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The Greek Economy under Reform: Turning the Tide

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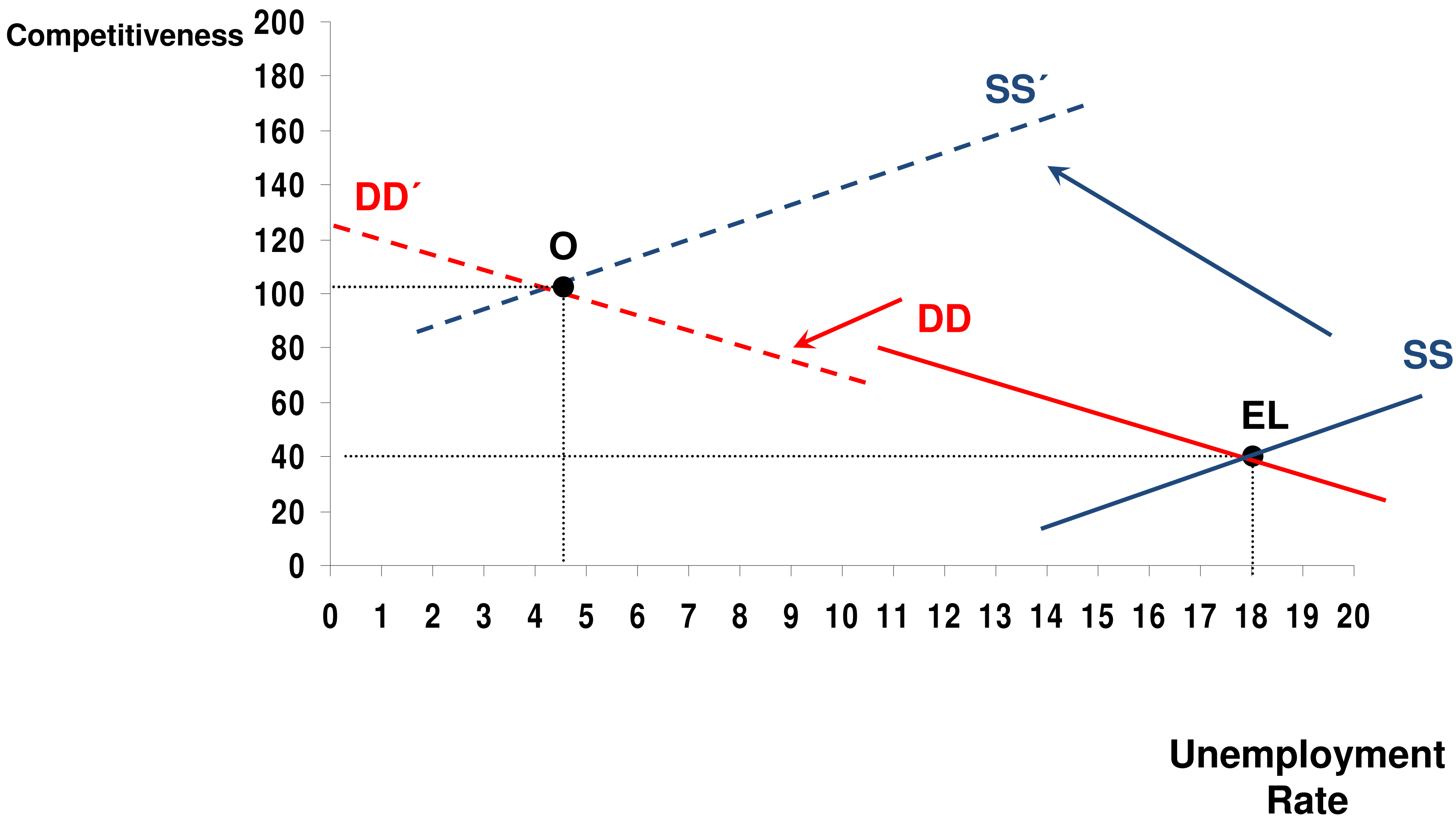
Greece needs a shift in aggregate supply & in aggregate demand (through investment)



