not think you should, nor do I think it appropriate, to give specific directions to the BLS. They know what has to be done in the technical sense and giving them instructions would indeed be a political fix.

I do, however, think that you ought to be careful to be certain that they have adequate resources to do what they can do. Beyond that, frankly, as far as the first track is concerned, if I may put it that way, I would step aside.

Senator BRYAN. And simply provide the BLS the resources. I take it from your comment that you believe that the BLS is sufficiently focused on the questions, some of which have been raised by both you and the Boskin Commission, of substitution, quality adjustment, the lag time in terms of new product introduction, and it is your sense that the BLS, without direction from the Congress, would proceed. In fairness, the BLS has made some corrections, as has been noted here.

Chairman GREENSPAN. They certainly have. Yes. I do not think that the Congress should endeavor to fine-tune statistical procedures in such a complex issue as trying to estimate the cost of living. That it would create the type of concerns which a lot of people have that for fiscal policy or budget reasons you are trying to manipulate the CPI to get the budget deficit down. I think that would be most unfortunate, sir.

Senator BRYAN. And I would agree.

Now, the independent national commission you propose would compile, as I understand it, the annual adjustment which we do not currently have. We do it incrementally on a month-to-month basis.

Would that independent commission rely upon the staff and resources of BLS, or is it contemplated that the commission would have other resources made available to it under this structure, or would it be capable, as you contemplated, Mr. Chairman, to develop the necessary data base from data base sources currently available without additional personnel or staff?

Chairman GREENSPAN. Senator, the appropriate mechanism is probably a national commission with appropriate staff. I would presume that they would work hand-in-glove with the BLS, because the BLS has got the basic, underlying, raw data. I would presume that they would endeavor to bring academic experts in this field into their discussions, as well as those at the BLS, and try to make as good a judgment as possible.

The difficulty is that the concept of price is not a notion which is unambiguously defined. For example, if we bought $100 worth of goods, $100 is an unambiguous number. But to break that down over, say, a period of time, into whether it is a change in real units is difficult. What is price is probably not terribly difficult for, say, hard red winter wheat. It is very difficult for many of the complex types of goods and services we produce in this country.

Senator BRYAN. And my last question. The Boskin Commission does indicate that there may be circumstances, particularly with those individuals who are on fixed retirement incomes on the lower end of the spectrum, that perhaps Congress should make some adjustment, recognizing that there might be some hardship visited upon those Social Security recipients, and other government pension programs that are indexed to the current COLA system.

One suggestion proposed would be to exempt the SSI program beneficiaries. Do you have any thoughts with respect to that concept, and if you do, what would you recommend that Congress consider exempting or adjusting?

Chairman GREENSPAN. Senator, I would separate that judgment from the strictly professional question of making judgments about the broad cost-of-living indexes. You are raising an issue of what the Congress should be appropriately focused on, namely the allocation of resources that are available to us. That is a political judgment, and an appropriate political judgment.

I would separate that from the price estimation procedures because you may conclude, were you to go on this two-track basis as I am recommending that the outcomes, even though they are professionally supportable and accurate, suggest additional actions on the part of the Congress. I think that is a perfectly appropriate issue to be on the table.

Senator BRYAN. I thank you.

I thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Bryan.

Senator Rockefeller?

Senator ROCKEFELLER. Mr. Chairman, you said at the beginning you would take other questions. I want to wander out of field just because of something which has been tremendously on my mind for the last 2 weeks.

I came back from spending about a week in Japan. I spent 3 years there as a student in the late 1950s, and I have never seen that country with less self-confidence and with more general anxiety about its future than it is now.

It is based on several assumptions. One, just from a foreign policy point of view, they think that we are no longer Japan-bashing but Japan-passing. That is, we are paying more attention to China than to Japan, and they worry about that. We have no ambassador over there, that kind of thing.

Second, they are going through, as you know, major deregulation. The government is declining to support their banks and their huge debts that come from the bubble economy. They have a sales tax which is going to go from 3 percent to five percent.

They have always honored their bureaucracies. The highest level of attainment in Japan, the Ministry of Finance, has had some major scandals there. The politicians basically have no staff whatsoever, so their work is basically just to rubber-stamp the work of the parties they represent, all of which I think is wrong.

They think their unemployment is going to go up to as much as four percent, which sounds pretty good to us, but which is disaster for them. Lifetime employment, et cetera, is in danger. They are cutting and they are out-sourcing more overseas, et cetera, et cetera.

In other words, they have a very, sort of, low self-esteem at this point as to their future. I do not happen to share that, based upon whatever it is I do understand about Japan.

I remember a couple of years ago when the yen was sort of the opposite of what it is right now. Businessmen were telling me in private they would be able to go ahead and do business at 80 yen if they had to do it. Certainly not at 100, but at 80. Now they have 120, which is favorable to their exports.

It always seems to me that the Japanese are able to get out of crises because they are able to do things because of social discipline, savings, and things of that sort which we in this country find harder.

I would just be interested in a quick-scan view of your point about Japan and whether they are overly worried.

Chairman GREENSPAN. Senator, I was there a few weeks before you were and I must say I came away with very much the same impressions that you have. The thing which I think is concerning the Japanese to an extent we should be able to appreciate here, is that where we have an aging population as our baby boomers age and that whole thrust of the demographics begin to work on our fiscal system, whatever problems we have, theirs are far more severe because the projections of the average age of the Japanese population, as you know, are scheduled to move up at a fairly dramatic pace and it creates great fiscal problems for them and they are focused on it. Indeed, the increase in taxes you are referring to is put there just for the purpose of trying to come to grips with the longer-term difficulty.

They have had a period since the end of World War II which has really been quite amazing. Their productivity capabilities, the ability to create rapidly growing standards of living, and indeed to create a really superb economic structure, is something which we, up until very recently, used to look across the Pacific and say, it is wonderful; I wish I knew how they did it.

The truth of the matter is, we do not fully understand exactly how the Japanese economy works. When we match our relationships of various different economic indicators in the United States, they look like the United Kingdom, they look like France, they look like Germany.

You could put them all together and get some interesting insights into the interrelationships because fundamentally they seem to be working in most ways—not all, but most—in a similar manner.

There is something different about the way the Japanese have managed to create a society in which their inflation rate is negligible, their unemployment rate is very low, and until very recently their growth rate has been really quite impressive.

