The world is shaken by worries over the state of public finances in Greece. Is there a need for you to be concerned by how much a foreign government spends?

What is Greece's problem?

Greece's budget deficit is 12.7% of GDP (Gross Domestic Product) in 2009. This means that the government's expenditure exceeds its income and that difference amounts to about 12.7% of the entire income of the country.

This is a strong sign of that Greece soon may not be able to repay its debts if the deficit is not reduced.

Why can't Greece just spend less. increase taxes or devalue its currency?

Decreasing government spending and increasing tax within a short time reduce the spending power of the whole economy (and therefore the GDP). For example, when government employees and contractors lose their jobs, they spend less and GDP decreases. Therefore, government deficit as a percentage of GDP may not be meaningfully reduced.

A country with deficits may sometimes devalue its own currency (to make imports more expensive and also to reduce the value of debt in say US dollar terms). However, Greece does not have this option since she is part of the European Monetary Union (also known as the Eurozone), which uses the Euro as the common currency.

Why does Greece's problem concern the world?

The Eurozone is the second largest economic region in the world and an important export market for the rest of the world.

The Euro's stability is dependent on the economic health of countries in the Eurozone. If Greece cannot control its deficit or finance everyday government expenditure, the rest of the countries in the zone would presumably be collectively obliged to make emergency loans to Greece, at the expense of their own economies. When major European economies like Germany divert funds away from their own economies, they would consume fewer imports from the rest of the world and thus potentially disrupt global economic recovery.

In the worst case, if Greece is not aided in any way and defaults on its debts, the Euro would decline sharply in value. Eurozone consumers would find imports much more expensive and consume even less. International banks, which lent to the Greek government and state-owned corporations, would face devastating losses and may even collapse, triggering another round of economic recession.

Not just a Greek problem

For the economic concerns to be resolved, besides taking emergency loans in the short term, Greece would have to drastically reduce its deficit in the next few years.

A similar problem is also looming in the United States, where the budget deficit s expected to exceed 10% of GDP in 2010.

(This article is part of a series which attempts to explain economic issues in simple terms)