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The Greek Economy under Reform: Turning a problem into an opportunity

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The Problems:

1. Greece

A. Fiscal derailment

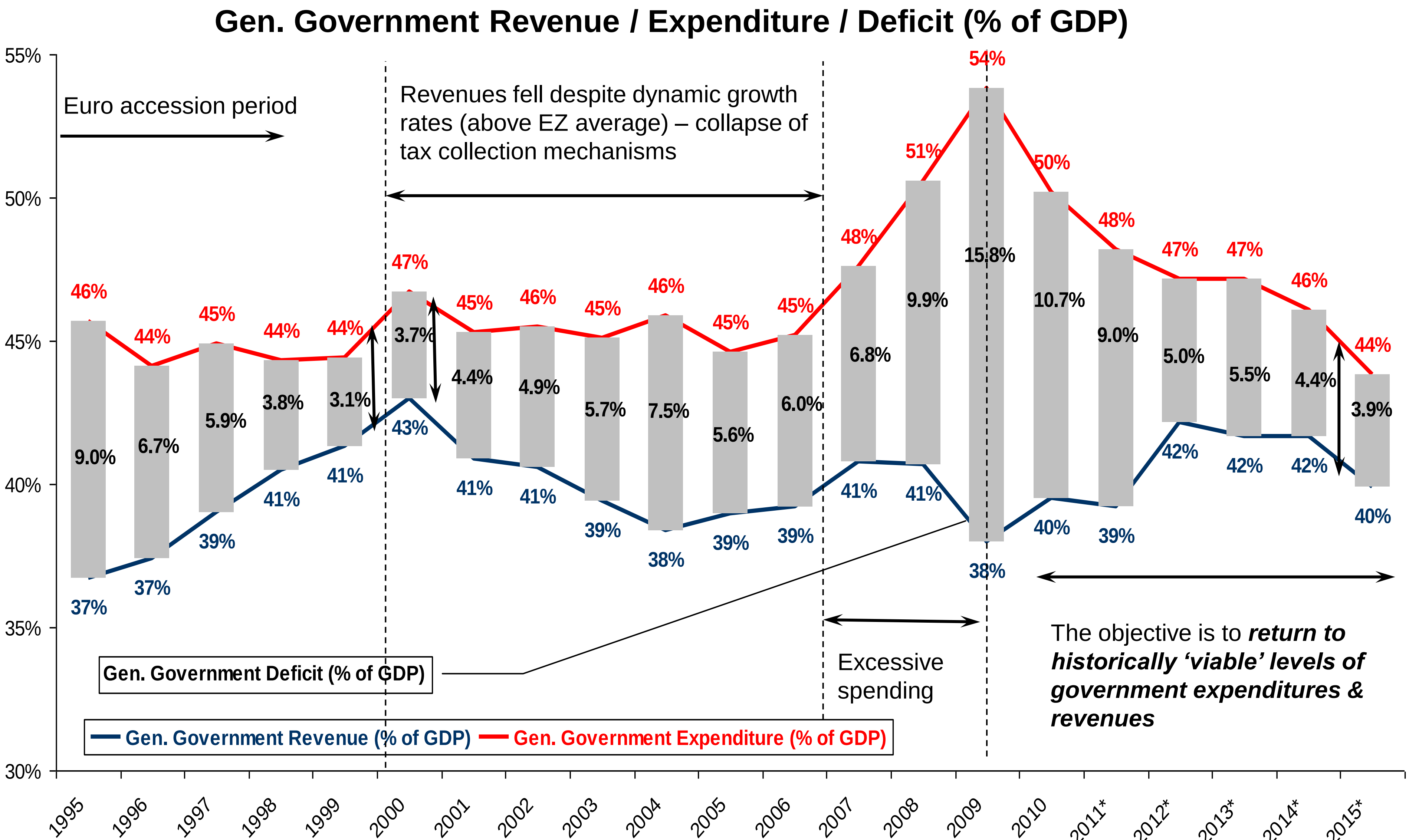
B. Loss of Competitiveness

2. Eurozone

A. “Currency without a state”

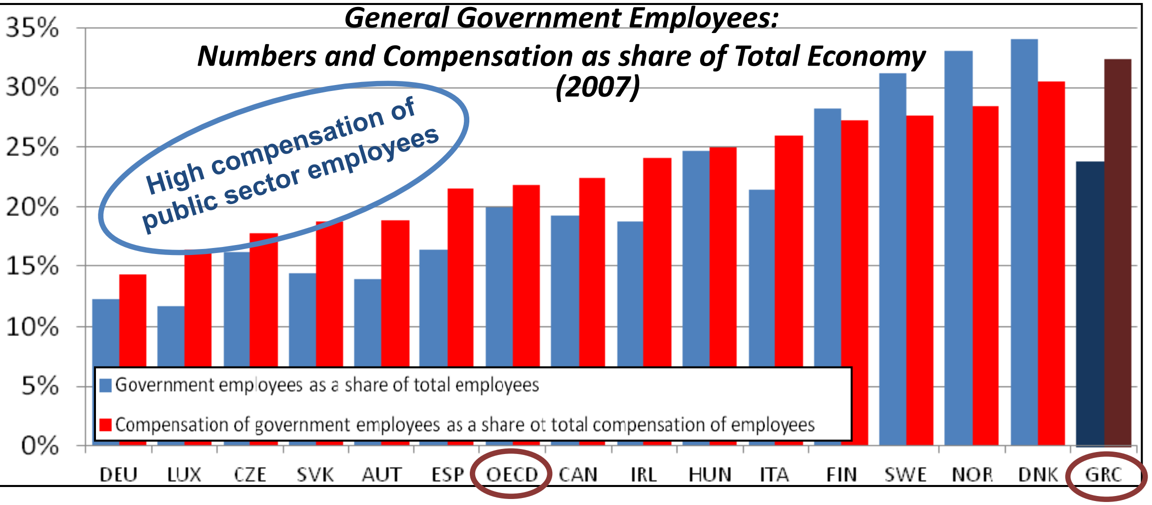
B. Deflationary Bias: Fiscal discipline needs a Growth counterpart

Fiscal Derailment: The lost decade



* Estimate. Sources: AMECO database, ELSTAT, 2012 Budget, Ministry of Finance, November 2011

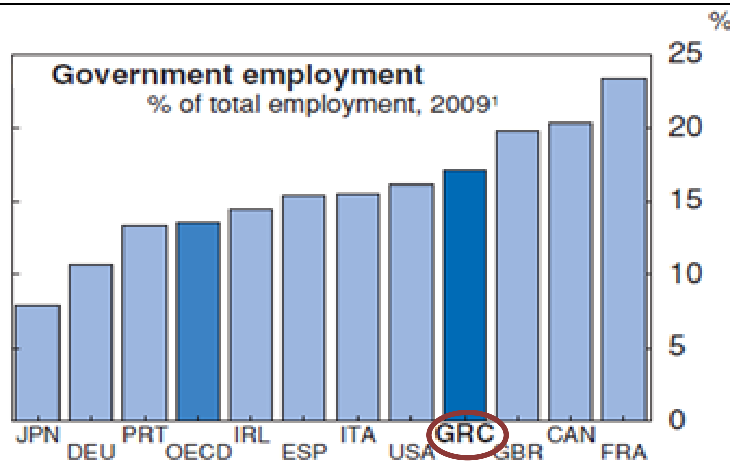
Fiscal Derailment
Main characteristics on the expenditure side



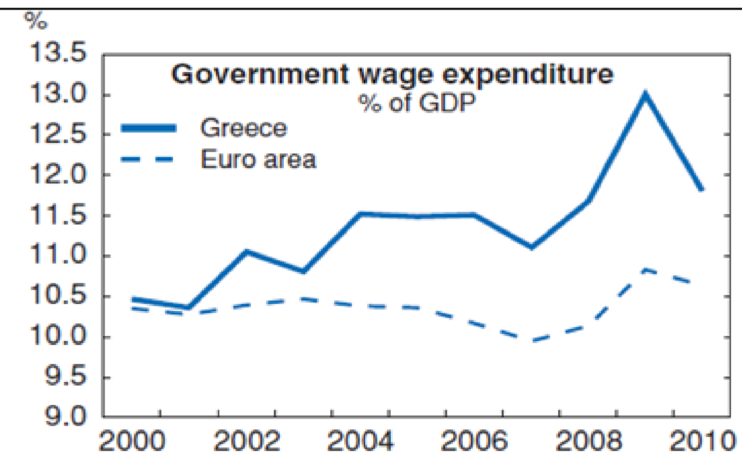
Expansion of the state:

- ➢ Increase in the number of civil servants (x2 since 1980)
- ➢ Provision of special privileges to social groups – Safeguarding status quo
- ➢ The average spending on public sector wages increased by 100% during the last decade, employment in public sector climbed over 10%.
- Public Sector: Lack of planning & measurement – transparency – incentives– quantification of results.

<u>Civil servants</u> account for a larger share of total employment in ***Greece*** (***17%***) than the ***OECD*** average (***15.3%***)



Over the past decade, ***public payroll*** has grown faster, and is now higher as % of GDP than the eurozone average



** Sources: Greece at a Glance, Policies for a Sustainable Recovery, OECD,March 2010 – OECD Economic Surveys: Greece, AUG 2011*

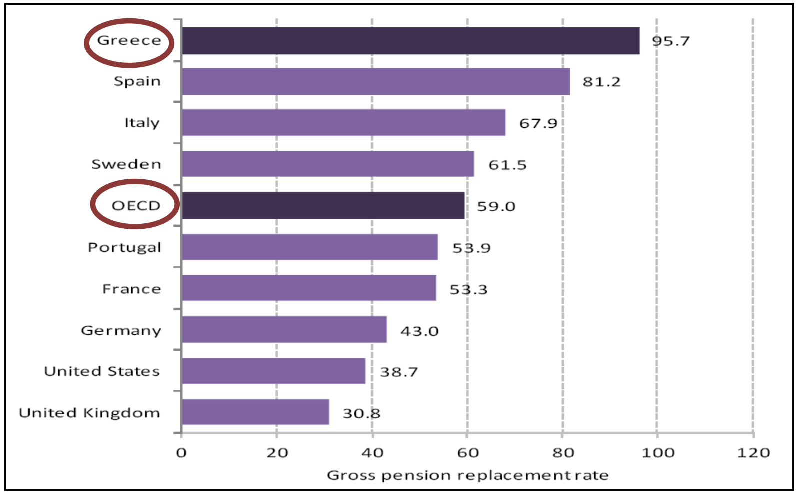
Fiscal Derailment
Main characteristics on the expenditure side

The social security system was not viable

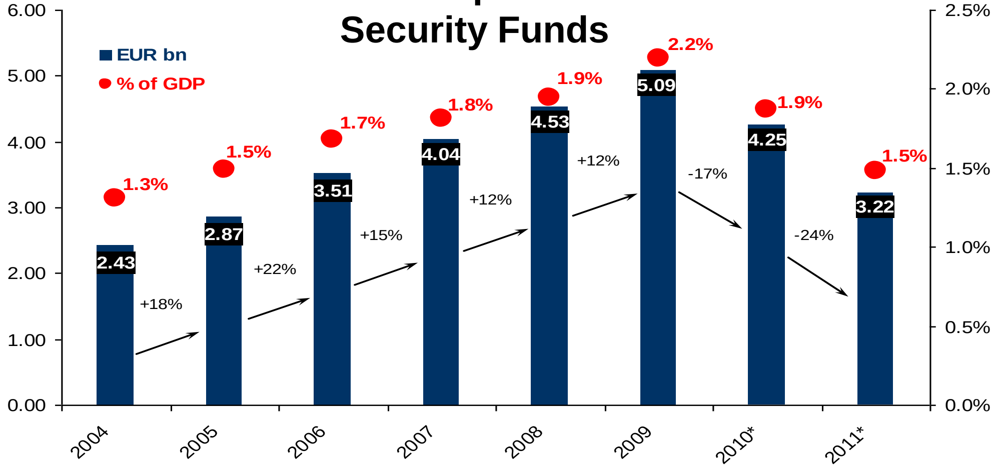
Pensions (% of GDP)

	2009	2010*	2060	2060**
Germany	10.4		12.7	
Greece	**11.7**	**13.2**	**24.1**	**13.9**
Spain	8.4		15.1	
France	13.0		14.0	
Ireland	4.7		11.1	
Italy	14.0		13.6	
Portugal	11.4		13.5	
Finland	10.0		3.3	
Cyprus	6.3		17.7	
Poland	11.6		8.8	
EU-27	10.2		12.6	
Euro Area	11.1		13.9	

Pension Replacement Rate *(before the reform)*



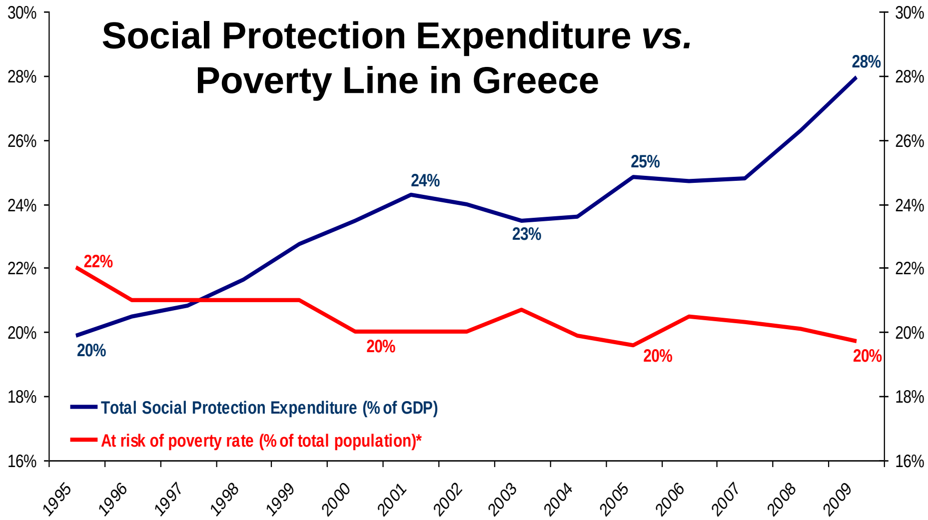
Pharmaceutical Expenditure of Social Security Funds



