Donald Luskin, Chief Investment Officer
David Gitlitz, Chief Economist

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Greenspan's Q&A: Hot Spots and High Points

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Donald Luskin

The best part of **Alan Greenspan's** congressional testimony is always the Q&A session that follows his prepared remarks. It's a chance to learn about his thought processes at one or two levels deeper than you ever get from prepared remarks -- and often his remarks here can act as thought contagions that influence debates going on in congress and in the media. But if you weren't glued to the tube yesterday, you missed it -- the Q&A is never covered in detail by the media, and transcripts are fragmentary and hard to come by. Here is our take on the best nuggets in the Q&A, with links to the relevant transcript sections.

- **On Enron:** Not especially damaging to the economy, corporate governance is fundamentally sound. But we've come off the rails with move toward stock buybacks instead of dividends, and in use of stock options in compensation. Greenspan says options have caused CEOs to "...game the accounting system in a manner to create the perception of short term earnings growth which would be confused with long-term earnings growth. If long-term earnings growth were properly evaluated over this period, I don't think we would have had many of the type of problems that we've had. But there's been a significant endeavor to make the data look as though something fundamentally different is going on in corporate America, and that has been unfortunate." Of course Greenspan himself has been doing just the same thing, trying to explain all the ups and downs of his beloved New Economy in terms of a productivity miracle which represents "something fundamentally different going on." Here's the link.

- **On options:** Greenspan re-emphasized the need to look at the way stock options distort incentives: "There has been a severance, in my judgment, of the interests of the chief executive officer in many corporations from those of the shareholders, and that should be pulled together. Stock options help, but not if they are functioning in the manner which they currently are." Remarks like this will supply intellectual ammunition to politicians seeking to have capitalism without capitalists -- **Senator John McCain** is already sponsoring legislation to change accounting and tax rules that would make options unattractive as a form of executive compensation. Here's the link.

- **On Japan:** Greenspan parrots the party line that dismisses the role of monetary deflation. "The problem with Japan, as I've indicated on many occasions, is that they have only one major form of financial intermediation, which is their banking system. And their banking system, as you know, is in very serious difficulty. So that the ability of monetary policy to function, in my judgment, is impaired in a manner which makes it very difficult to read what basically the level of rates and the level of economic activity are doing." He minimizes Japan's death-spiral as stability, and shrugs off risk to the US economy: "Japan has been essentially stable for a decade now. Growth has been effectively zero... Clearly, to the extent that they are the second largest economy in the world, they do affect us. And clearly what is going on in Japan is negative to the United States outlook. But I do not perceive it as a major factor containing a recovery in the United States which we believe is just beginning to get under way." Here's the link.

- **On long-term interest rates:** Greenspan credits low long-term rates for the housing boom, and notes the lack of inflationary premiums. ".. but at the moment I think that we do not see any really significant inflation premiums embodied in long-term rates. And that, frankly, is a good sign." Bad news for the rate-hike bears. Here's the link.

- **On recent productivity stats:** the great productivity bull is appropriately skeptical, as are we: "...the data that now appear to be in real-time, as you put it, probably are exaggerating the underlying trend in productivity if for no other reason that the numbers look just too large to be credible. We're going to have another upward revision in the fourth quarter's productivity numbers. ...while I doubt very much if they will be representative of the true underlying trend, they do nonetheless confirm that the long-term trend of productivity has managed to sustain itself through these very difficult times of, say, the second quarter of the year 2000 to date." Here's the link.

- **On tax-cuts causing higher interest rates:** Greenspan pretends to be cautious on this one, but he comes down clearly on the side of **Robert Rubin** and the Democrats when pressed by intense questioning from **Barney Frank:** ": I've always argued that there is a relationship, and indeed I think the markets respond as though there is a relationship, and I think quite properly so... As I've commented and testified previously, I do believe that the extent to which interest rates have not come down as much as they ordinarily would have in a period, say, such as this, is partly the result of a change in the long-term fiscal policy." Here's the link.

- **Challenge to fiat money:** Texan **Ron Paul** made a lengthy statement fundamentally challenging the legitimacy of fiat money, and urging a return to gold. For example, "Now, the Federal Reserve comes in and they buy that debt in order to maintain the interest rate that they think is the right interest rate, and they take that and use it as an asset. You put it in the bank, you call this debt that we created as an asset, and you use it as collateral for our Federal Reserve notes. So that's a pretty good scheme. And I think in the moral terms, as well as the economic terms, it's very similar to what the Enron - how Enron operates." Statements like Paul's come off like gold-bug survivalist stuff, but it's probably healthy that someone has the guts to hold up a light to otherwise unquestioned assumptions about the Fed's hegemony over money. A stunned Greenspan replied, "...I don't perceive that anything that we are doing as a central bank involves anything related to that. I hope that where we need to be transparent and indicate what we are doing, we do so, and we so except in those areas where it, as I mentioned to you previously, inhibits the ability to actually function as a central bank. But as I say in summary, I hope your analogy is inappropriate." Here's the link.

- **Effect of tax cuts, efficacy of fiscal policy:** When you've got a hammer, the world is nail. Greenspan naturally prefers micromanaging the economy with monetary policy, but he admits that **President Bush** got lucky this time with his tax cuts (ignoring that Bush specifically urged their passage on the grounds of shoring up a faltering economy). "The problem with fiscal policy, as economists have come to realize over the decades, is that it's very difficult to implement in a timely manner, largely because our capacity to forecast in a specific time frame itself is limited. ...I do think that the tax cuts of last year, in the middle of the year, did show up as increased expenditures in July and August. That's not the way they were constructed in that timing, but they turned out to be actually quite effective, as best I could judge." Here's the link.

- **Social Security:** Greenspan sounds as though he is giving comfort on the looming Social Security crisis, but in fact he is limning all the internal tensions that will drive it to the breaking point: the need to pay out existing claimants in full (somehow!), while at the same time recasting the system to produce better returns for younger workers (somehow!). "Nor do I think the American people have to be concerned about their benefits disappearing if the fund disappears. Now, what I think younger people are concerned about is the rate of return that they're getting in benefits from the numbers that they put into the fund is much lower than, for example, my generation. I mean, you look at what I put in and what I got out, or what I would have gotten out if I had retired at 65, is an extraordinary rate of return. And Social Security was remarkably popular for my generation. I don't think it is for the younger generation, but because of the fact that they're not perceived as getting back an adequate return." Here's the link.

- **Linkage between deficits and long-term interest rates:** Greenspan is surprising agnostic on this shibboleth, arguing that deficits may only drive up interest rates *in extremis*: "I think everyone agrees that under extreme circumstances where, in fact, you have huge deficits and inflation is being engendered, that long-term interest rates go up. And indeed, in those types of economies you cannot sell long-term debt; no one will buy it. But there is a legitimate dispute as to what the relationship is between surpluses and deficits. When those are in a relatively narrow range, is it conceivable that the changes are very modest? And the answer is yes, it is conceivable, and that may indeed be the case." Here's the link.

- **Stimulus is not necessary:** Framing it as a Keynesian matter of stimulating "final demand," Greenspan argues that the economy is recovering well enough with intervention: "If you believe that there is not enough potential final demand, then one could argue for some form of stimulus program. I've argued that it's probably not necessary. The economy is very likely to recover without it. And that would be my judgment." Here's the link. TM