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## **The Economic Adjustment Programme for Greece**

**Interim Review (Athens, 14 – 17 June 2010)**

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## EXECUTIVE SUMMARY

*A joint EC/IMF/ECB mission visited Athens during 14-17 June 2010, for an interim review. Although there was no formal requirement for this review for the EU, and the mission did not undertake a comprehensive assessment, it provided a good opportunity for following up on recent developments, monitoring policy implementation under the Greek economic adjustment programme, and discussing with the Greek government and the Bank of Greece nascent measures and new challenges. Whilst this overall assessment is positive, with programme implementation being broadly on track, the interim review identified a number of pressure points and areas where further progress is needed.*

**Macroeconomic developments are broadly in line with the macroeconomic scenario underlying the programme, though inflation is markedly higher than projected.** Economic activity contracted by 2 ½ % in 2010 Q1 (y-o-y), largely as projected, though with a slightly different composition, with private consumption more robust than expected. Consumer prices have been much more dynamic, reflecting the stronger-than-projected impact of VAT and excises increases, higher oil prices and a weaker euro. The high pass-through of indirect tax increases to final prices, despite the deep recession, is indicative of a lack of competition and the prevalence of oligopolistic market structures.

**Fiscal consolidation is ongoing, broadly in line with plans.** State revenue performed somewhat below programme targets, but state expenditure contracted beyond the target. However, no complete set of information and data is available for outside the central government, including sectors that used to lead to large expenditure overruns in the past, such as health care.

**There has been significant progress in fiscal structural reforms**, such as 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. However, preparations are less advanced in the implementation of a system to monitor and control expenditure commitments. Conversely, in close cooperation with the EC/IMF/ECB staff, **substantial progress has been made in the preparation of the pension reform.**

**The government has initiated work on a broad range of other structural reforms**, with the interim review mission focussing on a limited number of more pressing issues. This included the law on the reform of local government, the law on the transparency of public spending, the horizontal legislative provisions required to implementing the Services Directive and the legislation to liberalise the road haulage sector. In addition, the government prepared a draft law on private sector wage bargaining and contractual arrangements.

**The banking system has been affected by the recent downgrades of sovereign and bank debt.** In order to safeguard the credit institutions' liquidity position over the coming months, the government contemplates putting into place another tranche of the government guarantee scheme.

**There has been good progress in preparing the draft law establishing a Financial Stability Fund.** The implementation of intensified supervision is well on the way. Moreover, the Bank of Greece has committed to increase the frequency of data reporting.

**The Eurostat/Greece action plan on statistics** is being regularly monitored by the Project Steering Committee which consists of Eurostat, EL.STAT, the Ministry of Finance and the Bank of Greece. As foreseen by the monitoring arrangements of the action plan, the 2<sup>nd</sup> quarterly meeting of the Project Steering Committee will take place in Athens at the beginning of July.

## **1. INTRODUCTION**

1. **On 2 May 2010, a joint European Commission/IMF/ECB mission concluded with Greece a staff-level agreement for a euro area/IMF financing package of EUR 110 billion and supporting economic policies.** On the same day the Eurogroup agreed to activate stability support to Greece via pooled bilateral loans. On 9 May, the IMF Executive Board approved a stand-by arrangement. 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.

2. **The second instalment of the financial assistance to Greece, planned to take place in the first fortnight of September 2010, will be subject to the first quarterly review of conditionality by the Commission, the IMF and the ECB.** This is scheduled for late July. The release of the second tranche will be conditional upon a positive evaluation of progress made with respect to conditionality criteria in the Memorandum of Economic and Financial Policies (MEFP) and the Memorandum of Understanding (MoU).

## **2. MACROECONOMIC DEVELOPMENTS**

3. **Economic activity in the first half of 2010 appears to be broadly in line with the macroeconomic scenario underlying the economic adjustment programme for Greece.** According to EL.STAT data, real GDP contracted by 2½% (y-o-y) and by 1% (q-o-q) in the first quarter of 2010. While the available high-frequency and advanced indicators suggest that the contraction in economic activity will aggravate in the second and third quarter of this year, at this stage, there is no compelling reason to revise, either upwards or downwards, the programme projection of an annual 4% fall in real GDP in 2010.

4. **The composition of growth in the first quarter was slightly different than anticipated, with private consumption being more robust than expected.** After four consecutive quarters of contraction, private consumption rebounded 1.5% (y-o-y) in the first quarter. Given the fiscal measures being implemented and financial developments, the robustness of private consumption in the first quarter is likely to be temporary in the context of an overall downward trend. In particular, in Q1 2010, private consumption benefitted from base effects (very weak Q1 2009) and seasonal factors (Easter was in the first week of April, so pre-Easter spending took place in March). Anticipatory behaviour by consumers (especially in cars and other durables), given the expectation of indirect tax increases, may also have contributed to the strength of private consumption. Noteworthy, though, there was probably an improvement in retail sales reporting, a phenomenon that may be related to some first results from the fight against tax evasion.

5. **Investment has weighed and will continue weighing on economic activity.** In the first quarter, investment fell by 14.6%. Private building activity continued to shrink in the first months of the year (by -14% in January-February); public investment programme disbursements in the first five months of the year fell by almost one third.

6. **On the external side, the expected adjustment has not yet taken full course.** On the basis of national accounts data published by EL.STAT, exports (in volume) decreased by 0.5%, while imports contracted by 6.6% (both y-o-y). The trade balance narrowed in the first quarter of 2010 by 1.4% of GDP compared to Q1-2009. Balance of payments data, compiled by the Bank of Greece show a somewhat different picture<sup>1</sup> with the trade balance deteriorating; that seems to be mainly related to higher oil import prices and large net payments for ship purchases. Excluding these two variables, the trade deficit fell slightly. In the first quarter, the current account deficit (Bank of Greece's data) rose to 16.7% of GDP, from 12.3.% a year ago. However, the planned fall in the current account deficit (national accounts data) from 13.1% of GDP in 2009 to 10<sup>3</sup>/<sub>4</sub>% of GDP in 2010 remains the central scenario.

