Debt sustainability during the pandemic

Luuk Oudshoorn

Supporting the economy

In March, the government announced up to 90B financial support.

Costs of COVID so far: 45-144B

1. Kolen (2020) ESB 4791 504-509
2. Frijters (2020) ESB 4791 510-513

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Fiscal stimulus

- ✓ **Job retention schemes**

- ✓ **Liquidity support**

- ✓ **Cash transfers to businesses**

- ✓ **Looking ahead: NGEU**

➤ FISCAL MONITOR: Policies for the Recovery (IMF, 2020)
➤ The risk of 9 million zombie jobs in Europe (Utermöhl, Ozyurt, and Subran 2020)
➤ Hagen-Zanker J., Bastagli F., Harman L., Barca V., Sturge G., Schmidt T.,2016, ODI Briefing. London: Overseas Development Institute
➤ Brunnermeier M., Krishnamurthy A., 2020
➤ Wilson D. J., 2012, American Economic Journal: Economic Policy, 4, 251
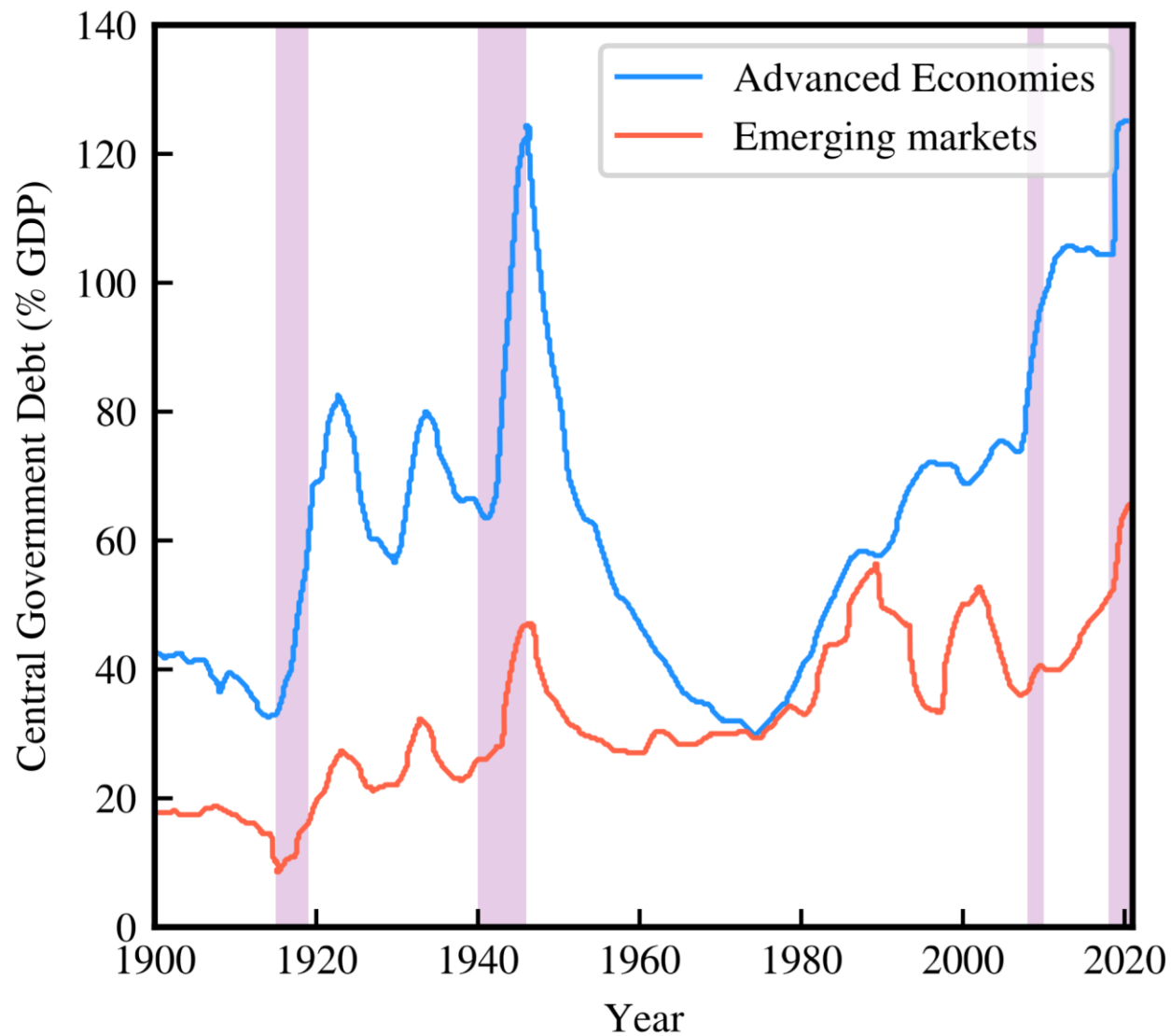
Financing these expenses

