

Dealing with Debt

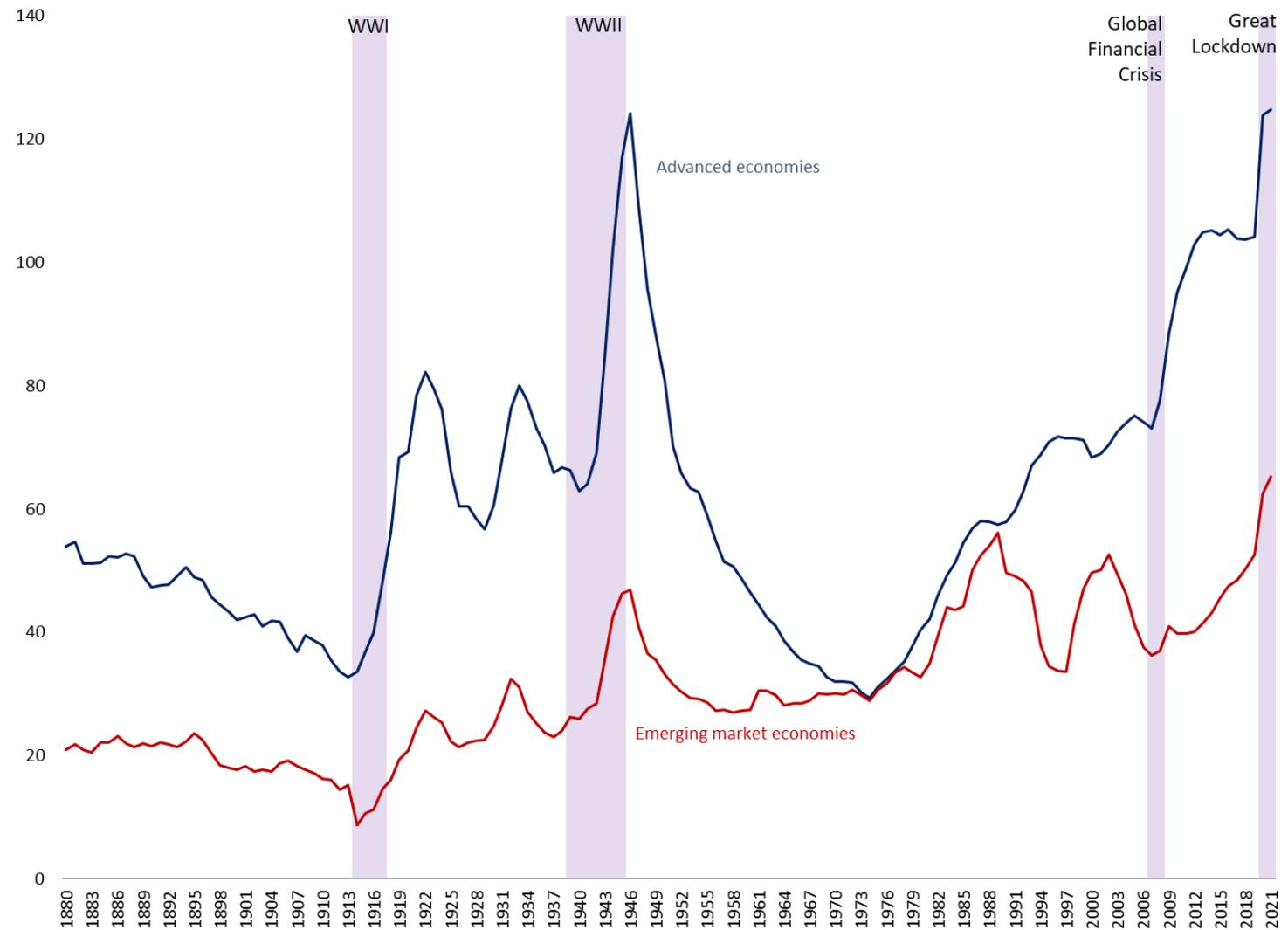
Facts, Challenges and Solutions

Ludger Schuknecht

Lee Kuan Yew School of Public Policy

Advanced country public debt at same level as in 1945

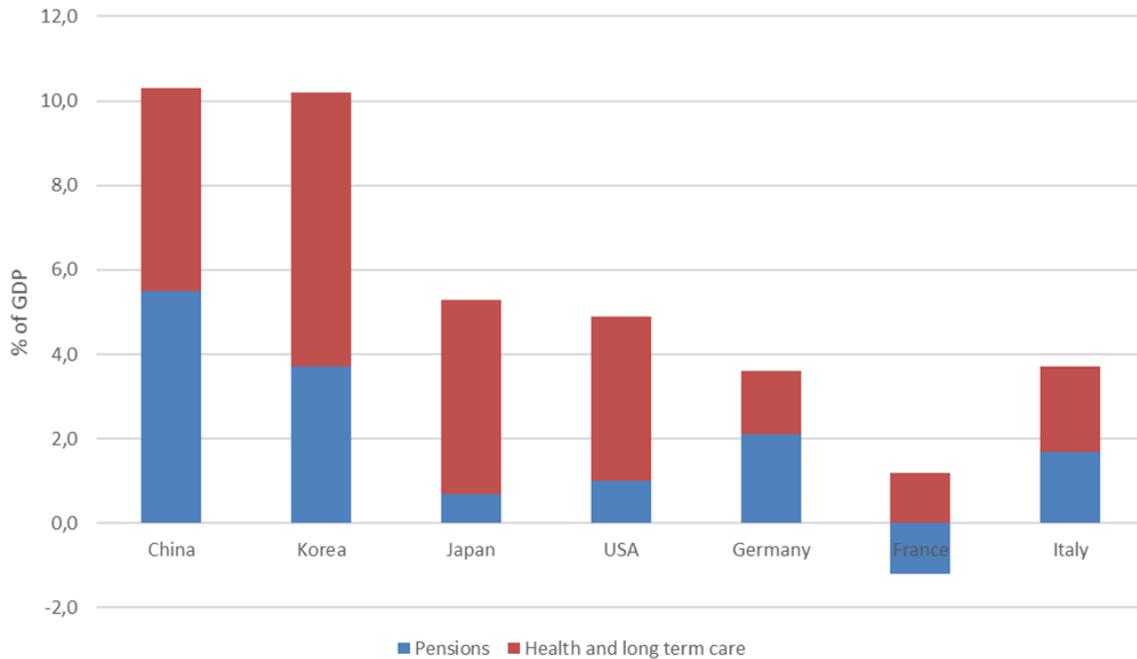
- Highest for G7 at 140% of GDP
- Also record debt in EMs, more „Keynesian“
