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Don't mention the debt

By Ian Ball | 7 November 2014

The damage done to the Greek economy by poor accounting methods remains the EU's elephant in the room.

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The Greek economy has been in the spotlight, or is it the cross hairs, since the government's misreporting of its financial performance triggered the sovereign debt crisis. The consequences have been extreme. They include huge losses (euphemistically 'haircuts') imposed on investors in Greek debt, drastic cuts in public services and social dislocation brought about by painful austerity. High unemployment rates, especially for young people, persist. Without sustained economic growth this situation will not be remedied.

The media, ratings agencies and international organisations have failed to adequately address the accounting origins of the crisis. It has remained the 'elephant in the room' when the Greek economy and the need for reform is discussed. The recommendations of the European Parliament's economic and financial affairs committee in 2011, that all member states should adopt the International Public Sector Accounting Standards within three years, was rejected for a process that, three years later, has not even resolved a path forward, let alone taken steps along this path.

Yet better public sector accounting and financial management enables greater economic growth. The importance of economic growth lies not in the numbers, but in the impact on individuals and society as a whole. It determines a society's ability to meet the needs of its citizens, whether safety and security, health or education. It is especially important for avoiding the adverse social consequences of high and persistent unemployment, especially youth unemployment, associated with a stagnant or declining economy.

It might have been expected that an accounting failure by a sovereign government, with huge national, regional and global ramifications, would have generated a momentum for reform. But, even in Greece, there have been no serious steps to improve accounting. The troika imposed hundreds of reform requirements, but did not require the Greek government to move its accounting, budgeting and financial management to an internationally recognised accounting basis.

Lack of accounting reform leaves the financial position of Greece as opaque as it was before the crisis. Damage to the economy and society was not confined to Greece – the consequences were felt throughout Europe and, through the highly interconnected international financial system, around the world.

Better accounting in Greece would lead to economic growth, but in all countries better quality numbers enable better decision-making and enhanced accountability. Transparency acts to inform voters and constrain decisions that have unsustainable financial consequences. While the relationship between good numbers and good decisions is universal, Greece provides the most dramatic example of the damage that can be done by poor accounting and weak financial management.

Greece is commonly cited as having a government debt: GDP ratio of 175%. The perception that this is an extraordinarily high debt burden impacts on the Greek economy in a number of ways. However, the 175% is based on the Maastricht Treaty, which uses the nominal or face value of debt. In other words, it does not reflect the time value of money or that restructuring pushed out the maturity of Greek debt significantly and also reduced the interest payable. Imagine the consequences if Greece was seen to have a debt level significantly less than 60%. That would be the result if IPSAS (or International Financial Reporting Standards) were used to measure debt. A government with a debt: GDP level of less than 60% would attract more investment, achieve more favourable borrowing terms, and have both greater ability to borrow and greater scope to invest.

There are a number of ways this would flow through into economic growth. First, Greece would become a more attractive country in which to invest. This would be reinforced if it were accompanied by a credible undertaking from the Greek government that it was implementing IPSAS in its own accounting. Greater investment means greater economic activity means more jobs.

Second, because Greek government borrowing rates would decline, companies would pay less for loans. As they currently pay significantly more than rivals in other European countries, they would become more competitive.

Small- and medium-sized enterprises would also be able to borrow more easily and at lower interest rates, improving profitability. Households would have lower debt costs and be able to borrow more. Both these effects would have positive economic effects and encourage job growth. There would be more finance for housing construction and development, increased activity in the building sector and, again, more jobs.

Greece is unusual. The impact of its accounting failure was dramatic. Fixing this problem can have a dramatic result, if the Greek government accounts for its debt according to international accounting standards and signals the intent to be transparent.

But my key point is not about Greece, which is simply an extreme example of a common threat to economic growth. That threat comes from governments not imposing on themselves the same requirements for transparent financial statements, prepared in conformance with international accounting standards, that they impose on companies. Without that information, it is impossible for them to meet acceptable standards of financial management. Governments conduct a significant proportion of economic activity in most countries, and to have decisions in a major sector made without good financial information necessarily constrains economic growth.

CIPFA, with the International Federation of Accountants, has long advocated the case for improved accounting and financial management by governments, and progress is being made. That progress is aided if professional accounting organisations around the world both press for reform and are equipped to assist their governments. CIPFA's institute-to-institute offer, presented in its Taking responsibility report, offers support to all professional accounting organisations that would like to draw on its resources and expertise.

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