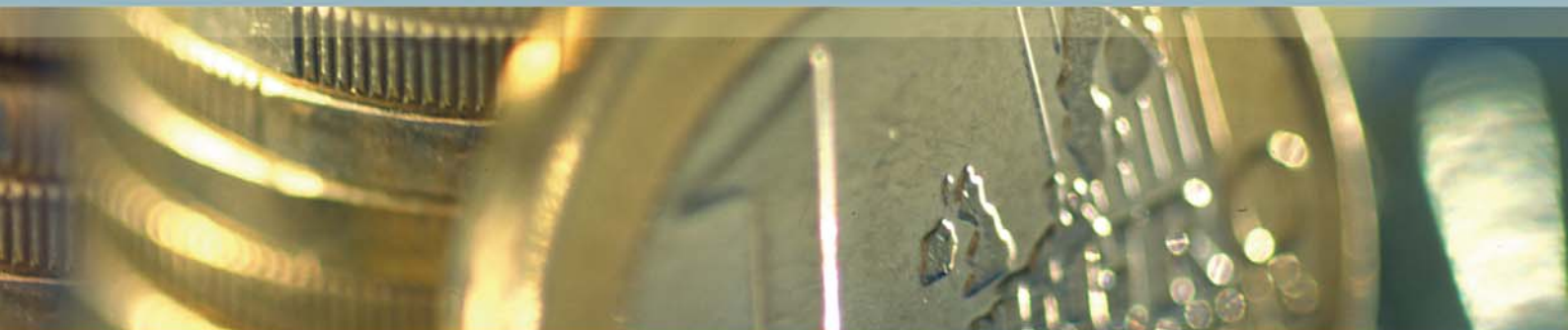


EUROPEAN ECONOMY

Occasional Papers 68 | August 2010



The Economic Adjustment Programme for Greece First review – summer 2010

Directorate-General for Economic and Financial Affairs

Occasional Papers are written by the Staff of the Directorate-General for Economic and Financial Affairs, or by experts working in association with them. The “Papers” are intended to increase awareness of the technical work being done by the staff and cover a wide spectrum of subjects. Views expressed do not necessarily reflect the official views of the European Commission. Comments and enquiries should be addressed to:

European Commission
Directorate-General for Economic and Financial Affairs
Publications
B-1049 Brussels
Belgium
E-mail: <mailto:Ecfin-Info@ec.europa.eu>

Legal notice

Neither the European Commission nor any person acting on its behalf may be held responsible for the use which may be made of the information contained in this publication, or for any errors which, despite careful preparation and checking, may appear.

This paper exists in English only and can be downloaded from the website
ec.europa.eu/economy_finance/publications

A great deal of additional information is available on the Internet. It can be accessed through the Europa server (ec.europa.eu)

ISBN: 978-92-79-16545-0
doi: 10.2765/69759

© European Union, 2010
Reproduction is authorised provided the source is acknowledged.

The Economic Adjustment Programme for Greece

First review – summer 2010

CONTENTS

Executive summary	7
1. Introduction	9
2. Macroeconomic developments	11
3. Financial markets and financial sector developments	15
4. Programme compliance and policy discussions	21
4.1 Fiscal policy	21
4.2 Structural fiscal reforms	27
4.3 Financial sector policy	35
4.4 Other structural reforms	39
4.4.1 Labour market	41
4.4.2 Business environment	43
4.4.3 Energy	46
4.4.4 Transport	49
4.4.5 Absorption of structural funds	51
4.4.6 Public enterprises and privatisation	53
5. Programme financing and treasury management	55
Annex 1 High-frequency indicators	57
Annex 2 Assessment of compliance with required action for the first review	60
Annex 3 Provision of data requirements	71
Annex 4 Updated macroeconomic forecast	74
Annex 5 Quantitative performance criteria	75
Annex 6 Financing gap projections	76
Annex 7 Statement by the European Commission, the ECB and IMF on the First review Mission to Greece	77
Annex 8 Updated programme documents	79
Letter of intent	79
Memorandum of Economic and Financial Policies	81
Memorandum of Understanding on Specific Economic Policy Conditionality	89
Technical Memorandum of Understanding	112

LIST OF BOXES

1. The economic adjustment programme for Greece	9
2. The effect of indirect taxation on inflation	13
3. Debt restructuring – Are market fears founded?	16
4. CEBS Stress Tests of Greek banks	20
5. From cash accounts to ESA95 accounts	24
6. The tax reform	32
7. The pension reform law	34

8. The Hellenic Financial Stability Fund	36
9. Potential growth	40
10. Opening up the electricity sector	48
11. Restructuring Greece's railway sector	51
12. State-owned enterprises and privatisation	53
13. Euro area stability support to Greece: main features	55

LIST OF TABLES

3.1 Banking sector soundness indicators	18
4.1 Summary of compliance with policy conditionality for the first review	21
4.2 Quantitative performance criteria and outcomes (EUR billion)	26
4.3 State budget execution (January to June 2010, cash data)	27
4.4 Payment claims	52

LIST OF GRAPHS

2. 1 Main macroeconomic indicators	11
2. 2 Correlation of output gap and inflation in Greece and the euro area (1998-2010)	12
3. 1 Market sentiment indicators	15
3. 2 Loan and deposit developments in Greece	15
3. 3 Bank interest rates on new deposits and loans vis-à-vis euro area residents	18
4. 1 Budgetary consolidation under the programme (EUR million)	22
4. 2 State budget cash balance (as of end June 2010)	27
4. 3 Developments of general government primary cash balance and spending compared to the end June performance criterion	28
4. 4 Public employment – Structure (June 2010) and changes (June 2009 to June 2010)	30
4. 5 Long-term change in age related expenditures at unchanged policy, prior to reform (2007 -2060)	32
4. 6 Long-term scenarios for government debt with and without pension reform	32
4. 7 Greek banks' borrowings from the ECB	36
4. 8 Strictness of employment protection legislation (OECD indicator)	43
4. 9 World Bank Doing Business 2010 rankings	43
4.10 Barriers to entry in services: composite indicator (1998-2008)	44
4.11 Regulation in professional service indicator (1996-2008)	46
4.12 Composite indicator of product market regulation in the EU (1998-2008)	46
4.13 Share of the largest electricity generator in the domestic market (2007)	47
4.14 Road transport – indicator based on the number of (semi-) trailers indexed to GDP	50

ACKNOWLEDGEMENTS

This report was prepared in the Directorate-General of Economic and Financial Affairs under the direction of Servaas Deroose, acting Deputy Director-General.

Contributors:

Servaas Deroose, Uwe Böwer, Giuseppe Carone, Declan Costello, Leila Fernández Stembridge, Luis García Lombardero, Loukas Kaskarelis, Filip Keereman, Daniel Kosicki, Paul Kutos, Sven Langedijk, George Moschovis, João Nogueira Martins, Elena Pavlova, Milda Valentinaite and Peter Weiss. Christos Zavos was responsible for the layout.

The report was prepared in liaison with the ECB.

Comments on the report would be gratefully received and should be sent, by mail or e-mail to:

João Nogueira Martins,
European Commission,
Unit ECFIN-F-3
BU-1 01-140
B-1049 Brussels
e-mail: joao.nogueiramartins@ec.europa.eu

EXECUTIVE SUMMARY

A joint EC/IMF/ECB mission visited Athens between 26 July and 5 August 2010. The aim was to assess compliance by Greece with the terms and conditions for the first review of the economic adjustment programme required for the quarterly disbursements of bilateral financial assistance from euro area Member States. The mission also discussed policy challenges ahead and an update and specification of the conditionality requirements for the next reviews. This report provides a detailed assessment of compliance and summarises the main findings of the mission.

Greece has managed **impressive budgetary consolidation** during the first half of 2010. It has also achieved **impressive progress in major structural reforms** which will help to transform the economy. Some of these reforms have been undertaken ahead of schedule.

While economic activity declined in line with projections, inflation has been significantly higher than previously forecast. The economy is expected to contract by 4 percent in 2010 and by some 2½ percent in 2011. Large indirect tax increases have pushed up HICP inflation to 4¾ percent in 2010. Inflation at constant taxes is falling and has declined below the euro-area average for the first time since Greece joined the euro area. Moreover, there is no evidence of a pass-through of higher prices to wages, and the recently signed national collective agreement contributes to moderating wage growth and improving competitiveness.

Fulfilment of obligations under the ambitious and frontloaded programme is found to be **largely on track**:

- **All budgetary performance criteria for June 2010 have been met.** Revenue performed below programme targets, but was more than compensated by a contraction of state expenditure beyond the target.
- **All fiscal measures foreseen to be taken in 2010 have been adopted.** In line with the requirements set in the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU), Parliament has adopted in May measures that generate savings for a total amount of 2.5 percent of GDP in 2010, plus carryovers of 1.1 percent of GDP for 2011. That brings total budgetary measures in four successive packages to around 8 percent of GDP in 2010.
- **Significant progress has been achieved in structural fiscal reforms:** Key reforms include the preparation of the new organic budget law, measures against tax evasion and steps forward in setting up a single payment authority for public wages. Significant progress has also been made in strengthening tax administration and in reforming public administration. Preparations are less advanced in the implementation of a system to monitor and control expenditure commitments.
- **Major steps forward have also been made in the broader structural reform agenda.** Business environment reforms, measures to accelerate absorption of structural and cohesion funds and horizontal legislation to implement the services directive are on track; major labour market and pension reform laws were adopted ahead of schedule, though they may require some further actions. The privatisation and restructuring of state-owned enterprises needs to be sped up and in many cases be more ambitious.

- **The Financial Stability Fund has been established and the Bank of Greece is committed to strengthen banking supervision.**
- **Efforts to improve the collection and processing of data which is essential for budgetary control need to be accelerated.**

Despite the significant progress made, **major challenges and risks remain:**

- **The main immediate challenge is to safeguard adequate liquidity and financial stability of the banking sector.** In this context, the authorities are committed to adopt legislation enabling a new tranche of government-guaranteed bank bonds for the amount of EUR 25 billion. Furthermore, following up on the results of the July 2010 CEBS stress tests, necessary measures will have to be taken for the bank that did not pass. A strategic vision on the future of the banking sector is also to be developed.
- **Slippages in budgetary execution in the second half of the year have to be avoided.** This requires close monitoring of revenue shortfalls, the accumulation of payables, state guarantees which may be called as the recession deepens, local governments and social security funds performance, catch up spending, and hidden deficits and debts in public enterprises. Should fiscal performance fall short of target, or revenue drop below schedule, the government has to stand ready to take corrective action.
- **The structural reform agenda needs to be pressed ahead to unleash the huge potential for raising growth.** While the policy discussion of the interim mission in June focused on fiscal policy, the July/August mission also paid particular attention to enhancing growth and competitiveness and strengthening public administration through structural reform. Decisive action on key reforms will bolster confidence in the adjustment programme, lowering risk premia and underpinning demand thereby speeding up the recovery. In addition to the pension reform and substantive labour market reform which are ahead of plans, other reforms that are scheduled for early implementation are transportation, where important progress has already been made with liberalisation of road haulage, and energy. Restoring competitiveness and boosting potential growth remains critical to the programme's success. The challenge facing the government in this regard will be to overcome resistance from entrenched vested interests to opening-up of closed professions, deregulation, implementation of the services directive, and elimination of barriers to the development of tourism and retail.

Next steps: Subject to approval by the Eurogroup, the overall positive assessment of compliance with the conditionality up to end June 2010 will allow releasing the next tranche of the loan agreement by mid-September. The euro-area share in the next disbursement is EUR 6.5 billion; the IMF adds EUR 2.5 billion for a total disbursement in September of EUR 9 billion.

1. INTRODUCTION

1. **This Report assesses compliance by Greece with the terms and conditions for the first review.** ⁽¹⁾ The assessment is based on Greece's report on 'The economic adjustment programme' ⁽²⁾ and the findings of the joint EC/IMF/ECB review mission to Athens of 26 July - 5 August 2010. It presents the progress, challenges and further policy steps towards meeting the objectives of the economic adjustment program for Greece of securing fiscal sustainability, safeguarding the stability of the financial system, and boosting potential growth and competitiveness (See Box 1).

Box 1: The economic adjustment programme for Greece

The origin of the crisis

Over the last decade, Greece's growth performance was based on unsustainable drivers: consumption and residential investment booms were accompanied by high real wage increases and rapid credit growth; low real interest rates associated with euro adoption and financial market liberalisation fed the boom. The 2008-2009 global crisis exposed the vulnerabilities, including:

- Unsustainable fiscal policies, partly hidden by unreliable statistics and temporarily high revenues;
- Rigid labour and product markets;
- Loss of competitiveness and rising external debt;
- While not at the origin, the banking sector was affected by the economic and confidence crisis.

The extent of the deterioration in the fiscal position was revealed late due to grave deficiencies in Greece's accounting and statistical systems. This delayed the implementation of corrective measures.

As concerns about Greek fiscal sustainability arose and global risk aversion heightened, market sentiment vis-à-vis Greece worsened sharply in early 2010. In April 2010, Greece asked for international financial assistance as it was confronted with sizeable financing needs and not able to access international capital markets.

On 2 May 2010, a joint European Commission/IMF/ECB mission concluded a staff-level agreement with Greece on an encompassing adjustment programme supported by financial assistance provided by the euro-area Member States and the IMF amounting to EUR 110 billion. A first tranche was disbursed in mid May 2010: EUR 14.5 billion paid by the euro-area Member States and EUR 5.5 billion by the IMF.

Programme objective

The overarching objective of the programme is to durably **restore Greece's credibility for private investors** by securing fiscal sustainability, safeguarding the stability of the financial system, and boosting potential growth and competitiveness. To this end, the programme consists of a comprehensive set of ambitious and mutually reinforcing policies.

Programme design

The fiscal leg of the adjustment programme has been designed to maximise credibility and enforceability by prudent macroeconomic assumptions, strong frontloading, implementation and legislation of difficult measures upfront, by fully specifying measures over the programme period and selecting measures of a structural nature. The

⁽¹⁾ The assessment is based on performance criteria and required actions by the Greek authorities to be complied with by end-June 2010 as set out in the Memorandum of Economic and Financial Policies (MEFP), the Memorandum of Understanding on Specific Economic Policy Conditionality (MoU), the Technical Memorandum of Understanding (TMU) and the Council Decision (2010/320/EU) of 10 May 2010. This Report is released together with Commission Communication "Follow-up to the Council Decision of 10 May 2010 addressed to Greece" (COM (2010) 439) of 19 August 2010.

⁽²⁾ The report submitted to the Council and the Commission by Greece on 6 August is available for download at: http://ec.europa.eu/economy_finance/sgp/deficit/countries/greece_en.htm.

programme also includes reforms to strengthen the budgeting system and fiscal framework to support the consolidation strategy for the coming years.

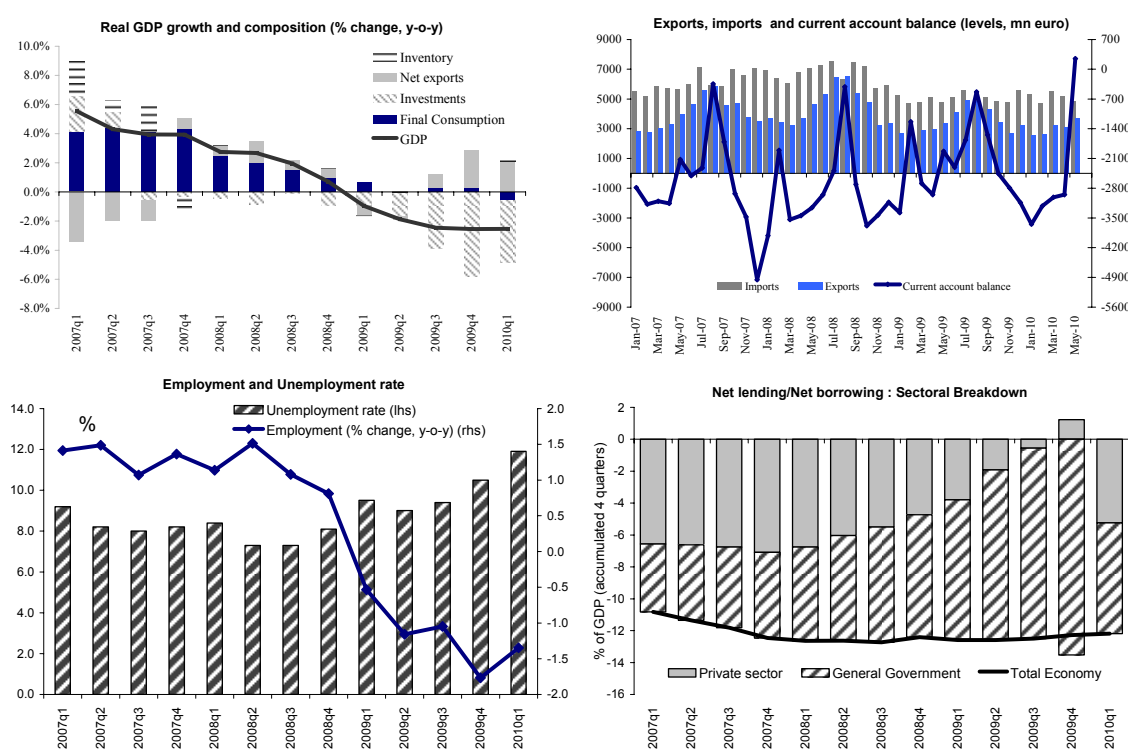
The financial sector policies aim at restoring confidence and ensuring long-run viability of the banking sector. To this end, the programme includes bank liquidity support in the short-term (approval of an additional EUR 25 billion tranche of government-guaranteed bank bonds), measures to recapitalise banks without prejudice to competition rules, the establishment of the Financial Stability Fund (FSF) and the need for a restructuring plan of the banking sector.

The structural reform agenda prioritises those reforms that have a large macroeconomic or budgetary impact in the short-to-medium run. Reforms to tackle undeclared work will broaden the scope of the formal economy, thereby increasing tax collection. Labour market reforms will spur job creation and increase wage flexibility. Product market reforms, namely in the services sector, will step up market contestability, reduce the rents of vested interest groups and help to curb price pressures. Other than efficiency aspects, reforms are also needed to improve equity, as they will increase job opportunities for young and long-term unemployed and improve access to services.

2. MACROECONOMIC DEVELOPMENTS

2. **Growth prospects remain largely unaltered.** Economic activity is weakening in line with expectations. The year-on-year decline in real GDP in 2010 Q1 was 2.5 percent (-1 percent quarter-on-quarter), reflecting a pronounced contraction in domestic demand, in particular public consumption and investment (See Graph 2.1). Private consumption was more resilient than expected, reflecting base effects (very weak 2009 Q1), seasonal factors (pre-Easter spending taking place in March), anticipation of the VAT increases by consumers (especially in cars and other durables) and possibly an improvement in retail sales reporting (a first favourable result of measures to tackle tax evasion). High-frequency indicators (see Annex 1) suggest that the decline in economic activity continued in 2010 Q2. ⁽³⁾ The annual projection for real GDP growth remains unchanged at -4 percent in 2010. Labour market developments are in line with the macroeconomic scenario of the programme. The unemployment rate was 11.6 percent (n.s.a) in March 2010, compared to 9.2 percent in March 2009. The current account deficit-to-GDP ratio declines slightly faster than expected due to a favourable denominator effect, but remains very large. In 2010 it would tighten to 10.6 percent of GDP.

Graph 2.1: Main macroeconomic indicators

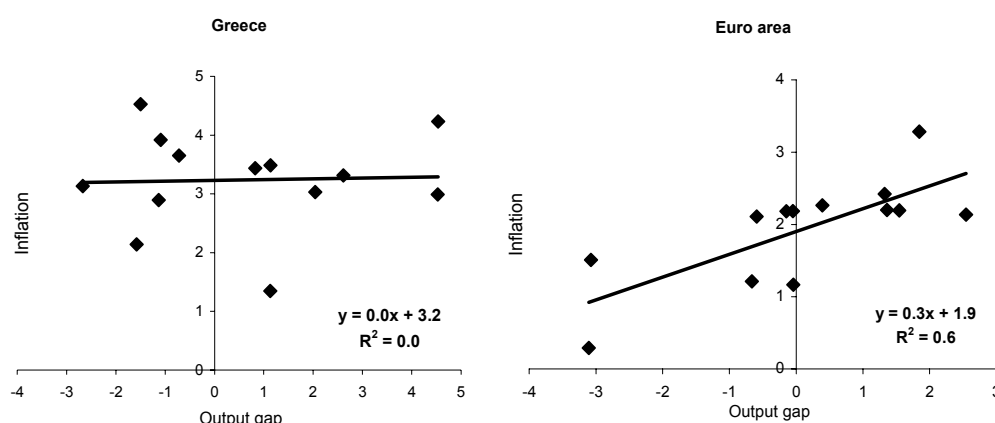


Source: Commission services.

⁽³⁾ Flash estimate on 2010-Q2 and revised data on Q1 were published on 12 August 2010 after the cut-off date (6 August) of this report.

3. **Inflation is revised upwards.** Price increases were much stronger than projected. In July, HICP inflation was 5.5 percent, well above the euro-area average estimated at 1.7 percent. The markedly higher-than-expected inflation rate reflected mainly the several increases in VAT and excises decided and implemented in January-July (Box 2). Considering price developments in the first half of the year, annual inflation in 2010 is now revised to 4¾ percent on average. The tax component exceeds 3 percent. Headline inflation is expected to peak at around 6 percent y-o-y in August; thereafter, price pressures are expected to ease, as base effects and tax effects fade out, and slack in the economy and wage moderation start feeding through. Given the impact of the very high annual average inflation in 2010 and the planned re-classification of goods currently subject to reduced VAT rate, the 2011 projection has also been revised upwards to 2.2 percent.
4. **There is little risk that high inflation will be entrenched and spill into wages.** Weak activity, public sector wage cuts and moderate wage developments in the private sector push unit labour costs down, after a long period of rapid growth. In that context, the 15 July 2010 agreement on limited increases in minimum wages in 2010, 2011 and 2012 marks an important break with the past. The agreement on minimum wages provides for a nominal wage freeze in 2010, a 1.5 percent rise in July 2011 and a 1.7 percent increase in July 2012. Though more pronounced wage moderation would have been desirable in 2011 and 2012, the agreement marks a major step towards wage formation in line with productivity and competitiveness considerations in the monetary union.
5. **The higher-than-expected inflation should not have a significantly adverse impact on competitiveness.** The taxation component of domestic prices is only partially transferred to export prices. However, tourism, a very important sector in Greece, is affected by the tax-driven price increases.

Graph 2.2: Correlation of output gap and inflation in Greece and the euro area (1998-2010)



Source: Commission services.

6. **The stickiness of the constant-tax HICP in face of the ongoing recession signals product market rigidities.** Comparing the apparent responsiveness of inflation to the output gap in Greece and the euro area confirms the stickiness of prices in Greece (Graph 2.2). There has been no correlation between output gap and inflation in Greece, while it is positive – as expected – in the euro area as a whole. In 2012-2015, as the impact of structural reforms in product and labour markets unfold and price flexibility increases, headline inflation should head much lower in Greece.

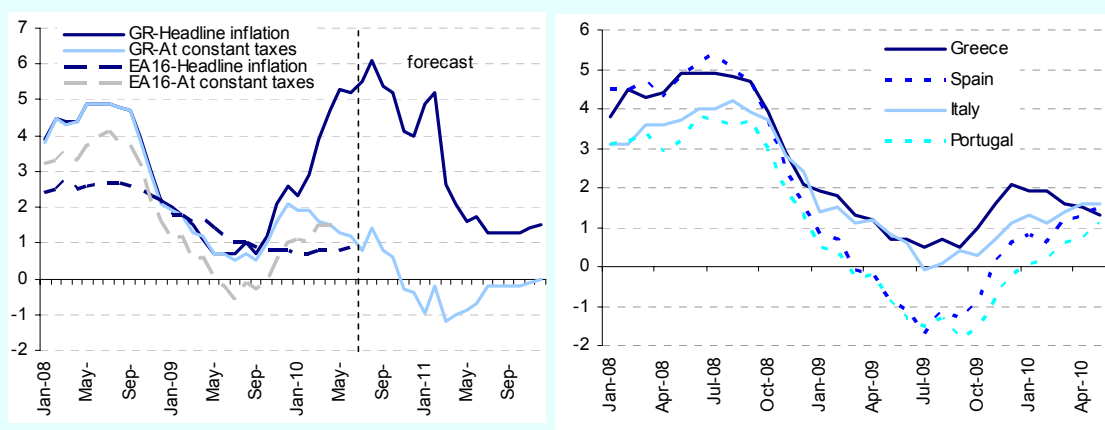
Box 2: The effect of indirect taxation on inflation

The recent increase in headline inflation has been largely tax-induced. Taxation has pushed up HICP. The inflation rate at constant taxes has fallen, but remained positive at 1.2 percent y-o-y in June. The large impact of taxes on inflation, in the context of a severe recession, provides evidence of inflexible domestic markets. VAT rises in mid-March have been fully passed through to consumer prices. The m-o-m price increases were even significantly higher than justified by the tax increase. This may point to ‘menu cost’ effects, with the occasion of the VAT increase to be used for larger price increases.

In the remainder of 2010 and in 2011, headline inflation will continue to be pushed up by indirect tax measures. The only small increase in headline HICP in July, VAT increases notwithstanding, provides evidence that the pass-through of tax measures to consumer prices may be gradually levelling off. The tax component of HICP is estimated at around 3½ percent in 2010 and 2¾ percent in 2011. The ongoing recession, possibly early effects of structural reforms and moderate wage agreements are affecting y-o-y constant-tax inflation. For the first time since 2004, it is expected to head into negative territory in 2010 Q4 and remain slightly negative in the course of 2011. Albeit unprecedented for Greece, prolonged periods of decreasing prices at constant taxes have been recorded in several countries at the onset of the financial crisis in 2009 (see Graph below).

High headline inflation favourably affects some programme indicators by the denominator effect. In particular, projections for government debt-to-GDP and the current account-to-GDP ratio are revised downwards. At the same time it should not significantly affect competitiveness. Taking into account very low constant-tax inflation and decreasing labour cost, the underlying competitiveness developments are favourable.

Graph: HICP inflation developments and projections (% change, y-o-y)

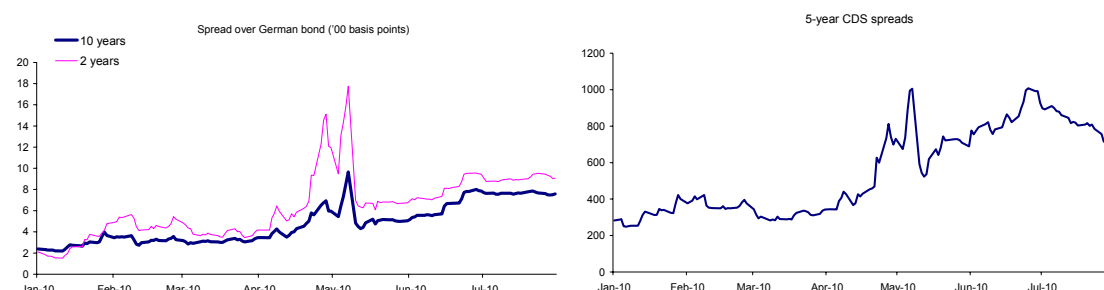


Source: Hellenic Statistical Authority and Eurostat.

3. FINANCIAL MARKETS AND FINANCIAL SECTOR DEVELOPMENTS

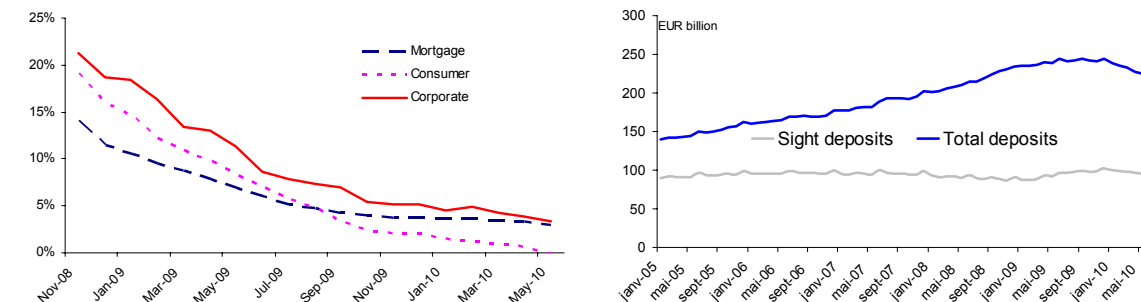
7. **Market sentiment has improved markedly since end June.** Greek government bond yields initially fell sharply from their May peak level (Graph 3.1.) as agreement on the economic adjustment programme and financial assistance package supported investor confidence, with crucial support from ECB purchase operations. As a result, the benchmark 10-year government bond yields in mid-May promptly dropped by 4 percentage points, while credit default swap spreads, a market indicator of sovereign default likelihood, abruptly narrowed. In mid-June Moody's Investors Service downgraded Greek sovereign debt rating by four notches, raising worries again and triggering an automatic exit of investors that could no longer hold securities rated below the investment grade. The impact of the downgrade started to fade away in July with fiscal data giving some support to the favourable outlook. Government bond yields stabilised despite shrinking ECB purchases and credit default swaps narrowed. T-bill auctions in July witnessed strong demand with increasing interest from foreign investors.
8. **While sovereign bond risk premia have come down, they remain high as markets price in a high risk of debt restructuring.** The programme does not foresee Greece to issue sovereign bonds until 2012. ⁽⁴⁾ Still, the high sovereign risk premia may adversely affect economic developments by spilling over into financial, corporate and household sector risk premia (see Box 3).

Graph 3.1: Market sentiment indicators



Source: Commission services.

Graph 3.2: Loan and deposit developments in Greece



Source: Commission services.

⁽⁴⁾ However, the programme foresees the continuous roll-over of short-term bills.

Box 3: Debt restructuring – Are market fears founded?

Government bond and CDS markets are pricing in a very high probability of Greek sovereign default, despite the economic adjustment programme. Some fear that the programme may not work as it requires immense fiscal effort and radical structural reforms, which are difficult to implement and may face fierce opposition by the Greek authorities or population. Others question Greece's debt sustainability and in particular the country's ability to raise money in the market after the programme funding ends. Finally, some argue that Greece will have a high incentive to voluntarily restructure unilaterally once it reaches a primary budget balance. These fears are unfounded:

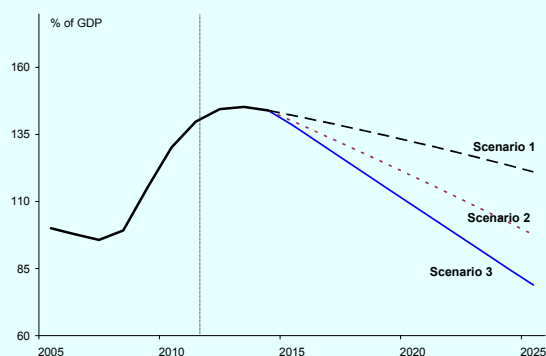
The programme is robust and Greece is abiding by it.

- **The programme is frontloaded** and more than half of the required budgetary consolidation measures up to 2014 have already been adopted by Parliament and are being implemented.
- **Assumptions on the effectiveness of measures and growth are prudent.** Over the whole period 2010-2014 the programme even assumes negative average real growth.
- **The authorities are fully committed** and closely cooperate with the European Commission, IMF and ECB. The programme is largely supported by the Greek population, while public discontent remains limited to the narrow affected groups. Overall, there is broad awareness that a change in the institutional fabric was needed.
- **The programme is on track.** The fiscal targets for the first half of the year have been met. Significant advance has been made in the field of structural reforms with some reforms (pension, labour market) being implemented ahead of schedule.

The combination of fiscal consolidation, institutional and structural reforms will ensure long-term debt sustainability.

