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Greek Public Finance: Is it a modern tragedy?

International Economic Forum

Prague, March 16, 2010

Topics of the presentation



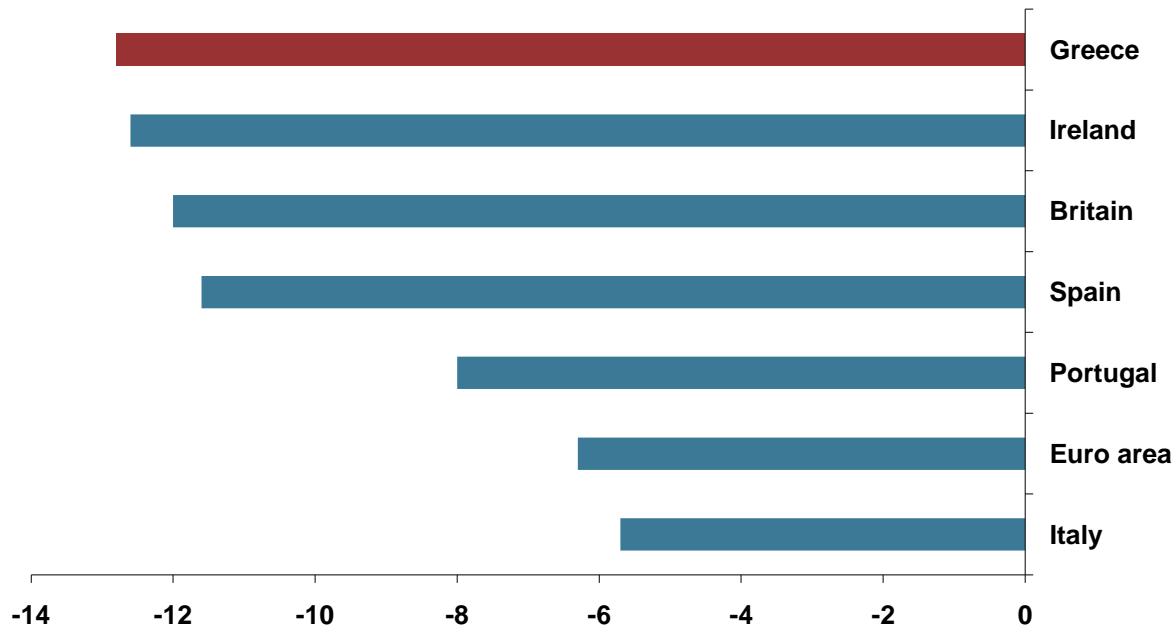
- What happened / is currently happening in Greece?
- Why did it happen?
- How does Greece plan to recover?