✓ **Lower taks revenue and higher costs**

✓ **Government deficit**
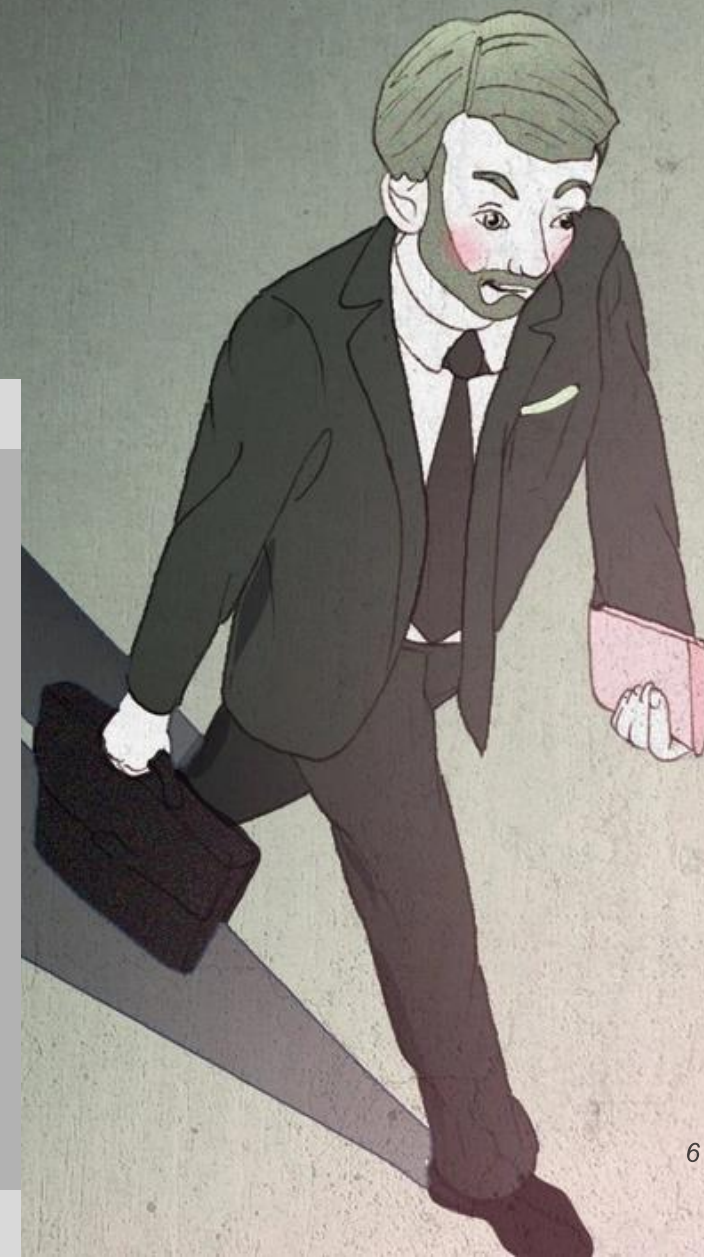
