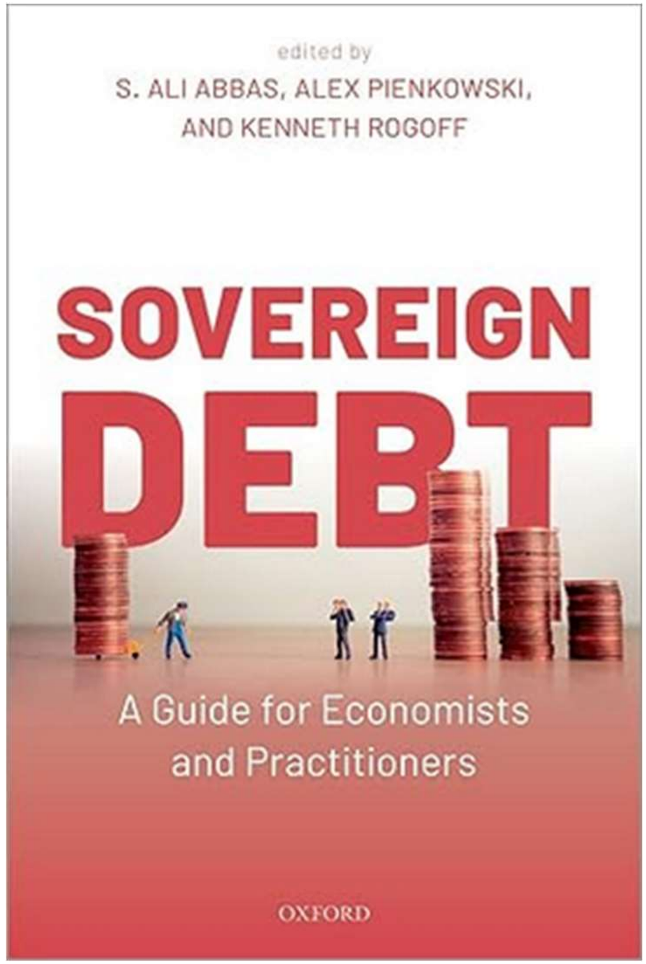
A Modern History of Public Debt

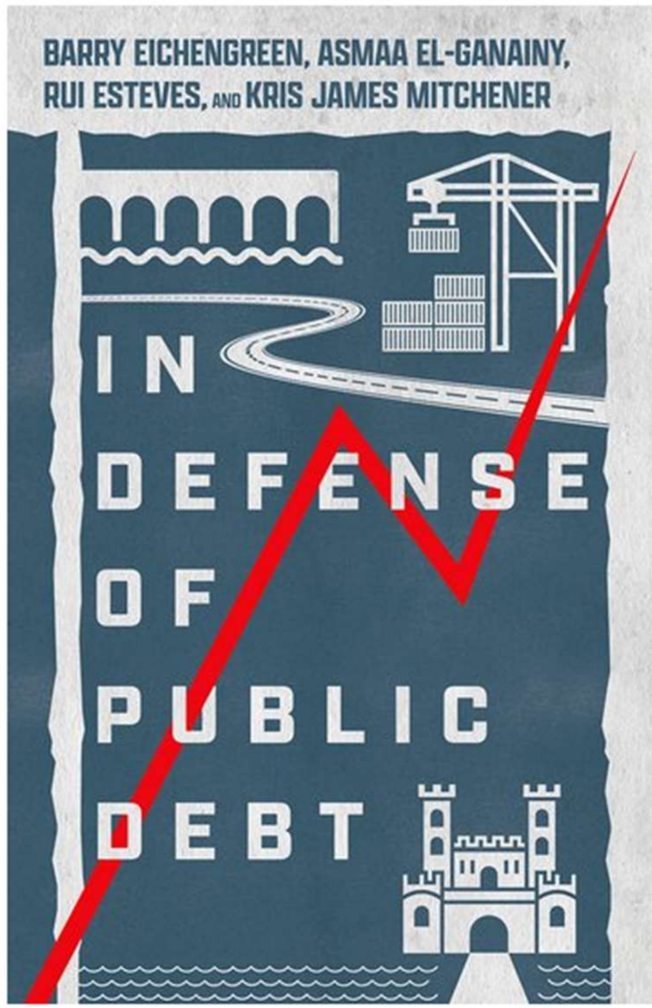
In Three Acts

Barry Eichengreen

May 18, 2025

Chapter 1


edited by
S. ALI ABBAS, ALEX PIENKOWSKI,
AND KENNETH ROGOFF
SOVEREIGN
DEBT
A Guide for Economists
and Practitioners
OXFORD


BARRY EICHENGREEN, ASMAA EL-GANAINY,
RUI ESTEVES, AND KRIS JAMES MITCHENER
IN DEFENSE OF PUBLIC DEBT

We are unabashedly (unfashionably) Eurocentric

- In arguing that early public debt history is European history.
- Because war was especially prevalent in Europe.
  - For much of its history, the European continent was divided into hundreds of princely kingdoms, many no more than cities with modest hinterlands.
  - Average state size was just 25,000 sq. kilometers (a la Charles Tilly).
  - Europe's geography as a landmass riven by mountain ranges and river valleys posed a natural obstacle to the formation of larger territorial states (a la Jared Diamond).

Contrast China

- Much of which is a great plain.
- With a unitary state as early as 221 BC.
- Along with a uniform written language, standardized currency and unitary tax system.
- For reasons of geography and internal unity, China lacked the same need to borrow to finance warfare.

