

Greece: Staff Report on Request for Stand-By Arrangement

The following documents have been released and are included in this package:

- The staff report, prepared by a staff team of the IMF, following discussions that ended on May 9, 2010 with the officials of the Greece on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 5, 2010. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A Press Release summarizing the views of the Executive Board as expressed during its May 9, 2010 discussion of the staff report for Greece
- A statement by the Executive Director for Greece

The document(s) listed below will be separately released.

Letter of Intent sent to the IMF by the authorities of Greece*

Technical Memorandum of Understanding*

Memorandum of Economic and Financial Policies*

Letter of Intent and Memorandum of Understanding on Specific Economic
Policy Conditionality (European Commission and European Central Bank)*

*Also included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

GREECE

Request for Stand-By Arrangement

Prepared by the European Department in Consultation with Other Departments

Approved by Poul M. Thomsen and Martin Muhleisen

May 5, 2010

Executive Summary

Background:

- The Greek economy is teetering due to heavy public debt and loss of market access.
- The structural fissure is in weak competitiveness—inflation has consistently out-paced the euro average.
- The dual challenge of undertaking very large fiscal adjustment and simultaneously achieving internal devaluation is bound to limit growth for a protracted period, weighing in turn on the banking system.
- Banks entered the crisis with sound liquidity and solvency indicators, but sovereign downgrading dragged them down, and the recession and uncertainty are causing distress.

Main elements of the program:

- Greece is adopting an ambitious comprehensive multi-year adjustment program to lower the fiscal deficit and the debt ratio, reduce domestic demand in line with capacity, and increase supply and competitiveness so that the economy can step onto a higher growth path led by investments and exports.
- In the attached letter, the authorities request a 3-year Stand-By Arrangement under the exceptional access policy and the emergency financing mechanism for €30 billion (SDR 26.4 billion or 3,212 percent of quota) with an initial purchase of €5.5 billion (SDR4.8 billion) available upon Board approval. The euro-zone partner countries are prepared to commit €80 billion with a first disbursement of €14.5 billion. It is an extraordinary international support effort for what needs to be an extraordinary Greek adjustment effort.
- Fiscal policy is frontloaded with measures of 7½ percent of GDP in 2010, 4 percent of GDP in 2011, and 2 percent of GDP in 2012 and 2013, each, to turn around the fiscal position and help place the debt ratio on a downward path. Measures are identified up to 2013. The fiscal deficit is targeted to drop below 3 percent of GDP by 2014, and the debt-ratio would peak at 149 percent of GDP in 2013.
- The program includes provisions to shield low-income households from the brunt of the adjustment effort, including exempting those living on the minimum from the reductions in wages and pensions, and social expenditures will provide the safety net for the most vulnerable.
- Banking problems could intensify, which would magnify fiscal risks. Therefore, a Financial Stability Fund (backed by the international financing package) will be established to ensure adequate capitalization of the banking system. Liquidity pressures would be met, including with ECB support.
- Coordination with the European Commission (EC) and the European Central Bank (ECB) on program implementation and financing will be crucial to the success of the program.
- Risks to the program are high. The adjustment needs are unprecedented and will take time, so fatigue could set in. Any unforeseen shock could weigh on the economy and the banking system even if the fiscal program is on track. Greece needs to persevere to ensure continued international support.

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I. INTRODUCTION

1. **Greece entered the recent crisis with deep-rooted vulnerabilities:**

- **High fiscal deficits and dependency on foreign borrowing fueled demand.** Upon entering the euro area, access to low-cost credit boosted domestic demand, and growth averaged some 4 percent over the period 2000–08. Fiscal policies were pro-cyclical, with tax cuts and increased spending on wages and entitlements worsening the primary balance by nearly 7 percentage points of GDP over this period. Then, in 2009 output dropped by 2 percent and election-driven and partially-unreported spending, amid weak overall expenditure control, worsened the fiscal deficit to 13.6 percent of GDP, straining Greece’s ability to fund itself in the market.
- **High aging and entitlement costs.** Mounting aging-related spending, among the highest in the EU, is a threat to long-term fiscal sustainability. In particular, spending on pensions is projected to increase by 12½ percentage points of GDP over 2010–50, while the health system is severely fragmented and its spending is projected to increase by 4½ percentage points of GDP over the same period.
- **Weak competitiveness, limited supply capacity, and a poor business environment.** Inflation has consistently exceeded the Eurozone average, contributing to an estimated overvaluation of Greece’s real effective exchange rate of 20–30 percent. Competitiveness was further eroded by rigidities in the domestic economy. (Greece scores poorly on OECD and EU indicators for economic efficiency and flexibility.) Competition in internal markets is impaired, particularly in network industries (with large public sector participation) and liberal professions, but other industries have also oligopolistic features that keep margins high. Weakly contested domestic markets result in high costs and poor underlying productivity. Poor governance and regulation depress the potential for inward FDI, which is correspondingly low, while state enterprises are notoriously inefficient.

2. **Thus, Greece needs a strong and sustained adjustment program** to lower the fiscal deficit substantially and create the basis for a declining debt ratio, bring domestic demand in line with domestic supply capacity, and improve competitiveness so that the economy can step onto a higher growth path. The global financial crisis put a spanner in the wheels of the Greek growth model that was overly reliant on public spending. Now the dual challenge of achieving an internal devaluation and strong fiscal adjustment, amid a very difficult funding environment, is bound to weigh heavily on growth for a prolonged period. To avoid feedback loops, the soundness of the banking system needs to be safeguarded with proactive actions to stem potential liquidity pressures and preserve adequate capitalization.

3. **To support their efforts to transform fiscal policies, and the economy more broadly, the authorities have requested a three-year Stand-By Arrangement from the Fund.** The arrangement is in the amount of SDR 26.4 billion (3,212 percent of quota), with SDR 4.8 billion to be made available upon Board approval, and the remainder in twelve installments, subject to quarterly reviews. Program monitoring will be conducted jointly with the EC and the ECB, and Greece's large prospective financing needs will be met by the use of Fund resources and bilateral financial support from eurozone partner countries (Box 1).

**Box 1. Framework for Cooperation between the Fund,
the European Commission, and the ECB**

Close cooperation between the three institutions is crucial in three areas:

Program design

The authorities' program represents a coordinated framework for policy adjustment and financing supported by the EC, the ECB and the IMF. Program discussions were conducted on a quadrilateral basis between the authorities and the three institutions, resulting in a unified and consistent set of macroeconomic and structural policy parameters. These are set out in the MEFP/TMU of the IMF and the MEFP/MoU of the EC (attached for information). The MEFP focuses on macroeconomic policies and selected structural measures, while the MoU covers the full structural reform agenda agreed between the authorities and the EC.

Program monitoring

Conditionality for Fund Board reviews is based on a standard quarterly framework of performance criteria and structural benchmarks. For the EC, conditionality is based on an overall assessment of progress against the structural agenda in the MoU as well as the macroeconomic targets. The EC conducts this assessment in liaison with the ECB, and then makes a recommendation to the Euro Group committee of finance ministers, to approve the disbursement. Conditionality for both the IMF and EC is set on the basis of regular end-quarter test dates, with joint review missions consisting of IMF, EC and ECB staff and with disbursements intended to coincide to the extent possible in a fixed proportion of 3-8 between the Fund and the European financing mechanism, described next.

Financing arrangements

Bilateral support is provided by Greece's 15 partner eurozone countries, in ratio to their shares in ECB capital. The loans will be governed by a single loan agreement between Greece and the euro countries, signed by the EC on their behalf, covering the full three years of the program. The loans will have the same maturities as the Fund purchases, and will carry floating rate interest rates (3-month Euribor) plus a spread of 3 percentage points, rising to 4 percentage points for amounts outstanding beyond three years. Each drawing is subject to a one-off service charge of 0.5 percent. Greece has undertaken to draw on the IMF and EC facilities in a constant 3:8 ratio throughout the program period.

II. RECENT ECONOMIC DEVELOPMENTS

4. **Amid slowing growth and reduced global risk appetite, Greece's heavy dependence on foreign borrowing heightened concerns over long-standing fiscal and external imbalances.** A significant revision to the 2008 and 2009 fiscal deficit data shocked markets because they were twice as large as hitherto projected and revealed misreporting of official statistics (Box 2). Public debt was commensurately increased from below 100 percent of GDP to 115 percent of GDP by end-2009. Further, despite the recession in 2009, the current account deficit stood at 11 percent of GDP—evidence of significant domestic demand inflation and external competitiveness problems. When the new fiscal deficit and public debt data were revealed by the new government, markets reacted by increasing spreads on Greek bonds and lowering credit ratings.

Box 2. Data Misreporting

In October 2009, the new government disclosed that fiscal data were misreported. The deficit for 2008 was revised from 5 percent of GDP to 7.7 percent of GDP. At the same time, the projected deficit for 2009 was revised from 3.7 percent of GDP to 12.5 percent of GDP. After more data became available, the provisional estimate of the deficit for 2009 now stands at 13.6 percent of GDP. The corresponding public debt figure was also corrected from 99.6 percent of GDP to 115.1 percent of GDP at end-2009. Eurostat has not validated these data, highlighting that an upward revision of the 2009 deficit (0.3–0.5 percent of GDP) and the debt (5–7 percent of GDP) are possible. Also, corrections for previous years cannot be ruled out as the Statistical Office is working on classification and methodological improvements.

Consistent with the Fund's procedures, consultations have taken place with the authorities.^{1/} Staff established that the provision of inaccurate information was the result of serious institutional shortcomings (including little public accountability on the side of data producers) as well as problems with data sources. Moreover, as documented by Eurostat, there was political interference with the disclosure of some fiscal operations.

The authorities are taking remedial actions to prevent the reoccurrence of data misreporting in the future. A new law approved in Parliament grants independence to the Statistical Office. Also, the authorities have prepared an action plan jointly with Eurostat (to be endorsed by ECOFIN by mid-May 2010) to improve processes and procedures. The plan is based on 3 pillars:

- **Enhancing the institutional and governance framework of the Greek statistical system** through the swift implementation of the new law establishing the Hellenic Statistical Authority.
- **Strengthening Greek statistical capacity** through a comprehensive capacity building and technical assistance program with active support of the European Statistical System. As part of that program, Eurostat will provide a high-level resident expert.
- **Improving Greek fiscal data** including by assigning clear responsibilities on data collection, quality checks, and data transmission processes through the adoption of memoranda of understanding among providers of data on general government and its subsectors.

^{1/} See rule K-1 report on breach of obligations under Article VIII, Section 5 of the Articles of Agreement (the K-1 report is forthcoming).

5. **Initial attempts by the new government in January 2010 to address these vulnerabilities were not convincing.** Greece was already in the Excessive Deficit Procedure of the SGP and the authorities agreed to reduce the fiscal deficit to below 3 percent of GDP by 2012. The 2010 budget targets, however, were not underpinned by sufficient measures, and the macroeconomic assumptions underlying the deficit correction program appeared too optimistic, failing to calm the market. After extensive consultations with the EC, additional measures were announced in February and March, but these also failed to instill confidence. Lastly, while the authorities took significant cumulative measures, markets were further unsettled by what was perceived to be insufficiently clear financing assurances from euro partner countries.

6. **As a result, concerns about fiscal sustainability deepened and market sentiment weakened further, triggering a confidence crisis.** Access to foreign funding dried up and spreads on government paper took off, threatening in the process the banking system and the economy at large with a downward spiral of unfolding risks.

7. **Despite a strong capital base, the slippage of confidence in the sovereign spilled over into the banking system.** Banks entered this period of heightened turbulence with a strengthened solvency position as capital buffers had been increased from €24 billion to €33 billion during 2009, as a result of the government's banking support package in 2009 in the wake of the global financial crisis, shareholders contributions, and a conservative policy of profit retention. This resulted in an average capital adequacy ratio of 11.7 percent at end-2009 for the whole banking system. However, successive sovereign downgrades by rating agencies and market volatility put pressure on banks' liquidity while the deepening recession caused credit to drop and loan impairments to rise rapidly with NPLs reaching 7.7 percent at year end. This caused a significant decline in profitability across all banks. Amidst increasing funding costs and difficulties in accessing wholesale markets, banks have increasingly used Eurosystem credit for their operations.

8. **Concerns heightened that a worsening of the economic crisis in Greece could precipitate powerful spillovers to other countries.** Immediate contagion channels include: (1) the sovereign debt and financial markets of other eurozone countries with relatively weak fiscal finances as reflected in recent week's market volatility and downgrades; (2) foreign financial sector institutions with substantial exposures to Greek paper; and (3) depositors confidence in Southeastern Europe (SEE) where Greek banks' subsidiaries are important. Beyond these immediate effects, contagion could become extremely unpredictable, including serious risks to the still fragile world recovery.

III. OVERALL STRATEGY

9. **The authorities' program focuses on the three key challenges:**

- **Restoring confidence and fiscal sustainability:** the program envisages an exceptionally strong frontloaded fiscal effort, with fully identified measures through 2013. This is to bolster confidence, regain market access, and put the debt-to-GDP ratio on a declining path from 2013.
- **Restoring competitiveness:** the program includes nominal wage and benefit cuts and structural reforms to reduce costs and improve price competitiveness, which would help Greece transition to a more investment and export-led growth model. It also envisages improved transparency and a reduced role of the state in the economy.
- **Safeguarding financial sector stability:** As the banking system goes through a period of disinflation, which is expected to impact profitability and bank balance sheets, tools for dealing with solvency pressures will be expanded by establishing a Financial Stability Fund (FSF). To mitigate potential liquidity pressures, the existing government banking liquidity support facilities will be extended. The ECB's recent suspension of the application of the minimum credit rating threshold in the collateral eligibility requirements on debt instruments issued by the Greek government will also serve as a useful liquidity backstop.

10. **The authorities' exceptional efforts are envisioned to be met with exceptional financial support from the international community to allow the government time to turn the economy and the fiscal balance around.** Under the baseline macroeconomic framework, strict adherence to program policies with the strong support by the international community should allow a gradual rebuilding of market access at reasonable spreads.

IV. MACROECONOMIC FRAMEWORK

11. **Transitioning toward a more sustainable model for the Greek economy will take time.** Fiscal consolidation needs are large, and will have to be sustained over several years. With no recourse to the exchange rate to kick-start relative price changes, Greece needs to rely on internal devaluation—usually a long and painful process. Given the relatively closed economy, fiscal multipliers are bound to be large and the foreign sector too small to bring about a quick export-led growth response. In addition, the external environment is expected to remain weak in the short term, and structural reforms to boost the supply response will take time to be implemented and bear fruit.

12. **Real GDP growth is expected to contract sharply in 2010–11 and recover thereafter.** Growth is expected to follow a V-shaped pattern: the frontloaded fiscal

contraction in 2010–11 will suppress domestic demand in the short run; but from 2012 onward, confidence effects, regained market access, and comprehensive structural reforms are expected to lead to a growth recovery. Unemployment is projected to peak at nearly 15 percent by 2012.

13. **Inflation is expected to remain below the euro average.** The needed adjustment in prices is expected to come from domestic demand tightening, both through fiscal adjustment and efforts to moderate public wages and pensions, and other costs in the economy. Demonstration from improved public wage dynamics should contribute to a moderation of private sector wages. This will help restore price competitiveness over time.

Greece: Selected Macroeconomic Indicators, 2009-2015
(Percentage change; or percent)

	2009	2010	2011	2012	2013	2014	2015
Nominal GDP growth	-0.7	-2.8	-3.1	2.1	2.8	3.1	3.8
Real GDP growth	-2.0	-4.0	-2.6	1.1	2.1	2.1	2.7
CPI inflation	1.3	1.9	-0.4	1.2	0.7	0.9	1.0
Employment growth	-1.4	-2.6	-3.2	-0.2	0.7	0.3	0.9
Unemployment rate	9.4	11.8	14.6	14.8	14.3	14.1	13.4
Per capita real GDP growth	-2.2	-4.2	-2.7	1.0	2.1	2.0	2.6

Sources: Greek authorities; and Fund staff projections.

14. **The current account deficit is expected to narrow gradually.** As domestic demand and inflation moderate and the economy responds to structural reforms, dependence on imports should decrease and export supply improve. However, continued high interest costs on the large accumulated external debt will prevent a swifter reduction in the headline current account deficit.

15. **The authorities broadly agreed with the overall macroeconomic outlook.** They acknowledged that the frontloaded adjustment will dampen growth sharply in the short term but, with necessary reforms, would help engineer a faster recovery later on. They agreed that price adjustment was needed but thought adjustments in the private sector should come mainly through productivity improvements (linked to the intended reform agenda) rather than from measures to reduce private sector wages.

Greece: Selected External Indicators, 2009-2015
(Percent of GDP, unless otherwise indicated)

	2009	2010	2011	2012	2013	2014	2015
Current account balance	-11.2	-8.4	-7.1	-5.6	-4.0	-2.8	-1.9
Primary current account 1/	-5.4	-1.1	2.1	3.8	4.9	5.7	6.1
International Investment Position	-86	-95	-104	-106	-106	-105	-102
Real export growth 2/	-18.1	4.5	5.4	5.9	6.0	5.9	6.0
Real import growth 2/	-14.1	-9.7	-6.1	1.6	3.8	4.6	3.7

Sources: Greek authorities; and Fund staff projections.

1/ Excluding interest payments.

2/ National accounts basis. Percentage change.

V. THE PROGRAM: POLICY DISCUSSION

A. Fiscal policy

16. **The authorities and staff agreed that fiscal adjustment should be frontloaded and aimed at reducing the debt-GDP ratio from 2013 and the general government deficit to well below 3 percent of GDP by 2014.** This would bring the primary balance to its medium-term target of 5–6 percent of GDP, essential to secure a rapidly declining debt ratio (Annex 1). The total package of fiscal measures (11 percent of GDP during 2010–13, in addition to the 5 percent of GDP in measures already adopted in 2010) is very large, but necessary to counteract the poor starting position of very high deficits and debt, the sharp erosion in market confidence, higher interest payments, and the cyclical impact on revenue and expenditure. Moreover, structural aging-related spending pressures also add to this mix.

17. **The authorities' adjustment package of 11 percent of GDP through 2013 is based on five prongs (Box 3):**

- **Frontloading and full identification of measures.** The annualized effect of the new 2010 measures will account for 3½ percent of GDP, in addition to the 5 percent already in place. Strong frontloading is expected to minimize implementation risk, avoid adjustment fatigue, and rebuild confidence swiftly. All of the measures have been identified. However, staff stressed that their yield will need to be reassessed at subsequent reviews, pending progress in supporting reforms.
- **Mostly permanent measures.** Of the 11 percent of GDP, only about 0.5 percent of GDP relates to measures that will expire by end-2013 (temporary crisis levies).

Box 3. The Adjustment Measures

Expenditure measures are estimated at 5.2 percent of GDP. The elimination of the Easter, summer, and Christmas pensions and wages, as well as cuts in allowances and high pensions are frontloaded and will, by themselves, yield 2 percent of GDP of the 11 percent total package. Other expenditure cuts involve employment reductions, cuts in discretionary and low priority investment spending, untargeted social transfers, consolidation of local governments, and lower subsidies to public enterprises.

Revenue measures add another 4 percent of GDP to the package. This includes an increase in the standard VAT rate from 21 to 23 percent and the reduced rate from 10 to 11 percent, moving lower taxed products such as utilities, restaurants and hotels to the standard VAT rate, and increasing excises on fuel, cigarettes, and tobacco to bring them in line with EU averages. Those measures yield 2.1 percent of GDP. The remaining measures cover higher assessment of real estate; a temporary crisis levy on profitable firms; presumptive taxation; taxes and levies on unauthorized establishments and buildings; and new gaming royalties and license fees.

Structural fiscal reforms would yield 1.8 percent of GDP in 2013. This includes the results from improvements in budget control and processes (lowering expenditure), and also from improved tax administration (increasing revenue buoyancy). Because it is difficult to quantify the results from structural fiscal reforms, their budgetary effects have been reserved for the end of the program in 2013, but they could give some earlier upside adjustment potential. (Table 1 of the LOI/MEFP includes these effects as expenditure measures.)

These measures protect the most vulnerable. Through means-tested benefits, low-income retirees (nearly two-thirds of retirees of the largest pension fund) are protected from the elimination of the Easter, summer, and Christmas bonus; surcharges to high pensions apply only to the top 10 percent of pensioners; low-earners in the public sector would receive means-tested bonuses to offset the suspension of the Easter, summer, and Christmas payments; cuts in allowances are concentrated in high earners. Additionally, the increase in the basic VAT rate—which is applied to food and likely to affect all groups of the population—is only one percentage point, compared to two percentage points for the standard rate.

Greece: Composition of Measures
(Percent of GDP)

	2010	2011	2012	2013	Cum.
Total	2.5	4.1	2.4	2.0	11.1
Revenue	0.5	3.0	0.8	-0.3	4.0
Excises	0.2	0.3	0.1		0.6
VAT	0.3	0.9	0.2		1.5
PIT		0.2	0.0		0.2
CIT		0.4			0.4
Property tax		0.8	0.1	0.0	0.9
Other		0.4	0.3	-0.3	0.4
Expenditure	2.0	1.1	1.7	0.5	5.3
Wages	0.5	0.2	0.3	0.2	1.2
Pensions	0.8	0.3	0.1	0.1	1.3
Social benefits	0.2	0.0	0.2		0.4
Consumption	0.3	0.4	0.2	0.2	1.1
Subsidies			0.7		0.7
Investment	0.2	0.2	0.2		0.7
Structural reforms				1.8	1.8

Sources: Greek authorities; and Fund staff projections.

