



# DEBT OVERHANG AND STABILIZATION POLICIES

<http://www.oecd.org/eco/achieving-prudent-debt-targets-using-fiscal-rules.htm>

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# Debt dynamics needs to be kept under control

- At public debt above 75% of GDP, private saving may offset a fiscal stimulus (Röhn, 2010)
  - Overall (short and long-run) effect of spending shocks can become negative beyond debt ratios of 65% to 70% (Nickel and Tudyka, 2014) .
- Keeping public debt dynamics under control is key to achieve the stabilization objective

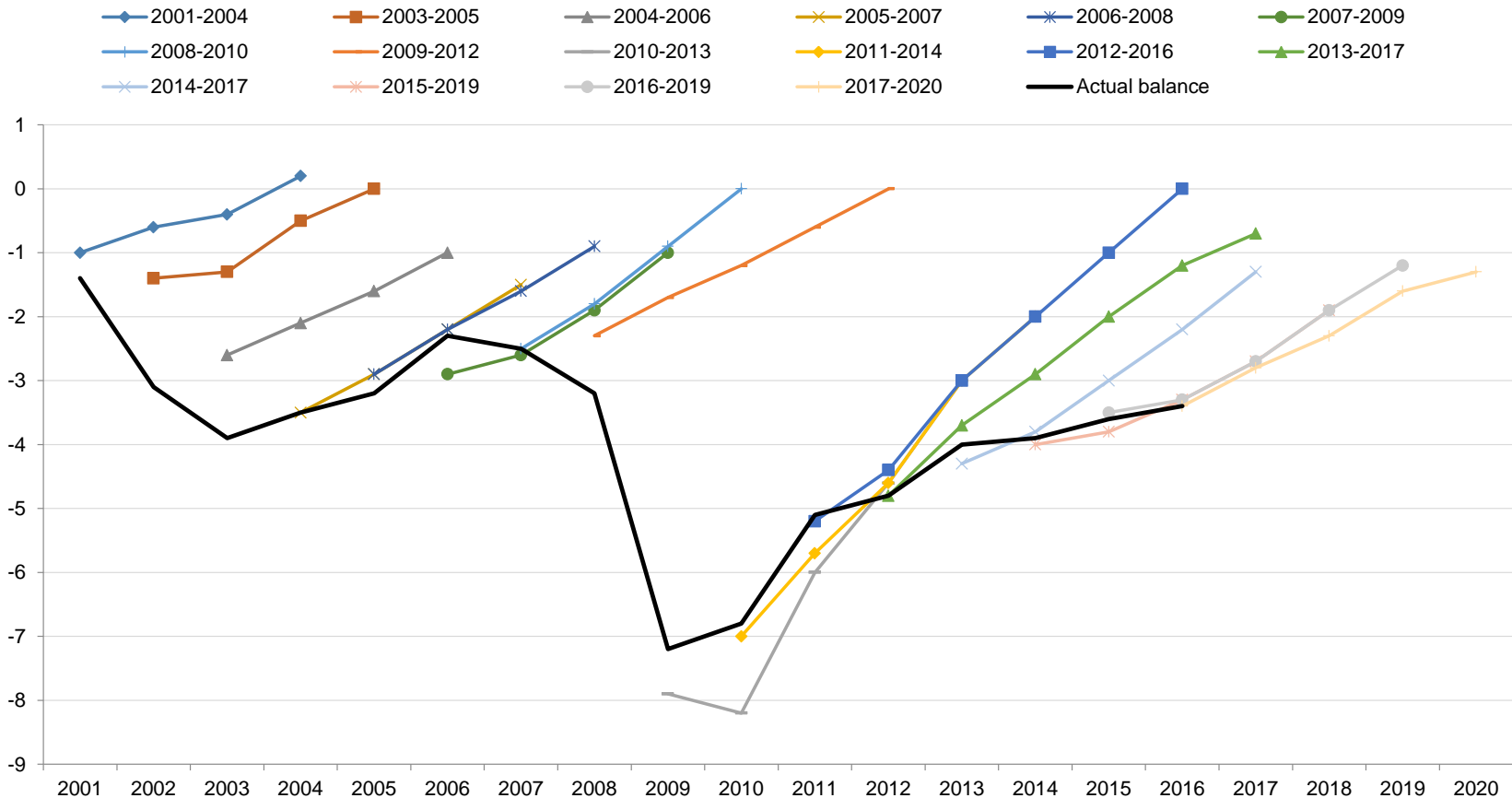
$$d_t = \underbrace{(r_t - g_t)}_{macro} d_{t-1} - \underbrace{pb_t}_{fiscal}$$

- Squaring the circle: fiscal rules need to ensure that public debt reaches a reasonable target, while allowing the use of fiscal policy to stabilise the economy



