**What Is Sovereign Debt?:**

Sovereign debt is how much a country's government owes to outside creditors

Sovereign debt is an accumulation of a government's annual[deficits](http://useconomy.about.com/od/fiscalpolicy/p/US_Debt_Deficit.htm). Therefore it shows how much more a [government spends](http://useconomy.about.com/od/fiscalpolicy/tp/US_Federal_Budget.htm)than it receives in revenue over time.

Governments usually finance their debt through bonds, such as U.S. [Treasury notes](http://useconomy.about.com/od/bondsfaq/f/Treasury_Bonds.htm). These bonds have terms from three months to 30 years. The government pays [interest rates](http://useconomy.about.com/od/interestrateindicators/p/interest_rate.htm) to give bond buyers a return on their investment. The more likely it is the bond will be repaid, the lower the interest rate paid -- and the lower the cost of the sovereign debt. Governments can also take on loans directly from banks, private businesses/individuals or other countries.

**How Sovereign Debt Is Measured:**

Sovereign debt is measured differently according to who is doing the measuring and why. For example,

[Standard & Poor's](http://useconomy.about.com/od/glossary/g/S-and-P-Rating.htm) is a debt rating agency for businesses and investors. Therefore, it only measures debt owed to commercial creditors. It doesn't measure what a government owes to other governments, the [IMF](http://useconomy.about.com/od/internationalorganizations/p/IMF.htm), or the [World Bank](http://useconomy.about.com/od/internationalorganizations/p/World_Bank.htm). It also only measure [national debt](http://useconomy.about.com/od/fiscalpolicy/p/US_Debt.htm), not what is owed by states or municipalities within a country. However, S&P does takes into account the potential effect these obligations have on the country's ability to honor its sovereign debt.

The [European Union](http://useconomy.about.com/od/worldeconomy/p/european_union.htm) has restrictions on how much total debt a country is allowed to have to stay in the [euro](http://useconomy.about.com/od/glossary/g/euros.htm) zone. Therefore, its measurements are broader, and includes state and local government debt, as well as future obligations owed to social security. (Source: Eurostat, [Statistics Explained](http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/Government_finance_statistics#Government_debt))

**Why Expanding Sovereign Debt Usually Boosts Growth:**

Whether a government spends on social security, health care or new fighter jets, it's pumping money into the economy. This boosts economic growth because businesses expand to meet the [demand](http://useconomy.about.com/od/demand/a/demand_primer.htm) created by the spending. This usually results in new jobs, which has a multiplier effect in boosting further demand and growth.[Deficit spending](http://useconomy.about.com/od/fiscalpolicy/p/deficit.htm) is a powerful stimulant because the demand is being created now, and the cost won't come due until sometime in the future.

As long as the sovereign debt remains within a reasonable level, creditors feel safe that this expanded growth means they will be repaid with interest. Government leaders keep spending because a growing economy means happy voters who will reelect them. Basically, there is no reason for them to cut spending.

**When Sovereign Debt Goes Wrong:**

All goes well until creditors start to doubt whether they will be repaid. These doubts start to creep in when sovereign debt reaches 77% of the country's annual economic output, or Gross Domestic Product (GDP). For emerging market countries, the tipping point comes sooner -- at 64% [debt-to-GDP ratio](http://useconomy.about.com/od/glossary/g/Debt-to-GDP-Ratio.htm).

Creditors first start to worry whether the country will default on the interest payments. This becomes a self-fulfilling prophecy because, as worries rise, so does the amount of interest a country must promise to pay to float new bonds. Countries must borrow at ever-more expensive rates to pay off the older, cheaper debt. If this cycle continues, the country may be forced to default on its debt altogether. (Source: The World Bank, [Finding the Tipping Point](http://econ.worldbank.org/external/default/main?pagePK=64165259&theSitePK=478060&piPK=64165421&menuPK=64166093&entityID=000158349_20100730091629))

**Sovereign Debt Defaults:**

Debt crises have occurred for centuries, usually as a result of wars or [recession](http://useconomy.about.com/od/grossdomesticproduct/f/Recession.htm)s. In the 1980s, a wave of defaults occurred in East Europe, Africa and Latin America. This was a result of a boom in bank lending in the 1970s. When the 1981 recession hit, interest rates rose, triggering defaults in the [emerging market](http://useconomy.about.com/od/glossary/g/emerging_market.htm) countries.

