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'Deficit Financing' or 'Deficit-Reduction Financing?' Debates in Contemporary Economics: Origins, Confusions and Clarity

Ann Pettifor

Director, Policy Research in Macroeconomics (PRIME), and Council Member, Progressive Economy Forum, London, UK

Abstract. The analysis of government deficits and public debt points to a fundamental error in contemporary economic discussions. It is not possible to assess the stance of fiscal policy from estimates of the public sector deficit. John Maynard Keynes's macroeconomics and the empirical evidence discussed in this paper indicate that expansionary fiscal policy financed by loan issues will lead to growth in economic activity and employment. In an economy with spare capacity and idle resources, high government expenditure generates income, including tax revenues and thereby reduces the government deficit, and cuts public debt. The main purpose of increased *loan-financed* government spending at times of private economic weakness is *to increase the nation's income.* Keynes argued that any such government spending was not deficit spending, because he understood the spending as the most sensible means to cut the deficit. *Deficit-reduction spending* might be a more appropriate definition, because as he argued with Josiah Stamp: "You will never balance the budget through measures which reduce national income" (Keynes, 1978, vol. 21, p. 149).

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***KAUJIE Classification*:** R7, R73, G3, G32, G33

1. Introduction

"Deficit financing" in contemporary economics is controversial – largely because of flawed economic approaches to a sovereign nation's public finances. The first is the *microeconomic approach* that treats government budget deficits in much the same way as a household deficit. In other words, the assumption that like a household, a government budget deficit is the consequence of a shortfall of government tax revenues over expenditure, and this in turn is due to a combination of excessive expenditure and low taxes. The only sound response to a rise in the budget deficit, micro-economists argue, is for government to increase taxes and/or cut expenditure. In Britain, the Institute for Fiscal Policies adopts this approach, as do many other orthodox economic institutions. Most politicians in western governments approach the public finances in this simplistic way.

The second flawed approach is to ignore evidence that government deficits, and a rise in public debt, are most often the consequence of a slump – a fall in economic activity ('growth') and, therefore, of a fall in government revenues. In other words, the budget deficit expands as a percentage of a *shrinking* economic 'cake' – the GDP. When the economic 'cake' expands, the budget deficit in turn shrinks as a share of GDP. To focus on the budget deficit as opposed to the size of the 'cake' is to view the economy as if through the wrong end of a telescope.

In 2010 and then again in 2016, Victoria Chick, Geoff Tily and the current author published evidence covering a century of UK data that contradicted the possibility of improving the government's fiscal position by cutting expenditure. The data and analysis is contained in our publication, *The Economic Consequences of Mr Osborne* (Chick, Pettifor, & Tily, 2016)[(1)]. The period before the Second World War provides examples of genuine 'fiscal consolidations', that is, episodes when UK government spending actually fell in money terms. These periods are contrasted with fiscal expansions. Spending figures are shown alongside outcomes for the ratio of government debt to GDP, interest rates, unemployment, GDP, and prices.

Outcomes for the public finances from this evidence are almost entirely contrary to today's conventional wisdom derived from microeconomic thinking. Sustained fiscal consolidation increases rather than reduces the public debt ratio and is, in general, associated with adverse macroeconomic conditions. The analysis was extended to the post-war era in which government expenditure never actually falls but the pattern is sustained: when expenditure rises comparatively rapidly, the debt ratio falls and the economy prospers, and when it levels off, the debt ratio worsens and macroeconomic indicators are less favorable.

The analysis points to a fundamental error in contemporary discussions. It is not possible to assess the stance of fiscal policy from estimates of the public sector deficit. Keynes's macroeconomics and the empirical evidence discussed in our paper indicate that an expansionary fiscal policy will lead to growth in activity and employment, so that, with spare capacity, high government expenditure reduces the deficit.

2. Deficits Don't Matter

Another approach, adopted mostly by the Modern Monetary Theorists (MMT) asserts that perpetual government budget deficits are both necessary and unproblematic. Government spending, it is argued, can be financed almost ad infinitum by a central bank that has the exclusive power to "print" or create fiat currency (legal tender whose value is backed by the government that issued it).

Central to MMT theory is the accounting identity: Domestic Private Surplus = Government Deficit (Mitchell, 2009). For every surplus, it is argued, there has to be a deficit. For every deficit there has to be a surplus.

