Public Debt in the Eurozone

In the wake of the outbreak of the recent global financial crisis, public deficits and government debt have increased substantially among member states of the European Union. These issues have since been hotly debated among economist and politicians.

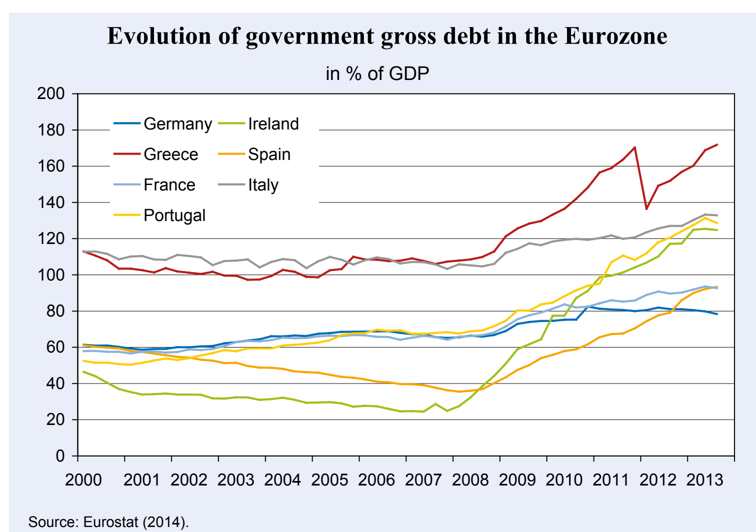
Government debt is the accumulation of past borrowing and therefore the result of repeatedly running budget deficits. It is usually measured as a percentage of a country's gross domestic product (GDP) at nominal value. According to the Maastricht definition of debt, general government debt comprises of the consolidated gross debt of the entire government sector including central, state and local government, as well as social security funds outstanding at the end of a quarter. Sub-sector data are consolidated at the national level by the statistical authorities of the member states (Eurostat 2014).

To prevent excessive budget deficits and the over accumulation of debt, the Maastricht Treaty of 1992 and the Stability and Growth Pact of 1997 introduced rules to maintain stable public finances. More specifically, members of the European Union, and especially members of the Eurozone, were required to limit annual public deficits to three percent of GDP and public debt to 60 percent of GDP. Since the introduction of this rule-based policy framework, however, not all members have succeeded in achieving fiscal discipline. Although there is no scientific consensus on the proper size of public deficits and public debt, the latest reform proposals for the Stability and Growth Pact acknowledge the need for stricter fiscal governance in the Eurozone. Schuknecht et al. (2011), for example, demand that national budget deficits require approval at the European level.

The evolution in the public debt levels of selected EU countries is shown in Figure 1. A notable feature is that most countries managed to reduce their level of debt over the first decade of the millennium. Spain and Ireland in particular have made tremendous efforts to reduce their indebtedness. Although Greece and Italy registered small successes in their debt reduction, they were among those countries with the highest debt levels that entered the monetary union. The two largest countries of the Eurozone, France and Germany, experienced steady increases in their budget deficits and exceeded the Maastricht deficit criteria, which led to a controversy over the temporary suspension of sanctions. In 2009, however, all of the countries in the EU were forced to react to the global financial crisis by increasing their government spending and providing fiscal stimulus. Government debt levels rose to historical highs as a result. Currently, less than half of the EU countries meet the target of debt levels below 60 percent, as shown in Figure 2. Table 1 provides a detailed summary of the debt levels in the European Union during the financial crises.

Figure 2 also reveals that the group of countries below the 60 percent debt criterion consists mostly of new member states. A crucial question is whether similar debt levels in the EU countries have a similar effect on economic activity and growth levels. It is widely accepted, that beyond a certain threshold level, further increases in the level of debt as percentage of GDP lead to lower economic growth. Reinhart and Rogoff (2010) find that for both advanced and emerging countries, high debt/GDP ratios of 90 percent and above are associated with notably lower growth outcomes. For countries in the EU Mencinger, Aristovnik and Verbic (2014) provide evidence that the turning point for new member states is substantially lower than that for old member states. These findings are important for fiscal governance in the Eurozone, as they indicate different levels of economic activity for similar debt levels.

