MANAGING THE PUBLIC DEBT IN AN ERA OF SURPLUSES

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTH CONGRESS

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MANAGING THE PUBLIC DEBT IN AN ERA OF SURPLUSES

WEDNESDAY, JUNE 24, 1998

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The Committee met, pursuant to notice at 10 a.m. in room 1100, Longworth House Office Building, Hon. Philip Crane presiding.

[The advisory announcing the hearing follows:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

FOR IMMEDIATE RELEASE
June 16, 1998
No. FC-13

CONTACT: (202) 225-1721

Archer Announces Hearing on Managing the Public Debt in an Era of Surpluses

Congressman Bill Archer (R-TX), Chairman of the Committee on Ways and Means, today announced that the Committee will hold a hearing to review the debt management practices of the U.S. Department of the Treasury in an era of budget surpluses. **The hearing will take place on Wednesday, June 24, 1998, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. Witnesses will include representatives of the Treasury Department, as well as other invited experts. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

BACKGROUND:

To cover any difference between revenues and expenditures, and in order to rollover existing debt as it matures, the Treasury Department raises money by selling securities to the public. Most of the securities that constitute debt held by the public are marketable, meaning that they can be resold by whoever owns them. These marketable securities consist of bills, notes, and bonds with a variety of maturities ranging from 3 months to 30 years. The broad concept of debt management includes the Treasury Department's ability to change the characteristics of debt issues. Examples of these characteristics include the length of maturity, call features, conversion features, variable rate features, and indexation for changes in the price level.

As a result of the budget surplus, the Treasury Department recently suspended auctions of its 3-year notes and cut the number of its 5-year note auctions from 12 to 4 each year. In addition, the Treasury Department started issuing inflation-indexed bonds beginning in January 1997.

The Committee on Ways and Means has jurisdiction over the authority of the Federal government to borrow money. Title 31 of Chapter 31 of the U.S. Code authorizes the Secretary of the Treasury to conduct any necessary public borrowing subject to a maximum limit on the amount of borrowing outstanding at any time (i.e., the public debt limit). The Committee's jurisdiction also includes conditions under which the Treasury Department manages the Federal debt, such as restrictions on the conditions under which certain debt instruments are sold.

In announcing the hearing, Chairman Archer stated: "As a result of last year's historic budget agreement, and with the assistance of a robust economy, we are now entering a new era of budget surpluses. Last month, the Congressional Budget Office projected a budget surplus for the current fiscal year of $43 billion to $63 billion, with larger surpluses projected for later years. This is the first budget surplus in nearly three decades. As we enter this new era, it is appropriate for the Committee to review the debt management practices of the Treasury Department, with particular emphasis on recent changes instituted by the Treasury Department in response to the budget surplus."

(MORE)

FOCUS OF THE HEARING:

The hearing will review the current debt management practices of the Treasury Department. Some of the issues expected to be addressed at the hearing are as follows: As the United States moves from an era of budget deficits to an era of budget surpluses, what changes, if any, would be required to manage the public debt; to what extent should the Treasury Department utilize indexed bonds in managing the public debt; what effect will the so-called "year 2000" problem have on debt management; and as the public debt continues to decrease, what effect will this have on the purchasers of debt in the market place and economy generally?

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Any person or organization wishing to submit a written statement for the printed record of the hearing should *submit six (6) single-spaced copies of their statement, along with an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, with their name, address, and hearing date noted on a label,* by the close of business, Wednesday, July 8, 1998, to A.L. Singleton, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Committee office, room 1102 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be submitted on an IBM compatible 3.5-inch diskette in WordPerfect 5.1 format, typed in single space and may not exceed a total of 10 pages including attachments. **Witnesses are advised that the Committee will rely on electronic submissions for printing the official hearing record.**

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, company, address, telephone and fax numbers where the witness or the designated representative may be reached. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press, and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are available on the World Wide Web at "http://www.house.gov/ways_means/".

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

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Chairman CRANE. The Committee will come to order, and if everybody will please take seats we can begin.

Today's hearing will focus on managing the public debt in an era of surpluses. Frankly, it's a pleasure to chair this meeting. I was first elected to the Congress in 1969 and that was the last year we had a budget surplus. It was $3.6 billion, as I recall, that we came in in the black that year, but I kind of took it for granted that that would be an ongoing thing. And we waited until this year before we were confronted with the possibility of again having a budget surplus. As a result of last year's Balanced Budget Act, and with the help of a strong economy, CBO now projects we are entering an era of budget surpluses, and last month CBO projected a surplus for the current Fiscal Year of between $43 and $63 billion with larger budget surpluses as far as the eye can see.

In today's hearing we will review the debt-management practices of the U.S. Treasury, including recent changes adopted by the Treasury Department in response to the budget surplus. For example, last month the Treasury suspended its auctions of 3-year notes and cut the number of its 5-year note auctions from 12 to 4 each year. In addition, the Treasury Department also issued inflation-indexed bonds for the first time beginning in January of 1997.

I will now turn to my distinguished colleague Ben Cardin for an opening statement.

Mr. CARDIN. Thank you, Mr. Chairman, and on behalf of Ranking Member Rangel, let me thank you for holding these hearings. The Department of Treasury is widely recognized for its excellent job of managing our public debt soundly and diligently. They do so in a completely professional manner, devoid of partisan political influence. They do so in a manner that holds the cost of debt management at a prudent level. They are always mindful of the status of our financial markets and the importance of maintaining their stability. Let me take this opportunity to congratulate the Treasury Department on a job very well done.

Mr. Chairman, you have made note of the current budget surplus. Isn't it wonderful that President Clinton's economic policies of the last five years and the bipartisan Balanced Budget Act enacted last year have made it possible for us to regain control of our fiscal finances. Back in the 1980's and early 1990's, we were faced with deficits well above $100 billion and soaring to $300 billion-plus in the worst years. It seemed as if this day may never come. We should not squander this opportunity to make the future better for our children and grandchildren.

I must say, though, Mr. Chairman, I don't see a whole lot of significance that the surplus holds for debt management. Naturally, if we have a surplus, the Treasury will have to borrow less from the public in order to fund the operations of government, and so they will reduce the amount of certain securities they offer to the public. I'm sure that Assistant Secretary Gensler can describe the technical details if we are interested in that.

One of the great debt-related opportunities that the surplus provides us is that we can reduce our national debt, thus preserving our resources to save Social Security first, as the President has so wisely suggested.

So, I commend the chairman for convening these hearings today so we can learn more about how the Treasury Department manages our financial debt and how they are able, in the last few months, to save some of the government's money, so that we can dedicate it to making the Social Security System solvent for many decades to come.

I look forward to the testimony of all of our witnesses and I thank you, Mr. Chairman, for this opportunity.

Chairman CRANE. Thank you, Mr. Cardin.

[The opening statement of Mr. Stark follows:]

STATEMENT OF CONGRESSMAN PETE STARK
COMMITTEE ON WAYS AND MEANS
JUNE 24, 1998

ON THE MANAGEMENT OF THE PUBLIC DEBT "IN AN ERA OF SURPLUSES"

Mr. Chairman:

What "surpluses"? This hearing is built on a faulty premise that we have surpluses. The Social Security and Medicare Trust Fund surpluses disguise the fact that we are still running "on-budget" deficits in the daily operations of the government.

What "era"? The word era implies a long period of time. The apparent surpluses will turn to roaring deficits once the Baby Boom generation starts retiring in 2011 and starts using up the Social Security reserves. Medicare Trust Funds will need more resources even before 2008.

Instead of this hearing, we should be holding a hearing on how to use today's apparent surpluses to prepare for the certainty of the coming deficits. We should be educating the American public why tax cuts are foolish when we will soon need every penny we can get to support Social Security and Medicare.

In January, the Congressional Budget Office first estimated that we would have about $650 billion in surpluses over the next ten years (the numbers are now much higher). I asked the Medicare Chief Actuary how many years of life we could give to the Medicare Hospital Insurance Trust Fund (due to expire in 2008) if we saved that surplus for Medicare. The answer: we could make Medicare solvent to 2020--well into the retirement of the Baby Boom generation--and that assumed no further provider cuts after 2002. With higher surplus estimates, the life of Medicare could be extended even further.

Mr. Chairman: any surpluses we have should be invested in solving the looming generational problems we face. Rather than spending our time on how Treasury is managing the debt, we should be spending our time making sure the Ways and Means Committee doesn't dribble away this golden opportunity to solve a large part of the coming Medicare and Social Security crisis.

Our first witness today is Paul Posner of the General Accounting Office, and he is accompanied by Thomas McCool and Jose Oyola, also of GAO. And we've asked Mr. Posner to present a primer on the Federal debt, if you will, as a prelude to the more technical discussion of debt management practices which will follow. Our normal procedure is five minutes in oral presentation and all written remarks will be made part of the permanent record, but in as much as you are monopolizing the time for your panel, Mr. Posner, we'll yield you additional time, especially since you have these important charts to present before the committee.

STATEMENT OF PAUL L. POSNER, DIRECTOR, BUDGET ISSUES, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY THOMAS J. McCOOL, DIRECTOR, FINANCIAL INSTITUTIONS AND MARKETS ISSUES, GENERAL GOVERNMENT DIVISION; AND JOSE R. OYOLA, ASSISTANT DIRECTOR, BUDGET ISSUES, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION

Mr. POSNER. Thank you very much, Mr. Chairman. It's a pleasure to be here. I'll submit my statement for the record. Our role here, as you indicated, is to set the stage for the subsequent discussions. We at GAO have not yet done any independent analysis of Treasury's debt-management operations. What we have done is substantial amount of work on the meaning of debt and deficits and we culminated this with a primer that you referred to. We felt the primer was necessary because, as big as the debt was and as large as interest is as a share of the budget, there still seemed to be substantial confusion in the public about such things as the difference between deficits and debt, different kinds of debt, what does debt mean for our long-term future, what can we do about it. And that's what our charts are going to address in the next few minutes.

The first chart here shows you the total gross Federal debt of $5.4 trillion and this, with fairly minor exceptions, tracks the limit on the public debt which is currently $5.9—which, according to CBO, will be reached sometime in fiscal year 2001.

The chart shows that, essentially, the debt is comprised of two rather disparate elements that serve very different purposes and respond in very different ways to a surplus. The first one there on the bottom is the one we're all familiar with, on the left side is debt held by the public which currently stands at $3.8 trillion and this is really the single best figure that summarizes how much of the Nation's wealth is used to finance government's obligations. Essentially it represents the cumulative total of all past deficits and all past surpluses in the Nation. The owners of the public debt are wide-ranging. They include individuals, corporations, banks, pension funds, State and local governments, and, increasingly, foreign governments and individuals. In fact, foreign holders now comprise 33 percent of the debt held by the public.

The next chart shows the next component of debt which is debt held by Government accounts, which happens when the government ends up owing money to itself. Essentially what happens, as you can see in the pie chart there, trust funds take in surpluses

from the public of revenues over spending and they essentially park those surpluses in Treasury notes. They essentially accumulate these IOU's from Treasury, these are not real assets, and when it comes time for the trust fund's need to tap those notes, to pay off benefits, Treasury actually has to go out and get money to back those. So the special Treasuries that trust funds hold are government debt, the government-held debt, but there really is no money there. These are really IOU's that the Treasury will have to go out and borrow from the public or raise taxes or cut spending elsewhere to come up with the money to satisfy these future claims on the budget.

Let me go to the next chart here, and this starts to tell you a little bit about the trends in the debt over time and shows you how different the trends are for those two components of the debt I just talked about. Overall, over the next 10 years, gross debt will rise by $1.8 trillion, and as the chart shows, this rise in the gross debt is driven by the government-held debt which is that dotted line there. That's the debt driven by the large Social Security surpluses, primarily, that are accumulating and buying up these Treasury securities. So that kind of debt will be increasing at the same time as the solid line that you see there, the debt held by the public, will be dropping as a share of the economy from 47 percent as it stands today to 24 percent in the next 10 years. And, again, this largely reflects as you've indicated, the surpluses that we've achieved in the budget and the growth of the economy itself. So the developments with the overall debt held by the public are very salutary; the rising share of debt held by government accounts indicates that there is a cloud on the horizon in the form of potential future claims on downstream budgets, if you will. And so that's what those two lines, essentially, represent.

I'm going to turn to the next figure here, 5 and 6, which gives you a little bit of the history which says a lot about the present and the future as well. The history we're portraying is debt is a share of GDP because that's really the best measure that tells you how much the public debt is consuming of our Nation's economic resources. And one of the interesting things you can see here is that, really, in our Nation's history from 1797, high public debt, exceeding 30 percent of GDP, is an exception essentially—that has only been broached by the Civil War, World War I, World War II, and the Great Depression. So, basically what we, as a Nation, have collectively decided is that it is reasonable to borrow from the public for cataclysmic national events and all of us would probably agree with that: To save the nation itself and save the economy. But what you can see is that after those events occur, the Nation's debt returns to a fairly low level as a share of the economy after a number of years. As the economy starts to grow again, as the government becomes more contractionary in its fiscal policies, the debt begins to shrink. And that's what makes the most recent 30 years so unusual in our history, beginning in the 1970's, because, as you can see, in the 1970's, the debt held by the public started to rise again, above these levels that are only seen in wars and depression, up to 50 percent of GDP in recent years.

And what was unusual about this is, as you know, we did not have a great war or cataclysmic depression. This was really fueled

by a kind of chronic deficit period that we entered into during that time. Now the bottom part of this chart shows the budget deficits themselves, and the differences between the deficits and debt are illustrated nicely here. The deficits essentially are related to the debt in that they essentially are annual events that add to the stock of debt. Debt, in turn, adds to deficits by requiring interest payments that are recorded in the budget as outlays. The two closely track each other.

As you can see, the deficits really sharply grew in the same cataclysmic national events that I just talked about but, as you can also see, once those events were over, whether as wars or depression, the nation returned very quickly to a policy of budget surplus or balance which is essentially the norm for the Nation's fiscal policy in our broad sweep of history. Essentially, conservative fiscal policy, strong economies, and inflation all succeeded in pulling the nation back out of the deficit.

But what is interesting is when you look at the debt chart above, you can see how much more sluggish the debt has been to respond to those reversals; that while the deficit quickly reverses itself, the debt is a legacy which is more sluggish to change and whose momentum takes longer to reverse. Essentially, this is because it takes a longer time for economic growth to take over and a longer time for the accumulation of budget surpluses to eat into the stock of debt that we accumulated during these very sharp periods of national crisis.

Let me go to the next chart here and this shows you why the debt makes a difference. Why should we be worried about the debt? There are really two reasons. One of them has to do with the economic consequences of our borrowing and the other has to do with the budgetary consequences of our borrowing. Very simply put, borrowing by the public sector absorbs savings that otherwise would be available for private investment. That's a familiar story to many of you; this bids up the price of capital by Treasury and private investment that might enable us to increase our productivity, wages, and potential growth in the economy is not as large as it otherwise would be. The effects, importantly, are cumulative. You are not going to sometimes see this in a given year or two, but over time, as the private investment is lower than it otherwise might be, the Nation's productivity and growth rate declines. And as Charles Schultz once said, the debt crisis is not the wolf at the door; it's the termites in the basement, and that's why it is so difficult sometimes to grasp.

What's most disturbing about the growing debt in recent years is the low national savings that you see in this chart. The size of those bars is the total net savings available from the domestic economy to fund investment. As you can see, the total size of that bar has been going down and the share absorbed by the deficit which is the white part has been growing. Now recently that's reversed, and foreign owners of debt have helped as well by investing in our economy. But, nevertheless, the size of those bars is something that's quite worrisome.

Finally, the next chart here, is really what we might call the bottom line. GAO has done a long-term model linking these annual budgets to long-term economic growth and what we've tried to dem-

onstrate is that, short-term aside, the cumulative results of deficits and debt over time are quite compelling. We have modeled two fiscal policy paths. One is what we call no-action, which is the bottom line there, which essentially assumes we will just follow the baseline and after a while, after we come out of these periods of surpluses, Social Security, Medicare, and Medicaid are going to kick us into a deficit again and that is going to lower our real incomes by 2050.

If we maintain budget balance through this entire period, you can see that by 2050, we reach a real increase in the per-capita GDP available for Americans to 25 percent above this baseline. So, essentially, what we've done this modeling for is to help leaders understand the long-term consequences of these budget choices. This increased income available to Americans is particularly critical because as you know, future generations are going to be much smaller than ours and are going to have to pay for the large retirement costs of the Baby Boom generation. That generation—those smaller work forces are going to need higher incomes to be able to afford these burdens that are going to be foisted on them unless we change our policies. So, again, this is trying to illustrate how important the deficit and debt are to the future incomes of this country.

And the final point I will make, and will close at this point, is just to illustrate another familiar story, which is that debt also has a legacy for the budget itself. In other words, when you see this chart here, you see the largest outlays in the budget by function and, net interest on the debt is the third-largest function in the budget. And unlike any other functions, Social Security, national defense, Medicare, and whatever, it's the most uncontrollable. We can't do anything directly to reduce this. We can't trim benefits, we can't improve administrative efficiency; essentially this comes right off the top before we allocate resources to anything else and the principal way you can really change the interest path in the budget is by fundamentally doing something about deficits and, ultimately, going into a surplus that will actually reduce your nominal debt as a share of the economy.

So, that basically, in a nutshell, summarizes, the broad issues. We, will hand it off to Treasury to talk more specifically about the debt management consequences of the budget surpluses.

[The prepared statement and attachments follow:]

United States General Accounting Office

GAO

Testimony

Before the Committee on Ways and Means
House of Representatives

For Release on Delivery
Expected at
10:00 a.m.
Wednesday,
June 24, 1998

BUDGET ISSUES

An Overview of Federal Debt

Statement of Paul L. Posner
Director, Budget Issues
Accounting and Information Management Division

GAO/T-AIMD-98-221

Mr. Chairman and members of the Committee:

I appreciate the opportunity to appear before you to discuss issues related to federal debt. My testimony today responds to your request that we present basic information on the federal debt, including how debt is defined in its various forms; how it is measured and how much it has grown up to now and could be reduced in the future; who holds federal debt; and why it is important to the national economy.