But, from the start, sovereign borrowing was subject to commitment problems

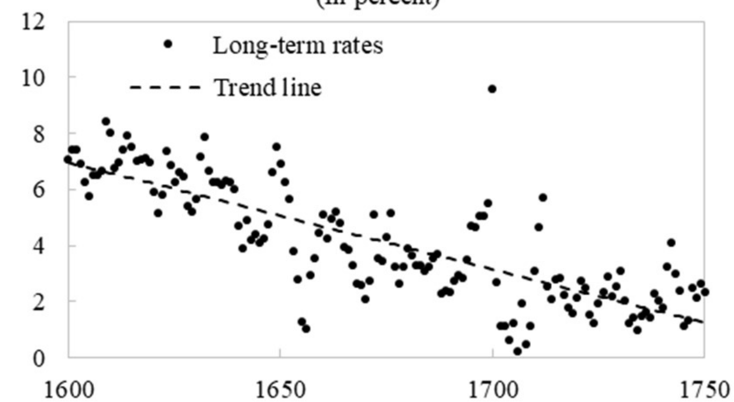
- The king or sovereign was the supreme earthly power and embodiment of the state. But this same unlimited power limited his ability to borrow, since there was nothing to prevent him from reneging on his obligations.
- Sovereigns could borrow, it followed, only at short terms and high interest rates.

Political preconditions

- Sovereign debt began its progressive march to higher modern levels, therefore, only with the creation of representative assemblies, where creditors sat and were empowered to oversee tax collection, approve increases in spending, and authorize issuance.
- With the creation of such assemblies in Italian city-states such as Florence, Genoa and Venice and then in the Netherlands and England, interest rates on sovereign debt came down.
- Sovereign debt came to be recognized as an obligation of the state rather than of the individual occupying the throne.

Figure 3.1: Long-term Borrowing Costs for Holland, Real Interest Rates, 1600-1750

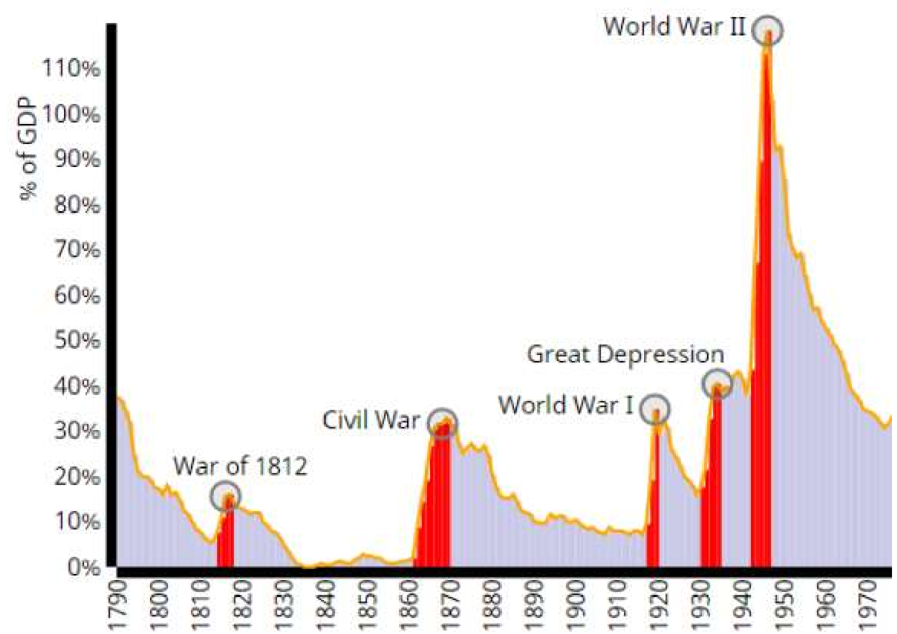
(In percent)



Sources: Schmelzing (2020) for the short-term rates and the Bank of England's database "A Millennium Macroeconomic Data" for the yields on long-term debt (consols) and prices.
Note: Inflation expectations are one-step-ahead forecasts from an ARMA(1,1) GARCH(4,1) model of Dutch price inflation.

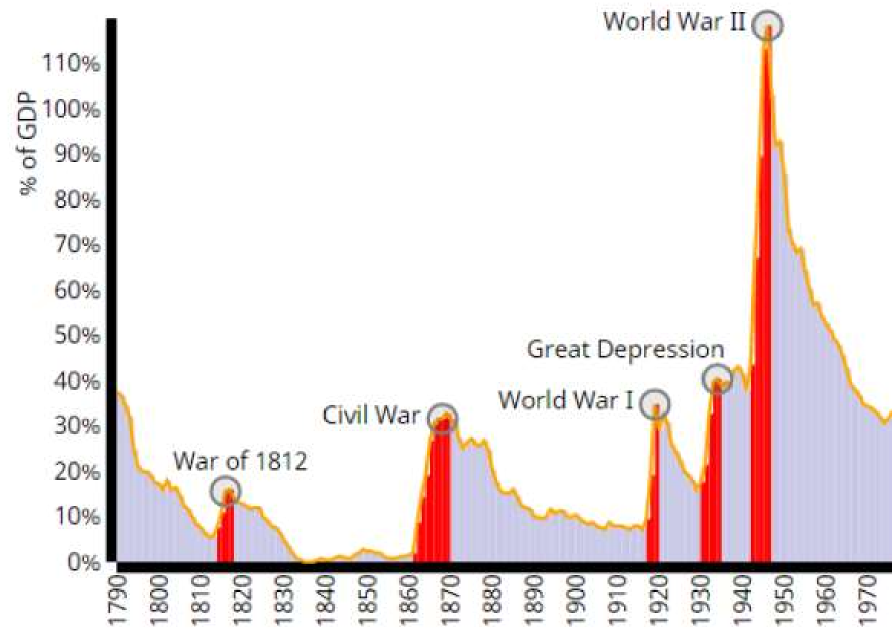
Public debt has always been used to meet emergencies

- Financing wars has always been of premier importance.
    - U.S. case at right.
- As has meeting public-health emergencies
    - COVID but also Sienna and Venice in the 14th century.
- And other exceptional circumstances.
    - Such as financial crises.