- **Balancing revenue and expenditure measures.** On the one hand, taxes need to be increased, especially from those sectors of society who have previously not carried their fair share of the burden. On the other hand, there is a strong need to scale back the public sector, including public employment and social transfer payments, which together amount to 75 percent of non-interest expenditures. Without a balanced combination of revenue and expenditure effort, it would be difficult to achieve the large adjustment required in the fiscal accounts.
- **High quality measures.** Revenue measures have been designed to broaden tax bases, improve the structure and equity of the tax system, and limit the impact on growth. Already the recent tax reform has made the system fairer and more progressive, reducing exemptions and introducing presumptive taxation for those professions that have tended to escape the tax net. Additional measures focus on consumption, green and health taxes, exploiting the previous underused property and excise taxes and imposing a heavy burden on the higher income segments of society. On expenditure measures, the reduction in public sector nominal wages and pensions is path breaking and should help improve competitiveness as the government is a wage leader in the economy. On other spending cuts, staff stressed that firm implementation of the structural reform agenda, including on public enterprise restructuring, and the important and large scale local administration reforms¹ will be key to ensure that those cuts are sustainable.
- **Ensuring a fair adjustment burden sharing and protecting vulnerable groups.** Revenues are made more progressive by including different elements of labor income in a single harmonized personal income tax base, and the marginal personal income tax schedule has been steepened. Further, the government is utilizing more heavily presumptive taxation to capture more of those who previously were able to stay outside the tax net. On the expenditure side, specific measures are in place to protect the most vulnerable persons in society. For instance, the lower income pension earners are shielded from the elimination of the 13th and 14th pension payment by receiving a compensatory flat annual benefit. This is also the case for low-income civil servants who would otherwise be affected by the wage cuts. Higher income pensioners and civil service have their incomes reduced by more than the average to pay for the compensation at the lower income end. Indeed, the minima have been protected.

18. **The large share of upfront measures should help reduce implementation risks to the fiscal program.** Nevertheless, risks remain, including lower revenue due to weaker

¹ The subnational government reform involves government and local government entity mergers and consolidation and is ambitious. When fully implemented, it should reduce the number of elected and appointed officials from around 50,000 to some 25,000.

growth, higher social transfers, additional financial sector and public enterprise liabilities, and fiscal data weaknesses. However, the program is built on cautious estimates for the yield from structural fiscal reforms, in particular from revenue administration, and the government has committed to cut discretionary spending further, if needed, to safeguard its fiscal deficit targets. Continuous technical support by the international community to strengthen institutions will be provided to minimize implementation risks. Should revenue turn out higher than projected, the authorities will save the overperformance to achieve a faster return to fiscal sustainability and debt reduction.

Greece: Medium-term fiscal strategy
(Percent of GDP)

	2008	2009	2010	2011	2012	2013	2014	2015
Passive without measures								
Revenue	40.6	36.9	40.0	39.0	38.5	38.2	37.2	36.3
Noninterest expenditure	43.7	45.4	44.9	46.6	46.5	46.0	43.9	42.5
Measures cumulative			2.5	6.7	9.0	10.9	12.6	12.2
Primary balance	-3.2	-8.6	-2.4	-0.9	1.0	3.1	5.9	6.0
Interest	4.6	5.0	5.6	6.6	7.5	8.1	8.4	8.1
Overall balance	-7.7	-13.6	-8.1	-7.6	-6.5	-4.9	-2.6	-2.0
Cyclical fiscal balance	-5.9	-10.0	-2.4	0.8	2.8	4.6	7.2	7.1
General government debt	99	115	133	145	149	149	145	139

Sources: Greek authorities; and Fund staff projections.

19. **The authorities plan a crucial pension reform in 2010.** The reform will introduce a new system consisting of a contributory pension to top-up a non-contributory, means-tested pension. The new system will continue to be financed in a pay-as-you-go basis. The planned reform would contain spending by reducing replacement rates (from an average of 75 percent of wages to 60 percent), limiting early retirement (benefits will only be available starting at age 60 for all workers), increasing the normal retirement age in line with life expectancy, and indexing benefits to prices. If these measures are fully implemented, the reform would reduce the increase in pension spending over 2010–50 from 12½ percentage points of GDP to less than 4½ percentage points. Risks stem mainly from partial implementation—using more generous parameters or a slower transition—as many of the details are not yet decided (Annex 2). Therefore, staff recommended an actuarial report to be produced by the National Actuarial Authority to verify the long-term impact of the reform proposal on pension system sustainability before proceeding fully with the new system.

20. **The authorities are giving priority to improving management of the health sector, especially of hospitals.** The authorities acknowledged health spending has been one of the main culprits of recent fiscal slippages. Thus, following a recent IMF TA mission, they agreed on the need to close budget loopholes and force arrears to be reported to

Parliament as they develop (currently they are revealed only about every three or four years, when governments tend to turn over, and no aggressive policy response is discernible). Staff urged the government to immediately start the implementation of double-entry accrual accounting in hospitals, the periodic publication of audited accounts, and the improvement in pricing and costing mechanisms. Additionally, as part of the pension reform, health funds would be separated from pension administration, including achieving a better delineation of tasks and accountability. In the medium term, health-related activities need to be unified under one ministry.

21. Further progress in revenue collections and spending monitoring is critical to the successful implementation of the program.

- **There is an urgent need to strengthen data reporting and the budgetary framework.** The authorities agreed that this was critical to restore confidence in fiscal policy formulation and for monitoring the implementation of their consolidation plans. They also agreed that it was important to reprioritize some of the reforms that they already had underway, including efforts to set up an advanced system of program budgeting, which would be too far-reaching for Greece at this moment. Thus, they intend to focus more on the most urgent challenges. They acknowledged that fiscal monitoring needs to be strengthened, including through better budget preparation and approval, a top-down and medium-term focus, and improved commitment controls that are critically lacking. The authorities' planned reforms address the key issues, and the amendment of the budget law will be timely for these reforms to become effective for the preparation of the 2011 budget. Follow-up technical assistance from the Fund and the EC will assist the authorities in the continuous implementation of these reforms.
- **Improvement in tax administration is also crucial to support fiscal consolidation.** Given the wide tax evasion and corruption in tax administration, staff agrees that there is a large revenue base which should be exploited to make the tax system more equitable, efficient, and to increase collections. Effective implementation of the authorities' recent tax collection initiatives will be key, which should be integrated within a well-targeted anti-evasion plan and reforms in tax administration. However, many of those reforms take time. With this in mind, and as noted above, there was understanding that the yield of those reforms would best be considered later in the program once they were showing material results. Technical assistance from the Fund will help the authorities in this reform process as well.

B. Structural Policies

22. Greece needs a strong program of structural reforms to restore competitiveness and growth. Greece's price competitiveness gap reflects high administrative costs and inefficiencies, high margins in several sectors, and rising labor costs. Thus, reforms will

focus on streamlining public administration and making it more transparent, improving the business climate and seeking better contested markets throughout the economy. Further, to complement public sector pay restraint, the authorities are taking measures to improve wage flexibility in the private sector. The authorities' agenda in these areas is significantly shaped by long-term discussions and efforts with the EC, as reflected in the broad range of measures covered in the EC MoU annexed to this paper.

- **Public administration.** A reorganization of sub-central governments and public entities will be implemented to reduce the number of local administrations, entities and elected and appointed officials. The authorities also plan to reduce risks stemming from state-owned enterprises through greater transparency and to enhance accountability. They further agreed it was necessary to review which state-held assets could be divested in the context of improved asset-liability management with a view to reduce the role of the state in the economy, and improve flexibility and cost competitiveness. Therefore, they intend to publish financial statements of large loss-making state companies, and also prepare a plan to divest state assets to help reduce public debt (structural benchmark for December 2010).
- **Incomes policy.** The legal framework for wage bargaining and arbitration in the private sector will be reformed, and entry-level wages will be introduced below the current statutory minimum wage to assist the young and long-term unemployed to find jobs. Employment protection legislation will be revised to facilitate entry and exit in the job market, including for part-time workers, where Greece has ample potential to boost employment.
- **Business environment and competition.** The authorities will move forward with a plan to cut red tape facing firms, including by establishing one-stop shops for business start-ups. They will also tackle tariff and other restrictions in important professions (including notaries, road haulage, and in legal, pharmacy, engineering, architect, and auditing professions) where distortions, tax evasion, and excessive cost burdens are known to hamper market functioning. Network industries will be progressively liberalized, the competition authority strengthened, and the EU Services Directive forcefully implemented. Improvements in the absorption of EU structural funds will help bolster the productive capacity of the economy.

C. Financial Sector Policy

23. **The immediate challenge for the banks is to manage carefully the current tight liquidity conditions.** Greek banks have lost wholesale market access to fund their operations since end-2009 as a result of market concerns about the sovereign debt. Maturing interbank liabilities have not been renewed, or only at high costs, some moderate deposit outflows took place during the first months of 2010, and prices of pledged collateral have fallen, putting pressure on the liquidity position of many banks. As a result, reliance on ECB

liquidity has increased. To assist the banks, the government has extended the support package of early 2009 (the portion that was not used at that time), to provide a substantial €17 billion in additional liquidity and is implementing another extension of this support facility, subject to approval by the EC. The announcement by the ECB on May 3 that market debt instruments issued or guaranteed by the Greek government will remain eligible as collateral for repo transactions, independent of rating agencies grading, is anticipated to provide significant relief from liquidity pressures. In the highly unlikely case that these measures were to be insufficient, the existing Eurosystem framework also includes adequate options for national central banks to give support to temporarily illiquid, but solvent institutions against adequate collateral. If such support were given by the Bank of Greece, it would be fully guaranteed by the Greek state in a manner that is consistent with relevant ECB and EU requirements.

24. **An additional safety net will be provided by the creation of a FSF.** The FSF will bolster confidence in the banking sector by offering additional capital support (Box 4). Declining profitability and the possibility of losses in what could be a drawn-out recession has the potential of eroding capital bases. Thus, the authorities are establishing, through specific legislation, and in consultation with the EC, the ECB, and the IMF, a fully independent FSF funded by the government out of the resources available under the IMF/EC resources under the program (a structural benchmark for end-June). Taking into account the amounts provided by the Fund and the eurozone under the program, the overall resources available to the authorities will be sufficient to fund the FSF. The FSF will have governance arrangements in place that ensure the safeguarding of international financial resources.

25. **The primary purpose of the FSF is to ensure that banks in Greece remain adequately capitalized during the downturn to preserve stability.** If supervisory assessments conclude that a bank's capital buffer might fall below adequate levels, shareholders will be invited immediately to bring additional capital or take bridging capital support from the FSF. The capital support program would provide equity to banks in the form of preferential shares that could convert to ordinary shares. When banks are not able to repay the capital support after an adequate amount of time, a restructuring process will be devised for the credit institution. Should the bank fail to meet the targets during the restructuring policies, the shares will be converted at a price in line with EU requirements for competition and state aid.

26. **Resources dedicated to banking supervision will be increased to allow for increased supervision.** The frequency and speed of data reporting will be increased and the framework for conducting stress-testing of financial institutions will be enhanced. Staffing will be increased both for on-site inspections and off-site review, 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.

Box 4. The Financial Stability Fund

Sovereign downgrades, increasing loan impairment, and the deteriorating economic outlook have undermined confidence in the Greek banking sector. The sharp slowdown in economic activity is expected to reflect negatively on banks' profitability, with the potential of eroding capital bases. To safeguard the soundness of the financial sector, the FSF will be set up to provide banks with a safety net in the event additional capital resources cannot be found from the private sector.

The new entity would provide capital support to the banks through the purchase of preference shares. Such instruments will be convertible in ordinary shares and will have the benefit of strengthening the core capital base of banks. In this way, participation of the FSF in the shareholder base of the banks will be limited, in the first instance. By providing investors with a credibly stronger equity base, it will facilitate banks to re-access capital markets for financing and thus limit recourse to Eurosystem facilities.

After an appropriate amount of time, if the preference shares have not been repaid, the FSF would require a restructuring plan. This would be consistent with the EU legislation requirements for state aid and fair competition. The restructuring plan will be devised by the FSF specifically for the credit institution, in consultation with the Bank of Greece. Should the financial targets set under the restructuring plan not be complied with, the FSF will have the power to convert the preference shares into ordinary shares. The conversion price will be determined by applying the principles of EU legislation on state aid and fair competition.

The FSF will manage its participations in the banks with a view to sell all its holdings in a limited timeframe and to maximize sale proceeds. The FSF will have a duration limited to 7 years to de-couple it from the political cycle. It will make use of its shareholder rights to steer the board of the credit institution in a direction which would maximize its market value. Any shares remaining in the FSF at the time it ceases its activities will be transferred to the MoF.

The MoF will fund adequately the FSF from the proceeds of the IMF-eurozone credit disbursement to Greece. The amount of funds destined for the FSF will be €10 billion, which would accommodate expected losses under a stress-test scenario. The resources made available by the eurozone and the IMF under the program are more than sufficient to cover this amount

The FSF will be independent, transparent and accountable. Appointees by the Bank of Greece, the Governor of the Bank of Greece, and the Ministry of Finance will sit on the board, while the appointees by the ECB and the EC will have the right to participate in board meetings as observers. The power of the Governor of the Bank of Greece to nominate its director is expected to give it some distance from domestic treasury operations. However, the FSF will report regularly to the Greek parliament, the EC, the ECB, and the IMF staff.

27. **The authorities intend to strengthen additional elements of the legal framework to promote efficient intermediation.** The current proposal for the personal insolvency law will be strengthened to ensure that strong credit discipline is maintained, creditor and consumer rights are protected, and important information concerning borrower's history is not lost.

28. **The authorities will maintain close coordination with home and host country authorities within the EU framework of cross border banking supervision.** A number of MOUs have been signed with host supervisory authorities to clarify and strengthen supervisory arrangements in countries where Greek banks have a significant presence, notably in SEE.

VI. PROGRAM MODALITIES

A. Access, Phasing, Conditionality

29. **The authorities request a three-year SBA in an amount equivalent to SDR 26.4 billion, or 3,212 percent of the quota (€30 billion), with a frontloaded disbursement of €5.5 billion²; the eurozone members are expected to contribute €80 billion to the overall financing package.** With this large backstopping of exceptional financing from the eurozone and the Fund, the program assumes that the government would continue to issue T-bills for the program period (keeping the stock at around €8 billion), but the rollover of medium- and long-term debt from the private sector will only be gradually restored, starting in 2012. The total external financing gap for the fiscal program is projected to be around €110 billion, within which resources for the FSF are expected to be €10 billion. In the event that the program unlocks a better-than-projected private sector response, program financing could be reduced, *pari passu* with eurozone countries' assistance. Greece's external debt service profile will give rise to a substantial need on the part of the authorities to make external payments over the program period that will be met, in part, from the purchases from the Fund.

30. **The scope for increasing market access will be explored.** The strength of the program and the scale of official support are expected to catalyze market access over time as the authorities demonstrate their success in adhering to the program. There may be scope to bolster this by seeking coordinated voluntary rollover understandings among creditor groups (similar in spirit to the European Bank Coordination Initiative), although the dispersion of government debt holdings may make it difficult to build a critical mass for such understandings. Prudent debt management could also help lengthen debt maturities to reduce bunching in the post program period. Banks largely rely on a traditional deposit-based model, and reliance on foreign funding, with the exception of overnight

² Reflecting the phasing of the fiscal gap.

funding, is relatively low, so potential gains from coordinated rollover initiatives for the financial sector may be modest.

31. **Program conditionality is focused on comprehensive monitoring of the fiscal performance.** Quantitative performance criteria include ceilings on the primary deficit of the central government (or state) budget and changes in financial asset of the social security funds and local authorities in the banking system; the level of primary current expenditure; and new government guarantees. In addition, the program will seek to gain better insight in the performance of key public enterprises, beginning with publication of their financial accounts.

32. **Given the large structural reform agenda with leadership of the EC, structural benchmarks for the Fund-supported SBA are set on fewer but more macrocritical reforms.** They include modernizing public administration, streamlining the local authorities, improving data reporting and budget framework, reforming social security, reducing risks from the state-owned enterprises, and enhancing tax administration.

B. Exceptional Access Criteria

33. **The proposed Stand-By Arrangement entails exceptional access.** Staff's evaluation of the criteria for granting exceptional access is as follows:

- **Criterion 1:** *The member is experiencing or has the potential to experience exceptional balance of payments pressures on the current account or the capital account resulting in a need for Fund financing that cannot be met within the normal limits.* This criterion is met as heightened market concerns have led to a sharp increase in sovereign spreads and, as a result, market access is restricted to an extent that would make it impossible to cover financing needs within normal limits. Greece's large rollover requirements on maturing foreign obligations result in significant pressures on the capital account.
- **Criterion 2:** *A rigorous and systematic analysis indicates that there is a high probability that the member's public debt is sustainable in the medium term.* Under the staff baseline, public debt will increase to almost 150 percent of GDP and then decline after 2013, provided that the authorities continue to implement strong and sustained fiscal and structural reforms to comply with their commitments under the Stability and Growth Pact, and Greece regains market access at favorable terms. However, significant uncertainties remain. The initial level of government debt is very high (115 percent of GDP in 2009), it may be revised upwards by 5–7 percentage points according to Eurostat, and the realization of hidden and potential liabilities may increase it further. Moreover, debt dynamics may significantly worsen under weaker economic growth, lower inflation, or higher real interest rates, in particular after the program period when gross market financing

needs increase significantly. On balance, staff considers debt to be sustainable over the medium term, but the significant uncertainties around this make it difficult to state categorically that this is the case with a high probability. Even so, Fund support at the proposed level is justified given the high risk of international systemic spillover effects. Going forward, such an approach to this aspect of the exceptional access policy would also be available in similar cases where systemic spillover risks are pronounced.

- **Criterion 3:** *The member has prospects of gaining or regaining access to private capital markets within the timeframe when Fund resources are outstanding.* This criterion is met. Greece's reduced access to capital markets reflects heightened sustainability concerns, linked to its precarious fiscal situation and problems with fiscal data reporting, and a re-evaluation of sovereign risk following the global financial crisis. Successful implementation of a strong program, in combination with undertakings of Greece's EU partners to stand ready to provide financial assistance, would help address market uncertainty. With improved fiscal management and structural reforms, Greece is expected to gain policy credibility and normalize access to capital markets within the timeframe when Fund resources are outstanding.
- **Criterion 4:** *The policy program provides a reasonably strong prospect of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.* While Greece's past track record of structural and fiscal reform implementation is mixed and the adjustment needed is large, a number of considerations lead staff to conclude that this criterion is met. In particular, the current government, since taking office in October, has already implemented strong measures and demonstrated its willingness to tackle the challenges ahead. Additionally, the economic reforms that would be supported by a Fund-supported SBA are backed at the highest political levels in both Greece and among its EU partners—the politically most difficult measures are being passed by Parliament before Board approval. Finally, the government's institutional capacity to deliver the program's adjustment will also be strengthened by ongoing technical support from the Fund and the EU.

C. Capacity to Repay the Fund and Risks to the Program

34. **With disciplined program implementation, Greece's debt is expected to be sustainable in the medium term, and its repayment capacity to be adequate.** Given no outstanding use of Fund resources, the Fund's cumulative exposure to Greece will remain manageable, albeit high, by the end of the program. Outstanding credit to the Fund is expected to peak in 2013 at about 12 percent of GDP, and debt service to the Fund as a ratio of exports of goods and services will peak at 17 percent (Table 8). However, overall debt service will rise sharply after the program: payments to both the Fund and EU would peak at 62 percent of exports of goods and service, and about 17 percent of GDP in 2015. These

metrics suggest that successful access to the market will be critical for Greece's repayment capacity to the Fund. Tapping the markets earlier and active debt management can help to smooth the repayment profile. At the same time, the risks to the Fund are mitigated by the long-standing Fund's preferred creditor status in relation to other private and official bilateral creditors. In addition, fiscal adjustment and the resumption of growth are expected to offer powerful assistance to place the debt on a declining path from 2013 onwards.³

35. **That said, there are also substantial risks to the program.** Restoring competitiveness through internal price adjustment while implementing fiscal consolidation is very challenging, and the margin to respond to negative shocks is limited at this early stage.

- **Growth may be weaker than projected.** Given the size of adjustment effort and still a tentative external growth environment, Greece may experience a deeper upfront contraction. While a moderate shock could be accommodated, persistently weaker growth would have a powerful negative effective on debt dynamics (Annex 1 and Annex 3).
- **The large multiyear fiscal and structural adjustment requires a decisive break from past behavior.** Greece has run into fiscal problems before, which were often resolved only temporarily and by stop-gap measures. A decisive break now requires strong political will and public support. Mitigating factors include a strong mandate of the governing party and measures in the program to protect vulnerable groups.
- **Debt sustainability analysis** assumes that the headline primary surplus will improve on a sustained basis by 2.9 percentage points after the end of the program, as agreed between the authorities and eurozone partners. The public debt would still decline, but at a much slower pace, with smaller primary surpluses.
- **Restoring market access.** Greece's access to private capital markets in 2012 and later years may be more constrained than has been assumed, particularly under any of the adverse shocks shown in the debt sustainability analysis.
- **Absent exchange rate flexibility,** sustained wage discipline by both the public and private sectors is required to improve competitiveness. With weak growth, the needed increase in public and private savings will be challenging.
- **The side effects of the adjustment could make fiscal consolidation difficult.** Wage and price deflation, and contraction in activity could lead to sharp reductions in tax revenues.

³ See FIN's paper on the Assessment of the Risk to the Fund and the Fund's Liquidity Position.