- Plus other risk factors
- No sense of urgency



Source: IMF Fiscal Monitor, Oct. 2020

Plus major fiscal risks from population aging and potential financial crises

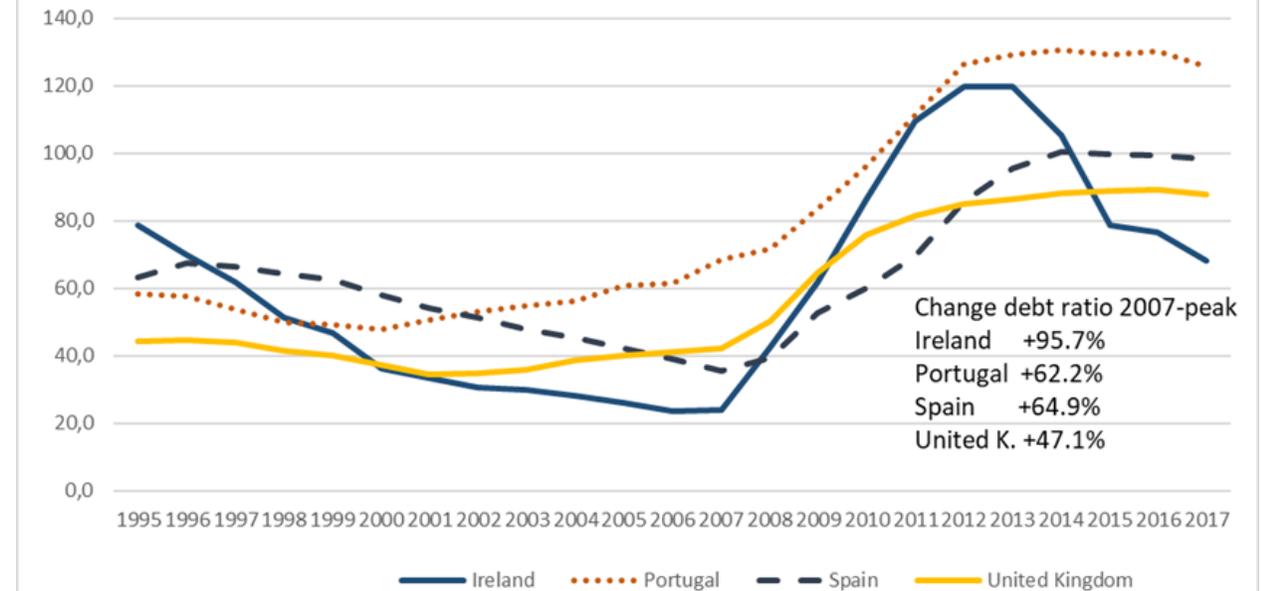
Chart 3.3 Projected Increase in Ageing Related Spending 2015-2050



Sources: EU Ageing Report 2018; OECD; IMF.

