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Accountable Sovereign Governments

Is Greece's debt 170 percent of GDP or below 100 percent? Sovereign bankruptcy risk becomes easier to detect when international accounting standards are also introduced for sovereign governments, writes Dag Dyrdal.

Dag Dyrdal

Greece's bankruptcy in 2012 reminded us that government bonds are not risk-free. But investors still lack the desire and ability to assess credit risk in the eurozone. A solution is something as basic as international public sector accounting standards.

Most euro sovereign governments currently have a debt ratio that is well above the Maastricht Agreement, 60 percent, considered a sustainable limit for debt as a share of the economic value added defined as the country 's gross domestic product (GDP). Sovereigns like France and Italy, respectively, have ratios of 93 and 133 percent; levels many would say are not sustainable. At the same time, the eurozone exhibits a great interest in making the restructuring of sovereign debt more efficient, which should worry investors.

New debt restructuring rules

In January last year, the EU introduced new mandatory debt restructuring rules ("collective action clauses") for newly issued euro sovereign bonds, which means that it

only requires approval of a qualified majority of bondholders to modify euro sovereign bond terms - such as lowering interest rates, extending maturities, or reducing principal amounts. International investors should compare this low approval amount of 50 percent with the percentage of euro sovereign government bonds owned within a country, where for example, Spain is probably close to 65 percent.

To better assess risk

This rules change has thus increased credit risk for investors, but is not balanced with measures to enable investors to better assess the risk. Euro states are even exempt from EU directives requiring detailed information from issuers. Many sovereign governments provide no detailed financials or sustainability analysis for government debt, but merely provide a brief summary of the main financial information.

The wake of the financial crisis has prompted investors and authorities to discusss reducing reliance on credit rating agencies. However, the results have not occured. Some investors have indeed reduced their exposure to government bonds with perceived high credit risk, and some have developed models to analyze a country's fiscal strength. However, both these models and credit ratings use official debt figures and assume that they are relevant and comparable.

A ”lost generation”

As to why investors do not go deeper into the details, it can be explained by looking both historically and culturally. For decades, bonds have ridden a wave of falling interest rates and rising prices. Thus, there has emerged a "lost generation" of investors who consider government bonds as risk-free.

History shows, however, that restructuring of government debt is a recurring phenomenon. Is Greece a special case or the first in a series?

The only international accounting standards are IPSAS

Many investors lack the skills and tools to be able to give a good answer. Competence can be built by strengthening the internal analytical knowledge of government financials. But, they still lack coherent and relevant data. EU countries use different standards and different methods of reporting debt. While investors take for granted that companies in which they invest follow international accounting standards, there is no such requirement for sovereigns. The only international accounting standard for sovereigns is called the International Public Sector Accounting Standards (IPSAS), a public sector version of IFRS. It is used by pioneers such as New Zealand and Canada, but only by a small, elite number of EU countries.

In the wake of the euro crisis, European financial experts recommend the EU implement IPSAS, to bring improved decision-making, increased transparency, and strengthened

accountability. Still, however, debt is reported in the euro zone in a manner that does not take into account the time value of money or financial assets.

Greece debt is well below 100%

With Greece as an example, it means that the effects of its restructurings - such as below market interest rates, deferred interest payments, and extended maturities are not reflected in the debt-to-GDP figures from Eurostat. While the official figure is 172 per cent, Greece, using international accounting standards, IPSAS-based accounting, has a debt ratio well below 100 percent.

A Norwegian mountaineering rule

These international accounting standards will also make visible the payment obligations not recognized in the euro states today. For bond investors, IPSAS will thus provide a more complete picture of the gearing and future obligations, not to mention a basis for comparing countries. Without such common standard, investments in eurozone government bonds continue to happen - expressed as a Norwegian mountaineering rule – with no visibility, map, or compass.

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