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## **Deficit financing in developing countries: Application and consequences**

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# Deficit financing in developing countries

## Application and consequences

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### Abstract

This article discusses briefly various aspects and forms of deficit financing in modern economies. It deals with deficit financing (i) within countries and (ii) between the member countries of the International Monetary Fund (IMF) and that institution as aid provider to a member in difficulty. In (i) it focuses mainly on the use of deficit financing as an instrument to part fund development and its consequences. In (ii) it sees deficit financing on a global scale, explains IMF conditionality and the sort of programs it envisaged the aid seeking members to follow; it presents illustration and critique of these programs. In conclusion it contains some observations including a few policy suggestions.

**Key words:** Deficit financing, Economic development; IMF conditionality; Arms race; Environment

JEL Codes: E 30 E31 F 35

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### 1. Introduction

In a generic sense, the term deficit financing has wide applications even extending to TV shows.<sup>1</sup> In economics, it connotes the amount by which a resource falls short of a given target; indicating most often a difference between cash inflows and outflows or the shortfall by which expenses or costs exceed income or revenues. In the context of developing countries here we use the term as referring to central government budgetary deficits.

According to Britannica.com “Deficit financing is a practice in which a government spends more money than it receives as *revenue*, the difference being made up by borrowing or minting new funds”. To have a balanced budget where revenues of a government match its expenditures *prima facie* seems an ideal fiscal policy. However, even as socio-economic dynamism may not usually allow a perfect synchronization of the two variables, there are occasions where governments are forced by circumstances to run into a surplus or a deficit but there are also reasons where they may find it expedient to deliberately make a policy decision to run a deficit or plan a surplus. This is true with reference to both crisis management and developmental efforts. History bears testimony on both counts.

It is well to note that the concept of deficit is not as simple as it looks. Various indicators of deficit in the budget are:

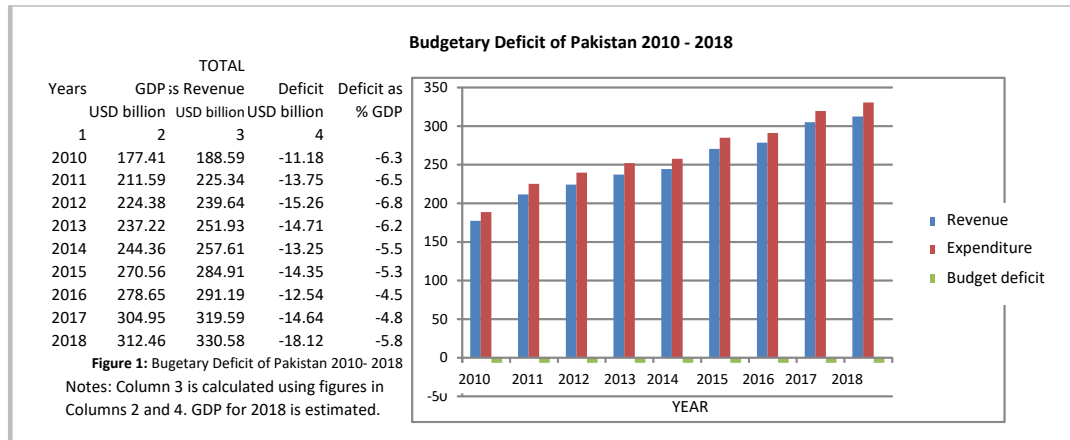
1. Budget deficit = total expenditure – total receipts
2. Revenue deficit = revenue expenditure – revenue receipts
3. Fiscal Deficit = total expenditure – total receipts except borrowings

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<sup>1</sup> Television deficit financing is the practice of a network or channel paying the studio that creates a show a license fee in exchange for the right to air the show. For more see Wikipedia [https://en.wikipedia.org/wiki/Television\\_deficit\\_financing](https://en.wikipedia.org/wiki/Television_deficit_financing)

4. Primary Deficit = Fiscal deficit- interest payments
5. Effective revenue Deficit = Revenue Deficit – grants for the creation of capital assets
6. Monetized Fiscal Deficit = that part of the fiscal deficit covered by borrowing from the Central Bank<sup>2</sup>

Deficit may refer to any one or more of the above versions in a description Thus, specification is always needed for clarity. Using the first concept may especially be deceptive. See for instance the following case of Pakistan on Budget deficit. Notice that in figure 1 revenue and expenditure are not much different and the overall deficit is small and fairly uniform. This is so because the details of income inflows and expenditure outflows *totals* are not available. Debt has swollen the receipts.



