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Greece's Accounting Problem

By Jacob Soll | January 20, 2015

Greece is back as a focal point of the world financial crisis. While coming elections are spooking the markets, the supposed cause of the crisis has not changed. Greece has a declared debt of 319 billion euros, or about $369 billion, 175 percent of its 182-billion-euro ($210 billion) gross domestic product. This sounds like a nearly impossible task for any government: to govern effectively, spur economic growth and avoid default. The shackles of the declared Greek debt have effectively paralyzed the country. Yet maybe all of this debt drama is unnecessary.

The way this story is usually told, inside and outside Greece, is as a morality play: the profligate Greeks don't pay taxes and their banks and elites, in turn, rob Greek citizens and foreign investors alike. The Greeks, it seems, need to be held accountable and to pay back their debt at any cost.

The brutal and counterproductive response has been austerity. But given Greece's problems, what the country really needs is transparency and accountability. Greece has a very weak tradition of accounting, with few homebred trained accountants. The government does not use International Public Sector Accounting Standards, or IPSAS, which measure liabilities and assets over time, similar standards to those used by leading governments, businesses, banks and investors at all levels. It's of little surprise that without internationally verifiable accounting standards, no one feels the need to be accountable.

This lack of accountants not only means poor administration; it also means that the Greek government has done a lousy job of accounting for its debt number. In fact, the debt has been calculated to be larger than it actually is, or would be if one used IPSAS.

Without real accounting, we also can't evaluate the claims of Prime Minister Antonis Samaras's government — as well as those of numerous commentators — that Greece has made improvement in its fiscal position over the last two years. If the European Commission, the International Monetary Fund and the European Central Bank (known as the troika) are giving Greece 283 billion euros ($327 billion) of financing in return for good economic indicators — and credit ratings agencies like Moody's shake Greek and eurozone economies with pronouncements made on these numbers — one would think they would want to verify the numbers, using IPSAS, which would be much more transparent and something people outside the troika could realistically evaluate.

But the Greeks are not the only ones content with bad accounting and fishy numbers. The troika itself does not use IPSAS in calculating Greek debt, but rather what is confusingly called the Maastricht definition of debt, which is based on face value.

Think of face value as a promise to pay something in the so-far-distant future because its value is essentially worthless today if you don't get interest payments. This means that the troika calculates debt neither according to its financial worth, but rather according to a political agreement that ignores very low interest rates and the fact that money increases in value the longer you can hold and invest it. This is working to Greece's advantage, but Greece can't show it, and thus benefit from better credit ratings.

Neither economic principles nor international accounting standards would regard this as an acceptable way to report a debt position. Greece was so cash-strapped and used to European Union handouts that its leaders signed off on the bailout deal without international accounting standards.

The fact that Germany has acted as a vigilant gatekeeper over Greece's agreement to abide by the agreed debt and austerity measures should deserve scrutiny. Look again at the 57 billion euros ($66 billion) in German loans through the lens of accounting logic. The loans have been made at under 2 percent with maturities as far out as 2054.

That means that, in reality, the interest on this loan is under market rates. Giving loans well under market rates with gaping repayment schedules amounts to a grant. According to IPSAS standards on German debts, this portion of the debt alone would require only about 13 billion euros ($15 billion), leaving Germany with a considerable 44-billion-euro ($51 billion) loss.

But given the current draconian austerity conditions, Germany might be able to avoid showing the losses on the loan, but it will destroy Greece in the process. Germany's demands for both austerity and overvaluing of the debt are both unjust and counterproductive for Greek and European stability.

Greek debt is not what it seems. One reason might be that the Germans have refused to price the debt fairly, or properly report its value, which means in the short run that they extract more austerity from the Greeks than they should, and that they also keep this loan off the budget balance sheets because it would come up as a loss under any legitimate accounting standard.

A little-known fact is that the Germans also do not use IPSAS and have notably opaque public finance standards. This means their potential loss on the Greek loan is out of sight of the German public, who, not great fans of the Greek bailout, would be even less enthusiastic if they understood the terms.

It should also be noted that the Greek crisis has contributed to the 15 percent drop in value of the euro over the last year, and, with this low rate, German exports have been given a huge boost.

By overstating Greek debt and effectively creating a false sense of crisis (the Greeks have been bailed out), the troika is undermining growth and investment through both the drama of overstated debt and by austerity measures that are ripping apart Greek society. If Greece continues with the yoke of this inaccurate debt number, it faces more recession and possibly political unrest, further destabilizing a hobbled Europe and the euro.

Greek leaders should demand neither more austerity nor debt default. They should simply ask that the debt be calculated using IPSAS. And while they are at it, they should implement IPSAS at home to boost confidence, investment, credit and political stability. Clear accounting would show the Greek debt to be lower, stabilize the country, and bring confidence to Greece and, correspondingly, to the euro.

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