Government Debt in Europe

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The financial and economic crisis during the past two years exerted a strong pressure on government budgets in the EU member states. According to Eurostat (2010),[1] public debt (as a percentage of GDP) in the euro area (EU16) rose to a peak of around 79 percent in the 4th quarter of 2009 compared to a level of 66 percent in the beginning of 2008. In addition to the negative effects on government debt caused by the automatic stabilizers, the rapid increase in public indebtedness was mainly driven by government fiscal stimuli and especially financial support to the banking system aimed at avoiding a long-lasting economic downturn.

Since the beginning of the crisis some countries' financial positions have worsened dramatically leading to rising concerns about these countries' solvency. As a consequence of its liabilities and due to the weak ability to sell government bonds, Greece asked the European Monetary Union (EMU) and the International Monetary Fund (IMF) for financial aid in April this year. The risk of a national insolvency in an EU member state has never been as imminent since the establishment of the EMU. This implies challenges of a new degree to policy makers in the EU.

To appreciate the size of government indebtedness in an international comparison, Figure 1 depicts the stock of government debt as a percentage share of GDP in 27 European countries in the 4th quarter of 2009.[2] In recent years, countries at the southern periphery of Europe, such as Portugal (debt-to-GDP ratio of 77 percent), Italy (116 percent) and Greece (115 percent) struggle particularly with excessive debt. Figure 1 also suggests, however, that countries like Belgium (97 percent), Hungary (78 percent) and France (78 percent) must also deal with high debt-to-GDP ratios.

Some northern and eastern European countries show public indebtedness below or close to 40 percent of GDP. In Sweden, for instance, the share reached 42 percent in 2009. Germany (73 percent), Austria (67 percent) and the Netherlands (61 percent) capture the medium range on the scale between 60 to 75 percent, even though these countries also exceed the Maastricht criterion of the Stability and Growth Pact which allows a ratio of government debt to GDP of 60 percent.

In order to assess the impact of the financial crisis on national debt, we compare current government debt with the corresponding figures before the crisis. Figure 2 illustrates the change of each country's indebtedness (expressed in a percentage of GDP) since the beginning of 2008. The strongest increase of debt was observed in Ireland, where public debt grew by 39 percent of GDP, followed by Latvia (around 27 percent) and Britain (23 percent). Greece and Spain have widened their debt by approximately 19 and 17 percent of GDP, respectively. With a stock of debt-to-GDP of ca. 53 percent in the 4th quarter of 2009, Spain is one of the few countries which still fulfill the Maastricht criterion with respect to the debt-limit (see Figure 1). However, it remains to be seen whether Spain will be able to stabilize its public finances since the country has been heavily hit by its real estate crisis and by an increase of unemployment.

In Germany (8 percent increase) and Austria (7 percent increase) the crisis has not yet resulted in new government debt to the same extent as elsewhere in Europe (Figure 2). However, recent economic forecasts for Germany have predicted a strong increase in government deficits for 2010 (Carstensen *et al.* 2009).

The financial and economic crisis has resulted in accelerating government debt for the majority of European

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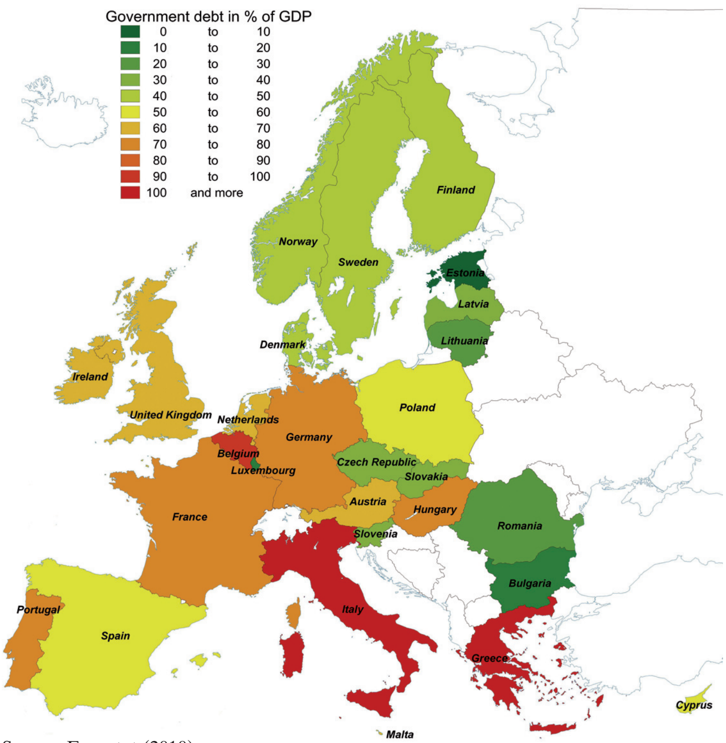
[1] The data on government debt in Europe for the 4th quarter of 2009 was published by Eurostat on 22 April 2010. It includes adjustments of previously published data for some countries: for example the debt-to-GDP ratio for Greece in the 3rd quarter of 2009 was revised from 113.2 percent towards 113.8 percent and the same value for Germany from 71.9 percent towards 72.6 percent.