- **Financial sector conditions could deteriorate quickly, bringing with it sizable fiscal consequences.** Low growth, deteriorating asset quality, and higher funding costs could all weigh on the banking sector. Potential bank solvency problems may require more public resources in resolution, which would further increase the government's debt burden. There is also a risk of a loss of confidence in banks leading to rapid liquidity needs. The establishment of the FSF and the availability of liquidity support from the ECB and the Bank of Greece will help to manage these risks.
- **Data weaknesses continue to pose a risk.** While the authorities are making strong efforts to address data reporting deficiencies,⁴ the accuracy and reliability of fiscal and national accounts data remain a concern, and they have continued to be revised significantly. Also, frequent revisions in the level and composition of GDP affect the calibration of the fiscal program and assessment of the strength of policies. Staff will monitor implementation of the measures in the joint Greek government and European Commission Statistical Action Plan to address these concerns. Assistance from a resident technical advisor (financed by the European partners) and close cooperation with Eurostat will help to assess and manage these data risks. The authorities have also agreed to host a Fund resident representative.
- **Coordination with EC and ECB may pose complications.** To help ensure that all institutions have consistent views in assessing program performance, the joint IMF/EC/ECB team will remain in close contact between missions, so that differences of view and assessment of developments can be identified and aired early and reconciled.

36. **In accordance with Fund policy, staff has initiated the safeguards assessment of the Bank of Greece, and the assessment is expected to complete by the time of the first review.** IMF funds will be deposited in the government account at the Bank of Greece.

VII. STAFF APPRAISAL

37. **Mounting concerns that the authorities are not coming to grips with the entrenched dual problem of lack of competitiveness and a highly unsustainable fiscal position has led to a loss of market access.** Greece has also lost access because of increasing doubts about whether its eurozone partners stood ready to provide timely and effective support.

38. **The new Greek authorities have risen to the challenge by embarking on a bold multi-year program that is extraordinary in terms of the scale of planned adjustment**

⁴ See K-1 report.

and the comprehensiveness of reforms. Greece's European partners, in cooperation with the IMF, are responding with an equally extraordinary three-year promise of unprecedented financial support to help see Greece through what will undoubtedly be a socially difficult period of adjustment and reform.

39. **The fiscal program is impressive.** The scale and the frontloading of the adjustment are unprecedented. Moreover, the decision to specify all measures for the entire full three-year period at the outset, together with the good balance between revenue and expenditure measures, adds to the program's credibility. So does the reliance in the first two years on concrete measures that have an easily projected impact. Thus, while Greece stands to reap significant gains from reforms to tax administration and expenditure controls, such gains are invariably difficult to project, and the program's assumptions in this regard are appropriately conservative.

40. **Staff strongly welcomes the ECB's recent decision regarding Greek government bonds.** This decision in effect ensures markets that such bonds will remain eligible for repo transactions, removing a serious uncertainty that had continued to weigh on banks' willingness to hold such bonds. With this change, the liquidity facilities available to Greek banks, including the mechanism for provision of emergency liquidity through the Bank of Greece, are in staff's view appropriate.

41. **While Greek banks have weathered the global crisis well and are comfortably capitalized, the decline in economic activity that lies ahead could expose vulnerabilities.** The establishment of a FSF that stands ready to inject funds in the case that a bank's capital gets impaired is a very important precautionary measure. The management of this fund must consist of independent experts, to ensure that affected banks quickly return to viability.

42. **The program's long-term success hinges on deep and comprehensive structural reforms**—to make labor markets much more flexible, to eliminate pervasive barriers to entry and unleash competition, and to reform state enterprises, among other important goals. Without such reforms, Greece would not restore competitiveness, growth and real incomes will remain stagnant and unemployment high, and the debt burden would eventually prove unsustainable. The authorities' structural reform program is ambitious, concrete and time-bound plans remain to be fully specified in important areas. In this regard, staff finds privatization plans disappointing and is concerned that plans for reform of state enterprises are weak. While the government's focus has understandably been on the immediate fiscal measures needed to restore market confidence, it must now focus attention on structural reforms, building on the considerable diagnostic work that already has been done in this area in cooperation with the EC.

43. **The authorities feel that reforms to boost productivity will be key to restoring competitiveness and that the level of wages in the private sector is less of a problem in**

this regard. They, therefore, decided not to extend the elimination of the 13th and 14th wages in the private sector, or to undertake other top-down measures to lower wages. Staff agrees that reforms are crucial, but believes—considering the time that it will take for them to take hold—that it is also necessary for private sector wages to decline in order to restore competitiveness. Staff agrees that wage reduction is likely to occur without top-down measures as economic activity declines and labor market pressures ease in the coming years, but such measures should be contemplated if this were not to be the case.

44. **The adjustment that lies ahead will be socially painful.** While all segments of Greek society will feel the burden, staff strongly welcomes the measures to mitigate the impact on the most vulnerable groups, not least the decision to shield people with low wages and pensions from the impact of wage and pension cuts.

45. **The strength and frontloading of the program creates the basis for a rapid improvement in market sentiments.** A challenge in this regard is that—with no recourse to exchange rate changes and because the economy is relatively closed—the large fiscal adjustment will be associated with a notable decline in nominal GDP and an attendant contraction in the tax base, causing debt-to-GDP to rise initially from an already high level, before beginning to decline at the end of the program period. However, the sharp improvement in the primary balance—it will turn positive already in 2012 after a deficit of 8.6 percent of GDP in 2009—points to an early, rapid underlying improvement. And as reforms begin to engender a supply response, the debt-to-GDP ratio will begin to decline apace.

46. **Nevertheless, the scale of the challenge facing the authorities means that it could take some time for markets to regain confidence.** Should this be the case, the size of the external support implies that the authorities have 1–2 years to demonstrate resolve and built a convincing track record before they need to return to the market. The combination of strong frontloading of measures and large external support is in staff's view key to the program's credibility.

47. **Still, there are obvious risks.** Fierce resistance from entrenched vested interests has stalled reforms in the past and the burden of adjustment will test the cohesiveness of Greek society. Downwardly rigid private sector wages and prices given inflexible markets are a further risk, as is the possibility of yet higher interest rates. Further, loss-making public enterprises could yet present additional pressures on the budget, and risks to banks are also acute until confidence in a strong downward path for the fiscal deficit takes firmer hold. External risks include the possibility of negative spillover from other highly indebted countries in the region. As the high indebtedness leaves little room for maneuver, the government must stand ready to take early and forceful corrective actions to make sure that the program remains on track. In this regard, the very strong measures taken by the government in early 2010—before entering into discussions on a program that could be

supported by eurozone countries and the Fund—is evidence of its determination and commitment. This augurs well for the program.

48. **While risks regarding debt sustainability are undeniably high, the Fund’s support is nevertheless justified** given the new government’s strong initiatives and the substantial cofinancing by the eurozone countries, coupled with the systemic concerns arising from spillover effects if Greece were not given an opportunity to improve its economic policies. In view of Greece’s balance of payments needs and the comprehensive package of adjustment measures already taken and proposed by the authorities, the staff supports the authorities’ request for an SBA in an amount equivalent to SDR 26.4 billion.

Table 1. Greece: Selected Economic Indicators

	2009	2010	2011	2012	2013	2014	2015
					Proj.		
	(Percentage change, unless otherwise indicated)						
Domestic economy							
Real GDP	-2.0	-4.0	-2.6	1.1	2.1	2.1	2.7
Output gap (percent of pot. output)	4.0	-1.1	-4.6	-4.7	-4.0	-3.7	-3.1
Total domestic demand	-2.4	-7.1	-5.2	0.1	1.7	1.8	2.1
Private consumption	-1.8	-4.0	-3.7	0.8	2.8	2.5	2.5
Public consumption	9.6	-10.6	-5.1	-3.6	-6.6	-3.2	-0.1
Gross fixed capital formation	-13.9	-11.4	-11.8	0.8	4.8	3.5	2.3
Change in stocks (contribution)	0.0	-1.0	0.0	0.0	0.0	0.0	0.0
Foreign balance (contribution)	0.7	3.8	3.6	1.0	0.4	0.5	0.3
Exports of goods and services	-18.1	4.5	5.4	5.9	6.0	5.9	6.0
Imports of goods and services	-14.1	-9.7	-6.1	1.6	3.8	4.6	3.7
Unemployment rate (percent)	9.4	11.8	14.6	14.8	14.3	14.1	13.4
Employment	-1.4	-2.6	-3.2	-0.2	0.7	0.3	0.9
Consumer prices (HICP), end of period	2.6	1.0	-0.5	0.7	0.8	1.2	1.0
Consumer prices (HICP), period average	1.3	1.9	-0.4	1.2	0.7	0.9	1.0
Core prices, period average 1/	2.3	1.4	...	...	...	...	...
GDP deflator	1.4	1.2	-0.5	1.0	0.7	1.0	1.1
	(Percent of GDP)						
Balance of payments							
Current account	-11.2	-8.4	-7.1	-5.6	-4.0	-2.8	-1.9
Trade balance	-7.7	-3.5	-0.2	0.6	1.3	1.9	2.4
Export of goods and services	17.8	21.1	23.6	24.8	25.8	26.8	27.7
Imports of goods and services	25.5	24.6	23.8	24.2	24.5	24.8	25.2
Total transfers	0.5	0.4	0.5	0.5	0.4	0.4	0.3
Net income receipts	-4.1	-5.2	-7.5	-6.7	-5.7	-5.1	-4.7
Net international investment position	-86	-95	-104	-106	-106	-105	-102
Public finances (general government)							
Total revenues 2/	36.9	40.0	39.0	38.5	38.2	37.2	36.3
Total expenditures 2/	50.4	50.5	53.2	53.9	54.0	52.3	50.6
Primary expenditures 2/	45.4	44.9	46.6	46.5	46.0	43.9	42.5
Measures (cum.) 3/	...	2.5	6.7	9.0	11.0	12.6	12.2
Overall balance	-13.6	-8.1	-7.6	-6.5	-4.8	-2.6	-2.0
Primary balance	-8.6	-2.4	-0.9	1.0	3.1	5.9	6.0
Gross debt	115	133	145	149	149	146	140
Interest rates and credit							
Long-term lending interest rate 4/	5.7	5.6	...	...	...	...	...
Private credit growth 5/	4.2	...	...	...	...	...	...
Exchange rates							
Nominal effective exchange rate 4/	0.7	0.6	...	...	...	...	...
Real effective exchange rate (CPI-based) 4/	1.8	1.6	...	...	...	...	...
Real effective exchange rate (man. ULC-based) 4/	3.8	-0.4	...	...	...	...	...
Memorandum item:							
Nominal GDP (billions of euros)	237	231	224	228	235	242	251
Nominal GDP (percentage change)	-0.7	-2.8	-3.1	2.1	2.8	3.1	3.8

Sources: National Statistical Service; Ministry of Economy and Finance; Bank of Greece; and IMF staff estimates.

1/ Core prices exclude energy, food, alcohol, and tobacco.

2/ Excluding unidentified measures.

3/ Measures fully identified up to 2013.

4/ As of January 2010.

5/ Domestic credit growth of households and enterprises.

Table 2. Greece: General Government Operations, 2009–15

	2009	2010	2011	2012	2013	2014	2015
	Projections						
	(Euro billions)						
Revenue 1/	87.5	92.2	87.2	87.9	89.8	90.0	91.3
Taxes on production, and imports	26.4	30.7	28.8	29.4	30.5	32.1	33.3
Taxes on income, and property	18.8	18.3	16.9	17.0	17.4	18.5	18.9
Social contributions	30.4	29.1	27.8	27.7	27.7	28.8	29.3
Other	8.8	9.1	8.7	8.9	9.1	9.4	9.8
Capital transfers	3.1	5.0	5.0	5.0	5.0	1.2	0.0
Primary expenditure 1/	107.9	103.6	104.2	106.1	108.0	106.2	106.9
Wages	29.5	28.0	27.6	27.1	26.7	26.6	27.2
Social benefits	48.8	50.1	52.0	53.8	55.0	56.5	57.9
Goods and services	14.5	11.7	10.6	11.2	12.1	12.2	12.3
Subsidies	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other current	3.9	3.7	3.7	3.7	3.8	3.8	3.8
Capital	10.9	9.9	10.0	9.9	10.0	6.9	5.4
Measures, cumulative	...	5.8	14.9	20.6	25.5	30.4	30.8
Measures, flow	...	5.8	9.2	5.6	4.8	4.6	0.0
of which: not yet estimated	...	0.0	0.0	0.0	4.2	4.6	0.0
Primary balance	-20.4	-5.6	-2.1	2.4	7.4	14.2	15.2
Interest payments	11.9	13.0	14.9	17.1	18.9	20.4	20.3
Overall balance	-32.3	-18.6	-17.0	-14.7	-11.5	-6.2	-5.1
Gross debt (Maastricht)	273.4	307.5	324.7	339.7	350.4	353.8	353.1
	(Percent of GDP)						
Revenue 1/	36.9	40.0	39.0	38.5	38.2	37.2	36.3
Taxes on production, and imports	11.1	13.3	12.9	12.9	13.0	13.3	13.2
Taxes on income, and property	7.9	7.9	7.6	7.4	7.4	7.6	7.5
Social contributions	12.8	12.6	12.4	12.1	11.8	11.9	11.7
Other	3.7	4.0	3.9	3.9	3.9	3.9	3.9
Capital transfers	1.3	2.2	2.2	2.2	2.1	0.5	0.0
Primary expenditure 1/	45.4	44.9	46.6	46.5	46.0	43.9	42.5
Wages	12.4	12.1	12.3	11.9	11.4	11.0	10.8
Social benefits	20.5	21.7	23.3	23.6	23.4	23.3	23.0
Goods and services	6.1	5.1	4.7	4.9	5.1	5.0	4.9
Subsidies	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other current	1.6	1.6	1.6	1.6	1.6	1.6	1.5
Capital	4.6	4.3	4.5	4.3	4.3	2.8	2.2
Measures, cumulative	...	2.5	6.7	9.0	11.0	12.6	12.2
Measures, flow	...	2.5	4.1	2.4	2.0	1.9	0.0
of which: not yet estimated	...	0.0	0.0	0.0	1.8	1.9	0.0
Primary balance	-8.6	-2.4	-0.9	1.0	3.1	5.9	6.0
Interest payments	5.0	5.6	6.6	7.5	8.1	8.4	8.1
Overall balance	-13.6	-8.1	-7.6	-6.5	-4.9	-2.6	-2.0
Gross debt (Maastricht)	115.1	133.2	145.2	148.7	149.2	146.1	140.4
Memorandum items:							
Nominal GDP (in euro billions)	237	231	224	228	235	242	251

Sources: Greece authorities, and IMF staff estimates.

1/ Excludes the measures supporting the program targets, but the package of 5.2 percent of GDP in effective measures taken under the March Stability Program.

Table 3. Greece: Public Sector Financing Requirements and Sources
(Billion of euros, unless otherwise stated)

	2009	2010	2011	2012	2013	2014	2015
Gross borrowing need	68.6	73.6	55.1	57.9	53.1	70.7	76.6
Overall balance	34.4	20.7	18.7	16.2	12.7	7.1	5.8
Amortization	29.7	37.4	35.3	40.5	40.2	69.2	75.6
M<	20.3	31.3	27.3	32.5	28.0	40.4	40.4
Domestic banks	4.6	15.7	10.3	16.0	13.6	16.6	14.7
BOP	15.8	15.6	17.0	16.5	14.4	23.8	25.6
ST	9.4	6.1	8.0	8.0	8.0	8.0	8.0
Domestic banks	3.9	4.2	5.0	5.0	5.0	5.0	5.0
BOP	5.5	1.9	3.0	3.0	3.0	3.0	3.0
Exceptional creditors		0.0	0.0	0.0	4.2	20.9	27.3
EU		0.0	0.0	0.0	2.8	13.9	18.2
IMF		0.0	0.0	0.0	1.4	7.0	9.1
Other	4.5	15.5	1.2	1.2	0.2	-5.6	-4.8
Gross financing sources	68.6	35.6	15.1	33.9	45.1	70.7	76.6
Privatization receipts	0.9	0.0	1.0	1.0	1.0	1.0	1.0
Other	6.0	2.1	1.8	1.5	1.3	-2.8	0.8
Market access	61.7	33.4	12.4	31.4	42.9	72.5	74.8
M<	55.6	25.4	4.4	23.4	34.9	64.5	66.8
Domestic banks	26.6	15.6	4.8	11.4	12.0	15.4	13.9
BOP	29.0	9.8	-0.5	11.9	22.9	49.1	52.9
ST	6.1	8.0	8.0	8.0	8.0	8.0	8.0
Domestic banks	4.2	5.0	5.0	5.0	5.0	5.0	5.0
BOP	1.9	3.0	3.0	3.0	3.0	3.0	3.0
Financing gap		38.0	40.0	24.0	8.0	0.0	0.0
EU (8/11 of the gap)		27.6	29.1	17.5	5.8	0.0	0.0
IMF (3/11 of the gap)		10.4	10.9	6.5	2.2	0.0	0.0
Net placement (market access-amortization)	32.0	-4.0	-22.9	-9.2	2.6	3.3	-0.8
Domestic banks	16.6	0.7	-5.5	-4.6	-1.6	-1.2	-0.8
M<	16.3	-0.1	-5.5	-4.6	-1.6	-1.2	-0.8
ST (net increase)	0.3	0.8	0.0	0.0	0.0	0.0	0.0
BOP	15.4	-4.7	-17.4	-4.6	4.2	4.5	0.0
M<	13.2	-6	-17.4	-4.6	8.5	25.3	27.2
ST (net increase)	2.1	1.1	0.0	0.0	-4.2	-20.9	-27.3
Rollover rates of existing debt, percent		89.4	35.0	77.4	119.1	149.9	154.7
Total Maastricht debt in billions of euros	273.5	307.5	324.6	339.4	350.1	349.6	348.7
Exceptional creditors		38.0	78.0	102.0	105.8	84.9	57.6
EU		27.6	56.7	74.2	77.2	63.3	45.1
IMF		10.4	21.3	27.8	28.6	21.6	12.5
percent of quota		1,110	2,277	2,978	3,060		
Private sector	273.5	269.5	246.6	237.4	244.3	264.7	291.1
Total Maastricht debt (percent GDP)		133.3	145.1	148.6	149.1	144.3	138.7
Exceptional creditors		16.5	34.9	44.7	45.0	35.0	22.9
EU		12.0	25.4	32.5	32.9	26.1	17.9
IMF		4.5	9.5	12.2	12.2	8.9	5.0

Sources: Ministry of Finance; and IMF staff's projections.

Table 4. Greece: Summary of Balance of Payments, 2009–15

	2009	2010	2011	2012	2013	2014	2015
	Prel.	Projections					
(In billions of euros)							
Current account balance	-26.6	-19.3	-15.9	-12.9	-9.4	-6.8	-4.9
Balance of goods and services	-18.1	-8.2	-0.3	1.5	3.1	4.7	6.1
Goods balance	-30.8	-25.9	-21.5	-21.7	-22.1	-22.8	-23.8
Exports	15.3	17.8	19.5	20.8	22.2	23.6	25.1
Imports	46.1	43.7	40.9	42.5	44.3	46.4	49.0
Services balance	12.6	17.7	21.1	23.1	25.2	27.5	30.0
Credit	27.0	30.9	33.4	35.8	38.4	41.2	44.4
Debit	14.3	13.2	12.3	12.7	13.2	13.7	14.4
Income balance	-9.8	-12.1	-16.7	-15.4	-13.5	-12.5	-11.8
Credit	4.1	4.7	3.9	6.3	7.5	8.2	8.5
Debit	13.9	16.8	20.7	21.7	20.9	20.6	20.3
Current transfers (net)	1.3	1.0	1.1	1.1	1.0	0.9	0.8
Capital and financial account balance	27.2	-18.7	-24.1	-11.1	1.4	6.8	4.9
Capital account balance	2.0	2.8	2.9	2.8	2.7	2.6	2.5
Financial account	25.2	-21.6	-26.9	-13.9	-1.3	4.2	2.3
Direct investment	1.1	1.0	0.9	0.8	0.8	0.8	0.8
Portfolio investment	27.9	-2.1	-10.1	4.4	13.8	14.6	10.4
of which: government	31.1	-4.7	-17.4	-4.6	4.2	4.5	0.0
Other investment	-3.6	-20.4	-17.7	-19.1	-15.9	-11.2	-8.9
Reserve assets (increase = -)	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	...	38.0	40.0	24.0	8.0	0.0	...
(In percent of GDP)							
Current account balance	-11.2	-8.4	-7.1	-5.6	-4.0	-2.8	-1.9
Balance on goods and services	-7.6	-3.5	-0.2	0.6	1.3	1.9	2.4
Goods balance	-13.0	-11.2	-9.6	-9.5	-9.4	-9.4	-9.5
Services balance	5.3	7.7	9.4	10.1	10.7	11.3	11.9
Income balance	-4.1	-5.2	-7.5	-6.7	-5.7	-5.1	-4.7
Current transfers	0.5	0.4	0.5	0.5	0.4	0.4	0.3
Capital and financial account balance	11.5	-8.1	-10.8	-4.9	0.6	2.8	1.9
Capital account balance	0.8	1.2	1.3	1.2	1.1	1.1	1.0
Financial account	10.6	-9.3	-12.0	-6.1	-0.6	1.7	0.9
Direct investment	0.5	0.4	0.4	0.4	0.4	0.3	0.3
Portfolio investment	11.7	-0.9	-4.5	1.9	5.9	6.0	4.1
of which: government	13.1	-2.0	-7.8	-2.0	1.8	1.8	0.0
Other investment							
Reserve assets (increase = -)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	-0.3	0.0	0.0	0.0	0.0	0.0	0.0
Financing gap	...	16.5	17.9	10.5	3.4	0.0	...
Memorandum items:							
Potential sources to fill the gap (billions of euro)	...	38.0	40.0	24.0	8.0	...	...
EU	...	25.3	26.7	16.0	5.3	...	...
IMF	...	12.7	13.3	8.0	2.7	...	...
External debt	170.0	185.0	193.3	198.4	202.2	203.8	200.9
Public sector	111.1	142.7	147.8	150.9	150.3	148.7	147.7
Private sector	59.0	42.4	45.5	47.5	51.8	55.1	53.2

Sources: Bank of Greece; and IMF staff estimates.

