HELLENIC REPUBLIC

MINISTRY OF ECONOMY AND FINANCE

THE 2008 UPDATE OF THE HELLENIC STABILITY AND GROWTH PROGRAMME 2008 - 2011

January 2009

This update of Greece's Stability and Growth Programme has been submitted to the European Commission in accordance with Article 4 of the European Council Regulation 1466/97.

The programme can be found on the Ministry's web site: http://www.mnec.gr

1 ECONOMIC POLICY FRAMEWORK

The persistence of the financial crisis emerging in mid-2007 and intensifying since the autumn of 2008 has increasingly severe global implications both for the stability of the financial system and for the real economy.

The repercussions from the international financial crisis are unavoidably felt also in Greece. To this end, and in line with the mid-October 2008 European Council agreement, the Greek government promptly implemented a rescue plan designed to ensure adequate financing for consumers and enterprises (especially SMEs) and to maintain confidence in the Greek financial system. Moreover, the Greek government increased the coverage level of the deposit guarantee scheme from 20,000 euros to 100,000 euros for a period of at least three years, and re-iterated its political commitment for the protection of deposits in all banks operating in Greece. In addition, and in view of the adverse economic developments, it announced a number of measures aiming at the protection of borrowers, mainly with respect to foreclosure requirements.

Further to safeguarding the stability of the banking sector, restoring proper functioning of the financial market and underpinning lending to the real economy, the Greek government's economic policy strategy is based on two pillars. First, it continues pursuing prudent fiscal policies ensuring the long term sustainability of public finances in line with the provisions of the Revised Stability and Growth Pact, while at the same time, and in the spirit of the European Economic Recovery Plan, it alleviates the effects of the crisis on the most vulnerable social groups. Along these lines, and in particular in order to safeguard social cohesion, maintaining employment growth through targeted measures in this difficult juncture is of the utmost importance.

On the other hand, the crisis is not leading to the delay of structural reforms, as the government recognises that such reforms are necessary to further enhance the resilience of the Greek economy and to enable it to be better positioned in the global environment after the crisis. Therefore, the second pillar of the economic policy strategy entails strengthening the growth potential of the Greek economy by means of structural reforms in line with the Lisbon Strategy and the European Economic Recovery Plan. Emphasis is placed on accelerating productivity growth, including though reforms to improve the business environment, reduce administrative burden, cut red-tape, increase the efficiency of the public sector and enhance innovation. Also, special attention is given to improving the educational system, along with training, re-training and life-long learning systems, and on rebalancing labour market policies to emphasize Active Labour Market Policies.

Based on this two-pillar strategy, the Greek government forecasts that real GDP growth, even taking into account adverse global economic developments, will exceed 1% for 2009, with a gradual acceleration expected within the horizon of the Programme.

The rest of the Programme is organised as follows. Section 2 presents the economic outlook and the medium-term scenario. The overall policy strategy and the targets for the general government balance and debt are presented in Section 3. Section 4 presents a sensitivity analysis and comparisons with previous updates. Developments regarding the quality of public finances are presented in Section 5. The sustainability of public finances and the consistency between the National Reform Programme and the Stability Programme are taken up in Sections 6 and 7 respectively.

2 ECONOMIC OUTLOOK

2.1 World Economy – Technical Assumptions

International economic activity has been on a downward path since mid-2007. The financial turmoil originating from the US subprime mortgage market, combined with relatively higher oil, commodity and food prices until July 2008, resulted in a highly uncertain global economic environment. The escalating crisis in financial markets caused severe solvency problems for a number of financial institutions and liquidity constraints in the interbank market. The consequences of this escalation were plummeting investors' confidence and rising uncertainty. During the third quarter of 2008, these problems have triggered an unprecedented U.S. and European response so as to alleviate the repercussions of the crisis as well as to secure the stability of the international financial system. Moreover, in a coordinated fashion, Central Banks around the world have eased their monetary policy stance. Nevertheless, economic and business sentiment is still tilted to the downside, whereas a negative feedback loop with the real economy is currently unfolding. Negative economic spillovers have also affected previously resilient emerging economies and, hence, world economic activity has markedly deteriorated. In many respects, the overall size and persistence of the adverse economic developments cannot be fully acknowledged yet.

According to the Commission's interim forecast of January the 19th, the world economy will move from a high 5% real growth rate in 2007 down to 3.3% in 2008 and only 0.5% in 2009. The recovery is expected to emerge in 2010, on the back of restored confidence in financial markets and enhanced fiscal stimulus, mainly from the US, supporting the real sector.

The economic situation in the EU remains equally highly uncertain, although structural reforms and sustained economic growth in the past years as well as coordinated actions in managing the financial crisis have enhanced EU's resilience and flexibility in curtailing the impact of the crisis. Real GDP is expected to contract by almost 2% in 2009 in both the EU and the euro area, putting pressure on the labour markets, while a slow recovery is foreseen in 2010. In this respect, temporary, timely, targeted and coordinated fiscal actions in line with Commissions' Economic Recovery Plan, aiming at easing credit constraints faced by firms and households alike and at strengthening domestic demand are being announced and are expected to take effect in the forthcoming months. Cyclical and structural factors will contribute to the substantial deterioration of the budgetary outlook in almost all EU member states in 2009 and for the largest part of 2010. On the positive side, inflationary pressures are weakening, mainly due to contracting economic activity as well as declining commodity and oil prices which had soared in the first half of 2008. Overall, EU inflation outlook includes substantial wage moderation, declining inflation expectations and consumer price inflation developments in line with medium term price stability objectives. In this context, the euro's depreciation could also be supportive to competitiveness and economic activity.

The 2008-2011 Hellenic Stability and Growth Programme is based upon the set of common external assumptions used in the European Commission's January 2009 interim forecast. These assumptions reflect sharply deteriorating economic and market conditions, underpinning an unfavourable and highly volatile international macroeconomic environment.

2.2 Cyclical Developments and Current Economic Prospects

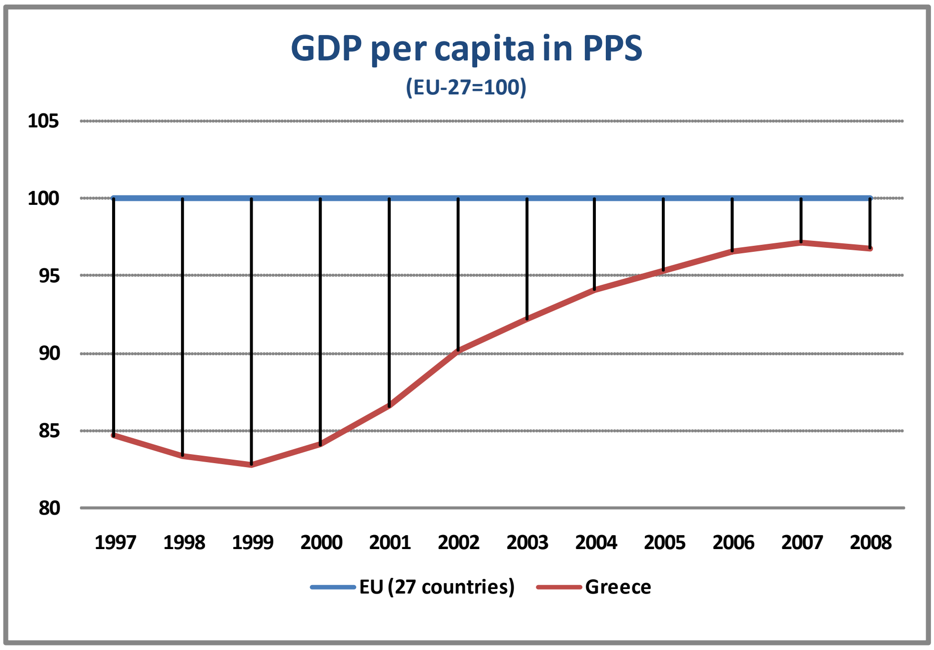
2.2.1 The Greek Economy in 2007

During 2007, the Greek economy continued to grow close to its long run trend, registering a 4% real GDP growth rate, down from 4.5% in 2006, but still 1.3 percentage points higher than the euro area average growth rate. Robust economic growth was mainly driven by high domestic demand, contributing 4.6 percentage points to growth. The external balance had a negative contribution of 1.62 percentage points to growth, since growth in imports of goods and services registered a 3.6 percentage points differential from the respective exports growth. Final demand contributed 6.41 percentage points to total growth, while the contribution of export of services was 1.6 percentage points, recording a substantial increase compared to historical standards.

Furthermore, investment growth, though slightly curtailed, remained particularly high. Total investment at constant prices grew by 4.9% and investment in equipment by 9.1% whereas at current prices investment amounted to 22.5% of GDP. From a savings-investment perspective, high investment growth and increased domestic demand contributed to an increasing savings-investment differential, reflected also on the current account deficit which reached 14% of GDP in 2007.