As agreed with the Committee's staff, we have updated the information in our 1996 report Federal Debt: Answers to Frequently Asked Questions. Although many excellent technical articles exist on the debt and its effects, we believed there was a need for a "plain English" document that clearly presented basic information on this complex topic. This publication and other related GAO publications are listed in the footnote below[1].

As the Committee staff requested, my presentation today will focus on background information by using a series of charts and graphs. Treasury's representative, who follows, will discuss issues involving debt management.

HOW IS FEDERAL DEBT MEASURED?

There are two main measures of federal debt–gross debt and debt held by the public. Figure 1 in the appendix shows the gross debt. It captures all of the federal government's

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[1]Federal Debt: Answers to Frequently Asked Questions, (GAO/AIMD-97-12, November 27, 1996). Other relevant documents include Social Security Financing: Implications of Government Stock Investing for the Trust Fund, the Federal Budget, and the Economy, (GAO/AIMD/HEHS-98-74, April 22, 1998); and Financial Audit: 1997 Consolidated Financial Statements of the United States Government, (GAO/AIMD-98-127, March 31, 1998).

outstanding debt, and totaled $5.4 trillion at the beginning of fiscal year 1998. This measure is composed of debt held by the public as well as debt held by government accounts.

Figure 2 shows Treasury's estimate[2] of who owns the federal debt held by the public. The federal debt held by the public represents the amounts borrowed from a wide variety of outside sources, including individuals, banks, businesses, pension funds, state and local governments, and foreign investors including governments. The debt held by the public is the measure used to reflect how much wealth has been used by the federal government to finance its obligations and best represents the cumulative effect of past federal borrowing on the economy.

Treasury estimated that, as of September 1997, foreign investors held about 33 percent of debt held by the public. The United States benefits from foreign purchases of government bonds because as foreign investors fill part of our borrowing needs, more domestic saving is available for private investment and interest rates are lower than they otherwise would be. To service this foreign-owned debt, the U.S. government must send interest payments abroad, which adds to the income of citizens of other countries rather than U.S. citizens.

Figure 3 shows the major federal government accounts holding federal debt. Debt held by government accounts generally represents the amount of money that is invested in special Treasury securities, primarily by trust fund accounts such as Social Security, to fund the operations of another part of the government. Social Security and civil and military retirement trust funds comprise 72 percent of the total debt held by government accounts. These trust funds' surpluses serve to reduce the need for the government to borrow from the public but also increase debt held by government accounts. Just as with

[2]This information is estimated because many securities are continually resold among investors and the Treasury does not track these sales.

Treasury's public debt holders, the government accounts earn interest on their Treasury holdings which is credited in the form of additional Treasury securities. When trust funds no longer bring in cash surpluses, they then draw down on their Treasury balances to meet their obligations, which in turn requires Treasury to obtain cash through some combination of public borrowing[3], spending cuts in other programs or revenue increases.

Figure 4 shows that while projected unified budget surpluses are expected to reduce debt held by the public, government held debt is expected to grow due to the large projected increases in trust fund surpluses invested in special Treasury securities. Interestingly, since the debt limit of $5.95 trillion is based on gross debt[4], the Congressional Budget Office (CBO) projects that even during a surplus period the limit will have to be raised in about 2001.

FEDERAL DEBT: CONTEXT AND MEASURES

Federal debt held by the public was $3.8 trillion at the beginning of fiscal year 1998, an amount more than five times greater than it was in 1980, without adjusting for inflation. This large amount by itself is not a good indicator of its burden to taxpayers and the economy. To get a better sense of its burden, debt should be viewed in relation to the nation's income, which often is measured by its gross domestic product (GDP). GDP is a rough indicator of the economic base from which the government draws its revenues.

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[3]If the unified budget were in surplus, then financing a trust fund's cash deficit would result in less debt redemption rather than requiring increased borrowing.

[4]A very small amount of the gross debt is excluded from the debt limit (less than 1 percent at the end of fiscal year 1997). The amount excluded is mainly issued by agencies other than the Treasury, such as the Tennessee Valley Authority.

Figures 5 and 6 show the historical trend of the federal deficit and the debt as shares of the Gross National Product (GNP)[5]. At the beginning of the current fiscal year, debt held by the public was about 47 percent of GDP. This level is very high by historical standards. Since the early days of the Republic, the only events prompting debt held by the public to increase above 30 percent of the economy were the Civil War, World War I, the Great Depression and World War II–until recently. Wartime borrowing allowed the government to protect the nation's security by increasing defense spending without enacting large tax increases that could be disruptive to the economy. Borrowing during the Great Depression helped the economy by maintaining income and spending levels and today our income, revenue, and spending structure is such that the deficit would rise automatically in a recession.

Recent increases in the debt broke with historical patterns by climbing significantly during a period marked by the absence of a major war or depression. Beginning in the 1970s, rising federal budget deficits fueled a corresponding increase in debt held by the public, which essentially doubled as a share of GDP over this period through the mid-1990's. Since then, the debt-GDP measure has stabilized and begun to drop, reflecting recent progress in reducing the deficit and continued economic growth. According to CBO projections, this proportion is expected to drop again to about 25 percent by 2008 due to projected budget surpluses.

RELATIONSHIP BETWEEN DEBT AND BUDGET DEFICITS OR SURPLUSES

Our annual unified budget decisions affect the nominal levels of debt held by the public, that is, the amount of Treasury securities outstanding. The unified budget is the most

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[5]GNP is the value of all final goods and services produced by labor and capital supplied by residents of the United States in a given period of time. GNP data were used for the earlier years of these graphs because GDP data were not available.

comprehensive measure of annual fiscal policy and represents the net amount of all federal spending and revenue. With some minor exceptions[6], it generally approximates the amount of annual federal borrowing from the public. Another measure of federal fiscal policy used for budget enforcement purposes is known as the "on-budget" measure, which excludes Social Security. Excluding Social Security's surpluses results in a deficit in the "on-budget" measure for the near term.

Each year's unified deficit adds to the amount of debt held by the public, while surpluses reduce it. In other words, deficits or surpluses essentially represent the annual change in the amount of government borrowing while the debt represents the amounts of deficits accumulated over time less any annual surpluses. The debt in turn affects the budget by requiring annual outlays to pay interest to public holders of federal securities.

Thus, in formulating each year's fiscal policy, Congress at least implicitly is also making a decision about the level of nominal debt held by the public. The only way to actually reduce the nominal level of debt held by the public would be to run a unified budget surplus. A balanced budget would not change debt levels themselves, but would reduce the ratio of debt to GDP assuming continued economic growth.

Balancing the budget would not reduce the amount of debt because the government does not retire a portion of its principal each year, as individuals do with a typical home mortgage. Rather, it pays only the interest costs of its debt. As will be noted below, the net interest paid to the public for holding federal debt constitutes a significant portion of annual federal budget outlays. The principal is paid off when securities come due, similar to a "balloon" mortgage. In order to pay these maturing securities, the government needs cash. When the government's budget is in deficit or in balance, the Treasury has no

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[6]The minor exceptions include changes in the Treasury Department's cash balances, outstanding payment obligations, and net disbursements by the government's loan guarantee and direct loan accounts.

excess cash to reduce the level of outstanding debt. In this case, the government raises the cash by issuing new securities to replace maturing debt, in effect "rolling over" its debt.

When the government is in a deficit, it not only rolls over its existing debt, it adds to the total amount of debt held by the public over the course of a year. If the government's budget were exactly in balance, it would roll over existing debt, but would not add to total debt held by the public. If the government is in surplus, it has some additional funds available to pay off a portion of maturing debt instead of borrowing again to fund the redemption of this debt, i.e. rolling it over. In this way, the total debt held by the public can be reduced. According to CBO's March projections, using the projected surpluses to pay off part of the maturing issues could reduce debt held by the public by about $550 billion between 2001 and 2008.

ECONOMIC AND BUDGETARY EFFECTS OF DEBT

Just as the budget can affect the levels of outstanding debt, the debt itself also affects both the economy and the budget. The main economic effect is the impact of federal deficits/surpluses on national saving and private investment. Interest on the debt constitutes the major budgetary effect.

Economic effects

Figure 7 shows the effects of federal budgets on net national saving. Since the federal government competes with private investors for scarce capital, federal borrowing can reduce the amount available for other investors and put upward pressure on interest rates. The large amounts of federal borrowing in the 1980s and early 1990s were particularly troublesome because, at the same time, private saving was declining as a share of the economy. These two trends have had a significant effect on the

economy–federal deficits have eaten up a larger portion of a shrinking pool of private saving, sharply reducing the amount of this saving that is available for private investment. While the deficit declined dramatically in recent years and CBO and the Office of Management and Budget now project budget surpluses, private saving has remained low, and total national saving and investment remain significantly below the levels experienced in the 1960s and 1970s.

Many economists and budget analysts might have had a different view of the rapid surge in federal borrowing in recent years if the borrowed funds had been accompanied by increased spending on effective investment programs. Well chosen public investment ultimately can boost productivity by enhancing infrastructure, human capital and research and development. Figure 8 shows however that federal nondefense investment has been declining as a share of the economy during the period of federal borrowing upswings.

A low national saving rate can have serious implications for the long-term growth of the economy. Saving provides the resources to build new factories, and develop new technologies. Such investments boost workers' productivity, which in turn produces higher wages and faster economic growth. Less investment today means slower economic growth tomorrow. An international comparison using Organization for Economic Cooperation and Development (OECD)[7] data showed that countries that saved more over the last several decades experienced higher rates of productivity growth.

While budget deficits and rising debt have potentially negative economic consequences, a balanced budget or budget surpluses can contribute to a stronger economy especially if private saving remains low. Some analysts believe that balancing the budget and achieving budget surpluses have helped to lower interest rates. The budget surpluses currently projected for the next decade could significantly improve national saving and

[7]OECD is an international organization that collects and publishes economic and budget data.

investment, which would boost economic growth and improve future living standards. Maintaining fiscal discipline beyond this period of surpluses would further improve living standards in the future and is necessary to prevent the emergence of an unsustainable path of spiraling deficits and debt as the baby boom generation retires.

Figure 9 shows that while the annual boost to economic growth of such fiscal policies would be small, over time the cumulative benefits could be quite significant. This figure is based on a 1998 update of GAO's long-term budget model which links fiscal policy decisions to economic outcomes[8]. Since 1992, we have used a macroeconomic model to look at the implications of current and alternative fiscal policy paths for long-term economic growth. Figure 9 compares the per capita levels of GDP that could be expected to result from two distinctly different fiscal policies. The first is what we call a "no action" simulation under which current policies are continued unchanged. This results in a period of budget surpluses until about 2015 when deficits reemerge and debt levels rise as the baby boom generation retires, eventually resulting in deficits exceeding 16 percent of GDP in 2050 and debt levels nearing 200 percent of GDP. The second simulation follows the "no action" path through 2014, and then maintains budget balance through 2050 thereby preventing deficits from reemerging through the baby boom retirement. Figure 9 reveals that, in our simulations, maintaining budget balance eventually yields a 25 percent greater level of per capita GDP by 2050.

Although always important, expanding the size of the economy over the long term is particularly critical due to the historic demographic shift occurring as a result of the baby boomers' retirement. In 1960, there were about five workers for every Social Security recipient. By 1997, this ratio had fallen to just under three and one-half workers per recipient. By 2030, the Social Security Trustees' best estimate is that it will drop to 2 workers per recipient, about a 40 percent decline from the 1997 level. A larger future

[8]Budget Issues: Long-Term Fiscal Outlook (GAO/T-AIMD/OCE-98-83, February 25, 1998).

economy would permit tomorrow's smaller work force to more easily finance the retirement costs of the baby boom generation.

Budget effects

Figure 10 shows that while deficits and surpluses can have significant economic effects, they also have an important impact upon the federal budget. To service its debt, the federal government pays interest to holders of Treasury securities. In 1997, net interest spending was $244 billion, making it the third largest spending item in the federal budget. These interest costs represented 15 percent of total federal outlays. A large interest burden can significantly reduce budgetary flexibility because, unlike any other part of the budget, it is not directly controlled by policymakers. By contributing to annual deficits, interest payments can help fuel a rising debt burden unless offset by sufficient economic growth. Rising debt, in turn, can further raise interest costs to the budget. In these instances, the federal government is paying interest to finance interest.

While interest spending contributes to deficits, a policy of balancing the budget or achieving a surplus can turn the dynamics of interest spending in the government's favor. As the deficit declines, the growth in the debt slows, which, in turn, causes interest payments to grow more slowly than they otherwise would have. In other words, deficit reduction slows the effects of the interest spiral described above, replacing a vicious circle with a virtuous circle. When comparing alternative fiscal strategies, the interest bonus means that taking early action actually requires fewer cuts in government programs over the long term than a policy in which fiscal restraint is delayed. Although early action requires steeper cuts in the short term, it reduces the sacrifices needed to achieve and maintain budget balance over the longer term.

Figure 11 shows that the surpluses projected by CBO over the next decade, if they materialize, would generate considerable savings in interest over time. In March, CBO projected that net interest would drop from $244 billion in 1997 to $194 billion in 2008.

As a percent of federal spending, net interest would decline from about 15 percent to 8 percent over this period.

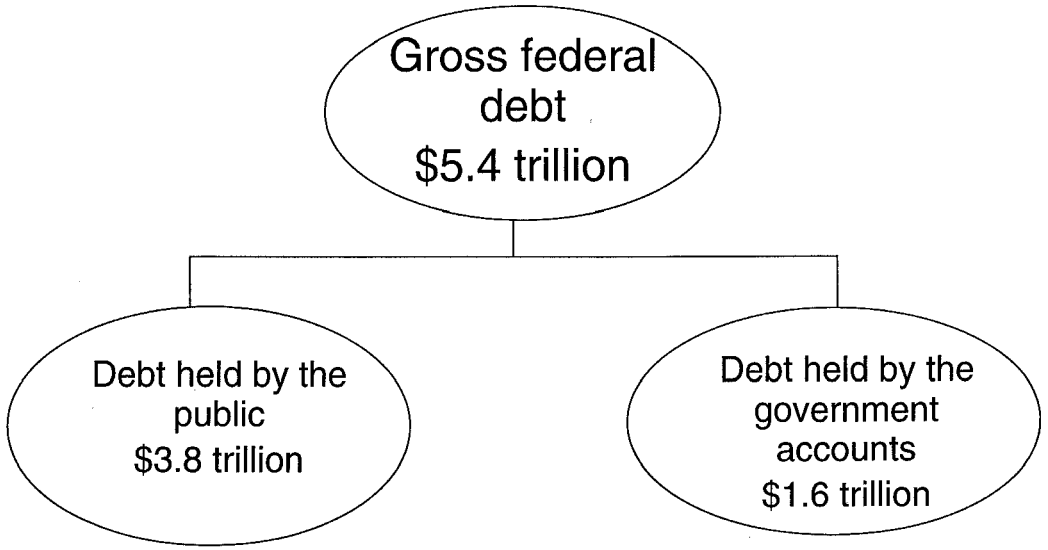
It may be particularly important to consider this opportunity to reduce the interest burden on the federal budget because these budget surpluses are temporary. Soon after 2013, when Social Security's tax revenues no longer exceed Social Security benefit payments, the budget will turn from surplus to deficit. Without additional action by policymakers, the deficits will reemerge leading to higher debt levels and higher interest expenditures. These simulation results from GAO's long-term macroeconomic model are shown in Figure 12.

* * * * * * * * * * *

When the deficit is growing, the government must design a strategy for financing that deficit. In a time of budget surplus, the government has an opportunity to design a strategy for reducing the debt held by the public. A discussion of these issues of debt management and the objectives it seeks to achieve will be the topic of the next presenter.

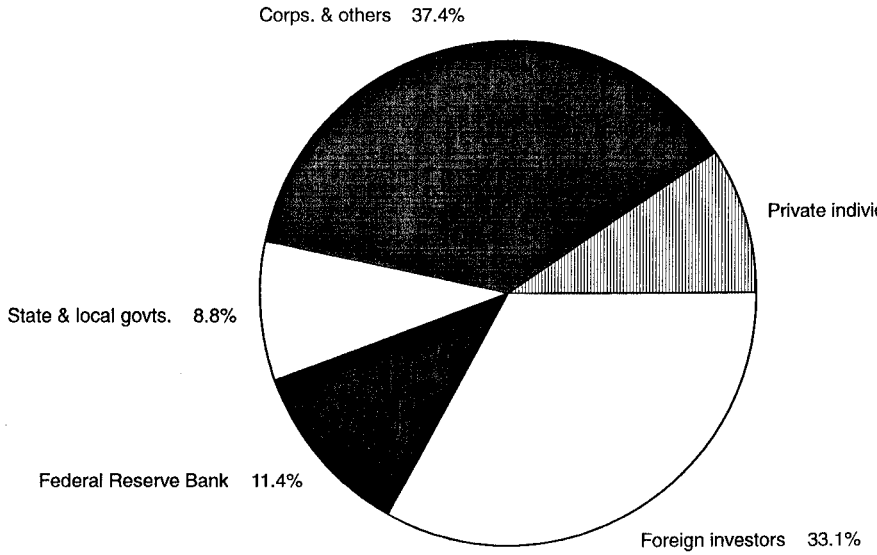
Mr. Chairman, this concludes my statement. I will be glad to respond to questions.

