Choosing Sound Economic Growth Strategies  
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In an ideal world a sound economic growth strategy would meet a number of important criteria:
- activating the productive resources of society (capital, labour, natural resources, technology and entrepreneurship);
- improving the productive efficiency of the productive resources;
- keeping prices stable by way of prudential fiscal and monetary policies, i.e. keeping a lid on deficit spending, government debt, tax levels, inflationary pressures and wasteful public bureaucracy and corruption.

Meeting these laudable criteria is easier said than done. The literature is replete with efforts to describe appropriate pathways to sustainable economic growth, ranging from the writings of the pioneers of political-economy, such as the French physiocrats and British pioneers Adam Smith, Malthus, Ricardo and Marshall to 20th century trail blazers such as Keynes, Von Hayek, Schumpeter, Samuelson, Solow, Friedman and a raft of modern exponents of macroeconomics. Today several schools of thought compete for pre-eminence and reputations are created or lost – sometimes more on account of peer-group ascribed eminence than on substance or evidence-based validity. When it comes to prescribing appropriate policies and actions in specific situations, many contentious and unanswered questions remain.

Defining Economic Growth

A country's economic growth is usually measured in terms of increases in its gross domestic product, i.e. the total output of all final goods and services produced by all productive resources of a country. The rate of growth depends on increases in the quantity of available productive resources (capital, labour, natural resources, technology and entrepreneurship) on the one hand, and on the "total factor productivity" on the other, i.e. the improvement of the productive efficiency of the productive resources. Enhancing total factor productivity, in turn, depends upon the suitability and durability of the capital equipment, the skill levels as well as the motivation of the workers, the non-disruptive nature of industrial relations, the acceptance and exploitation of superior and innovative production techniques, and on the willingness of business entrepreneurs to invest and reorganise their business enterprises to their maximum competitive advantage.

The requirement that a society should have a growing economy is not based on an acquisitive dogma, it is a *sine qua non* for the improvement of the quality of the lives of its citizens. Economic growth is the requisite for providing so many of the basic goods which people strive for: education, health services, housing, security, as well as a stable and fair political system. Without means, these goods slip out of reach and society is impoverished. What matters is a successful formula for achieving economic growth.

Supporting economic growth is as desirable a goal as striving for peace and happiness. Most informed people agree that it is a critically essential objective within the framework of sound geo-physical parameters. But how to achieve it remains an open question. What can be achieved by government intervention? How can the main drivers of job creating growth be activated?

Recent Policy Mistakes and Market Excesses

The current distress of the advanced economies was caused by policy mistakes as well as the financial world’s market excesses. The failure of financial markets was coupled with profligate government deficit spending. The world of finance has always been prone to bubbles, panics and crashes. Governments have often been involved in the regulation of financing practices: monitoring risky strategies, punishing scams and prescribing capital cover for banks. But in recent years, dodgy financial innovation has outpaced skilful governmental rule making. Derivatives such as
collateralised debt obligations and credit default swaps float undetected into the international financial circuits. The imbalances caused by China’s intervention to hold down its exchange rate against market trends, sent a wash of capital into Western capital markets. At the same time, the citizens of the advanced countries have saddled their political economies with unaffordable privileges, bloated bureaucracies, rigid labour relations and welfare benefits.

The Way Forward

The way out seems to be more a matter of better regulation than more regulation. What is needed is better government, not more government. Since governments are net consumers of taxable income, government spending cannot continue to grow unabated. Government intervention should be directed to catalyse private-sector driven job-creating growth. Also of critical importance are flexible industrial-labour relations for job contracts and wage determination. Inflexibility distorts job markets and sets up rigid distinctions between protected insiders and vulnerable outsiders.

Whenever governments step in to revive sagging demand and to restore investors’ confidence in job-creating growth, time-limited stimulus plans should be guided by the sustainability of debt levels and the restoration of market-led growth based on a credible exit strategy. Over-reaction to a crisis is as much a danger as under-reaction. Getting the right balance between supply-side and demand-side policies is the biggest challenge facing political decision-makers. The role of government, including the role of monetary policies, is to uphold and, if possible, to strengthen the private sector’s incentives to work, save, invest and innovate, and to take legitimate risks. The government also has a legitimate role to play in providing education, training and the development of productive skills and in maintaining or strengthening macroeconomic efficiency through ensuring the existence of well-functioning markets in goods, services, labour, credit and capital.

A bleak scenario of an economy spiralling downwards can only be avoided by creating a climate for enterprise which allows confident business entrepreneurship to re-ignite the engines of economic growth and prosperity for all. The restoration of investors’ confidence and a spirit of enterprise, are of overriding importance in any growth strategy.

A Growth Strategy Based on Conventional Precepts of Prudent Economics

These precepts refer to an economic system with a strong proclivity towards competitive free enterprise, limited government intervention, a strong emphasis on productive output, non-disruptive labour relations, conventional application of anti-cyclical monetary and fiscal policies and the illumination of the shady corners of the world of finance.

