Public Debt in the Flow-of-Funds Perspective

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Since the global financial crisis of 2008-2009, public debt in advanced economies has increased substantially. High levels of debt in mature economies are a relatively new global concern, after decades of attention on debt levels in developing and emerging countries. Four Eurozone countries, Greece, Portugal, Ireland and Cyprus have turned to IMF and other European governments for financial assistance in order to avoid defaulting on their public debts. There are also concerns about the sustainability of public debt in Japan and the US, and more recently, also in the major European countries. As of the end of 2015, the stock of gross central government debt exceeds annual nominal GDP in five OECD countries: Japan, Greece, Portugal, Italy and Ireland. The ratio of the former to the latter is over 80% in seven more countries: United States, United Kingdom, Belgium, Spain, Iceland, France and Slovenia. In the past, people blamed the governments for the high public debtâ€“GDP ratio; however, more recently, they began to notice that the real cause lies in the saving-investment imbalance in the private sector rather than in the lax fiscal policy of the government.
Over the past decades, a combination of diverse forces has created a significant increase in the supply of saving in the mature economies â€• a saving glut. One well-understood source of the saving glut is the strong saving motive of rich countries with aging populations, which must make provision for an impending sharp increase in the number of retirees relative to the number of workers. With slowly growing or declining workforces, as well as high capital-labor ratios, many advanced economies face an apparent dearth of domestic investment opportunities. If a country's saving exceeds its investment during a particular year, the difference represents excess saving that can be lent on international capital markets. As a consequence of high desired saving and the low prospective returns to domestic investment, the mature economies as a group seek to run current account surpluses and thus to lend abroad. On the other hand, if a country's saving is less than the amount required to finance domestic investment, the country can close the gap by borrowing from abroad. Actually, in the past, national saving in major emerging economies was low and fell short of the capital investment so that they heavily borrowed in the international market.
However, after the 1997-1998 financial crisis, there has been a remarkable reversal in the flows of credit to developing and emerging-market economies, a shift that has transformed those economies from borrowers on international capital markets to large net lenders. The matured economies can no longer find sufficient international lending opportunities. In a quasi-closed economy, a country's domestic investment in new capital and its domestic saving need be equal in each period; the only way to accommodate the private sector excess saving is to absorb it by the public deficit. If there are enough needs for public investment, the saving and investment will balance in the national economy that includes both private and public sectors. If there are not enough opportunities for public investment, the government has no option but to use the raised funds to close the current fiscal gap, which means offsetting the private-sector savings by the public-sector dissavings.
We will mainly use the National Accounts of the OECD Countries to review the relationship between the private-sector saving-investment imbalance and the public debt for each countries. We can observe the saving-investment imbalance both in the non-financial and financial accounts. In the non-financial account, saving-investment imbalance is defined as the difference between saving, which is derived as disposable income less final consumption expenditure, and net acquisitions of non-financial assets. In the financial account, net financial transactions is defined as the difference between the acquisition of financial assets and the incurrence of liabilities. The SNA refers both saving-investment imbalance and net financial transactions as net lending/borrowing because they are theoretically equivalent. If this balancing item is negative for the public sector as is the case in

most of the mature economies, there are two possibilities: either gross saving is positive or negative. While the former is the case of excess investment, the latter is the case of negative saving of the public sector.