Exports market growth declined to 5.7% down from 8.7% in 2006 and, consequently, the previous year's upward trend in the growth of exports of goods was reversed in 2007. Yet, services' exports at constant prices grew markedly by 12.7%, contributing 1.6 percentage points to GDP growth. On the other hand, despite the substantial deceleration in the growth rate in imports of goods at constant prices compared to 2006, the latter remained high at 6.7%, while imports of services also grew by 6.8%. Overall developments in the external sector of the economy were primarily geared by rising oil prices, the high energy dependence of the economy, euro exchange rate appreciation, lower growth of many European countries which receive over half of Greek exports, robust domestic demand, sustained high investment growth and high imports of machinery and equipment.

In the domestic sector, real disposable income of households increased by 4.2% and, as a result, private consumption at constant prices increased by 3.0%. Credit expansion to households and firms was the cornerstone of high domestic demand along with investment incentives. High GDP growth rates have resulted in an acceleration of the real convergence process, as indicated by GDP per capita (in PPS).



Source: Eurostat (2008 values are forecasts)

The sustained high growth in real economic activity underpinned the continuous decline in the unemployment rate to 8.0% down from 8.6% in 2006 as well as an increase in total employment by 1.3%. Labour productivity increased by 2.7%, compared to an average productivity growth of 1.1% in the eurozone. Inflationary pressures captured by the GDP deflator eased to 2.9% down from 3.2% in 2006, despite soaring oil and commodity prices since mid-2007. Private consumption deflator also decreased to 3.2% down from 3.5% in 2006.

2.2.2 The Greek Economy in 2008

Unfavourable economic conditions at the international level since August 2007 have had an impact also on the Greek economy. Economic developments in 2008 were driven mainly by two factors; on one hand by rising commodity and oil prices until July 2008 and, on the other, by the repercussions of the escalating financial crisis, mostly affecting macroeconomic variables in the last quarter of the year. Nevertheless, the retrenchment in GDP growth appears confined compared to the international economic outlook.

During the first three quarters of 2008, GDP growth remained strong, though on a declining path, and above the eurozone average. On a year-to-year basis, GDP increased by 3.6% in the second quarter and by 3.1% in the third quarter, compared to an average growth rate of 1.4% and 0.8% respectively in the eurozone. Domestic demand and export growth have been keeping up a relatively more favourable outlook, yet a slowdown in economic activity is evident.

Regarding investment, during the first three quarters of the year, gross fixed capital formation declined substantially compared to the corresponding period in 2007. Investment growth retrenchment mirrors a significant slowdown in private construction activity, and hence, a possible correction in the housing market. This view is also supported by the fact that there is a substantial decline of more than 20% in construction permits during the third quarter of 2008. Nonetheless, in the first three quarters of the year, credit to domestic enterprises and households retained a growth rate close to 20%, albeit with a somewhat lower credit expansion towards households. The latter reflects lower credit demand, due to increased interest rates on housing loans as well as more strict rules on credit approval by financial institutions.

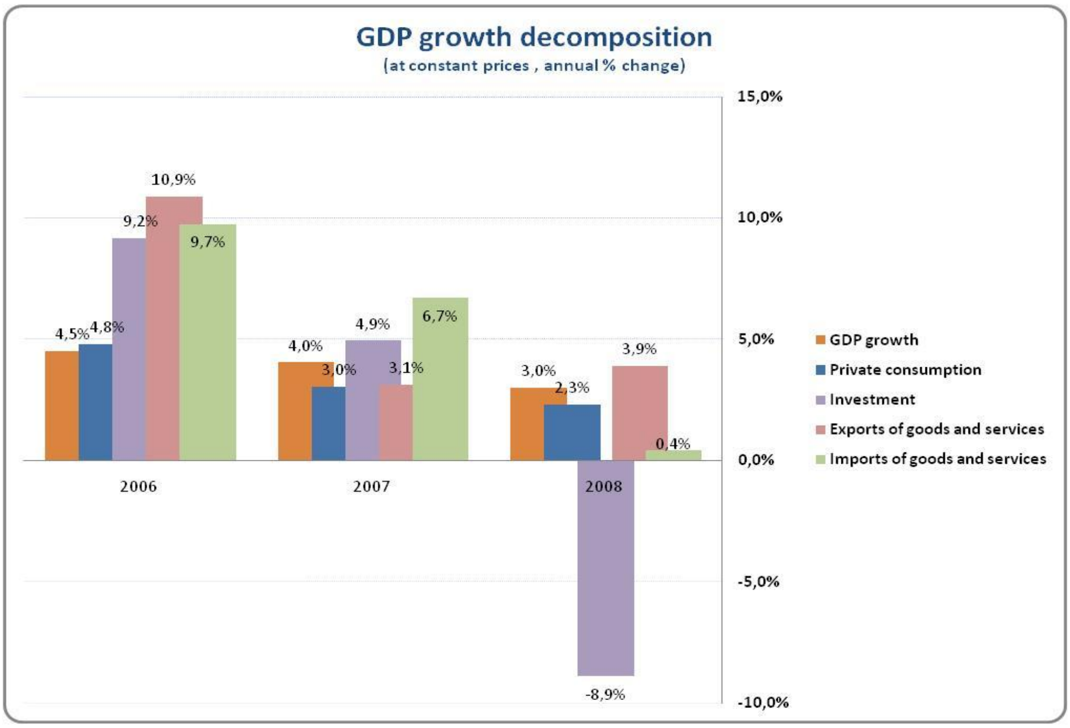
Domestic economic outlook reflects an increase in total private and public consumption until mid 2008, which reinvigorated total final demand, while starting from the third quarter, private and public consumption growth has been decreased. The reduction in the growth rate of consumption expenditure is partly due to a slowdown in the growth rate of retail sales. Economic sentiment indicators and indices of business expectations highlight a deteriorating economic situation and business environment, intensifying from the second quarter of the year and focusing in particular on the manufacturing sector.

Considering the external sector, imports of goods and services have recorded a sharp decline in the third quarter of 2008, indicating deterioration in the imports of goods. The developments in imports of goods are attributed to the accelerating import price index, as a result of rising oil prices. The growth in export of goods and services, on the other hand, was sustained at high levels in the first two quarters, mainly driven by higher growth in exports of services; however, in the third quarter the growth in export of goods and services was curbed. Overall, in the third quarter, the external sector deficit, on a national account basis declined, thus contributing positively to the GDP growth rate.

Regarding labour market developments, employment growth remains positive, indicating currently a relatively resilient labour market. The unemployment rate was brought down to 7.2% in the second and third quarter of 2008 from 8.3% in the first quarter (Labour Force Survey data).

In the light of deteriorating economic prospects, primarily materialising from the third quarter of 2008, GDP growth for 2008 is estimated at 3.0%. Estimates highlight a downward revision by 1.0 percentage point compared to the forecast included in the previous Update of the SGP. The deceleration in GDP growth results from lower growth rates in private consumption (2.3% at constant prices), a pronounced decline in gross fixed capital formation by 8.9%, reflecting a significant reduction by 15.0% in total construction activity and by 25.0% in housing investment. Total investment as a percent of GDP is expected to decline to 19.9% down from 22.5% in 2007. Yet, general government fixed investment is estimated to have increased in real terms by 4.0%, thus boosting demand and facilitating economic recovery.

On the positive side, although a slight decline in total exports would be anticipated, mainly stemming from curtailed growth in the exports of services (mainly tourism and transport services), the content of the exports of goods as well as the geographical specialization of the trade flows towards higher growth countries, are expected to ease potential pressures. Thus, exports of goods and services are estimated to have grown in 2008 by 3.9%, reflecting a 7.7% growth in exports of services and a 1.1% decline in the exports of goods. These developments imply a contribution to GDP growth of 0.93 percentage points. Imports of goods and services on the other hand, are estimated to have deteriorated sharply, with a growth rate of 0.4%, mainly due to a marked decline in imports of goods by 2.3%. These developments are in line with the reduction in consumption expenditure as well as easing pressures in the oil price hike. The external balance is expected to contribute 0.79 percentage points to GDP growth, whereas final domestic demand 0.30 percentage points; the latter constituting a historically low contribution which reflects the negative contribution of gross fixed capital formation to output growth by 2.18 percentage points.



Real unit labour costs are estimated to have accelerated modestly by 0.9% compared to a 3.5% growth rate in 2007, thus signalling an improvement in the country's overall competitiveness position, while slight nominal wage moderation is also foreseen. Employment is estimated to have grown moderately by 1.0% and the unemployment rate is estimated at 7.5% on a national accounts basis, recording a cumulative decline of 1.1 percentage point in the 2006-2008 period.

Despite the positive impact of reduced commodity and oil prices since July 2008, as well as the retrenchment in economic activity, both the GDP deflator measure of inflation and the private consumption deflator are estimated in 2008 at 4.3% and 4.2% respectively, up from 2.9% and 3.2% in 2007. This is due to base effects from soaring commodity and oil prices during the first two quarters of the year. The inflation rate (measured by the CPI) has remained at persistently high levels (4.6% for the January to September period); however, this trend appears to have rapidly reversed as CPI dropped to 3.9% in October 2008 and 2.9% in November further declining to 2.0% in December 2008. Core CPI also declined at 3.4% in December 2008, having remained on a rather stable path throughout the year. It should be noted that price stickiness is acknowledged when considering the overall pass-through of falling energy inflation on to CPI. On the other hand, the depreciation of the euro since August 2008, if sustained, could mitigate the potentially disinflationary impact of decreasing commodity prices.

