



# Three Myths About the Sovereign Debt Crisis and Parallels to the US

Macro Panel  
Sovereign Debt: A Cause for Concern?  
2011 Financial Markets Conference  
Navigating the New Financial Landscape

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# Myth No. 1

## The Sovereign Debt Crisis Was a Result of the Financial Crisis

- In Europe the countries with the most severe financial problems did not expend resources combatting the financial crisis
- The major commitments of funds were by central banks both in the UK and by the ECB

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Chart 2

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# Myth No. 2

## The European Financial Rescue Packages

- The European Debt Problems Were Not the Result of Having to Bail out Banks or Other Financial Institutions.
  - The main problems were persistent fiscal deficits
  - Over-commitment to labor and unions
  - Spending beyond means

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## Myth No. 3

### The Way Out of the Crisis is Through More Spending

- We have seen questions raised about the multipliers to federal spending
- There is little evidence that there was other than a one for one substitution of government for state and local debt financing during the rescue period
- Uncertainty seems to be rule of the day.

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## Parallels Between the US and Europe

- Are there parallels between the US and European Fiscal Problems?
  - Many of the states in the US are experiencing fiscal deficits like the European countries
  - The deficits result from over-commitment of funds, especially to government employees and retirees.
  - Tax revenues are unreliable –
    - In the US tax revenues depend largely upon individuals, sales taxes and property taxes
    - In Europe, the primary tax tool is the VAT
    - When spending slows, so do VAT collections
  - Borrowing has become extremely costly
  - Bankruptcy and debt restructuring seems to be off the table for the moment
  - States and EU countries have begun adopting austerity programs

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# Differences Between the US and Europe

- The US has a federal fiscal deficit problem in addition to state and local government fiscal problems
- The US has a much lower costs of debt now
- The ECB has bought up sovereign debt whereas the Federal Reserve has not purchased debt of the states or local gov'ts
- The US federal debt to GDP ratio is approaching 10%, the largest since WWII, but substantially lower than that of Japan for example.
- Europe has no federal taxing authority so it must rely upon member country contributions to support countries with fiscal difficulties

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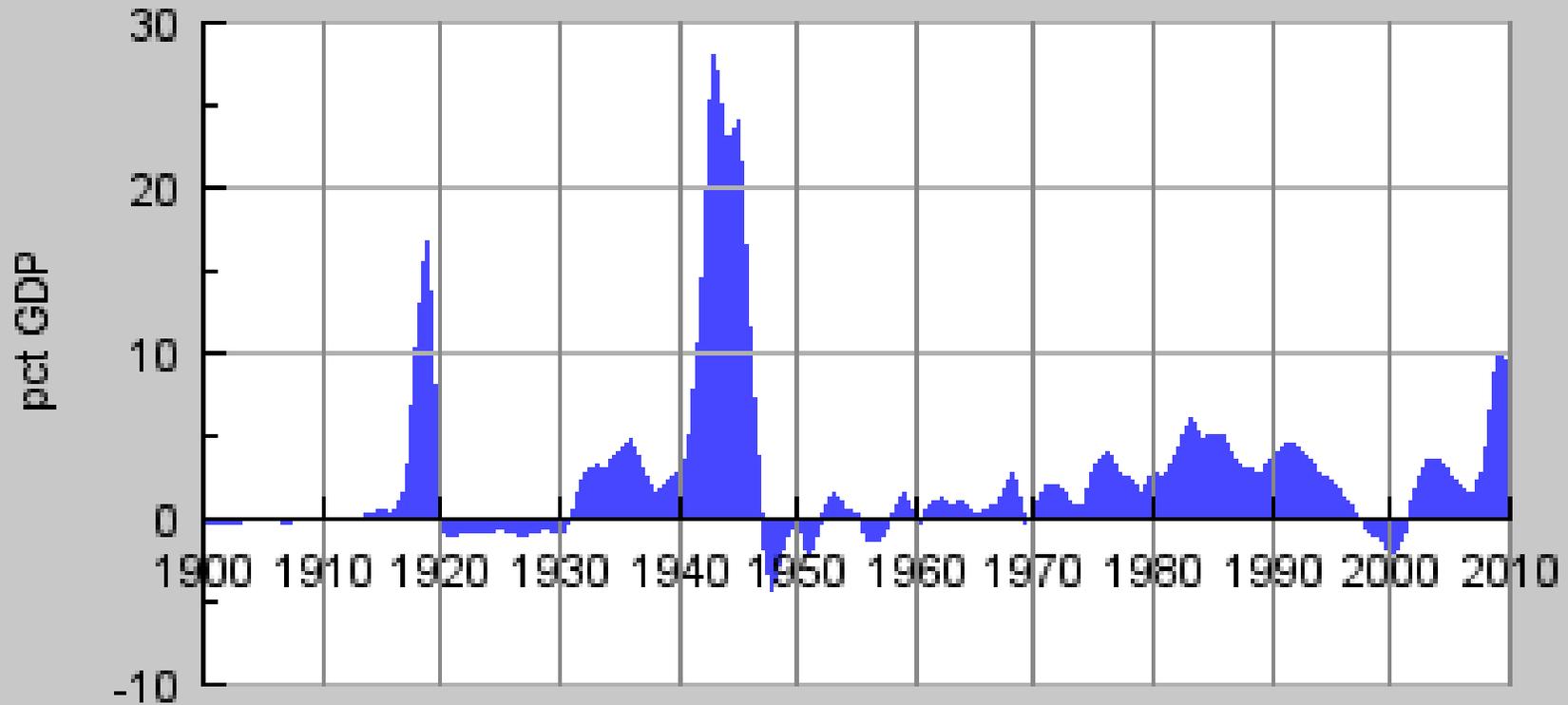
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Chart 6