> As a matter of accounting between the sectors, a government budget deficit adds net financial assets (adding to non-government savings) available to the private sector and a budget surplus has the opposite effect. … In aggregate, there can be no net savings of financial assets of the non-government sector without cumulative government deficit spending. … government budget surpluses [are] dollar-for-dollar manifested as declines in non-government savings. (Mitchell, 2009, paras 7-11)

(1) Originally published in 2010, revised first in 2011, and then again in 2016.

This accounting-based methodology is premised on the acceptance that cuts in government spending are synonymous with budget deficit reduction.

> If the government runs a balanced budget (spends 100 dollars and taxes 100 dollars) then private accumulation of fiat currency (savings) is zero in that period and the private budget is also balanced.
> Say the government spends 120 and taxes remain at 100, then private saving is 20 dollars which can accumulate as financial assets. In the first instance, they would be sitting as a 20 dollar bank deposit have been created by the government to cover its additional expenses. The government deficit of 20 is exactly the private savings of 20. (Mitchell, 2010, paras 11-12)

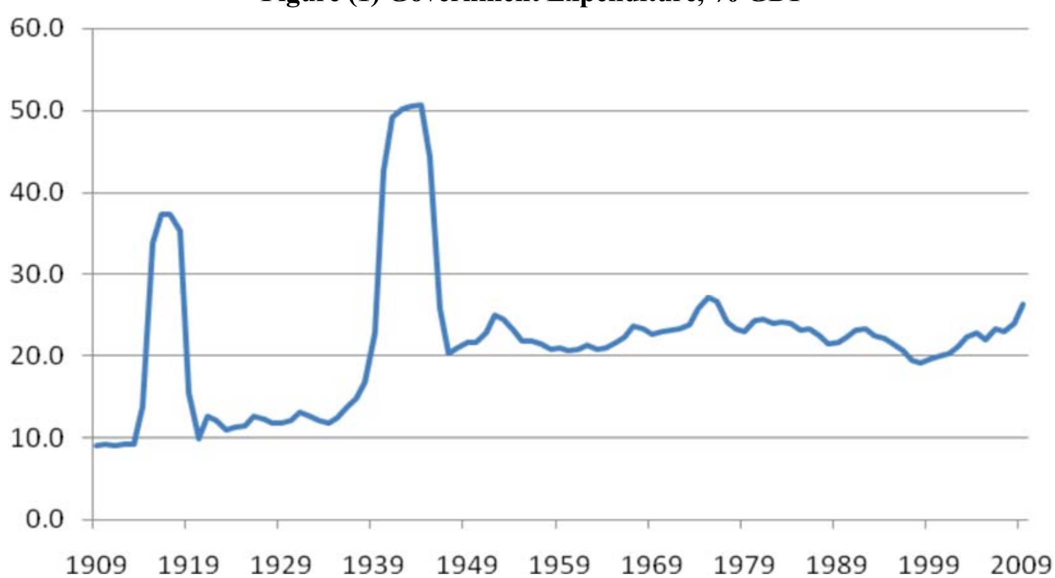
But the assumption here is that if government cuts spending to 80 and taxes remain at 100, then the private sector deficit must increase to 20 to maintain the accounting balance. But deficit spending and deficit financing are vital if the "net savings" of the non-government sector are to be maintained. To ensure the private sector remains in surplus, Modern Monetary Theorists conclude that the government *must not reduce its deficit.* In this respect, MMT theorists share the analysis echoed in the famous remark made by Vice-President Dick Cheney of the United States: "Reagan proved that deficits don't matter" (Leung, 2004, para 29).

Our evidence in *The Economic Consequences of Mr Osborne* contradicts both the microeconomic approach and the MMT approach. We make no appeal to disregard high public debt. We show that attempts to lower the debt ratio by cutting spending has always been counterproductive. We appeal instead for a policy that might be successful in reducing it.

The empirical evidence runs exactly counter to both conventional and MMT thinking. Fiscal consolidations have not improved the public finances. This is true of all the episodes we examined, except the consolidation after World War II, where action was taken to bolster private demand in parallel to public retrenchment.

In Britain's post-war era, the authorities focused on employment and economic expansion to reduce the debt. The approach was completely successful; within only two years, the debt was on a downward trajectory, and the wartime production and employment gains were preserved and extended through to the 1970s. After World War II, government expenditure had effectively doubled as a share of the economy relative to the 1920s (see Figure 1 below).

Figure (1) Government Expenditure, % GDP



Source: (Chick et al., 2016).

