PRESS POINTS FOR CHAPTER 3: *100 YEARS OF DEALING WITH PUBLIC DEBT OVERHANGS*
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Key Points

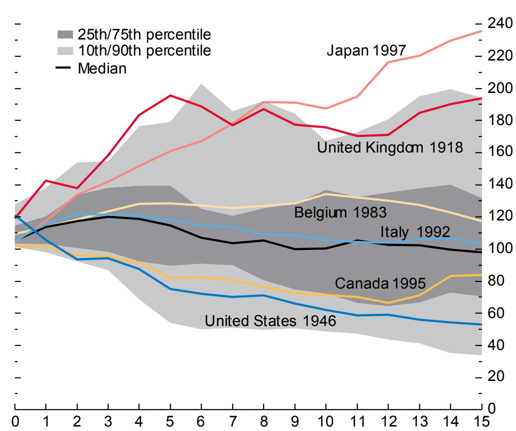
- Throughout the past century, numerous advanced economies have faced public debt burdens as high, or higher, than those prevailing today. They responded with a wide variety of policy approaches. We analyze these experiences to draw lessons for today and reach three main conclusions:
  - Reducing public debt takes time, especially in the context of a weak external environment. It is a marathon, not a sprint.
  - Successful debt reduction requires fiscal consolidation and a policy mix that supports growth. Key elements of this policy mix are supportive monetary policy and measures that address structural weaknesses in the economy.
  - Fiscal consolidation must emphasize persistent, structural reforms to public finances over temporary or short-lived fiscal measures. In this respect, fiscal institutions can help lock in any gains.
- Today, the first priority must be to complement fiscal consolidation with measures to support growth, especially, very accommodative monetary policy and structural reforms.

Public debt in advanced economies has climbed to its highest level since World War II. Gross debt levels in Japan, the United States, Greece, Italy, Portugal and Ireland are above 100 percent. Low growth, persistent budget deficits, and high future and contingent liabilities stemming from population-aging-related spending pressure and weak financial sectors have markedly heightened concerns about the sustainability of public finances.

Public debt levels above 100 percent of GDP are not uncommon. Over the past century, 14 out of 22 countries in our database experienced at least one episode where debt rose above 100 percent. Several countries experienced multiple episodes. The

Debt-to-GDP Dynamics after Crossing the 100 Percent Threshold
(Percent of GDP, advanced economies)

The selected case studies cover the broad range of debt-to-GDP dynamics historically experienced by advanced economies.



Sources: Abbas and others (2010); and IMF staff calculations.
Note: The horizontal axis shows the number of years after the debt-to-GDP ratio exceeds 100 percent.

evolution of the debt-to-GDP ratio for all countries whose debt ratio rose above 100 percent is illustrated in Figure 1. We observe that countries' experiences have differed greatly and that the debt ratio has generally declined only at a very slow pace. Out of all these episodes, we have selected six case studies, highlighted in Figure 1, and analyzed their experiences to draw lessons for countries dealing with public debt overhangs today.

Fiscal consolidation efforts need to be complemented by mesures that support growth: structural issues need to be addressed and monetary conditions need to be as supportive as possible. In the United Kingdom in the 1920s, despite substantial fiscal efforts that achieved and sustained large primary surpluses, public debt ratios actually rose! The combination of tight fiscal and monetary policies pursued by the authorities delivered negative growth, which exacerbated the debt problem. In Japan in the 1990s, structural reforms to the banking sector and a supportive monetary environment were needed before fiscal consolidation gained any traction.

Consolidation plans should emphasize persistent, structural reforms over temporary or short-lived measures. Belgium and Canada were ultimately much more successful than Italy in reducing debt, and a key difference between these cases is the relative weight placed on structural improvements versus temporary efforts. Importantly, both Belgium and Canada put in place fiscal frameworks in the 1990s that preserved improvement in the fiscal balance and helped to overcome consolidation fatigue.

Fiscal repair and debt reduction take time. As can be seen in the figure above, 15 years after debt rises above 100 percent, debt is only marginally lower on average. One reason is that primary deficits are difficult to reverse quickly. The largest post-World War II consolidation over a ten year period was achieved by Belgium between 1981 and 1991 when it improved its primary balance by 11 percentage points. Expectations about what can be achieved need to be set realistically.

Based on our analysis we suggest a road map for successful resolution of the current public debt overhangs:

1. Given the weak growth environment, support for growth is the first priority to cope with the contractionary effects of fiscal consolidation. Policies must emphasize the resolution of underlying structural problems within the economy, and monetary policy must be as supportive as possible.

2. Because debt reduction takes time, fiscal consolidation should focus on enduring structural changes. In this respect, fiscal institutions, such as those in Belgium, that enhance the transparency and accountability of the budget process, can help.

3. However, the case of Italy in the 1990s suggests that modest debt reduction is still possible without strong growth.