2.3 Medium-term scenario

The 2009-2011 baseline scenario mirrors the impact of the severe global economic downturn over the medium term on real economic activity. The assumptions used pertain to the short term moderation of oil and commodity prices and the marked downturn in economic growth in EU countries as well as world trade flows until late 2009.

Real GDP growth will be significantly affected by the global economic downturn and hence, will be on average at 1.67% over the next three years compared to 4.07% in the 2000-2008 period. On a yearly basis, GDP growth is expected to decelerate to 1.1% in 2009, rebounding at 1.6% in 2010 and at 2.3% in 2011 in line with the foreseen global economic recovery. Following the volatility and uncertainty in the global economic context, consumer and business confidence is expected to be gradually restored, with GDP growth recovery lagging at a slower pace. The latter is mainly due to the lagged positive effects on the real economy of the financial institutions’ rescue plan, as well as the positive impact on growth of the gradually recovering gross fixed capital formation. In 2009, growth rates in main GDP components are expected to remain on a sharp downward trend, while during 2010 this trend is expected to be reversed. Domestic demand is expected to be affected both by lower private consumption growth rates and by lower investment growth. The forecast for the external balance reflects that it would partly offset domestic demand developments and enhance output growth, at least until early 2010.

Private consumption growth is expected to moderate at 1.9% in 2009 and at 2.0% on average in the 2009-2011 period. The private sector savings rate is expected to increase from 2009 onwards, partly due to increased uncertainty related to the economic outlook as well as interest rate developments. Favourable developments in real disposable income growth, stemming from lower inflationary pressures and a resilient labour market, (as depicted on declining unemployment rates), are expected to sustain private consumption growth in the short term.

Domestic demand developments encompass lower government consumption growth at a 1.8% average rate for the 2009-2011 period, while equipment investment remains constant in 2009 and will increase at 4.0% during the two consecutive years. Investment in the construction sector mainly reflects an anticipated correction in the housing market, which at large started in 2008 and is expected to continue in 2009, gradually restoring its momentum later in the programme's horizon. Slow pace in the recovery process of the housing market signals low housing credit expansion to households as well as high levels of uncertainty regarding decisions for new housing investment initiatives from the side of constructors. The overall picture is improving if we take into account that private non residential investment activity will grow at a 4.2% average rate, mainly sustained by SME's support funding (e.g. via EIB initiatives), by bringing forward the implementation of investment projects based on EU Structural Funds and, last but not least by public-private partnerships and new investment projects supported by the investment incentives law. The importance of the latter is substantiated if we take into account that, up until now, 5,170 projects have already been approved, accounting for investment in the order of € 9.8 bio and 27,400 new direct job positions. This law is currently in a revision process to allow for new activities (such as desalination, standardization and packaging of agricultural products) to be added to the eligibility list.

Economic activity slowdown is expected to affect wage developments, leading to lower nominal labour costs, broadly in line with labour productivity growth. Policy initiatives and structural reforms on the labour market are bound to take effect, and hence, alleviate the repercussions from declining economic activity on the unemployment rate. The latter will stabilise at 7.9% in the 2009-2011 period, gradually declining from late 2010 onwards. Employment growth is projected to accelerate, growing at a 0.5% average rate.

On the other hand, the external sector and in particularly, growth in imports will be mostly affected by domestic demand developments. Imports of goods will decline by 3.5% in 2009, and are expected to grow moderately by 1.8% in 2010 and 2.4% in 2011, while imports of services will be sustained at a 3.4% average growth rate in 2009-11. Enhanced oil price movements will also affect import growth from 2010 onwards. Nonetheless, exports of goods and services are expected to largely retain their pace, growing at 2.4% on average in the 2009-11 period, hence, implying an improvement in cost-price competitiveness due to developments in unit labour costs and inflationary pressures, as well as moderate expectations about the euro exchange rate. In addition, geographical specialization of export trade flows towards higher growth countries will result to a moderate decline in the export of goods growth in 2009, which will rebound thereafter, marking a positive average growth rate over the medium term period. Transport and tourism growth will be partly restrained compared to 2006-2007 rates, attributed to the adverse international economic outlook. Hence, export of goods and services will grow at a 2.4% average rate over the medium term. Relative export and import price movements are bound to lead to an improvement in the real terms of trade, abating to a certain extent external competitiveness imbalances.

Over the programme's period, inflation, as measured by both the GDP deflator and the private consumption deflator will decelerate to average rates of 2.6% and 2.5% respectively. Private consumption deflator moderation is underlined by lower nominal unit labour costs, gradually decelerating to a 1.8% growth rate in 2011 down from 5.1% in 2009. Price developments are shaped by the current economic downturn and by the moderation in inflation due to imports. This development limits price-wage spirals.

The downside risks to the medium term scenario projections include currently high uncertainties on global economic developments, the lagged effects of the fiscal stimulus undertaken by many countries, as well as doubts surrounding the exact magnitude of the negative feedback loop of the financial turmoil on domestic real economic activity.

3 GENERAL GOVERNMENT BALANCE AND DEBT

3.1 Policy Strategy

Over the last years the Greek government has been actively implementing structural reforms so as to enhance the competitiveness of the economy and, in parallel, has pursued fiscal consolidation. Thereby, the government's economic policy is based on a two pillar strategy: further improving public finances while providing a social protection "safety net" for the most vulnerable population groups and implementing structural reforms so as to raise the potential growth of the economy.

However, the severe economic downturn adversely affected the implementation of the 2008 government budget. Given the severe economic downturn, the government deficit registers a deviation from what was budgeted, reaching 3.7% of GDP in 2008. The government deficit is expected to remain above the threshold value of 3% of GDP in 2009 and 2010 as adverse economic conditions are expected to persist, while the recovery is expected to materialise in the last year of the programme's period.

Moreover, amid the severe global economic downturn, originating from the international financial crisis and undermining the growth rate of the economy, substantial uncertainties remain in 2009. Based on currently available information, it would not be before the end of 2010 that economic conditions will improve both in Greece and the EU. Moreover, the recent interim EU Commission forecasts provide evidence that negative shocks, due to the global economic downturn, will continue to affect the economy in 2009 and for the largest part of 2010.

Despite the severe economic downturn, the Greek government remains committed to actively pursue fiscal consolidation and enhance the competitiveness of the economy, while sheltering the real economy. The government also considers alleviating the effects of the crisis for most vulnerable parts of the population to be of paramount importance.

As a result, the fiscal consolidation is pursued with a certain degree of flexibility over the programme's period, in line with the Revised Pact, so as not to jeopardize the growth prospects of the economy, while it provides the necessary "safety net" against poverty for the part of the population which is most exposed, allowing the automatic stabilizers to freely play their role.

3.2 Fiscal developments in 2008

The 2009 Budget presented before the Parliament in November last year, included an estimate for the general government deficit in 2008 of 2.5% as a ratio to GDP. Taking into account the latest data available, the outcome is 3.7% of GDP. The difference between the outcome of the general government deficit and the budgeted figure is mainly explained by shortfalls in revenue and, to a lesser extent by some expenditure overruns.

For the shortfall in ordinary budget revenue in the order of € 2 bio, there are various factors at play. First, the effect of decelerating growth on tax revenue. Second, the fact that setting up the mechanism for the new property tax was not as easy as initially perceived. There were some organisational issues and delays, but it is expected that the system will work smoothly from this year on. Thirdly, the response of the business community to the tax settlement did not match the original expectations of the government due to liquidity constraints caused by the financial crisis, as well as very short deadlines (which, however, were already extended into 2009). Last but not least, the revenue collection mechanisms had not been working at full steam for some time, especially the last two months of the year when also there were demonstrations affecting the market during the Christmas period and resulting to an unprecedented negative growth rate for VAT revenue in November and December. Tax refunds were also higher by € 453 mio, mainly as a result of the fact that there was an acceleration of VAT refund in order to enhance liquidity in the market.

A detailed decomposition of revenue shortfalls is presented below:

⇒ An additional amount of € 600 mio was expected from the new property tax, which will finally accrue in 2009 (the delay pertaining mainly to households).

⇒ An amount of € 850 mio was expected from the tax settlement and tax arrears but approximately € 530 mio was finally cashed in (mainly because of liquidity constraints).

⇒ The system for tackling tax evasion in heating fuel, introduced for the first time in 2008, did not yield the expected result, with a shortfall of approximately € 100 mio.

⇒ New car circulation duties were lower by € 80 mio, as a result of a significant fall in car sales.

⇒ As a result of the crisis, there were shortfalls in tax revenue, especially during the second semester of the year, accounting for approximately € 900 mio.

Regarding expenditure, overruns are the result of allowing the automatic stabilizers to play their role during this severe economic downturn. Overruns pertained mainly to items in order to safeguard social cohesion, such as pensions, financing of Social Security Funds and social solidarity benefits.