Table 5. Greece: External Financing Requirements and Sources, 2009-15

	(In billions of euros)						
	2009	2010	2011	2012	2013	2014	2015
		Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
GROSS FINANCING REQUIREMENTS	167.1	186.1	179.7	158.1	154.5	182.9	202.4
Current account deficit	26.6	19.3	15.9	12.9	9.4	6.8	4.9
Medium- and long-term debt amortization	28.2	22.8	28.1	25.8	25.4	47.7	55.3
Public sector	15.8	15.6	17.0	16.5	18.7	44.7	52.9
Banks	11.3	6.8	8.7	9.1	4.8	2.5	0.5
Corporates	1.1	0.3	2.3	0.2	1.9	0.6	1.9
Short-term debt amortization	112.2	144.0	135.7	119.4	119.8	128.3	142.2
Public sector & BoG	40.8	50.9	84.2	63.0	57.7	53.9	56.6
BoG 1/	35.3	49.0	81.2	60.0	54.7	50.9	53.6
Public sector 2/	5.5	1.9	3.0	3.0	3.0	3.0	3.0
Banks	70.2	92.1	50.6	55.7	61.3	73.5	84.5
Corporates	1.3	1.0	0.8	0.7	0.8	0.9	1.1
SOURCES OF FINANCING	167.1	148.1	139.7	134.1	146.5	182.9	202.4
Capital account (net)	2.0	2.8	2.9	2.8	2.7	2.6	2.5
Foreign direct investment (net)	1.1	1.0	0.9	0.8	0.8	0.8	0.8
Inward	2.4	2.3	2.3	2.3	2.3	2.4	2.4
Equities (net)	-0.2	-0.5	-0.8	0.8	1.3	1.8	2.3
by nonresidents	0.5	0.2	-0.1	1.5	2.0	2.5	3.0
Assets drawdown (- increase)	-26.1	-7.2	7.8	-12.2	-17.2	-17.2	-12.2
New borrowing and debt rollover	191.8	151.9	129.0	141.9	158.9	194.8	208.9
Medium and long-term borrowing	47.8	16.3	9.5	22.1	30.6	52.6	55.4
Public sector	48.1	9.8	-0.5	11.9	22.9	49.1	52.9
Banks	-8.5	6.1	7.9	10.0	5.8	3.0	0.6
Corporates	8.2	0.3	2.1	0.2	1.9	0.6	1.9
Short-term borrowing	144.0	135.7	119.4	119.8	128.3	142.2	153.6
Public sector & BoG	50.9	84.2	63.0	57.7	53.9	56.6	67.8
BoG 1/	49.0	81.2	60.0	54.7	50.9	53.6	64.8
Public sector 2/	1.9	3.0	3.0	3.0	3.0	3.0	3.0
Banks	92.1	50.6	55.7	61.3	73.5	84.5	84.5
Corporates	1.0	0.8	0.7	0.8	0.9	1.1	1.2
Other	-1.5	0.0	0.0	0.0	0.0	0.0	0.0
FINANCING GAP	...	38.0	40.0	24.0	8.0	0.0	0.0
European Union (8/11 of total)	...	25.3	26.7	16.0	5.3	0.0	0.0
IMF (3/11 of total)	...	12.7	13.3	8.0	2.7	0.0	0.0
<i>in percent of quota</i>	...	<i>1,156</i>	<i>1,217</i>	<i>730</i>	<i>243</i>	<i>0</i>	<i>0</i>
Memorandum item:							
Greece IMF quota (SDR millions)	823.0	823.0	823.0	823.0	823.0	823.0	823.0
Greece IMF quota (Euro millions)	1,095.8	1,095.8	1,095.8	1,095.8	1,095.8	1,095.8	1,095.8

Sources: Bank of Greece, Bloomberg, and staff estimates and projections.

1/ Includes liabilities to Eurosystem related to TARGET (e.g. ECB repo transactions).

2/ Includes market instruments and trade credits.

Table 6. Greece: Core Set of Financial Soundness Indicators for Deposit Taking Institutions, 2000–09

	(Percent)									
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Regulatory capital to risk-weighted assets 1/	13.6	12.4	10.5	12.0	12.8	13.2	12.2	11.2	9.4	11.7
Regulatory Tier I capital to risk-weighted assets 1/	13.5	10.9	8.8	9.8	10.0	10.9	9.9	9.2	7.9	10.6
Nonperforming loans net of provisions to capital	33.4	29.4	28.9	27.0	26.5	19.2	15.4	16.8	26.1	38.2
Nonperforming loans to total gross loans	11.7	8.3	7.4	7.0	7.0	6.3	5.4	4.5	5.0	7.7
Sectoral distribution of loans 2/										
Consumer credit	9.3	10.6	11.3	12.3	14.3	15.2	16.3	15.0	14.1	14.0
Lending for house purchase	18.8	21.0	24.4	26.1	27.7	31.4	33.4	34.5	32.4	35.0
Non-financial corporations	70.5	65.7	60.4	57.7	54.4	50.5	47.1	47.2	50.4	47.5
Insurance corporations and pension funds	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.1	0.0
Other financial intermediaries	1.1	2.2	3.2	2.6	2.3	1.6	1.8	1.5	1.5	1.9
Other	0.3	0.4	0.6	1.3	1.2	1.2	1.4	1.5	1.5	1.6
Return on assets (after taxes) 3/	1.4	1.0	0.5	0.6	0.4	0.9	0.8	1.0	0.2	-0.1
Return on equity (after taxes) 3/	15.4	12.4	6.8	8.9	6.4	15.9	12.7	14.8	3.2	-1.5
Interest margin to gross income 3/	54.5	62.8	72.5	73.9	77.0	75.5	72.3	71.9	83.1	74.8
Non-interest expenses to gross income 3/	53.0	59.0	69.0	63.0	64.3	54.5	52.2	52.6	60.0	57.4
Liquid assets to total assets 2/	46.4	41.1	39.5	37.0	33.4	34.0	33.6	35.1	38.7	45.2
Liquid assets to short-term liabilities 2/	60.7	53.0	48.7	46.5	43.2	47.0	46.5	48.0	50.0	56.9
Net open position in foreign exchange to capital 1/ 4/	...	3.5	7.2	5.7	3.5	2.8	4.8	3.9	7.9	11.7

Source: Bank of Greece.

1/ Data on a consolidated basis.

2/ On an aggregate resident-based approach (i.e. commercial banks, cooperative banks and foreign branches).

3/ From 2004 in accordance with IFRS.

4/ Based on revised figures from 2002 onwards.

Table 7. Greece: Access and Phasing under the Proposed Stand-By Arrangement, 2010–13

Review	Availability Date	Action	Purchase	
			Millions of SDRs	Percent of quota
	May 9, 2010	Board approval of SBA	4,805.9	583.9
First Review	August 30, 2010	Observance of end-June 2010 performance criteria, completion of first review	2,162.7	262.8
Second Review	November 30, 2010	Observance of end-September 2010 performance criteria, completion of second review	2,162.7	262.8
Third Review	February 28, 2011	Observance of end-December 2010 performance criteria, completion of third review	3,604.5	438.0
Fourth Review	May 30, 2011	Observance of end-March 2011 performance criteria, completion of fourth review	2,883.6	350.4
Fifth Review	August 30, 2011	Observance of end-June 2011 performance criteria, completion of fifth review	1,922.4	233.6
Sixth Review	November 30, 2011	Observance of end-September 2011 performance criteria, completion of sixth review	1,201.5	146.0
Seventh Review	February 28, 2012	Observance of end-December 2011 performance criteria, completion of seventh review	2,403.0	292.0
Eighth Review	May 30, 2012	Observance of end-March 2012 performance criteria, completion of eighth review	1,441.8	175.2
Ninth Review	August 30, 2012	Observance of end-June 2012 performance criteria, completion of ninth review	1,441.8	175.2
Tenth Review	November 30, 2012	Observance of end-September 2012 performance criteria, completion of tenth review	480.6	58.4
Eleventh Review	February 28, 2013	Observance of end-December 2012 performance criteria, completion of eleventh review	1,441.8	175.2
Twelfth Review	April 30, 2013	Observance of end-March 2013 performance criteria, completion of twelfth review	480.6	58.4
Total			26,432.9	3,211.8

Source: IMF staff projections.

Table 8. Greece: Indicators of Fund Credit
(Millions of euros, unless otherwise specified)

	2010	2011	2012	2013	2014	2015
Disbursements (percent of quota)	10,364 1,110	10,909 1,168	6,546 701	2,182 234	...	...
(Projected Debt Service to the Fund based on Prospective Drawings)						
Total	131	600	1,190	3,468	9,649	11,799
Interest and charges	131	600	1,190	1,797	1,842	1,196
Amortization	0	0	0	1,670	7,807	10,602
Total debt service, in percent of						
Exports of goods and services	0.3	1.1	2.1	5.7	14.9	17.0
GDP	0.1	0.3	0.5	1.5	4.0	4.7
(Projected Level of Credit Outstanding based on Prospective Drawings)						
Outstanding stock	10,364	21,273	27,818	28,330	20,523	9,921
(percent of quota)	1,110	2,277	2,978	3,033	2,197	1,062
(percent of GDP)	4.5	9.5	12.2	12.1	8.5	3.9
Memorandum items						
Exports of goods and services (in billion of euros)	48.6	52.9	56.6	60.6	64.8	69.5
GDP (billions of euros)	230.8	223.7	228.4	234.9	242.2	251.4
Euro/SDR	1.1					
Quota	934.1					

Source: IMF staff projections.

Table 9. Greece: Monetary Survey

	2005	2006	2007	2008	2009	2010 Proj.
(Billion of euros)						
Assets	242.1	265.5	298.7	357.7	380.4	394.9
Credit to the private sector	156.1	180.8	213.4	233.2	224.0	217.6
Credit to the government	62.4	59.6	58.4	55.4	72.1	72.8
Net credit to non-€ residents	-9.2	-8.7	-11.9	12.0	33.8	55.3
Other	27.5	28.1	33.5	51.9	45.2	43.9
Fixed assets	5.3	5.7	5.2	5.2	5.4	5.3
Liabilities	242.1	265.5	298.7	357.7	380.4	394.9
Total deposits	171.7	187.7	214.5	241.1	250.0	230.6
Other	46.4	51.9	54.0	86.8	89.2	124.2
Capital and reserves	24.0	25.9	30.2	29.8	41.3	40.1
(Percent change)						
Total deposits	7.9%	9.3%	14.3%	12.4%	3.7%	-7.8%
Credit to the private sector	17.8%	15.8%	18.0%	9.3%	-4.0%	-2.8%
Credit to the government	7.6%	-4.5%	-2.0%	-5.1%	30.0%	1.0%
(Percent of GDP)						
Total deposits	87.9	89.2	94.7	100.8	105.3	99.9
Credit to the private sector	79.9	85.9	94.2	97.5	94.3	94.3
Credit to government	31.9	28.3	25.8	23.2	30.3	31.5
(Percent)						
Memorandum items:						
Capital to assets	8.5	8.0	8.0	6.7	9.3	9.1
Credit to government & private sector over deposits	131.0	132.2	131.6	120.8	119.2	126.8

Sources: Bank of Greece; and IMF staff calculations.

Annex 1. Public Debt Sustainability

Despite favorable economic conditions, Greece was not able to consolidate its debt stock since 2000. Debt remained at around 100 percent of GDP during 2000–08, despite strong economic growth at around 4 percent, and low and declining real interest rates (at the backdrop of improved market confidence and high domestic inflation). This reflected procyclical fiscal policies and the assumption of contingent debts.

The sharp increase of general government debt to 115 percent of GDP in 2009 can be attributed to three factors, which will continue to weight on Greece for some time: (i) a drop in economic growth, (ii) high real interest rates (as the recession has brought down inflation significantly and market confidence weakened), and (iii) a sharp increase in the fiscal deficit to 13.6 percent of GDP.

Baseline and underlying assumptions

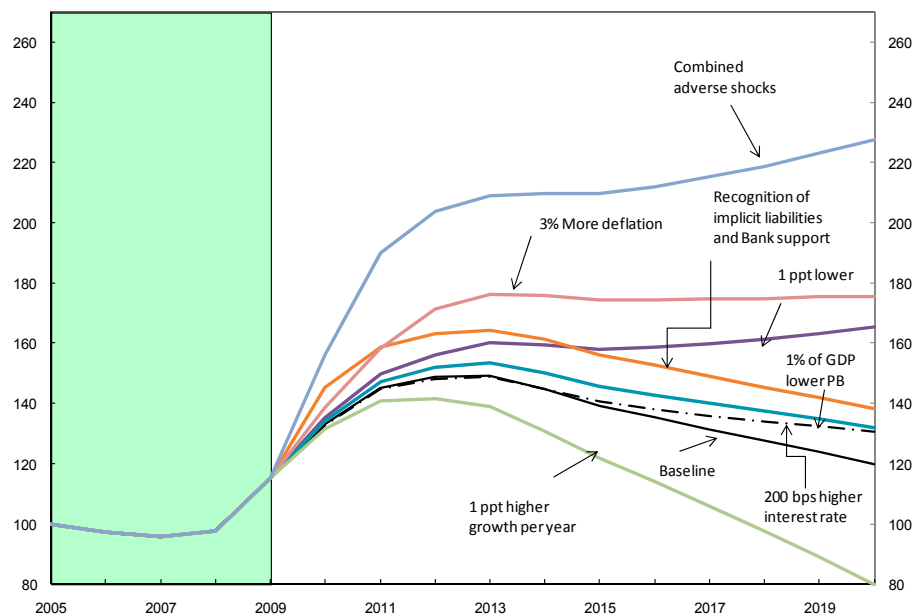
Under the baseline scenario, Greece’s public debt as a share of GDP would peak at 149 percent in 2013 and gradually decline to 120 percent by 2020.⁵ The increase in public debt reflects continued large deficits of the public sector which would drop to 4.6 percent of GDP by 2013, low growth and deflation. The baseline scenario assumes that the primary balance will improve from -8.6 percent of GDP in 2009 to 6 percent of GDP by 2014 and beyond. Output is expected to contract in 2010–11, but growth will reach 2¾ percent after 2015, while inflation is moderately below EU average. Interest rate spreads on new debt are projected to decline as confidence improves. Further, it includes €10 billion for the Financial Stability Fund, which would be recovered by 2015, and privatization proceeds of €1 billion every year after 2011 (Table A1).

Debt structure

Although the average maturity of the debt is relatively high, there are large rollover needs in the next three to five years. The average remaining maturity of the general government debt is eight years, but this largely reflects a few very long-term issues. More than one third of the debt stock will mature in the next three years, and almost half will mature in the next five years (Figure A1).

⁵ This is based on the Maastricht debt definition.

Figure A1. Greece: Public Debt Sustainability Analysis
(Percent of GDP)



Other aspects of the government debt's composition are relatively favorable. Of the total general government debt, 98.5 percent is denominated in euro and 89 percent is fixed rate debt. However, the share of floating rate debt is expected to go up to 40 percent during 2012/13 with EU bilateral and IMF loans (both floating) amounting to 30 percent in the total stock of debt. Moreover, the debt that is coming to maturity in the next few years was issued many years ago at relatively high nominal interest rates, so that the interest differential between new market debt and old maturing debt is not as high as in other crisis cases.

Sensitivity analysis

Sensitivity analysis shows that the baseline public debt outlook is mainly affected by growth shocks (Figure A2 and Table A2). Several risk factors could have a large potential impact on the fiscal path: lower growth, greater deflation, higher interest rates, and contingent liabilities from state-owned enterprises and the banking system. While adverse shocks of reasonable size to each of the shocks considered would be consistent with a turnaround in the debt dynamics, a combined adverse shock would render the dynamics clearly unsustainable. These include:

- Recognition of implicit or contingent liabilities:** The chart includes: Debts of public enterprises and identified guarantees to the public sector (for a total of 25.8 billion or 11 percent of GDP) and future debt-creating flows from losses made by public enterprises (cumulative amount of 2 percent of GDP, assuming public enterprise restructuring and privatization). This would leave the debt at 138 percent of GDP by 2020.

- **Weaker fiscal adjustment:** a smaller adjustment of 1 percent of GDP per year would imply a more gradual decline to about 132 percent of GDP by 2020.
- **Weaker growth:** a 1 percentage point reduction in the GDP growth rate each year would result in debt rising to around 166 percent of GDP by 2020; (on the other hand, faster growth by 1 percentage point would bring the debt down to 80 percent of GDP by 2020).
- **More severe deflation in 2010–12:** 3 percentage point lower inflation than in the baseline would result in the debt-to-GDP ratio peaking at 174 percent of GDP and declining to 168 by 2020.
- **Higher interest rate:** an interest rate increase of 200bps (reflecting a higher Euribor and SDR rate) would increase public debt to 131 percent of GDP by 2020.

Table A. 1. Greece: Public Sector Debt Sustainability Framework, 2008-2020
(In percent of GDP, unless otherwise indicated)

	Actual		Projections										Debt-stabilizing	
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	primary balance g/ balance g/
Baseline: Public sector debt 1/	98	115	133	145	149	149	145	139	135	131	127	124	120	1.9
Change in public sector debt	2.1	17.5	18.1	11.9	3.6	0.5	-4.7	-5.5	-3.9	-3.9	-3.9	-3.8	-4.1	
Identified debt-creating flows (4+7+12)	-0.5	16.3	18.2	11.9	3.6	0.6	-6.3	-5.5	-3.8	-3.8	-3.8	-3.7	-4.0	
Primary deficit	0.7	8.6	2.4	0.9	-1.0	-3.1	-5.9	-6.0	-6.0	-6.0	-6.0	-6.0	-6.0	
Revenue and grants	39.9	36.9	41.3	42.7	43.5	44.1	44.5	43.9	42.9	42.5	41.9	41.6	41.3	
Primary (noninterest) expenditure	40.6	45.4	43.8	43.6	42.5	41.0	38.6	37.9	36.8	36.5	35.9	35.6	35.3	
Automatic debt dynamics 2/	-2.1	6.2	9.0	10.9	4.5	4.0	3.9	2.8	2.2	2.1	2.1	2.2	1.9	
Contribution from interest rate/growth differential 3/	-2.1	6.2	9.0	10.9	4.5	4.0	3.9	2.8	2.2	2.1	2.1	2.2	1.9	
Of which contribution from real interest rate	0.5	4.2	4.3	7.3	6.0	7.1	6.9	6.5	5.8	5.6	5.5	5.5	5.1	
Contribution from real GDP growth	-2.7	2.0	4.7	3.6	-1.5	-3.1	-3.0	-3.7	-3.6	-3.5	-3.4	-3.3	-3.2	
Contribution from exchange rate depreciation 4/	0.0	0.0	...	...	...	...	...	...	...	...	...	...	...
Other identified debt-creating flows	0.9	1.5	6.7	0.1	0.1	-0.3	-4.3	-2.3	0.1	0.1	0.1	0.1	0.1	
Privatization receipts (negative)	0.0	-0.4	0.0	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3	
Recognition of implicit or contingent liabilities	0.9	0.3	6.7	0.5	0.5	0.1	-2.3	-1.9	0.5	0.4	0.4	0.4	0.4	
Other (specify, e.g. bank recapitalization)	0.0	1.6	0.0	0.0	0.0	0.0	-1.6	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	2.6	1.2	0.0	0.0	0.0	0.0	1.6	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	
Public sector debt-to-revenue ratio 1/	244.7	312.4	322.6	339.9	341.8	338.9	324.9	317.1	315.6	309.0	304.1	297.1	289.8	
Gross financing need 6/	5.0	13.6	21.3	23.4	24.7	24.0	31.8	31.3	24.7	22.0	17.8	22.9	14.3	
in billions of U.S. dollars	17.9	44.3	69.2	73.2	78.5	77.7	104.9	107.2	88.2	82.0	69.2	92.9	60.5	
Scenario with key variables at their historical averages 7/	133.3	132.2	131.1	129.6	129.6	129.6	125.0	122.9	121.8	120.8	119.7	118.7	117.6	-3.6
Scenario with no policy change (constant primary balance) in 2010-2020	133.3	146.7	153.7	153.7	153.7	159.9	163.9	167.1	172.2	177.3	182.6	188.2	193.6	0.9
Key Macroeconomic and Fiscal Assumptions Underlying Baseline														
Real GDP growth (in percent)	3.0	-2.0	-4.0	-2.6	1.1	2.1	2.1	2.1	2.7	2.7	2.7	2.7	2.7	
Average nominal interest rate on public debt (in percent) 8/	4.9	5.0	4.8	4.8	5.3	5.6	5.8	5.8	5.9	5.9	5.9	6.0	5.9	
Average interest rate on new market debt			5.0	5.3	5.4	5.5	5.6	5.6	5.6	5.6	5.7	5.7	5.8	
Average interest rate on all new debt (includes EU bilateral and IMF debts)			3.8	4.8	5.6	6.0	6.2	6.1	5.8	5.7	5.7	5.7	5.8	
Spreads above German bund			250	200	150	100	100	100	100	100	100	100	100	
German bund rate			175	275	350	350	350	350	350	350	350	350	350	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	0.7	4.3	3.4	5.4	4.0	4.9	4.8	4.7	4.4	4.4	4.4	4.5	4.4	
Nominal appreciation (increase in US dollar value of local currency, in percent)	114.6	-6.7	...	...	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	4.2	0.7	1.2	-0.5	1.0	0.7	1.0	1.1	1.5	1.5	1.5	1.5	1.5	
Growth of real primary spending (deflated by GDP deflator, in percent)	4.6	8.7	-7.7	122.6	-57.1	-1.6	-3.8	0.8	-0.2	1.7	1.1	1.8	1.6	
Primary deficit	0.7	8.6	2.4	0.9	-1.0	-3.1	-5.9	-6.0	-6.0	-6.0	-6.0	-6.0	-6.0	

1/ General government.