2.1 Expenditure Creates Its Own Income

From Keynes's macroeconomic perspective, the public sector finances are not analogous to household finances. A household can reduce its deficit by reducing its spending, but the public sector is too important for that; what happens to its deficit depends on the reaction of the economy as a whole. Keynes turns Say's Law on its head: "For the proposition that supply creates its own demand, I shall substitute the proposition that expenditure creates its own income" (Keynes, 1978, vol. 29, p. 81).

Given spare capacity, public expenditures not only are productive in their own right but also foster additional activity in the private sector, according to the multiplier. Increased production means increased incomes, which, from the point of view of government, means higher tax revenues and lower welfare (and, later, debt interest) expenditures. Keynes even went as far as claiming "Look after the unemployment, and the budget will look after itself" (Keynes, 1978, vol. 21, p. 150).

The actual outcome for the public sector finances depends on the value of the multiplier and rates of taxation and welfare expenditure, though the results discussed above indicate that he was not far from the mark (especially looking at matters as a share of GDP).

Conversely, reducing expenditure would normally reduce income. A reduction in public expenditure will be accompanied by rising income only if it is outweighed by an expansion in private expenditure. Such an expansion will have to be vigorous: any contraction in public expenditure will always have substantial adverse effects on private demand. There will be reverse multiplier effects as public sector unemployment increases and also as expenditure on procurement from the private sector is reduced; in addition, confidence is likely to be shaken.

3. Mainstream Economic Theory and Deficit Financing

Government budget deficits, argue orthodox economists in a similar vein to MMT, 'crowd out' the private sector (Carlson & Spencer, 1975). According to the dominant narrative, if governments increase taxes to reduce the deficit, this will reduce the discretionary spending of the private sector. The problem with this narrative is that it ignores the context in which taxes are increased. If the economy is at full capacity and inflation threatens, increasing taxes may be necessary to cool activity and restore price stability. If taxes are increased in a slump, the impact will be a further contraction of private discretionary spending and economic activity, deepening the slump.

Second, if instead the government borrows, so the argument goes, then it will do so from private sector investors. This will curtail the amount private investors have available to fund private investment. The latter argument ignores:

(a) the vital role that sovereign debt plays in meeting private sector demand for *safety* by providing the wider monetary system with *safe collateral*, and
(b) the fact that governments can both borrow from their own bank, the central bank; and central bank intervention in the bond market can help lower the yield on government debt.

A direct consequence of the economic narrative that public spending crowds out the private sector is the assumption that governments cannot afford to create employment for their young people; cannot afford to build houses for the poor; to build a health service free at the point of use; or to build schools and expand the capacity of an educated workforce. Nor can societies afford to tackle climate change. Only private, self-regulating markets, it is asserted, can finance such 'outsourced' services, and restore competitiveness and prosperity. We dispute that analysis. A government that issues its own fiat currency; that maintains an independent central bank; that builds sound institutions (a criminal justice system) for the enforcement of contracts, the maintenance of accountancy standards and the collection of tax revenues – such a government can always afford what the various arms of government can do.

3.1 The Dominant Paradigm

As Thomas Kuhn explained in his important work *The Structure of Scientific Revolutions* (1962) intellectual commitments are alleged to provide scientific descriptions of how the world *does* work, while they also constitute normative positions regarding how they *should* work (as cited in Gilpin, 1987, p. 16).

Today's dominant economic narrative (which emerged from the writings of Adam Smith, Friedrich Hayek, Milton Friedman and others) is based on a political economy that assumes politics and economics exist in different spheres. This paradigm – these ideas and theories – are taught in the economics departments of every western university to the exclusion of other schools of thought. It is a narrative that elevates free markets to the role of 'government' over the nation's shared public resources. At the same time, liberal economists favor removal of democratic, regulatory oversight of the private financial system.

The flaws in the orthodox economic approach are well known. Remarkable as it may seem, mainstream economics does not take money, banks, or debt seriously, as Steve Keen has cogently argued (Keen, 2014; Keen, 2011). Money, banks, and debt are often excluded from the models on which policy-making is based, as money is considered a mere 'veil' over real economic activity (trade transactions, employment, investment). Private bankers are assumed to be mere *intermediaries* between savers and borrowers. Until the Bank of England put paid to that delusion in Q1 of its 2014 Quarterly Bulletin (McLeay, Radia, & Thomas, 2014), many denied the existence of effortless credit creation by both traditional and 'shadow' bankers. As a result of this lacuna, economic orthodoxy's 'blind spot' for the activities of the finance sector (credit-creation and the determination of interest rates by individual creditors – not 'market forces') led to the deregulation of that sector. This in turn has led to the build-up of vast mountains of debt at high, real rates of interest; to extraordinary levels of corruption, and to a weakening of economic governance.

