

**FEDERAL OPEN MARKET COMMITTEE
CONFERENCE CALL
February 18, 1993**

PRESENT: Mr. Greenspan, Chairman
Mr. Corrigan, Vice Chairman
Mr. Angell
Mr. Boehne
Mr. Keehn
Mr. Kelley
Mr. LaWare
Mr. Lindsey
Mr. McTeer
Mr. Mullins
Ms. Phillips
Mr. Stern

Messrs. Jordan, and Forrestal, Alternate Members of the Federal Open
Market Committee

Messrs. Hoenig, Melzer, and Syron, Presidents of the Federal Reserve Banks of
Kansas City, St. Louis, and Boston respectively

Mr. Kohn, Secretary and Economist
Mr. Bernard, Deputy Secretary
Mr. Coyne, Assistant Secretary
Mr. Gillum, Assistant Secretary
Mr. Mattingly, General Counsel
Mr. Prell, Economist
Mr. Truman, Economist

Messrs. Lang, Lindsey, Promisel, Rolnick, Rosenblum, Scheld, Siegman,
Simpson, and Slifman, Associate Economists

Mr. McDonough, Manager of the System Open Market Account
Ms. Greene, Deputy Manager for Foreign Operations
Ms. Lovett, Deputy Manager for Domestic Operations

Mr. Stockton, Associate Director, Division of Research and Statistics, Board of
Governors

Mr. Wiles, Secretary of the Board, Office of the Secretary, Board of Governors
Mr. Winn, Assistant to the Board, Office of Board Members, Board of Governors

Messrs. Barron and Monhollon, First Vice Presidents, Federal Reserve Banks of San Francisco and Richmond respectively

Messrs. Beebe, J. Davis, T. Davis, Dewald, and Ms. Tschinkel, Senior Vice Presidents, Federal Reserve Bank of San Francisco, Cleveland, Kansas City, St. Louis, and Atlanta respectively

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CHAIRMAN GREENSPAN. Good afternoon, everyone. The purpose of this session is essentially to discuss the response of the Federal Reserve as a whole to the President's program of last night. Granted, we don't know terribly much about it. I thought the best way to proceed is to read to you a draft of a possible statement that I might make tomorrow morning to try to capture the point that, basically, our fundamental interest is in the deficit reduction and we don't have a position--nor should we--on how it is done. So let me read this and open it up for comment and, hopefully, we'll get some notions of how we can maneuver ourselves through a very narrow thicket at this particular stage, for lots of obvious reasons. The statement starts:

The President is to be commended for placing on the table for active debate the issue of our burgeoning structural budget deficit, which will increasingly threaten the stability of our economic system if we continue to fail to address it. Leaving aside the specific details, it is a serious proposal, its baseline economic assumptions are not implausible, and it is a detailed program-by-program set of recommendations as distinct from general goals.

It is obviously very difficult to get a consensus on deficit cutting. If it were easy, it would have been done long ago. The debate amongst the nation's elected representatives will be profoundly political, in the best sense of the word. As the nation's central bankers, we may as individuals have views on how best to do this but our primary and professional concern is having the structural deficit sharply reduced and soon.

Time is no longer on our side. After declining through 1996, the [projected] current services deficit starts on an irreversible upward path again. The deficit and the mounting federal debt as a percent of gross domestic product are corrosive forces slowly undermining the vitality of our free market system.

If we fail to resolve our structural deficit at this time, the next opportunity will doubtless confront us with still more difficult choices. How the deficit is reduced is very important. That it be done is crucial.

In this regard there are certain issues that I have discussed with this and other committees in the Congress over the years, which are worth repeating.

First, with current services outlays from 1997 and beyond rising faster than the tax base, stabilization of the ratio of the deficit to nominal gross domestic product, not to mention a reduction, would require ever increasing tax rates. Hence, there is no alternative to achieving much slower growth of outlays. This implies not only the need to make cuts now, but to control future spending impulses.

Second, the hope that we can possibly grow our way out of the structural deficit is fanciful. Certainly greater inflation is not the answer; aside from its serious debilitating effects on our economic system, higher receipts and expenditures, would not reduce the deficit. As I indicated in testimony last month to the Joint Economic Committee, there is a possibility that productivity growth may be moving to a faster long-term channel, boosting real growth over time. But even if that turns out to be the case, it wouldn't resolve the basic long-term imbalance in our budgetary accounts.