1. Create an enabling environment for confidence building

Underlying principles

- The creative action of people is the key resource available to any society. Their actions as economic role players – i.e. as producers, savers, investors and consumers – are determined by their needs, aspirations, expectations, values and ways of doing things. But in crisis situations the general way of thinking as expressed in the confidence levels are of critical importance.
- In an economic downturn overriding perceptions are of key importance:
  - the safety of bank deposits;
  - the security of jobs and income streams;
  - reduction of uncertainty about the causes of the crisis; and
  - convincing collective action to deal with the causes and culprits of the crisis.

Policies and Programmes

1.1 Guarantee the safety of bank deposits to avoid runs on banks.
1.2 Subject lending institutions to “stress” tests to determine their degree of volatility.
1.3 Set up transparent funds or schemes to assist in the rescue or bail-out operations.
1.4 Relentlessly pursue a forensic operation to bring the culprits in financial markets to book and to root out undesirable financial practices and instruments.
1.5 Recalibrate financial regulatory practices and institutions.
1.6 Replace the management of failed financial institutions and regulatory institutions to ensure that justice is seen to be done.

2. **Create a climate for enterprise and investment**

**Underlying principles**

- Business creation and business expansion are the key instruments of job- and wealth-creating growth. Wealth creation means more resources will be available – with reasonable levels of taxation – to generate public revenue to spend on social, health and education services as well as essential infrastructure.
- Vibrant market forces are required to generate a sustainable level of taxable income to finance essential government spending.
- Public expenditure and borrowing must be kept down, otherwise government would be taking away the very resources the private sector needs to invest and grow. In reality, investment can only be financed by savings – either domestically or cross-border based.
- An expanding, entrepreneurial economy based on business creation and business expansion is the most important welfare policy, urban policy, labour policy, affirmative action policy a country can have.

**Policies and Programmes**

2.1 Monetary policy should aim at maintaining a stable macroeconomic environment.
2.2 Tax policy should encourage savings as well as investments in productive assets.
2.3 Labour policy should be based on the improvement of productivity and the maintenance of non-disruptive labour relations.
2.4 The legal and regulatory framework should be predictable and transparent and aimed at facilitating competitive business transactions and the exploitation of innovative production techniques.
2.5 Development capital should be mobilised through appropriate development schemes (preferably private sector schemes) into small and medium size (SME) development programmes. SME’s are, after all, the largest, most agile and most versatile market-driven creators and providers of employment.

3. **Essential forms of government intervention and spending should be carefully scrutinised and monitored**

**Underlying principles**

- The proper functioning of a people-based, market-orientated, enterprise-driven economy requires a small, efficient and professional public service which can justifiably be endowed with dignity and social recognition.
- Even J.M. Keynes suggested that the "... important thing for government is not to do things which individuals (or companies) are doing already ... but to do those (necessary) things which at present are not done at all".
- It is unavoidable that societies turn to the state (which is after all the organised community) to relieve distress and to help solve problems. But it is vital to prevent the state from becoming so beneficent that it undermines the people’s will to help themselves.
- Next to market economies, the advance of political pluralism is an important megatrend throughout the world. The predominant emerging political framework is that of a democracy based on the recognition of human and civil rights, popular sovereignty and government accountability. There is strong evidence that political checks and balances, a free press and open debate on the costs and benefits of government policy tend to give a wider public stake in the benefits of development and growth. It also increases
governments’ incentives to perform well. Authoritarian governments are objectionable for many reasons, but the preservation of stability and civilised law and order are absolutely indispensable.

Policies and Programmes
3.1 Keep a lid on government spending to avoid a situation where government intervention “crowds out” market-driven creativity and innovation.

3.2 Keep a sharp surveillance on the quantity of government activity: its allocative efficiency as well as its productive efficiency.

3.3 Maintain accountability of public officials by measures such as an independent auditor or controller-general, media access to public information and surveillance by popularly elected political representatives.

3.4 Improve the professional competence in government institutions responsible for handling key functions such as tax collection, the administration of social security, the collection of statistics, as well as regulatory agencies that oversee banks and preserve competition.

3.5 Strengthen the effective functioning of the “rule of law” to ensure that governments are kept accountable, that free markets can function and that individual and commercial rights can be exercised effectively.

3.6 Public sector employment on all levels of government (i.e. all employees receiving the bulk of their total emoluments from the public purse) should be kept below 15 percent of the workforce and never be allowed to rise above 20 percent of the workforce.

4. When stimulus packages are considered essential to counter major economic meltdowns, ad hoc spending increases should be focused on productive assets such as infrastructure projects as well as emergency relief for the needy.