A definition revealing the correct measure of the gap is provided by fiscal deficit – total expenditure minus total receipt excluding borrowings. Thus, fiscal deficit represents government borrowings from the domestic market and is the best measure of budgetary health of a country.

The main factor that cause deficit in the budget is the revenue deficit - the difference between revenue receipts and revenue expenditure in an accounting sense.

The government can bridge budget gap from three sources:

- i. Mobilizing domestic savings through financial instruments like bonds or saving certificates. However, as the domestic savings pool is the same and its size is limited if government gets more, private enterprise will receive less. Aggregate mobilization and its impact on growth may be inconsequential.
- ii. Printing of new currency notes is an easier and cheaper – unlike bonds no interest is payable. But its perils are no less than its attraction. It carries inflationary potential that may tend to get out of hand apart from worsening income and wealth inequalities and depreciation of domestic currency.
- iii. The third source, and more commonly used source, in the modern era is to borrow from abroad mostly from the international financial institutions the IMF and the World Bank. But borrowings from these institution come with conditionality which the borrowing countries, we shall see, often find distasteful.

### ***Structure of the article:***

<sup>2</sup> See Indian Economy: <https://www.indianeconomy.net/splclassroom/what-is-deficit-financing-what-are-the-different-types-of-deficits-in-the-budget/>

This article is spread over four sections including the introduction. In the following Section two we explain how deficit financing defined as a budgetary gap can be used as an instrument to mobilize resources. We show the contribution of deficit financing to the achievements of the first two five year plans of India. Section three raises the discussion to global level. It shows how countries fall into deficit to meet their financial obligation and seek funds from the IMF of which they are the members to look back in hours of need. Here, we explain the term conditionality that has to be met for the grant of IMF assistance needed. We discuss the nature of programs falling under conditionality and evaluate them from the aid recipients' viewpoint. The final Section contains a few concluding observations and suggestions.

## 2. Examples from history

### A. Crisis management:

Individuals can and do indulge in deficit financing but it essentially is a macroeconomic concept strictly falling in public policy domain. J. M. Keynes vigorously advocated using deficit financing as an anti-crisis measure when 1930s Great depression peaked and the wage rigidity for downward adjustment being the obstacle in the way of public remedial action (Keynes *General Theory* 1936).

In the 1930s crisis deficit finance was needed to revive the falling demand to cheer the gloomy markets; it created what Keynes termed as *effective* demand. To this end, he advocated to employ people even to dig holes in the ground to put money in their pockets and to employ them to fill the same holes if needed and until needed. Thus, it was deficit financing mostly via printing money and was *internal* to governance. It was endogenous to the country's macroeconomic system

This changed drastically during great turmoil the subprime crisis of 2007 unleashed across countries for years. The locus for deficit finance shifted from revival of aggregate demand to the bailout of failing and falling of the giant financial institutions – banks, insurance companies and funds. The need was *external* to the macroeconomic systems. The economy was no longer the recipient; it was the giver to the players of the financial markets to save them from The total annihilation of their own creation; thanks to their greed and over exuberance. They were running into huge deficits to meet their liabilities. This deficit was met by public funds.

A study by the Government Accountability Office (GAO) puts the 2008 financial crisis cost to the U.S. economy at more than \$22 trillion. It further observes that the crisis was associated with not only a steep decline in output but also with the most severe economic downturn since the Great Depression of the 1930s," The agency said the financial crisis toll on economic output may be as much as \$13 trillion -- an entire year's gross domestic product. Furthermore, paper wealth lost by U.S. homeowners totaled \$9.1 billion while economic losses associated with increased mortgage foreclosures and higher unemployment since 2008 need to be considered as additional costs.<sup>3</sup>