✓ **Debt issuance**
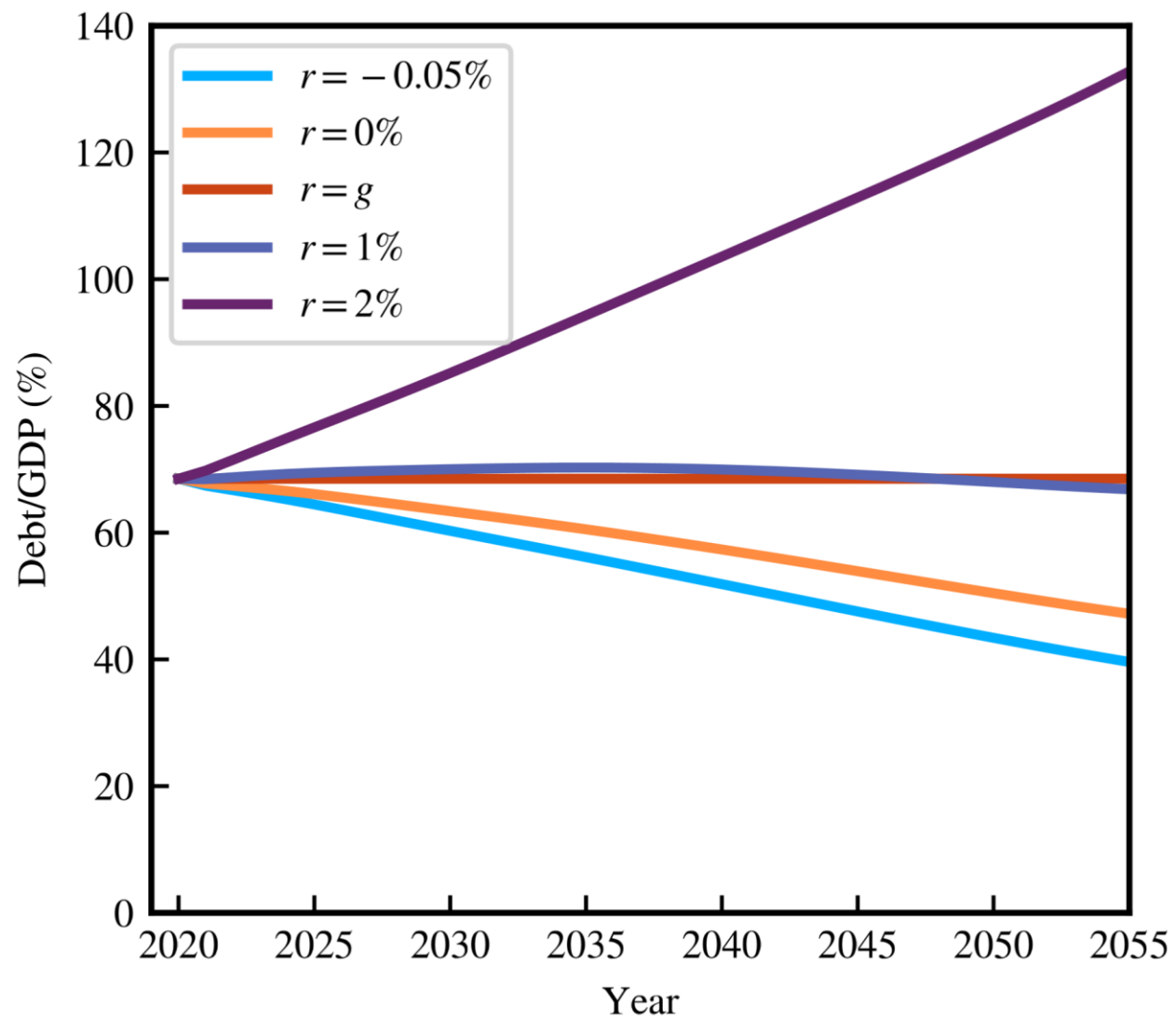
Stability and sustainability