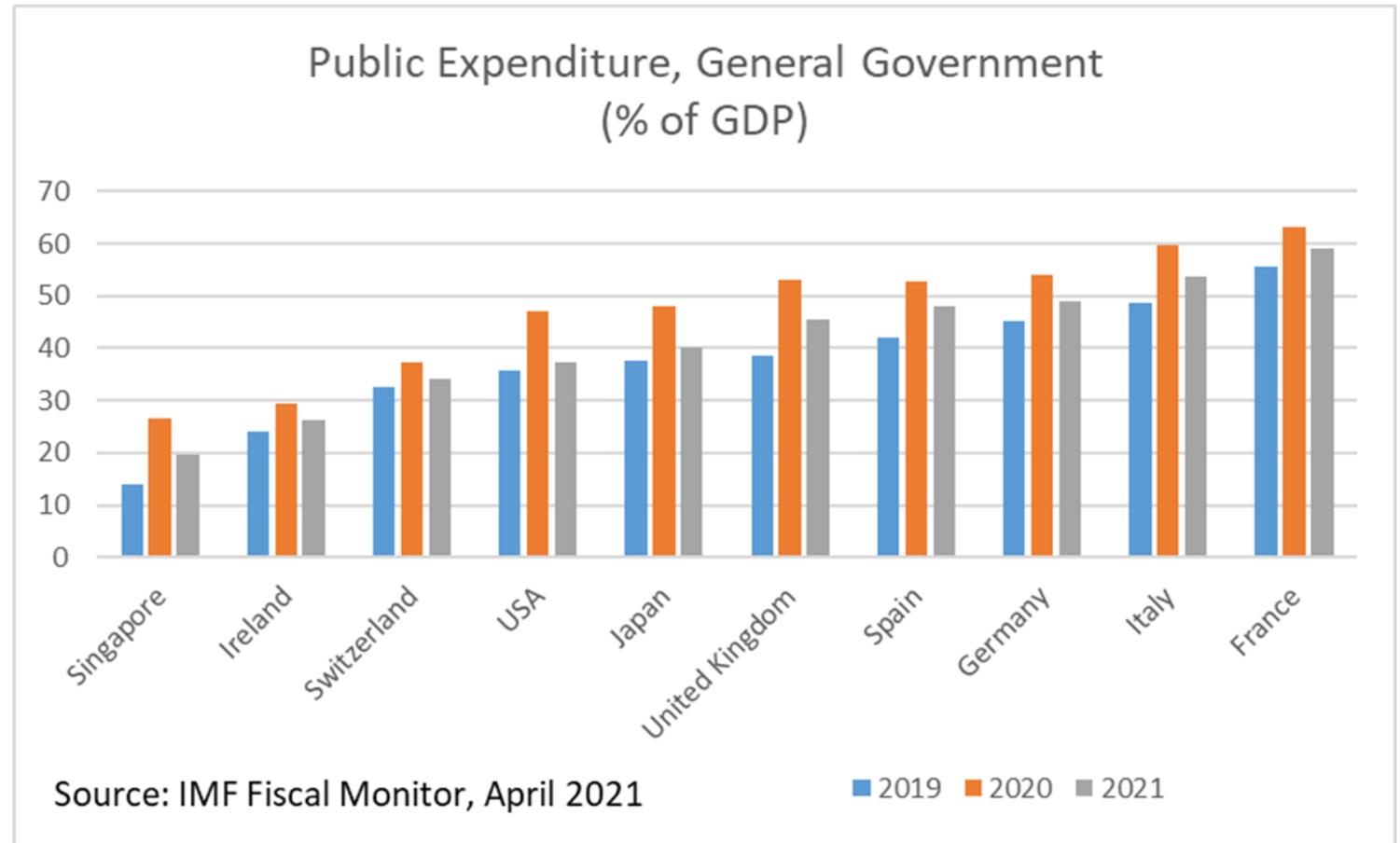
Debt increase during global financial crisis