* Estimate, Ministry of Labor & Social Solidarity (Nov 2011) ** Following Social Security System reform in June 2010

Sources: 2009 Ageing Report: Economic and Budgetary Projections for the EU-27 Member States (2008-2060), European Commission - Greece at a Glance, Policies for a Sustainable Recovery, OECD, March 2010, OECD Economic Surveys: Greece, AUG 2011 / General Secretariat of Insurance Funds and Pharmaceutical Department of Naval Insurance Fund

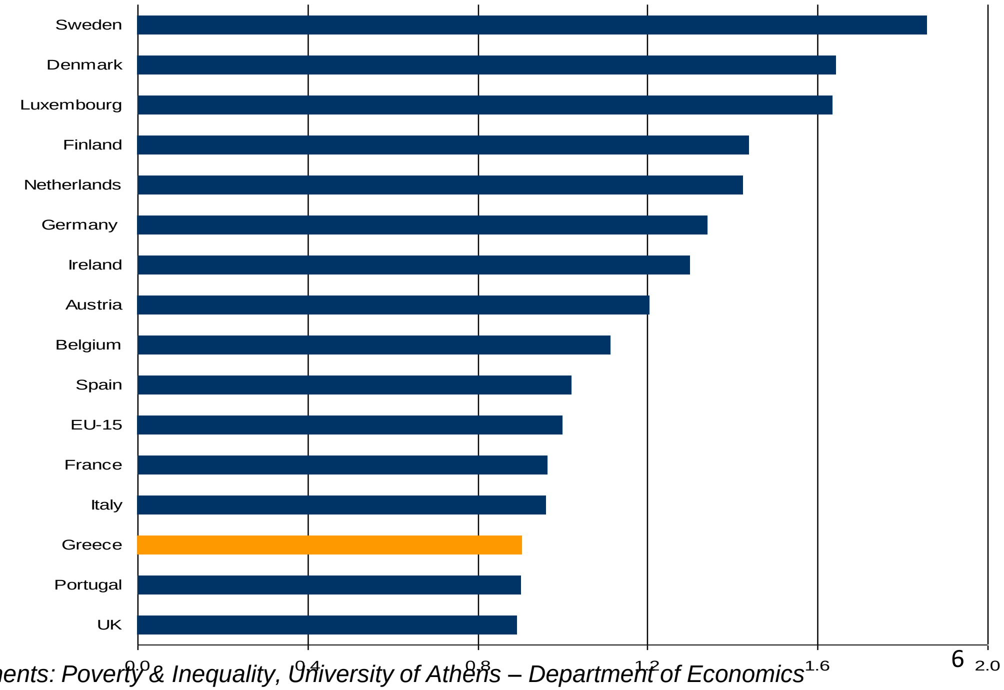
Fiscal Derailment
The paradox of social policy



While total expenditure on social protection has increased, the at-risk-of poverty rate has remained the same. Why?

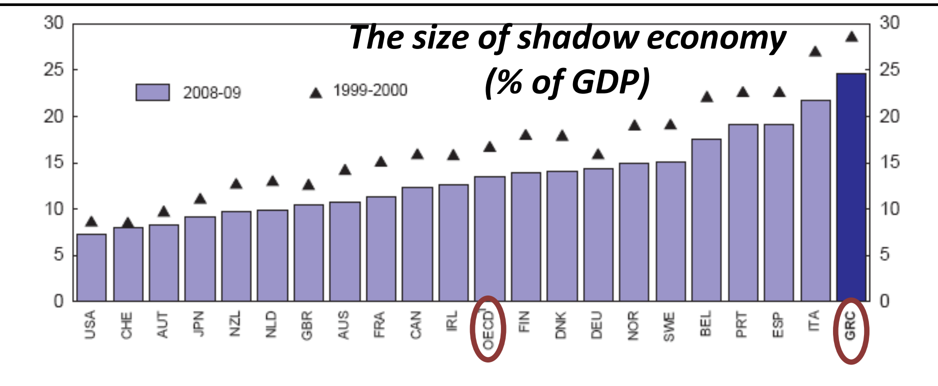
- Waste in pension spending
- High pensions without corresponding contributions
- Wasteful pharmaceutical drug prescription
- State hospitals lacking accounting standards / system (+under-capacity)
- Overpricing of medical supplies & equipment
- Lack of expenditure monitoring
- High profit margins of pharmacists

Relative effectiveness of social protection expenditure to the poverty rate (Index)
(avg 1995-2009)

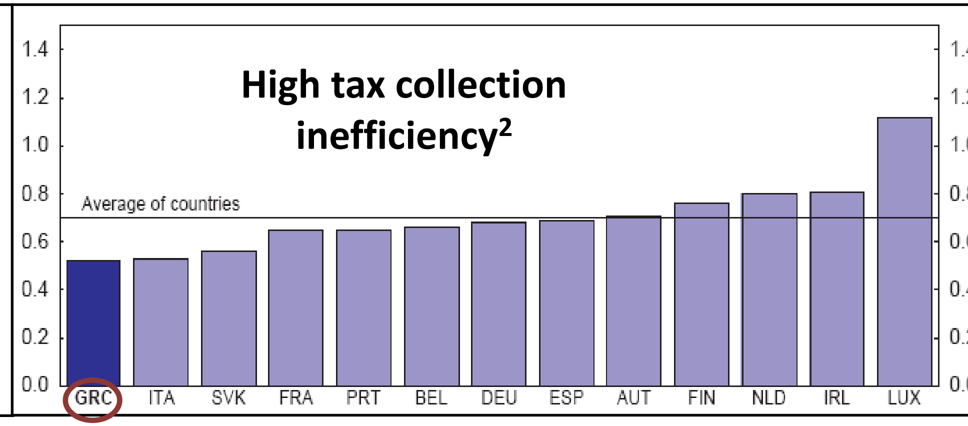


* (cut-off point: 60% of median equivalised income after social transfers)
Sources: Eurostat, INE GSEE – Observatory of Social-Economic-Fiscal Developments: Poverty & Inequality, University of Athens – Department of Economics

Fiscal Derailment
Main characteristics on the revenue side

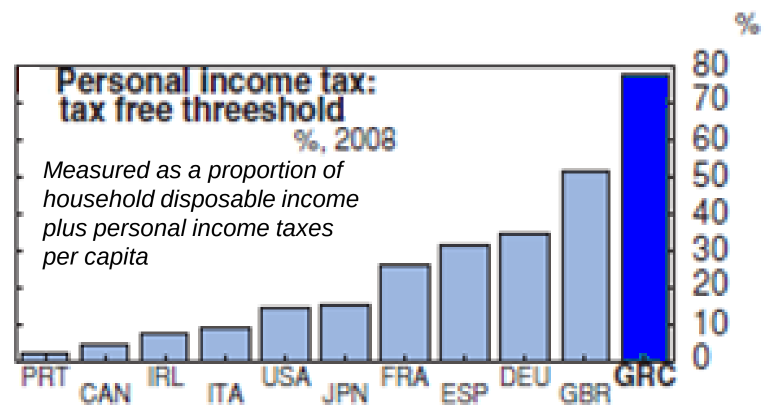


1. Unweighted average over 21 OECD countries.



[2] Tax efficiency, calculated as the ratio between effective (potential revenue from value added taxes on private consumption) and statutory rates

The most acute problems of efficiency & evasion relate to ***personal income tax***:

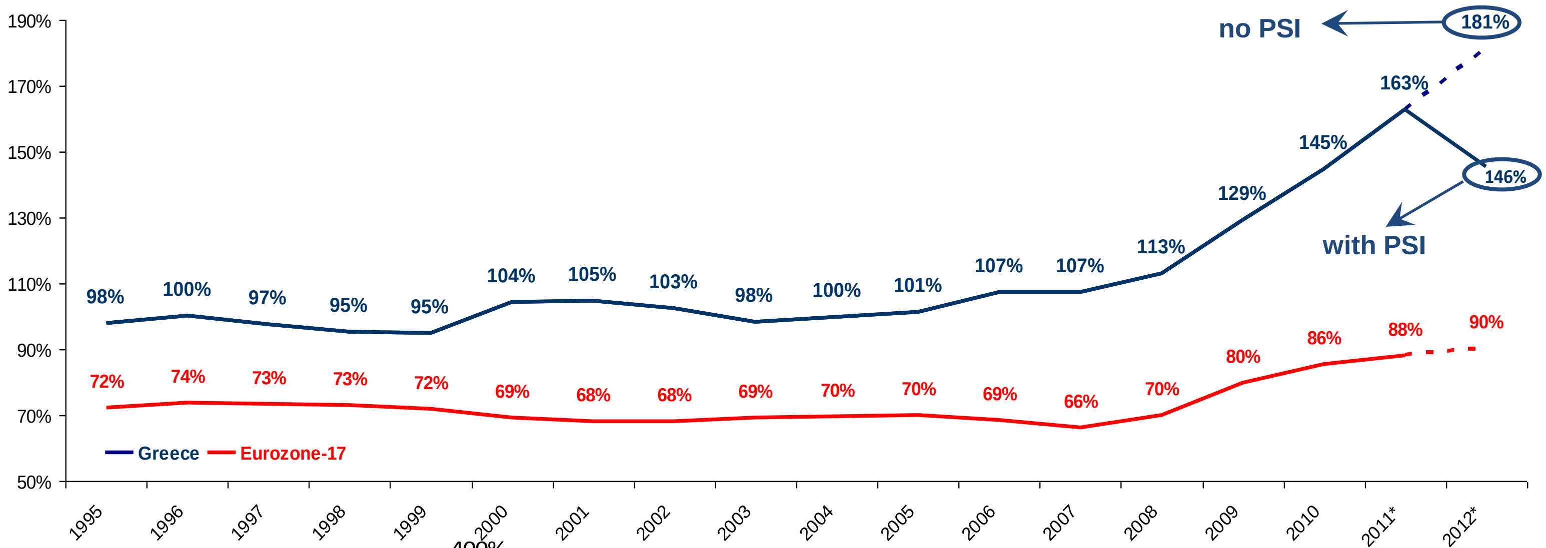


- ***Revenues from personal income tax were 4pps of GDP lower*** than the eurozone average for 2005-2009 (despite comparable tax rates)
- For 2009, ***94% of tax payers reported annual incomes of less than EUR 30,000***
- ***Personal income tax evasion: 2.5% - 3.8% of GDP***[1] (also related to the large share of the income of self-employed: 24% of GDP on avg. 2005-2009 vs. 12.5% of GDP in EZ).

Sources: Greece at a Glance, Policies for a Sustainable Recovery, OECD, March 2010. Schneider, F. (2009), "The Size if the Shadow Economy in 21 OECD Countries Using MIMIC and Currency Demand Approach". - OECD Economic Surveys: Greece, AUG 2011

[1] National Bank of Greece (2010), Matsaganis & Flevotomou "What are the margins for increasing PIT revenue in the Greek Economy?", Monthly macroeconomic Outlook, May 2010

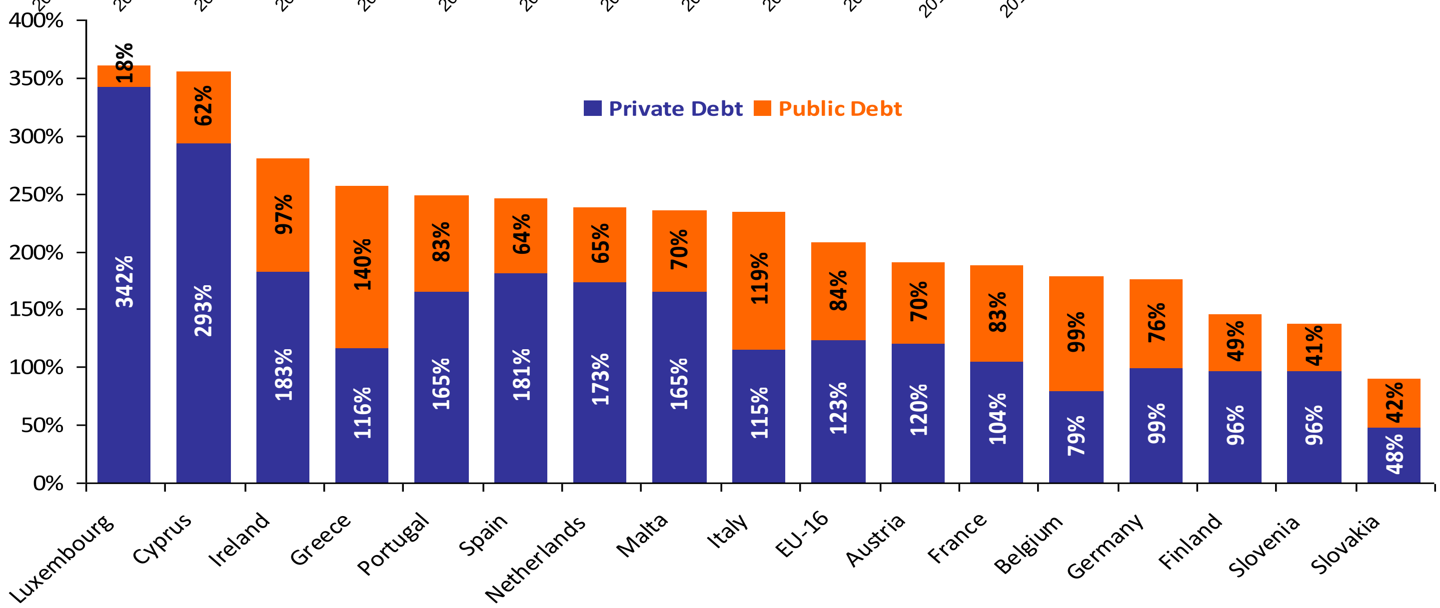
Debt dynamics



General Government Debt (% of GDP)