3.3 Fiscal prospects for 2009

3.3.1 Revenue

Taking into account the lower base of the 2008 implementation, and developments in tax revenue collection during the last two months of 2008, we have proceeded with more prudent forecasts regarding revenue in 2009. More specifically, receipts are expected to be lower by approximately € 2.5 bio compared to the estimate included in the 2009 State Budget. This shortfall can be approximated as follows:

⇒ Approximately € 600 mio from direct taxation (mainly corporate taxation which is based on lower profits for 2008).

⇒ € 1.6 bio from indirect tax revenue as a result of the deceleration in growth.

⇒ € 220 mio less than originally expected from the tax settlement and tax arrears as a result of liquidity constraints.

⇒ Tax refunds will be higher by some € 400 mio in order to keep ensuring adequate liquidity in the market (accelerated VAT refunds).

The implementation of the 2009 budget will be supported by revenue items such as the 2008 property tax on households (accruing, as mentioned, in 2009), part of the tax settlement and tax arrears receipts being transferred in 2009 and revenue from the tax package legislated in September.

In addition to these, this year the performance of tax offices will be closely monitored and evaluated based on specific targets, indices, comparisons and cross-checking so that an "early warning" system is set up. This system will allow tax authorities to identify potential shortfalls in time so that appropriate action is taken.

The privatisation process will continue, despite the currently unfavourable conditions of the financial markets, and is expected to yield at least € 1 bio.

3.3.2 Expenditure

As far as primary expenditure is concerned, specific rules will be enforced in order to safeguard the projections included in this Update of the Stability and Growth Programme. More specifically:

⇒ New hiring will be limited and, **in any case**, less than the number of civil servants who retire. This will result to a reduction of total general government employment, although the rule will not be enforced uniformly to all sectors: in specific sectors, such as the health sector or education, hiring could exceed the number of those who retire **without breaking the general rule**. The Interministerial Committee will have to provide the final approval for any hiring decisions taken at lower levels of the administration.

⇒ Moreover, a prudent wage policy will be followed, with wage increases covering inflation without jeopardizing the sustainability of public economics or leading to competitiveness losses.

⇒ Also, efforts will be intensified in order to consolidate entities and organisations in the public sector, with the whole process being supervised by the General Secretariat of the Government.

⇒ The system of remuneration of executives in public sector entities will be revised, with savings expected through close monitoring and the imposition of ceilings.

⇒ A central authority for wage payment will be established, ensuring transparency and efficiency so that a clear picture of earnings exists for all public servants.

⇒ Law 3697 / 2008 on the expenditure of general government entities will be strictly enforced, invoking all legal consequences as stated in the law (including discontinuing financing of non-compliant entities and the imposition of fines). This law is expected to contain expenditure in the general government sector, as local authorities, social security funds and hospitals will now be supervised by a new Interministerial Committee. All these entities are obliged to submit budgets and three-year business plans (with specific targets and objectives) and financial statements according to I.F.R.S. (for hospitals), while the standardization and upgrading of their accounting systems is also compulsory.

⇒ All elastic expenditure items will be closely monitored, strictly on a monthly basis, and specific rules will be enacted in the course of the year (including uniform “haircuts”). Savings will also be the result of using new methods (such as leasing) for public procurement of durable goods such as PCs and IT equipment as well as cars.

⇒ A comprehensive system of procurement for organisations supervised by the Ministry of Health and Social Solidarity has been established and will be implemented as of this year. The new system enhances transparency and promotes competition, while it controls the waste of resources, through collecting and grouping of the needs of hospitals in order to prepare integrated public procurement bids.

⇒ Saving on expenditure by Social Security Funds is also expected by the use of IT systems and bar codes on pharmaceuticals, as cross-checking and monitoring of prescriptions will now be feasible. Special emphasis will be placed on the control of prescribing behavior. In this direction, pilot projects have been initiated.

⇒ Efforts to consolidate the financial conditions of Public Enterprises and Entities (DEKO) will continue, through the pertinent Special Secretariat, placing emphasis on containing operational expenditure and borrowing requirements.

⇒ The plan for restructuring the **Hellenic Railways Organisation (OSE)** announced in August 2008 will be promptly implemented. This plan provides for a complete corporate transformation, while specific measures are included for the rationalisation of debt servicing, the gradual consolidation of the budget of OSE and the development of state property. Also, measures are included for strengthening monitoring mechanisms and promoting transparency.

⇒ One of the key government priorities is the change in the preparation, implementation and monitoring of the state budget, through the adoption of **programme budgeting**. The preparation of the budget based on programme budgeting will make it more comprehensible, with a clear presentation of government policies and priorities. At the same time, it will allow controlling the cost of each programme and evaluating the effectiveness of various policy actions. It should also be noted that one of the main objectives of the reform is the establishment of a three-year fiscal framework. In implementing the new system, the budget of each Ministry/organisation will indicate the projects that each Minister commits to complete using the available resources. The **full implementation of the programme budgeting is scheduled for 2012**. Major steps have already been taken in this direction, with pilots of editions of Programme Budgeting already accompanying the State Budget editions. For a more efficient implementation of programme budgeting, the reform of the accounting system used by the Central Government is also planned. The main pillars of the reform in the accounting system include:

- the establishment of modern accounting principles ,
- the development of a revised set of accounts, and
- the introduction of modern financial statements of financial position, financial performance and cash flows.

The first steps towards the formulation of **a new accounting plan** have already been taken. The plan will be based on standards developed for the private sector, with the necessary adjustments to the specific needs of Public Administration. The objective is, through this plan, to make the compilation of reliable financial statements for all general government units feasible.

However, and taking into account the lag required to reap the full effects of structural measures on the expenditure side, expenditure in 2009 will be higher by € 900 mio compared to the estimates included in the 2009 Budget. This amount will cover the increased needs of Social Security Funds and the required adjustment in the system of remuneration of healthcare personnel in order to conform to the relative EU Directive.

3.4 Current general government developments and the Medium Term Objective

In 2009 uncertainties for the EU and the Greek economy seem to persist with the general government deficit remaining stable at 3.7% of GDP. The reasons behind the deviation of the general government deficit from the previously budgeted figure are explained in detail in section 3.3. The main reason is the unforeseen severity of the global economic downturn which resulted to significantly lower than expected growth rates and led to revenue shortfalls and to some expenditure overruns. However, the government remains committed to implementing a prudent fiscal policy, aiming at reducing the general government deficit to 3.2% in 2010 and further to 2.6% in 2011. The fiscal targets are feasible as the negative shocks of the financial crisis are expected to be gradually easing over the coming years.

Table 3.1 presents the general government budgetary prospects. In detail, total general government revenue registered a slight increase up from 39.9% of GDP in 2007 to 40% of GDP in 2008. Structural measures to combat tax evasion continue to pay off along with higher excise taxes in fuel. In 2009, total revenue increases to 41% of GDP, and further to 41.1% in 2010 and 41.2% in 2011.

Table 3.1: General government budgetary prospects

	ESA Code	Year 2007	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
		Level Bn euros	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-7.9	-3.5	-3.7	-3.7	-3.2	-2.6
2. Central government	S.1311	-11.2	-4.9	-6.3	-6.2	-4.6	-3.9
3. State government	S.1312						
4. Local government	S.1313	-0.1	-0.05	-0.04	0.67	0.0	0.0
5. Social security funds	S.1314	3.3	1.5	2.6	1.8	1.3	1.3
General government (S13)							
6. Total revenue	TR	91.1	39.9	40.0	41.0	41.1	41.2
7. Total expenditure	TE[1]	99.0	43.4	43.7	44.7	44.3	43.8
8. Net lending/borrowing	EDP B.9	-7.9	-3.5	-3.7	-3.7	-3.2	-2.6
9. Interest expenditure	EDP D.41	9.3	4.1	4.0	4.5	4.4	4.3
10. Primary balance[2]		1.4	0.6	0.3	0.8	1.2	1.7
11. One-off and other temporary measures[3]			-0.5	0.4	0.5	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		46.0	20.2	19.9	22.0	21.8	21.8
12a. Taxes on production and imports	D.2	*27.5*	*12.1*	*11.9*	*12.3*	12.4	12.4
12b. Current taxes on income, wealth, etc	D.5	*18.1*	*7.9*	*7.8*	*9.3*	9.0	9.0
12c. Capital taxes	D.91	*0.4*	*0.2*	*0.2*	*0.4*	0.4	0.4
13. Social contributions	D.61	31.8	13.9	14.2	14.2	14.2	14.2
14. Property income	D.4	2.1	0.9	0.9	0.8	0.8	0.8
15. Other [4]		12.1	5.4	4.8	4.0	4.3	4.4
16=6. Total revenue	TR	91.1	39.9	40.0	41.0	41.1	41.2
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]			31.9	31.9	34.0	33.7	33.7
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	**37.0**	**16.2**	**16.3**	**17.0**	**16.8**	**16.6**
17a. Compensation of employees	D.1	25.2	11.0	11.3	12.0	11.9	11.7
17b. Intermediate consumption	P.2	11.8	5.2	5.0	5.0	4.9	4.9
18. Social payments (18=18a+18b)		*39.3*	*17.2*	*18.0*	*18.6*	*18.6*	*18.6*
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131						
18b. Social transfers other than in kind	D.62	*39.3*	*17.2*	*18.0*	*18.6*	*18.6*	*18.6*
19=9. Interest expenditure	EDP D.41	9.3	4.1	4.0	4.5	4.4	4.3
20. Subsidies	D.3	0.3	0.1	0.1	0.1	0.1	0.1
21. Gross fixed capital formation	P.51	6.7	3.0	3.0	2.7	2.7	2.7
22. Other[6]		6.4	2.8	2.3	1.8	1.9	1.7
23=7. Total expenditure	TE[1]	99.0	43.4	43.7	44.7	44.3	43.8

p.m.: Government consumption (nominal)	P.3	38.1	16.7	16.7	17.2	17.1	16.8

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

On the expenditure side, total expenditure, despite the severity of economic downturn, registers a limited increase of one percentage point to 44.7% of GDP in 2009, up from 43.7% in 2008. Thereafter, total expenditure declines to 44.3% in 2010 and further to 43.8% in 2011, providing the necessary quality of fiscal adjustment so as to reduce the general government deficit below the threshold value by 2011. This reduction of total expenditure is in line with the reformed Stability and Growth Pact which requires structural adjustment, mostly on the expenditure side.

