The Problem with Debt

WITH THE GLOBAL ECONOMY humming along, there would seem little reason to worry about tomorrow. But in many countries, the future has been mortgaged by high public and private debt, which risks choking off growth. In this issue of F&D we ask, “How much is too much debt?”

The problem with debt is that it keeps countries from investing in future growth—putting more resources toward education and health, for instance, and finding ways to address low productivity, which continues to hold back wages in many countries.

In simple terms, advanced economies can either raise taxes or lower spending to reduce debt. Alberto Alesina, Carlo Favero, and Francesco Giavazzi find that countries take a smaller hit to growth if they cut spending—including for entitlement programs—than if they raise taxes. In fact, the latter can be self-defeating, leading to even higher debt and lower growth, they write.

But with growing concern over inequality, social spending cuts can be hard to justify. The World Bank’s former chief economist, François Bourguignon, reviews how best to address rising inequality and assess difficult trade-offs.

In low-income and emerging market economies, the challenge is to expand tax base and increase the efficiency of public spending. Unlike previous debt crises, which were resolved through international collaboration, today’s crises are more difficult to fix because the debt landscape is more complex, writes Fanwell Bokosi of the African Forum and Network on Debt and Development.

With no easy solutions in sight, and electorates everywhere losing patience with the status quo, governments should use the current upswing to put their house in order. And while each country must chart its own course, the global recovery presents a rare opportunity—rising interest rates will soon make it harder to refinance and service debt.