Peterson Institute for International Economics

Debt Sustainability in U.S., Europe and Japan - Is There A Role for the Asset Side?

Asia-Europe Economic Forum
Eurozone Crisis and Global Economic Governance
Session 1:

Jacob Funk Kirkegaard

Peterson Institute

December 9th 2011

Outline

Peterson Institute for International Economics

1. Traditional Focus is Gross Government Debt
2. Government Crisis Interventions in Financial Markets Has Transferred a Lot of Private Distressed Assets to Governments
3. Governments Have Lots of Assets, Too, So If Crisis Means "We Will Do Whatever It Takes" Net Indebtedness Should Matter
4. Yet, The Historical Record of Privatization Revenues is Mixed and Has Limits – Even in a Deep Crisis

The Gross Government Debt Outlook is Daunting

- **Crisis Reverses Small Post-2000 Decline in Europe**
- **Crisis Accelerates Post-2000 US deterioration**
- **US To Reach 100% of GDP in 2011**
- **Euro Area To Reach 90% by 2012**
- **Japan To Reach 238% by 2012**

Table 1: General Government Gross Debt Levels 1980-2012p, Percent of GDP

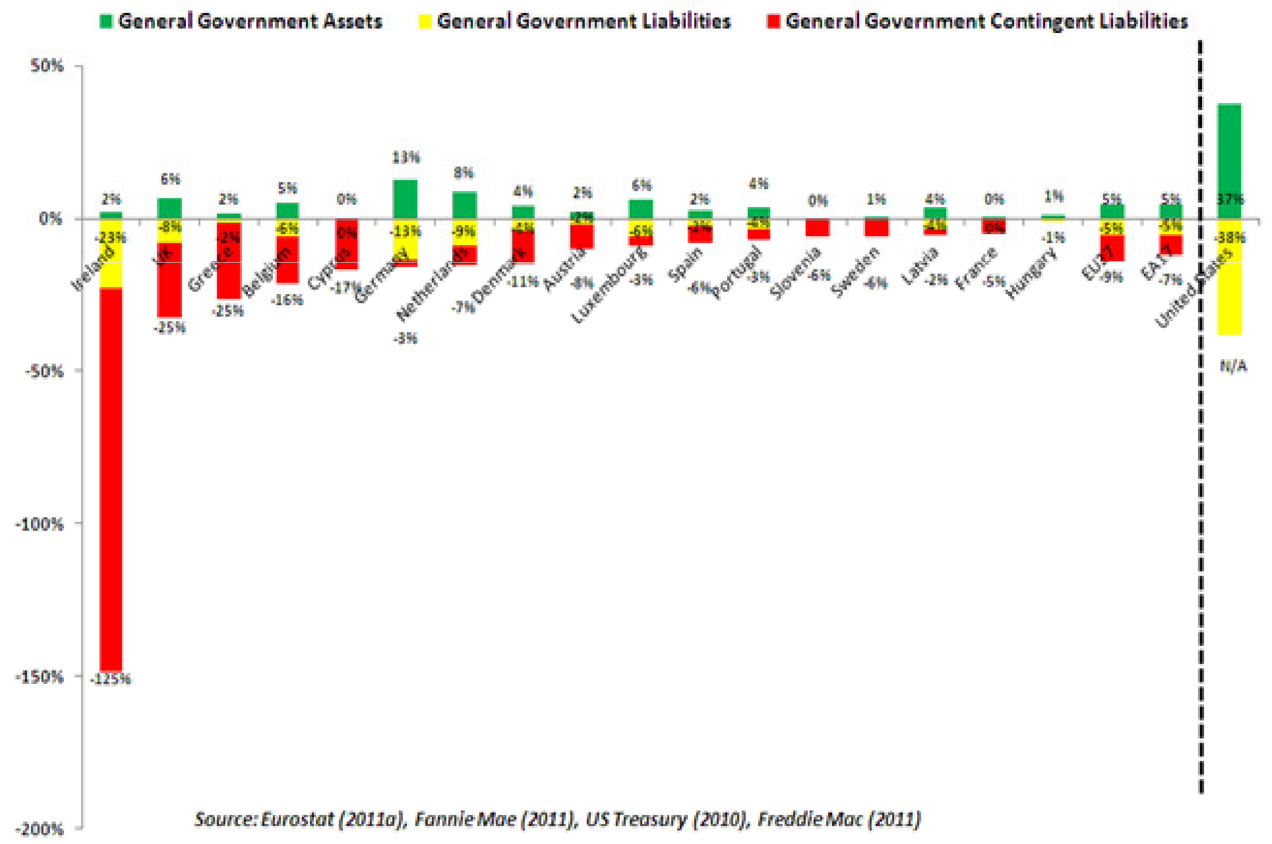
Country	1980	1990	2000	2007	2008	2009	2010	2011p	2012p
United States	42.3	63.9	54.8	62.3	71.6	85.2	94.4	100.0	105.0
EU-27	N/A	N/A	62.4	59.4	63.7	73.9	79.5	81.8	82.8
Euro Area 17	N/A	54.1	69.1	66.2	69.7	79.1	85.4	87.9	88.7
Japan	51.4	68.0	142.1	187.7	195.0	216.3	220.0	233.1	238.4
Korea	N/A	12.8	16.7	30.7	30.1	33.8	33.4	32.0	30.0