I do not think we know precisely all of the elements that are involved in the slow-down, but I must say, Senator, I am on your side on this. I think that their history suggests that their pessimism at this stage is probably being grossly overdone.

Senator ROCKEFELLER. Mr. Chairman, a quickie.

The President's Advisory Commission on Social Security, all three groups of opinions, all suggested investing in the stock market. Any thoughts on your part as to the wisdom of that, second, the effect on the stock market and the economy in general, individuals making decisions?

Senator MOYNIHAN. That is a quickie, Mr. Chairman. [Laughter.]

The CHAIRMAN. Thirty seconds.

Chairman GREENSPAN. I can answer it in under two hours, Senator. [Laughter.]

Just let me say that you have to be careful about this, because there is an impression about investing in equities which, to be sure over the history of this country have yielded in real terms more than any other types of instruments.

As a consequence, one gets the impression that if you switch the Social Security System from investments in U.S. Treasury issues into stocks which would earn more, one could solve the problem.

That is what I would call half-entry bookkeeping, if I may put it that way, or single-entry bookkeeping.

The difficulty with that is that we have to ask the question, what happens to the rest of the economy? Unless the overall level of saving in the economy rises, no matter what else you do, if you allow the Social Security Trust Fund to invest in stocks, somebody else is going to have to invest in a lower amount of stocks.

In effect—this is not exact, but close enough—you are asking the Social Security Trust Fund to swap its holdings of U.S. Treasury issues with private pension funds' holdings of equities. It is a zero sum game.

If the rate of return rises in the Social Security Trust Fund, which it probably would, it will fall in the private pension funds. So for the overall retirement system, private and public, nothing has happened. All you have done is shifted earnings from one segment to the other. That occurs because the overall saving/investment balance has not changed.

The reason why I think we ought to be moving toward a more privatized system is not because of the investments in stocks, bonds, or anything else of that nature. It has got to do with the question as to whether, in fact, we should have a more funded system in the private insurance sense rather than what we now have, which is essentially a generational transfer and a pay-as-you-go system, with the exception of—this may seem inappropriate—a very low stock of assets in the Social Security funds, even though it is the hundreds of billions of dollars. The numbers that we need are many, many multiples of that, so even though we are not exactly on a pay-as-you-go basis, we are close enough to make that an issue of concern.

The only solution to the so-called bulge in retirees which has to be funded as we move into the 21st century is to recognize that they have to be supported with real resources.

That means that the level of saving, investment, and productivity must rise so that the level of output when all of these people are retired are sufficient to supply real resources to both retirees and the people who are working at that time.

Finance is very interesting, but this is a real resource problem. Merely shifting some funding to the stock market from the U.S. Treasury issues does not come to grips with this question. Finance does not solve it, real resource allocation does.

The CHAIRMAN. Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

OPENING STATEMENT OF HON. CONNIE MACK, A U.S. SENATOR FROM FLORIDA

Senator MACK. First of all, let me express how pleased I am to join you and Senator Moynihan, and my other colleagues on this committee. I look forward to working with you. We have some challenging issues before us this year, and again I look forward to working with you.

I, too, want to express my appreciation, Chairman Greenspan, for your remarks with respect to CPI. If I have time, I will get in, maybe, to some specific questions about your proposal. But I want to explore some of the other ramifications of it.

Let me start with this. I am not sure I understood where you are with respect to where that bias might be number-wise. I think the Boskin Commission talked about a range of 0.8 to 1.8, 1.5, something like that. If that is the case, if there is an overstatement of the CPI by that range, I suspect that some are out there saying, well, that means the real Federal funds rate is somewhere in the three plus range, which some people might conclude that that is a statement of a too-restrictive monetary policy. I would be interested in your reaction to that.

Chairman GREENSPAN. Remember that if the bias has been the same for a period of time, if we were to draw a chart calculating the real Federal funds rate with the existing consumer price index, which is what we tend to do, we would have a series which would look like the numbers we are all used to seeing.

If you put in a truer measure of inflation, what would tend to happen is that the level of the real Federal funds rate by that calculation would rise, but it would be higher all through recent history.

And the evaluation of whether monetary policy was tight or loose if, in fact, that is the statistic you are using to do it, would presumably be a function of where it was relative to history.

Since the bias has probably not changed, you do not change the position where we are currently relative to history by altering the CPI because you are changing not only the current level of the real funds rate, but you are changing what the standard is that you are employing to determine whether it is too high, too low, or just about right, throughout recent history. So both the current level and the measure are changed identically, and in that regard no conclusion is altered in the process.

Senator MACK. Let me try another approach. A lower CPI does have an effect. If we went back, for example, and recalculated wages, GDP, there would be some modification or some adjustment in that number. Is that right?

Chairman GREENSPAN. Certainly.

Senator MACK. Give me a sense of what that would be.

Chairman GREENSPAN. You would tend to find that the growth in the real GDP was higher. Let us assume that the actual bias is 1 percent. My recollection is that the GDP deflator would not be fully 1 percent higher since it picks up part of that bias because it is already adjusted for so-called major items of substitution effect and therefore it is not as biased as the CPI, but it, nonetheless, is significantly overstated.

What that would imply is that the growth of GDP and the growth of productivity would be significantly higher, although the increase would be less than, say, the one percent CPI bias effect. But it would be throughout history. In other words, the growth rate would always have been higher. So our measure or our standard of what constitutes strong growth or weak growth would also change, and again the relationship to where we are now relative to history would not change.

Senator MACK. Would the debate change? For example, we have had these discussions before, but the growth in the economy, as measured by our present standards, is somewhere in the neighborhood of 2.4, 2.5 percent for the last three, 4 years.

There is statistical data to indicate that the five economic expansions prior to that were at 4.4 percent. Therefore, I would be saying that we ought to be growing faster, and I do make that case.

But are you saying to me that, in essence, nothing really changes, Connie: if we make a modification in CPI, yes, it would increase to some degree the growth rate for the last three or 4 years, but it also would increase the growth rate for the five expansionary periods previous to that.

Chairman GREENSPAN. Absolutely. You would not change your view. Or should not.

Senator MACK. I think that is comforting. I am not sure. [Laughter.]

Thank you very much. Maybe I will have a chance to get back into some of the specifics. Thank you.