7. **Labour market has deteriorated with unemployment increasing to a 10-year high above 12% in February.** The unemployment rate was 11.6% in March 2010 compared to 9.2% in March 2009 and 12.1% in February 2010. The marginal improvement reported in March can be attributed to seasonal factors. After a bleak first quarter (fall in employment by 1.4%, y-o-y) labour market trends are expected to deteriorate further, as the economy slides further down into recession.

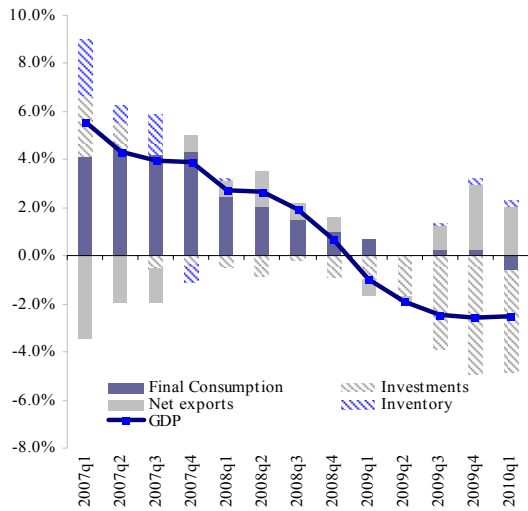
8. **The economic downturn should keep unfolding in the coming months.** In May 2010, business sentiment indicators remained very negative and showed a further deterioration in industry, services and retail trade. On the supply side, after an average fall by 10.8% in 2009, manufacturing production decreased by 3.5% in Q1 2010 and further 3.9% (y-o-y) in April. However, industrial production and industrial new orders recorded positive growth rates, in particular orders from the non-domestic market. The very negative sentiment in construction remained unchanged: new building permits fell further by 20.2% (y-o-y) in January-March 2010, signalling a continued contraction in the sector. Despite the relatively favourable developments in retail sales and private car registrations in the first months of the year, consumer sentiment surveys in April and May indicate weakening private consumption.

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<sup>1</sup> As in some other countries, balance of payments data compiled by the central bank often show significant deviations from national accounts.

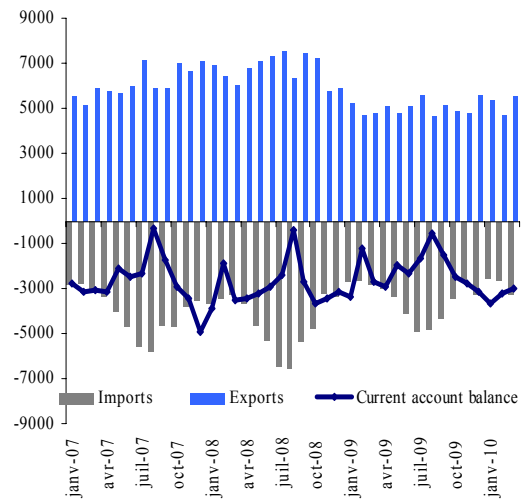
**Figure 1: Main macroeconomic indicators**