Figure 1: Gross Federal Debt and Its Components (September 30, 1997)



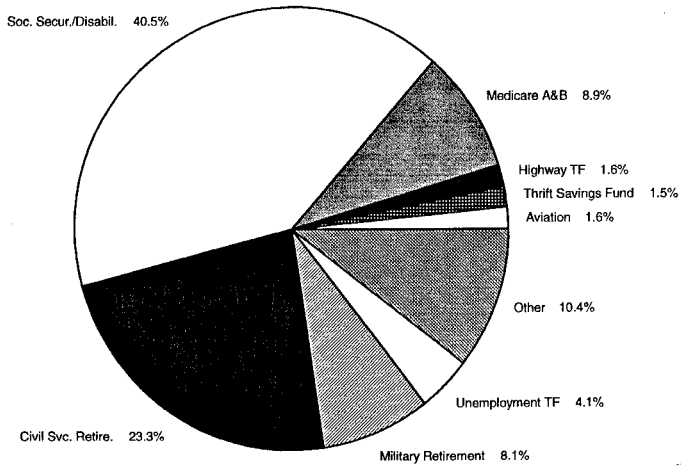
Source: Budget of the U.S. Government, Fiscal Year 1999

Figure 2: Estimated Ownership of Debt Held by the Public (September 30, 1997)



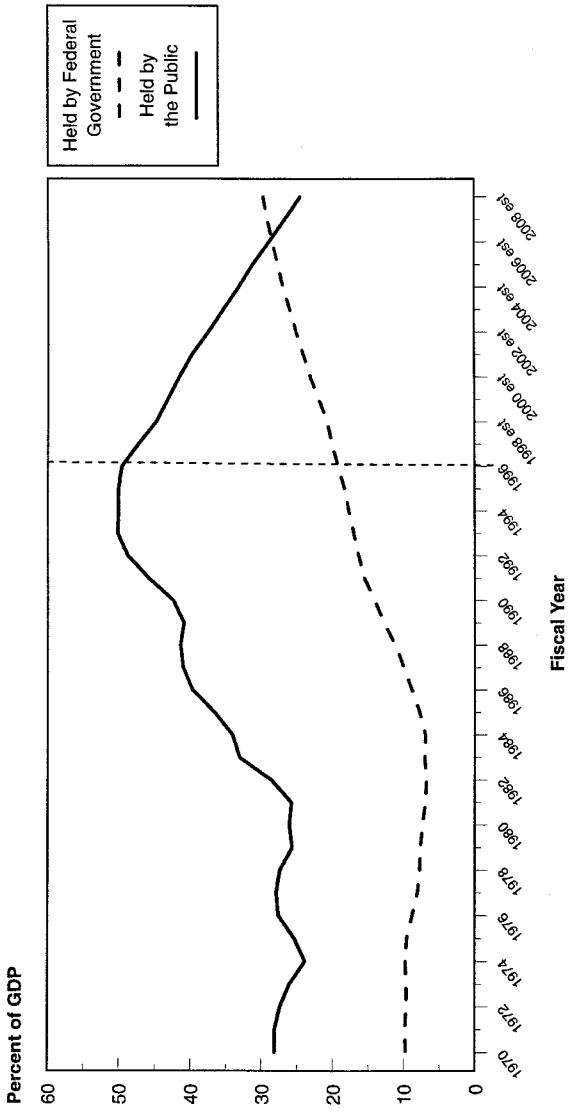
Source: U.S Department of the Treasury.

Figure 3: Federal Debt Held by Government Accounts, as of May 31, 1998



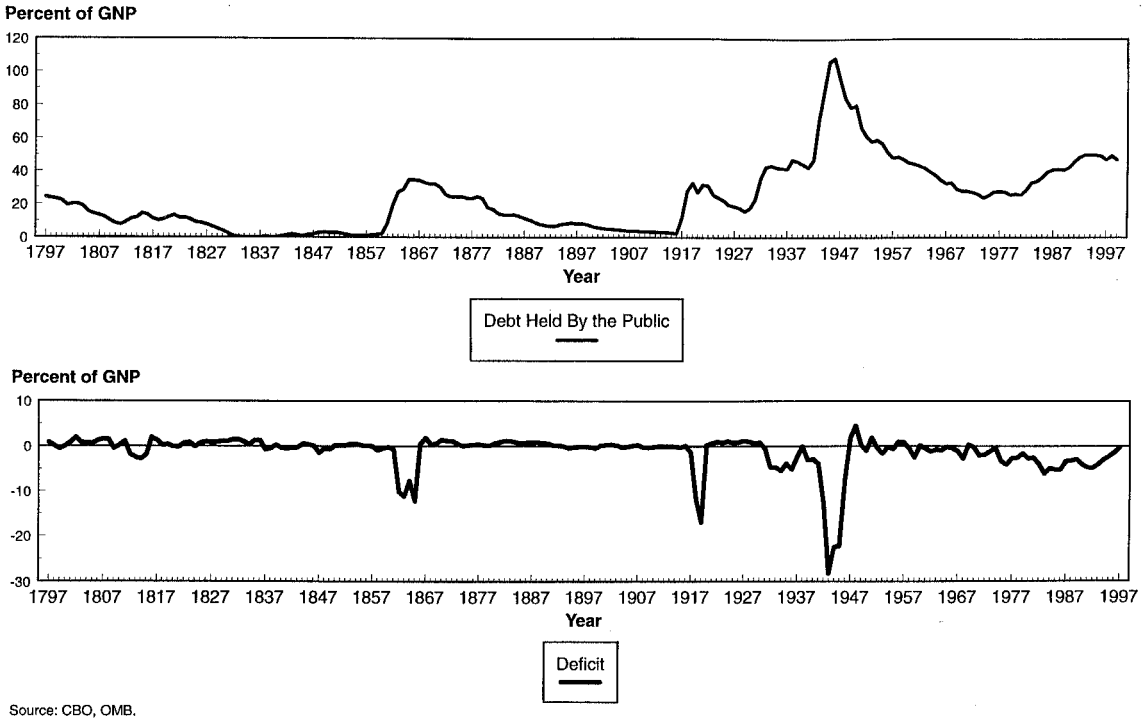
Source: Monthly Statement of the Public Debt of the United States, May 31, 1998

Figure 4: Federal Debt as a Percent of Gross Domestic Product (GDP)



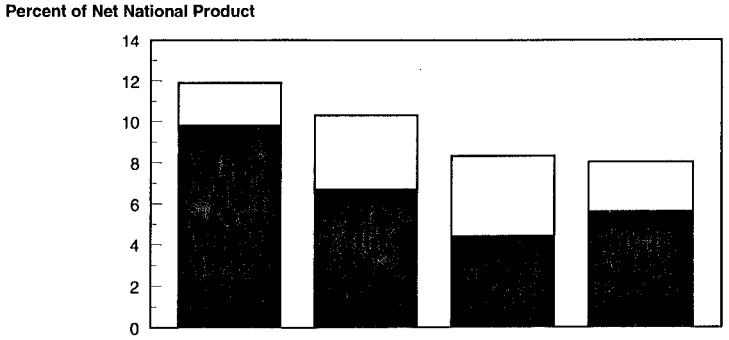
Source: Actual Debt: Budget of the U.S. Government, Fiscal Year 1999
Projected Debt: Congressional Budget Office,
The Economic and Budget Outlook January 1998.

Figures 5 and 6: Deficit and Debt Held By the Public as a Share of GNP (1797-1997)



Source: CBO, OMB.

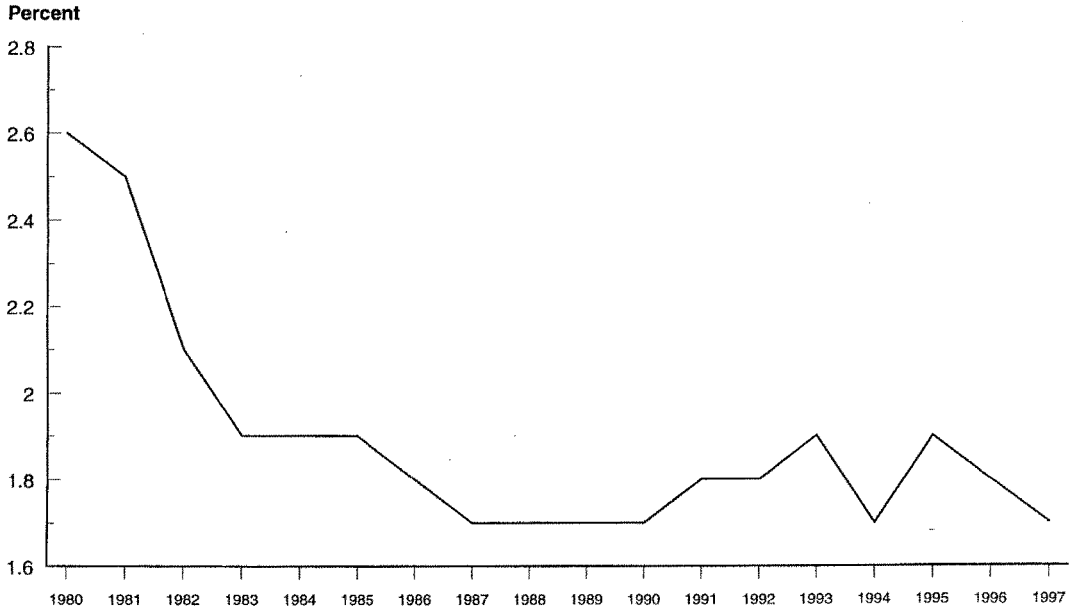
Figure 7: Effect of Federal Budget Deficits on Net National Saving (1970-1997)



Fiscal Years	1970-1979	1980-1989	1990-1992	1993-1997
Available for Private Investment ■	9.8	6.7	4.4	5.6
Absorbed by Federal Deficit □	2.1	3.6	3.9	2.4
Net Non-Federal Savings	11.9	10.3	8.3	8.0

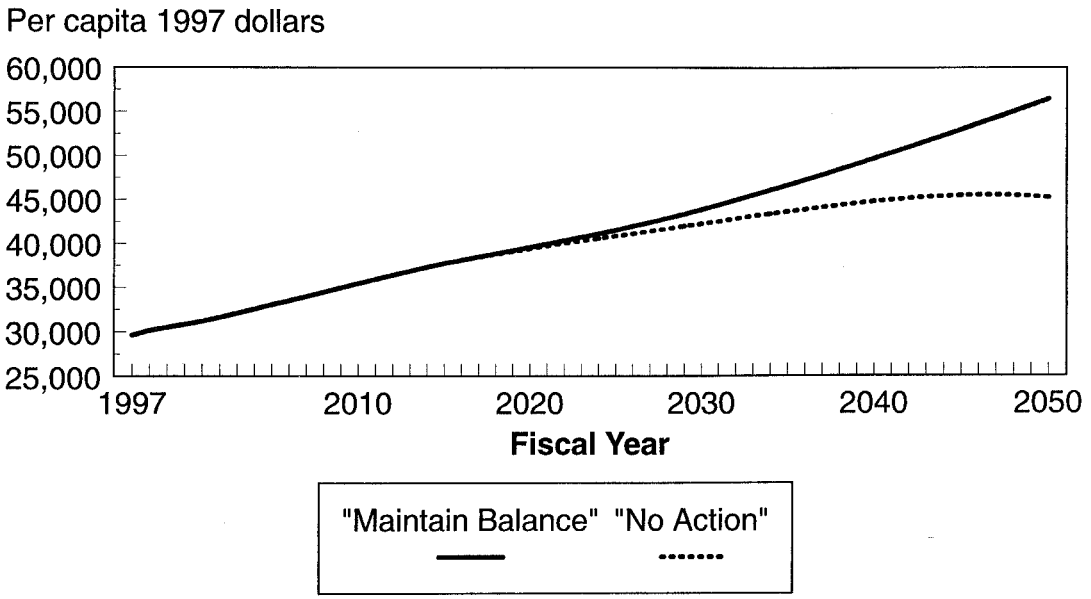
Note: Entire Bar represents nonfederal saving net of capital depreciation.
Shaded portion of bar represents net national saving.
Source: GAO analysis of U.S. Department of Commerce data.

Figure 8: Nondefense Investment as a Percent of Gross Domestic Product (1980-1997)



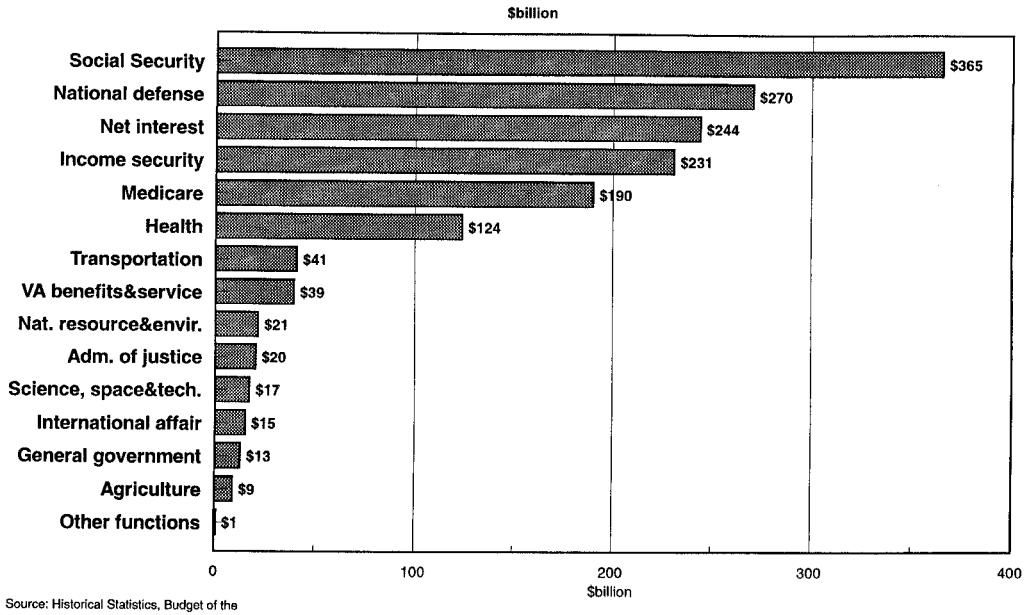
Source: Historical Tables, Budget of the U.S. Government, Fiscal Year 1999

Figure 9: GDP Per Capita Projected Under GAO's Fiscal Policy Simulations



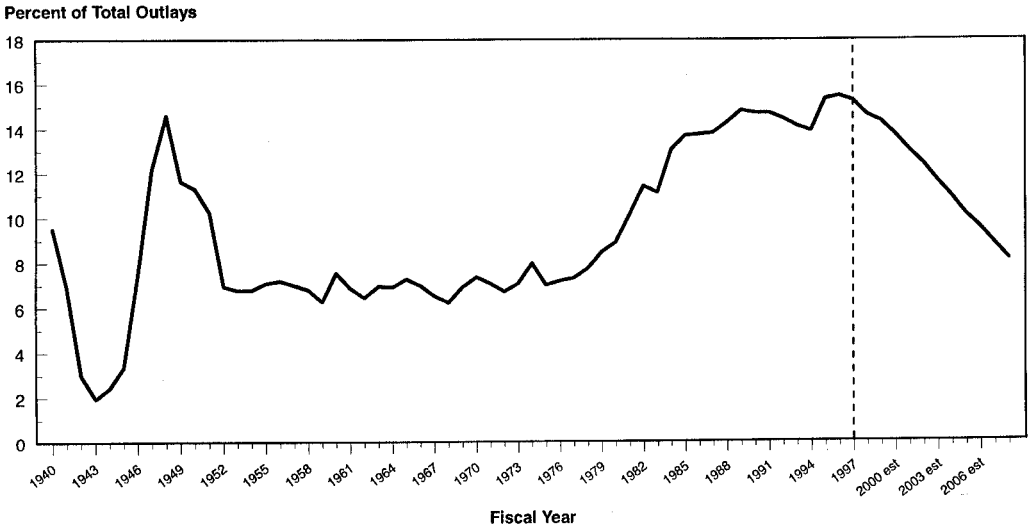
Source: U.S. GAO

Figure 10: Federal Outlays by Functions, Fiscal Year 1997



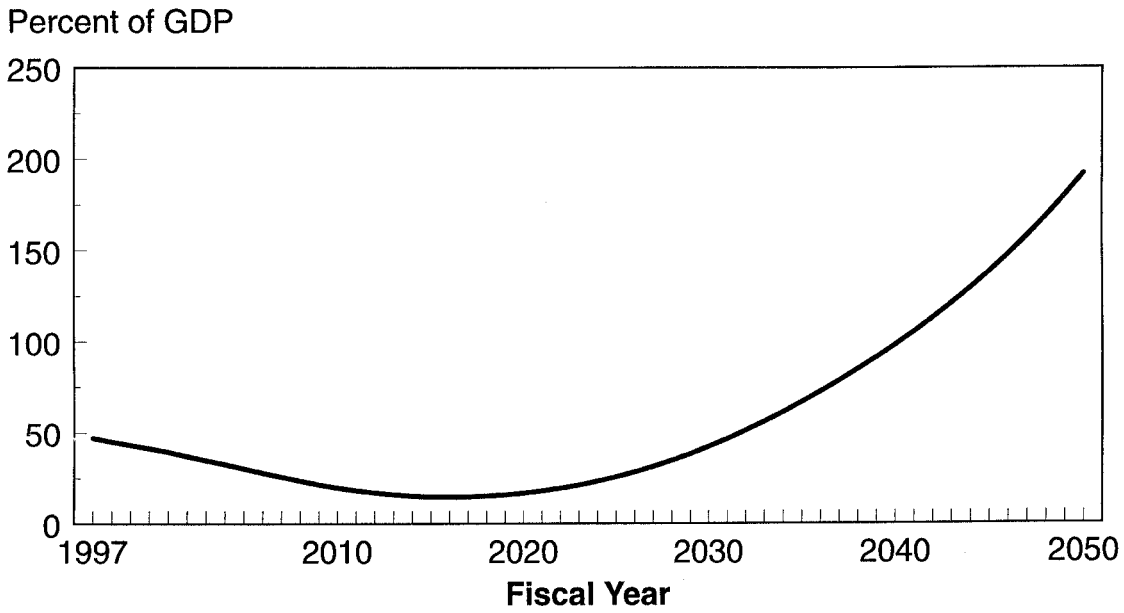
Source: Historical Statistics, Budget of the US Government, Fiscal Year 1999

Figure 11: Net Interest as a Percent of Total Federal Spending (1940-2008)



Source: Actual Net Interest/Total Outlays: Budget of the U.S. Govt, FY99
Projected Net Interest/Total Outlays: CBO, January 1998

Figure 12: Debt Held By the Public as a Percent of GDP Under GAO's No Action Simulation



Source: U.S. GAO

Chairman CRANE. Thank you very much, Mr. Posner.