Given these flaws, it is no wonder that the economics profession as represented by the London School of Economics could not answer the British Queen's question: Why was the crisis not foreseen? *Why did no one notice it?*

3.2 The Removal of Safeguards

During the 1945-70 era of the Bretton Woods system of *managed finance*, international capital was not easily mobile; credit creation was managed to ensure credit was aimed at productive, not speculative activity. And the rate of interest for loans across the spectrum of lending (short and long-term; safe and risky; and in real terms – relative to inflation) was managed by central banks *and kept low*.

As a result of the subsequent 'liberalization' of the international financial system after the 1960s and 70s, these safeguards were removed. And just as the removal of traffic safeguards leads to jams, crashes and deaths, so the removal of regulatory safeguards over mobile capital has led to high levels of corruption, weakened governance, and social disorder and disruption. As Salomon Brothers' Henry Kaufmann (aka Dr. Doom), now 91, observed at a recent conference that despite deregulation being a major factor in the recent Great Financial Crisis, it took less than a decade for many to forget. "A financial market deregulated is like a zoo without bars", he said (Ritholtz, 2018).

Finally, the dominant economic narrative assumes that a publicly-backed monetary system (which includes both the central bank and commercial banks and the associated institutions and policies) should be ready to be placed at the service of the *private* sector (including the shadow banking sector) but not the *public* sector. The argument for this is that the public sector, unlike the private sector, is rent-seeking.

3.3 Deficit Financing and Contemporary Debates

One of the most contentious of contemporary economic debates occurred after Carmen Reinhart and Kenneth Rogoff (both of Harvard) published *Growth in a time of Debt* in January, 2010, and argued: "When external debt reaches 60 percent of GDP, annual growth declines by about two percent; for higher levels, growth rates are roughly cut in half" (Reinhart & Rogoff, 2010, p. 1).

The 'evidence' in this paper was later cited in the US Congressional "Paul Ryan Budget" of 2013 and used by both Republicans, British Conservatives and European officials to argue for cuts in government spending ('austerity'). Reinhart and Rogoff's paper can be credited with persuading politicians to embark on many years of 'austerity' in Britain and Europe, where the double jeopardy of a financial crash combined with attempts to 'balance budgets' gave rise to high and prolonged levels of unemployment, falling real incomes, and weak growth. Herndon, Ash, and Pollin challenged the Reinhart and Rogoff evidence and found "coding errors, selective exclusion of available data, and unconventional weighting of summary statistics", which led, they argued, to "serious errors that inaccurately represent the relationship between public debt and GDP growth among 20 advanced economies in the post-war period" (Herndon, Ash, & Pollin, 2013, p.1). Nevertheless, the harm had been done. As John Cassidy noted in The New Yorker, Reinhart and Rogoff's paper

> created another huge embarrassment for an economics profession that was still suffering from the fallout of the financial crisis and the laissez-faire policies that preceded it. After this new fiasco, how seriously should we take any economist's policy prescriptions, especially ones that are seized upon by politicians with agendas of their own? (Cassidy, 2013, para 2)

Reinhart and Rogoff had made their mark – and millions were to suffer for it under the austerity policies of a Republican US Congress, and of European governments.

4. John Maynard Keynes and Deficit-Reduction Financing

For decades John Maynard Keynes's approach to public spending has been understood as 'deficit spending'. But this reflects a serious misunderstanding of his practical initiatives and the associated theoretical reasoning and justification, as Geoff Tily argues (Tily, 2015, para 1).

For John Maynard Keynes, the main purpose of increasing *loan-financed* government spending at times of economic weakness is *to increase the nation's income*. Keynes argued that any such government spending was not deficit spending, because he understood the spending as the most sensible means *to cut the deficit*. *Deficit-reduction spending* might be a more appropriate definition.

