# THE COMING ARMAGEDDON

DEBT AND PUBLIC FINANCE IN THE COVID-19 ERA

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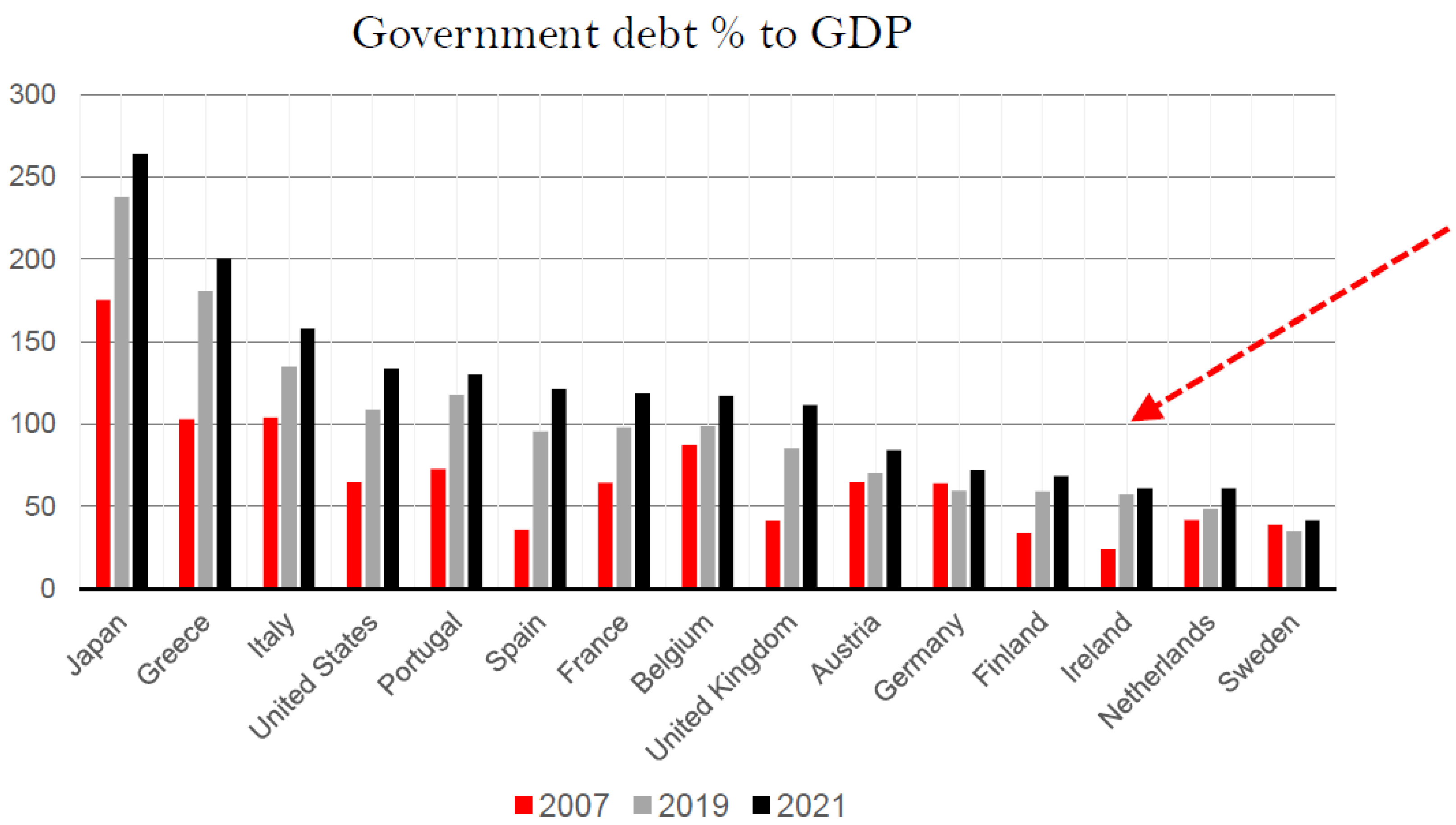
# EXPANSIVE FISCAL PROGRAMMES AND BUDGET DEFICITS