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# US Federal Deficit As Percent Of GDP US from FY 1900 to FY 2010



jpgraph

usgovernmentspending.com

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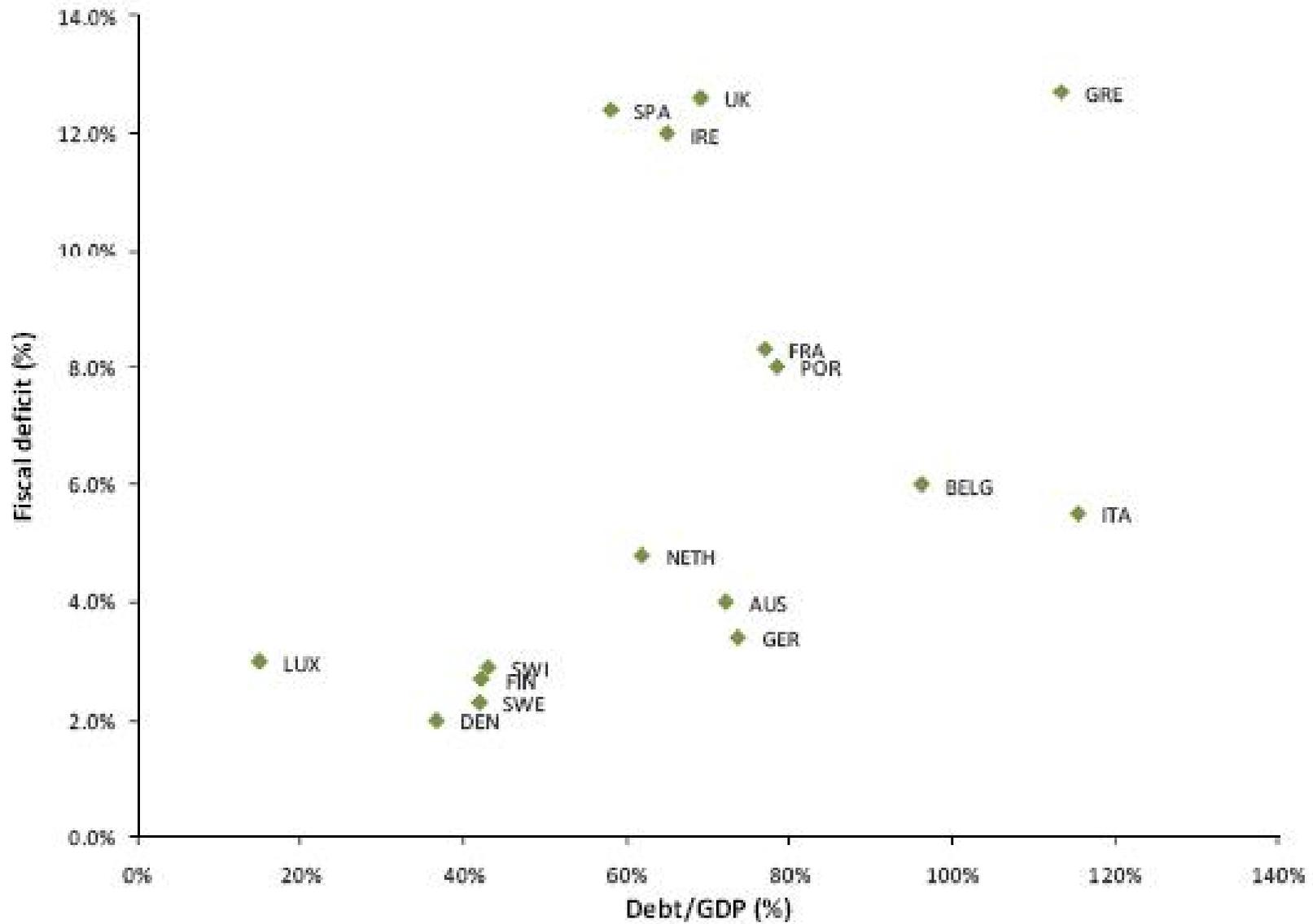
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Chart 7

