

Freie Universität Berlin  
Prof. Dr. Dr. Giacomo Corneo

## Theory of Public Debt

**Lecture time and place:** Wednesdays 4-7 p.m., Hs 104.

**Modul:** Topics in Economic Theory; Ausgewählte Themen der Steuertheorie und -politik – *Master VWL #10144006*. Credit for alternative modules is possible.

**Content:** This course (in English) provides a mainly theoretical overview of the role played by public debt in the economy and discusses its links with tax policy both from a normative and positive perspective. In a first step, students are introduced to the concept of public debt and its relationship with various measures of the net worth of the public sector. Then, the intertemporal budget constraint of the government is defined and the notion of fiscal sustainability is discussed. We then analyze various models that offer distinctive views on the effects – if any – of public debt. Thereupon the issue about the optimal management of public debt is attacked. In a further step, various politico-economics models are used to discuss the tendency of governments to overborrow and to assess rules and institutions aimed at counteracting that tendency. The final part of the course applies the insights gained so far to illuminate the current challenges faced by the European Union with respect to fiscal policy.

**Grade:** Final written exam.

### Syllabus - Topic of the week:

(required readings with an asterisk)

#### 19.4.: Overview, definitions and institutional background

Lit.:

- \*IMF, Fiscal Monitor - Managing Public Wealth, 2018, p.1-10.
- \*Barro, R. & V. Grilli, European Macroeconomics, Macmillan 1994, Ch.17, p.343-5.
- Eichengreen, B. et al. (2019), Public Debt Through the Ages, IMF WP/19/6.
- Von Weizsäcker, C.-C. & H. Krämer, Saving and Investment in the Twenty-First Century, Switzerland Springer 2021, Ch.6.
- Haeringer, G., Market Design, MIT Press 2017, p.113-119.

#### 26.4.: Sustainability

Lit.:

- \*Corneo, G., Lecture Notes on Public Debt, mimeo, 2021.
- Blanchard, O. (2019), Public Debt and Low Interest Rates, American Economic Review 109, 1197-1229.
- Werding, M. (2021), Fiscal Sustainability and Low Interest Rates: A Note, CESifo WP 8861.
- Bohn, H. (1995), The Sustainability of Budget Deficits in a Stochastic Economy, Journal of Money, Credit and Banking 27, 257-271.

#### 3.5.: Effects: Ricardian equivalence

Lit.:

- \*Barro, R. & V. Grilli, European Macroeconomics, Macmillan 1994, Ch.17 p.345-352.
- Barro, R. (1974), Are Government Bonds Net Wealth?, Journal of Political Economy 82, 1095-1117.

- Ricciuti, R. (2003), Assessing Ricardian Equivalence, *Journal of Economic Surveys* 17, 55-78.

#### 10.5.: Effects: Crowding out

##### Lit.:

- \*Diamond, P. (1965), National Debt in a Neoclassical Growth Model, *American Economic Review* 60, 1126-50.
- Stiglitz, J., On the Relevance and Irrelevance of Public Financial Policy, in Arrow, K. and M. Boskin (eds.), *The Economics of Public Debt*, Macmillan 1988.
- Von Weizsäcker, C.-C. (2014), Public Debt and Price Stability, *German Economic Review* 15, 42-61.
- Homburg, S. (2014), Overaccumulation, Public Debt and the Importance of Land, *German Economic Review* 15, 411-435.

#### 17.5.: Effects: Borrowing constraints, risk sharing, inflation

##### Lit.:

- \*Barro, R. & V. Grilli, *European Macroeconomics*, Macmillan 1994, p.352-357.
- Holmström, B. & J. Tirole (1998), Private and Public Supply of Liquidity, *Journal of Political Economy* 106, 1-40.
- Gordon, R. & H. Varian (1988), Intergenerational Risk Sharing, *Journal of Public Economics* 37, 185-202.
- Gale, D., The Efficient Design of Public Debt, in Dornbusch, R. and M. Draghi (eds.), *Public Debt Management: Theory and History*, CUP 1990, p.14-47.
- Corneo, G. (2022), Progressive Sovereign Wealth Funds, *Journal of Government and Economics*, 100033.
- Cochrane, J., *The Fiscal Theory of the Price Level*, PUP 2023, Ch.1-2.

#### 24.5.: Effects: Repudiation and multiple equilibria

##### Lit.:

- \*Calvo, G. (1988), Servicing the Public Debt: The Role of Expectations, *American Economic Review* 78, 647-661.

#### 31.5.: Optimal management: Reducing the burden of tax distortions

##### Lit.:

- \* Barro, R. (1979), On the Determination of Public Debt, *Journal of Political Economy* 87, 940-954.

#### 7.6.: Optimal management: Reducing fiscal vulnerability

##### Lit.:

- \*Missale, A., Sovereign Debt Management and Fiscal Vulnerabilities, in BIS (ed.), *Threat of Fiscal Dominance? Vol.65*, 2012.
- \*Cochrane, J., *The Fiscal Theory of the Price Level*, PUP 2023, Ch.8.
- \*Alesina et al., Public Confidence and Debt Management: A Model and a Case Study of Italy, in Dornbusch, R. and M. Draghi (eds.), *Public Debt Management: Theory and History*, CUP 1990, p.105-118.

#### 14.6.: Political economics: Dynamic common pool

##### Lit.:

- \*Alesina, A. & A. Passalacqua, The Political Economy of Government Debt, in *Handbook of Macroeconomics*, Vol.2B, Elsevier 2016, p.2610-2613.
- \*Persson, T. & G. Tabellini, *Political Economics*, MIT Press 2000, p.345-351.

#### 21.6.: Political economics: Government instability

Lit.:

- \*Persson, T. & G. Tabellini, Political Economics, MIT Press 2000, p.351-356.

28.6: Political economics: Balanced budget rule

Lit.:

- \*Peletier et al. (1999), Voting on the Budget Deficit: Comment, American Economic Review 89, 1377-81.
- \*Alesina, A. & A. Passalacqua, The Political Economy of Government Debt, in Handbook of Macroeconomics, Vol.2B, Elsevier 2016, p.2631-2636.

5.7.: International lending and country risk

Lit.:

- \*Eaton et al. (1986), The Pure Theory of Country Risk, European Economic Review 30, 481-513.

12.7.: Current issues in the EU: Budget rules and institutions

Lit.:

- \*Bilbiie et al. (2021), Fiscal Policy in Europe: Controversies over Rules, Mutual Insurance, and Centralization, Journal of Economic Perspectives 35, 77-100.

19.7.: Current issues in the EU: Next Generation EU

Lit.:

- \*Pfeiffer et al., Quantifying Spillovers of Next Generation EU Investment, European Commission, DP 144, 2021.
- \*Bankowski et al., The Macroeconomic Impact of the Next Generation EU Instrument on the Euro Area, ECB, N°255, 2021.