The Economics of Public Spending - Debt, Deficits and Economic Performance by *Hassan Bourgrine, Edward Publishing Ltd.,* UK and USA, 2000, Pages 177, Price £49.95

The post second world war period is often seen as the golden era of capitalism when most of the economies experienced sustained high economic growth while pursuing demand management strategy in the Keynesian framework. The initial euphoria, however, was replaced by strong recessionary pressure that swept through the world economy in the 1970s leaving its lasting impact on macroeconomic policy prescriptions. Fiscal profligacy became the standard explanation for the ills that afflicted the global economy and tight monetary and fiscal policies became the inherent part of strategy to stabilise the economy and revitalising growth through downsizing the public sector and privatisation. The balanced budgets, downsizing of the public sector and privatisation became the widely accepted way to prosperity.

Hassan Bourgrine and colleagues, through eight challenging essays in his book, endeavour to explain that the strategy supported by these principles is based on the misleading conception of the public finances, and the budget deficits, in fact, improve the private sector performance.

The author begins with the argument that the nature of the role and causes of the budget deficits depend on the type of the theory one relies on. The neoclassical theory states that government should follow the principle followed by the individual and should not spend beyond means. The Keynesian theory dwelled upon the capital budgeting supporting the view that government can and should borrow to spend on assets creation for the investments purposes. The macroeconomic models assume that investment in the economy depends on the savings of the private as well as the public sector. The higher budget deficits increase the demand of the funds and rate of interest. The high rate of interest leads to fall in the level of investment and growth rate of the economy.

In order to understand the book, it is necessary to revisit some fundamental propositions of Keynes and Kalecki. Keynes, as is well known, argues that to increase the output, the level of effective demand is the crucial factor. Kalecki has shown that in capitalism the tendency to raise the level of profits through increase in the cost-margins may actually result in decline in level of profits, income and employment. The book also takes the propositions of the circuit theory which states that the financing of the investment and the initiation of the production process is made through borrowings from the banks. The money taken from the banks is distributed to factors of production as payments to their services and the factors of production spend this income on consumption of goods and services to generate income to the firms. To the extent the factors of production save their income, the firms will not be able to get sufficient income to repay all the loans. A part of the debt will be rolled over and fresh borrowings will be made to maintain the cycle of production. It is shown in the book that deficit in the government sector compensates the portion of the income saved by the households which reduces the income of the firms. Thus, the budget deficits increase performance of the private sector. The balanced budget on the other hand, rule out the government role to respond to the cyclical downturns. The author argues that the slowdown during 1990s was the result of low inflation and high nominal rate of interest caused by tight monetary and fiscal policies which led to a decline in the private investment and consequent fall in the effective demand. In this event it becomes necessary for the government to run deficit. The higher debt - GDP ratio due to the deficit should not be considered as

destabilising factor as the policy was designed to counter the slowdown. The stability of the debt-GDP ratio would depend on the differential between the rate of interest and growth rate of real GDP.

Philip O'Hara presented the analysis of the institutional aspects of the production process to show that the economic growth depends on a suitable set of institutions which form a social structure of accumulation (SSA). The SSA approach assumes that there are some institutions conducive for growth which help the economic cycle to take an upward swing and degeneration of these institutions causes the downswing in the economic cycle. Any suitable SSA needs following conditions to be fulfilled - the institutions should contribute to economic stability, they should contribute to class and intra-class resolution of conflict, and they should enhance the profitability. In the post war II era, the Keynesian Welfare State (KWS) was the basis of SSA in the US and it provided a suitable set of institutions as State tried to balance the interests of workers and business, and sought to stabilise the trade cycle. The workers interests were ensured through unemployment insurance and safety net. But it failed to contribute to productivity and also the cost of welfare programmes rose steeply. Consequently, the KWS was replaced by Reagan during 1970s and 1980s. The neo-liberal State emerged with increased privatisation, flexible labour markets and free trade. The four basic tenets of the neo-liberal approach were balanced budget, privatisation, inflation-first strategy, and globalisation. It is shown in the book that neo-liberalism cannot constitute a viable social structure of accumulation because, along with other contradictions, it places constraints on the effective demand through austere fiscal and monetary policies.