2/ Derived as $[(1 - \pi)(1 + g) - g + \alpha \Delta(1 + \pi)] / (1 + g + \pi - 9\pi)$ times previous period debt ratio, with π = interest rate; g = real GDP growth rate; α = share of foreign-currency denominated debt; and Δ = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1 + g)$ and the real growth contribution as $-g$.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha \Delta(1 + \pi)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as general government deficit, plus amortization of medium and long-term general government debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table A. 2: Greece: Sensitivity Test of the Public Debt Sustainability 1/
(Percent of GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Baseline scenario	115	133	145	149	149	145	139	135	131	127	124	120
Higher growth of 1 percent per year	115	131	141	142	139	131	122	114	106	97	89	80
Lower growth of 1 percent per year	115	135	150	156	160	159	158	159	160	161	163	166
Deflation (3 percent lower inflation for 2010-2012)	115	139	158	171	176	176	174	174	175	175	175	175
Lower primary deficit (by 1% of GDP)	115	134	147	152	154	150	146	143	140	137	135	132
Recognition of contingent liabilities, bank support and new debt 2/	115	145	159	163	164	161	156	153	149	145	142	138
200 bps higher interest rate on German bund	115	133	145	148	149	145	140	138	136	134	132	131

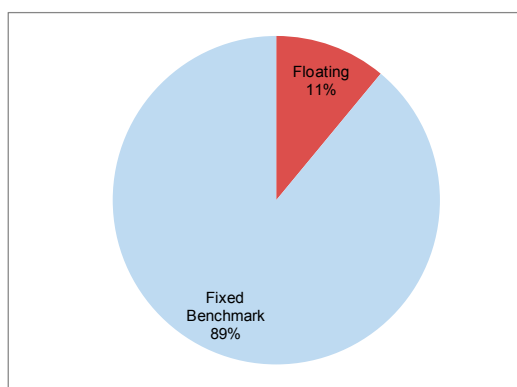
Source: Fund staff calculations.

1/ Changes in assumptions are relative to the baseline.

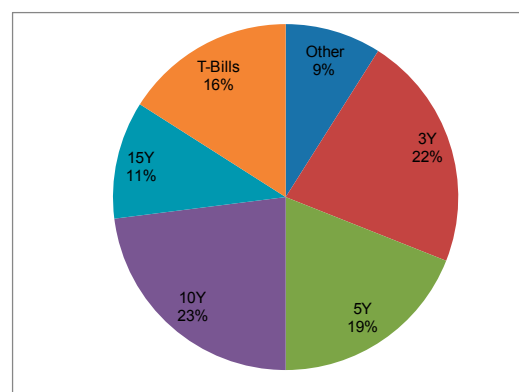
2/ This assumes €25bn in guaranteed debt, and addition new debt creation from public enterprises.

Figure A2. Greece: Composition of Public Debt

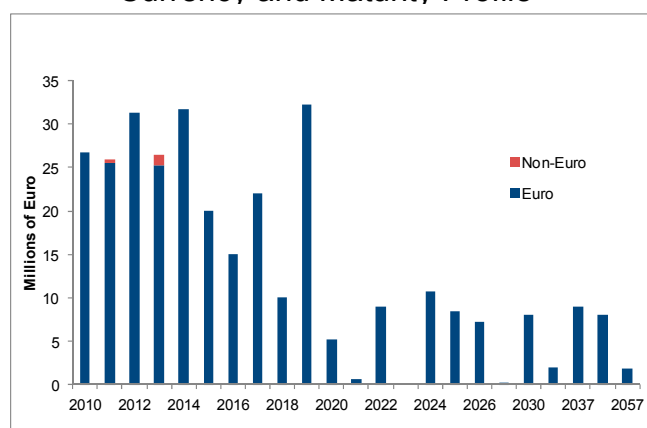
Composition by Type of Interest



Composition by Maturity Profile



Currency and Maturity Profile



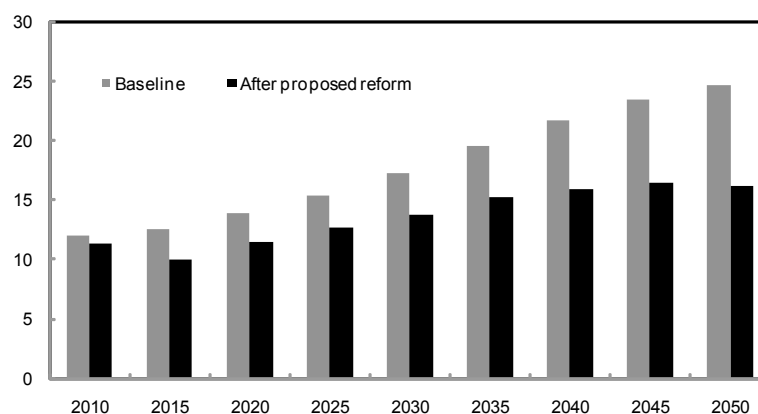
Source: Public Debt Management.

Annex 2. Pension Reform Assessment

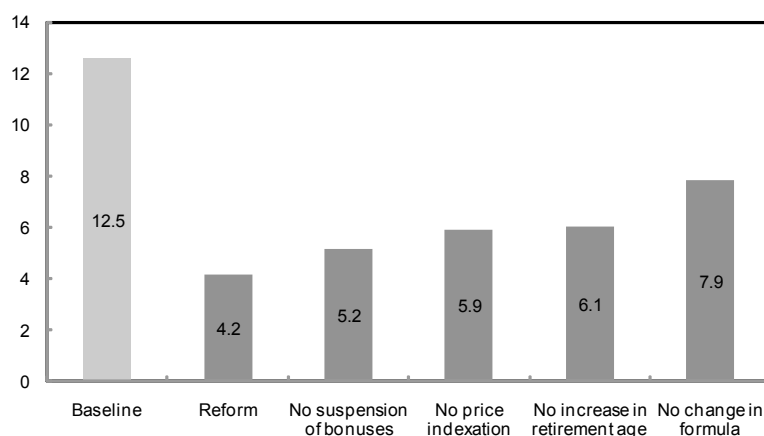
The current pension system is unsustainable and needs urgent reform. Spending in pensions is projected to increase by 12½ percentage points of GDP over the next four decades. Despite past merges of pension funds, the retirement system remains complex and severely fragmented, with provisions for contributions, benefit calculation, and retirement ages depending on gender, year of entry to the labor force, industry, or occupation. Benefits are generous relative to wages—an average replacement rate of nearly 75 percent—and can often be received before age 60. Furthermore, the benefit structure offers little incentive for older workers to remain in the labor force, especially for low-income workers whose minimum pension is not reduced for early retirement.

Greece: Pension Expenditure 2010-2050
(Percent of GDP)

The proposed reform would stabilize pension spending.



Main risk is one of partial implementation.



Sources: IMF staff projections; and EC Ageing Report (2009).

The proposed pension reform can curtail pension spending in the long term. The reform will introduce a new system consisting of a contributory pension to top-up a non-contributory, means-tested, minimum pension. Among other changes, the reform reduces the accrual rate from 2.0 percent per year to an average of 1.2 percent; increases the number of years of earnings used to calculate pension benefits from 5 to lifetime earnings; limits early retirement for those 60 years or older—including women in the public sector; equalizes the normal retirement age to 65 years increasing with life expectancy; and explicitly indexes the retirement age to life expectancy. Staff projections of pension expenditure for workers in the three major funds (IKA, OGA, and OAEE) and civil servants indicate that the reform could potentially reduce pension expenditure in 2050 by 8½ percentage points of GDP. The reform is, however, less successful in containing the growth in spending in the medium term. After the initial drop in pension expenditure, due largely to the elimination of the Easter, summer, and Christmas payments, spending is projected to increase by 3 percentage points of GDP between 2015 and 2035.

Great uncertainty surrounds these estimates, however, as the parameters and components of the reform are not yet final—an actuarial report is needed before adopting the reform. Original parameters circulated by the authorities suggested an average accrual rate of 0.9 percent per year (about half of the current accrual rate of 2 percent). More recently, however, the authorities have raised the proposed accrual rate to an average of 1.2 percent. The effects of the reform can be greatly reduced if some of the components are excluded. For example, the full reform would limit the increase in pension expenditure over 2010–50 to 1.9 percentage points of GDP compared to 12.5 under the no-reform baseline. But leaving the accrual rate unchanged would increase expenditures between 2010 and 2050 by about 4 percentage points of GDP; not adopting measures to prevent retirement before age 60 and increase the normal retirement age in line with increases in life expectancy would increase pension spending by 2 percentage points; and not indexing to prices would increase spending by about 2 percentage points.

Annex 3. External Debt Sustainability Analysis⁶

Greece's net external debt has been increasing. During the past several years, net external debt has increased from 51 percent of GDP in 2002 to 83 percent of GDP in 2009. This reflects rising current account deficit which reached over 11 percent of GDP in 2009. The debt ratio could be higher, as it is offset by relatively low interest rate, above EU average inflation, and above trend GDP growth.

Looking forward, the net debt position will further deteriorate under the baseline. The net debt-to-GDP ratio is projected to continue rising and peak at 103 percent of GDP in 2013 and then decline slowly afterwards to 96 percent of GDP in 2015. This evolution is largely a result of a sharp reversal in debt dynamics as growth weakens, inflation declines to below EU average, and interest rates rising, even when current account is improving rapidly under the program projections.

The analysis shows that the net debt position is sensitive to a few adverse shocks. The debt dynamics will be adversely affected by weaker growth, more severe deflation that could arise with the large fiscal consolidation and private sector adjustment; higher interest rates as policy rates in the advance economies including the euro zone increases more than anticipated, and market sentiment remain negative; and slower current account adjustment. For each individual shock, the debt ratio will increase, although the shape of debt path remains broadly similar. However, a combination of these shocks will have a very large negative impact to the debt ratio and debt path. (Figure A3 and Table A3)

- **Weaker real GDP growth.** A 1 percentage point lower GDP growth will increase net debt ratio by about 6 percentage points of GDP by 2015 relative to the baseline.
- **Higher deflation.** Reducing inflation by 3 percentage points in 2010 and 2012 will increase debt ratio by 6 percentage points by 2015 relative to the baseline.
- **Higher interest rate.** A 100 basis points increase in interest rate will increase the debt to GDP ratio by 6 percentage points by 2015 relative to the baseline.
- **Higher current account deficit.** A permanent $\frac{1}{4}$ standard deviation shocks to the current account deficit will increase debt to GDP ratio by 10 percentage points relative to the baseline.

⁶ The analysis is done on net rather than gross external debt to be consistent with external account projections which include projections for changes in gross external assets and liabilities.

Table A3. Greece: Net External Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Debt-stabilizing non-interest current account 6.
Baseline: External debt	58.0	62.0	67.7	73.8	83.4	92.7	101.5	103.1	102.2	99.7	95.8	-1.5
Change in external debt	4.4	3.9	5.7	6.1	9.6	9.3	8.7	1.6	-0.9	-2.4	-4.0	
Identified external debt-creating flows (4+8+9)	2.0	3.9	4.7	9.5	10.9	10.7	8.7	3.0	0.1	-1.1	-2.5	
Current account deficit, excluding interest payments	5.5	9.1	11.8	11.4	8.6	4.8	2.3	0.8	-0.5	-1.5	-2.2	
Deficit in balance of goods and services	6.1	9.5	11.0	11.3	7.6	3.5	0.2	-0.6	-1.3	-1.9	-2.4	
Exports	21.4	21.2	21.5	22.5	17.8	21.1	23.6	24.8	25.8	26.8	27.7	
Imports	27.4	30.6	32.5	33.8	25.4	24.6	23.8	24.2	24.5	24.8	25.2	
Net non-debt creating capital inflows (negative)	-2.8	-3.2	-5.3	-1.4	-0.8	-1.0	-0.9	-1.6	-1.7	-1.8	-1.9	
Automatic debt dynamics 1/	-0.8	-2.0	-1.7	-0.5	3.1	7.0	7.4	3.8	2.3	2.2	1.6	
Contribution from nominal interest rate	1.8	2.2	2.6	3.1	2.6	3.6	4.8	4.8	4.5	4.3	4.1	
Contribution from real GDP growth	-1.1	-2.4	-2.6	-1.3	1.5	3.4	2.5	-1.1	-2.1	-2.1	-2.6	
Contribution from price and exchange rate changes 2/	-1.5	-1.7	-1.8	-2.3	-1.0	-1.0	0.4	-1.0	-0.7	-1.0	-1.1	
Residual, incl. change in gross foreign assets (2-3) 3/	2.4	0.0	1.0	-3.5	-1.3	-0.4	-0.4	-0.4	-0.4	-0.3	-0.3	
External debt-to-exports ratio (in percent)	271.4	292.9	314.2	327.3	468.1	439.9	429.3	415.7	396.1	372.5	346.2	
Gross external financing need (in billions of euros) 4/	49.4	68.8	90.4	106.8	166.1	197.1	172.7	135.4	106.6	96.6	95.3	
in percent of GDP	25.3	32.7	39.9	44.6	69.9	85.4	77.2	59.3	45.4	39.9	37.9	
Scenario with key variables at their historical averages 5/						92.7	95.4	98.0	100.6	103.1	105.7	-3.7
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	2.2	4.5	4.5	2.1	-2.0	-4.0	-2.6	1.1	2.1	2.1	2.7	
GDP deflator in US dollars (change in percent)	2.8	3.1	3.0	3.5	1.4	1.2	-0.5	1.0	0.7	1.0	1.1	
Nominal external interest rate (in percent)	3.6	4.1	4.6	4.9	3.5	4.1	5.1	4.9	4.5	4.3	4.3	
Growth of exports (euro terms, in percent)	6.0	6.6	9.6	10.4	-21.5	15.0	8.7	7.1	7.0	7.1	7.2	
Growth of imports (euro terms, in percent)	8.6	20.3	14.3	9.6	-25.2	-6.0	-6.4	3.7	4.2	4.6	5.4	
Current account balance, excluding interest payments	-5.5	-9.1	-11.8	-11.4	-8.6	-4.8	-2.3	-0.8	0.5	1.5	2.2	
Net non-debt creating capital inflows	2.8	3.2	5.3	1.4	0.8	1.0	0.9	1.6	1.7	1.8	1.9	

1/ Derived as $[\dot{r} - g - r(1+g) + ea(1+r)]/(1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)]/(1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

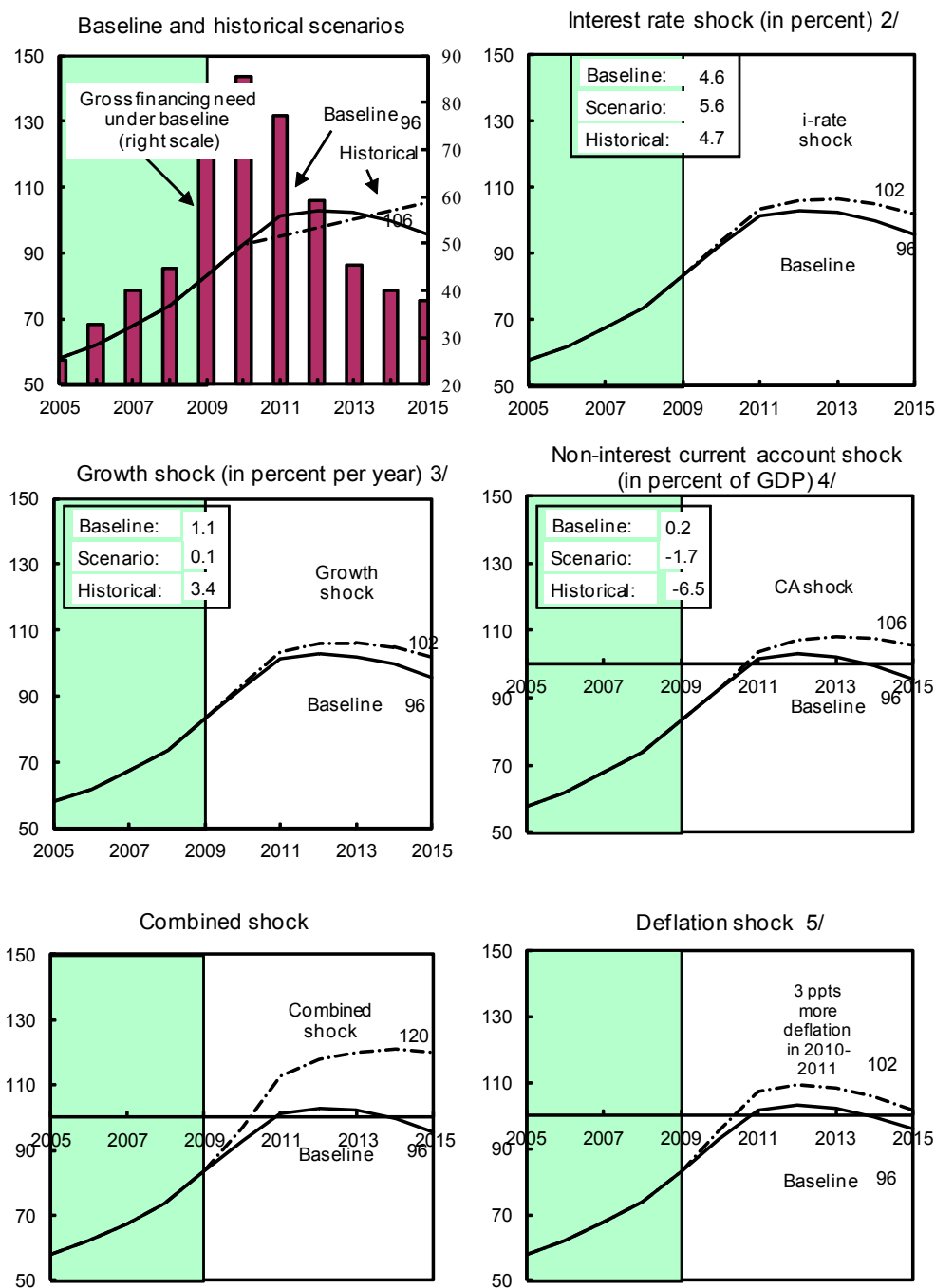
3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Figure A3. Greece: Net External Debt Sustainability: Bound Tests 1/
(External debt in percent of GDP)



Sources: Greek authorities, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ Interest rates are increased by 100bps for the projection period.

3/ Growth rates are lower by 1 percentage points.

4/ Current account deficit has higher by a 1/4 of standard deviation.

5/ Inflation lower by 3 percentage points in 2010 and 2011.

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington DC

Athens, May 3, 2010

Dear Mr. Strauss-Kahn:

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 during a difficult transition period toward a more open and competitive economy. The government is fully committed to the policies stipulated in this document and its attachments, to frame tight budgets in the coming years with the aim to reduce the fiscal deficit to below 3 percent in 2014 and achieve a downward trajectory in the public debt-GDP ratio beginning in 2013, to safeguard the stability of the Greek financial system, and to implement structural reforms to boost competitiveness and the economy's capacity to produce, save, and export. In this regard, the government is also fully and equally committed to the policies stipulated in the Decision and Recommendation issued by the EU Council on February 16, 2010.

The government is strongly determined to lower the fiscal deficit, including by achieving higher and more equitable tax collections, and constraining spending in the government wage bill and entitlement outlays, among other items.

In view of these efforts and to signal the commitment to effective macroeconomic policies, the Greek government requests that the Fund supports this multi-year program under a Stand-By Arrangement (SBA) for a period of 36 months in an amount equivalent to SDR26.4 billion (3,212 percent of quota; €30 billion). A parallel request for financial assistance to euro area countries for a total amount of €80 billion has been sent.

The implementation of the program will be monitored through quantitative performance criteria and structural benchmarks as described in the attached MEFP and Technical Memorandum of Understanding (TMU). There will be twelve quarterly reviews of the program supported under the SBA by the Fund, in coordination with the European Commission and the ECB, to begin with the first review that is expected to be completed in the course of the third calendar quarter of 2010, and then every quarter thereafter until the last quarterly review envisaged to be completed during the second calendar quarter of 2013, to 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 bilateral funding arrangement of the euro area member states for Greece.

The Greek authorities believe that the policies set forth in the attached memorandum are adequate to achieve the objectives of the economic program, and stand ready to take any further measures that may become appropriate for this purpose. The authorities will consult with the Fund in accordance with its policies on such consultations, and with the European

Commission and the ECB on the adoption of these measures and in advance of revisions to the policies contained in the MEF. All information requested by the Fund, the European Commission, and ECB to assess implementation of the program will be provided.

This letter is copied to Messrs. Juncker, Rehn, and Trichet.

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 strengthening 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 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 €11 billion had been used by end-2009), to provide a substantial €17 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 co-financing 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 €110 billion, for the program period, which we expect to cover through matching bilateral lending support from euro area member states (€80 billion) and through IMF support (€30 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.