So while responsible states borrow to meet emergencies

- They also enhance or restore that borrowing capacity once the emergency has passed.
- We can be sure there will be another emergency: another novel coronavirus, financial crisis, climate disaster, or geopolitical event.
- So prudent governments need to start thinking about that restoration process sooner rather than later (see the most recent WEO…).



Chapter 2:
Living with High Public Debt

Living with High Public Debt

Serkan Arslanalp and Barry Eichengreen[1]

August 2023

1. Introduction

Public debts have soared to unprecedented peacetime heights. These high debts pose economic, financial and political challenges.[2] Multilateral financial institutions and others have consequently laid out scenarios for bringing them back down.

Our thesis in this paper is that high public debts are not going to decline significantly for the foreseeable future. Countries are going to have to live with this new reality as a semi-permanent state of affairs. These are not normative statements of what is desirable; they are positive statements of what is likely.

First, large, persistent primary budget surpluses are not in the political cards. Over the last half century, episodes where countries have run primary surpluses of, say, 3 to 5 percent of GDP for extended periods are very much the exception to the rule. Maintaining large primary surpluses requires favorable economic conditions and a degree of political solidarity that does not exist. Divided government and slow growth make this route to debt consolidation even more challenging than in the past.

Second, it is difficult to imagine more favorable interest-rate-growth-rate differentials (favorable interest-rate-growth-rate differentials reducing debt ratios in an accounting sense). Real interest rates have trended downward to very low levels. It is hard to foresee them falling still lower. Faster global growth is pleasant to imagine but difficult to engineer.[3] History suggests that the reorganization required of firms to capitalize on Generative Artificial Intelligence and other new general-purpose technologies, in ways that translate into faster aggregate growth, may take a decade and more.

Third, inflation is not a sustainable route to reducing high public debts. Only unanticipated inflation has this effect. Although an anticipated increase in inflation may reduce debt ratios in the short run by raising the denominator of the debt-to-GDP ratio, in the long run it is apt to raise interest rates and shorten maturities. At both horizons, these effects are unlikely to be economically important.

Fourth, statutory ceilings on interest rates and related measures of financial repression are less feasible today than in the past. Investors opposed to the widespread application of repressive policies are a more powerful lobby. Financial liberalization, internal and external, is an economic fact of life. The genie is out of the bottle.

All of which is to say that, for better or worse, high public debts are here to stay.

[1] International Monetary Fund and University of California, Berkeley, respectively. We thank numerous colleagues for helpful comments and Qin Xie for excellent research assistance. The views expressed are the authors' and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.
[2] The same could be said of private debts. These, however, are not the subject of our already long paper.
[3] Institutions such as the World Bank anticipate slower, not faster, growth over the next decade.

1

Updated Arslanalp-Eichengreen Figure 1

- This figure shows the recent evolution of debt ratios for the word as a whole.
- It is an update of a figure in Arslanalp and Eichengreen (2024).
- The data cover government debt in the form of both securities and loans in both domestic and foreign currencies, for the general government where possible, central government otherwise.
- Consolidated debt (debt in the hands of the public definition).
- *Unweighted* averages for 182 countries.

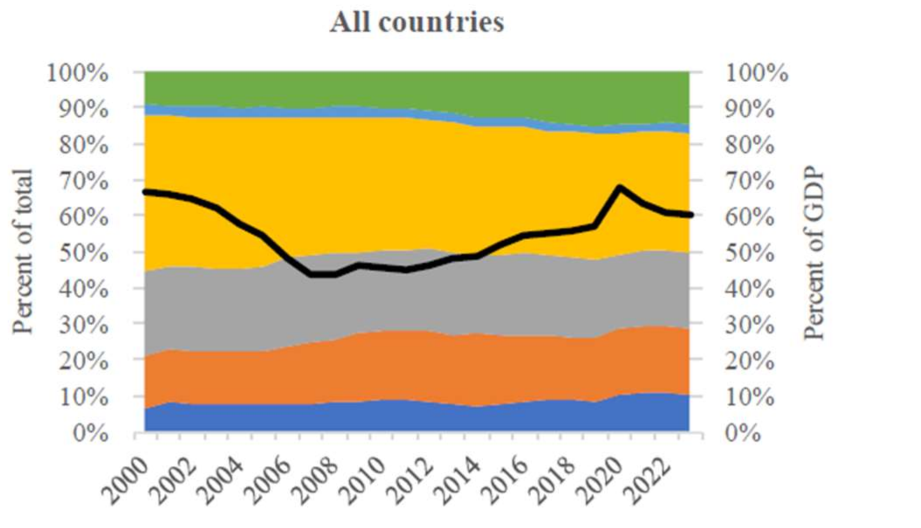


Figure 1. Holders of Government Debt, 2000-23
(Total in percent of GDP; Components in percent)

Updated Arslanalp-Eichengreen Figure 1

- Global averages trace out a u-shaped pattern, falling prior to the GFC and rising subsequently, and a further jump with COVID.
- There is a modest decline in 2020-22, reflecting unanticipated inflation and the resumption of growth.
- One noteworthy exception is major emerging markets, such as China and India (upper-left panel), which do not show a decline in recent years.
- Another is the US (lower-right panel) where, after falling with the burst of inflation in 2020-22, the debt ratio is heading up again.

