Challenge to public debt sustainability

Maximum sustainable level of public debt (Blanchard, 1985): $\hat{d} = \dfrac{s*}{r-y}$

<u>In the next 5Y</u>:

$s*$: maximum politically feasible primary surplus $\downarrow$: rise in defence, public investment, healthcare spending

r: average interest rate on public debt $\uparrow$: effect of end of ultra low interest rates

y: $\downarrow$ demography, AI (?)

$\Longrightarrow$ $\hat{d}$ goes down. If $d > \hat{d}$ the debt keeps increasing unless….

Vertical fiscal policy coordination

Central Fiscal Capacity

	National fiscal constraints	**Central Fiscal Capacity**	
		NO	**YES**
	YES	**Global Financial Crisis** (2009-2013) *[Market-driven austerity]* ➤ **No economic equilibrium**	**Geopolitical fragmentation** (2024-…) *[Vertical coordination: NEC, SAFE reformed EU budget , EU bonds]*
	NO	**Sovereign debt crisis aftermath** (2014-2019) *[SGP flexibility]* ➤ **No institutional equilibrium**	**Pandemic** (2020-2023) *[NGUE-GEC]* ➤ **No political equilibrium**

Incentivising national defence spending

(red: countries in EDP)

National Escape Clause

SAFE		NO	YES
	YES	Cyprus, **France**, **Italy**, **Romania**, Spain	**Belgium**, Bulgaria, Croatia, Czech Republic, Denmark, Estonia, Finland, Greece, **Hungary**, Latvia, Lithuania, **Poland**, Portugal, **Slovakia**
	NO	**Austria**, Ireland, Luxembourg, **Malta**, Netherlands, Sweden	Germany, Slovenia