Turning to chart number two, the ownership of our debt held by the public. Foreign investors is listed at little over 33 percent. Has that been affected by any of the panic in the Asian-Pacific region?

Mr. POSNER. I think it is probably safe to say that it has been affected by those recent trends, that is the dollar's strength and an open economy. There's the flight to safety and Treasury bills are considered a safe investment. Throughout the world the dollar is a reserve currency which are invested by many central banks and governments in Treasuries. Many observers feel, that those events are related to that spike.

Chairman CRANE. And has it resulted in more investment in our debt, or less, taking money out?

Mr. POSNER. I think it's more foreign investment. I believe it's grown from something like 25 percent several years ago to 34 percent today, so there's a greater foreign investment in our debt than before.

Chairman CRANE. And what percentage of that is held by the Japanese?

Mr. POSNER. We can provide that for you for the record. We don't have it right——

Chairman CRANE. Off the top of your head, do you think it's a majority?

Mr. POSNER. No, I don't think it's a majority. No.

Chairman CRANE. Who is the biggest investor in our debt?

Mr. MCCOOL. It would most likely be a combination of European governments, I would expect, governments, individuals, and institutions.

Chairman CRANE. No individual, single government comes to mind?

Mr. POSNER. The United Kingdom.

Chairman CRANE. The United Kingdom?

Mr. POSNER. Yes.

Chairman CRANE. Another question I would like to put to you is this booklet that GAO put out in 1996 "Federal Debt Answers to Frequently-Asked Questions." Are you contemplating getting a reissue published?

Mr. POSNER. We're actually contemplating doing that. Mr. Domenici, the chairman of the Senate Budget Committee, has asked us to do this and to, essentially, talk about what it means to run a surplus for the public debt. What are the new issues raised by the budget surplus, including debt management issues, the very topic of your hearing, so we are planning on doing that.

Chairman CRANE. Very good, I appreciate that. I'd like to now yield to our distinguished ranking minority member, Mr. Rangel.

Mr. RANGEL. I have no questions. I want to thank you, Mr. Chairman, for having these our hearings and our witnesses for helping us better understand the budget process.

Chairman CRANE. Mr. Camp. Mr. McCrery.

Mr. MCCRERY. Mr. Posner, I just have one question. In the periods of declining debt in our history, what is the process of actually reducing the debt held by the public? How do we do that?

Mr. POSNER. There's essentially two ways to think about that. One is just simply, when a war is concluded, or the Great Depres-

sion, for example, was over, just the rise in economic growth shrinks the proportion of debt to the economy, so that's one thing that happens. The other thing that happens is very typically we go into a budget surplus, which is the only way we can actually reduce the nominal level of debt and that's been the typical response.

Mr. MCCRERY. How do we reduce the nominal debt?

Mr. POSNER. By any combination of revenue increases or spending cuts that produces an annual budget surplus.

Mr. MCCRERY. Yes, I know, we have to have a surplus to reduce the debt, I'm with you. But what's the actual mechanical process of getting that debt back and extinguishing parts of the debt?

Mr. POSNER. Right. Essentially, the debt mechanically is rolled over, most of the debt is rolled over so the mechanical process that happens is you simply have less need to finance debt so you roll less of it over. That's essentially the way we reduce the debt. At least recently, we haven't bought back any outstanding debt, but basically the mechanics is you simply roll over less of it.

Mr. MCCRERY. How much of our debt, you know, we hear a lot of talk about buying down the publicly-held debt. We've got this surplus and we want to use it all to buy down the debt. How easy is it to buy down the debt? In other words, how much of that debt rolls over each year which would lend itself to buying back?

Mr. OYOLA. About 50 percent of the debt held by the public will mature within the next two years, which means that the Treasury has the ability to roll over less of it. As debt matures, the Treasury could choose not to issue new debt, so about 50 percent of the debt held by the public could, potentially, be subject to less reduction.

Mr. MCCRERY. Okay. Thank you.

Chairman CRANE. Let's see. Mr. Cardin?

Mr. CARDIN. No questions, Mr. Chairman.

Chairman CRANE. Mr. Herger. Oh, wait, I'm sorry, Mr. Portman is he here? Mr. Herger, then. Mr. Watkins. Is Mr. Watkins here? Mr. Houghton.

Mr. HOUGHTON. Thank you very much, Mr. Chairman. I have not been here for this whole discussion, but I do have a question and I'm not sure that it's easily answered and if it's not, then we can talk about it personally later on. I guess the thing I've always worried about is the short-term debt financing long-term objectives. And it just seems that when we were in a crunch we tend to shorten up in order to reduce the out-of-pocket costs to the government at that particular time. So the question really is, are we doing right by that ratio now and, also, what might be an ideal ratio?

Mr. POSNER. That is, as you noted, a complicated question that I think Treasury may very well address in their remarks because there are a number of variables to consider. Cost to the government being one, which shorter terms denominations generally gets you lower costs. The market conditions and the liquidity of the various Treasury notes in maintaining a healthy market for Treasuries is another. As they will tell you, there are a variety of factors that are considered. We have not, again, looked at this in any independent way at this point, but my understanding is that the maturities of the Treasuries on average have been on the upswing, in the past 20 years. I think they reached a low in the mid-1970's, and now they are averaging a little over five years. But as to how

they decide the mix of bills and notes and bonds and that kind of thing is something I think they will probably be addressing.

Mr. HOUGHTON. So you haven't done any studies on that?

Mr. POSNER. No, not right——

Mr. HOUGHTON. Thanks very much.

Chairman CRANE. Mr. Neal.

Mr. NEAL. Thank you, Mr. Chairman. I just bumped into a reporter in the hallway and he said that Speaker is very upset today with CBO numbers and that he is very upset with the Joint Tax Committee's estimates on revenue forecasts. Would you care to comment on the role that CBO plays here in offering these revenue estimates for us? Any of the panelists?

Mr. POSNER. We have not looked, and do not have the responsibility to examine and independently evaluate CBO's numbers. They are the, as you know, the forecaster for the budget, for the Congress, and they estimate costs, but we at GAO do not have the role to examine their assumptions or their models.

Mr. NEAL. You wouldn't suggest that they ought to fudge any numbers along the way so that they can comply with the request of the leadership for tax cuts that may not well be necessary?

Mr. POSNER. All I can offer in response to that is that we work very closely with the CBO analysts and they are highly professional and I've not known that to be a problem in their past history.

Mr. NEAL. Could I ask, do you know who appointed the current CBO team?

Mr. POSNER. Well, the current director is appointed by the Congress, by the leadership of the House and Senate, I believe, three-and-a-half years ago.

Mr. NEAL. Okay. Thank you, Mr. Chairman.

Chairman CRANE. Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman. Just one question in particular. We will see, with the rollover of the private sector portion of the debt, a reduction. We will see an increase with the public sector portion of it. What will be the bottom line as compared to a year ago? Will there be an increase or a decrease overall?

Mr. POSNER. Increase over all in the gross Federal debt.

Mr. COLLINS. And by how much? I looked for it in some of this information and I didn't——

Mr. POSNER. Basically the gross debt in 1997 was $5.3 trillion; in 1998, it will be $5.5 trillion; 1999, $5.7; and it grows to $7.1 trillion by 2008, the gross debt. And, again, the net debt to the public goes down; the debt held by the government accounts goes up.

Mr. COLLINS. Okay. One other question, the chairman mentioned foreign investors, particularly in Japan, and Japan has quite a bit of accumulated savings in private sector there. How does their interest rate for those savings compare to the investment in our securities?

Mr. POSNER. I'm sorry, could you repeat that?

Mr. COLLINS. In Japan, the private sector has an accumulated savings of about $10-$11 trillion. How does the interest rate on those savings in Japan compare with the interest rates we pay on securities? Or do you know?

Mr. POSNER. Don't know. Tom, do you——

Mr. MCCOOL. I don't know what longer-term interest rates in Japan are. I know that their short-term rates tend to be very low and, certainly, in comparison with U.S. rates. But then you also have to take into account the potential for currency fluctuations, so it's a fairly complicated mix but Japan's interest rates are, I think, quite low right now.

Mr. COLLINS. Okay. Thank you. Thank you, Mr. Chairman.

Chairman CRANE. Mr. Tanner.

Mr. TANNER. Thank you, Mr. Chairman. I, like Mr. Houghton, haven't been here the entire time. For that, I'm sorry because I am very interested in this subject. From the charts that I have seen, foreign investors, according to the chart, hold about a third of our public debt. Is that an acceptable number or should we be concerned or is it something that really matters?

Mr. POSNER. It's probably a dual-edged kind of answer to that. On the one hand, the foreign investors help us finance our investment at levels above that we can finance from our own savings because our savings from domestic sources are so low. So, on the one hand, foreign investment helps prop up our investment. In an open economy, the influx of foreign dollars the Treasuries is a reflection of the strength of the dollar, the strength of the American economy compared to other economies right now, and so it's in some sense a tribute to the American economy. On the other hand, the downside of this is that the earnings from those investments in our assets flow overseas to foreign residents and not to American citizens.

There is probably no one level that would be--that you can say is appropriate. But, certainly by propping up levels of investment, they are helping us attain higher levels of investment and plant equipment that ultimately helps long-term growth, assuming foreign dollars are invested in productive assets.

Mr. TANNER. Well, looking at this chart, from what you say, I assume that a third of the $244 billion or thereabouts is going overseas, which would be a trade imbalance with regard to currency, would it not?

Mr. POSNER. I'm not exactly sure how much of the net interest specifically is denominated to foreigners. The foreign holdings have just recently climbed to that level, so I'm not sure that a third would be the right figure there but——

Mr. TANNER. Well, would you have a comment as to whether a-third, in your opinion, was too high, too low, about right, or does it matter? I know that's very subjective--but, at home we get asked questions like this and when we say, well, the foreigners hold a-third of our debt and people ask if a third is too much? Should we be concerned? And I'd just like your opinion about it, that's not a——

Mr. MCCOOL. Well, again, I think part of the issue also is it's not just how much they hold of our debt, but how much we hold of their debt and the issue is really the net. So you would expect in a world where the U.S. is the dominant economy and the assets of the U.S. government are the most attractive risk-free assets around, that foreigners would want to hold a lot of our debt, so that's not really the issue. I think the issue is the relative flows and the relative stocks, compared with what we hold of theirs. And I think that, recently has, been the issue. There's been more of

their money investment flows coming to the U.S. than vice versa over that time.

Mr. MCCRERY. Will the gentleman yield?

Mr. TANNER. Yes.

Mr. MCCRERY. I think the gentleman asked a good question. Is it safe to say that in times of surplus here the extent of the debt held by foreigners is less of a problem? Let me explain. If we're in times of deficit, then we have to actually go to the markets and borrow money ourselves, the government, to finance our deficit. So, it's possible that if foreigners held too high a percent of that debt, that they could kind of hold us hostage because we have to go to them in effect to borrow money to finance our own operations. Whereas in times of surplus, we don't really care who holds the debt or who's buying it because we're not issuing new debt, we could be actually buying it back, so that's part of my fear when we were having high deficits and, as far as the eye could see, as that percent of debt grew, held by foreigners, I could see us possibly at some point in the future being held hostage by those foreign debt holders.

Mr. POSNER. I think certainly when the debt is declining and the share that is held by anybody is less--as you indicate perhaps less critical. The vulnerability point is something we have a little track record on. In the 1980's, there was a disinvestment of our bonds by Japanese investors, for example, and yet, in fact, many other international investors filled the gap. Spain, the United Kingdom, and other nations came in and bought Treasuries, and so there's a fairly active diversified worldwide market for Treasuries that helps address some of those vulnerability concerns. However, the other issue to raise here is that other economies are facing a baby boom crisis of their own, earlier than ours: Italy, Germany, Japan, France are also going to be facing quite a--problems in the public sector in the next 30 years, that are going to draw back into those nations their investment resources for public sector programs. So, the amount of foreign investment we can rely on over time may, in fact, decline from those sources at the very least.

Mr. MCCRERY. Thank you, I won't ask the gentleman why the Italian and the French have a sooner baby-boom problem than we do, I'll leave that to others. I thank the gentleman for yielding.

Mr. TANNER. Thank you. Mr. Chairman, could I ask unanimous consent for two additional minutes.

Chairman CRANE. Sure thing.

Mr. TANNER. Thank you. Following up on what Mr. McCrery said, I think the idea here is more maybe in the nature of a political fear or a political problem than it may be in terms of a financial matter. The political fear, of course, is that the fear that some have that this debt held by foreigners gives them inordinate leverage over what happens internally in America and so that's the reason for the discussion here about how much is too much. But I thank you for that.

Going back to one thing that Mr. Houghton said, if I may real quickly. I, too, have been concerned about the short-term nature of some structural debt that's basically built in. We can say we'll pay it back some day but the truth is we probably never will, and I'm not sure financially that it's necessary. It's always been my thought

that if we could stabilize the debt, and then let the economy double, triple, and quadruple, a $5 trillion debt in an $8 trillion economy is very much a problem, in a $20 trillion economy, it is much less of a problem. Which brings me to my second question. The interest that we pay on this debt amounts to somewhere around 14 cents out of every dollar that comes to the Treasury. Is that correct?

Mr. POSNER. Yes.

Mr. TANNER. All right, said another way and the way I explain it to people at home, 25 years ago about 7 cents of every dollar that came was paid in interest. Now, any business person knows that if one is paying 7 percent for one's inventory, if it's a car dealership or whatever, you can make a little money. If you're paying 14 percent interest on your inventory, it becomes very problematic as to whether or not your business can make it. Now, we have in effect a 14 percent mortgage on the country, would that be a fair statement in your opinion?

Mr. POSNER. Well, I think it's 14 percent of spending; it's roughly 3 percent of the economy, of GDP, but I think it's a fair way of saying that it's a concern. As we say, it comes right off the top, you can't do anything about it directly unless you reduce the size of the debt held by the public. The other concern is do we want this overhang from the debt buildups in the past 30 years to be carried forward into the next 30 years when we know that that next generation is going to be struggling to pay for these new bills that are going to be coming due for Social Security, Medicare, Medicaid that are also going to be facing them. So that's another concern and the question is we have an opportunity now to, reduce that as a share of the budget, to kind of reduce that legacy.

Mr. TANNER. I certainly thank the gentleman. I'm going to read this in depth and perhaps maybe we could follow up with a meeting at some point about this and I'd really like to get with Mr. Houghton and explore the imbalance in the debt versus the structure, particularly with no entitlement reform in sight. Thank you, very much, Mr. Chairman.

Chairman CRANE. Mr. Christensen.

Mr. CHRISTENSEN. Thank you, Mr. Chairman. Mr. Posner, I've got just a couple of questions. One is that as director of your Division of Accounting and Information Management, how are you guys prepared for the Y2K problems and, as the manager, are you up to speed on getting ready for the Year 2000?

Mr. POSNER. Well, in terms of—GAO has done—is making a major investment in analyzing the Federal agency's readiness for the Y2K. As a matter of fact, we have a request to look at the Bureau of Public Debt and those operations to make sure that they are Y2K compliant, which we have not yet begun but are about to begin. Is the question about our own operations?

Mr. CHRISTENSEN. Your own division.

Mr. POSNER. That's not in my bailiwick, but I know the GAO has been undertaking a review of our systems and that kind of thing to ascertain——

Mr. CHRISTENSEN. Do you know how far along you are?

Mr. POSNER. I really don't. We could certainly get back to you with information on that for the record.

Mr. CHRISTENSEN. I'd like to know that.
Mr. POSNER. Sure.
[The folllowing was subsequently received:]

Status of GAO's Y2K Efforts

GAO has been aggressively working to correct its year 2000 (Y2K) problems. We have identified 66 systems, 28 of which are deemed to be "mission critical." Of the mission critical systems, 9 were found to be Y2K compliant with 19 non-compliant and requiring either replacement or repair. Although GAO intends to bring all of its 66 systems into compliance, it has focused primarily on the 19 mission critical systems and the interfaces that move data among them.

The Y2K remediation effort involves five phases: awareness, assessment, renovation, validation, and implementation. We are following GAO's assessment guide and are currently on schedule to complete all these phases well before the end of 1999. Overall, as of July 15, 1998, we have completed the awareness and assessment phases of the project and most of the 19 non-compliant mission critical systems are well into the renovation phase. All but 2 are on schedule to be validated and implemented by the end of December 1998, with the remaining 2 systems completed by March 1999.

We are developing a testing plan for the 28 mission critical systems. The key strategy underlying our test plan is the insistence on end-to-end testing of interrelated systems. For example, we are creating a test facility which emulates our network that will allow us to test both network components and software and we are working closely with our government providers to test our corporate systems. We are also following GAO guidance for planning and implementing testing procedures.

Despite these plans, we realize this is not a risk free venture. The possibility of a system failure still exists, particularly in systems beyond our control, such as telecommunications. Because of this, we are developing separate contingency plans for each system as well as an overall plan that addresses our core business processes that must be sustained and the relationship of these processes to our mission critical systems. When our contingency plans are complete by the Fall of 1998, we will have procedures and systems in place to sustain core processes in the event of Y2K disasters, with the exception of major failures of the public infrastructure. These planning efforts are following GAO guidance on business continuity and contingency planning.

Mr. CHRISTENSEN. At what phase of review you are, at what percentage completion, and if it was tomorrow, what kind of catastrophe we would have in your division. Another thing I'd like to ask is what effects, if we were to significantly reduce the debt, will it have on our markets, and what effects has the Treasury's sale of the 4-, 7-, and 20-year had on our markets? The 20-year securities.

Mr. POSNER. Well, we have not really looked at the effects that individual denominations have had on markets of Treasury notes. What we have done is we've modeled the results for the economy for the long-term of debt reduction and what do you get in terms of long-term growth dividends from that? And that's the chart that we had up there before that shows that if, in fact, we reduce debt, essentially by following a balanced budget, once the baby boom bills come due, our per capita GDP would be much higher than it would be if we just followed the current course. And that's pretty much what we've done to try to illustrate the benefits of doing something about this. But we have not followed individual bills and issues.

