Greenspan testimony points to deepening US fiscal crisis

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In his semi-annual testimony to Congress last week, Federal Reserve Board chairman Alan Greenspan gave his now almost customary upbeat assessment of the prospects facing the US economy.

He began by noting that in the period since his previous testimony last July, when convincing signs of accelerated activity were not in evidence, the picture had now "brightened" with gross domestic product expanding "vigorously" and productivity surging. "Looking forward," he continued, "the prospects are good for the sustained expansion of the US economy."

At the same time, he promised that, while interest rates would eventually have to rise as the economy expanded, the Federal Reserve could be "patient in removing its current policy accommodation" which has seen rates at a 40-year low. These upbeat remarks—characterised rather acidly by a *Financial Times* editorial as "Mr Greenspan as the eternal optimist: everything is for the best in the best of all possible economies"—were the basis of major news reports that the American economy had turned the corner and helped fuel a sharp rise on Wall Street.

But looking behind the headlines there are indications, even in the Greenspan speech itself, that all is far from well in the US economy.

So far as the increase in US economic growth is concerned—a "transition from an extended period of subpar economic performance to one of more vigorous expansion"—Greenspan noted that household spending was once again the "mainstay" with real personal consumption spending increasing nearly 4 percent and outlays on residential structures rising by about 10 percent.

Rising consumption spending is generally taken to indicate a healthy economy. This is because it is normally the result of increased wages and employment levels, which in turn reflect increased investment and productive activity. Not in this case however.

As Greenspan acknowledged, the biggest factor in rising consumer spending was the low interest rates engineered by the Fed. These prompted automakers to offer incentive deals, thereby boosting sales, while "the lowest home mortgage rates in decades were a major contributor to record sales of existing residences, engendering a large extraction of cash from home equity." That cash was used to support personal consumption spending, home improvement, and the repayment of higher cost debt. In other words, far from indicating a healthy economy, the increase in consumption spending was largely the result of the housing bubble created by the Fed's low-interest rate regime.

Even as he put the best possible gloss on the state of the US economy, Greenspan was forced to recognise that the sharp increase in the budget deficit contained dangers both in the short and long term. The deficit, he noted, had risen to $375 billion in the 2003 fiscal year and "appears to be widening considerably in the current fiscal year" with current projections indicating that "very sizable deficits are in prospect in the years to come."

The imbalance in the federal budgetary situation would soon pose "serious longer-term fiscal difficulties" especially due to the retirement of the "baby-boom generation" in the next few years. "Without corrective action, this development will put substantial pressure on our ability in coming years to provide even minimal government services while maintaining entitlement benefits at their current level, without debilitating increase in tax rates. The longer we wait before addressing these imbalances, the more wrenching the fiscal adjustment will ultimately be."

The problems are not confined to the longer-term. If the prospects for increasing federal budget deficits are factored in by money markets, this could lead to a rise in long-term interest rates, leading in turn to cuts in investment and other interest-rate sensitive spending thereby undermining “the private capital formation that is a key element” in the economy’s growth prospects.

Rising concerns over the worsening fiscal position have been reflected in recent press commentary. For example, in a comment published last Friday by *BusinessWeek* described the government’s finances as a “fiasco of mammoth proportions”. It cited a recent article by Niall Ferguson, history professor at New York University, and Laurence J. Kotlikoff, professor of economics at Boston University, which “drew ominous parallels between fiscal overstretch in imperial Bourbon France and contemporary America.”

BusinessWeek noted that projected deficits over the next decade run to around \$2.4 trillion but that if Bush succeeds in his campaign to make the temporary tax cuts permanent, then “the red ink would exceed \$5.2 trillion.” In other words, if the tax cuts are made permanent, the deficit will be 100 percent worse than at present.

Given such warnings, one might have expected that, in his report to Congress, Greenspan would have come down firmly against the Bush tax cuts which have provided a major boost for high-income earners.

However, when questioned about his position in the Senate last week, Greenspan was adamant that the tax cuts should remain in force.

“I am in favour, as I have indicated in the past, for continuing the tax cuts that are in dispute at this particular stage,” he said. “It is crucially important that we try to find, wherever we can, reductions in outlays, before adverting to the question of revenues to fill the gap.” The gap, he insisted, “should be taken out on the expenditure side.”

As many economic commentators have pointed out, “taking it out in the expenditure side” means destroying what remains of the system of social security set in place in the programs of the 1930s and the 1960s.

Greenspan’s vigorous defence of the Bush tax cuts recalls editorial comments made by the *Financial Times* on the tax cut plan last May. It said that the “lunatics were now in charge of the asylum” with “more extreme Republicans” set on creating a fiscal disaster as way of destroying social welfare programs. “Proposing to slash federal spending,” the editorial noted, “particularly on social programs, is a tricky electoral proposition, but a fiscal crisis offers the tantalising prospect of forcing such cuts through the back door.”

Linking the tax measures to the war on Iraq, the editorial said that for the extremists “undermining the multilateral international order is not enough; long-held views on income distribution also require radical revision.”

These themes were voiced in an article by well-known economic commentator and author William Greider, published in the *Nation* last May. According to Greider, the Bush presidency has been anchored in a “hard-driving” right-wing movement whose aim is to roll back the twentieth century so that “the primacy of private property rights” is re-established over government regulation and “above all, private wealth—both enterprises and individuals with higher incomes—are permanently insulated from the progressive claims of the graduated income tax.”

As chairman of the Federal Reserve, Greenspan has to at least give the impression of political neutrality, claiming to base himself on the findings of economic analysis. But, as his history shows, he is flesh of one with some of the most aggressive defenders of the “free market” and private property and wealth within the American ruling class.

These views were clearly set out in an article published in 1966 defending the gold standard as the real basis of all finance, and subsequently reprinted in the book *Capitalism, the Unknown Ideal* by extreme right-wing philosopher Ayn Rand. According to Greenspan, “chronic deficit spending” was the hallmark of the welfare state, while the welfare state itself was “nothing more than a mechanism by which governments confiscate the wealth of the productive members of society to support a wide variety of welfare schemes.”

Asked in 1993 if he still agreed with the conclusions of his article, Greenspan replied: “Absolutely.” That basic agreement seems to have been underlined once again by his insistence that the answer to the growing fiscal crisis in the US is to make permanent the Bush tax cuts for the wealthy while slashing domestic government spending.