EXECUTIVE BOARD MEETING ON GREECE

FIRST AND SECOND REVIEWS UNDER THE EFF

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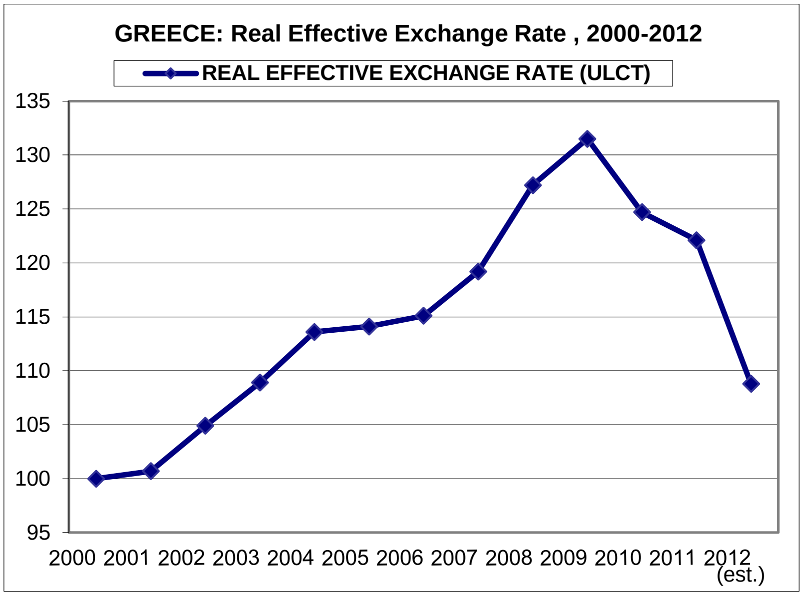
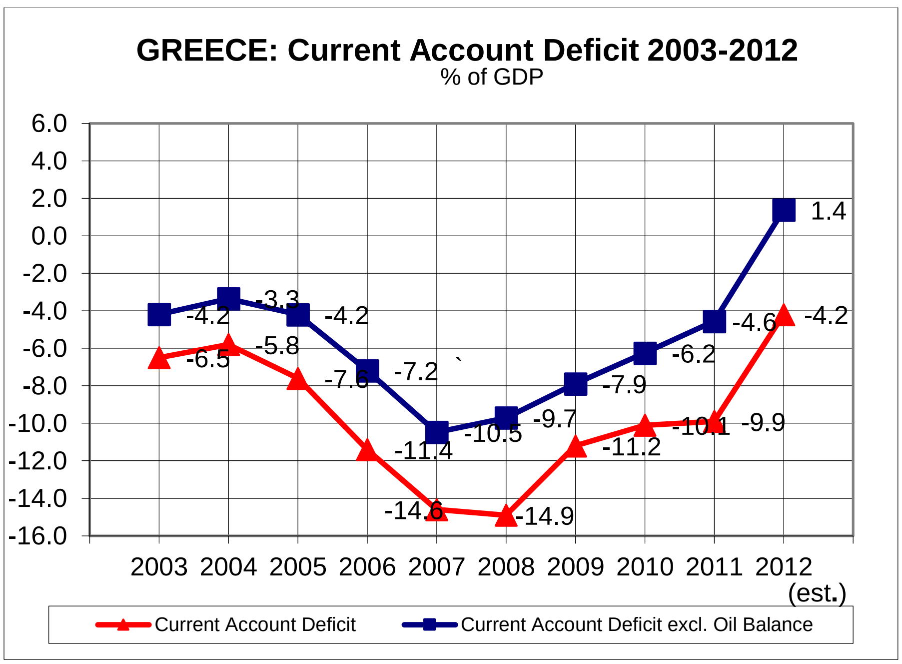
Following a prolonged pre-election period and two general election rounds, a new government, representing a three-party coalition headed by Prime Minister Antonis Samaras, was sworn in on June 21, 2012. The new government, known as the Government of National Responsibility, focused on regaining the ground that had been lost as a result of the political uncertainty and initiated a series of measures aiming at accelerating the economic adjustment program that had been approved by the IMF Board last March. The policy initiatives cover a broad range of areas: fiscal policy, revenue administration, public financial management, privatization and state-owned land development, structural reforms in product, services and labor markets, restructuring and recapitalization of the banking system, and improved absorption of EU structural funds. In short, Greece has continued to push ahead with a wide array of fundamental reforms, which are set to transform and modernize its economy in an unprecedented way.