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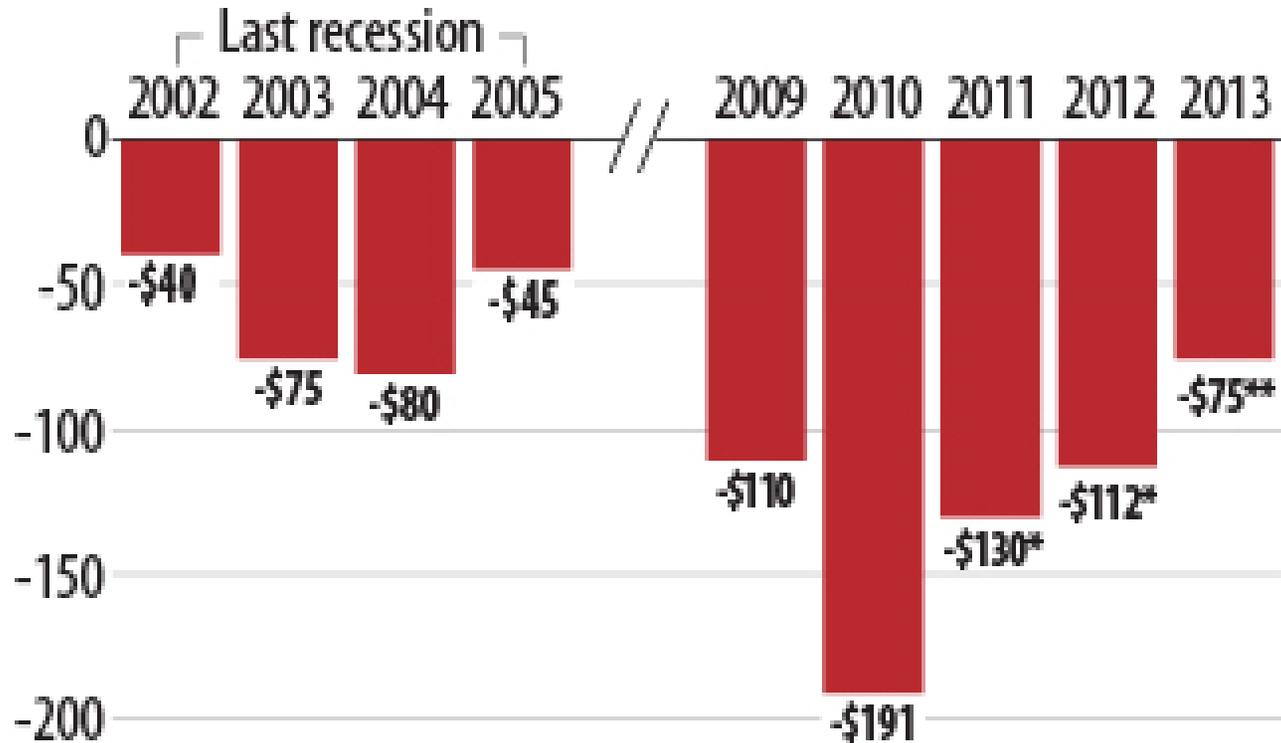
Chart 8