Finally, fear that the deficit reduction can be overdone and create a degree of "fiscal drag" that would significantly harm the economy I find misplaced. In our current political environment, to presume that the Congress and the President could jointly cut too much from the deficit too soon is in the words of my predecessor "nothing I would lose sleep over."

The Federal Reserve recognizes that it has an important role to play in this regard. The effects of changes in taxes and spending on the economy are complex and difficult to predict. Nonetheless, the Federal Reserve will be adjusting its policy as necessary to achieve our common goal of producing the greatest possible gain in living standards for the American people over time.

Then in addition to that oral statement there is a statement at the end of the written testimony, which I do not intend to read [when I testify], but I want to read it now because it is related to this particular issue:

The Federal Reserve in formulating monetary policy certainly needs to take into account fiscal policy developments. Of course, it is not possible for the Federal Reserve to specify in advance what actions might be taken in the presence of particular fiscal policy strategies. Clearly, the course of interest rates and financial market conditions more generally will depend importantly on a host of forces--in addition to fiscal policy--affecting the economy and prices. And the effects of fiscal policy on the economy in turn will depend importantly on the credibility of long-run deficit reduction and the market reaction to any package. The lower long-run interest rates that would result from a credible deficit reduction plan would themselves have an immediate positive effect on the economy. In any event, I can assure you of our shared goal for the American economy: the greatest possible increase in living standards for our citizens over time.

In the questions and answers, which I'm invariably going to get on this--and I suspect it may well be the dominant element of questioning in the hearing tomorrow--I'm going to try to stick very closely to my plan of not answering specific questions relevant to any of the particular programs or even to the overall composition of taxes

and spending; I plan to stay pretty close to areas I've covered in the past. It strikes me that what is evolving here is something that could be quite politically bitter, and I think it's crucially important that we remain basically noncommittal on these various issues. In any event, that's the substance of what I wanted to report today. And I would be pleased if anyone could suggest alterations, criticisms, or somewhat different directions. Yes, Mr. Lindsey.

MR. LINDSEY. Mr. Chairman, I have two very small but specific suggestions for the second point about growing our way out [of the deficit]. I think what you ought to say is that to inflate our way out is not [possible]. Further down in that paragraph you stated that productivity increases will not change the federal debt outcome. I would say that productivity increases, absent spending restraints, will not change the federal debt outcome. The reason I say that is that the new activity with respect to real income growth is quite high, on the order of 1.3 percent. The reason that down the road it will not bear on the deficit is that the spending growth [unintelligible]. So, I would propose those two very specific changes.

CHAIRMAN GREENSPAN. Well, let me look at it. The reason I'm a bit doubtful about the issue of spending restraint implying that something might happen is that I asked for a simulation, including your 1.3 percent adjustment, of what would occur on a 2 percent productivity growth [trend]. Even though there was a significant reduction over the long run in the structural deficit, it still was monumental in size. So I would prefer almost not to qualify that because I have a suspicion that this [future deficit] problem we're looking at is even larger than we suspect. One of the aspects of this that I really find quite disturbing is that the December tax agreement, which allegedly was to reduce the deficit by \$500 billion then, on revaluation by the CBO and the staff here still appears to be in place--meaning that very little has [been cut] from [the previous] expectation. This in turn suggests that the problem back then was much larger than they had perceived. What concerns me at the moment is that the current problem may also be larger than we perceive. And one of the reasons is that there is a downward bias tendency in the estimating procedures on the budgets. I would say that's largely because of the fact that the normal expected increases, which is how these estimates are made, will after the fact turn out to be a distribution with a long tail. A lot of individual items [that add to the deficit] tend to be outsized and usually they tend to very significantly overcome the shortfalls in the projections. And the concept of the current services budget is one which presupposes that there is no change in statutes or no change in anything, which is not credible considering that the Congress meets for 10 months of the year and invariably one of its basic purposes is to try to find elements within the budget that assist their constituents. So there is an element in the current services budget which is probably [understated by] \$20 billion a year; it's there but we don't know where it is.

MR. LINDSEY. What you're saying is that the programs may be more than we expect because they're underestimated by the committee or--

CHAIRMAN GREENSPAN. Yes.

MR. LINDSEY. And the Congress will add new [spending] programs. I think that's yet another reason to put in the words "absent spending constraints" because that's exactly where the shortfall--

CHAIRMAN GREENSPAN. Yes, why don't we look at that statute?