**1. Real GDP growth and composition (% change, y-o-y)**



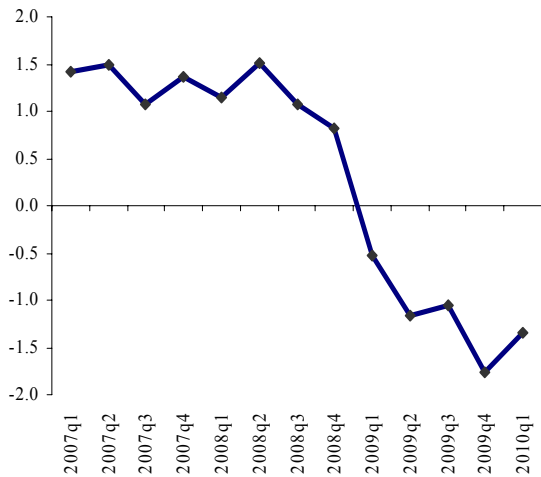
Source: Hellenic Statistical authority

**2. Exports, imports and current account balance (levels, mn euro)**



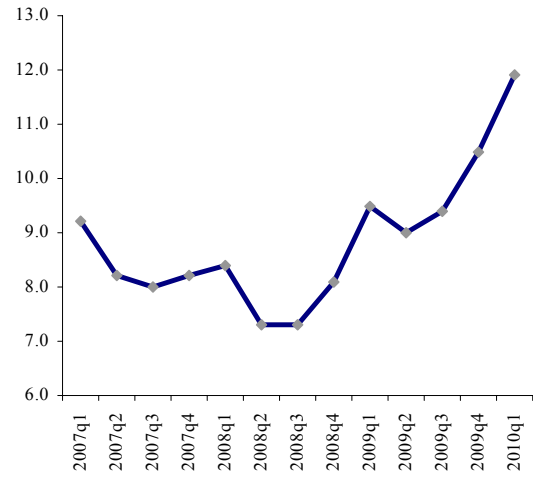
Source: Bank of Greece

**3. Employment (% change, y-o-y)**



Source: Hellenic Statistical authority

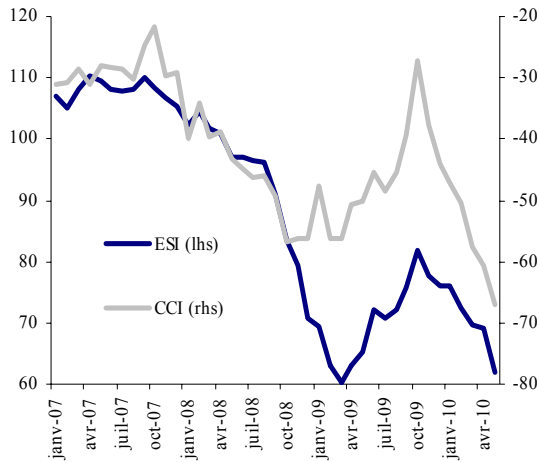
**4. Unemployment rate**



Source: Hellenic Statistical authority

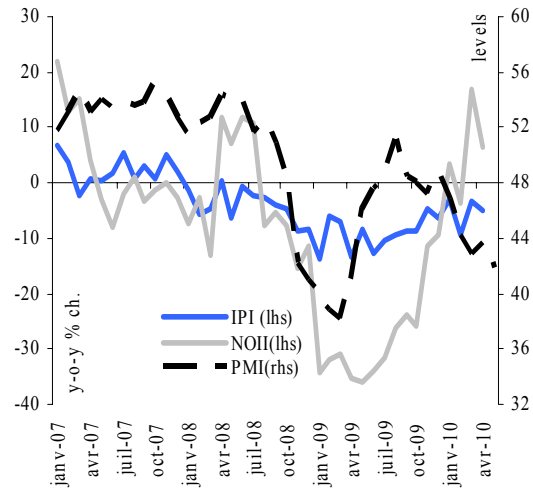
**Figure 2: High-frequency and leading indicators**

**5. Economic Sentiment and Consumer Confidence Indicators**



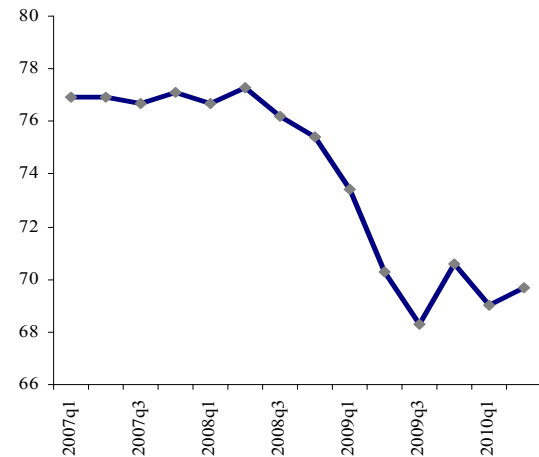
Source: DG ECFIN

**6. Industrial production, new orders and PMI**



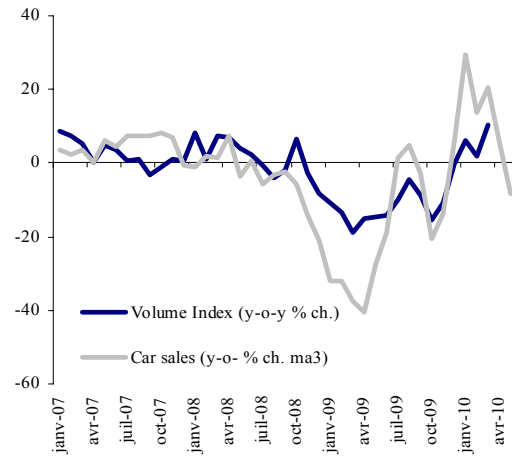
Source: Hellenic Statistical Authority

**7. Capacity utilization in manufacturing (%)**



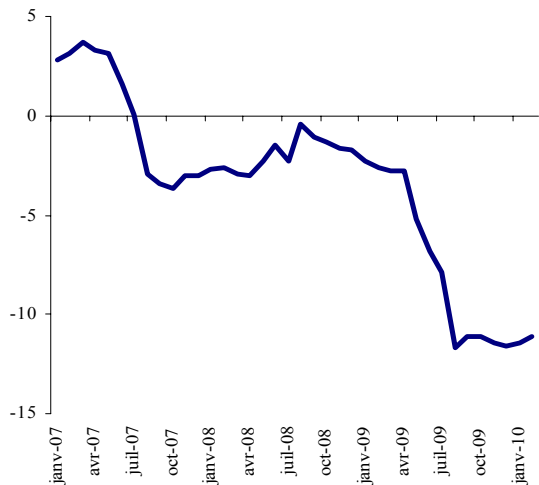
Source: ECOWIN

**8. Volume index in retail and car sales**

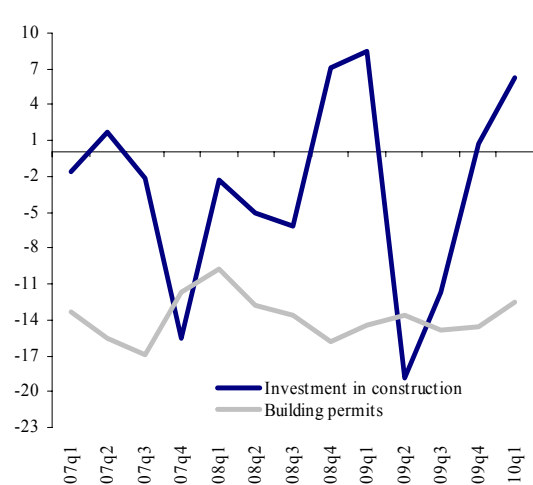


Source: Hellenic Statistical authority

**9. Tourist activity (travel receipts in 2005 prices, % change y-o-y, 12m, moving average)**



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



9. **Consumer prices have been much more dynamic than expected.** In May, HICP inflation stood at 5.3%, a level not observed since 1997. In the same period, HICP inflation in the euro area was 1.6%. Most of the high inflation rate owes to the several increases in VAT and excises implemented in January, February, March and May. According to the data published by EL.STAT and Eurostat, the inflation rate at constant taxes was 1.3% in May, four full points below the headline figure. In terms of components, energy continued to be the largest contributor to headline inflation; on the back of rising oil prices and taxes (both VAT and excises), the contribution of energy rose to 2.8 percentage points up from 1.5 points in January. The second largest contributor in May was the service sector (1.3 points), slightly up from 1.1 points in January. Within services, recreational and transport services played the major role, the latter mostly driven by passenger road transport.