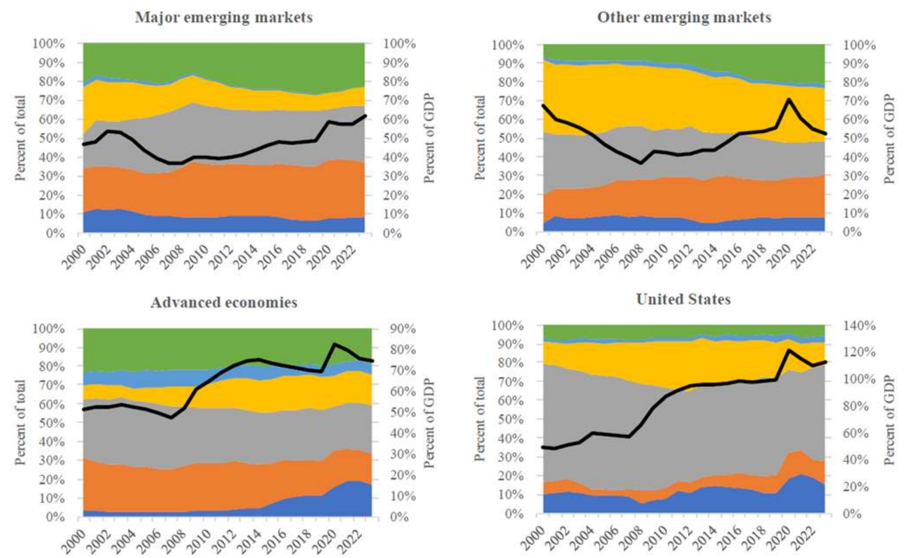
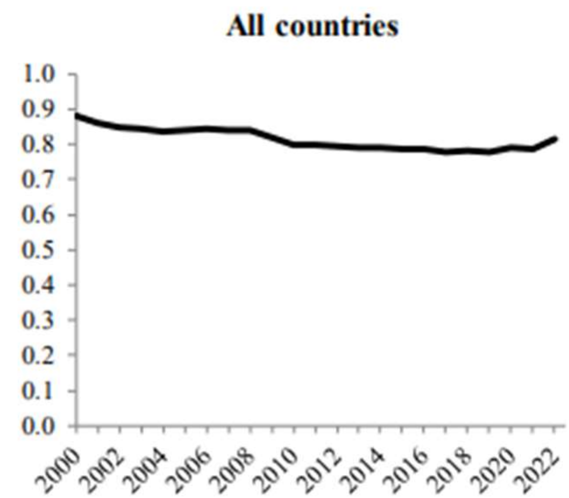


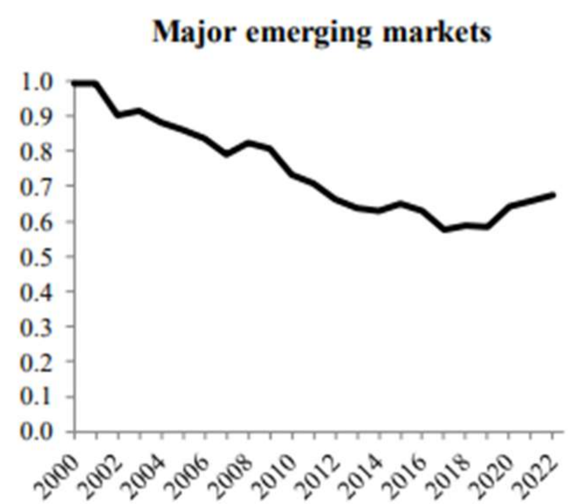
Figure 1. Holders of Government Debt, 2000-23
(Total in percent of GDP; Components in percent)

Domestic Central Bank, Domestic Banks, Domestic Nonbanks, Foreign Official
Foreign Banks, Foreign Nonbanks, Total debt (lhs)

And to ride my favorite hobby horse

- Globally, the problem of "original sin" (foreign currency denominated debt) has not gone away.
- OS = [1 – (Securities held externally and external loans taken by country i in currency i/Securities held externally and external loans taken by country i)]
- Unweighted averages once again.
- Only major emerging markets with relatively large local bond markets have made significant progress.





We then show that sharp, sustained reductions in public debt are exceptional

- We know this because public-debt-to-GDP ratios have been trending up in advanced countries, emerging markets, and developing countries alike.
- Governments have borrowed in response to financial crises, pandemics, wars and other emergencies, resulting in higher debt ratios, as noted.
- But only in rare instances have they brought those higher debt ratios back down once the emergency passed.

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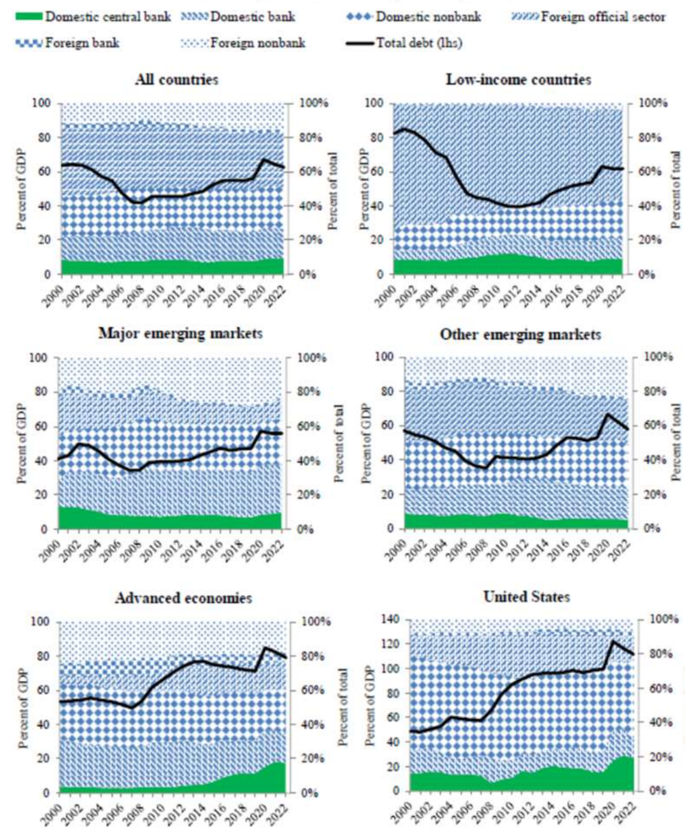


