Letter n°140

The evolution of global indebtedness.

"What misfortunes and tears will our fathers cost us!" Corneille, The Cid.

As early as 2018, ***Le Cercle Turgot***, in its book "Les Dettes Publiques à la Dérive" (English: *Public Debt Adrift*), warned of the unchecked worsening of debt on a global scale. Since then, however, the deterioration of public finances has become even more evident in a majority of countries. Tensions in long-term interest rates and the steepening of yield curves say it clearly.

While several countries managed to reduce their public debt between 1995 and 2007, nothing of the sort has occurred in recent years. Indebtedness, the burden passed on to future generations, as echoed by ***Corneille's*** words quoted above, has thus become the primary concern. Many are worried about the situation, yet in concrete terms no debt-stabilisation plan is in sight.

Debt deemed excessive acts as a drag on growth, as taxpayers fear higher taxation and increase their savings, and because, at the same time, the refinancing of government debt creates a crowding-out effect that is likely to penalise private investment. ***Hayek*** thus condemned public debt as a source of distortions that favour inefficient investments and, in the long term, as a cause of stagflation.

So, should revenues be increased? Should spending be reduced? To better grasp the issues at stake, we will briefly recall the causes of the worsening indebtedness, then examine how this indebtedness has evolved, and finally analyse the possible solutions.

The causes of indebtedness:

The problem of indebtedness is here to stay and is likely to worsen. It is driven by a combination of factors: ageing population, leading to slower economic growth; an inevitable drift in social protection spending, particularly on pensions and healthcare; rising defence budgets; the high cost of financing the energy transition, USD 18.8 trillion worldwide over the past 20 years; and fiscal laxity on the part of governments anxious to preserve social peace.

The slowdown in global GDP growth further exacerbates this problem. In the past, annual growth of 2–3% implied a doubling of GDP within 25 to 35 years; today, growth of only 0.5–1% per year requires 70 to 100 years to achieve the same result. Such weak growth fuels public frustration, leads to sporadic unrest, and facilitates the rise to power of populist governments that show little concern for fiscal discipline.

One consequence of this rising indebtedness is an increase in long-term interest rates, with rates exceeding nominal growth, creating a vicious cycle that is difficult to contain.

The evolution of indebtedness worldwide:

According to the IIF (Institute of International Finance), global debt, after increasing by USD 26.4 trillion in the first nine months of 2025 alone, now stands at 3.1 times global GDP, or USD 346 trillion. In 1970, it amounted to just 1 times global GDP!

Within this total, corporate debt has reached USD 100 trillion. However, the main concern, according to the latest IMF report, is the rise in global public debt since 2008, and even more so since the eve of the pandemic.

From 40% of GDP in developed countries in 2008, public debt has risen to 109% of GDP. Between 2019 and 2024, public debt did decline by 21 percentage points in Portugal and by 18 points in Belgium, but it increased by 16 points in the United Kingdom, 15 points in France, and by much more in the United States.

One of the causes of this indebtedness is the average budget deficit in OECD countries, which stood at 4.5% in 2024, compared with an average of 2.9% during the four years preceding COVID.

As a consequence of rising debt levels and tensions in long-term interest rates, interest payments on debt increased by 11% to USD 2.72 trillion in 2024, reaching 3.3% of GDP. France provides a clear example: from less than 1% ten years ago, the yield on 10-year government bonds has risen to 3.5%, increasing debt-servicing costs and potentially raising concerns over long-term solvency.

In 2024, according to the OECD, governments and corporations had to raise USD 25 trillion on the markets. In 2025, the United States is borrowing USD 5 trillion, of which USD 3 trillion is to refinance past debt and USD 2 trillion to fund the budget deficit. The United Kingdom is issuing GBP 300 billion, France EUR 300 billion, and Italy EUR 330–350 billion. Germany will also need to borrow heavily to finance its new investment effort. There is therefore competition among states to attract capital, creating a risk of upward pressure on long-term interest rates.