- Debt dynamics are sustainable even under a conservative scenario and measures are in place to ensure the fiscal discipline.
- The impressive progress with the structural reform agenda will ensure that real GDP growth is likely to be higher than assumed in the conservative programme's projections.
- The pension reform considerably reduces future spending pressures. It can be considered one of the largest reforms in the EU in terms of reduction of projected expenditure increases.
- Public administration reforms support the capacity to durably control budgetary implementation.

Graph 1: Debt scenarios



Note on assumptions: Nominal growth rates: 2.0, 3.5 and 5.0 percent for the scenarios 1, 2 and 3.

Common assumptions: primary surplus: 5.5 percent of GDP; implicit interest rate: 4.8%.

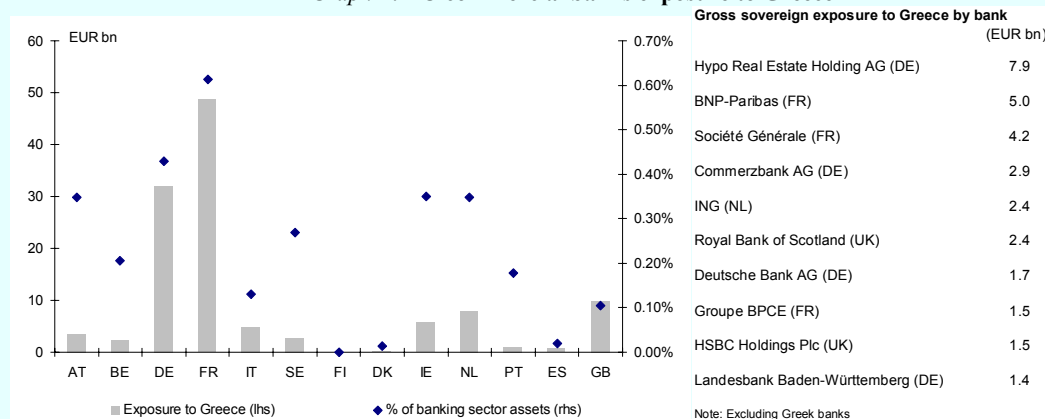
With the success of the programme, incentives for debt restructuring will decrease rather than increase. Sticking to prudent policies and delivering the results will gradually improve investors' confidence and drive risk premium down easing debt servicing costs. Moreover, as yields fall, the incentive to renege on the debt disappears. Risking to unravel years of efforts and reforms and regained credibility would not be rational.

Markets are overestimating the risk of default /debt restructuring and are underestimating the costs. Potential gains entail savings on debt servicing. The economic and social costs would, however, be enormous. The Greek authorities are making impressive progress towards putting government debt on a sustainable path avoiding the social misery that would be associated with the protracted economic disruption and broad financial crisis associated with debt restructuring. As the program's credibility is further established by meeting performance criteria and enhanced budgetary statistics, perceived risk of debt restructuring will come down further.

Not only would debt restructuring come at very high costs for Greece, also other euro-area countries would suffer high costs. EU commercial banks exposure to Greece amounts to EUR 120 billion, including both claims on the public and the private sector. It has been decreasing from its peak at EUR 140 billion in March 2008. French, German and British banks are most exposed in nominal terms, although claims on Greece represent a relatively small fraction of their balance sheets (Graph 2). Banks from other EU countries, including the Netherlands, Ireland and Italy, also hold a range of Greek assets in their portfolios. Government debt securities provide for a substantial share of the overall exposure. Finally, reputational damage would be exceptionally high for Greece.

All in all, debt restructuring is not an option.

Graph 2: EU commercial banks exposure to Greece



Source: BIS consolidated statistics, immediate borrower basis; data for March 2010. Data on individual banks based on sovereign risk disclosures published in the framework of the CEBS stress test. Note: for sovereign exposure of Greek banks see Box 4 on the CEBS stress tests

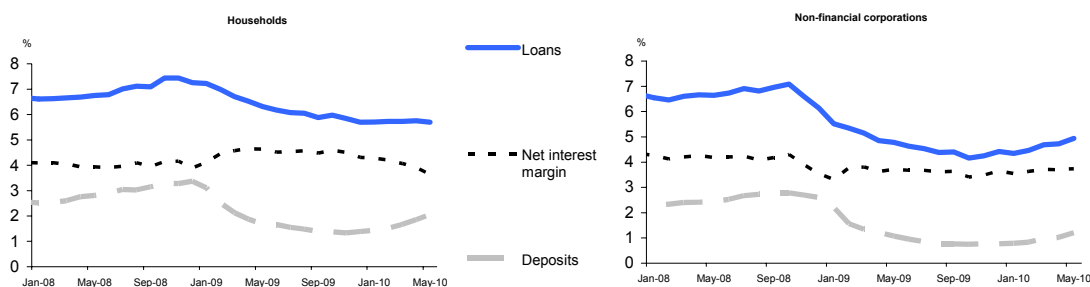
9. Loan growth is further decelerating and the deposit outflow slowed down but did not stop.

Against the background of the weak economic environment, credit growth continued slowing down in 2010 Q2 (Graph 3.2). In particular, consumer borrowing is low, while the decline in mortgage lending appears to be bottoming out. Loan growth has however remained positive throughout the crisis as the ECB provided ample liquidity. With the financial situation in Greece remaining fragile, deposit outflows have continued, albeit at a somewhat reduced pace recently. As previously, mainly large deposits have been withdrawn with little movement in retail deposits.

10. The interest rate margin of banks is under pressure. The liquidity needs of the banking sector and the competition for deposits led to an increase of interest rates on new deposits since the beginning of 2010. However, while the average interest on new loans for households remained broadly stable, both

in the housing and consumer lending, it has been increasing for loans to non-financial corporations (Graph 3.3). All in all, the intermediation margin in the household compartment is declining and broadly flat in the corporate segment.

Graph 3.3: Bank interest rates on new deposits and loans vis-à-vis euro area residents



Source: Bank of Greece

11. **The banking sector suffered from losses on impaired loans and trading books.** In 2010 Q2, the banking system capital ratio declined by 0.05 percentage points to 11.7 percent. The non-performing loans increased from 5 percent in 2008 and 7.7 percent in December 2009 to 8.2 percent in March 2010 (Table 3.1). Banks reacted by accumulating provisions for loan losses. By the end of 2010 Q1, the average coverage ratio slightly grew after three years of decline. The increase in provisioning, especially in the domestic lending portfolio, combined with the slump of value of government bonds held in the trading portfolios, resulted in heavy losses. Profitability (measured by return on assets and return on equity) fell to -0.6 percent and -8.7 percent, respectively, at the end of March.

Table 3.1: Banking sector soundness indicators

(In percent)	2005	2006	2007	2008	2009	Q1 2010
Regulatory capital to risk-weighted assets 1/	13.2	12.2	11.2	9.4	11.7	11.7
Regulatory Tier I capital to risk-weighted assets 1/	10.9	9.9	9.2	7.9	10.6	10.6
Nonperforming loans to total gross loans	6.3	5.4	4.5	5.0	7.7	8.2
Bank provisions to nonperforming loans	61.9	61.8	53.4	48.9	41.5	42.8
Return on assets (after taxes) 2/	0.9	0.8	1.0	0.2	-0.1	-0.6
Return on equity (after taxes) 2/	15.9	12.7	14.8	3.2	-1.5	-8.7
Liquid assets to short-term liabilities 3/	47.0	46.5	48.0	50.0	56.9	57.4

Source: Bank of Greece. 1/ Data on a consolidated basis. 2/ On a non-consolidated basis, in accordance with IFRS. 3/ On an aggregate resident-based approach (i.e. commercial banks, cooperative banks and foreign branches).

12. **The six largest Greek banks participated in the stress tests conducted by CEBS.** According to published results, Agricultural Bank of Greece (ATE) would need a capital injection of about EUR 250 million to maintain the targeted 6 percent Tier 1 ratio under the stress scenario. The other five banks passed the tests (Box 4). Markets reacted positively and stock prices of Greek banks initially rose. When publishing the results, the Bank of Greece said it would closely monitor the situation, while emphasising that scenarios are not forecasts and urging the bank that failed the test to take the necessary steps to bolster its capital adequacy.

13. **Prior to the publication of the stress tests results, Piraeus Bank made an unsolicited take-over bid on two state-owned banks: ATE and TT Postbank.** While the move towards consolidation of the Greek banking sector is welcome, the relatively poor performance of Piraeus Bank in the tests prompted comments that one of the bid's objective was to turn attention away from the bank's own solvency problems. Piraeus Bank's offer of EUR 372 million for ATE and EUR 329 million for TT translated to about a 30 percent premium over TT Postbank's market value and a 50 percent discount for ATE. ⁽⁵⁾ This operation would be financed by a raise of fresh capital targeted at above EUR 1 billion, which should also allow Piraeus Bank to pay back the preference shares received in 2009 and thus free itself from the EU state aid constraints which impede take-overs. The new entity that would result from the take-over would be the second largest bank in Greece with EUR 100 billion of assets and 20-25 percent market share. The acquisition of TT Postbank and ATE with their large and stable deposit pools would improve the liquidity situation of Piraeus Bank and, according to its own assessment, it would generate economic synergies in the banking sector of EUR 300 million per year. The government announced it would consider the offer. According to the EU competition rules, the sale of the state stakes in ATE and TT Postbank will require an open tender.

⁽⁵⁾ The offer excludes preferred shares on ATE held by the Greek government.

Box 4: CEBS Stress Tests of Greek banks

In May-July 2010, the Committee of European Banking Supervisors (CEBS) in cooperation with the European Commission and the ECB coordinated the stress test of 91 large European banking groups. The main objective was to estimate capital levels of participating banks at the end of 2011.

The adopted benchmark for passing the test was Tier 1 capital ratio at 6 percent, which is two percentage points above the EU regulatory minimum. The results published on 23 July revealed seven banks in three EU countries failing the tests, including Agricultural Bank of Greece (ATE). Apart from their capital estimates, participating banks also disclosed their total nominal exposures to sovereign risk (See Table).

The focus of the exercise was on the impact of credit risk and market risk on capital adequacy, while liquidity risk was not directly tested. The downward pressure on capital ratios was stemming mostly from impairment losses and trading losses. The tests were conducted according to three macroeconomic scenarios: the *Base* scenario, relying mainly on the Commission services' spring 2010 forecasts, the *Adverse* scenario, developed by the ECB, and the *Extreme* scenario, including a sovereign risk shock. For each scenario, a set of key variables, including GDP, unemployment, inflation, interest rates and real estate prices, was provided on a country-by-country basis.

The six largest Greek banking groups: National Bank of Greece (NBG), EFG Eurobank, Alpha Bank, Piraeus Bank, ATE and TT Hellenic Postbank participated in the stress test. High capital levels at the end of 2009 allowed four out of six banks to remain above the 6 percent Tier 1 benchmark even under the most adverse conditions. Piraeus Bank passed the test with 6 percent Tier 1 ratio and for ATE, the Tier 1 ratio fell to 4.4 percent in the Extreme scenario.

Table: Stress test results for Greek banks

Bank	Tier 1 ratio (%)				Exposure to Greek government (EUR bn)		
	31.12.2009	31.12.2011			31.03.2010		
		Estimate by scenario:			Gross exposure	of which:	
		Base	Adverse	Extreme		Banking book	Trading book
NBG	11.3	11.7	9.6	7.4	19.8	18.1	1.6
Eurobank EFG	11.2	11.7	10.2	8.2	7.5	7.4	0.1
Alpha Bank	11.6	12.3	10.9	8.2	5.1	4.9	0.2
Piraeus Bank	9.1	10.9	8.3	6.0	8.3	7.2	1.1
ATEbank	8.4	10.7	8.9	4.4	10.2	9.5	0.7
Postbank	17.1	17.0	15.0	10.1	5.4	5.2	0.1

Source: Banks' websites

While commenting on the stress test results, Bank of Greece emphasised that under the *Base* scenario all six banks, which account for more than 90% of the Greek banking sector's assets, were above the 6% benchmark. Furthermore, it stated that while "the results under the adverse scenario reflect neither the present situation nor the possible immediate capital needs," it would monitor the situation and ensure that capital adequacy of banks is enhanced where needed. The EUR 10 billion Financial Stability Fund and EUR 1.2 billion still available from the 2009 recapitalisation scheme were recalled as a safety net being in place for Greek banks.

In a joint press release issued upon publication of stress test results, the CEBS, the EC and the ECB urged those banks having failed the tests to "reinforce their capital positions by private-sector means and by resorting, if necessary, to facilities set up by Member State governments."

4. PROGRAMME COMPLIANCE AND POLICY DISCUSSIONS

14. **The government has made a vigorous start with implementing its economic program.** The fiscal program is progressing well, financial sector policies are being strengthened, and structural policies are ahead of schedule in key respects.
15. Annex 2 provides a detailed assessment of compliance with the specific required actions for the first review (to be completed by 2010 Q2 as set in the MoU). Annex 3 provides an overview of compliance with data provision requirements.

4.1. FISCAL POLICY

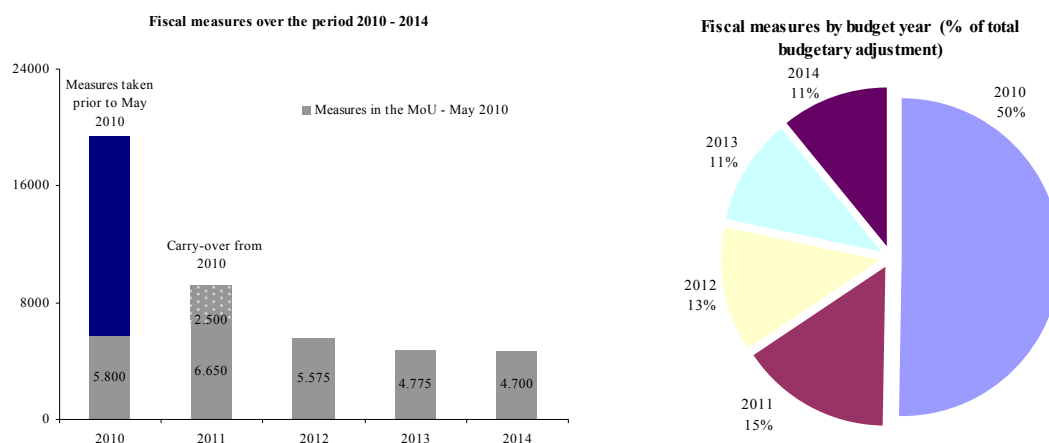
16. **The quantitative budgetary performance criteria for June 2010 have been met.** Strong expenditure restraint compensated for weaker than anticipated state revenue. All cash-based indicators were above their respective floor or below their ceiling as required by the programme. Continuing lack of timely, consistent and reliable budgetary accounting beyond central government renders assessment and control of budgetary developments at general government level problematic.

Table 4.1: Summary of compliance with policy conditionality for the first review

	Compliance with conditionality	Comments
Fiscal policy	Observed	All fiscal measures foreseen to be taken in 2010 have been adopted. All budgetary performance criteria for June 2010 are met. State and general government revenue performed below programme targets, but this was more than compensated by contraction of expenditure at central level beyond the target.
Structural fiscal reforms	Largely observed	The new organic budget law, measures against tax evasion and steps forward in setting up a single payment authority for public wages are on track. Preparations are less advanced in the implementation of a system to monitor and control expenditure commitments. Progress with improving tax administration efficiency and public administration in line with the programme. Also the major pension reform was adopted ahead of schedule, though adjustments will be necessary in the course of 2011.
Financial policy	Observed	The Financial Stability Fund has been established and the Bank of Greece is committed to intensify supervision.
Other structural reforms	Largely observed	Business environment reforms, measures to accelerate absorption of structural and cohesion funds and horizontal legislation to implement the services directive are on track. The privatisation and restructuring of state-owned enterprises needs to be speeded up and in some cases made more ambitious. Although a major labour market reform has been adopted ahead of schedule, there are still some required actions to be followed.
Data provision	Broadly observed	Most data was provided on time; some data was submitted late, while other data was not available. Efforts need to be intensified to improve the collection and processing of general government data which is essential for budgetary control.

Source: Commission services.

Graph 4.1: Budgetary consolidation under the programme (EUR million)



Source: Commission services.

17. **All required fiscal consolidation measures for 2010 have been fully adopted in the first half of the year.** In line with the requirements set in the MoU, the government adopted in May 2010 additional fiscal measures that are estimated to generate savings for a total amount of 2.5 percent of GDP in 2010 and carryovers of 1.1 percent of GDP for 2011. (See Annex 6 with overview of measures). Total budgetary measures, adopted in four successive packages, are quantified at around 8 percent of GDP in 2010. These measures are projected to reduce the government deficit from 13.6 percent of GDP in 2009 ⁽⁶⁾ to 8 percent in 2010, while the economy is in recession. This implies that fiscal consolidation is heavily frontloaded ⁽⁷⁾ (See Graph 4.1).

18. **State budgetary quantitative performance criteria for end-June were met.** According to the June 2010 cash data by the General Accounting Office (GAO), the state cash deficit shrunk by 46%, as compared to the respective period in 2009, compared to a targeted annual contraction of 40%. This sharp reduction beyond target was mainly the result of sharply lower-than-expected expenditure, which more than offset lower-than-expected revenue. Total state cash expenditure were reduced by almost 17% compared to the first half of 2009, while the official target reduction of expenditures for the year as a whole is 5.3%. This contraction mainly reflects primary expenditure cuts (including public wages) and squeezing capital expenditure, on the back of the implementation of the consecutive fiscal packages, while some additional expenditure savings adopted in May have not

⁽⁶⁾ Eurostat has not yet validated the 2009 government deficit and debt data notified by Greece. On 22 April 2010, Eurostat informed that, following completion of the investigations that Eurostat is undertaking in cooperation with EL.STAT on several issues (in particular, the sectoral classification of a number of public enterprises and the accounting of off-market swaps, as well as the need of more detailed and accurate data on social security revenue and expenditure), the 2009 government deficit ratio could be revised upwards by 0.3 to 0.5 percent of GDP, and the debt by 5 to 7 percent of GDP (see Eurostat News Release N° 55/2010).

⁽⁷⁾ The size of the required fiscal consolidation measures over the period 2010-2014 – 18 percent of GDP, including measures announced before May 2010 – exceeds by far the required reduction in the government deficit as the deficit would continue increasing at unchanged policies, reflecting, inter alia, negative real GDP growth, an increase in interest expenditure and unemployment benefits, and a higher public wage bill and pensions.

been fully reflected in the available data. Interest expenditure (on a cash basis) in turn, remains below budgeted targets, having to do with the calendar of interest payments and should return to normal, as reflected in the target, in the coming months. Total cash revenue increased by 5.9 percent in the first half while an annual increase of 15.6 percent is targeted for the year as whole. A considerable pick-up can be expected in the second half, as the full effect of the VAT and excise increases will feed through. However, it is likely that the revenue target will not be reached. The shortfall from revenue projections is however at odds with higher than projected nominal GDP growth and a tax-favourable growth composition. This suggests that reforms in tax administration and the fight against tax evasion have not yet given tangible results and need to be accelerated.

19. **Despite slippages, the performance criteria for the general government have also been met, thanks to the overachievement of state-level targets.** According to monetary statistics-derived data provided by the Bank of Greece for the first half of the year, local government cash balance remained at a surplus, albeit slightly smaller than previously projected; the social security funds' cash balance remained at deficit, instead of a surplus targeted. Moreover, there has been an accumulation of accounts payable in some cases beyond their due dates (arrears) in public hospitals, but also in transfers and other payments within general government units. The combined balance of the sectors other than state is on balance in the first half of the year, instead of an initially projected surplus of some $\frac{1}{4}$ percent of GDP.
20. **The overall stock of central government debt in end-June 2010 stands at EUR 317 billion,⁽⁸⁾ thus meeting the relevant performance criterion.** The trajectory of the debt-to-GDP ratio is significantly lowered in the macro-projections in line with the higher level of nominal GDP due to larger than expected price increases. General government debt – under the current definition of general government – is now projected to peak at 145 percent of GDP in 2013 rather than just below 150 percent of GDP.⁽⁹⁾
21. **However, there are significant budgetary risks during the remainder of 2010, with the revenue side being more vulnerable.** The government is committed to tight expenditure control, also stepping up efforts to enhance revenue collection, in order to consolidate under-spending and avoid revenue slippages. Fiscal risks may arise particularly in the following areas:
 - **State revenue:** Tax revenue has been performing below targets over the first half of the year, although the efforts to improve tax compliance and fight tax evasion have been intensified. Tax revenue in the second half of the year is expected to recover on the back of the full implementation of the revenue enhancing measures already legislated, such as the second VAT rate increase. Nevertheless, as the economy is deepening in the recessionary phase, the anticipated recovery might not be sufficient for the annual state revenue to meet the programme's targets.

⁽⁸⁾ Note that the general government consolidated gross debt (the 'Maastricht debt') is slightly smaller than the central government debt as part of the central government debt is held by social security funds and thus consolidated.

⁽⁹⁾ See footnote 6 on the expected reclassification of a number of public enterprises under general government leading to an increase in government debt which is projected in the range of 5 to 7 percentage points of GDP.

- **Accounts payable:** The cash balance for the general government, which has been over-performing in the previous months, can be easily distorted by arrears or accounts payable accumulation (both to the private sector and other government entities like social security funds), which are not recorded as payments. As in the past, risks for the accumulation of accounts payable concerns mainly health spending but also other sectors are affected.
- **Called Guarantees:** Guarantees may be called at an accelerated pace when the economy deepens in recession and some public enterprises encounter difficulties rolling over their debt. The authorities have estimated the amount of guarantees to state-owned enterprises' debts (and to a smaller extent private sector's) which are likely to be called in 2010 at 1.5 billion.
- **Local governments and social security funds.** So far performance of local governments has fallen short of program projections. The same applies to the fiscal performance of the social security funds. Upcoming local elections and deepening recession might induce further slippage. The fact that there is no consistent infra-annual data for these entities hampers a more detailed assessment of developments in those sectors. The underperformance of these sectors may, however, be related to delays in transfers to be paid by the state.
- **Catch-up spending.** Catch-up spending in the second half is anticipated, including for operating expenditure. While monthly spending has been much lower than planned in the first half of 2010, on the back of the restraining expenditure efforts by the authorities, there are obligations generated that will be settled in the second half of the year, as they take longer to be executed.
- **Public enterprises.** Government needs to speed up efforts to establish cost recovery in public enterprises, to reduce the risk of increased subsidies or other transfers with negative fiscal impact.

Box 5: From cash accounts to ESA95 accounts.

The target for the annual general government deficit (EUR 18 508 million for 2010) is defined according to ESA95, the European System of National and Regional Accounts. For each of the EU Member States, ESA95 data are only available after relatively long lags: the first notification of actual data for a complete year takes place at the end of March and data are then scrutinised and validated by Eurostat during the third week of April. ESA95 data are then subject to revision for a number of years. There are also quarterly ESA95-based government accounts. However, given the lag in their publication (3 months) and frequent revisions, those data are not adequate for a close monitoring of fiscal developments in real time.

The quantitative fiscal performance criteria (primary balance and state spending) under the economic adjustment programme for Greece are defined in a cash basis; they take into account a set of entities that does not cover the full general government, as defined in ESA95. There are relatively detailed monthly data for state revenue and expenditure. These data are published by the Ministry of Finance's General Accounting Office. For local government and social security funds, the balance concept that is monitored in a monthly basis is derived from the Bank of Greece's banking and monetary statistics.

To extrapolate the ESA95-based government deficit from the available cash figures, one needs to take into consideration a number of adjustments. Although they are usually referred to as cash-accrual adjustments, they also include other adjustments, like extending the sector to include extra-budgetary funds, and including a number of financial transactions like the takeover of liabilities by the state because guaranteed have been called.

Table 1 summarises the adjustment from the ‘cash’ accounts to the ESA95 accounts for the year 2010 as whole as estimated by the Commission services. The deficit-increasing adjustments (i.e. adding to the cash balance to approach the ESA95-based government deficit) concern the projected balance for extra-budgetary funds, the difference between cash outflows and deliveries in relation to military equipment procurement, guarantees called (these refer mainly debts owed by public enterprises, but the accounting would be identical for guarantees to private enterprises’ liabilities) and accounts payable. The accounts payable at the end of the year have been explicitly projected for healthcare-related spending only. It assumes that all payables in relation to procurement of pharmaceuticals and other medical supplies past their due date (arrears) will be settled by the end of 2010; therefore, the payables correspond to the normal lag in payments to suppliers of around 3 months. The deficit-decreasing adjustments (i.e. reducing the ESA95-based government deficit) refer to taxes pending collection (by convention a number of taxes collected in January and February 2011 are allocated to the 2010 accounts; one needs also to subtract the corresponding amounts of January and February 2010). A similar adjustment applies to structural funds-related flows, taking into account the usual lag between submission of payment claims to Brussels and the actual payments by the EU budget. Other than differences in the payment and accruing of interest on government debt, one should also consider that the settlement of accounts payable at the beginning of 2010 is included in the ‘cash’ data, but should be excluded from the ESA95 accounts. (*)

Table 1: Annual adjustment from cash accounts to ESA95 accounts
(estimate of end-July 2010)

<i>in EUR million</i>	
Extra-budgetary funds (balance)	500
Military procurement (difference between deliveries and cash)	300
Guarantees called	1500
Accounts payable	1000
Health (public hospitals)	600
Health (private clinics and suppliers)	400
Local government	0
Deficit increasing sub-total	3300
Tax-related time adjustment (accounts receivable)	1132
Direct taxes	427
Indirect taxes	705
Social contributions	0
Structural funds time adjustment	650
Hospitals spending, accrued in 2009 and paid in 2010	245
Interest	0
Deficit decreasing sub-total	2027
Total (deficit increasing)	1273

Table 2: Required cash balance and maximum state primary spending to reach the ESA95 target (2010)

<i>in EUR million</i>	
Ceiling for general government deficit (ESA95)	18508
Estimate for cash-to-ESA95 adjustment	1273
Required ceiling for cash balance to respects the ESA95 target	17235
Performance criterion (ceiling) for state primary spending	67000
Required state primary spending to reach ESA95 target	63106
Difference (required underexecution of state primary spending to respect the ESA95-defined government balance)	3894

Table 2 shows that to reach the ESA-95 defined balance target, the cash balance should not exceed EUR 17 235 million; this is below the end-year cash balance performance criterion. In other words, the ESA95-defined balance ceiling is more stringent than the cash-defined performance criterion.

Moreover, given the likely revenue shortfalls in revenue and slippages in local government and social security accounts, respecting the ESA-95 defined balance target requires the state to spend almost EUR 4000 million less than the state primary spending performance criterion.

(*) In the course of 2010, the Greek government has settled EUR 5.36 billion in long-due arrears to healthcare suppliers. This amount has been recorded as deficit-increasing in the accounts of 2009 and earlier years. By convention, it has not been included in the 'cash' accounts that are subject to monthly monitoring, and therefore no adjustment in relation to this payment is necessary when going from 'cash' to ESA95 accounts.

22. The government is committed to keep state budget primary spending below the annual ceiling by about EUR 4 billion, focusing on operating expenses – and if need be investment – while making all required transfers to the social security funds and local governments to allow them to become current in their payments (Jan-June state budget primary spending was EUR 5.6 billion below target). In addition, should performance run short of target, or revenue drop below schedule, the government stands ready to take corrective action, including if necessary curtailing domestically-financed investment. In addition to controlling for these budgetary risks, cash-budgetary performance criteria will have to be significantly overachieved in 2010 to meet the accrual-based criteria (defined according to the ESA95 rules). The ceiling for the ESA95-based accrual deficit is EUR 18.508 million. On the basis of the initial projections, this corresponds to 8% of GDP. Given a higher-than-projected nominal GDP on the back of higher prices, this deficit ceiling corresponds to 7.8% of GDP.

Table 4.2: Quantitative performance criteria and outcomes (EUR billion)

Quantitative performance criteria and outcomes (billions of euros)		
	Actual data end June 2010	QPC June 2010
General government primary cash balance	-4.26	-5.0 (floor)
State budget primary spending	28.4	34 (ceiling)
Overall stock of central government debt	316.7	342
New guarantees granted by the central government	0.3*	2.0
Accumulation of external payment arrears on external debt contracted or guaranteed by general government from multilateral or bilateral official creditors	0	0

* excludes guarantees to EIB loans.

QPC: Quantitative performance criteria.

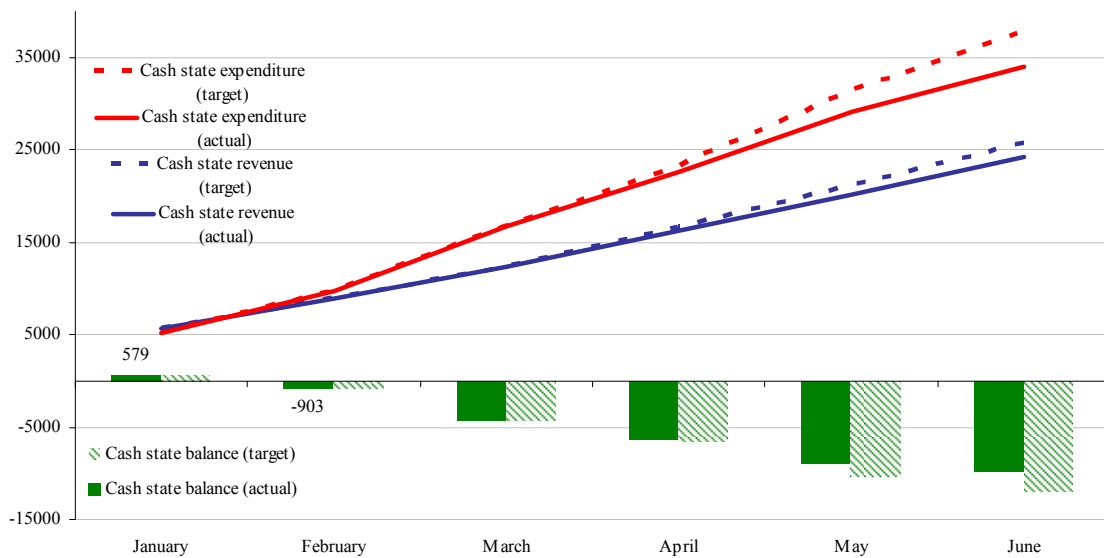
Source: Commission services.

Table 4.3: State budget execution (January to June 2010, cash data)

on cash basis (EUR million)	2009	2010	%Δ	2009	2010	%Δ
	Jan - June	Jan - June		Data	Programme	
Total revenues	22831	24180	5,9%	50509	58382	15,6%
Revenue before refunds	24639	26062	5,8%	53420	60224	12,7%
Tax refunds	2450	2266	-7,5%	4952	5100	3,0%
Capital revenue	642	384	-40,2%	2041	3258	59,6%
Other				0	0	
Total expenditures	40697	33824	-16,9%	81390	77318	-5,0%
Primary expenditure	27945	24398	-12,7%	57975	54856	-5,4%
Interest	6612	5731	-13,3%	12325	13017	5,6%
Capital expenditure	6140	3695	-39,8%	9588	9200	-4,0%
Other	0	0		1502	245	-83,7%
State Budget balance	-17866	-9644	-46,0%	-30881	-18691	-39,5%

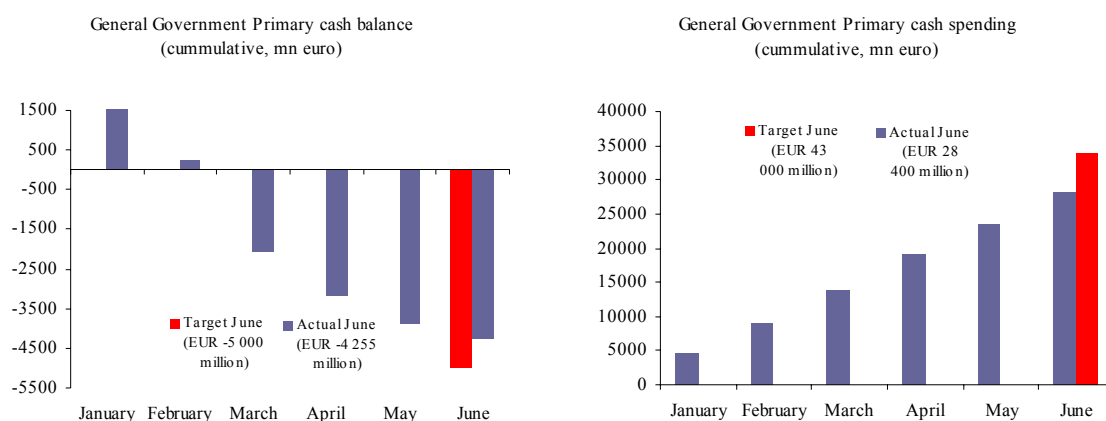
Source: Commission services.

