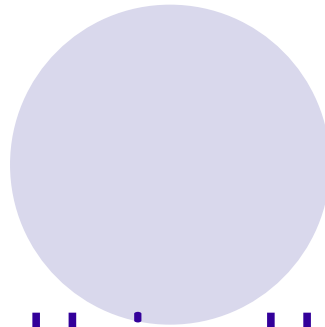
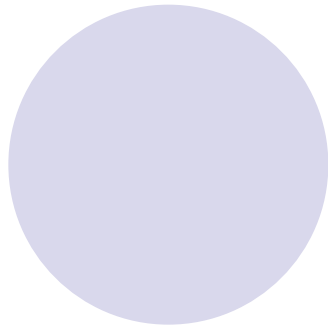


The Costs and Risks of Excessive Debt

Comment on **Ádám Török**



Heinz Handler

Vienna University of Technology

Ádám Török's Chain of Arguments

■ Early warning system for an impending debt crisis

- **Objective indicators:**
100% debt ratio, primary gap, maturity structure etc.
- **Subjective perceptions:**
Government bond risk premium, CDS spreads, communication etc.

Török: "...use of terms like 'debt crisis' should be absolutely excluded"

- *Many other dimensions*
- *Not all debt is odious*

- *Will most likely not work*
- *Needs anyway an objective foundation*
- *Transparency required*

■ Consequences of debt crises

- International: collapse of financial networks
- National: diminishing the growth potential

"Any country bankruptcy is a matter of political decision"

■ Remedies

- European: rescue packages, institutional reform
- National: budget consolidation, independent institutional actor

- *Can it break „fiscal alcoholism“?*
- *„Soft“ vs. „hard“ institution?*
- *Tasks?*

Indicators for country risk assessment: Hungary, Austria and Germany compared

	Hungary	Austria	Germany
Debt/GDP (%): 2007	66.1	59.3	64.9
2011	80.1	72.0	75.9
Budget balance/GDP(%): 2007	- 5.0	- 0.4	0.3
2011	- 4.7 ↓	- 3.6 ↑	- 2.7 ↑
Primary balance/GDP(%): 2007	- 0.9	2.3	3.0
2011	- 1.0	- 0.8	- 0.3
Gov't bond yields (%): 12/2010	7.92	3.43	2.91
CDS spreads (bp): 17.1.2011	367	96	60
Independent fiscal institutions	Fiscal Council terminated, now Government-dependent solution	Gov't Debt Committee, indep. research institutes, legal expend. targets	Sachverständigenrat, indep. research institutes, legal debt cap

Objective indicators

Market perception

Fiscal anchor

Not all debt is odious

■ Non-odious debt (if below threshold)

- Temporary debt financing (“deficit spending”)
- Long-term debt financing of investment in productive resources

Who repays?

Current generation

Next generation

■ Threshold: when does debt become excessive?

- Debt-to-GDP ratio > 100% (Török)
Reinhart/Rogoff (2009): 90%
Iletzki/Mendoza/Végh (2010): 60%

How reliable are numerical indicators? (“creative accounting”)

- Instead of numerical indicators, focus should be on fundamental problems (Eichengreen): ageing, costs of health care, labour market regulations, education, budget making institutions...

■ Public vs. private debt

■ Foreign vs. domestic debt

■ Is there “excessive saving” in the world?

- Buiter (2010) points at China, others at Germany.

■ Debt trap

- A country with increasing debt ratio is hit by an asymmetric shock.

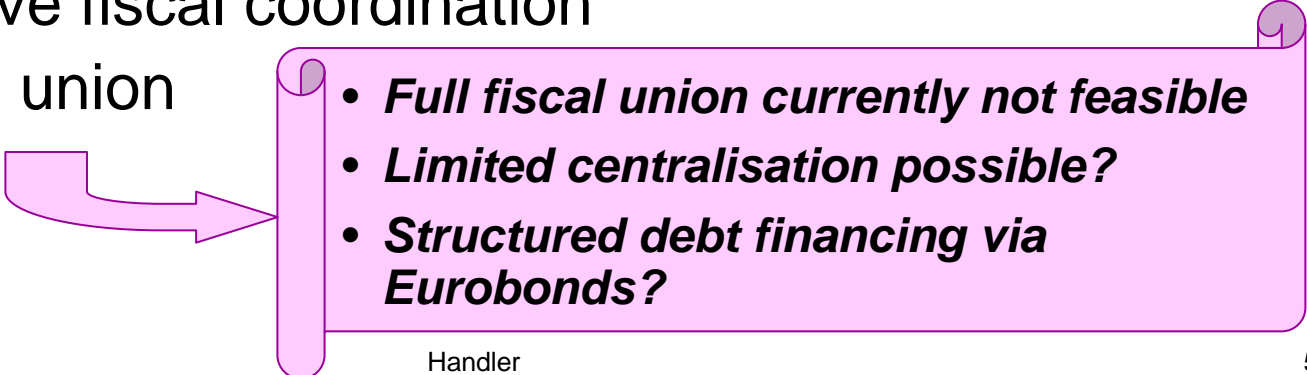
Remedies for the Eurozone

■ Short-term: rescue packages

- to avert imminent insolvency of member countries (Greece)
- to restore confidence in union solidarity (temporary EFSM, permanent ECRM)

■ Medium-term: institutional reforms

- Reform of Stability and Growth Pact (SGP) to improve fiscal coordination
- Fiscal union

- 
- ***Full fiscal union currently not feasible***
 - ***Limited centralisation possible?***
 - ***Structured debt financing via Eurobonds?***

Remedies for the Member States

- **Short-term: budget consolidation**
 - should be strategic, communicative, proactive, equity-oriented, growth-sensitive
 - with more weight on expenditure cuts than on tax increases
- **Medium-term reforms**
 - **Structural reforms**
 - **Independent fiscal institutions**
 - Aim: increase transparency
 - Tasks: forecasting, analysing, buttressing government
 - Decision-making should remain with elected politicians (accountability)