
JEL 90-0196

This is a self styled primer on the United States government debt and deficit. It is addressed to "Americans who are concerned about public policy issues" and "our fellow professionals." The authors' proximate motivation for the primer is a late 1988 poll in which 44 percent held that reducing the deficit should be the incoming administration's top priority. They wish to instruct their audiences that by no "sober reasoning can reducing it be the top priority": they wish "to instill a little understanding in place of fears,—worse frights" (p. 15).

They have produced a good and quick read for the interested public, which, in today's political climate, may well need to be made aware that the deficit is difficult to measure and that government spending is not all waste. As I broadly agree with the priors that guide the authors, I regret to note that there is little here of professional interest.

The authors fall into the trap of not distinguishing between the conditional deficit that the Kennedy tax cuts represent and the structural deficit that has been created over the past decade. The Kennedy-Johnson tax cuts were a reaction to an income elastic revenue structure, due largely to the then ruling progressive income tax, and spending commitments that did not automatically rise with the price level to the same extent as now. As a result even with the mild inflation of the time there was a built in fiscal drag: the problem was too much Federal revenue, not too little.

A muted debate took place on whether the drag should be overcome by spending increases or by tax reductions. The policy choice was to reduce taxes: the involvement in Viet Nam increased spending. This first, albeit inadvertent, fiscal irresponsibility was followed by the stop and go fiscal and monetary policies of the Nixon era. The inflation that Carter was unable to handle resulted.

The authors point out that a part of government spending creates capital assets and human capital. They view such spending, which is expected to yield benefits over an extended period, as being fit for debt financing: the analogy to private business that finances capital asset positions with debt is stressed. This leads them to resurrect the view that government spending should be separated into current and capital budget components. The advocacy of a capital budget is a harmless conceit.

They emphasize that the government debt should be viewed in relation to the gross national product. "As long as growth continues and the debt remains in the same relation to GNP, there is no reason that a national debt cannot increase indefinitely" (p. 48, authors' emphasis) even as they note, in a footnote, that a growing gross national product does not guarantee that the government's income also grows.

They also note that government debt need not be repaid, it only needs to be refunded. We live in an international financial world that is becoming ever more integrated. International portfolio diversification is becoming a dominant fact of financial life. This means that all debtors need to meet the common standard of "where are the supporting cash flows." Any
instrument that fails to meet that standard can quickly lose its market acceptance: this is true for the United States as well as for Argentina.

The view that deficits and debts are not serious problems leads to accepting what I have called Ponzi finance, in honor of a Boston "swindling financier" of the 1920s. In such an arrangement when shortfalls in cash flows occur, interest that is due is paid by adding to debt (the payment in-kind financing of some leveraged buy outs are Ponzi schemes). In private accounts such capitalizing of interest decreases the owners' equity account and increases indebtedness. The acceptance of these instruments from private parties comes to an end as equity is dissipated.

Heilbroner and Bernstein are correct in arguing that there is a need to think of government spending and debt in terms of the productivity of government spending: appropriate government spending increases potential gross national product even as it sustains aggregate demand. But potential gross national product is not what determines whether a market will accept government debt, the true determinant is whether the government is willing and able to tax. An antitax bias in public policy and the consequent acceptance, by the informed public as well as the political leadership, of a permanent Ponzi finance posture by the government is the relevant debt and deficit issue. The authors do not address what it would take to have the domestic and international financial markets reject United States government debt.

The voice of this primer is humane, the tone is tolerant. There is little heat or divisiveness. The authors are not mean spirited. The Debt and the Deficit stands as a model of the style a civil public discourse should take.

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