Private Sector – Public Sector Debt 2010 (% of GDP)

The private sector debt in Greece remains relatively low



** Estimates. Sources: AMECO, ECB, 2012 Budget, Ministry of Finance, November 2011*

Greece has lost ground in Structural Competitiveness

Loss of Structural Competitiveness

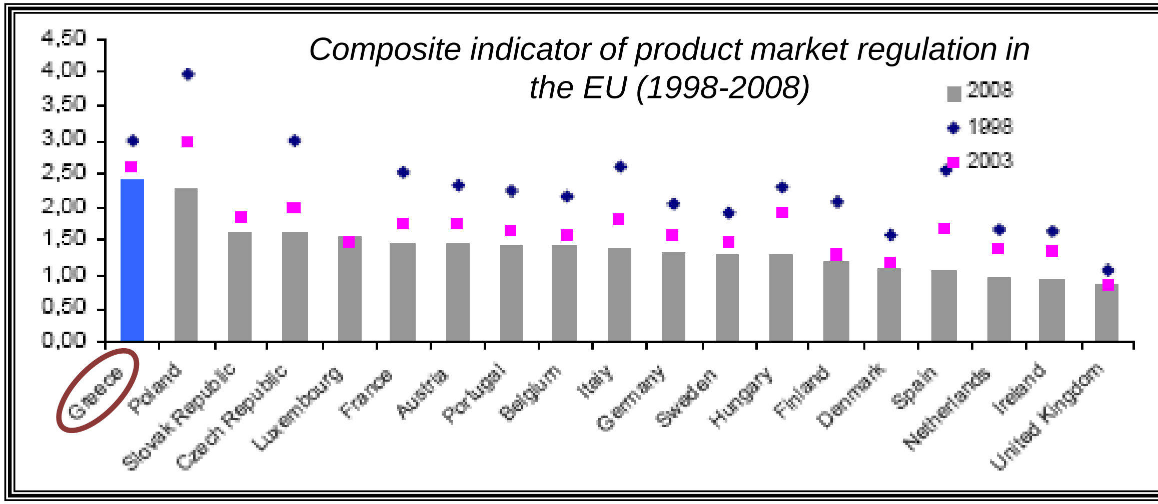
- ***IMD World Competitiveness Yearbook :*** *56th position in 2011 (out of 59 countries) – 37th position in 2004.*

- ***World Economic Forum:*** *83rd position in 2010 (out of 139 countries) - 35th in 2004*

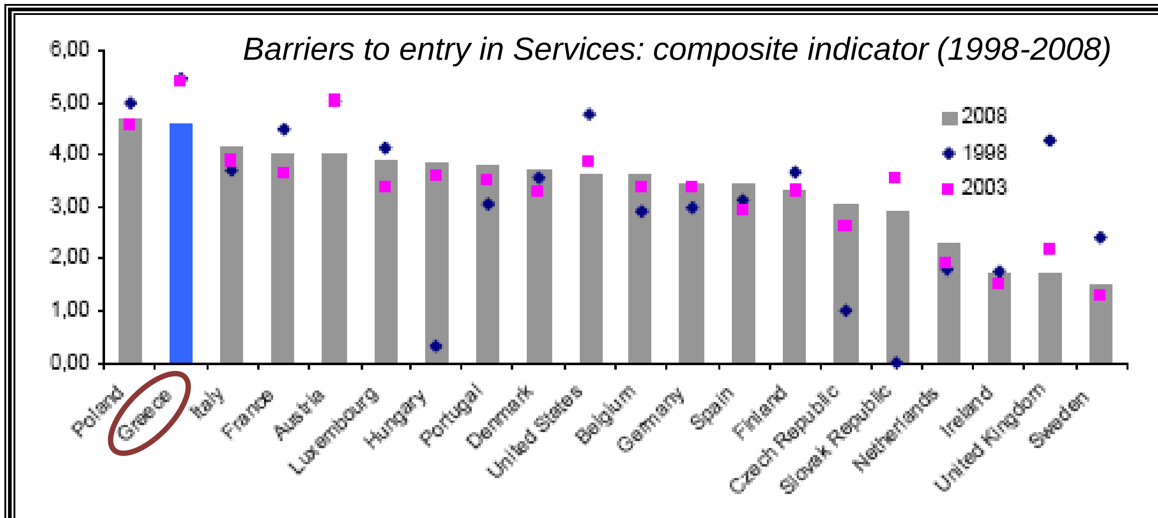
- ***Doing Business Report (World Bank):*** *100th position among 183 countries in 2011 - 80th position in 2006*

As a result of the overregulated market framework and the various restrictions in entrepreneurship and investments, ***the average profit margin in the non-tradable goods & services sector is 15% higher than the relevant eurozone margin, while in the labor market the margin is 10% higher (vs. eurozone)***

Overregulated product markets

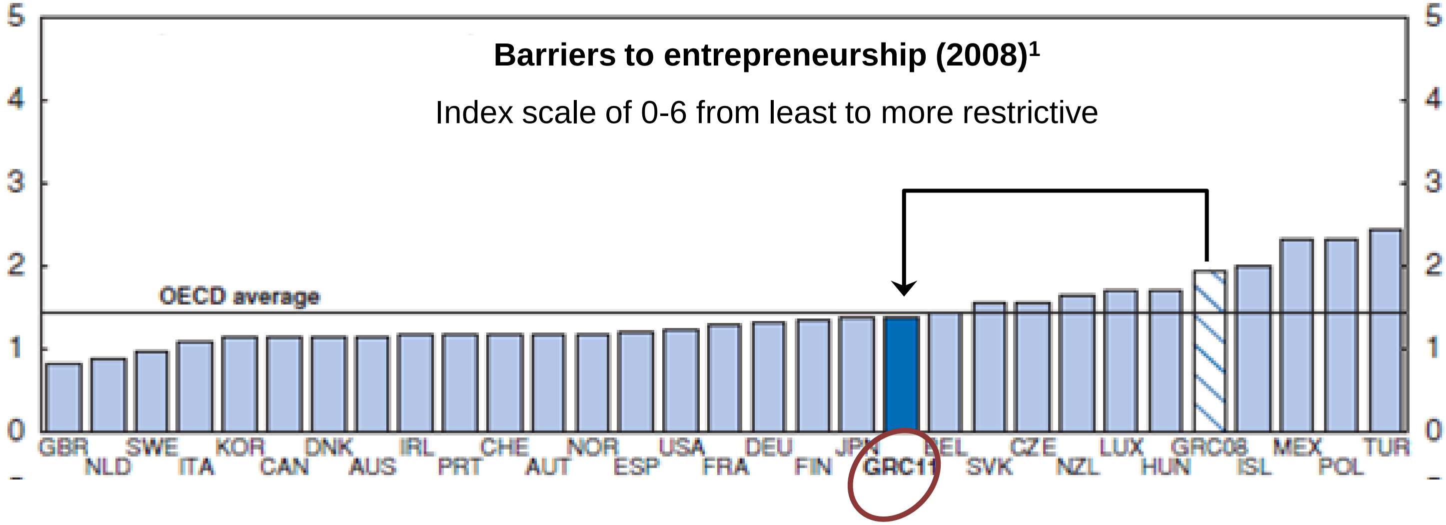


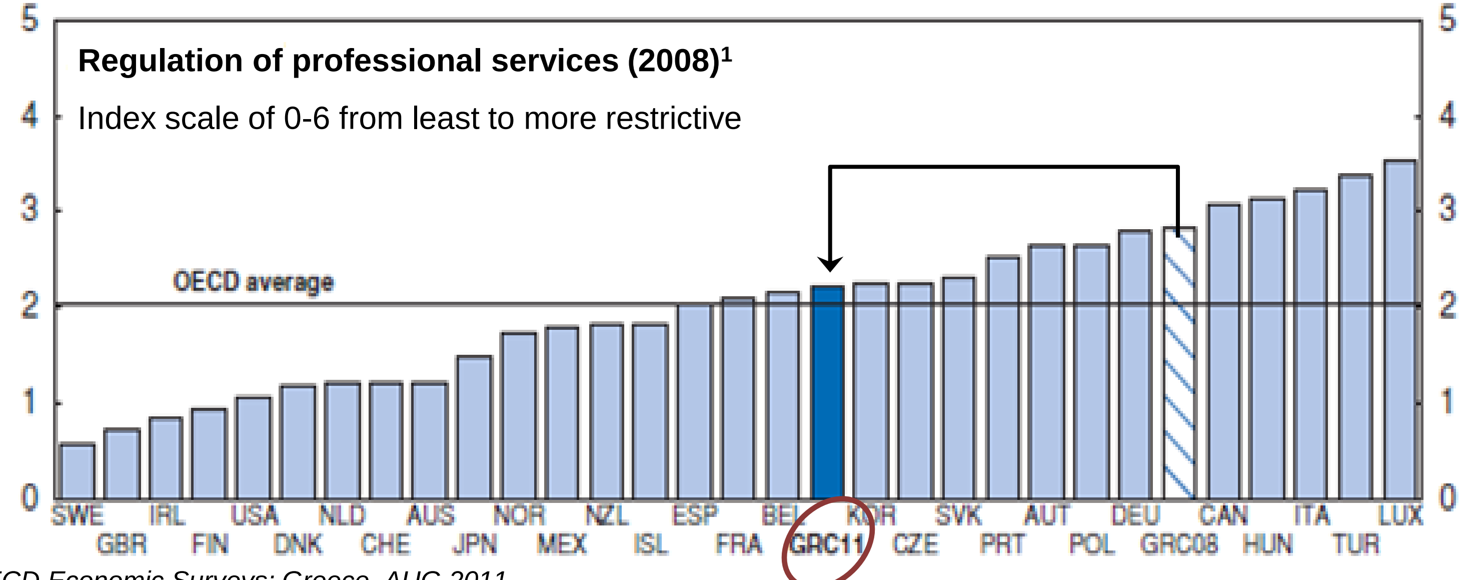
Restrictions in Service sectors



Source: OECD, from European Economy, Occasional Papers, no. 68, August 2010, European Commission

Structural Competitiveness problems



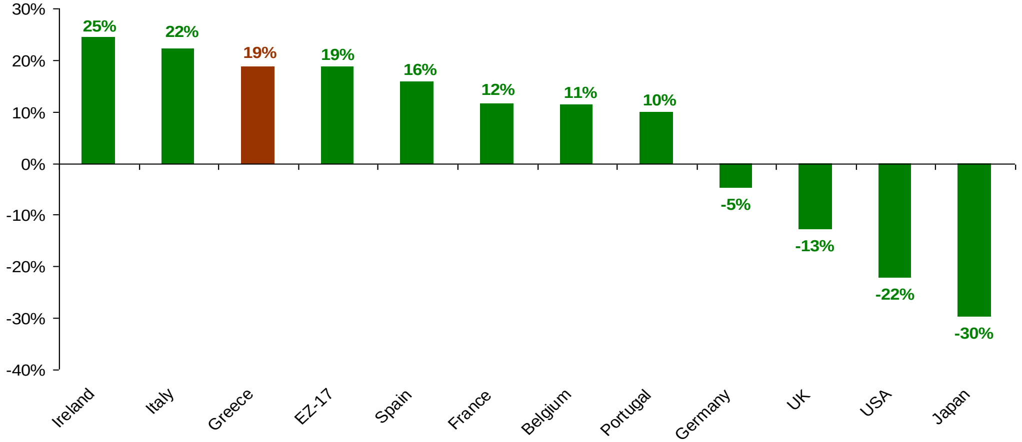


Sources: OECD Economic Surveys: Greece, AUG 2011

[1] The reference year is 2008 for all countries. The product market regulation & indicators for Greece for 2011 are based on an intermediate update conducted in the context of the OECD survey, thus accounting for the recent reforms towards improving business environment and opening closed professions

Greece has lost cost competitiveness (relative unit labor cost) - but it is not alone

Relative unit labor cost has increased by 19% during 2000-2010, but this is broadly in line with the performance of the periphery of the EU.