MR. BOEHNE. In the past you have expressed a preference that the budget deficit should be reduced more from the expenditure side rather than from the tax side, and that is not in this statement. I'm not advocating that it necessarily should be, but you undoubtedly will be asked about that, given that it is one of the essential issues in this debate. And I'm wondering how you will respond.

CHAIRMAN GREENSPAN. Well, I will just repeat what I've said in the past: That if the purpose is to get the budget deficit down, what evidence we have suggests that it is more productive to do so by cutting the expenditure side and programs than by increasing revenues. And I think the experience of the last 10 years has very clearly supported that.

MR. BOEHNE. In reading the transcripts of the hearing you had with the Senate Budget Committee a week or two ago, between the lines there seemed to be some thinking on the part of Senator Sasser that he had an understanding of some sort of a deal [with the Federal Reserve] following the 1990 budget accord and that there is some unhappiness on his part that he somehow feels that we didn't follow through on that. Is that view generally held--that the Fed committed to something and we didn't follow through? Or what is the origin of Sasser's views on that?

CHAIRMAN GREENSPAN. I think it's mainly Sasser. He has a view that we basically promised to respond in the event that there was a budget deal. Yet as I recall, and as I think the transcripts [of the hearings] tend to indicate, I was very careful always to say that the market would be the arbiter.

I've raised that with him in private and in public and I never seem to make terribly much progress. I have not seen it as a big issue elsewhere. But I do recall at the time that even though we said that should the bond markets respond, we might respond in ways unspecified I was very careful about [my response to] that question. I never veered from the mantra of: If the deal is perceived as credible by the market, then long-term rates would fall and we would respond to that. But I guess I didn't get through to James Sasser.

VICE CHAIRMAN CORRIGAN. Alan, could you read that sentence about [unintelligible] again please?

CHAIRMAN GREENSPAN. Yes, just a second, Jerry. "Finally, fear that the deficit reduction can be overdone and create a degree of fiscal drag that would significantly harm the economy..."

VICE CHAIRMAN CORRIGAN. It's not in that part, really. You [noted] three points that were important to you. I think at the end of the third point there was a specific sentence about policy.

SPEAKER(?). It's at the end, sir.

CHAIRMAN GREENSPAN. At the very end? Oh, I see; I beg your pardon. "Nonetheless, the Federal Reserve will be adjusting its policy as necessary to achieve our common goal of producing the greatest possible gain in living standards for the American people over time."

MR. MELZER. Alan, I think what Jerry might want to do is to add to the statement you started to read about overdoing it.

CHAIRMAN GREENSPAN. Okay.

VICE CHAIRMAN CORRIGAN. Actually, in the first instance the caveat in that sentence that Alan just read is that I'm a little concerned about that reference to adjusting policy in precisely that context. For example, later on when you talk about monetary policy you say that monetary policy has to take a lot of things, including fiscal policy, into account.

CHAIRMAN GREENSPAN. Yes.

VICE CHAIRMAN CORRIGAN. And that flavor, frankly, has a bit more appeal to me.

CHAIRMAN GREENSPAN. [Unintelligible] for some reason we can't put that in here, why don't we do that.

VICE CHAIRMAN CORRIGAN. It's hard to see that when we don't have the words in front of us, so let me just leave the thought with you that when you read that sentence that you just reread, it sounded to me as though it was something [akin] to the interpretation of dangling something out there here and now.

MR. ANGELL. I agree, Jerry.

CHAIRMAN GREENSPAN. Well, I think you're right; that looks slightly over the line.

VICE CHAIRMAN CORRIGAN. It's [unintelligible] when you don't have it in front of you; but that was my reaction as you read it, for what it's worth.

CHAIRMAN GREENSPAN. Sure.

MR. ANGELL. Alan, here again in this same area, when you talked about inflation, it seemed to be a very defensive statement. It was that somehow [or other] our goal was not to have inflation get worse, which seems to me something of a departure from our commitment to lowering the rate of inflation until it no longer is a factor taken into account in business decisions. And that leads to rising standards of living. I'm afraid that--

CHAIRMAN GREENSPAN. That's what is in the actual text. I'm reading text.

MR. ANGELL. I know, but what you just read in this statement--

CHAIRMAN GREENSPAN. You're [referring to] saying "Certainly greater inflation is not the answer"?

MR. ANGELL. Yes. I mean--

MR. MULLINS. There are several alternatives to dealing with the deficit--

CHAIRMAN GREENSPAN. Yes.