10. **The large impact of indirect tax increases on inflation, in the context of a severe recession, provides evidence of inflexible domestic markets, requiring significant product market reforms.** Nevertheless, the implication for competitiveness of inflation above the euro-area partners should not be overstated; VAT and excises do not apply to exports and there is, at this stage, no evidence of an adverse wage-price spiral, with private wages slowing down markedly to close to zero growth rates.<sup>2</sup> Price pressures are expected to abate substantially in the second half of the year, as activity contracts further. Nevertheless, the inflation projection for 2010 in the economic adjustment programme will need to be revised upward.

11. **Unit labour costs should fall slightly in 2010.** The main factor should be a downward pressure on wage developments exerted by: (i) the signalling effect of restrictive public sector wage policy; (ii) adverse demand and labour market conditions; and (iii) reforms in labour legislation aimed at increasing wage flexibility.

12. **Credit keeps slowing down, but year-on-year growth rates remain positive.** Credit expansion to the corporate and household sectors combined, slowed down to 3.2% (y-o-y) in April 2010 from 3.5% in March 2010 and 4.2% in December 2009. There was a continuing slight slowdown in the growth of consumer credit (April 2010: 0.6%) and of the outstanding stock of housing loans. The credit expansion to the private sector is expected to remain low over the next months and might possibly enter negative territory, as the weakness of economic activity is dampening demand for loans; supply of loans will also dampen, as bank lending terms and credit standards are expected to turn tighter in the period ahead. Reflecting these factors, bank interest rates on both deposits and loans have increased since the beginning of the year.

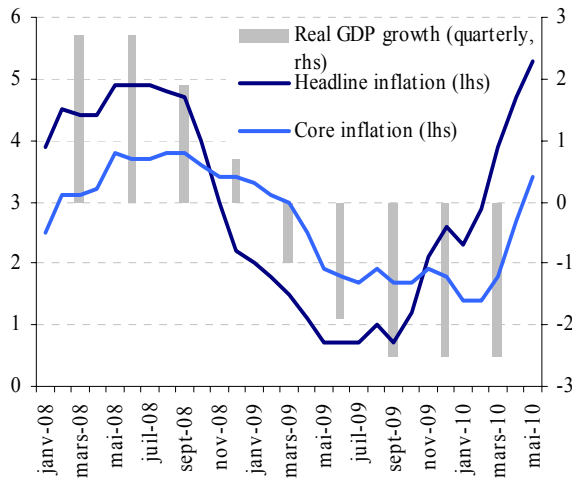
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<sup>2</sup> On private sector wages, the dialogue on the new collective wage agreement is ongoing between employers' and employees' organisations.



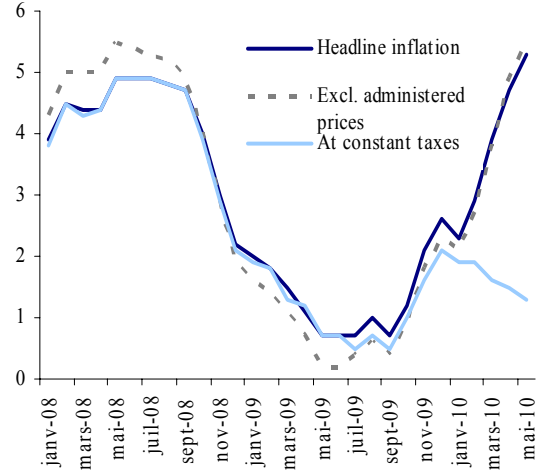
**Figure 3: Inflation developments**  
(Jan 2008- May 2010, monthly year-on-year growth rates)