Mr. CHRISTENSEN. That's all, Mr. Chairman.

Chairman CRANE. Mr. Hulshof.

Mr. HULSHOF. No questions, Mr. Chairman.

Chairman CRANE. Mr. English.

Mr. ENGLISH. Thank you, Mr. Chairman. This is a very distinguished panel. I really only have one question having to do with what is owed by the General Fund to Social Security. Social Security has over time accumulated nonnegotiable Treasuries as, in effect, a collection of IOU's against the $700 billion that the General Fund has taken out of the Social Security System. I know I am not describing this precisely, but, in effect, I am describing it accurately. In your view, is there a meaningful difference between negotiable and nonnegotiable government securities and is, simply if we were to try to compare their value, would it not be fair to say that a nonnegotiable Treasury security, by virtue of being nonnegotiable, inherently would have an inferior position because it can't be offered in the market. Do you care to comment?

Mr. POSNER. Well, the nature of these debt instruments is very, very different. Social Security has some advantage in that it gets unlike other trust funds, it gets redemption at par regardless of the market value or the change in the market.

Mr. ENGLISH. That's true.

Mr. POSNER. And that is an advantage that the Social Security fund has specifically by law. The whole question of even calling these securities is something that is problematic because it kind of leads to the impression that there's a funded portion that's available to be culled. And, as you know, these are IOUs, as you said, that, when the time comes, when Social Security runs out of surplus and has to dip into this reservoir of "assets," there really is no money there. And Treasury has to go out, unlike a State and local government pension fund, which has, you know, money that it can tap in the market, Treasury has to go out and either borrow it or raise taxes or cut spending somewhere else, as we're currently doing with Medicare, which has a $5 billion cash deficit. Medicare is starting to call back some of its treasuries on a net basis, al-

though it's hard to tell the impact of that on a $1.7 trillion budget; nevertheless, Medicare is becoming a net drain on the Federal budget. And that's the kind of thing that will happen with Social Security around 2014.

Mr. ENGLISH. I think that's actually a wonderful summary, Mr. Posner, and I thank you for it. What you've made clear in your statement is that a non-negotiable treasury is not like a standard negotiable security. And what seniors and others have in their name posted, wherever it is in West Virginia, really does not have the same value as the security. Although, as you've noted, there are some legal protections built in to make sure there's a payment. And I thank you for it, and I yield back the balance of my time.

Chairman CRANE. Mrs. Thurman?

Mrs. THURMAN. Mr. Posner, I am like Mr. Tanner—sorry I wasn't here for the full explanation—but I'm just trying to catch up and read through this by looking at your charts, and particularly the conversation that took place on the foreign investments. You made a statement where it says, "the United States benefits from foreign purchase of government bonds because as foreign investors fill part of our borrowing"—I can't even say the word—"more domestic saving is available for private investment, and interest rates are lower than they otherwise would be."

Based on the conversation, as you said, as France and others start to need these dollars, what happens then to our economy in the United States based on that statement?

Mr. POSNER. Well, several things could happen. One that you might hope is that our own domestic savings might grow so that we can finance more of our investment from our own sources.

Another scenario might be that as these advanced nations reach their own public sector crisis or challenge, if you will, that other nations throughout the world might find treasuries and our investments to be, a good investment. So it's hard to tell what will actually happen there.

Mrs. THURMAN. But is it something we should be watching and be concerned about, based on that?

Mr. POSNER. A number of economists would argue that yes, in some sense, it is; and that it's generally preferable to increase the national savings rate from domestic sources.

Anybody? Thanks.

I will yield back the balance of my time.

Chairman CRANE. Mrs. Johnson.

Mrs. JOHNSON of Connecticut. Thank you very much.

I don't know whether it's fair to ask these questions of the next panel or your work enables you to answer them. But over, say, the last six months, how much debt have we actually retired as notes have come due, and we have just not refinanced them because we had surplus dollars? And of that debt, how much was high-cost and how much was low-cost? The gradations and——

Mr. POSNER. I think because they have some of the figures there we can——

Mr. OYOLA. We have some of the figures here. As of September 30, 1997, the total marketable debt, which is comprised of bills, notes, bonds, and the Federal Financing Bank, was $3.4 trillion. As of May 30, 1998, the total marketable debt was $3.3 trillion. So

there has been a slight decrease, from $3.439 trillion to $3.353 trillion. That's $86 billion less in marketable debt—bills, notes, and bonds.

Mrs. JOHNSON of Connecticut. And of that, how much was what you would categorize as high-cost debt?

Mr. OYOLA. The bills, which will be normally lower-cost debt, in September were $702 billion. And in May 31, it was $648 billion. So there has been a reduction in the bills.

Mrs. JOHNSON of Connecticut. And that's the lower-cost debt?

Mr. OYOLA. Yes.

Mrs. JOHNSON of Connecticut. And a higher-cost debt?

Mr. OYOLA. Higher-cost debt would normally be bonds. And in the case of bonds, on September 30, there were $576 billion; and on May 31, there were $599 billion.

Mrs. JOHNSON of Connecticut. So actually there's more high-cost debt?

Mr. OYOLA. There has been an increase in the amount of long-term debt.

Mrs. JOHNSON of Connecticut. So the—all of the drop has been in the lower-cost debt?

Mr. OYOLA. There has been a decrease in the bills, which are lower cost. There has been an increase in the bonds, which are long-term; and in the present environment, they are higher cost. There has also been an increase in the amount of inflation indexed securities, which are notes and bonds.

Mrs. JOHNSON of Connecticut. Did—did—were the bonds that came due during that period were they retired? I'm finding it a little hard to understand why the amount of bonded indebtedness went up so significantly, and the amount of short-term debt went down. Was is that longer-term high-cost debt didn't come due. Or did they choose not to pay it off?

Mr. OYOLA. We don't have the amounts that came due in that period of time, but we can certainly find the information for you. What probably happened is that the bills, which are short-term in nature, came due at a higher volume than any bonds. So, naturally, the bills will have been retired.

Mrs. JOHNSON of Connecticut. And I didn't understand you correctly that the inflation-indexed debt went up?

Mr. OYOLA. Excuse me.

Mrs. JOHNSON of Connecticut. The inflation-indexed debt went up?

Mr. OYOLA. Yes.

Mrs. JOHNSON of Connecticut. Thank you.

Chairman CRANE. Ms. Dunn.

Ms. DUNN. No questions.

Chairman CRANE. Well, with that, I want to express appreciation to our panel for their presentation this morning, and we look forward to working with you in the future. You may be excused, and we shall invite next the Honorable Gary Gensler, Assistant Secretary of Financial Markets for the U.S. Department of the Treasury.

Mrs. JOHNSON of Connecticut. Mr. Gensler. Welcome.

STATEMENT OF HON. GARY GENSLER, ASSISTANT SECRETARY OF FINANCIAL MARKETS, U.S. DEPARTMENT OF THE TREASURY

Mr. GENSLER. Thank you, Madam Chairperson, and distinguished members of the committee. It is an honor to be here today in front of this committee to talk about debt management and the Treasury.

With the Clinton administration's policy of fiscal discipline and its fostering of a strong U.S. economy, we have experienced our first budget surplus since 1969. The administration welcomes the challenge of managing a surplus rather than financing a deficit.

If I could just submit for the record my written testimony, I'm going to just briefly summarize in some oral remarks.

It is important in this endeavor for the government to have goals and principles. And I'd like to just lay out some of those goals and principles that guide treasury and its debt management.

First, in terms of our goals, we broadly have three goals that drive our debt management. The first is sound cash management. That is to say, that we want to ensure that our cash balances at all time are sufficient to meet our obligations.

Second, is achieving low-cost financing for the taxpayers. We look at this over time, both in the short-term and the long-term. And we consider risk, as many of the members had mentioned earlier, with the earlier panel.

And third is the promotion of efficient capital markets, to ensure that the U.S. capital markets continue to be the strongest around the globe.

In achieving these goals, five interrelated principles guide us.

First is maintaining the risk-free status of Treasury securities. This is accomplished through prudent fiscal discipline and timely increases in debt limits.

Second is maintaining consistency and predictability in our financing. Treasury issues securities on a regular schedule, with set auction procedures. This reduces uncertainty in the markets and helps minimize our overall cost of borrowing.

Third, Treasury is committed to ensuring market liquidity. Liquidity promotes efficient capital markets and, again, lowers the cost of borrowing over time.

Fourth, Treasury finances across the yield curve. What this means is we not only borrow money for short-term periods, like 90 days or 6 months in what we call the Treasury Bill market, but we also finance over the long term, as long as 30 years. This appeals to the broadest range of investors. And we feel that by appealing to a broad range of investors, we, again, help lower the cost of financing and promote an important goal of having the most efficient capital markets in the globe.

And then fifth, Treasury employs unitary financing. We aggregate virtually all of the government's financing needs and finance as one nation. Thus, all programs of the Federal Government can benefit from Treasury's low borrowing rate rather than competing in the marketplace with smaller, more costly issuances.

We have been responding to dramatic changes in our financing needs. At the start of the Clinton administration estimates were that the level of privately held debt today would be approximately

$4½ trillion. As you can see from this exhibit—and I apologize if the print is a little hard to see—that currently there's about $3.4 trillion of privately held debt. That includes marketable debt of about $3 trillion and $400 billion of non-marketable securities—savings bonds, State and local government series, and the like.

In addition, the Federal Reserve holds a little over $400 billion of debt; and then, of course, the government accounts and trust funds hold $1.7 trillion.

But the $1 trillion less debt today than was estimated just five years ago is a remarkable accomplishment, which has benefitted all Americans through higher national savings and lower interest rates.

Exhibit D shows how the components of our financing needs have changed over the last several years. The unified budget deficit, which historically drove our borrowing needs, has decreased dramatically and finally has become a surplus. Just three years ago, the unified budget deficit of $164 billion really drove our needs. And this year, OMB estimates a $39 billion surplus.

Moreover, an increasing share of our financing needs come from non-marketable securities, this is the sale of securities to State and local governments, to small investors, through savings bond programs and other programs. This year, we estimate that over $50 billion of our financing needs will come through non-marketable securities.

Thus, in Fiscal Year 1998, with all these factors, we will pay down approximately $79 billion in marketable securities, which is our last component.

I would like just to discuss for one brief moment the May announcements. First, we stopped offering three-year notes, and, second, we reduced the frequency of our offerings of five-year notes. In formulating this strategy, there were three questions, all of which are more detailed in the prepared testimony that we've submitted. But all of them were meant to promote the efficient capital markets, lowest-cost financing, and cash management goals that I referred to earlier.

In addition, the Clinton administration has made innovations that this committee had asked us to address, one in particular in terms of the inflation index program. The securities diversify the government's financing sources, and we believe that this will lower Treasury's borrowing costs over the long run. In addition, they provide inflation protection for investors and help promote savings.

Other innovations have been the innovations in State and local government series. We have innovated in savings bonds to make them more attractive to American savers. And in addition, we are making our securities more accessible to small investors—putting savings bonds on the Internet and making enhancements to our Treasury Direct program for small investors.

I believe the committee had some questions on the Year 2000 that I would be glad to take, and there's more in the prepared testimony.

In conclusion, as I said earlier, the administration welcomes the challenge of managing a surplus rather than financing a deficit. I would also like to mention my deep appreciation and respect for

the career staff at Treasury, who have done such excellent work on these issues for so many years.

Mr. Chairman, I will be happy to answer any questions you may have regarding Treasury debt management in this new era of budget surpluses.

[The prepared statement and attachments follow:]

EMBARGOED UNTIL 2 P.M. EDT
Text as Prepared for Delivery
June 23, 1998

TREASURY ASSISTANT SECRETARY GARY GENSLER
HOUSE COMMITTEE ON WAYS AND MEANS

Mr. Chairman, and distinguished members of the committee, it is an honor to be here today to discuss Treasury debt management. With the Clinton Administration's policy of fiscal discipline, and its fostering of a strong U.S. economy, we are experiencing our first budget surplus since 1969. The Administration welcomes the challenge of managing a surplus rather than financing a deficit.

Our discussion of debt management will begin with the goals and principles that guide Treasury in this important endeavor. After outlining our changing financing needs, I will review the adjustments to Treasury debt management announced this May. I will then discuss the inflation-indexed program and a number of other innovations in debt management that have been implemented during the Clinton Administration. Finally, I will say a few words about the measures that we are taking to prepare our critical securities-related systems for the Year 2000.

1. Goals and Principles

Treasury debt management has three main goals (Exhibit A):

- The first is sound cash management -- ensuring that Treasury cash balances are sufficient at all times.
- The second is achieving the lowest cost financing for the taxpayers.
- And the third is the promotion of efficient capital markets.

In achieving these goals, five interrelated principles guide us (Exhibit B).

The first principle is maintaining the "risk-free" status of Treasury securities. This is accomplished through prudent fiscal discipline and timely increases in the debt limit. Ready market access at the lowest cost to the Government is an essential component of debt management.

Second, is maintaining consistency and predictability in our financing program. Treasury issues securities on a regular schedule with set auction procedures. This reduces uncertainty in the market and helps minimize our overall cost of borrowing. In keeping with this principle, Treasury does not seek to time markets; that is, we do not act opportunistically to issue debt when market conditions appear favorable.

Third, Treasury is committed to ensuring market liquidity. The U.S. capital markets are the largest and most efficient in the world. Treasury securities are the principal hedging instruments used by investors across the markets. Liquidity promotes both efficient capital markets and lower Treasury borrowing costs.

Fourth, Treasury finances across the yield curve, appealing to the broadest range of investors. A balanced maturity structure also mitigates refunding risks. In addition, providing a pricing mechanism for interest rates across the yield curve further promotes efficient capital markets.

Fifth, Treasury employs unitary financing. We aggregate all of the Government's financing needs and borrow as one nation. Thus, all programs of the Federal Government can benefit from Treasury's low borrowing rate. Otherwise, separate programs with smaller, less liquid issues, would compete with one another in the market. Paul Volcker, then Under Secretary of the Treasury, proposed to promote the concept of unitary financing by establishing the Federal Financing Bank. He brought that idea before this Committee 27 years ago. The Administration continues to vigorously endorse this principle.

2. Changing Financing Needs

As we experience the first budget surplus in almost 30 years, we are responding to dramatic changes in our financing needs. Exhibit C shows the components of outstanding Federal debt. Privately held debt totals just under $3.4 trillion. Baseline estimates made just prior to the Clinton Administration projected that today's level of privately held debt would be greater by roughly $1.1 trillion, or approximately 32 percent. This remarkable accomplishment has benefitted all Americans through a higher national savings rate and lower interest rates.

Exhibit D shows how the components of our financing needs have changed over the last several years. Unified budget deficits, which historically drove our net borrowing needs, decreased dramatically and finally became a surplus. Net Federal lending activities that are not included in the unified budget have added to our financing needs. (This is largely represented by the direct student loan program.)

Another significant change is that we have been filling an increasing share of our financing

needs by issuing nonmarketable securities. Upon the redesign two years ago of the nonmarketable securities issued to state and local governments ("SLGS"), we have seen a sharp increase in this type of financing. This year, we anticipate more than $50 billion in net SLGS issuance.

All of these factors lead to an anticipated $79 billion pay down in marketable debt this fiscal year. This compares to $169 billion in net market borrowing just three years ago. Treasury will still be the largest issuer in the market, however, as we need to raise the monies to pay off our maturing securities. This year, $510 billion of our longer term debt, known as "coupon" securities, will mature. In addition, there are $450 billion in Treasury bills outstanding which need to be refinanced on average several times a year. Treasury bills are our shortest term offerings, with maturities of less than one year.

3. May Announcements

To achieve the goals and to promote the principles that I described above, Treasury has a variety of financing tools at its disposal. These include issue sizes, offering schedules, instruments offered, auction rules and possible debt repurchases.

In May of this year, we used several of these financing tools to address the exciting challenge brought on by the new environment of budget surpluses. First, we discontinued issuance of 3-year notes. Second, we reduced the frequency of new issues of 5-year notes, shifting to a schedule of quarterly issuances instead of monthly issuances. I will discuss in some detail the actions that we took, as they best demonstrate how Treasury's debt management goals and principles guide our policy decision making.

In light of our lower borrowing requirements, we needed to develop a strategy for decreasing our issuances of Treasury securities. The first question we faced was whether to further decrease the issuance of Treasury bills. Over the last two years, we had been reducing the amounts of Treasury bills offered. Consequently, the market in privately held Treasury bills had declined in overall size by $135 billion, or 23 percent. Due to this change, the bill market had become less liquid. In addition, our previous reductions in bill issuances had caused the average life of our marketable debt to increase modestly. If left unaddressed, this would raise our borrowing costs because over long periods of time, interest rates on shorter term borrowings tend to be lower than on longer term borrowings. Moreover, Treasury bills, which are issued weekly, allow us flexibility to best manage Treasury's fluctuating cash needs. For all of these reasons, we decided to reduce our issuance of coupon debt, rather than further reduce issuance of Treasury bills.

The second question we faced was whether to make cuts across all of the existing types of coupon debt, or to eliminate specific issues or maturities. The current issue sizes had already been reduced to levels in existence in 1992. The size of the U.S. capital markets have expanded

significantly since that time. Accordingly, we decided to concentrate our borrowing in fewer but larger debt offerings. By reducing the total number of yearly coupon issues from 39 to 27, we will promote market liquidity and efficiency, and best achieve lowest cost financing for taxpayers.

The next question we faced was which issues or maturities to eliminate. The discontinuation of a maturity is not unusual – we discontinued 20-year bonds in 1986, 4-year notes in 1991, and 7-year notes in 1993. The 3-year note was chosen for elimination in response to market demands. It is closest in maturity to another of Treasury's coupon offerings, the 2-year note. In addition, the elimination of the 3-year note allows us to maintain financing across the yield curve. We chose to reduce the frequency of new issues of 5-year notes, shifting to a schedule of quarterly issuances to further concentrate our issuance. That change fits our cash management needs by providing us with the cash we need in the middle of fiscal quarters.