Increase in relative unit labor cost

(performance relative to the rest 35 industrial countries)

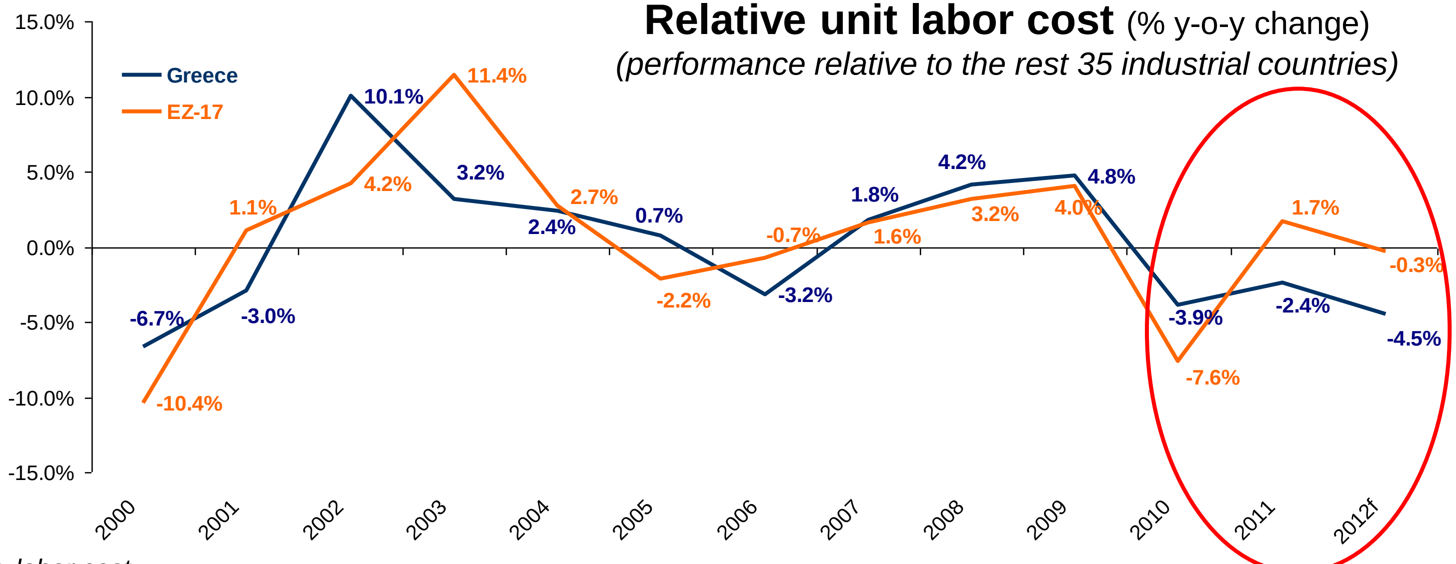
Relative unit labor cost (% y-o-y change)

(performance relative to the rest 35 industrial countries)

In 2010-2011 *cost competitiveness has improved significantly*.

Relative Unit Labor Cost:

2005-2009: +7.5%,
2010-2012f: -6.8%



Note: we account for the nominal unit labor cost
Source: European Commission Statistical Annex, Autumn 2011

EU-17 GDP Structure (Demand side) (2001-2010 avg.)

Greece *consumes too much* (91% of GDP) and *exports too little* (22% of GDP).

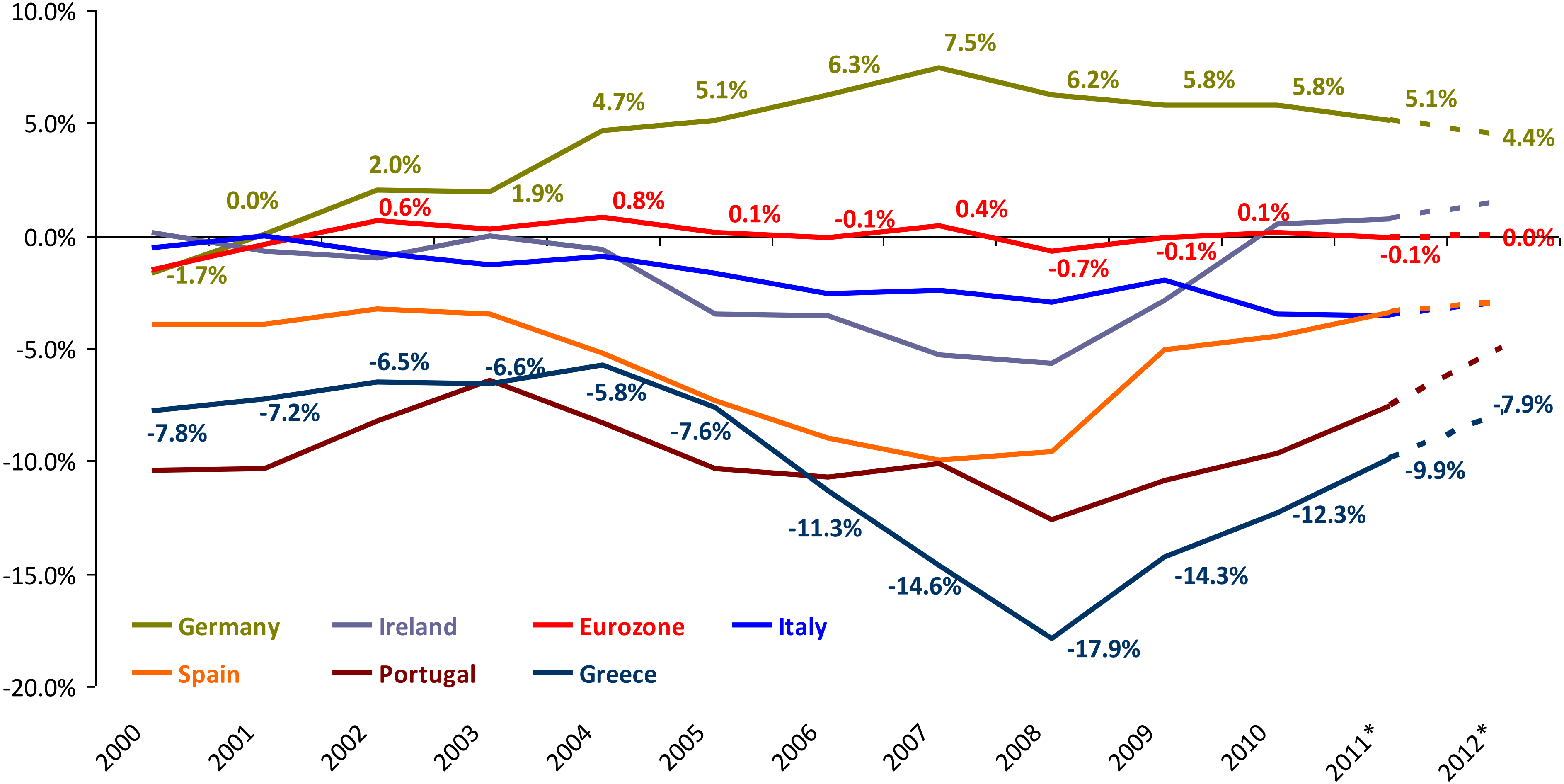
- Chronic general government imbalances
- Private sector imbalances since euro entry: rapid private sector leverage through bank credit

	Final Consumption (% of GDP)	Investments (% of GDP)	Exports (% of GDP)	Imports (%of GDP)
Eurozone-17	**77,4%**	**21,2%**	**41,6%**	**40,3%**
Belgium	**74,0%**	**21,7%**	**88,0%**	**83,9%**
Germany	75,6%	19,5%	44,0%	39,2%
Esthonia	73,8%	33,7%	79,2%	90,3%
Ireland	**63,1%**	**21,7%**	**101,6%**	**85,0%**
Greece	**90,7%**	**22,3%**	**22,4%**	**35,3%**
Spain	78,9%	27,2%	29,5%	35,9%
France	80,8%	19,7%	29,3%	29,9%
Italy	79,5%	21,0%	26,7%	27,2%
Cyprus	86,2%	19,9%	51,9%	57,1%
Luxembourg	54,0%	23,6%	170,0%	147,8%
Malta	85,3%	16,4%	91,4%	93,1%
Netherlands	**72,8%**	**20,3%**	**78,0%**	**71,0%**
Austria	**72,4%**	**22,8%**	**55,2%**	**50,5%**
Portugal	**85,3%**	**24,4%**	**32,9%**	**42,8%**
Slovenia	73,8%	27,9%	65,2%	67,1%
Slovakia	74,0%	26,8%	86,4%	86,8%
Finland	**70,8%**	**20,1%**	**46,4%**	**38,5%**
Sweden	**72,4%**	**18,5%**	**50,8%**	**41,4%**
United Kingdom	84,4%	17,5%	28,5%	32,1%

Source: Eurostat

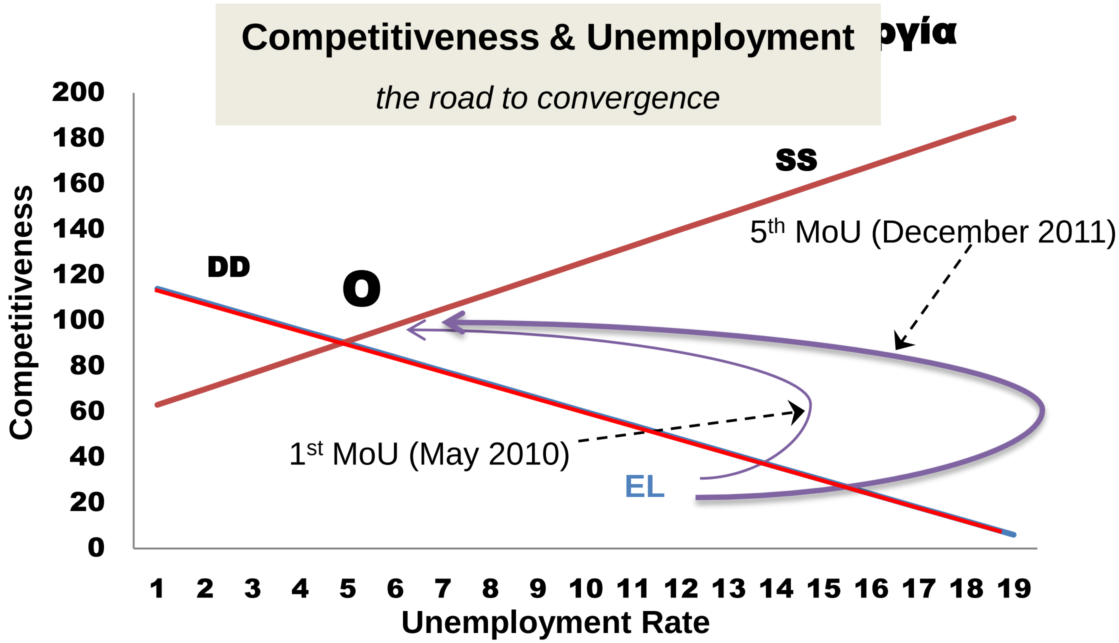
Current Account Balance (% of GDP)

Result: a high Current Account Deficit: Nobody paid attention!

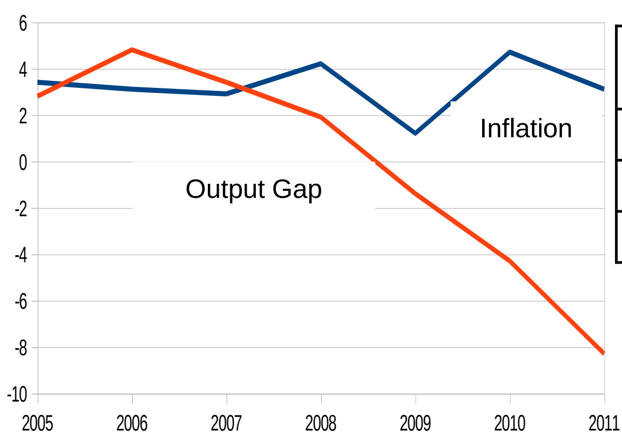


Sources: Eurostat/European Economic Forecasts, European Commission, Autumn 2011

Problems with the current policy mix



Inflation & Output gap



	Real Effective Exchange Rate	
	CPI	**Labor Cost**
2010	-0.3	-7.0
2011	0.9	-3.5

- Despite improvement compared to 2009, recent large deviations from fiscal targets
- Liquidity squeeze, credit crunch due to banking problems
- Large increases in indirect taxation instead of drastic reduction in current expenditure
- Drastic cuts in public investment to meet the deficit target
- Very limited structural reforms (product, services, professions and labor markets still overregulated)
- Very limited progress in removing barriers to private investment & entrepreneurship (out of 250 barriers, less than 10% have been removed)
- Very limited privatizations and no development of state lands

