Greek crisis may store hidden benefits for Europe

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By Brian Love, European Economics Correspondent - Analysis

PARIS (Reuters) - Greece's debt crisis may end up helping Europe in the long run if it pressures governments to start addressing the potentially colossal costs of pensions and healthcare in coming decades.

In the boom years of the past decade, racy rates of economic growth and ultra-cheap credit gave governments less incentive to prepare for a looming surge in the retiree population, and they were under little if any financial market pressure to do so.

But pension reforms being launched in Spain, France and Greece suggest the Greek crisis is now focusing governments' attention on those problems, and even giving them the political cover to act.

"Greece's woes have dragged everyone's longer-term fiscal prospects under the harsh lights of the interrogation room, and several countries have realized that in the longer term, they're all like Greece," said UniCredit economist Marco Annunziata.

"One quick look at the consequences seems to be enough to send them scrambling for remedial action. If that is the case, we should all be grateful to Greece."

Politicians facing voters every few years tend to balk at reforms that compromise their hopes of a return to office but pension age increases would conceivably be harder to reverse than tax hikes. And the pressure is on right now.

Indeed, the debts that the financial markets are so nervous about in Greece and several other European countries are dwarfed by estimates of the burden on governments if their commitment to future pension and healthcare provision are added to the mix.

U.S. economist Jagadeesh Gokhale calculates that adding all such "off balance sheet" liabilities would leave Greece with a debt worth 875 percent of gross domestic product rather than the 120 percent of GDP officially forecast for this year.

For the EU as a whole, the burden would have to be restated at more than 434 percent of GDP, roughly five times the official count. He estimates Spain's total burden at 244 percent of GDP, Germany's 418 percent, Britain's at 442 percent and France's at 549 percent, versus a Greek-like U.S. figure of 890 percent.

Gokhale, who wrote a report on the issue last year for the Cato Institute, a Washington think-tank, uses his figures to argue that governments should gradually withdraw and let the private sector handle pension and healthcare provision.

RAISING RETIREMENT AGE

But that ignores another option; pension and healthcare benefit is a social contract any government can rewrite and that is what Greece, Spain and soon probably France are doing by raising the retirement age at which people are entitled pension.

In Britain, the opposition Conservative party is promising to do something similar if it wins an election later this year and the Danish government spoke again of reforming the country's early retirement system when it said last week it would step up fiscal consolidation efforts in the years ahead.

Street protests last week over plans to raise Spain's retirement age to 67 from 65 show how fast the Socialist government there chose in the face of immediate pressures to take steps that will ease the longer-term financial strains of an aging population.

Greece, desperate to convince debt investors that it can fix its ragged public finances, is also considering plans to raise average retirement age to 63 from 61 along with tax reforms and a brief amnesty for tax evaders that may boost notoriously weak government revenues longer term.

And in France, President Nicolas Sarkozy is working on more reforms of the pay-as-you-go pension system that could feasibly push retirement age beyond a current average of 60, in addition to other structural cost-cutting steps such as non-replacement of one in two retiring civil servants.

The reasons for taking such painful measures have been clear for some time but are becoming more so as financial markets grow wiser to the extra debt the European governments are saddled with as the region emerges from recession.

For much of the time since it joined monetary union in 2001, Greece enjoyed trouble-free access to relatively cheap credit on bond markets but the speed at which that benign climate came to an end has delivered a wake-up for more than Greece.

The total sovereign debt of the 27 European Union countries is set to increase by about a third between 2008 and 2011 alone, from 63 to 84 percent of GDP, the European Commission says.

That increase largely reflects the damage recession caused to public finances through lost government income and higher public spending but it comes at a particularly inauspicious moment as the costs of catering to an aging population accelerate.

PENSIONER NUMBERS TO DOUBLE

With the number of pensioners set to more than double versus the working-age population in the next 50 years, the Commission estimates that government spending on pensions, healthcare and other age-related areas will rise on average by 4.3 percentage points of GDP, from an EU average of 23.2 percent in 2010.

Greece faces a particularly daunting challenge if it does not alter policy; the Commission estimates that its age-related spending needs will rise not far off four times as much as that EU average, or 16 percentage points, over those 40 years.

The fact that European governments appear to be concentrating at the moment on steps to limit structural spending drift rather than temporary tax hikes is "particularly welcome" as a result, said Deutsche Bank economist Gilles Moec.

Tens of thousands of protesters took to the Athens streets to protest over government austerity last week and the specter of pension reform sparked protests too in Spain and France.

Unfortunately for many governments, old age is not the only additional strain public finances have to bear as Europe crawls out of recession with a banking sector that is still dependent on massive public support.

Ireland has for example created a "bad bank" to buy stricken land and property development loans from the country's troubled banks at a price of some 54 billion euros, money that bad bank could in theory recoup over time.

Add that 54 billion of contingent "bad bank" liabilities and Ireland's debt ratio soars from the official 78 percent of GDP to 110 percent of GDP. Even there, the bad bank liabilities are just a part of "off-balance-sheet" commitments that would push the grand total to 405 percent of GDP in Gokhale's calculations.

Dublin has EU approval to keep the bad bank liabilities "off balance sheet," just as the White House did after the mortgage finance agencies Fannie Mae and Freddie Mac were taken under state control last September.

If all those off-balance-sheet commitments were accounted for, Cato's Gokhale says EU governments would on average need to set aside 8.3 percent of GDP every year until 2050 to cope, or else gradually raise taxes from 40 to 60 percent of GDP.

While they offer a pointer, his calculations remain controversial because they lump debt that governments have raised and must repay in bond markets with contingent liabilities they can alter through policy change.

"It is too early to consider that our rich societies are doomed, but it is clear some severe adjustments will have to be made," said Pierre Cailleteau, head of global sovereign ratings at Moody's Investors Service.

(Editing by Stephen Nisbet)

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