- ✓ **Since 1980s ever increasing debt**
- ✓ **Worries about sustainability**
- ✓ **Trade-off**

Historical evidence

Can we look at historical fiscal and monetary parameters to create future expectations?
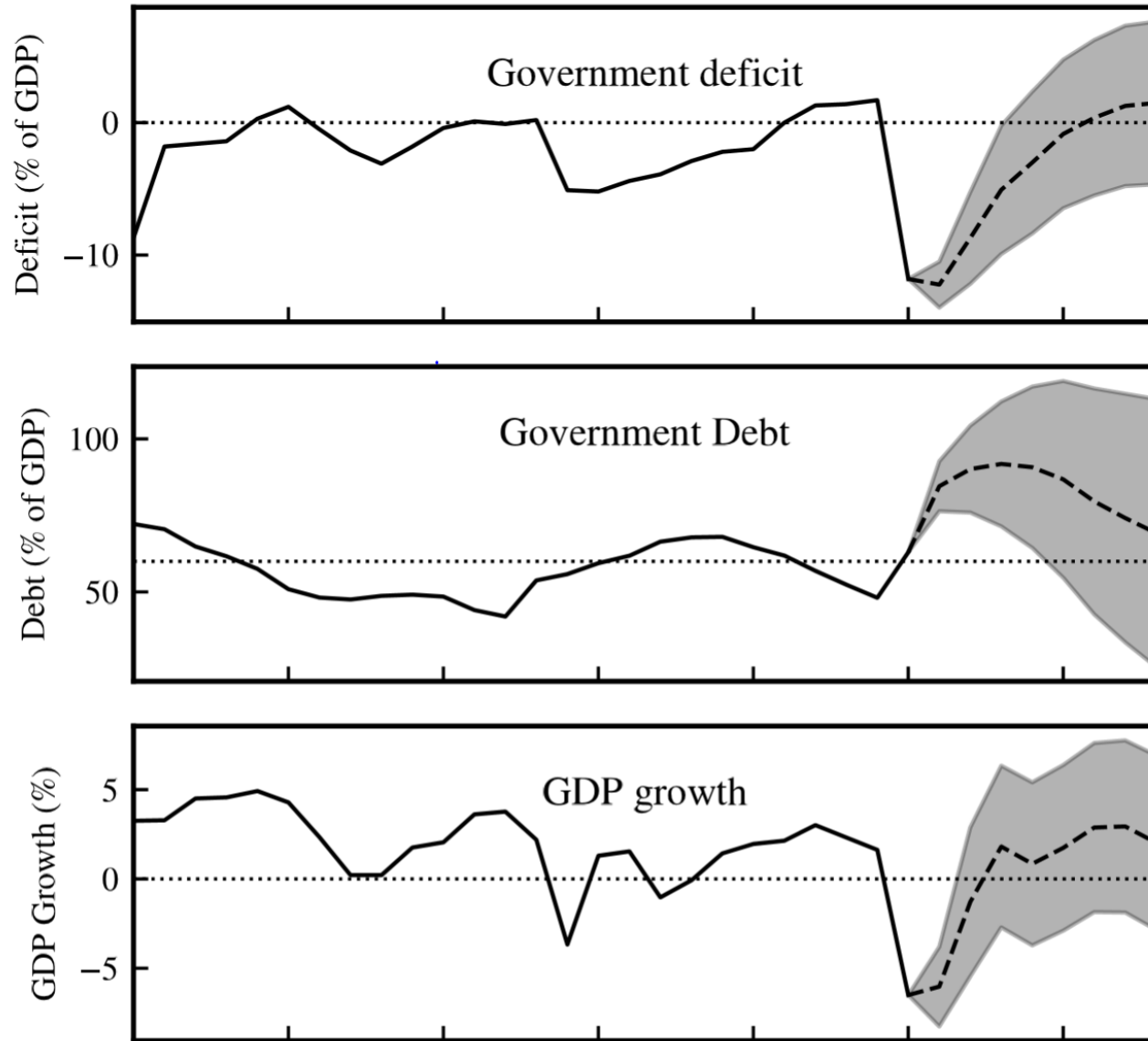
$$\mathbf{x}_t = c + \theta_1 \mathbf{x}_{t-1} + \theta_2 \mathbf{x}_{t-2} + \theta_3 \mathbf{x}_{t-3}$$
$$\mathbf{x}_t = (d_t, g_t, D_t, \pi_t).$$

$$\begin{cases} d_t = \underset{(0.24)}{0.84}\, d_{t-1} - \underset{(0.3)}{0.64} d_{t-2} - \underset{(0.07)}{0.3}\, D_{t-1} - \underset{(0.22)}{0.48}\, g_{t-1} - \underset{(0.33)}{0.57}\, \pi_{t-1} \\ D_t = -\underset{(1.16)}{2.05}\, d_{t-1} + \underset{(0.32)}{1.3}\, d_{t-1} D_{t-1} \end{cases}$$