➢Price rigidities despite wage flexibility

➢Recession larger than expected

The Economic Policy Program – Medium-Term Fiscal Scenario

Medium Term Fiscal Strategy Framework 2011-2015

Baseline Macroeconomic Scenario

% y-o-y change	2009	2010	2011		2012		2013		2014		2015	
			MinFin	IOBE	MinFin	IOBE	EC	IOBE	EC	IOBE	EC	IOBE
GDP	-3.3	-3.5	-6.5	*-6.7*	-4.2	*-4.0*	0.7	*-0.3*	2.4	*0.8*	2.9	*1.4*
Private Consumption	-1.3	-3.6	-6.2	*-7.1*	-4.1	*-6.8*	-0.9	*-1.1*	0.6	*-0.2*	0.7	*-0.2*
Public Consumption	4.8	-7.2	-8.0	*-7.1*	-7.5	*-8.3*	-7.0	*-7.4*	-4.0	*-6.2*	-1.0	*-3.3*
Gross Fixed Capital Formation	-15.2	-13.3	-15.0	*-17.6*	-3.6	*-5.3*	6.3	*1.6*	8.6	*5.7*	8.4	*6.4*
Imports of goods & services	-20.2	-7.2	-5.9	*-6.8*	-2.8	*-6.6*	0.6	*0.0*	2.7	*3.1*	3.0	*3.4*
Exports of goods & services	-19.5	4.2	4.5	*4.2*	6.4	*5.2*	6.5	*4.8*	7.0	*5.5*	7.0	*6.0*
HICP (%)	1.3	4.7	2.8	*3.2*	0.6	*1.5*	0.8	*0.6*	1.0	*0.6*	1.1	*0.8*
Unemployment Rate (%)	8.9	11.7	15.4	*17.4*	17.1	*19.4*	17.5	*19.6*	16.9	*19.7*	16.3	*19.2*
Current Account Balance (% of GDP)	-14.3	-12.3	-9.9	*-10.6*	-7.9	*-9.1*	-6.8	*-8.7*	-5.8	*-8.3*	-4.5	*-8.1*
Primary Balance (% of GDP)	-10.6	-5.0	-1.8	*-2.6*	-1.0	*-1.2*	0.5	*0.9*	1.7	*2.8*	2.1	*4.2*
General Government Budget Balance (% of GDP)	-15.8	-10.8	-9.2	*-9.5*	-6.3	*-6.4*	-6.1	*-5.3*	-5.1	*-2.9*	-4.2	*-1.1*
General Government Budget Balance (% of GDP) (target)							**-5.3**		**-2.9**		**-1.1**	
General Government Debt (% of GDP)	129.0	144.9	162.8	*166.3*	145.5	*145.7*	146.7	*154.2*	139.2	*152.1*	125.6	*143.7*

Note: The estimates for 2012 take into account the PSI effect

Sources: Eurostat / 2012 Budget / Medium-Term Fiscal Strategy (Update), Ministry of Finance, November 2011/ The Economic Adjustment Programme for Greece – 5th Review (draft) , Directorate-General for Economic and Financial Affairs, European Commission, Occasional Papers 82, October 2011

General Government Deficit (% of GDP)

Significant progress in fiscal consolidation which is largely underestimated

An unprecedented fiscal adjustment is occurring

General Government Deficit reduction in 2010-2011 reached c. EUR 16.6bn, exceeding the target set in the initial MoU (EUR 15.3bn) !!!

Fiscal adjustment in 2010-2011:

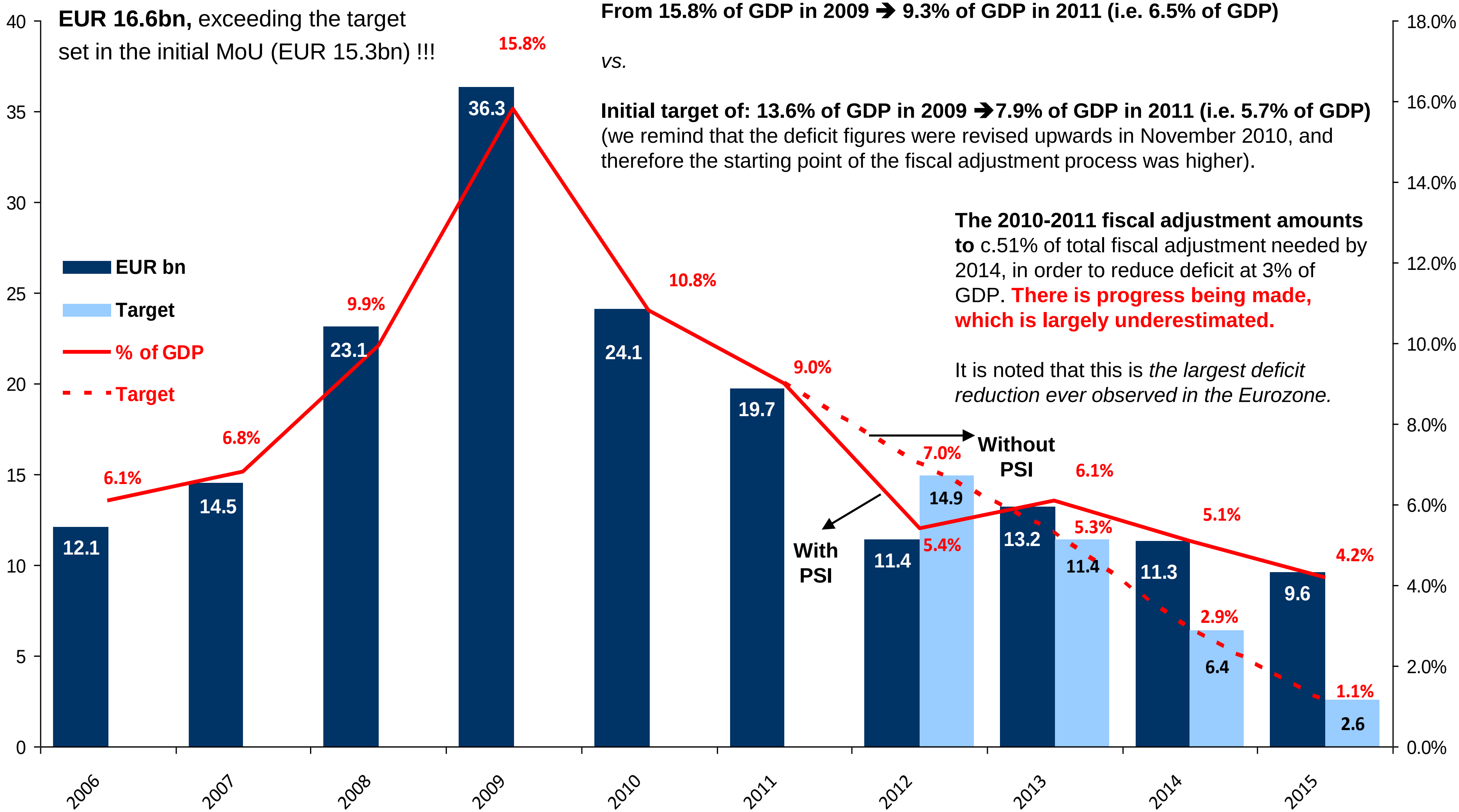
From 15.8% of GDP in 2009 ➔ 9.3% of GDP in 2011 (i.e. 6.5% of GDP)

vs.

Initial target of: 13.6% of GDP in 2009 ➔7.9% of GDP in 2011 (i.e. 5.7% of GDP) (we remind that the deficit figures were revised upwards in November 2010, and therefore the starting point of the fiscal adjustment process was higher).

The 2010-2011 fiscal adjustment amounts to c.51% of total fiscal adjustment needed by 2014, in order to reduce deficit at 3% of GDP. **There is progress being made, which is largely underestimated.**

It is noted that this is *the largest deficit reduction ever observed in the Eurozone.*



Sources: Eurostat/2012 Budget Draft, Ministry of Finance, October 2011/The Economic Adjustment Program for Greece – 5th Review , Directorate-General for Economic and Financial Affairs, European Commission, Occasional Papers 82, January 2012

Structural Reforms are being implemented… albeit with delays

Fiscal Reforms

- Independent Statistical Authority (ELSTAT).
- Overhaul of the tax system (new management information systems, shortened judicial procedures for tax cases).
- Law on combating tax evasion & restructuring of the tax services (fines EUR 3.4bn, +182% yoy).
- Fiscal Management & Responsibility Act (3-year budgets, Medium-Term Fiscal Strategy, Parliamentary Budget Office, binding expenditure ceilings in Ministries).
- Single Payment Authority for the wage bill in the public sector.
- Online publication of all decisions involving commitments of funds in the general government sector.

Support of the Financial System

- Establishment of the Hellenic Financial Stability Fund (EUR10bn).

Improvement of the Investment Framework

- Simplification of the start-up for a new business (GEMI): set up in 1 day (from 19 days), with the establishment of one-stop-shop.
- New Investment Law.
- «Fast-Track» Law for Strategic Investment (>EUR 200mn)

Local Administration Reform

- Merger of various local government authorities: reduction in municipalities from 1.034 to 325; decrease in local authority entities by 4.000.

Restructuring of the Public Sector

- Restructuring of the railway sector (OSE): EUR 150mn savings in 2010.
- Restructuring of the Urban Transport Entity (OASA).

Social Security –Health System Reform

- Private and public sector pension reform: reduction of the actuarial deficit to 2060 by 10% of GDP; retirement age raised to 65 years (40 years of work required for full pension).
- Healthcare reform

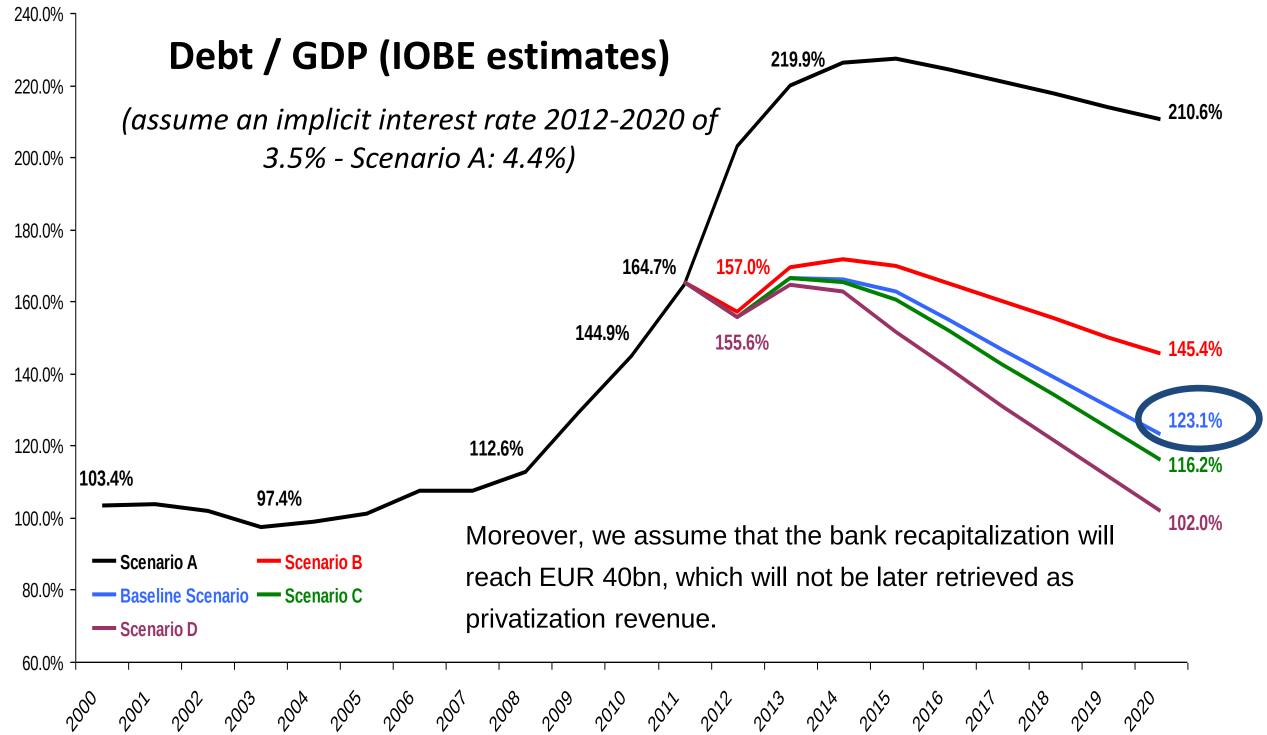
Market Regulation Reforms

- Labor market reform: firm-level agreements, measures promoting part-time employment, fully symmetric arbitration, cut in overtime remuneration by 20%, reduction in severance payments by 50%, increase of permissible dismissals from 2 to 5% per month, extension of probation period from 3 to 12 months.
- Horizontal legislation of the EU Services Directive.
- Liberalization of over-regulated markets (mainly professions): fully effective as of July 1, 2011, covers 150 professions.
- Liberalization of road freight transport: unlimited licenses with fees gradually declining to zero between Jan-2011 and Jun-2012.
- Abolition of cabotage restriction in order to boost cruise tourism.
- Transfer of the private insurance sector supervision to the Bank of Greece.

Public debt evolution scenarios (IOBE estimates)

	Scenarios				
	A	B	Baseline Scenario	C	D
Debt / GDP 2020	210.6%	145.4%	123.1%	116.2%	102.0%
Gen. Gov. Deficit (% of GDP) 2020	5.4%	1.4%	0.7%	-0.6%	-1.1%
PSI 2012 (% of GDP)	0.0%	54.0%	54.0%	54.0%	54.0%
Privatization Revenues (2014-2020) (% of GDP)	0.0%	0.0%	22.3%	22.3%	27.9%
Primary Surplus (avg 2014-2020) (% of GDP)	3.1%	3.1%	4.1%	5.1%	5.1%
Nominal GDP growth rate (avg 2014-2020)	3.4%	3.4%	3.4%	3.4%	4.3%

- **Scenario A** assumes no privatization revenues & no PSI .
- **Scenario B** additionally takes into account the PSI (95% participation, EUR 107bn debt reduction), which results to a debt reduction of 64pps of GDP.
- The **Baseline Scenario** additionally accounts for privatization revenues amounting to EUR 47bn, resulting in a debt reduction of 22pps of GDP.
- **Scenario C** additionally assumes a 1% higher primary surplus *vs.* the baseline, resulting in a debt reduction of 7pps of GDP.
- **Scenario D** additionally assumes a 1% higher nominal growth rate *vs*. the baseline, resulting in a debt reduction by 14pps of GDP.