3.5 Structural Balance – Fiscal Stance

We estimate that potential growth, due to the economic downturn, remains on a downward trend, down from 3.6% in 2007 to 3.2% in 2008 and 2.8% in 2009, reaching 2.4% in 2010 and 2011 (see Table 3.2). Based on that estimate, the cyclically-adjusted balance net of one-offs will reach 4.2% of GDP in 2009, down from 4.8% in 2008. In the years ahead, the structural deficit will fall further to 2.8% in 2010 and 2.2% in 2011. The improvement in the structural balance, despite the unfavourable economic conditions, is substantial: 0.6% of GDP in 2009, 1.4% of GDP in 2010 and 0.6% of GDP in 2011.

It is worth mentioning that the impact of the severe economic downturn becomes apparent in the estimates of the output gap, which turns negative in 2009 (at -0.1%), further declining to -0.9% and -1.0% in 2010 and in 2011 respectively. This adverse development signifies that the Greek economy is currently facing *'bad times'* as the change in the output gap also shows a rapid movement towards negative values despite taking a positive value in 2008, further emphasising the magnitude of the current economic downturn (the Greek economy for many years was characterised by positive output gaps).

Table 3.2: Cyclical developments

% of GDP	ESA Code	**Year 2007**	**Year 2008**	**Year 2009**	**Year 2010**	**Year 2011**
1. Real GDP growth (%)		4.0	3.0	1.1	1.6	2.3
2. Net lending of general government	EDP B.9	-3.5	-3.7	-3.7	-3.2	-2.6
3. Interest expenditure	EDP D.41	4.1	4.0	4.5	4.4	4.3
4. One-off and other temporary measures[1]		-0.5	0.4	0.5	0.0	0.0
5. Potential GDP growth (%)		3.6	3.2	2.8	2.4	2.4
contributions:						
- labour		0.7	0.7	0.6	0.6	0.6
- capital		1.2	1.1	1.0	1.0	1.0
- total factor productivity		1.7	1.4	1.2	0.8	0.7
6. Output gap		1.8	1.6	-0.1	-0.9	-1.0
7. Cyclical budgetary component		0.7	0.7	0.0	-0.3	-0.5
8. Cyclically-adjusted balance (2 - 7)		-4.2	-4.4	-3.7	-2.8	-2.2
9. Cyclically-adjusted primary balance (8 + 3)		-0.1	-0.4	-0.8	-1.5	-2,2
10. Structural balance (8 - 4)		-3.7	-4.8	-4.2	-2.8	-2.2

[1]A plus sign means deficit-reducing one-off measures.

3.6 Debt levels and developments

The government remains committed to continuing the fiscal consolidation efforts with particular attention given to public debt. Table 3.3 presents general government debt developments. In 2008, the general government debt slightly declined to 94.6% of GDP down from 94.8% in 2007. Due to the current economic downturn, the general government debt is projected to increase somewhat to 96.3% of GDP in 2009, while declining thereafter to 96.1% and 94.7% in 2010 and 2011 respectively. Over the programme’s horizon, primary balances are increasing from 0.3% in 2009 to 0.8% in 2010 and 1.2% in 2011. The stock flow adjustment follows a rapid declining path from 2.6% in 2008 to 1.5% in 2009 and further down to 0.5% in 2010 and 2011 respectively.

Despite the fact that in 2008 and early in 2009 the issuance policy of many countries was affected by the severity of global financial crisis, Greece has been following a prudent debt management strategy, supported by qualitative and quantitative risk analysis and was able to weather the crisis relatively well, adjusting efficiently to market conditions. As a result of the unavoidable increase in the cost of financing, interest expenditures increase to 4.5% in 2009 up from 4.0% in 2008, whereas they are expected to slightly decline to 4.4% in 2010 and to 4.3% in 2011 as market conditions are expected to gradually improve.

Table 3.3: General government debt developments

% of GDP	ESA Code	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
1. Gross debt[1]		94.8	94.6	96.3	96.1	94,7
2. Change in gross debt ratio		-1.1	-0.2	-1.7	-0.2	-1.4
Contributions to changes in gross debt						
3. Primary balance[2]		1.4	0.6	0.3	0.8	1.2
4. Interest expenditure[3]	EDP D.41	4.1	4.0	4.5	4.4	4.3
5. Stock-flow adjustment		1.8	2.6	1.5	0.5	0.5
of which: - Differences between cash and accruals[4]						
- Net accumulation of financial assets[5] *of which:* *- privatisation proceeds*						
- Valuation effects and other[6]						
p.m.: Implicit interest rate on debt[7]		4.9	5.1	5.3	5.2	5.0
Other relevant variables						
6. Liquid financial assets[8]						
7. Net financial debt (7=1-6)						

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2 of the Annex.

[3]Cf. item 9 in Table 2 of the Annex.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

4 SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE

4.1 An alternative scenario: Sensitivity of budgetary projections

A sensitivity analysis of the budgetary projections for the medium term scenario for the 2009-2011 period is based on a more “pessimistic” scenario on output growth developments during this period. The overall impact of such a hypothesis on budgetary projections is examined and the latter are compared to the baseline scenario.

The alternative scenario assumes that the negative shocks of the financial market turmoil on the real economy will exacerbate, resulting to lower consumption growth compared to the baseline scenario, to a slower recovery in gross fixed capital formation and to additional strains on the labour market, thus resulting to an increasing unemployment rate. On the revenue side, the alternative scenario assumes that the revenue elasticities of the baseline scenario are preserved. On the other hand, government expenditure grows at the same growth rate used in the baseline scenario. In this respect, wages and pensions increase only moderately, namely adjusting to inflation developments.

Under these assumptions, and **if a "no policy change" scenario is adopted**, then budgetary projections seem to deteriorate over the medium term period. Hence, the general government deficit as a percentage of GDP will increase over the period of the programme, remaining over 3%. In accordance to government deficit developments, the general government debt as a percentage of GDP will also deviate from the baseline scenario, **under a "no policy change" perspective**.

However, the alternative scenario presented below incorporates the aforementioned assumptions on government expenditure growth and revenue elasticities but with a "policy change" scenario to adjust budgetary developments to the respective baseline levels. In detail, the assumption is made that additional measures are undertaken on the expenditure side (and, to a lesser extent on the revenue side), with an aim to preserve the government deficit as a percentage of GDP in the same levels forecast in the baseline scenario (i.e., 3.7% in 2009, 3.2% in 2010 and 2.6% in 2011). Hence, in order to achieve this policy goal, government expenditure as a percentage of GDP will need to be reduced by 0.4 percentage points in 2009, 0.6 percentage points in 2010 and 0.9 percentage points in 2011. These government expenditure reductions can be achieved, after restraining basic government expenditure categories, such as public consumption, other current expenditure and subsidies.

Forecasts of the main macroeconomic variables in the alternative scenario include a 0.5% GDP growth rate in 2009 and a slower recovery path, with an average 1.5% GDP growth rate in the 2010-2011 period. Total final demand is forecast to accelerate at a slower pace than in the baseline scenario, alleviating possible inflationary pressures and maintaining the inflation rate close to the medium term price stability levels. On the other hand, the unemployment rate will reach higher levels, namely 8.1% in 2009 and 8.2% in the years to follow. Favourable price and wage developments will have a positive impact on external competitiveness, and thus, will curtail the current account deficit as a percent of GDP at 13.4% in 2009 and at 12.4% in 2011. Continuing the fiscal consolidation effort, and undertaking the aforementioned expenditure reductions, is expected to sustain public finances at the baseline scenario level.