The CHAIRMAN. Senator Moseley-Braun, you are next.

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman.

Mr. Chairman, welcome. I would like to, and I do not know if it has been done before, congratulate you on your engagement. I think it is wonderful.

Chairman GREENSPAN. Thank you.

Senator MOSELEY-BRAUN. To get back to the business at hand, the $1 trillion from getting our numbers right with the CPI really sounds wonderful, except that, given the concern that anything that sounds too good to be true normally is, I am sorry to say, Senator Moynihan.

With our obligation not to do any harm, I really do have a concern. Obviously we do not want to give people entitlements to which they are not entitled because the numbers are wrong, so we want to do the right thing in terms of fixing that.

But, at the same time, I think we have to also be very concerned about the impacts on transfer payments, specifically, and the impacts especially on the elderly poor. Senator Bryan touched, I think, a little bit on that matter in his questions.

But particularly for those people who are dependent solely on Social Security for their livelihood who may be impacted by the kind of changes that we have in Medicare and Medicaid with the reductions, or scaling back, or cuts, or whatever you want to call them.

These people may well find themselves with a double-whammy because they will be hit both on the revenue side and on the expenditure side.

Given the kind of almost consensus that there is some difficulty in evaluating the health care expenditure biases and that there may need to be—there has been a suggestion for us—a separate CPI for the elderly.

What would you suggest, in terms of the elderly who rely on Social Security payments for their livelihood? Would you suggest then that we might want to take a look at some alternatives, again, as a matter of a policy judgment as to whether or not we continue to study, which gets to, I guess, the second track of your two-track proposal?

The suggestion has been made that the BLS adopt some different expenditure weights with regard to the CPI. Then there is also, of course, the suggestion about the prototype for the elderly. What would you suggest that we do, confronted by the prospect that the elderly poor may be hit with a double-whammy by virtue of this exercise?

Chairman GREENSPAN. Senator, I would repeat what I said to Senator Bryan. I would be careful to separate the strictly statistical question, which is our endeavor to try to get the best estimate of the cost of living as we can in a professional sense, from the judgments of programmatic alterations which might or might not occur for any number of other reasons. We have to separate the statistical judgment from the political judgment. That does not mean that you do one or you do not do both. I am just saying that I hope we try to avoid mixing them in the same proposals.

In other words, we ought to merely look at the statistical question, assuming that it is the intent of the Congress to hold all beneficiaries whole with respect to changes in the cost of living.

Then if you decide that the consequences of that require some adjustments for other reasons, I would handle it separately. Once you bring into the question of what is fairness into a discussion of what is statistically accurate, you are creating a very difficult evaluation problem.

I would suggest that it probably would be wise to run a three-track system, if you want to put it in those terms, and leave the third track for political judgments. These are appropriate political evaluations, it is just that they have nothing to do with tracks one and two. I think to try to mix them creates problems which we should not have.

Senator MOSELEY-BRAUN. Well, I guess, again, getting to the statistical track, the argument has been made—and I am just asking you this by way of the analysis that we have to reach—that the BLS can not, or does not, adequately measure substitution effects as it pertains to the elderly.

If that is the case, then the impact on the statistical judgment on the elderly—again, particularly the elderly poor, given this double-whammy—really is a matter of statistics and not policy. I guess that is where the question comes, how do we fix that part of it so that we can reach the appropriate political judgment?

Chairman GREENSPAN. The political judgment would be to say that the BLS should create a cost of living index for the elderly, or any index you want them to do. It is just that you should not tell them how to do that.

In other words, we now say that the beneficiary programs, the retirement programs across the board and many Federal programs, are indexed by the consumer price index. We do not tell the BLS how to calculate the consumer price index. The Congress, however, says that it will be the consumer price index which will be employed for indexation.

If the Congress decides that it wants to change the indexation processes from, for example, a consumer price index to a cost-of-living index for the elderly, let us assume, that is a political judgment which is perfectly appropriate, and, indeed, the Congress is the only organization that can make that judgment.

I merely say to you, do not request the BLS to take any further instructions from the Congress on how to make those calculations. I am not saying that you should not endeavor to create a programmatic change just try to be careful not to overlap one issue with the other, because they really are fundamentally different types of decisions.

I would trust, Senator, that we keep the professional judgments on statistical procedures as wholly independent from political value judgments as we possibly can.

Senator MOSELEY-BRAUN. Thank you.

The CHAIRMAN. Mr. Chairman, if the Federal Government were to invest Social Security surpluses in the stock market, as some members of the advisory council recommended, the Federal Government could become a very significant holder of private capital in the economy, perhaps even the largest.

What is your view on the advisability of the Federal Government holding that kind of a position in the private capital market?

Chairman GREENSPAN. It would make me very uncomfortable, Mr. Chairman. I do not think that you could effectively insulate the holdings by the Federal Government from affecting business decisions. You can try. My impression is, over the years, at some point or in some manner you will fail.

Therefore, I would say under no conditions would I envisage it desirable to have any significant equity holdings, that is, claims on ownership of American business in the hands of the Federal Government. We may be thinking we are doing it for investment purposes, but it is very difficult to wall off strictly investment choices and actions from true impacts on economic decisions made by our business sector.

The CHAIRMAN. Would that problem be avoided if you privatize, with individuals having their own accounts and if they voted the stock?

Chairman GREENSPAN. Most certainly. Then you have 401(k) equivalents, or something like that and the problem does not exist in 401(k)s.

The CHAIRMAN. Senator Rockefeller talked about Japan. Let me ask you a question with respect to China's accession to the WTO. Should a convertible currency be a precondition to China's accession to the WTO?

Chairman GREENSPAN. Well, remember, there are several different levels of convertibility. That is, there is partial convertibility, current account convertibility, and full convertibility. This is a political judgment that the State Department and the Treasury Department are more capable of making than we, because the whole question of the WTO is a very important issue with respect to augmenting free trade around the world.

I can give personal opinions, but I do not think I ought to. That is something which should be left to the authorities whose responsibilities are directed toward producing the maximum effectiveness of the WTO.

The CHAIRMAN. Let me ask you this question. How will the multilateral negotiations to liberalize trade in financial services affect the Central Bank's ability to preserve the safety and soundness of financial institutions; is that a matter of concern?