IMF, WEO, October 2020

## DEBT AND PUBLIC FINANCE IN THE COVID-19 ERA

## UK SOVEREIGN DEBT IN A HISTORICAL PERSPECTIVE


Source: Bank of England

# DEBT AND PUBLIC FINANCE IN THE COVID-19 ERA

## A WORLD UPSIDE-DOWN?

Opinion **UK public finances**

### Restoring UK growth is more urgent than cutting public debt

Britain must reassure the world it is in the hands of competent leaders

MARTIN WOLF + Add to myFT

The Chancellor Rishi Sunak will need to lock in the low interest rates to take advantage of exceptional borrowing conditions © Simon Walker/HM Treasury

**Martin Wolf** DECEMBER 13 2020

Opinion **The FT View** + Add to myFT

### Now is not the time to worry about the UK debt burden

Britain should spur recovery by avoiding tax rises and austerity

THE EDITORIAL BOARD + Add to myFT

Rishi Sunak, the chancellor, was right to extend the furlough scheme to October © Reuters

**The editorial board** MAY 13 2020

## A WORLD UPSIDE-DOWN?

Carmen Reinhart, the eminent economic historian who is now chief economist at the World Bank, recommended countries should borrow heavily during the pandemic.

“While the disease is raging, what else are you going to do?” she asks. “ **First you worry about fighting the war, then you figure out how to pay for it.”**


The Big Read Coronavirus economic impact + Add to myFT

Global economy: the week that austerity was officially buried

The IMF and World Bank are urging richer countries to spend their way out of the pandemic, although some developing nations face cuts

Chris Giles in London OCTOBER 16 2020

## EX-POST DEBT ACCOUNTING

increase of sovereign debt

$$\boxed{\Delta d} \approx \boxed{-s} + \boxed{(r - \pi - g) \cdot d} + sf - \boxed{\Delta h}$$

fiscal consolidation

growth in relation to debt servicing

Increase in monetary base (debt monetization)

**All variables are ratios to GDP:**

- **s:** primary surplus
- **r**: nominal effective interest rate corresponding to the already-accumulated debt
- **g**: the growth rate of real GDP
- **d:** the public debt
- **sf:** the stock-flow adjustments
- **Δh**: the change of the monetary base

