Economic Review

Fiscal Sustainability: A Cross-Country Analysis

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A new country-specific framework quantifies the maximum level of debt a government can sustain given its economic and policy environment.

Since the global financial crisis, public debt has risen rapidly in many advanced and emerging market economies. Every country faces a fiscal limit at which taxes and spending can no longer adjust to stabilize debt. But quantifying fiscal limits can be challenging. Different countries have different capacities to service their debt. Moreover, two countries with similar debt levels may face drastically different default risks.

Huixin Bi introduces a new, country-specific framework of fiscal limits to quantify the maximum level of debt a government can sustain given its economic and policy environment. She finds that countries with relatively low government expenditures have significantly higher fiscal limits than countries with relatively high government expenditures. She also finds that sovereign default risks rise rapidly during an economic downturn, suggesting that debt levels viewed as safe in good times can quickly become unsustainable.

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