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 Program 1/
(in millions of Euros)

	2010	2011	2012	2013	Cum	% GDP
I. Revenue measures						
VAT rates increase by 10 percent (10% to 11%; 21% to 23%)	800	1,000	0	0	1,800	0.8
Broadening VAT base	0	1,000	500	0	1,500	0.7
Excise tax on fuel	200	250	0	0	450	0.2
Excise tax on cigarettes	200	300	0	0	500	0.2
Excise tax on alcoholic beverages	50	50	0	0	100	0.0
Excise goods on non-alcoholic beverages	0	0	300	0	300	0.1
Excise tax on luxury goods	0	100	0	0	100	0.0
Green taxes	0	300	0	0	300	0.1
Gaming royalties	0	200	400	0	600	0.3
Gaming licenses	0	500	225	-725	0	0.0
Special levy on highly profitable firms	0	600	0	0	600	0.3
Presumptive taxation of professionals	0	400	100	0	500	0.2
Taxation of wage in kind (cars)	0	150	0	0	150	0.1
Book specification of incomes	0	50	0	0	50	0.0
Increase legal value real estate	0	400	200	100	700	0.3
Amnesty land use violations	0	500	0	0	500	0.2
Taxation of unauthorized establishments	0	800	0	0	800	0.3
II. Expenditure measures						
Reduce wage bill by cutting bonuses/allowances	1,100	400	0	0	1,500	0.7
Workforce reduction beyond 5:1 (add. 20,000)	0	0	600	500	1,100	0.5
Savings from introduction of unified public sector wages	0	100	0	0	100	0.0
Eliminate pension bonuses (except for minimum pensions)	1,500	500	0	0	2,000	0.9
Additional pension reduction above a certain threshold	350	150	0	0	500	0.2
Nominal pension freeze	0	100	250	200	550	0.2
Means test unemployment benefit	0	0	500	0	500	0.2
Cancel second installment of solidarity allowance	400	0	0	0	400	0.2
Cut intermediate consumption	700	300	0	0	1,000	0.4
Kalikrates	0	500	500	500	1,500	0.7
Cut in transfers to public enterprises	0	0	1,500	0	1,500	0.7
Cut domestically funded investment spending	500	500	500	0	1,500	0.7
Yet to be quantified yield from structural reform initiatives	0	0	0	4,200	4,200	1.8
Total annual measures	5,800	9,150	5,575	4,775	25,300	11.0
Revenue measures	1,250	6,600	1,725	-625	8,950	3.9
Expenditure measures	4,550	2,550	3,850	5,400	16,350	7.1
Total measures (in percent of GDP)	2.5	4.1	2.4	2.0		11.0
Revenue measures	0.5	3.0	0.8	-0.3		3.9
Expenditure measures	2.0	1.1	1.7	2.3		7.1
Memorandum item:						
Nominal GDP	231	224	228	235		229

Source: Greece authorities, and IMF staff estimates.

1/ Yield of measures relative to the previous year.

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

	Performance Criteria				Indicative Targets				
	Jun-10 Progr. 1/	Sep-10 Progr. 1/	Dec-10 Progr. 1/	Jun-10 Progr. 1/	Sep-10 Progr. 1/	Dec-10 Progr. 1/	Dec-11 Progr. 2/	Dec-12 Progr. 3/	Dec-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	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 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] onward.

Greece. Table 3. Greece: Structural Conditionality for 2010 1/		
Measures	Date	Macrocritical relevance
<ol style="list-style-type: none"> 1. Reduce public wage bill by cutting bonuses/allowances; and pension bonuses (except minimum pensions). 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. 3. Appoint staff team and leader in GAO responsible for general government in-year cash reporting. 	Prior actions	<p>Improves fiscal sustainability; has signaling effect for private sector wage setting.</p> <p>Improves fiscal sustainability.</p> <p>Establishes in-year oversight responsibilities of general government fiscal policy.</p>
	End-June 2010	<p>Enhances financial stability.</p> <p>Improves fiscal sustainability.</p>
	Structural benchmarks	
	<ol style="list-style-type: none"> 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. 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 (Kallikrates). 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 4. The National Actuarial Authority to produce a report to assess whether the parameters of the new system significantly strengthen long-term actuarial balance. 	<p>Improves credibility of the budget and fiscal consolidation program.</p> <p>Reduces budgetary costs of ageing and improves long-term fiscal sustainability. Increases labor force participation.</p>
<ol style="list-style-type: none"> 1. Adopt a comprehensive pension reform that reduces the projected increase in public spending on pensions over the period 2010-60 to 2%; percent of GDP. 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). 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. 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. 	End-September 2010	<p>Improves fiscal sustainability.</p> <p>Reduces budget overruns.</p> <p>Increases transparency of fiscal risks to fiscal sustainability.</p> <p>Achieves revenue targets and enhances sustainability of the consolidation by increasing burden sharing of the adjustment.</p>
	End-December 2010	<p>Reduces wage escalation. Improves transparency of public sector employment.</p> <p>Enhance confidence in fiscal reporting and support the formulation of fiscal policy.</p> <p>Reduces state intervention in the real economy, improves market efficiency, and cuts fiscal contingencies.</p>

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

GREECE: TECHNICAL MEMORANDUM OF UNDERSTANDING

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 $\text{€}1 = 1.3315 \text{ U.S. dollar}$, $\text{€}1 = 125.81 \text{ Japanese yen}$, $\text{€}1.135 = 1 \text{ SDR}$.

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 (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by central or general government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to European Commission, ECB and IMF staff.

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

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

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

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

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 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 on debt contracted or guaranteed by the general government, which has not been made within seven days after falling due. The performance criterion will apply on a continuous basis throughout the program period.

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.

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. We 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 bringing up 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 periodic 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 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 bring forward the correction to the intended deficit 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 €11 billion had been used by end-2009), to provide a substantial €17 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 invited 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, 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 €110 billion, for the program period, which we expect to cover through matching bilateral lending support from euro area member states (€80 billion) and through IMF support (€30 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 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 purchases 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
	Revenue	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
	Expenditure	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	5800	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
	Revenue	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
	Expenditure	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
Unidentified cuts in operational expenditure	900	0.4
TOTAL ANNUAL IMPACT	5575	2.4

2013		
<i>in million EUR</i>		% of GDP
	Revenue	-0.3
Presumptive taxation	100	0.0
Gaming licenses	-725	-0.3
	Expenditure	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
	Unidentified measures	4200
	4200	1.8
	TOTAL ANNUAL IMPACT	4775
		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>		2.4
TOTAL ANNUAL IMPACT		1.9
TOTAL MEASURES 2010–2014		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

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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
<ol style="list-style-type: none"> 1. Reduce public wage bill by cutting bonuses/allowances, and pension bonuses (except minimum pensions). 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. 3. Appoint staff team and leader in GAO responsible for general government in-year cash reporting. 		<p>Improves fiscal sustainability; has signaling effect for private sector wage setting.</p> <p>Improves fiscal sustainability.</p>
Structural benchmarks	End-June 2010	Establishes in-year oversight responsibilities of general government fiscal policy.
<ol style="list-style-type: none"> 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. 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 (Kallikrates). 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. 4. The National Actuarial Authority to produce a report to assess whether the parameters of the new system significantly strengthen long-term actuarial balance. 		<p>Enhances financial stability.</p> <p>Improves fiscal sustainability.</p> <p>Improves credibility of the budget and fiscal consolidation program.</p>
<ol style="list-style-type: none"> 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. 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). 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. 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. 	End-September 2010	<p>Reduces budgetary costs of ageing and improves long-term fiscal sustainability. Increases labor force participation.</p> <p>Improves fiscal sustainability.</p> <p>Reduces budget overruns.</p> <p>Increases transparency of fiscal risks to fiscal sustainability.</p> <p>Achieves revenue targets and enhances sustainability of the consolidation by increasing burden sharing of the adjustment.</p>
<ol style="list-style-type: none"> 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. 2. Adopt new Regulation of Statistical Obligations for the agencies participating in the Greek Statistical System. 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. 	End-December 2010	<p>Reduces wage escalation. Improves transparency of public sector employment.</p> <p>Enhance confidence in fiscal reporting and support the formulation of fiscal policy.</p> <p>Reduces state intervention in the real economy; improves market efficiency, and cuts fiscal contingencies.</p>

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
A.	48.5	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
B.	53.0	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
C.	138.3	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
D.	50.0	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
E.	88.3	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
F.	1.5	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
G.	192.8	Public sector financing need (B+C+F)	27.0	13.0	10.4	9.4	18.4	17.7	15.5	10.0	23.2	17.3	16.7	9.6
H.		Rollover of short-term debt	...	0%	87%	93%	100%	100%	113%	113%	100%	100%	111%	111%
I.		Rollover of long-term debt	...	0%	0%	0%	0%	0%	0%	0%	75%	75%	75%	75%
J.	77.9	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
K.	47.0	of which short-term borrowing (D*H)	...	0.0	4.0	4.0	4.0	4.0	4.5	4.5	4.0	4.0	5.0	5.0
L.	30.9	of which long-term borrowing (E*I)	...	0.0	0.0	0.0	0.0	0.0	0.0	0.0	11.3	6.9	6.1	0.8
M.	0.0	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
N.	0.0	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
O.	10.0	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
P.	109.2	Financing gap (E-G-H-I+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
Q.	110.0	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
R.	30.0	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
S.	80.0	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

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

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:

- 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			
	2010	2011	2012	2013
(in million of euro)				
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>		1105	1231	1284
<i>Target of second half of the year</i>		2245	2499	2606
<i>Total annual target</i>	2750	3350	3730	3890

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;⁷
- 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;

⁷

Adjustments may be needed in case of negative inflation.

- Collect revenue from the licensing of gaming: at least EUR 500 million in sales of licences and EUR 200 in royalties;
- 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

1. 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

2. 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 ⁸	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

⁸ 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		
PUBLIC ADMINISTRATION REFORMS	Action	Time frame
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>
	- 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		<i>September 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
government	<ul style="list-style-type: none"> - 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>June 2011</i>
Better Regulation	<ul style="list-style-type: none"> -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	<ul style="list-style-type: none"> To prepare the revision of private sector wage bargaining and contractual arrangements - 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>June 2010</i> <i>December 2010</i>
Reform Employment Protection Legislation		
Reform minimum wages	<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 	<i>December 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	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	<p>Government to adopt a new simplified system (pro rata) for all current and future employees including:</p> <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 	<i>June 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	<ul style="list-style-type: none"> - 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>	September 2010
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, the publication of audited accounts	December 2010
BUSINESS ENVIRONMENT		
Facilitate business start ups	Simplify the start up of new businesses and make the General Commercial Registry (GEMD) fully operational	June 2010 September 2010

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
Simplify the licensing of industrial units and reduce the costs of doing business	- simplify and accelerate the process of licensing enterprises, industrial activities and professions through legislation and by making the spatial plans operational	<i>December 2010</i>
	- Government to change legislation to mitigate tax obstacles to mergers and acquisitions, and lower costs associated with customs	<i>September 2011</i>
Implement the Services Directive	- adopt horizontal legislation, finalize screening of sectoral legislation	<i>June 2010</i>
	- make single points of contact operational	<i>September 2010</i>
	- adopt measures in key service sectors such as tourism, retail and education	<i>December 2010</i>
Open up restricted professions	- propose sector-specific legislation to remove restrictions to trade in the legal profession, the pharmacy profession, the notary profession, architects, engineers, auditing services	<i>December 2010</i>
	- implement the Professional Qualifications Directive so that qualifications from third countries are recognized	<i>December 2010</i>
	- adopt legislation to open up restricted professions	<i>June 2011</i>
Reform road freight transportation	Liberalize road freight transport by removing all unnecessary restrictions on admission to the occupation of road haulage, including minimum fixed prices	<i>September 2010</i>
Competition policy framework	Modify the existing institutional framework of the Hellenic	<i>December 2010</i>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	Competition Commission, including to allow prioritisation on important cases and to strengthen the independence of HCC members	
Railways	- 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	<i>June 2010</i>
	- implement fully the recovery plan for the railway sector	<i>March 2011</i>
Energy	-finalise plans for the liberalization of the wholesale electricity market and commence with the rationalization of consumer tariffs	<i>September 2010</i>
	-adopt legislation to unbundle electricity and gas activities, including measures	<i>March 2011</i>
	- adopt measures to strengthen the independence and capacity of the Energy Regulatory Authority	<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 measures to facilitate PPPs, action to fast-track large FDI projects and measures to strengthen export promotion policy	<i>September 2010</i>
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>

STRUCTURAL REFORMS: CONDITIONALITY		
	Action	Time frame
	<ul style="list-style-type: none"> - 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	<ul style="list-style-type: none"> - put in place measures to achieve binding targets for payment claims of Structural and Cohesion Funds and for submission of large projects - 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 - introduce a 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 	<i>June 2010</i>
		<i>December 2010 and every six months thereafter</i>
		<i>December 2011</i>
		<i>December 2011</i>

GREECE: TECHNICAL MEMORANDUM OF UNDERSTANDING
May 3, 2010

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

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.

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.

VI. 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)

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.

• **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:

- . Central government revenue (Cumulative from January 1, 2010)
- . June 2010: €25,056 million
- . September 2010: €41,232 million
- . December 2010: €58,382 million.
- . **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)

. **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 (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by central or general government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to European Commission, ECB and IMF staff.

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

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

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.

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

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

. **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.

. **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.

. **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)

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

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

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

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

. **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

. 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

. **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.

. **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.

INTERNATIONAL MONETARY FUND

Greece—Assessment of the Risks to the Fund and the Fund's Liquidity Position

Prepared by the Finance and Strategy, Policy, and Review Departments

(In consultation with other Departments)

Approved by Thomas Krueger and Martin Mühleisen

May 6, 2010

This note assesses the risks to the Fund arising from the proposed Stand-By Arrangement (SBA) for Greece and its effects on the Fund's liquidity, in accordance with the policy on exceptional access.⁹ The authorities are requesting a three-year SBA with access of SDR 26.43 billion (3,212 percent of quota or 2,399 percent of post second-round quota). The arrangement would have a frontloaded purchase schedule with a first purchase of SDR 4.81 billion (584 percent of quota) upon approval, followed by twelve purchases of varying amounts as shown in Table 1. Access during the first year would reach almost 1,550 percent of quota and the last purchase under the arrangement would be available in May 2013.

Table 1. Greece: Proposed SBA—Access and Phasing

Availability	Date 1/	SDR mn	Percent of quota	
			Purchase	Cumulative
2010	May (approval)	4,805.9	583.9	583.9
	August	2,162.7	262.8	846.7
	November	2,162.7	262.8	1,109.5
2011	February	3,604.5	438.0	1,547.5
	May	2,883.6	350.4	1,897.9
	August	1,922.4	233.6	2,131.4
	November	1,201.5	146.0	2,277.4
2012	February	2,403.0	292.0	2,569.4
	May	1,441.8	175.2	2,744.6
	August	1,441.8	175.2	2,919.8
	November	480.6	58.4	2,978.2
2013	February	1,441.8	175.2	3,153.4
	April	480.6	58.4	3,211.8
Total		26,432.9	3,211.8	3,211.8

Source: Finance Department.

1/ Starting August 30, 2010, purchases will depend on the completion of a review.

⁹ See *IMF Concludes Discussion on Access Policy in the Context of Capital Account Crises; and Review of Access Policies in the Credit Tranches and the Extended Fund Facility*. Public Information Notice (PIN) No. 03/37; available via the internet: <http://www.imf.org/external/np/sec/pn/2003/pn0337.htm>.

VII. BACKGROUND

Greece made purchases from the Fund between 1974 and 1976 under different facilities. Fund credit, which totaled SDR 386 million, was used to finance short-term balance of payments financing gaps due to rising energy prices and falling Greek exports, and to facilitate counter-cyclical fiscal and monetary policies as the authorities' pursued a more flexible exchange rate regime and implemented wage restraint to improve external competitiveness. All obligations to the Fund have been met in a timely manner.

Greece's external debt, mostly denominated in Euros, is the highest of recent exceptional access cases, with public sector debt accounting for the largest share. At end-2009, Greece's total external debt stood at 170 percent of GDP, of which almost 65 percent was public sector debt (Table 2). Greece's total external and public external debts as ratios of GDP are the highest among recent exceptional access cases (Figure 1, Panels A and B).¹⁰ Private sector external debt, at 59 percent of GDP in 2009, has doubled relative to GDP since 2004 and is predominantly short-term. At end-2009, Greece's total stock of short-term external debt stood at approximately 60 percent of GDP, of which about a third are liabilities of the Bank of Greece to the ECB and the rest mostly consists of Greek banks' liabilities.

Table 2. Greece: Total External Debt, 2005–2009 1/

	2004	2005	2006	2007	2008	2009	Proj. 2010 2/
(In Billions of Euros)							
Total External Debt	186	223	253	309	363	404	427
Public	131	152	163	188	227	264	329
Short-term 3/	7	7	8	12	41	51	84
Long-term	125	145	154	176	186	213	245
Private	55	70	90	121	135	140	98
Short-term	21	28	35	56	71	93	51
Long-term	33	42	55	64	64	47	46
(In Percent of GDP)							
Total External Debt	100.1	114.1	120.2	136.3	151.6	170.0	185.0
Public	70.6	78.0	77.4	83.0	95.1	111.1	142.7
Short-term 3/	3.6	3.7	4.0	5.3	17.1	21.4	36.5
Long-term	67.1	74.3	73.4	77.7	78.0	89.6	106.2
Private	29.5	36.1	42.8	53.3	56.6	59.0	42.4
Short-term	11.4	14.4	16.6	24.8	29.9	39.2	22.3
Long-term	18.0	21.7	26.2	28.5	26.7	19.8	20.1
<i>Memorandum items:</i>							
Short-term external debt (billions of euros)	28	35	43	68	112	144	136
Short-term external debt (% of GDP)	15.0	18.1	20.6	30.1	46.9	60.6	58.8
Total public sector debt (% of GDP)	98.6	100.0	97.1	95.6	99.2	115.2	133.3

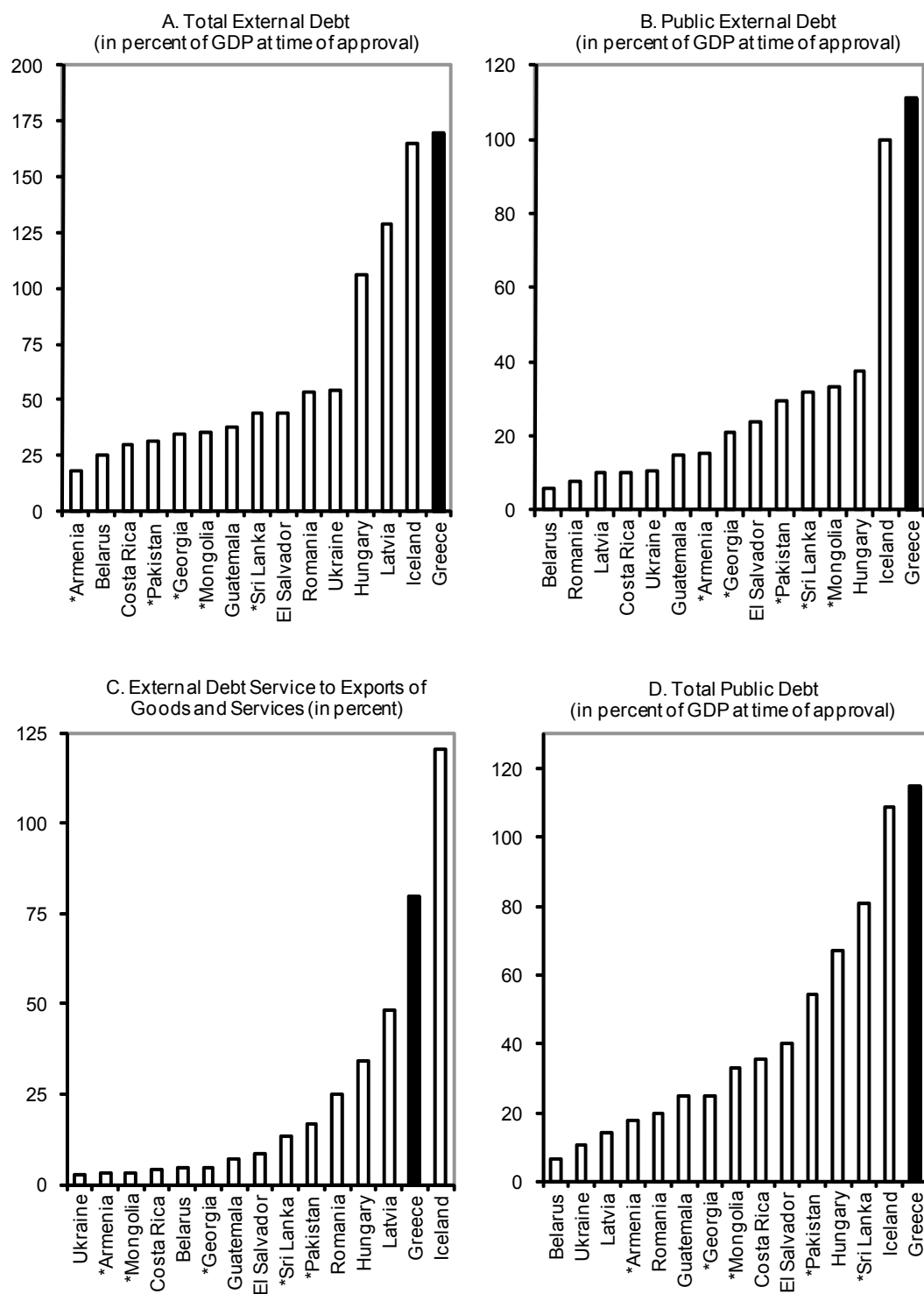
Source: Greek authorities and IMF staff estimates.

1/ End of year unless otherwise indicated.

2/ Staff projections for end-2010.

3/ Includes short-term liabilities of the Bank of Greece to the Eurosystem.

¹⁰ Throughout the paper recent exceptional access cases refer to arrangements since September 2008.