MR. ANGELL. The thing that concerns me is that--

CHAIRMAN GREENSPAN. Really [unintelligible] the same thing can inflate [unintelligible].

MR. ANGELL. Yes I know, but by and large we've been careful to keep in mind or we've always thought we had to keep the focus on a reduction of inflation in order to get bond prices to respond the way we wanted them to. And now that we've got bond prices responding, do we have some reason there why--

CHAIRMAN GREENSPAN. No, no, this is really a different issue. This is not a policy directive that we're doing that is directed toward restoring a noninflationary environment. This is the argument against those who are advocating inflating our way out of the budget deficit problem.

MR. ANGELL. Yes.

CHAIRMAN GREENSPAN. So it's their position, not ours.

MR. JORDAN. This is Jerry Jordan. I reacted the same way Jerry Corrigan did, and I think the confusion comes from making a reference to adjusting policy as opposed to actions to achieve our policy. Our policy isn't to raise and lower the federal funds rate. Our policy is to move toward price stability. And I think the way we communicate our objectives as opposed to the actions we take in the short run needs to be fairly clear. It's our actions that we adapt to what the fiscal impulse is, not what our policy [objective] is.

CHAIRMAN GREENSPAN. Well, now wait a second. There are two different questions here. There's the one that Jerry raised and there's the one that Wayne raised. Those are not the same issue.

MR. ANGELL. That's right.

CHAIRMAN GREENSPAN. I think Jerry's point is one that [is relevant] as far as adjustment. I'm not convinced that the issue that Wayne is raising requires that. [Wayne], maybe you ought to read this; since you're here, you can look at it and see whether--. I don't get the same sense that you do; that's my problem.

MR. ANGELL. Yes. In all the material that you've read you didn't once mention price stability.

CHAIRMAN GREENSPAN. Oh, but I'm only reading this fiscal part. There's a long section on price stability in there that I'll be reading tomorrow.

MR. ANGELL. But my sensitivity is to the bond market today. That seems to me all caught up in this notion that somehow or another a deal is being done on fiscal policy and monetary policy.

CHAIRMAN GREENSPAN. That's the issue Jerry [Corrigan] is raising, which I think we can get out. But I do want to say [adamantly] that we can't inflate. Do we want to not say that or what? I think we do.

MR. ANGELL. Okay, but the two times that you talk about a common goal, which is to raise the living standards, you do not mention that we raise the living standards on our end by proceeding toward price stability. That's the vehicle that's consistent with that.

CHAIRMAN GREENSPAN. Don, has [a comment]. Why don't you go ahead.

MR. KOHN. Governor Angell, Chairman Greenspan was just reading part of the testimony. Just before that there is a sentence he would be reading that says "Containing and over time eliminating inflation is a key element and a strategy to foster maximum sustainable long-run growth of the economy." And then he has a paragraph or two on that. So he restates the price stability goal before he gets to fiscal policy.

MR. ANGELL. Suppose you get a question that says "We know you want to proceed toward price stability but you also want fiscal improvement. How would you balance these?" Suppose you had to choose between them, how would you choose?

CHAIRMAN GREENSPAN. I wasn't aware that there is a contradiction between them. To me it's the same issue. I would say a necessary condition for long-term price stability is that we resolve the budget deficit problem. Wouldn't you answer it that way?

MR. ANGELL. No.

CHAIRMAN GREENSPAN. How would you answer it?

MR. ANGELL. I would be very concerned that you could get yourself in that spot. Then the fiscal policy people have got you.

CHAIRMAN GREENSPAN. Why?

MR. ANGELL. Because that almost gets back to the Brady argument of why won't you give us the kind of growth that gives us the revenue to fix our fiscal policy?

CHAIRMAN GREENSPAN. Okay, maybe I'm a little fuzzy [on] that. If we have very large federal deficits, it will make it difficult for us as a central bank to achieve price stability.

MR. ANGELL. Yes, my view is that when we move from a high-inflation environment to a low-inflation environment we are always going to have a fiscal policy problem. A fiscal deficit problem follows; that's one of the transition prices we pay.

CHAIRMAN GREENSPAN. You mean it's the same issue that Larry Lindsey was raising [unintelligible] the 1.3--

MR. ANGELL. Yes.

MR. LINDSEY. Yes.