- ***The United States***:

At its founding, the country's public debt represented around 30% of GDP. A peak of 112% of GDP was reached at the end of the Second World War, followed by a gradual reduction until the first oil shock. Debt began to rise again under President Reagan, who combined tax cuts with increased military spending. Although President Clinton subsequently managed to reduce the debt, it has grown rapidly since 2001. First, following the election of President Bush, military spending increased due to the wars in Iraq and Afghanistan. Then, after the 2008 financial crisis, stimulus programmes were implemented under President Obama. Under President Trump, tax cuts were introduced alongside higher military expenditure. From USD 3.3 trillion in 2001, federal debt has surged to nearly USD 38 trillion in 2025, slightly above 1 times GDP. At this stage, it is difficult to envisage a reduction in indebtedness, as the share of discretionary spending is limited. Federal spending, which represented 5% of GDP on the eve of 1929, subsequently increased and now stands at 25% of GDP, without Musk having succeeded in reducing it. According to S&P, debt servicing costs, currently at USD 973 billion in 2025, are expected to rise from 3% of GDP in 2024 to 3.8% in 2028. Looking ahead to 2030, the IMF fears that US debt could reach 143% of GDP, as the recent Trump tax legislation, the "BBB Act", will not be offset by revenues from tariffs.

- ***Japan***:

In Japan, between 1973 and 1985, public debt rose from 10% to over 60% of GDP. Then, between 1990 and the early 2000s, it tripled to reach 235% of GDP. For the past 20 years, the budget deficit has exceeded 6% of GDP annually, with little hope of improvement, as the new Prime Minister intends to increase spending.

Debt servicing accounts for one-quarter of the budget, while social expenditures (pensions, etc.) make up one-third. Under the Abe government, between 2012 and the end of 2017, the Bank of Japan increased its holdings of public debt from 12% to over 40%, an amount equivalent to 70% of GDP.

- ***The EU***:

Public debt in the eurozone stands at 87.8% of GDP, with 137% in Italy, 146% in Greece, and 64% in Germany. Incidentally, it is worth noting that the most indebted countries often have the highest unemployment rates!

The budget deficit reached 3.6% of GDP in 2024, including 5.5% in France, 7.2% in Italy, and 5.3% in Poland.

To stabilise this debt, a primary budget surplus is required. France is far from this, with a primary deficit of 3.2%, potential growth of 1%, and inflation at 1.2%. Net expenditures amount to €444 billion and revenues to €308 billion, leaving a deficit of €139 billion that represents 45% of state revenues, and thus resulting in the country's credit rating being downgraded to A+. Concerned, households maintain very high savings, at 19% of their income. Tax cuts since 2017, totalling €60 billion, have largely consisted of the abolition of the residence tax and reductions in corporate tax. Reductions in capital taxation amount to only €6 billion.

- ***The United Kingdom***:

The situation is broadly comparable to that of France. The budget deficit stands at 5.7% of GDP, and public debt exceeds 100% of GDP. However, the UK does not benefit from the protection of the euro or the European Central Bank, and therefore carries the highest 10-year interest rate among G7 countries, at 4.6%. Net public debt has increased by nearly 60% since 2007. Inflation, still at 3.2%, is slowing the decline in interest rates.

- ***China***:

The worsening of debt is striking both for the speed of its growth and for its current magnitude. In 2006, it did not exceed 1.5 times GDP; by 2017, it had risen to 2.7 times GDP, and today it stands at over 3 times GDP. The use of debt helped mitigate the impact of the global slowdown in 2008–2009 and then attempted to maintain growth. However, today, non-performing loans are accumulating, and Chinese companies are the most indebted in the world.

The state finances public enterprises at abnormally low costs, creating a crowding-out effect for private companies.

- ***Emerging countries***:

Public debt appears low, at 45% of GDP, but it worries the IMF because these countries have limited fiscal room for manoeuvre, and their access to financing is constrained by high interest rates.

Debt in middle- and low-income countries has never been so high: USD 8.9 trillion, according to the World Bank, including USD 1.2 trillion for the 78 most vulnerable countries. In interest payments alone, these countries have paid USD 415 billion, money unavailable for education, healthcare, and infrastructure, all of which hampers growth. In recent years, debt repayments have exceeded new loans, leaving 56 countries in a very difficult situation.

In summary, the main risk arising from rising debt worldwide is greater pressure on long-term interest rates and increased costs of debt servicing.

What solutions exist for the drift in indebtedness?

- ***Economic growth***:

Between 1945 and 1975, European debt was reduced from over 200% of GDP to 50%, thanks to a net real GDP growth rate exceeding 3%.

Today, Spain, for example, benefits from growth of 3.2%, nearly five times the European average, mainly due to the development of tourism and immigration, and sees its debt-to-GDP ratio decline. However, few countries can boast such a favourable situation.

- ***Reducing expenditures***:

In the absence of growth and faced with the need to stabilise their debt, states must consider either reducing public spending or increasing taxes.