$$\begin{cases} g_t = \underset{(0.13)}{1.2}\, g_{t-1} + \underset{(0.35)}{0.82}\, r_{t-1} - \underset{(0.58)}{1.6}\, r_{t-2} + \underset{(0.05)}{0.1}\, D_{t-4} \\ \pi_t = \underset{(0.12)}{0.9}\, \pi_{t-1} - \underset{(0.13)}{0.27}\, \pi_{t-4} \\ r_t = \underset{(0.13)}{1.35}\, r_{t-1} - \underset{(0.21)}{0.54}\, r_{t-2} - \underset{(0.019)}{0.038}\, D_{t-1} + \underset{(0.027)}{0.057}\, D_{t-2} \end{cases}$$
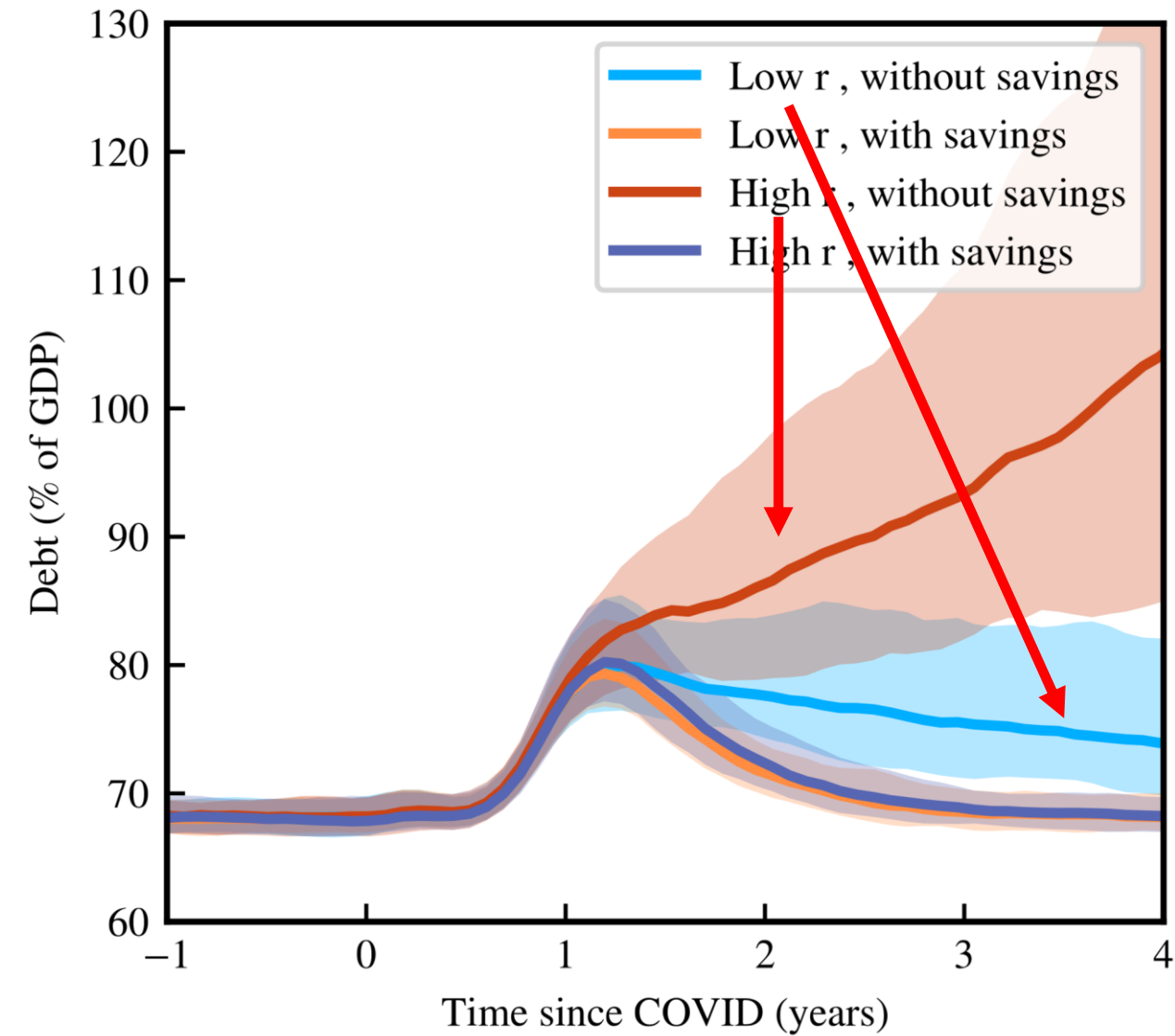
Dynamic behaviour