Figure 1. Debt Ratios for Recent Exceptional Access Arrangements 1/

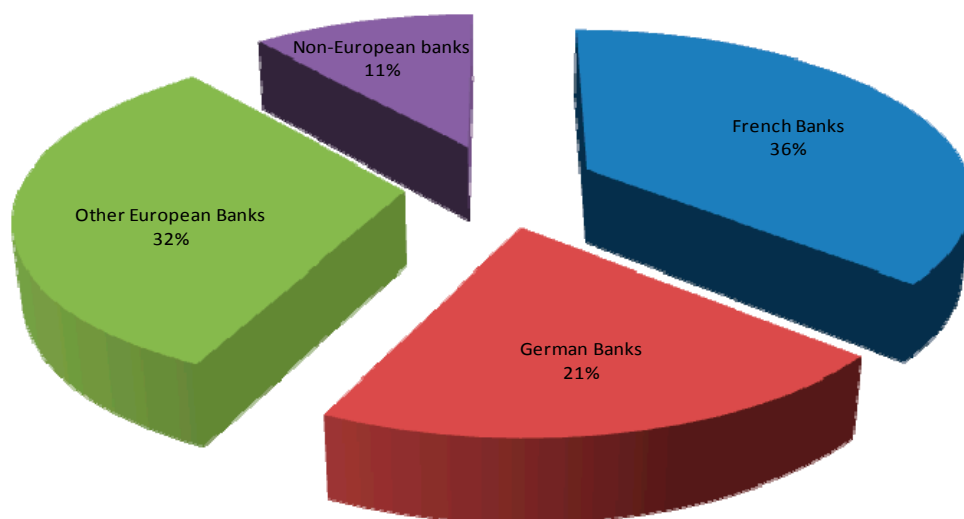
Source: Greek authorities and IMF staff estimates, and World Economic Outlook.

1/ For arrangements approved since September 2008, estimates as reported in each staff report on the request of the Stand-By Arrangement. For Greece, ratios reflect end-2009 data. Asterisks indicate PRGF eligible countries.

Greece's external debt service burden, particularly on short-term maturities, is heavy. Reflecting the country's high debt stock and low export earnings, Greece's external debt service is higher than that for most of the other exceptional access cases (Figure 1, Panel C).¹¹ If short-term obligations are also included, the debt service reaches about 375 percent of exports of goods and services.

5. **Public debt is high and mostly owed to external creditors.** Total public debt is estimated at 115 percent at end-2009—the highest ratio among recent exceptional access cases (Figure 1, Panel D).¹² Public external debt has increased rapidly since 2004 from 71 percent of GDP to 111 percent of GDP in 2009 (Table 2).¹³ In 2009, about 80 percent of public debt was owed to external creditors, up from about 70 percent in 2004. A large part of the public debt (Euro 150 billion at end-2009) is held by foreign banks, mostly European (Figure 2).

Figure 2. Consolidated BIS-reporting Bank Claims on Greece
end-2009, percent of total claims



Source: BIS Consolidated Bank Statistics and IMF staff estimates.

¹¹ For comparability with other recent access cases, public debt in Figure 1 is defined excluding short-term obligations.

¹² Public debt may be revised upwards by 5-7 percentage points according to Eurostat.

¹³ Total public sector debt, as defined by Eurostat, does not include external liabilities of the Bank of Greece (about 20 percent of GDP at end-2009), which, however, are included in total external public sector debt.

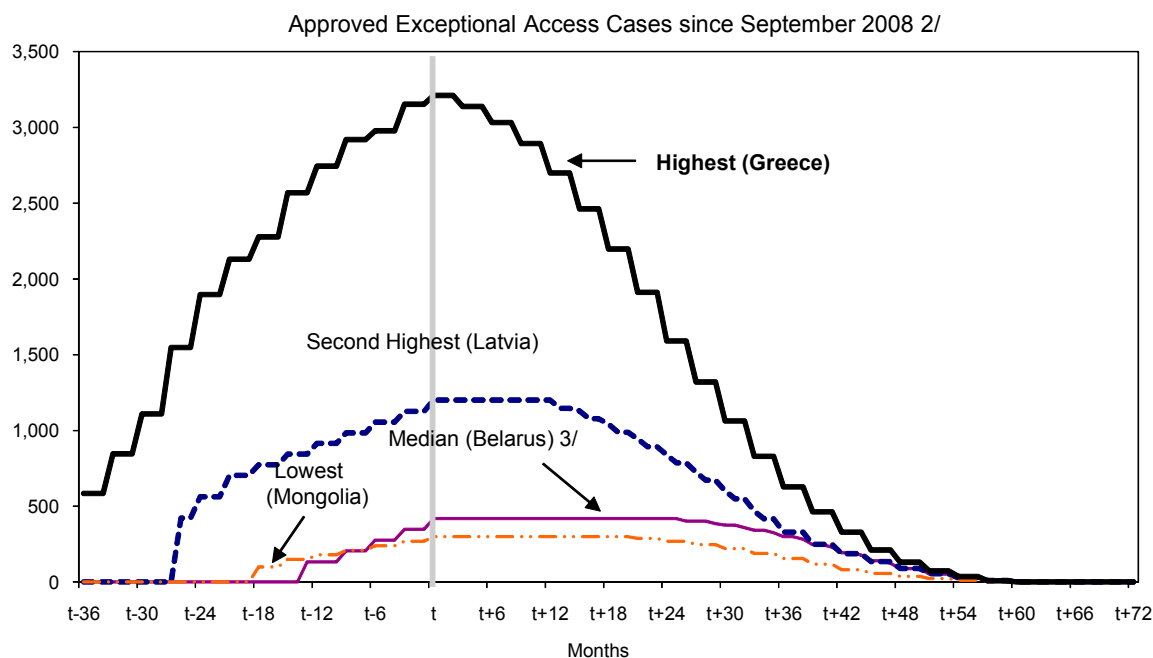
VIII. THE NEW STAND-BY ARRANGEMENT—RISKS AND IMPACT ON FUND’S FINANCES

A. Risks to the Fund

Access under the proposed arrangement would surpass the annual access limit and be among the highest in terms of various indicators:

- If all purchases were to be made as scheduled, Greece’s outstanding use of GRA resources would rise to 584 percent of quota upon approval, to about 1,550 percent of quota during the first year of the arrangement, and then peak at just over 3,200 percent of quota in May 2013. In terms of quota, this projected peak exposure would be the highest in Fund history (Figure 3).¹⁴

Figure 3. Fund Credit Outstanding in the GRA around Peak Borrowing 1/
(In percent of quota)



Source: IFS, Finance Department, and IMF staff estimates.

1/ Peak borrowing 't' is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be on an obligations basis.

2/ Including precautionary arrangements.

3/ Median credit outstanding at peak is 410 percent of quota; average is 611 percent of quota.

¹⁴ The previous arrangements with the highest approved access as percentage of quota were Korea (1,938 percent) in 1997 followed by Turkey (1,560 percent) in 2001.

- If all purchases under the proposed SBA are made, GRA credit outstanding to Greece would be equivalent to 12.1 percent of GDP and about 8.3 percent of total external public debt by 2013 (Table 3). The peak ratio in terms of GDP would be among the highest of recent exceptional access cases, below only Iceland (Figure 4, Panel A).¹⁵
- In terms of SDRs, the projected peak GRA exposure of SDR 26.43 billion would be the highest among recent exceptional access cases (Figure 5, Panel A).¹⁶

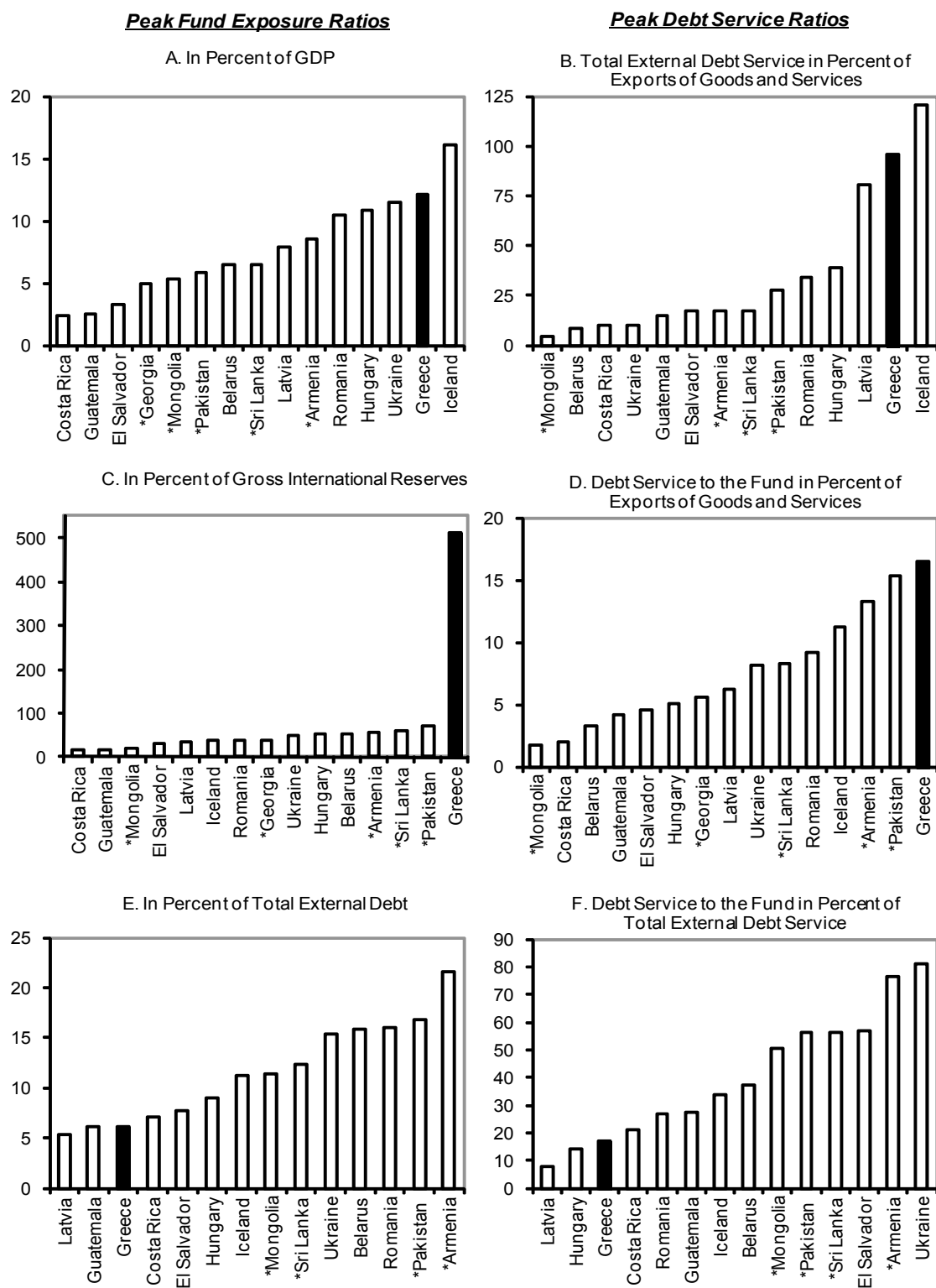
If all purchases under the proposed SBA take place as scheduled, debt service ratios to the Fund would be high in terms of a range of standard indicators, in the context of a heavy overall debt service burden.¹⁷ For comparability with risk assessments in other exceptional access cases, Table 3 shows debt service to the Fund projected under the assumption that the SDR interest rate remains at its current level. Greece's projected debt service to the Fund would peak at almost SDR 10 billion in 2015 (Table 3). This would be (i) about 4½ percent of GDP, (ii) over 12 percent of general government revenues, and (iii) about 16 percent of exports of goods and services (Figure 4, Panel D), the highest in recent exceptional access cases, and in the context of an overall external debt service burden peaking at over 100 percent of exports of goods and services (Figure 4, Panel B). Allowing for an SDR interest rate path rising to 3.5 percent by 2015, consistent with the recent medium-term income projections and those in the staff report (Table 8), debt service would be over 11 percent higher on average (see Annex). These ratios highlight the very substantial risks to the Fund.

The financial support from the eurozone members has a debt service schedule aligned with the Fund's repurchase schedule. When debt service on borrowing from the eurozone members is included, peak debt service would reach about SDR 36 billion annually, and bring the external debt service ratios to about 17 percent of GDP, about 46 percent of general government revenues, and over 60 percent of exports of goods and services. These figures, which are based on the SDR interest rate path in the staff report, underscore the scale of market access that needs to be secured soon after the end of the program, in the context of average amortizations of public medium- and long-term external debt of over 65 percent of general government revenue.

¹⁵ GRA credit outstanding to Greece would peak at over 500 percent of gross international reserves in 2013 (Figure 4, Panel C), but this indicator is less relevant in the case of Greece owing to its Euro-area membership.

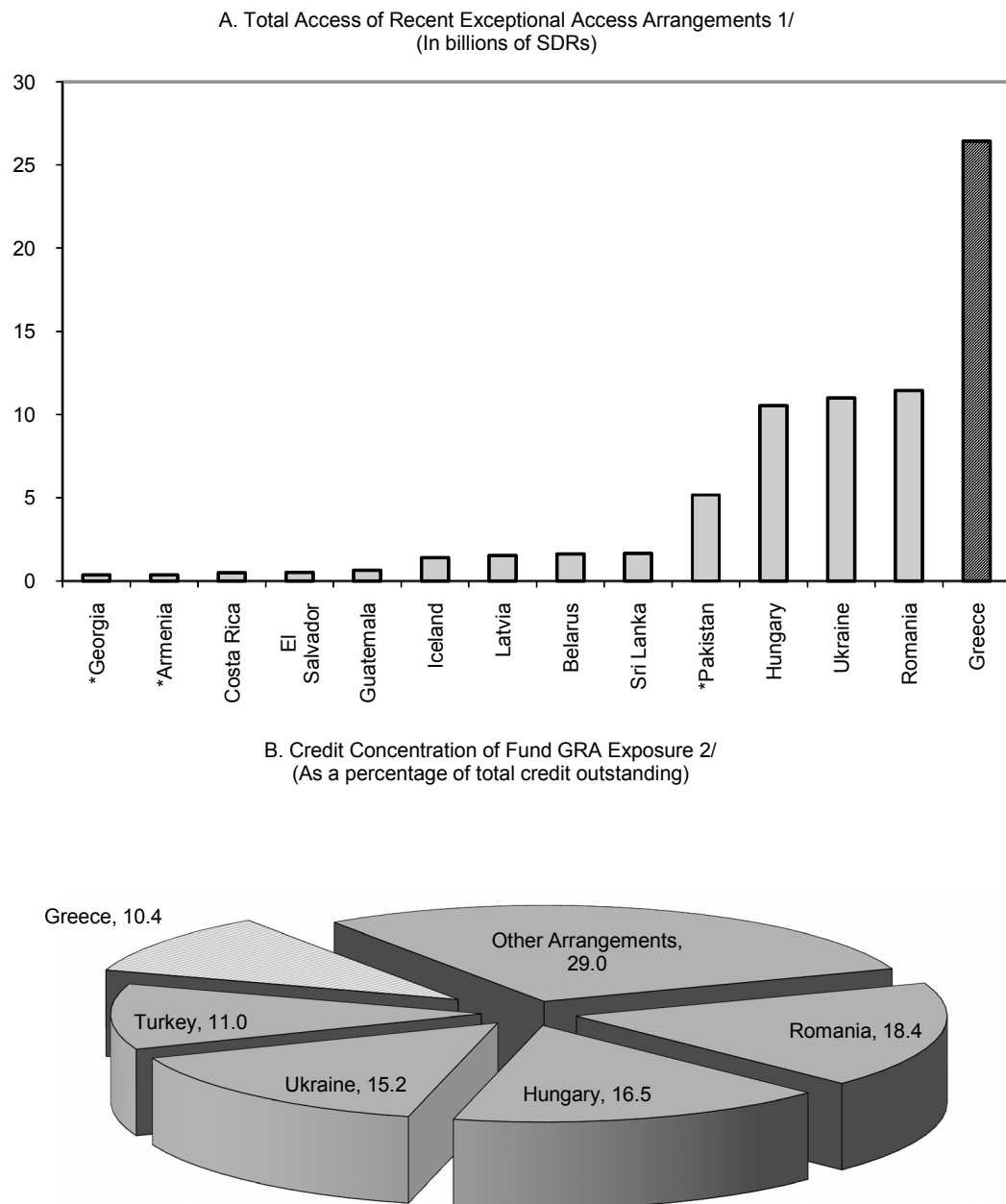
¹⁶ This assumes that no drawings will be made under the FCL arrangement with Mexico.

¹⁷ Debt service to the Fund is calculated assuming that all repurchases are made as scheduled, i.e., each purchase is repurchased in eight quarterly installments, beginning in 3¼ years after each purchase and ending after 5 years. Surcharges apply to outstanding credit above 300 percent of quota.

Figure 4. Peak Fund Exposure and Debt Service Ratios for Recent Exceptional Access Cases

Source: Greek authorities and IMF staff estimates, and World Economic Outlook.

1/ Asterisks indicate PRGF eligible countries.

Figure 5. Exceptional Access Levels and Credit Concentration

Source: Finance Department.

1/ Does not include FCL arrangements. Asterisks indicate PRGF eligible countries.

2/ Credit outstanding as of April 29, 2010 plus expected first purchase under the proposed arrangement with Greece.

Table 3. Greece—Capacity to Repay Indicators 1/

	May-10	2010	2011	2012	2013	2014	2015
Exposure and Repayments (In SDR millions)							
GRA credit to Greece 2/	4,805.9	9,131.3	18,743.3	24,510.5	24,951.1	18,082.6	8,740.9
(In percent of quota)	583.9	1,109.5	2,277.4	2,978.2	3,032.9	2,197.2	1,062.1
Charges due on GRA credit 3/	-	110.3	423.5	673.0	912.3	915.6	571.4
Debt service due on GRA credit 4/	-	110.3	423.5	673.0	2,384.1	7,794.2	9,913.0
Debt and Debt Service Ratios 5/							
In percent of GDP							
Total external debt	170.0	185.0	193.3	198.4	202.2	203.8	200.9
External debt, public	111.1	142.7	147.8	150.9	150.3	148.7	147.7
GRA credit to Greece	2.2	4.5	9.5	12.2	12.1	8.5	3.9
Total external debt service 6/	14.2	13.8	18.0	17.1	16.1	24.5	26.4
Public external debt service 6/	8.0	9.4	10.9	10.9	11.8	22.9	25.2
Debt service due on GRA credit	-	0.1	0.2	0.3	1.2	3.7	4.5
In percent of Central Government Revenues							
Public external debt service 6/	21.6	23.6	28.0	28.4	30.9	61.7	69.5
Debt service due on GRA credit	-	0.1	0.6	0.9	3.0	9.8	12.3
In percent of Gross International Reserves							
Total external debt	7,309.2	7,729.3	7,827.7	8,201.8	8,595.4	8,935.9	9,142.7
External debt, public	4,774.2	5,960.2	5,984.2	6,239.7	6,392.0	6,521.4	6,723.5
GRA credit to Greece	96.4	187.6	385.1	503.6	512.8	371.5	179.6
Debt service due on GRA credit	-	2.3	8.7	13.8	49.0	160.1	203.7
In percent of Exports of Goods and Services							
Total external debt service 6/	80.0	65.3	76.3	68.8	62.3	91.4	95.4
Public external debt service 6/	44.7	44.8	46.2	44.0	45.8	85.6	91.3
Debt service due on GRA credit	-	0.3	0.9	1.3	4.5	13.6	16.2
In percent of Total External Debt							
GRA credit to Greece	1.3	2.4	4.9	6.1	6.0	4.2	2.0
In percent of Total External Debt Service							
Debt service due on GRA credit	-	0.4	1.2	2.0	7.2	14.9	17.0
In percent of Total Public External Debt							
GRA credit to Greece	1.9	3.4	6.6	8.2	8.1	5.9	2.8
In percent of Total Public External Debt Service							
Debt service due on GRA credit	-	0.6	2.0	3.1	9.8	15.9	17.7

Sources: Greek authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawings.

2/ Repurchases are assumed to be made as scheduled.

3/ Includes GRA basic rate of charge, surcharges and service fees.

4/ Includes charges due on GRA credit and payments on principal.

5/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed SBA. For April 2010, the figures use stock values as of end-December 2009.

6/ Interest on and amortization of medium and long-term debt.

IX. IMPACT ON THE FUND'S LIQUIDITY POSITION AND RISK EXPOSURE

The impact of the proposed arrangement on the Fund's liquidity and credit risk exposure is very substantial:

- **The proposed arrangement would reduce Fund liquidity significantly (Table 4).** Commitments under the proposed arrangement would reduce the one-year forward commitment capacity (FCC), which currently stands at about SDR 169 billion, by over 15 percent.¹⁸
- **If the first purchase is made, Fund credit to Greece would represent over 10 percent of total GRA Fund credit (Figure 5, Panel B),** making Greece one of the larger users of Fund resources. The share of the top five users of Fund resources of total outstanding credit would decrease by several percentage points to about 71 percent (Table 4).
- **Potential total GRA exposure to Greece would be a multiple of the current level of the Fund's precautionary balances.** After the first purchase, Fund credit to Greece would be over 65 percent of the Fund's current precautionary balances (Table 4), and the total access would be over 3½ times the current level of precautionary balances. Credit outstanding to Greece will exceed the current level of precautionary balances through 2015, and average at over twice their size.
- **In the event Greece were to fully draw on resources available under the proposed SBA, the charges accruing to Greece's GRA obligations would far exceed the Fund's burden sharing capacity were they to fall into arrears.**¹⁹ Charges on GRA obligations would equal about SDR 110 million in 2010, over five times the current estimated residual burden-sharing capacity (Table 4).