Chart 9.12 Public Debt in Ireland, Portugal, Spain and United Kingdom, % of GDP



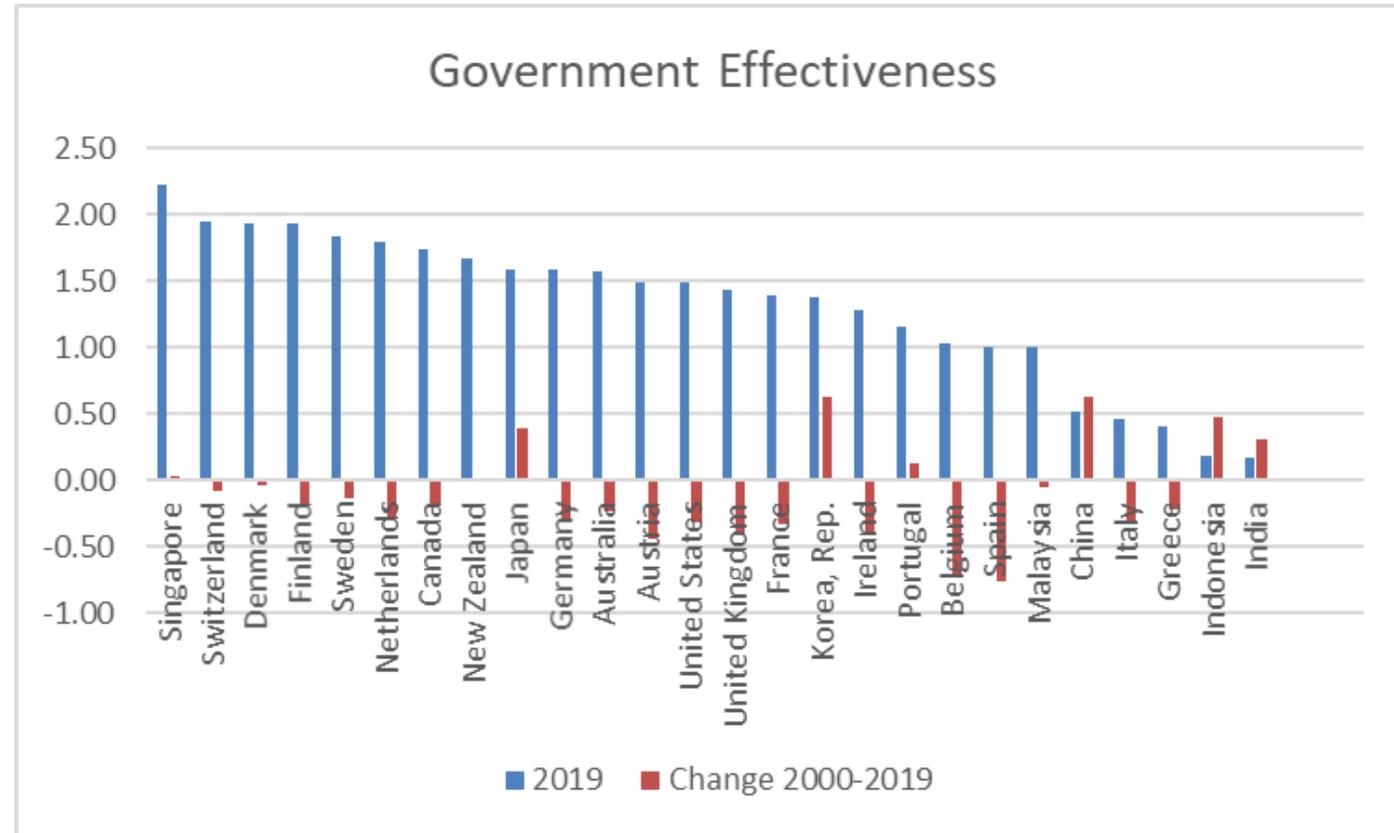
Risks from high public spending

- Often too high to be financable
- Not competitive
- Credibility of fiscal frameworks?