VICE CHAIRMAN CORRIGAN. Alan, I agree with what Wayne is saying but I assume that the testimony as a whole deals with that time and time again. And I must say that the way you have that [worded], at least as I remember your reading it, I think for this purpose is precisely the right way to do it because everything you read relates to the structural deficit. And in a context of a discussion about the structural deficit it seems to me that the point you're trying to make in that paragraph--in effect that we can't inflate [out of] a structural deficit--has to depend on its own merits. And I really don't think it's in your interest--as a matter of fact I think it might be almost suicidal--to try to entangle the price stability argument into that context. As I said, I assume that the price stability argument is thoroughly embossed in the main part of your overall testimony.

CHAIRMAN GREENSPAN. That is correct.

MR. ANGELL. Jerry I agree that it is there, and maybe I'm overly sensitive on this--

CHAIRMAN GREENSPAN. Well, why don't you and I--we have the advantage of being able to look at this where the rest don't--

MR. ANGELL. Sure.

CHAIRMAN GREENSPAN. We need to be questioning the definition of a structural deficit presumably as one we can't [inflate] our way out of. So it's sort of a circular reasoning--

VICE CHAIRMAN CORRIGAN. No, I thought the beauty of that statement as you have it drafted there was that you're talking solely about a structural deficit; and that's the power of the argument.

MR. MELZER. Alan, this is Tom Melzer. This is not something in the written statement but it picks up on something you said before and just mentioned a minute ago that I think you may have to be a little careful on. And that is saying "let the markets be the arbiter," with the implication being that if long-rates come down, that perhaps creates some scope for monetary policy to be eased. Now, I think that might be right if the posture of current monetary policy tended to be one of leaning against inflationary pressures in the economy and we were [restrictive] in some sense. But I don't know whether that would necessarily indicate a situation where real rates are larger [unintelligible] zero; it may not be a [restrictive] policy in a current sense. So I think it's really very tricky for you to say even that. I know there are conditions under which that would obtain; but if you say that, it creates the implication that if long rates came down and stayed down, then people could reasonably expect us to lower short rates. And I'm not sure that we want to be in that position.

CHAIRMAN GREENSPAN. Well, I agree with that, Tom. I think there is a danger playing that game for exactly the reason you suggest. My emphasis in this area is not so much the issue of policy but the question of who determines whether a fiscal policy is credible.

MR. MELZER. No, I understand.

CHAIRMAN GREENSPAN. And you're quite right that the next step is a very tricky one, and one we've got to stay very fuzzy on if we can possibly arrange it.

MR. MELZER. Yes, okay.

MR. MULLINS. I think this is particularly sensitive because by the time you testify the long bond may well have a 6 before it instead of a 7. And some people, having heard our testimony on this about the market being the arbiter many times before, may suggest that the market has ruled on whether this is credible and--

CHAIRMAN GREENSPAN. What is the "this" in this case?

MR. MULLINS. The package.

CHAIRMAN GREENSPAN. Well, the question is: Are they going to pass it?

MR. SYRON. But what I would argue is that one reason the rate may be down, with a 6 in front of it, is that monetary policy has been credible. It's only now being joined by the hope of fiscal stimulus; but it's because monetary policy has been credible.

CHAIRMAN GREENSPAN. Yes. I think, Dick, what the President has succeeded in doing in the last three or four weeks is to create an aura that he is really serious and that he has put the budget issue on the table. And last night he really cemented it in the sense that he has taken very large political risks. And I think the markets are aware that this is a serious effort, which even if it fails in total may succeed in part. And that's better than what we've had.

MR. SYRON. Mr. Chairman, you referred to the assumptions as being "not implausible." Are you likely to get a lot of questions about the assumptions or do you want to get into that if--

CHAIRMAN GREENSPAN. Remember, Dick, what I said is that the baseline economic assumptions--in other words really the CBO assumptions--are not implausible. I'm not arguing what the post-policy economic effect is going to be, which is something we want to stay away from like the plague.

MR. SYRON. Yes, I think it would be very early frankly, particularly given that they're just assembling a team at the Treasury, for them to have run through those things.

CHAIRMAN GREENSPAN. Oh no; they actually have done it. They have a policy estimate at CEA at this stage; Alan Blinder is a [macro]-economist who works on this all the time. So what we have is a standard DRI-type evaluation.

VICE CHAIRMAN CORRIGAN. It's true, Alan; what you're referring to there is that from '94 out they have a real GDP growth assumption in the baseline of 2-1/2 percent.

CHAIRMAN GREENSPAN. That's right.