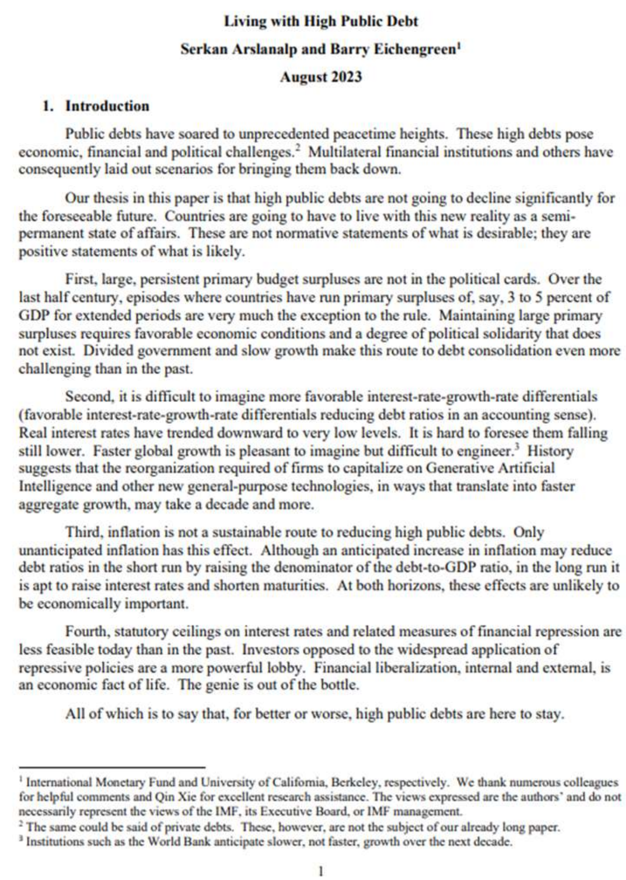
Source: Arslanalp and Tsuda (2014, updated).
Note: Government debt indicates general government gross debt on a consolidated basis, which excludes intergovernmental holdings. Domestic banks are depository corporations residing in the country (IFS definition). Foreign banks are BIS reporting banks residing outside the country. Foreign official includes foreign central bank holdings and foreign official loans. Foreign nonbanks and domestic nonbanks are imputed from external and total debt.

Both economic and political factors underlie this inability to reduce debt ratios

- Slowing GDP growth and rising real interest rates (r-g > 0) make for adverse debt dynamics.
  - We are now in a higher interest rate environment, owning in part to those same higher debt ratios.
  - The IMF and WB forecast slower growth in the medium term.
  - And now of course there is the Trump Shock.
- Ideological polarization and frequent government turnover make it hard to stay the course.
  - Polarization makes it hard to agree on how to share the burden of fiscal adjustment, fraying the coalition favoring debt reduction and causing policies to be reversed.
  - Turnover creates an opportunity for a new administration to repudiate the policies of its predecessor, disrupting efforts to sustain substantial primary budget surpluses.

This is what Serkan and I found in our Jackson Hole paper

- We found that the two robust correlates of large debt reductions are robust economic growth and low levels of political polarization.
- This finding, together with the aforementioned observations about slowing global growth and rising political polarization, leaves one pessimistic about the prospects.
- But perhaps not uniformly pessimistic…