Chairman GREENSPAN. It is a very interesting question, Mr. Chairman, and it is one which we give very considerable thought to. The very nature of a central bank in a fiat money system requires that we be very careful about the extent to which the implicit subsidies which occur by the use of the sovereign credit of the United States is injected into the financial system.

Economists have a term which we call moral hazard, which specifies that certain entities in the financial and business sector can create more risk than they have responsibility for in containing.

As a consequence of that, unless when we supervise and regulate the structure and when the Congress constructs the laws under which we do it, we all have to recognize that when you go to a rapidly changing financial structure which is based on technology, that we do not inadvertently create a major spread of what we now call the safety net or the subsidy underlying that safety net because we can create, without our knowing it, a degree of instability that was not intended.

So one of the key aspects which concerns us in this broadened discussion of how the supervisory/regulatory structure of our financial system ought to move forward, is the question of how we contain the safety net in an appropriate manner to avoid the types of problems that could inadvertently occur as a consequence of the very dramatic technological changes that are driving the financial structure of this country, and indeed, the world as a whole.

The CHAIRMAN. Well, I have a number of further questions in this area I would like to ask, but my time is up. Perhaps later we could continue.

Senator Moynihan?

Senator MOYNIHAN. Yes. I have to say I had an ambivalent response to your statement that you did not think the U.S. Government should have a large position in the stock market, as recommended by one of the groups in that rather fragmented Advisory Council on Social Security.

I was talking, just a few days after that came out, with our distinguished former Chairman, Lloyd Bentsen. I said I would like nothing better than to own half the stock market; the first thing I would do is sell Texas Instruments and buy Kodak. That politicization would be unavoidable. You could say, I will not do it, I really will not, honest I will not: you will.

Sir, I think today the Judiciary Committee is reporting out a Balanced Budget Amendment to the constitution. This came very close to enactment in the last Congress and at this point the outcome is in doubt. There are those of us who feel that the success we have had in moderating the business cycle over the last half century is really one of the great instances of social learning in history. It was thought not to be possible, but it has been done. We are now in the 70th month of an expansion, with very little inflation and low unemployment.

I do not want to press you where might not wish to go, but I wonder if you would want to comment on your judgment, as Chairman, of the advisability of writing a 12-month fiscal cycle into the constitution.

Chairman GREENSPAN. Senator, as I have testified before this committee before, while I recognize the motives which are driving the Balanced Budget Amendment and strongly sympathize with the concerns that many of the members of this body have, I think that if we recognize that it is the expenditure side that is creating long-term fiscal problems, if we decided to go towards an amendment to the constitution—and I am uncomfortable about amending that document with economic legislation—then I think we ought to create something which is self-enforcing, such as requiring super majorities to pass all authorization, expenditure and outlay bills, for example.

The problem that I have with the Balanced Budget Amendment is that it is not self-enforcing; there is nothing that requires that either the Congress or the President submit a balanced budget.

There is no enforcement mechanism of which I am aware, and that, under a constitutional amendment, if the Congress fails to come up with one, there is nothing that says you have to, because you may not have a majority vote for any particular combination of outlays and receipts.

It is conceivable that the Congress may be unable to reach a majority vote which fulfills the constitutional requirement, which then presumably throws the issue into the courts for enforcement. I find that rather chilling, as a thought, for lots of different reasons.

So unless this solution can be somehow resolved, even though I very strongly sympathize with the view of trying to come to grips with what is clearly a bias in our system towards excessive outlays, in the sense that an underlying set of pressures which tend to increase the rate of Federal outlays at a pace faster than the underlying tax base tends to grow, that is clearly a problem. I am not certain that one comes to grips with that bias through a balanced budget amendment.

Senator MOYNIHAN. I thank you very much. I can only agree. If you think you have an imperial Judiciary now, just wait. We will leave it there.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Moseley-Braun.

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman. I just would like to follow up on the Chairman's question about China and the WTO for a moment. Yesterday, the USTR representative was in this committee and in her remarks was a statement regarding China. in which she referred to, decision making pertaining to China should be based on commercial factors and not just political ones.

I think most people would probably at least concede that commercial factors obviously have to drive our trade negotiations.

But, at the same time, I have a real concern. China is still a Communist country and it still has a controlled economy. So if you are talking about integrating the activities of a controlled economy with free, to freer, to kind of free markets, the question becomes, how do you achieve anything like a level playing field for all the members?

Chairman GREENSPAN. Senator, you are raising a fundamental question about the degree of market freedom that exists in various different countries.

It is fairly evident that there is a very significant quasi-free market operation in many areas of China. In fact, the reason they have been able to grow as fast as they have—indeed, they are the most rapidly growing major country in the world at this particular stage—is because they have opened up their markets quite considerably.

The Congress has got to make judgments as to whether, in fact, that is a sufficient market-oriented system to basically conclude that they have come sufficiently far in opening up their system to effectively compete in a manner which the Congress perceives to be appropriate.

It is not an easy judgment because we are not dealing with a fully collectivized state in which all actions are dictated by a central planning authority, as indeed at one point the Soviet Union was very close to being.

This is a bit of a more mixed issue and I really cannot give you a judgment as to what would or would not be appropriate, because there are so many complex questions here that I am glad that we at the central bank have only to deal with simple issues like money.

Senator MOSELEY-BRAUN. Thank you very much, Mr. Chairman. I have no further questions.

Senator MOYNIHAN. Mr. Chairman, this has been a delight to have you on your annual appearance. I would just like to say, once again, that a standard objection to trying to get our numbers roughly right in the indexation area—I will read one statement. "The right way to adjust the CPI is to allow the experts at the BLS to continue doing their job and keep politics out of it."

I think you have superbly stated that the political decision would be to leave things unchanged in the face of the wide consensus that adjustment is in order. If you do not adjust it, it is because of a political decision not to do so. I do not want to ask for your comment, but I think that is what your statement said. It was typically forthright and it is why you are a national treasure, and remain so, sir. Do not, in any circumstances, let yourself be purchased by some foreign entity. [Laughter.]

Chairman Roth had to go to vote in the Government Affairs Committee, and asked that he be excused. He expresses his thanks to you and to your colleagues behind you who have been paying close attention to your every word, and appear satisfied so far. [Laughter.]

Chairman GREENSPAN. Do not be too sure of that.