[2] The figures show *gross government debt*, which indicates that the data does not account for the country's assets. This fact may raise some doubts about the comparability of the data (German Council of Economic Experts 2007).

Figure 1

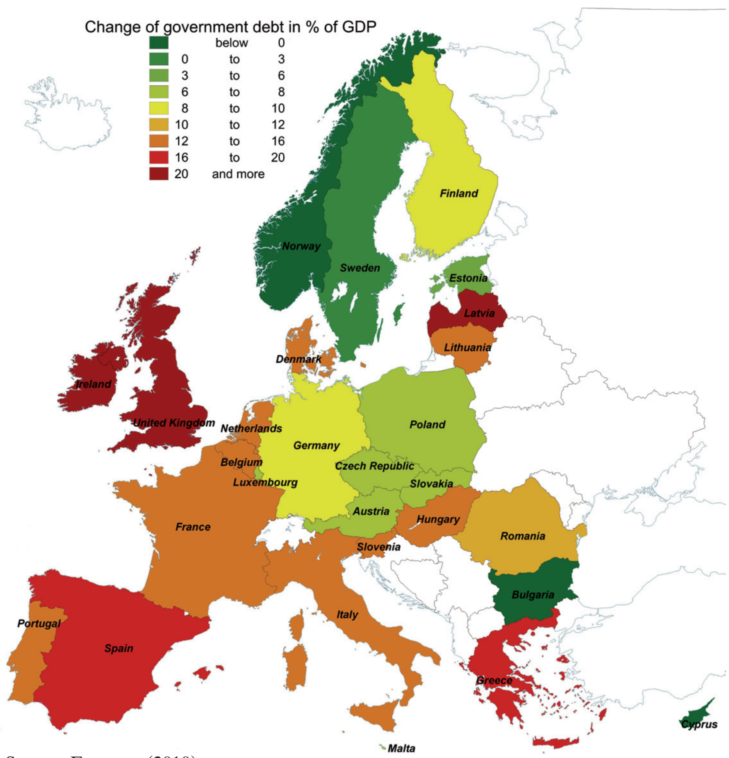
Government Debt as a Percentage of GDP in the 4th Quarter of 2009



Source: Eurostat (2010).

Figure 2

Change of Government Debt as a Percentage of GDP between the 4th Quarter of 2007 and the 4th Quarter of 2009



Source: Eurostat (2010).

countries. In the medium term, a break of this trend and a step towards fiscal consolidation seems to be indispensable in order to safeguard the stability of the EMU. In this context, fiscal consolidation packages have already been introduced (or planned) in a number of countries including Greece, Spain, Italy, Britain and Germany. The current lively discussion in these countries not only highlights the immediate political, economic and social burden caused by the implementation of such restrictive measures but also suggests a danger that an excessive simultaneous consolidation in the individual countries may, in turn, create large scale negative economic spillovers in Europe.

References

Carstensen, K. *et al.* (2009),"ifo Konjunkturprognose 2010: Deutsche Wirtschaft ohne Dynamik", *ifo Schnelldienst* 62(24), 17–64.

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