4.1 You Will Never Balance the Budget Through Measures Which Reduce National Income

In January 1933, Keynes and Josiah Stamp held one of their long series of discussions on economic issues on BBC Radio. In the course of the discussion, Keynes made the following comments:

> But Stamp, you will never balance the budget through *measures which reduce the national income* [emphasis added]. The Chancellor would simply be chasing his own tail – or cloven hoof! The only chance of balancing the Budget in the long run is to bring things back to normal, and so avoid the enormous Budget charges arising out of unemployment. …
>
> I do not believe that measures which truly enrich the country will injure the public credit. You have forgotten my point that it is the burden of unemployment and the decline in the national income which are upsetting the Budget. *Look after the unemployment, and the Budget will look after itself* [emphasis added].
>
> It is loan expenditure I am wanting. It is all those capital developments of varying utility. I agree that traditionally we think it quite proper to finance all the means by loans, and that expenditure of that kind is carried out by local authorities or by the central government. (Keynes, 1978, vol. 21, pp. 149-150)

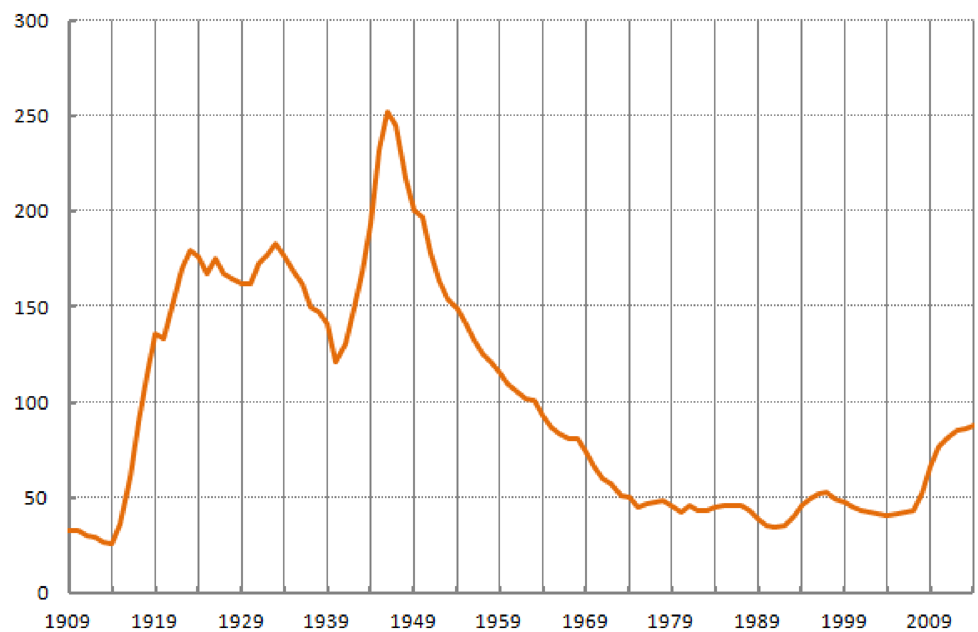
In an economy operating with spare capacity, such 'deficit-reduction spending' would be financed by loans, but would not, paradoxical as it may seem, increase the debt. On the contrary, debt as a share of the nation's income (GDP) would fall.

The clearest evidence for this is Britain's experience from the 1930s onwards, as illustrated by the chart below (figure 2). Five years after the crash of 1929 when public debt had risen as a result of the crash (which raised unemployment, cut tax revenues, and increased welfare spending) the British government was finally persuaded (by Keynes and others) to begin spending, and to finance that spending by borrowing. Cutting spending or raising taxes in a slump would have had the effect of reducing demand, cutting income (both private income but also tax revenues and weakening the economy further). The result of pre-war government spending at a time of high levels of public debt is clear from the chart below (figure 2). Public sector debt as a share of GDP began to fall. Unfortunately, World War II intervened, and the government began to borrow for military purposes; borrowing that was effectively destructive of lives, production, and income. As a result, the debt began to rise again, and at the end of the war, peaked at 250% of GDP. It was at that point that a newly-elected Labor government embarked on an expenditure program: to create employment for returning soldiers; to provide a National Health Service free at the point of use; to build affordable public houses for families that had given the lives of their loved ones in pursuit of war. Industries and public transport were nationalized, roads were built, and a national education service constructed, with free education offered at primary, secondary, and university levels. As a result of this massive program of investment, *Britain's public debt as a share of GDP fell precipitously to about 40% of GDP*. It remained at this level for many years, until financial deregulation (begun in the 1960s and 70s) caused increased economic volatility and led to a rise in Britain's debt as a percentage of GDP.