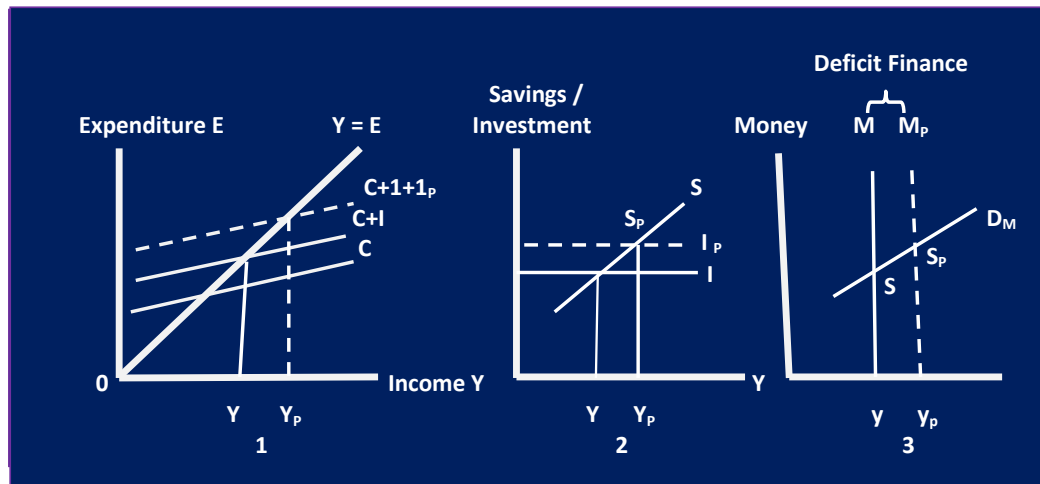
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<sup>3</sup>Melendez, E. D of Huff Post US: [https://www.huffingtonpost.in/entry/financial-crisis-cost-ao\\_n\\_2687553](https://www.huffingtonpost.in/entry/financial-crisis-cost-ao_n_2687553) It must however be noted that the costs exclude those in terms of output and wealth loss that the crisis inflicted on millions it impacted across the globe.

How the crisis affected the Islamic financial institutions is a moot point even as an IMF survey lauds Islamic banks as being ‘More Resilient to Crisis’<sup>4</sup> As a matter of fact, literature is full of praises for Islamic finance on that count ascribing the achievement to two factors: Islamic finance maintains its links with the real economic activities and is based on the principle of risk sharing. The claim of observed immunity might have elements of truth but it probably is being over stretched. We have shown elsewhere that some Islamic banks and financial institutions did come to grief during the crisis and that the crisis overtook them indirectly through its depressing impact on macroeconomic variables – savings, investment and output - across countries. Thus, one must take the superiority claims with a grain of salt.<sup>5</sup>

**B. Deficit financing and development:**

It may be a surprise for some to know that deficit finance can be used and was in fact used in India as a tool to mobilize resources, especially during 1950s. The financial resource estimate for the First Five Year Plan (1951-1956) from taxation and borrowings at the centre and state levels put together showed a substantial shortfall from the requirements to meet the growth targets. This brought under consideration the possible use for development of a third source - deficit financing. The term denoted the direct addition to gross national expenditure through budget deficits irrespective of being on revenue or capital account. In essence the policy implied government spending in excess of revenues it collected from taxation, earnings of state enterprises, loans from the public, deposits and funds and other miscellaneous sources. The government could cover the deficit either by running down its accumulated balances, or by borrowing from the banking system – mainly from the



**Figure 2:** Macroeconomic savings gap for deficit financing

<sup>4</sup> IMF Survey on line: <https://www.imf.org/en/News/Articles/2015/09/28/04/53/sores100410a>

<sup>5</sup> See Hasan, Zubair: *Risk Sharing – the sole basis of Islamic finance? Time for a serious rethink*, KAU Journal: Islamic Economics, Volume 19, No. 2, section5, pp. 30-31

Central Bank of the country. Thus *creating money* as Figure 2 shows.<sup>6</sup> Deficit finance at rupees 2900 million provided 7.5% of overall financial outlay (14% of public sector outlay) for the plan over the five year period.

To keep the inflationary potential of deficit financing in check, operations like taxation and saving schemes were launched for mopping up extra money generated. Price control and rationing of essential goods were put in place. There is no progress without tears, was the slogan. The nature was merciful; monsoon rains for three consecutive years was good putting a tab on the prices of food grains and raw materials. The plan achieved its targets beyond expectations. The economy was stable and kicking.