What - The story of deficits

1) Greek budget deficit as % of GDP has reached 12,7 in 2009



- Budget deficit as % of GDP (2009 estimate) -



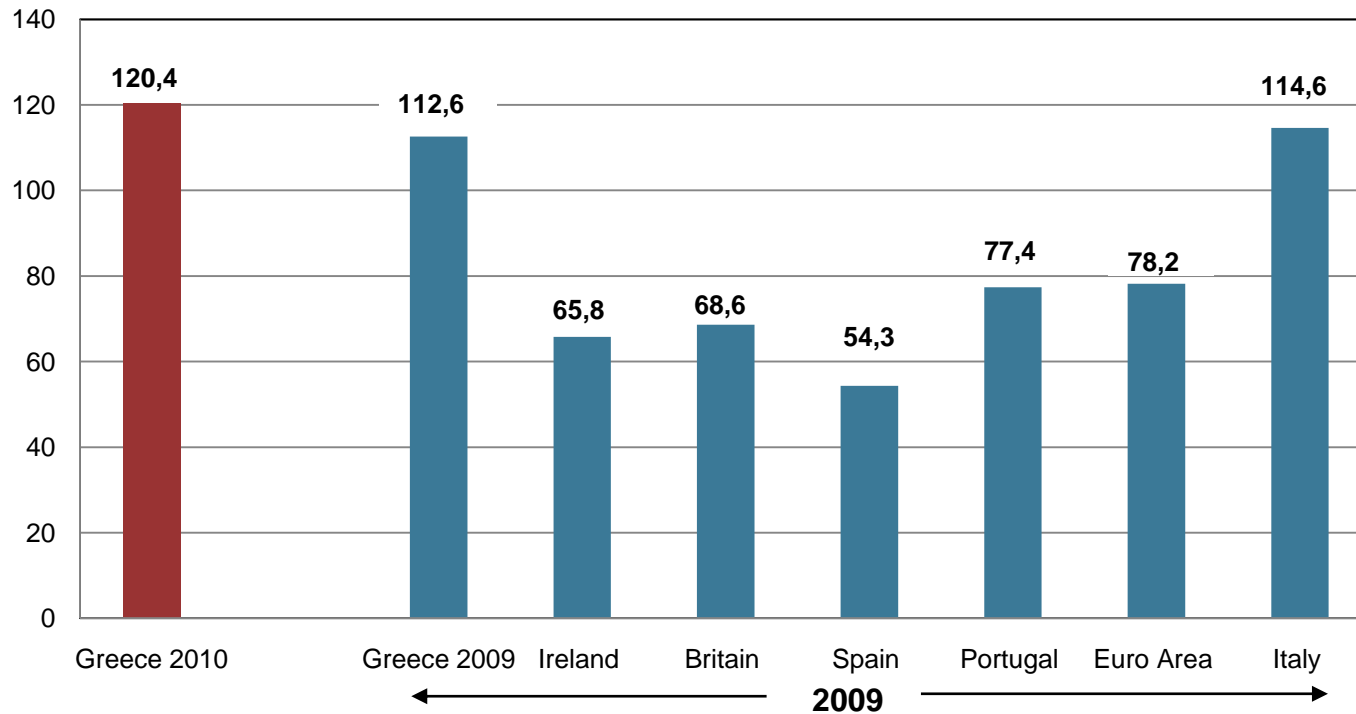
Source: European Commission

What - The story of deficits

2) Public debt has reached 112,6 % of GDP for 2009 while it is expected to reach 120 % in 2010



- Public debt as % of GDP -



Source: European Commission

What - The story of deficits

3) The credibility deficit: Why do EU / markets have a negative view for Greece



- ❑ Unreliable fiscal data
- ❑ Poor track record of fiscal adjustment
- ❑ Inflexible labor market
- ❑ Structural issues leading to weak competitiveness



This situation encouraged speculators to attack Greece as the weaker link in EMU by taking positions on Greece's default (short selling)

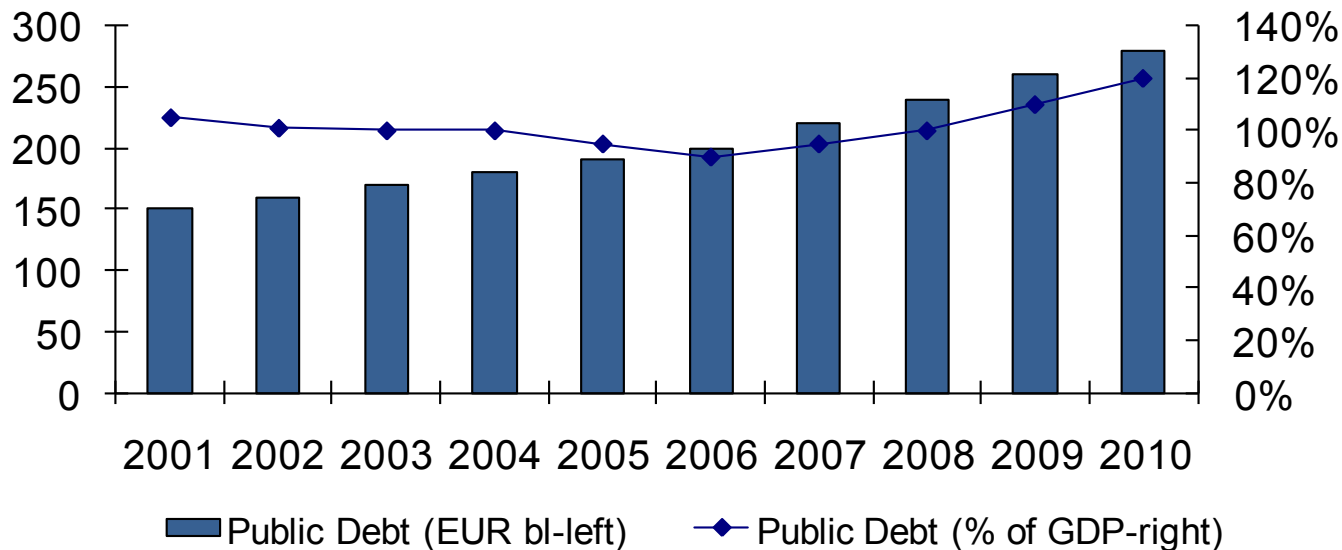
Why

Over the last decade Greece did not manage to significantly reduce the public debt