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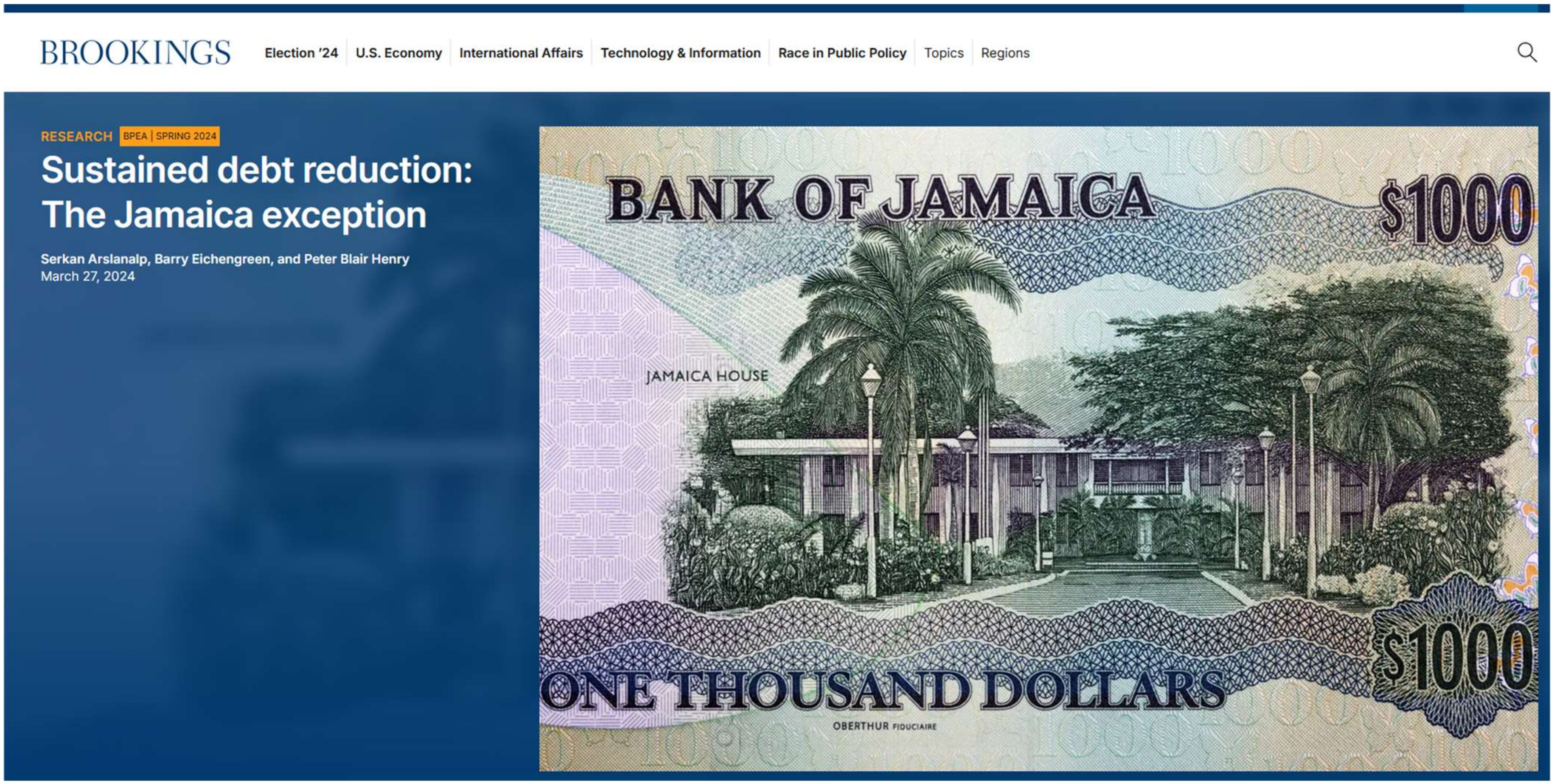
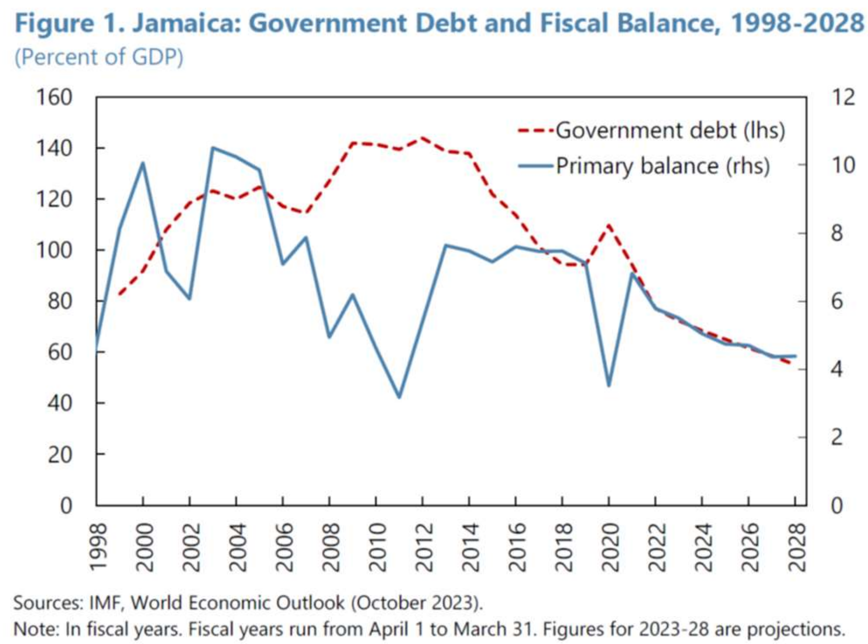
Chapter 3:
The Jamaica Exception



Jamaica is an exception

- You can here see what it has done.
    - Since 2013.
- And you can see how it has done it:
- By running very large primary surpluses.



This primary surplus record is exceptional

- At right is the list of all EMDCs that have reduced their debt by 40% of GDP or more over five years (2000-22 inclusive).
- Along with the contribution of the primary surplus in parentheses.
    - Sample excludes advanced countries and major defaults/debt restructurings.

40% of GDP or more	
BUL 2000-05	42.5 (12.2)
GEO 2002-07	42.6 (14.9)
JAM 2013-18	**44.4 (37.2)**
IDN 2000-05	44.8 (13.7)
LBN 2006-11	48.9 (12.2)
	44.6 (18.0)
	5

So how did Jamaica do it? Answer comes in two parts

- First, Jamaica adopted fiscal rules and procedures that increased fiscal transparency, encouraged formulation of a medium-term plan, and limited fiscal slippage.
- Second, elected officials leveraged Jamaica's hard-won tradition of consensus building – constructing over the course of 30 years social partnerships aimed at facilitating dialogue, limiting political instability, and reducing political polarization and violence – which fostered *ownership* of the resulting policies.

Fiscal Rules

- Introduced in 2010, the Fiscal Responsibility Framework required the Finance Minister to take measures to reduce, by the end of fiscal year 2016, the budget deficit to nil and the debt/GDP ratio to 100 percent.
- Strengthened in 2014 by requiring the minister, by the end of fiscal year 2018, to specify a multi-year fiscal trajectory to bring the debt/GDP ratio down to 60 percent by 2026.
- The FRF included an escape clause to be invoked in the event of large shocks. This prevented the rule from being so rigid, in a volatile macroeconomic environment, as to lack credibility.
- But it included clear criteria and independent oversight to prevent opportunistic use.

But fiscal rules don't always work, as we know

- They worked in Jamaica because democratic corporatism fostered ownership.
  - Starting in 2013, ongoing discussions within the National Partnership Council, a social dialogue collaboration involving the government, parliamentary opposition, and social partners, culminated in the Partnership for Jamaica Agreement on consensus policies in four areas, first of which was fiscal reform and consolidation.
  - The Partnership for Jamaica Agreement fostered the belief that the burden of fiscal adjustment would be widely and fairly shared.