Table 4.1: Comparison between the Baseline and the Alternative Scenarios

	Baseline scenario				*Alternative scenario*			
	2008	**2009**	**2010**	**2011**	**2008**	**2009**	**2010**	**2011**
GDP growth rate	3.0	1.1	1.6	2.3	3.0	0.5	1.3	1.8
Private consumption deflator	4.2	2.6	2.5	2.4	4.2	2.2	2.1	2.0
Unemployment rate	7.5	8.0	8.0	7.9	7.5	8.1	8.2	8.2
General government deficit, % GDP	3.7	3.7	3.2	2.6	3.7	3.7	3.2	2.6
General government debt, % GDP	94.6	96.3	96.1	94.7	94.6	97.2	97.6	96.9
Current account deficit, % GDP	14.6	13.1	12.5	11.7	14.6	13.4	13.0	12.4

4.2 Comparison with the previous update

The 2008-2011 SGP update forecasts are strongly affected by the severe economic downturn. Thus, deviations from previous 2007-2010 SGP forecasts are broadly accounted for.

Estimates for the real GDP growth rate in 2008 highlight a downward revision by 1.0 percentage point compared to the GDP growth forecast included in the 2007 Update of the SGP. In 2008, real output growth is estimated at 3.0%, mainly due to adverse developments in the economic activity during the last quarter of the year. The negative impact of the economic downturn is expected to weaken only later in 2010 and in 2011, and hence, during the 2009-2011 period, a marked deviation from the previous SGP's robust growth forecasts is observed.

Considering public finance developments, these are strongly affected both by the structural and the cyclical component. According to the current SGP update and due to the adverse impact of the economic downturn on public finances, the general government deficit as percentage of GDP will fall below 3% only in 2011,. In this respect, the forecasts included in the 2007 Update of the Programme, predicting a convergence of the deficit towards the medium term objective, are not currently valid. Following the same reasoning, the general government gross debt developments as a percentage of GDP also exhibit deviations from the previous SGP update.

5 QUALITY OF PUBLIC FINANCES

5.1 Policy Strategy

The economic policy of the Greek government is based on a two pillar strategy (see Section 3 for details). This two-fold strategy is expected to affect positively the potential growth of the economy and, thereby, to enhance the competitiveness of the economy while preserving social cohesion.

As noted in Section 2, the severe economic downturn at the global level has not compromised the importance given by the government to the quality of public finances. The improvement of the quality of public finances remains a top priority. Indeed, the current severe economic downturn, urges for action and not for complacency. In terms of the Greek policy strategy, this action pertains to the implementation of the tax reform and the improvement of the efficiency of public expenditure. The government expects that this strategy will provide sufficient support to the real economy and to the citizens in need, while it will accelerate the resurgence of growth when the crisis is over. Moreover, the success of this strategy is closely related to systematically tackling tax evasion. To this end, the Ministry of Economy and Finance launched a campaign in November 2008 focusing on the social dimension and repercussions of tax evasion.

5.2 Developments on the expenditure side

As reported in Section 3, the Law 3697/2008 on the expenditure of general government entities will be strictly enforced. This enforcement is expected to contain expenditure and to further enhance the accuracy of data submitted within the EDP procedure. Also, the social security system reform (Law 3655/2008) is an important step towards ensuring the long-term sustainability of public finances. Considerable savings are expected by way of economies of scale because of the reduction of the system's fragmentation, but also from a more efficient management of reserves and property. Since 1/10/2008, 133 social security organisations and branches have been merged to only 13.

In addition, most extra-budgetary accounts are abolished in 2009. Accounts which are maintained, such as those referring to international conventions, research purposes and the Community Support Framework, are subject to rules that ensure transparency, accountability and effectiveness. The abolition of these accounts is expected to improve transparency as part of government's initiatives to consolidate public sector accounts. As noted in Section 3, the introduction of Programme Budgeting is a further significant measure to enhance the quality of public finances, aiming at improving the effectiveness of public expenditure, while allowing for multi-annual budgeting and enhancing transparency and evaluation in fiscal management.

5.3 Developments on the revenue side

In order the support the most vulnerable part of the population, the tax-free bracket for employees and pensioners was increased from €10,000 to €12,000. The central tax rate for income up to €30,000 is decreased to 25% in 2009 down from 27% in 2008. According to legislation already approved by the Parliament, the central tax rate will decline further so as to reach 20% in 2014. The tax rate for incomes between €30,000 and €75,000 was decreased to 35% in 2009 down from 37% in 2008. In order to support long-term growth, the business tax rate follows a similar path and is expected to decline to 20% in 2014.

In the effort to continue tackling tax evasion, the government passed the Law 3634/2008, which equalized the excise tax rate for heating oil to the rate of diesel fuel used for transportation. This measure is expected to combat widespread tax evasion in the oil market where domestic heating oil, subject to lower excise taxes, used to be directed towards other uses. The same measure will be applied to maritime oil. Law 3634/2008 also modernised property taxation. A unique property tax was established, replacing a variety of taxes levied on real estates. The rate was set at 0.1% for households and 0.6% for corporations. In addition, in terms of institutional improvements, the staff recruitment of audit services is now based on thorough evaluation. Their term will be two quadrennials, while an interim assessment at the end of the first quadrennial will take place.

More recently, Law 3697/2008 was approved in September 2008. New measures include:

- A new initial tax bracket was established with a rate of 10% for self employed professionals (with specific exemptions for young professionals).
- The advance payment rate for enterprises was increased to 80%, up from 65%, while for banks it was set to 100%.
- A new tax rate of 10% on dividends was introduced. The same rate holds for capital gains from selling stocks.
- A new tax on stock options was introduced according to rules pertaining to wage income.
- Vehicle circulation duties were increased by 20%.

In addition, as noted in Section 3, an objective tax settlement is legislated, including delinquent obligations to the state and unsettled tax accounts for professionals and enterprises.

5.4 Quality of Fiscal Statistics

In recent years the Greek government has proceeded to substantially improve the transparency and the accuracy of fiscal statistics in close cooperation with Eurostat. In 2008, the Greek government swiftly acted to resolve all issues following the Eurostat's News Release 54/2008 of 18 April 2008 where some reservations were expressed about: the recording of EU grants for 2006 and 2007, the existence of statistical discrepancies in 2007 and the coverage of source data for extra-budgetary funds, local government and social security funds. The Greek National Statistical Service and Eurostat closely cooperated and resolved all pending issues in a timely manner. As a result, in the Eurostat's News Release 147/2008 of 22 October 2008 all reservations were withdrawn, while a detailed medium-term Action Plan was agreed with the Greek National Statistical Service.

6 LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES

6.1 Introduction

Safeguarding the long-term sustainability of public finances is a priority in the government's policy agenda and remains a significant challenge. In addition to the unfavourable initial conditions, Greece faces also a very significant increase in the long-term cost of age-related expenditure (LTC). The latest available common projections[1] indicated an increase in age-related spending by 1.2 percentage points of GDP between 2004 and 2050. However, the projected increase in LTC was significantly underestimated, as it did not include data on pension expenditure. In autumn 2008, national pension projections were submitted to the EPC Ageing Working Group in preparation of the 2009 common projections. These projections – currently under review by the EPC AWG – indicate a very significant increase in pension expenditure from 11.7% of GDP in 2007 to 24.1% in 2060.

The government is committed to safeguarding the sustainability of public finances by adhering to a three-pronged strategy aimed at:

- continuing fiscal consolidation and reducing the debt-to-GDP ratio,

[1] European Economy, *Special Report No. 1/2006*: "The impact of ageing on public expenditure: projections for the EU25 Member States on pensions, health care, long-term care, education and unemployment transfers (2004-2050)".

- consolidating the budgetary items with the highest risk, notably through a comprehensive reform of the social security system and
- raising employment rates and accelerating productivity growth by implementing an appropriate policy mix of structural reforms, in line with the goals of the Lisbon Strategy.

6.2 Pension Reform

Pension spending has consistently been documented to pose a very significant risk to the long-term sustainability of public finances. In line with the national priorities identified in the National Reform Programme, the Council recommendations and the previous update of the SGP, the government introduced in March 2008 a comprehensive reform of the social security system (Law 3655/2008). The reform takes a decisive step towards addressing the acute fragmentation of the system, allowing for improved supervision and significant savings in administrative costs. In addition, the law introduces a number of parametric adjustments, providing stronger incentives for prolonging working life, discouraging early retirement and raising female participation.

Box 6.1 - Key features of the recent reform of the social security system (Law 3655/2008)

- Addressing decisively the fragmentation of the system, by reducing the number of funds from 133 to 13, significantly reducing administrative costs and improving monitoring and supervision.
- Introduction of an Individual Social Security Number (ISSN), effective from 01.06.2009, allowing, inter alia, for improved expenditure control. The introduction of the Individual Social Security Number is also expected to assist employment inspection, thus contributing in reducing contribution evasion.
- Establishment of the Insurance Fund for Inter-generational Solidarity (AKAGE), in order to safeguard future pension payments. AKAGE will accumulate reserves in order to finance pension payments of social security funds for the years beyond 01.01.2019. Starting 01.01.2009, AKAGE will be funded by:
  - 10% of annual total privatization revenue,
  - 4% of the annual VAT revenue,
  - 10% of total annual receipts from special social resources of Social Insurance Funds, branches or accounts, outlined in article 150.
- Financial incentives for extending working life by up to 3 years past the statutory retirement age and increased disincentives for early retirement.