Graph 4.2: State budget cash balance (as of end June 2010)



Source: Commission services.

Graph 4.3: Developments of general government primary cash balance and spending compared to the end June performance criterion



Source: Commission services.

23. **Lack of timely and reliable budgetary data and accounting beyond state level renders assessment and control of budgetary developments at general government level problematic.** Ongoing implementation of reforms – helped by technical assistance programmes - to strengthen public financial management as required under the programme should improve the availability of data and budgetary control in the near future.
24. **Improving the public financial management and revenue administration is critical for the success of the large fiscal consolidation without recurring excessive risks of slippages and adverse fiscal surprises.** The new organic budget law will contribute by strengthening the legal basis for budget preparation, approval, and control also at general government level. Its implementation should contribute to improved budgetary procedures from the 2011 budget process. This is all the more important considering that the measures in the 2011 budget are of a less certain and robust nature than those in 2010. In particular, savings related to the reform of the local governments (the so-called Kallikratis reform) and additional revenues as a result of enhanced tax administration cannot be projected with precision. Against this background, enhanced expenditure control and stepped-up efforts to strengthen tax collection will be essential for safeguarding fiscal targets.

4.2. STRUCTURAL FISCAL REFORMS

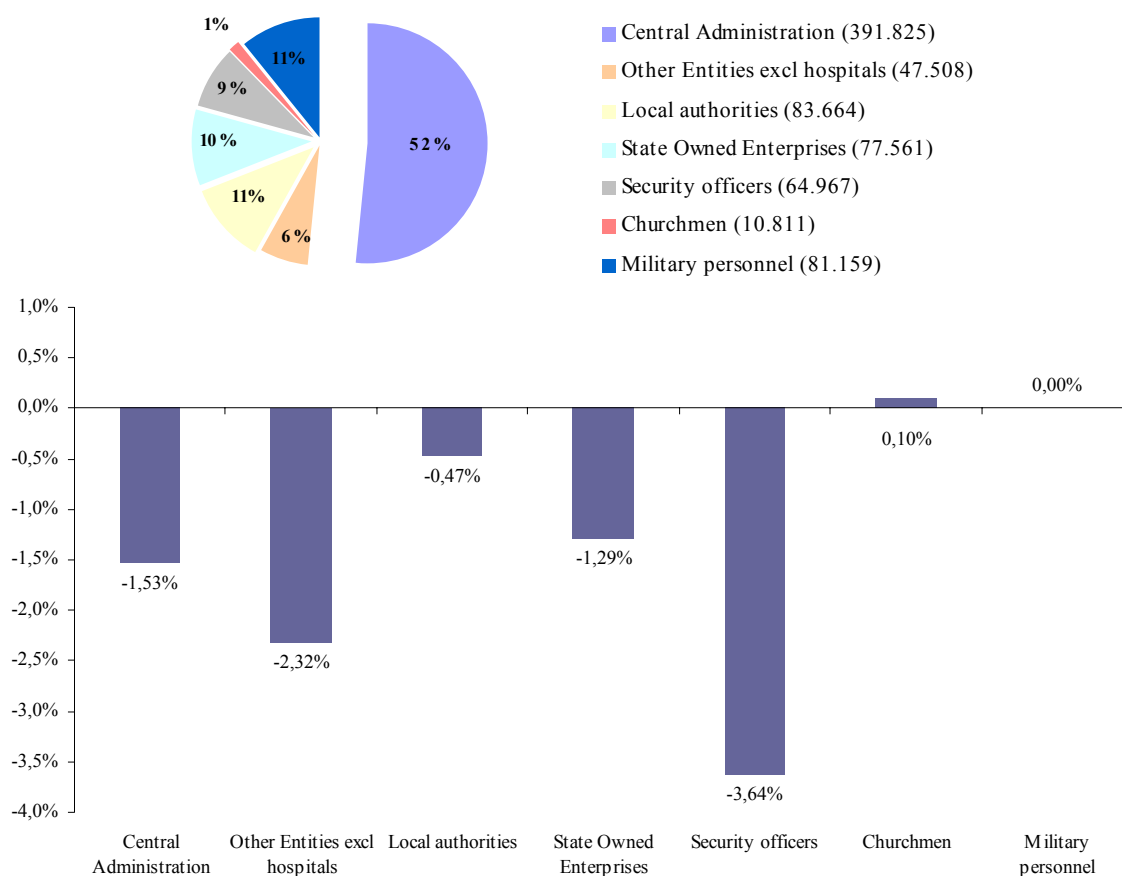
25. **Modernising public administration and increasing transparency is essential for a sustainable improvement in public finances.** In the short run, successful programme implementation relies on enhanced tax collection and expenditure control, based on better reporting and monitoring. In the medium run, it allows also delivering cost effective public services for businesses and citizens.

26. **Structural fiscal reforms are progressing in line with the ambitious programme requirements.**

Progress has been made with improving tax administration efficiency and public administration, including:

- Several initiatives have been taken to improve the efficiency of the **tax administration**, to **fight tax evasion** and **improve tax compliance**. Further efforts are needed to fully implement the *anti-evasion strategy* comprising a package of immediate intensified actions by specialist task forces to: (i) implement the new anti-evasion laws; (ii) collect large tax arrears; (iii) secure control over the largest 1 000 taxpayers; (iv) tackle evasion of high income self-employed and high wealth individuals; and (v) enforce tax return filing and payment; and a *medium-term structural reform program to modernise the tax administration* by: (a) establishing a risk-management framework and developing a comprehensive tax compliance strategy; (b) introducing modern taxpayer services; (c) re-building the tax audit function; (d) establishing a full-service large taxpayer office; and (e) introducing proven strategic and operational management practices and streamlining of the organisational structure (see Box 6).
- A new **organic budget law** requires multi-year top-down budgeting with expenditure ceilings for the state budget and deficit targets for the general government. The 2011 budget should be prepared accordingly, containing detailed information on outturn and plans of the entire general government sector, as well as key figures on the financial performance of the largest public enterprises. Significant challenges in the area of public finance management need to be addressed urgently, most notably in respect to the monitoring and control of expenditure commitments, where little progress has been made so far. The introduction of timely and detailed monthly cash-based general government fiscal reports and commitment controls by establishing commitment registers in all line ministries and public-law entities in order to prevent the accumulation of arrears is an important step forward.
- More effective control and management of public sector employment and wages is a key challenge. A **single authority for the payments of wages** for the public sector has been set up through which wages to all civil servants in central government should be paid by end 2010 and for the general government by March 2011. A **census of public employment** in the general government has been completed which will contribute to the work of the single payment authority, and plans to move in 2011 towards a **simplified remuneration system** covering basic wages and allowances. The first results from the census show that the total number of permanent staff amounted to more than 768 000 on 30 June 2010 (see Graph 4.4). It also showed that the number had been reduced already by more than 11 000 in the first half of the year.
- **Functional reviews of the central administration and social security** are scheduled to begin in the second half of 2010. These reviews which will identify operational policy recommendations to rationalise the organisation of public administration, including the reorganisation of human resources against the background of a decline in overall public sector employment.

Graph 4.4: Public employment – Structure (June 2010) and changes (June 2009 to June 2010)



Source: Ministry of Finance

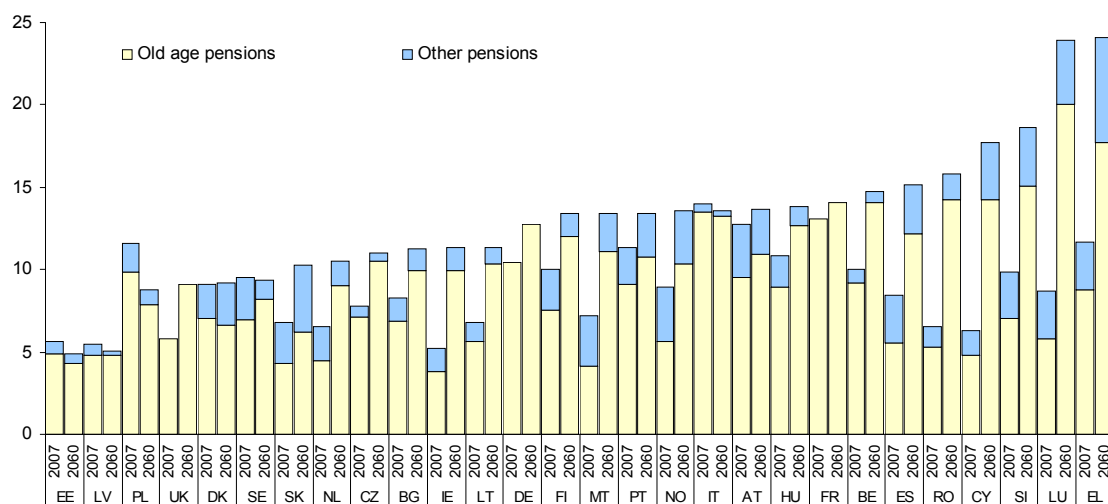
- Improvements are needed to **public procurement systems** in the Greek administration with a view to achieving better value for money and to facilitate the absorption of EU structural funds. The Greek authorities have committed to present an action plan in September 2010 leading to the creation of a central public procurement authority and to a fully fledged electronic procurement system. Progress is also being made in the transposition of two directives on public procurement.
- Legislation reforming **local public administration** has been adopted in May in the context of the so-called Kallikratis reform. This is a merger of local governments and a major reorganisation of relations across different levels of government which offers the potential for large budgetary savings and efficiency gains. Its success, however, hinges upon the effectiveness of a large number of implementing measures and actions. Moreover, there is a need to ensure that efficiency gains lead to effective savings that are cashed as a reduction in the deficit of the general government as a whole.

27. **A major pension reform has been adopted ahead of the September 2010 schedule.** Parliament approved two pension reform bills, on 8 and 15 July 2010 (for the private and public sectors,

respectively). The phase-in periods for increasing retirement ages and contributory periods are very short and the parametric changes should significantly improve the long-term sustainability of the pension system. The contribution of the reform to the long-term sustainability of the system shall be assessed by an overall set of long-term (2009-2060) pension projections to be provided by the National Actuarial Authority over the coming months. Before the reform, the projected increasing pension-related expenditure in Greece was one of the highest in the EU (see Graph 4.5).

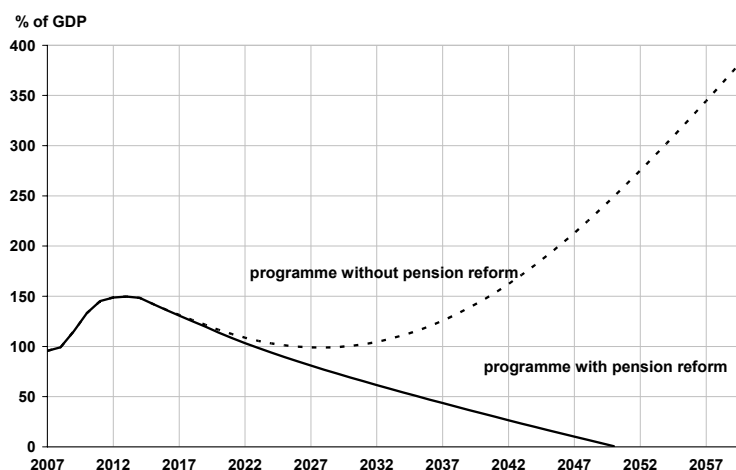
28. **However, some important aspects of the pension systems may have to be revisited over the coming months.** In particular, the modernization of the pension system has not yet involved the functioning of the supplementary/auxiliary public pension funds. Information on the functioning of the many supplementary funds is scarce. The new law introduces a provision that obliges the funds to provide the basic information to the National Actuarial Authority (NAA) in order to allow a proper assessment of the budgetary implications of these funds. According to the law (and the updated MoU), shortly after the publication of the long-term projection by the NAA, the main parameters of the funds, in particular the level of benefits paid, will be adjusted in order to stabilize pension expenditure and to guarantee the long-term sustainability of these funds. In addition, the revision (and significant reduction) of the list of heavy and arduous professions covering all current and future workers is also forthcoming (by 1 July 2011). Box 7 provides an overview.
29. **The reform will have a significant impact on public finances already within the next two decades.** Graph 4.6 shows debt scenarios based on the medium-term budgetary developments from the programme until 2014, which are then extended with the baseline macroeconomic scenario of the European Commission's 2009 Ageing Report. Without the pension reform, debt resumes increasing after initial stabilisation at around 100% GDP. If the reform is completed to meet its objective of curbing growth in pension expenditure below the euro-area average, public debt may keep declining.

Graph 4.5: Long-term change in age related expenditures at unchanged policy, prior to reform (2007-2060)



Source: Commission services

Graph 4.6: Long-term scenarios for government debt with and without pension reform



Source: Commission services

Box 6: The tax reform

A broad and ambitious tax reform was adopted by Parliament on 14 April 2010. The aim of the reform is to introduce a fairer and more efficient tax system, which is intended to simultaneously improve or even eradicate the weaknesses and defects in the tax system which has prevailed in Greece over many years in the past. It is expected to start generating additional tax revenue after the 2nd half of the year. In particular, efforts to widen the tax base for household and corporate income taxation (through the imposition of a unique taxation scale and elimination of

income tax exemptions) are expected by the authorities to increase tax revenue by some ½% of GDP, already in 2010. (*)

The following findings have paved the way and have been decisive for Government to proceed with a major tax reform in Greece:

- Low public revenue, disproportionate to government expenditure; (**)
- Low tax revenue-to-GDP ratio vis-à-vis the EU average; (***)
- The unfairness of the system;
- Pervasive tax evasion and tax avoidance;
- The conflicts in Greece's tax system (aimless tax exemptions, non-uniform taxation, etc.);
- Defective control mechanisms;
- Absence of strong motives and incentives for tax-payers to disclose their actual taxable incomes;
- Limited progressiveness in taxation scales;
- Factors which lead to falling tax awareness, e.g. transparency, complexity and complicated nature of the system, low quality public assets and services.

The main aim of the tax system reform is to tackle major shortcoming as identified by the authorities and international organisations, with a view to set-up a fair, redistributive, efficient, simple, transparent and sustainable tax system. To this end the areas that are subject to reform, are the following:

Personal income taxation

- i. Introduction of a single, progressive tax scale geared to the cost-of-living index for all incomes;
- ii. Abolition of uniform taxation and tax exemptions;
- iii. Taxation of corporate dividends according to the tax scales for personal income;
- iv. Generalization of proof of assets (origin principle) in tax returns;
- v. Accounting determination of income, for self-employed;
- vi. Introduction of a system to deduct receipts for goods and services from taxable income;
- vii. Taxation of the added value of long-term stock market transactions (speculation gains) through simultaneous offsetting of capital losses incurred.

Corporate taxation

- i. A distinction is made between distributed and retained profits;
- ii. Abolition of tax exemption/tax breaks for companies;
- iii. Imposition of the obligation to keep business accounts with banks, connection to the tax authorities' data systems and creation of an access option for the tax authorities;
- iv. Taxation of transactions with offshore companies;
- v. Monitoring of all transactions within a group of companies.

Property taxation

- i. Implementation of progressive taxation for major property owners from 2010;
- ii. Reintroduction of inheritance tax and tax for the so-called parental gifts, with a higher tax-free sum;
- iii. Enhanced monitoring and taxation on offshore properties.

In the context of the tax system reform, the government has launched a number of administrative actions with a view to intensifying the fight against tax and social contributions evasion, improving collection and to increasing compliance. The government expects to increase public revenue by more than ½% of GDP, already in 2010, as a

result of the fight against tax evasion. A similar amount is also expected to come from the fight against social contribution evasion.

- i. Upgrade of software for purposeful auditing and execution of tax audits on the basis of known data;
- ii. Verification of the origin of assets for all tax officials and introduction of measures against officials whose assets cannot be justified by their income. These measures will extend to suspension or dismissal of the official from office;
- iii. Electronic tracking and monitoring of the fuel market for the purposes of combating the black market;
- iv. Electronic and technological support for tax management;
- v. Expansion of services and systems for electronic administration on the Internet for the purpose of providing additional services for taxpayers;
- vi. Publication of the income and taxes of businesses and freelancers in Internet.

(*) Note however that for prudence reasons, the additional receipts from the fight against tax evasion have not been included in the currently available projections for government accounts for 2011 or later years.

(**) Whilst revenue (as a percentage of GDP) has steadily declined in recent years, from 40.9% in 2001 to 36.9% in 2009, public expenditure increased from 45.3% in 2001 to 50.4% in 2009.

(***) Tax revenues and social security contributions represent the largest, permanent source of public revenue. Greece's revenue from taxes is amongst the lowest in the EU (32.6% of GDP, compared with 39.3% of GDP on average in the EU-27). See Eurostat (2009), Taxation Trends in Europe—Main Results.

Box 7: The pension reform law

A comprehensive pension reform was adopted by Parliament, through two laws covering both the private sector and the public sector. The reform simplifies the current highly fragmented pension system; enhances transparency and fairness, postpones the retirement age and decreases the generosity of benefits, while preserving an adequate pension for the low-middle income earners.

The new universally binding rules on entitlements, contributions, accumulation rules and indexation of pension rights applies to the main pension funds (IKA, OGA, OAEE, public sector scheme, Bank of Greece scheme). The pension reform will be applied pro-rata to all current and future workers since the beginning of 2011.

The main elements of the reform are:

- (i) The introduction of a **new basic pension** of EUR 360/month (12 yearly payments). For those with less of 15 years of contributions, and thus not eligible for the contributory pension, the basic pension is means-tested, and provides an important social safety net.
- (ii) The **accrual rates** in the old system varied significantly across pension funds. The new system introduces accrual rates with the same profile for all workers that depend only on the length of the career (ranging from 0.8 to 1.5 percent of earnings). The new accrual rates are significantly lower than those in the old system (ranging from 2 to 3 percent), reducing the system's over-generosity. Taking into account the top up of the basic pension, this is particularly the case for medium- and high-wage earners.
- (iii) The old system allowed retirement on a full pension at age 60 and in some cases even earlier. The reform increases the **statutory retirement age** to 65. The **minimum age for retirement** is set at 60. If a person retires between 60 and 65 without having a full contributory period, their pension will be reduced by 6 percent per year before reaching 65 years of age.
- (iv) The **full contributory period** will increase from the current 35 years (or even lower, for some categories) to 40 years.

- (v) As from 2021, the minimum and statutory retirement ages will be adjusted in line with changes in **life expectancy** every three years.
- (vi) **Equalisation of retirement age of men and women** in both the private and public sector by 2013.
- (vii) **Indexation** of benefits will not exceed HICP inflation.
- (viii) **Pensionable earnings** will be calculated based on the full-earnings history. In the old system only five years (with the best earnings) of the 10 last years before retirement were used to determine pensionable earnings.
- (ix) A substantial revision of the list of **heavy and arduous professions** is forthcoming, aiming at reducing substantially the coverage to no more than 10% of the employees. The new list of difficult and hazardous occupations will apply with effect from 1.7.2011 to all current and future workers.

Sustainability clause

The new legislation includes a **sustainability clause**, which stipulates that if long-term projections show that the rise in public pension expenditure between 2009 and 2060 will be over 2.5 percentage points of GDP, then relevant parameters of the pension system will be changed to bring the increase of expenditure below the targeted threshold.

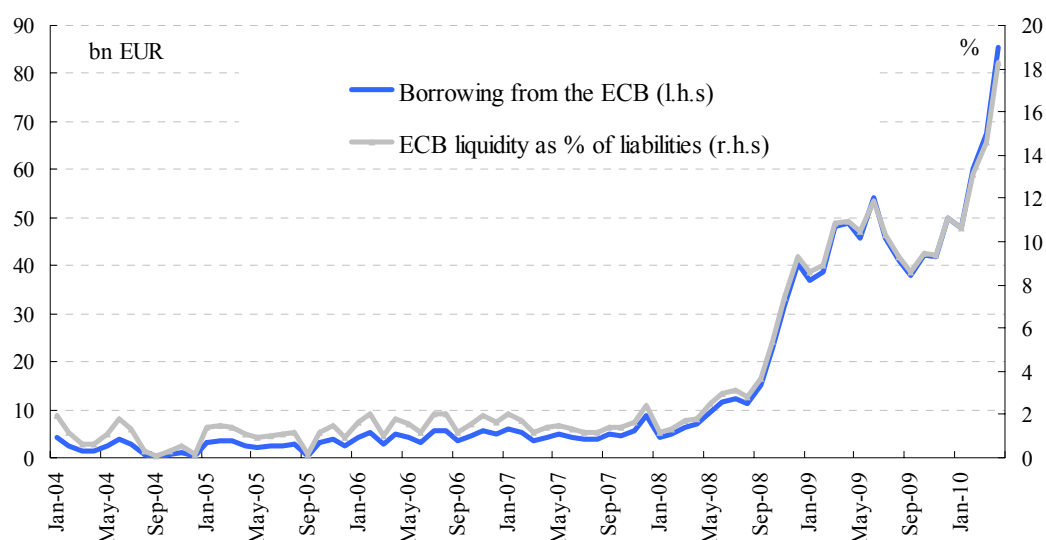
4.3. FINANCIAL SECTOR POLICY

30. **The banking sector is under significant strain and actions are needed to restore confidence and effective functioning.** A stable, well-capitalised and well-functioning financial sector allowing continuous financial intermediation without state support is crucial for growth and thus for the success of the economic adjustment programme.
31. **The liquidity situation of Greek banks remains tight and several measures were taken.** The combination of deposit outflows and the closure of the money market made the banks very dependent on the ECB for their liquidity provision. Borrowing from the ECB increased to about EUR 90 billion (May 2010) representing 18 percent of the banks' liabilities (Graph 4.7). Access to the ECB recently became more difficult for Greek banks because of the reduced availability of collateral due to the sovereign downgrade. In response to these difficulties, the ECB decided on 3 May 2010 to accept Greek government debt or other liabilities guaranteed by the Greek State as collateral, regardless of its rating. The government guarantee scheme under which banks can issue debt for collateral purposes was further increased by EUR 15 billion on 12 May following Commission approval in line with state aid rules. Most of the additional EUR 15 billion has already been used and on 18 June Greece requested an extension of the scheme until 31 December 2010 and a further increase of the ceiling of the guarantees by EUR 25 billion. The Commission approved the request in an emergency procedure on 30 June 2010. However, the government sent to Parliament draft legislation on an additional tranche of government-guaranteed bank bonds only on 4 August; this implies that final adoption is delayed until September after the end of Parliament summer recess. The law has a high priority in order to ease the funding stress of Greek banks. The government scheme to guarantee bonds issued by the Greek banks precisely aims at supporting bank's efforts in meeting their funding needs. By so doing, the scheme will support the provision of credit to the economy and will contribute to the overall stability of the Greek financial system.

32. On 13 July, the Greek parliament adopted the law establishing the Financial Stability Fund.

The European Commission received the respective notification, as required under state aid rules, on 23 July. With the creation of the Financial Stability Fund a major step was set to ensure that there is an institutional framework to deal with the recapitalisation and restructuring of financial institutions, if need be. There is still an implementing decree expected from Greece for the appointment of the members of the Board of Directors. From the operational side, care has already been taken of a building to host the FSF staff, and the Bank of Greece will provide the IT service, while remuneration and the number of personnel still have to be clarified. The financial resources of the Fund will amount to EUR 10 billion and be gradually disbursed, starting with the September tranche of financial assistance.

Graph 4.7: Greek banks' borrowings from the ECB



Source: Commission services.

Box 8: The Hellenic Financial Stability Fund

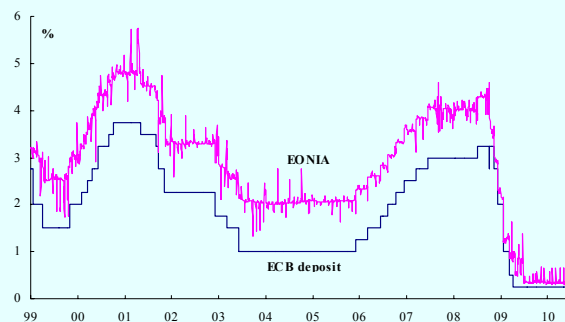
The purpose of the Financial Stability Fund is to **safeguard the financial stability** of the Greek banking system by **strengthening its equity base** including the subsidiaries of foreign credit institutions. **Liquidity support is explicitly excluded** as this may conflict with ECB objectives concerning monetary policy.

The Fund has a **strong governance structure** to make it independent of the politics and ensure transparency and accountability. It is set up for a **limited duration**, up to 30 June 2017, and operates under private law. Its Board of Directors comprises seven members: the President and two Vice-Presidents as executive members, and four non-executive members of which two are ex officio, namely the Director of the Financial Stability Department of the Bank of Greece and the Secretary General of the Ministry of Finance. The European Commission and the ECB each have an observer who can attend the monthly Board meetings without voting rights. Activity reports will be prepared monthly and shared with the Ministry of Finance and the Bank of Greece and a bi-annual report is to be submitted as well to the Greek Parliament, European Commission, IMF and ECB.

The Fund's **capital is EUR 10 billion** stemming from the euro-area/IMF financial assistance. The capital will be gradually paid to a deposit held by the Fund with the Bank of Greece, readily available and remunerated at a rate between the Eurosystem deposit facility and the EONIA rate.

The activation of the Fund can occur according to **three triggers determining the modalities of the capital injection**:

Graph 1: The remuneration range of FSF's deposits with the Bank of Greece



1. If on the basis of stress tests **Pillar II capital requirements are likely to be breached**, a bank on its own initiative, or on instruction of the Bank of Greece, **may turn to the Fund** when a market solution could not be found.
2. When the **capital ratio actually falls below the Pillar II level** which is different for each bank, and capital could not be raised in the market, addressing the Fund becomes obligatory.
3. The consequence of a **bank not complying with the minimum 8 % Pillar I ratio and not finding the capital in the market**, leads a further tightening of the conditions under which the Fund provides help.

The capital is injected in banks in the form of **preference shares**, carrying a remuneration determined by the Fund in accordance with EU rules (at present 10%). **In the case of the third trigger common shares** have to be used, which leads to an immediate dilution of the present share holders. The Fund provides the capital on presentation of an emergency business plan including a time table and in accordance with **EU state aid rules**. Within six month from granting the capital, the Ministry of Finance notifies a recapitalisation plan to the European Commission, as competition authority.

The issue price of the shares shall reflect the **fair value or market price** based on the valuations by two or three independent audit firms, while redemption is set at the highest price between the original issue or the price at the time of the shareholder meeting deciding on redemption. If redemption cannot occur within five years, a 2 percent, surcharge is imposed. In the event the targets of the restructuring plan are not met or the capital ratio falls below the Pillar I level of 8 percent, the preference shares are converted into common transferable shares at a price determined at the time of the capital injection defined by the Fund and the bank taking into account the assessment of the independent audit firms and EU state aid rules.

The rights attached to the preference shares include voting in the general shareholders' meeting and participation in the banks' boards of directors. The Fund representative has large powers, including the suspension of the board of directors' meeting for three days. Moreover, he or she can veto (i) any actions jeopardising the liquidity, solvency or smooth operation of the bank decisions and (ii) decisions regarding distribution of dividends and remuneration policy. In any event the top management of the banks receiving capital from FSF cannot earn more than the Governor of the Bank of Greece. Furthermore, the Fund representative has free access to the books and records of the bank.



The law being adopted, the practical implementation started with the Fund contracting office space. The Bank of Greece offers its IT platform and a website (<http://www.hfsf.gr>) has been created where the logo of the Fund and the announcement of the vacancies can be found.

33. **The legislation on the restructuring of household and corporate debt has been adopted by Parliament.** The January 2010 law on *"restructuring of business and professional debts owed to credit institutions"* provided for one-off temporary measures of limited material scope aimed at supporting liquidity for business, professional and agricultural activity. Applications for arrangements for debts should have been submitted by the 15 April 2010. Thus, essentially the law is no longer in force and its application has been completed. The impact of the law on the position of credit institutions has been assessed to be very limited. The amendments to the law on *"regulation of debts of over-indebted natural persons"* adopted on 28 July 2010, aim at a stronger protection of the interests of creditors and particularly those of mortgage lenders or secured creditors. In addition, the revised law has reinforced the necessary safeguards to avoid any moral hazard. In this context the automatic stay of individual proceedings provided in the initial draft has been abolished. Under the old procedure a debtor could request a stay of proceedings that would automatically be approved allowing debtors to delay their obligations. As per the amended law, new stringent conditions are in place, inter alia, requiring debtors to prove their inability to meet their obligations. Secured creditors create a separate voting class whose consent is required for the approval of the settlement plan and the rights of mortgage lenders are not restricted.
34. **Most of the initiatives to enhance quality of supervision are well on track.** The frequency and speed of data reporting has been increased: the key financial stability indicators (CAR, NPLs, external exposure) are available on a monthly basis and liquidity on a daily basis, while the delay between the release date and the period covered has been shortened. The framework for stress testing on a regular (quarterly) basis is being set in place. Concerning staffing, the Bank of Greece claimed to need an additional 30 posts for banking supervision, about equal numbers for insurance supervision and the pension funds summing up to 80-85 extra personnel. The new obligation to recruit all personnel through public sector exams and being subject to the all-embracing public administration rule of one new recruitment for every five departures, requires shifting personnel within the Bank.
35. **The Bank of Greece has reassured about its proactive approach to enhance coordination with home and host country supervisors within the EU framework.** Recently, communication has been intensified and the Greek supervisor has informed the host supervisory authorities about the financial health of the parent banks and how their tight liquidity situation is addressed. The Bank of Greece is aware of Greece's commitments under the European Banking Coordination Initiative and the role Greek subsidiaries play in the region. The EBRD initiative for supporting lending in the region by targeting Greek subsidiaries was welcomed as an additional confidence boosting measure. A number of bilateral and multilateral memoranda of understanding have been signed. Currently under negotiation are memoranda with Poland, Russia and Egypt as well as memoranda establishing

Colleges of Supervisors for EFG Eurobank and Piraeus Bank groups. The first meetings of the new Colleges for NBG and Alpha Bank are scheduled for October.

36. **The Ministry of Finance has launched a strategic study on the future of the Greek banking sector.** The initiative was undertaken in reaction to the Piraeus Bank take-over bid on ATE and TT Postbank. The study will present options for all stat-owned banks, including ATE, and a strategic vision for the government involvement in the banking sector. The Ministry of Finance started the process of hiring three international investment banks as consultants to carry out the study, which is due by mid-September. In this context, the Commission extended the deadline for ATE and other concerned banks to submit restructuring plans, or viability reviews, until 1 October. The European Commission, ECB and IMF discussed with the Minister of Finance a plan for the troubled ATE including:

- a reaffirmed public commitment by the Government to take all necessary steps;
- the strategic study on the banking sector;
- a vendor due diligence of ATE and other financial entities in which the state has a significant stake, involving external auditors; and
- a possible sale to be carried out in an open, transparent and non-discriminatory tender in compliance with the EU state aid rules.

Before strategic decisions on the future of ATE are taken, the bank will continue to implement interim restructuring measures, such as cleaning the loan portfolio, cutting costs and selling non core assets, under enhanced supervision by the Bank of Greece.