Moreover, we assume that the bank recapitalization will reach EUR 40bn, which will not be later retrieved as privatization revenue.

The return to the drachma is NOT an option

- ***An eventual return to the drachma is a shift to another currency, affecting the balance sheet of the state, banks, companies & individuals, triggering serial defaults***
- ***Disorderly default:*** drastic drop of the living standards, large reduction in real wages / pensions
- ***Currency crisis***: the subsequent large devaluation of the drachma will increase public debt and trigger a foreign exchange crisis. It will NOT necessarily increase competitiveness. *Reminder* : during 1980-2000, despite the large devaluation of the drachma vs. the dollar, the trade deficit more than tripled.

  Inability to import basic goods (fuel, pharmaceuticals, equipment)

  Currency risk ➔ higher cost of capital & increased uncertainty

  Hyperinflation
- ***Collapse of the banking system***
- ***Social unrest / Political instability***: black economy – mafia – national security concerns
- ***Exit from the EU*****:** Greece would lose its European orientation & EU structural funds (c. EUR 3bn net transfers annually) – Exclusion from financial markets
- ***Contagion effect to other eurozone economies***
- ***Loss of the appetite for structural reforms*****:** the political system will not have an incentive to promote the modernization of the economy – revival of clientelism
- ***Who will benefit?*** Those who have their property abroad and do not reside in Greece – Those who have invested in the country's default
- ***Who will lose?*** Citizens residing in Greece will see their real wages and pensions cut drastically

Growth Potential – Policy Suggestions:

A. Access to the largest bail-out scheme and to €15bn from European Structural Funds

B. Large potential from market liberalization, reforms, privatization and the development of idle state property

C. Rising sectors and investment opportunities

Large potential benefits from reforms will provide new sources of growth and facilitate fiscal adjustment

Can Greece enhance its competitiveness ?

Potential Gains from Market & Institutional Reforms - Results from a DSGE Model:

Structural measures could produce benefits as large as ***17% of GDP in the long run*** *(increase 10% of GDP within 5 years), according to the GIMF model calibrated by the Foundation for Economic and Industrial Research (IOBE)*

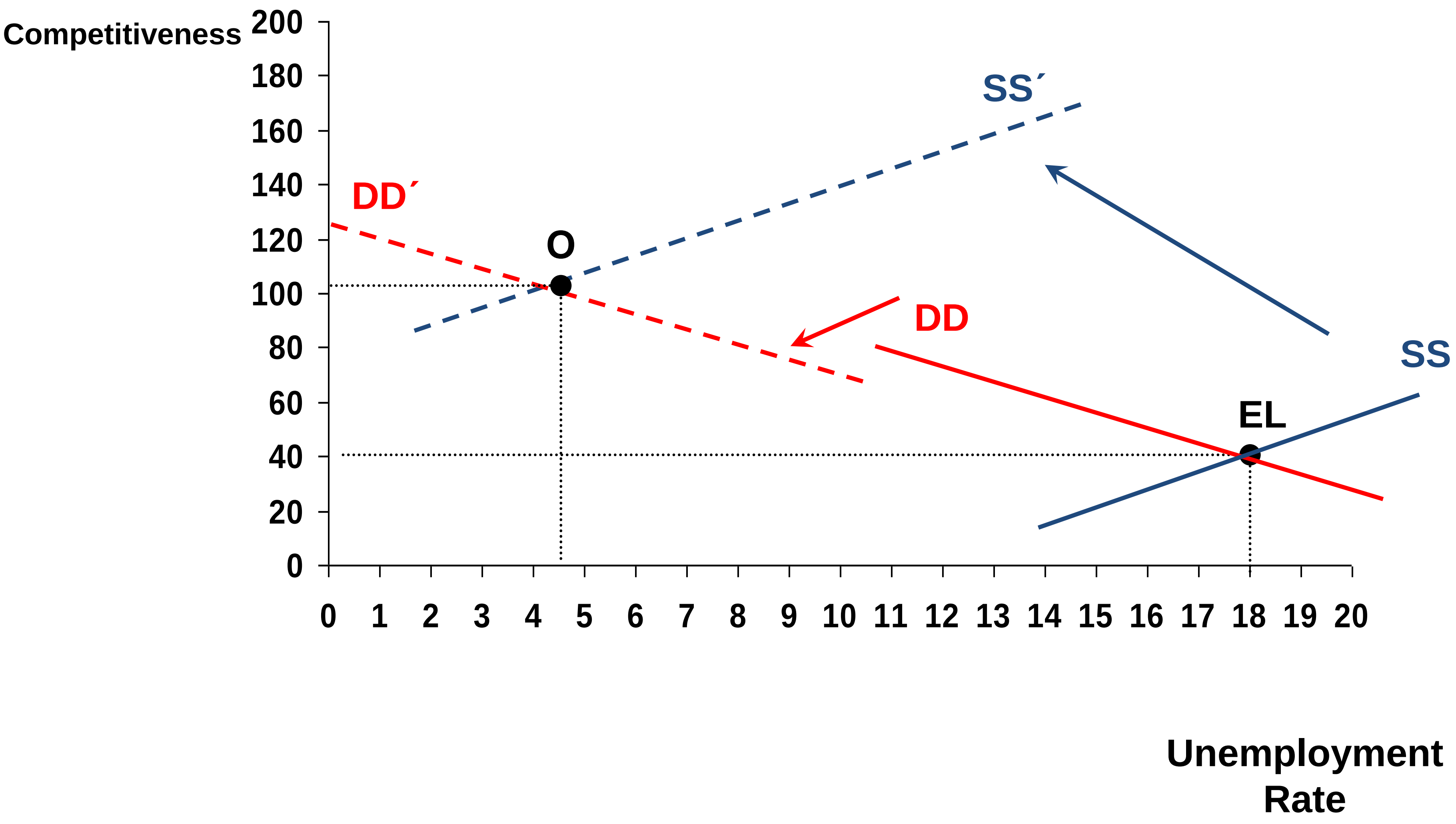
Long-term effects of increased competition in markets of non-tradable goods-services and deregulation in the labor market

(% changes w.r.t pre-reforms period)

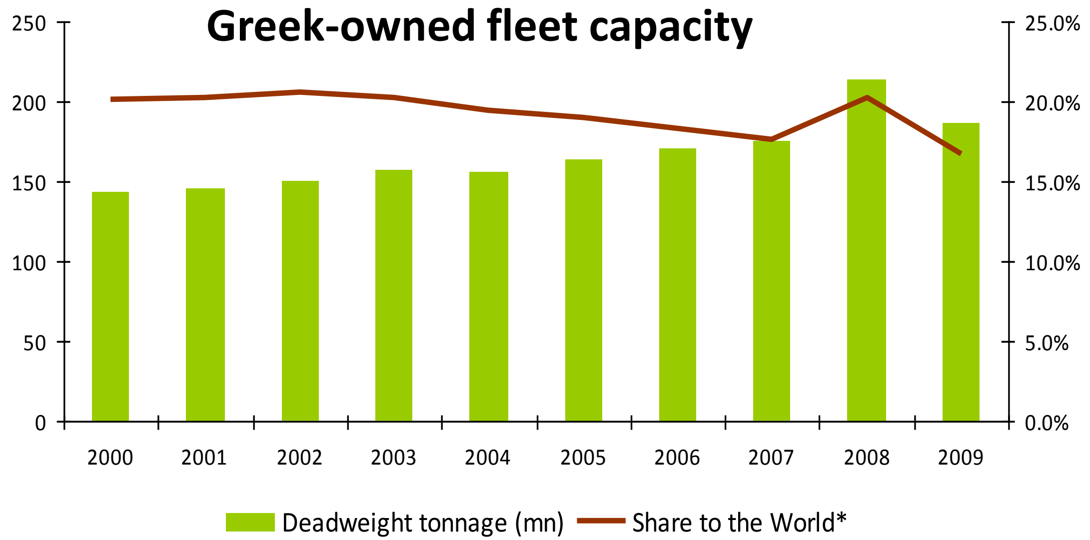
	Non-Tradable Sector Effect	Labor Market Effect	Overall Effect
GDP	13.5	3.2	17.0
Private Consumption	15.5	3.7	19.6
Private Investment	12.4	2.8	15.6
Real wage	12.8	-0.6	12.2
Employment (hours)	1.5	3.4	4.8
Exports	8.4	2.0	10.5
Imports	6.4	1.7	8.3

Source: IOBE, estimations by calibrating the IMF DSGE model (GIMF) to Greek/Euro Area economic conditions.

Greece needs a shift in aggregate supply & in aggregate demand (through investment)

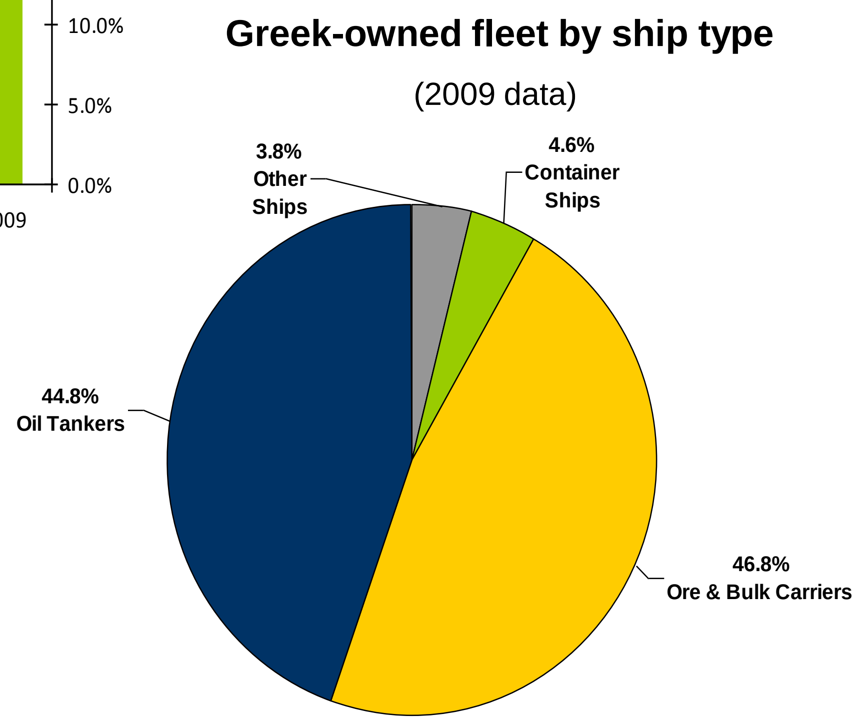


Sectoral Growth Prospects
Shipping



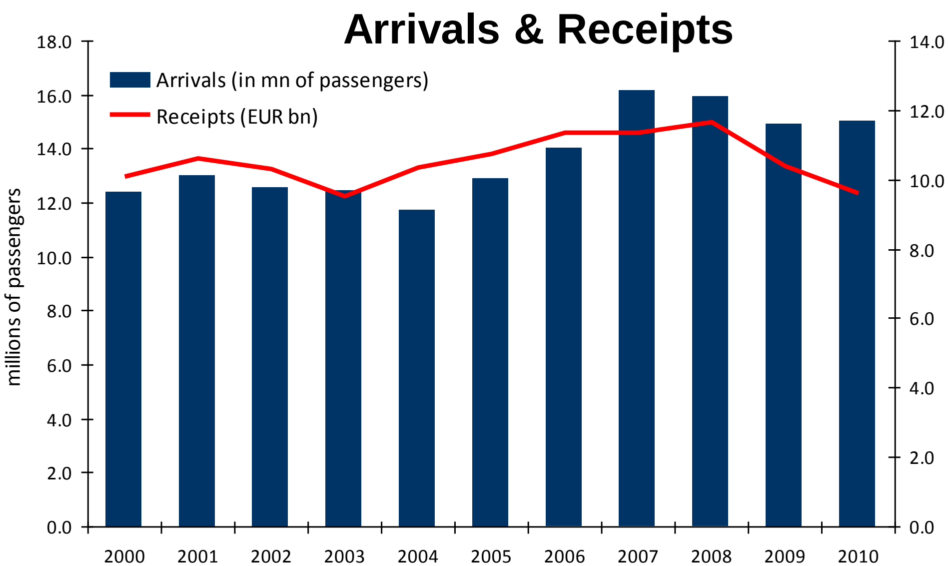
** Includes the 35 countries with the largest fleet capacity, accounting for more than 95% of capacity worldwide*
Source: Review of Maritime Transport Reports, UNCTAD

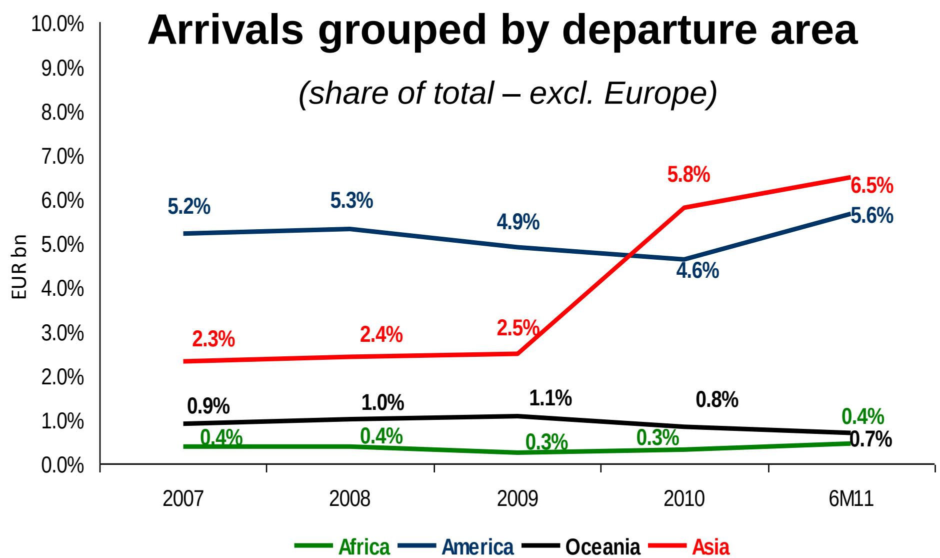
The Greek fleet (both Greek and foreign flag vessels) remains ***the largest in the world***, although its capacity share fell in 2009 below the 2000-2009 period average.

