# Macroeconomics
# &
# Global Economics

## **Presentation 8**

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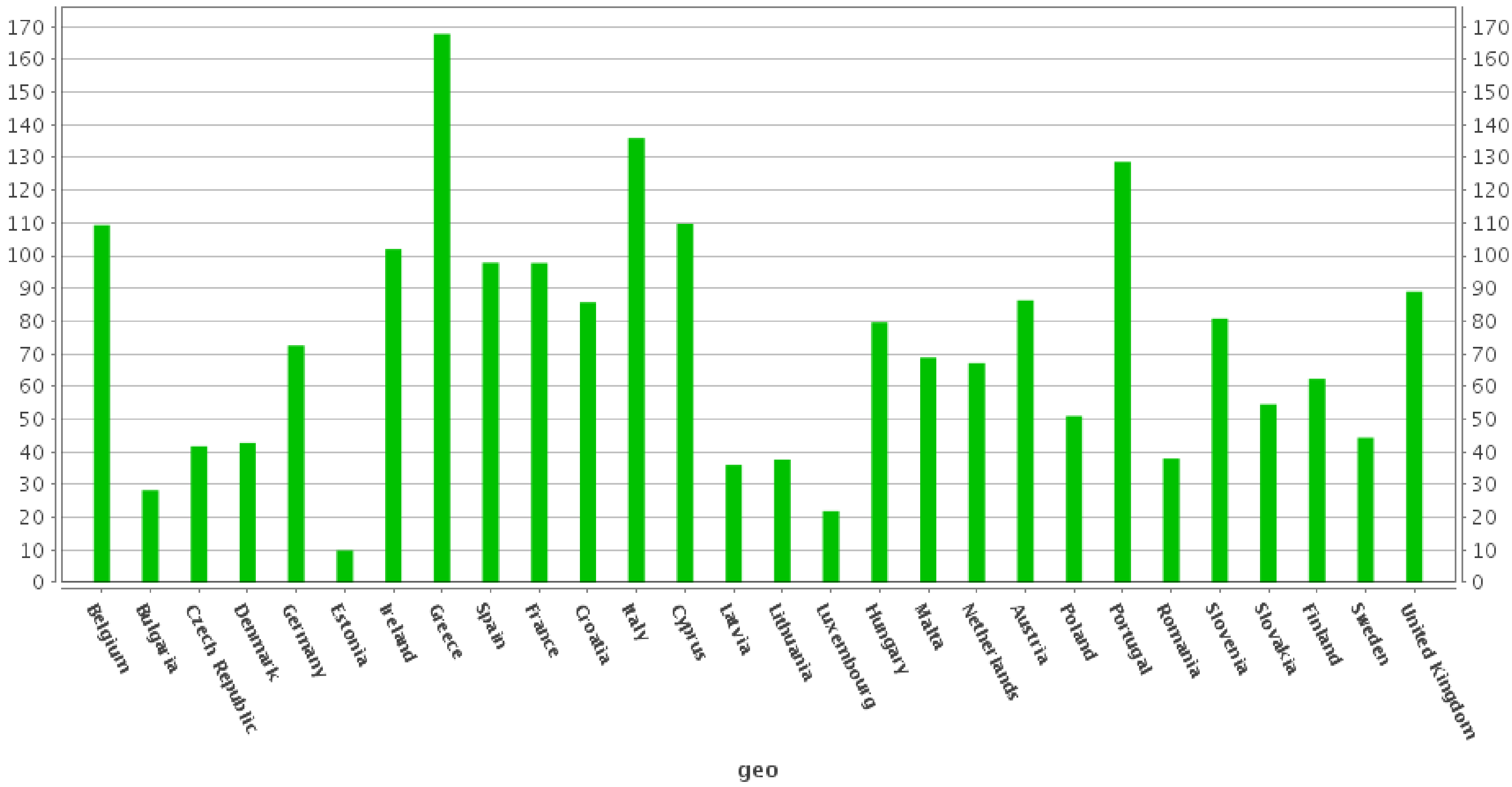
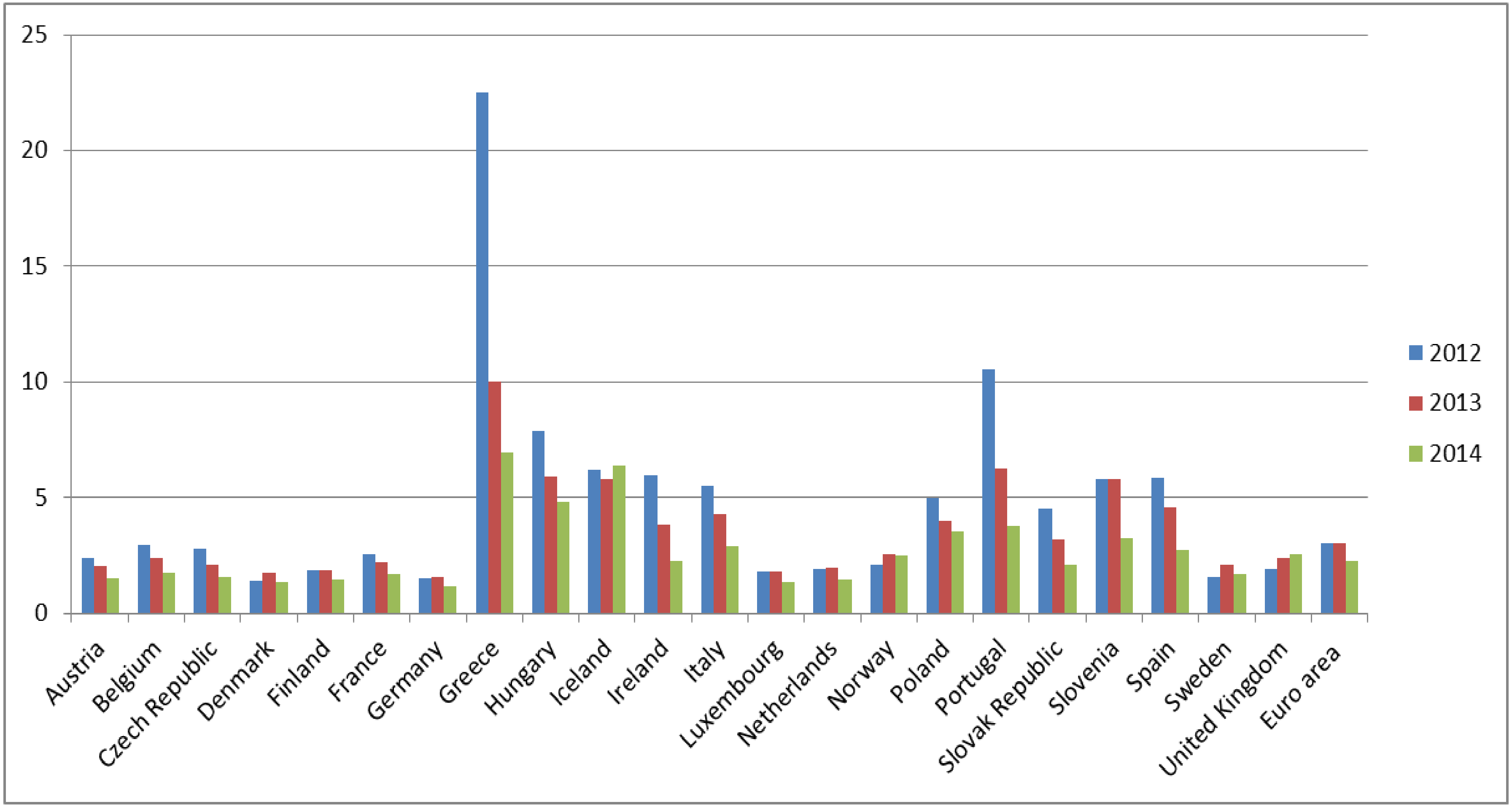
# General Government Debt/GDP – 2015 Q2



