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The Economic Adjustment Programme for Greece

Directorate-General for Economic and Financial Affairs

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

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European Commission

Directorate-General for Economic and Financial Affairs

The Economic Adjustment Programme for Greece

THE ECONOMIC ADJUSTMENT PROGRAMME FOR GREECE

(26 May 2010)

Background:

A joint EC/IMF/ECB mission visited Athens from 21 April to 3 May 2010 following a request for international financial assistance from Greece.

On 2 May the mission concluded a staff level agreement for a joint 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 bilateral loans centrally pooled by the European Commission. 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 bn of a pooled loan to Greece, following a disbursement of EUR 5.5 bn from the IMF

This report by European Commission staff provides an overview of the challenges faced by Greece, discussions with the authorities, and the objectives and design of the economic and financial programme.

Preparation of this report was coordinated by Servaas Deroose acting Deputy Director General of DG ECFIN of the European Commission. Contributors: Giuseppe Carone, Declan Costello, Leila Fernandez Stembridge, Anton Jevcak, Filip Keereman, Luis Garcia Lombardero, Peter Lohmus, George Moschovis, Laurent Moulin, João Nogueira Martins, Elena Pavlova, Matteo Salto and Alessandro Turrini.

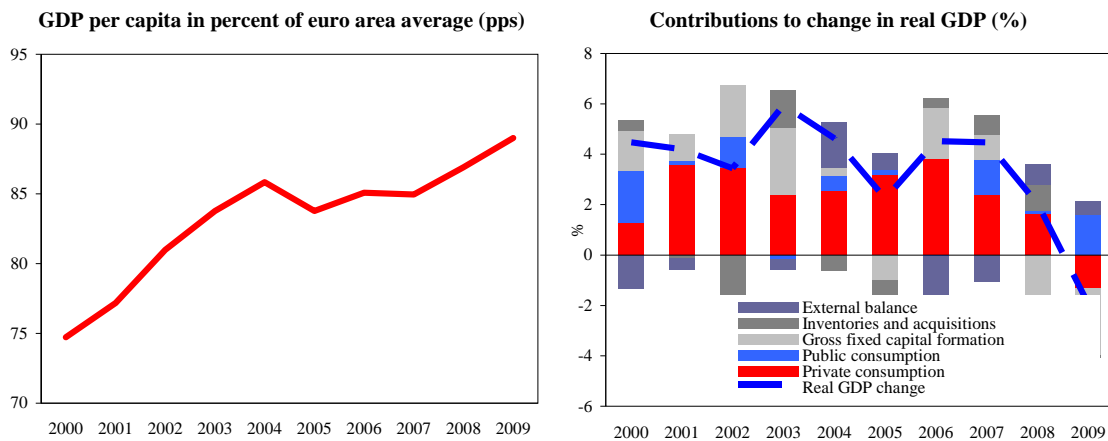
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I. INTRODUCTION AND BACKGROUND

1. **The strong growth performance of Greece over the last decade was based on unsustainable drivers.** With average real GDP growth at close to 4 percent per year between 2000 and 2009, against 2 percent in the euro area, Greece's income gap with the euro-area average was reduced from 25 to about 10 percent (Figure 1). This reflected a domestic demand boom, in particular in consumption and residential investment. High real wage increases, rapid credit growth – supported by financial sector liberalization and low real interest rates associated with euro adoption – and loose fiscal policy contributed to buoyant growth. Over 2000-2009 period, external trade imposed a drag on growth and the share of exports in GDP declined from 25 to 19 percent.

Figure 1: Greece - Macroeconomic developments



2. **The absorption boom and weak external competitiveness caused a fast increase in external imbalances.** Real wage growth consistently outpaced productivity gains over the past decade, in part reflecting spillovers from very high public wage increases. The resulting increase in ULC (unit labour costs) eroded external competitiveness, not least with respect to the rest of the euro area. Greece's real effective exchange rate (REER) appreciated by some 10-20 percent, depending on the deflator used, over 2000-2009 and according to Commission services' calculations was overvalued by 10 to 20 percent in 2009 (Box 1, Figure 4). The combination of high domestic demand growth and deteriorating external competitiveness translated into a rapid worsening of the current account deficit, which peaked at 14 percent of GDP in 2008.
3. **Fiscal imbalances remained persistently high.** Since Greece submitted its first stability programme in December 2000 (shortly after the decision that Greece would adopt the euro), which set a medium-term objective (MTO) of a balanced budgetary position, this target has never been reached. Worse, the headline balance has never been below 3% of GDP (Figure 2). Fiscal targets were consistently missed, despite the benign economic environment, due to systematic overspending, endemic tax evasion and persistently overoptimistic tax projections. The size of the government sector grew from 44% of

GDP in 2000 to over 50% in 2009, not only absorbing available external financing, but also crowding out private-sector resources and therefore weakening economic performance (Figure 3). In addition, unreformed health and pension systems posed a threat to the long-term sustainability of public finances.

Figure 2: Greece - Government finances

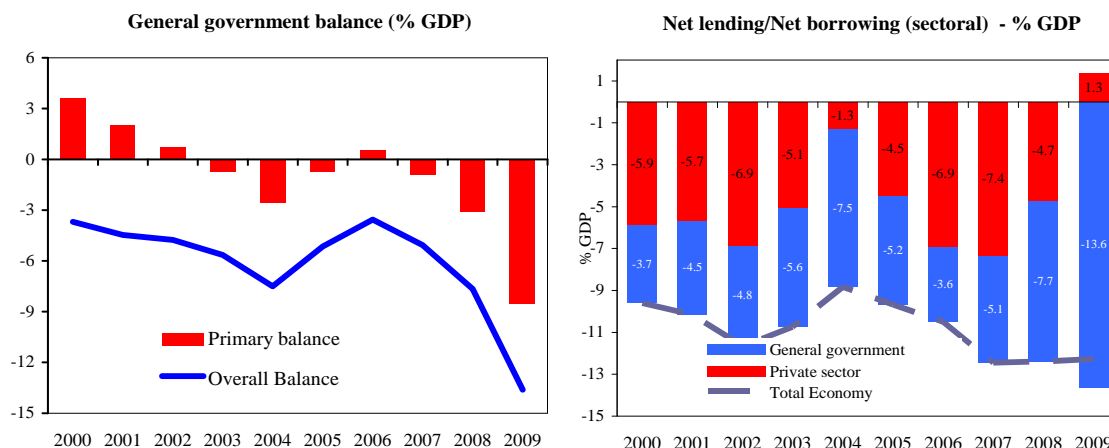
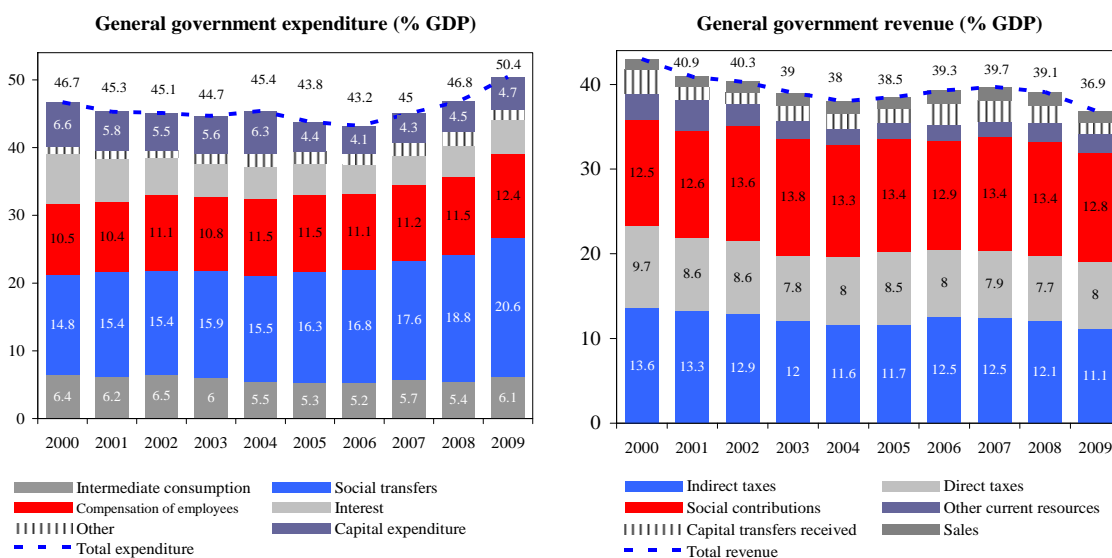


Figure 3: Greece - Government expenditure and revenue



Box 1: External competitiveness indicators and exchange rate valuation

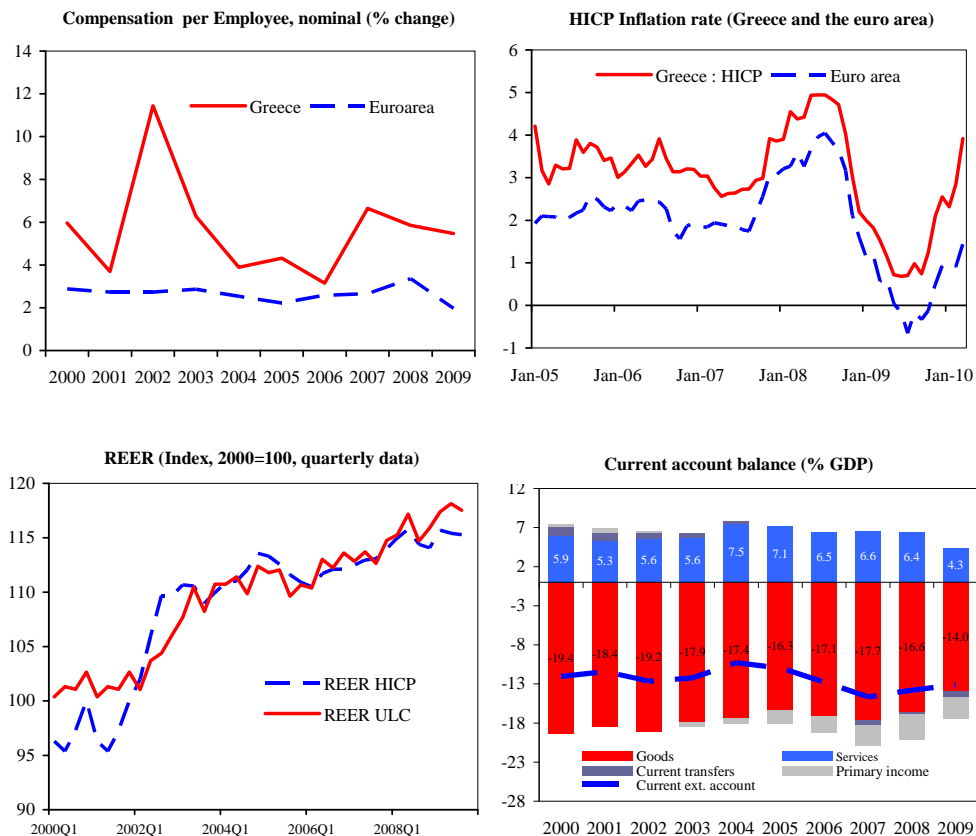
Greece's real effective exchange rate is moderately overvalued.

- Results based on the current account norm approach point to an overvaluation of the Greek REER of about 10% in 2010. This means that a 10% depreciation would be necessary to bring the underlying current account in line with a current account value in line with fundamentals driving the saving-investment balance (the current account norm).
- The NFA (net financial asset)-stabilisation approach indicates a higher degree of misalignment, with overvaluation in the order of 20%. The NFA-stabilising current account deficit is estimated to be quite low (about 3%), in light of low nominal growth. A substantial adjustment in the REER is therefore required to stabilise the stock of net foreign liabilities.
- The BEER (behavioural equilibrium exchange rate) method yields an overvaluation of about 15%. Panel regression results indicate that about 15% of the Greek consumption-deflator-based REER cannot be justified on the ground of fundamentals (government consumption, NFA stock, Balassa-Samuelson effects). The degree of misalignment appears slightly higher when the ULC-based REER is used (16%).

Caution is needed in interpreting these results.

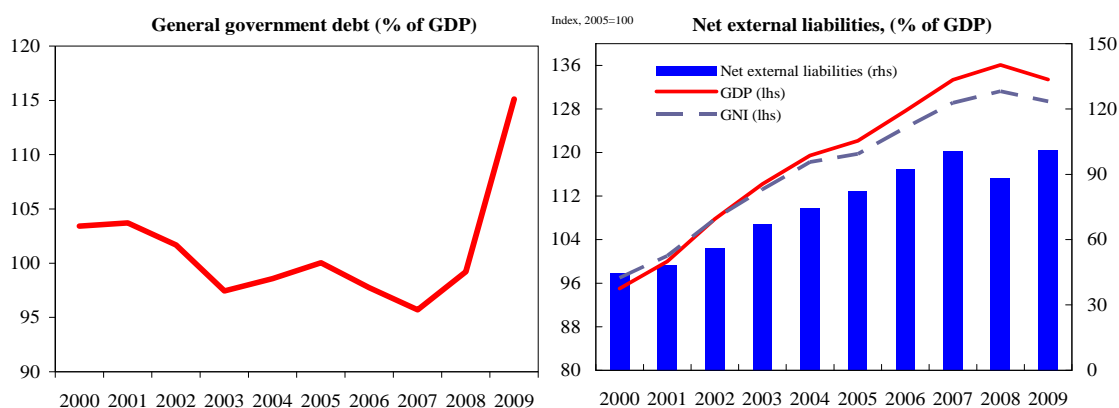
- During periods of financial turbulence current account balances are likely to be driven by temporary factors originating in financial markets and which have a counterpart in deviations of income and price trade elasticities from norms for which there is no correction in underlying current account estimates.
- Current-account-based methods are sensitive to the value of the current account elasticity. The approach based on NFA stabilisation yields results that are sensitive to assumptions on nominal growth. Results from the BEER and current account methods are sensitive to the empirical specification adopted and the sample used.

Figure 4: Greece - Competitiveness developments



4. **Persistent fiscal and external imbalances led to a significant increase in government and external debt.** In 2009, gross government debt reached 115 percent of GDP, up from 103 percent of GDP in 2000, and net external debt almost 100 percent of GDP, up from 45 percent of GDP in 2000 (Figure 5). Around $\frac{3}{4}$ of total external debt pertains to the public sector, and has relatively long maturities. Overall, the accumulation of macroeconomic imbalances, large stocks of public and external debt, weak external competitiveness, an unsustainable pension system, and weak institutions made Greece vulnerable to an increase of risk aversion in the international capital markets.

Figure 5: Greece - Government and external debt



5. **In addition, Greece has rigid product and labour markets.** Greece underperforms in many structural policy areas. This has had an impact on past economic performance, as shown in Greece's relatively low employment and labour productivity levels, which were only partly compensated by a high number of hours worked. Unless tackled in earnest, structural rigidities may undermine the Greek economy's capacity to adjust to the current situation.
6. **The 2008-2009 global crisis exposed Greece's vulnerabilities.** As a result, market sentiment vis-à-vis Greece worsened sharply in early 2010. The downturn took a heavy toll on public finances. Significant overspending and a sharp fall in government revenue pushed the general government deficit to an estimated 13.6% of GDP in 2009. Government debt reached 115 percent of GDP at the end of 2009. Moreover, the extent of the deterioration in the fiscal position was revealed quite late due to serious deficiencies in Greece's accounting and statistical systems (Table 1). This delayed implementation of corrective measures surprised the markets, which became concerned about fiscal sustainability. Leading rating agencies downgraded the sovereign, and the yield on sovereign bonds and CDS spreads increased sharply since the end of 2009.

Table 1. Revision to 2009 deficit estimates

	2009 deficit (% of GDP)
Budget 2009	2
SGP January 2009	3.7
EDP notification April 2009	3.7
EDP notification October 2009	12.7
Budget 2010	12.7
SGP January 2010	12.7
February 2010	12.9
EDP Notification April 2010	13.6

Sources: Greek authorities, Eurostat.

7. **While not at the origin of financial stress, the banking sector was affected by the economic and confidence crisis.** The average capital adequacy ratio of Greek banks improved to 11.7% at the end of 2009, partly thanks to public capital injections on top of banks' own efforts to bolster their capital buffer. However, nonperforming loans increased from 5% in 2008 to 7.7% in December 2009 (Table 2). Furthermore, rising concerns about the creditworthiness of the sovereign affected the banking system through various channels (Box 2), feeding worries of a disorderly adjustment. These developments called for a rapid policy response.

Table 2. Banking sector soundness indicators, 2005 - 2009

(In percent)	2005	2006	2007	2008	2009
Capital adequacy	13.2	12.2	11.2	9.4	11.7
Non performing loans	6.3	5.4	4.5	5.0	7.7
Return on equity	15.9	12.7	14.8	3.2	-1.5
Liquid assets to total assets	34.0	33.6	35.1	38.7	45.2

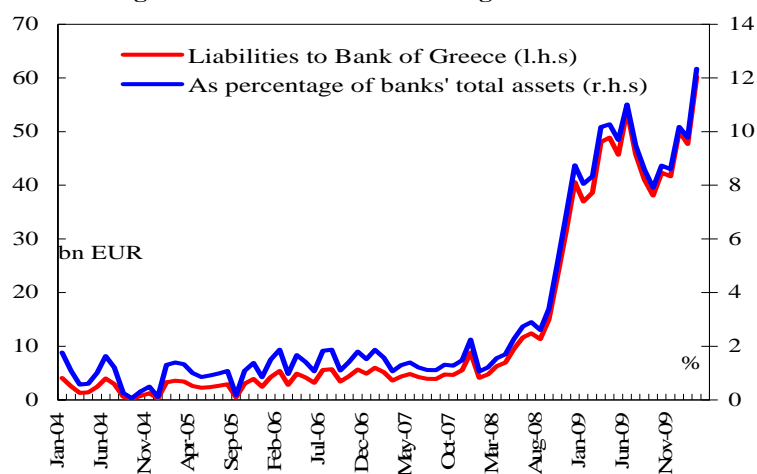
Source: Bank of Greece

Box 2: Impact of sovereign solvency risks on the banking sector

Concerns about the creditworthiness of the sovereign affected banks through three channels:

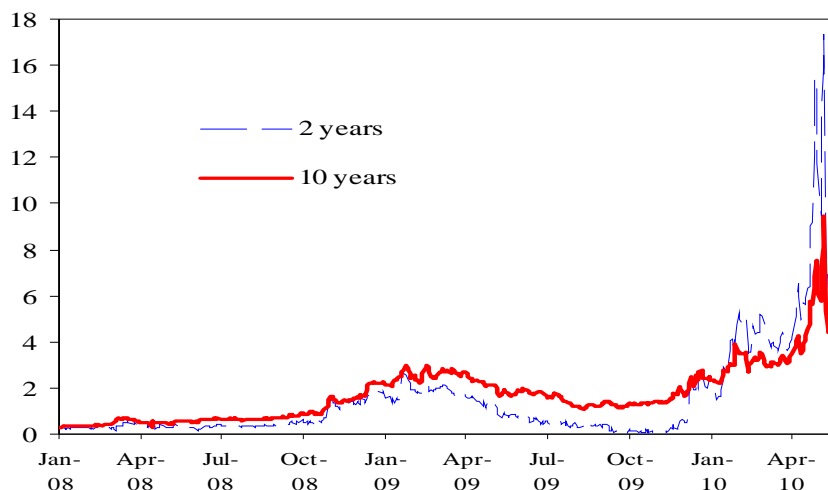
- **Direct exposure.** Greek bank exposure to government liabilities amounts to about EUR 40 billion (8% of banks' assets), of which EUR 32 bn in bonds. Higher yields mean a lower value of bonds and, to the extent that the bonds are in the trading book, losses for banks.
- **Valuation of the sovereign bond portfolio.** This affects banks' capacity to access ECB liquidity as also the collateral, mostly government paper, pledged with the ECB to obtain short-term financing is worth less. The closure of the money markets for Greek banks made them increasingly dependent on the ECB (Figure 6).
- **Confidence effects.** Exposure to the sovereign and liquidity problems undermined confidence in the banking sector leading to deposit withdrawals, first by foreign financial institutions, but also by Greek residents, especially since the last few weeks of 2009.

Figure 6. Greek banks' borrowings from the ECB



8. **In April 2010, the authorities asked for official financial assistance.** The government was confronted with sizeable fiscal financing needs in April and May 2010. The April needs were met through issuances of bonds – EUR 8bn in five-year bonds on 25 January, EUR 5bn in ten-year bonds in early March and EUR 5bn in seven-year bonds in late March – but at a high price (the average interest rate exceeded 6 percent). Following the further worsening of market conditions in the course of April (Figure 7), the authorities requested bilateral financial assistance from Euro area Member States and a Stand-By Arrangement from the IMF. A joint EC-ECB-IMF mission was sent to Athens on 21 April 2010 to discuss a policy package to restore macroeconomic stability and sustainable long-term growth. Agreement at technical level was reached on 2 May 2010 on a comprehensive policy package for the period 2010-13 supported by official financing for a total amount of EUR 110 billion. On the same day, the Eurogroup endorsed the policy programme and approved bilateral loans from Euro area Member States to the amount of EUR 80 billion. On 9 May, the IMF Board approved a EUR 30 bn Stand-By Arrangement (see Box 3 for a chronology of events since end- 2009).

