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Where Do We Put the Surplus?

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When historians look back on Alan Greenspan's tenure as chairman of the Federal Reserve and attempt to identify the source of his enormous success, last Thursday's Congressional testimony -- in which he advanced the course of tax reform -- will likely provide one answer. Mr. Greenspan raised a pressing public-policy question that has been overlooked by most, a question that will likely become the focal point of political and economic debate during President Bush's first four-year term.

If the U.S. government starts accumulating big surpluses, where should it put the money?

That might not seem so tricky. After all, the government already occasionally places deposits in private banks. But this time we aren't talking nickels and dimes. Current surplus estimates are so large that the government's passbook savings account, if nothing changes, will soon become the Mount Everest of cash hoards.

Let's look at the numbers. The latest Office of Management and Budget forecast is for the surplus to reach about \$5.5 trillion over the next 10 years. Rumor has it that the soon-to-be-released Congressional Budget Office forecast will peg it at \$6 trillion, with almost \$1 trillion arriving in 2011 alone.

Why not just pay down the debt? Put simply, there's not that much debt to pay. According to the Treasury Department, total government debt held by the public is only about \$3 trillion. With no change in tax policy, projected surpluses would pay down the debt by around 2008. Government will subsequently have to decide in what it will invest the massive surpluses.

But that is far in the future. Many opponents of tax reduction have suggested that we wait until the uncertain surpluses arrive, and the \$3 trillion of existing government debt is retired, before considering tax cuts. Mr. Greenspan had an answer for that as well: "Private asset accumulation may be forced upon us well short of reaching zero debt."

Indeed, by some estimates, as much as half of existing government debt will be almost impossible to retire, since savings bonds and state and local government series bonds often aren't redeemed until maturity, and because many holders of long-term treasury bills will be unwilling to sell them back to the government. Factor in that surplus estimates keep getting revised upward, and government may well be forced to invest in private assets in just three or four years.

How big could the hoard get? Investing that much public money would likely mean the government purchase of stocks, because only equity markets are large enough to absorb such inflows and still remain liquid. Assuming the Treasury begins to invest surpluses in the stock market as soon as it has retired all the debt that it can, and that these investments earn a 10% annual return, our government will be sitting on a stock-market portfolio worth \$20 trillion by 2020. To put that in perspective, the current market value of all equities in the U.S. is about \$17 trillion, according to the Federal Reserve. Projecting forward, the U.S. government could own about one-fifth of all domestic equities by 2020.

Allowing the government to own that much of the private economy is an invitation to unbounded mischief. Firms will lobby to be put on the list of acceptable investments; those firms or assets left off will suffer hardship. Calls to sell firms that aren't "green" or that fail to pass litmus tests will become the latest in political lobbying. Which is why Mr. Greenspan stated flatly: "The federal government should

eschew private asset accumulation because it would be exceptionally difficult to insulate the government's investment decisions from political pressures." The risks are just too great.

His argument on Thursday caught Democrats flat-footed. Sen. Ernest Hollings of South Carolina told Mr. Greenspan that "in all candor, you shock me with your statement." An apoplectic Sen. Charles Schumer of New York dubbed Mr. Greenspan's analysis a "mistake." Such venom is reserved for truly decisive arguments. Indeed, word is out that economists at President Clinton's Council of Economic Advisers prepared an analysis of this issue that wasn't allowed to see the light of day.

Perhaps the Democratic senators had not previously recognized that their opposition to tax cuts would require the government to buy a massive share of private America. Mr. Hollings later warned Mr. Greenspan that he was "going to start a stampede." It is not a stampede we will observe, but a wholesale retreat by poll-conscious opponents of tax reform, who will have little stomach to defend such a massive government intrusion into private life. A large tax cut is virtually a sure thing.

Which doesn't mean we've seen the last of this important question. First, if supply-side arguments are correct, then the marginal-rate reductions proposed by Mr. Bush will eventually increase tax revenues and surpluses, presenting us once again with the quandary of what to buy. Second, Social Security continues to be on very weak footing in the long run, and something must be done to stave off fiscal disaster. This puts Democrats in a tough position. For if they reject the option of allowing the government to hoard private assets in anticipation of retiring baby boomers, there is -- as Mr. Greenspan highlighted elsewhere in his remarks -- one inevitable alternative: individual accounts.

In taking a stand on such important issues in such a public forum, Mr. Greenspan has fundamentally altered the debate on the surplus, taxes and government investment. From now on, opponents of privatization will have to reveal just where it is they intend to put our money, and convince us that those investments will be economically benign.

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