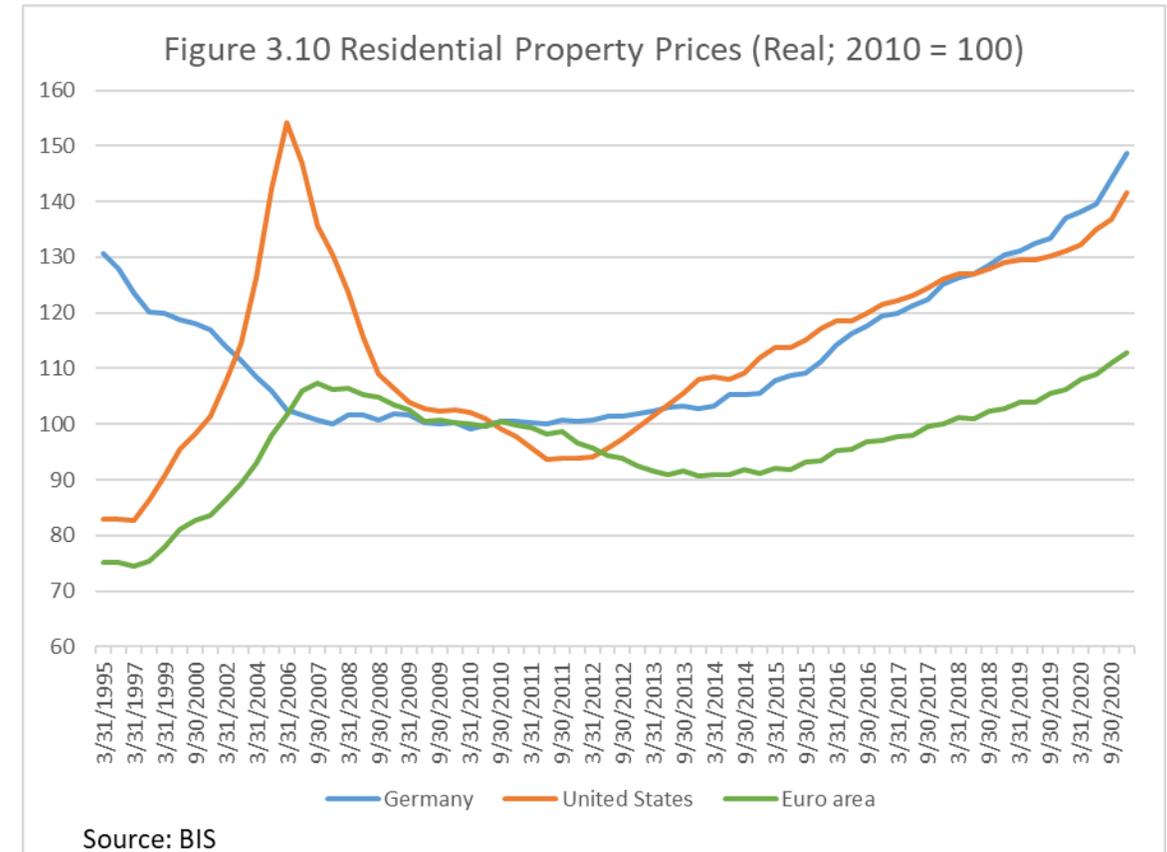
Growth potentially lower

- Framework conditions and rules of the game worsening?
 - Interventionism
- Decarbonisation
- Zombification
- Protectionism



Financial distortions and financial stability

- Excessive risk taking, credit growth plus asset price booms imply risk of financial busts
- Central bank balance sheets and expectations by governments and financial industry
- Money overhang and decline in money velocity
- Demand, supply and monetary factors in place for more persistent inflation?



International dependence and contagion

- Growing interdependence and spillovers via capital flows
- Advanced country contagion possible (GFC!)
- Emerging economies with mixed resilience, fiscal matters!
- Safety nets from IOs, central banks + macro prudential measures

Table 3.3 The Size of International Support Programs

		Amount Approved (Billion SDRs)	Amount Approved (% of GDP) 1/	Additional European financial support (% of GDP)
Argentina	2018	40.7	11.2%	
Greece	2012	23.8	14.9%	135.9%
Portugal	2011	23.7	15.0%	30.1%
Ireland	2010	19.5	13.7%	25.6%
Argentina	2001	16.9	8.7%	
Korea	1997	15.5	3.8%	
Thailand	1997	2.9	2.6%	
Mexico	1995	12.1	4.9%	

Sources: IMF Members' Financial Data, GDP from World Bank.

1/ GDP of respective country in indicated year.

4 Scenarios for Debt Reduction

- High debt and fiscal risks, notably in largest economies; not much prospect of decline it seems.
- Debt will have to come down at some point, at the latest when financing conditions tighten significantly.
- Scope of adjustment and reform needed is manageable, within historic ranges
- Four scenarios:
 1. Consolidation and reform desirable, likely for many
 2. Debt restructuring, a realistic option?
 3. Financial repression for long but stable?
 4. Risk scenario: Destabilisation