Before Keynes, *war had been the only object of governmental loan-expenditure on a large scale*. While governments were reluctant to borrow to maintain the employment, health and stability of society, they considered loan-financed expenditure on military kit as respectable financing. Keynes argued:

> I hope that her government will show that Great Britain can be energetic even in the tasks of peace. It should not be difficult to perceive that 100,000 houses are a national asset and 1million unemployed men a national liability. (Keynes, 1978, vol. 9, p. 355)

Figure (2) Public Sector Debt, % GDP (1909-2014)



Source: (Tily, 2015).

4.2 How Then Can Governments – Backed by a Sound Monetary System – Finance Their Activity?

There are of course many poor country economies that lack a sound and well-developed monetary system. In those cases, governments cannot rely on the central bank and on the private financial system for loan-funded expenditure. In countries without the institutions that underpin a sound monetary system, there is effectively, *no money*. Instead, the government must rely for financing on individuals and institutions that hold *existing savings* – in both the domestic as well as the international financial spheres. Governments in poor countries turn to savers in the domestic economy to raise finance, but also to international sources including private capital markets, and institutions such as the World Bank, IMF or to foreign governments. Such financing is invariably tied to conditions that favor the creditor, not the debtor. Second, such financing is often obtained at high, *real* rates of interest.

For these reasons, it is vital that poor countries expend their resources on building and maintaining the public institutions that underpin a sound monetary system. Only development of such a system will provide poor country governments with the institutions and tools needed to manage the economy – and finance investment – in much the same way as rich country governments manage their economies.

In an economy with a well-developed monetary system "anything we can actually *do* we can afford".

> Where we are using up resources, do not let us submit to the vile doctrine of the nineteenth century that every enterprise must justify itself in pounds, shillings and pence of cash income, with no other denominator of values but this. … Why should we not set aside, let us say, £50 million a year for the next twenty years to add in every substantial city of the realm the dignity of an ancient university or a European capital to our local schools and their surroundings, to our local government and its offices, and above all, perhaps, to provide a local centre of refreshment and entertainment with an ample theatre, a concert hall, a dance hall, a gallery, a British restaurant, canteens, cafés and so forth. Assuredly we can afford this and much more.
>
> Anything we can actually *do* we can afford. Once done it is *there*. Nothing can take it from us. …
> Yet these must be only *the trimmings* on the more solid, urgent and necessary outgoings on housing the people, on reconstructing industry and transport and on re-planning the environment of our daily life. … With a big programme carried out at a properly regulated pace we can hope to keep employment good for many years to come. We shall, in very fact, have built our New Jerusalem out of the labour which in our former vain folly we were keeping unused and unhappy in enforced idleness. [emphasis added] (Keynes, 1978, vol. 27, p. 270)

The reality is that governments backed by sound monetary institutions – an independent central bank responsible for a sound currency; a criminal justice system for enforcing contracts; a well-trained system of accounting; a rigorous tax collection system and a trusted banking system – any government backed by such institutions will not face financial constraints. It will have the power to issue currency and bonds to finance investment in employment and thereby expand what Keynes called a nation's "realm of dignity" – while at the same time balancing the government budget.

4.3 In a Monetary Economy, Savings Are Not Needed for Investment

> Modern finance is generally incomprehensible to ordinary men and women. The level of comprehension of many bankers and regulators is not significantly higher. It was probably designed that way. Like the wolf in the fairy tale: "All the better to fleece you with". (Das, 2010, para 1)

In a developed monetary economy (as opposed to a barter economy) savings are an *outcome* of investment or expenditure (both public and private) financed by credit/money/liquidity/reserves generated (at a macro level) by the central bank and (at a micro level) by commercial banks. *Savings are not the source of financing*. Credit is the source of finance. To adopt Keynes's analogy, saving is not the dog but the tail (Keynes, 1978, vol. 13, p. 276). Economic activity (investment, employment, trade) is not constrained by saving.

Therefore, if a poor country has low levels of savings, this is *a consequence* of low levels of spending and investment. And low levels of public investment are invariably a consequence of an under-developed monetary system. In a developed monetary system, savings are not needed for investment. Instead, *economic activity financed by credit generates savings*. Credit – at low real rates of interest – that is put to good, productive use, generates employment, which generates income (both personal and tax income) and savings.

Tax revenues and savings are *an outcome* of government's and the private sector's investment in employment and are not necessarily *a source* of financing (even while tax revenues help in repaying loans and 'balancing the books'). We all know from our own experience that we pay taxes as a consequence of employment; as a consequence of making a sale (VAT); or as a consequence of making a profit (corporation tax).