Germany	N/A	N/A	59.7	65.0	66.4	74.1	84.0	82.6	81.9
France	20.7	35.2	57.3	64.2	68.2	79.0	82.3	86.8	89.4
Netherlands	N/A	N/A	53.8	45.3	58.2	60.8	63.7	65.5	66.5
Belgium	74.1	125.8	107.9	84.2	89.6	96.2	96.7	94.6	94.3
Austria	N/A	56.1	66.5	60.7	63.8	69.6	72.2	72.3	73.9
Finland	10.8	13.9	43.8	35.2	33.9	43.3	48.4	50.2	50.3
Slovak Republic	N/A	N/A	50.3	29.6	27.8	35.4	41.8	44.9	46.9
Slovenia	N/A	N/A	26.8	23.4	22.5	35.5	37.3	43.6	47.2
Luxembourg	N/A	N/A	6.2	6.7	13.6	14.6	18.4	19.7	21.5
Estonia	N/A	N/A	5.1	3.7	4.6	7.2	6.6	6.0	5.6
Cyprus	N/A	N/A	48.7	58.3	48.3	58.0	60.8	64.0	66.4
Malta	N/A	N/A	55.9	61.8	61.3	67.3	67.1	66.3	66.1
Countries Supported By the ECB									
Italy	N/A	94.7	109.2	103.6	106.3	116.1	119.0	121.1	121.4
Spain	16.6	42.5	59.3	36.1	39.8	53.3	60.1	67.4	70.2
IMF Program Countries									
Greece	22.6	73.3	103.4	105.4	110.7	127.1	142.8	165.6	189.1
Portugal	N/A	57.3	48.5	68.3	71.6	83.0	92.9	106.0	111.8
Ireland	65.2	93.5	37.8	24.9	44.4	65.2	94.9	109.3	115.4
Non-Euro "Old EU Members"									
United Kingdom	46.1	32.6	40.9	43.9	52.0	68.3	75.5	80.8	84.8
Denmark	N/A	N/A	60.4	34.1	42.2	41.8	43.7	44.3	45.8
Sweden	N/A	N/A	53.2	40.2	38.8	42.8	39.7	36.0	32.6
Other OECD Countries									
Australia	N/A	16.2	19.3	9.6	11.7	16.9	20.5	22.8	23.8
Canada	N/A	75.2	82.1	66.5	71.1	83.3	84.0	84.1	84.2
Switzerland	N/A	38.2	61.1	57.2	54.8	54.8	54.5	52.4	51.2

Source: IMF World Economic Outlook September 2011

The Crisis Saw Massive Private-To-Public "Distressed Transfers"