**11. HICP inflation (% change, y-o-y)**



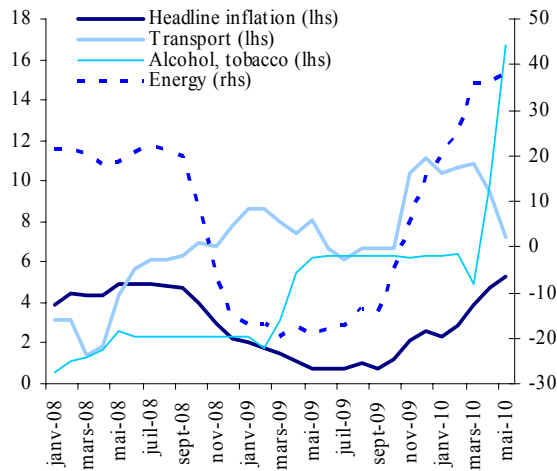
Source: Hellenic Statistical Authority

**12. HICP inflation excluding administered prices and at constant taxes (% change, y-o-y)**



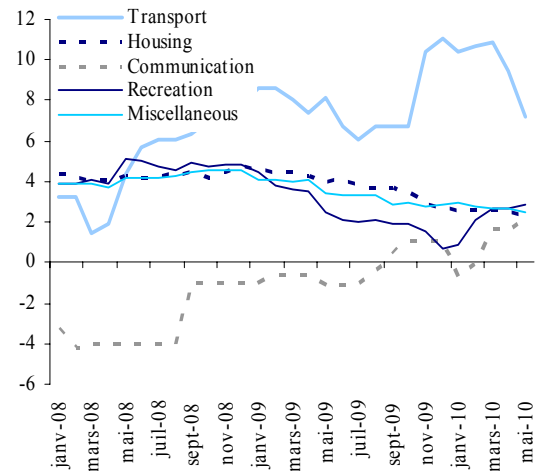
Source: Hellenic Statistical Authority

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



Source: Hellenic Statistical Authority

**14. Services sector inflation (% change, y-o-y)**



Source: EUROSTAT

**3. FISCAL CONSOLIDATION**

*a. Actions to be taken by Greece before end-June 2010 according to the MoU*

13. In the course of 2010, the Greek government has adopted four packages of fiscal measures: in January, in the context of the stability programme; in February, just before the stability programme assessment by the Commission; in March in response to the Council Decision under Article 126(9) of the Treaty, and in May shortly after, and in response to the MoU. These fiscal packages add to the initial 2010 budget which had

been put forward by the government in October 2009 and adopted by Parliament in late December 2009. These four packages of measures are quantified at around 8% of GDP and are expected to reduce the government deficit from 13.6% of GDP in 2009<sup>3</sup> to 8% in 2010.

14. **The budgetary impact of the fiscal measures in the MoU amounts to 2.5% of GDP in 2010, plus carryovers of 1.1% of GDP for 2011.** For most of these measures indicated in the table, the quantification indicated in the MoU appears to remain valid. However, on the basis of the budget execution over the second half of the year, possible adjustments in quantification of these measures might be necessary.

Measures in the MoU (by end-June 2010)	Comments
Increase in VAT rates, with a yield of at least EUR 1800 million for a full year (EUR 800 million in 2010);	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;	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.	

<sup>3</sup> Note that Eurostat has not yet validated the 2009 government deficit and debt data. On 22 April 2010, Eurostat informed that, following completion of the investigations that Eurostat is undertaking on these issues in cooperation with EL.STAT, the 2009 government deficit ratio could be revised upwards by 0.3 to 0.5% of GDP, and the debt by 5 to 7% of GDP.

*b. Budgetary execution*

15. **Budgetary developments over the period January to May 2010 are broadly positive.** According to monthly data published by the General Accounting Office (GAO), and monetary statistics-derived data, the state budget cash-deficit has shrunk by some 40% as compared to the respective period in 2009.

16. **Total revenue has performed somewhat below expectations.** State revenue has increased by some 7% compared with the respective period of 2009, below the targets. Tax revenue (before refunds)<sup>4</sup> grew by 5.7%, including the collection of a number of one-off taxes in the beginning of the year (such as the extraordinary tax on highly profitable enterprises and large real-estates). The majority of the four fiscal packages, although already implemented, had not yet fully reflected in the data available until May. Taking into consideration their full estimated fiscal impact, the state revenue target is expected to be broadly achieved with some downside risks.

17. **Total expenditure of the state budget has contracted beyond the target so far, by almost 13% compared with the respective period of 2009.** 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 the additional expenditure savings adopted in May have not yet been reflected in the available data. Interest expenditure (on a cash basis) in turn, remains below budgeted targets: this has to do with the calendar of interest payments and should return to normal, as reflected in the budgeted targets, in the coming months. Risks in relation to state expenditure refer to the accumulation of arrears in the first 5 months of the year, on which available information is scarce. Another source of concern refers to the state budget funding to the social security funds, a number of which have already absorbed more than half of annual budgetary appropriations and might need additional funding, beyond the budgeted amounts. Finally, according to the authorities, a non-negligible amount of state guarantees (to public enterprises outside the general government) may be called and constitute an additional concern for the budgetary execution. Nevertheless, as a number of expenditure restraining measures has not yet taken effect, its full implementation by the end of 2010 should be enough to compensate for possible slippages.

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<sup>4</sup> Tax refunds, which are currently significantly lower than anticipated, are expected to normalise after September and especially during the last quarter of 2010.

**Table 1: State budget execution (January to May 2010, cash data)**

<i>on cash basis (m. euro)</i>	2009	2010	%Δ
	Jan - May	Jan - May	
<b>Total revenues</b>	<b>18785</b>	<b>20066</b>	<b>6.8%</b>
Revenue before refunds	20355	21508	5.7%
Tax refunds	2115	1751	-17.2%
Capital revenue	545	309	-43.3%
Other			
<b>Total expenditures</b>	<b>33440</b>	<b>29045</b>	<b>-13.1%</b>
Primary expenditure	23013	20418	-11.3%
Interest	5837	5397	-7.5%
Capital expenditure	4590	3230	-29.6%
Other	0	0	
<b>Central Gvt balance</b>	<b>-14655</b>	<b>-8979</b>	<b>-38.7%</b>

18. **No complete set of information and data is available for outside the central government so far.** Available monetary statistics-derived data (such as deposits and loans by social security and local authorities), which are still under scrutiny, suggest that the general government balance as a whole is broadly on track. However, there is limited available information on the sectors that used to lead to large expenditure overruns, such as healthcare where cost overruns and accumulation of arrears used to be pervasive. Although some progress with the implementation of relevant structural reforms has been made, they seem moving slowly, which constitutes a source of concern. There is anecdotal evidence suggesting that the practice of accumulating hospital arrears has not yet been eradicated.