Figure 1:

## Largest State Budget Shortfalls on Record

Total state budget shortfall in each fiscal year, in billions

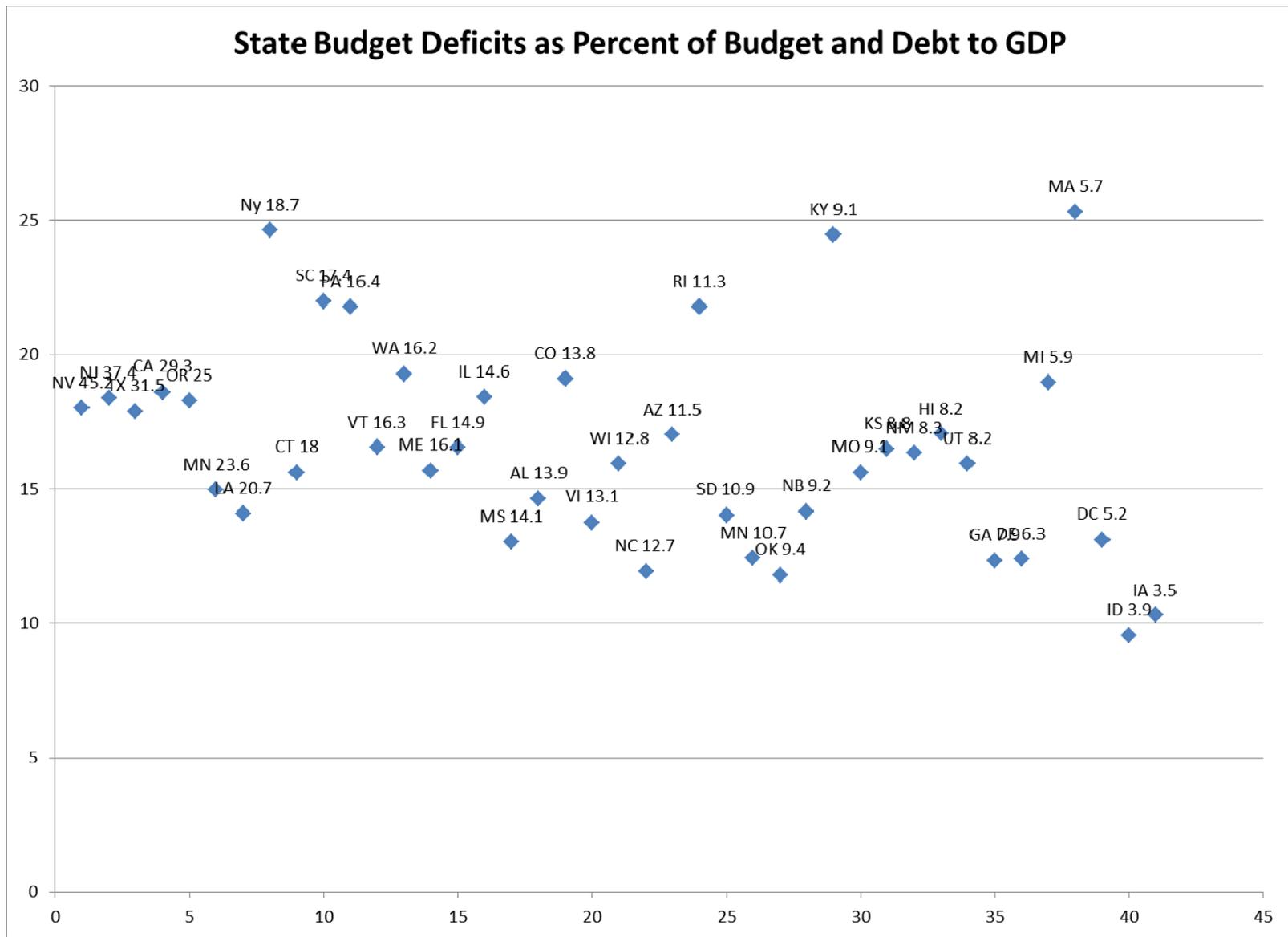


\*Reported to date.