- Public debt grew significantly in 80s by an un-rational public spending
- Following entry in EMU, Greece managed to slightly decrease public debt below 100% of GDP (close to 95% of the GDP)
- This decrease though, was driven by a favorable financial environment (low interest rates making new borrowing cheaper) rather than from the necessary structural changes

- Public debt evolution -



Source: Greek Stability and Growth Program (SGP), January 2010

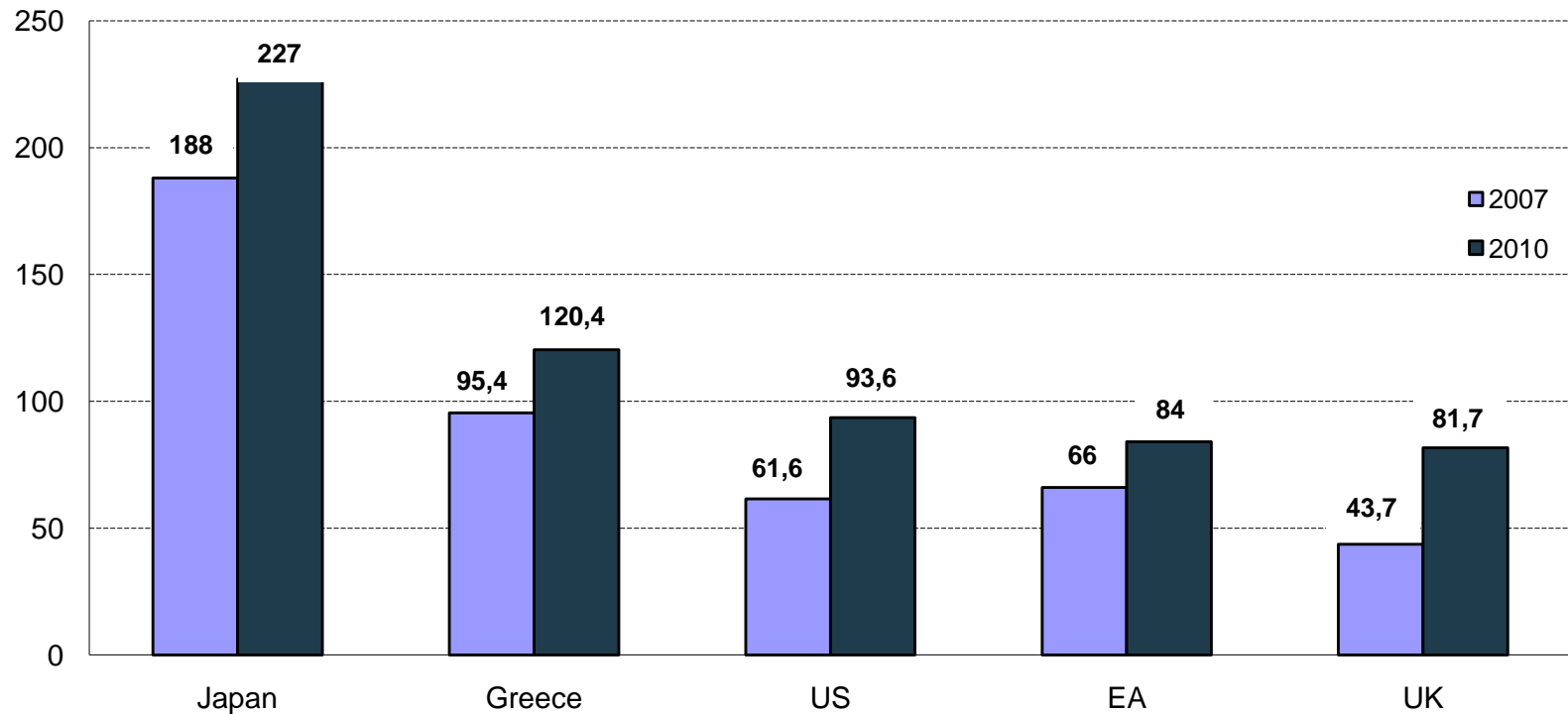
Why

On the other hand, this fiscal imbalance (public debt explosion) became evident the moment growth stopped



- This was not a Greek phenomenon only; to an extent it was driven by the global crisis
- Similar debt explosion was observed in other markets as well