In the 1998 [debt crisis](http://useconomy.about.com/od/usdebtanddeficit/a/US-Debt-Crisis.htm), [Russia](http://useconomy.about.com/od/worldeconomy/p/Russia_economy.htm) defaulted after plummeting [oil prices](http://useconomy.about.com/od/economicindicators/p/Crude_Oil.htm) decimated its revenue. Russia's default led to a wave of defaults in other emerging market countries. However, the IMF prevented many [debt defaults](http://useconomy.about.com/od/usdebtanddeficit/p/US-Debt-Default.htm) by providing needed capital. (Source: Federico Sturzenegger and Jeromin Zettelmeyer, Chapter 1, [Debt Defaults and Lessons from a Decade of Crises](http://useconomy.about.com/od/worldeconomy/l/Debt_Default.pdf), MIT Press: January 2007)

**Sovereign Debt Rankings - The Good:**

Here are 13 countries with debt less than 10% of their annual economic output (GDP). These countries have plenty of revenue, mostly from natural resources, to pay for government services. They have a healthy [GDP growth](http://useconomy.about.com/od/grossdomesticproduct/f/GDP_Growth_Rate.htm) rate, so they don't need to boost economic growth through deficit spending.

1. 9.6% -- Kuwait
2. 9.2% -- Chile
3. 9.0% -- Russia
4. 8.6% -- Qatar
5. 8.0% -- Uzbekistan
6. 7.5% -- Gibraltar
7. 6.6% -- Estonia
8. 6.6% -- Algeria
9. 5.6% -- Wallis/Futuna
10. 5.2% -- Azerbaijan
11. 5.1% -- Equatorial Guinea
12. 4.0% -- Oman
13. 3.5% -- Libya

(Source: CIA World Fact Book)

**Sovereign Debt Rankings - The Bad:**

Here are 11 countries with debt greater than their entire annual economic output (more than 100% of GDP). Most of them are in danger of default. In fact, [Iceland](http://useconomy.about.com/od/worldeconomy/p/Iceland_economy.htm) already defaulted in 2008. [Japan](http://useconomy.about.com/od/grossdomesticproduct/a/Japan_Recession.htm) and Singapore are the exceptions. Japan owe most of its debt to its own citizens, who buy government bonds as a form of personal savings. Most of Singapore's debt is held by its social security trust fund. In fact, Singapore hasn't borrowed to finance deficit spending since the 1980s.

1. 233.2% -- Zimbabwe
2. 199.7% -- Japan
3. 185.0% -- St. Kitts/Nevis
4. 142.7% -- Greece
5. 133.8% -- Lebanon
6. 126.3% -- Iceland
7. 126.2% -- Jamaica
8. 119.1% -- Italy
9. 105.8% -- Singapore
10. 102.1% -- Barbados
11. 100.7% -- Belgium

**Sovereign Debt Rankings -- The Just Plain Ugly:**

These countries don't have the worst debt-to-GDP ratios, but nevertheless have investors worried about default. The United States has a public debt-to-GDP ratio of 62.9%. This isn't so bad -- it's not in the top five -- but the total amount owed is $14.7 trillion, larger than any other single country. If the U.S. defaulted on its debt, it would bring the global economy to its knees. Therefore, a monster debt that has any risk of default is uglier than a smaller debt with a higher risk of default.

Most countries in Europe exceeded the self-imposed threshold debt limit, Investors are worried about [default in Greece](http://useconomy.about.com/od/Europe/p/What-Is-The-Greece-Debt-Crisis.htm), one of the five-worst indebted countries in the world, as well as the other "PIGS"

* Portugal -- 93.0%
* Ireland -- 94.9%
* Spain -- 60.1%

However, the debt-to-GDP ratios of the European countries that are bailing out the "PIGS" are also high -- [Germany](http://useconomy.about.com/od/worldeconomy/p/Germany.htm)'s is 83.5% and France's is 84.2%. European banks are large holders of this debt, which could therefore export a [European default](http://useconomy.about.com/od/Europe/p/Eurozone-Crisis.htm) to the global financial system.*(Article updated January 17, 2012)*