EUROGROUP MEETING – FEBRUARY 16, 2015 – BRUSSELS
NON-PAPER FROM THE GREEK GOVERNMENT

1. Outcome of Technical Discussions

Technical discussion took place on Feb. 13-14 between Greek officials and representatives from the EU Commission, the ECB and the IMF to identify common ground between the two parties and discuss the content of the current MoU.

On structural reforms, good progress was made to identify areas where the Greek authorities can support the ongoing reform agenda: tax reform, revenue administration reform, public financial management, fighting corruption, e-government, public procurement reform, business climate improvement, judicial system reform, implementation of EU legislation on network industries and competitive sectors.

Time is needed over the coming weeks for the new government to make a more detailed assessment of ongoing reforms. The Greek government is fully committed to continue efforts made in these areas. It considers as an essential part of its political mandate to accelerate implementation of decisive policy actions the previous government failed to implement: decisively confronting tax evaders, fighting corruption and reforming public administration. It stands ready to commit to the short-term implementation of key policy actions.

Technical discussions revealed real differences of logic on a limited number of issues. The Greek government considers current labor market reform agenda as unfit to the current situation of the economy. It will promote a different approach, with technical assistance from ILO, to ensure workers' protection in a way that is consistent with economic growth.
The government will also promote a different approach for managing public assets. Privatizations will not be stopped but assessed on a case by case basis to ensure that they are consistent with public interest. Fire sales must be prevented, and a longer time horizon, in particular with respect to the banking sector, must be considered.
On public administration reform, the government supports the goals to make SoEs more efficient and establish a more efficient civil service but systematic dismissals will end. On taxation, the government will review current policies to protect the poorest segments of the population. It will review the brackets for income tax to increase progressivity and replace the current property tax by a wealth tax. VAT reform will be reviewed.

Finally, the Greek authorities identified some areas where there is a general agreement on broad objectives but where they would like to discuss new ideas to meet the policy goals of the MoU. On banking sector reform, the authorities would like to discuss the creation of an Asset Management Company to address NPLs. To support investment, the government considers a priority to develop the social sector and create a public development bank.

On this basis, the Greek authorities consider that there exists sufficient common grounds to constructively discuss with its European partners, on the basis of fresh views and a forward looking approach, the terms of a new commonly agreed policy agenda that will fully encapsulate the government's views. The government is committed to continue a reform agenda which takes the best elements of the current program and of its own reform agenda. These discussions should be held in an appropriate format that builds on the ECB's and EU Commission's specific mandates.

2. Debt sustainability

The Greek authorities are committed to continued primary surpluses over the next decade to ensure sound publics finances. However, implementing the primary surplus targets envisaged by the MoU would be counterproductive. A 3% primary surplus in 2015 and 4.5% in 2016 would jeopardize the current fragile recovery. Moreover, it is not at all necessary to put the debt on a steady declining path. A 4.5% primary surplus would lead, according to our projections, to extinguish entirely the debt by 2050. This is not the standard definition of debt sustainability.

The current program sets the objective of a 124% nominal debt-to-GDP ratio in 2020 to ensure sustainability and full market-access in 2023 when large maturities will have to be refinanced. The authorities consider this target as artificial and inappropriate. As stated by the Director General of the ESM in 2013, the structure of the Greek debt is as important as the debt-to-GDP ratio to assess sustainability. Long term maturities and reduced interest rates already entail a lower debt ratio in 2015 in net present value terms. In NPV terms, the debt stands at 135% of GDP and would fall below the bar of 120% if the same 1,5% primary surplus as in 2014 was achieved. The government looks forward to discuss with the IMF and the other institutions a more accurate assessment of debt sustainability.

Privatization receipts can contribute to improve the debt trajectory. However, past commitments made by the previous Greek government fell short of the targets. Quantitative objectives should be realistic. Forcing sales of public assets in a depressed environment is unjustified. The authorities will stop all sales that are not in the public interest.

3. Covering Funding Needs in 2015

Funding needs in the year 2015 and over the coming months is a pressing and immediate concern.

Budget Balance

On the revenue side, the previous period was dominated by political interventions, of varying intensity and from numerous sources that promoted uncertainty and thus affected economic activity and tax collection. Revenue shortfall as of end-January reached €2 billion compared to MoF forecast.

The authorities contemplate exceptional action in terms of revenue mobilization in 2015. Up to €5.5bn are expected over the year thanks to a strong effort to (i) fight illegal trading, tax evasion and corruption (ii) better control transfer pricing in companies active abroad (iii) reform arrears collection process and (iv) implement a more progressive taxation on the wealthiest.

The authorities will look forward to maintain a 1.5% primary surplus over the year. This objective depends on economic stabilization. New spending (humanitarian package) will be financed through reprioritization of expenditures and cuts in other budgetary items.

Debt Amortization

Greece faces exceptional funding needs in 2015. Payments to the IMF as well as to the ECB and other creditors will amount to c. €17bn over the year.

Budget deficit itself, in cash term, will not add much to this figure, especially if the SMP profits are incorporated in the government resources.