## SOME QUESTIONS



**Question 1:** *Can we ‘grow’ ourselves out of debt?*

**Question 2:** *Can austerity be a solution or option?*

**Question 3:** *Is the level of debt actually a problem?*

**Question 4:** *Is fiscal expansion inflationary?*

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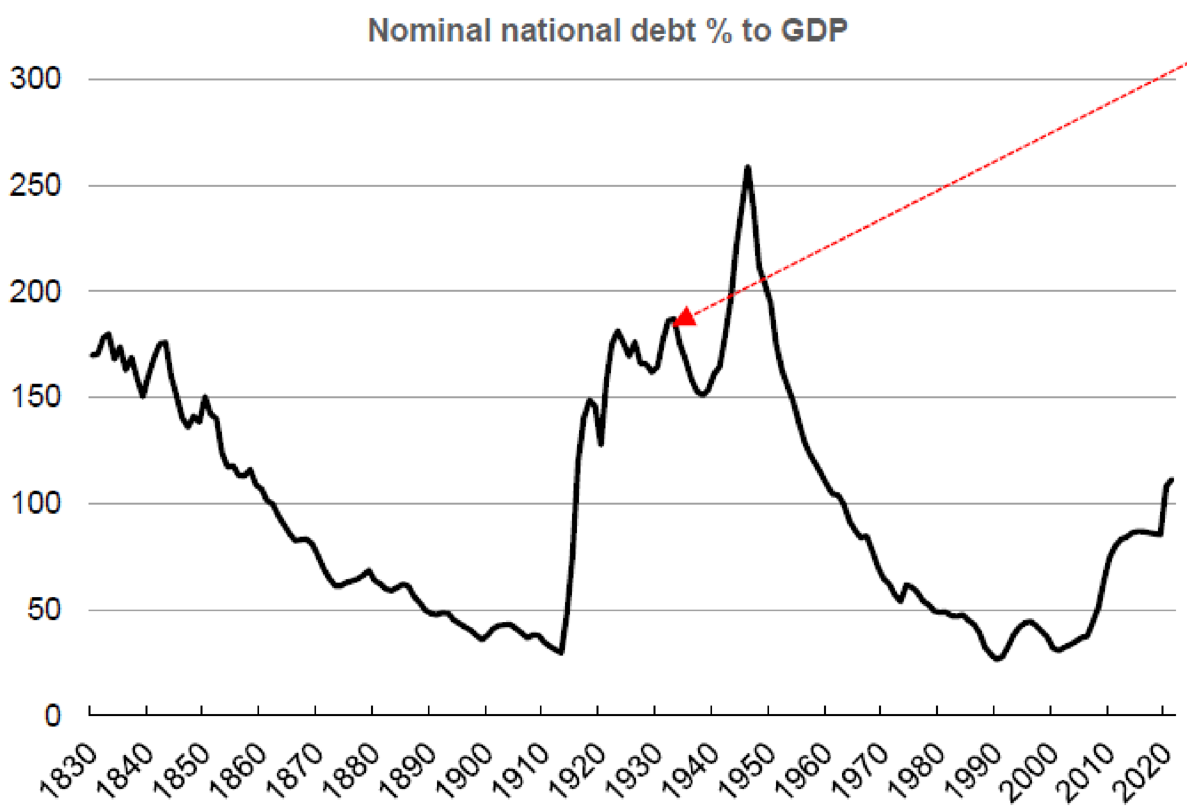
# Historically possible, but…