Senator MOYNIHAN. We thank you.

[Whereupon, at 12:04 p.m., the hearing was concluded.]

APPENDIX

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

PREPARED STATEMENT OF HON. ALAN GREENSPAN

Mr. Chairman and members of the Committee, I appreciate the opportunity to appear before you today. The Committee is faced with a number of complex policy issues that will have an important bearing on the fiscal health of the nation and the welfare of our people well into the next century. I will be happy to respond to questions relating to any of those issues, but in my formal comments this morning I intend to focus on the accuracy of the consumer price index.

I would like to begin by commending this Committee for having done so much to bring the issue of possible bias in the CPI to the attention of the Congress and of the nation in general. The hearings conducted by this Committee in 1995, as well as the report produced by the advisory commission that was sponsored by this Committee, have advanced the discussion considerably. These efforts, along with the continuing contributions of the Bureau of Labor Statistics' research staff, have added importantly to our understanding of the sources of measurement error in the CPI.

Any index that endeavors to measure the cost of living should aim to be unbiased. That is, a serious examination of all available evidence should yield the conclusion that there is just as great a chance that the index understates the rate of growth of the target concept as there is that it overstates the truth. The present-day consumer price index does not meet this standard. In fact, the best available evidence suggests that there is virtually no chance that the CPI as currently published understates the rate of growth of the appropriate concept. In other words, there is almost a 100 percent probability that we are overcompensating the average social security recipient for increases in the cost of living, and almost a 100 percent probability that we are causing the inflation-adjusted burden of the income tax system to decline more rapidly than I presume the Congress intends.

A major reason for this is that consumers respond to changes in relative prices by changing the composition of their actual marketbasket. At present, however, the marketbasket used in constructing the CPI changes only once every decade or so. Moreover, new goods and services deliver value to consumers even at the relatively elevated prices that often prevail early in their life cycles; currently, that value is not reflected in the CPI.

For that and other reasons outlined in the Boskin Commission report and other studies, we know with near certainty that the current CPI is off. We do not know precisely by how much, however. There is, nonetheless, a very high probability that the upward bias ranges between ½ percentage point per year and 1½ percentage points per year. Although this range happens to coincide with the one I gave two years ago, it does reflect both the improvements in the index that the BLS has implemented since then and the emergence of evidence suggesting that the initial problem was of a slightly greater dimension than had previously been estimated. This estimate is consistent with a number of microstatistical studies as well as an independently derived macroevaluation by staff at the Federal Reserve Board, which I will discuss shortly.

In judging these evaluations, it is incumbent upon us to resist the evident strong inclination to believe that precision is the equivalent of accuracy in price bias estimation. If we cannot find a precise estimate for a certain bias, we should not implicitly choose zero as though that was a more scientifically supportable estimate.

There is no sharp dividing line between a pristine estimate of a price and one that is not. All of the estimates in the CPI are approximations, in some cases very rough approximations. Further, even very rough approximations can give us a far better judgment of the cost of living, than holding to a false precision of accuracy. We would be far better served following the wise admonition of John Maynard Keynes that "it is better to be roughly right than precisely wrong."

Estimates of the magnitude of the bias in our price measures are available from a number of sources. Most have been developed from detailed examinations of the microstatistical evidence. However, recent work by staff economists at the Federal Reserve Board has added strong corroborating evidence of price mismeasurement using a macroeconomic approach that is essentially independent of the exercises performed by other researchers, including those on the Boskin Commission. In particular, employing the statistical system from which the Commerce Department estimates the national income and product accounts, the research finds that measured real output and productivity in the service sector are implausibly weak, given that the return to owners of businesses in that sector apparently has been well maintained. Taken at face value, the published data indicate that the level of output per hour in a number of service producing industries has been falling for more than two decades. In other words, the data imply that firms in these industries have been becoming less and less efficient for more than twenty years.

These circumstances simply are not credible. On the reasonable assumption that nominal output and hours worked and paid of the various industries are accurately measured, faulty price statistics are almost surely the likely cause of the implausible productivity trends. The source of a very large segment of these prices is the CPI.

For this exercise, the study used the GDP chain-weight price measures. Although these price measures are based on many of the same individual price indexes included in the CPI, they do not suffer from upper-level substitution bias. Hence, the price mismeasurement revealed by this data system largely reflects shortcomings in quality adjustment and in the treatment of new goods and services. If, instead of declining, productivity in these selected service industries was flat, to up a modest one percentage point per year, the implicit aggregate price bias associated with these service industries alone would be on the order of ½ percentage point or so per annum in recent years—very similar in magnitude to the Boskin Commission estimate of total quality adjustment and new products bias.

To be sure, it is theoretically possible that some of the measured productivity declines in these service industries merely reflect mispricing of intermediate transfers among various industries. Such an occurrence would cause an understatement of productivity in some sectors, but a corresponding overstatement in others. But the available evidence suggests that for these particular service industries this theoretical possibility is not of a sufficiently large empirical magnitude to overturn the basic conclusion that there are serious measurement problems in our price statistics. Moreover, the study did not attempt to evaluate possible quality and new products bias in other industries.

Some observers who are skeptical that the bias in the CPI could be very large have noted that the evidence on the magnitude of unmeasured quality change and the importance of new items bias is incomplete and inconclusive. Without a doubt, quality change and new items are among the most difficult of the problems currently confronting the BLS. But since I raised this issue two years ago in my testimony before this committee, a number of studies have documented significant new examples of cases in which the current treatment in the CPI results in an overstatement of the rate of growth of the cost of living.

There doubtless are certain components of the CPI that are biased downward because quality change is handled inappropriately. One instance in which there may well be a problem in this regard pertains to new vehicles, where it may be more appropriate to treat pollution control and mandatory safety equipment, at least in part, as raising price to a consumer rather than improving quality, as is the present practice. But the potential downward bias introduced by current methodology for such equipment can only be slight. We should be prepared to embrace credible new research on quality adjustment, regardless of whether that research points to additional sources of upward bias or previously undetected instances of downward bias. Nonetheless, currently available evidence very strongly supports the view that, on balance, the bias is decidedly toward failing to appropriately capture quality improvements in our price indexes. There is little reason to believe that this conclusion will change unless we alter our procedures.