VICE CHAIRMAN CORRIGAN. By any standard I think that is conservative or typical or--

MR. SYRON. I think that's right, Jerry. But the question I had is: Do we have to say "not implausible"? Maybe it would just be better to say "plausible" rather than--

CHAIRMAN GREENSPAN. I chose the double negative because I was trying not to be too direct.

MR. ANGELL. But when you get on that point, we have to recognize that they have low growth in there. But low growth, then, is consistent with a 3 percent fed funds rate as far as the eye can see.

CHAIRMAN GREENSPAN. The CBO has a rise in the funds rate.

MR. ANGELL. Beginning when?

CHAIRMAN GREENSPAN. When is it--next year?

MR. PRELL. I think it's this year.

SPEAKER(?). The end of this year, I think.

VICE CHAIRMAN CORRIGAN. I think it's rather inappropriate to have a sentence in there like that. This is the first time in my memory that a budget and economic planning are based on anything other than a rosy scenario; the rosy scenario is what we've had in the past. I think they deserve credit for that.

CHAIRMAN GREENSPAN. Yes. I don't know how far I would go on this whole thing, but there's a sense in which President Clinton is being really straight. I don't particularly like [some aspects of] the program, but there are 150 items on which the President has specific budgetary changes.

MR. SYRON. But the only question I had is whether someone would see the double negative as being overly grudging; they may not, given it's our usual way of putting things.

MR. ANGELL. Right.

CHAIRMAN GREENSPAN. I don't know. If anybody thinks I should take it out, I'll take it out.

MR. KEEHN. Alan, this is Si Keehn. First of all, I think the statement is very well drawn. I must say, listening to it, it sounds like a very good [statement] on these issues. But let me come back to a point that Ed Boehne raised--this is a question I'm sure you're going to be asked--on this balance between expenditures and revenues. I do understand the arithmetic that you tried to point out, but I

wonder if you can try to emphasize the expenditure side just a little more, particularly the timing, so that we don't get out so far that we lose this. Losing on the expenditure side would raise the dangers that the credibility of the package will dissipate and that will have an adverse market reaction.

CHAIRMAN GREENSPAN. The problem that I have, Si, is that I'm on the record, as Ed points out, as making this statement on what I thought was the right position then and that, frankly, I think is the right position now--

VICE CHAIRMAN CORRIGAN. Alan, it's Jerry again. That could be a pesky issue. In the context of Si's question and maybe Ed's question as well, is it possible that you could say what you said before but at least in generic terms raise the question of the enforcement mechanism on the spending side?

MR. KEEHN. Yes, that's a good suggestion.

VICE CHAIRMAN CORRIGAN. Without having to get into the line-by-line type of stuff?

CHAIRMAN GREENSPAN. You mean the type of mechanism that was in the 1990--?

VICE CHAIRMAN CORRIGAN. I don't think you have to endorse one or the other.

CHAIRMAN GREENSPAN. Actually, I think there is an enforcement mechanism in the present [proposal]. It's a diminishing version, somebody told me. I haven't seen it; I just heard it as hearsay.

VICE CHAIRMAN CORRIGAN. As I said, I don't think you have to get to the point where you endorse one mechanism or another. But it seems to me that you can stick to that answer you gave to Ed Boehne before but if you get further pressure, along the lines of Si's question, you might be able to get away with just conceptually stressing the importance of a credible enforcement mechanism on the spending side and avoid getting trapped into a line-by-line discussion of individual spending programs.

MR. KEEHN. That really is the point I was trying to make--to emphasize the danger of losing ground on the expenditure side.

MR. BOEHNE. Alan, this is Ed Boehne again. As far as the overall statement goes, I think it's well crafted and I'm supportive of it. However, while it's clear you're going to get a lot of questions on [general] policy and that people up there will try to get you on one side or the other of these various issues, I think you're quite right that we want to stay away from that. But the central issue that we have to be concerned about--and where you're going to get pressed--is how monetary policy will react. And your position is that the economy, of course, depends on a lot of things, [including] fiscal policy, and that the Fed is going to stay ready and do what is right. But I think you could get pushed a little more, especially if you look at what has happened to the money supply. We're not just getting small declines in M2, we're getting some big declines and M1 seems to be weakening. Now, these numbers will not be available up

there as we have them now, but I suspect the argument will go something like this: "Look, we have a credible [program for deficit] reduction going here and the long bond market says it's credible. We could buy [the argument] that there might something wrong with M2 but now we really seem to be getting almost a crashing in these aggregates." I don't think I fully understand why, but I think it makes this issue of how monetary policy is going to respond a more difficult one for us to deal with.