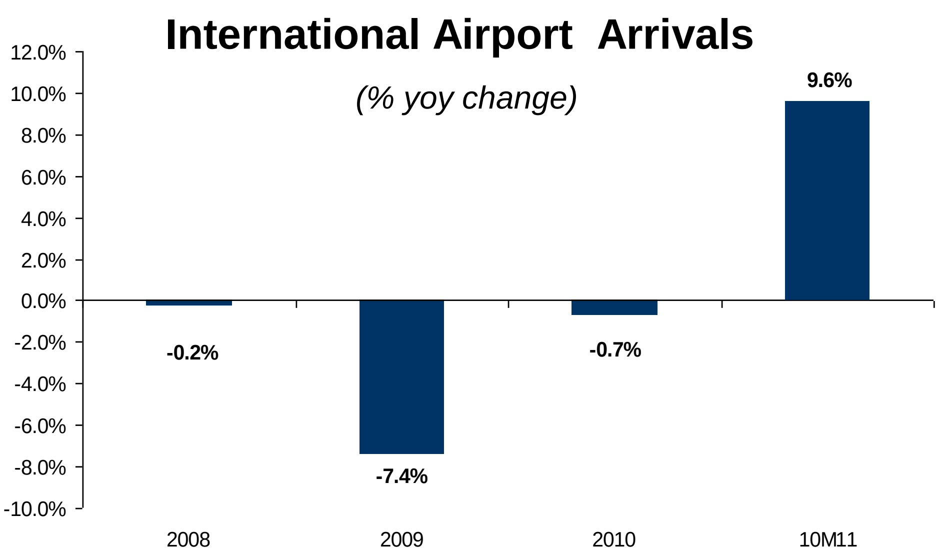


Source: Lloyd's Register – Fairplay, January 2010

Sectoral Growth Prospects
Tourism



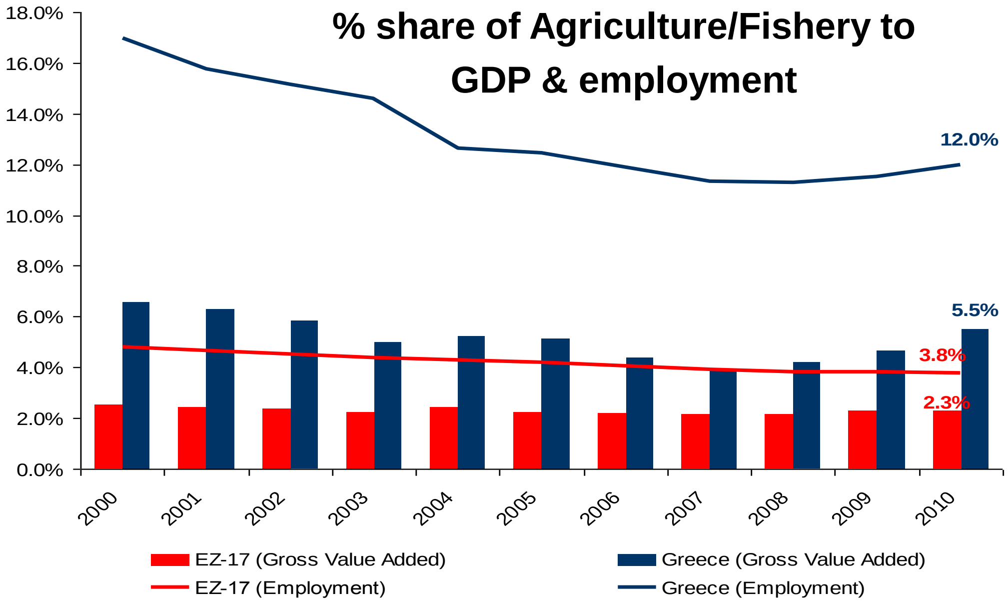




**to the 13 main airports of the country*
Source: Association of Greek Tourism Enterprises (SETE)

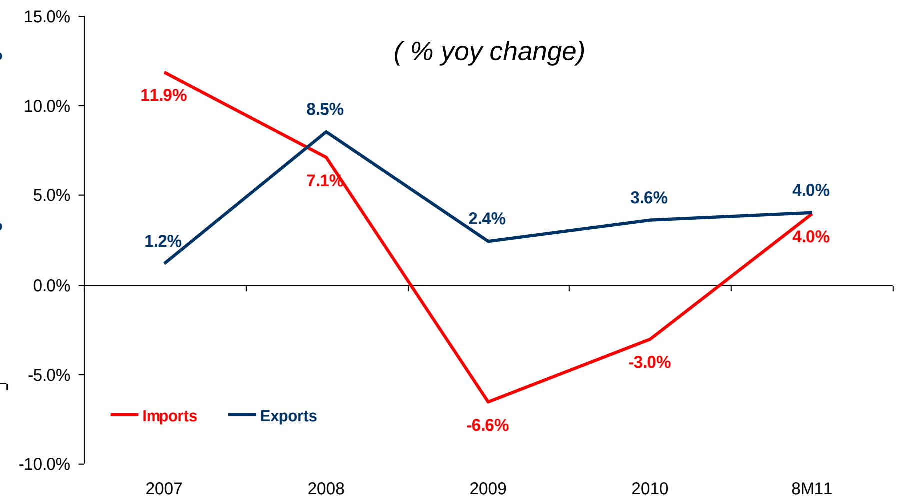
- ***Tourism receipts*** have been falling since 2008, partly reflecting the consequences of the global economic crisis.
- ***International airport arrivals*** have been rising since the beginning of 2011, for the first time since 2008.
- ***Higher traffic from Asia*** is one of the driving forces of this upward trend. The share of travelers to Greece from Asia to the total number of international arrivals, has more than ***doubled*** in just one year, thus making Asia the departure area with the second largest share, after Europe (*c. 89% of tota*l).
- **New Opportunities:** Medical Tourism

Sectoral Growth Prospects Agriculture / Fishery



Source: Eurostat, National Accounts

Evolution of imports / exports of agricultural products

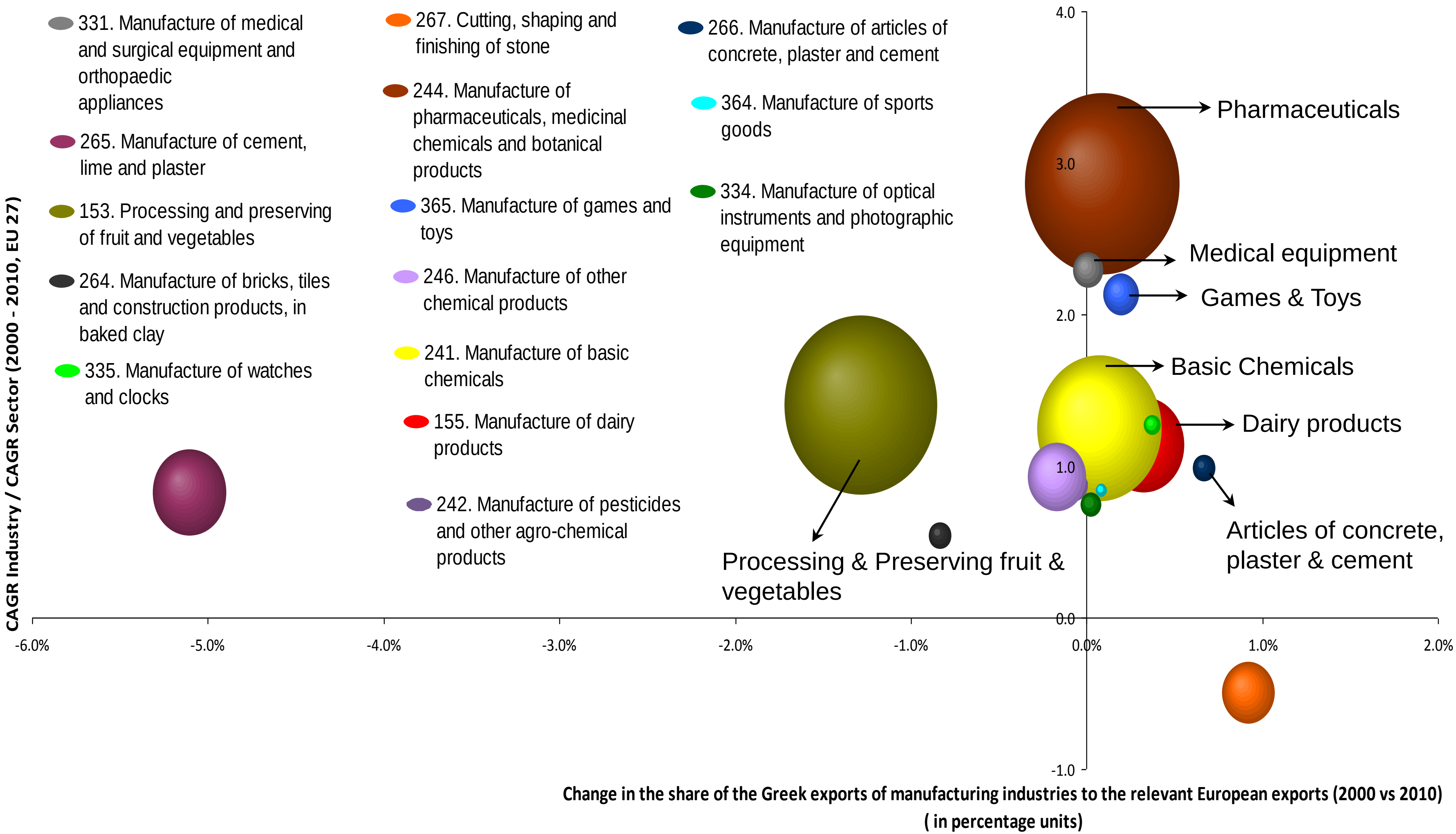


Source: Hellenic Exporters Board

- The ***sector's contribution to the gross value added*** in Greece was 2x that of the EZ-17's average, for the period 2000-2010.
- The difference between the sector's contribution to the economy in Greece vs. EZ-17 is much more evident in ***employment*** terms: More than 13% of labor force in Greece, was employed in the Agriculture/Fishery during 2000-2010.
- Agriculture/fishery is the sector with the ***highest employment growth*** during 2009-2010
- Moreover, despite the recession in 2009-2010, ***the sector's gross product continued to grow***, unlike any other sector of the Greek economy.
- Greece's potentials in agro business stem from its mild climate and its soil (***exports of agricultural products*** account of c. 19% of total exports and mark a considerable increase since 2009)

International Competitiveness of the Manufacturing Sector

Industries of the Manufacturing Sector that (1) are facing increased external demand and (2) have increased their export share to the relevant European exports (2000-2010)



Notes: (1) the size of the "bubble" represents the relevant share of the exports of the manufacturing industry to the total exports of the sector in Greece, (2) data analysis is based on the matching of the Combined Nomenclature (CEN) to NACE Rev 1.1. (3) CAGR: Compound Annual Growth Rate - Source: Eurostat

Sectoral Growth Prospects Pharmaceuticals

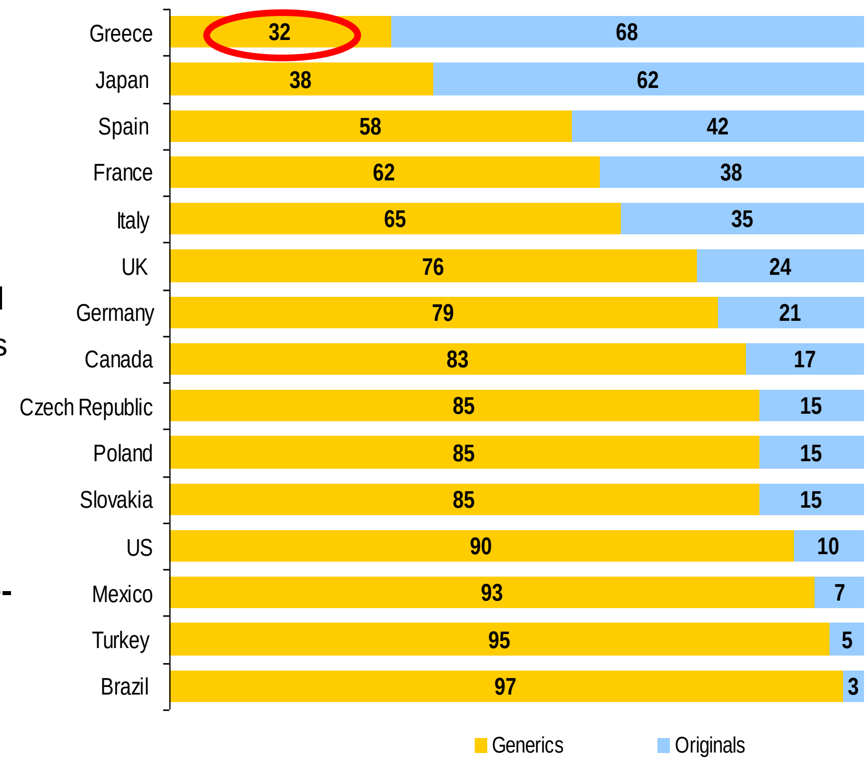
- The MoU has set strict targets regarding **cut backs on public pharmaceutical expenditure.** While from 2004-2009 public pharmaceutical expenditure was increasing by approximately EUR 0.5bn per annum, with the measures implemented by the government according to the MoU targets, it was **reduced by 16.5% in 2010 and by 24.2% in 2011**, according to IOBE estimations.

