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Sovereign Debt Crises: It's All Greek to Me

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"Some debts are fun when you are acquiring them, but none are fun when you set about retiring them."
—Ogden Nash

The recent recession affected not only household pocketbooks and budgets but also the financial status of governments at all levels. National government debt—both U.S. and foreign—has garnered headline attention and concerned investors and creditors. When a government's outlays exceed its tax receipts in a given fiscal year, it runs a deficit and may have to borrow money to make up the difference. Sovereign debt is the accumulation of such borrowing from foreign and domestic creditors. If creditors are unsure whether a national government is able or willing to repay its debts, then the government may have to pay a higher interest rate on the bonds it issues to entice buyers. If a government is unable to issue bonds to cover its debts, then it must resort to other means: cutting expenditures, raising taxes, or borrowing from international agencies such as the International Monetary Fund. Greece and a few other European countries currently find themselves in this situation. Is the United States close to a similar debt crisis?

Greece's government debt is exceptionally large. Its gross debt–to–gross domestic product (GDP) ratio is nearly 115 percent. This means its debt is greater than its annual GDP. After Greece joined the European Union (EU), investors assumed the EU would not allow Greece's debt to exceed the Maastricht treaty limit. As a result, Greece was able to borrow funds at low interest rates normally available only to more creditworthy countries. Oddly, the same reason that Greece was able to accumulate this debt—joining the EU—may also be the reason it defaults on this debt. When Greece adopted the euro, it ceded control over monetary policy to the European Central Bank and is prohibited from devaluing its currency as a means of reducing the real value of its debt (a tactic used throughout history by many countries). Greece is not alone: Portugal, Ireland, Italy, and Spain also face excessive debt because of their high spending and accumulated borrowing. (The group, along with Greece, is somewhat harshly referred to as PIIGS.)

In recent years, the U.S. government has also acquired substantial debt. Its fiscal year 2009 gross debt–to–gross GDP ratio reached 82 percent. Although U.S. debt has been increasing, it may not foreshadow a Greek-style crisis. The sharp increase in the U.S. deficit has been largely due to the recent deep recession and financial crisis. When GDP decreases, government tax receipts also decrease; at the same time, government spending increases to finance programs such as unemployment benefits. The United States recently implemented two major fiscal stimulus plans to boost the economy. As the U.S. economy recovers, the deficit should fall as government revenues increase and recessionary spending decreases. According to the Congressional Budget Office, the U.S. deficit-to-GDP ratio was 9.9 percent in fiscal year 2009 and projected to decrease to 4.1 percent by 2012. In comparison, Greece had a deficit-to-GDP ratio of 13.5 percent in 2009, which is projected to be 15.4 percent by 2012. This projection drops to 6.5 percent if Greece implements its promised austerity measures. In the meantime, the United States should be able to avoid a Greek-style debt crisis. Because the United States is the world's largest economy, investors continue to perceive U.S. debt as a stable, valuable source of revenue and have been willing to purchase U.S. bonds at relatively low interest rates.

Although the United States does not have the same fiscal problems as Greece, there are still issues of concern. High sovereign debt levels levy an undue burden on a country's citizens, specifically in the form of lower GDP growth and higher taxes.

—By Bryan J. Noeth, Research Analyst

[1] See Reinhart, Carmen M. and Rogoff, Kenneth S. *This Time Is Different: Eight Centuries of Financial Folly*. Princeton, NJ: Princeton University Press, 2009, for more information on how sovereign debt crises follow financial crises.

The views expressed are those of the author and do not necessarily reflect the official positions of the Federal Reserve Bank of St. Louis, the Federal Reserve System, or the Board of Governors.

Additional Articles on Sovereign Debt

"Sovereign Debt Shadows," by Silvio Contessi, Federal Reserve Bank of St. Louis *Economic Synopses*, Number 22, 2010.

This article provides specific details about the debt burden in specific EU countries.

"Demystifying Sovereign Debt in Greece: Why It Matters to Us," by Andrew Flowers, Federal Reserve Bank of Atlanta *EconSouth*, Volume 12, Number 2, Second Quarter 2010.

This article explains how Greece's reliance on sovereign debt put the country in such a difficult position. This is also a podcast associated with this article.

"Greece's Debt Crisis: Overview, Policy Responses, and Implications," by Rebecca M. Nelson, Paul Belkin, and Derek E. Mix, Congressional Research Service, *CRS Report for Congress* No. R41167, May 14, 2010.

This article gives an overview on the causes, progress, and the implications of the Greek debt crisis. Also available on the Council of Foreign Relations website, with links to additional articles and resources.

"It's All Greek to Me: Understanding the Debt Crisis in Europe," by Shannon Doyne and Holly Epstein Ojalvo, *The Learning Network, Teaching and Learning with the New York Times*, May 4, 2010.

This is an article and a lesson plan from the *New York Times* and a good resource for high school teachers who want to incorporate the Greek debt crisis into their curriculum.

Free Data Sources and Reports

Data: *Eurostat Yearbook 2009*
Description: Eurostat collects economic data on all the EU countries. Data include the fiscal positions of the members. Table 2.6 has statistics on the countries' debt-to-GDP ratio.
Published by: Eurostat
Location: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-CD-09-001-02/EN/KS-CD-09-001-02-EN.PDF

Data: Treasury Direct
Description: Treasury Direct is run by the U.S. Treasury and has various data for U.S. government debt. The Debt Position and Activity Report provides a detailed account of the U.S. debt and includes charts and graphs.
Published by: U.S. Department of the Treasury, Bureau of the Public Debt
Location: http://www.treasurydirect.gov/govt/reports/pd/pd_debtposactrpt.htm

Data: *The Long-Term Budget Outlook, 2010*
Description: The Congressional Budget Office is a nonpartisan agency that provides congress with economic data. *The Long-Term Budget Outlook* is a forecast of various components of the federal government's budget, including the debt and the deficit (see Figure 1-2).
Published by: Congressional Budget Office
Location: http://www.cbo.gov/ftpdocs/115xx/doc11579/06-30-LTBO.pdf

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