What we do in the book

- Public debt has grown significantly around the world since 2007.
- Not surprisingly, the topic is under spotlight.
- Our goal is to describe public debt, its functions and the evolution of D/GDP ratio in a rigorous but accessible way
- It is important to be aware that a high D/GDP ratio may trigger financial crises and severely condition the choices of future generations.

GIORGIO **DI GIORGIO**
ALESSANDRO **PANDIMIGLIO**
GUIDO **TRAFICANTE**

NELLE TASCHE DEGLI ITALIANI

IL DEBITO PUBBLICO SPIEGATO BENE. COME FUNZIONA, COME LIBERARCENE.

NEWTON COMPTON EDITORI

The legacy of the crises: fiscal fragilities

Gross debt on GDP: General Government

	2007	2010	2020	2021
Canada	66.9	81.2	117.8	112.1
France	64.5	85.3	115.2	112.3
Germany	64.2	82.0	68.7	70.2
Italy (*)	103.9	119.2	155.3	150.9
Japan (*)	172.8	205.7	259.0	263.1
United Kingdom	41.4	74.0	102.6	95.3
United States (*)	64.6	95.2	134.2	132.6

(*) 2021 estimated. Percentage values. Source: IMF WEO April 2022.

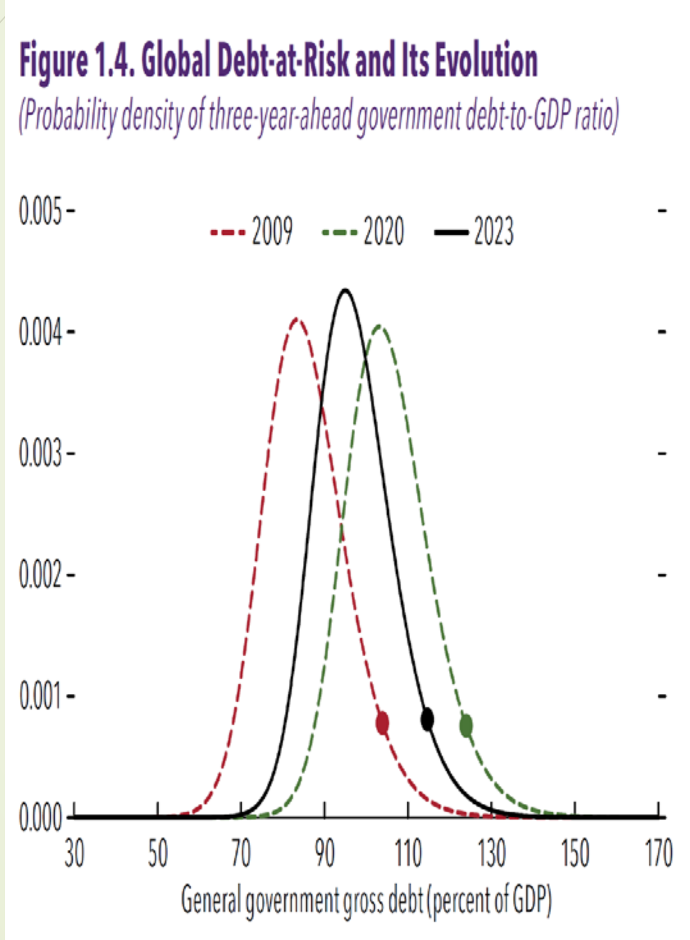
Last IMF's projections

- Public debt levels are expected to exceed $100 trillion in 2024.
- After a decline in 2022, global public debt edged up again in 2023 and is projected to approach 100 percent of GDP by 2030, with the world's two largest economies, China and the United States, largely driving the increase.
- Debt will be higher than before the pandemic with significant upside risks.
- The political discourse on fiscal issues has increasingly tilted toward higher government spending over the last three decades.