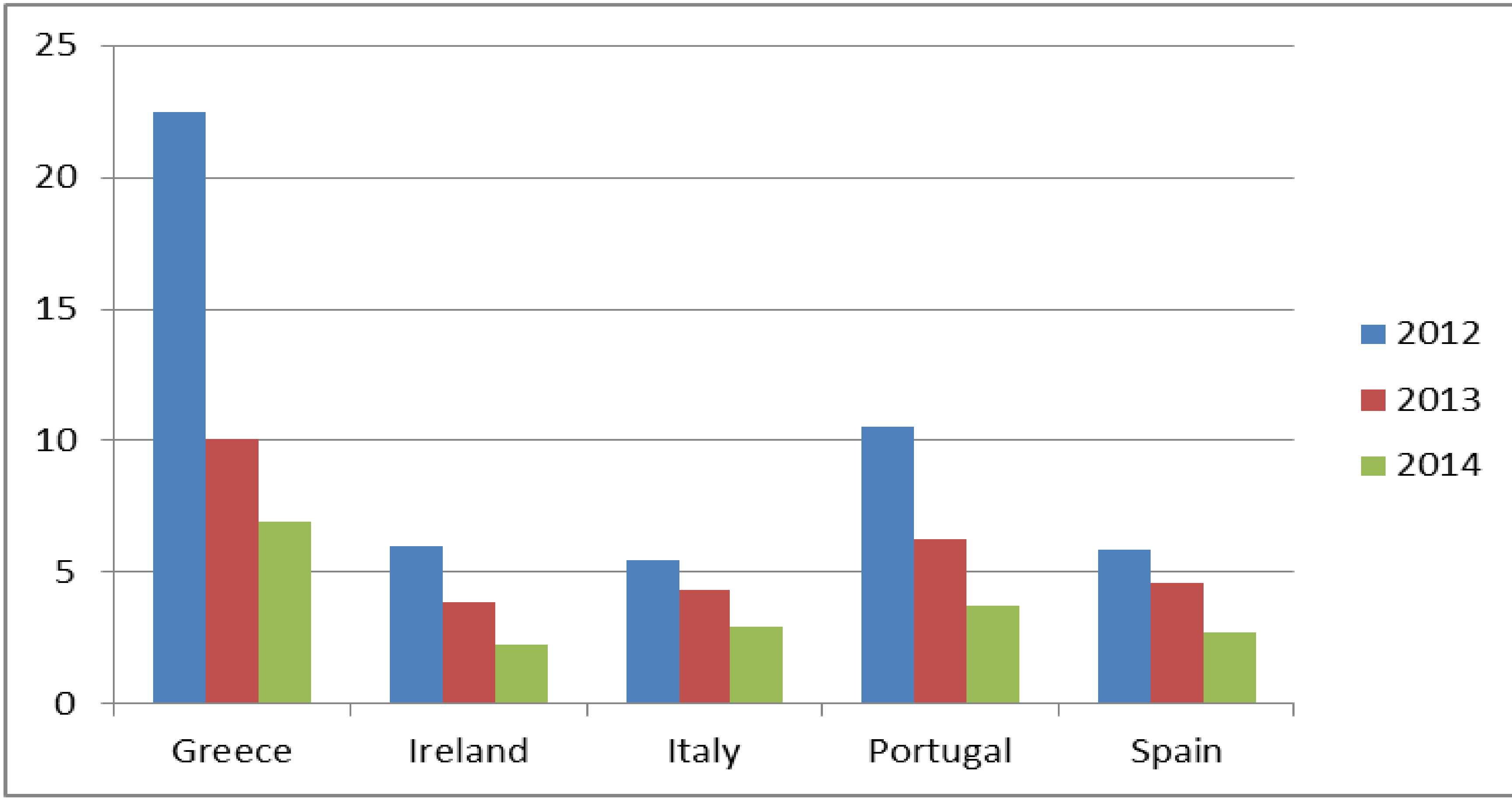

Source: Eurostat

# Interest rates




Source: ECB

# Interest rates - PIIGS




Source: ECB

# Four episodes of reduction of a high public debt

- **Germany in the post-war period**
- **France in the post-war period**
- **The UK in the post-war period**
- **The USA after the Second World War**

**Source: Blanchard, Amighini and Giavazzi, Macroeconomics: A European Perspective.**

Source: ECB

# Germany

- Germany financed military spending during the First World War mainly through borrowing.
- But Germany lost the war and at the end of the conflict found itself with a very high debt stock.
- **After the war, the German political situation was particularly unstable.**
- In the first half of the 1920s, the debt problem was aggravated by the high budget deficits accumulated by the Weimar government.
- The political and fiscal policy impasse of these years left, as the only solution, monetisation which led, as we will see in the next chapter, to hyperinflation.

# Germany

- One of effects of the German hyperinflation was the total cancellation of the debt that had existed at the end of the war.
- By the autumn of 1922, the debt did not exceed 5% of its real value in 1919.
- This dramatic reduction of wealth struck especially the middle class, which held the largest share of government debt.

# France

- In the decade that followed the end of the First World War, the debt was a particularly difficult problem due both to its size – the public debt represented about 150% of GDP
- At the beginning of the decade, there seemed to be an easy solution to the French public debt problem: have the Germans pay for it through reparations.
- It was only at the end of 1922, and after the occupation of the Ruhr, that the French began to understand that German taxpayers would not be able to pay

# France

- Then an endless debate began between the opposition, on the one hand, and the conservatives on the other… **Huge political instability!**
- Risk of hyperinflation… BUT in the second part of th 1920s…. Raymond Poincaré assumed the leadership announced a drastic stabilisation programme.