Figure 7. Spread over German Bond ('00 basis points)



Box 3: The sovereign debt crisis in Greece – chronology of events

- **23 December 2009:** Parliament adopts the 2010 budget setting a general government deficit target of 9.1 percent of GDP.
- **15 January 2010:** Government submits the updated stability programme (SP), projecting a reduction of the government deficit of 4 percentage points to 8.7 percent of GDP in 2010, and correction of the excessive deficit by 2012. The debt ratio was projected to peak at 121 percent of GDP in 2011.
- **1 February 2010:** 2-year bond spreads reach 347 basis points; 10-years bond spreads reach 270 basis points.
- **3 February 2010:** The Commission adopts (i) a proposal for a Council Decision, in view of the excessive deficit correction in Greece by 2012, (ii) a draft Council Recommendation with a view to ending the inconsistency with the broad guidelines of the economic policies, and (iii) a draft Council Opinion on the SP.
- **2 February 2010:** Greece announces a set of measures in addition to those announced in the SP (freezing wages and raising excises with the aim of reducing the government deficit).
- **11 February 2010:** European Council invites the ECOFIN Council to adopt these documents, and calls on the Commission to monitor implementation of the Council decision and recommendation, in liaison

with the ECB and drawing on the expertise of the IMF. The euro-area Member States declare their readiness to take determined and coordinated action, if needed, to safeguard the financial stability in the euro area as a whole.

- **16 February 2010:** Council adopts the above-mentioned documents, after discussion in the Eurogroup.
- **3 March 2010:** Shortly after a visit of Commissioner Rehn to Athens, Greece announces new deficit-reducing measures of over 2% of GDP, including an increase in the VAT rates and other indirect taxes and a cut in the wage bill (through the reduction in allowances, and partial cancellation of the Easter, summer and Christmas bonuses, of civil servants). These measures are welcomed by the Commission, the ECB and the IMF.
- **8 March 2010:** Greece submits a report on progress with implementation of the SP and additional measures.
- **9 March 2010:** The Commission concludes that Greece is implementing the Council Decision of 16 February 2010 and the measures outlined in its SP, and that the additional fiscal measures announced by the Greek authorities appear sufficient to achieve the 2010 budgetary targets.
- **15 March 2010:** The Eurogroup welcomes the report by Greece and the Commission Communication assessing action taken. It embraces the Commission assessment that the additional measures appear sufficient to safeguard the 2010 budgetary targets, if fully implemented.
- **25 March 2010:** Heads of State and governments of the euro-area countries reaffirm that they fully support the efforts of the Greek government and welcome the additional measures announced on 3 March, which appear sufficient to safeguard the 2010 budgetary targets.
- **8 April 2010:** 2-year bond spreads reach 652 basis points; 10-years bond spreads reach 430 basis points.
- **11 April 2010:** The Eurogroup reaffirms the readiness by euro-area Member States to take determined and coordinated action, if needed. It clarifies the technical modalities enabling a decision on coordinated action, highlighting that the objective is not to provide financing at average euro-area interest rates, but to safeguard financial stability in the euro area as a whole.
- **15 April 2010:** Greece requests 'discussions with the European Commission, the ECB and the IMF on a multi-year programme of economic policies (...) that could be supported with financial assistance (...), if the Greek authorities were to decide to request such assistance.'
- **23 April 2010:** Greece requests financial assistance from the euro-area Member States and the IMF.
- **27 April 2010:** 2-year bond spreads reach 1552 basis points; 10-years bond spreads reach 755 basis points.
- **2 May 2010:** Greece, the Commission, the ECB and IMF announce an agreement on a three-year programme of economic and financial policies. The Eurogroup unanimously agrees to activate stability support to Greece via bilateral loans centrally pooled by the European Commission
- **4 May 2010:** The Commission adopts a Recommendation for a Council Decision according to Articles 126(9) and 136 of the Treaty. The draft Decision includes the main conditions to be respected by Greece in the context of the financial assistance programme.
- **6 May 2010:** The Greek Parliament votes to accept a series of policy measures included in the programme of economic and financial policies, including an increase in VAT and excises, as well as further reductions in public sector wages and pensions.
- **6 May 2010:** ECB adopts temporary measures relating to the eligibility of marketable debt instruments issued or guaranteed by the Greek Government.
- **7 May 2010:** 2-year bond spreads reach 1739 basis points; 10-years bond spreads reach 1287 basis points.
- **7 May 2010:** The Council adopts a Decision according to Articles 126(9) and 136 of the Treaty including the main conditions to be respected by Greece in the context of the financial assistance programme.
- **9 May 2010:** IMF executive board approves the Stand-by arrangement (SBA).
- **9 and 10 May 2010:** The Council and the EU Member States endorse a financial stabilisation mechanism.
- **18 May 2010:** The euro-area Member States disburse the first instalment (EUR 14.5 billion) of a pooled loan to Greece.

II. MAIN PROGRAMME OBJECTIVES

9. **The short-term programme objectives are to restore confidence and maintain financial stability:**

- **Sustainability-enhancing fiscal consolidation is urgently needed.** The immediate priority is to contain the government's financing needs and reassure markets on the determination of the authorities to do what ever it takes to secure medium- and long-term fiscal sustainability. Consolidation should rely on measures that generate savings in public sector expenditure and improve the government's revenue-raising capacity. In parallel, measures are needed to reassure on the durability of the fiscal adjustment, including by specifying and locking in consolidation measures for 2011 and 2012, reforming the pension system and strengthening the fiscal framework. The programme should also consider flanking structural policies, such as public administration reforms and measures to fight against corruption and tax evasion.
- **Financial sector policies need to maintain stability of the system.** An urgent task is addressing the tight liquidity conditions in the Greek banking system. Banks have lost access to international money markets and their funding since end-2009 has increasingly relied on Eurosystem credit operations. In order to avoid deposit outflows, credible measures and good communication are needed to provide reassurance on the stability of the system. In parallel, it will be important to strengthen monitoring of liquidity and asset quality (including nonperforming loans), with a view to preventing problems in individual banks.

10. **The medium-term programme objective is to improve competitiveness and alter the economy's structure towards a more investment- and export-led growth model.** In parallel with short-term anti-crisis fiscal measures, there is a need to prepare and implement an ambitious structural reform agenda to strengthen external competitiveness, accelerate reallocation of resources from the non-tradable to the tradable sector, and foster growth. Structural reforms that boost the economy's capacity to produce, to save and to export are critical for the success of the programme and recovery of the economy. Reforms are, in particular, needed to modernize the public sector, to render product and labour markets more efficient and flexible, and create a more open and accessible business environment for domestic and foreign investors, including a reduction of the state's direct participation in domestic industries. The deep structural reforms foreseen in the programme, including reform of public management, will not only help address current challenges but will also boost growth prospects in the medium and long run.

11. **An overarching objective is to durably restore Greece's credibility for private investors.** The poor track record of Greece in terms of delivering on commitments and promises, and a history of unreliable fiscal and macroeconomic statistics are major additional burdens on the programme. Greece needs to improve its signature through positive track record in data reporting and policy implementation. This is critical for the success of the programme because Greece will need to raise some EUR 60 billion in

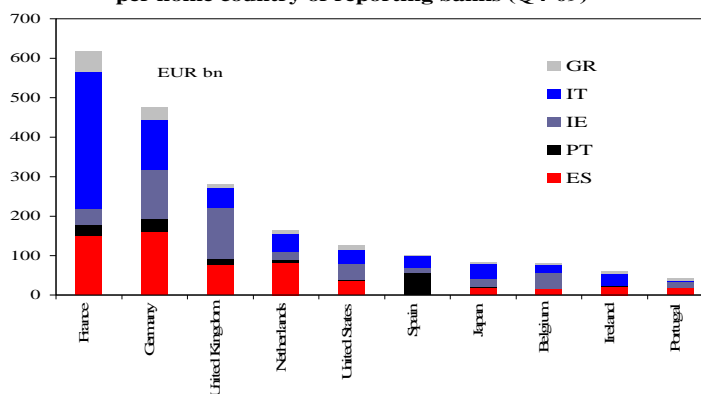
financial markets both in 2014 and in 2015 – after the end of the programme – to finance its public sector deficits, roll over its debt and also repay maturing liabilities to euro-area partners and the IMF.

Box 4: Contagion risks to the euro area and South Eastern Europe.

The transmission channels to both regions are different. Financial distress in Greece spreads to other euro-area Members (Portugal, Spain and Ireland) mainly through an increase in investors' perception of sovereign risk. It may spread to South Eastern Europe largely through potential problems in subsidiaries of Greek banks, requiring adequate preparedness in these countries..

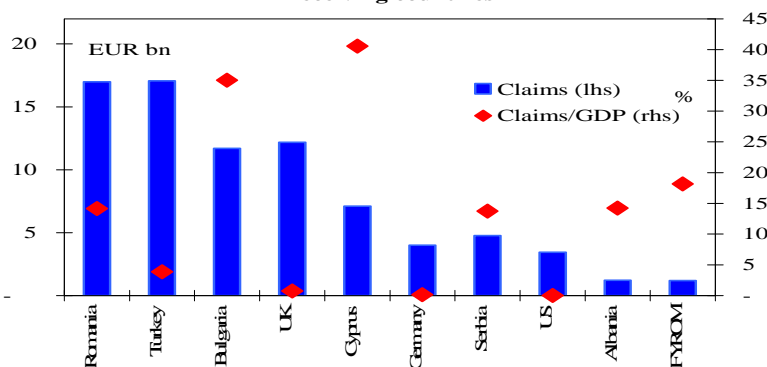
There has been contagion to some other euro-area Member States. Spain and Ireland have large public deficits and debts and high indebtedness of the private sector as a consequence of the housing boom. Portugal also has large fiscal imbalances, and private debt is high, though it has suffered less from a housing bubble. These countries have been subject to a re-assessment of risk by investors, who accordingly reduced their exposures to all four countries. Italy has escaped the turmoil, as a larger part of its government debt is owned domestically. Banks and insurance companies in France and Germany have large claims on Southern Europe and are therefore more vulnerable (Figure 8).

Figure 8. Exposure to euro-area periphery economies per home country of reporting banks (Q4-09)



Contagion to South Eastern Europe has been limited. Investments in South Eastern Europe and Turkey represent 17 percent of Greek banks' assets (Figure 9). Bank subsidiaries abroad made a positive contribution to the groups' profits overall. The main concern is that problems in parent banks could spill over to subsidiaries with consequences for countries in which Greek banks have a significant presence (Romania, Bulgaria, Serbia, Albania and FYROM). Parent banks might have difficulties to provide the appropriate capital for their subsidiaries or might repatriate liquidity. Furthermore, subsidiaries might be faced with loss of depositors confidence.

Figure 9. Foreign claims of Greek banks – role in the receiving countries



III. POLICY DISCUSSIONS WITH THE AUTHORITIES AND OVERALL DESIGN OF THE PROGRAMME

12. **Greece needs considerable fiscal and balance-of-payment adjustments.** Under programme assumptions, stabilising the government debt ratio at the end of the programme period (2013-14) will require an improvement of the primary balance from a deficit of 8½ percent of GDP in 2009 to a surplus of just below 6 percent of GDP. Similarly, bringing the current account deficit to a level more in line with fundamentals (say 2 to 3 percent of GDP) will require, given the large outflows of income to service external debt, a broadly balanced account of goods and services (from a 10 percent of GDP deficit in 2009).

13. **Moreover, Greece will have to 'swim against the tide' during adjustment.**

- **The short-term real growth outlook is unfavourable** (Table 3). Real GDP growth is set to contract significantly in 2010-2011 and to recover only slowly thereafter. The economic programme assumes negative growth of 4 percent in 2010 and 2½ percent in 2011. High uncertainties, expensive external financing, tight credit conditions and fiscal consolidation will weigh on the private sector in 2010-11. A rebound will only be possible when market and private sector confidence returns and the effects of structural reforms start to materialize.
- **Domestic price level adjustment will make fiscal consolidation more difficult.** Greece simultaneously needs to restore price competitiveness and to contain high government deficit and debt ratios. The difficulty is that policies aimed at restoring external price competitiveness, which in monetary union have to rely on adjustments in domestic costs and prices, tend to weigh on debt dynamics. Moreover, low or negative inflation environments are not favourable to fiscal consolidation because of nominal rigidities – real expenditure cuts are easier to obtain if inflation is high.

Table 3. Macroeconomic framework

	2009	2010	2011	2012	2013	2014
	(percent change over the previous period)					
Real GDP growth	-2	-4.0	-2.6	1.1	2.1	2.1
Domestic demand contribution	-2.5	-7.5	-5.9	-0.7	0.8	1.0
Net trade contribution	0.7	3.5	3.2	1.7	1.4	1.1
Unemployment rate	9.5	11.9	14.8	15.3	14.9	14.6
HICP inflation (average)	1.3	1.9	-0.4	1.2	0.7	0.9

Source: Greek authorities and Commission services

14. **Policy discussions with the authorities were open and frank.** The attitude of the authorities was generally very constructive, including when the discussion entered politically sensitive areas. There was a similar understanding of the genesis of the crisis, the limited number of available policy options, as well as the high sense of urgency – as the crisis was spreading to the financial and broader private sectors.

15. **Discussions on policy options and structural reforms did not start from scratch.** The EU Council Decision (on the excessive deficit procedure) and Recommendation (on structural reforms) of 16 February 2010 constituted an important basis and the starting point for programme discussions, especially on fiscal and structural policies. The debate on financial sector issues was, in that respect, less advanced when negotiations started.

Fiscal policy

16. **The policy programme foresees a very large macroeconomic adjustment, especially in the public sector.** The fiscal balance is projected to be reduced from almost 14 percent of GDP in 2009 to below 3 percent of GDP in 2014 (Table 4). Relative to an unchanged-policy baseline, this will require fiscal measures amounting to 13 percent of GDP over the period 2010-2014, over and above those already implemented in 2010 (estimated by Commission services at 5½ percent of GDP). The debt ratio should start declining in 2014, but would remain more than 30 percentage points above the 2009 level in 2014. Fiscal, incomes, and structural policies, together with a crisis- and credit-crunch-driven increase in the private sector savings ratio are projected to trigger a reduction of the current account balance to around 5½ percent of GDP in 2013. Net external debt should start declining in 2013 after peaking at just below 120 percent of GDP.

Table 4. Macro-fiscal adjustment

	2009	2010	2011	2012	2013	2014
	(in percent of GDP)					
General government balance, baseline	n.a.	-10.5	-14.2	-15.6	-15.9	-15.6
General government balance, with	-13.6	-8.0	-7.6	-6.5	-4.9	-2.6
Primary government balance	-8.6	-2.4	-1.0	0.9	3.2	5.9
Interest payments	5.0	5.6	6.6	7.5	8.1	8.5
General government gross debt	115.1	133.2	145.2	148.8	149.6	148.4
Current Account balance	-13.1	-10.8	-8.4	-6.9	-5.6	-4.3
Trade balance	-10.2	-7.3	-4.7	-3.2	-1.9	-0.6
Non-trade items	-2.9	-3.6	-3.8	-3.8	-3.7	-3.6

Source: Greek authorities and Commission services

17. **The size of the required fiscal consolidation measures over the period 2010-2013 exceeds by far the required reduction in the government deficit.** This was a source of misunderstanding with authorities. In a baseline scenario projecting fiscal developments at unchanged policy the government deficit would increase reflecting, inter alia, negative real GDP growth, an increase in interest expenditure and unemployment benefits, and higher public wage bill and pensions. This is why the fiscal consolidation measures from 2010 to 2014 – 18 percent of GDP, including measures announced before May 2010 – are well in excess of the 11 percentage points of GDP reduction of the deficit over the same period.

18. **The fiscal policy recommendations issued by the EU Council had to be adapted.** The Greek stability programme of January 2010 and the Council Decisions of mid-February envisaged a reduction of the government deficit to 8.7 percent of GDP in 2010, and to below 3% of GDP in 2012. At the beginning of the mission, it appeared that the credibility of these targets was a stake for several reasons:

- **Worse starting fiscal position.** On 22 April, 2010 Eurostat published a revised government deficit estimate for 2009 of 13.6 percent of GDP compared to the previous 12.7 percent of GDP and announced a possible further upward revision of up to 0.5 percent of GDP. Therefore, even if the measures in the Council acts were fully implemented, and the deficit ratio fell by 4 percentage points as planned in January, the deficit target for 2010 would be missed by a sizeable margin.
- **Deeper recession.** The mounting stress in financial markets implied heightened risks for macroeconomic and fiscal developments. While the authorities expected a mild recession (-0.3% of GDP in January), all indications were that the recession would be more severe and longer lasting. This would impede the planned deficit reduction, worsen debt dynamics, and imply larger contingent liabilities from the banking sector.
- **Lack of specific measures for the outer years.** In spite of sizeable fiscal consolidation decisions (announced at the end of 2009 in the budget for 2010, and then in January, February and March 2010), there were no concrete plans on how to reduce the government deficit in 2011 and 2012. Moreover, the deadline of 2012 for the correction of the excessive deficit was no longer credible given the worse starting position and economic prospects.

19. **The planned adjustment relies primarily on expenditure cuts** (Table 5). Expenditure cuts equivalent to 7 percent of GDP will be implemented. Experience shows that expenditure-based consolidation has more chance of success, in particular for large consolidation efforts. These cuts and the respective release of resources for the private sector are also expected to contribute to restoring competitiveness in a medium-term perspective. Revenue increases were indispensable given the scale of consolidation efforts. Tax measures amount to 4 percent of GDP, but exclude increases in direct taxation and production costs as these would be detrimental to competitiveness. The authorities are implementing a number of measures to trim down tax evasion: despite being a crucial ingredient of the fiscal consolidation package, these measures are not taken in consideration in the programme fiscal projections for the sake of prudence; yields from anti-evasion measures are hard to quantify and materialise only over time. Generally, fiscal consolidation measures were quantified in a prudent way, making fiscal over performance possible. In case of better than expected fiscal outcomes, the authorities committed to speeding up the reduction of the deficit compared to the targets in the programme.

20. **The fiscal programme has been designed to maximise credibility and enforceability:**

- **Consolidation is strongly frontloaded.** Following measures amounting to 8 percent of GDP in 2010 (including those announced up to March 2010), consolidation measures of 4 percent of GDP will be implemented in 2011 (including carryover effect). The adjustment will be smaller – in a range of 2 to 2½ of GDP – in 2012, 2013 and 2014.
- **Difficult measures will be legislated and implemented upfront.** This applies to nominal wages and pensions cuts and to the increase in VAT and excises taxes. On the other hand, measures of a more administrative nature (such as savings from the reform of local governments) are considered in the projections at a later stage.
- **Measures are structural in nature.** Of the total package, only a few measures (amounting to some 1½% percent of GDP) are one-off or temporary in nature. These measures are temporary levies on profitable firms and to regularise illegal buildings, as well as the sale of gambling and gaming licences, and are to be replaced by permanent measures thereafter.
- **Measures are fully specified.** All measures for 2010 and 2011 and almost all those needed for 2012 have been identified with the authorities and carefully quantified. Parliament has already endorsed these measures, and legislated those to be implemented in 2010, thus lending certainty to their effective implementation.

21. **Large cuts in public wages and pensions are inevitable.** In 2009, the wage and pension bill amounted to around three-quarters of total primary expenditure, and these were the most dynamic components of expenditure over the past decade (Box 5). Cuts in average wages and pensions are therefore indispensable to achieve the required adjustment, even taking into account the authorities' commitment to reduce employment and control wage drift or freeze the indexation of pensions.

- **Cuts in wages** consist of the abolition of the Easter, summer and Christmas bonuses and their replacement by a flat bonus (EUR 1000) for those earning less than EUR 3000 per month (gross). Moreover, the allowances (wage top-ups) paid to the high-wage earners are also reduced.
- **Cuts in pensions** also consist of the abolition of the Easter, summer and Christmas bonuses and their replacement by a flat bonus (EUR 800), for monthly pensions of less than EUR 2500 (gross). The higher pensions, exceeding EUR 1400 per month in gross terms, are reduced by an average of 8 percent, starting in 2010. This affects about 10 percent of pensioners.

Box 5: Public wages in 2010

The wage bill of the general government increased by almost 100% over 2000-2008, to EUR 27480 million (11.4 percent of GDP). Over the same period, nominal GDP increased by only 74 percent. The public wage bill increased further by 7½ percent in 2009, to EUR 29460 million (12.4 percent of GDP).