4.4. OTHER STRUCTURAL REFORMS

37. **The potential for raising productivity and output growth in Greece is substantial.** Many sectors are sheltered or subject to distorted competition due to state aid and implicit or explicit barriers to entry. Business start-up and operating costs are high and obstacles to increasing firm size are numerous, preventing economies of scale. As a result, mark-ups are amongst the highest in the EU. The obstacles to company development also induce a complex business structure that inhibits investment in, and developments of, exporting sectors. Labour is underutilised and there is a disproportionately large informal economy.
38. **The programme sets out a very ambitious agenda that prioritises a number of reforms that will strengthen the supply-side and will contribute both to potential growth and budgetary objectives.** Successful reforms strengthen the supply-side of the economy already in the short run. They can contribute to addressing competitiveness concerns without economy-wide deflationary pressures. By supporting higher sustainable growth and by facilitating budgetary consolidation, productivity-enhancing reforms induce more favourable debt dynamics and a more rapid reduction of

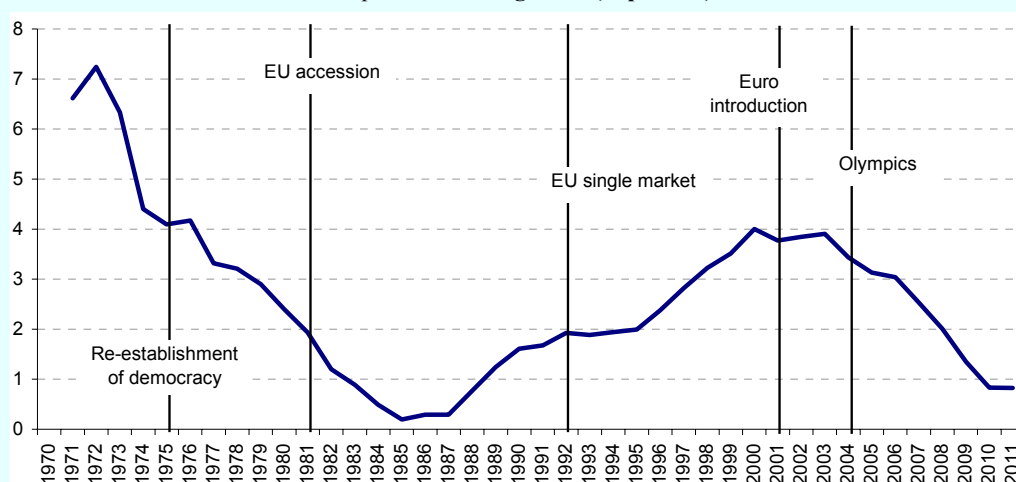
the debt burden. Decisive action on key reforms should bolster confidence in the adjustment programme in the short run, lowering risk premia and underpinning demand thereby helping to speed up recovery.

39. **The implementation of the structural reform agenda up to June 2010 is broadly positive and on track with the timetable set down in the Memorandum of Understanding.** Following past delays, efforts are now underway to improve compliance with EU law in the area of services, energy, and road and rail transport. Looking forward, these reform efforts need to be sustained, in order to lay the strongest possible foundations for future potential growth and job creation.

Box 9: Potential growth

Potential growth in Greece has fluctuated between 7% and ¼% since 1970 (see Graph 1). After peaking at 7.2% in 1972, potential decreased steadily until its trough at 0.2% in 1985. After the re-establishment of democracy in 1975 and EU accession in 1981, the Greek economy underwent fundamental structural change. During the late 1980s and the late 1990s, potential growth picked up substantially, peaking at 4% in 2000. The financial market liberalisation of the EU single market, introduced in 1992 as well as the interest rate convergence related to the euro area entry in 2001 and the preparation of the Olympic Games in 2004 induced major capital inflows. Heavy investments have been made in the construction sector which, however, have only limited impact on future production capacity. During the first decade of the new century, potential growth decreased to 0.8% in 2010.

Graph 1: Potential growth (in percent)



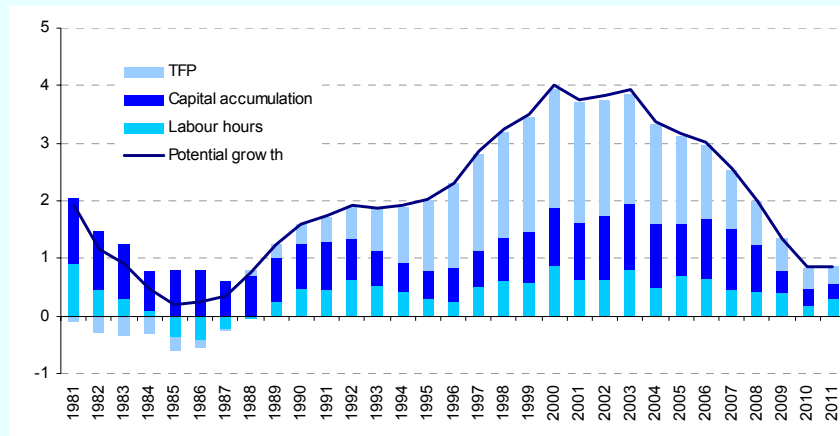
Source: Commission services.

The increase in potential growth during the last two decades was only to a lesser extent related to capital accumulation and labour contributions. Graph 2 shows that the bulk of potential growth increase during the late 1990s and early 2000s was induced by the residual element of total factor productivity (TFP). The smaller role of capital accumulation shows that large parts of resources were not allocated to enhance the productive capacity of the Greek economy. Indeed, the Greek economy was largely demand-driven in the presence of low interest rates and rapid credit expansion. Private consumption reached around 70% of GDP which is the highest level in the euro area (average 58%), contributing to high external deficits and external debt.

Empirical evidence suggests that growth based on economic fundamentals was below the estimated potential growth during the last decade. Based on growth regressions using a wide range of growth determinants in 62 countries over 50 years, the estimated growth predictions can be interpreted as those growth rates which can be justified by long-run economic fundamentals and not by cyclical fluctuations or other short-term, non-structural influences. (*) Graph

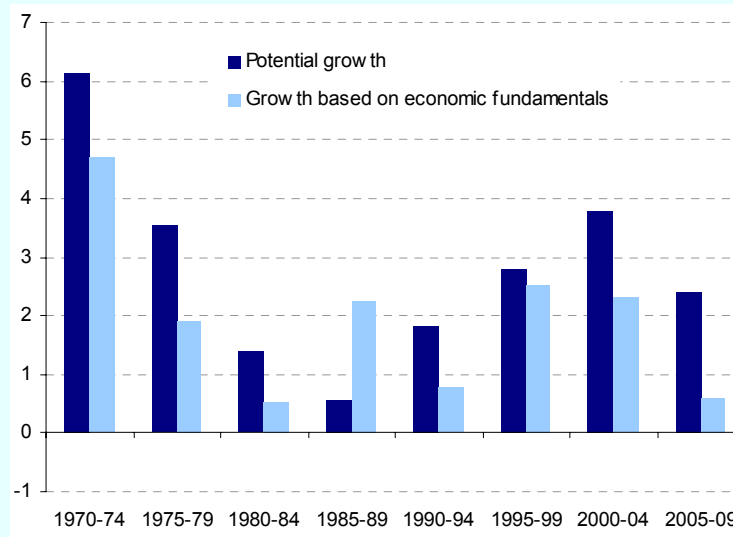
3 shows that these predicted growth rates are largely below potential growth, most notably during the potential growth boom between the early 1990s and the late 2000s. Hence, the high rates of potential growth during that period may have overestimated the actual growth potential of Greece based on economic fundamentals, as measured in an extensive regression model based on a cross-country panel.

Graph 2: Potential growth contributions (in %)



Source: Commission services

Graph 3: Potential growth and growth based on economic fundamentals



Source: Commission services

(*) See Böwer and Turrini (2010), 'EU Accession: A Road to Fast-Track Convergence?', *Comparative Economic Studies*, 52(2).

4.4.1. Labour market

40. Employment Protection Legislation has been hampering the functioning of the labour market.

For instance, severance payments have been biased in favour of white collars, in detriment of blue collars. The minimum threshold on collective dismissals (especially for larger companies) has been

too low (below 2 percent of total dismissals). There have also been obstacles to temporary and part-time work. The probationary period for new jobs has been too short (just two months). In addition, there has been an excessive centralization of contractual arrangements and in the private sector wage bargaining system; and there have been far too many minimum wages, varying across economic sectors.

41. Major labour market reforms are now advanced well ahead of the December 2010 deadline.

The reform was enacted in the New Insurance Scheme and Related Provisions and Arrangements for Labour Relations (Law 3862/2010), approved by Parliament on 15 July 2010. The law is a step in the right direction as it:

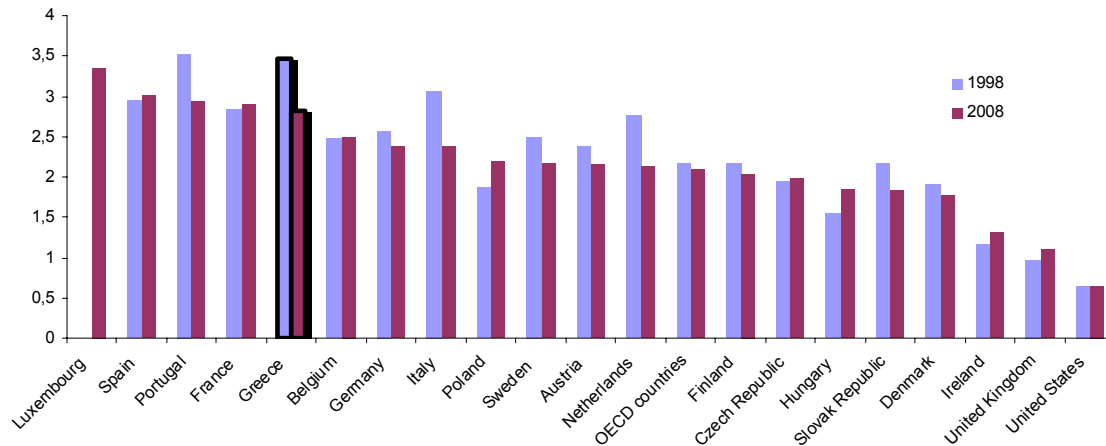
- eases *employment protection legislation*, including provisions aimed to modernise the process of severance payments and collective dismissals;
- reduces the *overtime premium* and introduces a sub-minimum wage to be applied to newly recruited workers younger than 25 years old (84 percent of minimum wage). Overtime also becomes cheaper (it has gone down by 15 percent);
- *older workers* beyond 55 years old should not be more than 10 percent of total lay offs (special provisions have been included for them).

42. These initiatives will increase adjustment capacity of firms, ultimately boosting employment.

Despite progress made, labour market rules could be brought further into line with best practices in other European countries and the common principles on flexicurity. For this, there is a need to:

- extend probationary periods for new jobs from two months to one year;
- facilitate the use of temporary and part-time contracts, as well as increase flexibility in working hours: this can encourage the entry to the formal labour market for groups such as women and the young. EU funding can help promote security in the labour market through training and other activation programmes;
- clarify the legal framework for collective bargaining to ensure that there is a clear legal framework for firm level agreements. The Greek authorities aim to adopt new legislation by late August, in particular by allowing firm-level agreements to prevail over other levels; this should be a positive step;
- reform the arbitration system, which should operate according to transparent and objective principles, guaranteeing non-interference from the government.

Graph 4.8: Strictness of employment protection legislation (OECD indicator)

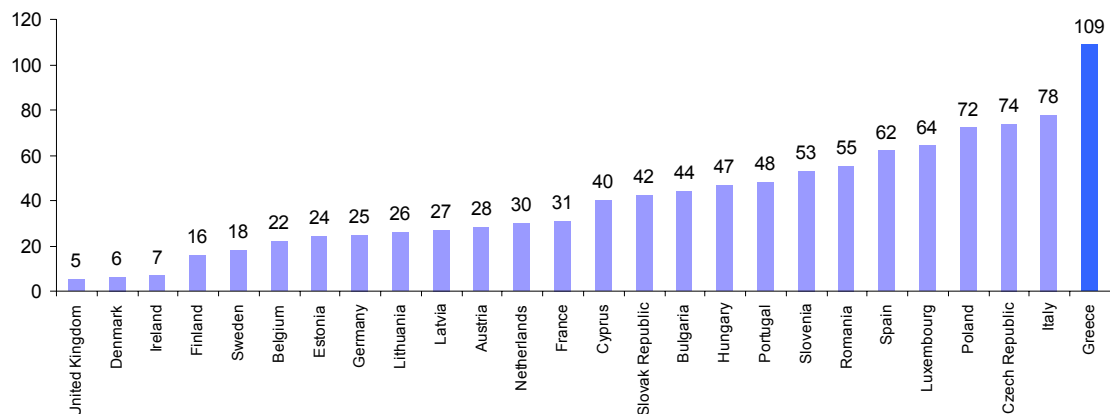


Source: OECD

4.4.2. Business environment

43. **Despite a high propensity towards entrepreneurship (mainly due to the importance of self employment), Greece has been performing badly in terms of business environment.** The 2010 ‘Doing Business’ indicator of the World Bank (109th out of 183, see Graph 4.9) points to a large number of lengthy procedures needed to enforce contracts, to register property and to obtain licences. In addition, the business environment also suffers from obstacles to starting a business, the overall rigidity of employment, the little protection given to investors and the difficulty to access finance.

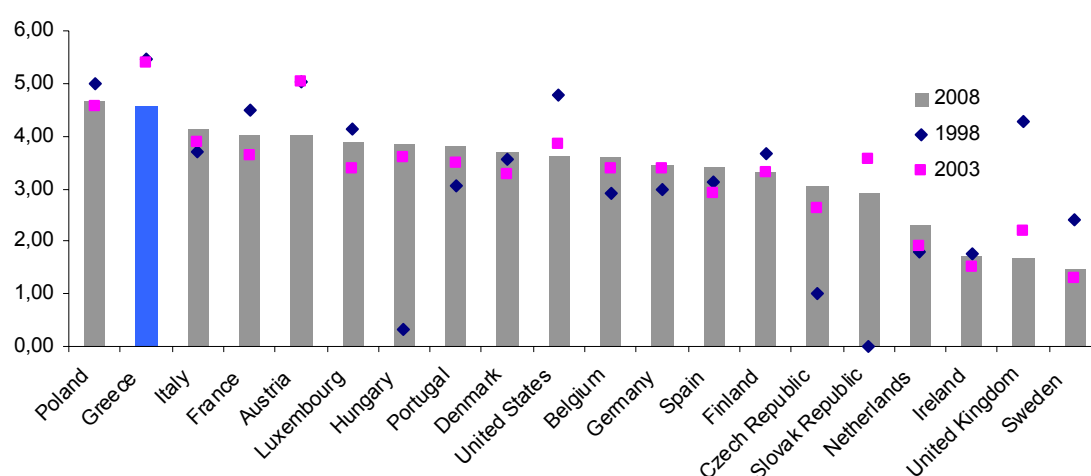
Graph 4.9: World Bank Doing Business 2010 rankings



Source: World Bank

44. **Mark-ups and gross profit margins have been particularly high in Greece.** The reasons behind higher mark-ups in services are linked to the insufficient degree of competition in the sector, which remains to a large extent sheltered. As regards the barriers to entry in services, Greece ranks at the second position across EU Member States. Professional services, which represent 7 percent of employment, face strict licensing requirements and restrictions on fees or prices charged. Licensing requirements are also high in the retail distribution sector.

Graph 4.10: Barriers to entry in services: composite indicator (1998-2008)



Source: OECD

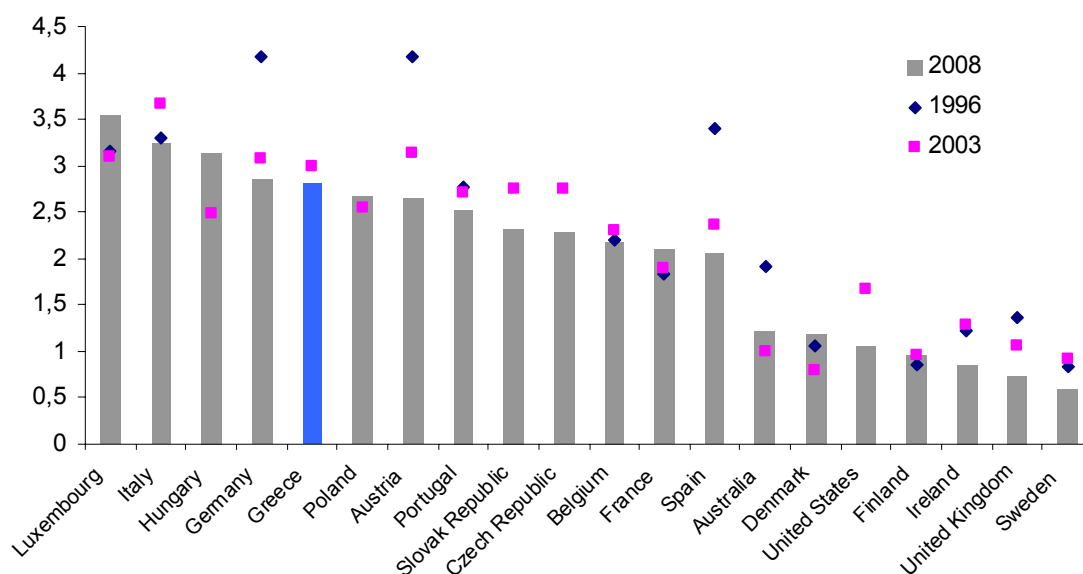
45. **Progress with the implementation of the programme requirements for June 2010 as regards enhancing competition in open markets is being made.** More specifically:

- Progress has been made to **improve business environment** with the adoption of a law that achieves a significant reduction in costs and time of start-ups, though the law will only become operational at the end of November after the approval of a number of joint ministerial decisions and the setting up of GEMI: the general electronic commercial registry. Progress is also underway in the revision of the institutional framework for the licensing of manufacturing firms. The deadline in the MoU for these and other actions – such as the revision of the spatial plan – is December 2010. Lastly, a new Investment Law, which would simplify procedures, is being prepared.
- As part of the implementation of the **Services Directive**, horizontal legislation has been adopted. Steps are underway to ensure that the points of single contact become operational in the second-half of 2010, and priority should be given to ensuring that common features can be completed by electronic means for the most important sectors and professions. A critical challenge is now to complete the screening exercise as to adopt sectoral specific legislation that removes unnecessary or prohibited restrictions in service sectors, so as to facilitate cross-border provision of services

and the freedom of establishment. In particular this process should be completed by end-2010 in key fields of **tourism, retail and education**.

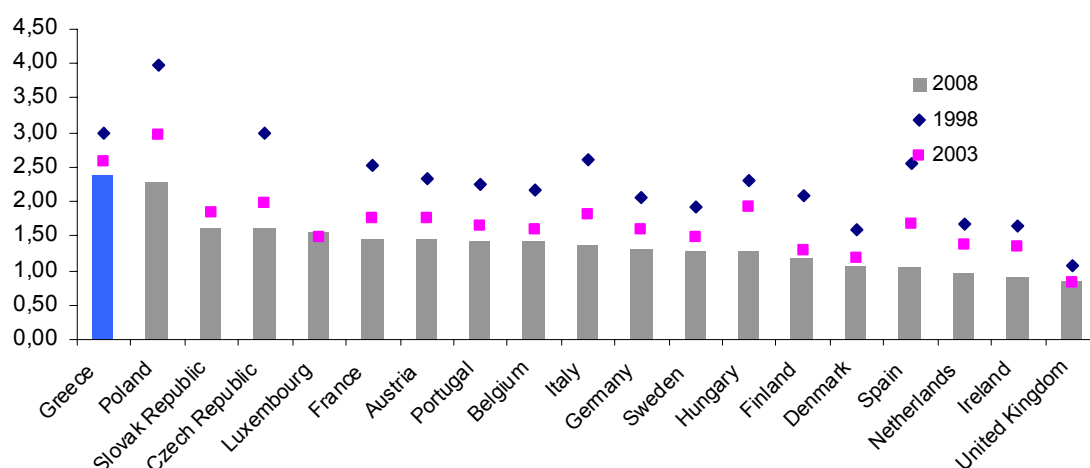
- Similarly, under the Services Directive Greece is required to remove all unnecessary restrictions in a wide range of **closed professions**. This is essential to promote competition and improve the business climate. The MoU identifies six professions (lawyers, pharmacies, notaries, architects, engineers and auditing services) where there is a requirement to present legislation by the end of 2010. Related to this, Greece has adopted a Presidential Decree to implement the EU Directive on the Mutual Recognition on Professional Qualifications and has set up the administrative body competent for dealing with the applications under the general system. It is now important that the Government takes all necessary measures to ensure the effective application of the legislation adopted and compliance with ECJ rulings in particular in relation to franchised diplomas. All pending applications for recognition of franchised diplomas should be immediately dealt with. The Greek government is also invited to present a timetable for dealing with pending applications.
- Legislation is being proposed to strengthen the effectiveness of the **Hellenic Competition Commission** by end 2010. An expert committee has provided its suggestions, and the Greek government is planning to adopt legislation in coming months. It is important that the legislation adheres to the main thrust of the recommendations of the expert group, especially regarding the capacity of the Authority to effectively prioritise its work. Efforts should also be made to ensure that adequate levels of qualified staff are available to enable the Authority to swiftly upgrade the scale and quality of its work.

Graph 4.11: Regulation in professional service indicator (1996-2008)



Source: OECD

Graph 4.12: Composite indicator of product market regulation in the EU (1998-2008)



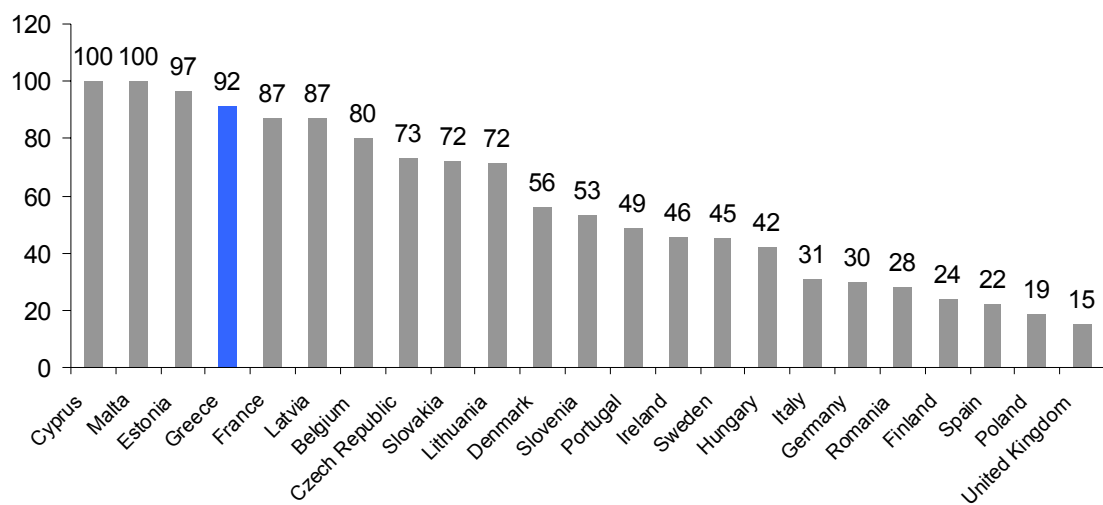
Source: OECD

4.4.3. Energy

46. Reforms that bring competition to the monopolised energy sector are essential for improving the efficiency and competitiveness of the Greek economy and for ensuring long-term security of

supply while assuring the achievement government's environmental targets (see Box 10). Progress is being made in adjusting the regulated electricity tariffs so as to better reflect wholesale market prices and protect vulnerable customers. Moreover, measures are foreseen to strengthen the powers and independence of the regulator. Progress is less clear regarding the creation of fully-independent transmission system operators for electricity and gas (ownership unbundling) which is important to create a truly competitive market with fair treatment of all market participants.

Graph 4.13: Share of the largest electricity generator in the domestic market (2007)



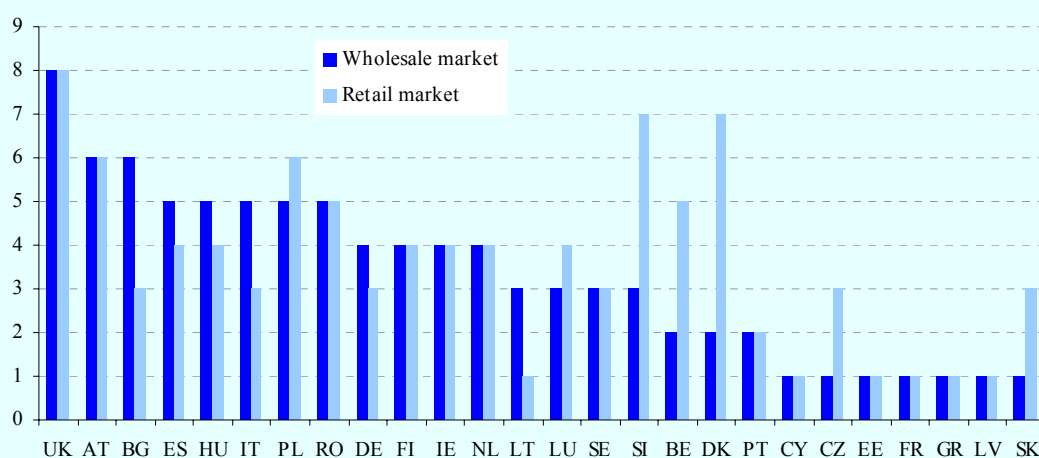
Source: OECD

Box 10: Opening up the electricity sector

The electricity wholesale and retail markets of Greece are highly monopolised. The Public Power Corporation (PPC) holds 80 percent of the wholesale and 97 percent of the retail electricity market in Greece. Compared to other Member States, Greece is among the few countries with only one large player in both the wholesale and retail markets (see Graph 1). PPC controls 100 percent of Greek lignite and oil-fired capacity and around 95% of hydro power capacity, 83 percent of gas-fired power plants and 9 percent of renewables. Greece operates no nuclear power.

Graph 1: Electricity wholesale and retail market position

(Number of companies with more than 5 percent of electricity generation capacity in the wholesale market and number companies with more than 5 percent of electricity retail sales, respectively (2008))



Source: Regulators data.

A comprehensive approach is suggested for opening up the energy market in Greece, in line with existing EU legislation. First, it is proposed to ensure balanced portfolios for competitors of PPC by granting access to lignite-fired and hydro capacity. For lignite, there are two options which involve selling existing plants and/or granting exploitation rights on new deposits. Second, it is recommended to straighten up the framework for competition and investment by reinforcing the regulator, fully unbundling monopoly network activities, and rationalising regulated retail tariffs.

The economic rationale of opening up the wholesale electricity market in Greece aims at spurring investment and jobs, avoiding bankruptcy and job losses of independent producers, reaping the competition benefits of improved resource allocation and more efficient prices as well as safeguarding the long-run security of supply.

- **Investment and jobs:** Granting access to the exploitation of additional lignite deposits will spur major investment and create new jobs. According to preliminary estimate, adding 40 percent or 2GW of the existing 5GW of lignite-fired capacity could imply investments in new plants of around EUR 4 billion and investments in mine exploitation and related infrastructure of around EUR 400 million. In total, an estimated 1 500 new jobs would be created.
- **Avoid bankruptcy and job losses:** Independent power producers in Greece are likely to go bankrupt in the absence of rapid structural change, putting jobs and existing investments of around EUR 1 billion at risk. Without access to other energy sources, independent power producers will not be able to compete with PPC.
- **Competition:** Opening up the energy sector is an opportunity for major structural reform in a key sector. Giving competitors a fair chance to compete against the incumbent monopolist is likely to improve the allocation of resources by exerting competitive pressure on PPC and by making prices more cost-reflective. Given that energy prices are set to increase, due inter alia to CO₂ and renewables charges, it is essential to limit price increase by ensuring competition.

- **Security of supply:** Opening up the energy sector is going to improve long-term security of supply. In the past, PPC has not always been able to ensure sufficient energy generation capacity due to its operative inefficiency; the Greek state repeatedly had to subsidise the construction of new plants which has never happened in other Member States.

Budgetary incentives of wholesale market liberalisation depend on whether the government chooses to sell existing plants or grant exploitation rights to new lignite deposits.

- **Revenue of selling existing PPC plants:** Should the Greek government decide to sell 40 percent of PPC's lignite-fired power plants with the related lignite deposits would generate around EUR 2 billion. Given the 51% government stake in PPC, the resulting state revenue amounts to EUR 1 billion.
- **Higher tax revenue from increased profits:** Allowing for competition will enable competitors to run profitable businesses and improve the efficiency of PPC's operation, thereby generating higher tax revenue from both sides. The long-term tax revenue will be even higher in the case of expanding capacity by allowing competitors to exploit new deposits and run additional power plants.

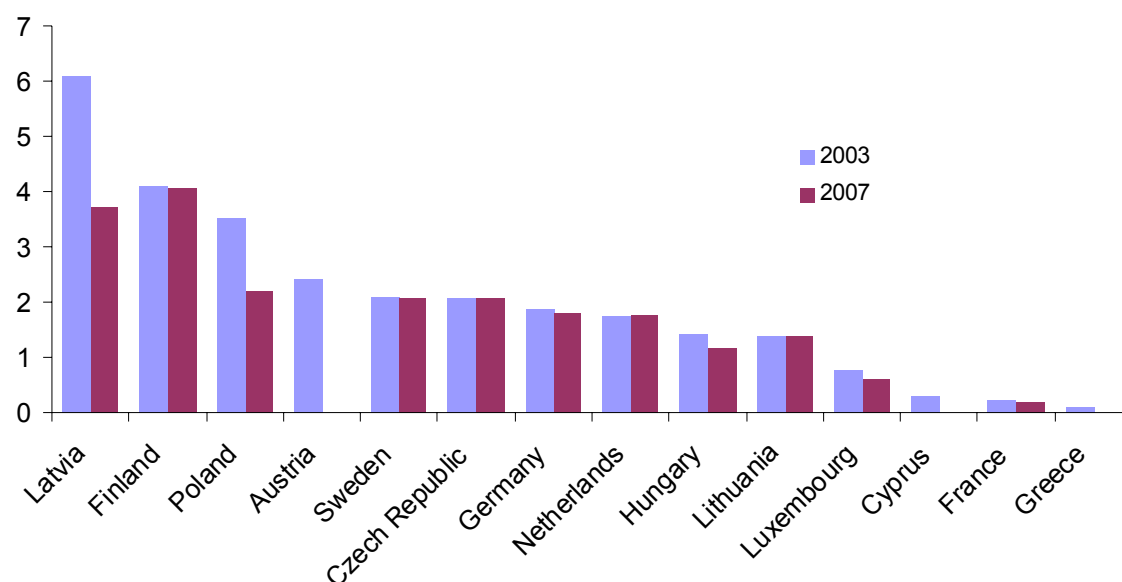
Environmental goals of the government will not be affected by opening up the wholesale market.

- **Lignite will remain as part of the energy mix** in Greece like in a number of other member states. It is expected to represent at least one third of electricity in Greece's own energy forecasts for 2020 in the scenario with the highest development of renewables.
- **New lignite exploitation and plants have to abide by environmental rules** in Greece like anywhere else in the EU and investments will have to be made in a more environmentally-friendly manner. New technologies are being developed to emit less and to capture and store CO₂ and these will be applied to new lignite-fired capacity. This is already taken into account by PPC in its two new power plant projects and is the case for other generators elsewhere in the EU (Germany, Czech Republic etc).

4.4.4. Transport

47. **Reform of the transport sector is a key structural milestone for the sustained success of the programme.** It is essential for effective and low-cost domestic and international trade and mobility of resources. Reform includes opening up of the road freight transport sector and developing a sustainable business plan for railways, which also aims at reducing the drain on public finances. Similar measures for occasional road passenger transport are to be elaborated."
48. **Road freight transport accounts for the bulk of transportation of goods.** Licensing restrictions have constrained the potential of the sector to grow (see Graph 4.13). The government has recently put forward legislation to ensure compliance with EU Directives. The new law provides for the opening of the sector, through the removal of license restrictions that have been severely constraining road haulage capacity. It also leads the road freight transport sector to have a more positive impulse to cost competitiveness and growth capacity.