#### **4. STRUCTURAL FISCAL REFORMS**

##### ***a. Actions to be taken by Greece before end-June 2010 according to the MoU***

19. The table below reproduces the text of the MoU in relation to structural fiscal reforms to be adopted by the end of June 2010, and provides information on their implementation.

<b>Measures in the MoU (by end-June 2010)</b>	<b>Comments</b>
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.	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. The legal act required by the MoU is expected to be adopted in the context of the new organic budget law, which is being prepared.

20. **The authorities have already proceeded with the preparation of the new organic budget law**, which, according to the MoU, is an obligation to be fulfilled by end September 2010. According to planning, the draft law will be adopted by the Cabinet and submitted to Parliament by end-June 2010. On the basis of information provided by the GAO, the draft law seems to be broadly in the right direction. Nevertheless, a number of elements need possible further consideration, 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 authorities, the new organic budget law will be put into effect immediately and the 2011 budget will be prepared accordingly.

21. **Greece has also proceeded with several policy initiatives and preparation for a number of structural fiscal reforms to be adopted during the second half of the year.** Initiatives have been taken and/or planned to improve the efficiency of the tax administration, to fight tax evasion and improve tax compliance. So far the authorities have put in place a 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.

22. **Greece has also proceeded with the set up of the single payment authority for public wages** (required in the MoU for December 2010) which already covers wages paid to almost 80% of the total number of the civil servants in central government. The ongoing census of public employment (to be concluded in July 2010) will contribute to widen the coverage to the whole general government by the end of the year. However, Greece still has difficulties in complying with the data provision requirement, in relation with the monthly data on public employment and wages for the general government.

*b. Pension reform*

23. **There has been substantial progress in the preparation of the pension reform law.** The Greek authorities have advanced work on adopting a pension reform ahead of the end-September deadline established by the MoU. The MoU aims at limiting the increase of public sector spending on pensions, over the period 2009-2060, to below 2.5 percentage points of GDP (the projected increase for the euro-area Member States average). This objective compares with a projected increase in pension spending by 12.4 percentage points of GDP in 2010-2060 if the current pension legislation remained unchanged.

24. **The pension reform is 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.** However in the absence of complete long-term projections, a pension reform to be adopted by Greece in advance of the MoU requirement will have to be adjusted in the next quarters. A specific 'contingency clause' is inserted in the draft pension law to that end.

## 5. FINANCIAL SECTOR REGULATION AND SUPERVISION

### a. *Situation in the banking sector*

25. **The tight liquidity condition for banks remains an issue for consideration.** Borrowing from the ECB has increased further. The pool of eligible collateral at the disposal of Greek banks, such as ABS, credit claims and covered bonds has weakened following the recent 4-notch downgrade by Moody's. There is still some room under the recently increased guarantee scheme, although further extensions may be needed to increase the liquidity buffer of the banking sector.

26. **The deterioration of asset quality has weighed on the solvency indicators of the banking sector.** Non-performing loans (NPLs) have increased further to 8.2% in March. The banks hold capital buffers of EUR 10 billion above the minimum capital adequacy ratio of 8%. With a capital adequacy ratio of 11.7% in 2009, the Greek banking system is around the European average. The balance sheet of the Greek banking sector has expanded in the first quarter of 2010 driven by a small increase in loans and the purchase of government bonds.

### b. *Actions to be taken by Greece before end-June 2010 according to the MoU*

27. The table below summarises progress in relation to the financial sector-related requirements in the MoU before end-June 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.	Draft law establishing the FSF almost complete.
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.	Ongoing, with the Bank of Greece (BoG) committing to increase the frequency of data reporting. The absorption of the insurance sector into the BoG 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.	The review of the bankruptcy law is ongoing.

28. **The key aspects of the draft law establishing a Financial Stability Fund have been agreed between the Bank of Greece and the EC/IMF/ECB staffs.** Most of the key points of the draft Law were settled, though some legal issues still needed to be clarified. These include the potential conflict of vetoing rights in the recapitalized banks between the representatives of the FSF and the Ministry of Finance. Submission to the Parliament of the draft law was tentatively planned for late June. If the law is adopted in

July, the process of putting in place the FSF structures will be launched over the summer.

29. **The main purpose of the FSF is to address banks' solvency stress resulting from the implementation of the Economic Adjustment Programme for Greece.** The FSF will be available to provide capital to all banks headquartered in Greece upon their request and/or recommendation from the Bank of Greece. The recapitalisations from the FSF will have to be preceded by reasonable efforts to obtain capital from existing or new shareholders.

30. **All capital injections by the FSF will be made under the recapitalisation scheme approved by the European Commission as competition authority.** Each recapitalisation will be followed by submission of a new or updated restructuring plan for approval by the EC in order to verify compliance with the competition and state aid rules.

31. **The implementation of intensified supervision is well on the way and the Bank of Greece (BoG) has committed to increasing the frequency of data reporting.** The audited supervisory data will now be provided on a quarterly basis. Monthly data is available, but only on a statistical (i.e. non-audited) basis. Furthermore, the absorption of the insurance sector into the BoG has started by launching the recruitment process for an extra 30 qualified staff. It is expected to be finalised by October 2010. Staffing will be increased both for on-site inspections as well as for the off-site review. A comprehensive framework for regularly stress-testing financial institutions has been further developed and the capacity has been stepped up.

32. **The private sector bankruptcy law has so far been partially implemented.** The law on restructuring of business professional debts owed and to credit institutions and on credit bureau data processing was adopted in January, with the ECB opinion being partially taken into account. The draft law on debt arrangements for over-indebted individuals is in the process of being adopted and implemented.