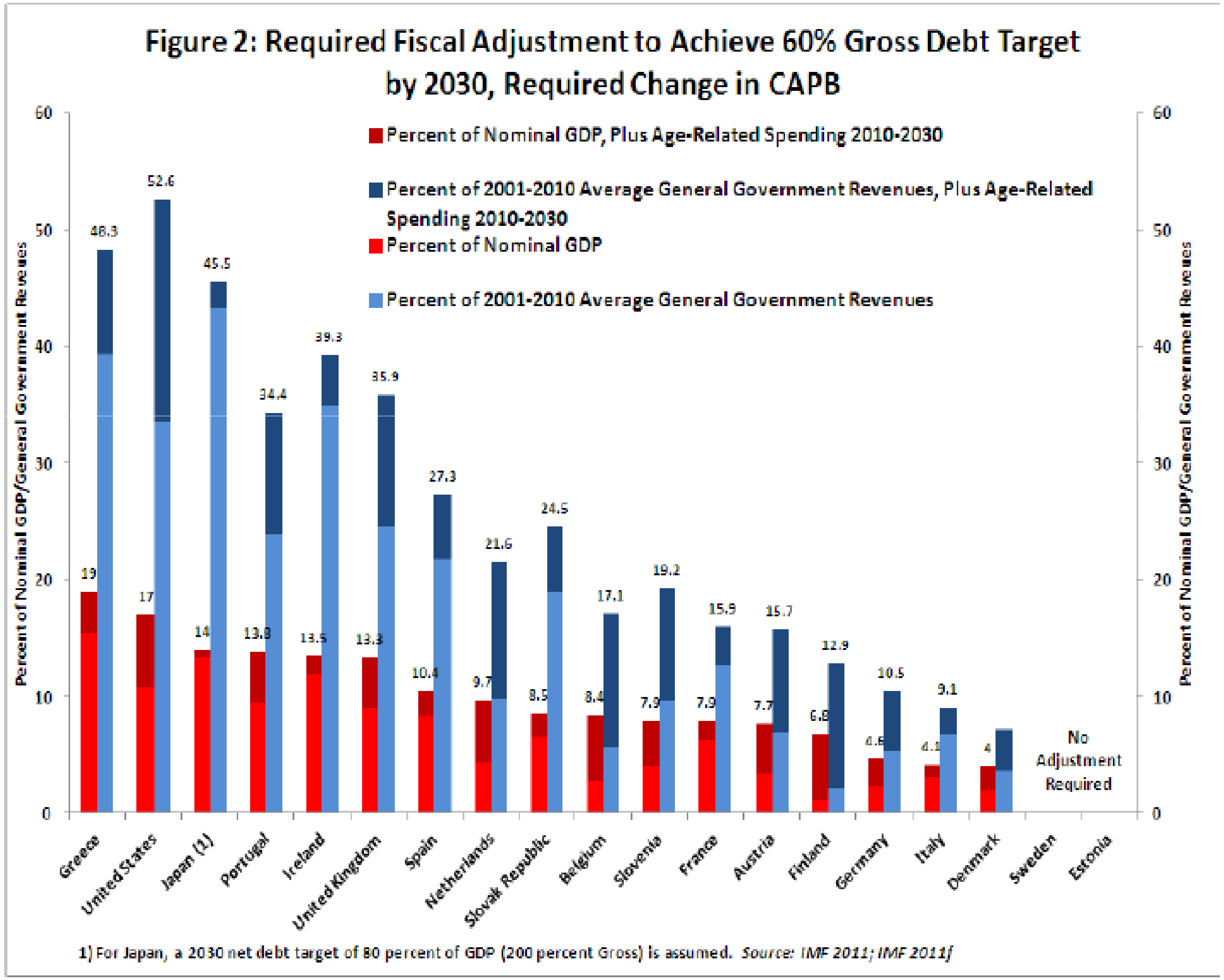
- Ireland a "Private-to-Public Outlier" in Europe – Contingent Liabilities Even Larger
- Germany second-largest transfers at 13% of GDP (€318bn – 75% of EU total and 3x UK and MUCH worse than Spain)
- German transfers consolidated into GG debt (9.5pp in 2010)
- US (Fannie, Freddie, TARP) even larger (3x Germany), but kept outside GG

Figure 1: General Government Assets, Liabilities and Contingent Liabilities from Public Interventions to Support Financial Institutions End-2010, Percent of GDP



The Crisis Saw Massive Private-To-Public "Distressed Transfers"

- Fiscal consolidation very large – especially as the Great Recession didn't end ageing
- Political challenge is colossal and not fully captured with the GDP-denominator
- LT GG revenues a better metric for the required improvement relative to the current "political status quo"