While the First Five Year Plan (1956-1961) was designated largely to agriculture and irrigation; the Second Five Year Plan aimed at mainly on industrialization and transportation, though not to the neglect of agriculture. Public sector expansion was the priority as before in view of the declared objective of establishing a socialistic social order. Emboldened by the success of the First Five Year Plan, the size of the Second Five Year Plan in outlay terms was raised to rupees 480 billion of which no less than rupees 120 billion or 25% was the deficit finance component.

The two plans raised the GDP of the country at constant prices by 42 % and per capita income by 18% despite rapid increase in population. 30 years were also added to the life expectancy of an Indian. Laudable achievements these were wherein deficit financing contributed significantly as a tool for resource mobilization.

However, this merry march could not continue due to massive diversion of resources from development to defense after the 1962 Chinese attack across the North-Eastern border of the country.<sup>7</sup>

### ***C. Deficit finance and inflation:***

Deficit finance is a double-edged weapon that cuts both ways. If it facilitates resource mobilization say for development it can initiate and fuel inflation as well. Deficit finance adds to money supply and if the saleable output increases at slower rate additional money is not fully absorbed and must result in inflationary pressures via increase in demand. The situation aggravates if money adds to speculative activity. To ward off such possibilities effort is made to pull back the created money into savings fold accompanied with a well managed system of price controls and rationing

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<sup>6</sup> This explanation of deficit finance that the Planning Commission of India provided in paragraph 35 of the First Five Year document in 1951 is comprehensive highlighting its nature possible sources, measurement and net outcome – money creation.

<sup>7</sup> It was debated for some time as to why did Chinese if they eventually had to withdraw voluntarily after reaching Tezpur in the Assam valley. Ayub Khan the ex-president of Pakistan provides the logic behind the action in his book *Friends not masters*. He thought that West had started comparing economic progress of democratic India with communist China. The latter attacked India to make them spend on arms too.

of wage goods. But such systems seldom remain clean; they more often than not give rise to corruption and black markets. Inflation beyond a limit alters the relative price structures to the disadvantage of weaker social groups; it perpetuates income and wealth inequalities generating social unrest. Thus, deficit finance has to be used, if at all, with utmost caution.

### 3. Deficit country bailout

So far we have been with deficit financing on a small scale – its use within a country between governments and economic entities for various purposes. However, a much bigger drama of deficit finance is staged between a country and the international community operating through the International Monetary Fund (IMF) established for helping member countries out of financial deficits, if they land in, by granting loans under a programmed spelling under the terms of what is popularly known as conditionality.

Countries may land into difficulties for a variety of reasons mostly of their own making – corruption and/or macroeconomic mismanagement, civil disturbances, in-fights, uncalled for wars or natural calamities. Whatever be the reason, in essence the country is not able to escape default on its external commitments and liabilities unless helped to come out of the impasse. The last source for succor is the IMF. The help seekers are usually the developing countries while the funds the IMF provides to bridge the deficit come from the developed countries, the institution acting as their collective *mahajan*. IMF bailout loan is no charity; it has to be paid back in the common pool so that others in need could be helped.

The conditions IMF imposes are therefore tight. At times these are so tight that they tend to make the patient bleed white. The IMF Greece bailout is a case in point. The pending case is of Pakistan who has approached the fund for help under compelling economic chaos. The country is neck-deep in foreign debt mostly related to China Pakistan Economic Corridor the CPEC involving \$60 billion Chinese investment. Political economy seems clouding this amount.<sup>8</sup> The IMF has asked Pakistan to be transparent in revealing the details of the Chinese debt before its application to meet the deficit could be considered to which the country has agreed. Interestingly, China insists that the term of their debt to Pakistan must be fairly evaluated. Let us have a brief look at the manner the IMF conducts its bailout business and what repercussions it has on the borrowing nation.

#### ***(i) The IMF Conditionality:***

When a country approaches the IMF for help, its government agrees to adjust its economic policies to overcome the problems that led it to seek financial assistance

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<sup>8</sup> US opposes IMF bailout for Pakistan. They apprehend that the IMF loan may be used to pay off the Chinese debt. | The Express Tribune <<https://tribune.com.pk/story/1770653/1-us-opposes-imf-bailout-pakistan/>>

from the international community. The terms on which IMF agrees to financially help a country in trouble are collectively called the IMF *conditionality*.