The year 2010 is the first year - since at least the dawn of previous decade –that the public wage bill is set to decline. Taking into account the cuts in temporary public employment and the 10% cut in allowances (according to the January 2010 update of the stability programme), the complete freeze in remuneration (as of 2 February), the additional 2% cut in allowances and the cuts in the Easter, summer and Christmas bonuses (as of 3 March), as well as the further cuts announced in May (through the full abolition of the seasonal bonuses, aka the 13th and 14th wage payment), the general government wage bill is expected to fall by 10½% in 2010. The fall in nominal remunerations amounts to 14¼% as compared to 2009, if one considers that the allowances used to be taxed at a lower tax rate and, from now on, will be included in the normal income bracket and thus taxed at higher rate.

Table 5. Consolidation measures in the authorities' programme

2010		2011		2012		2013	
	% GDP		% GDP		% GDP		% GDP
Revenue measures	0.5%	Revenue measures	2.9%	Revenue measures	0.7%	Revenue measures	-0.3%
Increase in VAT rates	0.3%	Carry-over from previous year	0.4%	Excise non-alcoholic beverages	0.1%	Presumptive taxation	0.0%
Increase in excise tax on fuel	0.1%	Carry-over from previous year	0.1%	Gaming licenses	0.1%	Gaming licenses	-0.3%
Increase in excise tax on cigarettes	0.1%	Carry-over from previous year	0.1%	Gaming royalties	0.2%		
Increase in excise tax on alcohol	0.0%	Carry-over from previous year	0.0%	VAT - broadening base	0.1%		
		Taxation on unauthorised establishments	0.4%	Presumptive taxation	0.0%		
		Luxury goods tax	0.0%	Increase of legal values of real estate	0.1%		
		Book specification of income	0.0%				
		Gaming royalties	0.1%				
		Gaming licenses	0.2%				
		Special levy on profitable firms	0.3%				
		Levies on illegal buildings	0.2%				
		VAT - changes of categories, broader base	0.4%				
		Green tax	0.1%				
		Presumptive taxation	0.2%				
		Increase of legal values of real estate	0.2%				
		Taxation of wage in kind (cars)	0.1%				
Expenditure measures	1.9%	Expenditure measures	1.2%	Expenditure measures	1.7%	Expenditure measures	2.3%
Wage bill cut (13th 14th wage, allowances)	0.5%	Carry-over from last year	0.2%	Public investment reduction	0.2%	Reduction of public employment	0.2%
Intermediate consumption	0.3%	Intermediate consumption	0.1%	Reduction of public employment	0.3%	Pension freeze	0.1%
Pension cuts (highest pensions)	0.1%	Introduction of unified public sector wages l	0.0%	Means test unemployment benefit	0.2%	Kalikrates savings	0.2%
Elimination of solidarity allowance	0.2%	Pension freeze	0.0%	Pension freeze	0.1%	Unidentified measures	1.8%
Pensions cut (13th 14th monthly payment)	0.6%	Carry-over from last year	0.2%	Kalikrates savings	0.2%		
Public investment reduction	0.2%	Kalikrates savings	0.2%	Cut transfers to public entities	0.4%		
		Pension cuts (highest pensions)	0.1%	Reduction in operational expenditure	0.4%		
		Public investment reduction	0.2%				
TOTAL ANNUAL IMPACT	2.5%		4.1%		2.4%		2.0%

Sources: Greek authorities, Commission services, and IMF staff

Structural fiscal reforms

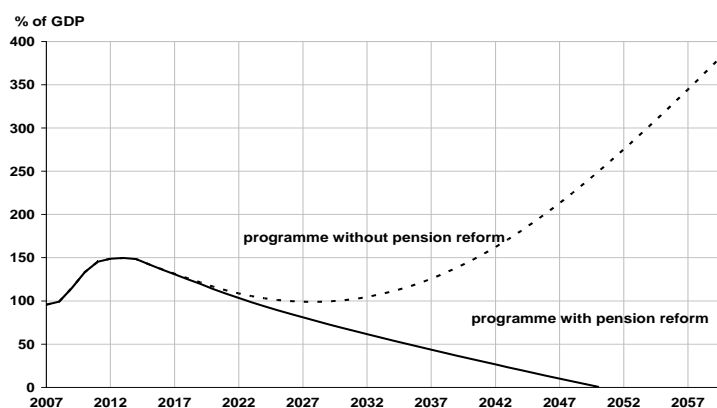
22. The programme foresees the implementation of an ambitious pension reform.

- **Diagnostic** -- The authorities agreed that the current system was unsustainable and would become insolvent if measures were not taken to place it on a sound footing – if nothing was done the fund for self-employed would face liquidity problems already in the second half of 2010. Under unchanged policies, Greece has a sustainability gap of 14.1% of GDP, compared to an EU average of 6.5% of GDP (Box 6). Pension expenditure as a share of GDP is projected to increase (under unchanged policies and in a partial equilibrium projection) by 12.5 percentage points by 2060 relative to 2010, well above the EU average of 2.4 points of GDP.
- **Process** -- On 9 February 2010 the Labour and Social Security Minister proposed a reform of the system. The draft reform planned to increase the average retirement age to 63, separated the financing of healthcare and pension systems, and increased the retirement age of women in the public sector. Considering that the plan was not ambitious enough, the Commission and the IMF suggested that the authorities should strengthen their proposal. They reacted positively to most of suggestions, including the automatic adjustment of the retirement age to increases in life expectancy. The Commission and the IMF also stressed the need for frontloading the implementation of the reform.
- **Outcome** -- The existing pension funds will be merged in three funds, and a new system will be introduced to strengthen the link between contributions and benefits, with uniform rules that will apply pro-rata to all current and future workers. The normal retirement age will be 65 years, increasing in line with life expectancy from 2020 on. The increase in the retirement age for women in the public sector will be phased in immediately after adoption and will be completed by December 2013. The pension award formula will be amended in the contributory-based scheme to strengthen the link between contributions paid and benefits received, with the accrual rate limited to an average annual rate of 1.2%, and pensions indexed to prices. The reform will remove incentives for retirement before the statutory age. In particular, pension benefits will be reduced by 6 percent per year for people entering retirement between the ages of 60 and 65 with a contributory period of less than 40 years.
- **Follow up** -- The Greek Cabinet approved a draft bill on the reform of the social security and the pension systems on 10 May 2010. Before presentation of the draft bill in Parliament, the National Actuarial Authority will produce pension spending projections for the period 2010-2060. On the basis of this calculation, there will be a preliminary assessment by the EU Economic Policy Committee of the long-term impact of the reform through a peer review process. The results of the peer review will be an important element in assessing whether the reform will achieve the envisaged reduction in the increase of pension expenditure. If necessary, further changes to the draft bill will be requested from the Greek authorities.

Box 6: Reform of the pension system

The impact of an ageing population poses risks to the public finances in the longer term. Greece has one of the largest projected increases in pension expenditure in the EU, implying that a reform of the pension system is unavoidable. The agreed measures to bring the growth in pension expenditure below the euro area average would have a significant impact on public finances already within the next two decades. Figure 10 shows debt projections based on the medium term budgetary developments from the programme until 2014, which are then extended with the baseline macroeconomic scenario of the 2009 Ageing Report. The graph illustrates that debt would start increasing after a period of stabilisation (at a level of around 100% of GDP) if medium term consolidation is implemented without making structural reforms to the pension system. If, in addition the planned reform of the pension system was fully implemented, public debt would decrease steadily.

Figure 10: Two scenarios for very long-term government debt projections



Source: Commission services.

23. **The programme also foresees the implementation of important reforms to strengthen the budgeting system and fiscal framework.** This will address the root cause of recurrent overspending and support the consolidation strategy for the coming years. The following core elements were agreed with the authorities: (i) introduction of a medium-term fiscal framework covering the general government based on rolling three-year expenditure ceilings for the State, social security and local governments; (ii) strengthened budget procedures introducing binding expenditure ceilings for each Ministry consistent with the deficit target; (iii) strengthening the position of the Finance Minister in relation to the line Ministers in both budget preparation and execution phases, and introduction of compulsory contingency reserves in the budget; (iv) reforming the General Accounting Office, to make it more active in fiscal policy making and budget planning and control; and (v) creation of a non-partisan fiscal agency to provide independent and expert scrutiny of government finances. The authorities reaction to these proposals was positive.
24. **The programme includes reforms of the tax system and its administration.** A tax bill was recently passed that will make the tax system more efficient and equitable, such as making the income tax more progressive. The government will further review the tax system to simplify it and increase efficiency as the need arises. In parallel, the authorities will introduce reforms to improve tax administration. They will safeguard revenue from the largest taxpayers, introduce stronger enforcement and auditing of high-wealth

individuals, strengthen enforcement of VAT filing and payment, and reduce the large stock of tax arrears. For the medium-term, the government will design a programme of reforms in key tax compliance areas, including an improvement in the enforcement operations, particularly in audit and using risk-based approaches, as well as building headquarters for strategic management and planning capabilities in tax and customs administration. They will rely on technical assistance from the IMF and the European Commission on these matters.

25. **With the public sector responsible for many of Greece's woes, a reform of public administration is urgently needed and is a key element of the programme.** As part of the fiscal adjustment, the government has already introduced measures to curb the government's wage bill via prices and quantities. The Government also plans large savings from the local administration reform. However, the programme has set additional conditionality requirements in the area of public wages, namely by asking for the setting up of a unified and transparent wage scale structure, which will rationalize the system, avoid fraud and inequities, and ultimately lead to savings. In addition, it includes conditionality on a functional review of public administration to take stock of resources to carry out government functions, identify actions to rationalize its administration, and assess the effectiveness and appropriateness of existing social programmes. A census of public employees will be launched and the Greek government will be asked to act upon its findings by June 2011 and in the context of the 2012 budget.

Other structural reforms

26. **The policy programme includes ambitious labour and product market reforms.** Greece is underperforming in many areas (Box 7). Structural reforms will help the implementation of the macroeconomic adjustment program by bolstering growth and supporting budgetary consolidation. Reforms to tackle undeclared work will broaden the scope of the formal economy, thereby increasing the scope for tax collection. Labour market reforms will spur job creation and increase wage flexibility. Product market reforms, namely in the services sector, will step up market contestability, reduce the rents of vested interest groups and help to curb price pressures. Other than efficiency aspects, reforms are also needed to improve equity, therefore increasing job opportunities for young and long term unemployed and improving access to services.
27. **In particular, the reform programme is key for Greece to overcome its competitiveness problems.** To illustrate, price inflation has consistently outstripped that of other euro-area Member States, partly due to poorly functioning markets that result in higher mark-ups. Secondly, wage developments fail to cater for the particular circumstances of specific firms and regions. Thirdly, an inefficient public sector stifles business activity through excessive regulation, and produces expensive and poor quality public services. Lastly, public policies, from education to R&D and innovation policies, fail to provide an adequate support for the drivers of productivity growth.

28. **The programme prioritizes those reforms that have a large macro impact in the short to medium run and sequences them accordingly.** Several reforms had long been discussed between the Commission services and previous governments. The required reforms are appropriately ambitious as the country underperforms in virtually all policy areas – labour, product market, public administration – relative to the EU average. To ease implementation, the scope and timing of conditionality requirements have been carefully chosen, prioritising those that can bolster growth and jobs in the coming years as the economy goes through a painful adjustment process and, whenever possible, aligning reforms to the Greek authorities' reform calendar.

Labour market reforms

29. **The programme does not include conditionality on private sector's wages.** The issue of whether to impose such conditionality was discussed between the authorities and the Commission, IMF and ECB staffs. Technically, the authorities could force a reduction in private sector wages inter alia through the abolition of bonuses, changes in overtime remuneration or a cut in minimum wages. The idea of imposing an across-the-board cut in private sector wages was finally not retained, for various reasons:

- An imposed cut on private sector wages would probably have implied an even larger disruption in economic activity in 2010-11. This would have made fiscal consolidation even more difficult and could have potentially jeopardised debt sustainability.
- The oligopolistic nature of several sectors of the Greek economy implies that cuts in labour costs could have been absorbed by increases in mark-ups, with a reduced impact on external competitiveness.
- Greece's export structure is concentrated in exports of services, demand for which is not price elastic, and in capital-intensive goods (such as chemicals and pharmaceuticals), for which the cost of labour is a marginal component.
- A cut in private wages would have contributed to a more inequitable distribution of income across society.

30. **Instead, the programme foresees a strengthening of wage-setting mechanisms that will support adjustment through normal market forces.** This strategy was shared by the authorities, the trade unions and the industrialists. Although acknowledging the need to adopt a number of changes in the wage bargaining system, the industrialists stressed that the hurdles to external competitiveness were more in relation to an unfriendly business environment, excessive red-tape and insufficiencies in the public institutions rather than to excessive labour costs. In parallel with labour market reforms, it is expected that cuts in public sector wages and the reduction in public employment will impact private sector wages through demonstration effects.

31. **Labour and wage reforms will help to curb undue wage pressures, which affect Greek competitiveness negatively.** Reforms will ease entry to the formal labour market for groups like women and the young, and facilitate transition from temporary to permanent contracts. Labour market and wage reforms should also enable the public sector reforms to rapidly put downward pressure on private wages and improve competitiveness. Given the sensitivity of labour market and wage reforms, it was decided to follow a two-step approach after consultation with the authorities (in particular with the Ministry of Labour) and social partners. Firstly, the government will launch a social pact with social partners to forge consensus on decentralization of wage bargaining (to allow the local level to opt-out from the wage increases agreed at the sectoral level), the introduction of sub-minima wages for the young and long-term unemployed, the revision of important aspects of firing rules and costs, and the revision of part-time and temporary work regulations. Secondly, the government will enforce the required changes in the wage- setting mechanisms and labour market institutions.

Product market reforms

32. **The policy package covers a wide range of product market reforms, which will lead to an improvement in the business environment.**

- In the next few months the Government plans to adopt the horizontal legislation for the implementation of the Services Directive, as well as some sector specific legislation. However, the programme asks for a more ambitious implementation, so that the main principles will apply early to sectors such as tourism, education and retail and, at a later stage, to regulated professions for which no plans to liberalize (auditors, lawyers, pharmacists, engineers, architects) had been envisaged.
- Work is being advanced in the simplification of business start-up requirements, on lowering the licensing burdens, on reducing the administrative burden on firms, and on the creation of an electronic platform for public procurements overall.
- On energy, conditionality includes effective implementation of key electricity and gas directives and locks in deadlines put forward by the authorities about plans to increase the independence of the energy regulator, to liberalize the energy sectors and to rationalize consumer tariffs.
- On transport, conditionality reflects the need to put an end to persistently large losses in the railway sector, by first presenting a plan and, later on, acting upon it. In addition, implementation of EU directives on railways is also expected to open up the market to competitors.

Box 7: Benchmarking Greece's performance across structural policies

Structural policy conditionality for Greece is underpinned by evidence-based analysis. The benchmarking of structural policies based on methodologies developed by the EU Economic Policy Committee reveals that Greece is underperforming relative to the EU15 average in many policy domains, covering labour market institutions, product markets and policies relevant for innovation and R&D.

In the **labour market**, three features stand out. Firstly, Greece's high EPL for temporary workers combined with higher levels of protection for permanent white-collar workers hinders young workers', women and long term unemployed entry and re-entry into the labour market as well as their transition into permanent contracts. Secondly, specific characteristics of the wage bargaining system (such as the extension of collective agreements to all enterprises, including those not involved in the negotiations) prevent wage moderation and put pressure on inflation. Moreover, wage bargaining processes have also resulted in setting relatively high minimum wage levels, thereby hindering labour demand of young workers, who are also affected by the lack of proper links between formal education and training and the needs of the labour market. Thirdly, Greece has a substantially higher rate of in-work poverty risk compared to the EU, though, given the high share of undeclared work, this figure need to be treated with caution.

In the area of **product markets**, one of the most salient features is the poor performance of Greece in indicators related to the business start-ups, operations and licensing activities, as extensively shown in the World Bank Doing Business indicators. Moreover, Greece lags behind in the implementation of key directives in the area of services, energy and transport. In this respect, Greece should take the transposition of the EU Services directive as an opportunity to simplify the legislative framework for the establishment and cross border provision of services.

The Greek authorities should also press for the effective implementation of key electricity and gas directives, to foster competition in this sector. Moreover, effective implementation is also lacking in transport, specifically as regards the road freight and railway sector. In addition to the need to improve the business environment and to implement EU legislation, Greece needs to review the functioning of its public sector. Public administration is overstuffed, characterized by complex, burdensome and lengthy administrative procedures, does not provide legal certainty to businesses and does not always ensure that policies are implemented fully and efficiently once the legislation has been passed.

Lastly, most **R&D and innovation indicators** point to Greece having a gap in this area. This is shown in the relatively low gross domestic expenditure on R&D as a percentage of GDP, reflecting the sectoral specialization of the economy in services, the high share of small firms and the low representation of high tech firms in overall production.

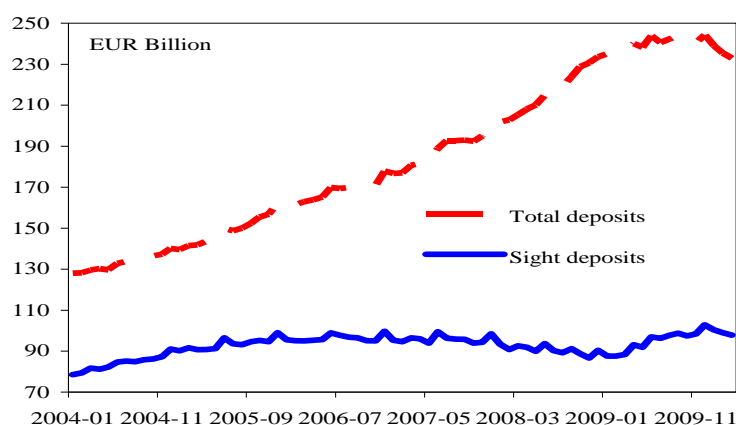
It could be safely assumed that structural rigidities put a break on Greece's convergence in income per capita with the EU average. Greece's relatively lower GDP per capita stems from relatively lower employment rates, despite the high number of hours worked, and above all, from weak labour productivity. Relatively low labour productivity reflects lower capital intensity, lower qualifications of labour and lower total factor productivity. Hence, there appears to be ample scope to tackle structural reform policy in a way that will improve productivity and labour resource utilization.

Financial sector reforms

33. **The immediate challenge is to tackle the tight liquidity conditions of banks.** Banks lost access to wholesale markets at end-2009 and have since then been facing deposit outflows as well as being dependent on ECB refinancing (Figure 11). Moreover, banks were confronted with the threat that all rating agencies would downgrade the sovereign below BBB-, making Greek government securities ineligible as ECB collateral. To ease strains two measures have been agreed.

- First, a possible extension in the duration and size of the existing EUR 28 billion government support package to banks, subject to Commission approval of the state guarantees for debt issued by banks. The credit institutions will then be able to use these instruments as collateral.
- Second, the Bank of Greece will be allowed to grant emergency lending assistance (ELA) backed by a state guarantee, respecting the EU competition requirements and ECB rules.
- Moreover (although not agreed in the context of the macroeconomic adjustment programme), the threat of acute liquidity stress was avoided when the ECB decided on 3 May 2010 to accept Greek government debt (or other liabilities guaranteed by the Greek State) as collateral, regardless of its rating.

Figure 11. Developments in bank deposits



34. **The programme foresees the creation of a Financial Stability Fund.** Anticipating a further worsening in asset quality and losses down the road, possibly impacting the Bank's equity position, this Fund will provide capital (not liquidity – the creation of an institution for liquidity provision could conflict with ECB objectives) to Greek banks. The Greek authorities and the three institutions involved agreed on the size and technique to be used. The Fund's capital will amount to EUR 10 billion, financed by the international financing package. The Fund will have a strong governance structure and will as far as possible be independent of political influence. An annex to the Memorandum of Understanding details the establishment of the Fund including its legal status, the composition of its Governing Council, as well as the different triggers of the capital injections and the need for Commission approval of bank restructuring plans.
35. **Banking supervision will be strengthened and close coordination will be established with host country supervisors.** The authorities and the Commission, IMF and ECB staff concurred on the need to further strengthen supervision, including through quarterly stress tests, speedier data reporting and staff increase in the Bank of Greece, also to allow it to assume its new responsibilities in the insurance domain. In parallel, given the significant presence of Greek banks in South Eastern Europe, close coordination has to

be maintained with home and host country supervisors regarding risk assessments and liquidity contingency plans. It was agreed with the authorities that this could be done within the existing EU framework of cross-border supervision.

Statistics

36. Improvement of fiscal and other public sector reporting is an integral part of the programme. Upon taking office in October 2009, the new government disclosed that the fiscal deficit for 2008 was under-reported and needed to be revised, while the projections for 2009 were also severely underestimated. Working closely with Eurostat, the government has started to take measures to prevent the recurrence of such problems and designed jointly with the European Commission an action plan to address outstanding statistical issues. Among these, full independence has been granted to the Greek Statistical Office and sufficient resources will be devoted in the coming years to improve statistical systems and seek appropriate resident technical assistance to ensure rapid progress in this respect. To that end, the measures in the joint Greek government and European Commission Statistical Action Plan will be fully implemented. Since January 2010, timely monthly central government budget reports on a cash basis have been published. The General Accounting Office (GAO) will also start publishing monthly data on expenditures pending payment, including arrears, from July 2010. Efforts will also be intensified to improve the collection and processing of general government data compiled according to ESA and to compile comprehensive data on employment in the general government.