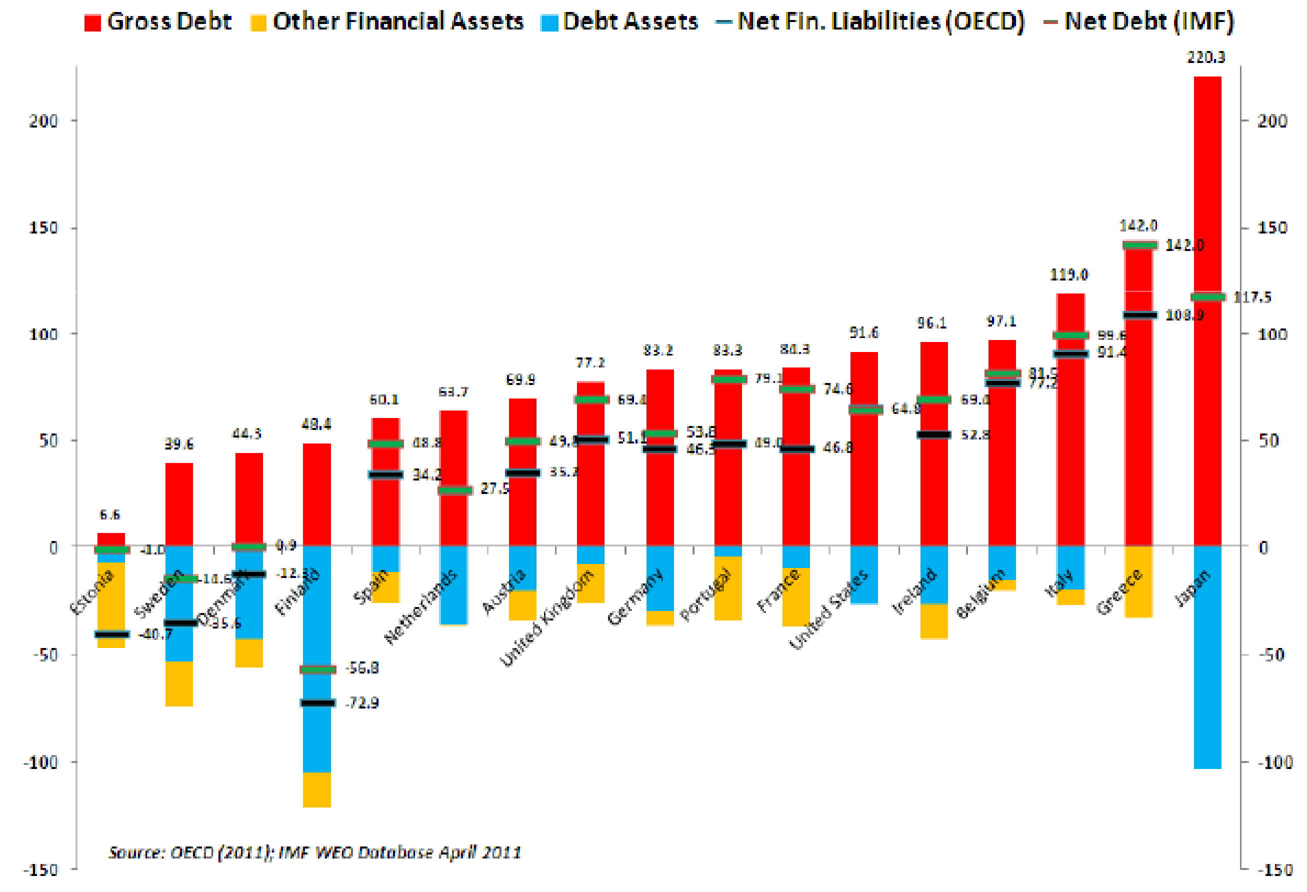


What About the Asset Side and Government Net Debt?