In sum, the debt management changes that we announced in May promoted the achievement of Treasury's debt management goals. We reduced the Treasury offering schedule to align new Treasury security issuance with the Government's need for financing. By concentrating our financing on larger, more liquid issues, we are promoting capital markets as well as lowest cost financing for the taxpayers.

4. Recent Innovations

The changes that we instituted in May are just one example of the innovations in debt management that have been achieved during the Clinton Administration.

One of our most significant innovations has been the development of inflation-indexed securities. These securities, first offered in January 1997, diversify the Government's financing sources. We believe that this will lower Treasury's borrowing costs over the long term. They also provide an important diversification tool for investors. Moreover, by providing inflation protection, we believe that inflation-indexed securities promote savings. In addition, U.S. capital markets now have securities that price inflation risk. Treasury has made a long-term commitment to develop the inflation indexed market further.

In 1996, Treasury made it easier and less costly for state and local governments to refinance and invest in Treasuries. We redesigned SLGS and made them more flexible. As noted, we are now experiencing record net new borrowing in the form of SLGS.

In 1997, Treasury took steps to make savings bonds more attractive for American savers. We began to calculate the savings bond interest rate using a different formula, which raised the rate. We also began to accrue the interest on a monthly basis, instead of every six months. Later this year, we will be introducing inflation-indexed savings bonds. These bonds will protect hard-earned savings from inflation. They will be issued in denominations as low as $50, making them affordable for all Americans.

We are also introducing some new services designed to make our securities more accessible to investors. For example, later this year, we expect to offer savings bonds over the Internet. In addition, we've made improvements to the Treasury DIRECT book-entry system. The changes to Treasury DIRECT make it easier for investors to sell and to pay for Treasury securities, and to reinvest proceeds.

5. Year 2000 Problem

Before I conclude, I would like to take a moment to discuss the steps we are taking to address the Year 2000 computer problem as it relates to the functioning of the market for Treasury securities.

On Friday, December 31, 1999, the Treasury Department is scheduled to make principal and interest payments of $35 billion. We are also scheduled to issue securities on that day. On Monday, January 3, in the year 2000, we currently plan to conduct our usual weekly Treasury bill auctions. Treasury is committed to taking all the necessary steps to avoid any significant disruption on that first trading day of the new millennium.

Our efforts in this area are both internal and external. Internally, the Treasury and the Federal Reserve have identified 14 critical securities-related systems, and are in the process of ensuring that all of those systems are Year 2000 compliant. The critical systems include the national book entry system, which maintains and transfers marketable Treasury securities; and our auction and trading systems, which receive and process auction tender information. We expect to complete coding and testing for all but one of the systems by the end of 1998.

Externally, Treasury has been reaching out to Treasury market participants to encourage them to engage in Year 2000 readiness testing. Just last week, we co-sponsored a conference on readiness testing in New York. In addition, we have been engaging with other members of the Working Group on Financial Markets, both at the principal level and at the staff level, to address this important issue.

6. Conclusion

As I stated earlier, the Administration welcomes the challenge of managing a surplus rather than financing a deficit. I will be happy to answer any questions you may have regarding Treasury debt management in this new era of budget surpluses.

-30-

Exhibit A

GOALS OF DEBT MANAGEMENT

- **Sound cash management**
- **Lowest cost financing for taxpayers**
- **Promoting efficient capital markets**

Exhibit B

GUIDING PRINCIPLES

- **Maintaining "risk free" status**
- **Maintaining consistency and predictability**
- **Ensuring market liquidity**
- **Financing across the yield curve**
- **Employing unitary financing**

Exhibit C

Public Debt

As of May 31, 1998
(Billions)

I. Privately held	
Marketable:	
Bills	**$ 449**
Coupons	**2,430**
Inflation-indexed securities	**48**
Subtotal	**2,926**
Nonmarketable:	
State and Local Government Series	**151**
U.S. Savings Bonds	**181**
Other	**100**
Subtotal	**432**
II. Held by the Federal Reserve Banks	**444**
III. Held by U.S. Government Accounts	**1,704**
TOTAL	**$ 5,506**

Note: Detail may not add, due to rounding.

Exhibit D

Financing Need

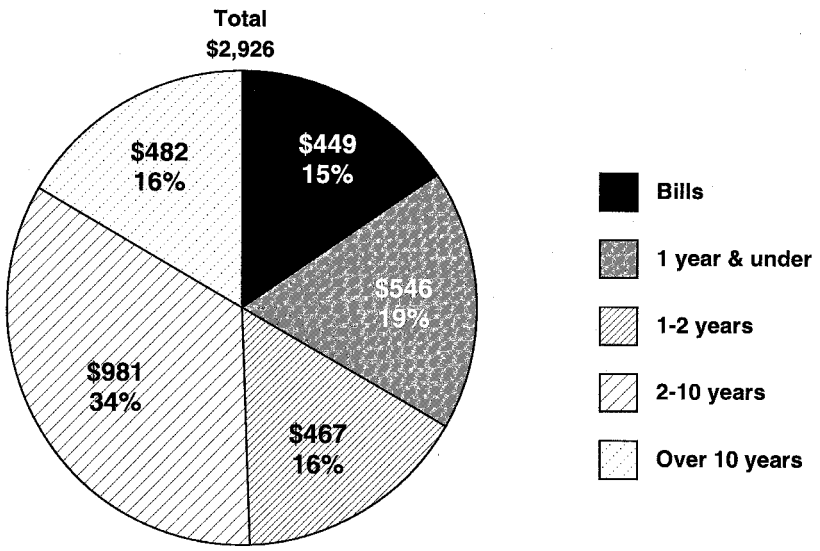
(Billions)

	FY 1995	FY 1996	FY 1997	FY 1998 (estimate)
Unified Budget	$ -164	$ -107	$ -22	$ 39
Financing Accounts	-4	-12	-21	-16
	$ -168	$ -119	$ -42	$ 23
Nonmarketable Securities	-19	-15	16	52
Adjustments to Cash Basis and Other	18	-24	6	3
Net Market Borrowing	169	158	21	-79
	$ 168	$ 119	$ 42	$ -23
Maturing Coupon Securities	$ 351	$ 440	$ 481	$ 510

Note: Detail may not add, due to rounding.

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT BY REMAINING MATURITY

Billions of dollars



As of May 31, 1998

Chairman CRANE. Thank you, Mr. Gensler.

Mr. Rangel.

Mr. RANGEL. Treasury now has a history of selling inflation-indexed bonds. Could you summarize how this new policy has unfolded?

Mr. GENSLER. We introduced the inflation indexed bonds just about a year and a half ago, and since then have had six issuances. And we're about to announce our next issue—I believe it's next week. We've been very satisfied with the inflation indexed program to date, and we feel it's an important innovation, again broadening out the access that the Treasury has to markets. Some have said that this is a new asset class. We believe that it brings new investors into the Treasury. And importantly, as we said, it offers inflation protection for investors and a way for the economy as a whole to see inflation signals. So we're quite pleased.

It still, though, of course, is embryonic. We only have a little—about $50 billion of our financing through this program, which is a small portion of our program at this time.

Mr. RANGEL. Thank you.

Chairman CRANE. Mr. McCrery.

Mr. MCCRERY. Mr. Gensler, if we were to drastically reduce, or even eliminate, the debt. What effect would that have on capital markets? Since you can imagine that.

Mr. GENSLER. No, it's a very good question, and hopefully not just a hypothetical question. Over the long term, we think that it would have an effect of most likely lowering interest rates. And more specifically to your question about capital markets, there is a very important function that Treasury securities serve: to be the benchmark or the—if I may use a technical term—the hedge security for the markets. That means, whether it's corporations' borrowing, or mortgage borrowing, many people use the Treasury securities as a benchmark for pricing that borrowing.

There would be effects on capital markets if there were no Treasuries, and the market would have to find another hallmark or benchmark security n that hypothetical case. But, again, I think that would be an interesting and good challenge.

Mr. MCCRERY. Thank you.

Chairman CRANE. Mr. Herger.

Mr. Collins.

Mr. COLLINS. Thank you, Mr. Chairman.

Mr. Gensler, in the previous panel it was estimated that in 2008 the debt would be somewhere around $7 trillion. Do you know what percentage of ratio that will be at that time as projected based on private versus public?

Mr. GENSLER. And was this in the year 2000, sir?

Mr. COLLINS. 2008.

Mr. GENSLER. 2008, I see.

Mr. COLLINS. I was going to ask the other panel, but I didn't.

Mr. GENSLER. I don't know the specifics of their model, sir, but currently the privately held debt, as we showed in the earlier table, is $3.4 trillion. And that, in fact, through 2008 will decline as the unified budget balances in surplus. So one would—we could get back to you specifically, but it would be well less than half of that $7 trillion that you referred to.

[The following was subsequently received:]

In the May Midsession Review of the Budget, the Office of Management and Budget estimated that the U.S. Government debt held by the public will total $2.1 trillion at the end of FY 2008. That figure includes holdings of the Federal Reserve System, which were not estimated for FY 2008, but which totaled $424 billion of the $3.7 trillion of debt held by the public at the end of FY 1997.

Mr. COLLINS. Well, one other question pertaining to the $7 trillion, too. I'd like to know what the projected percentage of that public debt would be Social Security, because that's just before the Baby Boom generation is hitting the eligibility rolls.

Mr. GENSLER. We could get back to you, sir, with the specific number on what the Social Security Trust Fund balance would be in ten years time.

[The following was subsequently received:]

Based upon the 1998 Social Security Trust Fund Trustee's Report, it is estimated that the Social Security Trust Fund will hold $1.964 trillion at the beginning of 2008.

Mr. COLLINS. Okay. There's one other thing: In your opening comment, you mentioned that due to the Clinton administration's policy, fiscal policy, that it's fostered the strongest economy and experienced the first balanced budget surplus since 1969. You know, it just gets to be a point that it seems like some people like to stand up and say, look what we did. Look what I did. You know, I want to point out to you that in 1993 and 1994, the Clinton administration policy to deal with the budget and the deficit was to raise taxes, increase entitlements, interest rates went up, the stock market kind of held stable.

But you look at what happened in 1995, 1996, and 1997. It had to be signed by the president. It was a joint effort. The budget has been balanced, erasing the deficit. Tax reduction. Entitlement reform in the era of welfare and Medicare. Interest rates are down. The stock market's more than doubled. It wasn't all the Clinton fiscal policy. A lot of it came from Congress. It had to originate in Congress, in cooperation with the president and his signature.

So it wasn't one of these I did it, Mr. Gensler. It was a we did it. Thank you.

Mr. GENSLER. If I might say, I think the bipartisan cooperation has been very, very positive.

Mr. COLLINS. Good. Then maybe you should change your opening statement.

Chairman CRANE. Mrs. Johnson. Oh, wait. I'm sorry, Mrs. Johnson. Mr. Hulshof.

Mr. HULSHOF. Thank you, Mr. Chairman.

Mr. Gensler, how does your statement and the charts you brought us on debt management square with the Clinton administration's call that every penny of the surplus should go to save Social Security?

Mr. GENSLER. Congressman, as you've said, the President called in his State of the Union address to save Social Security first, and reserve the surpluses until a long-term solution is, on a bipartisan basis, sorted through on Social Security. What we have done is—on a basis of financing, as opposed to budget—borrowed less money in this period of time. But we have not used those dollars for any spending or tax programs. And, in fact, just as I believe one of the

earlier panelists said, we have borrowed less money in this period of time as we've had stronger fiscal results.

Mr. HULSHOF. Because you were running out of time, let me invite you to expand a bit, if you want to, on some of the May announcements. I know one of the first questions was whether to further decrease the issuance of Treasury bills and the response in May was what? And I'll give you chance to expand a bit.

Mr. GENSLER. Well, we looked at three questions, that I believe Congresswoman Johnson had asked in the earlier panel. We had experienced a decrease in the shorter-term offerings of Treasury securities over the past 18 months of about 23 percent, as the fiscal picture continued to improve. Rather than decreasing short-term securities issuance further, we chose to instead, in May, decrease the amount of longer-term debt. And, in fact, our hope is to increase the offerings of the shorter-term, and, as the Congresswoman had pointed out, less costly debt. That was our first desire.

The second question was, now that we would do that, how would we best do that? How would we best shrink the longer-term offerings? And we thought it best to concentrate the offerings in fewer offerings, again to promote liquidity and promote lower cost borrowings for the taxpayers.

And then lastly, it was a more technical question as to, well, if we're going to concentrate, at which ones?

Mr. HULSHOF. Elimination of the three-year T-bill, and again, the reason you mentioned was market response? Was that because of the two-year maturity——

Mr. GENSLER. That's right, Congressman.

Mr. HULSHOF [continuing]. Being close enough or—or——

Mr. GENSLER. We surveyed the market. We talked to many market participants. Because we also offer two-year securities, and five-year securities, we felt that the three-year security was the least demanded by the marketplace.

Mr. HULSHOF. Thank you, sir. Nothing further. I yield back.

Chairman CRANE. Mr. Cardin.

Mr. CARDIN. Thank you, very much. Thank you, Mr. Gensler, for your testimony.

As the projections indicate, although debt will be increasing over the next decade, the amount held by the public will actually be decreasing and that they'll be more interagency debt. And, as I look at one of the charts that was prepared by GAO, it shows that the debt held by the public as a percentage of GDP is declining significantly between 1997 and the year 2020. And I guess my question—I'll appreciate your observations on it—would it, therefore, be a good time for us to consider investing some of the Social Security Trust Funds in the private market by the trustees. That would trigger more debt held by the public, keeping it more constant in our economy, allowing the Social Security Administration to have a more diversified investment return for the recipients under our Social Security system, and it seems to me—and you look at the projections going into the year 2050, with public debt, again, with there being no changes, would then tend to increase. So that, therefore, we try to keep it more level in our economy—the amount of debt held by the public as a percentage of GDP. Any thoughts on that?

Mr. GENSLER. Congressman, it's a very good question and an important question of great national import. And the President has suggested that he look to 1998 as a year of debate and dialogue with this Congress and with Americans broadly about Social Security. And so I would not want to, in essence, comment on that great national debate about which I think there will be many hearings.

Mr. CARDIN. I appreciate your candor on that. I thought we were supposed to start the debate this year, and resolve it next year. So I thought it was a fair question to ask.

Mr. GENSLER. I think it's a very fair question, a very important question. But as a representative of the Treasury, focused on debt management, I feel it's best to allow others to engage in that broader, very important debate.

Mr. CARDIN. And I won't press you anymore on that question, except to say that perhaps you could get us some figures, or get me some figures, as to how much of the debt held by—how much of the securities held by SSA could be invested privately to be able to maintain a constant amount of publicly held debt as a percentage of GDP over the next decade. That might be an interesting number for us to be able to take a look at for some of us who are trying to project ways of solving the Social Security issue.

Mr. GENSLER. Congressman, it would be our pleasure to get you those figures. It's also a great honor to be here as I was born and raised in your district.

[The following was subsequently received:]

In the May Midsession Review of the Budget, the Office of Management and Budget projects that the GDP will increase by 4½ to 5 percent per year over the next decade a period of time in which OMB projects budget surpluses. Therefore, OMB projects that the Federal debt held by the public will decline from 45 percent of GDP in FY 1998 to 16 percent of GDP in FY 2008—a decline of 29 percent of GDP.

Mr. CARDIN. See, if I knew that. You still vote in my district? [Laughter.]

Thank you very much. Thank you, Mr. Chairman.

Chairman CRANE. Mr. Houghton.

Mr. HOUGHTON. Yes, good morning. I want to ask a question of comparison or contrasts. In taking a look at the average length of privately held marketable debt, how do we compare in our planning with, let's say, Germany or Great Britain or Japan? Are we more or less conservative?

Mr. GENSLER. It's a very good question. What we find actually, sir, is that many of these nations look to us for our debt management principles and skills and guidance. And many Treasury representatives actually are called upon and asked to speak at international conferences about our approach to markets.

Having spent much of my career in the financial markets, and only joining Treasury nine months ago—I actually lived in Asia for three years, trading Japanese government bonds. I would say we have the most efficient, broadest markets. And, in part, that is because of Treasury policies over many administrations. We look overseas also to see if they have innovations that we might adopt. We recently adopted inflation-indexed securities which were offered in England and Canada and elsewhere.

But I'd say, broadly speaking, we're at the cutting edge or the forefront of innovation in our markets.

Mr. HOUGHTON. Yes, I'm not quite sure that's what I was searching for. You know, when you try to make money on money, sometimes you do things on a national scale which are inimical to a very sort of conservative, basic Treasury policy on bond management. So, I just wondered, how on a rating of between one and ten, ten being the most conservative, one being the most liberal, how do we rate with other countries? I know we're innovative. I know we've got a broad market. There's no market like it in the world. But how are we in terms of our conservative policy?

Mr. GENSLER. Congressman, I take your question to be about our debt management. And within our debt management, I think that we benefit from being conservative in many aspects of what we do.

We are conservative in cash management. We feel, foremost, it is our job at Treasury to make sure we have sufficient cash. I think, though, we benefit in a way that other countries can't by borrowing longer term. Our economy is stronger, more stable, over two centuries. And so many other nations cannot borrow as long term—out to 30 years—as we can, because we're such a strong and viable economy.

I view that as conservative, but other nations can't do that. And so for many of them, it would be risky to try to borrow that long. But I would think that overall, our debt management does have some conservatism in it that I would think this Congress would want us to have.

Mr. HOUGHTON. Okay. Thank you very much.

Chairman CRANE. Mrs. Johnson.

Mrs. JOHNSON of Connecticut. Thank you.

You mentioned in your earlier comments that, you know, you were looking at working down the long-term, more costly debt. Are you succeeding in doing that because it doesn't show up in the figures yet?

Mr. GENSLER. Well, with three trillion plus dollars of debt, it takes a little time to steer this thing. The changes that we announced in May will first begin to take place in July 1998 and moving forward. We were trying to arrest the lengthening of the average maturity of the debt that you've rightly pointed out.