Programme Financing

37. In spite of the considerable adjustment planned by the authorities, very large financing gaps will have to be covered by official financial assistance.

- According to calculations by Commission and IMF staffs, the external financing gap between May 2010 and June 2013 reaches some EUR 110 bn, including banking sector support (Table 6). The official financial assistance is planned to amount to some EUR 38 bn in 2010, EUR 40 bn in 2011, EUR 24 bn in 2012, and EUR 8 bn in 2013. Except for the EUR 10 bn allocated to the Financial Stabilisation Fund (see below), the full amount is projected to be used to cover public sector financing needs.
- With the public sector gross financing need estimated at some EUR 193 bn between May 2010 and June 2013, the euro-area and IMF financing covers about 57 percent of gross public sector funding requirements over the period. It is assumed that the rollover of medium- and long-term debt from the private sector will be restored only very gradually. The programme assumes a roll over of maturing medium- and long-term public debt of 0% between May 2010 and December 2011, 75% in 2012 and 100% in the first half of 2013.

38. **Greece's partner euro area countries will provide over 70 percent of the total programme financing, in proportion to their shares in ECB capital.** Programme financing will come through bilateral lending from euro-area member states (€80 billion) and IMF support (€30 billion). The loans from euro- area Member States will be governed by a single loan agreement between Greece and the euro-area countries, signed by the European Commission on their behalf, covering the full three years of the program (Box 8).

Box 8. Stability Support to Greece by Euro area Member States

Funding is organized through bilateral loans of the participating Member States. The loans are centrally pooled by the Commission, which will 'transform' the bilateral loans into a single loan to Greece, conceptually similar to loan syndication. The shares of participating Member States in the total loan will be calculated using the adjusted ECB paid capital key. The loan will be disbursed in quarterly tranches subject to conditionality. The interest is calculated on the basis of floating rate (3-month Euribor) with a margin of 300 basis points for the first three years (400 basis points thereafter). Member States will also charge an up-front service charge of 50 basis points.

The European Commission coordinates the programme. As reflected in Council conclusions and the inter-creditor agreement of the 15 lending euro area Member States, signed on 9 May 2010, the Commission will coordinate and implement the programme on behalf and under the instruction of the euro area Member States and provide the support, including negotiation and signing with Greece, of a Loan Facility Agreement and Memorandum of Understanding regarding policy conditionality. The Commission will open an account in the name of the Lenders with the ECB. The account will be used for the processing of all payments on behalf of the Lenders and from the Borrower. The Commission will ensure co-ordination of the process for disbursements, distribution amongst Lenders of payments and provision of information to Lenders regarding breaches of the Loan Facility Agreement or requests for waivers or amendments in respect thereof. The Commission will calculate the interest margin above funding costs to compensate Member States which have higher funding costs than the interest received from the Borrower. At the end of the disbursements a rebalancing will take place in order to ensure that all participating Member States not only contribute pro rata to the ECB capital key but also share the same exposure profile.

39. **The programme implies that the Greek government will not need to tap international bond markets for the next 18 months.** It would gradually return to markets for long-term funding in early 2012. This strategy has strong advantages:

- Greece needs time to build a positive track record, accumulate a large primary surplus and restore market confidence in its ability to serve its debts over the medium-term. The very front loaded fiscal consolidation effort in the policy programme is another key element of the strategy.
- Failure to attract long-term funding at acceptable costs in case of premature return to market-based financing would further damage market sentiment and thus unnecessarily prolong the need to rely on official international financing.
- Demonstration of the capacity of euro-area Member States to effectively provide financial assistance to fellow Member States, in addition to the confirmation of their willingness to ensure funding access throughout the whole programme period, is an important condition for the reversal of market sentiment .

Table 6. Greece - financing gap, quarterly profile (bn euro) 1/

	2010				2011				2012				2013	
	Jan-Apr	May-Jun	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
A. GG deficit	6.1	3.1	4.6	4.6	4.1	4.1	4.1	4.1	3.6	3.6	3.6	3.6	2.7	2.7
B. GG deficit + PE borrowing need	6.8	3.4	4.9	4.9	4.5	4.5	4.5	4.5	4.0	4.0	4.0	4.0	3.0	3.0
C. Debt amortization (existing bonds)	20.1	9.5	5.4	4.4	13.8	13.1	10.8	5.4	19.1	13.2	12.6	5.5	9.8	15.6
D. of which short-term debt	...	0.0	4.6	4.3	4.0	4.0	4.0	4.0	4.0	4.0	4.5	4.5	4.0	4.0
E. of which long-term debt	...	9.5	0.8	0.1	9.8	9.1	6.8	1.4	15.1	9.2	8.1	1.0	5.8	11.6
F. Stock flow adjustment	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
G. Public sector financing need (B+C)	27.0	13.0	10.4	9.4	18.4	17.7	15.5	10.0	23.2	17.3	16.7	9.6	12.9	18.7
H. Rollover of short-term debt	...	0%	87%	93%	100%	100%	113%	113%	100%	100%	111%	111%	100%	100%
I. Rollover of long-term debt	...	0%	0%	0%	0%	0%	0%	0%	75%	75%	75%	75%	100%	100%
J. New GG borrowing	28.9	0.0	4.0	4.0	4.0	4.0	4.5	4.5	15.3	10.9	11.1	5.8	9.8	15.6
K. of which short-term borrowing (D ³)	...	0.0	4.0	4.0	4.0	4.0	4.5	4.5	4.0	4.0	5.0	5.0	4.0	4.0
L. of which long-term borrowing (E*)	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	11.3	6.9	6.1	0.8	5.8	11.6
M. Privatisation receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
N. PE borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
O. Bank support scheme	0.0	5.0	5.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
P. Financing gap (G-J-M-N+O)	-1.9	18.0	11.4	5.4	14.4	13.7	11.0	5.5	7.9	6.4	5.6	3.8	3.1	3.1
Q. Loan disbursements	0.0	20.0	9.0	9.0	15.0	12.0	8.0	5.0	10.0	6.0	6.0	2.0	6.0	2.0
R. of which IMF	0.0	5.5	2.5	2.5	4.1	3.3	2.2	1.4	2.7	1.6	1.6	0.5	1.6	0.5
S. of which EU	0.0	14.5	6.5	6.5	10.9	8.7	5.8	3.6	7.3	4.4	4.4	1.5	4.4	1.5

Source: BoG, Commission Services, IMF staff

1/ Data in this table are subject to revision.

IV. RISKS AND PROGRAMME MONITORING

40. **The Greek programme rests upon very strong foundations.** The strong resolve of the authorities to implement the agreed policies, the frontloaded and fully specified fiscal consolidation package, the socially-balanced approach taken, the unprecedented amount of financing available, and the broad support of the programme by the international community are very positive elements. There is no doubt that disciplined implementation of the programme would ensure external and sovereign debt sustainability and go a long way towards restoring Greece's credibility vis-à-vis foreign investors, as well as helping the country to recover successful access to international capital markets.
41. **The fiscal adjustment is fairly distributed across the society, and protects the most vulnerable.** These are important conditions to ensure broad support for the programme. The choice of the fiscal consolidation measures and structural reforms has taken into account the social dimension, and the government has made a commitment to fairness in their implementation. The lowest-income and lowest-pension earners, as well as the most vulnerable and those requiring family support, will all be protected and compensated for the adverse impact of the adjustment policies. The pension reform will introduce a means-tested social pension for all pensioners above 65 years. The decision of not forcing a quick reduction in nominal private sector wages was also taken with social considerations in mind. Moreover, the authorities have committed themselves to forging consensus on policies to overcome the crisis, and to inviting representatives of businesses and labour to sign a social pact that should contribute to the objectives of the program.
42. **Importantly, the authorities are fully aware of the challenges, and they strongly own and support the programme policies and objectives.** They realize the seriousness of the situation and the need for bold measures are needed to help Greece out of the current situation. Their resolve to restore market confidence through large, frontloaded fiscal consolidation measures is strong, as confirmed by the adoption of the consolidation package in Parliament only two days after the end of the discussions on the programme.
43. **Moreover, the design of the programme makes it robust to a number of unfavourable developments:**
- **The fiscal programme is based on conservative assumptions.** Measures were quantified in a prudent way and applied to a rather cautious baseline scenario. The programme does not explicitly envisage gains from the fight against tax evasion, and the reform of public administration could bring earlier and larger savings than assumed, given the potential for improvement in this area. Overall, the perception of the Commission staff is that, assuming that growth does not surprise on the

downside, over performance on the fiscal deficit is possible, including in the short term.

- **The programme assumes that most of the reduction in external imbalances will come from a contraction in imports.** Projections for exports and foreign direct investment are very prudent. Better-than-expected results for exports and FDI, which depend on the success of adjustment policies and the credibility of the programme, would strengthen growth and imply lower external and fiscal financing needs, making the programme stronger.

44. **But there are obvious risks.**

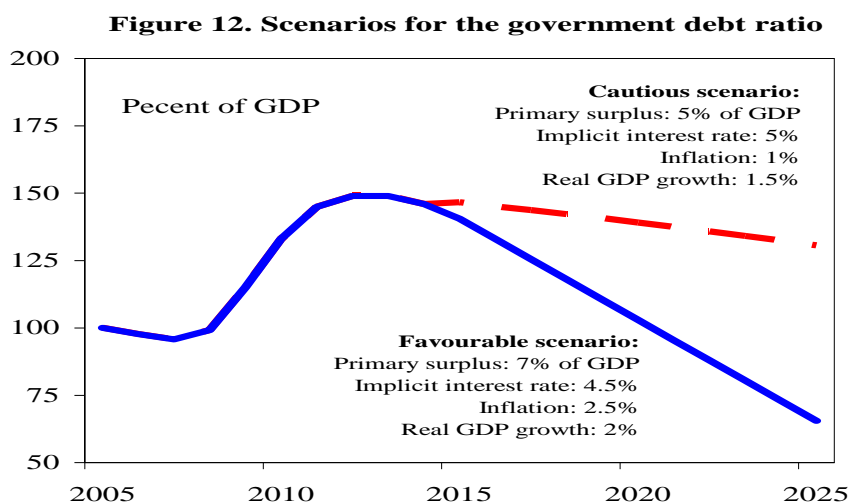
- **Growth** -- The reaction of the economy to ongoing financial stress is highly uncertain and prolonged social unrest could imply a sharper contraction of economic activity than assumed in the programme. This would directly impact fiscal accounts, both through lower revenue and a faster increase in the debt ratio, putting fiscal sustainability further at risk.
- **Inflation** -- A steeper fall in inflation is possible, given the large cuts in public wages and pensions. Lower inflation – or larger deflation – would be positive for competitiveness, as the REER would move faster towards equilibrium. However, it could have a negative impact on government debt dynamics.
- **Market reaction** -- Spreads may remain elevated even in case of full policy implementation. The fiscal programme is robust to a slow improvement in market sentiment – Greece is sheltered from the market for 18 months – but stabilisation of spreads at a high level would negatively impact the private sector and economic growth, with repercussions on fiscal accounts.
- **Implementation risk** -- Policies supporting the arrangement are very ambitious and the associated social costs are significant. Relatively weak administrative capacity and risks of social unrest and acute political tensions are important threats to the programme. The frontloading of the fiscal adjustment and their rapid adoption by parliament are mitigating factors.
- **Data surprises** -- New negative surprises on fiscal estimates (going beyond reservations already expressed by Eurostat) would have a negative impact on market sentiment. If any, such surprises should be communicated in a very open way and, together with credible offsetting measures, preferably during programme reviews.
- **Banking sector** -- In spite of important measures in the programme, further bouts of stress in the banking system cannot be excluded. This would weaken the economic and financing situation (and solvency problems would potentially lead to

a larger financing gap), with consequences for public finances and the credibility of whole programme.

- **Contagion from abroad** -- Greece has so far been the focal point of attention of financial markets. However, as Greece regains credibility and stress eases, tensions in other euro- area Member States cannot be excluded, which would most likely negatively affect market sentiment towards the whole euro area, and Greece in particular.

45. **The programme allows sufficient flexibility.** The authorities made a commitment in the context of the programme to respond flexibly to economic developments. In case of better economic and fiscal outcomes than assumed in the programme, they will speed up fiscal consolidation and, whenever possible, they will refrain from drawing on planned disbursements. Symmetrically, the authorities signalled their readiness to take additional measures so as to reach fiscal targets and accelerate the adjustment in external competitiveness if needed.

46. **The authorities committed to keep a large primary surplus after the programme horizon.** At the end of 2013, the government debt ratio will remain at historically high levels. To ensuring continuity of private financing at acceptable conditions beyond the programme horizon, it will be important to maintain a large primary surplus and ensure a reduction of the debt burden as a share of GDP. In the context of the programme, the authorities committed themselves to keeping the primary balance in a sizeable surplus (at least 5 percent of GDP) up to 2020. This would ensure under almost all scenarios a decline in the government debt ratio (Figure 12).



47. **Progress in programme implementation will be monitored by European Commission, ECB and IMF teams through quarterly programme reviews.** Fiscal performance will be assessed through updated forecasts and respect of quantitative performance criteria (in particular related to fiscal consolidation). Compliance with other macroeconomic and structural policies will be assessed against the conditionality

and timetable in the Memorandum of Understanding. The Commission will in parallel monitor compliance with the Council Decision 9443/10 in accordance with Articles 126(9) and 136 of the Treaty.

ANNEX 1. DETAILED MACROECONOMIC PROJECTIONS

Table 1: Use and supply of goods and services (volume)

<i>Annual % change</i>	2006	2007	2008	2009	2010	2011	2012	2013
1. Private consumption expenditure	5.3	3.3	2.3	-1.8	-3.8	-4.5	1.0	1.1
2. Government consumption expenditure	-0.1	8.4	0.6	9.6	-8.2	-8.0	-6.0	-1.0
3. Gross fixed capital formation	9.8	4.6	-7.4	-13.1	-7.3	-7.0	-2.6	1.1
4. Final domestic demand	5.8	5.0	1.0	-2.4	-5.1	-5.5	-0.7	0.8
5. Change in inventories								
6. Domestic demand	5.7	5.0	1.1	-2.3	-6.8	-5.4	-0.7	0.7
7. Exports of goods and services	5.3	5.8	4.0	-18.1	1.5	6.1	5.7	7.3
7a. - of which goods	11.7	1.5	3.7	-11.6	4.2	6.0	6.0	6.5
7b. - of which services	1.0	9.0	4.1	-22.6	-0.9	6.3	5.5	8.0
8. Final demand	5.6	5.1	1.6	-5.0	-5.5	-3.5	0.5	2.0
9. Imports of goods and services	9.0	7.1	0.2	-14.1	-10.3	-6.6	-1.5	1.5
9a. - of which goods	9.6	6.6	-3.1	-14.4	-10.7	-6.9	-1.5	1.5
9b. - of which services	6.8	9.0	13.6	-13.0	-9.0	-5.7	-1.5	1.3
10. Gross domestic product at market prices	4.5	4.5	2.0	-2.0	-4.0	-2.6	1.1	2.1
<i>Contribution to change in GDP</i>								
11. Final domestic demand	5.9	4.8	0.1	-2.5	-5.6	-5.9	-0.7	0.8
12. Change in inventories + net acq. of valuables	0.4	0.8	1.0	-0.1	-1.9	0.1	0.0	-0.1
13. External balance of goods and services	-1.7	-1.1	0.8	0.7	3.5	3.2	1.7	1.4

Table 2: Use and supply of goods and services (value)

<i>Annual % change</i>	2006	2007	2008	2009	2010	2011	2012	2013
1. Private consumption expenditure	8.8	6.4	6.5	-0.5	-2.0	-4.9	2.2	1.9
2. Government consumption expenditure	4.8	13.0	5.2	9.8	-11.9	-9.4	-4.7	0.0
3. Gross fixed capital formation	12.8	6.8	-4.2	-13.8	-5.4	-6.5	-1.0	2.1
5. Change in inventories								
6. Domestic demand	9.3	8.2	4.9	-1.5	-5.1	-5.5	0.6	1.6
7. Exports of goods and services	8.8	8.2	7.9	-19.5	3.3	6.9	6.8	9.2
8. Final demand	9.2	8.2	5.4	-4.6	-3.8	-3.5	1.7	3.0
9. Imports of goods and services	13.2	9.6	4.5	-15.3	-7.1	-5.0	0.3	3.5
10. Gross national income at market prices	7.5	6.9	5.3	-0.5	-3.1	-3.3	2.1	2.8
11. Gross value added at basic prices	6.2	7.4	5.5	1.1	-4.7	-3.7	2.2	3.1
12. Gross domestic product at market prices	7.7	7.6	5.6	-0.7	-2.9	-3.1	2.1	2.9

Table 3: Implicit price deflators

<i>% change in implicit price deflator</i>	2006	2007	2008	2009	2010	2011	2012	2013
1. Private consumption expenditure	3.4	3.0	4.1	1.3	1.9	-0.4	1.2	0.8
2. Government consumption expenditure	4.9	4.3	4.6	0.2	-4.1	-1.5	1.4	1.0
3. Gross fixed capital formation	2.7	2.0	3.4	-0.8	2.0	0.5	1.6	1.0
6. Domestic demand	3.4	3.0	3.8	1.0	1.8	0.0	1.3	0.9
7. Exports of goods and services	4.3	3.0	2.7	-4.7	1.8	0.8	1.0	1.8
8. Final demand	3.4	2.9	3.8	0.6	1.8	0.0	1.2	1.0
9. Imports of goods and services	3.9	2.1	5.1	-1.9	3.6	1.7	1.8	2.0
10. Gross domestic product at market prices	3.1	3.0	3.5	1.3	1.2	-0.5	1.0	0.7
HICP	3.3	3.0	4.2	1.3	1.9	-0.4	1.2	0.7

Table 4: Labour market and cost

<i>Annual % change</i>	2006	2007	2008	2009	2010	2011	2012	2013
1. Labour productivity	2.4	3.1	1.9	-0.8	-0.4	0.5	0.1	0.5
2. Compensation of employees per head	3.1	6.6	5.9	5.5	-1.0	0.1	0.1	0.1
3. Unit labour costs (1995=100)	0.7	3.5	3.9	6.3	-0.6	-0.4	0.0	-0.4
4. Total population	0.4	0.4	0.4	0.5	0.3	0.2	0.2	0.2
5. Population of working age (15-64 years)	0.2	0.3	0.3	0.9	0.5	0.4	0.4	0.4
6. Total employment	2.0	1.4	0.1	-1.2	-2.6	-3.0	-0.4	0.8
7. Calculated unemployment rate - EUROSTAT Definition (%)	8.9	8.3	7.7	9.5	12.0	14.7	15.2	14.8

Table 5: External balance

<i>levels</i>	2006	2007	2008	2009	2010	2011	2012	2013
1. Exports of goods (fob)	20.5	21.5	22.8	19.2	20.6	22.1	23.6	25.5
2. Imports of goods (fob)	56.4	61.4	62.6	52.5	48.7	46.1	46.2	47.9
3. Trade balance (goods, fob/fob) (1-2)	-35.9	-40.0	-39.7	-33.3	-28.0	-24.0	-22.6	-22.4
<i>3a. p.m. (3) as % of GDP</i>	-17.1	-17.7	-16.6	-14.0	-12.1	-10.7	-9.9	-9.5
4. Exports of services (a)	27.0	30.0	32.7	25.5	25.6	27.4	29.2	32.2
5. Imports of services (a)	13.4	15.1	17.5	15.3	14.3	13.8	13.8	14.3
6. Services balance (a) (4-5)	13.6	14.9	15.2	10.2	11.3	13.6	15.4	17.9
<i>6a. p.m. 6 as % of GDP</i>	6.5	6.6	6.4	4.3	4.9	6.1	6.7	7.6
7. External balance of goods & services (3+6)	-22.3	-25.1	-24.5	-23.1	-16.8	-10.4	-7.2	-4.5
<i>7a. p.m. 7 as % of GDP</i>	-10.6	-11.1	-10.2	-9.7	-7.3	-4.7	-3.2	-1.9
8. Balance of primary incomes and current Transfers	-4.6	-8.1	-8.5	-8.1	-8.2	-8.4	-8.6	-8.8
<i>8a. - of which, balance of primary income</i>	-4.5	-6.6	-7.9	-6.6	-6.7	-6.9	-7.1	-7.3
<i>8b. - of which, net current Transfers</i>	0.0	-1.5	-0.7	-1.6	-1.6	-1.5	-1.5	-1.5
<i>8c. p.m. 8 as % of GDP</i>	-2.2	-3.6	-3.6	-3.4	-3.6	-3.8	-3.8	-3.7
9. Current external balance (7+8)	-26.9	-33.2	-33.0	-31.2	-25.0	-18.8	-15.8	-13.3
<i>9a. p.m. 9 as % of GDP</i>	-12.8	-14.7	-13.8	-13.1	-10.8	-8.4	-6.9	-5.6
10. Net capital transactions	4.8	5.0	3.4	2.0	2.1	2.3	2.6	2.8
11. Net lending (+)/ net borrowing (-) (9+10)	-22.1	-28.2	-29.6	-29.2	-22.9	-16.5	-13.2	-10.4
<i>11a. p.m. 11 as % of GDP</i>	-10.5	-12.5	-12.4	-12.3	-9.9	-7.4	-5.8	-4.4