Figure 1



Source: Eurostat (2014).

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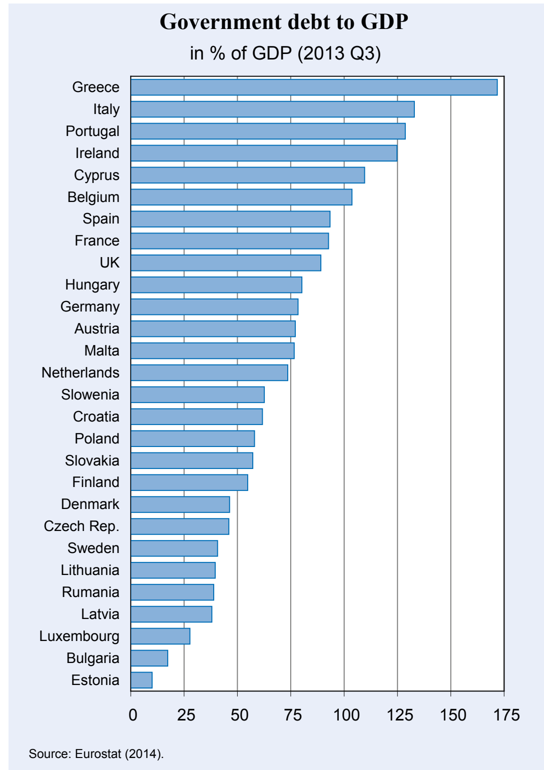
Figure 2



Source: Eurostat (2014).

References

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Table 1

General government gross debt (Maastricht debt) in % of GDP

	2006	2007	2008	2009	2010	2011	2012
Austria	62.3	60.2	63.8	69.2	72.3	72.8	74.0
Belgium	87.9	84.0	89.2	95.7	95.7	98.0	99.8
Bulgaria	21.6	17.2	13.7	14.6	16.2	16.3	18.5
Croatia				36.6	44.9	51.6	55.5
Cyprus	64.7	58.8	48.9	58.5	61.3	71.5	86.6
Czech Republic	28.3	27.9	28.7	34.6	38.4	41.4	46.2
Denmark	32.1	27.1	33.4	40.7	42.7	46.4	45.4
Estonia	4.4	3.7	4.5	7.1	6.7	6.1	9.8
Finland	39.6	35.2	33.9	43.5	48.7	49.2	53.6
France	64.0	64.2	68.2	79.2	82.4	85.8	90.2
Germany	68.0	65.2	66.8	74.5	82.5	80.0	81.0
Greece	107.5	107.2	112.9	129.7	148.3	170.3	156.9
Hungary	65.9	67.0	73.0	79.8	82.2	82.1	79.8
Ireland	24.6	24.9	44.2	64.4	91.2	104.1	117.4
Italy	106.3	103.3	106.1	116.4	119.3	120.7	127.0
Latvia	10.7	9.0	19.8	36.9	44.4	41.9	40.6
Lithuania	17.9	16.8	15.5	29.3	37.8	38.3	40.5
Luxembourg	6.7	6.7	14.4	15.5	19.5	18.7	21.7
Malta	62.5	60.7	60.9	66.5	66.8	69.5	71.3
Netherlands	47.4	45.3	58.5	60.8	63.4	65.7	71.3
Poland	47.7	45.0	47.1	50.9	54.9	56.2	55.6
Portugal	69.4	68.4	71.7	83.7	94.0	108.2	124.1
Romania	12.4	12.8	13.4	23.6	30.5	34.7	37.9
Slovakia	30.5	29.6	27.9	35.6	41.0	43.4	52.4
Slovenia	26.4	23.1	22.0	35.2	38.7	47.1	54.4
Spain	39.7	36.3	40.2	54.0	61.7	70.5	86.0
Sweden	45.3	40.2	38.8	42.6	39.4	38.6	38.2
United Kingdom	42.7	43.7	51.9	67.1	78.4	84.3	88.7

Source: Eurostat (2014).