Underlying principles
- For the period since the onset of the GFC, the G20 economies have introduced stimulus packages worth an estimated average of 2 percent of GDP each year. Some politicians and commentators have claimed that these stimuli played an important mitigating role. But economists are not in agreement about the success of either tax cuts or stimulus spending. The debate hinges on the scale of the “fiscal multiplier”, which is bound to vary according to economic conditions. If the economy is operating at full capacity, the fiscal multiplier would be zero because there would be no spare capacity to utilise. However, when workers and factories are idle, a fiscal boost could increase overall demand. If a stimulus package triggers a cascade of investment, the multiplier can well be more than one.
- The overall size of the multiplier depends on how people react to higher government borrowing to finance budgetary deficits. If the government’s actions bolster confidence, the multiplier would rise as a result of private investment. However, if deficit spending drives interest rates higher, private investment could be “crowded out”. If consumers expect higher future taxes in order to finance government borrowing, they would spend less and thereby reduce the fiscal multiplier.
- It seems to be a very complex task to isolate the short-term impact of changes in government spending or tax cuts. It is also difficult to determine what proportion of the stimulus might “leak” abroad via imports (e.g. of Chinese goods).
- The simple truth is that the impact of fiscal measures is not properly understood. Fiscal multipliers are likely to be lower in heavily indebted economies than in prudent ones. But it can be said that stimulus measures do tend to bolster confidence levels.
- Stimulus packages are appropriate to the extent that they help to restore confidence, contribute to the provision of essential infrastructure, assist in providing urgent welfare relief to the needy and remain within the parameters of affordability, i.e. create a debt burden that does not stifle growth or lead to an unmanageable inflationary spiral.
Policies and Programmes

4.1 The more aggressive the stimulus programmes the greater the urgency to outline a clear strategy to shrink deficits. Concerns about inflation or even default could push up interest rates.

4.2 A credible programmed reduction of the scale of deficits would pre-empt corrosive uncertainty. It would reassure markets and allow an orderly exit from fiscal stimulus. Monetary policy should be tightened when inflation threatens to emerge.

4.3 Spending cuts could be achieved by way of the judicious curtailment of entitlements, wage freezes for the public sector and reductions in the number of employees in the public sector.

4.4 One way to handle these highly controversial policy decisions would be to establish non-partisan commissions to fix entitlements, taxes and spending cuts, coupled with non-partisan public education programmes which are subject to public scrutiny.

5. Public expenditure should be limited to sustainable levels

Underlying principles
- Economic history shows that the state is not a successful creator of wealth. It is better known as a consumer of wealth, or a redistributor of wealth. If its allocative powers are wisely used it could serve as a facilitator of development and growth.
- In recent years we have witnessed a consistent tendency for government expenditure to rise as a share of GDP. This growth rate has consistently outpaced that of the economy as a whole. This trend would inevitably lead to the “crowding out” of the taxable income generating private sector.
- The issue of the sustainability of public expenditure is intricately related to how it is paid for. To pay for public expenditure (consumption as well as investment expenditure) governments have to rely on taxes and borrowing (from domestic or foreign savings).
- Increasing taxes are associated with disincentives to work, to save and to invest. These disincentives have a negative impact on economic growth.
- If higher government spending results in larger fiscal deficits, then the government is forced to turn to deficit financing by either creating money (quantitative easing) or borrowing from the domestic private sector or foreign markets. Money creation invariably leads to inflation and rising public debt raises the question of sustainability, the “crowding out” of private sector investment and the spectre of a “debt trap”.
- The pursuit of a fiscal policy that is not sustainable from a macroeconomic point of view will result in insolvency and the destruction of the economy’s productive capacity.

Policies and Programmes

5.1 Special efforts should be made to channel a larger portion of the contractual savings in the hands of institutional investors into projects directly involved in job- and infrastructure creation. An allocation of up to 10 percent of the cash flows generated by contractual institutionalised savings should be allocated to independently prioritised, parliamentary approved, investment projects creating productive assets.

5.2 Suitable investment instruments should be devised (with acceptable returns and security cover) to attract investment funds from institutional investors.

5.3 Governments should avoid using funds derived from loans on the capital market for the financing of government consumption expenditure or any expenses of a non-capital nature.

Unconventional Interventionist Strategies

In recent years a number of unconventional options have entered the arena of the policy debate particularly in the wake of the impact of the Global Financial Crisis on the highly leveraged public finances of the neo-socialist profligate welfare states. The “unconventional” policy options emerged because it was felt that the conventional anti-cyclical weapons had run out. Central banks had pushed interest rates to zero and governments were drowning in debt caused by continuous deficit budgeting. Hence, a different sort of weaponry was introduced.
Unconventional policy instruments cover everything from negative interest rates to a change in inflation targets and the use of “quantitative easing” (QE), meaning the creation of money to buy assets. QE, coupled with reduced interest rates, became weapons of choice in several troubled countries. Raising inflation-rate targets is the latest addition to the unconventional policy arsenal.