Peterson Institute for International Economics

- **Substantial "data issues" inhibit net debt comparisons**
- **US net debt levels generally higher than EU (indicating fewer financial GG assets)**
- **Japan's net debt levels now very high**
- **US "Debt-Held-By-Public" ~ Net Debt**
- **GG Assets Small Compared to High Debt Country Gross Liabilities (excl. JP)**

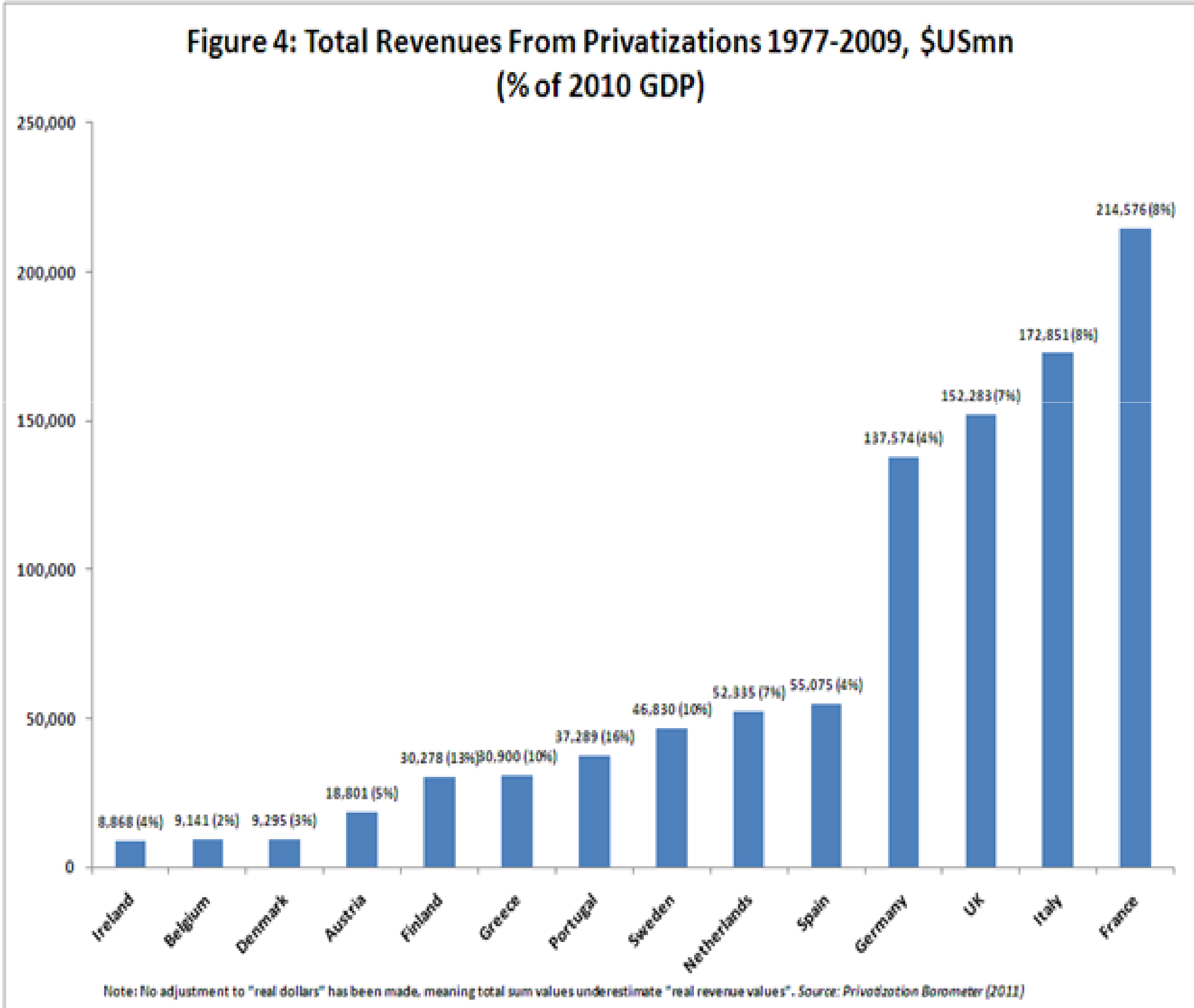
Figure 3: General Government Gross and Net Debt, Debt Assets and Other Financial Assets, Percent of GDP 2010



Privatization Revenues Have Varied Dramatically Across Europe

Peterson Institute for International Economics

- France Europe's biggest privatizer in $-terms
- PT, FI, SE, GR most intensive EU-15 privatizers
- Greece's 2015-IMF privatization commitment VERY large
- U.S./Japan have traditionally been reluctant privatizers
- Broader estimates of GG fixed assets equals fractions of liabilities