The IMF conditionality broadly consists of two parts: the design of its support programs and the tools for monitoring the progress of their implementation. In principle, the programs are designed in consultation with the country seeking help. They essentially aim at resolving the balance of payments problems of the country avoiding measures harmful to the national or international prosperity. The monitoring measures at the same time oversee that resources the IMF commit to help the country remain safe. The essence of conditionality is to help resolve the country its problems such that it is in a position to repay the IMF loan.

The member country seeking help has primary responsibility for selecting, designing, and implementing the policies that will make the IMF-supported program successful. The program is described in a letter of intent (which often has a memorandum of economic and financial policies attached to it). The program's objectives and policies depend on the country's circumstances. But the overarching goal is always to restore and maintain the balance of payments viability and macroeconomic stability while setting the stage for sustained, high-quality growth and, in low-income countries, for reducing poverty.<sup>9</sup>

For ensuring progress in program implementation and to mitigate risk to IMF provided resources, the loan granted is released in installments linked to demonstrable policy pursuit. The progress is reported to the IMF Executive Board for review to see if the program is on track or modifications are needed for achieving the prescribed objectives. The review approvals are based on various policy commitments agreed with the country authorities.<sup>10</sup>

### ***(ii) Programs evaluation***

A typical IMF program focuses on correcting the balance of payment problems of a country seeking a bailout. Its main components are devaluation of domestic currency, liberalization of trade and expansion of the private sector. The three elements are assumed as mutually compatible and each supportive of others.

Currencies of developing countries are mostly over-valued relative to the IMF based parities.<sup>11</sup> The depreciating currency of these countries bears testimony to this statement.<sup>12</sup> The assumptions supportive of devaluation are that the act would make

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<sup>9</sup> Apparently this looks fair and nice However,, the needy nowhere to go has to sign on dotted lines. The free enterprise commitment of these programs is obvious. The beggars cannot be the choosers.

<sup>10</sup> For details see IMF Conditionality March 6, 2018:  
<https://www.imf.org/en/About/Factsheets/Sheets/2016/08/02/21/28/IMF-Conditionality>

<sup>11</sup> In fact, most developing countries find it advantageous to keep if they can their currencies over-valued as their exports are not usually price elastic; they get imports cheaper for defense and development.

<sup>12</sup> Note that the depreciation of a currency is not the same thing as its devaluation. Depreciation is a market phenomenon where on currency depreciates relative to some other. Devaluation is the reduction in official



domestic goods cheaper for the foreigners boosting exports, and imports costlier reducing their inflows. This combined with liberal trade policy would help correct the adverse balance of payments the borrowing countries suffer from. Since public enterprises lack motivation, are prone to corruption and slow to act, encouragement to privatization of the economy may be an added advantage for program implementation. The question is how valid are these assumptions?

The catch in this argumentation is that it ignores the issue of export and import elasticity. Most developing economies are exporters of primary products where price elasticity is generally less than one. To get the same revenue as before, the country must export more in physical terms than before. This apart, would they in all cases have an exportable surplus ready at hand? On the other hand, imports of these countries are even less price elastic. They import food grains to feed the teeming masses, machinery and spares for their upcoming industries and technical knowhow. They cannot cut down much on such survival needs. Devaluation for them ipso facto means – continue imports at the same even increased level and pay more. Debt servicing also becomes costlier. Corruption is not the monopoly of the public sector. Private sector across the globe is showing itself no less corrupt if not more if what caused the 2007 subprime debacle and what followed in its wake is an indicator. Thus, the IMF bailout programs may not always or entirely prove conducive or helpful to the seekers.

In the year 1966, the currencies of 34 countries, mostly developing, went down on their knees under IMF programs. The Indian rupee was one of them; 35% being the devaluation. The University Grants Commission (UGC) same year organized, probably under government instructions, a seminar at Meerut entitled ‘ Foreign aid in our plans’ One of the specified topics was – devaluation and foreign aid. The above arguments were then outlined by the author in his paper on the topic. Later developments vindicated the position taken. Food grains imports created payment problems as the Americans expressed their inability to export wheat to India and the USSR had to help the country out of the predicament with a wheat loan.