The Bank of Japan (BOJ) pioneered QE in 2001 with the object of ending deflationary pressures. By buying increased quantities of securities in the market, through its “open-market operations” (buying or selling securities), the BOJ was aiming to supply more reserves in the hands of banks, keeping interest rates low and encouraging spending and investment which would boost the economy. Subsequently QE has come to include several forms of asset-purchasing programmes. One version is called “credit easing” which aims to support the economy by boosting liquidity and reducing interest rates when credit channels are clogged. The US Fed’s purchases of mortgage-backed securities fall into this category. A second type of asset purchase aiming to boost the economy without creating new money is the Fed’s “Operation Twist” where the Fed sells short-term debt and uses the proceeds to buy long-term debt. Giving investors cash for long-term debt held in their hands, should, theoretically, prompt them to invest more money in other assets. The third type of QE, the most straightforward, is meant to promote “portfolio balancing”. The investors sell securities to the central bank and then take the proceeds to buy other assets, thereby raising their prices. Lower bond yields encourage borrowing, helping investment and boosting demand. When the central bank holds onto the government debt it buys, QE supports the economy by cutting government’s borrowing costs and reducing the future burden of taxation.

The actual results of these unconventional interventions are, as yet, not entirely clear. Unconventional monetary tools had not been in general use before the GFC struck. It is not easy to isolate its impact after such a brief trial period. It is clear though, that QE exercises exert a downward pressure on interest rates and an upward pressure on equity price levels. But the critical question is whether these monetary quirks boost the broader economy.

It should be clear that these unconventional measures are not risk free. Some of the risk affects the functioning of financial markets in their role as suppliers of credit when interest rates are at zero levels. Another danger is the artificial lowering of the costs of government debts. With their borrowing costs reduced, governments have no incentive to cut their deficit spending habits. In addition, with their cost of borrowing so low, financial markets are deprived of their monitoring role on the maintenance of public finance discipline. If the financial market loses confidence in sovereign debt, the central bank inevitably also loses control over inflationary pressures.

Welfare State Excesses

The modern “welfare state” came about with a heavy political-economic price tag. The question of affordability was generally ignored as deficit spending became standard fiscal policy and practice. More and more countries started to finance running government expenses – including welfare transfer payments – with borrowed funds. These practices created unsustainable fiscal positions. The growing demands on the public purse outstripped the tax and income base of the “welfare state”. Governments were committed by their multi-year budgetary cycles to unaffordable benefits and entitlements to their citizens. They became totally dependent on over-sized, inefficient and ineffective bureaucracies. The “welfare” state became a “big government” state. Competition between political parties started to bid up benefits over time – with scant regard to affordability. Continued inflation-driven price rises across the board sapped economic efficiency and competitiveness which eventually caused economic growth to decline and unemployment to rise. Mountains of rising public debt also started to become a standard feature of public finance in social democracies: chronic deficit budgeting coupled with declining revenues.

When the Global Financial Crisis struck in 2008, all the Western social democracies retreated to more interventionist social and economic policies by way of massive “stimulation plans” and large-
scale interventions to rescue banks and large business corporations and special measures to
maintain employment levels. By the end of the first decade of the New Millennium, the rich
countries found themselves deeply entangled in the suffocating coils of the welfare state: over-
extended banks, over-indebted governments, overweight public sectors and too many citizens
depending on government support in proportion to those contributing to the public purse.

In view of the general reluctance to cut “mandatory” expenditures on entitlements and public sector
emoluments (the beneficiaries of which provide electoral support to left-wing political parties), the
focus turned to the productive elements of society to rescue the sinking economies by raising taxes
on incomes and other assets such as savings and retirement funds. It instigated a battle between the
productive and the redistributive forces in society with the latter counting on the majority support
of the beneficiaries of welfare state handouts.

In modern democracies, public policy making takes place in a highly politicised environment. Left-
ing political parties, cheered on by trade unions and affiliated economists (mostly academic) are
propagating more government involvement: deficit spending on welfare and unemployment
entitlements, demand enhancing stimulus packages, interest rate reductions, quantitative easing,
liquidity injections, tax increases on high income earners, expanding public sector employment and
emoluments, etc. Right-wing political parties, cheered on by business interests and affiliated
economists (mostly private sector or independent) are propagating a range of austerity measures
such as debt-reducing spending cuts, balanced budgets, deregulation, infrastructure directed
stimulus packages, tax concessions, limitation of welfare and public sector payments as well as
growth strategies based on entrepreneurship and business expansion.

Progressive Liberalism

The Economist, a newspaper that used to be a supporter of classical “liberal” economic policies, has
now switched to become a propagandist for the “progressive liberalism” of the American left. It
supports continued deficit budgeting, which is understandable in view of its ownership by major
bond market interests, without taking a stand on devising a credible exit strategy. It has taken a
populist stand against austerity measures, paradoxically juxtaposing austerity measures and
growth.