To cover all its refinancing needs, the government proposes to open discussions with its European partners on the terms of a new contract that will provide the appropriate framework for continued support from the ECB and Member States. Technical work conducted with the three partner institutions demonstrated that there is room for a new deal. The government is confident that a fresh look at DSA will demonstrate that the objectives of the government are on target. Once an agreement is reached on the desired pattern of fiscal adjustment, the Greek government believes a holistic agreement will be on reach on structural reforms.

Short Term Bridge Funding

To solve short run liquidity problems, the government foresees an agreement on a combined involvement of the Eurosystem and its ELA program (in relation to the issuance of T-bills), of the IMF through new disbursements and of the Eurogroup for allowing the release of the unused HFSF resources.

We are confident that such an agreement can be reached on the basis of the sufficient common grounds identified with the three institutions on the content of the current MoU.

Annex 1: Privatization Receipts

The expected cumulative privatization proceeds are expected to reach €22.3bn by 2020 according to the IMF. However, the Greek authorities consider this target unrealistic.

Privatization Receipts have fallen Short of Expectations since 2011

In 2011, under the first program, the MoU agreed with the Eurogroup expected €50 billion of privatization receipts over the period 2011-2016, with a €5bn target for 2011, €10bn for 2012 and €5bn in 2013 (€20bn total receipts at the end of 2013 and €35bn at the end of 2014).

In 2012, the second MoU stated that the €50bn target was maintained, but over a much longer time horizon. The end-2020 target was revised down to €22bn in April 2014 considering the "unsatisfactory privatization process".

In practice, privatization proceeds amounted to €1.6bn in 2011, zero in 2012, 1bn in 2013 and were expected to reach 1.5bn in 2014 and 2.2bn in 2015.

These figures demonstrate the practical inability of privatizations to bring sizeable resources to repay public debt in the current Greek context.

The New Government's Intentions

The intentions of the new Government to halt the systematic approach to privatizations will result in a shortfall over the short and medium run, but could ultimately produce higher proceeds over the long run by avoiding fire sales and/or asset disposals that are not in the interest of the Greek people.

This new attitude will inevitably deteriorate the debt sustainability over the short run and prevent Greece to reach the arbitrary target of 124% of nominal debt to GDP ratio by 2020, but it will with no doubt contribute to improve the debt trajectory over the longer run.

Regarding financing needs, privatization receipts for the year 2015 were estimated at €2,2bn by the IMF. The distribution of SMP profits for 2014 (€1,9bn) would allow to make up for most of this shortfall.

Annex 2: Debt Sustainability

Debt sustainability is about keeping the debt-to-GDP ratio under control. This typically requires that the deficit is low enough to guarantee that the debt ratio is falling rather than rising. To compute this threshold one needs to make assumptions on growth. An economy with zero (nominal) growth needs a balanced budget. With positive growth, some deficit is consistent with solvency; all it takes is for the debt to grow less rapidly than GDP.
In the case of Greece, with a debt-to-GDP ratio at 175%, the deficit that would stabilize the debt to GDP ratio at its current level is 7% of GDP (=4%*1.75) assuming a conservative growth of 4% in nominal term. Greece has already better performed since in 2014, the deficit fell under the Maastricht benchmark of 3%. In structural terms, correcting the measure of the deficit for the output gap, Greece is actually engineering a fiscal surplus of 1.6% of GDP (according to IMF).
In other words, a 3% deficit is well within the boundaries of sustainability as conventionally defined. Given the interest bill, of about 3% of GDP today and potentially of 4.5% in the future (once the interest deferral on EFSF loans expires), a primary surplus of 1.5% is up to the task.
The attached simulation shows the downward debt trajectory until 2054 assuming a constant 1.5% of GDP primary surplus.
Discussion with the IMF over such DSA-style discussions would be critical. The 4.5% primary target is only required to bring debt below an arbitrary threshold of 124% by 2020 (according to the latest DSA) and below 120% in 2022. However, the IMF does not take into account the adverse consequences on growth of the austerity shock that is required to meet this fiscal target. Yet, GDP growth is as important, and even more important, than the primary surplus to reduce the debt to GDP ratio. Besides, any attempt to further squeeze the budget in the current context of humanitarian crisis and slight resurgence of economic growth would have a disastrous impact on both the economic and social fronts.