Table 6: Fiscal accounts

	2006	2007	2008	2009	2010	2011	2012	2013	2014
	<i>% GDP</i>								
Total revenue	39.10	39.51	38.95	36.81	39.62	42.60	42.79	43.01	42.43
Indirect taxes	12.43	12.46	12.05	11.11	13.44	15.03	15.15	15.18	14.55
Direct taxes	7.82	7.85	7.60	7.92	7.70	8.81	8.87	8.79	8.05
Social contributions	12.87	13.37	13.34	12.75	12.44	12.52	12.22	11.96	11.31
Other current resources	1.98	1.98	2.44	2.30	2.10	2.29	2.54	3.17	4.85
Capital transfers received	2.44	2.39	2.03	1.33	2.10	2.10	2.19	2.13	2.00
Sales	1.56	1.45	1.49	1.41	1.84	1.86	1.82	1.77	1.66
Total expenditure	43.04	44.86	46.58	50.32	47.64	50.22	49.32	47.86	44.99
Intermediate consumption	5.16	5.66	5.36	6.12	4.70	4.12	4.07	4.10	3.83
Compensation of employess	11.04	11.16	11.44	12.39	11.42	11.68	10.95	10.23	9.55
Social transfers other than in kind	16.79	17.51	18.69	20.53	20.33	22.00	21.83	21.57	20.23
Interest	4.40	4.43	4.56	4.97	5.58	6.64	7.48	8.05	8.23
Subsidies	0.13	0.13	0.12	0.13	0.10	0.13	0.13	0.13	0.12
Other current expenditure	1.61	1.78	1.95	1.61	1.55	1.70	1.47	0.53	0.00
Gross fixed capital formation	2.96	2.92	2.74	2.87	2.56	2.66	2.45	2.36	2.20
Other capital expenditure	0.95	1.28	1.71	1.71	1.40	1.28	0.95	0.88	0.82
General Government balance (EDP)	-3.55	-5.05	-7.62	-13.60	-8.02	-7.63	-6.53	-4.85	-2.56
	<i>% change</i>								
Total revenue	9.5%	8.9%	4.2%	-6.5%	4.5%	4.2%	2.6%	3.4%	1.7%
Indirect taxes	15.2%	8.0%	2.2%	-8.8%	17.4%	8.3%	3.0%	3.1%	-1.2%
Direct taxes	-0.5%	8.2%	2.2%	3.2%	-5.6%	10.8%	2.8%	1.9%	-5.6%
Social contributions	4.0%	11.9%	5.5%	-5.4%	-5.3%	-2.5%	-0.4%	0.7%	-2.5%
Other current resources	12.6%	8.1%	29.9%	-6.8%	-11.2%	5.6%	13.4%	28.2%	58.0%
Capital transfers received	67.4%	5.4%	-10.1%	-35.4%	53.7%	-3.1%	6.4%	0.0%	-3.0%
Sales	6.7%	0.5%	8.6%	-6.7%	27.0%	-2.3%	0.0%	0.0%	-3.0%
Total expenditure	6.1%	12.3%	9.7%	6.9%	-8.1%	2.2%	0.3%	-0.2%	-3.1%
Intermediate consumption	5.8%	18.1%	0.1%	13.0%	-25.5%	-14.9%	0.7%	3.7%	-3.8%
Compensation of employess	4.0%	9.0%	8.3%	7.2%	-10.5%	-0.9%	-4.3%	-3.9%	-3.8%
Social transfers other than in kind	11.3%	12.4%	12.8%	8.7%	-3.9%	4.9%	1.3%	1.6%	-3.3%
Interest	3.2%	8.3%	8.9%	7.7%	9.1%	15.3%	14.9%	10.8%	5.4%
Subsidies	7.8%	3.2%	4.5%	2.3%	-24.6%	30.0%	0.0%	0.0%	-3.0%
Other current expenditure	2.6%	18.8%	15.9%	-18.6%	-6.3%	6.2%	-11.8%	-63.1%	-99.4%
Gross fixed capital formation	13.9%	6.2%	-0.8%	3.7%	-13.2%	0.5%	-5.9%	-0.8%	-3.9%
Other capital expenditure	-34.6%	44.8%	41.3%	-1.0%	-20.7%	-11.2%	-24.4%	-4.3%	-4.2%
General Government balance (EDP)	-25.5%	53.1%	59.5%	76.7%	-42.4%	-7.8%	-12.6%	-23.6%	-45.7%
<i>Nominal GDP</i>	211.0	227.3	240.2	237.8	230.8	223.7	228.4	234.9	242.2

Table 7: Debt dynamics

	2006	2007	2008	2009	2010	2011	2012	2013	2014
EDP deficit (% GDP)	-3.55	-5.05	-7.62	-13.60	-8.02	-7.63	-6.62	-4.85	-2.55
EDP Gross debt (% GDP)	97.51	95.34	98.75	114.97	133.19	145.22	148.91	149.72	148.36
	<i>levels</i>								
EDP deficit	-7.50	-11.48	-18.30	-32.34	-18.51	-17.07	-15.12	-11.40	-6.18
Gross debt	205.74	216.73	237.25	273.41	307.46	324.83	340.05	351.65	359.33
Change in gross debt	10.32	10.99	20.52	36.16	34.06	17.37	15.22	11.60	7.68
GDP nominal	210.99	227.32	240.25	237.80	230.84	223.68	228.36	234.87	242.20
GDP real	173.99	181.77	185.43	181.79	174.44	169.83	171.62	175.26	178.92
GDP real growth (% change)	4.5	4.5	2.0	-2.0	-4.0	-2.6	1.1	2.1	2.1
Change in gross debt (% GDP)	4.9	4.8	8.5	15.2	14.8	7.8	6.7	4.9	3.2
SFAs	1.3	-0.2	0.9	1.6	6.7	0.1	0.0	0.1	0.6
	<i>% GDP</i>								
Gross debt ratio	97.5	95.3	98.8	115.0	133.2	145.2	148.9	149.7	148.4
Change in debt ratio	-2.5	-2.2	3.4	16.2	18.2	12.0	3.7	0.8	-1.4
<i>Contributions²:</i>									
Primary balance	-0.9	0.6	3.1	8.6	2.4	1.0	-0.9	-3.2	-5.7
"Snow-ball" effect	2.0	1.8	-7.4	-26.5	-27.4	-13.2	-2.9	2.3	6.4
Of which:									
Interest expenditure	4.4	4.4	4.6	5.0	5.6	6.6	7.5	8.1	8.2
Growth effect	-4.2	-4.0	-1.8	2.0	4.8	3.6	-1.5	-3.1	-3.0
Inflation effect	1.8	1.4	-10.1	-33.4	-37.8	-23.4	-8.9	-2.7	1.2
Stock-flow adjustment	1.3	-0.2	0.9	1.6	6.7	0.1	0.0	0.1	0.6
<i>Implicit interest rate</i>		4.59%	4.70%	4.65%	4.50%	4.77%	5.08%	5.39%	5.52%

Table 8: Fiscal adjustment path and consolidation measures (% of GDP)

% GDP	2010			2011			2012			2013			2014		
	Programme	Measures	Baseline	Programme	Measures	Baseline	Programme	Measures	Baseline	Programme	Measures	Baseline	Programme	Measures	Baseline
Total revenue	39.6	0.5	39.1	42.6	3.5	39.1	42.8	4.5	38.4	43.0	5.0	38.0	43.8	6.5	37.3
Indirect taxes	13.4	0.5	12.9	15.0	2.0	13.1	15.2	2.5	12.7	15.2	2.4	12.8	15.0	2.4	12.6
Direct taxes	7.7		7.7	8.8	1.3	7.5	8.9	1.5	7.4	8.8	1.5	7.3	8.3	1.0	7.3
Social contributions	12.4		12.4	12.5		12.5	12.2		12.2	12.0		12.0	11.7		11.7
Other current resources	2.1		2.1	2.3	0.2	2.1	2.5	0.5	2.0	3.2	1.1	2.1	5.0	3.0	2.0
Capital transfers received	2.1		2.1	2.1		2.1	2.2		2.2	2.1		2.1	2.1		2.1
Sales	1.8		1.8	1.9		1.9	1.8		1.8	1.8		1.8	1.7		1.7
Total expenditure	47.6	-2.0	49.6	50.2	-3.1	53.3	49.3	-4.5	54.0	47.9	-6.1	54.0	46.4	-6.6	52.9
Intermediate consumption	4.7	-0.3	5.0	4.1	-0.7	4.8	4.1	-0.9	4.9	4.1	-1.1	5.2	3.9	-1.1	5.0
Compensation of employess	11.4	-0.5	11.9	11.7	-0.7	12.4	10.9	-1.0	11.9	10.2	-1.2	11.4	9.8	-1.2	11.0
Social transfers other than in kind	20.3	-1.0	21.3	22.0	-1.3	23.3	21.8	-1.6	23.5	21.6	-1.7	23.3	20.9	-1.7	22.6
Interest	5.6		5.6	6.6		6.6	7.5		7.5	8.1		8.1	8.5		8.4
Subsidies	0.1		0.1	0.1		0.1	0.1		0.1	0.1		0.1	0.1		0.1
Other current expenditure	1.6		1.6	1.7		1.7	1.5		1.7	0.5	-1.1	1.6	0.0	-1.6	1.6
Gross fixed capital formation	2.6	-0.2	2.8	2.7	-0.4	3.1	2.5	-0.7	3.1	2.4	-0.7	3.0	2.3	-0.7	2.9
Other capital expenditure	1.4		1.4	1.3		1.3	1.0	-0.4	1.3	0.9	-0.4	1.2	0.8	-0.4	1.2
General Government balance (EDP)	-8.0		-10.5	-7.6		-14.2	-6.5		-15.6	-4.9		-15.9	-2.6		-15.6

NOTE: The impact of unidentified measures in 2012, 2013 and 2014 are recorded in these tables by convention under 'Other current resource' and 'Other current expenditure'

ANNEX 2 – PROGRAMME DOCUMENTS

Athens, May 3, 2010

Mr. Jean-Claude Juncker
President
Eurogroup

Mr. Olli Rehn
Commissioner
European Commission

Mr Trichet
President
European Central Bank

Dear Messrs. Juncker, Rehn and Trichet,

The attached Memorandum of Economic and Financial Policies (MEFP) outlines the economic and financial policies that the Greek Government and the Bank of Greece, respectively, will implement during the remainder of 2010 and in the period 2011-2013 to strengthen market confidence and Greece's fiscal and financial position. An annexed Memorandum of Understanding (MoU) specifies detailed economic policy measures that will serve as benchmarks for assessing policy performance in the context of the quarterly reviews under the financial assistance programme.

The authorities will work closely with the European Commission and the European Central Bank to pursue reforms to meet our conditionality. The Greek authorities will fully implement the policies included in the Decision and the Recommendation addressed by the European Union on 16 February 2010, frame tight budgets in the coming years with the aim to reduce our deficit significantly below 3 percent of GDP in 2014, achieve a downward trajectory in the public debt-GDP ratio in 2013, safeguard the stability of the financial system, and implement structural reforms to boost the economy's capacity to produce, save, and export.

The authorities are particularly determined to lower the fiscal deficit, including by implementing a significant effort to achieve higher and more equitable tax collections, and by constraining spending in the government wage bill and entitlement outlays, among other items.

In view of these efforts and to signal our commitment to effective macroeconomic policies, we request financial assistance from euro area Member States for a total amount of €80 billion over a 36 months period, in support of our ambitious multi-year policy programme.

We sent a parallel request for financial assistance to the IMF for a total amount of €30 billion (SDR 26.4 billion).

The implementation of our program will be monitored through quantitative performance criteria and structural benchmarks as described in the attached MEFP, and through the detailed and specific economic policy criteria in the MoU. There will be quarterly reviews of the arrangement, in coordination with the IMF. The first review is expected to be completed in the course of the third calendar quarter of 2010. The reviews will assess progress in implementing the program and reach understandings on any additional measures that may be needed to achieve its objectives. Each review will include an in-depth assessment of program financing in light of the joint financing of this program by the IMF.

The Greek authorities believe that the policies set forth in the attached memorandum are adequate to achieve the objectives of our economic program, but stand ready to take any further measures that may become appropriate for this purpose. The authorities will stay in very close contact and consult with the European Commission, the ECB and the Fund on the adoption of these measures and in advance of revisions to the policies contained in the MEFP and the MoU. All information requested by the European Commission, the ECB and the Fund to assess implementation of the program will be provided.

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

Sincerely,

/s/

George Papaconstantinou
Minister of Finance

/s/

George Provopoulos
Governor of the Bank of Greece

GREECE

Memorandum of Economic and Financial Policies

May 3, 2010

I. RECENT DEVELOPMENTS

1. **The economic downturn accelerated coming into 2010.** Greek real GDP declined by 2 percent in 2009 and indicators suggest that activity will weaken further in 2010. Following the Greek elections in October, the realization that the fiscal and public debt outturn for 2008 and 2009 were significantly worse than had been reported by the previous government caused confidence to drop, financing costs to increase, and growth and employment to suffer.

2. **The crisis exposed the weak fiscal position.** The deficit of 5.1 percent of GDP in 2007, at the top of the cycle, shows that Greece entered the downturn with a large underlying public deficit. With weak revenue policies and tax administration, especially leading up to the 2009 elections and aggravated by the recession, revenues declined notably. Spending, meanwhile, increased significantly, especially on wages and entitlements, reflecting weak spending discipline and monitoring and control, which also led to new arrears. The deficit jumped to an estimated 13.6 percent of GDP while the public debt rose to over 115 percent of GDP in 2009. The monitoring and control deficiencies delayed the implementation of corrective fiscal policies.

3. **The financial system has been adversely affected.** With the deteriorating fiscal results came downgrades of government bonds by rating agencies, and investors started backing out of Greek bonds, driving up their yields. Furthermore, it is clear that the deep macroeconomic and structural problems combined with unavoidable strong fiscal adjustment over the medium term are likely to weigh on activity for some time. This combination of factors affects negatively the banking system. Impaired loans are rising while borrowing costs in the interbank and wholesale markets have increased, putting pressure on bank profitability.

4. **Despite the recession, the external deficit is declining only gradually.** Inflation and domestic costs have increased well above those of Greece's euro partners over the last decade and Greece has lost competitiveness. As a result, the external current account deficit at end 2009 was still over 11 percent of GDP, and the net international investment position is over negative 83 percent of GDP. The external interest bill on the foreign debt has increased to over 5 percent of GDP, so it will take a surplus in trade of goods and services to return the current account to a more sustainable position. This will require a strengthening of economic policies and competitiveness to lay the foundations for a growth model that relies more on investment and exports.

II. KEY OBJECTIVES AND THE OUTLOOK

5. **The main objectives of the program are to correct fiscal and external imbalances and restore confidence.** Without regaining confidence in the sustainability of fiscal and economic developments, the cost of funding the economy is bound to stay high if not increase further. The fiscal and the external imbalances need to be corrected. Facing these two tasks at the same time is challenging, requiring a major reorientation in the economy. Growth is unlikely to be buoyant as the initial corrective fiscal measures are implemented, but with financial sector policies to preserve the soundness of the banking sector and strong medium-term fiscal and structural policies, the economy will emerge from this experience in better shape than before with higher growth and employment.

6. **The government foresees an extended adjustment period:**

- **Real GDP growth** is set to contract significantly in 2010-2011, but should gradually recover thereafter. The economic program assumes negative growth of 4 percent in 2010 and 2½ percent in 2011. While fiscal consolidation is bound to weigh on economic activity at first, it is expected that confidence effects from the front-loaded fiscal measures and the strong medium-term economic program in combination with comprehensive structural reforms will create the conditions for a return to growth from 2012 onward.
- **Inflation** needs to be reduced significantly below the euro area average for Greece to regain swiftly price competitiveness. Domestic demand tightening, both through fiscal adjustment and efforts to moderate wages and pensions, together with cost-cutting measures in the economy, will be essential to bring inflation down in a meaningful way. In this regard, addressing oligopolistic structures to reduce high markups in some sectors will also be important.
- **The external deficit** is projected to decline gradually over the medium term as domestic demand and inflation moderate and the economy responds to structural reforms to improve the supply of exports and reduces the dependence on imports. This process will naturally take several years, while the interest costs on the substantial external debt will pressure the current account for some time.

III. ECONOMIC POLICIES

7. **To achieve the program objectives, all available fiscal, financial, and structural policies will be used.** The economy needs a strong and sustained adjustment program to correct fiscal imbalances and place debt on a downward path in the medium term, maintain banking sector stability, and restore competitiveness:

- **Fiscal adjustment will have to be the cornerstone of the program.** The government is committed to put in place durable adjustment measures, on top of those already announced in March this year, of 11 percent of GDP in cumulative terms through 2013, with additional remedial measures in 2014 to reduce the deficit to well below 3 percent of GDP. This large adjustment is needed to put the debt-

GDP ratio on a downward trajectory from 2013 onward, which will be sustained after the program by keeping primary balances in a sizeable surplus (at least 5 percent of GDP) up to 2020. To sustain fiscal consolidation over the medium term, the government also is committed to strengthen the fiscal policy framework and fiscal institutions.

- **Incomes and social security policies need to buttress the fiscal adjustment effort and restoration of competitiveness.** Realigning incomes to sustainable levels is necessary to assist fiscal correction, support a reduction in inflation well below the euro area average, and improve price and cost competitiveness on a lasting basis. Social security programs need to be strengthened to confront underlying structural imbalances that result from the ageing of the population, where growth in entitlement costs for Greece is projected to be among the highest in the European Union with current policies. As the largest annual overruns in the budget consistently come from the social security funds, reforms cannot be postponed any longer to safeguard the viability of the system.
- **Financial sector policies need to maintain stability.** While currently capital buffers in the banking system are reassuring, bank supervisors will need to monitor closely liquidity and nonperforming loans at individual banks. The Bank of Greece and the government will further strengthen and clarify the key elements of Greece's supervisory and financial crisis framework to assist the banking system through this period of lower growth.
- **Structural reforms that boost the economy's capacity to produce, save, and export will be critical for the medium-term recovery.** Greece's openness is lagging euro-area peers. The government is determined to implement an ambitious program of reforms to modernize the public sector and render product and labor markets more efficient and flexible, create a more open and accessible environment for domestic and foreign investors, and reduce the state's direct participation in domestic industries.

8. **The government is committed to fairness in the distribution of the adjustment burden.** Our resolve to protect the most vulnerable in society from the effects of the economic downturn was taken into account in the design of the adjustment policies. In consolidating government finances, larger contributions will be raised from those who have traditionally not carried their fair share in the tax burden. With regard to the reduction in public wages and in pensions, the minimum earners have been protected:

- Pension reductions: The elimination of the 13th and 14th pensions is compensated, for those receiving less than €2500 a month, by introducing a new flat bonus of €800 a year. The benefit reduction is weighted toward the higher pension earners.
- Wage bill reductions. The 13th and the 14th wage payments will be eliminated for all employees. To protect the lower income segment, here too, for those receiving less than €3000 a month, a flat bonus payment of €1000 a year per employee will

be introduced, which will be financed through cutting salary allowances for higher income segments.

- Further, minimum pensions and family support instruments will not be cut, and the most vulnerable will be compensated for the possible adverse impact of policies. To explain and forge consensus on policies to overcome the crisis, the government will invite representatives of businesses and labor to sign a social pact for the duration of the program. The spirit of the above considerations is to maintain strong social cohesion, fight poverty, and maintain employment.

A. Fiscal Policies

9. **The Greek government recognizes the need to implement a frontloaded multiyear adjustment effort given Greece's very high and still growing debt ratio and large fiscal deficit.** All the necessary measures to strengthen market confidence and convince creditors that Greece will regain control over the debt dynamics will be taken. A difficulty is that policies to restore external price competitiveness, which in a monetary union have to rely on reductions in domestic costs and prices, will initially weigh on economic activity, government revenue and debt dynamics. Therefore, the effort has to take place in a period of contracting economic activity, naturally slowing revenues, and cyclically high expenditure. However, it is imperative to place fiscal policies, and the economy, on a sound path for future growth. It is clear that the public sector has become too large and costly and has to become smaller, more efficient and agile, and oriented to providing better services to citizens.