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**

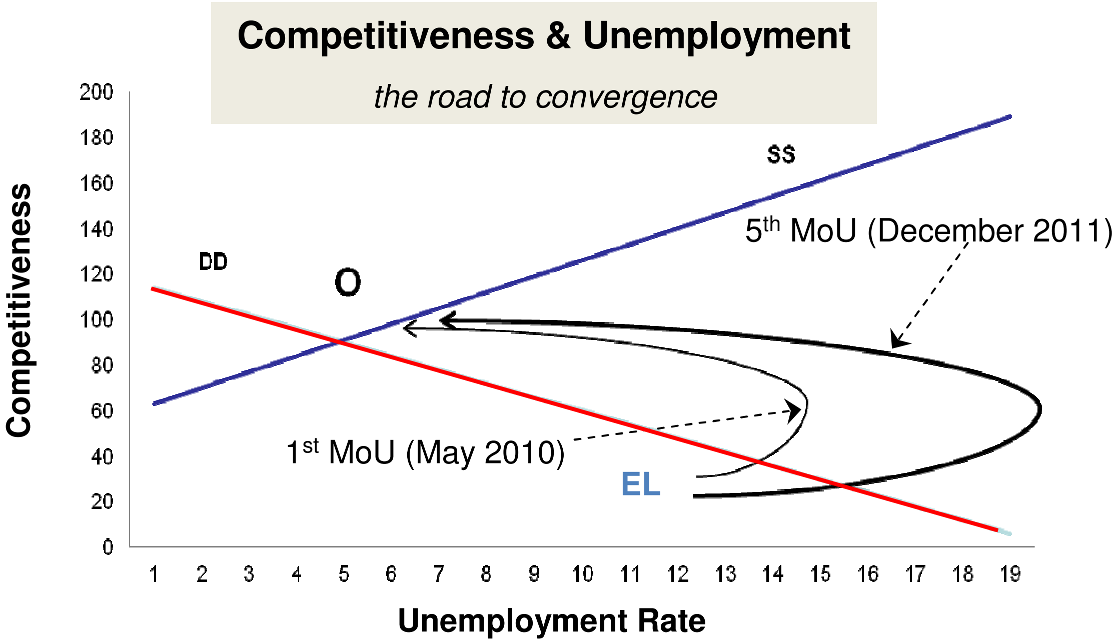
C. **Rising sectors and investment opportunities**

D. **10-year growth horizon needed – "Greece 2020" Business Plan:**

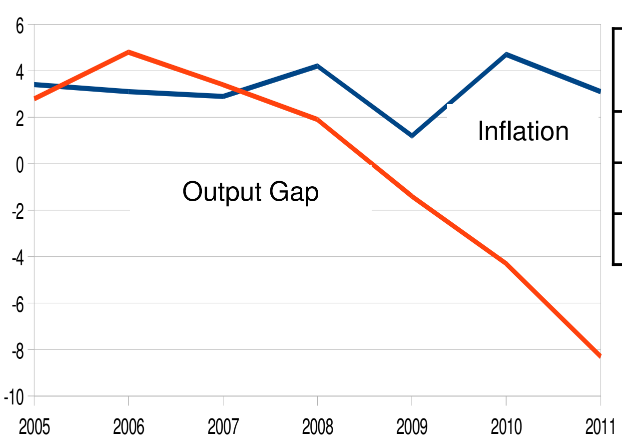
✓ To account for the macroeconomic effects of reforms, privatization and the rebalancing of the Greek economy away from consumption and towards exports, import substitution & investment.

✓ To focus on sectors with comparative advantage (tourism, transportation (regional hub in Southeastern Europe), agriculture / fishery, green renewable energy, education, mineral resources, technology).

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**

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

Can Greece enhance its competitiveness ?

Potential Gains from Market Liberalization & the elimination of the investment impediments:

*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.