In Europe, Germany was able to reduce its public debt from 80% in 2010 to 64% today. However, fiscal discipline seems to be an outdated concept. In Europe, the 3% budget deficit rule or the 60% public debt-to-GDP limit are largely ignored. For many countries, returning to 60% would require years of primary surpluses exceeding 5%. This seems unrealistic, as citizens are unlikely to accept the austerity measures required.

In Italy, to reduce public spending, Prime Minister Meloni eliminated programmes equivalent to France's RSA and cut support for energy-efficient renovations. The budget deficit is expected to fall to 3% in 2025 from 7.2% in 2023. Yet despite the regularisation of one million immigrants, labour shortages persist, and economic growth remains weak at 0.7%.

In Portugal, the current account was in deficit by 10% of GDP in 2010, and Portuguese households saved only 9% of their income. Between 2011 and 2013, the right-wing government cut salaries by 3.5% for civil servants earning more than €1,500/month. In 2013, employees and retirees lost four public holidays, their 13th and 14th month pay, faced a 7% increase in social contributions, while VAT on gas and electricity rose from 6% to 23%, and public transport fares increased by 20%.

In France, a €45 billion reduction in spending would not be sufficient to stabilise debt. A reduction equivalent to 3.2% of GDP is required, as this represents the primary deficit. The spread with Germany, 0.8 percentage points, reduces economic growth by a similar amount. According to S&P, debt servicing is expected to rise from 2.1% of GDP in 2024 to 3.2% in 2028.

Since 2000, several European countries have at times succeeded in reducing their debt ratios, for example, Ireland, Belgium, Denmark, Sweden, and the Netherlands. But today, across Europe, given economic growth limited to 1–2%, an annual budget surplus of 5–7% would be required for over ten years to return to a public debt ratio of 60% of GDP, which is not realistic.

- ***What about quantitative easing***?

A restrictive monetary policy has a recessive effect. Consequently, central banks often have an expansionary bias. QE is a policy targeting long-term interest rates to reduce the debt burden of states – a purchase of securities, mainly government bonds, to make excessive public debt more sustainable.

Since 2008, monetary laxity has been significant in OECD countries. True, quantitative easing was halted a few years ago, and negative interest rates have disappeared. Yet today, in Japan and the United Kingdom, central banks hold around 50% of public debt; in the eurozone, one-third; and in the United States, 25%.

If Trump succeeds in forcing the Fed to lower rates to 1%, tensions on long-term rates will be strong. Debt financing in the United States would then concentrate on short-term maturities, increasing the country's vulnerability.

QE is often judged to have little impact on private lending. However, "financial repression" – keeping interest rates below where they should be, below nominal growth – is dangerous because it removes the market signal function of rates. When interest rates are low, long-term asset valuations become difficult, creating bubbles. Excess liquidity lowers risk premiums and forces investors to choose between cash and risky assets.

With QE, central banks have become large investment funds, supporting stock market appreciation and preventing long-term rates from rising. At the same time, Basel III encourages banks to hold government bonds as low-risk assets requiring little capital. Yet this lax monetary policy has not stimulated investment.

If rates are below real rates, part of the debt is effectively erased, amounting to a transfer from savers to the state – a kind of tax. Low interest rates lead to a general decline in returns on various bond assets. Consequently, a reduction in retirees' purchasing power is to be expected, or a "euthanasia of rentiers" in ***Keynes'*** words. This expropriation increases risk aversion, further dampening growth.

In the EU, the euro is a malignant blessing, as certain economies, such as France today, escape the discipline of high rates or currency depreciation and assume they can avoid making competitiveness efforts.

- ***Stephanie Kelton's Modern Monetary Theory***:

A professor in the United States, she supports public deficits to ensure full employment, fight poverty, improve social protection, and increase public investment. She suggests financing this deficit through money creation with low interest rates.

The liberal approach challenges this view. Very low rates benefit states in their borrowing but penalise private investment, and thus the growth of productive capital, because the required return on capital, higher than the interest rate, discourages investment in private projects.

Conclusion: ***"Public debt is not a tonic but a parasite. Restoring confidence through debt reduction is probably the best investment one can make." Peyrelevade.***

Despite unconventional policies pursued over many years, the constraint of indebtedness remains, and economic growth remains fragile.

Just as companies constantly strive to adapt to international competition, states often neglect constraints and allow public debt to rise – a drift that seems painless in the short term but is costly in the medium term.

Inflation cannot be the solution, as there are many obstacles to its increase. One can only hope for higher economic growth, if AI delivers on its promises. In the meantime, central banks strive to keep interest rates low, ideally below the rate of growth.

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