10. **The fiscal strategy is anchored in placing the debt-GDP ratio on a declining path from 2013 onward and reducing the general government deficit to well below 3 percent of GDP by 2014.** To avoid reform fatigue and boost market confidence, the government's strategy is strongly to frontload the fiscal adjustment. All the fiscal measures for the remainder of 2010-2012 have been identified, and most of them will be adopted in the coming weeks. Fiscal measures for 2013 have also been identified with some residual gap remaining that will need to be addressed in coming reviews.

11. **A very strong start has already been made leading to a significant reduction in the 2010 first quarter deficit. For the remainder of 2010 additional measures will be implemented beyond those stipulated in the EU Council Decision and Recommendation of 16 February 2010 and those announced in March 2010** (Table 1). The three biggest upfront measures are an immediate cut in the public sector wage bill, and in pension outlays, and further increases in the VAT and selected excises (together with other steps yielding 2½ percent of GDP in further savings already in 2010). This will assure that the deficit, notwithstanding the recession, drops from an estimated 13.6 percent of GDP in 2009 to 8.1 percent of GDP in 2010. These very large upfront efforts show the government's resolve in responding to the recent deterioration in market sentiment and the large fiscal challenges, and will help overcome the adverse developments on revenue and support payments such as higher unemployment outlays. These large measures come on top of those already undertaken, which include the first installment of lowering the

government's wage bill and selected social security benefits (while safeguarding the minima), the substantial reductions in operating expenditures in all ministries, and significant permanent revenue measures and special taxes on highly profitable enterprises and large properties, and on luxury goods. Thus, the government's resolve is unwavering and every effort will be made to distribute the burden equitably.

12. **For 2011 and beyond, further revenue and expenditure measures have been identified to secure fiscal targets.** Together with the full-year effect of the advance measures taken in mid-2010, these will cover the adjustment needs for 2011 projected at 4 percent of GDP. Adjustment measures in 2012 will continue at a pace of 2½ percent of GDP and in 2013 they are projected to be 2 percent of GDP. Given the expected weakness in GDP, the headline deficit in percent of GDP is expected to drop to 7½ percent in 2011, with more significant headline declines in subsequent years when economic growth resumes.

- **Expenditures will be cut by the equivalent of around 7 percent of GDP through 2013.** Since adoption of the euro, Greece has increased its noninterest expenditures by 8 percentage points of GDP, including with public wages, consumption, and social transfers imposing an overly large burden on the state. This needs to be reversed. As a result, wage and entitlement program costs need to be curtailed as they represent the bulk of the primary budget expenditures, and thereafter wages and pensions will be subsequently frozen in nominal terms for the duration of the program. The government has also planned other reductions in government spending, including by replacing over time only 20 percent of retiring employees, and by consolidating municipalities and local councils. It is essential that the burden of the adjustment on the expenditure side be distributed over multiple programs, so even investment spending will need to be rationalized and shifted to more intensive and efficient use of EU structural and cohesion funds, as feasible. Independent reviews will be launched, conducted by internationally renowned experts, of the public administration and of existing social programs to help identify actions to rationalize the organization of public administration and improve targeting of social programs so that resources are channeled to the most vulnerable.
- **Revenues will be increased by the equivalent of around 4 percent of GDP through 2013.** Revenue from higher income segments of society will include a boost in (presumptive) taxation on liberal professions, an increase in luxury goods taxation, and (temporary) surcharges on highly profitable entities and high valued properties as well as other measures to combat tax evasion included in the recently adopted tax reform legislation. Other revenue increases will include broadening the VAT base, increasing rates and raising excise taxes where Greece is below the euro area average and collection efficiency is low. Green taxes and "health" taxes (such as on consumption of alcohol and tobacco) will also play a part in the revenue raising effort.

13. **Besides these direct fiscal steps for the budget, the government also has initiated a series of important structural fiscal reforms.** These will boost sustainability by helping to strengthen control over revenues and expenditures:

- **Pension reform.** The current pension system is unsustainable and will become insolvent if responsible measures are not taken to place it on a sound footing. The government has initiated a reform which should be adopted before end-June 2010. The National Actuarial Authority will produce a report to verify that the parameters of the new system ensure long-term actuarial balance. The existing pension funds will be merged in three funds. The reform will introduce a new system to strengthen the link between contributions and benefits, with uniform rules that will apply pro-rata to all current and future workers. The normal retirement age will be set to 65 years, increasing in line with life expectancy. Benefits will be indexed to prices. The reform will also restrict early retirement, including for those insured before 1993, and reduce the list of heavy and arduous professions. The new system will also include a means-tested social pension for all citizens above the normal retirement age so that an important safety net is provided, consistent with fiscal sustainability.
- **Health sector reform.** The government will implement double-entry accrual accounting in hospitals, the regular publication of audited accounts, and improvements in pricing and costing mechanisms. The government also plans to separate health funds from administration of pensions, merge the funds to simplify the overly fragmented system, and bring all health-related activities under one ministry.
- **Tax reform.** The government has obtained passage of a tax bill that includes important components to make the tax system more efficient and equitable. The income tax system has become more progressive; exemptions and deductions have been reduced to broaden the tax base; and a number of reforms have been introduced to fight tax evasion, including the tightening of obligations to issue receipts for VAT and to document living expenses, and the introduction of presumptive taxation. The government will further review the tax system to simplify it and increase efficiencies as necessary.
- **Tax administration.** Tax administration improvements are being implemented for which technical assistance has already been received from the IMF. In the short run, the government's strategy will focus on safeguarding revenue from the largest taxpayers, stronger enforcement and auditing of high-wealth individuals and self-employed (where risk of evasion is largest) and prosecuting the worst offenders, strengthening enforcement of VAT filing and payment, and collecting on the large stock of tax arrears. For the medium-term, the government will design a program of structural reforms in key tax compliance and administration areas, including: developing and maintaining a comprehensive compliance risk management framework (notably preparing a compliance strategy for 2012); developing taxpayer service capacity to support compliance improvement efforts; substantially

improving enforcement operations, particularly in audit, using risk-based approaches; and building headquarters strategic management and planning capabilities in tax and customs administration.

- **Public financial management and fiscal framework.** Technical assistance from the IMF and the European Commission on public financial management and longer-term budgeting reforms will be re-prioritized to address the short-term challenges we are facing. In this context, the General Accounting Office (GAO) will be responsible for monitoring and reporting of general government data; the government will introduce standardized commitment control procedures for all public entities to prevent the re-emergence of arrears; ensure that all budgets are prepared within a medium-term fiscal strategy for the general government and presented before the start of the fiscal year; introduce top-down budgeting with expenditure ceilings, a sufficient contingency reserve, and a medium-term expenditure framework for the State budget; require a supplementary budget for any overruns above this contingency provision; and amend the 1995 budget management law to give effect to the above. The government will continue to work with the technical assistance teams of the IMF and the European Commission to implement the recommendations already received, and to make further improvements over the course of the program, including the creation of an independent fiscal agency attached to parliament.
- **Debt management framework.** The government will update its debt management strategy and the tools to ensure that risk is adequately managed. To enhance market confidence and communication, the government plans to review the operational and risk management framework for debt management to ensure the transparency and predictability of our actions. The government has already sought technical assistance in this area from the IMF.
- **Fiscal and other public sector reporting of information, including statistical aspects.** Upon taking office in October 2009, the new government immediately disclosed that the fiscal deficit for 2008 was under-reported and needed to be revised. Working closely with Eurostat on fiscal data processing and reporting, the government has already taken remedial measures to prevent the reoccurrence of such problems and has designed jointly with the European Commission an action plan to address outstanding statistical issues. Among these, full independence has been granted to the Greek Statistical Office and sufficient resources will be devoted in the coming years to improve statistical systems and seek appropriate resident technical assistance to ensure rapid progress. To that end, the measures in the joint Greek government and European Commission Statistical Action Plan will be fully implemented. Going forward, we feel confident that we are in a position to provide accurate fiscal data to the Fund and our European partners. Further, since January 2010, timely monthly central government budget reports on a cash basis have been published. The GAO will also start publishing monthly data on expenditures pending payment, including arrears, from July 2010. Efforts will also be intensified to improve the collection and processing of general government data compiled

according to the European System of National and Regional Accounts (ESA) required under the existing EU legal framework, and compile comprehensive data on employment in the general government. Detailed information will be furnished to the European Commission, the ECB and the Fund on the operating accounts and balance sheets of key public enterprises.

14. **The program will be closely monitored and measures will be taken as necessary.** There are risks to the program from lower revenue, higher social transfers, further downward revisions of growth, additional fiscal liabilities from the public and financial sector, and higher interest costs. However, these can be managed and the government stands ready to take appropriate measures to preserve the program objectives, including by reducing discretionary spending, as necessary. At the same time, there is some upside potential. Our 2010-2011 projections include cautious estimates of the measures taken, positive confidence effects could boost GDP growth and reduce market risk premia, and our revenue administration efforts could start to yield more revenue gains than currently assumed in the program. Should confidence rebound and the market support Greece earlier than expected, or the supply response from reforms comes in more vigorously, these benefits will be saved and the correction to the intended deficit will be brought forward to achieve a speedier return to fiscal sustainability.

B. Financial Sector Policies

15. **Despite a strong solvency position, at present, the Greek banking system is facing challenges.** The system's equity base was substantially strengthened in 2009, jumping from €24 to €33 billion, including through capital injections from the government, for €3.8 billion, capital increases from the owners, and retained earnings. All banks are in compliance with the capital adequacy requirement of 8 percent, and the average capital adequacy ratio rose to 11.7 percent at end 2009. However, the fiscal crisis and a weakening economic environment resulted in a reversal in credit growth and an increase in non-performing loans, which reached 7.7 percent at end-2009 while profitability declined and might become negative this year.

16. **The immediate challenge for the banks is to manage carefully the current tight liquidity conditions.** In the general context of the turbulence affecting the debt markets for the Greek government, the Greek banks have lost wholesale market access to fund their operations since end-2009. Maturing interbank liabilities have not been renewed, or only at high costs, and some moderate deposit outflows were noted during the first months of 2010, which has put pressure on the liquidity position of many Greek banks. As a result, the banks have increasingly relied on Eurosystem credit operations. To assist the banks in these difficult times the government has extended the banking assistance package of early 2009 (€28 billion of which €1 billion had been used by end-2009), to provide a substantial €7 billion in additional liquidity and the government is implementing another extension of this support facility subject to approval by decision of the European Commission. Within the existing Euro system framework, national central banks may give support to temporarily illiquid, but solvent institutions. In the event that such support is

given by the Bank of Greece, it will be fully guaranteed by the Greek state in a manner that is consistent with relevant ECB and EU requirements.

17. **The government and the Bank of Greece are also putting in place a new safety net to preserve the sound level of bank equity, and thus improve conditions to support the real economy.** Anticipating that banks profits may decline further, possibly impacting their equity position, the government will establish (by June 30, 2010, as a structural benchmark), through specific legislation and in consultation with the IMF, the European Commission, and the ECB, a fully independent Financial Stability Fund (FSF). The FSF's key decision makers will be persons of recognized standing in financial matters, appointed by the government and the Governor of the Bank of Greece (who will make most of the appointments).

18. **The primary purpose of the FSF is to preserve the financial sector's soundness and thus its capacity to support the Greek economy, by providing equity support to banks as needed.** Whenever supervisory assessments conclude that a bank's capital buffer might fall below adequate levels, the shareholders will be required to immediately bring additional capital or take bridging capital support from the FSF. If banks are then not able to expeditiously raise additional capital on their own and repay the FSF, a restructuring process will take place under the lead of the FSF, in line with EU competition and state aid requirements.

19. **Other elements of the safety net for the financial sector will also be strengthened.** Corporate debt restructuring legislation, and the current proposal for a personal debt restructuring law, will be in line with international best practices, to ensure that credit discipline is maintained, that creditor and consumer rights are protected, and that relevant information concerning borrowers' track record is preserved.

20. **The Bank of Greece will implement intensified supervision and increase the resources dedicated to banking supervision.** This will include an increase in the frequency and speed of data reporting, and the further development of a comprehensive framework for regularly stress-testing financial institutions. Staffing will be increased both for on-site inspections and off-site review, also taking into account the new responsibilities of the Bank of Greece with respect to insurance supervision. Additional flexibility will be introduced in the management of human resources, and all Bank of Greece staff will be granted strong legal protection for actions performed in good faith.

21. **Close coordination will be maintained with home and host country supervisors within the EU framework for cross-border bank supervision.** In this context, the authorities are fully aware of the significant presence of Greek banks in South Eastern European (SEE) countries; a number of MoUs with the host supervisory authorities (both EU and non-EU) have been signed. Communication with regulators in SEE regarding risk assessments and liquidity contingency plans are also intensifying.

C. Structural Policies

22. **Structural policies are strengthened in order to boost competitiveness and emerge from the crisis quickly.** These will enhance the flexibility and productive capacity of the economy, ensure that wage and price developments restore and then sustain international competitiveness, and progressively alter the economy's structure towards a more investment and export-led growth model. The Greek government will work closely with the European Commission and the ECB to pursue reforms as specified in the MoU attached to this MEFP. In particular:

- **Modernizing public administration.** Fragmented employment practices will be reformed by reorganizing recruitment procedures and finalizing the single payment authority for wages. A simplified remuneration system will be introduced, in a cost-saving manner that will cover basic wages and all allowances which apply to all public sector employees. Procurement practices will be strengthened to generate efficiency gains and ensure transparency. The health care system, where there have been major expenditure overruns, will be overhauled through reforms in management, accounting and financing systems. A reorganization of sub-central government will be implemented to reduce the number of local administrations and elected/appointed officials. The government will collaborate with the EC to launch an independent external functional review of public administration at the central government level. These reforms will help prioritize government activities and, strengthen the fight against waste and corruption throughout the public administration.
- **Strengthening labor markets and income policies.** In line with the lowering of public sector wages, private sector wages need to become more flexible to allow cost moderation for an extended period of time. Following consultation with social partners and within the frame of EU law, the government will reform the legal framework for wage bargaining in the private sector, including by eliminating asymmetry in arbitration. The government will adopt legislation for minimum entry level wages in order to promote employment creation for groups at risk such as the young and long-term unemployed. In parallel, the government will implement the new control system for undeclared work and modernize labor market institutions. Employment protection legislation will be revised, including provisions to extend probationary periods, recalibrate rules governing collective dismissals, and facilitate greater use of part-time work. The scope for improvements in the targeting of social expenditures will be revised in order to enhance the social safety net for the most vulnerable.
- **Improving the business environment and bolstering competitive markets.** The government will shortly adopt legislation establishing one-stop shops for starting new enterprises to cut procedures, costs and delays. Legislation will be introduced to cut licensing and other costs for industry. The government will fully implement key steps of the EU Services Directive in 2010, especially in priority areas such as tourism, education and retail. Over the course of next year, restricted professions

will be opened by reducing fixed tariffs and other restrictions in the legal, pharmacy, notary, engineering, architect, road haulage, and auditing professions. The role of the Hellenic Competition Commission (HCC) will also be strengthened. Network industries will be progressively liberalized, especially in the transport and energy sector while strengthening regulators in these sectors in line with EU policies.

- **Managing and divesting state enterprises.** These need to be subject to greater transparency to increase efficiency and reduce losses. As a first step, 2009 financial statements audited by chartered accountants of the ten largest loss makers will be published on the internet. A time table and action plan for improving the financial performance of main loss-makers, most notably in the railway and public transportation companies will be produced. This action plan will include concrete steps to reduce costs, including by streamlining the networks serviced and increasing tariffs. The government will review the role for divesting state assets, including of land owned by public enterprises or the government. The government will further review the scope for improving corporate governance, and enhancing oversight of state-ownership.
- **Improving the absorption of EU structural and cohesion funds.** The government will work closely with the EC to raise the absorption rate of Structural and Cohesion Funds, including by establishing targets for payment claims based on Management Information System (MIS) data every six months to be measured by certified data and a system of "fast track project production" which includes deadlines for each step of the approval and implementation of projects. A minimum of ten major projects per annum will be submitted. Within the overall public investment envelope agreed in this program, a central account will be established to be used for budgetary appropriations for the national cofinancing of Structural and Cohesion Funds. A specific Task Force will be established with the Commission to ensure the faster delivery of high-quality projects.

IV. PROGRAM FINANCING

23. **We anticipate covering the program's financing requirements with financial support from euro-area member states and the IMF while strengthening access to the private capital markets.** Notwithstanding the significant fiscal adjustment, we project a public financing gap of around €10 billion, for the program period, which we expect to cover through matching bilateral lending support from euro area member states (€8 billion) and through IMF support (€3 billion). Greece will draw on these resources in parallel throughout the program period, drawing on the bilateral and IMF financing in a ratio of 8 to 3 in each disbursement (measured at the program exchange rate). We are confident that resolute implementation of our economic program will help our economy recover and bolster market sentiment. If fiscal consolidation proceeds faster than expected or if market conditions improve significantly during the program period, we would refrain *pari passu* from drawing on the full bilateral and IMF support.

V. PROGRAM MONITORING

24. Progress in the implementation of the policies under this program will be monitored through quarterly (and continuous) quantitative performance criteria (PCs) and indicative targets, structural benchmarks, program reviews and consultation clauses. These are detailed in Tables 2 and 3. The attached TMU contains definitions. Quantitative targets up to December 2010 are PCs. Targets for 2011-2013 are indicative and for 2011 will be converted into PCs at the time of the second review before end-2010. A joint EC/ECB MoU specifies, notably, the structural policies recommended in the MEFP, and sets a precise time frame for their implementation.

25. In the context of the arrangement, the Bank of Greece will undergo a safeguards assessment in accordance with the IMF safeguards policy . In this regard, and to facilitate a timely completion of the assessment, the authorities have provided the information requested for the assessment to commence, and have also authorized the external auditors to provide information to and hold discussions with the staff of the IMF. As a related matter, and given that financing from the IMF will be used to provide direct budget support, a memorandum of understanding between the government and the Bank of Greece will establish a clear framework on the modalities for the repayment of IMF financing and the servicing of interest payments and other charges. As part of these arrangements, Fund disbursements will be deposited into the government's single treasury account at the Bank of Greece pending their use.

