The Only Win-Win Solution for Europe Requires a "Fresh Start" on Greece State-Building and a "Fresh Start" on Greece Correctly Calculating Debt Relief from Prior Restructurings

-- Japonica Partners Internal Summary Slides --

Re-Thinking Sovereign Debt
Multi-Disciplinary Summit

8-9 July 2015
Munich, Germany

Organizer: CESifo

Sponsor: JAPONICA PARTNERS®

Working Draft v.3.4

Re-Thinking Sovereign Debt Summit

- Two day conference: 8-9 July 2015
- Location: Munich, Germany
- Organizer: CESifo
- Sponsor: Japonica Partners
- **Attendees from** Australia, Austria, Belgium, Canada, France, Germany, Greece, Netherlands, New Zealand, Spain, Switzerland, UK, USA…
- 40+ of the world's **leading minds** on sovereign debt and state-building
- **Multi-Disciplinary**: accounting, business, economics, finance, government, history, investment, legal, management, media, statistics, think-tank…

Goals for a "Fresh Start"

#1. For prosperity in Greece, the Greece ministers' first priority must be to **build trust and confidence** with all stakeholders.

#2. To build trust and confidence, Greece ministers **must make transparency and accountability** of government finances their most important reform.

#3. And, the starting point for transparency and accountability in Greece is **accurate government financial information** obtained through the best international public sector accounting standards and audits.

“Fresh Start” Solution Benefits

- The only **win-win** solution for Europe and Greece.
- For Europe:
  - **No haircuts**.
  - **No new present value reductions**.
- For Greece:
  - **Meaningful state-building** using the best international transparency and accountability rules.
  - Recognizes significant **debt relief** from **prior** restructurings.
- **Super simple** and easy to understand.

“Fresh Start” Three Point Plan

1. To improve state-building and correctly calculate debt relief from prior restructurings:
   - Greece will use the **best international financial reporting rules** on transparency and accountability.
   - Partners will provide **technical assistance** to Greece.
2. Greece will publicly disclose **net debt and financial assets monthly**.
3. Greece will form a non-partisan council to recommend **finance ministry leadership based solely on merit** with globally respected experience in finance, accounting, and turnaround management.

Note: The best international financial reporting rules are IPSAS and economic rules are 2008 SNA and ESA 2010.

The "Fresh Start" Solution is Multi-Disciplinary

- Proper accounting by debtors undergoing troubled debt restructuring (also known as **"fresh start"** accounting).
  - Financial Accounting Standards: FAS 15, IPSAS 29, IAS 39.

- Economics of debt restructurings: "Both efficiency and equity dictate providing a **fresh start**."
  - Joseph E. Stiglitz, April 2013 (*Debt Restructuring: Gaps in Legal and Institutional Structures*)

- For management, historian, and German business leader (e.g., der Mittelstand) perspectives on **"fresh start"**, see the following three slides.

“Fresh Start” from a Management Perspective: HBS Case Study – 16 June 2015

HARVARD | BUSINESS | SCHOOL

N2-115-063
JUNE 16, 2015

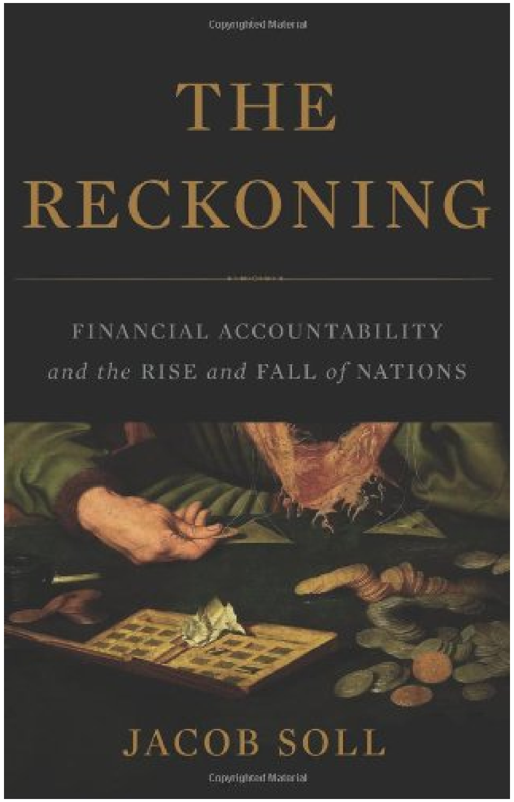
GEORGE SERAFEIM

Greece’s Debt: Sustainable?

After six years of economic recession, substantial disagreement surrounded the level of indebtedness of Greece and whether the country had actually too much debt, which needed to be subject to a haircut, or too little debt, which actually represented a competitive advantage. The situation was further complicated by an announcement, made in May 2015 by the Greek deputy finance minister Dimitris Mardas, that Greece would adopt accrual accounting and the International Public Sector Accounting Standards (IPSAS).[a] This announcement was previously made several times since the beginning of the crisis but was never fulfilled.[1]

“A fresh start to strengthen state-building and recognize debt relief from prior restructurings is a brilliant solution to **improve the competitive position** of Greece.”
George Serafeim, HBS Professor – July 2015

“Fresh Start” Lessons from History



“Tallying the debt by modern, internationally accepted accounting standards is the **simplest and smartest strategy to solve this crisis** [in Greece].”