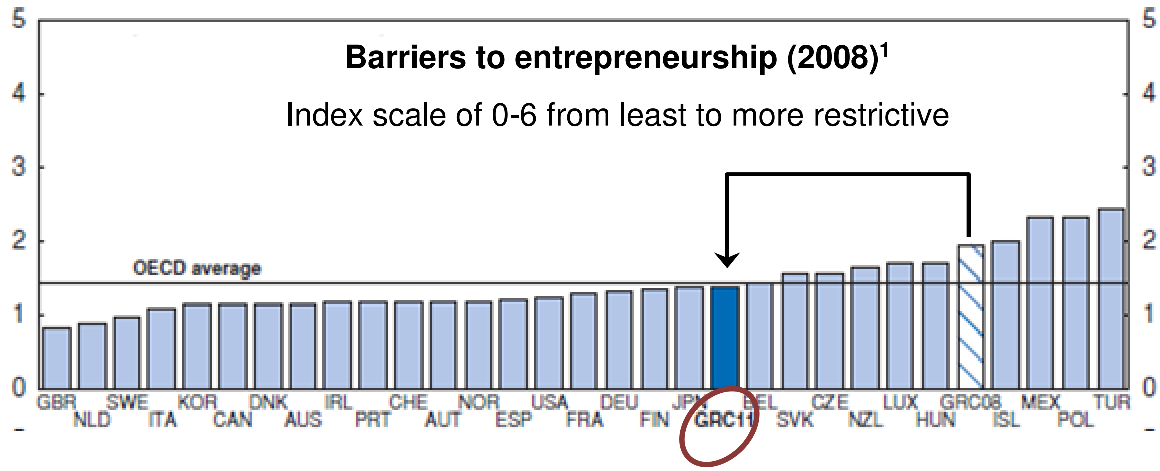
Greece can quickly gain lost ground in structural competitiveness

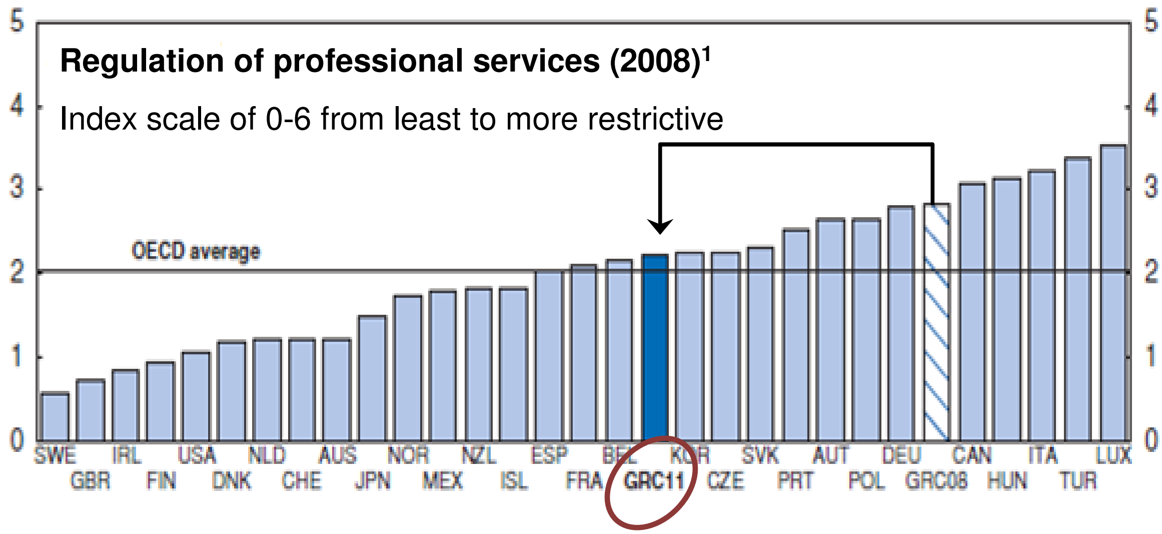
<u>Loss of Structural Competitiveness</u>

- ***IMD World Competitiveness Yearbook :*** *56th position in 2011 (out of 59 countries)*
- ***World Economic Forum:*** *83rd position in 2010 (out of 139 countries)*
- ***Doing Business Report (World Bank):*** *100th position among 183 countries in 2011*

As a result of overregulated goods, services & labor markets, and the more than 250 restrictions on private investment and entrepreneurship, ***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)***

- ***Serious Investment Impediments: Environmental licensing, Land use legislation***