Privatization Revenues Have Varied Dramatically Across Europe

Peterson Institute for International Economics

Table 3: Debt Sustainability Estimates, By Gross and Net Debt Levels

	Country	Germany	France	Italy	Spain	Portugal	Ireland	Greece	Japan	United Kingdom	United States
1	General Government Gross Debt 2011(p), % of GDP	83%	87%	121%	67%	106%	109%	166%	233%	81%	100%
2	General Government Net Debt 2011(p) (IMF), % of GDP	57%	81%	100%	56%	102%	99%	153%	131%	73%	73%
3	General Government Net Financial Liabilities 2011(p) (OECD), % of GDP	50%	60%	101%	46%	75%	70%	125%	128%	62%	75%
4	Average Nominal Growth Rate(p) 2011-2016	2.5%	3.6%	2.6%	3.3%	2.0%	3.6%	1.0%	1.2%	5.2%	3.9%
5	General Government Implicit Interest Rate (p) (1)	3.0%	3.5%	4.4%	3.7%	4.7%	4.2%	4.8%	1.2%	4.2%	3.1%
6	*Primary Balance Required for Debt Sustainability - Gross Debt*	*0.4%*	*-0.1%*	*2.0%*	*0.3%*	*2.8%*	*0.7%*	*6.2%*	*0.03%*	*-0.8%*	*-0.8%*
7	*Primary Balance Required for Debt Sustainability - IMF Net Debt*	*0.3%*	*-0.1%*	*1.7%*	*0.3%*	*2.7%*	*0.6%*	*5.7%*	*0.02%*	*-0.7%*	*-0.6%*
8	*Primary Balance Required for Debt Sustainability - OECD Net Financial Liabilities*	*0.2%*	*-0.1%*	*1.7%*	*0.2%*	*2.0%*	*0.4%*	*4.7%*	*0.02%*	*-0.6%*	*-0.6%*
9	Average Projected Primary Balance (p) 2011-2016 (2)	1.4%	-0.9%	3.5%	-2.2%	1.5%	-1.2%	3.0%	-6.4%	-1.8%	-4.7%
10	*Implied required improvement in projected average primary balance 2011-2016 - Gross Debt*	*-1.0%*	*0.8%*	*-1.4%*	*2.5%*	*1.3%*	*1.9%*	*3.2%*	*6.4%*	*1.0%*	*3.9%*
11	*Implied required improvement in projected average primary balance 2011-2016 - IMF Net Debt*	*-1.2%*	*0.8%*	*-1.8%*	*2.4%*	*1.2%*	*1.8%*	*2.8%*	*6.4%*	*1.1%*	*4.2%*
12	*Implied required improvement in projected average primary balance 2011-2016 - OECD Net Financial Liabilities*	*-1.2%*	*0.8%*	*-1.8%*	*2.4%*	*0.5%*	*1.6%*	*1.7%*	*6.4%*	*1.2%*	*4.1%*

(1) Annual interest expense as percent of gross general government debt of preceding year. (2) The five-year 2011-2016 average value covers a period during which very large improvements in the primary balance in several countries are projected. As such, it is inherently an optimistic value, which assumes that governments do as projected in the IMF September 2011 WEO. Values in italics are estimated, while 2011 data are projected. *Sources: IMF (2011); OECD (2011); European Commission (2011)*

- **Very basic debt sustainability criterion, where the GG primary surplus (PS) required to stabilize debt levels is PS = d(r-g)/(1+g), d=debt/GDP, g = nominal growth rate, r = government interest rate**

- **Gross vs. net debt levels make relatively little difference for debt sustainability – what matters is growth rates and interest costs**

Concluding Remarks

Peterson Institute for International Economics

1. Even assuming a “crisis effect” a’ la 1989, new revenues from government assets can play only a minor role in restoring U.S., EU and Japanese fiscal sustainability (or save Greece)

2. Successful “wind-up” of distressed assets taken over during financial crisis can nonetheless have significant positive gross debt effects in places like Germany and Ireland (NAMA)

3. “Asset types” matter and allowing for “data issues”, US net debt levels look worse than in Europe, while “debt held by the public” is not a realistic metric of the future economic debt burden in America (or Japan), as it ignores that “assets are earmarked“ for pension provision

4. In general, focusing on net debt levels instead of gross levels must not remove the focus from the need to either restore growth or keep interest costs low to retain debt sustainability