The Economist argued that austerity measures are ill-advised because it would lead to a decline in
GDP as a result of a decline in consumer spending. Hence, to avoid such a decline, governments
should continue to pump liquidity into the economy with the assumption that such liquidity would
somehow generate growth. The instruments of choice to finance continued government deficit
spending are bond issue borrowings and quantitative easing by central banks combined with
negative interest rate policy guidelines. The question of inflationary pressures is considered to be a
manageable problem in view of the under-utilised capacity present in most economies. In view of
the fact that in 2012 the US government borrowed around 30 cents of every dollar it spent, failure to
raise the debt ceiling would force spending cuts equal to an estimated 6 percent of GDP. The
Economist of January 12th, 2013, argued that failure to raise the American debt ceiling would send
the American economy into recession, depriving millions of people of meeting their own obligations,
setting off a chain of defaults and turmoil in the global financial system.

The solution offered by The Economist of 2nd February, 2013, to stimulate the British economy
(and supposedly also other inert economies) is to persuade the head of the Bank of England, Mark
Carney, to lift the nominal inflation target to a level that is at least 10 percent higher than today’s
2 percent. It should be done by increased “quantitative easing” (printing money to buy bonds) and
to push interest rates further down. They should guide people’s expectations of the future path of
inflation by credible promises to keep interest rates low and so boost the economy.

There are serious deficiencies in the solution proposed by The Economist. Its national accounts
optic only focuses on GDP, the “turnover” part of the national economy. GDP figures are simply
“snapshot” aggregates of monetary transactions, they do not provide qualitative information about the causal relationships and interaction of microeconomic determinants. It ignores important qualitative components of national accounts such as the assets and liabilities on the balance sheet, non-monetary activities, non-market transactions, quality improvements and other creative, value-adding, wealth-generating activities. Ironically, GDP figures do include welfare transfer payments which are not of a value-adding, wealth-expansion nature. Such transfers may actually divert available funding from wealth-generating activities. Distinctions must be made between transfers of wealth and wealth creation, between the quantity and quality of the growth measured, between costs and returns within the context of the timeframe analysed (long, medium or short terms).

The accuracy of GDP calculations – whether nominal or real – is at best highly questionable and often highly politicised. The GDP is not the only important barometer of a country’s economic health. GDP numbers can be dangerously misleading when they do not reflect the real strengths and weaknesses of an economy. It is essential to look at the balance sheets of national economies, of individuals and businesses – but particularly at the position of middle-class households – the backbone of free enterprise economies. It is the size and well-being of the middle class that determine the balance between consumption, saving and investment, the real tax base of government spending and the mainspring of the productive output of society.

Monetising Government Debt

It is important to quote The Economist’s challenged proposal verbatim: “By promising to keep monetary conditions loose until nominal GDP has risen by 10%, the Bank would provide certainty that interest rates will stay low even as the economy recovers. That will encourage investment and spending. At the same time an explicit target of 10% would set a limit to looseness, preventing people’s expectations for inflation becoming permanently unhinged. It is an approach similar in spirit to the Federal Reserve’s recent commitment not to raise interest rates until America’s unemployment rate falls below 6.5%.” (See The Economist, February 2nd, 2013, p.11)

This proposal raises more questions than it answers. Economists brought up to believe that inflation is a bad thing, choke at the idea of welcoming more of it as a policy objective. It is a slippery slope from QE to monetising government debt and then to sanctioned inflation. As soon as inflation expectations soar, the central bank loses control of price levels. Soaring inflation also discourages saving and investment which really are crucial propellants of growth. There is always a risk that inflation could get out of control. Runaway inflation is usually the result of fiscal excess, financed by printing money, or rigid labour markets which produce a wage-price spiral that is difficult to stop. Is it possible to anchor inflation expectations by setting an explicit inflation target as high as 12 percent? Normally interest rates on bank deposits need to be raised in line with inflation to encourage households to keep their money in the bank rather than speculate in property or shares. Otherwise negative real interest rates will inflate asset bubbles. How accurately can the nominal GDP be measured in the light of declines in productivity? If all the growth comes through inflation, is this a case of chasing “fools gold”? The most serious problem with artificial, manipulated “solutions” to major structural problems, is the possibility of unintended consequences.

Dangers of Sanctioned Inflation

In terms of monetary theory, inflation occurs when there is a more rapid increase in the quantity money than in output. In terms of real life experience on the community level, it means a general decline in the purchasing power of money because of the rise in prices of goods, labour, property – of everything. Sanctioning inflation raises serious questions.