EPOC and Polarization

- In addition, the Partnership Agreement…
  - …supported the creation and ensured broad national acceptance of the Economic Programme Oversight Committee (EPOC) to monitor and report on fiscal policies and outcomes, and to provide independent verification that all parties were keeping to the terms of their agreement.
    - An independent fiscal council, if you will.
  - Consensus and less polarization made for policy continuity and continued debt reduction when a different political party came to power in 2016. The new government did not reverse the policies of its predecessor.
  - By creating a sense of fair burden sharing, Jamaica's organized process of consultation thus sustained public support for the operation of the country's fiscal rules, culminating in March 2023 with the establishment of a permanent, independent Fiscal Commission.

Why did Jamaica follow this distinctive path?

- The answer lies in its history.
- EPOC and the Partnership for Jamaica Agreement that launched and kept Jamaica on the path of debt reduction were products of a distinctive national learning process.
- This had begun a third of a century earlier with the Electoral Advisory Commission.
- This approach of inclusive consultations, once they proved their efficacy, was transferred to other domains, including the economic, and eventually, the financial and budgetary.
- The decision to start down this road reflected the country's history of race and class division and political violence.
- It was a function as well of leadership: of the conviction of leaders and society, at the end of the 1970s, when the country reached the economic and political brink, that they needed to build inclusive institutions.

Table 3. History of Partnership Agreements

1979: Electoral Advisory Committee (EAC)
Nonpartisan body established to monitor elections, consisting of representatives of the Electoral Office of Jamaica, each of the two major political parties and civil society.

1989: National Planning Council
Multisector body established to advise government on issues related to national planning.

1997: ACORN
Social dialogue group led by members of civil society.

2003: Partnership for Progress
Initiated by the Private Sector Organization of Jamaica

2008: National Social Partnership Consultative Committee
Creation of National Social Partnership Consultative Committee including representatives of government, parliamentary opposition, private sector, trade unions and civil society groups

2009: National Partnership Council (NPC)
Creation of National Partnership Council consisting of representatives of the government, parliamentary opposition, and other stakeholder groups. NPC engages in respectful, constructive, and sustained dialogue and collaborates on critical national economic and social issues. Established under the operating rubric of **Partnership for Transformation**, the NPC, has operated across successive administrations. It led further to the creation of the following:

2011: Partnership Code of Conduct

2013: Partnership for Jamaica

2016: Partnership for a Prosperous Jamaica

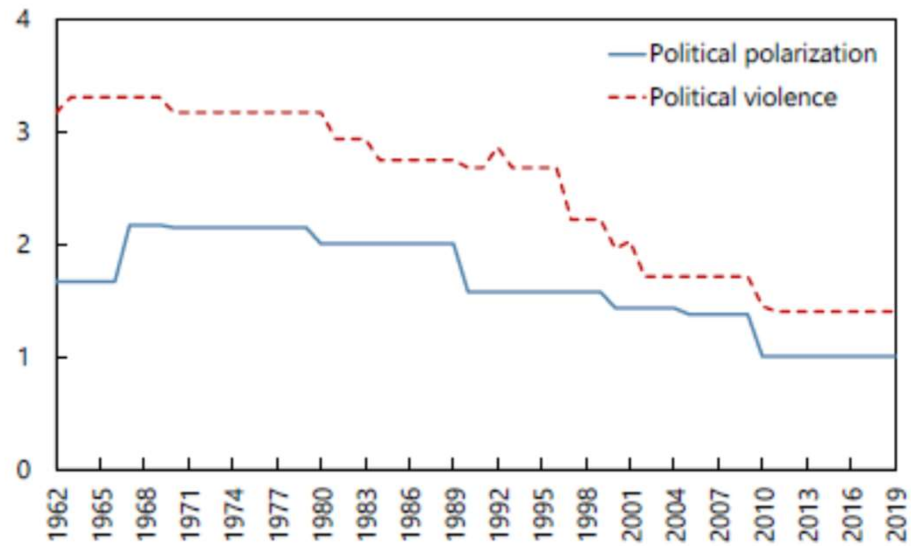
2022: Partnership for Jamaica's Strong and Sustainable Recovery.

Source: Jamaica, Office of the Prime Minister (2024): https://opm.gov.jm/national-partnership-council/

Resulting in an ongoing decline in political violence & polarization

Figure 2. Jamaica: Political Polarization and Political Violence

(Average Rating (0-4); lower figure indicates less polarization/violence)



Source: Varieties of Democracy (V-Dem) Dataset, Version 13.

An important question is whether the lessons from Jamaica generalize

- That Jamaica is such an outlier gives reason for doubt. (The list is short.)
- That Jamaica's experience flows from its earlier history (which is not exactly replicable elsewhere) gives further reason for caution.
- Perhaps to other small, open, relatively homogenous, highly structured economies.
  - We compare Ireland and Barbados as examples in the paper.
  - More recently Suriname has explicitly followed Jamaica's example, with fiscal rules, a program oversight committee, and strong private sector participation.