- Government deficits
- Debt
- GDP growth
- Interest rate + inflation

Dynamic behaviour

- ✓ **Government deficits**

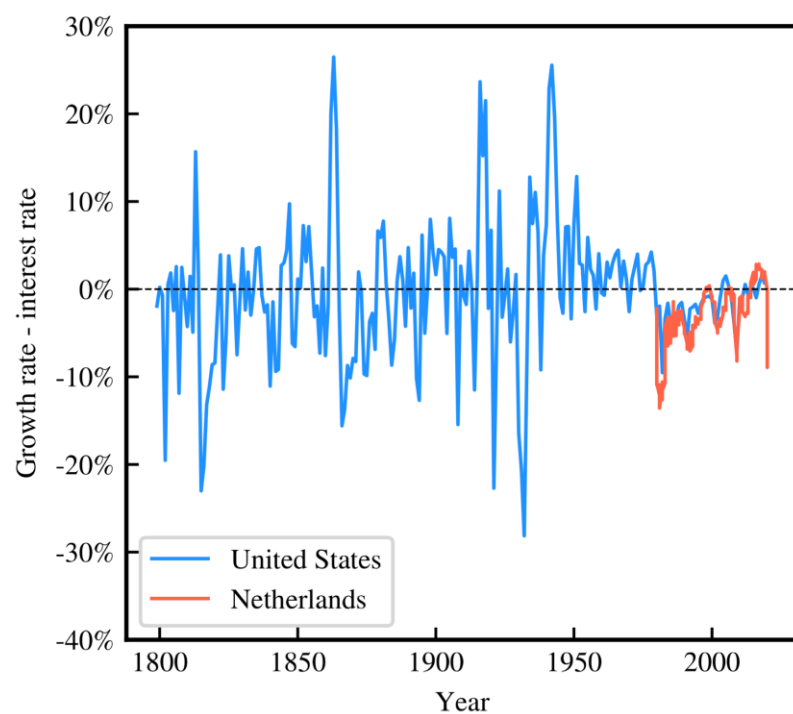- ✓ **Debt**

- ✓ **GDP growth**

- ✓ **Interest rate + inflation**

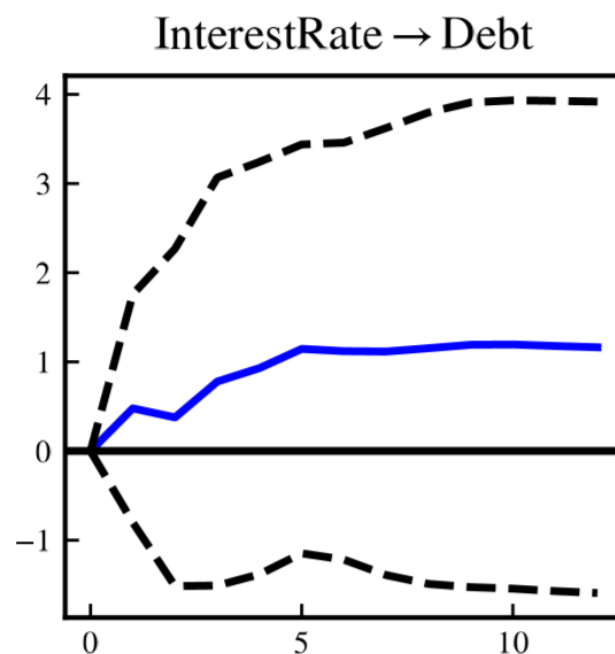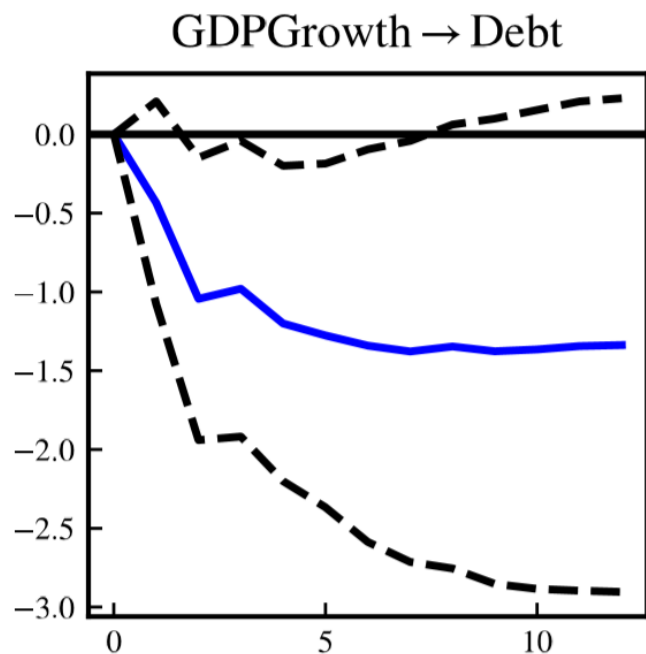# Key factors