- Public debt - to - GDP ratio -



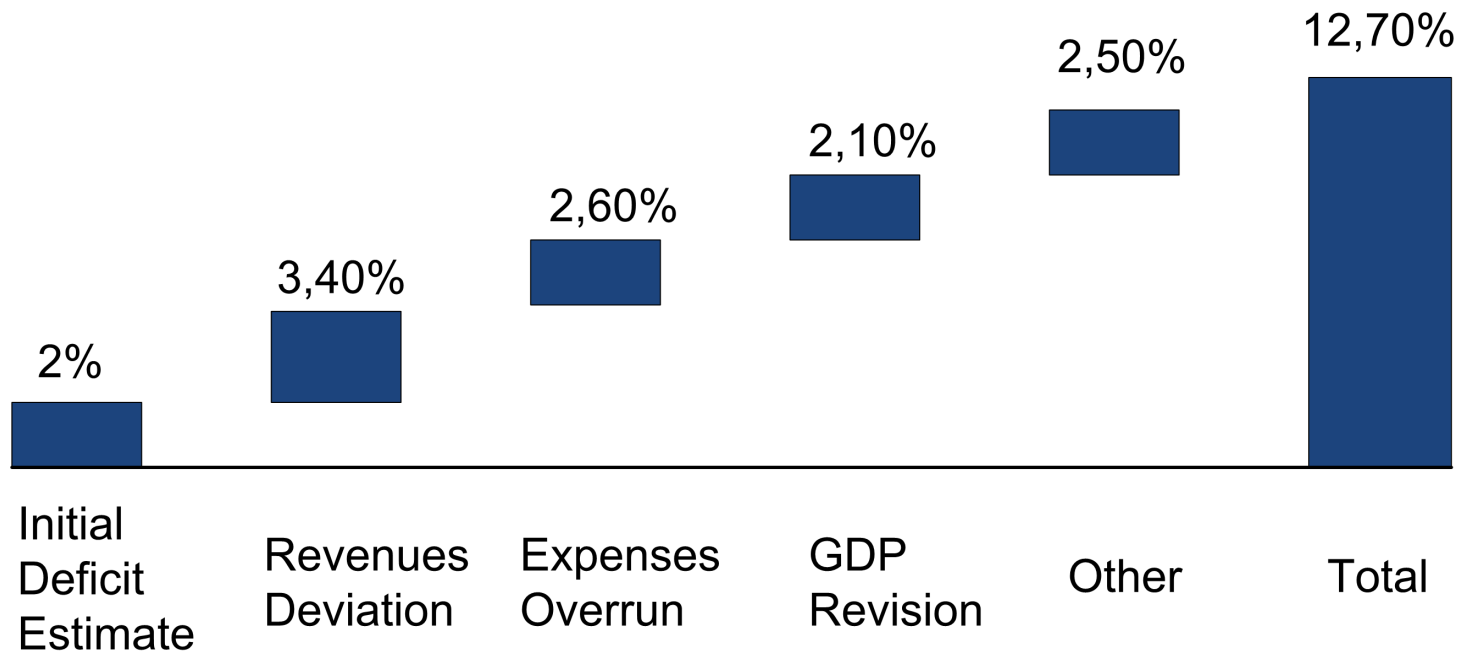
Sources: IMF, European Commission, SGP

Why

The budget deficit was driven by both reduced revenues (less taxes collected) as well as higher expenses



