How I Learned To Love the Deficit

"Measure, Theory, Fact, and Fancy: The Case of the Budget Deficit" by Robert Eisner, in *The Bulletin of the American Academy of Arts and Sciences* (April 1993), Norton's Woods, 136 Irving St., Cambridge, Mass. 02138.

The sense of alarm over the nation's mounting national debt is now so widespread that it is refreshing to read the occasional dissenter. One of these is Eisner, an economist at Northwestern University, past president of the American Economics Association, and a long-time critic of what might be called the "sky is falling" school of economics.

To whom is the government in debt? he asks. To the American people, largely through pension funds, insurance companies, and banks that have invested much of their wealth in government bonds. (Contrary to popular impression, only a small portion of the federal debt, about 12 percent, is owned by foreigners.) Indeed, Eisner asserts, the annual deficit "makes people in the private sector feel richer and spend more," and consumer spending fuels the economy. Such spending would cause inflation if the economy were operating near full capacity, but it is not.

Efforts to require a balanced budget are misguided, in Eisner's view. He suggests that the government instead ought to follow this "simple rule: The amount of debt you can reasonably sustain depends on your income." When mortgage lenders evaluate potential home-buyers, they use the debt-to-income ratio as a guide. With an estimated 1992 debt of $3 trillion (not including about $1 trillion held by the government itself) and gross domestic product of $6 trillion, the government's ratio is currently about 0.5. That is less than half of what it was at the end of World War II, he points out. Yet "we had a substantial postwar economic boom."

"The one seemingly sensible argument for reducing the deficit . . . ," Eisner says, "is that if you reduce the deficit, you'll have more saving and investment. . . ." This is the logic behind the warning of Ross Perot and many others that "we're spending our children's money." But when the deficit is properly adjusted for inflation, its delayed impact on the economy, and that part of it due to recession, Eisner says, it turns out that over the last 30 years, bigger deficits have been associated with *more* subsequent private investment.

In any event, he argues, the conventional measure of saving and investment is much too narrow. "It does not include government construction of roads, bridges, airports, sewage disposal systems, and the like, let alone investments in environmental protection." If an airline buys new planes, that is counted as investment, but if a new airport is built, that is counted only as government spending.

Washington, Eisner says, "does its accounting in a way that would horrify any businessperson. Other governments and virtually all private businesses separate capital expenditures from current expenditures." If capital spending were taken out (and depreciation put in), the $269-billion deficit of 1991 would have shrunk by an estimated $70 billion. If the $67 billion used for the savings-and-loan bailout—which really had nothing to do with that year's deficit, but simply made good on past guarantees—were also removed, the federal government's 1991 deficit would have been $132 billion. Adjusting that amount for inflation would have further reduced it by $85 billion.

But that is not all, says Eisner. State and local governments had a *surplus* of $30 billion in 1991. The total government deficit, therefore, was really only $17 billion. Which may explain why the sky has not yet fallen.

A New Golden Age?

"A Case for Gold" by David P. Goldman, in *Audacity* (Spring 1993), Forbes Building, 60 Fifth Ave., New York, N.Y. 10011.

Persuaded by his economic advisers that it was an obstacle to prosperity, President Richard Nixon in August 1971 severed the last link between the dollar and gold. No longer would the United States back its dollars in the international marketplace with a commitment to convert

them into gold. Two decades later, contends Goldman, vice president of an economic consulting firm, the precious metal is creeping back into the monetary system "through the back door, as one of the Federal Reserve's price targets for monetary policy."

In deciding whether to expand or contract the nation's money supply, and by how much, the Federal Reserve Board can follow various policies. These include: aiming for a fixed percentage for growth of the money supply (as monetarists advocate); establishing interest-rate targets; or tying the dollar to the price of gold or other commodities. Using a gold standard means expanding or contracting the money supply to keep prices stable. When the price of gold goes up, for example, the money supply must be shrunk: The dollar is getting too cheap. Testifying before the Reagan administration's Gold Commission in 1981, economist Alan Greenspan said the only apparent remedy for inflation is "to create a fiscal and monetary environment which

(M)ediocre (B)ut (A)rrogant?

The Harvard Business School and other institutions award some 75,000 Masters of Business Administration (MBAs) every year. Some critics say the initials should stand for "mediocre but arrogant." A lively debate about how well business schools are serving the needs of business raged recently in the *Harvard Business Review* (Sept.–Oct., 1992; Nov.–Dec., 1992). Henry Mintzberg, a professor of management at McGill University in Montreal, was one of the 23 participants.

