

Excessive debt accumulation, payments shocks and contagion: Mediterranean Europe experience and policy responses

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The history of financial crisis presents a vast range of situations of excessive debt accumulation originated by unbalanced public spending policies or by private consumer preferences highly oriented for actual spending or by private firms or banks behavior. When the rising debt reaches a threshold level the default risk become evident and the perception of the systemic risk spreads. The problem is that the threshold level tend to be pushed ahead during booms. There is what we may call a sort of debt-expenditure illusion.

When a country encounters a negative payments shock it become unable to make scheduled payments of interest or principal. The problem may spreads to neighboring countries that did not experience the original shock, leading to the contagion effect.

The aim of the paper is twofold. First, to contribute to a better understanding of the range of linkages through which a payments crisis can become contagious, in a context of excessive debt accumulation. The issue will be investigated in a general view, and then with special attention to the situation of Mediterranean countries. Second, to give the appropriate depth of analysis for policy responses to the post 2008 crisis and to future international financial problems.