A Misunderstanding

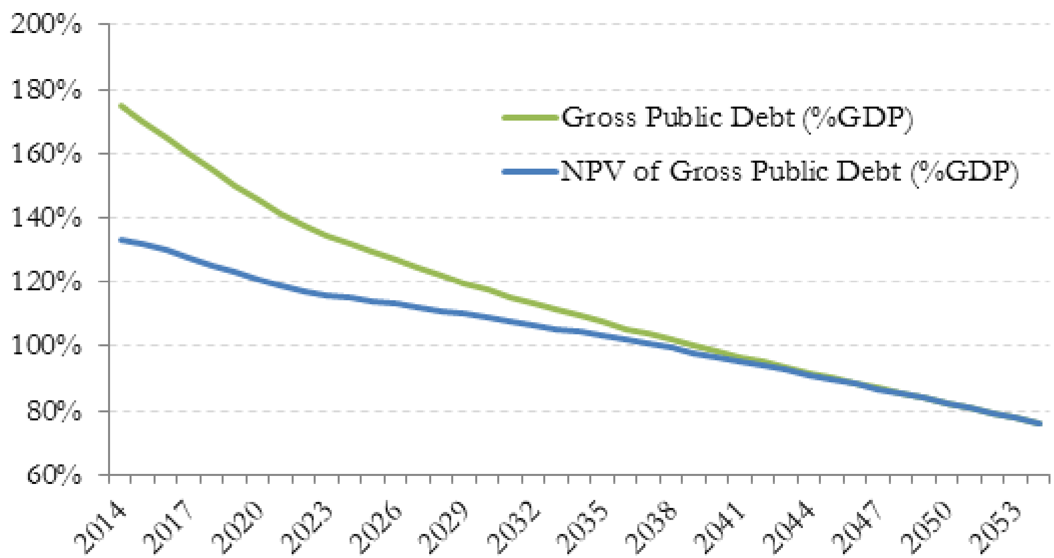
The misunderstanding regarding Greece solvency owes to the fact that the blunt 175% Debt-to-GDP number does not fully describe the actual burden of public debt over the Greek economy.
Greece currently owes the EFSF c. €142bn (75% of 2015 IMF projected GDP), bearing an interest rate of c. 2.5%, and having a final maturity of 39yrs (amortizing from year 2023 until year 2054). This high level of concessionality of the EFSF loans is not captured in the nominal debt/GDP ratio used by the IMF in the case of Greece. The same analysis can be made for GLF loans (interest rate at 50bp above Euribor, i.e. currently 0.65%, and final maturity 2041).
In an interview in September 2013, head of ESM Klaus Regling strikingly stated that DSA analyses undertaken by the IMF are "meaningless". A key argument from Regling is that the debt parameters are as important to assess debt

sustainability as the debt nominal level itself: EFSF loans are very long term, with very concessional interest rate reduced to EFSF funding cost of approximately 2% plus an operational margin cost of c. 50bp.

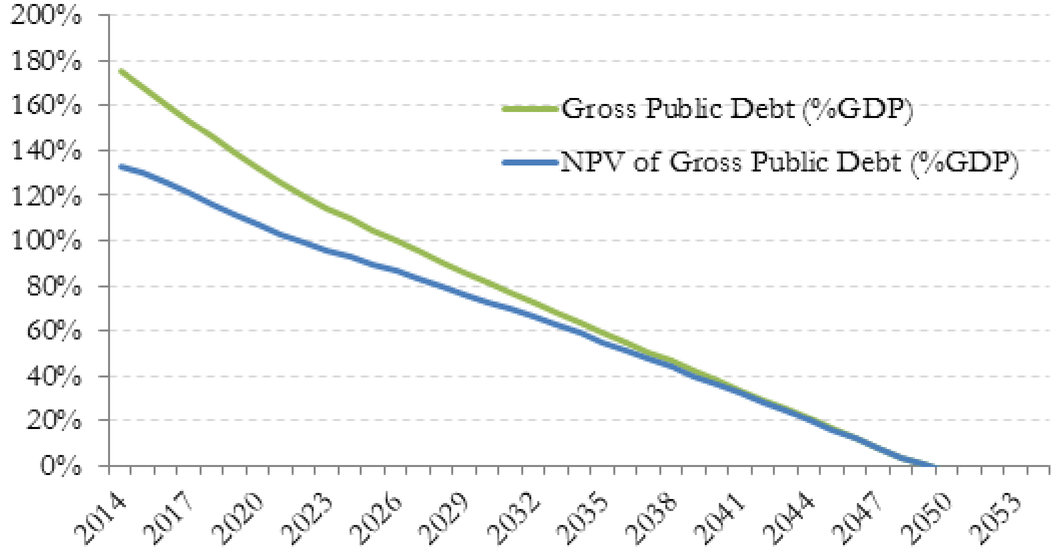
Indeed, if Greece's debt was calculated in NPV terms, say with a 5% discount factor, the Debt-to-GDP ratio would already be as low as 133% of GDP (see below), and reach 127% in 2020 (as expected by the IMF in nominal term) with a primary surplus maintained at 1.5% of GDP instead of 4.5%.

We show below the debt-to-GDP ratio dynamics under the assumption of a primary surplus maintained at 1.5% and conservative assumptions of nominal growth at 4% (below IMF expectations).

Under this set of assumptions, the NPV of Public debt reaches 120% of GDP in 2020.



We show below the same dynamics under the assumption of a long term primary surplus of 4% as requested by the EU. Under these unjustified assumptions, the debt would dramatically decrease and totally disappear within the next 30 yrs, which is not the definition of sustainability.


Gross Public Debt (%GDP)
NPV of Gross Public Debt (%GDP)
200%
180%
160%
140%
120%
100%
80%
60%
40%
20%
0%
2014
2017
2020
2023
2026
2029
2032
2035
2038
2041
2044
2047
2050
2053