Capital and Public Expenditure

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There is a paradox at the heart of political economy, which can be seen as follows. Suppose a capitalist economy is saddled with substantial unemployment and unutilized productive capacity, as is the case now over the entire capitalist world. Suppose in this situation the State increases its expenditure by enlarging its fiscal deficit, i.e. it spends, let us say, Rs.100 more without any increase in its tax revenue. And let us assume for simplicity that the capitalist economy is a closed, isolated one. Then the Rs.100 of expenditure will directly and indirectly, i.e. via the various rounds of further expenditure it generates, increase aggregate demand, and hence employment, and output in the economy (since no demand will be leaking out in the form of larger imports from elsewhere because of the closed economy assumption). This increase in output will of course increase profits as well. The paradox then consists in this: if a rise in fiscal deficit increases capitalists' profits, then why are they so opposed to fiscal deficits? Why do they keep harping on "fiscal responsibility", the financial capitalists most vocally, but the others too, though with lesser stridency?

It may be thought at first sight that the problem arises because we do not have closed capitalist economies, and that an increase in the fiscal deficit will leak out in the form of larger import demand, which will generate little additional employment at home but create a balance of payments problem. But, the capitalists' opposition to fiscal deficit arises not only in countries whose products are uncompetitive and whose additional demand therefore leaks out abroad in the form of larger imports; it arises even in strongly competitive economies, where recession could be overcome, and more profits generated, through a larger fiscal deficit, but where the capitalists' opposition prevents this from happening. This opposition therefore is more fundamental than merely the fear of a worsening of the balance of payments, which brings us back to the question: why do capitalists oppose fiscal deficits?

The typical answer given to this question is that fiscal deficits are simply bad policy, and the opposition of capitalists to them is because of this fact and has nothing to do with their self-interest. Just as a family cannot have a perpetual excess of expenditure over its income, without at some point ceasing to be creditworthy, likewise a government cannot keep having a perpetual fiscal deficit. By doing so it gets saddled with mounting debt, which is bad per se since it can never hope to pay back its debt, and which, for that very reason, undermines its creditworthiness beyond a certain limit.

This, however, is a completely wrong answer, since the analogy between the family and the government is a false analogy. To start with, if the government uses the fiscal deficit to make investments in productive assets, then it is doing something that is in principle no different from what corporations do: corporations after all have always a backlog of debt but still keep

borrowing for making fresh investments. But even if it is the case that the fiscal deficit is used to finance expenditure other than investment expenditure, or that government investment, unlike that of corporations, is not necessarily profit-making (out of which interest payments could be made), the government still stands on a very different footing from any other entity in the economy, for two obvious reasons.

One, it has the power to tax, including even those from whom it borrows to finance the fiscal deficit. Indeed the lesser is the leakage of demand out of the economy, and the more the fiscal deficit generates employment and output inside the economy, the greater is the borrowing from within the economy, and hence the government's capacity to tax the lenders. Two, since the government can always take recourse to borrowing from the central bank, which can print money to meet its borrowing requirements, the question of the government's losing its creditworthiness simply does not arise.

True, if the central bank is made "autonomous" as a result of "financial liberalization", and therefore ceases to be obliged to lend to the government what it asks for, then the government loses this privilege. But since the argument for making it "autonomous" is precisely to prevent the government from going on borrowing from it, such prevention must have some independent rationale. For exploring this independent rationale for preventing a perennial fiscal deficit, we must therefore deliberately preclude financial liberalization.

It may also be thought that running a perennial fiscal deficit of this sort, which is financed by borrowing from the central bank, would entail the emergence of inflationary pressures; but we are talking about the economy being in the midst of unemployment and unutilized capacity, where the need is for increasing, and not curtailing, aggregate demand. To be sure, the government should not run a fiscal deficit if the economy is producing close to full capacity output, for that may cause inflation; but why should there be any objection to its doing so when the economy is mired in recession?

The objection to a fiscal deficit (at least beyond a certain minuscule level relative to the gross domestic product) implies de facto an objection to larger public expenditure that boosts the level of aggregate demand. Since such larger public expenditure, if not financed through a fiscal deficit, would have to be financed through larger tax revenue, of which the capitalists would normally be called upon to provide a part, their opposition to fiscal deficits merges with their opposition to larger government expenditure: the two become indistinguishable. The question we again come back to is: why this opposition?