4.4 The Importance of the 'Multiplier'

Thanks to 'the multiplier'(2), public expenditure is self-financing. Public works expenditures have a cumulative impact on national income – both private

(2) The IMF's chief economist triggered an important debate on the multiplier in January, 2013 (see, Blanchard & Leigh, 2013; Batini, Eyraud, Forni, & Weber, 2016).

and public. The multiplier measures the impact on the economy (and the tax revenue generated or withheld) as a result of a change in government spending. A positive multiplier generates more income than the initial investment. A negative multiplier has the opposite impact when in a privately induced slump, public spending is cut, and the economy effectively shrunk.

Public expenditure on employment-generating activity triggers the multiplier – and creates new income, tax revenues, and savings, and at the same time cuts welfare spending (for more on the multiplier, see, Tily, 2009).

The size of the multiplier is a matter of controversy. Depending on economic conditions (and at present, in most parts of the world, economies are weak or faltering) a multiplier of 1.5 would be a reasonably conservative estimate. This means that an increase of spending of £50 billion would increase GDP (the economic 'cake') by £75 billion. Cutting spending in conditions of weakness would lead to lower economic activity (investment and employment) and would worsen public finances as tax revenues fall with falls in employment and other forms of economic activity.

The concept of the multiplier is neglected by today's economists in government finance ministries. That is to be regretted as it is a clear justification for government investment as self-financing.

4.5 The Rate of Interest

The rate of interest on credit charged for economic activity is fundamental to the health and stability of an economy, because the level of employment and activity in an economy depends critically on interest rates. It is also important for ensuring that credit is sustainable, and debt repayment affordable. Rates that are too high, stifle enterprise, creativity, and initiative, and ultimately render debts unpayable.

Usury is today widely accepted as normal in western economies whose monetary systems have been weakened by the parasitic grasp of private, deregulated finance capital, and enfeebled by heavy burdens of debt. This acceptance blinds society to the way in which usury exacerbates the destructive extraction of assets from both borrowers, but also the earth. This happens because, as Frederick Soddy (1877-1956, an English radio chemist) once explained:

> Debts are subject to the laws of mathematics rather than physics. Unlike wealth, which is subject to the laws of thermodynamics, debts do not rot with old age and are not consumed in the process of living. On the contrary, they grow at so much per cent per annum, by the well-known mathematical laws of simple and compound interest ... [which]leads with passage of time ever more and more rapidly to infinity, which, … is not a physical but a mathematical quantity. (Soddy, 1926, p. 70)

Keynes shared Soddy's distaste for usury – or debts "growing at so much per cent per annum". So, he developed a revolutionary theory for the management of low rates of interest by the central bank. His *Liquidity Preference Theory* is based on the understanding that the rate of interest must be managed and kept low – for loans across the spectrum of lending: short and long-term, safe and risky; and in real terms (i.e. relative to inflation). For Keynes, the rate of interest was the most important tool and indicator of the health of an economy. He argued that it was vital, therefore, for the public regulatory authorities to manage interest rates for lending across the spectrum of loans.

Keynes explained that in a developed monetary system, the rate of interest is influenced not by the public's demand for *savings* (as orthodox economists/monetarists argue) but by their demand for *safe or risky assets*. Savers, argued Keynes, had different motives over different time periods. The first was for cash; the second for security, and the third for speculative capital gains.

If the central bank working with a government treasury issues and manages a full range of assets (particularly safe government bonds issued over different time periods to satisfy investors' cash, security, and speculative motives), then the public authorities can jointly manage the 'price' or rate of interest for these assets, and keep interest low.

In other words, by issuing bonds, and by dominating markets for these assets, the central bank and treasury can thereby influence and manage the spectrum of interest rates applied across the economy for loans of different maturities and riskiness.

Today, central banks manage only one rate: the policy rate or bank rate. Orthodox economists argue that rates across the spectrum of loans can best be managed by financial 'free (i.e. unregulated) markets'. As a result of the deregulation of interest rates – creditors now decide on loans on the basis of the 'price' or the rate of interest that can be gained from the loan. As the most speculative and risky activity attracts the highest rates of interest – bankers increasingly prefer risky, high-cost lending. In Britain, close to 80% of bank loans are for speculation in property.

This helps to explain the explosion in credit for speculative purposes since the end of regulatory oversight during the Bretton Woods era, and the high, real rates of interest paid on this credit in advance of the "credit crunch" of 2007-2009, and since.

