

Fed Chair Warns Congress on Deficit Danger

Greenspan Remains Reasonably Optimistic About Economy Overall By JEANNINE AVERSA, AP

WASHINGTON (April 21, 2005) - **Bloated budget deficits pose a danger to the nation's long-term economic health**, Federal Reserve Chairman Alan Greenspan warned anew Thursday. He issued a fresh call to policy-makers to move swiftly to put the government's fiscal house in order.

Greenspan only very briefly touched on the economy's current performance, saying "activity appears to be expanding at a reasonably good pace," an assessment he has made repeatedly this year.

His comments to the Senate Budget Committee came as some private economists are concerned about the extent to which high energy prices will crimp economic activity.

Responding to questions, Greenspan suggested he is not concerned about the U.S. economy falling into a period of "stagflation" - the worrisome combination of rising inflation and slower economic growth. "It certainly doesn't seem that way," he said.

Greenspan also said China "should be moving sooner rather than later" to overhaul its currency system, which U.S. manufacturers contend hurts sales and has contributed to job losses.

The United States has been pressing China to stop directly linking the yuan to the dollar. Treasury Secretary John Snow, in recent days, said Beijing - having taken a number of steps to prepare for such a change - is now ready to take the move. China has indicated it needs more time.

On the fiscal front, Greenspan said the persistence of swollen budget deficits in the years ahead "would cause the economy to stagnate or worse" unless the situation is reversed.



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Greenspan told Congress he was 'wrong' when he predicted Bush's tax cuts wouldn't run deficits.

"The federal budget is on an unsustainable path, in which large deficits result in rising interest rates and ever-growing interest payments that augment deficits in future years."

-Alan Greenspan

The budget deficit is a problem because it is projected to rise significantly as the first of 78 million baby boomers start to retire in 2008.

Last year, the government produced a budget deficit of \$412 billion, a record in dollar terms. The deficit this year is projected to shatter that record, coming in at an estimated \$427 billion.

Greenspan's call for fiscal prudence touched a nerve with Democrats who still sting from Greenspan's endorsement of President Bush's \$1.3 trillion tax cut in 2001. It was proposed at a time when the government was expecting a decade of budget surpluses, which didn't materialize.

"I was wrong like everybody else on the issue of surpluses," Greenspan said.

In 2001, Greenspan said the tax cut should be accompanied by a trigger mechanism that would rescind the tax cut in later years if economic forecasts changed. The Fed chief said it was "frankly unfair" for people not to remember that point.

"I think it is fair to consider how your message would be taken," said Democratic Sen. Paul Sarbanes of Maryland, recalling the 2001 tax-cut endorsement. "It clearly was taken in the way that I have suggested in giving the green light."

Democrats mostly blame the growing budget deficits on President Bush's big tax cuts, which they contend mainly benefited the wealthy. Republicans credited the tax cuts with helping the economy rebound from the 2001 recession. The costs of the tax cuts along with paying for wars in Afghanistan and Iraq and fighting terrorism at home have led to the deficits, they say.

Persistently large budget deficits threaten the economy because they can push up interest rates for consumers and businesses. Higher borrowing costs would weigh on consumers' and businesses' willingness to spend and invest - two important forces that keep the economy going. Rising interest rates also would slow growth in the housing market, Greenspan said.

And, growing budget shortfalls would force the government to borrow more to finance those deficits.

"The federal budget is on an unsustainable path, in which large deficits result in rising interest rates and ever-growing interest payments that augment deficits in future years," Greenspan said.

Greenspan again supported a return to pay-as-you-go budgeting policies that would require Congress to offset future increases in government spending or new tax cuts with reductions in other government programs or tax increases.

The Bush administration supports bringing back the pay-as-you-go provision for spending, but not for tax cuts. A decade-long pay-as-you-go provision expired in 2002.

The administration says it aims to cut the deficit in half by 2009.

"Our budget position is unlikely to improve substantially in the coming years unless major deficit-reducing actions are taken," Greenspan said.

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