The episode also brought to the fore another danger of the devaluation led bailout. Many developing countries start manufacturing products as automobiles having a certain percentage of imported components. This percentage is gradually substituted with local makes until one looks back with satisfaction that a tiny fraction of the product is now imported. Many such industries find self at the sea, as we experienced in India, if that crucial fraction becomes unavailable due to the IMF program or its cost becomes prohibitive due to devaluation. Billions worth of plant investment stands still, rather hostage to foreign dictates.

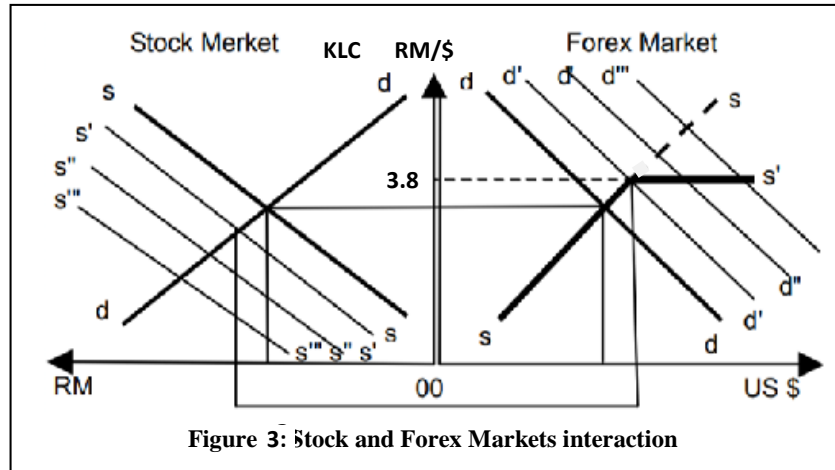
More recent comparative study of two countries dealing with financial crisis of 1997-98 would be both instructive and interesting. It was the massive short-term Western capital flight from South-East Asia that had then hit the flourishing

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equivalence in gold at the IMF. Thus, two currencies cannot depreciate relative to one another but both can devalue together at the IMF.

economies of the region. Originating from Thailand, the contagion spread fast to other nations including Malaysia even as her economic fundamentals - contrary to the IMF assessment - were sound. Anyway, Thailand sought relief from the IMF while Malaysia eventually took a different route – they resorted to the imposition of exchange controls.<sup>13</sup>

In a small open economy, like Malaysia, the flight of short-term capital during the 1997-98 crisis lead to a sequence of events involving the selling of shares by foreigners in the stock market and taking the sale proceeds to the currency market for buying the US dollars to be taken out, the process leading to a down turn in both the markets. The short-term capital account of the country recorded an extra-ordinary net outflow of funds – RM 11.3 billion in 1997, and 21.7 billion in 1998 (Bank Negara Report 1998, p.43). Probably bulk of this amount left the country during the sixty-three weeks of the crisis period. Figure 3 depicts the interaction between the stock and foreign exchange market on the basis of our hypothesis, and is self-explanatory.



To repeat, the sequence palpably was to sell equity in the stock market and use the released ringgits for buying dollars in the foreign exchange market to be taken out.<sup>14</sup> The run on Ringgit - the Malaysian currency - led to a rapid depreciation (35%) in its value vis-à-vis the US dollar in months. Action had to be taken to stem the rot. For some time the country experimented with raising the interest rates to arrest capital flight but it did not work. Eventually, Mahathir Muhammad that astute Prime Minister of Malaysia who knew that there was nothing wrong with the country’s economy, took the monumental decision to impose, despite internal dissention, exchange controls rather than go to the

<sup>13</sup> See Hasan Zubair (2002): *The 1997-98 financial crisis in Malaysia: causes, response, and results*, Islamic Economic Studies Vol. 9, No. 2, March in defense of Malaysian action

<sup>14</sup> Here is an illustrative remark from Stiglitz: “Even if the East Asian countries had sound financial systems and good policies, the crisis could still have occurred because of the runs on currencies and vicious cycles to which they give rise. All you need is instability in beliefs” (1998, 13)

IMF for bailout. The exchange rate was stabilized at RM 3.8 to a \$. The events unfolding in subsequent months vindicated the validity of his decision.<sup>15</sup>

Malaysia came out of the turmoil unscathed and faster than others in the region. The Economic and Social Survey of Asia and the Pacific of the UN released on April 4, 2001 declared: “The experience of Malaysia suggests that capital controls can help stabilize an otherwise difficult situation”. IMF now envisages imposing fewer conditions on loans granted to developing countries so that they may have greater freedom to design their recovery plans in the future. The IMF made this announcement later in March 2013.