# Implementation of a deficit rule is far from straightforward

## French government deficit forecast for the Stability and Growth Procedure versus actual deficit

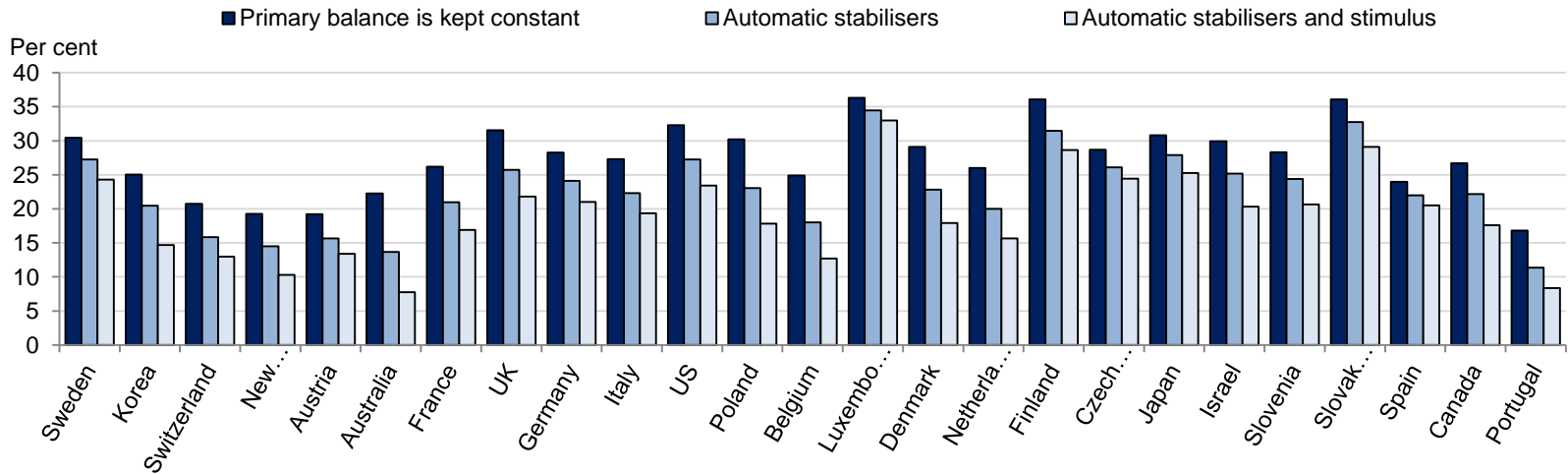


Source: Insee.

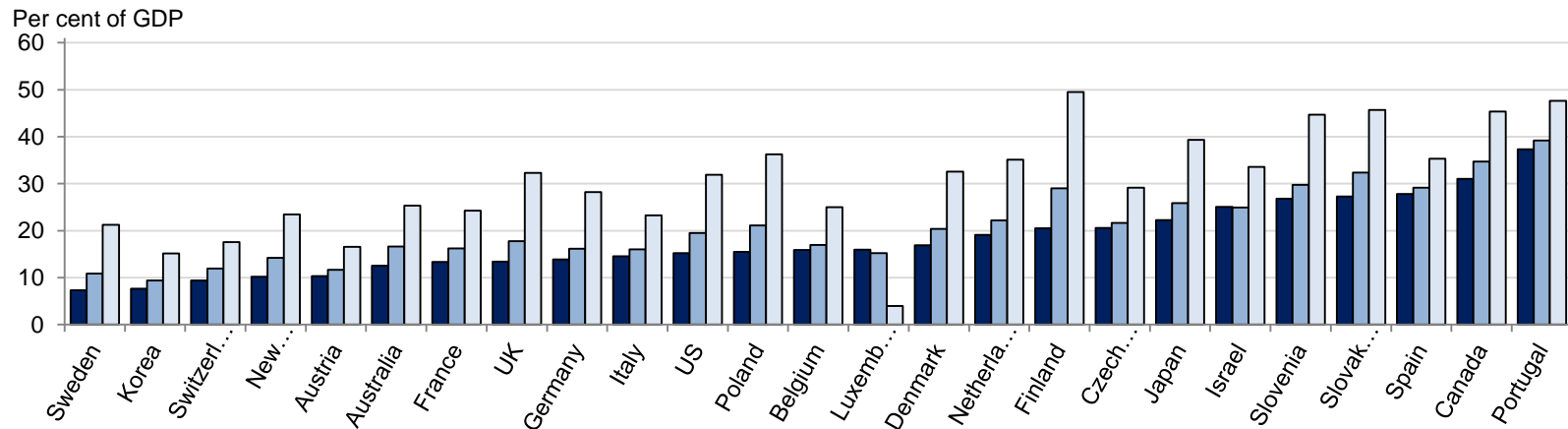


# The trade-off between counter-cyclical policies and debt dynamics

## Long-term recession risk



## Debt ratio uncertainty





# Revisiting fiscal rules to achieve both debt and economic stabilization objectives

- Targeting the debt-to-GDP ratio
- Introduce a spending rule
- Simplify the rules (e.g. merging the preventive and the corrective arms)
- Consider an incentive to issue GDP-linked bonds

$$d_t = \left( \underbrace{1 - \alpha}_{\text{share of nom. bonds}} \right) \underbrace{(r_t - g_t)}_{\text{macro}} d_{t-1} - \underbrace{pb_t}_{\text{fiscal}}$$



## Further information

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Fall, F., D. Bloch, J.-M. Fournier and P. Hoeller (2015), “Prudent Debt Targets and Fiscal Frameworks”, *OECD Economic Policy Papers*, No. 15, OECD Publishing, Paris.

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