

Navigating Debt Challenges in an Uncertain World

From Public Debt Reduction to Economy-Wide Balance-Sheet Resilience

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Kose's historical
evidence

365 debt-reduction
episodes

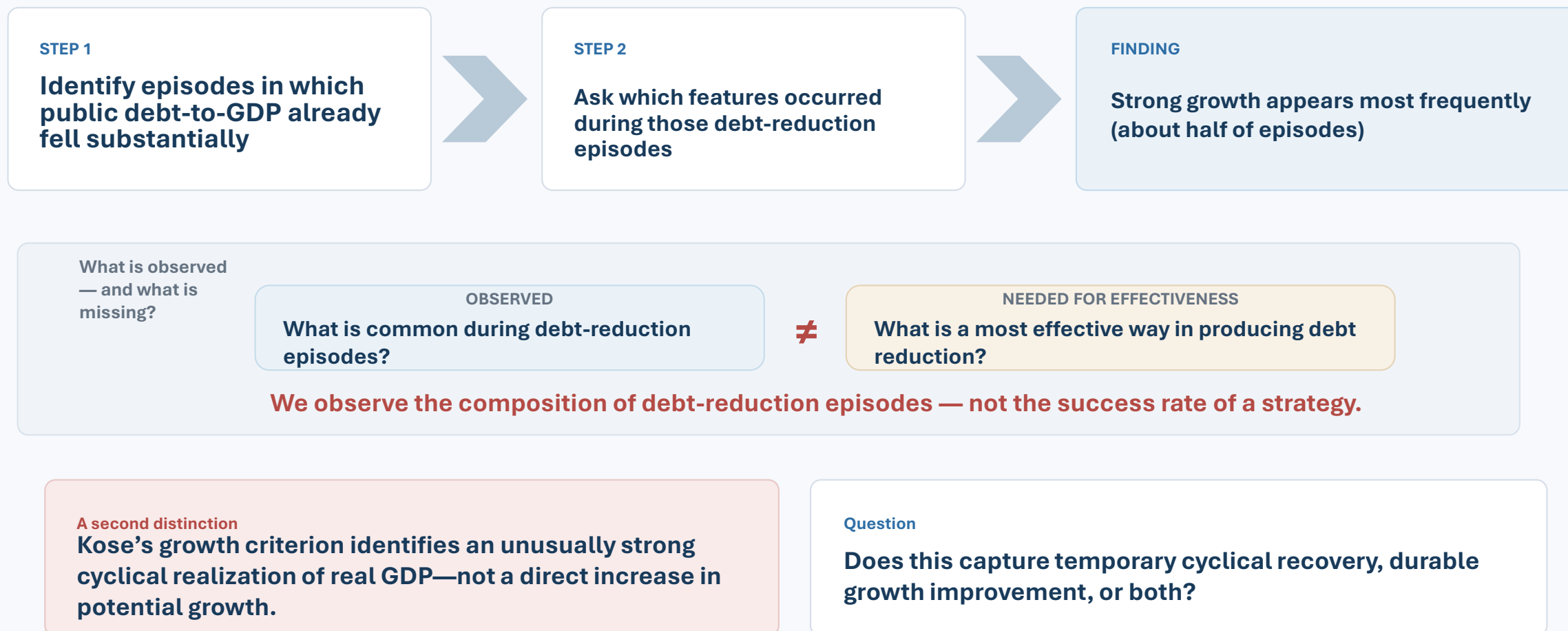
177 countries

296 episodes in
EMDEs

Core result

**Growth is the most common
feature of debt-reduction episodes.**

What Does “Growth Is the Most Common Feature” Actually Tell Us?



What Actually Drives the Decline in Debt-to-GDP?