Table 1. Greece: Fiscal measures included in the programme

2010		
<i>in million EUR</i>		% of GDP
	<i>Revenue</i>	0.5
Increase in VAT rates	800	0.3
Increase in excise tax on fuel	200	0.1
Increase in excise tax on cigarettes	200	0.1
Increase in excise tax on alcohol	50	0.0
	<i>Expenditure</i>	1.9
Wage bill cut by reducing the Easter, summer and Christmas bonuses and allowances	1100	0.5
Intermediate consumption	700	0.3
Pension cuts (highest pensions)	350	0.1
Elimination of solidarity allowance (second instalment)	400	0.2
Pensions cut by reducing the Easter, summer and Christmas bonuses	1500	0.6
Public investment reduction	500	0.2
	TOTAL ANNUAL IMPACT	2.5

2011

<i>in million EUR</i>		% of GDP
	<i>Carry over from last year</i>	1.1
Increase the VAT rates	1000	0.4
Increase in excise tax on fuel	250	0.1
Increase in excise tax on cigarettes	300	0.1
Increase in excise tax on alcohol	50	0.0
Wage bill cut by reducing the Easter, summer and Christmas bonuses and allowances	400	0.2
Pensions cut by reducing the Easter, summer and Christmas bonuses	500	0.2
	<i>Revenue</i>	2.2
Taxation on unauthorised establishments	800	0.4
Luxury goods tax	100	0.0
Book specification of income	50	0.0
Gaming royalties	200	0.1
Gaming licenses	500	0.2
Special levy on profitable firms	600	0.3
Levies on illegal buildings	500	0.2
VAT - changes in the sub-categories and broadening base	1000	0.4
Green tax	300	0.1
Presumptive taxation	400	0.2
Increase of legal values of real estate	400	0.2
Taxation of wage in kind (cars)	150	0.1
	<i>Expenditure</i>	1.0
Intermediate consumption	300	0.1
Savings from the introduction of unified public sector wages	100	0.0
Pension freeze	100	0.0
Kalikrates savings	500	0.2
Pension cuts (highest pensions)	150	0.1
Public investment reduction	500	0.2
	TOTAL ANNUAL IMPACT	9150 4.1

2012

<i>in million EUR</i>		% of GDP
	<i>Revenue</i>	0.7
Excise non-alcoholic beverages	300	0.1
Gaming licenses	225	0.1
Gaming royalties	400	0.2
VAT - broadening base	300	0.1
Presumptive taxation	100	0.0
Increase of legal values of real estate	200	0.1
	<i>Expenditure</i>	1.2
Reduction in public employment in addition to the 5-to-1 replacement rule	600	0.3
Means test unemployment benefit	500	0.2
Pension freeze	250	0.1
Kalikrates savings	500	0.2
Cut transfers to public entities	800	0.4
Public investment reduction	500	0.2
	<i>Unidentified cuts in operational expenditure</i>	0.4
	TOTAL ANNUAL IMPACT	2.4

2013

<i>in million EUR</i>		% of GDP
	<i>Revenue</i>	-0.3
Presumptive taxation	100	0.0
Gaming licenses	-725	-0.3
	<i>Expenditure</i>	0.5
Reduction in public employment in addition to the 5-to-1 replacement rule	500	0.2
Pension freeze	200	0.1
Kalikrates savings	500	0.2
	<i>Unidentified measures</i>	1.8
	TOTAL ANNUAL IMPACT	2.0

2014

<i>in million EUR</i>		% of GDP
	<i>Temporary measures</i>	-0.4
Special levy on profitable firms (discontinuation of temporary measures)	-600	-0.2
Levies on illegal buildings (discontinuation of temporary measures)	-450	-0.2
	<i>Unidentified measures</i>	5750
	TOTAL ANNUAL IMPACT	1.9
	TOTAL MEASURES 2010 - 2014	30000
		13.0

Table 2. Greece: Quantitative Performance Criteria (in billions of euros, unless otherwise indicated)

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

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

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

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

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

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

Table 3. Greece: Structural Conditionality for 2010 1/

Measures	Date	Macrocritical relevance
	Prior actions	
1. Reduce public wage bill by cutting bonuses/allowances; and pension bonuses (except minimum pensions).		Improves fiscal sustainability; has signaling effect for private sector wage setting.
2. Increase standard VAT rate from 21 to 23 percent and reduced rate from 10 to 11 percent and excise tax rates on alcohol, tobacco, and fuel with a yield of at least €1.25 billion in the remainder of 2010.		Improves fiscal sustainability.
3. Appoint staff team and leader in GAO responsible for general government in-year cash reporting.		Establishes in-year oversight responsibilities of general government fiscal policy.
	End-June 2010	
1. Establish the independent Financial Stability Fund (FSF) to preserve the financial sector's soundness and thus its capacity to support the Greek economy by providing equity support to banks as needed.		Enhances financial stability.
2. Adopt and start to implement a reorganization of sub-central government with the aim to reduce the number of local administrations and elected/appointed officials (Kalikrates).		Improves fiscal sustainability.
3. Submit to parliament amendments to Law 2362/1995 to (i) require the MoF to present a three-year fiscal and budget strategy, (ii) introduce top-down budgeting with expenditure ceilings for the State budget and multi-year expenditure estimates by line ministry, (iii) introduce standard contingency margins, (iv) require a supplementary budget for any overspending above the contingency, (v) and introduce commitment controls. The amended law should be immediately effective, including in the context of the 2011 budget.		Improves credibility of the budget and fiscal consolidation program.
4. The National Actuarial Authority to produce a report to assess whether the parameters of the new system significantly strengthen long-term actuarial balance.		Reduces budgetary costs of ageing and improves long-term fiscal sustainability. Increases labor force participation.
	End-September 2010	
1. Adopt a comprehensive pension reform that reduces the projected increase in public spending on pensions over the period 2010-60 to 2½ percent of GDP.		Improves fiscal sustainability.
2. Establish a commitment register in all line ministries and public law entities. Begin publishing monthly data on general government in-year fiscal developments (including arrears).		Reduces budget overruns.
3. Publish 2009 financial statements of the ten largest loss-making public enterprises, audited by chartered accountants, on the official website of the Ministry of Finance.		Increases transparency of fiscal risks to fiscal sustainability.
4. Put in place an effective project management arrangement (including tight MOF oversight and five specialist taskforces) to implement the anti-evasion plan to restore tax discipline through: strengthened collection enforcement and recovery of tax arrears—coordinated with the social security funds—of the largest debtors; a reorganized large taxpayer unit focused on the compliance of the largest revenue contributors; a strong audit program to defeat pervasive evasion by high-wealth individuals and high income self-employed, including prosecution of the worst offenders; and a strengthened filing and payment control program.		Achieves revenue targets and enhances sustainability of the consolidation by increasing burden sharing of the adjustment.
	End-December 2010	
1. Publish a detailed report by the ministry of finance in cooperation with the single payment authority on the structure and levels of compensation and the volume and dynamics of employment in the general government.		Reduces wage escalation. Improves transparency of public sector employment.
2. Adopt new Regulation of Statistical Obligations for the agencies participating in the Greek Statistical System.		Enhance confidence in fiscal reporting and support the formulation of fiscal policy.
3. Prepare 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.		Reduces state intervention in the real economy; improves market efficiency; and cuts fiscal contingencies.

1/ Structural benchmarks for 2011 will be determined in the reviews for end-September and end-December 2010.

Table 4. Greece: Fiscal financing gap and disbursement schedule, 2010-2013, billion euro 1/

		SUM	2010		2011				2012				2013			
		10Q2-13Q2	Jan-Apr	May-Jun	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
A.	GG deficit	48.5	6.1	3.1	4.6	4.6	4.1	4.1	4.1	4.1	3.6	3.6	3.6	3.6	2.7	2.7
B.	GG deficit + PE borrowing need	53.0	6.8	3.4	4.9	4.9	4.5	4.5	4.5	4.5	4.0	4.0	4.0	4.0	3.0	3.0
C.	Debt amortization (existing bonds)	138.3	20.1	9.5	5.4	4.4	13.8	13.1	10.8	5.4	19.1	13.2	12.6	5.5	9.8	15.6
D.	of which short-term debt	50.0	...	0.0	4.6	4.3	4.0	4.0	4.0	4.0	4.0	4.0	4.5	4.5	4.0	4.0
E.	of which long-term debt	88.3	...	9.5	0.8	0.1	9.8	9.1	6.8	1.4	15.1	9.2	8.1	1.0	5.8	11.6
F.	Stock flow adjustment	1.5	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
G.	Public sector financing need (B+C+F)	192.8	27.0	13.0	10.4	9.4	18.4	17.7	15.5	10.0	23.2	17.3	16.7	9.6	12.9	18.7
H.	Rollover of short-term debt	...	...	0%	87%	93%	100%	100%	113%	113%	100%	100%	111%	111%	100%	100%
I.	Rollover of long-term debt	...	...	0%	0%	0%	0%	0%	0%	75%	75%	75%	75%	100%	100%	100%
J.	New GG borrowing	77.9	28.9	0.0	4.0	4.0	4.0	4.0	4.5	4.5	15.3	10.9	11.1	5.8	9.8	15.6
K.	of which short-term borrowing (D*H)	47.0	...	0.0	4.0	4.0	4.0	4.0	4.5	4.5	4.0	4.0	5.0	5.0	4.0	4.0
L.	of which long-term borrowing (E*I)	30.9	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	11.3	6.9	6.1	0.8	5.8	11.6
M.	Privatisation receipts	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
N.	PE borrowing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
O.	Bank support scheme	10.0	0.0	5.0	5.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
P.	Financing gap (E-G-H-I+J+O)	109.2	-1.9	18.0	11.4	5.4	14.4	13.7	11.0	5.5	7.9	6.4	5.6	3.8	3.1	3.1
Q.	Loan disbursements	110.0	0.0	20.0	9.0	9.0	15.0	12.0	8.0	5.0	10.0	6.0	6.0	2.0	6.0	2.0
R.	of which IMF	30.0	0.0	5.5	2.5	2.5	4.1	3.3	2.2	1.4	2.7	1.6	1.6	0.5	1.6	0.5
S.	of which EU	80.0	0.0	14.5	6.5	6.5	10.9	8.7	5.8	3.6	7.3	4.4	4.4	1.5	4.4	1.5

1/ Data in this table are subject to revision.

GREECE: Memorandum of Understanding on
SPECIFIC ECONOMIC POLICY CONDITIONALITY
May 3, 2010

The quarterly disbursements of bilateral financial assistance from euro area Member States will be subject to quarterly reviews of conditionality for the duration of the arrangement. The release of the tranches will be based on observance of quantitative performance criteria, and a positive evaluation of progress made with respect to policy criteria in the MEFP and in this Memorandum, which specifies the detailed criteria that will be assessed for the successive reviews, up to the end of 2011. The detailed criteria for the years 2012 and 2013 will be specified at the occasion of the spring 2011 review.

The authorities commit to consult with the European Commission, the ECB and the IMF on adoption of policies that are not consistent with this memorandum. They will also provide them with all requested information for monitoring progress during program implementation and the economic and financial situation (Annex 1). Prior to the release of the instalments, the authorities shall provide a compliance report on the fulfilment of the conditionality.

1. Actions for the first review (to be completed by end Q2-2010)

i. Fiscal consolidation

- 1.
2. Progress with the implementation of the 2010 budget and fiscal measures adopted thereafter. Progress is assessed against the (cumulative) quarterly deficit ceilings in the MEFP (including the TMU). The authorities take the following measures, generating savings for a total amount of 2.5% of GDP in 2010:
3.
 - Increase in VAT rates, with a yield of at least EUR 1800 million for a full year (EUR 800 million in 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;
- 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.

ii. Structural Fiscal Reforms

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.

iii. Financial sector regulation and supervision

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 (Annex 2).

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.

Review the private sector bankruptcy law to ensure consistency with ECB observations.

iv. Structural reforms

Authorities undertake reforms to modernise public administration:

Parliament adopts legislation reforming public administration at the local level, notably by merging municipalities, prefectures and regions with the aim of reducing operating costs and wage bill.

Parliament adopts legislation requiring online publication of all decisions involving commitments of funds in the general government sector.

To strengthen labour market institutions:

Government starts discussions with social partners in order to revise private sector wage bargaining and contractual arrangements.

To enhance competition in open markets:

Government adopts law to simplify the start-up of new businesses.

Government adopts the horizontal legislation on the Services Directive.

Government adopts a recovery plan for the railway sector with a timetable for measures which:

- specify how operational activities will be made profitable, including by closing loss-making lines;
- ensure the effective implementation of EU Directives allowing for competition amongst providers of railway services;
- provide for the restructuring of holding company, including the sale of land and other assets.

To raise the absorption rates of Structural and Cohesion Funds:

Government will put in place measures, including the implementation of Law 3840/2010, the establishment of a "fast-track project production", to achieve the six-monthly targets for payment claims targets in the absorption of Structural and Cohesion Funds set down in the table below. Compliance with the targets shall be measured by certified data. The government will take steps to achieve an annual target of submitting 10 major projects applications to Commission services.

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

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.

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.

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

i. Fiscal consolidation

Rigorously implement the budget for 2010 and the fiscal consolidation measures announced afterwards, including those in this Memorandum. Progress is assessed against the (cumulative) quarterly deficit ceilings in the MEFP (including the TMU).

Government submits the draft budget for 2011 to Parliament. The budget provides information and reliable projections on the entire general government sector and targets a further reduction of the general government deficit in line with the MEFP. It includes a detailed presentation of fiscal consolidation measures amounting to at least 3.2% of GDP (4.3% of GDP, if carryovers from measures implemented in 2010 are considered), and detailed information on the situation of public enterprises.

The budget includes the following measures (in exceptional circumstances, measures yielding comparable savings could be considered in close consultation with European Commission, IMF and ECB staff):

- Implement the rule of replacing only 20 percent of retiring employees in the public sector (central government, municipalities, public companies, local governments, state agencies and other public institutions);
- Reduction in intermediate consumption of the general government by at least EUR 300 million compared to the 2010 level, on top of savings envisaged in the context of reforming public administration and the reorganisation of local government (see next measure);
- Government starts implementing legislation reforming public administration and the reorganisation of local government with the aim of reducing costs by at least EUR 1500 million from 2011 to 2013, of which at least EUR 500 million in 2011.
- Freeze in the indexation of pensions, with aim of saving EUR 100 million;¹
- Reduction in domestically-financed investments by at least EUR 1000 million, by giving priority to investment projects financed by EU structural and cohesion funds;
- Temporary "crisis levies" on highly profitable firms, yielding at least EUR 600 million in additional revenue per year in 2011, 2012 and 2013;
- Incentives to regularise land-use violations, yielding at least EUR 1500 million from 2011 to 2013, of which at least EUR 500 million in 2011;
- Enforce the presumptive taxation of professionals, with a yield of at least EUR 400 million in 2011 and increasing returns in 2012 and 2013;
- Broaden the VAT base by including services that are currently exempted and move a significant proportion (at least 30%) of the goods and services currently subject to the reduced rate to the normal rate, with a yield of at least EUR 1000 million;
- Start phasing in a "green tax" on CO2 emissions, with a yield of at least EUR 300 million in 2011;
- Collect revenue from the licensing of gaming: at least EUR 500 million in sales of licences and EUR 200 in royalties;

¹ Adjustments may be needed in case of negative inflation.

- Expand the base of the real estate tax by updating asset values to yield at least EUR 500 million additional revenue;
- Increase taxation of wages in kind, including by taxing car lease payments (at least EUR 150 million);
- Initiate the collection of a special tax on unauthorised establishments (at least EUR 800 million per year);
- Increase taxes on luxury goods by at least EUR 100 million;
- The budget will establish detailed expenditure ceilings for each line-ministry, local governments, and social security funds consistent with the general government deficit target. This also pertains to the medium-term fiscal framework for 2012-2013;
- The budget will contain indicative information on monthly revenue per category, and expenditure per Ministry. Updated figures will be regularly made available online.

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

ii. Structural fiscal reforms

Parliament adopts legislation to improve the efficiency of the tax administration and controls, implementing recommendations provided by the European Commission and IMF. In particular, they put in place an effective project management arrangement (including tight MOF oversight and taskforces) to implement the anti-evasion plan to restore tax discipline through: strengthened collection enforcement and recovery of tax arrears (coordinated with the social security funds) of the largest debtors; a reorganized large taxpayer unit focused on the compliance of the largest revenue contributors; a strong audit program to defeat pervasive evasion by high-wealth individuals and high income self-employed, including prosecution of the worst offenders; and a strengthened filing and payment control program.

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

- Simplification of the fragmented pension system by merging the existing pension funds in three funds and introducing a unified new system for all current and future employees. The new universally binding rules on entitlements, contributions, accumulation rules and indexation of pension rights shall be applied pro rata to everybody from 1 January 2013;
- Introduction of a unified statutory retirement age of 65 years, including for women in the public sector (phased in immediately after adoption), to be completed by December 2013;

- Gradual increase in the minimum contributory period for retirement on a full benefit from 37 to 40 years by 2015;
- Amendment of the pension award formula in the contributory-based scheme to strengthen the link between contributions paid and benefits received, with accrual rate limited to an average annual rate of 1.2%, and pensions indexed to prices;
- Introduction of an automatic adjustment mechanism that, every three years and starting in 2020, will increase the (minimum and statutory) retirement age in line with the increase in life expectancy at retirement;
- Extend the calculation of the pensionable earnings from the current last five years to the entire lifetime earnings (while retaining acquired rights);
- Reduction of the upper limit on pensions;
- Introduction of a means-tested minimum guaranteed income for elderly people (above the statutory retirement age), to protect the most vulnerable groups, consistent with fiscal sustainability;
- Measures to restrict access to early retirement. In particular, increase the minimum early retirement age to 60 years by 1st January 2011, including for workers in heavy and arduous professions and those with 40 years of contributions. Abolish special rules for those insured before 1993 (while retaining acquired rights). Substantial revision of the list of heavy and arduous professions;
- Reduction of pension benefits (by 6% per year) for people entering retirement between the ages of 60 and 65 with a contributory period of less than 40 years;
- Introduction of stricter conditions and regular re-examination of eligibility for disability pensions.

Government adopts a reform of the GAO, including the following elements:

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

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

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

- responsibility in cases of misreporting; and seek appropriate resident technical assistance to ensure rapid progress;
- Government starts to publish timely information on the financial situation in public enterprises (at least the 10 largest loss-making ones) and other public entities not classified in the general government (including detailed income statements, balance sheets and data on employment and the wage bill). To this end, a regular and timely reporting mechanism is introduced.

iii. Financial sector regulation and supervision

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

Review the adequacy of the insolvency framework, for banks as well as for non-financial entities.

iv. Structural reforms

Progress with reforms to modernise public administration:

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

Government launches independent functional reviews of the public administration at central level and of existing social programmes. It is to be conducted by internationally renowned and external experts. The Terms of Reference for the reviews will be agreed with European Commission, IMF and ECB staff. The objectives of the reviews are:

- To take stock of the use of resources, including human resources, to carry out government functions (e.g., employment, goods and services) in the central government and subordinated public institutions;
- To identify actions to rationalize the organisation of public administration and generate productivity gains, and quantify possible fiscal savings from implementation of these actions;
- To assess effectiveness and appropriateness of existing social programmes and make proposals for reform or cancellation of the least effective ones, while quantifying possible fiscal savings from implementation of these actions.

To strengthen competition in open markets

Authorities make the General Commercial Registry (GEMI) fully operational

Under the Services Directive, the government finalizes the review of existing sectoral legislation (screening), ensures that the point(s) of single contact is(are) operational.

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

Issue a Ministerial Decree for the liberalisation of wholesale electricity market and a Ministerial Decision on rationalisation of electricity consumer tariffs.

Promoting investments and exports

Government takes measures, in line with EU competition rules, to facilitate FDI and investment in innovation in strategic sectors (green industries, ICT etc...) through a revision of the Investment Law, the adoption of measures to facilitate PPPs, action to fast-track large FDI projects and measures to strengthen export promotion policy.

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

i. Fiscal consolidation

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

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

Government prepares a privatization plan for the divestment of state assets and enterprises with the aim to raise at least 1 billion euros a year during the period 2011-2013.

ii. Structural fiscal reforms

Government adopts draft legislation to strengthen the fiscal framework, following discussions with European Commission and IMF staff. The following elements should be part of the reform:

- Introduce a medium-term fiscal framework covering the general government based on rolling three-year expenditure ceilings for the State, social security entities and local governments;
- Strengthen the position of the Finance Minister vis-à-vis line ministers in both budget preparation and execution phases (giving him/her veto power on spending decisions and execution);
- Introduce a compulsory contingency reserve in the budget, corresponding to 10 percent of total appropriations government departments other than wages, pensions and interest; the use of the contingency reserve will be decided by the Finance Minister;
- Ensure that Parliament does not modify the overall size of the budget at the approval stage, and focus on the composition of public expenditure and revenue, and reliability of projections for expenditure and revenue;
- Introduce stronger expenditure monitoring mechanisms, particularly by implementing an appropriate control of spending commitments, through which spending entities (line ministries, local authorities, social security funds, hospital and legal entities) would report on a regular basis to the Treasury on their outstanding expenditure commitments against their authorised appropriations in the budget law;

- Introduce a revenue rule for the general government, according to which the allocation of higher-than-expected revenues should be specified *ex-ante* in the budget law;
- Creation of a fiscal agency attached to Parliament providing independent advice and expert scrutiny on fiscal issues, and reporting publicly on the budgetary plans and execution of the spending entities of the general government, and on macroeconomic assumptions used in the budget law.

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

iii. Structural reforms

To reform and modernise public administration:

Government adopts all necessary legislation and decree for the full entry into force of the local administration reform.

Government completes the creation of a Single Payment Authority for the payment of wages in the public sector. The Ministry of finance publishes a detailed report, based on information and in collaboration with the Single Payment Authority, on the structure and levels of compensation and the volume and dynamics of employment in the general government.

Authorities complete the first phase of the public procurement system reform, with a central procurement authority and involving a swift implementation of the electronic platform for public procurement and introducing the use of e-auctioning system. It should ensure a common approach and tendering procedures, *ex ante* and *ex post* controls.

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

To modernise the health care systems:

Government adopts legislation on the institutional framework for health supplies (Law 3580/2007), establishes new systems for the management of drugs that favour more use of generic medicines, including a new system for the electronic monitoring of doctors' prescriptions.

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

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

To strengthen labour market institutions:

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

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

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

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

To enhance competition in open markets:

Government adopts changes to existing (sectoral) legislation in key services sectors such as tourism, retail and education services. New legislation should facilitate establishment, by significantly reducing requirements covered by Articles 15 and 25 of the Services Directive, in particular requirements relating to quantitative and territorial restrictions, legal form requirements, shareholding requirements, fixed minimum and/or maximum tariffs and restrictions to multidisciplinary activities. It should also facilitate the provision of cross-border services by implementing the freedom to provide services clause in Article 16 of the Service Directive through an approach ensuring legal certainty for services providers, i.e. by clearly setting out in the respective (sectoral) legislation which requirements can and which requirements cannot be applied to cross-border services.

Government proposes legislation to remove restrictions to trade in restricted professions including:

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

Government adopts legislation and takes all necessary measures to complete the full and effective transposition of EU rules on recognition of professional qualifications, including the transposition of the Professional Qualifications Directive (Directive 2005/36/EC) including compliance with ECJ rulings.

Government adopts legislation to simplify and accelerate the process of licensing enterprises, industrial activities and professions, which inter alia revises Law 3325/05, makes Law 3335/05 for business areas, and operationalises the spatial plan.