Last IMF's projections

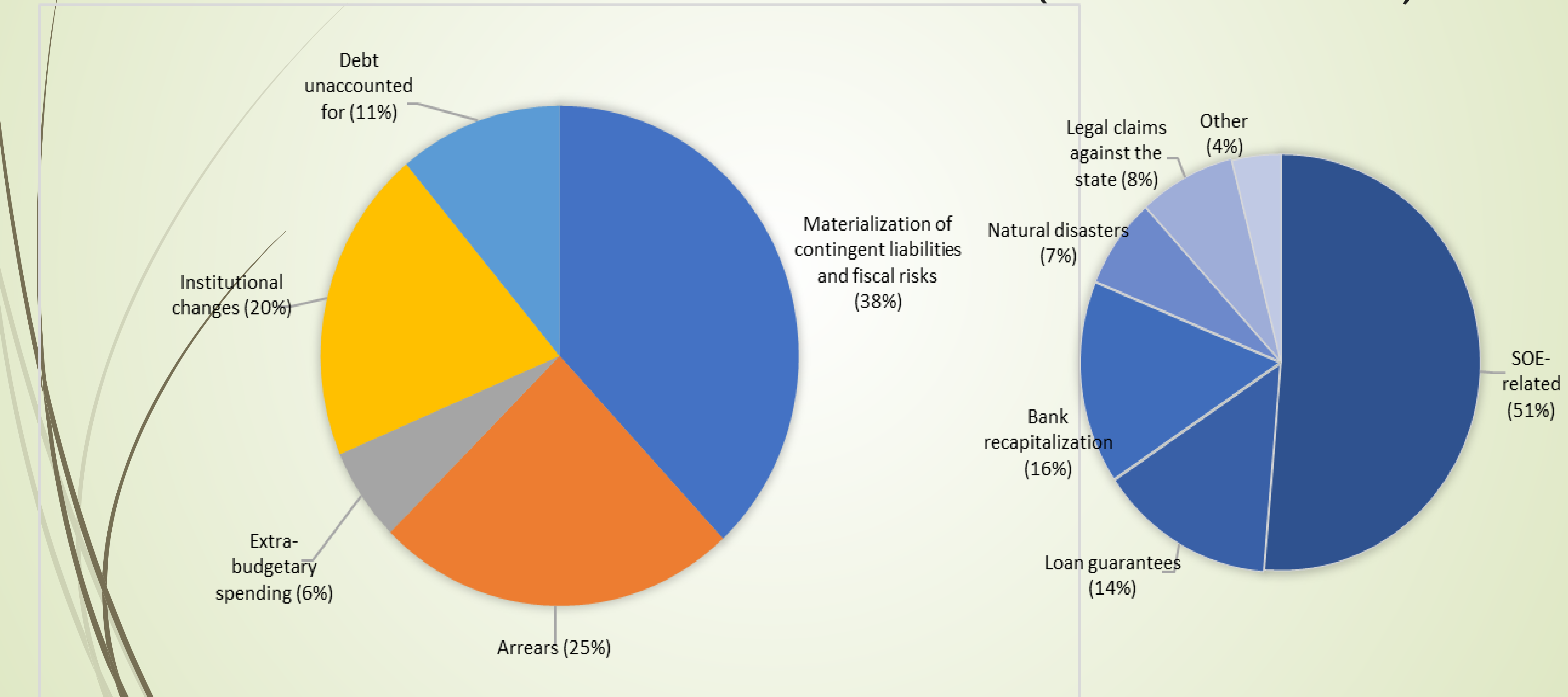
- Mounting spending pressures (eg for the green transition, defense, costly industrial policies, population aging) are not fully accounted for in current debt projections.
- So, a further buildup of public debt is very likely and this will reduce fiscal space and the governments' capacity to dampen business cycle fluctuations.
- Even countries with better position are at risk because they are exposed to countries characterized by elevated debt. A fiscal crisis in one (large) country can easily be exported elsewhere.
- The role of demography and climate as possible new large negative shocks largely underestimated.