40% of GDP or more	
BUL 2000-05	42.5 (12.2)
GEO 2002-07	42.6 (14.9)
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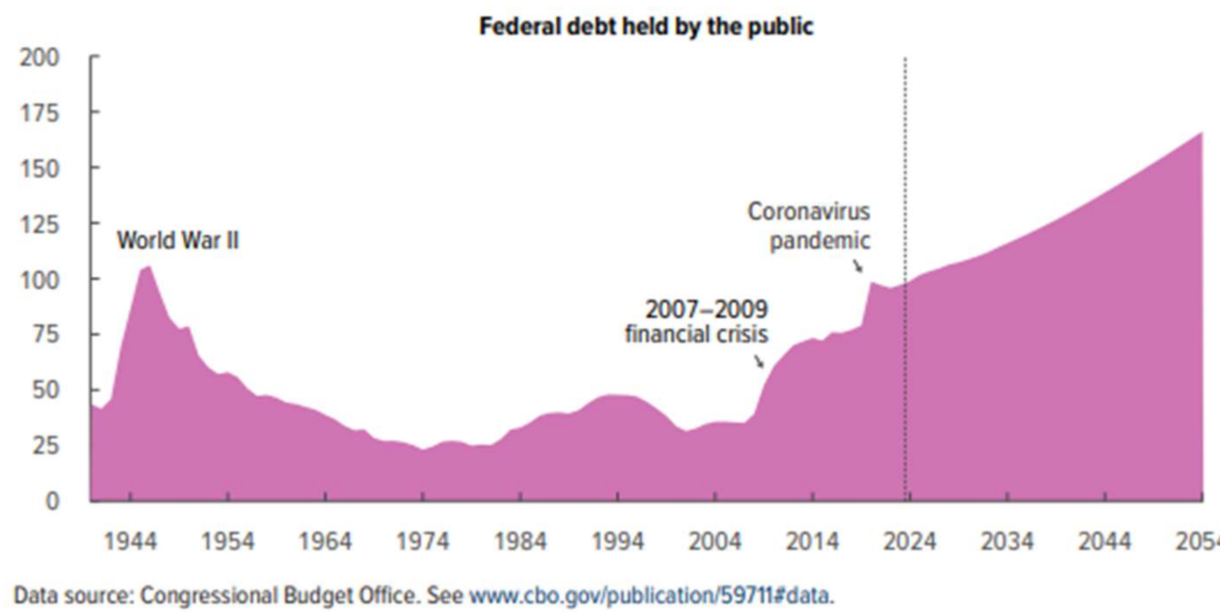
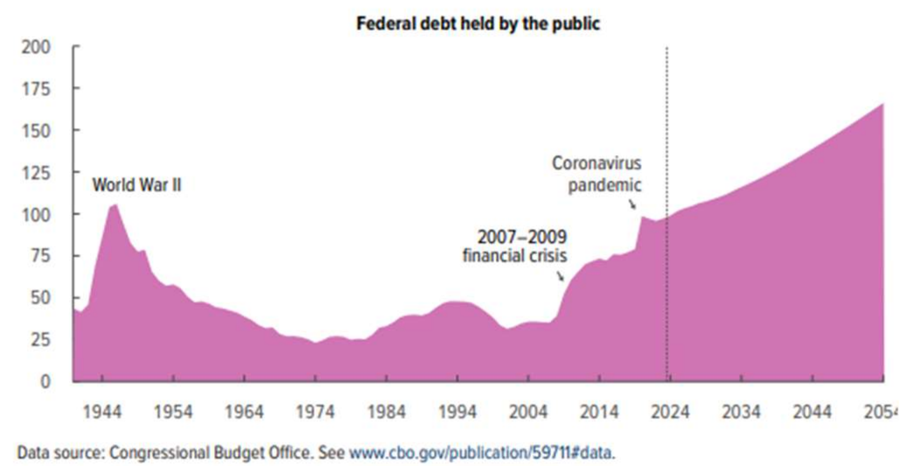
Chapter 3. Prospects for the United States

- This alarming picture is well known.
- So "how bad is it, really?"

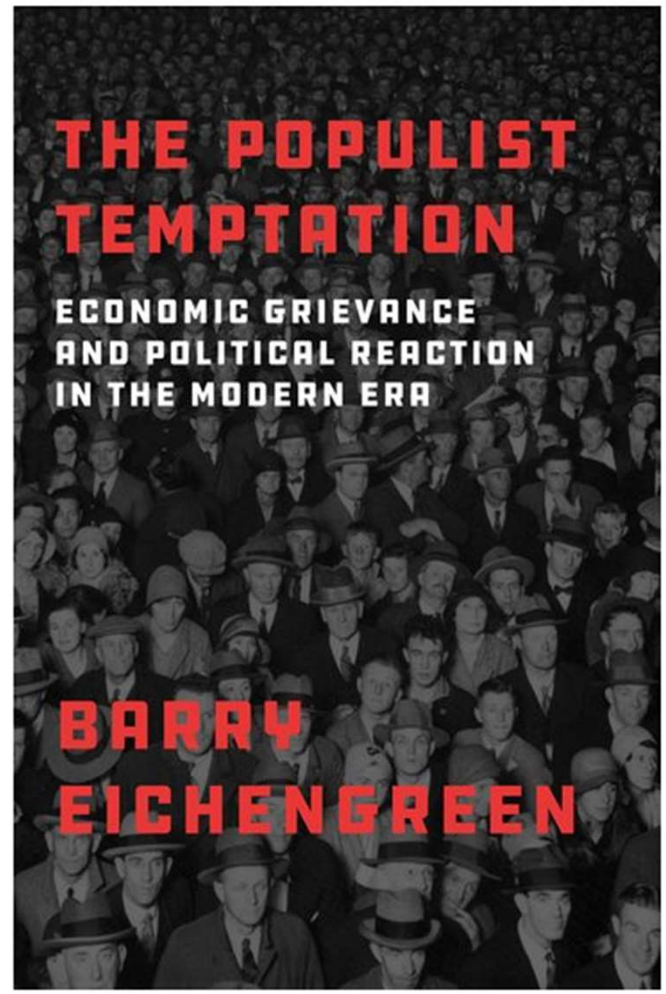


Note that this is on the (statutory) assumption of current law

- Which includes the assumption that Trump era tax cuts will expire as currently scheduled in 2025.
- Moreover, it does not include Trump's proposed addition tax cuts (on tips, on car loans, on overseas US citizens) or Harris's new spending plans.
- So the medium-term prospects may be even gloomier than shown here.



- The idea being, as here, that a history of racial divisions going back to slavery, together with more than a century of tension over immigration, result in a lack of social solidarity that make it hard for the U.S. to agree on the shared sacrifice needed to bring its debt (and other things) under control.



- On that happy note, let me say thank you.