CHAIRMAN GREENSPAN. Yes, especially since next Friday there will very likely be a major upward revision in the fourth-quarter GDP. The numbers around here are in excess of 5 percent.

MR. BOEHNE. Yes.

CHAIRMAN GREENSPAN. Now, I do think the first quarter is--if it's 3 percent they're doing well--and it looks less than that maybe. But I'm going to be getting it from both sides. I'm going to be getting questioned on [our] response to the CPI, to the strong growth, to the view that the stimulus is dangerous. I'll get that on the one hand and then presumably to a lesser extent on the other side that this is a faltering recovery with no employment growth. And I think it's very difficult to get a judgment at this stage as to where the balance [of the questioning] is going to be because it's going to depend in large part on which senators show up.

VICE CHAIRMAN CORRIGAN. I don't think you're going to have to worry about that, Alan.

CHAIRMAN GREENSPAN. It's on a Friday.

MR. LAWARE. If this massive tax increase dumps the economy, what are they going to expect us to do about it?

MR. MULLINS. That's another reason the long bond rate could be going down.

CHAIRMAN GREENSPAN. Yes, there's a good chance that what that bond rate is doing is not an anti-inflation issue but a deflation--

MR. MULLINS. Yes.

MR. ANGELL. Mike, if there were some depressing effects from the tax package, what do we think the timing would be?

CHAIRMAN GREENSPAN. I think it would be several years out. That's the real issue.

MR. PRELL. Well, obviously, the [programs] get phased in, but it's a conjecture. It's the same sort of conjecture that's involved in why interest rates are declining now in anticipation. As I have pointed out [in the past], you can make the same arguments that people expect their disposable incomes to be lower in future years and you could pull forward an expenditure depressant effect on consumption expenditures. So, I think it's very hard--

CHAIRMAN GREENSPAN. The income tax changes are effective, as of now, retroactive to January 1st. And the question really is: Is

the marginal propensity to consume of the upper income groups significantly different from everybody else? Evidence suggests not really.

MR. PRELL. [The difference is] not very large.

CHAIRMAN GREENSPAN. Not very large.

MR. MULLINS. [But the question is] whether they're the only ones who are going to adjust their behavior or whether the feeling that taxes are higher is more widespread.

CHAIRMAN GREENSPAN. Well, the energy tax doesn't crank in for a while--for a year, year and a half.

MR. MULLINS. Yes, but I think it's a very credible--

CHAIRMAN GREENSPAN. But nobody's paying it; it's all hidden.

MR. ANGELL. But when will this \$31 billion of extra spending [occur]? It is \$31 billion above the baseline, isn't it?

CHAIRMAN GREENSPAN. Yes.

MR. ANGELL. So when does the fiscal impact of that \$31 billion plus the baseline kick in?

CHAIRMAN GREENSPAN. Soon.

MR. PRELL. Well, they've made the incremental tax credit temporary. That means you could get a considerable tax credit; you could get a lot of bang from moving forward investment that would have occurred later. But that's probably more a '94 effect since [firms] have until the end of '94.

CHAIRMAN GREENSPAN. Which raises the interesting question: Can we credibly assume that the decline in long-term rates [reflects the anticipated] deflationary effect of a tax--

MR. ANGELL. I don't see how it could be.

MR. PRELL. Well, one way of looking at the argument is that what brings the real rate down is the anticipation of weaker aggregate demand down the road. That's one possible explanation. If it were all an inflation expectation story, then the real rate wouldn't be adjusting as much and we'd get less bang from this anticipatory effect. But--

SPEAKER(?). Mike, did you run this through your model?

MR. PRELL. One can only do that artificially because our model doesn't have this kind of anticipatory structure. But we have run simulations that just arbitrarily lower long-term rates. I might be able to put my finger on something, in fact.

VICE CHAIRMAN CORRIGAN. Alan, let me come back again to this long-term rate question. It seems to me that one has to be very, very careful here. If the reaction to the Clinton plan in the Congress is

politics as usual and within a week or 10 days we have a traditional partisan street fight going on in the Congress, that reduction in long-term interest rates could be reversed with a vengeance.

CHAIRMAN GREENSPAN. I think that's the danger, and that would bring the stock market down with it.

