The Advantages and Disadvantages of Money Financing Government Spending

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Abstract. A government funds its own expenditure by taxing its population. However, if it relied solely on money newly created by the central bank? What would be the advantages and/or disadvantages? This article analyzes this issue from multiple perspectives and provides reasonable suggestions for the government to better use policy tools.

Keywords: Money financing; Inflation; Sources of revenue;

1. Introduction

Money financing government spending is a controversial policy that could stimulate economic growth if properly managed but risks high inflation and instability if misused. Governments should not rely solely on money financing, instead using a balanced approach with responsible money printing, taxation, borrowing and alternative financing methods. International institutions can provide valuable guidance on policy approaches.

2. Money financing

Money financing involves central banks creating money to fund government spending. Proponents argue governments controlling their currency can never run out of money and should use taxes to regulate the economy, not fund spending (Bonizzi et al., 2019). They suggest money financing injects money into the economy, spurring demand and job growth (Galvin et al., 2020). This aligns with a Keynesian view, promoting government spending during downturns. For example, the New Deal implemented by the US government in the 1930s involved significant government spending on public works, creating jobs and stimulating growth. Estimates range from $32 billion to $50 billion between 1933 and 1940 (Olson, 2017). By 1933, 4,000 banks reopened and no depositor lost FDIC-insured money. Japan's 1990s response included large government spending on public works, financed by bonds purchased by the Bank of Japan, stimulating growth and job creation (Acs, 2006). Recently, the US, UK and others implemented large-scale fiscal stimulus programs financed by creating money, including relief for individuals, expanded unemployment benefits, and business grants, mitigating economic impact and supporting job growth (Caliendo et al., 2010; Lambovsk et al., 2021).

However, monetarists argue expanding the money supply too quickly spurs high inflation (Ofori et al., 2017). Zimbabwe, Venezuela and Argentina show the dangers of unchecked money printing. Zimbabwe's government printed money to fund deficits, causing 500 billion percent inflation (Haslam et al., 2014). Venezuela and Argentina's money printing to finance spending led to high inflation, shortages and recession (Coomer et al., 2011). The European Central Bank's (ECB) quantitative easing (QE) program involves the purchase of government bonds from the open market to inject more money into the economy and stimulate demand. While the program has been successful in boosting economic activity in the region, it has also faced criticism from various quarters, particularly regarding inflation and debt risks.

Critics argue that the ECB's QE program has already led to inflationary pressures, with some pointing to rising consumer prices in certain Eurozone countries (Vermeiren, 2017). For example, in May 2021, the annual inflation rate in the Eurozone was 2.2%, which was above the ECB's target of just under 2% (Lea, 2021). While rising inflation can be a sign of a healthy economy, sustained high inflation can erode the purchasing power of consumers and lead to negative economic consequences.
Another concern is the potential for QE to increase government debt. When the central bank purchases government bonds, it effectively finances government spending, which can lead to an increase in public debt (Bell, 2000). For example, in 2020, the ECB purchased over €1 trillion worth of government bonds, effectively financing government spending and contributing to an increase in public debt in countries such as Italy and Greece (Crosignani et al., 2020). Critics argue that this creates a vicious cycle, where the government becomes more reliant on the central bank to finance its spending, leading to even more debt (Stiglitz, 1998). This can lead to a loss of market confidence in the government's ability to manage its finances, potentially leading to higher borrowing costs and further economic instability.

International institutions like the IMF and World Bank need to provide guidance on using money financing sustainably, based on global experiences. For example, the Bank of England recognized quantitative easing to finance UK's COVID-19 stimulus could cause inflation and lost confidence, so it implemented policy controls to manage risks by buying bonds and monitoring inflation, adjusting policy accordingly. It maintained transparency, regularly communicating decisions and rationale to the public, updating on policy measures progress (Zhang et al., 2020). The World Bank emphasized careful debt management and targeted, temporary money financing for critical needs (Van Greuning & Iqbal, 2008). This aims for sustainable growth, not short-term fixes causing instability. Ghana, Indonesia and Kenya worked with the World Bank on a debt strategy focusing on debt sustainability and targeted, temporary funds (Ledgerwood, 1998). It includes improving debt transparency, strengthening management, and diversifying financing. The World Bank also provided support for investments in infrastructure, education, and healthcare to support sustainable development. The outcomes of Ghana, Indonesia, and Kenya's collaboration with the World Bank to develop debt management strategies that prioritize debt sustainability and targeted use of funds have been positive. As a result, these three countries have been able to access financing at lower costs and invest in critical infrastructure projects, such as the construction of new roads and bridges and made progress towards achieving sustainable development goals (Lewis et al., 2021). Lower financing costs mean that these countries have been able to borrow funds from lenders and investors at lower interest rates, reducing the cost of servicing their debt. By developing prudent debt management strategies with guidance from the World Bank, Ghana, Indonesia and Kenya have built market confidence in their ability to repay debts. This has made them attractive to lenders and allowed them to access funds at relatively low interest rates.