**1921-1938:**

r= 4.2%

π= 0.0%

g= 3.0%

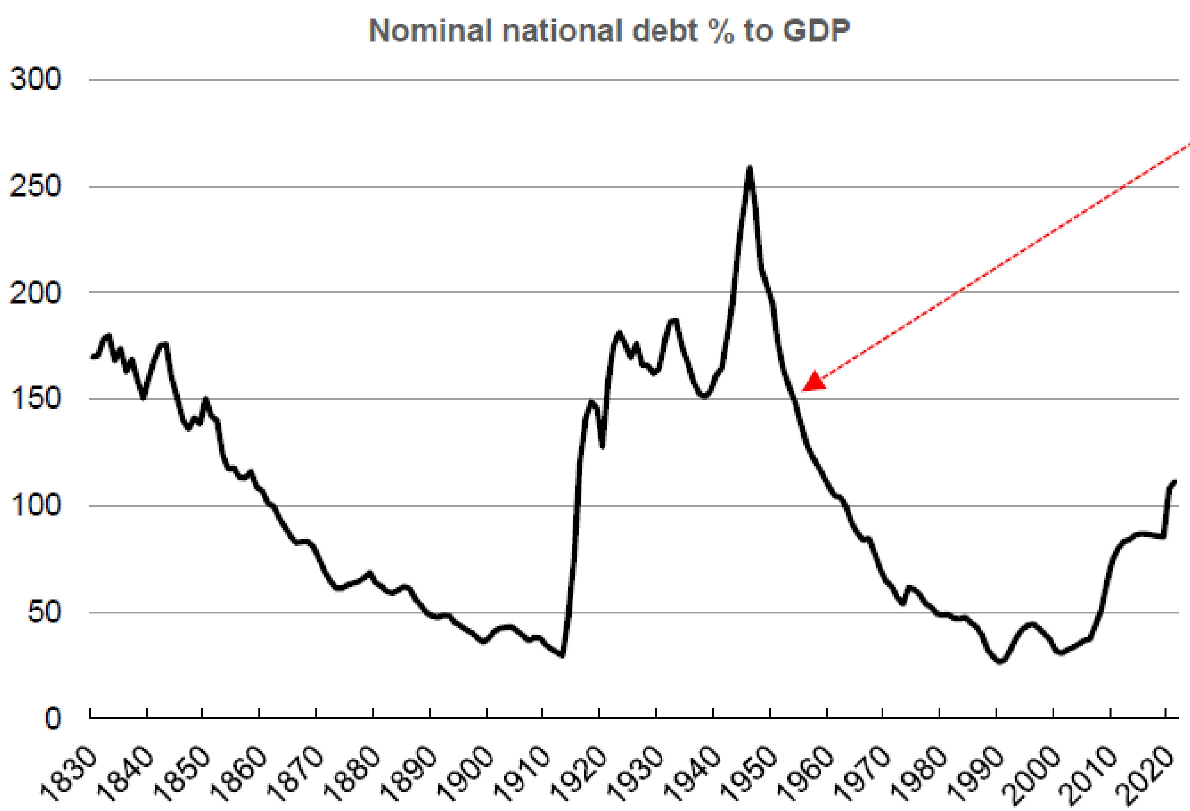
(r-π-g)=1.2%

s= 6%

Crafts (2016); my calculations

## QUESTION 1: CAN WE 'GROW' OURSELVES OUT OF DEBT?

# Historically possible, but…




**1950-1970:**

r= 4.1%

π= 4.0%

g= 3.0%

(r-π-g)=-3%

s= 2.4%

Crafts (2016); my calculations

## QUESTION 1: CAN WE 'GROW' OURSELVES OUT OF DEBT?

| | effective interest rate (r) | real GDP growth (g) | Primary surplus % GDP |
|---|---|---|---|
| | 2019 | 2010-2019 | 2010-2019 |
| Japan | | 1.3 | -5.0 |
| Greece | 1.6 | -2.0 | 0.7 |
| Italy | 2.5 | 0.2 | 1.3 |
| United States | | 2.3 | -4.1 |
| Portugal | 2.5 | 0.8 | -1.0 |
| Spain | 2.4 | 1.0 | -3.7 |
| France | 1.5 | 1.4 | -2.1 |
| Belgium | 2.0 | 1.6 | -0.1 |
| UK | 1.5 | 1.9 | -3.2 |
| Austria | 2.0 | 1.6 | 0.2 |
| Germany | 1.3 | 1.9 | 1.5 |
| Finland | 1.4 | 1.2 | -1.6 |
| Ireland | 2.2 | 6.4 | -4.1 |
| Netherlands | 1.5 | 1.4 | -0.5 |
| Sweden | 1.0 | 2.5 | 0.1 |

**Example:**

Debt=120%

g=2%

r=2%

$\pi$=2%

20 years to bring debt back to 80% (*ceteris paribus*)

AMECO, IMF, WEO, October 2020

## QUESTION 2: CAN AUSTERITY BE A SOLUTION?

| **Primary surplus % GDP** | |
|---|---|
| | **2010-2019** |
| Japan | -5.0 |
| Greece | 0.7 |
| Italy | 1.3 |
| United States | -4.1 |
| Portugal | -1.0 |
| Spain | -3.7 |
| France | -2.1 |
| Belgium | -0.1 |
| United Kingdom | -3.2 |
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| Germany | 1.5 |
| Finland | -1.6 |
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| Sweden | 0.1 |

IMF, WEO, October 2020

- Are Western capitalist societies ready for a next round of austerity?
- What about taxation? Is there room for a progressive taxation?

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IMF, WEO, October 2020

CHRIS GILES

It is wrong to assume that the chancellor Rishi Sunak will, or should, prefer fiscal consolidation over higher public borrowing © Hollie Adams/Bloomberg