\*\*Preliminary

Source: CBPP survey, revised March 2011.

Center on Budget and Policy Priorities | [cbpp.org](http://cbpp.org)



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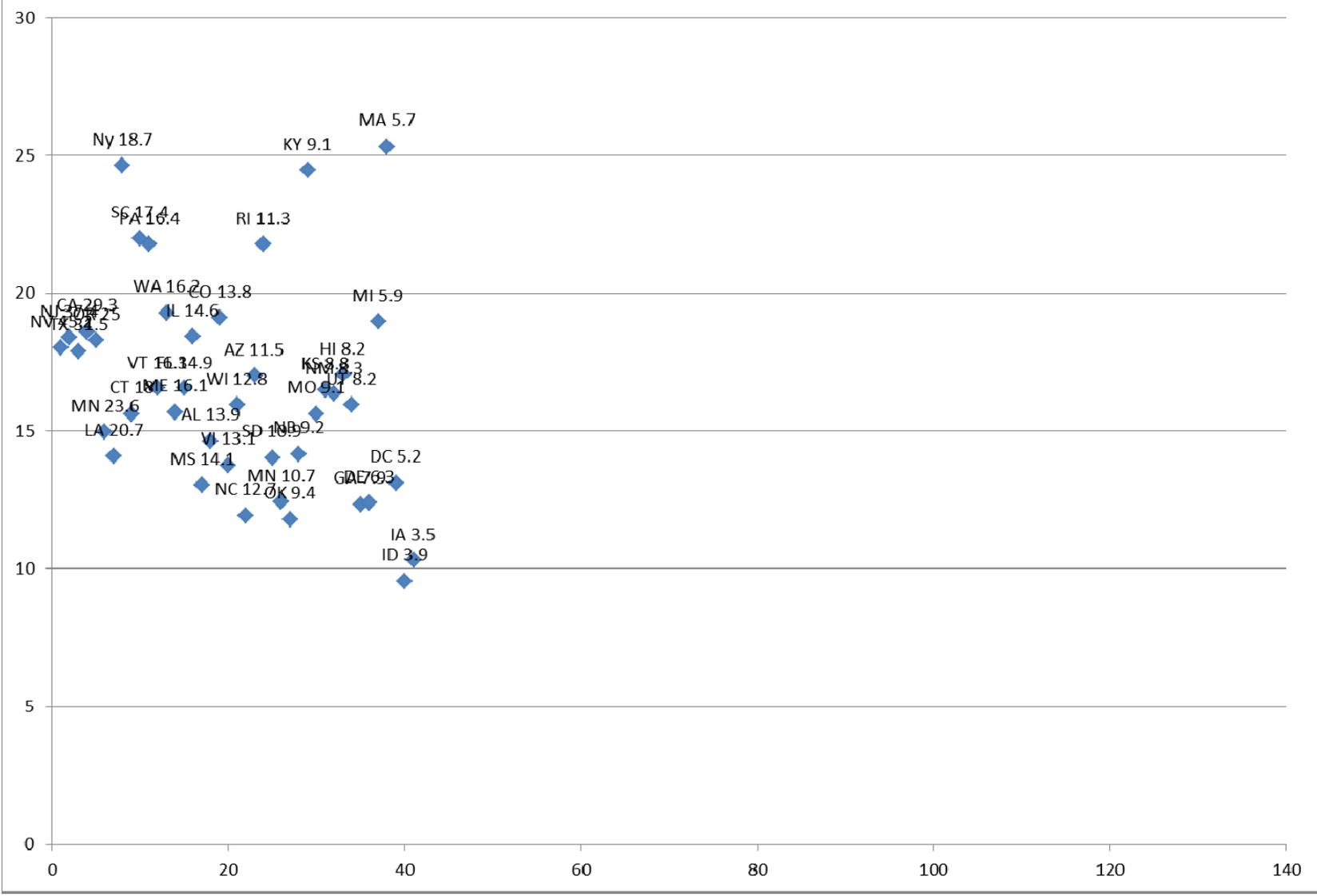
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Chart 11



## State Budget Deficits as Percent of Budget and Debt to GDP



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