- Stricter pension eligibility conditions, mainly for wage earners (IKA-ETAM).
- Strengthening provisions regarding maternity leave, aimed at facilitating female participation in the labor market.

The lack of updated figures on the projected development of pension expenditure has been a significant setback in the quantitative analysis of the long-term sustainability of public finances for Greece. In collaboration with the International Labour Office (ILO), the National Actuarial Authority has developed the necessary infrastructure to provide an actuarial analysis of the national pension system. The projections are reported in Table 7 of the Annex and utilize the macroeconomic and demographic assumptions agreed by the EPC AWG, in preparation of the 2009 common projections. The data have been submitted to the EPC AWG and await formal approval.

Due to methodological, data and time constraints, the projection of pension expenditure does not incorporate a number of the provisions of the recent pension reform (Law 3655/2008), including:

- the expected savings in administrative costs and improved expenditure control,
- the increased incentives for extending working life and the disincentives for early retirement,
- the improved provisions in support of female participation.

As a result, the reported projections do not fully capture the impact of enacted legislation and are likely to over-estimate the increase in pension spending. Also, due to the introduction of important parametrical changes and the ISS number (becoming obligatory for employment and social security purposes) as from this year (2009), more concrete results on the positive impact of the reform (including spectacular cuts of administrative costs) will be available by the end of next year (2010).

6.3 Reforms in the National Healthcare System

Based on the 2006 common projections, the path of healthcare expenditure in Greece poses a much lower risk to the long-term sustainability of public finances, compared to pension expenditure, rising by 1.7 percentage points of GDP between 2004 and 2050.

The National Healthcare System (NHS) is being reformed with the aim to improve financial, managerial and administrative control. Ongoing reforms are covered in detail in the National Reform Programme 2008-2010 and include the following:

- Law 3697/2008 provides a new regulatory framework regarding the operation of entities in the broader public sector, including hospitals and social security funds. The new framework aims at containing expenditure and improving transparency.
- Law 3580/2007 was activated in June 2008, providing for the first time a comprehensive procurement system for institutions supervised by the Ministry of Health and Social Solidarity. It aims at enhancing transparency and improving expenditure control in health procurement.
- The regional structure of the NHS is being reformed (Law 3527/2007), reducing the number of Regional Health Authorities to seven down from seventeen. The new structure aims at improving effectiveness and efficiency, while allowing for improved expenditure control.
- The active utilization of Public Private Partnerships in construction and maintenance of NHS infrastructure.

6.4 Increasing employment and productivity

Given the projected, sharp deterioration in the old-age dependency ratio, labour force shortages will have a toll in the future rate of potential economic growth. In this context there is increased scope for raising the utilization of potential labour input, by raising employment rates and encouraging participation in the labour market.

In line with the national priorities outlined in the National Reform Programme 2008-2010 and the Council recommendations, increased emphasis is placed on active labour market policies, targeted primarily on youth, females and older workers. In addition, the recent pension reform provides increased incentives for prolonging working life and encourages female participation through improved provisions regarding maternity leaves. Active promotion of gender equality, investment in childcare and social care infrastructure, as well as promotion of part-time employment has facilitated in recent years an encouraging increase in the female employment rate.

In addition, emphasis is placed on raising productivity by investing in human capital, reforming the educational system, strengthening the training and life-long learning systems, but also by opening up markets to competition and facilitating the spread and uptake of ICT. The improvement in the efficiency and effectiveness of the public sector remains a key area of focus.

7 CONSISTENCY BETWEEN NRP AND SGP

The Stability and Convergence Programme (SCP) and the National Reform Programme (NRP) are both coordinated by the Minister of Economy and Finance, ensuring consistency in overall policy design and target setting. While the SCP is drafted exclusively by the Ministry of Economy and Finance, the NRP is drafted with the assistance of the Standing Lisbon Committee under the supervision of the Minister of Economy and Finance, in his capacity as National Lisbon Coordinator. The Standing Lisbon Committee represents competent Ministries, Social Partners, Regions and NGOs and allows for a wide exchange of views between all parties involved. The NRP is finalized under the responsibility of the National Lisbon Coordinator, ensuring consistency with the SCP strategy of the government.

The SCP dimension is strongly reflected in the NRP, which clearly identifies fiscal consolidation and strengthening the long-term sustainability of public finances as top national priorities. In addition, the national priorities outlined in the NRP are entirely consistent with the three-pronged strategy aimed at:

- reducing the debt-to-GDP ratio and continuing the efforts on fiscal consolidation,
- consolidating the budgetary items with the highest risk, notably through a comprehensive reform of the social security system and

- raising employment rates and accelerating productivity growth by implementing an appropriate policy mix of structural reforms, in line with the goals of the Lisbon Strategy.

The direct budgetary impact of the structural reforms envisaged in the NRP is partly reflected in the budgetary projections in the SCP. Although the impact of fiscal measures, such as the tax reform, are explicitly taken on board, the quantification of other structural reforms, aimed e.g. at enhancing human capital is less straightforward, given the available modeling tools. Nevertheless, there has been significant progress in improving the available infrastructure for projecting the long-term developments of age-related expenditure, reported in section 6.

ANNEX

FULL SET OF REVISED TABLES TO BE ANNEXED TO THE SGP ACCORDING TO THE CODE OF CONDUCT

Table 1a. Macroeconomic prospects

	ESA Code	**Year 2007** Level Bn euros	**Year 2007** rate of change	**Year 2008** rate of change	**Year 2009** rate of change	**Year 2010** rate of change	**Year 2011** rate of change
1. Real GDP	B1*g	182.0	4.0	3.0	1.1	1.6	2.3
2. Nominal GDP	B1*g	228.2	7.0	7.4	3.8	4.2	4.9
Components of real GDP							
3. Private consumption expenditure	P.3	130.8	3.0	2.3	1.9	2.0	2.1
4. Government consumption expenditure	P.3	29.1	7.7	3.1	3.5	1.0	1.0
5. Gross fixed capital formation	P.51	44.4	4.9	-8.9	-0.5	3.0	3.5
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	0.2	0.1	2.0	0.2	-0.2	-0.3
7. Exports of goods and services	P.6	43.6	3.1	3.9	1.5	2.5	3.3
8. Imports of goods and services	P.7	66.2	6.7	-0.4	-1.8	2.2	2.6
Contributions to real GDP growth							
9. Final domestic demand		-	4.59	0.30	1.82	2.24	2.43
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	1.06	1.91	-1.72	-0.49	-0.04
11. External balance of goods and services	B.11	-	-1.62	0.79	1.00	-0.15	-0.09

Table 1b. Price developments

	ESA Code	**Year 2007** Level Bn euros	**Year 2007** rate of change	**Year 2008** rate of change	**Year 2009** rate of change	**Year 2010** rate of change	**Year 2011** rate of change
1. GDP deflator			2.9	4.3	2.7	2.6	2.5
2. Private consumption deflator			3.2	4.2	2.6	2.5	2.4
3. HICP[1]			3.0	4.3	2.6	2.5	2.4
4. Public consumption deflator			3.2	4.5	2.9	2.5	2.4
5. Investment deflator			2.2	4.4	2.7	2.3	2.2
6. Export price deflator (goods and services)			2.4	4.8	2.6	2.5	2.4
7. Import price deflator (goods and services)			3.0	6.0	1.4	1.8	1.7

[1] Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	Year 2007 Level	Year 2007 rate of change	Year 2008 rate of change	Year 2009 rate of change	Year 2010 rate of change	Year 2011 rate of change
1. Employment, persons[1] (000)		4701.7	1.3	1.1	0.2	0.6	0.7
2. Employment, hours worked[2]							
3. Unemployment rate (%)[3] (000)		406.9	8.0	7.5	8.0	8.0	7.9
4. Labour productivity, persons[4]			2.7	1.9	0.9	1.0	1.6
5. Labour productivity, hours worked[5]							
6. Compensation of employees bn euro	D.1	79.0	10.8	9.8	7.1	4.3	4.5
7. Compensation per employee			9.1	7.6	6.1	3.4	3.5

[1]Occupied population, domestic concept national accounts definition.

[2]National accounts definition.

[3]Harmonised definition, Eurostat; levels.

[4]Real GDP per person employed.

[5]Real GDP per hour worked.