A more difficult quality related issue is whether to reflect changes in broad environmental and social conditions in price measures that are used for indexing various components of federal outlays and receipts. That is, should the CPI reflect the influence of factors such as the level of crime, air and water quality, and the emergence of new diseases, which are not specifically related to products that consumers purchase? There is little in the record to suggest that, when it enacted the indexation of social security benefits in 1972, the Congress intended for the beneficiaries of that program to be compensated for changes in such environmental and social factors. Nor do these issues appear to have been raised when Congress debated the indexation of various tax parameters during the 1980s. Taking account of such conditions, particularly those that lie outside of the markets for goods and services, would be an interesting exercise in its own right, but would appear to extend well beyond the original intent of the Congress.

A considerable professional consensus already exists for at least two actions that would almost surely bring the CPI into closer alignment with a true cost-of-living index. First, we should move away from the concept of a fixed marketbasket at the upper level of aggregation, and move toward an aggregation formula that takes into account the tendency of consumers to alter the composition of their purchases in response to changes in relative prices. The BLS already calculates such an index on an experimental basis with a lag of about a year. If the Bureau adopts the Boskin Commission's recommendation that it publish a best practicer version of the CPI with a lag of a year, it should, without question, build that index on the foundation of a variable marketbasket.

There is a somewhat more difficult issue as to whether the concept of a variable marketbasket can be applied in "real time," that is, with the same degree of timeliness that characterizes the current CPI. It is not possible to implement the textbook versions of any of the so-called "superlative" index formulas in real time, because those formulas require contemporaneous data on expenditures, and those data are not presently available until about a year after the fact. However, this hardly forecloses the possibility of implementing an approximation to a superlative formula, and work should continue on the development of such an approximation.

A second area that will require attention is the aggregation of prices at the most detailed level of the index. This is a highly technical area, and an important example of how research by the staff at the BLS has advanced our knowledge. Without going into the details of the matter, it is sufficient to say that a selective move away from the current aggregation formula is warranted, and would probably make a modest further contribution to bringing the index more in line with the concept of a cost-of-living index.

Beyond these rather limited steps, most of the needed developments will require time, effort, and quite possibly additional resources. It is important that the Congress provide the Bureau with sufficient resources to pursue the agenda vigorously. These are difficult problems, and cannot be solved tomorrow or next week. But with adequate support and diligent effort, the pace of improvement should quicken. Moreover, an accelerated pace of BLS activity, and heightened congressional interest should galvanize analysts outside the government to contribute to the research effort.

Where will this longer-term effort be required? One of the key areas, by all accounts, is quality adjustment. As the Bureau has rightly noted, they do indeed already employ a variety of methods to control for quality change, but available evidence suggests that these are not sufficient to the task. Unfortunately, making improvements on this front will be difficult: Each item will have to be considered on its own, and there may well be limited transfer of knowledge from one item to the next.

Another key area on the longer-term agenda will be the estimation of the value of new products to consumers. Significant innovations, such as the personal computer, the cellular telephone, and the heart bypass operation create value for consumers, even at their typically high initial prices; moreover, this value is even greater at the much lower prices that often prevail when new products are, in fact, introduced into the CPI. A true cost-of-living index would reflect this value and its implication for the true rate of growth of the cost of living. The CPI does not reflect it, and accordingly fails to capture a significant offset to price rises in other products. Deriving an estimate of this value and building it into the CPI will not be an easy undertaking. But conceptually, it is unquestionably the right direction to be heading, and some recent research suggests that it could measurably affect the index.

Over time, we will need to investigate alternative sources of data. Already, there is interesting work being done to develop techniques for processing data collected from bar-code scanners at the check-out counter. Scanner data will allow the BLS to track not just a small sample of products, but virtually the entire universe of products in selected lines of business and, perhaps most importantly, virtually the universe of transactions, regardless of whether those transactions happen on a weekday, at night, or on a holiday.

We should also move to improve our understanding of the value that consumers place on their own time. Absent such knowledge, it will be impossible for the BLS to estimate the value of many goods and services that mainly serve to enhance convenience and save time.

Finally, we will have to attempt to build an understanding of why consumers shop at the places they do: What characteristics of an outlet are important, and how much so? Location, hours of operation, inventory, and quality of service all are likely influences on the value that consumers place on their shopping experience, and all will be important in helping the BLS to develop a more sophisticated statistical method for dealing with the appearance of new consumer outlets, including those that operate over the Internet.

Even if the BLS moves aggressively, some upward bias will almost surely remain in the CPI, at least for the next several years. Two years ago, in testimony before this committee, I suggested that a workable structure for dealing with this situation might involve a two-track approach. That suggestion still seems to me to make sense. The first track would involve action by the BLS to address those aspects of the bias that can be dealt with in relatively short order, say within the next year. The second track would involve the establishment of an independent national commission to set annual cost-of-living adjustment factors for federal receipt and outlay programs. The Commission would examine available evidence on a periodic basis, and estimate the bias in the CPI taking into account both the latest research on the sources and magnitudes of the bias, and any corrective actions that had been taken by the BLS. This type of approach would have the benefit of being objective, nonpartisan, and sufficiently flexible to take full account of the latest information. Moreover, there is no reason why the two tracks could not proceed in parallel.

Without the second track, we are implicitly assuming, contrary to overwhelming evidence, that the most accurate estimate of the bias is zero. There has been considerable objection that such a second track procedure would be a political fix. To the contrary, assuming zero for the remaining bias is the political fix. On this issue, we should let evidence, not politics, drive policy.

We have an overarching national interest in building a better measure of consumer prices and in implementing more rational indexation procedures. Through these efforts, we are most likely to ensure that the original intent of the relevant pieces of legislation will be fulfilled in insulating taxpayers and benefit recipients from the effects of ongoing changes in the cost of living. At present this objective is not being met.

Chairman Greenspan submitted the following in response to questions from Chairman Roth received subsequent to the January 30, 1997, hearing before the Senate Committee on Finance:

Q.1. First, earlier this week, Moody's downgraded the credit ratings of four medium-sized Japanese banks from "stable" to "negative." Moody's action resulted in further deterioration in the share prices of Japanese banks to the point that over the past year, those prices have declined by roughly half. Since Japanese banks rely heavily on the unrealized gains in their equity portfolios to bolster their incomes and meet international capital adequacy requirements, I'm concerned about the ability of Japanese banks to meet these requirements at the end of the Japanese business year on March 31. Can you provide your views on the ability of Japanese banks to meet these requirements?

