Date - 06/18/2010

QUESTION: Did you see the recent Greenspan article in WSJ? Here are the most salient points:

"We **cannot grow** out of these fiscal pressures. The modest-sized post-baby-boom labor force, if history is any guide, will not be able to consistently increase output per hour by more than 3% annually. The product of a slowly growing labor force and limited productivity growth will not provide the real resources necessary to meet existing commitments. (We must avoid persistent borrowing from abroad. We cannot count on foreigners to finance our current account deficit indefinitely.)Only politically toxic cuts or rationing of medical care, a marked rise in the eligible age for health and retirement benefits, or **significant inflation,** can close the deficit. I rule out large tax increases that would sap economic growth (and the tax base) and accordingly achieve little added revenues. With huge deficits currently having no evident effect on either inflation or long-term interest rates, the budget constraints of the past are missing. It is little comfort that the dollar is still the least worst of the major fiat currencies. But the inexorable rise in the price of **gold indicates a large number of investors are seeking a safe haven** beyond fiat currencies."I highlighted the points he makes that I think are key. My interpretation is him saying growth is impossible, realistic cuts are political suicide, inflation is the only way. Buying more tangible assets, gold included. Chris

ANSWER: Though I have not read the article you are referring to as of the original posting, what you have included above is not as "gloom and doom" as you are thinking. Greenspan is pretty pragmatic, and it appears that these comments are designed to outline the options available to solve our government debt problem. He is providing leadership as a respected analyst, to smooth the way for responsible political figures in Washington. (my sense, anyway) With Greenspan, you have to read between the lines to gauge what is and what is not doable. The first point he makes re: "limited productivity growth" is an important factor. My sense is that productivity <u>can</u> grow like it did in the late 90's, with the right combinations of innovation and business management efficiencies. This has happened in this country since late 2008, generating significant bottom line corporate profits even during one of the worst economic recessions since the 1930s. His second (highlighted) comment - "Only politically toxic cuts or rationing of medical care, a marked rise in the eligible age for health and retirement benefits, or **significant inflation,** can close the deficit." - offers several likely steps toward fiscal responsibility through government action. I cannot imagine that Congress will not reinstitute "Pay-Go" sooner rather than later; Medicare and Social Security age targets will be raised, probably, to age 70, in stages, to reduce or stabilize government expenditures in this area; inflation is a longer term likelihood, but that will require a recovery of our economy and in particular, growth in private sector business. Dick

Additional Comments:
I've now read Greenspan's article and have a couple of additional comments that might be useful to you.

1. Regarding his comment about not being able to increase output beyond 3% annually due to only a modest increase in the labor force..... In fact, and I do not believe he didn't consider this, when the SSI age is increased to age 70, the labor force will grow faster than he suggests, without the retirement attrition that would occur otherwise. In addition, an experienced labor force is going to be more productive than the young and inexperienced labor that is coming into the economy.

2. His most important point, and the focus of this article, is that "we must avoid persistent borrowing from abroad"...or anywhere, for that matter (my extension).

3. The most interesting comment he offers is the one in which he states that "the fears of budget contraction inducing a renewed decline of economic activity are misplaced". He justifies this statement by suggesting that "If we contained the amount of issuance of Treasury securities, pressures on private capital markets would be eased." His target is the lack of a multiplier attached to government spending, versus the leverage of private sector investing, which effectively creates money supply growth by a multiplier of 3 to 4 times the amount invested. Government spending typically has a negative multiplier of 0.90 to 0.95.