Graph 4.14: Road transport – indicator based on the number of (semi-)trailers indexed to GDP



Indicator: Number of trailers and semi-trailers divided by GDP in EUR million.

Source: Commission services

49. **The Greek railways currently account for only a small share of passenger and freight transport in spite of low tariffs.** Only a fraction of expenses is recovered and the railway company has recorded persistent heavy losses which eventually fall on the government public finances (See Box 11).
50. **The government is now preparing a business plan for full restructuring of the railways sector.** The MoU deadline for submission of a restructuring plan by 30 June has not been observed, but the process is underway. The aim is to break even the railway operator (TRAINOSE) and prepare it for privatization, to suspend the group's loss-making lines, to streamline its management, to cut costs by selling its land and other assets, by downsizing its staff, by cutting all allowances and overtime. Last but not least, the restructuring aims to open the railways market, by facilitating track and terminal access for new entrants, liberalizing its licensing procedure, and having future acquisitions and maintenance concessions at market rates.

Box 11: Restructuring Greece's railway sector

Greece's railway sector is currently in the hands of the State and is organized into two groups:

1. **OSE Group** (OSE+EDISY) is the network infrastructure manager and has two subsidiaries: **ERGOSE** (railway network construction); **GAIAOSE** (real estate development);
2. **TRAINOSE** is the railway operator (passenger and freight transport).

The railway sector has an accumulated debt of circa EUR 10 billion, deriving from:

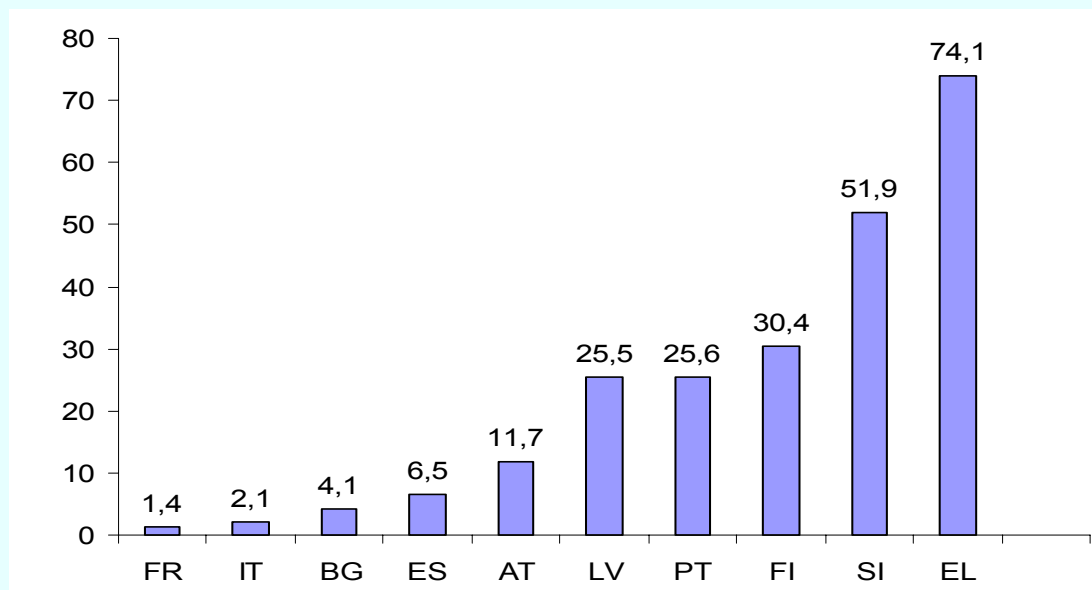
1. **Pricing policy and service supply**

- in passenger transport: lack of price increase in passenger tickets since 2000, inadequate control over revenues leading to significant revenue leakage, low demand in certain routes; an estimated 20 percent of total passengers enjoy free travelling;
- in freight transport: low market share (circa 1¼ percent of total freight transport), high discounts policy (70%-80%).

2. **Excessively high personnel costs**

- TRAINOSE: overtime and allowances amount to circa 50 percent of base salary (30 percent of total personnel costs). In 2009, TRAINOSE had 1 762 employees and personnel costs added to EUR 116.5 million;
- OSE: overtime and allowances amount to circa 25 percent of base salary (20 percent of total personnel costs). In 2009, OSE had 4 817 employees and personnel costs added to EUR 270.7 million.

Graph: Costs per staff member/passenger transport by operators (selected countries)



Note: Unit is cost per staff member (1 000 euros) divided by passenger transport (1 000 mio passengers per km.). Country selection reflects availability of data.

Source: Commission services

4.4.5. Absorption of structural funds

51. **Progress has been made to address regulatory and organisational obstacles to absorb structural and cohesion funds**, but further steps are needed to ensure an increase in the quality and pace of projects. A Ministerial Decision to shorten the deadlines at each step of the approval and

implementation of projects has been issued. A task force to improve the absorption of EU structural and cohesion funds will operate from the Deputy Prime Minister's office and a special bank account has been opened at the Bank of Greece to ring-fence the budgetary appropriations of national co-financing. The government appears to be on target to meet the payment claims targets, although efforts should be made to gradually reduce the recourse to non-targeted *de minimis* state aid projects, which is a suboptimal use of resources and may distort competition.

52. Table 4.4 presents the **payment claims for structural and cohesion funds made by Greece to the European Commission from January through June 2010**. Compared to the annual targets foreseen by the MoU, European Regional and Development Funds and Cohesion Funds taken together amount to a share of 27 percent of the annual target. The share of submitted European Social Funds claims stood at 43 percent. The combined share of nearly 30 percent highlights that the Greek authorities need to accelerate the submission of payment claims to reach the annual target.

Table 4.4: Payment claims			
	MoU targets for 2010	Payment claims submitted by end June 2010	Share (%)
ERDF + CF	2330	638.7	27.4
ESF	420	215.0	44.4
Total	2750	853.7	31.0
ERDF: European Regional Development Fund; CF: Cohesion Fund; ESF: European Social Fund.			
Source: Commission services			

4.4.6. Public enterprises and privatisation

53. Privatisation plans have been rather vague so far, lacking a clear time planning. In early June 2010, the Greek government announced a wide ranging privatization program, spanning rail and road transport, airports and ports, utilities, gaming and public real estate holdings. Measures include outright sales to strategic investors, initial public offerings, new and extended public-private partnerships and the creation of private holding companies intended for eventual listing on the Athens Stock Exchange. It remains unclear whether all privatisations in the various sectors announced will effectively take place in the next months and how much privatisation will be in 2011 (see Box 12)

Box 12: State-owned enterprises and privatisation

Several State-owned enterprises have been running losses over many years. The biggest deficits originate in public transportation enterprises, particularly in OSE, ETHEL, HLPAP, HSAP, OASA, where payroll alone tends to exceed total revenues.

Table : **Greece's largest loss-making SOEs (2009)**

	Total losses before income tax (mn euros)	Number of employees (units)	Average wage per employee (euros)	Current state budget subsidy (mn euros)
Hellenic Railways (OSE S.A.)	-481.8	187	41.426	0.00
Thermal Buses Corporation (ETHEL S.A.)	-316.4	6.733	37.526	75.23
TRAINOSE S.A. (Operating Railway Company)	-231.1	1.784	50.414	0.00
Railway Infrastructure Manager (EDISY S.A.)	-173.8	4.737	40.621	0.00
Hellenic Defense Systems (EVO-PYRKAL)	-164.7	1.575	41.794	0.00
Athens Piraeus Electrical Railways (ISAP S.A.)	-93.3	1.337	57.584	26.15
Trolley Buses Corporation (ILPAP S.A.)	-69.3	1.564	36.408	21.56
Tourism Development Co.	-47.7	473	33.946	0.00
Hellenic Horse Racing Org.	-27.9	343	48.626	0.00
National Highways Fund (TEO S.A.)	-15.1	347	28.771	0.00

Source: Greek Ministry of Finance, according to the Greek General Chart of Accounts (not IFRS).

Due to the continuous accumulation of losses and bad management, **SOEs will need to be restructured** and follow adequate corporate governance guidelines. Most SOEs have not been receiving current subsidies (or payments for public service obligations) from the State, therefore leading to the accumulation of hidden fiscal costs and regularly requiring debt takeovers or capital injections.

By end-September 2010, the government has committed to:

- publish financial statements (certified by external auditors) of the ten largest loss makers in order to increase transparency and reduce fiscal uncertainties;
- draw up a timetable and action plan for improving the financial performance of main loss-makers (especially the railways and other public transportation companies);
- review the scope for divesting assets (including land) and for improving corporate governance in SOEs.

Specific quantitative targets in relation to public enterprises include:

- a privatization plan for divesting state assets raising at least EUR 1 billion per year in the period 2011-2013. This plan should be prepared by end-December 2010;
- a cut in capital injections to public enterprises of EUR 1.5 billion (0.7 percent of GDP) in 2012.

Financial advisers will be selected to conduct a study on privatisation objectives and to provide options on strategic solutions. Based on these studies, the government will make a strategic decision on what to do with the particular object under consideration.

As of today, progress has been made in banking, partially due to political perception that redesign of the financial sector is needed. The study prepared by consultants on the financial sector is expected by end September. Consultants have also been hired for railways restructuring. For the privatization of other objects, consultants will be selected in September-October and results are expected towards the end-2010. Preference will be given to privatize those that can be sold at a high price and have a high level of demand, i.e., motorways, airports, maritime ports.

As the privatization plan remains vague, the Ministry of Finance is expected to provide an updated list of assets by end-September. The authorities will also be providing an estimate of 2011 quarterly profile of privatization revenue, including information from which object the revenue will come.

5. PROGRAMME FINANCING AND TREASURY MANAGEMENT

54. **On 18 May 2010, the euro-area Member States disbursed their first instalment of EUR 14.5 billion of a pooled loan to Greece, following a disbursement of EUR 5.5 billion from the IMF.** Subject to programme implementation, further disbursements are scheduled quarterly until mid 2013 (see Annex 6).

Box 13: Euro area stability support to Greece: main features

Euro area Member States provide financial support to Greece through pooled bilateral loans, managed by the Commission on their behalf. On 2 May, the Eurogroup agreed on a financing package of up to EUR 80 billion over three years to meet Greece's financing needs, in conjunction with an IMF stand-by arrangement of up to EUR 30 billion. The assistance is provided in quarterly instalments, whose respective size reflects the forecasted profile of financing needs. Disbursements are made *pari passu* by the euro area and the IMF based on their shares in the total assistance package (8:3). The ECB acts as paying agent for the euro-area stability support.

The framework is set up in a way that foresees participation by all euro area Member States. The share of each Member State in the total loan is calculated using the ECB paid capital key.

Table: Member States' contributions to the support package for Greece

	BE	DE	IE	ES	FR	IT	CY	LU	MT	NL	AT	PT	SI	SK	FI
ECB paid capital key (% of EA-15 total)	3,58	27,92	1,64	12,24	20,97	18,42	0,20	0,26	0,09	5,88	2,86	2,58	0,48	1,02	1,85
Contribution to support package (EUR billion)	2,861	22,336	1,310	9,794	16,774	14,739	0,161	0,206	0,075	4,704	2,290	2,065	0,388	0,818	1,479

Note: The Kreditanstalt für Wiederaufbau (KfW) acts as lender on behalf of Germany.

Stringent conditionality is an integral element of the support package, so as to ensure that Greece effectively tackles underlying fiscal and macroeconomic imbalances. The key elements of policy conditionality have been enshrined in a Council Decision under Articles 126(9) and 136 TFEU. (*) The specific conditions for the release of loan instalments are further detailed in a Memorandum of Understanding agreed with the Greek authorities. Conditionality is consistent across the euro area and IMF programmes.

Compliance with policy conditions is reviewed by the Commission, in liaison with the ECB, on a quarterly basis. Close co-ordination with the IMF is maintained. Based on a report by the Commission, the contributing Member States decide unanimously on the release of each instalment.

The loans are priced with a view to providing an incentive to return to market-based financing as soon as feasible. They carry a variable interest rate, calculated as the three-month Euribor rate plus a charge of 300 basis points. For amounts outstanding for more than three years, the charge rises to 400 basis points. To cover operational costs, a one-off service fee of 50 basis points is also charged for each drawing.

Given the need for Greece to address underlying imbalances so as to restore orderly market access, the financial support is medium-term in nature. The euro area loans are envisaged to carry the same maturities as IMF lending, i.e. a three-year grace period and subsequent repayment of principal in eight equal quarterly tranches.

(*) Council Decision of 10 May 2010 addressed to Greece with a view to reinforcing and deepening fiscal surveillance and giving notice to Greece to take measures for the deficit reduction judged necessary to remedy the situation of excessive deficit (OJ L 145, 11.6.2010, p. 6).

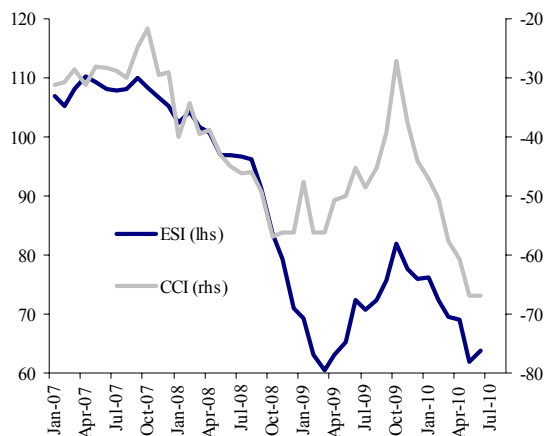
55. **In July, the Greek Treasury successfully issued EUR 4.5 billion of short-term bonds.** Auctions attracted strong demand including from international investors. While the yield was somewhat higher for 6-months maturity (4.05%) compared to the previous auction, it remained broadly unchanged for 3-months bills (4.65%).
56. **Improved treasury management should contribute to reducing borrowing costs on T-bills.** In particular, T-bill auctions could be planned monthly rather than quarterly. Stronger liquidity buffers

at the Treasury to deal with risks associated to potential contingencies could also contribute to reducing risk premia on short-term paper.

Annex 1: High-frequency indicators

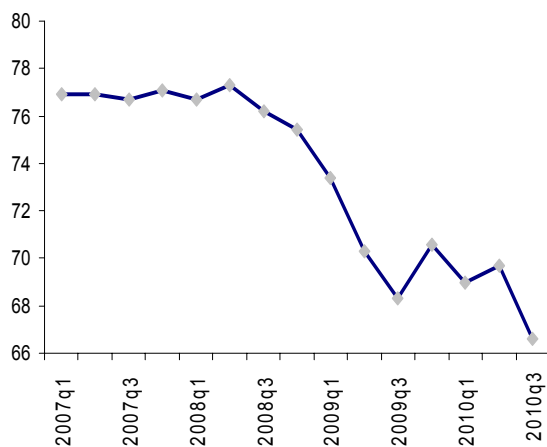
Leading indicators

Economic Sentiment and Consumer Confidence Indicators



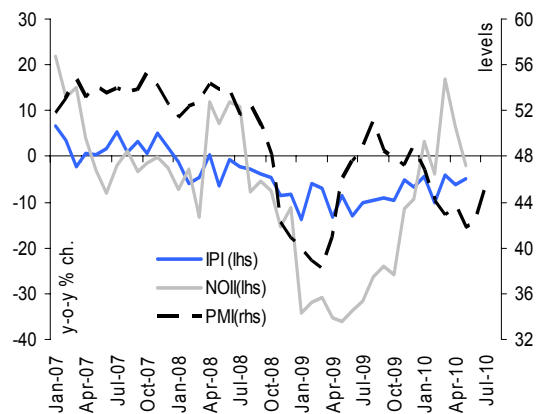
Source: DG ECFIN

Capacity utilization in manufacturing (%)



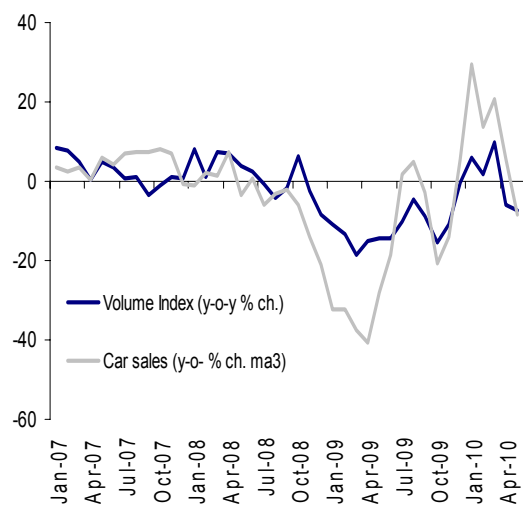
Source: ECOWIN

Industrial production, new orders and PMI



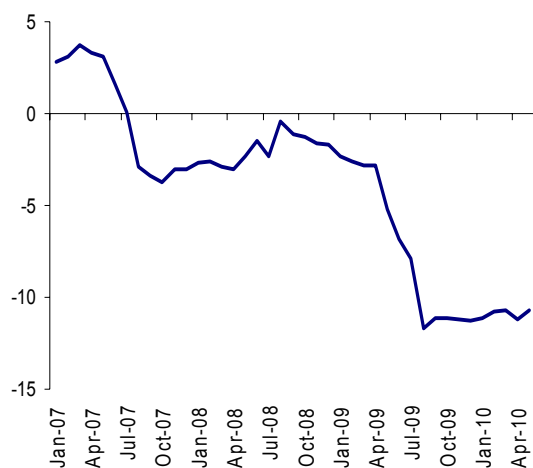
Source: Hellenic Statistical Authority

Volume index in retail and car sales



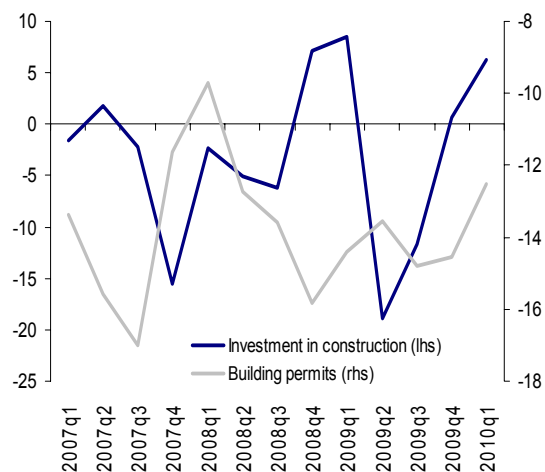
Source: Hellenic Statistical authority

Tourist activity (travel receipts in 2005 prices, % change y-o-y, 12mma)



Source: Bank of Greece

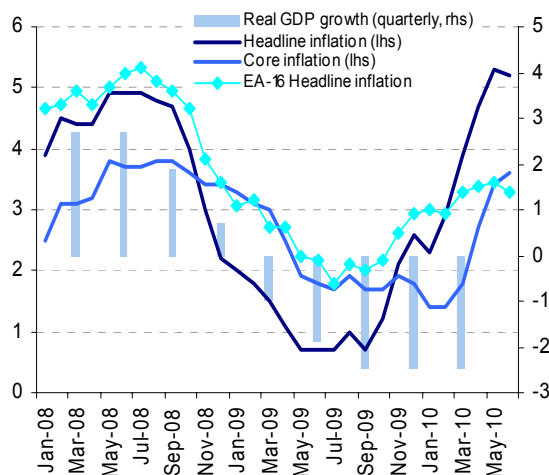
Construction activity and new building permits (% change, y-o-y)



Source: Bank of Greece and EUROSTAT

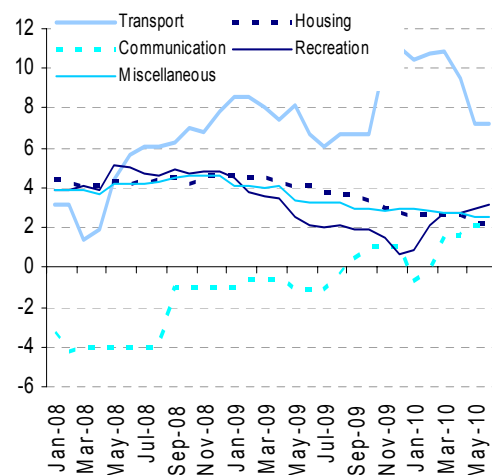
Inflation developments

Inflation and GDP growth (% change, y-o-y)



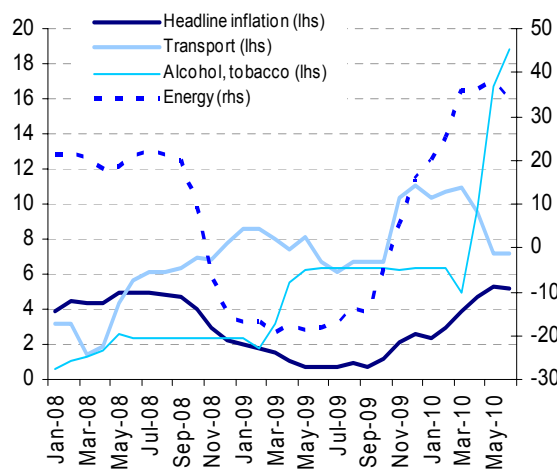
Source: EUROSTAT

Services sector inflation (% change, y-o-y)



Source: EUROSTAT

Main drivers of inflation (% change, y-o-y)



Source: Hellenic Statistical Authority

Annex 2: Assessment of compliance with required action for the first review

Table A2-1: Overview of fiscal measures for the first review

Measures in the MoU (by end-June 2010)	Assessment and comments
Increase in VAT rates, with a yield of at least EUR 1800 million for a full year (EUR 800 million in 2010);	<i>Observed</i> The relevant law (Law 3845/2010, ΦΕΚ 65Α / 06.05.2010) was adopted by Parliament in May 2010.
Increase in excises for fuel, tobacco and alcohol, with a yield of at least EUR 1050 million for a full year (EUR 450 million in 2010);	
Reduction in the public wage bill by reducing the Easter, summer and Christmas bonuses and allowances paid to civil servants, with net savings amounting to EUR 1500 million for a full year (EUR 1100 million in 2010);	
Elimination of the Easter, summer and Christmas bonuses paid to pensioners, while protecting those receiving lower pensions, with net savings amounting to EUR 1900 for a full year (EUR 1500 million in 2010);	
Cancel budgetary appropriations in the contingency reserve with the aim of saving EUR 700 million;	
Reduce the highest pensions with the aim of saving EUR 500 million for a full year (EUR 350 million in 2010);	
Abolish most of the budgetary appropriation for the solidarity allowance (except a part for poverty relief) with the aim of saving EUR 400 million;	
Reduce public investment by EUR 500 million compared to plans;	

Parliament adopts, as planned in the stability programme of January 2010, a Law introducing a progressive tax scale for all sources of income and a horizontally unified treatment of income generated from labour and assets;	<i>Observed</i> The relevant law (Law 3842/2010, ΦΕΚ 58Α / 23.4.2010) was adopted by Parliament in April 2010.
Parliament adopts, as planned in the stability programme of January 2010, a Law abrogating exemptions and autonomous taxation provisions in the tax system, including income from special allowances paid to civil servants. The law applies retroactively from January 1, 2010.	

Table A2-2: Overview of structural fiscal measures for the first review

Measures in the MoU (by end-June 2010)	Assessment and comments
Government adopts by end-June 2010 a law that requires the monthly publication by the General Accounting Office (GAO) of timely monthly statistics (on a cash basis) on revenue, expenditure and financing for the State, as well as on spending pending of payment, including arrears.	<i>Partially observed</i> The relevant law was adopted by Parliament on 12 July 2010. Greece has been regularly publishing detailed cash data on revenue, expenditure and financing of the state since January. Data on spending pending payment is not yet available.

Table A2-3: Overview of structural reforms for the first review

Measures in the MoU (by end-June 2010)	Assessment and comments
To reform and modernise public administration	
Parliament adopts legislation reforming public administration at the local level, notably by merging municipalities, prefectures and regions with the aim of reducing operating costs and wage bill.	<i>Observed</i> Law approved by Parliament on 27 May. The entry to force of this law will require around one hundred implementing decrees by the end of 2010.
Parliament adopts legislation requiring online publication of all decisions involving commitments of funds in the general government sector.	<i>Observed</i> Law adopted by Parliament on 5 July.

To strengthen labour market institutions	
Government starts discussions with social partners in order to revise private sector wage bargaining and contractual arrangements.	<i>Observed</i> The government has started labour market discussions with social partners.
To enhance competition in open markets	
Government adopts law to simplify the start-up of new businesses.	<i>Observed</i> Law adopted by Parliament on 17 June 2010 on simplifying the start-up of companies. The goal of the law is to reduce the number of steps needed to create a company and to be able to complete all the procedures in one day. The law will become fully operational by end November 2010, as there are two Joint Ministerial decisions (between the Ministry of Economy and the Ministry of Interior) pending. The system also relies on the connexion of the one-stop shops with the tax authorities and the Social Security Registry, as well as on GEMI –the General electronic commercial registry- becoming fully operational. Once in place, the new regime will reduce the time and cost to set up a business, though some fees are still in place –e.g., the fee to the Competition Commission and the contributions to the lawyers' social fund, which still apply to the start up of limited and general partnership enterprises.
Government adopts the horizontal legislation on the Services Directive.	<i>Observed</i> The horizontal legislation was adopted on 29 April 2010. The horizontal framework law closely mirrors the Directive, including the provisions concerning the point of single contact, the provisions for establishment related requirements and for the freedom to provide services as well as the rules concerning administrative cooperation. Some provisions –such as those regulating the relationship with other rules or the rule on data protection- may be legally not in full compliance with the Directive. However, these provisions may not have any effects in practice. In addition, the real challenge will be the amendments of sectoral legislation.

Government adopts a recovery plan for the railway sector with a timetable for measures which: (i) specifies how operational activities will be made profitable, including by closing loss-making lines; (ii) ensures the effective implementation of EU Directives allowing for competition amongst providers of railway services; (iii) provides for the restructuring of holding company, including the sale of land and other assets.	<i>Ongoing</i> A draft working document was circulated to the Commission services at the end of June.
To raise the absorption rates of Structural and Cohesion Funds	
Government will put in place measures, including the implementation of Law 3840/2010, the establishment of a "fast-track project production", to achieve the six-monthly targets for payment claims targets in the absorption of Structural and Cohesion Funds set down in the table below. Compliance with the targets shall be measured by certified data. The government will take steps to achieve an annual target of submitting 10 major projects applications to Commission services.	<i>Observed</i> On 30 June, the Greek government passed a ministerial decision to fast track project production. This ministerial decision shortens deadlines for the completion of the various procedural stages in the evaluation, approval and inclusion of a project in an operational programme co-funded by structural and cohesion funds, as well as for the execution of payments. However, there are many other sources of delay, which this ministerial decision cannot tackle, stemming from lengthy judicial procedures, studies of environmental impact and that should be addressed by further legislative work.
Government establishes a technical task force in direct contact with Commission services, to ensure rapid implementation of a) major projects in transport sectors, b) environmental projects; c) financial engineering instruments and d) public administration reform, relying on increased technical assistance.	<i>Ongoing</i> It has been agreed that this task force will be chaired by Deputy Prime Minister to accelerate absorption rates and to improve the coordination of NSRF actions. The task force will consist of one European Commission official and three other experts recruited by the EIB, all of them with sufficient and proven technical knowledge in the specified sectors.
Government shall have completed steps to ensure that budgetary appropriations for the national co-financing of Structural and Cohesion Funds are channelled to a special central account that cannot be used for any other purposes and which should be available to provide co-financing to all entities in the general government.	<i>Observed</i> The bank account at the Bank of Greece was created on 30 June to ring-fence the budgetary appropriations of national co-financing. A Joint Ministerial decision, which specifies procedural details, is yet to be issued (as of July 30 th 2010).

Programming period 2007-2013 (in million of euro)	Payment claims to be submitted between 2010-13				<i>Ongoing</i> Regarding the MoU targets on payment claims (see table), the Greek authorities have submitted payment claims of EUR 825 mn in the first half of 2010, corresponding to 30% of the 2010 annual targets (27% as regards European Regional and Cohesion Funds, 44% as regards European Social Funds). However, a full assessment of compliance with the payment claims targets can only be made at the end of 2010.
	2010	2011	2012	2013	
European Regional Fund and Cohesion Fund	2330	2600	2850	3000	
European Social Fund	420	750	880	890	
<i>Target of first half of the year</i>		<i>1105</i>	<i>1231</i>	<i>1284</i>	
<i>Target of second half of the year</i>		<i>2245</i>	<i>2499</i>	<i>2606</i>	
<i>Total annual target</i>	<i>2750</i>	<i>3350</i>	<i>3730</i>	<i>3890</i>	

Table A2-4: Overview of financial sector regulation and supervision measures for the first review (to be completed by Q2-2010)

Measures in the MoU (by end-June 2010)	Comments
The Bank of Greece, on behalf of the Government, establishes an independent Financial Stability Fund, with a strong governance structure, to deal with potential solvency issues and to preserve the financial sector's soundness and its capacity to support the Greek economy, by providing equity support to banks as needed.	<i>Observed</i> The relevant law was adopted by Parliament on 13 July 2010.
Start implementation of intensified supervision of banks, including by allocating more human resources, also with a view to the take-over of insurance supervision, frequent reporting under tighter deadlines and quarterly solvency stress tests.	<i>Ongoing</i> The Bank of Greece has increased the frequency of data reporting. The absorption of the insurance sector into the Bank of Greece has started and is expected to be finalised by October 2010. A comprehensive framework for regularly stress-testing financial institutions has been further developed and the capacity has been stepped up.

Review the private sector bankruptcy law to ensure consistency with ECB observations.	<i>Observed</i> Amendments incurred to the draft law on the "Restructuring of business and professional debts owed to credit institutions" pursuant to the ECB's Opinion have been taken into consideration and the respective sections of the draft law have been amended before its adoption by Parliament in January 2010 (Law 3816/2010). The revised law for the "Regulation of debts of over-indebted individuals" was adopted on 28 July 2010.
--	---

Table A2-5: Overview of measures taken ahead of schedule (to be completed beyond Q2-2010)

Measures in the MoU (after first review deadline)	Comments
To reform and modernise public administration	
Government completes the creation of a Single Payment Authority for the payment of wages in the public sector. The Ministry of finance publishes a detailed report, based on information and in collaboration with the Single Payment Authority, on the structure and levels of compensation and the volume and dynamics of employment in the general government. (By December 2010)	The government has proceeded with the set up of the single payment authority ahead schedule. It already covers wages paid to almost 80 percent of the total number of the civil servants in central government. The census of public employment concluded in July 2010 should contribute to widen the coverage to the whole general government by the end of the year.
Parliament adopts legislation to improve the efficiency of the tax administration and controls, implementing recommendations provided by the European Commission and IMF. In particular, they put in place an effective project management arrangement (including tight MOF oversight and taskforces) to implement the anti-evasion plan to restore tax discipline through: strengthened collection enforcement and recovery of tax arrears (coordinated with the social security funds) of the largest debtors; a reorganized large taxpayer unit focused on the compliance of the largest revenue contributors; a strong audit program to defeat pervasive evasion by high-wealth individuals and high income self-employed, including prosecution of the worst offenders; and a strengthened filing and payment control program. (By September 2010)	Several initiatives have been taken to improve the efficiency of the tax administration, to fight tax evasion and improve tax compliance. So far the authorities have put in place the new tax law (already adopted by Parliament) which in several respects reforms the current tax system, introduces stronger enforcement of income and VAT filling and payment processes, widens the tax base by cancelling deductions and exemptions and introduces the presumptive taxation. The authorities have started developing a compliance risk management framework and building strategic management capacity in tax and customs authorities, through the reorganization of the relevant services. The set-up of five specialist task forces at the Ministry of Finance and the tax administration has also been launched and should to be concluded by end-September 2010.