- 2009 budget deficit deviation explanation -



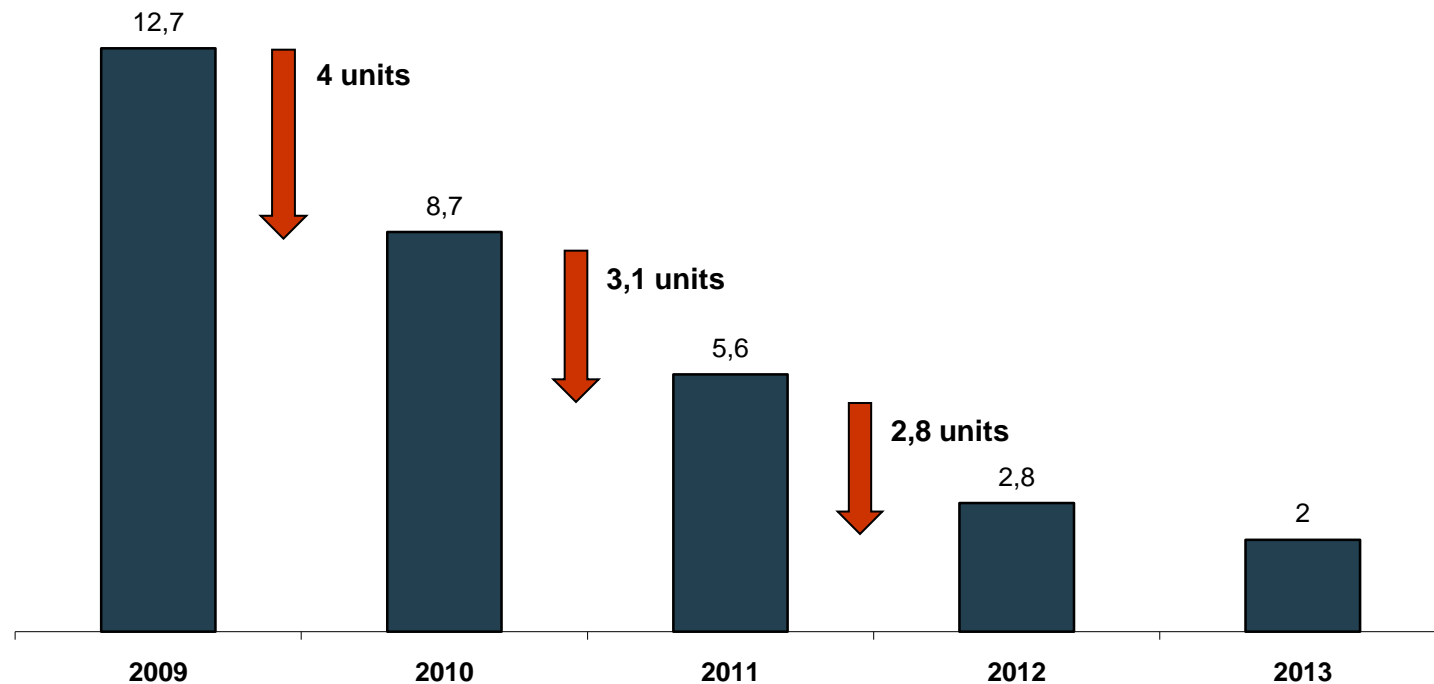
Source: Greek Stability and Growth Program (SGP), 2010

How to recover

In order to recover Government has promised to reduce budget deficit by 10% (from 12,7% down to 2%) in the next 3 years



- Budget deficit as GDP percentage -



To achieve the targets set, Greece has put in place a 3-year **Stability and Growth Program (SGP)**

How to recover

Greek government has taken (for the first time) a number of tight immediate measures to reduce public deficit



SGP: Immediate Measures

- ✓ Public-sector wages cut around 10%
- ✓ Hiring freeze in 2010
- ✓ Implementation of a 5:1 rule from 2011 in the public sector
- ✓ Tax reform with tax base broadening and a fight against tax evasion
 - Value Added Tax increase by 2 points (from 19% to 21%)
 - New special levy and 45% taxation rate for individuals income
 - Higher taxes on fuel, alcohol, tobacco and luxury goods, including cars and yachts
 - Special tax for energy consumption

How to recover

Moreover, Greek government is planning a number of structural changes to ensure longevity of results



SGP: Structural Changes

- ✓ Closure of loss-making public enterprises
- ✓ Pension reform to avoid explosive rise in debt due to aging population
- ✓ Structural reforms to encourage domestic competition (reducing bureaucracy)
- ✓ Labor market reform to reduce unemployment, improve competitiveness
- ✓ Willingness to proceed with a new export-oriented growth model
- ✓ Privatization revenues of approximately 2.3% of GDP per year

How to recover

Finally, to re-gain confidence the Government is re-designing the budget framework



SGP: Budget Framework Redesign

- ✓ Monthly reporting requirements for key ministries
- ✓ Creation of a Parliamentary Budget Office
- ✓ Use of external auditors in public sector entities
- ✓ Creation of a 10 percent contingency reserve
- ✓ “Zero-basis” budget re-evaluation
- ✓ National Statistical Agency becomes independent

Will Greece manage to recover?

Risks are still there but strong determination exists



Risks to be managed

- ✓ Risk of deep recession / Ability to restore growth
- ✓ Ability to fulfill the budget assumptions regarding tax collections / revenues gathering
- ✓ Probability of social unrest

Conditions for success

- ✓ Successful resistance to speculators
- ✓ EU support to Greece → Is there a solidarity deficit?
 - Recently EU provided strong (but only verbal ...) support
 - Behavioral variations within EU (e.g. France vs. Germany)
- ✓ Access to cheap financing
 - Currently, Greek 10-year bond yield is 300 basis points above the German ones
 - Amount to be borrowed (50 bn Euros for 2010) is feasible provided a convenient interest rate



Thank you!