3. Other financing options

Governments also have various options for financing their spending needs, including borrowing, public-private partnerships (PPPs), asset sales, and money financing by printing money. Borrowing involves issuing bonds or other debt instruments to investors to raise funds for government spending. This method can be beneficial in the short term as it allows governments to access large amounts of funds quickly. Japan has historically relied heavily on borrowing to finance its government spending. The country has one of the highest debt-to-GDP ratios in the world, with its debt exceeding 200% of its GDP (Doi et al., 2011). Despite this, Japan has been able to borrow at relatively low interest rates due to its strong credit rating and the demand for Japanese government bonds. This has allowed Japan to finance its spending needs without resorting to money financing by printing money. PPPs involve collaboration between the government and private sector companies to fund and manage public infrastructure projects. This method can be beneficial as it allows governments to access private sector expertise and resources, while also spreading the risks and costs of projects across multiple parties. The United Kingdom has used PPPs to finance a range of public infrastructure projects, including hospitals, schools, and transportation systems. One example is the London Underground PPP, which was established in the 1990s to upgrade and maintain the city's subway system (Hoshi & Kashyap, 1999). While the project faced some initial challenges and criticism, it ultimately delivered significant improvements to the subway system and was considered a success. Asset sales involve
selling government-owned assets, such as land or buildings, to raise funds for government spending. This method can be beneficial in the short term as it allows governments to access funds quickly without incurring debt. Greece has resorted to asset sales to finance its government spending in recent years. The country has sold off a range of government-owned assets, including airports, ports, and electricity companies, to raise funds and reduce its debt levels. While the asset sales have helped Greece access funds quickly without incurring debt, they have also led to criticism and concerns over the loss of important public assets (Gabor & Ban, 2016). Additionally, there are concerns that the government may become overly reliant on asset sales to finance its spending needs, potentially leading to long-term financial instability. Selling off government-owned assets may lead to the loss of important public assets and infrastructure, which could have long-term consequences for the country. If the government becomes too reliant on asset sales to finance its spending needs, it may lead to a situation where the government has few assets left to sell, leaving it with fewer options to raise funds in the future. In 2015, the Greek government sold a majority stake in the country's largest port, Piraeus, to a Chinese shipping company in a deal worth around $440 million (Mitrović, 2014). However, the Piraeus port was a major gateway for goods entering and leaving Greece and played an important role in the country's economy. The sale could lead to the Chinese company gaining a dominant position in the Mediterranean shipping market, potentially undercutting Greek shipping companies and reducing Greece's influence in the region (Grammenos & Choi, 1999). Additionally, there were concerns about potential security risks associated with a foreign company controlling such an important port (Stulz, 2009).

Comparing borrowing, PPPs, asset sales, and money financing by printing money, it is clear that each method has its own advantages and disadvantages. Borrowing can provide access to large amounts of funds quickly, but can lead to high levels of debt and potentially higher interest rates. PPPs can provide access to private sector expertise and resources, but can be more expensive due to the involvement of private sector companies. Asset sales can provide quick funds without incurring debt, but can lead to the loss of important public assets and potentially lead to long-term financial instability. Money financing by printing money can provide quick funds without incurring debt, but can lead to inflation and harm a country's international standing (Bresser-Pereira, 2020). To address the challenges associated with each method, governments can consider a range of solutions. For borrowing, governments can carefully manage their debt levels and ensure that they do not become overly reliant on borrowing to finance their spending needs (Riding & Haines, 2001). Additionally, governments can work to maintain a strong credit rating and improve their fiscal management to ensure that they can access financing at reasonable interest rates. For PPPs, governments can ensure that they negotiate favorable terms and carefully manage the involvement of private sector companies to ensure that public interests are prioritized. Additionally, governments can work to improve their own expertise and capacity to deliver public infrastructure projects, reducing the need for private sector involvement. For asset sales, governments can carefully consider the assets that are being sold and ensure that they are not selling off important public assets that are needed for the long-term development and growth of the country (Khanna & Palepu, 1999). Additionally, governments can work to diversify their sources of revenue and not rely solely on asset sales to finance their spending needs. For money financing by printing money, governments can carefully manage their money supply and work to control inflation. This can involve implementing sound monetary policies, such as controlling the money supply and adjusting interest rates, to ensure that inflation remains under control.

4. Conclusion

Money financing is no panacea. Yet, when used judiciously, it can fund stimulus in times of crisis. The key is prudent governance and strict controls. Fiscal discipline must come first. No country can print its way to prosperity. Governments should rely on a balanced mix of responsible money creation, taxes, borrowing and alternative finance. Money creation holds promise and peril. When times are
dire, it can serve as a lifeline, funding critical needs as a last resort. But without safeguards, it leads to debt and inflation. Governments must keep a steady hand, using the minimum required before returning to fiscal ground. The rewards of wisdom are renewal; the penalty of folly, chaos. Leaders must choose wisely.

References


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