2011-09-13

PRESS RELEASE

Economic impact of the public debt
(Article for the Economic Review, September 2011)

Following the financial and economic crisis, the public debt of the euro area countries, the United States, the United Kingdom and Japan have markedly increased. In addition, without a change of policy, the public debt of those countries would maintain an upward trend, a key factor being the rising costs associated with population ageing.

This article analyses the risks and implications of the expansion of the public debt currently evident in most of the advanced countries. The difficulties which certain euro area countries are experiencing in borrowing on the financial markets illustrate some of those risks.

After outlining the movement in the public debt in the advanced countries in recent years, a simulation is produced in view of showing the future debt pattern in the absence of any change of policy. This exercise clearly shows the explosive dynamics of the public debt in most of the countries analysed. In the absence of consolidation measures, the budget position of those countries is likely to deteriorate further in the future. To avoid a marked deterioration in that position, substantial adjustments are therefore required.

Next, the article examines the impact of the public debt on economic activity and inflation. That impact is heavily dependent on the circumstances, which may vary greatly over time and between countries. In estimating the impact of the public debt on economic activity, it is vital to begin by distinguishing between the short and the long term. In the short term, the effects of fiscal consolidation could cause economic activity to slow down. However, in the long term the effects of a budgetary rebalancing are undeniably positive. They include in particular a decline in long-term interest rates, owing to a contraction in the supply of government securities on the market and a reduction in risk premiums. In addition, the reduction in interest charges resulting from consolidation frees up more resources for productive public spending or for reducing the fiscal and parafiscal burden.

Finally, the article sets out the need for fiscal consolidation and appropriate strategies for achieving that. Consolidation of public finances is unavoidable in almost all the advanced countries. To that end, there is an urgent need for credible consolidation programmes and large-scale reforms. Nonetheless, the strategy may vary from one country to another. It will be more urgent and more severe for the countries whose solvency is called into question by the financial markets and which face high and rising risk premiums. For the other countries, the adjustment can be implemented more gradually. A three-pronged consolidation strategy is needed combining a reduction in the level of public debt, with boosting of the employment rate and productivity, and with a reform of the pension and health care systems. The consolidation measures must focus mainly on reductions in public spending. Given the scale of the adjustment needed in most of the advanced countries, measures which increase revenues will probably also be necessary. Some countries have already implemented consolidation measures while others have yet to put most of the measures in place.

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