I would say also just to possibly address your earlier question to the earlier panel, the debt that we're retiring was issued at much higher interest rates than we are issuing debt today. So, in fact, the American people are saving money as we retire close to a half a trillion dollars of older, longer-term coupon debt. And we're borrowing today fortunately at some of the lowest interest rates in the last 30 years.

Mrs. JOHNSON of Connecticut. I agree, absolutely. And that's why I was really surprised at this drop in short-term debt, and the actual increase in long-term debt. It seems to me that from the very beginning, the Treasury would have focused on, you know, really working down that long-term debt. And while I understand maturity times vary, it does seem to me in the period that we've had surplus that there would have been more evidence of a reduction in long-term debt burden.

Mr. GENSLER. In 1993, at the start of the administration, there was a decision to do precisely what the Congresswoman suggests and shorten the maturity, from about a six-year average maturity to a little over five-year average maturity. In the last 18 months, as you rightly point out, there's a bit of a gradual creep the other way, as we reduced Treasury bills to manage the very strong cash flows that were coming in, and sometimes unexpected cash flows. And now we feel we've had time to reflect on that and address it again.

Mrs. JOHNSON of Connecticut. Well, thank you. I appreciate those comments very much.

I also would like to just comment on the part of your testimony in which you address the year 2000. And I'm particularly pleased that you expect to complete coding and testing. Is that end to end testing, is that complete testing of all but one system by the end of 1998?

Mr. GENSLER. It is. We're looking at both code testing and interface testing. There are 14 critical systems that we look at, and all but one of them will be tested by the end of 1998.

Ms. JOHNSON of Connecticut. So those would be system-wide tests that you'd have confidence in? I'm looking—there's a lot of different kind of tests you can do along the way. We certainly want to be sure the equipment works. We want to be sure it works within an office. But the important thing is it works throughout the system. And the end testing——

Mr. GENSLER. That's right. And for many of our systems, we're testing the interface with the dealer community and investor community, and we're working with them on what's called end to end testing, literally. How they enter a trade and the cash movements and the flow of all the documents.

Mrs. JOHNSON of Connecticut. When will you be able to start that level of testing?

Mr. GENSLER. Well, in fact, because there are 14 systems, much of that has started. Some of it this summer. Some of it through the fall. I believe the bulk of those 14 systems will have been tested by October, if I recall the specific dates.

Mrs. JOHNSON of Connecticut. I was also very pleased that you have been having conferences to raise the issue of readiness with all market participants. And are you satisfied that you are reaching the major market participants and what are you doing to reach the minor market participants, the smaller ones?

Mr. GENSLER. This, as the Congresswoman points out, is a challenging task, and it is one that is not without risk. But we're reaching out—and the New York Federal Reserve is working with us. We're working with The Bond Market Association. We're also, I should say, working through the various international organizations—the G–7 and G–10 and other organizations, reaching out internationally, to highlight this very critical issue.

Mrs. JOHNSON of Connecticut. Since so much of our debt is held by foreigners, it is very critical that at least some portion of the international community be well prepared. What is your sense of their preparedness? Has Europe's preoccupation with the Euro and its other issues diverted it from this? Has the Asian financial prob-

lems diverted the Asian community from the year 2000 compliance attention?

Mr. GENSLER. While I'm not an expert on some of those matters, I think the Congresswoman is correct. The challenges in Europe, given their integration, are very real. They understand the year 2000, but this administration and the Federal Reserve, I know, have highlighted those issues around those international conferences. Asia, of course, has great other challenges.

Mrs. JOHNSON of Connecticut. Thank you. I would just say I appreciate having you testify. Mr. Chairman, I appreciate your having this hearing. I think it's a very important one, but I also think the public ought to understand that we—our obligation is to manage to debt to minimize taxpayer costs. And that all the rhetoric around Social Security and all those things is actually just rhetoric. That as long as Social Security is running the potential deficit that it is running, it is in everyone's interest, people of ages, that we reduce the national debt and the carrying costs.

Thank you.

Chairman CRANE. Ms. Thurman.

Ms. THURMAN. I have no questions.

Chairman CRANE. Mr. Gensler, before you leave, I was just told that the British have issued debt in perpetuity. Are you familiar with that?

Mr. GENSLER. I must—I can get back to the Chairman and give you and your staff more details on the British perpetuity debt.

[The following was subsequently received:]

Prior to 1948, the British Government had issued some debt instruments without a maturity date that required only the payment of interest. These perpetual bonds were known as consols.

Chairman CRANE. Yes, I'm curious as to what the advantages would be of that. I mean, to me, we should be focused on total elimination of debt if possible. And to make that a permanent component of your national budget? The service on a debt in perpetuity would put people on the dole. I guess, that is the rationale behind it. But I was curious—I had not heard of that before either. I thought maybe you could fill me in.

Mr. GENSLER. No, I hadn't. There are some studies as to how long a maturity debt should be for low-cost financing. The 30-year horizon is one that the Treasury has studied at times whether to go further, and we have been comfortable that, for promoting our goals over time and given risk, 30 years is probably the most appropriate horizon. But you raise an additional point of fiscal discipline.

Chairman CRANE. Well, we thank you very much, Mr. Gensler. And we look forward to continuing to work with you. With that, I would like to call our final panel: Stephen Francis, Vice Chairman of Fischer, Francis, Trees and Watts, Inc.; Mark Warner, Managing Director, Interest Rate Markets of North America; Dr. John Campbell, Otto Eckstein Professor of Applied Economics at Harvard University.

And if our panel will take their seats. We shall start with Mr. Francis, and then Mr. Werner, and then Dr. Campbell. If you gentleman can try and keep your presentations—your oral remarks to

five minutes or less, any printed statements will be made a part of the permanent record. Mr. Francis?

STATEMENT OF STEPHEN C. FRANCIS, VICE CHAIRMAN, FISCHER, FRANCIS, TREES & WATTS, INC., NEW YORK, NY, AND MEMBER, TREASURY BORROWING ADVISORY COMMITTEE

Mr. FRANCIS. Thank you, Mr. Chairman. Mr. Chairman and distinguished members of the committee on Ways and Means, I am pleased to have been invited to appear before you today.

You are reviewing in this hearing the debt management practices of the U.S. Department of Treasury in an era of budget surpluses. In my judgment, the objectives and principles of debt management should be largely unaffected by whether the budget is in deficit or in surplus. Building on the Treasury's public statements repeated here today by Assistant Secretary Gary Gensler, I believe there are three main objectives of debt management.

The first objective is to raise whatever cash is required to ensure that the Government's functions smoothly everyday and meets every financial commitment on time.

The second objective is to keep the cost of borrowing and hence the cost of the debt to the taxpayers as low over time as is possible and with due regard to risk.

The third objective is to promote an efficient market for the Government's debt.

The first two objectives—raising the cash required and minimizing the cost over time—are necessarily overriding. The third—promoting an efficient market for the Government's debt—furthers the first two objectives and in addition has significant ancillary benefits for the national and international capital markets.

To translate these objectives of debt management into practice, the Treasury has adopted some important operating principles. One is to issue securities on a consistent and predictable basis. This is an extremely potent principle for it reduces uncertainty. Reduced uncertainty about the Treasury's future borrowing plans means lower borrowing costs.

The second operating principle is to issue securities across a broad spectrum of maturities. Offering a wide choice of investment alternatives encourages participation in the Treasury market from all types of fixed income investors around the world. Enlarging the pool of investors fosters liquidity. Liquidity is a valuable attribute because it makes Treasury securities more attractive to investors which has the consequence of lowering borrowing costs. A broad spectrum of maturities also diversifies the Treasury's financial liabilities, providing resilience in changing financial conditions and a solid financial platform for any future change in debt management strategies.

The third operating principle is to introduce innovations after ample time for discussion and evaluation. Change in debt management as in all areas of finance is inevitable. The opportunity for improvements is always present. Many changes are technical refinements, but some are innovations. Among the important innovations during the span of my own career are the replacement of fixed price offerings by competitive auctions, the supplementing of

multiple price auctions by single price auctions, and the issuance of inflation-indexed securities. All innovations are accompanied by some degree of uncertainty. The aim is to keep any potential cost associated with the uncertainty as low as feasible.

The Treasury has done this by airing prospective changes it is considering publicly over comparatively long periods so that the market has an opportunity to digest the changes and adapt. To my mind, these objectives and operating principles of debt management are important constants which are essentially unaffected by whether the budget is in deficit or in surplus.

Periods of budget surpluses do, however, raise one specific challenge to debt management. That challenge is one of ensuring that the new issues of Treasury securities sold to redeem and refund maturing issues are large enough to be liquid. In periods of surplus, the concern is that the smaller sizes of new issues compared to the levels to which the market is accustomed may result in a degree of illiquidity for the new issues. Illiquidity deters investors and consequently raises the cost of borrowing and reduces the efficiency of the market.

The solution to this problem is fairly straightforward although the scheduling steps can be intricate. Essentially, it is a matter of consolidating a larger number of issues of declining size into a smaller number of so-called benchmark issues whose size are each sufficiently large to ensure superior liquidity. In its announcement last month in connection with the regular quarterly funding, the Treasury set forth such a program of issue consolidation.

In my judgment, debt management is functioning effectively—now and, in fact, throughout the past few administrations. During this period, debt management has adapted to changing budget considerations in a manner that has avoided surprises and consequently helped keep borrowing costs to a minimum. Credit for the success, it should be noted, belongs both to the official appointees and to the Civil Service employees who together are responsible for debt management at the Treasury.

What should be addressed? While still in our minds, I would urge Congress to find a way in the present benign budget environment to eliminate the delays in passing the debt limit that we endured in the past. These episodes are shameful and costly, and they damage our country's standing among advanced nations. I do not disparage the political aims behind the delays and I find it difficult to blame politicians for using tactical tools which are available. But as the world of finance becomes more open and more global, our competitive state becomes increasingly important to the future growth of our economy. Now, it seems to me, is a propitious time to move up a rung on the ladder of fiscal responsibility.

That concludes my statement. I would be pleased to respond to any questions.

[The prepared statement follows:]

STATEMENT OF STEPHEN C. FRANCIS
VICE CHAIRMAN
FISCHER FRANCIS TREES & WATTS, INC.

BEFORE THE
COMMITTEE ON WAYS AND MEANS

"MANAGING THE DEBT IN AN ERA OF SURPLUS"

June 24, 1998

Chairman Archer and distinguished members of the Committee on Ways and Means, I am pleased to have been invited to appear before you today.

You are reviewing in this hearing the debt management practices of the U.S. Department of the Treasury in an era of budget surpluses.

In my judgment, the objectives and principles of debt management should be largely unaffected by whether the budget is in deficit or in surplus, at least within the bounds and circumstances of recent years and those expected in the years immediately ahead.

Building on the Treasury's own public statements, I believe there are three main objectives of debt management:

1. To raise whatever cash is required to ensure that the government functions smoothly every day and meets every commitment on time.

2. To keep the cost of borrowing, and hence the cost of the debt to the taxpayers, as low over time as is possible.

3. To promote an efficient market for the government's debt.

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2. Issue securities across a broad spectrum of maturities. Offering a wide choice of investment alternatives encourages participation in the Treasury market from all types of fixed-income investors around the world. Enlarging the pool of investors fosters liquidity in Treasury securities. Liquidity is a valuable attribute because it makes the securities more attractive to investors, which has the consequence of lowering market yields and hence the cost of borrowing. A broad spectrum of maturities also diversifies the Treasury's financial liabilities, providing resilience to changing financial conditions and a solid financial platform for any future changes in debt management strategies.

3. Introduce innovations after ample time for discussion and evaluation. Change in debt management, as in all areas of finance, is inevitable. The opportunity for improvements is always present. Many of the changes are technical refinements, but some are major innovations. Among these are the replacement of fixed-price offerings by competitive auctions, the supplementing of multiple-price auctions with single-price auctions, and the issuance of inflation-indexed securities. All innovations are accompanied by some degree of uncertainty. The aim is to keep any potential cost associated with the uncertainty as low as feasible. The Treasury has done this by airing the prospective changes it is considering publicly over comparatively long periods so that the market has the opportunity to digest the changes and adapt.

To my mind, these objectives and operating principles of debt management are constants which are essentially unaffected by whether the budget is in deficit or in surplus.

Periods of budget surpluses do, however, raise one specific challenge to debt management that differs from periods of budget deficits. That challenge is one of ensuring that the new issues of Treasury securities sold to redeem and refund maturing issues are large enough to be liquid. In periods of surplus the concern is that the smaller sizes of new issues, compared to the levels to which the market is accustomed, may result in a degree of illiquidity for the new issues which deters investors and consequently raises the cost of borrowing and reduces the efficiency of the market.

The solution to this problem is fairly straightforward, although the scheduling steps involved are quite intricate. Essentially, it is a matter of consolidating a

larger number of issues of declining size into a smaller number of issues whose size is sufficient to ensure that liquidity remains adequate. The announcement by the Treasury last month in connection with its regularly quarterly refunding set forth a program of issue consolidation.

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What should be addressed? While still in our minds, I would urge Congress to find a way in the present benign budget environment to eliminate the delays in passing the debt limit that we have endured in the past. These episodes are shameful and costly, and they damage our country's standing among advanced nations. As the world of finance becomes more open—more global—our competitive status becomes increasingly important to the future growth of our economy. Now, it seems to me, is a propitious time to move up a rung on the ladder of fiscal responsibility.

That concludes my statement. I would be pleased to respond to any questions.

Chairman CRANE. Thank you, Mr. Francis.
Mr. Werner.

STATEMENT OF MARK B. WERNER, MANAGING DIRECTOR, INTEREST RATE MARKETS NORTH AMERICA, J.P. MORGAN & CO. INCORPORATED, NEW YORK, NY

Mr. WERNER. Mr. Chairman and members of the committee, thank you for giving me this opportunity to share my views with you on this very important topic for all of us today.

To put my views in context, please consider the following: The federal budget picture has shifted dramatically over the past few years. Going from a deficit of $255 billion just 5 years ago to what we at J.P. Morgan estimate will be a surplus of $60 billion in the current fiscal year. Moreover, we would expect a surplus of $50 billion in the 1999 fiscal year. You should all be commended for this dramatic improvement and grateful for the extraordinary economic environment which helped make it possible.

While the Government will not be likely to need to raise new cash for the next year or longer, the U.S. Treasury will still face the daunting task of managing over $3.4 trillion of total publicly-held debt outstanding, which arguably forms the most important fixed-income securities market in the world. I would like to make four points with regard to the U.S. Treasury's financing needs.

First of all, the U.S. Treasury will need to retain a high degree of flexibility going forward due to our extraordinary current environment. The forecast for financing needs have often been subject to wide margins of error. For instance, the mid-session review of the Fiscal Year 1998 budget made last Fall, called for a deficit of $121 billion. It is now widely acknowledged that the budget will be in substantial surplus. These divergences stem only in a small degree from fiscal policy actions, rather they are primarily due to miscalculations and forecasting of overall course of the economy and its precise impact on the various components of Government revenues and expenditures.

In recent years, budget performance has benefitted enormously from what Fed Chairman Alan Greenspan has called a virtuous cycle affecting the economy. Robust payroll tax increases reflecting the strongest labor market in 30 years and capital gains receipts resulting from 3 successive years of sharply rising stock prices have been particularly important in this regard. It is important to remember that changes in the economic or market environment can produce negative, as well as positive surprises with little notice, and a corresponding risk that budget performance may be considerably less favorable than the current best forecast. Sensitivity to actual budget performance and to actual cash flow and a willingness to make small financing adjustments in the absence of formal forecast revisions, is likely to produce more favorable borrowing rates for the Treasury than abrupt changes. To repeat, a high degree of flexibility will be key.

My second point is that the U.S. Treasury, as a large issuer of securities, will be rewarded by predictability and transparency in its offerings to market participants. Over the years, Treasury has, for the most part, observed a set of debt management principles that allow the markets to make informed judgments regarding re-

sponse to changes in the size of its borrowing need. I think the Treasury would benefit by continuing to observe these principles, which I would summarize as follows:

One, the changes in the composition of the Treasury's cycle of offering, that is the timing and frequency of various maturities, are far less frequent than changes in offering sizes of individual maturities.

Two, gradual changes in the offering size of individual maturities, even when frequent, are preferable to abrupt changes.

Three, note and bond offering sizes should be less volatile than bill offering sizes.

Four, seasonal and other large temporary cash needs should be met, to the maximum extent feasible, by issuance of off-cycle cash management bills, thereby minimizing impacts on regular cycle issues.

If the dealers are to maintain the excellent depth, breadth, and liquidity that the Treasury securities market currently enjoys, then changes in the issuance pattern should be rare, well advertised, and gradual.

My third point is that the Treasury will benefit by anything that enhances liquidity. That is to say, prefer large benchmark issues. Reduce the number of issues, but raise the outstanding sizes of those issues. Liquidity in secondary markets and financing markets is of major importance in eliciting the broadest possible investor interest and participation in the Treasury market, and has become a more critical issue in the context of reduced overall debt issuance. In general, liquidity is enhanced by opting for fewer, but larger, individual debt offerings. Treasury's recent revamping of its auction cycle should go a long way towards improving liquidity in several sectors. Larger individual issues should benefit the intermediate sector, while the bill sector should benefit from increased overall issuance.

My final point is that the U.S. Treasury market is the benchmark for interest rate capital markets around the globe. In this capacity, U.S. Treasuries function as benchmarks and hedging vehicles for a wide variety of markets around the world. The benchmark status not only enhances the overall demand for Treasuries, but also may be vital for the efficient functioning of markets such as corporate bonds, Federal agency securities, mortgage-backed securities, and interest rate swap transactions. All of these securities trade at a spread relative to U.S. Treasuries. In making financing decisions, Treasury officials must consider factors such as this that potentially impact all the closely linked dollar denominated capital markets.

Ours is the most efficient debt market in the world. It got that way through the extraordinary cooperation of the Congress, the Treasury, the Federal Reserve, and the dealer community. This fortunate period of budget surplus requires that this cooperation and flexibility continues. Thank you.

