Discussion of “Perceptions of Public Debt and Policy Expectations”, by Francesco Bianchi, Era Dabla-Norris and Salma Khalid

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Overview

- Large levels of public debts: quasi-global phenomenon.
- In models: Private views on resulting policies key for macroeconomic consequences.

  Critical: views on the budget constraint of the public sector.
- However: still little is known empirically on how households form expectations about fiscal policy and public finance issues.

This paper: evidence on household perceptions in multiple countries

- Widespread underestimation of debt levels and limited understanding of gov. budget constraint.
- Individuals perceive to disproportionally bear the burden of the fiscal consolidation.
- Fiscal consolidation experience matters for how fiscal announcements are interpreted

Main comments

My view: This paper gives strong push to the literature on why HH fiscal beliefs are important for *fiscal* and *monetary* policies.

1. Fiscal consolidation may backfire via beliefs: on long-run growth, on fiscal consolidation itself, on inflation.

2. Why consolidation contributes to pessimism/lower trust?

3. Important insights on how HH think about fiscal space.

Fiscal stagnation?

This paper: Experience of fiscal consolidation associated with:

- lower trust in government (institutional trust),
- pessimism regarding macroeconomic outlook.

$\Rightarrow$ *Fiscal stagnation = consolidation backfires through lower growth.*

- In Fornaro and Wolf (2025): higher taxes can reduce incentives to innovate and/or lower public spending reduce supply of public goods.
- Here: potential alternative mechanism via (institutional) trust (e.g., Algan and Cahuc, 2010).

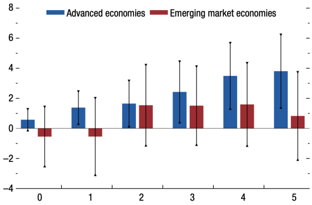
Additional comments:

- Inter-personal trust – also a driver of long run growth? Question Q9.1 in the questionnaire.
- Trust: inherited/portable. Do immigrants from countries with a track record of fiscal consolidation have lower trust in institutions/more pessimists about fiscal/economic outomes?

Why consolidation contributes to pessimism/lower trust?

Figure 3.3. Effect of Fiscal Consolidation on Debt to GDP
(Percentage points)

On average, fiscal consolidations do not reduce debt-to-GDP ratios.



Sources: IMF, Global Debt Database; IMF, Historical Public Debt Database; and IMF staff calculations.
Note: Figure shows the average treatment effect of fiscal consolidation on debt to GDP using augmented inverse probability weighted estimation. Vertical lines represent the 90 percent confidence interval. *X*-axis denotes the number of years from fiscal consolidation. Sample consists of 17 advanced economies from 1978 to 2020 and 14 emerging market economies from 1989 to 2020 with narrative consolidation shocks.

Figure: Source: IMF World Economic Outlook, April 2023

Fiscal consolidation fatigue? Consolidations do not curb public debt.

Why consolidation contributes to pessimism/lower trust?

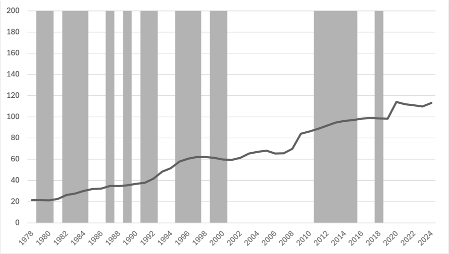


Figure: Debt-to-GDP ratio (in % of GDP) – France

The plain black corresponds to the debt-to-GDP ratio of France (source: IMF Global debt database). Shaded areas indicate fiscal consolidation.

More generally:

- Except Poland and Hungary, fiscal consolidation = 22% to 42% of years in 1967-2023.
- Except Japan, countries with higher debt levels in 2024 have spent more years of fiscal consolidation (+10,4pp of debt per additional year of fiscal consolidation).

Also: countries with lower debt levels require less fiscal consolidation?

Why consolidation contributes to pessimism/lower trust?

- Less pessimism/more trust for countries with more successful fiscal consolidation?
  - Distinguish between fiscal consolidation leading to a decline in debt / an increase in debt.
  - or look directly at experience of decline in debt-to-GDP ratios

- Low-efficacy fiscal consolidation + rising debt = sign of "insidious fiscal dominance"?
  - Leeper (2023): welfare programs (pensions/heathcare) are slowly drying up fiscal resources with population aging.
  - Governments "kick the can down the road" and do not implement deep reforms/fiscal consolidation but focus on marginal/less efficient measures.
  - Barthélemy, Mengus, Plantin (2024): in high-debt contexts, fiscal authorities postpone adjustment/double down on debt to make monetary financing more likely.

Lessons for monetary policy

In this paper: HH associate views on debt with inflation.

Experience of fiscal consolidation $\rightarrow$ perceptions of more acute debt problems associated with higher inflation.

$\Rightarrow$ Fiscal dominance risk or pessimism?

Pessimism: HHs associate inflation with bad macroeconomic outcomes (e.g., Binetti et al. 2024).

Fiscal dominance:

- Consistent with cross-country evidence in Barro and Bianchi (2023).
- Andrade et al. (2025): micro evidence that HH perceptions of fiscal space key for the perceived connection btw. debt and inflation.
    - Low perceived fiscal space $\Rightarrow$ More exp. inflation if more exp. debt.
    - Consistent with a fiscal dominance logic, not just pessimism.

Lessons for monetary policy

Two potential policy implications:

1. Past failed fiscal consolidations can lower perceive fiscal space hence increase perceive risk of fiscal dominance - difficult to handle by MP.
2. Informing HH about the true level of debt could reinforce the problem.
   - but maybe this is a way for the fiscal authority to pressure the CB to inflate?

At a minimum: communication of high debt levels should be associated with credible signals on future (efficient) fiscal consolidations.

Understanding perceptions of fiscal space

This paper: HHs expect fiscal consolidation to disproportionally affect them.

- Very informative on how households think about fiscal space.
- Limited fiscal capacity may mean:
  - Richer HH do not perceive that taxes (on them) can be increased further.
  - Poorer HH perceive that spendings (from which they benefit) cannot be cut.
- **Next step:** How do people think about limits to tax increase/spending cuts?
  - Political economy: sufficiently influent group?
  - or simply economic constraints (Laffer curve-type of arguments, etc).
- In the paper: mostly experiences of spending-based consolidations (Table A.13) are important but for whom?
  - rich, poor HHs or both?
  - left or right-leaning HHs (Q8 in the questionnaire)? (e.g., Coibion, Gorodnichenko and Weber, 2021).

More questions on fiscal space

Should all the debt be reimbursed with future primary surpluses?

- In a monetary union, a budget constraint at the level of the union but not necessary a tight one at the country level.
  - In the sample: Germany, France, Italy, Netherlands in the euro area.
  - Bailouts in EA (Gourinchas, Martin and Messer, 2020).
  - Fiscal dominance in monetary unions (e.g., Mackowiak and Schmidt, 2025).
- A bubble component in public debt? Bassetto and Cui (2018) for FTPL with a bubble component.

To sum up

An important paper which pushes further the frontier on knowledge on perceptions of fiscal policy and public finance.

- Important as these perceptions are critical for the ability of high-debt country to manage indebtness.
- Opens up new dimensions of these beliefs: political economy, experience, ...
- Critical implications for both *monetary* and *fiscal* policies.