✓ **Savings**
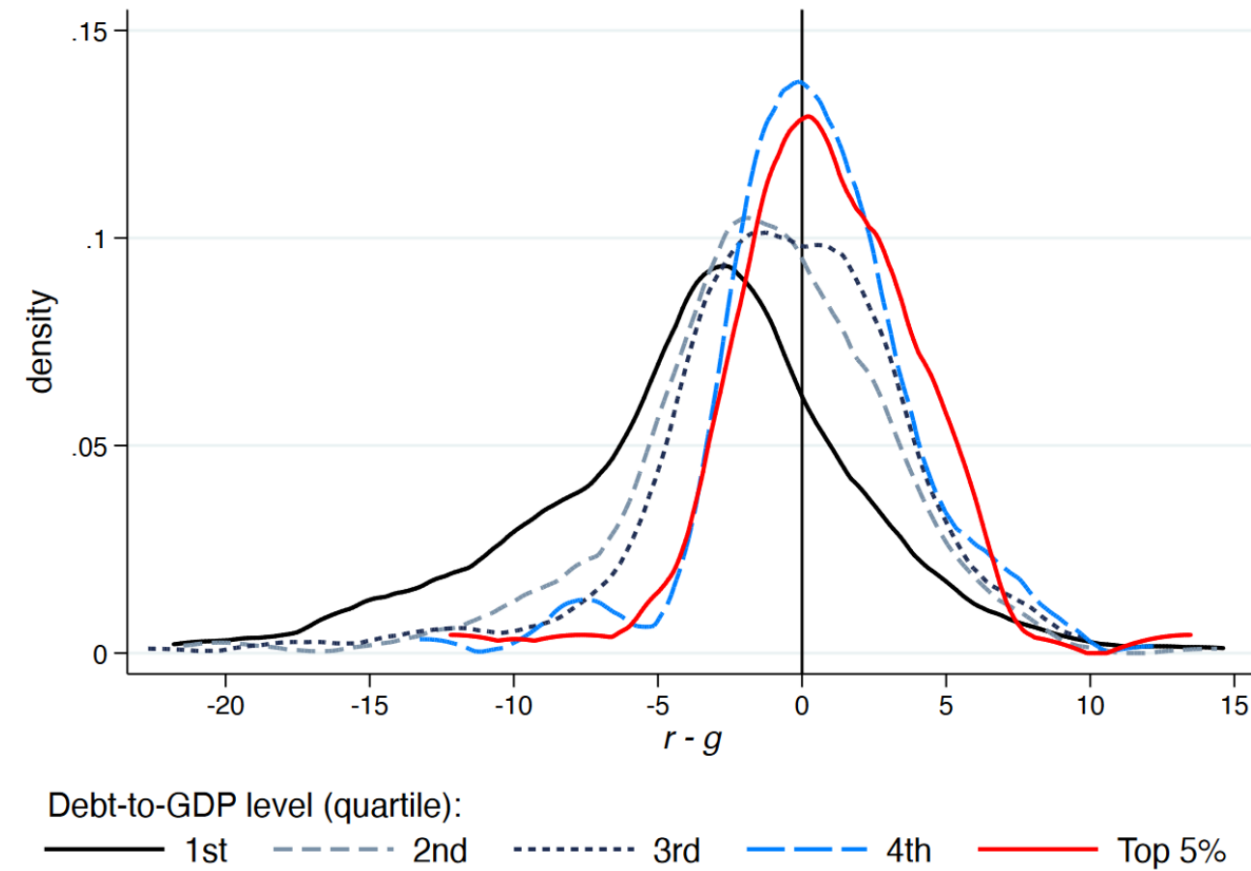
✓ **But even more: r-g**

Historical r-g

✓ **Before COVID: positive**

✓ **But not clear to predict**

Historical r-g

Before COVID: positive

But not clear to predict

Lian et al 2020

Conclusions

- *Concise overview*
- *Literature shows: fiscal support works*
- *But it should be financed. Is this debt sustainable?*
- *r-g is key factor but also hard to predict: future work*
- *History shows: no problem*

Thanks! Questions

👤 *Luuk Oudshoorn*