In contrast, after paying the last installment of the IMF loan in 2013 the Thailand Prime Minister vowed to never seek IMF bailout in future.<sup>16</sup> The lament of the prime minister was not without reason. The IMF conditionality framework *has* some inbuilt difficulties for the borrowers. The important ones are as follows.

1. Reduce borrowing – increase taxes cut expenditure.
2. Raise interest rate to stabilize currency
3. Let failing firms liquidate
4. Initiate structural changes including increased privatization, deregulation and reduction in corruption as well as in official delays in decision making.

The difficulty is that these conditions not only betray an ideological bias,<sup>17</sup> the insistence on structural adjustment and the macroeconomic interventions they require often make the situation worse for the recipient country, not better. This was the experience not only of Thailand but also of Indonesia and other aid receivers during the 1997 crisis. As a result of enforcing tight monetary regimes pursuant to the IMF conditions purportedly meant to reduce budget deficit and stabilize currency, problems aggravated. Contrary to their objectives the enforcement tended to slow down growth and spread unemployment in the aided countries. What happened on the exchange rate front? Even as the IMF aid programs’ conditions have not understandably remained unchanged over time and space the departure in the case of Kenya concerning the rate of exchange during 1990s is of interest. The IMF made the Central Bank of the country remove all restrictions to allow a free flow of capital in or out of the country. The critics validly argue that the decision

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<sup>15</sup> The present author has suggest a package of measures involving exchange control to remedy the situation in a seminar at the IIUM in June 2008 when the crisis was in the making. He later defended the action against criticism tooth and nail. See Hasan Zubair (2003): *The 1997-98 financial crisis in Malaysia: causes, response, and results – a rejoinder*, Islamic Economic Studies Vol. 10, No. 2, March.

<sup>16</sup> Thaksin made the declaration on the national TV on August 1, 2003 after the last installment of debt to the IMF had been cleared two years ahead of time.  
<<https://assassinationthaksin.wordpress.com/2013/03/24/thaksinomics-the-hero-of-thailands-financial-crisis-or-populous-madness/>>/

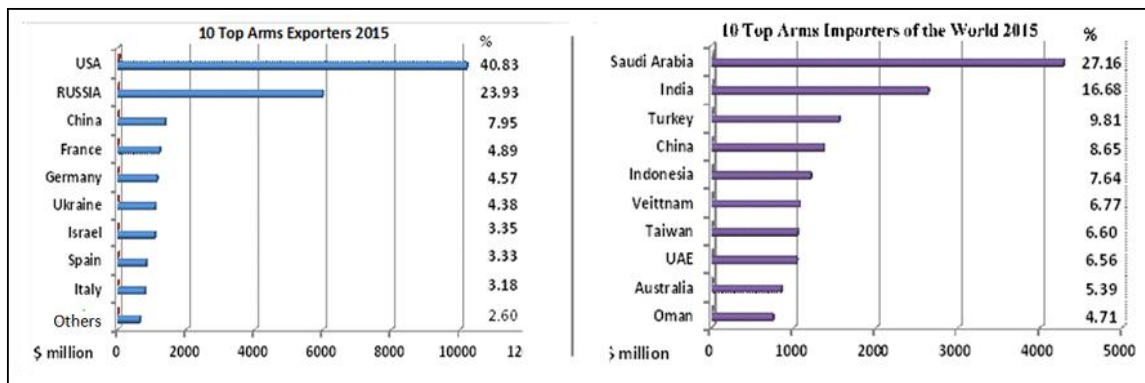
<sup>17</sup> The free market advocates criticize the IMF for the interventionist component in its relief program and demand that the institution should not interfere in the free play of demand and supply even in foreign exchange markets. Liberalization may especially be damaging in the least developed economies.

went against the country as it allowed the politicians to take their ill-gotten money out of the country.<sup>18</sup>

***(iv): Demonstration Effect and arms race***

The vital question is: why do developing economies fall into external debt traps? Some reasons are obvious. There is a demonstration effect. Expanding means of transportation and communication, especially the internet resources and global advertising, have really converted the planet earth into a global village. The living standards and material affluence of the West coming into observation of people and leaders in developing economies awaken in them the urge to copy. In their eagerness to imitate the society is more and more divided into haves and have-nots. The upper class is created in a good measure through corrupt and exploitative practices to finance lavish living. Foreign loans taken in the name of development projects in part land in Swiss or Panama accounts of leader and the affluent. Can this all be stopped so that money is spent where it is meant to be spent? Imran Khan is trying to do it for building a Pakistan of his vision. Either he will soon give up or will achieve a miracle.

