

## **20100902 IMF : Advanced Economies Need Long-Term Efforts to Tame Public Debt, IMF Studies Find (Press Release and Staff Position Notes)**

**Source: International Monetary Fund**

Advanced economies must pursue long-term policy reforms to reduce public debt levels over the coming decades and ensure future fiscal sustainability, according to three papers published today by the International Monetary Fund (IMF). In order to protect the fragile economic recovery, support growth and job creation and provide reassurance to capital markets, fiscal adjustment plans must be clearly defined—but with a focus on the medium term rather than seeking a quick fix.

“Public debt levels among advanced economies have reached levels not seen before in the absence of a major war,” said Mr. Carlo Cottarelli, Director of the IMF’s Fiscal Affairs Department and one of the authors of two of the reports. General government debt in the G20 advanced economies surged from 78 percent of gross domestic product (GDP) in 2007 to 97 percent of GDP in 2009 and is projected to rise to 115 percent of GDP in 2015.

“High public debt is due not only to the financial crisis, but also to weak fiscal policy over the preceding decades, when debt levels ratcheted up during hard times but failed to fall in better years. The task ahead is all the more complicated because aging societies and global warming are putting additional pressure on public finances. This calls attention to the critical need for long-term fiscal reforms that will guarantee a gradual but sustained improvement in debt positions over the coming decades,” Mr. Cottarelli said.

The most indebted economies are approaching a “debt limit” beyond which their fiscal positions may become unsustainable. “Debt limits are not etched in stone, but they show that a fundamental change in behavior relative to historical patterns will be needed to restore sustainability. In other words, ‘business as usual’ won’t cut it,” said Jonathan D. Ostry, Deputy Director of the IMF’s Research Department and lead author of one of the papers.

“Countries will generally want to target debt levels well below their debt limits because governments may get little or no warning about imminent spikes in borrowing costs or curtailed access to markets as public debt rises or as views about fiscal risks or the reliability of fiscal data change,” Mr. Ostry said.

[Long-Term Trends in Public Finances in the G-7 Economies](#), one of the three Staff Position Notes the Fund is publishing, looks at the evolution of public debt levels in the most developed economies in the decades leading up to the recent crisis, discusses the surge in debt during the crisis, and assesses the outlook for cutting debt ratios in the years ahead. Beyond the 2008-09 crisis, advanced countries’ indebtedness reflects persistent upward trends in debt ratios since 1974. Rising spending on healthcare and pensions accounts for most of the weakening in primary balances. To avoid undermining the fragile economic recovery while providing reassurance to capital markets, fiscal policy should be clearly defined with a focus on gradual but sustained adjustment over the medium term rather than just near-term tightening, the paper concludes.

[Fiscal Space](#) examines debt sustainability across a range of advanced economies, and estimates the degree to which governments have room for fiscal maneuver before markets force them to tighten policies sharply. Fiscal space—the distance between current debt levels and the debt limit beyond which a country’s debt becomes unsustainable based on past performance—is severely limited in some countries while others enjoy much greater room for fiscal maneuver to deal with unexpected shocks. In the first group, a fundamental break from the normal pattern of fiscal adjustment is needed to restore sustainability. The analysis underscores the importance of maintaining significant margins of fiscal space because there is uncertainty about where precisely the debt limits lie, and because both theory and empirical evidence suggest that the move from a situation with full and risk free access to capital markets to shut out from those markets can happen abruptly, with little advance notice from rising interest rates.

[Default in Today’s Advanced Economies: Unnecessary, Undesirable, and Unlikely](#) examines recent speculation among market participants and commentators that worsening public finances could lead to a debt default in certain advanced countries, in particular some “peripheral” European countries. The paper judges that the risk of debt restructuring is currently significantly overestimated, arguing that whereas debt defaults by primarily emerging markets in preceding

decades have been triggered foremost by spiraling debt service costs, the current challenges to fiscally stressed advanced countries stem from their large primary deficits. Because of the long maturity of public debt in advanced countries at the beginning of the crisis, their debt service is still relatively contained: the problem is not the debt burden, but the primary deficit. As highlighted in the accompanying papers, the long-term drivers of public spending need to be tackled over the medium term to ensure fiscal sustainability. The study concludes that therefore defaulting on debt would make little sense for these countries.

**NovaRes Team**