

Box 7

GROSS GOVERNMENT DEBT AND GOVERNMENT FINANCIAL ASSETS IN THE EURO AREA

The purpose of this box is to discuss the definition and use of various concepts of government debt. First, it presents two concepts of gross government debt in the euro area, namely the Maastricht (or EDP) debt and the ESA 95 debt. Second, it introduces and assesses the concept of net government debt, i.e. government debt net of financial assets held by government.

In general terms, gross government debt consists of the liabilities owed by general government. The two concepts of gross government debt presented below differ mainly in terms of the liabilities that they include and their valuation.

The first concept of government debt in EU countries, usually referred to as the Maastricht debt, is defined as the gross debt of general government at nominal value outstanding at the end of the year and consolidated at general government sub-sector level.¹ It covers government liabilities in the form of currency and deposits, loans and securities other than shares. The Maastricht debt excludes certain financial instruments, such as financial derivatives and trade credits. This concept of government debt applies within the framework of the excessive deficit procedure (EDP) and is therefore also called EDP debt. It is the relevant concept for procedural purposes in the EU. In particular, it is used for fiscal monitoring under the Stability and Growth Pact to assess whether the criterion of a government debt ratio below the 60% of GDP reference value is met.

The second definition of gross government debt is directly derived from the national accounts in line with the European System of Accounts 1995 (ESA 95) and is therefore referred to as ESA 95 debt. Although there is no formal definition of ESA 95 government debt in national accounts, in practice it covers all government liabilities, excluding only equity. In addition to the instruments included in the EDP debt, the ESA 95 debt also covers some financial instruments, namely financial derivatives, other accounts payable and insurance technical reserves, if applicable. As regards the valuation of liabilities, the ESA 95 debt as it appears in the balance sheet of general government is recorded at market value.

¹ As defined in Protocol No 12 on the excessive deficit procedure annexed to the Treaty on the Functioning of the European Union and in Article 1(5) of Council Regulation (EC) No 479/2009.

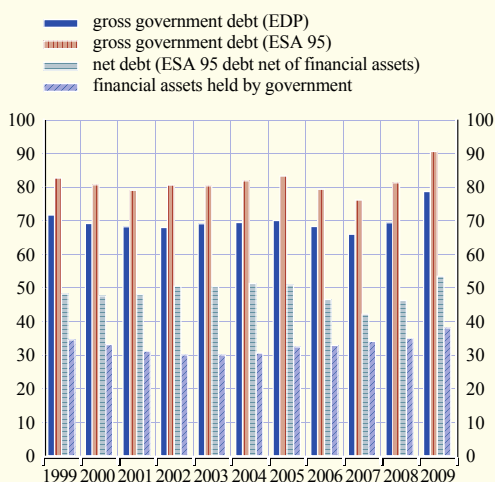
Chart A exhibits euro area average gross government debt-to-GDP ratios, in the sense of both the EDP debt and the ESA 95 debt, for the period 1999-2009. By the end of 2009 the euro area average EDP debt ratio amounted to 78.7% of GDP and the ESA 95 debt ratio to 91.5% of GDP. As shown in Chart A, the ESA 95 debt was on average around 12% of GDP higher than the EDP debt during that period, which is mainly explained by the differences in instrument coverage and valuation. In particular, the level of the ESA 95 debt is affected by changes in market yields, since liabilities are recorded at market value. This is not the case for the EDP debt, under which the financial instruments are measured at nominal value.

From a solvency perspective, it is also interesting to look at an indicator of net government debt, whereby the financial assets held by government are subtracted from the liabilities. Doing so requires data on the stock of financial assets. Government financial assets mainly include currency and deposits, loans granted by government, securities other than shares, shares and other equity, insurance technical reserves and other accounts receivable. These financial assets are also recorded at market value as they appear in the balance sheet of general government. The average amount of financial assets held by governments in the euro area has fluctuated at between 30% and 38% of GDP over the past ten years and was around 38% of GDP at the end of 2009, as shown in Chart A. In other words, the market value of government financial liabilities is more than twice as large as that of government financial assets. This is why the euro area average net government debt, defined here as the ESA 95 debt minus financial assets, hovered at around 50% of GDP in the last decade and increased to 53.4% of GDP in 2009.

Looking more closely at the composition of financial assets, in 2009 the financial assets held by governments in the euro area mainly consisted of shares and other equity (about 38% of total financial assets), currency and deposits and other accounts receivable (both about 19%), loans (13%) and securities other than shares (11%) (see Chart B). The financial assets held by

Chart A Euro area government gross and net debt and financial assets in 1999-2009

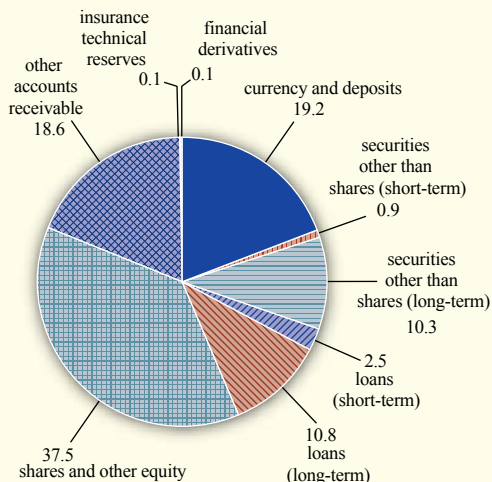
(as a percentage of GDP)



Sources: European Commission and ECB, based on Mink, R. and Rodriguez, M. "The Measurement of Government Debt in the Economic and Monetary Union", Sixth Banca d'Italia Workshop on Public Finance, 2004.

Chart B Composition of euro area government financial assets in 2009

(percentages)



Source: ECB.

governments constitute only to some extent a buffer against government liabilities, as some of these assets (for example, shares and other equity invested in public corporations) are illiquid and cannot therefore be quickly mobilised for redeeming gross debt. The short-term financial assets, which are supposed to be liquid, include currency and deposits, short-term debt securities, short-term loans and other accounts receivable. They represent about 41% of the total financial assets held by euro area governments.

Three conclusions can be drawn from this analysis of government debt. First, irrespective of the definition used, the euro area average government debt ratio both in gross and net terms has been on an upward trend since 2008 and has increased by 11% to 15% of GDP in the past two years. Second, the euro area average net debt is large, which implies that the financial assets held by governments do not constitute a sufficient buffer, especially as some of these assets are illiquid. Third, each measurement of debt sheds light on specific issues. In particular, the concept of gross debt is useful for analysing government short-term refinancing risk, while both gross and net concepts may be relevant for assessing longer-term solvency. Ideally, it would also be interesting to measure government net worth, which could be defined as the balancing item of total government (financial and non-financial) assets and liabilities. However, this is currently not feasible given the unavailability of data on government non-financial assets.