Economists, especially Marxist economists who have attempted to go deep into the political economy of the system, have for long been intrigued by this paradox and have answered it in a variety of ways. And all of them have noted that the opposition of capitalists is never to all forms of public expenditure, but only to some. Public expenditure in the form of "transfer payments" to the poor and working people, even though the spending out of such transfers has the effect of

increasing output and capitalists' profits, is opposed by the latter because it increases the bargaining power of the workers. Likewise public expenditure in specific spheres, even when it increases aggregate demand and profits, tends to compete with private interests in those spheres in which it is undertaken. Thus larger government expenditure in building hospitals has the effect of making private hospitals less profitable by exposing them to public competition; larger government housing construction has the effect of reducing the profitability of private house-builders; and so on. Capitalists' opposition to public expenditure however gets muted if such expenditure is undertaken neither in the form of transfer payments nor in spheres where there is such competition. And one obvious sphere that satisfies both these requirements is military expenditure, which explains, according to Baran and Sweezy, why post-war capitalism relied upon larger U.S. military expenditure to keep up its level of aggregate demand.

But the opposition of big capital, especially financial interests, to public expenditure cannot just be explained by these factors alone. There are more fundamental objections, which also explain why, in the midst of the current recession, the right-wing demand in the United States is not so much for a step up in military expenditure (which could be made to appear plausible given the fact that the US is at present engaged in two wars), but for a cutback in public expenditure together with tax concessions to the super-rich. What explains such policy advocacy in the midst of the recession?

This brings us to the crux of the problem. The fundamental property of a capitalist system is that its level of output and employment is determined essentially by the so-called "state of confidence" of the capitalists. When they feel "confident", they invest; and this raises the level of aggregate demand, and hence output and employment. When they do not feel "confident", the opposite happens. To be sure, this does not mean that the functioning of a capitalist economy is purely a matter of psychology. Undoubtedly, the capitalists' outlook is governed by what their actual experience has been, i.e. how certain objective indicators have behaved (e.g. whether sales have been increasing). But how this experience is interpreted and gets translated into investment decisions depends also upon the state of "confidence" of the capitalists.

Indeed this fact is what gives the capitalists an upper hand. If employment has to increase, then, within the logic of the system, the State must take steps to improve the "confidence" of the capitalists. If on the other hand the State directly tries to increase employment through its own expenditure, then that makes the "state of confidence" of the capitalists irrelevant, and hence amounts implicitly to undermining the logic of the system and the role of capitalists within it. This is why all public expenditure that directly serves the interests of the capitalists, for instance investment subsidies, guaranteed rates of return, input subsidies, making land available at throwaway prices, are welcomed by the capitalists, as are tax-cuts in their favour. But all public expenditure that by-passes capitalists and directly generates employment is opposed by them (with the exception of military expenditure).

Consider just two examples. The Cameron government in Britain, which never tires of preaching the virtues of "austerity" and has imposed drastic "austerity" measures, has recently announced a programme of subsidizing capitalists' investment in infrastructure from the budget; but the capitalist press that systematically hails "austerity" has not complained about this programme! Likewise in the United States, when the right-wing and the corporate media were opposing a continuation of Obama's meagre $700 billion stimulus package, as much as $13 trillion was being made available under various heads for bailing out the financial system that was engulfed in crisis because of the collapse of the housing "bubble". But the big corporate and financial interests were only too happy with the latter expenditure!

This also explains the fate of Keynesianism. Keynes was worried that if unemployment continued at high levels, then capitalism would succumb to the socialist challenge. So keen was he to preserve capitalism that he advocated public expenditure as a means of directly combating unemployment, and not indirectly by boosting the "state of confidence" of the capitalists. For this unpardonable sin, however, even Keynes, notwithstanding the fact that he was trying to protect capitalism, is shunned by capitalists today.

A barometer of the "state of confidence" of the capitalists is the stock market, which in turn reflects the "state of confidence" of the financial speculators. Finance capital therefore is particularly concerned that the "revival of the state of confidence" route, which is so advantageous to itself, for generating employment, must not get by-passed. The fact that finance capital is particularly insistent upon "sound finance", i.e. eschewing fiscal deficits, can be explained by this.

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