VICE CHAIRMAN CORRIGAN. Be very careful about [unintelligible] this improvement in long-term rates as characterized. I would personally be very, very hesitant about trying to draw fine lines of distinction as to what [deficit reduction] is saying about inflation or what it's saying about anything. Again, it wouldn't take much at all, based on the track record of the way these things work out in the Congress from a process point of view, for the bond market to tank in a hurry.

CHAIRMAN GREENSPAN. How would you answer the question of "What's your explanation of why the long-term rates are going down?"

VICE CHAIRMAN CORRIGAN. Well, I personally would answer it by saying that it reflects a broad-based judgment that we have a fighting chance of getting a real measure of fiscal restraint. And if you want [unintelligible] because if you don't, it's going to back up.

CHAIRMAN GREENSPAN. That's the position we've been taking. And it's only very recently that the notion has surfaced that this tax [change] could be coming on in a somewhat different mode. I could say "What has happened here is that President Clinton has all of a sudden broken the mold of this chronic runaway long-term deficit, and even a slight improvement is a part of [the reason]. It's up in the air."

VICE CHAIRMAN CORRIGAN. That's the point in the context of a number of the other comments and observations that are being made here. If one tries to get into this sophisticated fine-tuning argument about how much of the improvement of long rates is due to X and how much is due to Y and how much is due to Z, I see that as a black hole.

CHAIRMAN GREENSPAN. It is probably worse than that. There is absolutely no way we can know.

VICE CHAIRMAN CORRIGAN. Again, I don't know what your feeling is but my feeling is that if we have the usual partisan street fight in the Congress starting tomorrow or next week, this [decline in long-term rates] could turn around in a flash and with a vengeance.

CHAIRMAN GREENSPAN. Yes. I think if the Republicans come together in the Senate, the Democrats probably do not have the capability of holding a majority in the Senate for anything close to the President's program. In the House, they may be able to.

MR. ANGELL. You mean on the procedural votes?

CHAIRMAN GREENSPAN. Any of the votes. I mean that I think there could be enough defections from Southern Democratic senators who, with the unanimous Republicans, would be a majority. So they would object not only on procedural votes, I think they could actually--

MR. ANGELL. So you think it's not just a question of the votes where they have to have 60 votes to close?

CHAIRMAN GREENSPAN. No, I'm--

MR. ANGELL. You're talking about 50?

CHAIRMAN GREENSPAN. Yes, I'm talking about 50.

MR. MULLINS. I thought they would always want to raise taxes.

CHAIRMAN GREENSPAN. Who, the Democrats?

MR. MULLINS. Yes.

CHAIRMAN GREENSPAN. Not always.

MR. MULLINS. The Congress.

CHAIRMAN GREENSPAN. The vast majority have always wanted it.

MS. PHILLIPS. A lot of those cuts, though, are going to be hard to swallow. For example, on agriculture, it doesn't take--

MR. MULLINS. But they're mixed in agriculture.

MS. PHILLIPS. But they're still--

MR. MULLINS. With those cuts, stitches will not be required.

MR. LINDSEY. Mr. Chairman, one specific question you might get is on the \$11 billion--the proposal that is supposed to come from rejiggering the term structure of Treasury offerings.

CHAIRMAN GREENSPAN. Yes, I think Secretary Bentsen's response to that is that [the estimate] is highly tentative and the plugged number will be evaluated after the full study of the Treasury is completed.

MR. LINDSEY. That's more than 100 percent of the spending reduction, which is the proposal--

CHAIRMAN GREENSPAN. It's more than 100 percent?

MR. LINDSEY. Well, net, there is almost no spending reduction in the proposal. The spending increases cover the spending reductions pretty much. Another way of doing it, I think, is that it's one of the few areas--. If you look at most of the spending reductions, they're actually user fees.

CHAIRMAN GREENSPAN. Yes, I know that that's--

MR. LINDSEY. But I think it is going to come to you--it's a monetary policy question--as: Do you find that \$11 billion a plausible number?

MR. MULLINS. It's not hard wired.

CHAIRMAN GREENSPAN. I'll fudge that as best I can. Anything else, anybody? I'm going back up to the Hill because I haven't had enough punishment on Tuesday and Wednesday.

SPEAKER(?). Oh gosh!

CHAIRMAN GREENSPAN. It's going to be a delight.

SPEAKER(?). Well, good luck to you.

CHAIRMAN GREENSPAN. Thank you all.

SEVERAL. Thank you.

END OF SESSION