The book addresses the issue of resuscitation of demand management policies by tracing the progress of capitalism since the second world war and concludes that the golden age of capitalism was achieved during 1950s and 1960s because of a compromise maintained between the capitalists and labour interests. The slowdown set in the 1970s, after a good economic performance during the 1950s and 1960s, has its roots in the break down of the institutions which enabled the compromise between competing interest groups in the capitalist economy. This is wrongly perceived as the failure of the demand management policies. In the monetary production system the money supply, inflation and the interest rate have different implications for the business and the financiers. The financial wealth owners loose due to high inflation rate and low interest rate and the producers gain on account of rising prices and falling interest rate. The remedy to the problem is the middle path of maintaining the demand pressure through fiscal policy and adequate money supply to keep the real interest rate low but not negative. Thus, the compromise attained during the 1950s and 1960s, broken by the rentiers in what is called the revenge of rentiers, should be restored.

One redeeming feature of the book is its critical assessment of the Asian debacle. The Asian crisis is examined in different perspective to conclude that it was a real crisis and not a financial one as argued by many analysts. The major cause of the crisis was the lack of effective demand and not the Ponzi finance as explained by several corners. The fiscal deflation by the rich as well as emerging countries resulted in the long-run shortage of the aggregate demand. It is shown in the book that the fiscal austerity will cause poverty and demise of democracy. The alternative is to develop a welfare State based on general theory of dynamic monetary accumulation, where public deficit enhances the profitability and the production.

One of the major problem perceived to be associated with budget deficits is inflation. The book, however, denies that budget deficit is the major cause of inflation. The authors dwell on empirical studies to deny the positive relationship between public deficit and inflation. The budget deficit can be inflationary if debt becomes unsustainable in Domar sense or in terms of Barro's rate of growth of government bonds exceeding the output growth. It is found from the data from G-7 countries that there is no relationship between deficit and inflation. The results, instead, provide strong support for those who call for greater provision of government finance at low real rate of interest as means of moving the world economy along a sustained growth path. Even in the long-run, the deficit is shown to have positive effects on profits so far the growth rate of economy is sufficiently higher relative to the real rate of interest.

The impact of the public investment on the growth is examined with the help of the modified version of Domar model. It is shown that expansion in the public investment will bring the economy on a higher growth path. A comparison is made between the economy with and without public sector to show that the economy with public sector will grow at faster growth. The crucial element here is the difference between the private propensity to consume and the share of public total revenue devoted to current spending.

Finally the book elucidates that the fiscal policy is more effective than the monetary policy in attaining the full employment state. The deficit financing and the direct state intervention should be used to attain the goal of full employment. It is shown that the national debt does not pose any hindrance in the achievement of full employment but maintaining the same becomes a political matter as the full employment state is incompatible with capitalist system, because it strengthens the working class and in the struggle of capitalist and workers former get weakened.

The book provides convincing arguments for the policy makers in favour of active fiscal policy to revive and stabilise the economic activity. The fundamental propositions of Keynes and Kalecki is restated in the context of the new economic developments. An illuminating critique of public sector downsizing and privatisation is relevant in the context of the debate on disinvestment in India. The book attempts to redefine the role of budget deficit in modern economies particularly in meeting social welfare objectives.

The book, however, is not without limitations. Most of the arguments in the book are based on the circuit theory which assumes some beginning point of the production process. In practice, however, the production process is continuous and it cannot be judged at what point the budget deficit will contribute to private sector profits. Secondly, the deficit is assumed to be financed through creation of new money by the central bank. In the present world, however, the Government is borrowing from the market to finance its expenditures. This causes large outgo on account of interest payments inevitably leading to reduction of social spending and the resultant effect on distribution of income. Thus, the book pays scant attention to the debt financing versus money financing debate in the conduct of fiscal policy. Again, it is argued in the book that capital flows will ultimately bring equilibrium and stability in the system. But the experience of South-East Asian countries with capital flows is completely ignored in the book. The impact of money supply on the prices and external balance needs to be examined more carefully and thoroughly before agreeing to the fiscal expansion. Another aspect which does not receive the

due space in the book is the efficiency or cost of production. The book does not discuss how the public sector can ensure the use of resources more efficiently than the private sector. Finally, the stability of Debt/GDP ratio is dealt with in a passing manner only. The GDP growth rate higher than interest rate does not necessarily implies or ensures the sustainability of debt. Neither does the book prescribe the policy measures to deal with unsustainable levels of public finances. In retrospect, even as the book deviates from run-off-the mill economics, it is thought-provoking and challanging to the reader.

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