

Government Deficit and Debt

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What is the difference between deficit and debt?

- When the government spends more than it collects in revenue and runs a **deficit**, it needs to make up the difference through borrowing
- The sum of all that borrowing is the national **debt**

How does a country borrow money?

- **By issuing securities: government bonds and bills.**
 - Government securities are backed by the credit and taxing power of a government. Governments can raise taxes or print more money to repay the debt
 - Bonds are longer term debt
 - Bills are short term debt less than one year

Debt/Deficit to GDP Ratio

- Debt / GDP
- Deficit/GDP
- This measure gives an idea of the ability of a country to make future payments on its debt. If a country were unable to pay its debt, it would default, which could cause a panic in the domestic and international markets.
- The higher the debt-to-GDP ratio, the less likely the country will pay its debt back, and the higher its risk of default.

Stability and Growth Pact

- An agreement among the members of the European Union (EU) that take part in the Eurozone, to facilitate and maintain the stability of the Economic and Monetary Union.
- Based on the treaty establishing the European Community, it consists of fiscal monitoring of members by the European Commission and the Council of Ministers and, after multiple warnings, sanctions against offending members.
- The actual criteria that member states must follow:
 1. an annual budget deficit no higher than 3% of GDP (this includes the sum of all public budgets, including municipalities, regions, etc)
 2. a national debt lower than 60% of GDP or approaching that value.

2010 Rule Breakers

- Ireland: 32.4% deficit as a percent of GDP
- Greece: 10.5% deficit as percent of GDP
- Spain: 9.2% deficit as percent of GDP
- Portugal: 9.1% deficit as percent of GDP
- Slovakia: 7.9% deficit as percent of GDP
- France: 7.0% deficit as percent of GDP
- Slovenia: 5.6% deficit as percent of GDP
- Netherlands: 5.4% deficit as percent of GDP
- Cyprus: 5.3% deficit as percent of GDP
- Austria: 4.6% deficit as percent of GDP
- Italy: 4.6% deficit as percent of GDP
- Belgium: 4.1% deficit as percent of GDP
- Malta: 3.6% deficit as percent of GDP
- Germany 3.3% deficit as percent of GDP

That leaves only Luxembourg, Finland, and Estonia within the rules.

http://articles.businessinsider.com/2011-04-26/markets/30099119_1_deficit-gdp-maastricht-treaty#ixzz1ne9dazSb



European Sovereign Debt Crisis

- A continuing crisis where countries in Europe have found it impossible to refinance their debt without the help of a third party
 - **Portugal**
 - **Italy**
 - **Ireland**
 - **Greece**
 - **Spain**



Inflation and increased borrowing

- If the economy is in recession or growing below trend rate, higher borrowing may increase growth, without causing inflation.

HOWEVER

- As the government borrows more money, there are fewer funds available to private investors, and as demand exceeds supply, interest rates rise.



What is the European Economic Recovery Plan?

The objective is to drive a coordinated EU response to the economic crisis, that builds on the unprecedented level of coordination shown in response to the financial market crisis. The priority is to treat the symptoms of the economic crisis and protect jobs and purchasing power in the short-term while also investing in Europe's long-term economic health and in boosting the fight against climate change.

Rescue Plans. . .

- **European Financial Stability Facility (EFSF)**
 - Can raise funds to provide loans, buy debt or recapitalize banks
 - Backed by guarantees of euro member banks in proportion to their capital in the ECB
 - Can be combined with EFSM
 - IMF can provide up to 250 billion euro
- **European Financial Stabilisation Mechanism (EFSM)**
 - Emergency funding
 - Backed by European Commission using budget of EU as collateral
- **European Stability Mechanism (ESM)**
 - Will replace both programs above
 - Permanent rescue program that will have firewalls to prevent ripple effects when one country has a crisis

Resources

- <http://econ.economicshelp.org/2007/05/evaluate-problems-of-high-government.html>
- http://www.wikinvest.com/concept/Interest_Rates
- <http://www.ey.com/GL/en/Issues/Business-environment/EUROZONE-COUNTRY>

Questions?