A.1. At the end of September 1996, the last date for which the capital positions of Japanese banks have been reported, the average total risk-based capital ratio of the twenty major Japanese banks was about 9.3 percent, with all of the banks above the minimum of 8 percent and only three banks below 9 percent. The decline in equity values since then, everything else equal, will reduce the value of banks' unrealized gains on their holdings of equities and thus will have a negative effect on banks' capital.

In assessing Japanese banks' capital position, other factors must be taken into account. On the one hand, although Japanese banks have begun the process of setting aside provisions against possible losses on non-performing loans, they have further to go. On the other hand, they -- as well as Japanese authorities -- are now more fully aware of their need to recognize possible losses, and have taken important steps over the past year to raise new capital to help cover the losses.

Q.2. Second, as you know, on July 1, Hong Kong will revert to Chinese sovereignty. Beijing has promised that Hong Kong will be able to "exercise a high degree of autonomy" for fifty years following reversion. In 1993, the Hong Kong Monetary Authority was established, and it now performs the functions of a central bank. Interference from China in the affairs of the Authority would clearly have severe repercussions for the world's confidence in Hong Kong's economic future. In your view, how independent will the Hong Kong Monetary Authority be from such interference?

A.2. The agreements and legislation pertaining to the transition to Chinese sovereignty in Hong Kong provide for a continuation of current monetary arrangements in Hong Kong, consistent with the principle of "one country, two systems," which is to apply to nearly all aspects of the Hong Kong economy. Public statements by officials of the People's Bank of China and the Hong Kong Monetary Authority have not suggested any substantive difficulties with these arrangements. I have no basis on which to doubt the ability of the Hong Kong Monetary Authority to continue to exercise its responsibilities in an independent manner.

Q.3. I understand that a body called the Asian Monetary Network involving 11 central banks is currently in a formative stage. The Network originally focused on repurchase agreements of U.S. treasuries and is now working on creating a system of real-time settlements. I know the Fed has been consulted by members of the Network, but I have also have been told that one of the member central banks has been insistent on keeping the United States out of the group as a formal participant. In your view, how important is the Asian Monetary Network, what can it achieve, and would it be in America's interest to join this group as a formal member?

A.3. I believe your question refers to the so-called EMEAP group of central banks and monetary authorities where EMEAP stands for Executive Meeting of East Asia and Pacific Central Banks and includes as its members the 11 central banks or monetary authorities of: Australia, China, Hong Kong, Indonesia, Japan, Korea, Malaysia, New Zealand, the Philippines, Singapore and Thailand. The group was founded in 1991. Some members, on a bilateral basis, have entered into repurchase arrangements based on U.S. Treasury securities. The Federal Reserve is aware of these arrangements; we were not asked to participate in them.

The Federal Reserve has ongoing relations with each of the central banks or monetary authorities in EMEAP and has had some contact with the group itself. This is an important area of the world, and EMEAP may become an important grouping to the extent that it deals with common issues of economic and financial stability. We see no pressing need at this time for the Federal Reserve to become a formal member of the group.

Chairman Greenspan submitted the following in response to questions from Senator J. Robert Kerrey received subsequent to the January 30, 1997, hearing before the Senate Committee on Finance:

Q.1. Under what circumstances could you envision substantial wage growth that is not inflationary?

A.1. Wage increases that are matched fully by increases in labor productivity do not raise unit costs of production and thus are not inflationary. This observation underscores the point that lasting progress in raising real wages comes through the achievement of greater productivity.

Q.2. Last week before the Senate Budget Committee you stated "heightened job insecurity explains a significant part of the restraint on compensation and the consequent muted inflation." Could you explain what you meant by this?

A.2. Compensation increases in recent years have tended to be smaller than one might have expected, based on what occurred in the past in similar economic circumstances. Concerned about the loss of income that might be associated with job loss, and seeing the risk of job loss as higher than in the past (owing to a highly competitive economic environment and rapidly changing technology), many workers in effect have been willing to accept lesser wage increases in order to make it attractive for their employers to maintain employment levels. Because of competitive forces, some of this wage-saving has benefited consumers via smaller price increases.

Q.3. According to the recent Labor Department report, Americans are more concerned about keeping their jobs than actively seeking out larger paychecks. The result of this is that workers will settle for smaller wage increases despite tight labor markets. Why do you believe this phenomenon exists?

A.3. For the reasons I noted in responding to Q.2.

Q.4. What is the correlation, if there is any, between the employment cost index and inflation? Why might an unusual increase in the employment cost index cause some Fed officials to push for higher interest rates to prevent inflation? What is the reason behind this policy?

A.4. As I noted in my response to Q.1, increases in compensation rates not fully offset by increases in productivity tend to put upward pressure on prices. Historically, movements in the employment cost index and general price inflation have been positively correlated--though they have not moved in lockstep in every period.

In pursuing the goal of maximum sustainable economic growth, it is necessary to ensure that inflationary imbalances do not develop in the system. Excessive pressures show up in different places from cycle to cycle, and in some instances labor markets may be the initial locus. When the Federal Reserve acts to stem a buildup of inflationary pressures, the restriction on the growth of money and credit tends to push up interest rates, which, through various market channels, helps to bring aggregate demand and supply into better balance.

Q.5. I think we both agree that the future of America's fiscal health depends greatly on the need to address entitlement reform. According to your vision on a healthy long-term economy, what should Congress focus on as it considers changing entitlement law?

A.5. The immediate focus, it seems to me, must be on the financial viability of the individual programs and their ability to meet their essential purposes. From a macroeconomic perspective, however, we must not lose sight of how important these programs loom in the overall federal budget surplus/deficit--and the role, in turn, that the federal government's net borrowing requirements play in the national savings flows and our ability to finance productivity-enhancing capital formation.

Q.6. As you know the Boskin Commission reported the present CPI is an inaccurate measure of the cost of living. The BLS, which calculates this measurement, also agrees that the CPI is not an inefficient measurement for this purpose. I also know you did some analysis awhile back with very similar findings to the Boskin Commission. What recommendations did you come up with from your analysis?

