

"Greenspan'speak" on Taxes

C. Eugene Steuerle

**"Economic Perspective" column reprinted with permission.
Copyright 2001 TAX ANALYSTS**

Document date: February 05, 2001

Released online: February 05, 2001

The nonpartisan Urban Institute publishes studies, reports, and books on timely topics worthy of public consideration.

The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, or its funders.

Interpreting an economist, especially an inscrutable economist, is a job for another economist—the advantage being that if he is wrong, no one will know, thus keeping him employed; of course, if he is right, the same applies. Herewith, therefore, is my interpretation of Federal Reserve Board Chairman Alan Greenspan's recent comments supporting a tax cut.

Greenspan's Long-Standing Stance: In recent years Greenspan has generally taken the following approach to fiscal policy. First, reducing the national debt and thereby increasing national saving is better than tax cuts. Second, tax cuts are better than spending increases. Third, social security and Medicare and the other entitlements must be reformed.

What Is New: Projections of future budget surpluses keep increasing in size. Under current law, it is more and more likely (even under a pessimistic scenario) that the nation's debt to the public will be paid off sometime over the next 10 or 15 years.

The Asset Ownership Problem: Paying off the national debt raises a number of very interesting problems and possibilities—many of which have not been addressed by economists for decades. Among the most intriguing is what to do with its excess cash that can't be used to buy back its debt. Eventually, the government would have to start buying other assets. (This would actually occur even before surpluses were adequate to pay off the debt, as some debt would inevitably be left in the private economy.) As the value of its portfolio grew, it would be in the position of exercising control over large segments of the economy.

That would not be the government's only problem as an asset owner. Once the federal government starts owning significant assets, the issue will arise over what assets it should buy. You might be tempted to respond that the government could largely be a passive buyer, but at some levels that's impossible. For example, if the government decided to invest in the Standard and Poor's 500, what about the companies that don't make the list. The firms that are "501" and "502" would be put at a competitive disadvantage because of that government decision.

If the government invested in all publicly traded stock, what about stock that is not publicly traded? And how would the government avoid buying the stock of a new company artificially running up its price as it goes public to take advantage of an automatic government investment? In effect, there is no such thing as a perfectly passive portfolio when you're the government.

Greenspan's Problem: Greenspan does not like the idea of widespread government ownership of private assets. (I know, it owns a lot already, and so do many state and local governments, but the issues of degree and kind still arise.) It's not that he has changed his mind about reducing the government's debt to the public, he's just looking beyond that issue.

The Monetary Policy Problem: Lurking closely in the shadows, monetary policy has largely operated through the purchases and sales of government securities. Economists grapple with what would happen if those securities dried up. Perhaps monetary authorities would buy guaranteed debt instruments (generally mortgage securities), but it is not clear that this is a business they want to be in.

Still another monetary issue is that a very fast rate of growth of surpluses could have a dampening effect on the economy as it pulls money out of that economy. The Treasury might put that money back in by buying back its bonds as long as they were available, but this, too, could have an effect on monetary policy.

In fact, one of the struggles in monetary theory is over what "money" is. It is often defined to include interest-bearing assets such as savings accounts and even Treasury bills. That is, at its core, monetary theory tries to determine how private asset ownership of more liquid assets tends to affect spending and

private investment in real assets. A Treasury paying off the national debt and buying assets in the private economy would create a whole new world for the conduct of monetary policy.

Tax Cuts Versus Spending Increases. As already indicated, Greenspan generally favors tax cuts over spending increases. Big government is not his bag. He also adheres to a traditional tax reform agenda: lower tax rates are preferable to targeted tax cuts. Since targeted cuts are often nothing more than expenditures disguised as tax cuts, that is not surprising. Lower tax rates, on the other hand, generally provide positive incentive effects. Greenspan doesn't need to resort to any strong "supply side" argument that those incentive effects are large. As long as some distortions are removed by tax rate cuts, he prefers them to what he believes are the distortions generally induced by more expenditures.

The Aging Issue. Programs for the aged fit into Greenspan's equation as well. He knows that if existing promises were all to be met, surpluses would turn to large deficits and the asset accumulation phase of government ownership would be over eventually. But he wants to reform those programs long before then to bring them in line with the future resources of the nation.

It is also highly unlikely that he would favor a policy of large public ownership of private assets, the return from which would be used to support an eternal deficit machine supporting a pared-back set of old-age programs. Admittedly, similar issues still confront the public if somehow it decides to draw down its private wealth, or spend a larger share of returns on capital to support the future aged. But Greenspan generally trusts the private sector and private markets to sort this all out better than the government. In the same vein, he would probably accept government-mandated saving in individual retirement accounts, as opposed to direct governmental ownership of retirement assets, backed up by government's rules that attempted to limit interference in the market.

In sum, I'm not convinced that Greenspan is inconsistent. Certainly, he does not want to appear opposed to the first major initiative of a new president, and he was quite careful in the words he chose. But outside of preferring tax rate cuts, he really didn't indicate a preference for the size or style of a tax cut to be enacted. He still left a lot of room for compromise even for those who want to follow the inscrutable.

Other Publications by the Authors

- [C. Eugene Steuerle](#)

Usage and reprints: Most publications may be downloaded free of charge from the web site and may be used and copies made for research, academic, policy or other non-commercial purposes. Proper attribution is required. Posting UI research papers on other websites is permitted subject to prior approval from the Urban Institute—contact publicaffairs@urban.org.

If you are unable to access or print the PDF document please [contact us](#) or call the Publications Office at (202) 261-5687.

Disclaimer: *The nonpartisan Urban Institute publishes studies, reports, and books on timely topics worthy of public consideration. The views expressed are those of the authors and should not be attributed to the Urban Institute, its trustees, or its funders. Copyright of the written materials contained within the Urban Institute website is owned or controlled by the Urban Institute.*

Source: The Urban Institute, © 2012 | <http://www.urban.org>