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

Promoting investments and exports

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

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

To raise the absorption rates of Structural and Cohesion Funds

Government to meet targets for payment claims (to be measured against certified data) and for the submission of large projects.

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

i. Fiscal consolidation

Rigorously implement the budget for 2011 in line with this memorandum, and the fiscal consolidation measures in the budget. Progress is assessed against the (cumulative) quarterly deficit ceilings in the MEFP (including the TMU).

ii. Structural fiscal reforms

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

iii. Structural reforms

To reform and modernise public administration:

Government completes effective transposition of Directive 2007/66/EC on public procurement regarding remedies, and at the same time ensures that responsibility for the

review of award procedures be vested with the administrative courts. Government completes the transposition of Directives 2009/81 on defence and security expenditure.

Reforms to improve the business environment:

Government fully implements the recovery plan for the railway sector to make operational activities profitable, implement EU Directives and restructure the holding company.

Parliament adopts legislation unbundling electricity and gas activities.

Government adopts measures, in line with EU requirements to strengthen the independence and capacity of the Energy Regulatory Authority and further unbundle the transmission system operators DESMIE (electricity) and DESFA (gas), including by bringing forward transparent criteria and procedure to govern the selection of the chair and members of RAE.

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

i. Fiscal consolidation

Rigorously implement the budget for 2011 in line with this memorandum, and the fiscal consolidation measures in the budget. Progress is assessed against the quarterly deficit ceilings in the MEFP (including the TMU).

ii. Structural reforms

Reforms to modernise public administration:

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

On the findings of the external and independent functional review of public administration at central level, the government adopts legislation and measures to rationalize the use of resources, the organisation of the public administration and social programmes.

Authorities take the following measures to strengthen labour market institutions:

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

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

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

To strengthen competition in open markets:

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

To raise the absorption rates of Structural and Cohesion Funds:

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

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

i. Fiscal consolidation

Rigorously implement the budget for 2011 in line with this memorandum, and the fiscal consolidation measures in the budget. Progress is assessed against the quarterly deficit ceilings in the MEFP (including the TMU).

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

- Reduce public employment on top of the rule of 1 recruitment for each 5 retirements in the public sector; the reduction in public employment on top of the 5-to-1 rule should allow savings of at least EUR 600 million;
- Establish excises for non alcoholic beverages, for a total amount of at least EUR 300 million;
- Continue the expansion of the base of the real estate tax by updating asset values to yield at least EUR 200 million additional revenue;
- Continue the reorganisation of local government, to generate at least EUR 500 million in savings;
- Nominal freeze in pensions;
- Continue to increase the effectiveness of the presumptive taxation of professionals, with the aim of collecting at least additional EUR 100 million;
- Reduction of transfers to public enterprises by at least EUR 800 billion following their restructuring;
- Make unemployment benefits means-tested (aiming at savings of EUR 500 million);
- Collect further revenue from the licensing of gaming: at least EUR 225 million in sales of licences and EUR 400 in royalties;
- Further broadening of VAT base, by moving goods and services from the reduced to the normal rate, with the aim of collecting at least additional EUR 300 million.

ii. Structural reforms

Reforms to modernise public administration:

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

Improve the business environment:

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

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

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

i. Fiscal consolidation

5. Government achieves the programme target for the 2011 general government deficit.

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

ii. Structural reforms

To raise the absorption rates of Structural and Cohesion Funds:

Government to meet targets for payment claims (to be measured against certified data) and for the submission of large projects.

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

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

Annex 1. Provision of data

During the programme, the following indicators and reports shall be made available to the European Commission, the ECB and the IMF by the authorities on a regular basis. In general, reporting information provided to other multilateral and bilateral lenders involved in the programme of financial assistance of which the assistance provided by the Community forms part shall at the same time also be provided to the Commission, unless the Commission has indicated that this is not specifically required. The authorities shall provide the Commission and the ECB with compliance reports on the fulfilment of conditionality immediately after test dates.

To be provided by the Ministry of Finance

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

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

To be provided by the Bank of Greece

Assets and liabilities of the Bank of Greece	Weekly, next working day
Assets and liabilities of the Greek banking system - aggregate monetary balance sheet of credit institutions	Monthly, 30 days after the end of each month
Evolution of the external funding provided by Greek banks to their subsidiaries abroad ²	Monthly, 15 days after the end of each month
External funding flows for the banking, corporate and government sector, including also expected developments in the 12 months ahead	Monthly, 30 days after the end of each month
Report on banking sector liquidity situation	Weekly, next working day
Report on the evolution of financial stability indicators	Quarterly, 15 days after the end of each quarter depending on data availability
Report on results from the regular quarterly solvency stress tests	Quarterly, 15 days after the end of each quarter depending on data availability
Detailed report on the balance sheet of the Financial Stability Fund with indication and explanation of changes in the accounts	Weekly, next working day

² All forms of debt instruments and capital, as well as net deposits provided to subsidiaries abroad.

Annex 2. Financial Stability Fund

General

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

Legal status

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

Funding

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

Organizational issues

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

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

Powers of the Fund

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

Conditions applicable to capital increases

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

Approval of restructuring plan by European Commission

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

Follow-up

- The Greek authorities would prepare the necessary legislation implementing the details of the above by the end of June 2010, at the latest.

Annex 3. Structural reforms conditionality

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
PUBLIC ADMINISTRATION REFORMS		
Simplify the remuneration system for public sector employees	- launch a process to create a simplified remuneration system to cover basic wages and all allowances applying to all public sector employees and ensuring that remuneration reflects productivity and tasks	<i>September 2010</i>
	- establish a fully operational Single Payment Authority to centralize the payment of all salaries paid to civil servants at all levels of government	<i>December 2010</i>
	- adopt legislation for a simplified remuneration system	<i>June 2011</i>
Public procurement	- complete the first phase of the public procurement system for all sectors and levels of government with a fully operational electronic platform introducing the use of e-auctioning systems	<i>December 2010</i>
	- implement EU Directives and have an effective appeals system	<i>March 2011</i>
Transparency of public spending decisions	- adopt legislation to ensure transparency by requiring online publication of all government expenditure decisions	<i>June 2010</i>
Local administration reform	- adopt legislation reforming public administration at the local level	<i>June 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	- adopt all legislation and decrees for full entry force of the reform on 1 January 2011 involving transfer of responsibilities and resources across entities	<i>December 2010</i>
Independent functional review of the central government	- launch an independent and external review of the organization and functioning of the central administration - adopt legislation and measures to rationalize the use of resources, the organisation of the public administration and the effectiveness of social programmes	<i>September 2010</i> <i>June 2011</i>
Better Regulation	-adopt legislation to implement the Better Regulation agenda - ensure full implementation to reduce administrative burden by 20 compared with 2008 level and submit a progress report to the Commission	<i>December 2010</i> <i>September 2011</i>
LABOUR MARKET and WAGES		
Start discussion with social partners	To prepare the revision of private sector wage bargaining and contractual arrangements	<i>June 2010</i>
Reform Employment Protection Legislation	- extend the probationary period for new jobs to one year - reduce the overall level of severance payments which should apply equally to blue and white collar workers - raise the minimum threshold for activating rules on collective dismissals especially for larger companies - put measures in place to guarantee that current minimum wages remain fixed in nominal terms for 3 years - facilitate use of temporary contracts and part-time work	<i>December 2010</i>
Reform minimum wages		<i>December 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	<ul style="list-style-type: none"> - following dialogue with social partners, government to adopt legislation on minimum wages to introduces sub-minima for groups at risk such as the young and long term unemployed, - guarantee that current minimum wages remain fixed in nominal terms for three years 	
Reform private wage bargaining system to ensure wage moderation	<ul style="list-style-type: none"> - adopts legislation to reform wage bargaining system in the private sector, including local territorial pacts to set wage growth below sectoral agreements - introduce variable pay to link wages to productivity performance at the firm level - amend regulation of the arbitration system 	<i>December 2010</i>
Increase the flexibility of working hours	<ul style="list-style-type: none"> - adjust legislation to introduce annual time accounts and reduce overtime pay 	<i>December 2010</i>
Fight undeclared work	<ul style="list-style-type: none"> - strengthen legislation to enforce the registration of new employees - ensure the Labour Inspectorate is fully staffed and quantitative controls targets are in place 	<i>June 2011</i>
Review social safety net	Review the scope for improvements in the targeting of social expenditures to enhance the social safety net for the most vulnerable	<i>June 2011</i>
PENSIONS		
Reform pension system	Government to adopt a new simplified system (pro rata) for all current and future employees including:	<i>June 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	<ul style="list-style-type: none"> - by December 2015, a unified statutory retirement age of 65 years, including for those insured before 1 Jan 1993 - an increased retirement age of women in the public sector to 65 by 2013 - strengthened link between contributions and benefits - pension earnings calculated on the entire lifetime - an average annual accrual rate of 1.2 - price indexation of pensions - an automatic adjustment mechanism that links the retirement age with increases in life expectancy at retirement - an increased minimum contribution period from 37 to 40 years by 2015 - restricted access to early retirement and increased minimum retirement age of 60 years by 1st January 2011, including for workers in heavy and arduous professions, and those with 40 years of contributions - a revised disability scheme - reduced (by 6 per year) pension benefits for people retiring between the ages of 60 and 65 with less than 40 years of contribution - no special rules for those insured before 1 Jan 1993 - substantial cuts in the list of heavy and arduous professions (to no more than 10 of employees) - a means-tested minimum guaranteed pension for people aged above 65 years of age - a reduction in the number of funds to 3 <p>Parliament adopts the pension reform</p>	<i>September 2010</i>
HEALTHCARE		
Healthcare reform	Complete reforms to improve management and procurement systems of health system: complete move to double accounting systems, establish operational oversight by the Finance Minister,	<i>December 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	the publication of audited accounts	
BUSINESS ENVIRONMENT		
Facilitate business start ups	Simplify the start up of new businesses and make the General Commercial Registry (GEMI) fully operational	<i>June 2010</i> <i>September 2010</i>
Simplify the licensing of industrial units and reduce the costs of doing business	<ul style="list-style-type: none"> - simplify and accelerate the process of licensing enterprises, industrial activities and professions through legislation and by making the spatial plans operational - Government to change legislation to mitigate tax obstacles to mergers and acquisitions, and lower costs associated with customs 	<i>December 2010</i> <i>September 2011</i>
Implement the Services Directive	<ul style="list-style-type: none"> - adopt horizontal legislation, finalize screening of sectoral legislation - make single points of contact operational - adopt measures in key service sectors such as tourism, retail and education 	<i>June 2010</i> <i>September 2010</i> <i>December 2010</i>
Open up restricted professions	<ul style="list-style-type: none"> - propose sector-specific legislation to remove restrictions to trade in the legal profession, the pharmacy profession, the notary profession, architects, engineers, auditing services - implement the Professional Qualifications Directive so that qualifications from third countries are recognized - adopt legislation to open up restricted professions 	<i>December 2010</i> <i>December 2010</i> <i>June 2011</i>
Reform road freight transportation	Liberalize road freight transport by removing all unnecessary	<i>September 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	restrictions on admission to the occupation of road haulage, including minimum fixed prices	
Competition policy framework	Modify the existing institutional framework of the Hellenic Competition Commission, including to allow prioritisation on important cases and to strengthen the independence of HCC members	<i>December 2010</i>
Railways	<ul style="list-style-type: none"> - prepare a recovery plan for the railway sector to restore profitability to operational services, ensure compliance with EU Directives, and specify a timetable for the restructuring of the holding company including the sale of land and other assets - implement fully the recovery plan for the railway sector 	<i>June 2010</i> <i>March 2011</i>
Energy	<ul style="list-style-type: none"> -finalise plans for the liberalization of the wholesale electricity market and commence with the rationalization of consumer tariffs -adopt legislation to unbundle electricity and gas activities, including measures - adopt measures to strengthen the independence and capacity of the Energy Regulatory Authority 	<i>September 2010</i> <i>March 2011</i> <i>March 2011</i>
PROMOTING INVESTMENT AND EXPORTS		
Promoting FDI and investment in strategic sectors	Government to take measures to facilitate FDI and investment in innovation in strategic sectors (green industries, ICT etc...), through a revision of the Investment Law, the adoption of	<i>September 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	measures to facilitate PPPs, action to fast-track large FDI projects and measures to strengthen export promotion policy	
R&D and innovation	- Carry out in depth evaluation of all R&D and innovation actions, including in various Operational Programmes, in order to adjust the national strategy	<i>December 2010</i>
	- create an Advisory Council financed through the 7th R&D programme, to consider how to foster innovation, how to strengthen links between public research and Greek industries and the development of regional industrial clusters	<i>December 2010</i>
STRUCTURAL AND COHESION FUNDS		
Increase absorption of Structural and Cohesion Funds	- put in place measures to achieve binding targets for payment claims of Structural and Cohesion Funds and for submission of large projects	<i>June 2010</i>
	- establish Task Force with the Commission to speed-up the development of high quality projects, through better coordination and other actions	
	- complete steps to prioritize public investment spending for projects benefiting from EU funds, including the introduction of a central bank account	
	- meet targets for payment claims (measured against certified data) and large projects	<i>December 2010 and every six months thereafter</i>
	- introduce a web-based open access monitoring tool of procedures for approval of project proposals and for implementation of public projects	<i>December 2011</i>
	- ensure that the managerial capacity of all Managing Authorities and Intermediate Bodies of operational programmes	<i>December 2011</i>

GREECE: TECHNICAL MEMORANDUM OF UNDERSTANDING (TMU)**MAY 3, 2010**

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to quantitative targets (performance criteria and indicative targets), specified in the Letter of Intent (LOI). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets. We will consult with the Fund, European Commission and ECB before modifying measures contained in this letter, or adopting new measures that would deviate from the goals of the program, and provide the European Commission, ECB and the Fund with the necessary information for program monitoring.
2. For program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at “program exchange rates” as defined below, with the exception of the items affecting government fiscal balances, which will be measured at current exchange rates. The program exchange rates are those that prevailed on April 30, 2010. In particular, the exchange rates for the purposes of the program are set €1 = 1.3315 U.S. dollar, €1 = 125.81 Japanese yen, €1.135 = 1 SDR.

General Government

3. **Definition:** For the purposes of the program, the general government includes:
 - The entities covered under the State Budget as defined in Chapter 2 of the Law 2362/1995 regarding “Public Accounting, Auditing of Government Expenditures and Other Regulations.”
 - Local authorities comprising municipalities, prefectures, and regional governments including their basic and special budgets, including all agencies and institutions attached thereto, which are classified as part of local authorities according to ESA 95.
 - Social security funds comprising all funds that are established as social security funds in the registry of the National Statistical Service.
 - This definition of general government also includes any new funds, or other special budgetary and extra budgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF’s *Manual on Government Finance Statistics 2001*. The authorities will inform IMF, European Commission and ECB staff of the creation of any such new funds or programs immediately.

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

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

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

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

- **The cash balance of the ordinary state budget.** The cash balance of the ordinary state budget will be measured from above the line, based on ordinary budget revenues (recurrent revenue plus non-recurrent revenue minus tax refunds) minus ordinary budget expenditures (ordinary budget expenditures will exclude amortization payments and capital transfers to social security funds by bonds but include salaries and pensions; grants to social security funds, medical care and social protection; operational and other expenditure; returned resources; payments in exchange of claims of insurance fund for the personnel working in the Public Electricity Company; interest payments; payments for military equipment procurement; and NATO expenses) of the ordinary state budget as published monthly on the official website of the General Accounting Office of the Ministry of Finance, and in line with the corresponding line items established in the ordinary state budget.
- **The cash balance of the investment state budget.** The cash balance of the investment state budget will be measured from above the line, based on investment budget revenues minus investment budget expenditures of the investment state budget as published monthly on the official website of the General Accounting Office of the Ministry of Finance, and in line with the corresponding line items established in the investment state budget.
- **Net financial assets of local authorities** are defined as financial assets minus financial liabilities of local authorities. Financial assets include deposits of local authorities in the Bank of Greece and deposits of local authorities in the commercial

domestic banking sector. Deposits will be measured at face value excluding accrued interest in line with recording for monetary survey data. Financial liabilities include short and long term loans from the domestic banking system to local authorities, measured at face value, consistent with recording for monetary survey data.

- **Net financial assets of social security funds** are defined as financial assets minus financial liabilities of social security funds.
 - Financial assets include
 - Deposits of social security funds in the Bank of Greece and direct deposits of social security funds in the domestic commercial banking system and indirect deposits held by the IKA mutual fund. Deposits are measured at face value excluding accrued interest, consistent with reporting requirements for monetary survey data.
 - Holdings of direct shares or indirect shares (through the IKA mutual fund), held by social security funds quoted on the Athens Stock Exchange. Holdings of shares will be measured at the end-of-month market value.
 - Direct or indirect holdings of Mutual Fund units issued by Greek management companies (other than the IKA mutual fund). Holdings of holdings will be measured at the end-of-month market value.
 - Holdings of central government bonds, including short and long-term securities issued domestically, long-term securities issued abroad operated from Bank of Greece accounts, and indirect holdings through the IKA mutual fund. Holdings will be measured at nominal value.
 - Financial liabilities include the short and long term loans from the domestic banking system to the social security funds, measured consistently with monetary survey data.

6. **Adjustments.** For the purpose of the program, the primary expenditure of the central government that is monitored excludes payments related to bank support, when carried out under the program's banking sector support and restructuring strategy. Costs that may be excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchases of troubled assets. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff. Further, this performance criterion will be adjusted upward for any possible revenue overperformance in the central government against the current projection as indicated below:

7. Central government revenue (Cumulative from January 1, 2010)

8. June 2010: €25,056 million
9. September 2010: €41,232 million
10. December 2010: €58,382 million.

11. **Supporting material.**

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

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

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

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

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

14. **Definition.** For the purpose of the program, domestic arrears are defined as accounts payable to domestic suppliers past due date by 90 days. Data will be provided within four weeks after the end of the month. The stock of arrears as of end-April stood at 5.6 billion euro.

15. **Supporting material.** The General Accounting Office of the Ministry of Finance will provide data on monthly expenditure arrears of the ordinary state budget, as defined above. Data will be provided within four weeks after the end of the month.

D. Ceiling on the Overall Stock of Central Government Debt (Indicative Target)

16. **Definition.** The overall stock of central government debt will refer to debt that corresponds to the activities of the state budget and will be defined for the purposes of the program as the total outstanding gross debt liabilities of the central government. It will include, but not be limited to, liabilities in the form of securities and loans. The program exchange rate will apply to all non-euro denominated debt. For the purposes of the program, the ceiling on the stock of central government debt will exclude debt arising from payments for bank restructuring, when carried out under the program's banking sector restructuring strategy. This includes loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by the central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff.

17. **Adjusters.** The ceiling on the overall stock of central government debt will be adjusted upward (downward) by the amount of any upward (downward) revision to the stock of end-December 2009 central government debt.

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

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

19. **Definition.** The ceiling on the new central government guarantees shall exclude guarantees to support banks and exclude guarantees related to EIB financed loans.

20. **Supporting material.** All new central government guarantees, excluding from public banks, will be reported in detail, identifying amounts and beneficiaries. The General Accounting Office will provide the data on a monthly basis within three weeks after the end of each month.

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

21. **Definition.** For the purposes of the program, an external debt payment arrear will be defined as a payment by the central government, which has not been made within seven days after falling due. The performance criterion will apply on a continuous basis throughout the program period.

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

G. Overall Monitoring and Reporting Requirements

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

H. MONITORING OF STRUCTURAL BENCHMARKS

24. **Pension reform.** The government has initiated a pension reform which should be adopted by the end of September 2010. In preparing this reform, the authorities will consult with EC/IMF/ECB experts and the National Actuarial Authority will produce a report to assess whether the parameters of the new system significantly strengthen long-term actuarial balance. The draft law for the new and actuarially-balanced system should be available by the end of June, 2010.

25. **Expectations for the Pension Reform.** The reform will:

- Merge pension funds in three funds by 2018.
- Introduce a new system to strengthen the link between contributions and benefits, with uniform rules that will apply pro-rata (as a sum of the accrued rights under the old system and the benefits accrued under the new system) to all current and future workers. Workers retiring in and after 2015 will collect benefits from this system.
- Set the normal retirement to age 65 across all systems, including for those insured before 1993 and women in the public sector, by 2015. After 2020, the normal retirement age will increase in line with life expectancy.
- Restrict early retirement to age 60 by 2011, including for those insured before 1993, workers in heavy and arduous professions, and those with 35 or more years of contributions.
- Index benefits to changes in the consumer price index, starting in 2014 (benefits will be frozen 2010-2013).
- Include a means-tested pension for all citizens older than the normal retirement age so that an important safety net is provided, consistent with fiscal sustainability.
- Lengthens the years over which the pensionable earnings base is calculated from the top 5 out of the last 10 years of earnings to lifetime earnings.
- Review conditions for disability pensions by the end of March of 2011 and introduce stricter conditions for eligibility by December of 2011, including periodic re-examination of those with disability pensions.