A standard debt-dynamics decomposition links the historical approaches to three accounting components.

$$\Delta d_t = \frac{i_t - g_t^N}{1 + g_t^N} d_{t-1} - pb_t + sfa_t$$

d = nominal government debt / nominal GDP i = effective nominal interest rate g^N = nominal GDP growth

pb = primary surplus / GDP sfa = stock-flow adjustment / GDP

1

Interest-growth differential (snowball effect)

Stronger real growth and inflation raise nominal GDP growth. Financial repression keeps the effective interest rate low relative to nominal GDP growth. All three make the snowball term more favorable.

2

Primary balance

Fiscal consolidation works mainly through a stronger primary balance. A larger primary surplus directly reduces debt accumulation, holding the other components fixed.

3

Stock-flow adjustments

Privatization affects debt through financial-asset transactions; proceeds used to retire debt lower the debt stock. Restructuring can reduce debt through haircuts or write-downs. Valuation changes can move debt in either direction.

QUANTITATIVE EXTENSION

Of the typical 30 ppt decline over 6 years, how much each mechanism actually contributed to the decline in the debt ratio?

Within the snowball effect, separate real growth, inflation, and effective borrowing costs.

Public vs. Private Debt: Different Risks at Different Stages

There is no single ranking of “which debt is worse”: different balance sheets matter for different macro-financial outcomes.



Bottom line: no universal ranking — the answer depends on crisis risk, crisis severity, and medium-term growth.

Public Debt Is Only Part of the Balance-Sheet Story

Korea illustrates why fiscal space and private-sector vulnerability need not move together.

GENERAL GOVERNMENT DEBT

42.1% → **48.9%**
2019 2020

General government debt rose sharply with pandemic support, but remained relatively low by advanced-economy standards.

HOUSEHOLD CREDIT

₩1,600.1tn → **₩1,862.1tn**
2019 Q4 2021 Q4

Household credit rose by about 16% in two years. The IMF highlighted the rapid buildup in household debt and housing prices as an important macro-financial vulnerability.

WHERE LEVERAGE ACCUMULATES MATTERS

A relatively strong sovereign balance sheet can coexist with private vulnerabilities.

When evaluating a public-debt reduction episode, should we also ask what happened to private-sector leverage?

Debt-Reduction Policy Should Consider Both Sides of the Balance Sheet

Fiscal adjustment may be necessary—but its macroeconomic cost can depend on private-sector balance-sheet conditions.

PRIVATE BALANCE SHEETS HEALTHIER

Fiscal repair is less likely to reinforce simultaneous contraction in household consumption and business investment.

Policy can focus more directly on rebuilding fiscal buffers and reducing sovereign risk.

PRIVATE DEBT OVERHANG

Fiscal consolidation can compound private deleveraging and deepen the shortfall in aggregate demand.

Klein (2017): larger output costs when private debt is high. Klein & Winkler (2019): larger inequality effects under private-debt overhang.

Bernardini & Peersman (2018): government-spending multipliers are also larger under private-debt overhang.

Should the pace and composition of fiscal adjustment depend partly on private-sector balance-sheet conditions?

Klein (2017, JMCB); Klein & Winkler (2019, EJPE); Bernardini & Peersman (2018, JAE). Evidence is mainly from advanced economies; EMDE external validity remains open.

From Public Debt Reduction to Economy-Wide Resilience

1

Frequency is not effectiveness

Growth is common during debt-reduction episodes, but this does not identify which strategy raises the probability of debt reduction.

2

Debt type and initial conditions both matter

Private credit and public debt create different risks, and the cost of public debt adjustment can depend on the balance sheets that households and firms bring into the process.

3

Public debt is only part of the macro balance sheet

A relatively strong sovereign balance sheet can coexist with substantial vulnerability in households or firms, and economy-wide resilience also depends on what is happening to private-sector leverage .

Two questions

1. How much of the typical debt-ratio decline reflects real growth, inflation, primary balances, interest costs, and stock-flow adjustments?
2. Do the conclusions change when public-debt reduction is evaluated alongside private leverage?

The ultimate objective is not simply lower public debt, but greater economy-wide balance-sheet resilience.