Global Debt-at-Risk.
Source: IMF – Fiscal Monitor (October 2024)



- Debt-at-risk: how current conditions affect the distribution of risks?
- The global debt distribution is skewed to the right side.
- Financial and economic factors have a larger impact on debt risks when initial debt levels are higher.
- Sovereign spreads also significantly predict upside debt risks in the near term (one to three years).

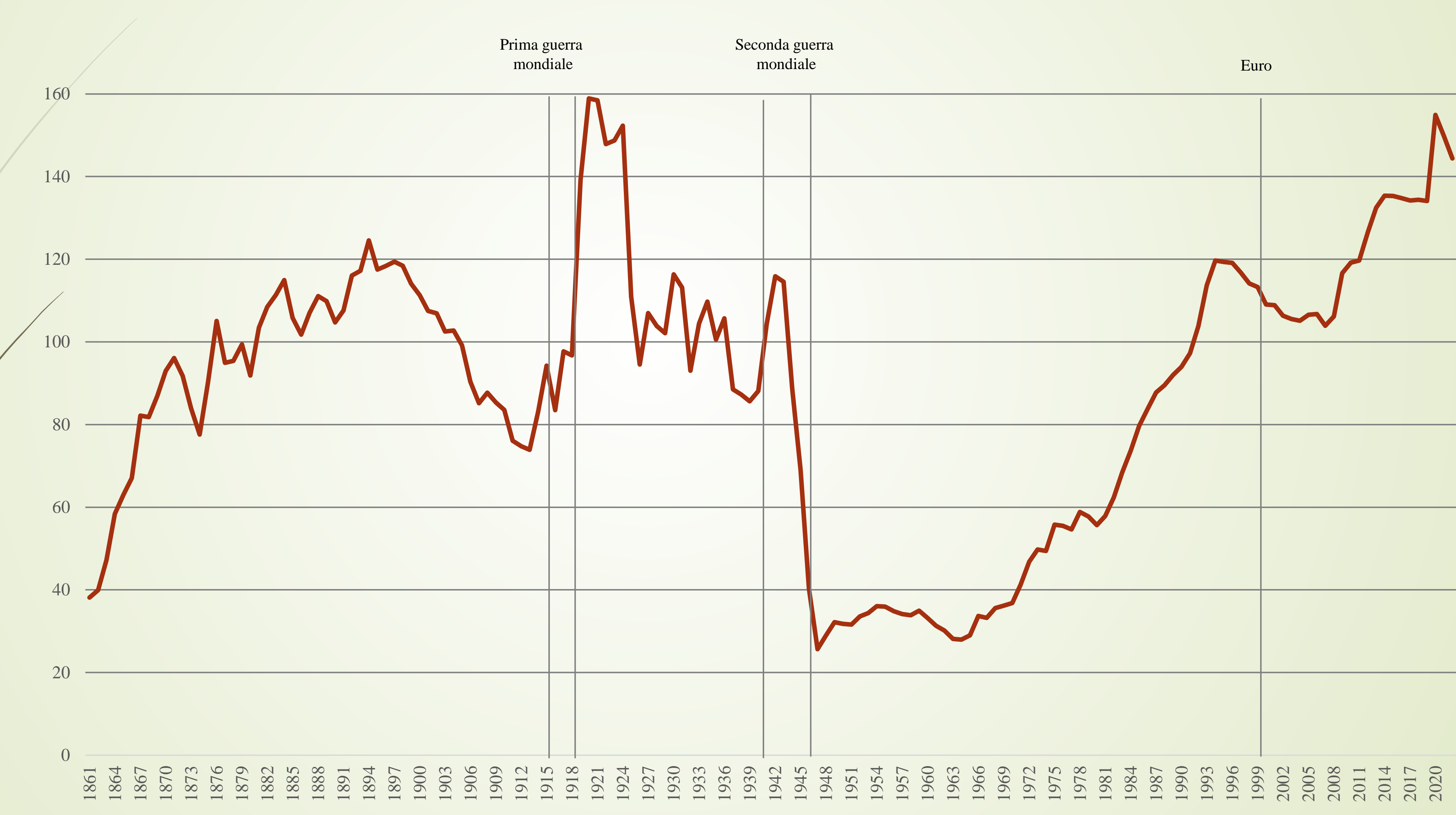
Components of Unidentified Debt. Source: IMF – Fiscal Monitor (October 2024)