Chris Giles YESTERDAY

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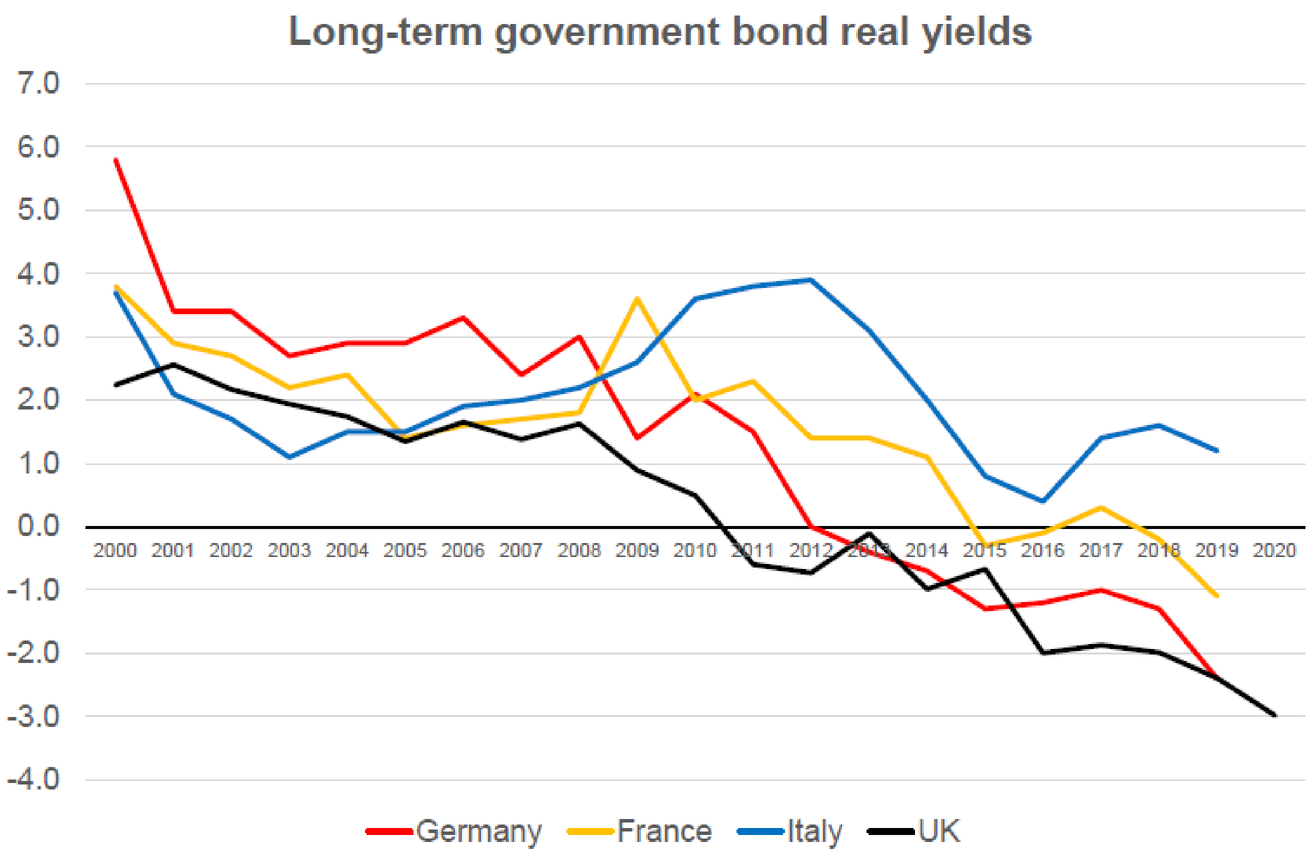
Get instant email alerts