Parliament adopts modifications to the organic budget law, if necessary, to ensure that the draft budget law for 2011 onwards contains detailed information on outturn and plans of the entire general government sector – including local government, social security, hospitals and legal entities. An annex to the budget will present key graphs on the financial performance of the largest public enterprises, concomitant budgetary and tax expenditures, and related fiscal risks. (By September 2010)	According to the MoU, the adoption of the new organic law was an obligation to be observed by end September 2010. The government proceeded ahead of targets and the draft law on public finance management framework, medium-term fiscal framework and personal responsibility in fiscal policy, as part of the new organic budget law, was submitted to Parliament on 30 July 2010 and should be adopted shortly. Although a number of elements in law might need clarifications, they can be addressed with ministerial decisions and acts, such as the binding nature of the budgets for local governments and social security funds, as well as the budget law's interaction with the annual updates of the stability programme. According to the government, the new organic budget law will be put into effect immediately and the 2011 budget will be prepared accordingly, containing detailed information on outturn and plans of the entire general government sector, as well as key data on the financial performance of the largest public enterprises.
--	--

Pension reform

Parliament adopts a reform of the pension system to ensure its medium- and long-term sustainability. It should limit the increase of public sector spending on pensions, over the period 2010-2060, to under 2.5 percent of GDP. The reform will be designed in close consultation with European Commission, IMF and ECB staff, and its estimated impact on long-term sustainability will be validated by the EU Economic Policy Committee. The parameters of the system will ensure long-term actuarial balance, as determined by the National Actuarial Authority. The reform should include the following elements:

- Simplification of the fragmented pension system by merging the existing pension funds in three funds and introducing a unified new system for all current and future employees. The new universally binding rules on entitlements, contributions, accumulation rules and indexation of pension rights shall be applied pro rata to everybody from 1 January 2013;
- Introduction of a unified statutory retirement age of 65 years, including for women in the public sector (phased in immediately after adoption), to be completed by December 2013;
- Gradual increase in the minimum contributory period for retirement on a full benefit from 37 to 40 years by 2015;
- Amendment of the pension award formula in the contributory-based scheme to strengthen the link between contributions paid and benefits received, with accrual rate limited to an average annual rate of 1.2%, and pensions indexed to prices;
- Introduction of an automatic adjustment mechanism that, every three years and starting in 2020, will increase the (minimum and statutory) retirement age in line with the increase in life expectancy at retirement;
- Extend the calculation of the pensionable earnings from the current last five years

Important progress ahead of the September 2010 schedule has been made in the area of pension reform. Parliament approved two pension reform bills, on 8 and 15 July 2010 (for the private and public sectors). The reform has been designed in close consultation with European Commission, IMF and ECB staff and reflects most (but not all) of specific reform parameters included in the MoU.

In the absence of complete long-term projections, the pension reform law may have to be adjusted, based on its estimated impact on long-term sustainability to be provided by the National Actuarial Authority and validated by the EU Economic Policy Committee. A specific 'contingency clause' has been inserted in the pension law to that end.

The MoU is revised to that respect and reiterate the overarching objective of reducing the projected long-term increase in pension expenditure up to 2060. The deadline for the availability of complete long-term projections should be 2011Q1, while the adjustment in the law on the basis of those data should take place in 2011Q2. Note that this adjustment of the pension law will have no impact on budgetary data up to 2013.

to the entire lifetime earnings (while retaining acquired rights); - Reduction of the upper limit on pensions; - Introduction of a means-tested minimum guaranteed income for elderly people (above the statutory retirement age), to protect the most vulnerable groups, consistent with fiscal sustainability; - Measures to restrict access to early retirement. In particular, increase the minimum early retirement age to 60 years by 1st January 2011, including for workers in heavy and arduous professions and those with 40 years of contributions. Abolish special rules for those insured before 1993 (while retaining acquired rights). Substantial revision of the list of heavy and arduous professions; - Reduction of pension benefits (by 6% per year) for people entering retirement between the ages of 60 and 65 with a contributory period of less than 40 years; - Introduction of stricter conditions and regular re examination of eligibility for disability pensions. (By December 2010)	
--	--

To strengthen labour market institutions

Following dialogue with social partners, the government proposes and parliament adopts legislation to reform wage bargaining system in the private sector, which should provide for a reduction in pay rates for overtime work and enhanced flexibility in the management of working time. Allow local territorial pacts to set wage growth below sectoral agreements and introduce variable pay to link wages to productivity performance at the firm level.

Government amends regulation of the arbitration system, (Law 1876/1990), so that both parties can resort to arbitration if they disagree with the proposal of the mediator.

Following dialogue with social partners, government adopts legislation on minimum wages to introduce sub-minima for groups at risk such as the young and long-term unemployed, and put measures in place to guarantee that current minimum wages remain fixed in nominal terms for three years.

Government amends employment protection legislation to extend the probationary period for new jobs to one year, to reduce the overall level of severance payments and ensure that the same severance payment conditions apply to blue- and white-collar workers, to raise the minimum threshold for activation of rules on collective dismissals especially for larger companies, and to facilitate greater use of temporary contracts and part-time work.

(By December 2010)

Regarding the labour market legislation deadlines of December 2010, the Greek authorities have made progress ahead of time and reforms are going in the right direction. The reform was enacted in the New Insurance Scheme and Related provisions and Arrangements for Labour Relations (Law 3863/2010) approved by Parliament on 15 July 2010.

Further measures are required, in particular reform of the wage bargaining system, extension of probationary period to one year, facilitating the use of temporary and part-time contracts and increasing flexibility in working hours. These remaining measures can be grouped in an additional single act or bound in a consistent package.

Based on the outcome of the parliamentary work on the first stream of measures and the dialogue amongst social partners, the MoU has been adjusted while keeping intact the spirit of the initial version.

Annex 3: Provision of data requirements

To be provided by the Ministry of Finance

Preliminary monthly data on the state budget execution (including functional breakdown by main categories of revenue and expenditure and by line ministry)	Monthly, 15 days after the end of each month; these data should also be included in subsequent transmissions in case of revision	PROVIDED
Updated monthly plans for the state budget execution for the remainder of the year, including functional breakdown by main categories of revenue and expenditure and by line ministry	Monthly, 30 days after the end of each month	NOT YET PROVIDED
Preliminary monthly cash data on general government entities other than the State	Monthly, 30 days after the end of each month, these data should also be included in subsequent transmissions in case of revision	PROVIDED
Monthly data on the public wage bill (of general government, including a functional breakdown in nominal wage and allowances paid to government employees per line ministry and public entity), number of employees (including a functional breakdown per ministry and public entities outside the central government) and average wage (including the relative shares of the base wage, allowances and bonuses). A functional breakdown of these data into the main public entities will be added.	Monthly, 30 days after the end of each month (starting in June 2010)	NOT YET PROVIDED
Quarterly data on general government accounts, and general government debt as per the relevant EU regulations on statistics	Quarterly accrual data, 90 days after the end of each quarter	PROVIDED
Weekly information on the Government's cash position with indication of sources and uses as well of number of days covered as well as information on the main government spending and receipt items	Weekly on Friday, reporting on the previous Thursday	PROVIDED
Data on below-the-line financing for the general government	Monthly, no later than 15 days after the end of each month, ; these data should also be included in subsequent transmissions in case of revision	PROVIDED

Data on expenditure pending payment (including arrears) of the general government, including the State, local government, social security, and legal entities	Quarterly, within 55 days after the end of each quarter	NOT YET PROVIDED
Data on expenditure pending payment (arrears) of the State and hospitals	Monthly, 30 days after the end of each month	NOT YET PROVIDED
Public debt, and new guarantees issued by the general government to public enterprises and the private sector	Monthly, within one month	PROVIDED
Income and expenditure statement and balance sheets of 30 largest public enterprises by total expenditures	Quarterly, three months after the end of the quarter	NOT YET PROVIDED
Data on EU project grants (reimbursements and advances), capital expenditures and subsidies covered by EU advances or eligible for EU reimbursement on EU supported projects specifically agreed with the EU	Monthly, within three weeks of the end of each month	NOT PROVIDED
Monthly statement of the transactions through off-budget accounts	Monthly, at the end of each month	PARTLY PROVIDED
Monthly statements of the operations on the special account	Monthly, at the end of each month	PARTLY PROVIDED

To be provided by the Bank of Greece		
Assets and liabilities of the Bank of Greece	Weekly, next working day	PROVIDED
Assets and liabilities of the Greek banking system - aggregate monetary balance sheet of credit institutions	Monthly, 30 days after the end of each month	PROVIDED
Evolution of the external funding provided by Greek banks to their subsidiaries abroad ¹⁰	Monthly, 15 days after the end of each month	PARTLY PROVIDED (only quarterly data, last data for 2010 Q1; without breakdown)
External funding flows for the banking, corporate and government sector, including also expected developments in the 12 months ahead	Monthly, 30 days after the end of each month	PARTLY PROVIDED (without forward-looking component)
Report on banking sector liquidity situation	Weekly, next working day	PROVIDED
Report on the evolution of financial stability indicators	Quarterly, 15 days after the end of each quarter depending on data availability	PROVIDED WITH DELAY
Report on results from the regular quarterly solvency stress tests	Quarterly, 15 days after the end of each quarter depending on data availability	PROVIDED (last available results for 2010 Q1)
Detailed report on the balance sheet of the Financial Stability Fund with indication and explanation of changes in the accounts	Weekly, next working day	NOT RELEVANT

¹⁰ All forms of debt instruments and capital, as well as net deposits provided to subsidiaries abroad.

Annex 4: Macroeconomic forecast
May 2010 and update of August 2010

<i>Annual % change</i>	2007	2008	2009	2010		2011		2012		2013		2014	
				August	May	August	May	August	May	August	May	August	May
GDP	4,5	2,0	-2,0	-4,0	-4,0	-2,6	-2,6	1,1	1,1	2,1	2,1	2,1	2,1
Private consumption	3,3	2,3	-1,8	-3,5	-3,8	-4,5	-4,5	1,0	1,0	1,1	1,1	1,2	1,2
Public consumption	8,4	0,6	9,6	-9,0	-8,2	-8,0	-8,0	-6,0	-6,0	-1,0	-1,0	-0,3	-0,5
Gross fixed capital formation	4,6	-7,4	-13,1	-7,3	-7,3	-7,0	-7,0	-2,6	-2,6	1,1	1,1	1,2	1,2
Exports (goods and services)	5,8	4,0	-18,1	1,3	1,5	6,1	6,1	5,7	5,7	7,3	7,3	6,7	6,7
Imports (goods and services)	7,1	0,2	-14,1	-10,3	-10,3	-6,6	-6,6	-1,5	-1,5	1,5	1,5	2,1	2,1
Contribution to GDP growth : Domestic demand	4,8	0,1	-2,5	-5,5	-5,6	-5,9	-5,9	-0,7	-0,7	0,8	0,8	1,0	1,0
Inventories	0,8	1,0	-0,1	-1,9	-1,9	0,1	0,1	0,0	0,0	-0,1	-0,1	0,0	0,0
Net exports	-1,1	0,8	0,7	3,5	3,5	3,2	3,2	1,7	1,7	1,4	1,4	1,1	1,1
Employment	1,4	0,1	-1,2	-2,6	-2,6	-3,0	-3,0	-0,4	-0,4	0,8	0,8	0,8	0,8
Unemployment rate (a)	8,3	7,7	9,5	11,6	11,6	14,5	14,5	15,0	15,0	14,6	14,6	14,1	14,1
Compensation of employees/head	6,6	5,9	5,5	-1,0	-1,0	0,1	0,1	0,1	0,1	0,1	0,1	0,3	0,3
Unit labour costs whole economy	3,5	3,9	6,3	-0,6	-0,6	-0,4	-0,4	0,0	0,0	-0,4	-0,4	-0,4	-0,4
GDP deflator	3,0	3,5	1,0	3,5	1,2	1,3	-0,5	0,4	1,0	0,7	0,7	1,0	1,0
Harmonised index of consumer prices	3,0	4,2	1,3	4,6	1,9	2,2	-0,4	0,5	1,2	0,7	0,7	1,0	0,9
Trade balance (c)	-17,7	-16,6	-14,0	-12,0	-12,1	-10,4	-10,7	-9,7	-9,9	-9,3	-9,5	-9,0	-9,3
Current account balance (c)	-14,7	-13,8	-13,1	-10,6	-10,8	-8,0	-8,4	-6,6	-6,9	-5,4	-5,6	-4,4	-4,6
Net lending(+) or borrowing(-) vis-à-vis ROW (c)	-12,5	-12,4	-12,3	-9,8	-9,9	-7,0	-7,4	-5,6	-5,8	-4,2	-4,4	-3,1	-3,3
General government balance (c)	-5,1	-7,7	-13,6	-7,8	-8,0	-7,6	-7,6	-6,5	-6,5	-4,9	-4,9	-2,6	-2,6
General government gross debt (c)	95,7	99,2	115,1	130,2	133,2	139,8	145,2	144,4	148,9	145,3	149,7	143,9	148,4

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.

Annex 5: Quantitative Performance Criteria

(in EUR billion, unless otherwise indicated)

	Performance Criteria			Indicative Targets		
	juin-10 Progr. 1/	sept-10 Progr. 1/	déc-10 Progr. 1/	déc-11 Progr. 2/	déc-12 Progr. 3/	déc-13 Progr. 4/
1. Floor on the modified general government primary cash balance	-5.0	-4.0	-5.7	-2.1	2.4	7.4
2. Ceiling on State Budget primary spending	34	50	67	67	68	69
3. Ceiling on the accumulation of new domestic arrears by the general government 5/	..	..	..	0	0	0
4. Ceiling on the overall stock of central government debt	342	342	342	365	..	..
5. Ceiling on the new guarantees granted by the central government	2.0	2.0	2.0	1.0	0.0	0.0
6. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by general government from multilateral or bilateral official creditors 5/	0	0	0	0	0	0

1/ Cumulatively from January 1, 2010 (unless otherwise indicated).

2/ Cumulatively from January 1, 2011 (unless otherwise indicated).

3/ Cumulatively from January 1, 2012 (unless otherwise indicated).

4/ Cumulatively from January 1, 2013 (unless otherwise indicated).

5/ Applies on a continuous basis from April 30, 2010 onward.

Annex 6: Financing gap projections

Greece - financing gap, quarterly profile, bn euro ¹

		2010			2011			2012			2013		
		May-Jun	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q2
A.	GG deficit	3,6	5,3	5,3	4,2	4,2	4,2	4,2	3,7	3,7	3,7	3,7	2,8
B.	GG deficit (adjusted to cash basis and PE borrowing)	3,6	7,7	1,8	3,7	4,4	7,2	2,1	3,7	3,9	5,1	2,1	3,1
C.	GVT debt amortization (bonds & T-bills)	11,4	4,1	5,6	13,3	13,1	15,9	10,3	23,0	13,4	17,5	9,8	15,6
D.	of which short-term debt	2,1	3,3	5,5	3,7	4,0	9,0	9,0	8,0	4,0	9,0	9,0	4,0
E.	of which long-term debt	9,3	0,8	0,1	9,7	9,1	6,9	1,3	15,0	9,4	8,5	0,8	11,6
F.	Public sector financing need (B+C)	15,0	11,8	7,4	17,1	17,5	23,0	12,5	26,7	17,3	22,6	11,8	18,7
G.	Rollover of short-term debt	0%	167%	36%	136%	253%	100%	67%	63%	250%	89%	56%	100%
H.	Rollover of long-term debt	0%	0%	0%	0%	0%	0%	0%	75%	75%	75%	75%	100%
I.	Gross GVT debt issuance	2,0	5,5	2,0	5,0	10,0	9,0	6,0	16,3	17,1	14,4	5,6	15,6
J.	of which short-term borrowing ² (D*G)	2,0	5,5	2,0	5,0	10,0	9,0	6,0	5,0	10,0	8,0	5,0	4,0
K.	of which long-term borrowing (E*H)	0,0	0,0	0,0	0,0	0,0	0,0	0,0	11,3	7,1	6,4	0,6	11,6
L.	Privatisation receipts	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
M.	PE net borrowing	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0	0,0
N.	Bank support scheme	0,0	2,5	2,5	1,0	1,0	1,0	1,0	0,0	0,0	0,0	0,0	0,0
O.	Financing gap (F-I-L-M+N)	13,0	8,8	7,9	13,1	8,5	15,0	7,5	10,5	0,3	8,2	6,3	3,1
P.	Loan disbursements/repayments	20,0	9,0	9,0	15,0	12,0	8,0	5,0	10,0	6,0	6,0	2,0	2,0
Q.	of which IMF	5,5	2,5	2,5	4,1	3,3	2,2	1,4	2,7	1,6	1,6	0,5	0,5
R.	of which EU	14,5	6,5	6,5	10,9	8,7	5,8	3,6	7,3	4,4	4,4	1,5	1,5

Source: GAO, Commission Services and IMF staff estimates

1. Data in this table are subject to revision

2. Schedule is based under conservative assumptions that only 3 and 6 months securities will be issued in 2010 and 2011, which increases the roll-over needs.

Annex 7: Statement by the European Commission, the ECB and IMF on the First Review Mission to Greece

IP/10/1033

Brussels, 5th August 2010

Staff teams from the European Commission (EC), the European Central Bank (ECB), and the International Monetary Fund (IMF) visited Athens during July 26-August 5 for the first quarterly review of the Greek government's economic program, which is being supported by a EUR 80 billion loan from Euro area countries and a EUR 30 billion Stand-By Arrangement with the Fund. The strategy and key policies remain as described in the May 2010 Letter of Intent and Memorandum of Economic and Financial Policies..

Our overall assessment is that the program has made a strong start. The end-June quantitative performance criteria have all been met, led by a vigorous implementation of the fiscal program, and important reforms are ahead of schedule. However, important challenges and risks remain.

The contraction in the economy is in line with May program projections: GDP is expected to decline by 4 percent in 2010 and some 2½ percent in 2011. Inflation is higher than expected - we have revised our estimate for 2010 to 4¾ percent - pushed up by indirect tax increases. With no signs of second-round effects, inflation is expected to decline rapidly.

In the **fiscal area**, the authorities have kept spending significantly below budget limits at the state level. This has offset slippages caused by problems in controlling expenditures at the sub-national level (local governments, hospitals, social security funds), and the overall deficit target for end-June was met. Going forward, to address potential risks to fiscal targets, it is critical to tighten expenditure control and monitoring, in particular at sub-national levels. Another key challenge is to further strengthen tax administration, including to reduce tax evasion by high-income and wealthy individuals. This is essential to secure tax revenues and to promote the overall fairness of the adjustment program.

In the **financial sector**, there has been a moderate deterioration in capital adequacy as nonperforming loans have increased in line with expectations. Recently, the CEBS stress tests covered more than 90 percent of Greek banking system assets and all but one state-owned bank passed, thus helping to reduce market volatility. We welcome that the government has commissioned a strategic review for the banking sector and a due diligence for state banks. The Financial Stability Fund (FSF), which is soon to become operational, will provide an important backstop to deal with potential capital shortfalls. In our view, the 10 billion euro earmarked for the FSF under the program remains adequate. Continued close monitoring of the financial sector will be important in the period ahead.

Impressive progress is being made on **structural reforms**. The mission welcomes Parliament's approval of the landmark pension reform, which is far-reaching by international standards. Substantive labor market reform is also well underway. Implementation of recent tax reform and budget reform is key in order to consolidate fiscal consolidation. Other reforms that are scheduled for early implementation are transportation, where important progress has already been made with liberalization of road haulage, and energy. Restoring competitiveness and boosting potential growth remains critical to the program's success. The challenge facing the government in this regard will be to overcome resistance from

entrenched vested interests to opening-up of closed professions, deregulation, implementation of the services directive, and elimination of barriers to development of tourism and retail.

The Greek government is still unable to access international capital markets except for placement of short-term T-bills. However, market sentiments appear now to be improving. Taking advantage of the breathing space afforded by the large-scale international financial support, the key challenge facing the Greek authorities remains to establish a strong track record of policy implementation in order to regain access to international capital markets.

Next Steps. The staff-level agreement reached with the Greek authorities will pave the way for the conclusion of the first review under the loan facility agreement (euro area) and Stand-By Arrangement (IMF), subject to approval by the Commission, the Eurogroup, and the IMF's management and Executive Board. Such approval will allow the disbursement of EUR 9 billion (EUR 6.5 billion by the euro area Member States, and EUR 2.5 billion by the IMF).

The mission for the next program review is scheduled for October, 2010.

Annex 8: Updated programme documents

Athens, 6 August 2010

Mr. Jean-Claude Juncker
President
Eurogroup

Mr. Olli Rehn
Commissioner for Economic and Monetary Affairs
European Commission

Mr Jean-Claude Trichet
President
European Central Bank

Dear Messrs. Juncker, Rehn and Trichet,

In the attached update to the Memorandum of Economic and Financial Policies (MEFP) and the Memorandum of Understanding on Specific Economic Policy Conditionality of 3 May 2010, we describe the progress and further policy steps towards meeting the objectives of the economic program that is being supported by financial assistance provided by the euro-area Member States in the context of the loan facility agreement. The policies of the government of Greece remain fully oriented toward securing fiscal sustainability, safeguarding the stability of the financial system, and boosting potential growth and competitiveness.

We have made a vigorous start with our economic program. The fiscal program is progressing well, financial policies are being strengthened, and structural policies are ahead of schedule in key aspects:

- The end-June quantitative performance criteria have all been met, led by a strong implementation of the fiscal program. Not unexpectedly, it has proven difficult to fully control expenditures at some entities, and in anticipation of such problems we significantly under-executed budget implementation at the state level, thereby ensuring that targets for the general government were met. Going forward, we are redoubling our efforts to strengthen controls at all levels of government and are determined to continue to over-perform at the state level until such controls become fully effective.
- Reflecting the weaknesses in expenditure controls at some entities, the indicative target on the non-accrual of domestic arrears has not been observed as the monitoring system for general government commitments, accounts payable, and arrears is still being developed and implemented. We commit to bringing these arrears down to zero by year-end, so that only a normal level of accounts payable is carried over into 2011.
- While the financial system continues to feel the effects of tight liquidity, sentiment indicators are gradually beginning to improve, and policy progress has been made by

establishing the Financial Stability Fund to backstop any capital needs that banks might have in the future owing to an expected increase in impaired loans as the recession runs its course. Stress tests suggest that the funds allocated by the authorities for the FSF remain adequate.

- The government has made significant progress in structural reforms with far-reaching pension and labor market reforms being approved ahead of schedule. Parliament has also already adopted important budgetary reform and reforms of local government. Other major reforms that are at an advanced stage aim at liberalizing the trucking industry and restructuring the railroad system, while reforms of the energy sector, protected professions, the licensing and business regulatory framework and preparations for implementation of the services directive are gaining momentum, as foreseen in our program.

On this basis and the completion of the prior action, we request the disbursement of the second instalment of financial assistance by the euro-area Member States in the amount of EUR 6 500 million, in line with the loan facility agreement.

We believe that the policies set forth in the 3 May 2010 Letter of Intent, MEFP and MoU, and the attached updates, are adequate to achieve the objectives under the program. We stand ready to take any corrective actions that may become appropriate for this purpose as circumstances change. We will consult with the European Commission and the ECB, as well as with the IMF, on the adoption of any such actions and in advance of revisions to the policies contained in this letter.

We are copying this letter to Mr. Strauss-Kahn, Managing Director of the IMF.

Sincerely,

/s/

George Papaconstantinou
Minister of Finance

/s/

George Provopoulos
Governor of the Bank of Greece

Greece—Memorandum of Economic and Financial Policies

1. **The government has made a vigorous start at implementing its economic program.** The fiscal program is progressing well, financial policies are being strengthened, and structural policies are ahead of schedule in key respects. The May 2010 Letter of Intent (LOI) and Memorandum of Economic and Financial Policies (MEFP) describing the 3-year economic program remain fully in force. This update to the MEFP combined with the updated MoU presents a review of achievements and policy steps toward the second review scheduled for late 2010.

2. **The growth outlook remains unaltered; short-run inflation is revised up.** The government continues to envisage a contraction of activity by about 4 percent in 2010 and some 2½ percent in 2011. However, because the government frontloaded a number of large indirect tax increases, which have been passed on as a step up in the price level, the rate of consumer price inflation and the implicit deflator have increased. The high pass through of indirect tax increases to final prices is indicative of a lack of competition and the prevalence of oligopolistic market structures. HICP inflation is now expected to approach 4¾ percent for the year. Inflation at constant taxes is falling and has declined below the euro-area average for the first time since the creation of the euro. Moreover, there is no evidence of pass through of higher prices to wages, and the national collective agreement just signed contributes to moderating wage growth and improving competitiveness.

Fiscal Policies

3. **The fiscal program is making good progress.** The cash state budget is leading the consolidation effort with an impressive cut in its deficit by over 40 percent in Jan-Jun (y/y). Current revenue has increased in the Jan-Jun period by 7 percent, despite the deepening recession, and current expenditure and transfers have been cut by some 10 percent. Local governments, hospitals, and social security funds have also taken steps but their progress is more gradual as controlling their expenditures is more difficult, as was expected. Through June, the large margin under the targets created in the state budget has offset the overruns to date in subnational entities. However, there has been some undesirable buildup in accounts payable/arrears in hospitals and social security funds and, as described below, steps are underway to gain a firmer grip on risks for the targets going forward.

4. **Looking to the second half of the year and consistent with the May program, the government will limit the annual general government fiscal deficit (on accrual terms) to €18.5 billion:**

- **Continuing implementation of the measures:** The fiscal measures (VAT and excises, and particular the benefits from the pension and wage cuts) will be fully realized in the second half of the year and should generate substantial resources to allow all payments and the amortization of any mid-year arrears by end-2010.
- **Under-execution of spending:** In the January-June period, the government under-executed state budget primary spending by €5.6 billion. The government intends to maintain this overperformance through September, and to end the year by a margin of overperformance of €4 billion to cover risks coming from other parts of general government. The expenditure containment will focus on operating expenses while

making all required transfers to the social security funds and local governments to allow them to become current in their payments. At any time, should performance run short of these objectives, or revenue drop below schedule, the government stands ready to take corrective actions.

5. **The government achieved an important milestone in end-July by passing a new budget law that strengthens the fiscal management framework.** This implies that the budget for 2011 will be part of a three-year rolling medium-term framework, and that the Minister of Finance will be able to set top-down expenditure ceilings for line ministries, local governments and social budgets so as to broaden the scope of fiscal policy to general government. Also, the budget will now contain standard contingency margins to facilitate absorbing shocks, and the government will set up commitment registers in the line ministries (a structural benchmark for end-September) to manage better accrual spending—beyond cash outlays. In addition, the government is also developing monthly fiscal reporting for general government entities (a benchmark by end-September).

6. **The preparation of general government budgets for 2011 in line with the new budget law commitments is underway.** The budgets will be prepared under the new law and the government will present the pre-budget to parliamentary committees in early October together with the consolidated draft local government and social budgets and consistent with a general government fiscal deficit target (in ESA95 terms) of €17 billion in 2011. The government will take into account the sustainability of discretionary spending cuts, and if needed replace them with permanent savings. At the same time, the government will put in place the 2011 fiscal measures that were agreed in May.

7. **In line with the original Memorandum, the government will focus on bolstering tax administration and fighting tax evasion in the months ahead.** Improving tax administration is essential for fairness in the adjustment program and to facilitate broadening the tax base, with moderate average tax rates. The government will kick-start the improved tax administration by implementing the recommendations received from technical experts. By end-September, the government will set up five dedicated task forces to:

- Ensure prompt implementation of the new tax legislation,
- collect tax arrears,
- reorganize the large tax payers unit,
- strengthen the audits for high-wealth and income individuals,
- strengthen filing and payment controls, and improving tax payer services.

Meanwhile, the government will make intensive use of payments receipts to bolster tax compliance, and cross-check tax information with data on wealth and spending habits to reduce tax abuse and evasion in particular of high-income and wealthy tax payers, while also reviewing the existing legal processes to ensure timely and effective prosecution of tax offenders.

8. **Public administration reform is advancing.** The government is setting up a single payment authority through which wages of civil servants in central government will be paid by end 2010 and for general government by March 2011. Plans to move in 2011 to a simplified remuneration system are facilitated by the completed public employment census. A functional review of central administration, beginning in the second half of 2010, will seek to identify operational steps to rationalize and make more efficient the public administration.

9. The government envisages specific efforts to limit risks to its program, in particular to help strengthen expenditure control in subnational entities.

- *Health sector.* In the hospital sector the government will accelerate payments to avoid the buildup of arrears and to limit the carryover of obligations into 2011. Further, the government has reduced procurement prices of pharmaceuticals by 20 percent by implementing price caps for approved drugs lists, and improved profiles and benchmarking for patients and doctors to avoid unnecessary prescriptions, which should yield important savings during the second half of this year. Indeed, the government stands ready to reduce pharmaceutical costs further (where there is room to expand the drugs lists, the use of generics, and by introducing e-prescriptions). The government will enforce the €3 for regular outpatient services in public hospitals and extend the “all day” operation of hospitals (afternoon shift) in order to develop and improve healthcare services and increase hospital revenues, including with increased copayments of outpatient and diagnostic services. The government has placed accounting firms in state hospitals to improve their financial management to gain control over spending and accounts payable
- *Local governments.* The recently passed Kallikratis bill for local government reform will sharply reduce the number of local administrations, entities, and elected and appointed officials. The government will tightly implement the bill, in particular the targeted employment reduction and efficiency-enhancing reforms to secure improved budgetary results of €500 million subsequently in each of the three years during 2011-13. To ensure that those savings contribute to the overall fiscal consolidation of general government, the government will limit borrowing, reduce transfers, and control local government budgets consistent with the medium-term fiscal strategy.
- *State enterprises.* The government will strengthen performance of the major loss-making public enterprises in order to reduce contingent risks to the budget, including by enhancing efficiency, increasing tariffs in public transportation, and further reducing excessive allowances and overtime. In particular, the government will restructure the loss-making railroad enterprise as described below. Under the restructuring plan operating PSO’s (public service obligation—subsidies) will be limited to €50 million per year, and no new debt guarantees by the state will be provided to the restructured rail enterprise, which has to break with a long history of large losses. The 10 largest loss-making enterprises will have their financial statements through 2009 published on the web before end-September (structural benchmark) to enhance transparency in their financial condition.

10. Parliament approved a substantial pension reform ahead of schedule. It introduces a new system consisting of a contributory pension to top-up a non-contributory, means-tested, basic pension, aiming to control the increase in pension spending. The National Actuarial Authority will complete an assessment of the effects of the reform on the main pension funds by end-December 2010, and of the largest auxiliary pension funds by end-March 2011. These assessments will determine whether further adjustments to the parameters of the pension system would be needed to contain the increase in pension spending to 2.5 ppts of GDP between 2009–2060. Any further adjustments, if needed, will be completed by end of June 2011 in consultation with pension experts, as foreseen in Law 3863.

11. Financing and cash management. The latest assessment confirms that the state financing need in 2010-11 remains fully financed from the loans of the Euro-area member

states and the IMF, with the government able—as foreseen in the program—to roll over its relatively small stock of T-bills. However, the tight liquidity position will require careful cash management. In this light, the public debt management agency will start monthly T-bill auctions beginning in September (from quarterly placements) to improve cash management and smooth maturity profiles.

Financial Sector Policies

12. The Greek banking system continues to face a challenging environment. In the first quarter of the year the banking system capital ratio declined by 0.05 percentage points to 11.7 percent as non performing loans grew to 8.2 percent from 7.7 percent at end 2009. Increases in provisions and revaluation losses in the trading book generated a loss for the system on a consolidated basis. All banks remained in compliance with the minimum capital adequacy requirement of 8 percent. The recent CEBS stress tests covered more than 90 percent of banking system assets and all but one bank passed. The results contributed to reduce market volatility.

13. Liquidity conditions have remained strained although market volatility has declined. The Greek banks have not regained access to wholesale markets to fund their operations and maturing interbank liabilities put pressure on their liquidity positions. The sovereign downgrade by Moody's in June put further pressure on collateral valuations and, to preserve adequate liquidity buffers in the sector, the authorities are committed to the adoption of the legislation enabling a new tranche of government guaranteed bank bonds in the amount of €25 billion (a prior action to proceed to the IMF Board meeting on September 10). Such guarantees will ensure sufficient loan provision from the ECB/Eurosystem to the Greek banks and economy, as well as to withstand possible further market turbulence.