- Political stability along with a CREDIBLE fiscal consolidation programme made the difference: the demand for government bonds recovered and inflation ended abruptly, even before the government had started the fiscal adjustment!!!!

## UK

- Even in the UK, the debt was very high at the end of the First World War: the debt-to-GDP ratio had reached 130% in 1919.
- What distinguished the UK from Germany and France? **Here the political situation was particularly stable.**
- Democratic institutions were very solid and, despite very high unemployment, were never really threatened by the risk of a social revolt.

## UK

- This made it possible to introduce fiscal and monetary contractions, whose main objective was the stability of sterling and its return to its pre-war value – thus allowing a return to the gold standard.
- At the same time, the government produced budget surpluses in order to reduce the high public debt.
- **The UK was one of the very few European countries where no expansionary fiscal policies were implemented to promote economic recovery.**

## UK

- The debt-to-GDP ratio started to decline in the second half of the 1930s, 15 years after the war.
- Who bore the burden of debt reduction in the UK? Certainly not those who had bought government securities!!!
- The burden of adjustment was borne primarily by taxpayers… and especially less wealthy classes were especially affected, because of an increasingly regressive tax system (taxes on goods such as tea, sugar, milk, etc…)

## USA

- The debt accumulated by the USA at the end of the Second World War was very close, in relation to GDP, to the debt ratio in the UK after the First World War.
- Very stable political situation.
- Great success of the fiscal adjustment without being forced to resort to repudiation.
- 15 years after the end of the Second World War, the debt-to-GDP ratio was halved!!!
- Why so quick? High growth rate after the Second World War!
- During the period 1948–1968, the average growth rate of GDP in the

# Important lessons from the past

It is easier to reduce a high debt when:

- the economy is growing
- there is political stability and democratic institutions are solid