Can the churn of inflationary pressures be roped in to unleash growth in a sclerotic economy? Is a little inflation a good thing for the economy – spurring growth momentum by enhancing confidence, rising expectations, promoting consumer spending and encouraging investment? Would inflationary pressures replace hoarding instincts with expectations of a better future: bidding up prices and
boosting production? Or is stripping inflation indicators from our national accounts akin to chasing “fool’s gold”? Can runaway inflation be avoided or tamed?

Economists generally consider wage and salary increases, higher food prices, higher energy prices and exchange rate depreciation as “cost-push” factors causing inflationary pressures on the supply side of the economy. The “demand-pull” factors precipitating inflationary pressures are increased money supply, generous credit extension, lowering interest rates and other measures fuelling consumer spending. Normally the interaction of these factors drives inflationary pressures along a circular path. Increased government spending financed by way of increased government borrowing through a central bank creates the expansion of the money supply. Pressure group action based on inflationary expectations lead to higher prices for labour and goods. So the inflationary pressures keep spiralling along, securely buffeted by inflation-indexed wage or salary increments and inflation-indexed government funded welfare entitlements. The pace of this spiral normally outstrips the pace of real growth in output which, if unrestrained, can escalate into hyperinflation.

In specific instances, several additional factors can impact on inflationary pressures: speculative capital flows, surges in government military spending, pressures from external creditors and trade patterns. Of special significance is the potent influence of human factors such as the social and psychological trauma generated by hyped-up inflationary expectations. It undermines confidence in the purchasing power of money to such an extent that it not only shipwrecks the economy, but also destroys the foundations of orderly civic life.

It is important to give careful consideration to the undesirable effects of inflation. Most importantly, it creates uncertainty that undermines business confidence and depresses investment in economic expansion. It alters the rewards accruing to the different types of economic activity (eg. consumers, producers, workers, savers, investors, entrepreneurs) leading to weaker output and lower real income levels. By eroding the purchasing power of money, it reduces the value of savings, fixed wages and salaries, fixed pensions and interest on fixed deposits. It induces redistribution from lenders to borrowers if nominal interest rates do not fully compensate for inflation. Volatility in inflation expectations creates uncertainty regarding economic prospects and hence militates against investment in productive assets. It enhances speculative activities which crowd out production.

For several decades some form of inflation targeting has been adopted as policy objective in most advanced economies. The main purpose being to reduce inflationary expectations by providing a credible anchor for economy-wide price and wage adjustments. It also provides a yardstick for assessing current economic trends and to promote transparency and accountability in the conduct of government monetary and fiscal policy. It also helps the general public to form more accurate expectations about inflationary trends. A low and stable rate of inflation creates a stable financial environment which must be considered crucial for sustainable growth and equitable distribution of resources.

It has become conventional prudent central banking policy to target inflation at fixed margins in order to make their currencies credible and their policies predictable, for instance keeping consumer prices growing at 2 to 3 percent per annum. For the past few decades this approach succeeded in taming inflationary pressures. But, per se, it failed to safeguard economies against serious decline. Some analysts argue that if central banks tweak interest rates to very low levels and at the same time use quantitative easing to bring more money into circulation, the additional liquidity would drive up the nominal GDP and thereby spur growth momentum. But many questions remain.

How do you put the inflation tiger back in its cage? A range of practical problems arise: selecting an appropriate ceiling, selecting a credible underlying price index, keeping a lid on public and private sector trade union demands for higher salaries and wages, keeping global financial interests and their destructive instruments under control, turning around a culture of short-termism, controlling cross-border liabilities, neutralising the reciprocal induction between wage inflation and price
inflation, managing the trade-off between supply-side and demand-side policies and between unemployment and inflation, monitoring the redistribution of wealth from creditors to debtors which can lead to populist battles between lenders and borrowers as voter identification moves away from the middle and closer to extremes. Unconventional policies will have to be disciplined by political realities.

The best example of how runaway inflation can turn into hyperinflation is the experience of Germany during the 1920s under the Weimar Republic. After the First World War, the victorious Allied powers used the Versailles Treaty to impose enormous war reparations debt on Germany. This created unsustainable current account deficits that were financed by the printing of more and more paper money. This process was accompanied by excessive public spending on generous public union wage settlements and insufficient tax collection. Although the downward slide of the mark boosted German exports, the inflationary pressures continued unabated until 20-billion mark notes were in everyday use. Eventually money – including all forms of wealth and income fixed in terms of marks – was rendered worthless. The collapse of the currency led to the collapse of the economy: soaring unemployment, poverty, moribund banking, social and psychological distress and, ultimately, political disorder and the beginning of the Great Depression era. Other countries where rampant inflationary pressures ultimately led to disaster during the past century include, inter alia, Argentina, Chile and more recently, Zimbabwe. Nassim Taleb of Black Swan fame, claims that our inability to predict outliers, implies our inability to predict the course of history.