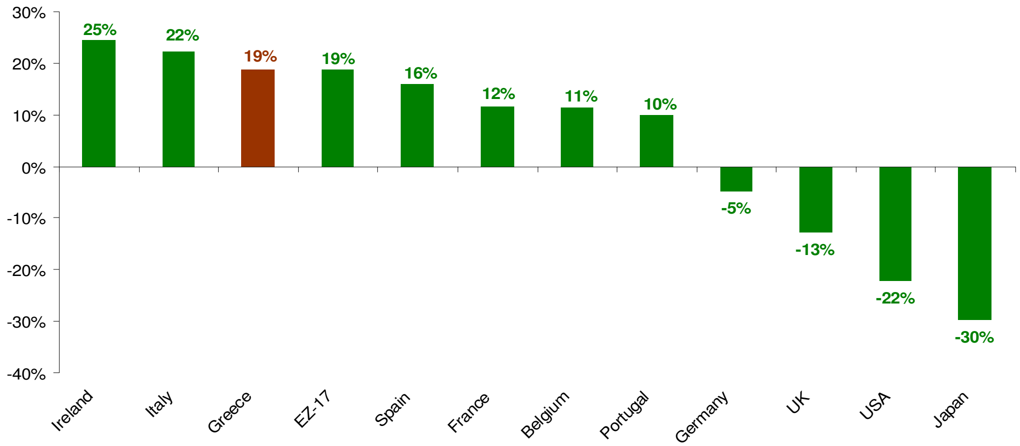


Sources: OECD Economic Surveys: Greece, AUG 2011

[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)

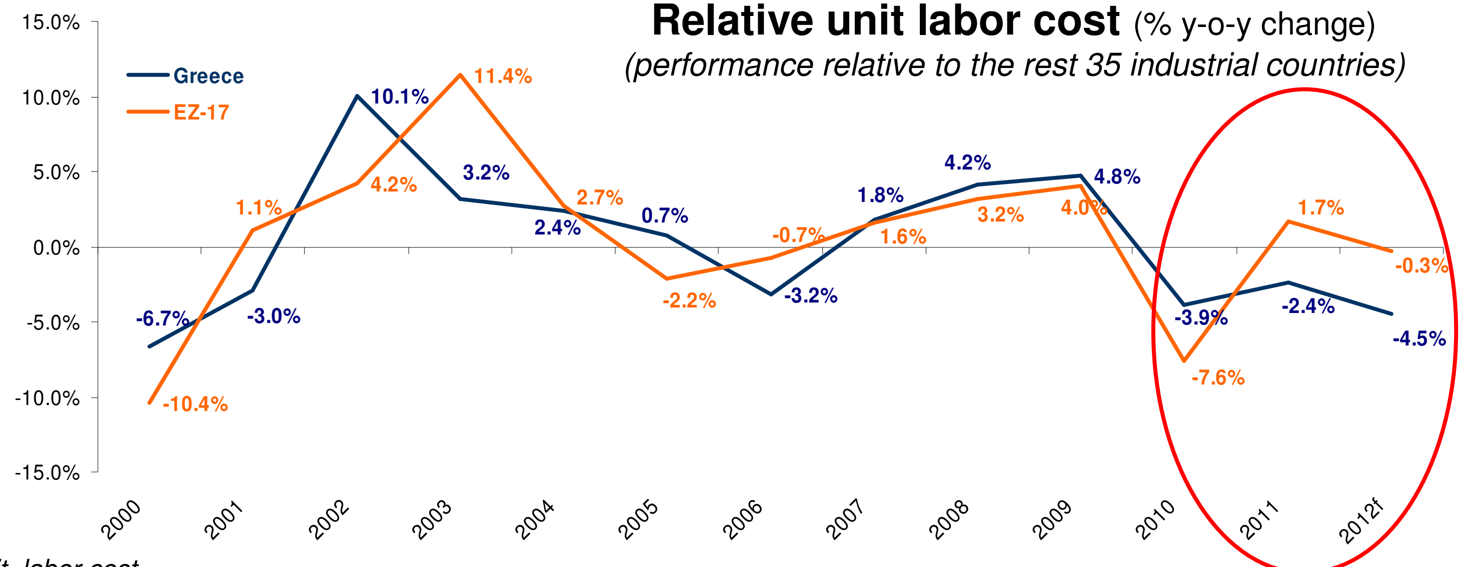
In 2010-2011 *cost competitiveness has improved significantly*.