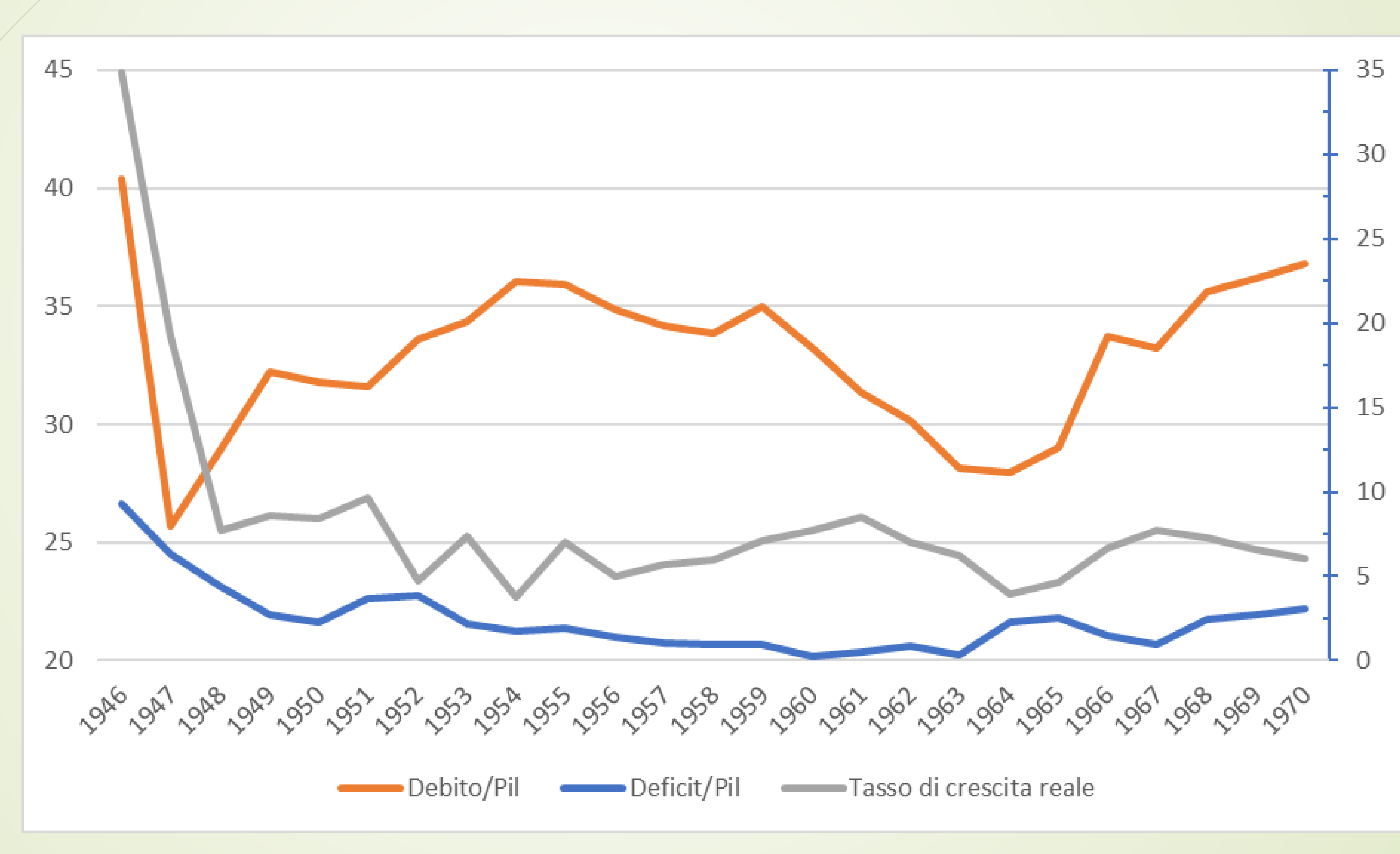
How to reduce public debt..

