

## BOOK REVIEWS

### **Generational Accounting: Knowing Who Pays, and When, for What We Spend**

Laurence J. Kotlikoff

New York: Free Press, 1992, 220 pp.

Budget wonks may be the only people to have noticed a new chapter in the FY 1993 federal budget, one titled "Generational Accounts Presentation." Seldom has a new economic idea moved so fast from conception to semi-official status, so it is important for the broader community to understand what is at issue.

Generational accounting is a framework for estimating the distribution of payments and receipts across generations from any specific set of government fiscal policies. Laurence Kotlikoff, the primary developer of this concept, has written this book for the intelligent lay reader. He explains why the current budget concepts are inadequate or misleading and lays out the implications of this new concept. His book is largely successful on both counts.

Conventional budget accounting is on a cash-flow basis. The purchase of new assets is treated as an expense, and existing assets are not depreciated. Current commitments for future expenses, such as for government employee pensions and loan and deposit guarantees are not treated as an expense until the payments are made. This budget concept is useful for cash management, but it seriously misrepresents the level and time distribution of the cost of current government services and it invites the abuse of financing current services from future payments.

The national income concept of the budget, in contrast, is on a partial accrual basis. Current expenditures are reduced by the amount of net loans and the purchase of other financial assets and are increased by the amount of commitments for government employee pensions. In recent years, for example, the deficit on the national income basis has been substantially smaller than on the budget basis, primarily because of the large amount of payments to purchase the assets of failed S&L associations.

For many years, based on the theory developed by John Maynard Keynes in the 1930s, current government expenditures were considered an addition to total demand in the economy, and current tax receipts were considered as a reduction to total demand. The deficit, thus, was considered the best measure of net fiscal stimulus and, depending on the state of the economy and financial markets, was expected to increase

some combination of output, employment, the general price level, and interest rates.

Given this perspective, which of the two budget concepts above is the best measure of the economic impact of the government budget? The answer, maybe surprisingly, is neither! When I first made such comments at a public meeting in 1981, it provoked a storm of protest similar to that provoked by the boy who observed that the emperor has no clothes, and I was nearly fired from my position as a White House economic adviser. Since that time, there has been a large empirical literature to test the economic effects of fiscal policy and the development of a new budget concept by Robert Eisner in an attempt to rescue Keynesian macroeconomics.

Kotlikoff's response to this debate has been to start all over, to develop a framework for evaluating the economic effects of fiscal policy on a microeconomic foundation. He pulls no punches; the first sentence of this book asserts that "the government's budget deficit . . . is a number devoid of economic content and that its use has repeatedly led us astray." He is indifferent to the measured deficit but not to current fiscal policy, because he demonstrates that future generations will have to pay at least 21 percent more of their lifetime incomes than today's young workers in order to maintain current policies. Moreover, he demonstrates that most of this burden on future generations is a consequence of policies approved between 1950 and 1979, a period in which the ratio of the public debt to current output declined almost continuously.

The first part of this book is a devastating critique of Keynesian macroeconomics and of the leading apocalypics among contemporary economists that will either delight or offend the reader. Kotlikoff then argues that each of the several definitions of the deficit is arbitrary, and he summarizes a large body of empirical tests of the Keynesian conjectures. My sense is that he has overstated his case on these issues. The several definitions of the deficit are arbitrary for some purposes but not for others. Kotlikoff summarizes the growing body of studies that are inconsistent with the Keynesian conjectures but does not mention or evaluate any of the confirming evidence. Some simple studies of my own, for example, find a significant positive effect of (the national income measure of) the deficit on the real corporate bond rate and on the U.S. net foreign balance. A broader survey of the empirical studies provides only mixed evidence for Kotlikoff's unqualified conclusions; there is still a basis for a legitimate dispute among economists on these issues.

Whatever one's views about the economic effects of the measured deficit, Kotlikoff makes an effective case that his framework of generational accounting provides better estimates of the intergenerational effects of the full range of fiscal policies. He is also careful to caution readers about drawing normative conclusions from his results. He first captures the reader's attention by summarizing the generational accounts for the policies in effect in 1989, results that should shock anyone under

the age of 40. He then demonstrates the power of this technique by simulating the effects of five specific policy changes and the combination of policy changes in each of the past four decades.

These results are very interesting by themselves, rather like reading the national income accounts for the first time. The appropriate next stage of this research is to test whether these new accounts help explain the fiscal effects on a range of current economic conditions. For the moment, Kotlikoff has left this task for another day or for other scholars.

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**The Development Frontier: Essays in Applied Economics**

Peter Bauer

Cambridge, Mass.: Harvard University Press, 1991, 241 pp.

Peter Bauer has, for a half-century, employed a sharply critical intellect, fortified by training in economic reasoning, examination of the literature, and field researches done most intensively in Southeast Asia and West Africa, to challenge stereotypical ideas in the popular, political, and academic minds about the causes of poverty in the world.

His writings have had substantial influence. The notion that the improvement of the conditions of life of the poor requires the aggressive intervention of the state in markets has now, because of his writings, much less currency and acceptance than it did some decades ago. Since the state's intervention often had adverse consequences, he has rendered a signal service to the poor of the world.

The politico-economic environment within which he has written his papers may, among others, be characterized by following features: (1) Government policy in the poor countries has been interventionist. This has distorted the composition of economic output, diminished economic growth rates, and intensified poverty. The policy has reflected a mistrust of markets where exchanges are consensually consummated, the terms of exchange are set by market forces, and there is freedom to exit and enter. (2) Interventionist policy has been generated by a number of variables, such as the state's legal monopoly in the exercise of coercive power and the officeholders' penchant for imposing behavioral rules. (3) Public officeholders perceive their role as benign. They fail to see that their behavior can have unforeseen, adverse, and malign consequences. (4) Rule-making is often a source of income for public officeholders. Those in the community who would be privileged by a rule may be willing to pay those who exercise rule-making authority. By lobbying legislatures and officeholders, special interests secure governmental arrangements that serve them at the expense of others. (5) In most of the poor countries that were once colonies, the traditions of