Table 1d. Sectoral balances

% of GDP	ESA Code	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-12.1	-12.8	-11.4	-10.8	-10.0
of which:						
- Balance on goods and services		-10.5	-9.9	-8.4	-8.2	-7.8
- Balance of primary incomes and transfers		-3.6	-4.7	-4.7	-4.3	-3.9
- Capital account		1.9	1.7	1.7	1.7	1.7
2. Net lending/borrowing of the private sector	B.9	-8.6	-9.1	-7.7	-7.6	-7.4
3. Net lending/borrowing of general government	EDP B.9	-3.5	-3.7	-3.7	-3.2	-2.6
4. Statistical discrepancy			optional	optional	optional	optional

Table 2. General government budgetary prospects

	ESA Code	Year 2007 Level Bn euros	Year 2007 % of GDP	Year 2008 % of GDP	Year 2009 % of GDP	Year 2010 % of GDP	Year 2011 % of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-7.9	-3.5	-3.7	-3.7	-3.2	-2.6
2. Central government	S.1311	-11.2	-4.9	-6.3	-6.2	-4.6	-3.9
3. State government	S.1312						
4. Local government	S.1313	-0.1	-0.05	-0.04	0.67	0.0	0.0
5. Social security funds	S.1314	3.3	1.5	2.6	1.8	1.3	1.3
General government (S13)							
6. Total revenue	TR	91.1	39.9	40.0	41.0	41.1	41.2
7. Total expenditure	TE[1]	99.0	43.4	43.7	44.7	44.3	43.8
8. Net lending/borrowing	EDP B.9	-7.9	-3.5	-3.7	-3.7	-3.2	-2.6
9. Interest expenditure	EDP D.41	9.3	4.1	4.0	4.5	4.4	4.3
10. Primary balance[2]		1.4	0.6	0.3	0.8	1.2	1.7
11. One-off and other temporary measures[3]			-0.5	0.4	0.5	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		46.0	20.2	19.9	22.0	21.8	21.8
12a. Taxes on production and imports	D.2	*27.5*	*12.1*	*11.9*	*12.3*	12.4	12.4
12b. Current taxes on income, wealth, etc	D.5	*18.1*	*7.9*	*7.8*	*9.3*	9.0	9.0
12c. Capital taxes	D.91	*0.4*	*0.2*	*0.2*	*0.4*	0.4	0.4
13. Social contributions	D.61	31.8	13.9	14.2	14.2	14.2	14.2
14. Property income	D.4	2.1	0.9	0.9	0.8	0.8	0.8
15. Other [4]		12.1	5.4	4.8	4.0	4.3	4.4
16=6. Total revenue	TR	91.1	39.9	40.0	41.0	41.1	41.2
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)[5]			31.9	31.9	34.0	33.7	33.7
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	**37.0**	**16.2**	**16.3**	**17.0**	**16.8**	**16.6**
17a. Compensation of employees	D.1	25.2	11.0	11.3	12.0	11.9	11.7
17b. Intermediate consumption	P.2	11.8	5.2	5.0	5.0	4.9	4.9
18. Social payments (18=18a+18b)		*39.3*	*17.2*	*18.0*	*18.6*	*18.6*	*18.6*
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131						
18b. Social transfers other than in kind	D.62	*39.3*	*17.2*	*18.0*	*18.6*	*18.6*	*18.6*
19=9. Interest expenditure	EDP D.41	9.3	4.1	4.0	4.5	4.4	4.3
20. Subsidies	D.3	0.3	0.1	0.1	0.1	0.1	0.1
21. Gross fixed capital formation	P.51	6.7	3.0	3.0	2.7	2.7	2.7
22. Other[6]		6.4	2.8	2.3	1,8	1.9	1.7
23=7. Total expenditure	TE[1]	99.0	43.4	43.7	44.7	44.3	43.8
p.m.: Government consumption (nominal)	P.3	38.1	16.7	16.7	17.2	17.1	16.8

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

[2]The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

[3]A plus sign means deficit-reducing one-off measures.

[4] P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

[5]Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

[6] D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	**Year 2006**	**Year 2011**
1. General public services	1		
2. Defence	2		
3. Public order and safety	3		
4. Economic affairs	4		
5. Environmental protection	5		
6. Housing and community amenities	6		
7. Health	7		
8. Recreation, culture and religion	8		
9. Education	9		
10. Social protection	10		
11. Total expenditure (=item 7=23 in Table 2)	TE[1]		

[1]Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	**Year 2007**	**Year 2008**	**Year 2009**	**Year 2010**	**Year 2011**
1. Gross debt[1]		94.8	94.6	96.3	96.1	94.7
2. Change in gross debt ratio		-1.1	-0.2	-1.7	-0.2	-1.4
Contributions to changes in gross debt						
3. Primary balance[2]		1.4	0.6	0.3	0.8	1.2
4. Interest expenditure[3]	EDP D.41	4.1	4.0	4.5	4.4	4.3
5. Stock-flow adjustment		1.8	2.6	1.5	0.5	0.5
of which:						
- Differences between cash and accruals[4]						
- Net accumulation of financial assets[5]						
of which:						
- privatisation proceeds						
- Valuation effects and other[6]						
p.m.: Implicit interest rate on debt[7]		4.9	5.1	5.3	5.2	5.0
Other relevant variables						
6. Liquid financial assets[8]						
7. Net financial debt (7=1-6)						

[1]As defined in Regulation 3605/93 (not an ESA concept).

[2]Cf. item 10 in Table 2.

[3]Cf. item 9 in Table 2.

[4]The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

[5]Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

[6]Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

[7]Proxied by interest expenditure divided by the debt level of the previous year.

[8]AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
1. Real GDP growth (%)		4.0	3.0	1.1	1.6	2.3
2. Net lending of general government	EDP B.9	-3.5	-3.7	-3.7	-3.2	-2.6
3. Interest expenditure	EDP D.41	4.1	4.0	4.5	4.4	4.3
4. One-off and other temporary measures[1]		-0.5	0.4	0.5	0.0	0.0
5. Potential GDP growth (%)		3.6	3.2	2.8	2.4	2.4
contributions:						
- labour		0.7	0.7	0.6	0.6	0.6
- capital		1.2	1.1	1.0	1.0	1.0
- total factor productivity		1.7	1.4	1.2	0.8	0.7
6. Output gap		1.8	1.6	-0.1	-0.9	-1.0
7. Cyclical budgetary component		0.7	0.7	0.0	-0.3	-0.5
8. Cyclically-adjusted balance (2 - 7)		-4.2	-4.4	-3.7	-2.8	-2.2
9. Cyclically-adjusted primary balance (8 + 3)		-0.1	-0.4	-0.8	-1.5	-2.2
10. Structural balance (8 - 4)		-3.7	-4.8	-4.2	-2.8	-2.2

[1]A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
Real GDP growth (%)						
Previous update		4.1	4.0	4.0	4.0	-
Current update		4.0	3.0	1.1	1.6	2.3
Difference		-0.1	-1.0	-2.9	-2.4	
General government net lending (% of GDP)	EDP B.9					
Previous update		-2.7	-1.6	-0.8	-0.0	
Current update		-3.5	-3.7	-3.7	-3.2	-2.6
Difference		-0.8	-2.1	-2.9	-3.2	
General government gross debt (% of GDP)						
Previous update		93.4	91.0	87.3	82.9	
Current update		94.8	94.6	96.3	96.1	94.7
Difference		1.4	3.6	9.0	13.2	

Table 7: Long-term sustainability of public finances

% of GDP	2000	2007	2020	2030	2040	2050	2060
Total expenditure							
Of which: age-related expenditures							
Pension expenditure	10.82	11.7	13.2	17.1	21.4	24.0	24.1
Social security pension	10.82	11.7	13.2	17.1	21.4	24.0	24.1
Old-age and early pensions		8.8	9.9	13.1	16.3	17.9	17.7
Other pensions (disability, survivors)		2.9	3.3	4.0	5.1	6.1	6.4
Occupational pensions (if in general government)							
Health care							
Long-term care *(this was earlier included in the health care)*							
Education expenditure							
Other age-related expenditures							
Interest expenditure							
Total revenue							
Of which: property income							
Of which: from pensions contributions (or social contributions if appropriate)							
Pension reserve fund assets							
Of which: consolidated public pension fund assets (assets other than government liabilities)							
Assumptions							
Labour productivity growth		2.5	2.9	1.8	1.7	1.7	1.7
Real GDP growth		3.8	2.9	1.3	1.0	1.2	1.4
Participation rate males (aged 15-64)		78.8	78.5	76.2	75.9	76.7	76.4
Participation rate females (aged 15-64)		55.2	60.1	60.0	60.6	61.2	61.0
Total participation rate (aged 15-64)		67.1	69.4	68.3	68.4	69.1	68.8
Unemployment rate		8.5	6.2	6.2	6.2	6.2	6.2
Population aged 65+ over total population		0.19	0.21	0.24	0.28	0.32	0.32

Table 8. Basic assumptions

This table should preferably be included in the programme itself; if not, these assumptions should be transmitted to the Council and the Commission together with the programme.

	Year 2007	Year 2008	Year 2009	Year 2010	Year 2011
Short-term interest rate[1] (annual average)	4.3	4.6	2.1	2.8	2.7
Long-term interest rate (annual average)	4.3	4.0	3.1	3.3	3.0
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.37	1.47	1.38	1.38	1.38
Nominal effective exchange rate	0.9	4.4	3.2	0.0	0.0
(for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)					
World excluding EU, GDP growth	5.6	3.9	1.2	3.3	3.5
EU GDP growth	2.9	1.0	-1.8	0.5	2.0
Growth of relevant foreign markets	5.7	3.2	1.0	3.0	4.0
World import volumes, excluding EU	7.2	4.1	-1.3	3.6	4.0
Oil prices (Brent, USD/barrel)	72.5	98.5	52.1	61.7	60.0

[1]If necessary, purely technical assumptions.