Knowledge Exchange Seminar Series (KESS)

Options for public debt management

Dr Dimitris Sotiropoulos

Senior Lecturer, The Open University Business School, UK.

Austerity policies in the wake of the 2008 global financial meltdown have left a host of developed capitalist economies struggling with very high levels of sovereign indebtedness. Given that prospects for economic growth still remain anaemic, and that financial risks have not been completely eliminated, the recovery process is slow and fragile. Discussions about sovereign debt do not reach the frontline news any more, but this does not mean that the problem has ceased to exist. Sovereign debt overhang is here, quietly shaping the long term economic and political agenda.

Contemporary policy-making thus encounters an unusual debt overhang puzzle. How important is this issue for the major developed economies? Is there an easy way out? Should policy-makers continue to rely on ‘business as usual’, or should they seek answers in the unchartered waters of unconentional monetary solutions? How important is central banking to tackling the problem? The crisis of 2008 has been a game changer for the context of monetary policy. Central banks in the major economies have set a different policy paradigm, adopting a whole range of new measures to influence economic and financial conditions. These 'unorthodox' or 'unconventional' monetary interventions tend to become the new and permanent standard. Quite contrary to the pre-crisis typical model, central banks embark on extensive balance sheet transactions, and do not hesitate to introduce negative interest rates, practically paying their borrowers.

In the post-crisis era, central banks have been forced to show their tremendous economic power. Could they also be an answer to the sovereign debt overhang? Austerity policies cannot deal with the problem in the major economies being unable to put growth back on track, at least in the medium term. Hence, a comprehensive solution to the debt problem could only come from unconventional monetary policies. Drawing upon a recent policy proposal for the resolution of the Euro-area sovereign debt overhang, this presentation briefly discusses a simple illustration of how an unconventional central bank intervention could potentially eliminate the sovereign debt overhang: (1) at a cost that is comparable to current monetary policy interventions, and (2) without violating the existing monetary policy context.

This illustration highlights the tremendous firepower of central banks in major economic unions. It aims at triggering the democratic discussion of possible effective responses to one of the key social problems of our time. It indicates that the problem of sovereign indebtedness is a political and not a technical one. Economies with weak currencies are better off within monetary unions and unconventional central bank policies are the only means to deal with the problem without jeopardizing the welfare aspects of social policy.