14. The FSF law was passed establishing a new backstopping facility for a sound level of bank equity. On July 13 the Parliament enacted the Financial Stability Fund Law. Steps needed for the FSF to become operational by mid-September are well on course and it will receive its first tranche of funding at that time.

15. Banking supervision is being strengthened. Reporting requirements have heightened and reporting lags are being reduced. However expanding supervisory resources is slow, especially taking into account the transfer of insurance supervision to the Bank of Greece. The necessary flexibility to address this issue will be provided.

16. The government has commissioned an in-depth study on the strategic options for the banking sector. In addition, the government has requested a preliminary due diligence analysis for those financial entities in which the state has a significant stake. Both the study and the due diligences will be completed by mid-September. Taking into account the outcome of the study and the due diligences, the Government, in consultation with experts, will formulate a program to preserve financial stability and enhance efficiency in the banking system.

17. The authorities are following up on the result of the July 2010 CEBS stress tests. While expecting the results of the due diligence, the single bank that did not pass the most stringent scenario will continue to implement interim restructuring measures under enhanced supervision by the BoG. The government has reaffirmed its full support to this bank and will ensure that it complies with the requirement of implementing a restructuring plan under the EU rules for state aid, including compliance with the 1 October 2010 deadline for submission.

18. **The Bank of Greece will maintain close coordination with home and host country supervisors.** Regular communications with regulators in SEE regarding risk assessments and liquidity contingency plans have intensified and participation in colleges of supervisors will continue. The authorities have also made good progress on their commitments under the MEFP and the personal insolvency law has been adopted after amending it to ensure that creditor's rights are adequately protected.

Structural reform policies

19. **Consistent with the May Memorandum, the government is making headway on structural reforms that promote growth, competitiveness, and reduce budgetary risks.**

The potential for raising productivity and output growth is large. Unleashing growth potential requires pursuing a genuine competition culture and ensuring collective bargaining institutions that deliver wages commensurate with productivity. Also, the reform agenda aims at developing open markets in a business-friendly environment. Finally, measures are needed to remove restrictions that hamper activity, innovation, and reforms in state-owned enterprises, and to promote the absorption of structural funds.

20. **Labor market reform is almost completed.** Substantive legislative changes were introduced in July easing employment protection legislation and collective dismissals, reforming minimum wages, reducing overtime premia, and allowing firm-level agreements to prevail over other levels. Alongside reforms in public employment to reduce labor-market distortions, these will increase adjustment capacity of firms, ultimately boosting employment. Further measures will be taken to reform collective bargaining, including the elimination of the automatic extension of sectoral agreements to those not represented in the negotiations. Finally, the government will adopt legislation to introduce symmetry in the arbitration system while strengthening its independence and transparency.

21. **The government will reform and/or privatize state-owned enterprises:**

- **Railways.** The draft enabling law to restructure the railway sector will be discussed in parliament by end-September and, in parallel, the government will approve a business plan with time-bound actions. Cost reductions aim at significantly reducing fiscal pressures from the enterprises, while making the train operator profitable for the fiscal year 2011. The business plan will include a clear strategy to render the infrastructure manager economically viable over the medium term in line with EU law. If necessary, further measures will be implemented to ensure that financial objectives are achieved.
- **Energy.** The government will enable the effective liberalization of the wholesale electricity market and proceed with the rationalization of tariffs while ensuring vulnerable groups are protected.
- **Other state-owned enterprises.** Privatization could boost domestic and foreign direct investments and stimulate growth. Thus, a list of privatization projects has been identified and a fully elaborated plan will be prepared before end-December.

22. **Efforts are underway to increase competition and achieve a rebound in growth:**

- **Restricted professions.** Pervasive restrictions to entry in a number of important professions impose high costs on the economy. As a first step, the government will remove barriers in the legal, pharmacy, notary, architecture, engineering, and auditing

professions. This will include reducing licensing requirements, geographic restrictions, and regulated tariffs.

- **Services sectors.** An ambitious and strategic implementation of the Services Directive will be pursued. In road freight transport, by end-September the government will seek approval for the law that removes restrictions on licenses and liberalizes prices.
- **Business environment.** The government will take measures to facilitate start-ups by making fully operational one-stop shops and eliminating unnecessary fees. On licensing, legislation will be adopted to simplify and accelerate the authorization for enterprises, industrial activities, and professions. Remaining restrictions to business activity and innovation will be identified and an action plan (“business friendly Greece”) will be formulated to remove the most important ones.
- **Tourism and retail.** The government will also commission a report analyzing the potential contributions of tourism and retailing to growth and jobs, and follow up with pointed actions and legislation.
- **HCC.** The government will amend the Greek Competition Act to strengthen the independence of the Hellenic Competition Committee and increase its effectiveness.

23. **The absorption of structural funds will be raised.** To enhance the growth impact of funds, recourse to non-targeted *de minimis* state aid measures will be gradually reduced. The government will adopt legislation to tackle delays related to environmental, archeological and expropriation impediments. A task force has been established to address these and other implementation bottlenecks.

Safeguards Assessment

24. **The Bank of Greece safeguards assessment has been completed by the IMF.** A Memorandum of Understanding between the Minister of Finance and the Bank of Greece Governor has been signed regarding the management and use of Fund disbursements.

Table 1. Greece: Quantitative Performance Criteria 1/
(Billions of euros)

	Jan-Jun 2010	Jan-Sep 2010	Jan-Dec 2010
1 Floor on primary balance			
Target	-5.0	-4.0	-5.7
Actual	-4.3		
Margin (+)	0.7		
2 Ceiling on state budget primary spending			
Target	34.0	50.0	67.0
Actual	28.4		
Margin (+)	5.6		
3 Ceiling on new domestic arrears 2/			
Target	0.0	0.0	0.0
Actual	1.0		
Margin (+)	-1.0		
4 Ceiling on the stock of debt			
Target	342.0	342.0	342.0
Actual	316.7		
Margin (+)	25.3		
5 Ceiling on new guarantees			
Target	2.0	2.0	2.0
Actual	0.3		
Margin (+)	1.7		
6 Ceiling on new external arrears			
Target	0.0	0.0	0.0
Actual	0.0		
Margin (+)	0.0		

Sources: LOI and MEFP; National authorities; and IMF staff calculations.

1/ As defined in the TMU.

2/ Indicative target.

Table 2: Greece: Structural Conditionality for 2010 1/

	Measures	Date	Status	Remarks
	Structural benchmarks	End-June		
1	Establish FSF		Observed	Law for FSF approved in parliament on July 13, 2010
2	Adopt Kallikratis law		Observed	Kallikratis Law approved in parliament on June [], 2010
3	Adopt new Financial Management Law, amending the budget Law of 1995, and including: - 3-yr fiscal strategy - Top down budgeting with exp ceilings for state budget and expenditure estimates by line ministries - standard contingency margins - supplementary budget for overspending - commitment controls - effective for 2011 budget		Observed	New budget law approved in parliament on July 29, 2010
4	NAA to produce actuarial report		Incomplete	Rescheduled to end-December 2010 for main social security funds, and end-March 2011 for remaining supplementary funds, in recognition of size of task and to allow more data collection
	Prior action for First Review Board Meeting			
1	Enactment of €25 billion bond guarantee tranche			To support bank liquidity
		End-September 2010		
1	Adopt comprehensive pension reform	Well advanced; and mostly observed, with follow up at end-December 2010 and end-March 2011		Pension reform law was adopted in parliament on July 8, 2010. Incremental pension costs now estimated at slightly above 2.5 percent of GDP. Safeguard clause to be triggered in June 2011 pending full actuarial report.
2	- Establish commitment register - Publish monthly data on GG - Report all arrears monthly			ongoing ongoing ongoing
3	Publish financial statement of 10 largest loss-making SOEs			ongoing
4	Kick-off the tax administration plan and set up five task forces - collection of tax arrears - Reorganize large tax payers unit - Strengthen audits for high-wealth and income individuals - Start prosecuting worst offenders - Strengthen filing and payment controls			Progress underway ;TA received with follow-up planned ongoing ongoing ongoing ongoing ongoing
		End-December 2010		
1	Report with single payment authorities on public sector remuneration structures			Work has begun; employment census has been completed
2	Adopt new regulations for Statistical Action Plan			Work has begun; MOUs are being drafted; Greece has received resident expert; new President of ELSTAT in place
3	Present detailed privatization plan with dates and revenue guidelines			Work has begun; potential privatization list has been drawn up; details need to be fleshed out

1/ Benchmarks for 2011 to be set in reviews for end-September and end-December 2010 (second and third review).

GREECE

Updated Memorandum of Understanding on Specific Economic Policy Conditionality

August 6, 2010

The quarterly disbursements of bilateral financial assistance from euro area Member States will be subject to quarterly reviews of conditionality for the duration of the arrangement. The release of the tranches will be based on observance of quantitative performance criteria, and a positive evaluation of progress made with respect to policy criteria in the MEFP and in this Memorandum, which specifies the detailed criteria that will be assessed for the successive reviews, up to the end of 2011. Detailed criteria for the structural reform requirements in 2010 and 2011 have been updated and further specified during the summer 2010 mission.

The authorities commit to consult with the European Commission, the ECB and the IMF staffs on adoption of policies falling within the scope of this Memorandum allowing sufficient time for review. They will also provide them with all requested information for monitoring progress during program implementation and the economic and financial situation (Annex 1). Government provides quarterly a report in line with Article 4 of Council Decision 2010/320/EU.¹

1. Actions for the second review (actions to be completed by end Q3-2010)

i. Fiscal consolidation

Rigorously implement the budget for 2010 and the fiscal consolidation measures announced afterwards, including those in this Memorandum (including its previous version).

The Ministry of Finance ensures tight supervision of expenditure commitments by the government departments, and effective tax collection, to make certain that the general government deficit targets in cash and ESA95 bases (cumulative quarterly deficit ceilings in the Memorandum of Economic and Financial Policies (MEFP) including the Technical Memorandum of Understanding (TMU); and Article 1 of Council Decision 2010/320/EU) are achieved.

The 2011 budget will provide information and reliable projections on the entire general government sector and target a further reduction of the general government deficit in line with the original MEFP. It includes a detailed presentation of fiscal consolidation measures

¹ OJ L 145, 11.6.2010, p. 6.

amounting to at least 3.2% of GDP (4.3% of GDP, if carryovers from measures implemented in 2010 are considered), and detailed information on the situation of public enterprises.

The budget will include the following measures, as planned in the original version of this Memorandum (in exceptional circumstances, measures yielding comparable savings could be considered in close consultation with European Commission, IMF and ECB staffs):

- Implement the rule of replacing only 20 percent of retiring employees in the public sector (central government, public companies, local governments, state agencies and other public institutions);
- Reduction in intermediate consumption of the general government by at least EUR 300 million compared to the 2010 level, on top of savings envisaged in the context of reforming public administration and the reorganisation of local government (see next measure);
- Government starts implementing legislation reforming public administration and the reorganisation of local government with the aim of reducing costs by at least EUR 1500 million from 2011 to 2013, of which at least EUR 500 million in 2011.
- Freeze in the indexation of pensions, with aim of saving EUR 100 million;
- Reduction in domestically-financed investments by at least EUR 500 million, by giving priority to investment projects financed by EU structural and cohesion funds;
- Temporary "crisis levies" on highly profitable firms, yielding at least EUR 600 million in additional revenue per year in 2011, 2012 and 2013;
- Incentives to regularise land-use violations, yielding at least EUR 1500 million from 2011 to 2013, of which at least EUR 500 million in 2011;
- Enforce the presumptive taxation of professionals, with a yield of at least EUR 400 million in 2011 and increasing returns in 2012 and 2013;
- Broaden the VAT base by including services that are currently exempted and move a significant proportion (at least 30%) of the goods and services currently subject to the reduced rate to the normal rate, with a yield of at least EUR 1000 million, or a measure of the same yield to be agreed with the EC/IMF/ECB staffs;
- Start phasing in a "green tax" on CO₂ emissions, with a yield of at least EUR 300 million in 2011;
- Collect revenue from the licensing of gaming: at least EUR 500 million in sales of licences and EUR 200 in annual royalties;
- Expand the base of the real estate tax by updating asset values to yield at least EUR 400 million additional revenue;
- Increase taxation of wages in kind, including by taxing car lease payments (at least EUR 150 million);
- Initiate the collection of a special tax on unauthorised establishments (at least EUR 800 million per year);
- Increase taxes on luxury goods by at least EUR 100 million;
- The budget will establish detailed expenditure ceilings for each line-ministry, local governments, and social security funds consistent with the general government deficit target. This also pertains to the medium-term fiscal framework for 2012-2013;
- The budget will contain indicative information on monthly revenue per category, and expenditure per Ministry. Updated figures will be regularly made available online.

Government implements the new organic budget law, and ensures that the draft budget law for 2011 onwards contains detailed information on outturn and plans of the entire general government sector – including local government, social security, hospitals and legal entities. An annex to the budget will present key figures on the financial performance of the largest public enterprises, concomitant budgetary and tax expenditures, and related fiscal risks.

ii. Structural fiscal reforms

Tax administration

Parliament adopts legislation to improve the efficiency of the tax administration and controls, implementing recommendations provided by the European Commission and IMF staffs. In particular, they put in place an effective project management arrangement (including tight oversight by the Ministry of Finance and taskforces) to implement the anti-evasion plan to restore tax discipline through:

- strengthened collection enforcement and recovery of tax arrears (coordinated with the social security funds) of the largest debtors;
- a reorganized large taxpayer unit focused on the compliance of the largest revenue contributors;
- a strong audit program to defeat pervasive evasion by high-wealth individuals and high income self-employed, including prosecution of the worst offenders; and
- a strengthened filing and payment control program.

Accounting and control

Government implements the reform of the general accounting office (GAO), including the following elements:

- Strengthening of the role of the GAO in budget planning and control;
- Provision of the necessary resources in terms of high-level personnel, infrastructure and equipment support, managerial organisation and information-sharing systems;
- Provision of safeguards for GAO staff against political interference, and personal accountability in the provision of reliable data;
- Strengthen the institutional mechanisms for providing reliable and plausible official budgetary forecasts that take into account available recent execution developments and trends; to this end, the official macroeconomic forecasts should be reviewed by external experts.

Government takes the following measures to ensure timely provision of reliable fiscal accounts and statistics:

- GAO starts, in June 2010, the publication of timely monthly statistics (on a cash basis) on revenue, expenditure and financing and accounts payable for the "available general government" and its sub entities (state, social security, hospitals, local governments and legal entities);
- Government adopts a detailed time-bound action plan, agreed with Eurostat, to improve collection and processing of general government data required under the existing EU legal framework, in particular by enhancing the mechanisms that ensure the prompt and correct supply of these data, and ensure personal responsibility in cases of misreporting; and receive appropriate resident technical assistance to ensure rapid progress;

- Government starts to publish timely information on the financial situation in public enterprises (at least the 10 largest loss-making ones) and other public entities not classified in the general government (including detailed income statements, balance sheets and data on employment and the wage bill). To this end, a regular and timely reporting mechanism is introduced.

The Ministry of Finance establishes a comprehensive central registry for public enterprises.

iii. Financial sector regulation and supervision

The Bank of Greece and the Government ensure that the Financial Stability Fund is fully operational.

Government makes available an in-depth study on the strategic options for the banking sector as well as a preliminary due diligence analysis for those financial entities in which the state has a significant stake.

Following up on the result of the July 2010 CEBS stress tests, the bank which did not pass the test implements interim restructuring measures under enhanced supervision by the Bank of Greece. Government provides its full support to this bank and ensures that it complies with the requirement of implementing a restructuring plan under the EU rules for state aid, including compliance with the 1 October 2010 deadline for submission.

The Bank of Greece commits to reduce remuneration of its staff in light of the overall effort of fiscal consolidation.

iv. Structural reforms

To strengthen labour market institutions

Following dialogue with social partners, Government adopts and implements legislation to reform wage bargaining system in the private sector, which should provide for a reduction in pay rates for overtime work and enhanced flexibility in the management of working time. . Government ensures that firm level agreements take precedence over sectoral agreements which in turn take precedence over occupational agreements. Government removes the provision that allows the Ministry of Labour to extend all sectoral agreements to those not represented in negotiations.

Government amends employment protection legislation to extend the probationary period for new jobs to one year, and to facilitate greater use of temporary contracts and part-time work.

Government amends regulation of the arbitration system, (Law 1876/1990), so that each of the parties can resort to arbitration if they disagree with the proposal of the mediator without exceptions on subject or coverage, according to the provisions of Law 3863/2010. It should provide for an arbitration procedure that operates according to transparent objective criteria, and with an independent committee of arbitrators with decision making capacity free from government influence. The objectives of the arbitration should ensure that due attention is paid to cost competitiveness, thereby supporting job creation.

To modernise public administration

Public sector wages and human resource management

Government launches the process, including the principles and timetable, for establishing a simplified remuneration system covering basic wages and allowances. It shall apply to all public sector employees, and be part of an overall reform of Human Resource management. This should lead to a system where remuneration reflects productivity and tasks. As a general principle, it should avoid increases in remuneration for employees as a result of the transition process.

Functional reviews

Government launches independent functional reviews of the public administration at central level and of existing social programmes. It is to be conducted by internationally renowned and external experts. The Terms of Reference for the reviews will be agreed with the European Commission, IMF and ECB staffs. To ensure ownership, participation shall *inter alia* include the office of the Prime Minister, the Ministry of Interior, the Ministry of Finance, the Ministry of Labour and Social Security and the Ministry of Health and Social Solidarity.

The objectives of the review on public administration at central level are:

- To take stock of the use of resources, including human resources, to carry out government functions (e.g., employment, goods and services) in the central government and subordinated public institutions;
- To identify actions to rationalize the organisation of public administration and generate productivity gains, and quantify possible fiscal savings from implementation of these actions. The review shall encompass horizontal issues related to planning, organisation, staffing and control functions (including internal audit), and shall include specific studies for all main ministries and key public bodies.

The objectives of the review on existing social programmes are:

- To assess effectiveness and appropriateness of existing social programmes and make proposals for reform or cancellation of the least effective ones, while quantifying possible fiscal savings from implementation of these actions.
- To assess the options for reform of the overall health care system (both public and private) with the aim of securing more efficient use of public resources and delivery of better quality health care services.

Public procurement

Government agrees an action plan, with a timetable for concrete actions, leading to the creation of a central procurement authority, involving a swift implementation of the electronic platform for public procurement and introducing the use of an e-auctioning system. It should ensure a common approach across government authorities for tendering procedures, *ex ante* and *ex post* controls.

To strengthen competition in open markets

Services Directive

Under the Services Directive, the government finalizes the review (screening) of existing sectoral legislation, and provides a list of restrictions that are being abolished or amended as a result.

The Government also ensures that the electronic point of single contact is operational with a user-friendly internet portal which:

- lists all relevant information for the specific service;
- for each service activity provides an overview of procedures to be complied with, distinguishing between the requirements that apply in establishment cases and for cross-border service provision;
- allows common procedures (including for the most important regulated professions and in the areas of tourism, retail, education and construction) to be completed by electronic means with the necessary forms available on-line and recognising electronic signatures in accordance with Decision 2009/767/EC.

Transport

Government adopts a law on road freight transport that removes restrictions not provided for in Directive 96/26/EC of 29 April 1996 on admission to the occupation of road haulage, including minimum fixed prices.

The government adopts legislation, proposed by the Ministry of Infrastructure, Transport and Networks, establishing the necessary enabling conditions for the development and the implementation of a business plan in the railway sector and submits it to Parliament for voting. The legislation should *inter alia*:

- ensure compliance with all relevant EU legislation on the railway sector to effectively ensure market opening, employment and social policies, as well as competition and state aid policy
- establish an upper limit of EUR 50 million for the annual Public Service Obligation (PSO) contribution from the general government for the period 2011-2013 and establishes the principle that the State provides no additional explicit or implicit support to TRAINOSE;
- provide for any future changes to the level of PSO transfers to the railway operators to be approved only after an independent and transparent assessment by the Hellenic Competition Commission and to be fully in line with all legislation related to budgetary control and execution;
- provide certainty that the managing boards of TRAINOSE and OSE have the legal authority to negotiate new collective agreements covering remuneration and employment conditions and to take staffing decisions that assure a viable business;
- ensure that decisions on the transfer of debt to the State become effective only after the implementation of key actions in the approved business plan;

The government adopts a business plan, proposed by the Ministry of Infrastructure, Transport and Networks, with a detailed timetable for concrete actions, which *inter alia*:

- specifies how operational activities will be made profitable, including covering depreciation costs, as from 2011 including by closing loss-making lines, by increasing tariffs and by reducing wages and staffing;
- provides a detailed sensitivity analysis on the implications for wage costs of various scenarios for the outcome of collective agreement. This provides information on several options concerning staff;
- ensures the effective implementation of EU Directives, including EU Directives 2007/59/EC and 2007/57/EC on the Train Driver Certificate and on the Interoperability of the Rail System, respectively, allowing for competition amongst providers of railway services;
- provides for the restructuring of the holding company, including the sale of land and other assets.

To promote investments and exports

Government takes measures, in line with EU competition rules, to facilitate FDI and investment in innovation in strategic sectors (green industries, ICT, etc...), the adoption of measures to facilitate public private partnerships (PPPs), action to fast-track large FDI projects and measures to strengthen export promotion policy. These actions focus on removing rigidities and administrative constraints and must be fully in line with the fiscal requirements of the Memorandum of Understanding.

2. Actions for the third review (to be completed by end Q4-2010)

i. Fiscal consolidation

Government achieves the programme target for the 2010 general government deficit.

Parliament adopts the budget for 2011 targeting a further reduction in the general government deficit and including the required consolidation measures including those specified in this Memorandum.

The Ministry of Finance ensures tight supervision of expenditure commitments by the several government departments, and effective tax collection, to make certain that general government deficit target in cash and ESA95 bases (see respectively Table 2 of MEFP and Article 1 of Council Decision 2010/320/EU) are achieved.

Government prepares a privatization plan for the divestment of state assets and enterprises with the aim to raise at least EUR 1 billion a year during the period 2011-2013. The restructuring and privatization programme will span the state's holdings in rail, road transport, airports, ports, utilities, the gaming industry and public real estate; leverage private investment so as to restructure the economy, foster economic growth and contribute to fiscal consolidation; use the know-how of the private sector through outright sales of government holdings, concession agreements, initial public offerings, strategic public-private partnerships and the establishment of new holding companies.

Accounting and control

Government ensures that the central registry for public enterprises is operational.

ii. Structural fiscal reforms

The fiscal framework

Government implements legislation to strengthen the fiscal framework. The following elements should be part of the reform:

- Introduce a medium-term fiscal framework covering the general government based on rolling three-year expenditure ceilings for the State, social security entities and local governments;
- Strengthen the position of the Finance Minister vis-à-vis line ministries in both budget preparation and execution phases (giving him/her veto power on spending decisions and execution);
- Introduce a compulsory contingency reserve in the budget, corresponding to 10 percent of total appropriations of government departments other than wages, pensions and interest; the use of the contingency reserve will be decided by the Finance Minister;
- Ensure that Parliament does not modify the overall size of the budget at the approval stage, and focus on the composition of public expenditure and revenue, and reliability of projections for expenditure and revenue;
- Introduce stronger expenditure monitoring mechanisms, particularly by implementing an appropriate control of spending commitments, through which spending entities (line ministries, local authorities, social security funds, hospitals and legal entities) will report on a regular basis to the Treasury on their outstanding expenditure commitments against their authorised appropriations in the budget law;
- Introduce a revenue rule for the general government, according to which the allocation of higher-than-expected revenues should be specified *ex-ante* in the budget law;
- Creation of a fiscal agency attached to Parliament providing independent advice and expert scrutiny on fiscal issues, and reporting publicly on the budgetary plans and execution of the spending entities of the general government, and on macroeconomic assumptions used in the budget law.

Parliament adopts the reform of the public wage legislation consistent with this Memorandum.

To complete the pension reform

The National Actuarial Authority provides by 1 December 2010 interim long-term projections of pension expenditure up to 2060 under the July 2010 legislation covering the main pension schemes (IKA, OGA, OAEE, public sector scheme).

iii. Financial sector regulation and supervision

Taking into account the outcome of the strategic study and the due diligences of banks, the Government formulates a programme to preserve financial stability and enhance efficiency in the banking system.

iv. Structural reforms

To reform and modernise public administration

Local administration

Government adopts all necessary legislation and decrees for the full entry into force of the local administration reform (*Kallikrates*) and ensures that it achieves savings of EUR 500 million in 2011 and additional EUR 500 million per year in 2012 and 2013 for the general government as a whole. Government shall adopt a decree disallowing local governments to run deficits at least until 2014.

Public sector wages and human resource management

The Ministry of Finance together with the Ministry of Interior completes the establishment of a Single Payment Authority for the payment of wages in the public sector. The Ministry of Finance publishes a detailed report, in collaboration with the Single Payment Authority, on the structure and levels of compensation and the volume and dynamics of employment in the general government. The report should present plans for the allocation of human resources in the public sector for the period up to 2013 that *inter alia* specifies plans to reallocate qualified staff to areas necessary to implement the Memorandum of Understanding, including the tax administration, GAO, the labour inspectorate, regulators and Hellenic Competition Commission.

Government presents a detailed action plan with timeline to complete and implement a simplified remuneration system.

Better Regulation

Government adopts legislation and measures needed to implement the Better Regulation agenda.

To modernise the health care systems

Government adopts legislation on the institutional framework for health supplies (Law 3580/2007, as revised in May 2010 by Law 3846/2010), establishes new systems for the management of drugs that favour more use of generic medicines, including a new system for the electronic monitoring of doctors' prescriptions. The aim is to move to the average EU generic drug penetration rate, including by procurement of pharmaceutical products by hospitals and doctors' prescriptions on the basis of drastic substances.

Government enforces the payment of EUR 3 for regular outpatient services in public hospitals and extends the 'all day' functioning of hospitals (afternoon shift) in order to develop and improve healthcare services and increase revenue, including by increasing co-payment of outpatients and diagnostic services.

Government completes the programme of hospital computerisation, upgrading hospital budgeting systems, and the reform of management, the accounting (including double-entry accrual accounting) and financing systems.

Government ensures greater budgetary and operational oversight of health care spending by the Finance Minister, the publication of audited accounts and improvement in pricing and costing mechanisms.

Government seeks technical assistance from independent international experts on all aspects of the efficiency and effectiveness of the health procurement system and management of hospitals, aiming at enhancing efficiency and reducing waste.

To enhance competition in open markets

Government makes the General Commercial Registry (GEMI) fully operational.

Services directive

Government adopts changes to existing (sectoral) legislation in key services sectors such as tourism, retail and education services. New legislation should:

- facilitate establishment, in particular, by
 - abolishing or amending requirements which are prohibited by the Services Directive; and
 - significantly reducing requirements, including those relating to quantitative and territorial restrictions, legal form requirements, shareholding requirements, fixed minimum and/or maximum tariffs and restrictions to multidisciplinary activities.
- facilitate the provision of cross-border services so that service providers providing cross-border services only have to comply with specific requirements laid down in Greek legislation in exceptional cases (when admitted by Articles 16 or 17 of the Services Directive).
- provide legal certainty for service providers providing cross-border services by clearly setting out in the respective (sectoral) legislation which requirements can and which requirements cannot be applied to cross-border services.

Government specifies, a limited number of priority service sectors, which are key for growth, a timetable for adopting sectoral legislation by end Q2 2011 that ensure full compliance with the requirements of the Services Directive.

Restricted professions

Government proposes legislation to remove restrictions to competition, business and trade in restricted professions including:

- the legal profession, to remove unnecessary restrictions on fixed minimum tariffs, the effective ban on advertising, territorial restrictions on where lawyers can practice in Greece;
- the pharmacy profession, covering limits on the number of pharmacies and minimum profit margins;

- the notary profession, covering fixed tariffs, limits on the number of notaries, territorial restrictions on where notaries can practice and the effective ban on advertising;
- architects, covering fixed minimum tariffs;
- engineers, covering fixed minimum tariffs;
- auditing services, covering fixed tariffs.

Government adopts legislation and takes all necessary measures to complete the effective transposition of EU rules on recognition of professional qualifications, including compliance with all ECJ rulings (*inter alia*, related to franchised diplomas), the setting up of the administrative structures responsible for the application of the rules of recognition of professional qualifications as well as timely information of citizens about their pending requests for recognition.

Sectoral growth drivers

Government presents a report analysing the potential contribution of the tourism sector to growth and jobs in the Greek economy. It should identify all legislative, administrative and other obstacles hindering competition and market entry to the realisation of the potential.

Government presents a report analysing the potential contribution of the retail sector to price flexibility, growth and jobs in the Greek economy. It should identify all legislative, administrative and other obstacles hindering competition and market entry to the realisation of the potential.

Business environment

Government adopts legislation to simplify and accelerate the process of licensing enterprises, industrial activities and professions, which *inter alia* revises Law 3325/05, makes the spatial plan and Law 3333/05 for business areas operational.

Government adopts an 'action plan for a business friendly Greece' that presents a timetable for the removal of 30 of the most important remaining restrictions to business activity, investment and innovation.

Government accelerates the completion of the land registry and prepares a progress report, including an action plan.

Government adopts a law modifying the existing institutional framework of the Hellenic Competition Commission (HCC) with the aim of abolishing the notification system for all agreements falling within the scope of Article 1 of Law 703/1977/, to give the HCC the power to reject complaints, to increase the independence of HCC members, and to establish reasonable deadlines for the investigation and issuance of decisions.

Energy

Government presents its detailed plans for the liberalisation of the energy market, including opening up lignite-fired electricity generation to third parties in line with EU requirements.

Government adopts plan for phased transitory cost-based access to lignite-fired generation, taking into account the decommissioning of the power plants scheduled under the

Government's Energy Plan to meet the 20-20-20 target. This access will remain in place until effective implementation of the liberalisation has taken place.

Government adopts a plan to either award the hydro reserves management to an independent body or to assign this role to the independent system operator.

Government adopts a mechanism to ensure that the energy component of regulated tariffs reflects, gradually and at the latest by June 2013, wholesale market prices, except for vulnerable consumers. Government adopts a revised definition of vulnerable consumers and a tariff for this category of consumers.

In order to ensure that network activities are unbundled from supply activities as foreseen in the second and third energy liberalisation packages, Government identifies the assets and personnel associated with the electricity transmission system and the electricity distribution system.

To promote investments and exports

Government carries out in depth evaluation of all R&D and innovation actions, including in various Operational Programmes, in order to adjust the national strategy and limit the use of government subsidies and guarantees.

Government creates an external advisory council financed through the 7th R&D programme, to consider how to foster innovation, how to strengthen links between public research and Greek industries and the development of regional industrial clusters.

To raise the absorption rates of Structural and Cohesion Funds

Government meets targets for payment claims in the absorption of Structural and Cohesion Funds set down in the table below. Compliance with the targets shall be measured by certified data. In addition, Government achieves an annual target of submitting 10 major projects applications to the Commission services. In meeting absorption rate targets, recourse to non-targeted *de minimis* state aid measures should be gradually reduced.

Government presents a report on the activities of the task force assessing progress in ensuring the rapid implementation and absorption of structural funds, and proposing improvements when necessary.

<i>Programming period 2007-2013</i>	<i>Payment claims to be submitted between 2010 and 2013</i>			
<i>(in EUR million)</i>	2010	2011	2012	2013
<i>European Regional Fund and Cohesion Fund</i>	2330	2600	2850	3000
<i>European Social Fund</i>	420	750	880	890
<i>Target of first half of the year</i>		1105	1231	1284
<i>Target of second half of the year</i>		2245	2499	2606
<i>Total annual target</i>	2750	3350	3730	3890

Without prejudice to the Greek Constitution, Government adopts legislation to tackle delays in the implementation of public works and investment projects in general. Legislation should *inter alia*:

- shorten and simplify judicial procedures challenging contract awards or land expropriation decisions;
- shorten deadlines to get permits by the Central Archaeological Council in Athens;
- simplify and shorten procedures to complete studies on environmental impact and to get the approval of environmental terms for infrastructure projects.