## **6. OTHER STRUCTURAL REFORMS**

### ***a. Actions to be taken by Greece before end-June 2010 according to the MoU***

33. **The economic adjustment programme contains a wide-ranging and very ambitious structural reform agenda.** The programme provides a unique opportunity to modernise Greece's public administration and labour and product market regulations. Structural reforms, however, take time to enact and implement, and moreover there can be long lags before their effects on economic performance become visible. The programme therefore provides for a phased approach to structural issues over the coming years, which balances the need for ambition with the need for practical solutions so that reforms are properly designed and implemented. For June 2010, the conditionality package locks in various commitments made by the Greek government on local administration reform, transparency in the use of public funds, business start-up simplification, as well as on the Services Directive. For September, the requirements become more substantive. The government is required to launch the functional review of the public administration and start the process of moving towards a unified remuneration system. There are also additional requirements on the Services Directive, energy, road freight transport, the business environment and the promotion of FDI.

34. **Overall, the Greek authorities are proceeding with efforts to introduce structural reforms in a wide range of fields.** The economic adjustment programme appears to be acting as catalyst including in areas where reform efforts have been lacking for many years. There is, however, a need for greater coordination of structural reform efforts linked to the Memorandum of Understanding across Ministries, and this could be centralised within the Ministry of Finance. Particular attention should be paid to projects which cut across several Ministries and/or levels of government: a prominent example concerns the efforts to establish a unified public procurement system where a number of legislative and technical actions are underway in several Ministries.

### ***b. Reform of the public administration***

35. **The Greek Parliament has approved a law which provides for a major reorganization of the sub-central government.** As of 1 January 2011, the law will reduce the number of regions and prefectures (from 76 to 13) and municipalities (from 1,034 to 325), as well as municipal firms (from 6,000 to 1,500). The law will reduce the number of elected/appointed officials by 25,000 (many of which are remunerated). According to authorities, it will lead to important budgetary savings in the order of €1.500 million over the next three years. This law also provides a basis for the more efficient provision of public services. The implementation of this law will be challenging, given its sheer size, the need for further quantitative analysis, the many implementing decrees (up to 110) required, and the practicalities involved in the transfer of responsibilities and resources across entities.

36. **A law on the transparency of public spending decisions** (which will require on line publication of public spending commitments) will, according to the Greek authorities, be legislated shortly. A pilot project will be launched in June, and by mid-September, it should be expanded to all ministries and localities. The aim is for compliance to be compulsory by January 2011.



*c. Reform in the area of the labour market*

37. **The government has launched discussions with social partners on private sector wage bargaining and contractual arrangements.** The draft law covering issues such as severance payments, sub-minimum wages, arbitration procedures, collective dismissals has been prepared and submitted to Parliament. The Greek authorities plan to pass this legislation at the same time as the pension reform.

*d. Reform in the area of product markets, investment and the business environment*

38. **Services Directive and regulated professions:** on 3 May, the Greek Parliament adopted the horizontal legislative provisions required to implement the Services Directive. In practice, however, market opening effects hinge upon the adoption of sector specific legislation. The Greek authorities reported that technical work is underway for specific sectors (outdoor itinerant trade, organised street markets, exhibitions, real estate agents, commercial representatives. The same applies in the area of restricted professions (lawyers, architects, etc.) where discussions with stakeholders suggest that resistance to systemic change can be expected from vested interest groups.

39. **Road haulage:** the Greek authorities have launched a public consultation on plans to liberalise the road haulage sector. Consultations will continue in coming weeks.

40. **Simplifying the start-up of new companies:** on 17 June 2010, the Greek Parliament adopted a law to simplify the start up of new companies. According to information provided by the Greek authorities, this would reduce the costs of establishing a company by between 50 and 75%.

41. **A recovery plan for the railway sector** is now being discussed between the Ministry of Infrastructure, Transport and Networks and the Ministry of Finance. According to the Greek authorities, it would encompass three elements, (i) the establishment of an independent regulatory body (RAS), and which will be providing new licenses for new operators, while supervising the railways system in Greece, (ii) the creation of a committee for the investigation of railway accidents, and (iii) the creation of two subsidiaries within the OSE Group, i.e., ERGOSE (project manager) and GAIAOSE (development of OSE's property), which should be given more independence. The plan will also have to define how operational activities will be made profitable, how the effective implementation of EU Directives will be ensured for competition amongst providers of railway services and how the holding company will be fully restructured, including the sale of land and other assets.

*e. Reforms to increase the absorption of structural funds*

42. **Increasing the absorption of structural funds is key to support demand during a contractionary period and to secure the long-term productive potential of the economy.** The Government is taking steps to shorten approval and implementation deadlines by means of a ministerial decision. Moreover, work is underway to open a special bank account in the Bank of Greece that will provide co-financing to all entities in the general government. Furthermore, the Greek authorities also informed about the creation of a technical task force in direct contact with the Commission services. By improving coordination, the task force could help ensure rapid implementation of transport, environmental and public administration projects and will increase the use of financial engineering instruments. Finally, meeting the payment claims' targets is the best measure of success though increasing the pace of absorption cannot come at the price of project quality or an excessive reliance on state-aid projects.