There is a wider and more sinister angle to the developed and developing economies divide in the world – the bloody wars – there is a chain from Vietnam to Afghanistan.



**Figure 4:** 10 top global Exporters and Importer of arms in 2015

Flourishing economies have been destroyed on the whims and imaginary fears of the powerful to attain more power. Arms trade is the most lucrative of all businesses; it values profit, not blood. A mere look at Figure 4 will make one understand the economics of war and peace.

Modern warfare is also a major contributor to international pollution. As per estimates released by the Council on Foreign Relations (CFR), in 2016 alone the US administration rained at least 26,171 bombs on seven different countries, averaging three an hour every day, every month, over the entire year. The figures, says the report, are relatively conservative, meaning the number of bombs dropped in 2016 could have been much higher. The report concludes that there

<sup>18</sup> For more case studies in an interesting evaluation of the IMF conditionality programs see the work of an independent researcher, Shula, Kampamba (January 2012): *Critique of IMF loan conditionality*, [file:///C:/Users/ZUBAIR%20HASAN/Documents/\(PDF\)%20Critique%20of%20IMF%20Loan%20Condi%20onality.html](file:///C:/Users/ZUBAIR%20HASAN/Documents/(PDF)%20Critique%20of%20IMF%20Loan%20Condi%20onality.html) It is a well documented comprehensive research article.

was no legal validity for this action save through stretching the interpretation of an old authorization for the use of military force. Further, Trump admits that costly wars are responsible for the current economic troubles of the US, not the trade with Beijing.<sup>19</sup>

Thus, so long as wars – hot or cold – continue to fuel armament industry the distinction between developed and developing economies will continue. The desire of the less privileged to “catch up with them” will continue creating deficits providing business to the IMF – the world *mahajan* – the great money lender.

#### **4. Concluding remarks**

Deficit finance refers to the act of meeting the shortfall in an amount of money from a specified target. For example filling the gap caused by lack of income to meet expenditure actual or targeted. It may also refer to meet deficiency in volume of assets to meet given liabilities measured in money. Thus, for a country, there can be a deficit in its balance of payments to be filled by advances from an external agency such as the IMF. We have dealt with both these cases and related issues in this article. We have shown how a country can use deficit finance as a tool for mobilizing physical resources to support plan targets.

On the global level, countries can run into massive debts which they at some stage find to have become liabilities they cannot meet on their own and approach IMF for assistance with a loan to bridge the gap. This assistance comes with what is known as conditionality. We explained the content and aspects of conditionality and the sort of programs demanding the structural changes it deems fit to restoring to health of the aid recipient economy and ensuring simultaneously the safe return of its loan to the country. We find that the IMF conditions not only have pronounced free market ideological tilt, they are designed in oblivion to the socio-political environs of the recipient country and unduly intrude into its sovereignty. They tend, at times, to create more problems than they resolve

Finally, Sharia scholars invariably consider a writing on an economic topic incomplete unless its Islamic support or implications are not spelled out. deficit finance would not be an exception. To provide a religious angle to many post Islam modern developments like deficit financing falls in this category. The Qur’an refers in Sura Yusuf to save out of the current surplus crop to fall back upon to meet the deficit forecast for the years ahead. Beyond this there is nothing in our view that can be related to current practice of deficit financing. We accept it until it is convincingly shown going against the Islamic law or custom in the same way as we have accepted not a few things in Islamic banking and insurance.

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<sup>19</sup> Former French Prime Minister Dominique de Villepin, speaking at the Global Leadership Forum organised by Sri Sri Ravi Shankar’s Art of Living Foundation, said, ‘Military intervention is stupid, war on terrorism is stupid. The global leadership has been wrong in responding to Afghanistan, Iraq, Libya and Mali.’ He said that the world needs new weapons of peace and not weapons of war (*Times of India*, 13 March 2016).