Jacob Soll, Historian - 2 July 2015

Wirtschaftsrat der CDU on Greece Implementing International Financial Reporting Rules

“The Economic Council [of the CDU] is thus proposing that consent for an extension be coupled with transparent accounting… Greece may only receive further assistance if it submits accounts that are **prepared according to international standards** (IPSAS – International Public Sector Accounting Standards) and audited by an internationally recognized auditing firm. It is not acceptable that while all of Europe discusses Greek debt, no reliable figures are available. The Greek government always refers to its debt burden of EUR 315.5 billion, or 176% of GDP, as not being sustainable. Yet it is the fair value of a loan that is decisive, not the nominal value. Thanks to various debt restructuring rounds, Greece is relieved of its full risk premium on financial markets. Heavily subsidized Greek debt is not even subject to repayment until 2020. This 'competitive edge' is kept quiet. If Greece were subject to IPSAS accounting, it would have to state significantly lower debt than the nominal value of EUR 315.5 billion. **What matters is establishing transparency** and putting an end to 'Greek statistics’… Greece needs to start now.”

(Unofficial Translation)

Debt Relief Calculated Under International Economic and Accounting Rules

European System of Accounts: **restructured debt** is considered extinguished and replaced by a new debt instrument at **transaction value**. (20.236, 20.221)

System of National Accounts: **rescheduled debt** is considered extinguished and replaced by a new debt instrument valued at the **present value of the new debt using market prices** as the reference point. (22.106-113)

IPSAS/IFRS: **fair value of debt instruments** is measured as the **present value** of all future cash receipts discounted using the **prevailing market rates**. (IPSAS 29/IAS 39)

IMF and the World Bank on Present Value of Debt

1. This debt burden is **best measured** using the **net present value** (NPV) of debt to **capture the concessionality** of outstanding debt. (IMF/World Bank)
2. Countries that primarily rely on concessional financing, the **net present value** (NPV) of debt is **needed to be informative** as a measure of a country's effective debt burden. (IMF/World Bank)
3. Reprofiling of payment flows [NPV] **does not imply nominal haircut or budgetary costs** for creditors. (IMF)

Global Benchmarks on Net Debt

United Kingdom: Two of the **main measures** used for fiscal management are the current deficit and public sector net debt.

Canada Public Sector Accounting Standards Board: Net debt and change in net debt are the **single most important** performance metrics.

Australia National Audit Commission: Net debt as the **main stock indicator**.

New Zealand Treasury: Net debt **better reflects** the underlying strength than gross debt.

Austrian Federal Ministry of Finance: Net debt is one of the ratios we discuss **first and foremost**.

IMF: Staff should consider three important issues including **gross versus net debt**.

Correctly Calculating Debt Relief from Prior Restructurings

(€, Billions)

SN	Type of Debt	Before Debt Relief	Debt Relief 2010-2012 *(Four events: 2010, 2011, and two in 2012)*	After Debt Relief
1.	Loans	€ 213	Interest rates reduced from over 5% to as low as 0%. Maturities extended from as short as five years to as long as 45 years.	€ 60
2.	Bonds	€ 63	Interest rates reduced from as high as 7.5% to as low as less than negative 4%. Maturities extended from as short as less than one year to as long as 30 years.	€ 20
3.	Other Debt, incl. T-bills	€ 44	No change.	€ 44
4.	Gross Debt	€ 319		€ 124
5.	Gross Debt as % of GDP	175%		68%
6.	Financial Assets	€ 91		€ 91
7.	Net Debt	€ 228		€ 33
8.	Net Debt as % of GDP	125%		18%
9.	GDP Estimate	€ 182		

As of 31 December 2013. Highlights summarize the range of terms.

Greece Net Debt to GDP Ratio Using International Accounting Standards was 1/4 of Peers

(€, billions; 2013 data except as noted.)

		Greece	Peer Average	Post-Programme Countries			
				Ireland	Spain	Portugal	Italy
1.	Maastricht Debt/GDP	**175%**	**120%**	124%	94%	129%	133%
2.	GDP	€ 182		€ 164	€ 1,023	€ 166	€ 1,560
3.	Maastricht Debt (EDP)	€ 319		€ 203	€ 961	€ 214	€ 2,069

IPSAS/IFRS:

		Greece	Peer Average	Ireland	Spain	Portugal	Italy
4.	Gross Debt	€ 124		€ 189	€ 940	€ 185	€ 2,069
5.	Gross Debt/GDP	68%		115%	92%	112%	133%
6.	Financial Assets	€ 91		€ 65	€ 292	€ 69	€ 317
7.	Net Debt	€ 33		€ 125	€ 647	€ 116	€ 1,752
8.	Net Debt/GDP	**18%**	**80%**	76%	63%	70%	112%

		Greece	Peer Average	Ireland	Spain	Portugal	Italy
9.	IPSAS/IFRS Impacted Debt	€ 275		€ 62	€ 41	€ 72	€ 0

GREECE IPSAS/IFRS NET DEBT HAS BEEN INDEPENDENTLY VERIFIED ON 15 AUGUST 2014.

Note: Financial Assets data from Eurostat, Financial Balance Sheets 2013 data (accessed on 31 May 2014), except Ireland, Italy, and Spain (2012); Greece financial asset data also noted in the IMF, 5th Review for Greece, June 2014, page 51.

Accurate Debt Ratios Really Matter

Examples:

1. Debt ratios drive Greece **revenue and expenditure policies** designed by the "Partners".
2. Debt ratios drive eligibility to the **ECB's quantitative easing** programs and the level of collateral haircuts.
3. Debt ratios drive **borrowing costs** and **IMF DSA**.