The Potential for Currency Wars

The danger of currency wars emerges when all the struggling economies follow the same unconventional measures: suppressing interest rates while buying heaps of government bonds with newly created money (QE) inevitably results in putting pressures on currency values which, in turn, boosts exports and discourages imports. With all struggling economies explicitly following the same “inflation-driven” recipe coupled with exchange-rate adjustments, the relative international trade and investment pattern would remain unchanged with a “merry-go-round race to the bottom” in full swing.

In the world of monetary and fiscal policy the dividing line between rhetoric and active intervention is a faint distinction. It can easily unleash a currency war to attain or protect export markets. Aggressive monetary expansion by the USA, China, Japan and the EU, could all be justified as efforts to stimulate domestic spending and investment. But because lower interest rates usually weaken currency levels it also depresses imports. Countries with strong currencies like Australia, Switzerland, Japan and euro zone Germany, would all benefit from increased exports on the back of lower currencies. Hence, these countries would be tempted to look at capital controls (even concealed import control) to avoid currency speculation – or join the club which is inflating away their debt burdens. If all countries join the club, the underlying structural deficiencies would not be faced and resolved.

The Need to Scrutinise Monetary Pumping

The Economist, is an important source of current economic news around the world, but all readers should be fully aware of its editorial bias. It is not a source of expert knowledge about the fundamentals of economic growth. The “ghost writers” of The Economist may be experts on the political economy of finance and banking. But when it comes to generating economic growth they seem to rely on monetary pumping solutions. Economic growth problems are certainly not always and everywhere simply monetary phenomena. There are multiple causes and consequences that do not appear on the monetary radar or cannot be dealt with on the strength of the arsenal of monetary measures. Unconventional monetary policies must be scrutinised with a watchful eye.
Maintaining Prudent Monetary and Fiscal Policies

Prudent monetary policy aims at keeping prices stable just as fiscal policy should aim at reducing government debt to the lowest levels possible. There is nothing admirable about mountainous government debt levels. Supplying millions of dollars of reserves to banks and reducing interest rates to zero cannot force banks to lend or households and companies to borrow. For governments to spend borrowed money in order to spur consumer spending is not an alternative to growth through investment in productive assets. The only beneficiaries of loose monetary and fiscal policies are the bondholders and the manufacturers and exporters of low-priced consumer goods.

Scrutinising Deficit Budgeting

There is much controversy surrounding the relationship between deficit budgeting and growth. When an economy is at full employment deficit spending unleashes inflationary pressures. When an economy is in a contraction phase with high unemployment levels, the Keynesian approach supports the use of budget deficits to stimulate the economy by injecting demand. This in turn boosts output via the multiplier, resulting in increased capacity utilisation and higher employment. But the impact of deficit budgeting on the economy depends on the size of the deficit, how it is financed and how wisely the government of the day invested the extra spending. Different methods of financing the deficit have different outcomes: domestic borrowing can increase interest rates and “crowd out” private investments; money creation can lead to inflationary pressures; foreign borrowing is exposed to exchange rate fluctuations and interest rate hikes. If government spending is not efficient and does not add to growth, deficits should be avoided. Deficits and growth are negatively correlated because the negative “crowding out” effects of deficits tend to be stronger than the positive “crowding in” and increased aggregate demand effects. Consequently, deficits have generally been associated with low economic growth – either due to ineffective government spending or to ill-advised deficit financing.

The biggest danger in chronic deficit budgeting is that a government could find itself caught in a debt trap. This is a situation where a rise in the debt-to-GDP ratio can no longer be prevented by fiscal measures, eg. when the conventional deficit (total government expenditure minus total government revenue for any given year), as a percentage of total debt, is greater than the economic growth rate. High levels of accumulated public debt lead to high annual interest payments. If the debt is increasing faster than the rate of economic growth, the government will have to keep borrowing to service the old existing debt. Under such circumstances, a government’s ability to redeem old debt becomes highly problematic. When the government’s creditors (bond market) no longer believe that a government will be able to finance interest payments through higher taxation, let alone to redeem the debt, it will not be able to borrow. Government would be insolvent and the only way it can service or redeem its debts would be through money creation. When the growth of money supply gets out of hand, it results in hyper inflation.

Deficit spending on growth-inducing projects can be beneficial only insofar as the economic growth rate in the long run exceeds the interest rate. However, if the deficit spending is made on items that are not growth inducing (such as public administration and salaries), the interest rate could exceed economic growth and the country might find itself moving towards a debt trap.

Improving Productivity

The momentum of growth in a country is reflected in improvements in productivity. If the standard of living in a country is measured as the average consumption per capita, it implies that increasing the average production per capita holds the key to achieving higher living standards, generating higher economic growth, creating employment opportunities, ensuring competitiveness and curbing inflation.
Productivity is measured by the ratio between goods and services produced in the national economy, in an industry, or any individual organisation on the one hand, and the resources used to produce them on the other. It indicates the productive efficiency with which labour, capital, materials, technology and other inputs are combined and used to produce goods and services.

