DEFICIT FINANCING

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The recent switch over of the economists from the maintenance of a stable price economy to an income and employment economy has changed not only the methods of analysis of a disequilibrium but also the ways and means suggested formerly to correct one. This shift of analysis has led us over to the Keynesian analytical tools of income employment, investment etc., whereas the full-employment is the goal to be achieved, not the general rule, as the Classicists assumed it to be. This implies that the importance formerly given to money and monetary controls for the stabilization of the economy has also given place to some other means of adjustment, the much abhorred Government intervention. In fact the Great Depression, and the extremely unsatisfactory income and employment conditions in the under-developed countries of the world have forced economists to realize the self-destroying nature of the 'sacrosanct' *laissez faire* and the shocking inadequacy of the unregulated price mechanism. Thus Government intervention has come in almost all walks of economic life; it is related now not only to regulating the existing factors or holding a control over them, but it has entered the field of investment itself, be the object 'pumppoiming' or 'compensatory spending', to prop up and maintain high level of investment, or a regulation of consumption function.

This, then, is the importance of fiscal policy to-day. Fiscal policy we define as "the process of shaping public taxation and public expenditure so as (1) to help dampen down the savings of the business-cycle, and (2) to contribute towards the maintenance of a progressive high employment economy free from excessive inflation and deflation." The first aspect of fiscal policy is only a counter-cyclical device aiming at a budget balanced over the business-cycle, but our main consideration would be the second aspect of it, which involves a long range action designed to lift the average level of purchasing power and employment throughout the business-cycle as a whole.

Budget is undoubtedly the pivot of financial administration, and unless it is properly balanced and based on sound principles, financial disorder is sure to follow. But in order to finance a 'compensatory' or 'development' fiscal policy, 'deficit financing' has been resorted to by countries when necessary. 'Deficit financing' is carried on under a budget the estimated revenues of which fall short of the expected expenditure by the Government in the ensuing year. The expenditures exceed the revenues usually due to various causes, such as, (1) With an increase in the area and population of the country, the state coffers have to cater for the needs of more people over a wider area. (2) The price level may rise, thus necessitating larger expenditure for the Governments over commodities and services. (3) War and prevention of warfare a very big factor contributing to making a deficit in the budget. This is the period when Governments resort to every possible method of increasing revenues to meet large expenditure and unexpected deficits. (4) With a view to raising the level of National Income and the standard of living of a people. This object is of special importance to the under-developed countries which are deficient in private investment, and lack enough employment opportunities in general.

Having defined the objectives of deficit financing, we may examine them critically, and weigh the arguments in favour of and against them. Deficit financing need not necessarily be harmful, its need should be judged by the objective and the effects, *i.e.*, whether conditions and justification exist for deficit financing and whether its effect can be controlled. The main difficulty lies with the timing of such public works plans or other welfare expenditure, and also in the determination of the extent to which it should be carried. Another set-back in its way is the effects it may have on private investment. Government expenditure through deficits may not be able to have the desired effects if the private investment is frightened away by it, or else its initiative is dampened. This would result in induced private disinvestment and the multiplier chain may be stopped dead in its track. But this is only one side of the picture; private investment may take heart with the Government expenditure to help him, perhaps, in some complementary industry, and thus accelerate the pace of recovery and development. In such a case the guide for fiscal policy should be-facts rather than arguments.

Another difficulty lies with the possibility of a 'perverse cyclical flexibility' of the local governments with respect to the expenditure of the central authority in that they may curtail their expenditure when the centre is spending more freely. But this can be overcome by proper control and supervision of such 'loop holes' by the central fiscal authorities.

Experience of countries has shown that the deficit financing has helped faithfully during the Great Depression, and we may even quote examples to show this to "its advantage. The total net deficit for the Commonwealth and its

States was £ 66.3 million for the decade 1929-30 to l939-40. Same is the case with United States of America. The increase in debt of U.S. from $ 15.1 billion in 1929 to $ 34.9 trillion in 1939 is not some thing to be ignored, and it has been continuously increasing due to its huge war expenditure and ever flourishing massive developmental projects till it reached to $ 257 billion in 1947, though of course this figure is in terms of the inflated $. This quotation from the proceedings of the second Working Committee of Experts on Mobilization of Domestic Capital convened by E.C.A.F.E. in September 1052 may prove useful here: "……… Governments might find it difficult to avoid deficit financing; indeed it was already taking place to some degree in some countries ……… Deficit financing need not be inflationary (but if it were so), …… it carried with it most serious consequences ………" Considering the various factors relevant to deciding at what point deficit financing became inflationary in effect, they enumerated "the size of foreign exchange resources, the sensitivity of the cost and price structure, and of exports and imports, the speed with which particular development projects would lead to increase production, the efficiency of the monetary weapons available for limiting private expenditure ………"

Whatever the policy in this regard, one fact should not be forgotten, that the deficit financing should be exclusively for the development or recovery projects; in no case should it go over for ordinary government expenditure.

The measures generally adopted to meet such deficit budgeting are:

1. Utilization of the reserves of the government.
2. Imposition of new taxes and increase in rates of the old.
3. Floatation of loans by the government, temporary as well as permanent.
4. Creation of new money through expansion of inconvertible paper money, *i.e.*, printing of new notes.

In case of financing required for war purposes, the expenditure is very vast, and the government may start with utilizing its formerly held reserves. But this source is not of much value, because it would not go far; the government will have to resort to the other three means-suggested above, and they are the chief mainstay of a modern government in any such financial difficulty, be it financing of the war expenditure, a compensatory counter-cyclical policy or a development programme requiring a large amount of domestic capital. But all these three involve the danger of inflation which in the words of Dalton, "is a paradise for speculators and profiteers …… but hits the poor consumer, the fixed-income and wage earner hard … … with the net result that it brings undue gains to some and undeserved losses to many." Whatever the dangers involved, however, it is imperative to resort to deficit financing for counter-cyclical and developmental purposes, but to quote the Report on "Domestic Financing of Economic Development" issued by the U.N. (1950).

"It is generally agreed that economic development should be achieved with a minimum inflation. (But) if voluntary savings are not sufficient, funds should be obtained through compulsory saving in the form of 'Taxation'. If this is not sufficient, various controls and external financing should fill the gap. If even these latter are not sufficient and the development programme is essential, inflationary, borrowing or printing of money may be considered as a last resort …… the development should not necessarily be suspended in order to avoid inflationary methods."

It, then, proves the fact, that deficit financing is a useful tool for correcting the disequilibria in economic activity provided public investment is directed into channels through which both full employment and welfare are promoted concurrently. It is not only useful in helping the 'secular stagnation' conditions, but it also promotes the development in the under-employment situation and so it is worth having in any case.