

Contents

1	Introduction and Overview	1
2	Sustainability of Public Debt	5
2.1	Theoretical Considerations	5
2.1.1	Public Debt and the Primary Surplus	6
2.1.2	Conditions for Sustainability of Public Debt	7
2.1.3	Conclusion	11
2.1.4	Appendix	11
2.2	Empirical Results for Developed Countries: Euro Area Countries and the USA	14
2.2.1	The Primary Surplus and Public Debt	15
2.2.2	Analysis of the Deficit Inclusive of Interest Payments	33
2.2.3	Conclusion	37
2.2.4	Appendix	38
2.3	Empirical Evidence for Developing Countries	43
2.3.1	The Estimation Strategy	44
2.3.2	Estimation Results	45
2.3.3	Conclusion	68
3	Public Debt and Economic Growth: A Theoretical Model	71
3.1	The Structure of the Growth Model	72
3.1.1	The Household Sector	73
3.1.2	The Productive Sector	74
3.1.3	The Government	74
3.2	Analysis of the Model	75
3.2.1	Permanent Deficits and the Inter-temporal Budget Constraint	77
3.2.2	The Balanced Budget Rule	78
3.3	Conclusion	79
	Appendix	79

4	Public Debt, Productive Public Spending and Economic Growth with Full Employment	83
4.1	The Endogenous Growth Model	84
4.1.1	Households	84
4.1.2	Firms	85
4.1.3	The Government	86
4.1.4	Equilibrium Conditions and the Balanced Growth Path	87
4.2	Analyzing the Model	88
4.2.1	The Asymptotic Behaviour of the Model	88
4.2.2	Growth Effects of the Different Scenarios	90
4.2.3	Welfare Analysis	94
4.3	Excursus: Human Capital Accumulation	96
4.3.1	The Structure of the Growth Model	97
4.3.2	Analysis of the Model	101
4.4	Conclusion	106
	Appendix	108
5	The Role of Real Wage Rigidity and Unemployment	111
5.1	The Growth Model	111
5.1.1	The Household Sector	112
5.1.2	The Productive Sector and the Labor Market	113
5.1.3	The Government	115
5.1.4	The Balanced Growth Path	116
5.2	Analysis of the Model with Real Wage Flexibility	117
5.2.1	Balanced Government Budget	117
5.2.2	Permanent Public Deficits	118
5.3	The Model with Real Wage Rigidities	121
5.3.1	Balanced Government Budget	122
5.3.2	Permanent Public Deficits	123
5.4	Discussion and Comparison to the Model Without Unemployment	124
5.5	Conclusion	125
	Appendix	126
6	Conclusion	129
A	Non-parametric Estimation	133
B	Some Useful Theorems from Dynamic Optimization	135
	Data Sources	139
	Bibliography	141