A.6. It is clear that there is at least some upward bias to the CPI measurement of changes in the cost of living. Therefore, I believe it is appropriate for the Congress to take action to correct the excessive adjustment in benefit and tax programs that occurs under current law.

In order to address this situation, I advanced the view in my testimony that a two-track approach would be appropriate. The first track would involve continued concerted effort on the part of the Bureau of Labor Statistics to improve the CPI to the maximum degree possible. However, the measurement problems in this area are notoriously difficult, and even if the BLS moves aggressively, some upward bias almost surely will remain in the CPI, at least for the next several years. As a remedy for this residual upward bias, I proposed a second track of activity involving establishment of a national commission to set annual cost-of-living adjustment factors for federal receipt and outlay programs.

Q.7. The most recent expansion that we have been experiencing seems to be benefitting the high wage earners as opposed to the low wage earners. Recent reports indicate that the richest fifth's share of the wealth has been increasing, while the poorest fifth's share has been decreasing. This trend seems to support there is an ever-increasing gap between rich and poor. What are your thoughts on how to address this problem?

A.7. This is not a problem we can expect to solve overnight. A major focus for the long run must be to ensure that our workforce possesses the skills to operate in an economy that puts an increasing premium on the ability to deal with changing technology and with conceptual work.

Q.8. How do you view the current American savings rate? What kind of policies do you thing would encourage Americans to save more?

A.8. The national saving rate is too low. This has been showing through recently in a considerable reliance on foreign capital. Ultimately, we should expect to finance more of our investment from domestic resources.

The available evidence is ambiguous on whether tax incentives for household saving are efficient in generating higher net national saving. My judgment would be that, in terms of fiscal policies, the surest means of elevating national saving is to eliminate the federal budget deficit.

PREPARED STATEMENT OF HON. CONNIE MACK

It is indeed a pleasure to welcome Chairman Greenspan to today's hearing. His renowned knowledge and expertise on economic issues continue to provide essential guidance to me and to Congress as a whole as we deal with today's complex fiscal issues.

Under his guidance, the Federal Reserve has done a tremendous job of focusing on a stable and sound monetary policy that is essential for strong economic growth. There is no doubt that Chairman Greenspan's solid leadership has produced confidence and certainty among investors throughout the world.

While the economy has shown slow and steady growth over recent years, one of my concerns is the complacency that seems to exist over current growth rates. I believe our economy can and should grow faster. Stronger economic growth would mean more jobs, better paychecks, and a higher standard of living. And, faster growth would help us in our efforts to balance the budget by boosting revenues. Stronger economic growth would bring new opportunities to all Americans and a brighter future for our children and grandchildren.

Of course many incorrectly blame the Federal Reserve for slow economic growth. The Federal Reserve should remain focused on price stability. Chairman Greenspan and I would certainly agree that simply printing more money or artificially holding down interest rates is not the way to boost long-term economic growth. Real growth does not come from printing more money or artificially low interest rates. Genuine growth comes from hard work, creative ideas that improve productivity, and entrepreneurial activity. Therefore, we must be sure our fiscal policies foster and reward saving, investing, and risk taking while the Federal Reserve is best focused on reducing the level of inflation. Stable prices enhance economic growth by reducing the risk of fluctuations in interest rates, currency values and the cost of inputs.

For most of this century, American families have enjoyed the benefits of stronger economic growth—with each generation leaving the next better off. But recently, we have seen our economic growth rate fall from a robust 4.4 percent annual average during the last five expansions to only 2.4 percent during President Clinton's tenure. Still, many people, including President Clinton, now consider a growth rate of 2.4 percent to be acceptable—even laudable. We should not accept such mediocrity and I'm sure that with the right policy changes we can do much better.

In recent years, major tax hikes, increased government spending and growing regulations have taken their toll on the economy and the American family. Conversely, the periods of our nation's strongest economic growth were marked by lower taxes, less spending and fewer federal regulations. However, I am optimistic to see our current budget debate focused on bipartisan support for balancing the budget through less spending and lower taxes.

I am anxious to hear Chairman Greenspan's views on just how fast our economy can grow. Maybe 2.5 percent average growth is all we can expect under today's high federal tax and deficit spending structure. I would greatly appreciate Chairman Greenspan's input on what pro-growth policy changes Congress can make in order to raise the bar for our potential economic growth level. I strongly believe that we must make GROWTH the centerpiece of our fiscal policy efforts. After all, growth is really nothing less than a proxy for the American Dream.

PREPARED STATEMENT OF HON. WILLIAM V. ROTH, JR.

Good morning. Today we will hear testimony from the Chairman of the Federal Reserve System, Dr. Alan Greenspan. Dr. Greenspan is currently in his tenth year at the helm of the Federal Reserve and is widely respected on Wall Street, main street, and of course on both ends of Pennsylvania Avenue.

Clearly your views on the national economic outlook are particularly important to our Committee given our jurisdiction over all major entitlements and tax policy. We are all aware of your keen interest in a balanced federal budget as a way to improve our national economic outlook and growth potential.

It has always been my belief that a balance federal budget will lead to a stronger, sustainable, expanding economy. But more importantly, I believe that we must translate higher economic growth into higher wages and personal economic security for each individual American.

Today our Committee looks forward to your comments on the economy and the federal budget. In our invitation to you to testify I have also asked that you comment on the newly proposed personal security or private investment accounts that have recently become a major component of reform proposals by two of the three Social Security Advisory Council reports.

Earlier this week. the Wall Street Journal detailed the importance of accurate economic statistics as policymakers such as yourself and the members of the Congress work toward a better economy.

As you know, Dr. Michael Boskin and his Commissioners studying the accuracy of the Consumer Price Index have found that this important statistic has overstated the rate of inflation by about 1.1 percentage points. We look forward to your comments on his findings.

Recent news reports have also suggested that some other important economic statistics may not be as accurate as possible—productivity numbers, trade numbers and wage increase data—to name a few. Clearly this news is troubling.

Another area of particular concern to me is the stagnating wages of workers in America. Clearly the economic recovery in recent years has been somewhat lukewarm. While GDP growth has been hovering around 2 percent, and interest rates are generally low, many Americans do not feel that their pocket books have benefitted from our recent economic recovery. Personal bankruptcies have gone up and many wage earners do not fee! better off today than they were during the robust expansion of the late 1980s.

Again, thank you for appearing before our Committee today to discuss these important issue.

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