- Not easy to do that, it requires sacrifices.
- Public debt in current year reflects public deficits run in previous years.
- For Italy, a debt-to-GDP ratio amounting to 135% (end of 2023) is the main problem to tackle today, since it imposes constraints on governments' political decisions and affects the lives of citizens.
- The consequences of the high public debt are evident: public services provided in an inefficient and limited way, high taxes are required to pay the interests on huge amounts of outstanding debt.

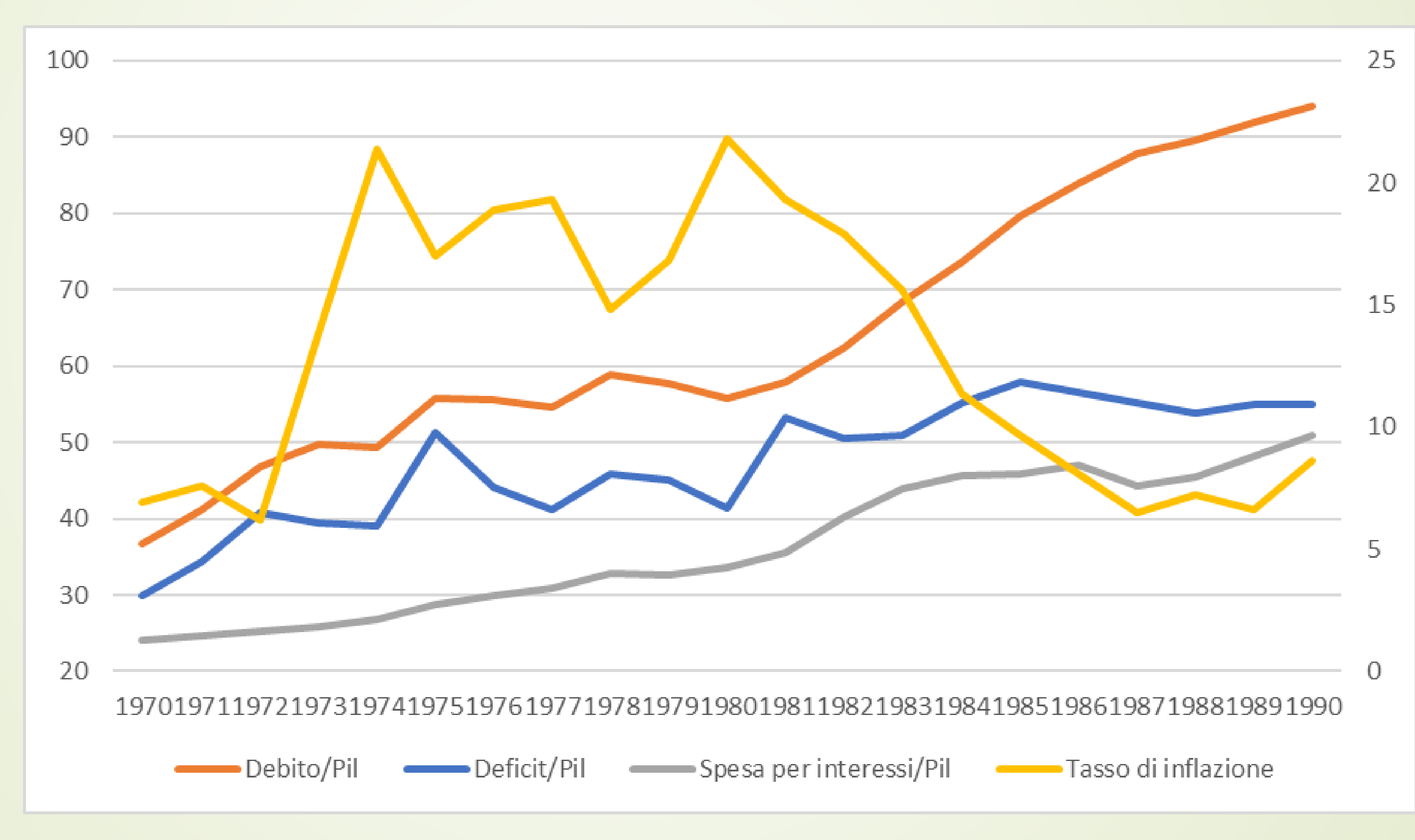
D/GDP evolution over time in Italy



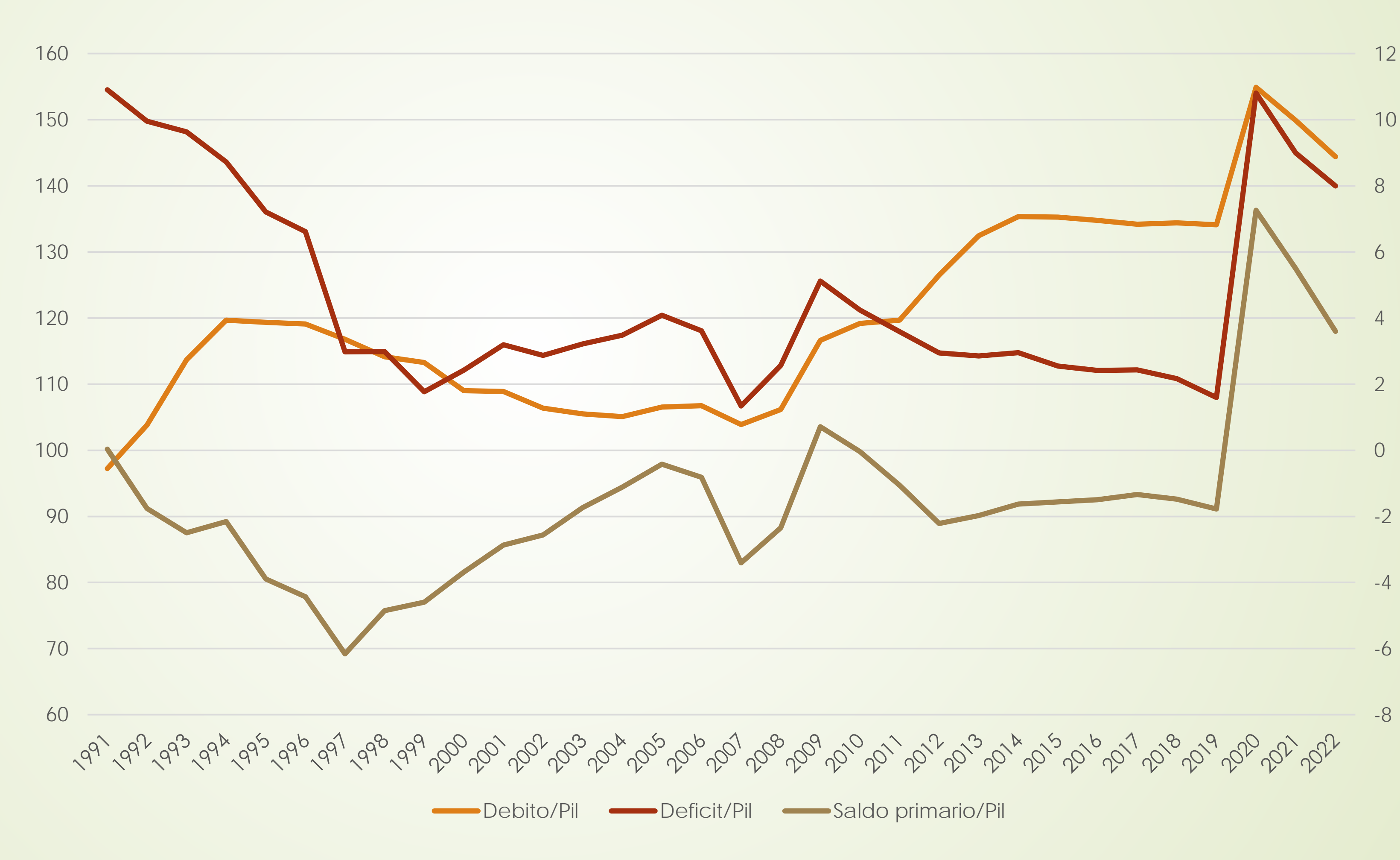
When the D/GDP ratio was low…



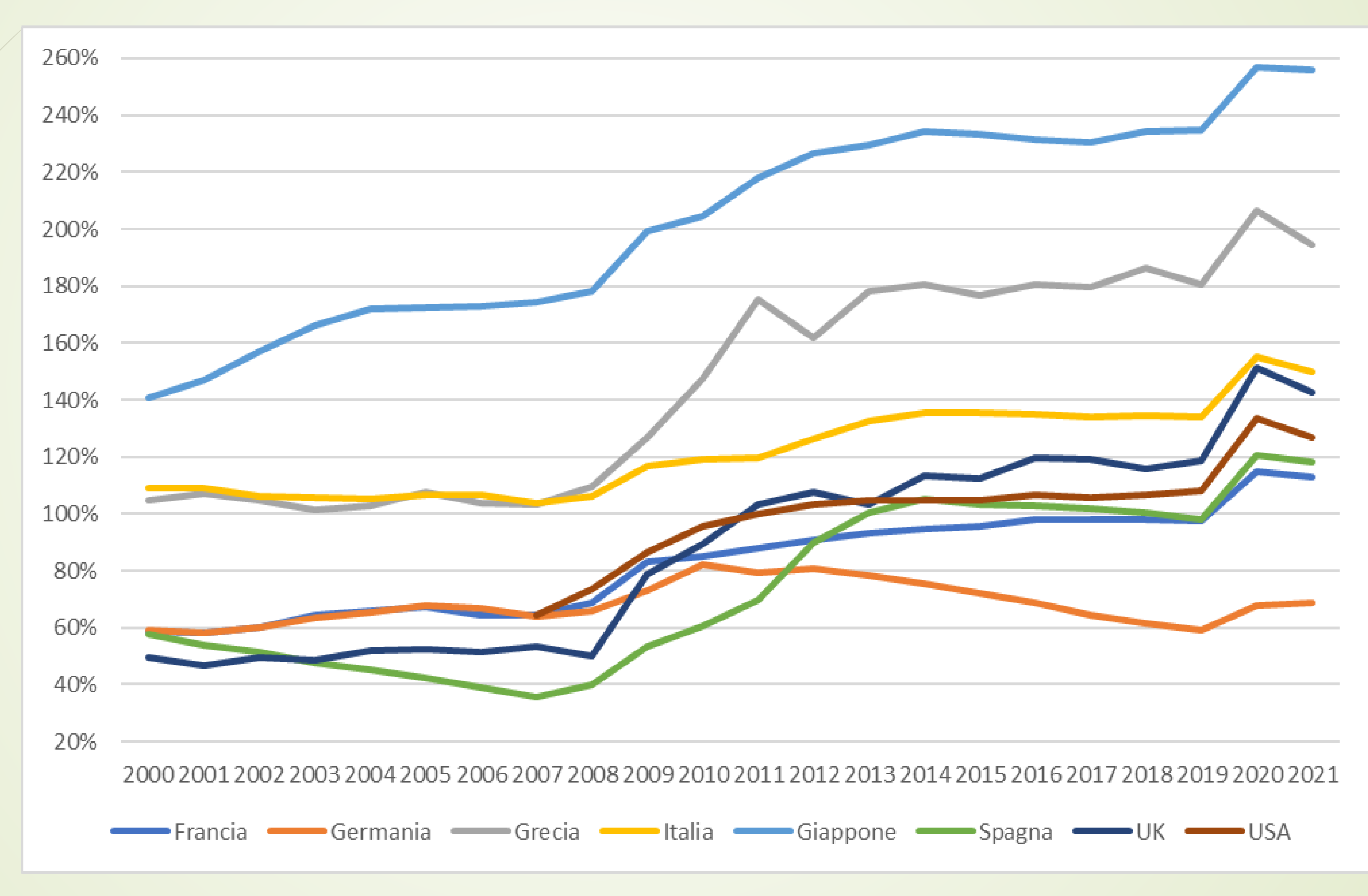
A worrying reversal from the 70s



Up and downs in the last 30 years



International comparison



The origin is the public deficit

- DEFICIT = Public Spending – Taxes
- Public Spending: for education, healthcare, public safety, justice, defense... and for interest on the debt!!!!
- What Italy pays in terms of interests on outstanding debt is as much as what we spend for education.