[The prepared statement follows:]

Testimony of Mark B. Werner
Managing Director
J.P. Morgan & Co. Incorporated
before the
U.S. House of Representatives
Committee on Ways and Means
June 24, 1998

"Managing Debt in an Era of Surpluses"

Good Morning. Let me introduce myself, my name is Mark Werner, I am a Managing Director at J.P. Morgan & Co. Incorporated in New York City. I am responsible for managing our Interest Rate Markets business in North America.

Mr. Chairman, and members of the Committee, thank you for giving me the opportunity to share my views on this very important topic for all of us today.

To put my views in context, please consider the following: The federal budget picture has shifted dramatically over the past few years. Going from a deficit of $255 billion just 5 years ago, to what we at J.P. Morgan estimate will be a surplus of $60 billion in the current fiscal year. Moreover, we would expect a surplus of $50 billion in the 1999 fiscal year. You should all be commended for this dramatic improvement.

While the government will not be likely to need to raise new cash for the next year or longer, the U.S. Treasury will still face the daunting task of managing over $5.5 trillion of total public debt outstanding, which arguably forms the most important fixed income securities market in the world.

I would like to make 4 points with regard to the U.S. Treasury's financing needs:

First of all, the U.S. Treasury will need to retain a high degree of flexibility going forward, due to our extraordinary current environment. The forecasts for financing needs have often been subject to wide margins of error. Just prior to the beginning of fiscal year 1997, the OMB, like the CBO and many private sector economists, were calling for a deficit in excess of $100 billion, the actual deficit was $23 billion. The mid-session review of the fiscal year 1998 budget (made in September 1997) called for a deficit of $121 billion. It is now widely acknowledged that the budget will be in substantial surplus. These divergences stem only in small degree from fiscal policy actions. Rather they are primarily due to miscalculation in forecasting the overall course of the economy and its precise impact on the various components of government revenues and expenditures. In recent years, budget performance has benefited enormously from what Fed

Chairman Greenspan has called a "virtuous cycle" affecting the economy. Robust payroll tax increases, reflecting the strongest labor market in 30 years, and capital gains receipts resulting from three successive years of sharply rising stock prices have been particularly important in this regard. It is important to remember that changes in the economic or market environment can produce negative as well as positive surprises with little notice, and a corresponding risk that budget performance may be considerably less favorable than the current best forecast. Sensitivity to actual budget performance and to actual cash flow, and a willingness to make small financing adjustments in the absence of formal forecast revisions, is likely to produce more favorable borrowing rates for the Treasury than abrupt changes. To repeat, a high degree of flexibility will be key.

My second point is that the U.S. Treasury, as a large issuer of securities, will be rewarded by predictability and transparency in its offerings to market participants. Over the years, Treasury has, for the most part, observed a set of unwritten rules that allow the markets to make informed judgments regarding response to changes in the size of its borrowing need. I think the Treasury would benefit by continuing to observe these rules which I would summarize as follows:

1. Changes in the composition of Treasury's cycle of offering (the timing and frequency of the various maturities) are far less frequent than changes in offering sizes of individual maturities.
2. Gradual changes in the offering size of individual maturities, even when frequent, are preferable to abrupt changes.
3. Note and bond offering sizes should be less volatile than bill offering sizes.
4. Seasonal and other large temporary cash needs should be met, to the maximum extent feasible, by issuance of off-cycle cash management bills, thereby minimizing impacts on regular cycle issues.

If the dealers are to maintain the excellent depth, breadth, and liquidity that the Treasury securities market currently enjoys, then changes in the issuance pattern should be rare, well advertised, and gradual.

My third point is that the Treasury will benefit by anything that enhances liquidity. That is to say, prefer large benchmark issues. Reduce the number

of issues, but raise the outstanding sizes of those issues. Liquidity in secondary markets and financing markets is of major importance in eliciting the broadest possible investor interest and participation in the Treasury market, and has become a more critical issue in the context of reduced overall debt issuance. In general, liquidity is enhanced by opting for fewer, but larger, individual debt-offerings. Treasury's recent revamping of its auction cycle should go a long way towards improving liquidity in several sectors: Larger individual issues should benefit the intermediate sector, while the bill sector should benefit from increased overall issuance.

My final point is that the U.S. Treasury market is the benchmark for interest rate capital markets around the globe. In this capacity, U.S. Treasuries function as benchmarks and hedging vehicles for a wide variety of markets around the world. The benchmark status not only enhances the overall demand for Treasuries, but also may be vital for the efficient functioning of markets such as Corporate Bonds, Federal Agency Securities, Mortgage Backed Securities, and Interest Rate Swaps. All of these trade at a spread relative to U.S. Treasuries. In making financing decisions, Treasury officials must consider factors such as this that potentially impact all the closely linked dollar denominated capital markets.

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Thank you.

Chairman CRANE. Thank you, Mr. Werner.
Dr. Campbell.

STATEMENT OF JOHN Y. CAMPBELL, OTTO ECKSTEIN PROFESSOR OF APPLIED ECONOMICS, HARVARD UNIVERSITY, CAMBRIDGE, MA

Mr. CAMPBELL. Mr. Chairman and distinguished members of the committee, I'm honored to have been asked to give you an economist's perspective on the Treasury's task of managing the public debt.

I'd like to begin by questioning the assumption that the Treasury's job is simply to minimize the average cost of financing the debt. While this assumption is a natural one, it omits two critically important factors. The Treasury must also consider the risk of the debt and its role as a form of infrastructure for private financial markets.

First, the Treasury must take account of the risk of alternative financing strategies. If the Treasury were to disregard risk—I should say that I'm not suggesting that the Treasury does disregard risk—it could reduce the average cost of financing the debt to any desired level by including desirable insurance features in the claims it sells to the public. For example, the Treasury could issue bonds that would pay extra in the event of a stock market crash. Such bonds would be highly attractive to investors, and would have a low cost on average since stock market crashes rarely occur. Of course, no responsible person would advocate the issue of such bonds since they would involve extreme risk to the Treasury, and hence to the American taxpayer.

How should the Treasury measure the risk of a financing strategy? It should consider alternative plausible scenarios, and in each scenario it should calculate the long-run tax burden of servicing the public debt. If the tax burden is much greater in some scenarios than in others, the financing strategy is a risky one; the burden is stable across the scenarios, the strategy is relatively safe.

Now this procedure is very different from calculating the short-run variability of the market value of the debt. Treasury bills have stable market value in the short run, but they involve risk to the Treasury because they must be rolled over at uncertain future interest rates. If interest rates rise in the future, for example, because there's a financial crisis or because the Federal Reserve is forced to raise rates to control inflation, then short-term financing with Treasury bills becomes expensive. For this reason, it would not be prudent for the Treasury to rely exclusively on short-term debt.

Long-term bonds, on the other hand, have unstable market value in the short run, but they protect the Treasury against the risk of interest rate movements. When the Treasury borrows long, it can avoid expensive refinancing if interest rates rise in the future. This advantage of long-term financing is especially pronounced for inflation-indexed bonds which stabilize the tax burden of the public debt even in the face of uncertain future inflation. I and many other economists therefore applaud the Treasury's move last year to begin issuing inflation-protected securities—known as TIPS.

A second important consideration for the Treasury is that public debt instruments provide infrastructure for financial markets, analogous to the infrastructure of the Internet or the highway system. The Treasury should manage this infrastructure to maintain liquidity, to provide information, and to stimulate innovation in U.S. financial markets.

An important attribute of our financial markets is liquidity—the ability of investors to trade at low cost and with confidence that trading costs will remain low in the future. Markets for Treasury debt securities are liquid because these securities are issued in large quantities, in standardized form, and with essentially no risk of default. Investors are willing to pay a premium for this liquidity, bidding up the prices particularly of Treasury benchmark bonds which are the most actively traded. If the Treasury sought to minimize its financing costs, it might be able to exploit its position as a monopoly supplier by restricting the supply of benchmark bonds in order to receive the scarcity premium. But this would be an inappropriate policy in light of the Treasury's responsibility to act on behalf of the public.

Treasury debt markets also provide information about investors' expectations of future interest rates. The issue of TIPS, together with conventional bonds is particularly helpful in this regard because it makes it possible to measure investors' expectations of future inflation. This information is valuable for private market participants, and also for policymakers at the Federal Reserve who can evaluate the credibility of their anti-inflationary stance.

Finally, Treasury innovations promote beneficial innovations in the private sector. TIPS issues have been followed by some private issues of inflation-protected debt, and the existence of TIPS will make it much easier for pension funds and insurance companies to offer inflation-protected annuities. Such products will become increasingly important as the U.S. population ages in the early part of the next century.

In conclusion, the Treasury should consider far more than just average cost when managing the public debt. I believe it has done so in a highly competent fashion. Recent developments in Treasury policy, including the gradual lengthening of the average debt maturity since the low point reached in the mid-1970's and the issue of inflation-protected bonds, are justified both as prudent risk management and as a form of infrastructure provision to U.S. financial markets.

[The prepared statement follows:]

Testimony before the Committee on Ways and Means
U.S. House of Representatives
Hearing on Managing the Public Debt in an Era of Surpluses
Wednesday, June 24, 1998

John Y. Campbell
Otto Eckstein Professor of Applied Economics
Harvard University

I am honored to have been asked to give you an economist's perspective on the Treasury's task of managing the public debt.

I would like to begin by questioning the assumption that the Treasury's job is to minimize the average cost of financing the debt. While this assumption is a natural one, it omits two critically important factors. The Treasury must also consider the *risk* of the debt and its role as a form of *infrastructure* for private financial markets.

First, the Treasury must take account of the risk of alternative financing strategies. If the Treasury were to disregard risk, it could reduce the average cost of financing the debt to any desired level by including desirable insurance features in the claims it sells to the public. For example, the Treasury could issue bonds that would pay extra in the event of a stock market crash. Such bonds would be highly attractive to investors, and would have a low average cost since stock market crashes rarely occur. Of course no responsible person would advocate the issue of such bonds since they would involve extreme risk to the Treasury, and hence to the American taxpayer.

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scenarios, the strategy is relatively safe.

This procedure is very different from calculating the short-run variability of the market value of the public debt. Treasury bills have stable market value in the short run, but they are risky to the Treasury because they must be rolled over at uncertain future interest rates. If interest rates rise in the future - for example, because there is a financial crisis, or because the Federal Reserve is forced to raise rates to control inflation - then short-term financing with Treasury bills becomes expensive. For this reason it would not be prudent for the Treasury to rely exclusively on short-term debt.

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A second important consideration for the Treasury is that public debt instruments provide infrastructure for financial markets, analogous to the infrastructure of the Internet or the interstate highway system. The Treasury should manage this infrastructure to maintain *liquidity*, to provide *information*, and to stimulate *innovation* in US financial markets.

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In conclusion, the Treasury should consider far more than just average cost when managing the public debt. Recent developments in Treasury policy, including the gradual lengthening of the average debt maturity and the issue of inflation-protected bonds, are justified both as prudent risk management and as a form of infrastructure provision to US financial markets.

Chairman CRANE. Thank you, Dr. Campbell. Generically, for all of you, what are the characteristics of past debt reductions and are there any lessons for the present?

Mr. FRANCIS. Trying to think of when there was a period of past debt reduction. [Laughter.]

It's certainly beyond my career.

Chairman CRANE. Well, let's see before World War I we got down from that slide from the Civil War. Then after World War II, we went from roughly 100 percent of debt held by the public during the war, as late as 1947; down to—the lowest figure here looks to be about 25 percent in roughly 1970; and it's gone up since that time.

Mr. FRANCIS. There're two dimensions. One is the nominal reduction and the other is relative to the size of GNP. As GDP grows, the relative size of debt declines if the total remains constant. The nominal amount can decline when fewer securities are sold—when the refunding amounts are smaller than the maturing amounts. That's the process which has begun in this period.

Chairman CRANE. Anyone else have any observations?

Mr. CAMPBELL. Well perhaps, I could bring in the experience in some other parts of the world which have faced declining debt. An issue that's arisen in some places is whether to continue issuing long-term debt given very minor financing needs. Nations have made different choices. For example, in New Zealand, I understand they're planning simply to eliminate borrowing altogether. Whereas in Hong Kong, the decision has been to maintain long-term borrowing in order to provide a benchmark for the financial markets even though frankly speaking their financing needs don't require such borrowing. I would support the Hong Kong approach on the grounds that benchmark issues are important for financial markets. However, of course, we're nowhere near that point yet and the debt will remain out there for a very long time to come.

Chairman CRANE. Mr. Werner, do you have any observations?

Mr. WERNER. I guess I would reiterate what my colleague, Mr. Campbell, has just said that the benchmark status of the U.S. Treasury market is a reserve holding, or dollar denominated reserve, that many countries hold U.S. Treasuries in. Many markets trade at a relative spread to the U.S. interest rate benchmark. I think it's probably very important for our capital markets in this country to maintain that status.

Chairman CRANE. Thank you. Mrs. Thurman.

Mrs. THURMAN. Thank you, Mr. Chairman. Mr. Francis, in your short statement, you mention at the very end that quite frankly you think Treasury is doing well in handling and all of those things are going pretty good. But you said that one of the things that you suggested for Congress was to not delay the raising of the debt limit. Is that correct?

Mr. FRANCIS. Yes, that's correct.

Mrs. THURMAN. Okay. Are there other things that Congress should be doing, as well? I mean, you mentioned that as one. Are there other issues that we should also be looking at that could put us into some kind of turmoil, or cause us some problems that you could give us some examples of?

Mr. FRANCIS. Well, I think that first of all, that Congress is obviously part of the political process in the Nation and there has to be give and take and a lot of debate. Occasionally statements made in the debates have some effect on the market, but the markets have to live with that. I put Congress's role higher in importance than market stability day-by-day. I do think there is something that Congress has done—or put it the other way around—hasn't done that is useful with respect to debt management and that is by and large it hasn't interfered. Debt management is a fairly technical area. And, a lot of people would consider debt management fairly boring. It certainly hasn't engendered the impassioned statements that occur sometimes before the Ways and Means Committee. I think there's a reason for that. Not just in this administration but also in past administrations, debt management has functioned quite effectively. I think it's not a bad idea to let it continue to work the way it has.

Mrs. THURMAN. What about the debate that's going on now as we're putting our budgets together and looking at issues and the surplus, of course? We all go home and talk about how wonderful this is. Then the next question is what do we do with these surpluses? Do we look at the Social Security? You hear Greenspan say that's the best thing you can do because then you give more private probability to have more borrowing. I mean, if I'm stepping out of line here—but I'm just kind of curious to find out where and what your thinking is as far as the debate that is going on in Congress today.

Mr. FRANCIS. Well, Congressman Thurman, you're—yes, we're going beyond debt management here to views on what the Nation's finances ought to be. I have, of course, my own views and everyone else in this room does, too.

Mrs. THURMAN. But you get an opportunity to tell us those views now if you'd like. [Laughter.]

Mr. FRANCIS. As I recall, the government spending in the United States amounts to something like 40 percent of the GDP? That's a lot. Wouldn't it be nice to see that trailing off over time? That's my view.

Mrs. THURMAN. Would any—Mr. Werner, Dr. Campbell? Come on.

Mr. CAMPBELL. Congressman Thurman, perhaps I could add a word. In thinking about Social Security, the Social Security system has large future liabilities. Now the accounting system under which we operate doesn't record that as a form of debt, but in economic terms, it has perhaps equivalent meaning. The existence of these future liabilities—the future retirement of the baby boom generation is a serious issue. We should all be concerned about promoting national savings in order to build up the capital that we need to cover these liabilities. So this switch to a period of surpluses, I think is very appropriate seen in that light.

Mrs. THURMAN. Okay. Mr. Werner?

Mr. WERNER. I don't have any further comments on it.

Mrs. THURMAN. That's fair enough. Thank you, Mr. Chairman.

Chairman CRANE. Mr. McCrery.

Mr. MCCRERY. Thank you, Mr. Chairman. I have no questions but I appreciate the panel dealing with such an arcane and boring subject so well today.

Chairman CRANE. Mr. Houghton?

Mr. HOUGHTON. Yes, just a couple of quick questions. I guess the issues that I'm always wrestling with is should we try to pay down or grow out of our debt? Because that will come into consideration in terms of our budget consideration. Also, if you had a different scenario, the surplus dipped—maybe went into deficit, inflation were up, more borrowings—would you suggest the same policies under those conditions that you're suggesting now? Those are the two questions.

Mr. FRANCIS. I'm pleased to respond to the second question that you asked—and my answer is yes. I think the same objectives and the same operating principles that the Treasury is following and has been following in greater or lesser degree for the past decade or so would be the correct objectives and practices to follow if the surplus were to turn to deficit. I think with respect to your first question, I've said about as much as I can on that. My own belief is that the Government's portion—claim on GDP is larger than it ought to be and it ought to be declining over time. But that again, is just a personal view.

Mr. CAMPBELL. Perhaps I could add a word. I basically endorse Mr. Francis' answer with one qualification which is that if the Government could anticipate a particular moment in the future when revenues would be particularly robust, it might be appropriate to structure the debt in such a way that more of it becomes due at that time. Now this is more of a theoretical issue in most countries. I think that the forecast for the U.S. fiscal position are very smooth over time, so it just doesn't suggest lumping—concentrating a debt on any particular maturity. But there are circumstances where a government may have a major asset which is going to throw off a lot of cash at a particular time. For example, the UK at one point had tremendous North Sea oil which had a very predictable revenue pattern. In managing that, it was appropriate to have debt come due at a time when the oil revenues would be there to pay it off. But as I say, in the U.S. situation with a very diversified tax base and smooth forecast, what we should try to do is have a smooth pattern of maturing debt in the future.

Chairman CRANE. Well, we want to express appreciation to all of our panelists for their patience and participation today. Please continue to provide ongoing input to all of us here on the committee. We need your assistance. Thank you so much. With that the committee stands adjourned.

[Whereupon, at 11:54 a.m., the hearing was adjourned subject to the call of the Chair.]