Relative Unit Labor Cost:

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

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

(performance relative to the rest 35 industrial countries)

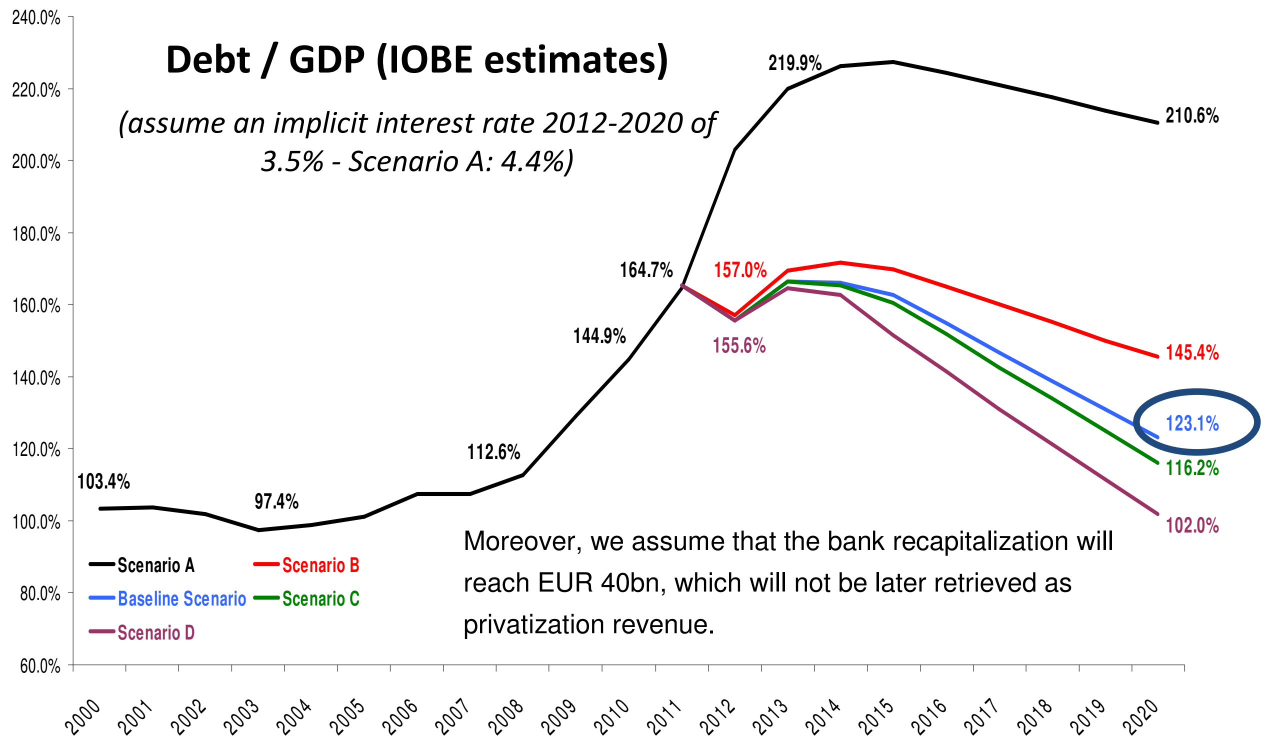


Note: we account for the nominal unit labor cost
Source: European Commission Statistical Annex, Autumn 2011

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.

Investment Initiatives – Urgent need for a Growth Memorandum

Use EC Structural Funds to strengthen the privatization process – Boost private investments – Development of Public Real Estate Property – 'Fast Track' mentality

Privatizations

Catalyst for solvency and growth:

- ***Infrastructure***: Airports, Ports, Motorways, Touristic Facilities (marinas)
- ***Energy***: PPC, Public Gas Corporation, Hellenic Petroleum
- ***Telecommunications***: Hellenic Telecommunications Organization, Frequency Spectrum
- ***Gaming***: OPAP, Hellenic Casino of Parnitha, Hellenic Horse Racing Organization, State Lottery
- ***Banking Sector***: ATEbank, Loan & Consignment Fund, Hellenic Postbank
- ***Real Estate*** (state owned)
- ***Other holdings***: LARCO, TRAINOSE, Hellenic Defense Systems, Hellenic Vehicle Industry, Hellenic Post
- ***Private – Public sector partnership***: e.g. public hospital infrastructure currently operating below capacity

PRIORITY 1:
Income will be generated from abroad

PRIORITY 2:
Liberalization of the energy market / selling of lignite power stations

PRIORITY 3:
The Greek State owns large real estate property

Tourism

Enhancing competitiveness:

- ***New Opportunities***: High-quality tourism, Medical Tourism
- ***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 total).