I am increasingly convinced that the more Harvard and similar business schools succeed, the more U.S. business fails. That is because these schools confer important advantages on the wrong people. They parachute inexperienced people with mercenary pretensions into important positions. For the most part, these people are committed to no company and no industry but only to personal success, which they pursue based on academic credentials that are almost exclusively analytic, devoid of in-depth experience, tacit knowledge, or intuition. . . .

Stanford takes people, many with a minimum of experience, and pumps them full of theory, which they cannot possibly understand in context, because there is no context, neither personal nor in the classroom nor in the professor's head. That is bad enough. But Harvard goes one step further. It takes people who know nothing about a particular company and then insists, based on 20 pages of verbalized and numerical abstractions, that they pronounce on it in the classroom. The students have never met any of the company's customers, never seen the factories, never touched the products.

But because good managers are decisive, good Harvard Business School students must take a stand. . . . After you have done this several hundred times, what kind of a manager do you become? Glib and quick-witted, to be sure, just the kind to race up the fast track. But to what effect?

Out come these students, committed not to particular industries or companies but to management itself as a means to personal advancement. They are parachuted into companies at middle levels, with authority over people who know the customers, the factories, the products. In effect, two tiers of employees are created, the ones who know the situation but have no MBA, and the others with the opposite credentials—as their bosses! Why should anyone be surprised at what has been happening in U.S. businesses these past years?

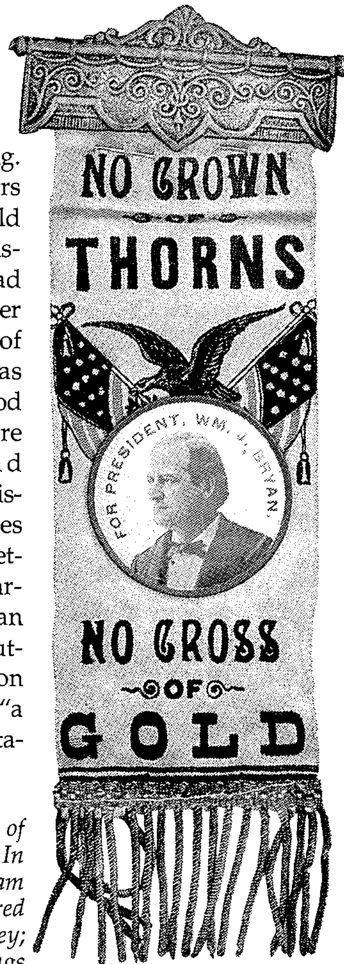
Let's stop pretending to train non-managers to be managers through the use of detached case studies and disconnected theories. We do have good things to teach in management schools, in particular, our understanding of how organizations function, developed through the research of the past 25 years. Let's convey this understanding to real managers in real contexts, to people who can assess the values of the theories by applying them to living problems.

in effect makes the dollar as good as gold, i.e. stabilizes the general price level and by inference the dollar price of gold bullion itself." Greenspan, who has been chairman of the Federal Reserve Board since 1987, was giving advance notice of what his agenda as chairman would be, Goldman maintains.

During the past year, Goldman says, the Federal Reserve Board increasingly looked to the price of gold and other commodities as an indicator of what to do about the nation's money supply. Wayne Angell, a senior member of the board, seems to have acknowledged this: "The Federal Reserve prefers to have sound money, and sound money generally means that the currency will be stable against gold [and certain other] commodities. . . ."

That is not quite the same as using gold alone as the standard, of course. And the Fed is under no legal obligation to follow the policy. Even so, most academic economists, and, indeed, most economists on the Fed's own staff, Goldman says, are hostile to any comeback by the "barbarous relic," as John Maynard Keynes called it. Both liberal Keynesians and conservative monetarists have long insisted that to tie the dollar to gold is to handcuff the government. Gold, they say, is not a reliable monetary standard. Its price is influenced not only by the value of the dollar but by other factors, such as the supply of gold itself.

Goldman argues that the experience of recent decades has proved the Keynesians and monetarists wrong. Private investors have bought gold when they saw rising inflation ahead and sold it at other times. The price of gold therefore has remained a good predictor of future inflation—and lately it has been rising. Taking its cues from the marketplace, Goldman argues, the Fed can prevent a new outbreak of inflation and inaugurate "a new era of price stability."



Gold is a perennial of U.S. politics. In 1896, William McKinley favored "hard" money; William Jennings Bryan, a more expansionary policy.

SOCIETY

Two Parents, One, or None?

A Survey of Recent Articles

Social scientists have gathered masses of evidence that confirm what was once considered common sense about families, writes Barbara Defoe Whitehead in the *Atlantic* (April 1993): Children in single-parent families are more likely to be poor, to have emotional or behavioral problems, to drop out of high school, to become pregnant as teenagers, to abuse drugs, to get in trouble with the law, and to be victims of physical or sexual abuse.