<b>Measures in the MoU (by end-June 2010)</b>	<b>Comments</b>
<b><i>To modernise public administration:</i></b>	
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.	Law approved by Parliament on May 27th (160 out of the 285 present MPs voted for it).
Parliament adopts legislation requiring online publication of all decisions involving commitments of funds in the general government sector.	Ongoing
<b><i>To strengthen labour market institutions:</i></b>	
Government starts discussions with social partners in order to revise private sector wage bargaining and contractual arrangements.	Discussions are ongoing, while a Draft Ministerial Decree on the Labour Law changes is now being circulated for comments.
<b><i>To enhance competition in open markets:</i></b>	
Government adopts law to simplify the start-up of new businesses.	Law published on June 17 <sup>th</sup> on simplifying the start-up of private and capital holding companies.
Government adopts the horizontal legislation on the Services Directive.	The horizontal legislation is adopted, while work is underway on the point of single contact.
Government adopts a recovery plan for the railway sector with a timetable for measures which: <ul style="list-style-type: none"> <li>- specify how operational activities will be made profitable, including by closing loss-making lines;</li> <li>- ensure the effective implementation of EU Directives allowing for competition amongst providers of railway services;</li> <li>- provide for the restructuring of holding company, including the sale of land and other assets.</li> </ul>	The recovery plan is still being drafted, but should be ready before end-June. Discussions are ongoing with the Ministry of Finance.

<b><i>To raise the absorption rates of Structural and Cohesion Funds:</i></b>	
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.	Ongoing.
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.	Ongoing.
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.	Ongoing.

***f. Public enterprises and privatisation***

43. **The financial and labour information gathered by the Ministry of Finance Special Secretariat of State-Owned Enterprises (SOEs) of more than fifty public enterprises is ongoing.** Plans for the near future include the establishment of internal auditing procedures, through quarterly reports. Data provision should be completed by this summer. The deadline for the publication of the 2009 financial statements of the ten largest loss-making public enterprises on the official website of the Ministry of Finance is end-September 2010.

44. **Privatisation plans were published on 2 June in the following sectors:** banks (Agricultural Bank, Hellenic Post Bank), transport (airports, ports, railway operator OSE), utilities (water providers EYDAP, EYATH), energy (public power corporation PPC, gas company DEPA, petroleum company ELPE), telecoms (OTE), gaming (OPAP, casinos, ODIE), real estate (OSE train operator real estate). The privatisation proceeds in 2011 have been estimated by the authorities at around 1 to 1.4 bn euros. The MoU requires the preparation of a privatization plan for the divestment of state assets and enterprises, with the aim to raise at least 1 billion euro a year during the period 2011-2013.

***g. Action plan on statistics***

45. **Eurostat conducted together with its High Level Expert in Athens a mission beginning of June 2010 to make an intermediate assessment of progress made.** The majority of actions were progressing according to plan (no red flags identified). Eurostat drew the attention of the Greek authorities to the actions to be implemented shortly and for which rapid progress was expected, as well as to the need to have

adequate project management arrangements in place to ensure implementation of all actions according to the plan. In this context, the Eurostat High Level Expert has started to provide assistance to the Greek National Statistical Office (ELSTAT) in June 2010. The action plan is regularly monitored by the Project Steering Committee which consists of Eurostat, ELSTAT, the Ministry of Finance and the Bank of Greece. As foreseen by the monitoring arrangements of the action plan, the 2<sup>nd</sup> quarterly meeting of the Project Steering Committee will take place in Athens at the beginning of July. The state of implementation of the action plan will be reviewed, also in view of providing adequate impulses where needed.

## **7. CONCLUSIONS AND NEXT STEPS**

46. **The implementation of the programme seems to be on track.** According to available information, macroeconomic developments are unfolding in line with expectations, though prices have been much stronger than anticipated; price projection will have to be reconsidered in the first quarterly review in late July. There has been some progress in fiscal consolidation, as evidenced by the implementation of all fiscal measures announced until March and by the adoption of the consolidation measures agreed in the MoU. Budget execution over the period January to May 2010 suggests a significant reduction of the state budget deficit by almost 40% compared with the same period in 2009. However, a number of risks for fiscal consolidation remains apparent and requires the continuation of a rigorous implementation of the economic adjustment programme. These concern, in particular, developments in the healthcare sector, where progress seems to be slow and hard data available are scarce. Other fiscal developments outside central government, including on public enterprises, require for a better reporting mechanism and need to be thoroughly scrutinised. On the financial sector, good progress is being made toward establishment of the Financial Stability Fund. There has been progress in structural reforms, but some areas are clearly more advanced than others.

47. **The first quarterly review mission will take place at the end of July and first days of August.** Such a review will assess progress in relation to the MoU requirements and will prepare decisions by the Eurogroup and the IMF board on the second instalment of financing assistance to Greece.

## Annex: Press Statement

IP/10/758

Brussels, 17 June 2010

### **Press statement by the European Commission, European Central Bank and International Monetary Fund, on the Interim Review Mission to Greece, 14-17 June, 2010**

*Staff teams from the European Commission, the European Central Bank, and the International Monetary Fund visited Athens during June 14-17 to follow up on recent developments and implementation of policies under the economic program for Greece.*

While the mission did not undertake a comprehensive review at this time, its discussions suggest that the program is on track and that policies are being implemented as agreed:

- **Fiscal developments** are positive with central government revenues coming in closely as expected and with firm expenditure control in the state budget. Based on preliminary cash data, through end-May, the state budget deficit was lower than was projected in the program. A final assessment would have to take account of developments outside central government, for which complete information is not available at this time.
- The **pension reform** is advanced and agreement has been reached on many key parameters as envisaged in the memorandum of understanding. The authorities are conducting the required projections to assess the contribution that pension reform will make to improve the long-term sustainability of public finances.
- Other **structural reforms** are also progressing, including in the areas of local administration, privatization, labor market, and tax administration.
- On the **financial sector**, good progress is being made toward establishment of the Financial Stability Fund. Liquidity in the banking sector remains adequate.

**Next steps.** The three teams will return to Athens toward the end of July to conduct a comprehensive review under the program, including an assessment of progress relative to quantitative targets and benchmarks for end-June. This will be the first formal review under the program. Satisfactory completion of this review would enable Greece to make the second drawing under the program.