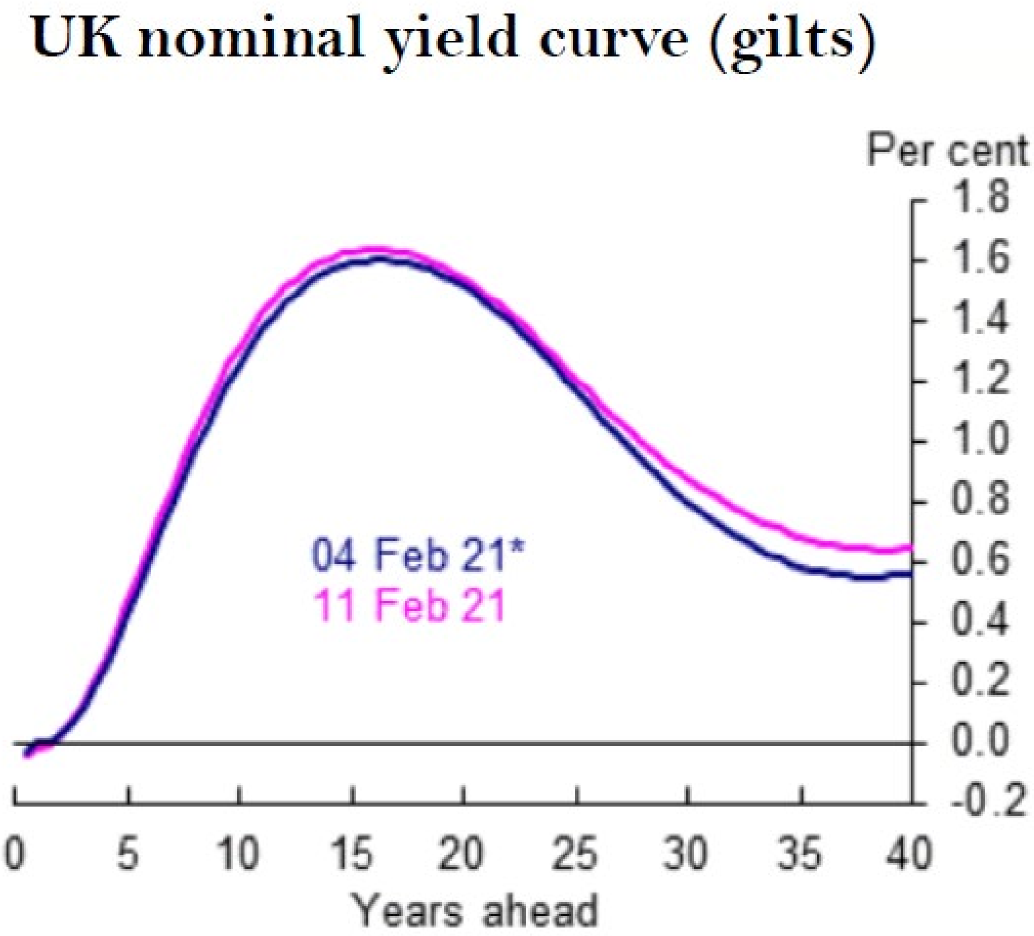
Rishi Sunak's message to the UK on Wednesday was stark. The nation's "economic emergency has only just begun", the chancellor said before warning that public borrowing and debt were "clearly unsustainable". Anyone who did not get the message that tax rates would need to rise and that there would be more stealthy austerity was not listening.

# 'Financial repression'… without capital controls and interest rate ceilings



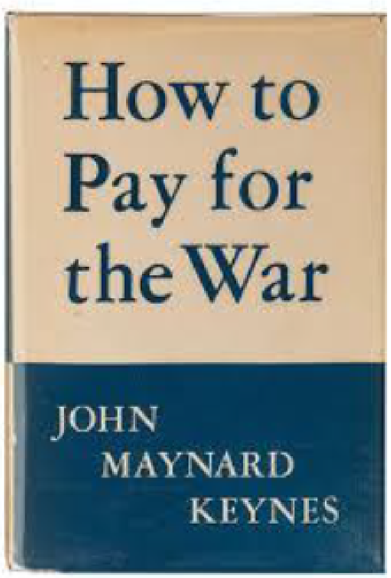

Source: AMECO and BoE

## QUESTION 4: IS FISCAL EXPANSION INFLATIONARY?



## QUESTION 4: IS FISCAL EXPANSION INFLATIONARY?

Fiscal expansion → Aggregate demand → Inflation




- Consumer goods will not increase with production
- Higher wages (demand for labour)
- Inflation (redistribution)
- 'Invest' **surplus purchasing power** (preferred from taxation)

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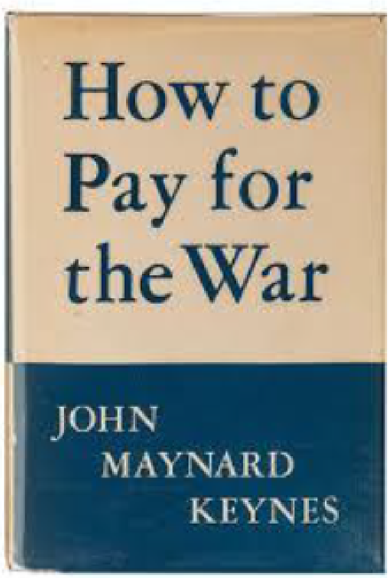