It is our view that high, unmanaged rates of interest will once again be the 'trigger' that will detonate the next debt bubble, and lead to renewed financial crisis.

5. Conclusion

Countries that issue their own currency, and that maintain a monetary system underpinned by institutions that protect the integrity of the system, need never face a shortage of finance. In countries with a monetary system, "we can afford what we can do". The monetary system is managed to enable us (citizens, entrepreneurs, governments) to do what we can do. In countries with a sound monetary system, employment, education, health, the arts and culture, can all be afforded. And where employment, education, health, and culture are financed and supported by governments, social and political stability invariably prevails.

Savings are not needed to finance investment. Credit (borrowing) can be used to finance investment. Savings are a consequence of investment, not a source of finance.

Government finances are not like household finances, and government deficits are not like household overdrafts. Instead, government deficits are an indicator of the health or weakness of the economy. Deficits rise and fall as a share of a nation's Gross Domestic Product – and if GDP expands, the deficit shrinks.

Finally, management of the rate of interest to keep it low for loans across the spectrum of lending, is vital to the health and stability of economies, and therefore, to the health and stability of society.

If policy-makers pursued the policies advocated in his General Theory by John Maynard Keynes, then we could expect a revival of 'the golden age' of economics inflation in the late 1910s and 1970s which were not periods of rapid debt reduction.

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Ann Pettifor is known for predicting the Great Financial Crisis in *The Coming First World Debt Crisis* (Palgrave 2006). She edited New Economics Foundation’s *Real World Economic Outlook* (Palgrave 2003) which predicted a credit crunch. She authored *The Production of Money* (Verso 2017) on the nature of money, debt and the finance sector. In 2018, the Heinrich Böll Foundation of Germany awarded Pettifor the Hannah Ahrendt Prize. Soon after, she was appointed a Council member of the Progressive Economy Forum. She is also the director of a network of Keynesian economists, PRIME economics. In 2015, Jeremy Corbyn MP asked her to join the UK Labour Party’s Economic Advisory Committee. The Newcastle University awarded her an honorary doctorate in 2000 for her leadership of a campaign for the cancellation of $150bn of debt owed by 35 of the poorest countries, Jubilee 2000. She is also a trustee of the charity *Promoting Economic Pluralism*.

E-mail: ann.pettifor@primeeconomics.org

"تمويل العجز" أو "تخفيض العجز في التمويل؟"

مناقشات في الاقتصاد المعاصر: الأصول والالتباس والوضوح

آن بيتيفور

مديرة بحوث السياسات في الاقتصاد الكلي (برايم)،

وعضو مجلس، منتدى الاقتصاد التقدمي، لندن، المملكة المتحدة

المستخلص. يشير تحليل العجز الحكومي والديون العامة إلى خطأ جوهري في المناقشات الاقتصادية المعاصرة. ليس من الممكن تقييم موقف السياسة المالية من تقديرات عجز القطاع العام. نظرية جون مينارد كينز للاقتصاد الكلي والأدلة التجريبية المطروحة في هذه الورقة تشير إلى أن السياسة المالية التوسعية الممولة بإصدار القروض ستؤدي إلى نمو في النشاط الاقتصادي والعمالة. الإنفاق الحكومي المرتفع في اقتصاد ذي قدرات فائضة وموارد خاملة، يولد الدخل، بما في ذلك الإيرادات الضريبية، وبالتالي يقلل من عجز الحكومة، ويخفض الدين العام. الغرض الرئيسي من زيادة الإنفاق الحكومي الممول بالقروض في أوقات الضعف الاقتصادي للقطاع الخاص هو زيادة دخل الدولة. ينظر كينز بأن أي إنفاق حكومي من هذا القبيل لا يعتبر عجزًا، لأنه فهم أن الإنفاق هو الوسيلة الأكثر منطقية لخفض العجز. قد يكون "إنفاق لتخفيض العجز" تعريفاً أكثر ملاءمة لنظريته، لأنه جادل مع جوزايا ستامب: "لن توازن الميزانية أبداً من خلال إجراءات تقلل الدخل القومي" (كينز، 1978م، المجلد 21، ص 149).

الكلمات الدَّالة: السياسة المالية ، المؤسسات المالية ، المضاعف ، تمويل العجز ، الدين العام.

تصنيف JEL: E12, H62, H63

تصنيف KAUJIE: R7, R73, G3, G32, G33