- But what matters is the ratio between Debt and GDP. When economic growth is high the problem tends to reduce on its own, but when this does not happen it is necessary to act.
- "Primary" surpluses have to be reached and maintained over time. This means reducing spending (services) or increasing taxes, things that are difficult to do "politically".

How can we get out of it?

- The problem today is serious and widespread.
- The best strategy is to commit seriously and credibly to a gradual but constant reduction of the ratio
- A Too fast reduction plan may not work because it can worsen the situation inducing a recession.
- But there is no room for new "free meals" at the expense of future generations.
- Serious fiscal policies have to be accompanied by structural reforms aiming at fostering growth. This might require reallocating government spending across sectors, using taxation as a powerful “incentive” to affect agents’ behavior and so on
- This is a formidable challenge!!!

How can we get out of it?

- Why not reducing debt/GDP ratio by increasing the denominator?
- We focus on achieving primary surpluses because we were not able to increase growth in a satisfactory way. Growth can be hardly affected by national policies in the short run.
- The European framework allows for flexibility. In some cases it may also be too much….
- Important to realize that a reduction in the ratio is in the interest of each country per se and not because asked by the EU!
- High debt makes a country vulnerable to increases in interest rates, to negative macro, demographic and climate shocks

Here you can see a long list of structural problems faced by Italy!!!

Low productivity, negatively affecting growth

Low competitivity (high costs of energy, rigid labur market, too much burocracy)

More consolidation needed in the banking sector

Inefficient labor and goods markets

High unemployment and low labour participation in the South, among women and the young

Excessive weight of SMEs, and of micro-firms among the latter

Capital markets underdeveloped

Inefficient and costly PA

Service sectors highly regulated and protected

Inadequate infrastructures (material and immaterial)

High costs of politics and too many (and inefficiently coordinated) decision levels

Lack of Assesment-Evaluation-Intervention procedures in public spending

Too many laws, rare enforcement

Slow and inefficient Justice

High taxes on families and firms (if they are compliant)

Costly and inefficient local public services

Quite Low Social expenditure (excluding pensions)

SUMMING UP

A strong, credible, bipartisan commitment to gradually reducing the debt-to-GDP ratio would bring benefits

A cultural revolution needed so that structural reforms will be requested by voters. Maybe a category looses from some intervention but might benefit from others. Collective vs private interest trade off

Reforms should be implemented to exit from the stagnation period we have been living with in the last 3 decades

Even if we did not experience a financial default, we had several *de facto* defaults, in particular the large number of young and talented people leaving our country, decreasing our human capital and increasing the debt/GDP ratio per capita!

Thanks for your attention!