What drives productivity? What can be done to increase productivity? Historical experience shows that the answer to these questions lies in the intricate linkages between all the factors exerting an influence on the level of productivity in a society: technological progress, education, practical training, culture, demography, policies, institutions, political stability, non-disruptive labour relations, climate and the level of creative human dynamism as manifested in the constructive activities of people as economic role players as workers, savers, investors, managers, innovators and entrepreneurs.

The concept of efficiency is central to a proper understanding of productivity. Efficiency describes a situation where goods and services are produced at minimum cost or the least possible wastage of resources required for competitive productive output. Outputs must be maximised with given inputs and the input mix must reflect opportunity costs (i.e. the cost of foregoing alternative uses). Like inefficient, uncompetitive, unproductive companies, unproductive societies usually end up as losers. The ultimate dynamism that drives development is the inventiveness and creativity of people to improve their productivity.

**Entrepreneurship and Economic Growth**

Surprisingly, the causal relationship between entrepreneurship and economic growth has been relegated to the periphery of the theoretical concerns of economics as an intellectual discipline. Not surprisingly, even the question of economic growth does not occupy the centre stage of the theoretical models of mainstream economics. Hence the time is overdue for putting the interaction between entrepreneurship and economic growth back on the agenda of scholars, policy makers, government and corporate executives, public news commentators and enlightened citizens.

The role of entrepreneurship comes into play as the prime mover of the factors of production: labour, resources or materials, technology and capital goods. These elements of productive capacity must be put together and organised into producing units, with their productive efforts directed as successfully functioning operations. The business persons who are performing these functions are commonly called entrepreneurs. They perform the initiating, innovating and directing business roles to get things done in practically effective ways. The entrepreneur performs the key role in the rough and tumble process of establishing, running and expanding a business enterprise. Hence entrepreneurship is the primary source for providing the dynamism of economic progress.

In most countries small businesses are the main drivers of job creation. They are by far the most mobile, flexible and versatile form of enterprise. They are the least bureaucratic and most creative. They are adaptable by being quick to adopt new ways when conditions change. They use competition, customer choice and other non-bureaucratic mechanisms to get things done as creatively and effectively as possible. Everything possible should be done to promote the SME sector - access to financing, a flexible employment regime and a removal of burdensome regulatory obstacles to starting or expanding SME activities. The SME sector is the natural home of the entrepreneurial spirit of free enterprise. No entrepreneur can be sure that his or her planned investment will succeed, but if they do not take risks the other production factors (labour, resources, capital and technology) will remain idle. Optimistic people tend to gravitate to entrepreneurship. Although a large percentage of new small businesses fail in the first five years, it is the successful entrepreneur who knows how to calculate and manage risks.
Concluding Remarks

The processes driving economic growth and development are by no means fully understood - let alone effectively harnessed. That is why poverty remains such an obdurate problem in many parts of the world. Even in advanced economies many unresolved questions remain: some are related to the systemic monetary intricacies of the world of finance; others are deeply imbedded in the socialist mindset of the political culture of the welfare state financed by deficit budgeting. What will bond markets do when central banks start unloading the large holdings acquired over time? What can the banks’ creditors do to protect their investments/deposits from near-zero interest rates and floating exchange rates? What are the side effects of an extended period of negative interest rates? These are vexing monetary issues, but there are even more momentous fiscal questions to confront. Can the wealth redistributive sentiments and practices (liabilities) of the modern "transfer" state be tamed or counter-balanced by the more "productive" wealth creation elements (assets) of society? What is the inevitable outcome of chronic deficit spending? What is the optimal pace of deficit reduction? How can the seeds of economic growth be generated? Job-creating economic growth can certainly not be ignited by welfare-on-credit policies.

It is essential to realise that government per se cannot turn around the lack of economic growth – it can only alleviate or cushion the unfavourable effects of a severe downturn in the short term. Growth depends on the interaction of human creativity, technological breakthroughs and business activity – producing goods and services for which there is a realistic market, either nationally or internationally. Profitable business activity is the mainspring of all taxable income without which all the desirable public goods remain out of reach.

In order to repair their damaged public finances, heavily indebted governments will have to lay out a restoration strategy to tighten their budgets: cutting spending and raising as well as efficiently collecting taxes. Banks will have to be required to stick to their key role in financing individuals and companies to expand their business enterprises, to refrain from proprietary trading and speculative activities, and to keep adequate capital cushions to cover their lending activities. They should be reined in and forced to stick to their proper role: financing the real economy – not speculative financial bubbles and stratospheric incentives. Governments need to stay within the parameters of prudent budget rules: reducing the dead weight of public bureaucracy and balancing their budgets. These changes will have serious political, social and economic implications and will take decades to achieve. It requires national as well as community leaders with a long-term perspective – and electorates that give support to leaders who look beyond the next election.

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