- The measures in the Memorandum include **the increase in the market shares of generics** in the Greek market, which is intended to reach **50% of the total volume of pharmaceuticals** in hospitals by 2012.

- This can be considered as another opportunity for growth for the Greek generic companies, since they can **enhance their production and exporting activity** and generate significant **value-added in the employment sector**.

- *Note*: ***Generics penetration in Greece is significantly lower vs. international markets*** (due to: 1. Generics prices fixed by law at 90% of Originals', 2. internationally, Generics are typically priced at 30-80% lower levels vs. respective Originals)

Unprotected[1] market segmentation by volume (% 2009)

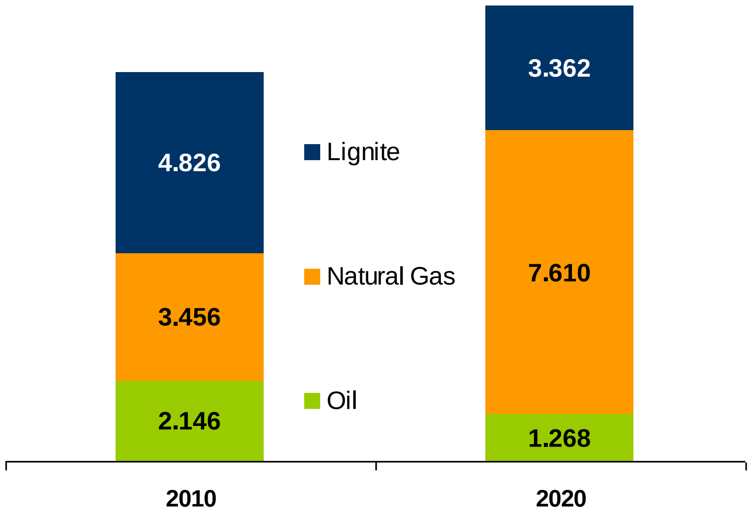


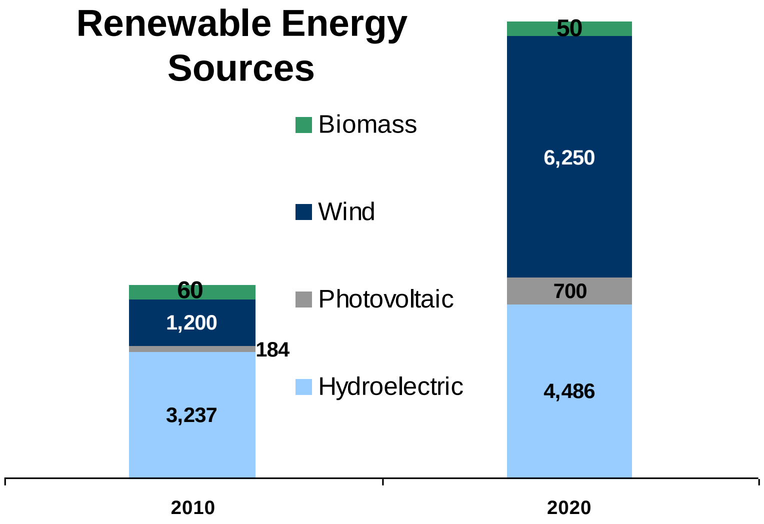
Source: IMS Health Data; Hellenic Association of Pharmaceutical Companies

[1] Off-patent drugs market

Sectoral Growth Prospects
Energy

Electricity Production (installed capacity in MW)





Source: Ministry of Environment, Energy and Climate Change

- The electricity market is still dominated by the Public Power Company (90% share in conventional power generation in 2010).
- However, ***the breakdown of the dominant operator's activities*** is one of the basic requirements of the MoU.
- ***Wholesale market liberalisation*** was de facto achieved in 2010, with shipments of spot-market LNG to independent suppliers and large-scale industrial consumers.
- Meanwhile, the country has adopted ambitious targets for the penetration of ***renewable energy sources*** in power generation (40% of final consumption) and networks (10% of final consumption).

- **Natural gas** still has a relatively low penetration in final energy demand in Greece (4% vs. 22% in the EU).
- ***Investment in renewables*** is backed by an incentive system with ***feed-in tariffs*** set to a level that ensures satisfactory financial return and fixed for the duration of the contract with the network operator (20 years).
- According to the Ministry of Environment, Energy and Climate Change, investments in renewables will reach ***EUR 16bn*** over the next decade, while the island interconnections and the remaining works on the grid will require EUR 4-5bn of new capital expenditure.
- Significant investment opportunities are also envisaged in ***energy efficiency and smart grid sectors.***

Utilization of State property – Privatizations, State Asset Management

Is Greece insolvent ?

Targets

1. Attract private investment (foreign & domestic) to crucial productive sectors of economic activity – driver for growth, employment & competitiveness
2. Significantly reduce public debt:
   - Revenues:
     - EUR 15bn in 2011-2013, EUR 50bn in total until 2015
     - EUR 10-15bn from enterprises & infrastructure, EUR 25-35bn from the development of State Real Estate Assets.
   - ↓ Debt / GDP by 20pps until 2015
   - ↓ annual interest expenditure by EUR 3bn

State Commercial Assets:

- **Infrastructure**: Airports, Ports, Motorways
- **Energy**: Public Power Corporation, Public Gas Corporation (DEPA), Hellenic Petroleum
- **Telecommunications**: Hellenic Telecommunications Organization, Frequency Spectrum
- **Gaming**: OPAP, Hellenic Casino of Parnitha, Hellenic Horse Racing Organization, State Lottery, e-gaming
- **Banking Sector**: Agricultural Bank of Greece (ATE), Loan & Consignment Fund, Hellenic Postbank
- **Real Estate**
- **Other Holdings**: LARCO, TRAINOSE, Hellenic Defense Systems, Hellenic Vehicle Industry, Hellenic Post

The Greek State owns large real estate property: Catalyst for solvency and growth

Source: Medium-Term Fiscal Strategy & Policies for Exiting the Crisis, (Ministry of Finance Presentation), May 2011, "The Complex Problem of Utilizing State Real Estate Property" – Vassilis Maglaras, Policy Brief, ISTAME (November 2010)

Processes

Sales

Concession Agreements

PPP

(Private-Public Partnership)

Strategic Investors

A specialized entity (‘**Sovereign Wealth Fund**’), in which all individual State assets are included, has been created

NEW IDEAS:

1. A ‘**Marshall Plan**’ could be activated via a private equity vehicle
2. **Transfer part of Greek state assets to EIB**. The proceeds will immediately be used to buyback public debt. **The EIB and the Sovereign Wealth Fund will gradually develop these assets** in order to avoid fire sales in a declining market

Proposals

1. ReformING Fiscal Management

Expenditure side

• **Lower public sector wage bill**: Abolition of a large number of allowances - wage maturity should be provided more sparsely (e.g. every 5 years) & should be linked to evaluation. **Reduction in the number of public sector employees** (↓ of fixed-term contracts, closing & merging public entities, rationalization of business plans & structures of public sector companies, reallocation of personnel)

• **Further Social Security Reform**: Transform the Supplementary Social Security Funds into Defined *Contribution* Funds (*vs.* Defined *Benefits* Funds currently), target social benefits to reduce poverty.

• **Further savings on health and defense expenditure.**

• **Restructure the state compensation system of local government:** Compensation of local expenditure following evaluation and abolition of the automatic determination of its revenues provided by the Central Government.

Revenue side

• **Revision & reduction of tax-free threshold & the numerous tax exemptions** in order to increase effectiveness & promote targeted social policies.

• Introduction of **book-keeping** for all economic activities.

• Simplification of **tax coding.**

• **Restructuring tax administration**: Automation (promotion of IT systems), central system coordination, minimization of procedures, focus on collection, promote evaluation based on revenue collection, enhance internal audit control, reallocation of resources.

• Improve **effectiveness in indirect taxation** (e.g. the abolition of tax advantage on heating oil will contribute to tackling oil smuggling).

• Introduction of the Double – Entry Accounting System and IFRS to all General Government entities.

Proposals

2. Use EC Structural Funds to strengthen the privatization process – Boost private investments – Development of Public Real Estate Property

• **Substantial EC structural funds (c. EUR 15bn) to fund Public Investment Program.** Reduce the 'national' part of Public Investment and increase the co-financed part. Present eligible investment plans (e.g. a small number of big projects: National highways, modernization of airports, ports, touristic facilities, energy infrastructure).

• **Leverage part of the EC Structural Funds with the European Investment Bank**

• **The EIB would provide guarantee to fill the financing gap that Greek & foreign commercial banks have left in major public work**

•Attract **FDIs** by adopting "**fast track**" procedures for all types of investment projects

• **Use Private-Public Partnership**, such as the utilization of **public hospital infrastructure**, currently operating below capacity: 1.concession of beds to private insurance companies, 2.concession of hospital clinics to private practitioners or private providers of health-care services, 3. promotion of Medical Tourism.

• **Real estate development of numerous military camps** which are not necessary to national security

• Liberalization of **energy markets** - Breakdown of the **Public Power Corporation** into subsidiaries (see ENEL)

•Eradicate all state arrears to private suppliers.

Proposals

3. Promote Structural Reforms

- **Elimination of all barriers to entrepreneurship and investments** (including simplification of procedures and licensing, determination of land use, adoption of the principle of 'silent approval', opening up of all markets and professions, improving liquidation procedures for companies)
- **Labor market flexibility**: Facilitate shifting of employment (10%-15% of labor force) from non-tradable goods & services sectors to tradable-goods and services sectors. **Role of the Social Partners and of the State:** Study benchmark models (German Kurzarbeit, Scandinavian flexicurity)
- **Targeting social benefits spending (value for money)**: Longer duration unemployment benefits, professional re-training of the unemployed, introduction of a minimum income threshold in order to combat poverty, financed by eliminating waste and excesses in pensions, health and defense spending, as well as by tackling tax – evasion.
- **10-year growth horizon** needed:
  - ✓ To account for the macroeconomic effects of reforms, privatization and the rebalancing of the Greek economy away from consumption and towards exports, import substitution & investment.
  - ✓ To focus on sectors with comparative advantage (tourism, transportation (regional hub in Southeastern Europe), agriculture / fishery, green renewable energy, education, mineral resources, technology).
- **The private sector** must also adapt to the new growth model:
  - ✓ Lower dependence on the State
  - ✓ Outward-looking entrepreneurship: Export orientation, import substitution, strategic international alliances
  - ✓ Rational use of human resources – training of employees
  - ✓ Introduction / use of ICT systems – modern organizational & management standards
  - ✓ Improvement in competitiveness through the appropriate adjustment of the corporate model
  - ✓ New growth cycle through innovation & investment in international networks

Greece: Conclusions

✓ **Large current problems, but also strong potential:**

- Remove current uncertainty (PSI / loan agreement)
- Open up (liberalize) markets for goods, services, professions and labor
- Eliminate barriers to private investment
- Privatize state property: use it as a catalyst to attract foreign capital
- Eliminate tax loopholes and combat tax evasion
- Cut wasteful public expenditure / Outsource state activities to the private sector
- Use EU Structural Funds effectively to boost public & private investment

✓ **Critical factors for success:**

- Maturity of the political system / Leadership / Ownership of the salvation programme
- Social acceptance: explain the implications of failure as well as the implications of success
- Present and adopt a “Greece 2020” business plan

The Eurozone needs a new model of economic governance in order to survive

- **Eurozone**: a complete monetary union <u>but</u> incomplete economic union: Euro is "***a currency without a state***", a currency without a common Finance Ministry, a crisis resolution mechanism and a common public debt policy.
- **Fiscal discipline** necessary but not sufficient: **Growth initiatives** equally important
- ***Insufficient monitoring*** of economic developments by the responsible EU authorities, insufficient monitoring of banking developments (leverage of European banks at historical levels).

<u>Need for</u>:

1. **ECB acting as 'lender of last resort':** Encouraging recent developments
2. **Strengthen EFSF-ESM / Issue Eurobonds**
   - Increase their financial resources
   - Allow them to buy government bonds in the secondary market
   - The Eurozone authorities should provide guarantees, thus motivating bond holders to exchange old with new bonds at lower market prices ('Brady' type bonds, voluntary debt restructuring).
   - Final solution: Issuing fully fledged eurobonds ("several & joint liability") in which all EZ-member states are jointly liable for each other's obligations
3. **Fiscal integration:** A Eurozone Finance Ministry ensuring fiscal discipline and monitoring the financial system
4. **Eliminate 'Deflationary Bias':** Member – States with Current Account Deficits should reduce them **<u>but</u>** those with Current Account Surpluses should **<u>also</u>** reduce them: Symmetry of adjustment

Thank you

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