Energy

Ambitious targets on the penetration of renewable energy sources:

- in ***power generation***: 40% of final consumption
- and ***networks***: 10% of final consumption
- Investment in renewables (reaching c. EUR 16bn until 2020) 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).
- Island interconnections & 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.

Investment Initiatives – Urgent need for a Growth Memorandum

Shipping

The Greek fleet (both Greek & foreign flag vessels) remains the largest in the world

Agriculture & Fishery

• 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)

Pharmaceuticals

• 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)

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

Steps to Growth

1

REMOVING UNCERTAINTY

• The continuing periodic uncertainty directly related to the quarterly review of the program and the disbursement of funding, destabilizes the real economy.

• The increasingly hostile rhetoric from certain political circles within the EU indicating that the EU is not fully united behind the rescue package is also responsible for increasing uncertainty and thus postponing any investment decisions for the future.

• Strong and reformist government following the elections should be given time to properly implement the reforms.

2

INCREASING LIQUIDITY

• The imminent recapitalization of banks should be based on a strategic plan that would not only guarantee the solvency of the banking system but also the restarting of the real economy through the gradual deleveraging of the business sector.

•The urgency of the first task should not undermine the design and implementation of the second. A strategic study should be undertaken in order to assess the situation and elaborate guidelines for deleveraging across sectors in the economy.

Steps to Growth

3

EIB & OTHER FINANCING

• Current liquidity constraints should be addressed through increased EIB financing of the private sector in Greece.

• More capital should be made available to finance productive activities and accept co-financing with Greek banks despite the current credit rating of domestic institutions.

• Market imperfections are exacerbated by the current credit and liquidity crisis and as a consequence risk funding is not readily available for a number of projects despite the fact that they are viable and have a commercial rationale. Private investors are reluctant to participate without official encouragement. We should look into new instruments of capital participation along the lines of EBRD financing in eastern Europe or EIB financing in JEREMIE/JESSICA.

4

IMPROVE IMPLEMENTATION

• The first loan agreement was more designed to achieve fiscal consolidation and less reforming the economy. Later, serious efforts have been made to address this deficiency. However, the pressure on implementation, which derives from the fact that the authorities do not follow required time schedules, leads to poorly designed policy instruments without any time or effort given to impact assessment. By improving the quality of policy making, we create a better investment environment.

Steps to Growth

5

STABLE TAX ENIRONMENT

• Stop tax surprises, improve transparency of the system and create a simplified tax code.

• Design tax policies with a 3 year horizon giving, assurances about business tax rates.

• Rely more on spending cuts and less on tax rises.

6

CONCENTRATE ON PRIVATIZATIONS

• The required inflow of private capital will come mainly through privatizations.

• Critical time has been lost with slow preparation of privatizations and wrong priorities.

• More technical support is required to speed up the design of markets, that will be fully functioning following privatization of network companies.

• The preparation of prime land for development must be made on a selective basis, so that scarce human resources are concentrated in promoting projects with high value added for the local economy.

Steps to Growth

7

RINGFENCE INNOVATION

• “Greece’s innovation system displays serious weaknesses. In Greece, high- and medium-high-tech industrial sectors and knowledge-intensive service sectors carry very little weight in the overall economy. There is little potential to leverage the development of fast-growing industries with high productivity levels” (Deutche Bank Report 2012).

• The current fiscal adjustment further undermines the capacity to innovate in the economy.

• It is an area that should be protected from current cuts and give more incentives to connect with the market.

• Existing technological parks should be evaluated and supported through extraordinary measures in order to sustain innovative activity throughout the crisis and attract new investment from abroad.

Thank you

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