3. Actions for the fourth review (to be completed by end Q1-2011)

i. Fiscal consolidation

Government rigorously implements the budget for 2011 in line with this Memorandum. Progress is assessed against the (cumulative) quarterly deficit ceilings in the MEFP (including the TMU).

ii. Structural fiscal reforms

Parliament adopts legislation to strengthen the fiscal framework, consistent with this memorandum.

To complete the pension reform

The National Actuarial Authority submits comprehensive long-term projections of pension expenditure up to 2060 under the adopted reform; the projection will be peer-reviewed and validated by the EU Economic Policy Committee and the European Commission, IMF and ECB. The projections shall encompass the supplementary (auxiliary) schemes, based on comprehensive set of data collected and elaborated by the National Actuarial Authority.

iii. Structural reforms

To reform and modernise public administration

Public procurement

Government completes effective transposition of Directive 2007/66/EC on public procurement regarding remedies, and at the same time ensures that responsibility for the review of award procedures be vested with the administrative courts. Government completes the transposition of Directives 2009/81 on defence and security expenditure.

Reforms to improve the business environment:

Restricted professions

Government adopts specific legislation on restricted professions including for the legal profession, the pharmacy profession, the notary profession, architects, engineers and auditing services.

Sectoral growth drivers

Government adopts legislation and takes other structural actions to implement the findings of the report analysing the potential contribution of the tourism sector to growth and jobs in the Greek economy.

Government adopts legislation and takes other structural actions to implement the findings of the report analysing the potential contribution of the retail sector to price flexibility, growth and jobs in the Greek economy.

To enhance competition in open markets

Energy

Government commences implementation of plan for opening up lignite-fired electricity generation to third parties.

Government implements its decision to either award the hydro reserves management to an independent body or to assign this role to the independent system operator.

Government starts to implement the mechanism to ensure that the energy component of regulated tariffs reflects, gradually and at the latest by June 2013, wholesale market prices, except for vulnerable consumers.

In order to ensure that network activities are unbundled from supply activities as foreseen in the second and third energy liberalisation packages, the following measures are implemented:

- Government adopts decision on the modalities of unbundling of the transmission system operator in line with the third energy liberalization package and adopts necessary legislation to ensure the creation of fully unbundled electricity and gas transmission system operators by March 2012.
- Government ensures the creation of an independent Distribution System Operator, in line with the third energy liberalisation package.

Government transfers to RAE (Regulatory Authority for Energy) all regulatory powers assigned to EU energy regulators in the third energy liberalisation package (licensing, network access, network charges, market monitoring, etc).

Government adopts measures to ensure the independence of RAE (impartial and transparent nomination of board, management authority with regard to budget and personnel, etc. in line with the third energy liberalisation package).

4. Actions for the fifth review (to be completed by end Q2-2011)

i. Fiscal consolidation

Government rigorously implements the budget for 2011 in line with this Memorandum, and the fiscal consolidation measures in the budget. Progress is assessed against the quarterly deficit ceilings in the MEFP (including the TMU).

ii. Structural fiscal reforms

To complete the pension reform

Government revises the main parameters of the pension system provided by Law 3863/2010, if the projections by the National Actuarial Authority show that the projected increase in public pension expenditure would exceed the limit of 2.5 percentage points of GDP over 2009-60. The revision should be designed in close consultation with the European Commission, the IMF and the ECB staffs.

Government implements an in-depth revision of the functioning of supplementary/auxiliary public pension funds. The aim of the revision shall be to stabilise pension expenditure and guarantee the budgetary neutrality of supplementary/auxiliary schemes.

Government substantially revises the list of heavy and arduous professions, and reduces its coverage to no more than 10% of the labour force. The new list of Difficult and Hazardous Occupations shall apply with effect from 1 July 2011 to all current and future workers.

The Bank of Greece commits not to grant pension privileges to its staff and to revise the main parameters of its pension scheme to align them with those of IKA.

iii. Structural reforms

To modernise public administration

Public sector wages and human resource management

Government adopts legislation establishing a simplified remuneration system covering basic wages and allowances that applies to all public sector employees ensuring that remuneration reflects productivity and tasks: this reform should be part of an overall reform of Human Resource management in the public sector.

Functional reviews

Government assesses the results, including operational policy recommendations, of a first phase of the independent functional review of public administration at central level are presented by the external experts. This should include the results of studies applied to a number of core ministries. The functional review of existing social programmes is finalised.

Public procurement

Government implements the reform of the public procurement system, as defined in the action plan.

To strengthen labour market institutions

Government completes the reform to strengthen the Labour Inspectorate, which should be fully resourced with qualified staff and has quantitative targets on the number of controls to be executed.

Government adapts the legislation on tackling undeclared work to require the registration of new employees before they start working.

Review the scope for improvements in the targeting of social expenditures to enhance the social safety net for the most vulnerable.

To strengthen competition in open markets:

Services Directive

Government adopts legislation on a limited number of priority service sectors identified in Q4 2010. Government specifies, for a limited number of priority service sectors, a timetable for adopting sectoral legislation by end Q4 2011 that ensure full compliance with the requirements of the Services Directive.

Business environment

Government presents an impact assessment evaluating Law 3853/2010 on simplification of procedures for the establishment of personal and capital companies in terms of the savings achieved in time and cost to set up a business.

Government ensures that the point of single contact is fully operational and completion of procedures by electronic means possible in all sectors covered by the Services Directive.

Energy

Government removes regulated tariffs for customers except households and small enterprises (as defined in the second and third energy liberalisation packages).

To raise the absorption rates of Structural and Cohesion Funds

Government meets targets for payment claims to be measured against certified data.

Government presents a report on the activities of the task force assessing progress in ensuring the rapid implementation absorption of structural funds, and proposing improvements when necessary.

5. Actions for the sixth review (to be completed by end Q3-2011)

i. Fiscal consolidation

Government rigorously implement the budget for 2011 in line with this Memorandum. Progress is assessed against the quarterly deficit ceilings in the MEFP (including the TMU).

Government adopts the draft budget for 2012 aiming at a further reduction of the general government deficit in line with the programme and including the detailed presentation of consolidation measures amounting to at least 2.2% of GDP, including the following measures (in exceptional circumstances, measures yielding comparable savings could be considered in close consultation with European Commission, IMF and ECB staffs):

- Reduce public employment on top of the rule of 1 recruitment for each 5 retirements in the public sector; the reduction in public employment on top of the 5-to-1 rule should allow savings of at least EUR 600 million;
- Establish excises for non alcoholic beverages, for a total amount of at least EUR 300 million;

- Continue the expansion of the base of the real estate tax by updating asset values to yield at least EUR 200 million additional revenue;
- Continue the reorganisation of local government, to generate at least EUR 500 million in savings;
- Nominal freeze in pensions;²
- Continue to increase the effectiveness of the presumptive taxation of professionals, with the aim of collecting at least additional EUR 100 million;
- Reduction of transfers to public enterprises by at least EUR 800 billion following their restructuring;
- Make unemployment benefits means-tested (aiming at savings of EUR 500 million);
- Collect further revenue from the licensing of gaming: at least EUR 225 million in sales of licences and EUR 400 in annual royalties;
- Further broadening of VAT base with the aim of collecting at least additional EUR 300 million.

ii. Structural reforms

To modernise public administration

Government ensures full operation of the Better Regulation Agenda to reduce administrative burden by 20% compared with 2008 level, and sends report to the European Commission.

To improve the business environment

Government changes legislation to mitigate tax obstacles to mergers and acquisitions such as the non-transfer of accumulated losses, together with the company and the complex computation of "excessive benefit" (Law 3522/2006, Article 11) in the transfer of private limited companies.

Government takes decisions to simplify the process to clear customs for exports and imports and give larger companies or industrial areas the possibility to be certified to clear cargo for the customs themselves; Government abolishes the requirement of registration with the exporter's registry of the chamber of commerce for obtaining a certificate of origin.

6. Actions for the seventh review (to be completed by end Q4-2011)

i. Fiscal consolidation

Government achieves the programme targets for the 2011 general government deficit.

Parliament adopts the budget for 2012 a further reduction of the general government deficit and including consolidation measures amounting to at least 2.2% of GDP, in line with Memorandum.

² Adjustments may be needed in case of negative inflation.

ii. Structural reforms

To modernise public administration

Functional reviews

Government assesses the results of a second phase of the independent functional review of public administration at central level are presented by the external experts. The government adopts legislation and measures to implement the first set of operational recommendations of the functional review of public administration at central level and the review of existing social programmes.

To strengthen competition in open markets

Energy

Government removes regulated tariffs for customers except households and small enterprises (as defined in the second and third energy liberalisation packages).

To raise the absorption rates of Structural and Cohesion Funds

Government meets targets for payment claims (to be measured against certified data).

Government introduces web-based open-access monitoring tool of procedures for approval of project proposals and for implementation of public projects.

Government ensures that the managerial capacity of all Managing Authorities and Intermediate Bodies of operational programmes under the framework of the National Strategy Reference Framework 2007-2013 has been certified by the International Organization for Standardization according to the standard ISO 9001:2008 (Quality Management).

Government presents a report on the activities of the task force assessing progress in ensuring the rapid implementation absorption of structural funds, and proposing improvements when necessary.

Annex 1. Provision of data

During the programme, the following indicators and reports shall be made available to the European Commission, the ECB and the IMF staffs by the authorities on a regular basis.

To be provided by the Ministry of Finance

Preliminary monthly data on the state budget execution (including functional breakdown by main categories of revenue and expenditure and by line ministry)	Monthly, 15 days after the end of each month; these data should also be included in subsequent transmissions in case of revision
Updated monthly plans for the state budget execution for the remainder of the year, including functional breakdown by main categories of revenue and expenditure and by line ministry	Monthly, 30 days after the end of each month
Preliminary monthly cash data on general government entities other than the State	Monthly, 30 days after the end of each month, these data should also be included in subsequent transmissions in case of revision
Monthly data on the public wage bill (of general government, including a functional breakdown in nominal wage and allowances paid to government employees per line ministry and public entity), number of employees (including a functional breakdown per ministry and public entities outside the central government) and average wage (including the relative shares of the base wage, allowances and bonuses).	Monthly, 30 days after the end of each month (starting in June 2010)
Quarterly data on general government accounts, and debt as per the relevant EU regulations on statistics	Quarterly accrual data, 90 days after the end of each quarter
Weekly information on the Government's cash position with indication of sources and uses as well of number of days covered	Weekly on Friday, reporting on the previous Thursday
Data on below-the-line financing for the general government	Monthly, no later than 15 days after the end of each month; these data should also be included in subsequent transmissions in case of revision
Data on expenditure pending payment (including arrears) of the general government, including the State, local government, social security, hospitals and legal entities	Quarterly, within 55 days after the end of each quarter
Data on expenditure pending payment (arrears) of the State and hospitals	Monthly, 30 days after the end of each month
Public debt, and new guarantees issued by the general government to public enterprises and the private sector	Monthly, within one month
Income and expenditure statement and balance sheets of 30 largest public enterprises by total expenditures	Quarterly, three months after the end of the quarter

Data on EU project grants (reimbursements and advances), capital expenditures and subsidies covered by EU advances or eligible for EU reimbursement on EU supported projects specifically agreed with the EU	Monthly, within three weeks of the end of each month
Monthly statement of the transactions through off-budget accounts	Monthly, at the end of each month
Monthly statements of the operations on the special account	Monthly, at the end of each month
Report on progress with fulfilment of policy conditionality	Monthly, at the end of each month

To be provided by the Bank of Greece

Assets and liabilities of the Bank of Greece	Weekly, next working day
Assets and liabilities of the Greek banking system - aggregate monetary balance sheet of credit institutions	Monthly, 30 days after the end of each month
Evolution of the external funding provided by Greek banks to their subsidiaries abroad ³	Monthly, 15 days after the end of each month
External funding flows for the banking, corporate and government sector, including also expected developments in the 12 months ahead	Monthly, 30 days after the end of each month
Report on banking sector liquidity situation	Weekly, next working day
Report on the evolution of financial stability indicators	Quarterly, 15 days after the end of each quarter depending on data availability
Report on results from the regular quarterly solvency stress tests	Quarterly, 15 days after the end of each quarter depending on data availability
Detailed report on the balance sheet of the Financial Stability Fund with indication and explanation of changes in the accounts	Weekly, next working day

³ All forms of debt instruments and capital, as well as net deposits provided to subsidiaries abroad.

Annex 2. Financial Stability Fund

General

- The purpose of the Financial Stability Fund (the 'Fund') is to maintain the stability of the Greek banking system by providing equity capital in case of a significant decline of capital buffers.
- The Fund will not provide liquidity support, which will be provided under existing arrangements.
- The equity will be provided in the form of preference shares to credit institutions authorised to operate in Greece by license from the Bank of Greece. The preference shares will be convertible into ordinary shares at a later stage under certain conditions to be further specified in the legislation establishing the Fund.
- Participation in the Fund will be mandatory, based on a trigger linked to the minimum required level of capital adequacy requirements, as established for specific credit institutions by the Bank of Greece, in its capacity as the competent supervisory authority, if no private solution has been found.
- If banks are then not able to expeditiously raise additional capital on their own and repay the Fund, a restructuring process will take place under the lead of the Fund, in line with EU competition and state aid requirements
- The Fund will be established by specific Greek legislation.
- An initial lifespan of seven years will be set for the Fund. After the end of the lifespan of the Fund, the ownership of the Fund rests with the Greek state to the extent of its shareholding in the Fund

Legal status

- The Fund will be established as a private law legal entity in order to enhance its flexibility and efficiency (e.g., to facilitate the recruitment and remuneration of appropriately qualified staff).
- The legal structure of the Fund should allow for private participation.

Funding

- The FSF will be fully funded by the government out of the resources available under the EU-IMF program for this purpose in the amount of EUR 10 billion. This implies that the risk of losses arising out of the Fund's operations would lie exclusively with the Greek Government, as the primary shareholder in the Fund. The purchase of preference shares by the Fund shall be made in cash.

Organizational issues

- The Fund will be managed by a Governing Council composed of (1) a Chairperson, a Chief Executive and three directors appointed by the Governor of the Bank of Greece and (2) two ex officio directors who represent the Minister of Finance and the Governor of the Bank of Greece. The European Commission and the ECB will each nominate an observer who would have a right to participate, without voting, in meetings of the Governing Council (without prejudice, in the case of the Commission observer, to the application by the Commission of state aid and competition rules).

- The Chairperson, Chief Executive and the non-ex officio directors will be required by law to be persons of recognised standing in banking or financial matters in Greece, the EU or internationally.
- Each of the Chairperson and the non-ex officio directors will be appointed to a five year term of office, renewable for a further two years, and may only be compulsorily removed from office by an appropriate Greek court on application of either the Governor of the Bank of Greece or the Governing Council of the Fund where (1) no longer capable of fulfilling the conditions required for the performance of the duties of office or (2) guilty of serious misconduct.
- No member of the Governing Council may be represented on the board of directors of any credit institution.
- The legislation establishing the Fund will provide that, when exercising the powers and carrying out the tasks and duties conferred upon them under the legislation, neither the Governor of the Bank of Greece nor the members of the Governing Council of the Fund shall seek or take instructions from the Greek Government or any other State entity, institution, body or undertaking.
- The Governing Council will present a semi-annual report to the Greek Parliament, the European Commission, the ECB and the IMF.
- The operating expenses will be covered by the Fund.

Powers of the Fund

- In order to fulfil its purposes the Fund will enjoy certain powers over credit institutions receiving capital from the Fund, to be exercised following consultation of the BoG. These powers will be without prejudice to the supervisory powers of the Bank of Greece, and will include, without limitation, the power:
 - to require the BoG to provide the Fund with all information on financial institutions necessary for it to fulfil its tasks;
 - to appoint a member of the Board of Directors of a credit institution;
 - to require a credit institution to present a restructuring plan;
 - to veto key decisions of a credit institution (e.g., business strategy, dividend distributions, salary caps, liquidity and asset-liability management, etc.);
 - to call a general shareholders' meeting for a credit institution in accordance with Greek company law;
 - to require conversion of preference shares into ordinary shares insofar as a credit institution fails to meet (1) the minimum required level of capital adequacy requirements established for credit institutions generally under applicable regulatory requirements or (2) certain financial conditions to be established in the restructuring plan for the credit institution; the legislation establishing the Fund will further specify an objective procedure to be followed in establishing a market-based conversion price, taking account of the impact of the Fund's intervention, the rights of shareholders under Greek law and EU state aid requirements; and
 - to conduct diagnostic studies and special audits with the help of outside consultants to assess the solvency of a credit institution where the Fund considers this necessary.
- Each of the Bank of Greece, in its capacity as the competent authority for the supervision of credit institutions, and the Fund will be authorised to exchange confidential information with one another to the fullest extent permitted by EU law.

Conditions applicable to capital increases

- The conditions applicable to any capital increases should be aligned with the Commission Decision of 19.11.2008 (N 560/2008 support measures for the credit institutions in Greece). The granting of equity capital is made subject to the following conditions in particular.
- The credit institutions will be expected to pay a market-oriented, non-cumulative remuneration unless an analysis of the restructuring plan warrants an alternative approach. A market-oriented, non-cumulative remuneration can either be 10% as stipulated in the above decision or depending on the risk profile of the credit institution and the quality of the capital, between 7% and 9.3%, whereas core tier 1 capital for fundamentally sound credit institutions should normally be remunerated at not less than 9%.
- The credit institutions will not pay dividends or coupon on hybrid capital, unless they are legally obliged to do so, which is typically the case when a credit institution is profit making (the credit institution should however not be allowed to use reserves to book a profit).
- Preference shares shall be repurchased by the credit institution for an amount that is equivalent to the amount originally invested in the credit institution. After five years the shares shall be repurchased or be remunerated at penal rates. If they cannot be repurchased because the capital adequacy requirements are not fulfilled, the preference shares shall be converted into ordinary shares.

Approval of restructuring plan by European Commission

- Any restructuring plan needs to be in accordance with State aid rules and approved by decision of the European Commission ensuring that the credit institutions will restore viability at the end of the restructuring period, burden sharing of shareholders is achieved and distortion of competition is limited.

GREECE: TECHNICAL MEMORANDUM OF UNDERSTANDING

August 6, 2010

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to quantitative targets (performance criteria and indicative targets), specified in the tables annexed to the Memorandum of Economic and Financial Policies. It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets. We will consult with the Fund, European Commission and ECB before modifying measures contained in this letter, or adopting new measures that would deviate from the goals of the program, and provide the European Commission, ECB and the Fund with the necessary information for program monitoring.

2. For program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at “program exchange rates” as defined below, with the exception of the items affecting government fiscal balances, which will be measured at current exchange rates. The program exchange rates are those that prevailed on April 30, 2010. In particular, the exchange rates for the purposes of the program are set €1 = 1.3315 U.S. dollar, €1 = 125.81 Japanese yen, €1.135 = 1 SDR.

General Government

3. **Definition:** For the purposes of the program, the general government includes:

- The central government. This includes:
 - The entities covered under the State Budget as defined in Chapter 2 of the Law 2362/1995 regarding “Public Accounting, Auditing of Government Expenditures and Other Regulations.”
 - Other entities or extra-budgetary funds (EBFs) not part of the State budget, but which are, under European System of Accounts (ESA95) rules (“*ESA95 Manual on Government Deficit and Debt*”), classified under central government.
- Local government comprising municipalities, prefectures, and regional governments including their basic and special budgets, including all agencies and institutions attached thereto, which are classified as local governments according to ESA 95.
- Social security funds comprising all funds that are established as social security funds in the registry of the National Statistical Service.
- This definition of general government also includes any new funds, or other special budgetary and extra budgetary programs that may be created during the program period to carry out operations of a fiscal nature. The government will inform IMF, European Commission and ECB staff of the creation of any such new funds, programs, or entities immediately. The general government, as measured for purposes

of the program, shall not include entities that are re-classified from outside general government into general government during the course of 2010.

4. **Supporting material:** The Ministry of Finance (MoF) will provide to the European Commission, ECB and IMF detailed information on monthly revenues and expenditures, domestic and foreign debt redemptions, new domestic and foreign debt issuance, change in the domestic and foreign cash balances of the central government at the central bank of Greece, all other sources of financing including capital transactions, and arrears of the general government. Data will be provided within 30 days. The Bank of Greece will provide detailed monthly data on assets and liabilities of local authorities and social security funds in line with monetary survey data.

I. QUANTITATIVE PERFORMANCE CRITERIA, INDICATIVE CEILINGS, AND CONTINUOUS PERFORMANCE CRITERIA: DEFINITIONS AND REPORTING STANDARDS

A. Floor of the Modified General Government Primary Cash Balance (Performance Criterion)

5. **Definition:** The modified general government primary cash balance (MGGPCB) is defined as the modified general government cash balance (MGGCB) minus interest payments by the state budget. The MGGCB is defined as the sum of the cash balances of the ordinary state budget, the cash balance of the public investment budget, the change in net financial assets of local government, the change in net financial assets of social security funds, and the change in net financial assets of extra-budgetary funds. Privatization receipts will be excluded from cash receipts. Net lending operations by the state budget will be recorded as cash expenditures.

- **The cash balance of the ordinary state budget.** The cash balance of the ordinary state budget will be measured from above the line, based on ordinary budget revenues (recurrent revenue plus non-recurrent revenue minus tax refunds) minus ordinary budget expenditures (ordinary budget expenditures will exclude amortization payments but include salaries and pensions; grants to social security funds, medical care and social protection; operational and other expenditure; returned resources; payments in exchange of claims of insurance fund for the personnel working in the Public Electricity Company; interest payments; payments for military equipment procurement on a cash basis; and NATO expenses net of NATO revenues) of the ordinary state budget as published monthly on the official website of the General Accounting Office of the Ministry of Finance, and in line with the corresponding line items established in the ordinary state budget. Primary spending of the ordinary state budget shall also include capital transfers to social security funds by bonds, and called guarantees where the state or central government assumes payments on behalf of entities outside of the general government.
- **The cash balance of the public investment budget.** The cash balance of the public investment budget will be measured from above the line, based on investment budget revenues minus investment budget expenditures of the investment state budget as published monthly on the official website of the General Accounting Office of the

Ministry of Finance, and in line with the corresponding line items established in the investment state budget.

- **The change in net financial assets of local governments** is defined on a transactions basis, as the change in the total of financial assets minus financial liabilities of local authorities adjusted for valuation changes by the Bank of Greece.
 - Financial assets include (but are not limited to) deposits of local governments in the Bank of Greece and deposits of local governments in the commercial domestic banking sector and in the Consignment Fund. Deposits will be measured at face value excluding accrued interest in line with recording for monetary survey data.
 - Financial liabilities include (but are not limited to) short and long term loans from the domestic banking system and in the Consignment Fund to local governments, measured at face value, consistent with recording for monetary survey data.
- **The change in net financial assets of social security funds** is defined on a transactions basis, as the change in the total of financial assets minus financial liabilities of social security funds, adjusted for valuation changes by the Bank of Greece; minus the change in the stock of accounts payable of public hospitals to the private sector.
 - Financial assets include
 - Deposits of social security funds in the Bank of Greece and direct deposits of social security funds in the domestic commercial banking system and indirect deposits held by the IKA mutual fund. Deposits are measured at face value excluding accrued interest, consistent with reporting requirements for monetary survey data.
 - Holdings of direct shares or indirect shares (through the IKA mutual fund), held by social security funds quoted on the Athens Stock Exchange.
 - Direct or indirect holdings of Mutual Fund units issued by Greek management companies (other than the IKA mutual fund).
 - Holdings of central government bonds, including short and long-term securities issued domestically, long-term securities issued abroad operated from Bank of Greece accounts, and indirect holdings through the IKA mutual fund. Holdings will be measured at nominal value.
 - Bank bonds issued abroad.

- Financial liabilities include the short and long term loans from the domestic banking system to the social security funds, measured consistently with monetary survey data.
- The change in the stock of accounts payable of public hospitals to the private sector.
- **The change in net financial assets of extra-budgetary funds (EBFs)** is defined on a transactions basis, as the change in the total of financial assets minus financial liabilities of extra-budgetary funds, adjusted for valuation changes by the Bank of Greece. EBFs shall exclude ELGA and OPEKEPE.
 - Financial assets include
 - Deposits of EBFs in the Bank of Greece and deposits of EBFs in the commercial domestic banking sector. Deposits will be measured at face value excluding accrued interest in line with recording for monetary survey data.
 - Holdings of shares, held by EBFs quoted on the Athens Stock Exchange.
 - Direct or indirect holdings of Mutual Fund units issued by Greek management companies.
 - Holdings of central government bonds.
 - Bank bonds issued abroad.
 - Financial liabilities include the short and long term loans from the domestic banking system to EBFs, measured consistently with monetary survey data.

6. **Other provisions.**

- For the purpose of the program, the primary expenditure of the central government that is monitored excludes payments related to bank support, when carried out under the program's banking sector support and restructuring strategy. Transactions that may be excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchases of troubled assets. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff.
- For 2010, capital transfers to social security funds by bonds and called guarantees will be excluded from primary spending. Similarly, during 2010, changes in the stock of accounts payable of public hospitals to the private sector will be excluded from the change in net financial assets of social

security funds; the change in net financial assets of EBFs will also be excluded from the modified general government primary cash balance during 2010. However, from the 2011 fiscal year onward, these factors will be included.

7. **Revenue adjuster.** Further, this performance criterion will be adjusted upward for any possible revenue over-performance in the central government against the current projection as indicated below: Central government revenue (Cumulative from January 1, 2010)

- June 2010: €25,056 million
- September 2010: €41,232 million
- December 2010: €58,382 million.

8. **Supporting material.**

- Data on cash balances of the ordinary and state budgets will be provided to the European Commission, ECB and IMF by the General Accounting Office in the Ministry of Finance within three weeks after the end of the month. Data will include detailed information on revenue and expenditure items, in line with monthly reports that are published since January 2010 on the official website of the Ministry of Finance. Data will also include data on capital transfers to social security funds in bonds, and called guarantees.
- Data on net financial assets of local authorities and social security funds, and extra-budgetary funds will be provided to the IMF, European Commission and ECB by the Statistics Department of the Bank of Greece within four weeks after the end of the month. Data on accounts payable of public hospitals will be provided by the Ministry of Health.

B. Ceiling of State Budget Primary Spending (Performance Criterion)

9. **Definition:** The state budget primary spending consists of state budget spending (spending of the ordinary state budget plus spending of the public investment budget) minus interest expenditures paid by the state budget, in line with the definitions provided above. Primary expenditure of the central government that is monitored for the Performance Criterion excludes any cash payments related to bank restructuring, when carried out under the program's banking sector restructuring strategy. Costs that may be excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by central or general government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to European Commission, ECB and IMF staff.

10. **Other provisions.** Capital transfers to social security funds by bonds and called guarantees will be excluded from primary spending during 2010. However, from the 2011 fiscal year onward, such exclusion will no longer apply.

11. **Supporting material.** The General Accounting Office of the Ministry of Finance will provide monthly expenditure data of the ordinary and investment state budget, as defined above.

**C. Non-accumulation of Domestic Arrears by the General Government
(Continuous Indicative Target)**

12. **Definition.** For the purpose of the program, domestic arrears are defined as accounts payable to domestic suppliers past due date by 90 days. In case no due date is specified on the supplier contract, the due date is assumed to be 90 days of the initiation of the billing invoice. Data will be provided within four weeks after the end of the month. The continuous non-accumulation of domestic arrears is defined as no accumulation of arrears at the end of every month during which quarter the indicative target is being monitored.

13. **Supporting material.** The Ministry of Finance will provide data on monthly expenditure arrears of the general government, as defined above. Data will be provided within four weeks after the end of the month.

D. Ceiling on the Overall Stock of Central Government Debt (Performance Criterion)

14. **Definition.** The overall stock of central government debt will refer to debt that corresponds to the activities of the state budget and will be defined for the purposes of the program as the total outstanding gross debt liabilities of the central government. It will include, but not be limited to, liabilities in the form of securities and loans. It will exclude accounts payable. Debt will be measured at nominal value. The program exchange rate will apply to all non-euro denominated debt. Inflation indexation will apply to inflation indexed debt, using the relevant index as specified in the debt instrument. For the purposes of the program, the ceiling on the stock of central government debt will exclude debt arising from payments for bank restructuring, when carried out under the program's banking sector restructuring strategy. This includes loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by the central government to support banks, including the issuance of guarantees or provision of liquidity, with the exception of Hellenic Republic intermediation in repos between foreign and domestic financial institutions will be immediately reported to IMF, European Commission and ECB staff.

15. **Adjusters.** The ceiling on the overall stock of central government debt will be adjusted upward (downward) by the amount of any upward (downward) revision to the stock of end-December 2009 central government debt. In addition, the ceiling on the overall stock of central government debt will also be revised upward by the amount of debt assumed by the central government following the railway sector restructuring.

16. **Supporting material.** Data on the total stock of central government debt will be provided to the European Commission, ECB and IMF staff by the General Accounting Office consistent with the debt published in the public debt bulletin no later than 30 days after the end of each month.

E. Ceiling on New Central Government Guarantees (Performance Criterion)

17. **Definition.** The ceiling on the new central government guarantees shall include new guarantees granted by the state, as well as new guarantees granted by any other entity that is classified under ESA95 under central government. Guarantees issued by TEMPME shall be included in the ceiling. The ceiling shall exclude guarantees to support banks and exclude guarantees related to EIB financed loans. New guarantees are guarantees extended during the current fiscal year. The latter shall include also guarantees for which the maturity is being extended beyond the initial contractual provisions.

18. **Other provisions.** The end-September 2010 PC on new central government guarantees shall exclude any new guarantees extended by entities (including TEMPME) other than the state. For the end-December 2010 PC on new central government guarantees, these factors shall be included on a cumulative basis starting October 1, 2010.

19. **Supporting material.** All new central government guarantees will be reported in detail, identifying amounts and beneficiaries. The General Accounting Office will provide the data on a monthly basis within three weeks after the end of each month. Non-state entities classified under the central government shall report the new guarantees they extended to the General Accounting Office on a monthly basis within three weeks after the end of each month.

F. Non-accumulation of External Debt Payments Arrears by the General Government (Continuous Performance Criteria)

20. **Definition.** For the purposes of the program, an external debt payment arrear will be defined as a payment on debt to non-residents contracted or guaranteed by the general government, which has not been made within seven days after falling due. The performance criterion will apply on a continuous basis throughout the program period.

21. **Supporting material.** The stock of external arrears of the general government system will be provided by the General Accounting Office with a lag of not more than seven days after the test date.

G. Overall Monitoring and Reporting Requirements

22. Performance under the program will be monitored from data supplied to the EC, ECB and IMF by the Ministry of Finance, the General Accounting Office, and Bank of Greece. The authorities will transmit to the IMF, EC and ECB staff any data revisions in a timely manner.

H. Monitoring of Structural Benchmarks

23. **Pension reform.** Parliament adopted separate laws reforming pensions for the public and private sector in mid-July, ahead of the end-September deadline under the program. An actuarial evaluation of this law is currently underway. The National Actuarial Authority will complete an assessment of the effects of the reform on the main pension funds by the end of December 2010, which will be expanded to include the largest auxiliary pension funds by end

of March 2011. This actuarial assessment will determine whether further adjustments to the pension system would be needed to contain the increase in pension spending 2010-2060 at 2.5 percentage points of GDP. Any needed adjustments to the parameters of the main pensions will be completed by end of June 2011 in consultation with the EC/IMF/ECB; and a full review of the auxiliary and welfare funds would be completed by end of December 2011.

24. **Financial information of the ten largest loss-making public enterprises.** The ten largest loss-making public enterprises will be defined based on the 2009 net income, after state budget subsidies. Net income will be defined based on financial statements that are compiled in line with Greek accounting standards. Published information on financial statements, however, will include the IFRS financial statements.