Columbia Business School

Leading Through Crisis

Government Debt and Deficit: Myth or Reality

Professor Shivaram Rajgopal moderates a debate between economist Jared Bernstein and financial expert Paul Kazarian ’81 on deficits during the pandemic.

By Toby Milstein and Stephen Chupaska | 23 July 2020

(Youtube: https://www.youtube.com/watch?v=GVeeTAkot1o)

Largely due to the Congressional relief bills passed in April to help stem the economic downturn caused by the COVID-19 pandemic, the US increased its budget deficit to $2.7 trillion in June, $2 trillion more than the deficit recorded in the same period last year, according to the Congressional Budget Office.

The financial fallout of the $2 trillion CARES Act has reignited a discussion about what the long-term effects of larger deficits will mean for economic growth in the aftermath of the pandemic.

As part of the Leading Through Crisis series, two top experts – Paul B. Kazarian ’81, the CEO of Japonica Partners and the Kazarian Center for Public Financial Management, and Jared Bernstein ('94SW), the former chief economist to Vice President Joe Biden and senior fellow at the Center on Budget and Policy Priorities, debated the wisdom of the decision to increase the budget deficit.

Moderated by Shivaram Rajgopal, the Roy Bernard Kester and T.W. Byrnes Professor of Accounting and Auditing, the discussion included Bernstein’s and Kazarian’s views on the role of economic cycles and infrastructure spending in the context of deficits as well as their opinions on Modern Monetary Theory (MMT).

A longtime critic of the debt and deficit model, Kazarian opened the discussion by elucidating what he said are popular misconceptions that perpetuate its use.

“The model is badly broken, massively value-destructive and should be tossed in the bin of failed theories and replaced,” Kazarian said.

Kazarian sought to dispel the notion of the supposed nonexistence of government balance sheets and pushed back against the model’s significance as a financial indicator.

“There are more insightful indications of financial performance,” Kazarian said. “They include citizens’ wealth, the total government net worth, and government net worth as a percentage of GDP.”

In a critique of the US debt and deficit model, Kazarian suggested alternatives like New Zealand’s system of public financial management.

“It is a full system of laws, rules, and processes used to mobilize revenue, allocate public funds, manage outcomes, outputs, and audit results,” Kazarian said.

Another problem, according to Kazarian, is the perception of the United States as a global benchmark of financial performance.

“Unfortunately, and disappointingly, this is very wrong,” he said.

Again using New Zealand as a comparison, Kazarian presented a chart indicating that since 2000, the amount of citizen wealth per person in the US declined by more than $25,000 while New Zealanders saw an increase by more than $44,000 in the same period.

Bernstein generally agreed with the view that the model is broken and that many of the traditional financial indicators are inadequate, but he questioned Kazarian’s concerns with the precariousness of the current method, given that interest rates have remained low.

“If we're truly using accounting methods that would make Enron blush and we're truly carrying tens of trillions in unfunded mandates, how come nobody's getting swallowed up?” Bernstein asked.

He noted that if interest rates remain low, the risk of carrying such debt each year is drastically reduced as compared to when the yield on the treasury bond was at 6 percent; essentially, government debt can be rolled over for a long time in this rate environment. Bernstein's real concern is interest rates returning to levels at which they once were. He indicated the government could continue to carry debt service payments at 0.6 percent, but would be unable to do so if rates were to increase above 6 percent.

Bernstein argued that some analysts are overly consumed with the threat of unfunded liabilities and that they forget that there are opportunities to offset them with increased productivity and a growing GDP over the long term.

"The unfunded liability is actually an easier problem to tackle than the truly scary liabilities we face: global warming, four decades of growing income and wealth inequality, four centuries of systemic racism," he said.

Bernstein distinguished between "good debt" and "bad debt," where the former is debt that invests in productive, growth-enhancing public goods, or offsets market failures and meets the basic needs of economically vulnerable people and communities. Bad debt is engendered by regressive tax cuts or spending on inefficient sectors with distorted prices—most notably, healthcare.

Throughout the session, the panelists engaged in a robust debate stemming from Bernstein's criticism of what he called Kazarian's use of "bespoke numbers" in his data on New Zealand.

"All the numbers, when you refer to 'bespoke numbers' that we have, every number when we talk about New Zealand, the UK, the US—they all come directly from the US, the UK, or New Zealand financial statements," Kazarian countered. "And the GDP numbers come directly from the IMF."

Kazarian and Bernstein also gave their views on the frequency of economic cycles, MMT, and the rise and fall of nations.

Bernstein, who has written extensively on the "shampoo economy" and its cycle of "bubble, bust, repeat," shared his concern for an economy that is not resilient enough to withstand a shock.

Kazarian agreed with Bernstein and continued to admonish governments for their "misleading" and "destructive" approach to measuring debt and deficit, especially in Europe, where he contended shocks are getting more severe.

On the topic of MMT, Bernstein said that as a whole, the theory has been helpful in disarming the "hysteria" around debt and deficit that undermines the pursuit of good debt and good investment. However, he added that MMT is preoccupied with inflation and the limited role the Federal Reserve can play in mitigating the problem.

Kazarian said that the objectives of MMT are well-intentioned; however, he believes that MMT is weakened by its "siloed thinking."

"They're not managers. They don't understand the government balance sheet. They don't understand the magnitude of the assets," he said. He recommended that they bring in professional talent.

In response to a question from Rajgopal about economic empires that are “crushed by debt,” both Kazarian and Bernstein agreed that change will come at a steep price.

“Until there's a cost, there won't be a reckoning, and I'm afraid that we're a ways away from said reckoning,” Bernstein said.

Kazarian cited historical research from *The Reckoning: Financial Accountability and the Rise and Fall of Nations* by Jacob Soll, which traces the use of government balance sheets dating back to Genoa, Italy, in the 1350s. The book documents the undeniable relationship between good government accounting and national prosperity, as well as the link between reckless balance-sheet management and the decline of nations.

Noting that the panel featured the perspectives of an accountant, an investor, and an economist, Rajgopal praised the intellectual spirit of the debate, saying it would undoubtedly lead to further inquiry of the problem of government debt.

“It opened up more questions than answers,” he said.

(*Article source: https://leading.gsb.columbia.edu/webinars/government-debt-and-deficit-myth-or-reality/*)