¹⁸ The FCC is the principal measure of Fund liquidity. The (one-year) FCC indicates the amount of GRA resources available for new financing over the next 12 months. See *Borrowing by the Fund—Operational Issues*.

¹⁹ Under the burden-sharing mechanism, the financial consequences for the Fund that stem from the existence of overdue financial obligations are shared between creditors and debtors through a decrease in the rate of remuneration and an increase in the rate of charge, respectively. The mechanism is used to compensate the Fund for a loss in income when debtors do not pay charges. Under current Board decisions, no burden sharing adjustments can be made that would result in a rate of remuneration below 85 percent of the SDR interest rate. While this limit could be changed, under the Articles the rate of remuneration cannot be below 80 percent of the SDR interest rate (Article V, Section 9(a)). No corresponding ceiling applies to the rate of charge.

Table 4. Greece—Impact on GRA Finances

(millions of SDR unless otherwise noted)

	as of 4/29/2010
Liquidity measures	
One-year Forward Commitment Capacity (FCC) 1/	169,119
Impact on FCC on approval 2/	-26,433
Prudential measures	
Fund GRA commitment to Greece	
in percent of current precautionary balances	373
in percent of total GRA credit outstanding 3/	64
Fund GRA credit outstanding to top five borrowers	
in percent of total GRA credit outstanding 3/	78
in percent of total GRA credit outstanding including first Greek purchase	71
Greece's annual GRA charges in percent of the Fund's residual burden sharing capacity for 2010	554
Memorandum items	
Fund's precautionary balances (as of end-2009) 4/	7,093
Fund's Residual Burden Sharing Capacity 5/	19.8

Sources: Greek authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ May-June 2010 FTP. The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance.

2/ A single country's negative impact on the FCC is defined as the country's sum of Fund credit and undrawn commitments minus repurchases one-year forward.

3/ As of April 29, 2010, not including Greek purchases.

4/ Precautionary balances exclude amounts in Special Reserves attributable to profits on gold sales in FY2010.

5/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

X. ASSESSMENT

The proposed Stand-By Arrangement for Greece intends to support the authorities' economic program during a period of substantial adjustment. The primary objective of the program supported by the Fund and the eurozone members would be to restore market confidence and lay the foundations for sound economic growth in the medium-term through strong and sustained fiscal consolidation and deep structural reforms while safeguarding financial sector stability and reducing the risk of international systemic spillovers.

There are significant risks to the program that could affect Greece's capacity to repay the Fund. Given the lack of alternative instruments, Greece's ability to move toward a sustainable medium-term growth path critically hinges upon fiscal adjustment of an exceptional magnitude coupled with steadfast implementation of similarly ambitious structural reforms. Regaining competitiveness through internal price adjustments and bold fiscal consolidation will be extremely challenging. At the same time, risks to the authorities' program are large and include:

- A deeper-than-expected upfront economic contraction and/or a slower economic recovery could further weaken tax revenues and impart a negative impulse to debt

dynamics while undermining the political consensus for reform amid an already tense social environment;

- The financial sector could require additional public resources as compared to those allowed for in the baseline scenario to stave off the risk of losing public confidence in the banking system, which would increase an already heavy debt burden. The establishment of the Financial Stability Fund should mitigate the solvency risks in the banking sector, while the availability of liquidity support from the ECB and the Bank of Greece should help reduce liquidity risks.
- Greece could find it challenging to secure a further substantial improvement in the primary fiscal balance after the end of the program.
- Greece's access to capital markets may be more constrained than assumed in the program, which would raise the possibility of prolonged Fund financial involvement.

Overall, while the Fund's liquidity position would remain adequate, the proposed access would entail very substantial risks to the Fund against the backdrop of Greece's large external financial obligations and fiscal adjustment requirements. The Fund would be highly exposed to Greece in terms of both the stock of outstanding credit and the projected debt service, in a context of overall debt and debt service burdens that would be peaking at high levels when repayments are due to the Fund. The associated risks would be still larger should any of the risks to the outlook discussed above materialize. However, the circumstances that led to the proposed policy framework are highly exceptional, requiring a strong sign of support from the international community in light of the high risk of international systemic spillovers. While Greece's capacity to repay its Fund obligations, and other creditors, rests crucially on its ability to mobilize sizeable resources from the private sector in the medium term, the authorities' commitment to their comprehensive adjustment program, the strong support of their European partners and the Fund's preferred creditor status all serve to mitigate the financial risks to the Fund.

Annex Table 3. Greece—Capacity to Repay Indicators 1/

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Exposure and Repayments (In SDR millions)							
GRA credit to Greece 2/	4,805.9	9,131.3	18,743.3	24,510.5	24,961.1	18,082.6	8,740.9
(In percent of quota)	584.0	1,109.5	2,277.4	2,978.2	3,032.9	2,197.2	1,062.1
Charges due on GRA credit 3/	-	116.1	528.6	1,048.3	1,586.9	1,622.5	1,053.7
Debt service due on GRA credit 4/	-	116.1	528.6	1,048.3	3,058.7	8,501.0	10,395.3
Debt and Debt Service Ratios 5/							
In percent of GDP							
Total external debt	170.0	185.0	193.3	198.4	202.2	203.8	200.9
External debt, public	111.1	142.7	147.8	150.9	150.3	148.7	147.7
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Public external debt service 6/	8.0	9.4	10.9	10.9	11.8	22.9	25.2
Debt service due on GRA credit	-	0.1	0.3	0.5	1.5	4.0	4.7
In percent of Central Government Revenues							
Public external debt service 6/	21.6	23.6	28.0	28.4	30.9	61.7	69.5
Debt service due on GRA credit	-	0.1	0.7	1.4	3.9	10.7	12.9
In percent of Gross International Reserves							
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GRA credit to Greece	96.4	187.6	385.1	503.6	512.8	371.5	179.6
Debt service due on GRA credit	-	2.4	10.9	21.5	62.8	174.7	213.6
In percent of Exports of Goods and Services							
Total external debt service 6/	80.0	65.3	76.3	68.8	62.3	91.4	95.4
Public external debt service 6/	44.7	44.8	46.2	44.0	45.8	85.6	91.3
Debt service due on GRA credit	-	0.3	1.1	2.1	5.7	14.9	17.0
In percent of Total External Debt							
GRA credit to Greece	1.3	2.4	4.9	6.1	6.0	4.2	2.0
In percent of Total External Debt Service							
Debt service due on GRA credit	-	0.4	1.5	3.1	9.2	16.3	17.8
In percent of Total Public External Debt							
GRA credit to Greece	0.0	0.0	0.0	0.0	0.0	0.0	0.0
GRA credit to Greece	1.9	3.4	6.6	8.2	8.1	5.9	2.8
In percent of Total Public External Debt Service							
Debt service due on GRA credit	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debt service due on GRA credit	-	0.6	2.5	4.8	12.5	17.4	18.6

Sources: Greek authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawings.

2/ Repurchases are assumed to be made as scheduled.

3/ Includes GRA basic rate of charge, surcharges and service fees.

4/ Includes charges due on GRA credit and payments on principal.

5/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed SBA. For April 2010, the figures use stock values as of end-December 2009.

6/ Interest on and amortization of medium and long-term debt.

**INTERNATIONAL MONETARY FUND**EXTERNAL
RELATIONS
DEPARTMENT

Press Release No.
FOR IMMEDIATE RELEASE

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves €30 Billion Stand-By Arrangement for Greece

The Executive Board of the International Monetary Fund (IMF) today approved a three-year SDR 26.4 billion (€30 billion) Stand-By Arrangement for Greece in support of the authorities' economic adjustment and transformation program. This front-loaded program makes SDR 4.8 billion (about €5.5 billion) immediately available to Greece from the IMF as part of joint financing with the European Union, for a combined €20.0 billion in immediate financial support. In 2010, total IMF financing will amount to about €10 billion and will be partnered with about €30.0 billion committed by the EU.

The Stand-By Arrangement, which is part of a cooperative package of financing with the European Union amounting to €110 billion (about US\$145 billion) over three years, entails exceptional access to IMF resources, amounting to more than 3,200 percent of Greece's quota, and was approved under the Fund's fast-track Emergency Financing Mechanism procedures.

"The Greek government should be commended for committing to an historic course of action that will give this proud nation a chance of rising above its current troubles and securing a better future for the Greek people," IMF Managing Director Dominique Strauss-Kahn stated. "Today, the IMF has demonstrated its commitment to doing what it can to help Greece and its people. The road ahead will be difficult, but the government has designed a credible program that is economically well-balanced, socially well-balanced—with protection for the most vulnerable groups—and achievable. Implementation is now the key. Together with our partners in the European Union, we are providing an unprecedented level of support to help Greece in this effort and—over time—to help restore growth, jobs, and higher living standards.

"Today's strong action by the IMF to support Greece will contribute to the broad international effort underway to help bring stability to the euro area and secure recovery in the global economy," the Managing Director stated.

The Greek government has designed an ambitious policy package to address the economic crisis facing the nation. It is a multi-year program that rests on the twin pillars of substantial up-front efforts to correct Greece's grave fiscal imbalances and to make the economy more competitive that in time will restore growth and jobs. The authorities' program is designed with fairness in mind so that the burden will be shared across all levels of society and that the most vulnerable groups will be protected. Exceptional

financial assistance from the international community will support the authorities' efforts by providing sufficient financial resources to allow time for building a track record of policy implementation that will restore market confidence, foster growth and reduce Greece's fiscal imbalances.

Following the Executive Board's action on Greece, Mr. John Lipsky, First Deputy Managing Director and Acting Chair, said:

"The Greek economy has been shaken by adverse market sentiment in the past few months. These pressures reflect concerns about unsustainable public finances and weak competitiveness. Initial attempts to address these problems failed to restore market confidence, with adverse spillover to the banking sector.

"The Greek authorities have now developed a bold program with strong upfront policies to re-establish credibility and regain market confidence. The program focuses on: (i) restoring fiscal sustainability, (ii) boosting external competitiveness, and (iii) safeguarding financial sector stability. To allow time for Greece to implement these reforms and demonstrate a credible track record, as well as ease the burden of adjustments on the part of the Greek people, the international community has embarked on an unprecedented financial support package. The ambitious measures that the Greek authorities are strongly committed to undertaking under the program, including against the backdrop of the significant risk of spillover to other countries, merit an exceptional level of access to Fund resources.

"At the heart of the adjustment strategy is a fiscal consolidation to lower the deficit to well below 3 percent of GDP by 2014 and restore debt sustainability. The authorities have designed a large package of fiscal measures of 11 percent of GDP to achieve this target. The measures have been heavily frontloaded and fully identified. The package appropriately includes a fair distribution of the adjustment burden across society by protecting the most vulnerable and imposing a higher tax burden on the relatively affluent. It also includes measures to rationalize the public sector.

"While short-run output will necessarily contract as the economy adjusts, structural reforms should help to restore external competitiveness and, together with improved market confidence, set the economy on a recovery path. Strong implementation of reforms aimed at increasing the flexibility of the labor market, improving domestic competition, and streamlining public administration will be key.

"The recent European Central Bank's decision to extend Greek bond eligibility for repurchase transactions of market debt instruments issued or guaranteed by the Greek government should help improve bank liquidity. Also, the establishment of a Financial Stability Fund will ensure that banks remain adequately capitalized during the downturn, preserving financial stability. Banking supervision and the legal frameworks will also be strengthened.

"The Greek authorities' program is an appropriately ambitious response to the current circumstances and constraints, but considerable downside risks remain. The challenge

ahead will be to implement the program rigorously, while securing the necessary public consensus for reforms.

“The misreporting of Greece’s 2008 fiscal and public debt data, which led to a breach of obligations under Article VIII, Section 5 of the Fund’s Articles of Agreement, is regrettable. The authorities have already taken remedial measures to address data deficiencies, and they are committed to taking additional corrective actions in consultation with the Fund, EU partners, and Eurostat. No further action is required by the Fund under its procedures for the breach of obligations. Going forward, strict compliance with reporting requirements to the Fund will be required.”

ANNEX

Recent Economic Developments

Greece entered the global recession with deep-rooted vulnerabilities. Amid slowing growth and reduced global risk appetite, the country’s heavy dependence on foreign borrowing heightened concerns over long-standing fiscal and external imbalances. A significant revision to the 2008 and 2009 fiscal deficit data announced by a newly elected government shocked markets because they were twice as large as projected and revealed misreporting of official statistics. Public debt was commensurately increased from below 100 percent of GDP to 115 percent of GDP by end-2009. Further, despite the recession in 2009, the current account deficit stood at 11 percent of GDP—evidence of significant domestic demand inflation and external competitiveness problems.

Initial attempts by the new government to address these vulnerabilities in January 2010 were not convincing. Greece was already in the Excessive Deficit Procedure of the European Union’s Stability and Growth Pact and the authorities agreed to reduce the fiscal deficit to below 3 percent of GDP by 2012. The 2010 budget targets, however, were not sufficiently underpinned by measures, and the macroeconomic assumptions underlying the deficit correction program appeared too optimistic, thus causing further market jitters.

After extensive consultations with the European Commission, additional fiscal measures were announced by the Greek authorities in February and March 2010, but these also failed fully to cement market confidence. Lastly, markets were further unsettled by what was perceived to be insufficiently clear financing assurances from euro partner countries. As a result, market sentiment turned down further, and concerns about fiscal sustainability deepened, thereby worsening the crisis of confidence. Access to foreign funding dried up and spreads on government paper widened sharply, threatening the economy with a downward spiral of unfolding risks.

Program Summary

The authorities’ program focuses on the three key challenges:

1) Restoring confidence and fiscal sustainability: The program envisages an exceptionally strong frontloaded fiscal effort, with fully identified measures through 2013. This is to bolster confidence, regain market access, and put the debt-to-GDP ratio on a

firmly declining path from 2013. The measures are also designed to buffer Greece's most vulnerable.

2) Restoring competitiveness: The program includes nominal wage and benefit cuts and structural reforms to reduce costs and improve price competitiveness, which would help Greece transition to a more investment and export-led growth model. It also envisages improved transparency and a reduced role of the state in the economy.

3) Safeguarding financial sector stability: As the banking system goes through a period of deflation, which is expected to impact profitability and bank balance sheets, the safety net for dealing with solvency pressures will be expanded by establishing a Financial Stability Fund (FSF). To mitigate liquidity pressures stemming from the downgrading of the sovereign, the already existing government banking liquidity support facilities will be extended.

Growth and Inflation Expectations

Real GDP growth is expected to contract sharply in 2010–2011, and recover thereafter with unemployment peaking at nearly 15 percent of GDP by 2012. The frontloaded fiscal adjustment in 2010–11 will suppress domestic demand in the short run; but from 2012 onward, improved market confidence, a return to credit markets, and comprehensive structural reforms, are expected to lead to a rebound in growth.

Inflation is expected to remain below the euro average. The needed adjustment in prices is expected to come from domestic demand tightening, both through fiscal adjustment and efforts to moderate public wages and pensions, and other costs in the economy. Due to their demonstration effects, private sector wages are also expected to moderate. This will help restore price competitiveness.

Additional Background

Greece, which became a member of the IMF on December 27, 1945, has an IMF quota of SDR 823.0 million.

For additional background on the IMF and Greece, see:
<http://www.imf.org/external/country/GRC/index.htm>

Sources: National Statistical Service; Ministry of Economy and Finance; Bank of Greece; and IMF staff estimates.
1/ Excluding unidentified measures.
2/ Measures fully identified up to 2013.
3/ As of January 2010.
4/ Domestic credit growth of households and enterprises.

**Statement by Panagiotis Roumeliotis, Alternate Executive Director for Greece
May 9, 2010**

Despite fast growth during 1997–2007, Greece did not manage to correct its fiscal and external imbalances. The global crisis found Greece with a combination of high public debt, high fiscal deficits, and persistent current account deficits. A sharp revision of 2009 fiscal data undermined market confidence and led to increasing risk premia on sovereign debt. Moreover, a steady erosion of competitiveness reflected underlying distortions of a structural nature.

To restore market confidence and the country's credibility vis-à-vis the investors, Greece undertook corrective fiscal measures at the beginning of 2010. However, these measures failed to restore market confidence.

In this context, the authorities are requesting a three-year Stand-By Arrangement for €30 billion (SDR 26.4 billion), in parallel with bilateral financial support of €80 billion available from euro area partners. The total amount of €110 billion will cover the expected public financing gap during the program's period. Greece has undertaken to draw on the IMF and European Commission resources in a constant ratio of 3 to 8 in each disbursement throughout the program's period. Under this arrangement, Greece is strongly committed to implement a multi-year stabilization program to consolidate public finances, safeguard the financial system, and promote the necessary structural reforms to restore competitiveness, including in the labor market.

Main Elements of the Program

The main objectives of the program are: (i) reducing the fiscal deficit to below 3 percent of GDP by 2014, with the debt-to-GDP ratio beginning to stabilize by 2013 and then declining gradually; (ii) safeguarding the stability of the financial system; and (iii) restoring the competitiveness of the Greek economy through structural reforms.

Fiscal Policy

The fiscal adjustment is frontloaded and all fiscal measures have been identified. The objective of fiscal consolidation will be achieved mainly through the following measures: (i) an increase of tax revenues by 4 percent of GDP by 2013, primarily through the increase of VAT rates, consumption excise taxes for fuel, alcohol, and tobacco; the broadening of the tax base; and the introduction of new taxes (e.g., a green tax); (ii) the significant reduction of expenditures (by 5.2 percent of GDP) by 2013, primarily through: abolishing the 13th and 14th salaries of civil servants and the 13th and 14th pensions both in the public and private sectors, except for those with low-salaries and low-pensions; freezing public salaries and pensions, and drastically limiting new hiring in the public sector in order to achieve a substantive reduction of civil servants (only one new civil servant will replace five retirees); and (iii) the significant reduction of the operational costs of local governments, in the context of the general administration reform.

Overall, the increase in tax revenues and the reduction in public expenditures will amount to 11 percent of GDP in 2010–13. This correction will be achieved through permanent measures, and is expected to yield primary surpluses starting in 2012.

Corrective measures in the tax, pension, and health areas are designed to ensure the sustainability of the systems. The tax reform aims at making the system more progressive by abolishing tax exemptions, fighting tax evasion, and broadening the tax base. To achieve these objectives, the following measures will be implemented: modernizing the tax administration, focusing on collecting revenues from the largest taxpayers; thoroughly enforcing and auditing high-wealth individuals and self-employed; prosecuting the worst offenders; strengthening VAT compliance; and collecting on the large stock of tax arrears.

The pension reform focuses on: merging the existing pension funds into only three funds; linking contributions and benefits; increasing the normal retirement age to 65 years; and restricting early retirement.

On the health front, significant savings of resources are expected through: the introduction of a double entry accrual accounting in hospitals; the periodic publication of audited accounts; improvements in pricing and costing mechanisms; and the separation of health funds from the administration of pensions.

The program includes measures to protect the most vulnerable segments of the population. My authorities are committed to an equitable and fair distribution of the adjustment burden. The tax burden for the rich will increase, while the minimum pension and family allowances will be preserved.

Financial Sector Policies

While the Greek financial sector was able to weather the global financial crisis in 2008, the deterioration of public finances and market confidence poses new challenges. The timely increase in the maximum deposit insurance reassured depositors in 2008, and the recent provision by the government of substantial additional liquidity (€17 billion) helped banks manage tight liquidity conditions.

In the context of the program, the reinforcement of the financial system, in particular the banking sector, will be achieved through the establishment of a fully independent Financial Stability Fund (FSF). The FSF will support banks, if necessary; decisions will be made by an independent board made up of persons of recognized standing in financial markets. Furthermore, other elements of the safety net for the financial sector will be strengthened; in the context of the EU framework for cross-border bank supervision, the Bank of Greece will intensify its supervisory activity and its resources will be augmented.

On May 3rd, the European Central Bank suspended the application of the minimum credit rating threshold in the collateral eligibility requirements for the purposes of the Euro system's credit operations in the case of marketable debt instruments issued or guaranteed by the Greek government. This decision will provide important support to the program by helping to maintain financial stability.

Competitiveness and Structural Policies

The Greek authorities are strongly committed to a very comprehensive structural reform agenda to regain competitiveness and restore growth.

Changes in the collective bargaining processes in the private sector and the new law on labor market flexibility will improve competitiveness. The amelioration of the business climate and the curtailment of bureaucracy in licensing private enterprises will promote investment in the private sector. This will contribute to increasing jobs, including for new entrants into the labor force. Furthermore, my authorities will exercise tight control over the underground economy related to the informal labor market. Finally, Greece will undertake all necessary measures to absorb the EU structural funds through the preparation of project proposals and implementation.

Statistical Issues

The Greek Statistical System suffered for many years from chronic deficiencies, especially in the area of fiscal data.

A few days after coming to power, the new government published revised figures on public sector deficit and debt. In order to establish a credible and independent statistical system, the Parliament approved a new law that changed the legal status of the Statistical Service, formerly a section of the Ministry of Finance. The Statistical System is now a fully independent authority whose President and Board of Directors are appointed with a four-fifths majority vote by a Parliamentary Committee. The law also provides new guidelines according to international standards. Moreover, the Parliament endorsed the government's proposal to establish an Investigation Committee to look into past misreporting episodes. The Greek authorities also asked an independent expert committee to analyze the sources of statistical deficiencies and to propose solutions. The expert committee's report was completed last January, and corrective actions have already been taken.

Conclusion

To comply with its European and international commitments, Greece has already taken significant corrective measures in the past few months, and is fully committed to implement the measures indicated in the program. The strong ownership of the program on the part of the authorities is supported by the vast majority of the Greek people.