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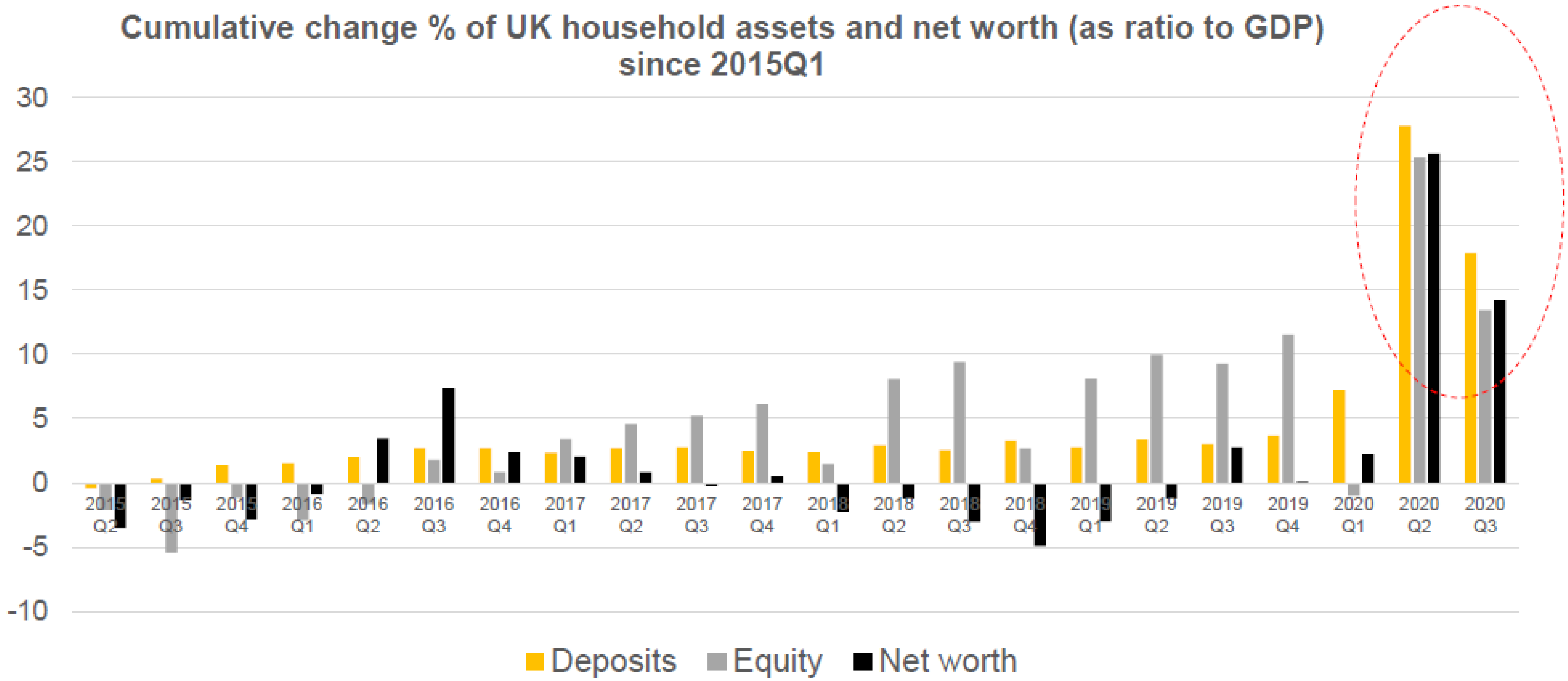

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Unsustainable mix…

(1) Fiscal expansion is noninflationary but => inequality.
(2) Sovereign debt overhang cannot be addressed or sustained without some kind of ‘financial repression with open markets’ (financialization cannot be undone, low r-π, central bank interventions…)
(3) Low real interest rates => aggressive risk taking/more financialization
(4) Austerity?
(5) Climate change, rising inequalities: an over-indebted state cannot utilize resources.

# THANK YOU