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Greece and The Eurozone At A Tipping Point

By Vincent J. Truglia | February 7, 2015

I don't have to repeat my long-time opposition to the Eurozone as presently structured. However, I was recently challenged by a German colleague to not just criticize the project, but rather to present a solution. I don't have to repeat all the various solutions that have been proposed, including ring-fencing Greece as was done with Cyprus or a Grexit or even a German-exit from the Eurozone. However, recently I was persuaded that there might be another solution, which may surprise some of my economist colleagues.

As economists, we are often thought a modern version of the medieval theologian, where we defend our positions, almost as articles of faith. In this case, I believe we need to take a broader view.

NPV and MTM are not the Solution

We economists are comfortable with the idea of net-present-value (NPV) and mark-to-market (MTM) pricing of securities. They fit into our usual paradigm. However, recently I was presented with an unusual (at least for this economist), but invaluable insight into another more universally accepted approach to measuring sovereign deficits and debt. What will be disquieting for most of my economist colleagues is that it comes from the world of accounting.

IPSASB

I have been persuaded that Greece and the whole Eurozone, perhaps even the entire EU, should require the use of IPSASB (International Public Sector Accounting Standards –version B). These standards have been vetted over many years, and are presently being used in a number of the more successful countries. For instance, for years, New Zealand, Australia and Canada have all been using IPSASB accounting standards, not just for state-owned enterprises, but for their national governments as well. I should note that these three countries moved to these standards post a crisis, in hopes of avoiding another crisis in the future, which to date, has proved quite successful. Some Eurozone countries have already started or are in the early stages of moving towards IPSASB accounting. However, Greece definitely has not, nor has Germany.

Rescheduled Debt At Face-Value?

You might already be asking why this matters. It matters a great deal because without proper accounting, fiscal statistics are often extremely distorted. Although, I am not at liberty to disclose the sources, I have seen two versions of the Greek fiscal situation using IPSASB standards. One was produced by a private firm, and the other by a major accounting firm. Although both worked independently, their final results were remarkably similar. If Greece used IPSASB

accounting, the government and the Greek people would find that they are in a rather healthy fiscal position unlike the purely bogus numbers resulting from Maastricht-oriented rules indicate. Almost anyone who has looked at the Greek debt numbers will immediately know that the often quoted debt/GDP ratio of 175% is completely arbitrary since the existing rules require that even rescheduled debt between EU governments is counted at face value, a ridiculous idea if ever there was one.

Mendacity

No private firm would ever be allowed to do that. Why is that being done? I hypothesize that there are two possible reasons: 1) Eurozone creditor governments do not want to write down the Greek debt because it would affect their own deficit targets, and would likely pose thorny political problems for all these governments (including the ECB); and, 2) Past Greek governments have had a vested interest in representing such a dire debt position because it meant more aid inflows from the rest of the Eurozone, and was in line with some of their own philosophical ideas regarding the nature of government. In other words, obfuscation was/is at the heart of the crisis.

IPSASB Is Well Established

For those not familiar with IPSASB, for instance, it values rescheduled debt and financial and other assets using an approach similar to the one used by the private sector for years. In fact, it is usually mandated by governments for firms within their borders to follow IPSAS accounting standards, which they themselves don't use. It seems odd that these governments refuse to employ similar standards, which they require to be used throughout their economy.

A Leipzig-Style Debate Is Required

I liken the debate over whether to use IPSASB or existing measures to determine Eurozone fiscal and debt statistics to theological debates of the past. Therefore, borrowing from history, I suggest that the EU organize a Martin Luther-John ECK Leipzig-style Disputation (in 1519 for history wonks like me), where reformists and traditionalists would debate the substance of the issues involved.

An Interim Proposal

In the interim, it is clear to me that Eurozone leaders and the ECB should grant the new Greek government a little more time to develop its own program. Clearly that was the will of the Greek people in a free and democratic election. At the same time, it is in the interest of Eurozone leaders to avoid a financial crisis, which might ensue if Greece defaults and/or exits the Eurozone.

No one can predict the consequences of a default or Grexit, especially given all that has gone on in recent years. A Greek exit was far more feasible several years ago than it is now, since European banks and governments' fiscal positions are worse today than in the pre-Great Recession era (reminding ourselves that we really don't know what the actual government accounts are for most Eurozone countries).

Unilateral Action By Greece Is Possible

Even if Germany wishes to keep its own government antiquated accounting practices, the new Greek government is free to present IPSASB-based numbers, which if the balance sheets I saw for Greece are even remotely correct, then Greece doesn't need another bailout. Its fiscal position is actually quite comfortable.

Summary

There is a possible solution to the present Greek crisis, and it comes from the world of accounting, which has independently vetted these standards over many years. If Greece unilaterally adopts these standards – and there is nothing stopping the Greek government from doing that – then Greece will be set free from the present austerity-driven downward economic and social spiral.

As a famous US TV detective of old used to always say when investigating a criminal case, “Just the facts, mam, just the facts.”

As always, **Clear and Candid.**