I. OUTCOMES AND SUCCESSES OF RECENT ECONOMIC POLICIES

From its inception, the main objective of the IMF/EU/ECB-supported program has been to help Greece regain its lost competitiveness and set the stage for a new development model based on flexible labor and product markets, an efficient public sector, and an effective tax administration. As a result of the policies adopted since the beginning of the EFF-supported program, unit labor costs have continued their downward path that began in 2010-2011, and it is now estimated that at the end of 2012 Greece had regained more than 18 percentage points of the competitiveness lost in 2001-2009. The recovery in competitiveness and attendant increase in exports, together with the fall in imports due to the domestic recession, has significantly shrunk the current account deficit from a high of about 15.0 percent of GDP in 2008 to an estimated 4.2 percent for 2012, thanks also to a reduction in interest payments on government debt following the successful PSI in February 2012.





The significant achievements on the structural front since the beginning of the Fund-supported adjustment program have been reflected in a substantial improvement of the business environment; as a result, the 2013 Doing Business Report of the IFC has ranked Greece 78th, up from 89th in the previous edition, and has listed the country as one of the top 10 economies that has shown the greatest progress across three or more areas. In the case of Greece notable improvements include (a) simplifying the construction permit process; (b) introducing legislation to protect investors, and (c) resolving insolvency issues. Also, in 2012 Greece ranked first according to the Adjustment Progress Indicator calculated by the Lisbon Council for the 17 Euro area countries, plus Poland, Sweden and the U.K.

II. The Political Economy of the Reform Efforts

Over the last two-and-a half years Greece has achieved impressive macroeconomic adjustments, but one should be mindful that the effects in the real economy have been far reaching and painful: the cumulative decline of GDP in the five-year period 2008-2012 is expected to exceed 21 percent, and the rate of unemployment has tripled from 7.6 percent in 2008 to 23.6 percent in the second quarter of 2012 and to 26.0 percent in September. Youth unemployment reached 56.4 percent. Greece is beginning to face an "unemployment trap": the length of the Greek recession entails the risk that the skills of the long-term unemployed will become obsolete; this would hinder the re-entry of unemployed workers into the labor force.

In addition, the financing conditions for enterprises, in particular the availability of bank loans, have continued to deteriorate; the accumulation of arrears by the public sector and negative credit flows hinder export activity by Greek firms, including entrepreneurial initiatives to move from declining traditional sectors to dynamic export-oriented sectors.

Moreover, the protracted recession has intensified uncertainty about the future of the Greek economy, which in turn has led to capital flight and has discouraged foreign investment and the mobilization of domestic capital formation.

Such developments, but particularly the high unemployment rate and the increase in the official poverty statistics, risk eroding the ownership of the adjustment program among significant strata of the population. Nevertheless, and despite the painful austerity measures, Greeks continue to envisage the future of the country within the Eurozone.

III. The Way Forward

The Greek government recognizes the importance of continuing structural reforms to achieve sustainable economic growth. Following the impressive achievements in the labor market, the main goal of the Fund-supported program going forward is to further liberalize the product and services markets by removing unnecessary restrictions and barriers to entry that currently impede competition and have been an important factor in oligopolistic pricing. Equally important, the Government plans to achieve the fiscal goals under the program not only through tax and expenditure measures, but also by a broad overhaul of Revenue Administration and Public Financial Management rules and procedures. Finally, the Government is taking decisive steps to accelerate the privatization program that effectively stalled during 2012.

Within this context, the Greek authorities welcome the extension of the fiscal consolidation period until 2016 and the consequent smoothing of the adjustment targets. They also appreciate the availability of additional financing through the generous easing of repayment terms and new commitments by the European partners. They are also pleased to note the success of the buyback initiative of Greek bonds that took place in December. The government is committed to take advantage of this extended framework by intensifying its efforts in all areas of macroeconomic policy and management, overcoming entrenched vested interests, and reinvigorating the ownership of the program by tackling tax evasion and corruption in public administration.

IV. Specific Policies and Measures

A. Fiscal Developments, the 2013 Budget and the Medium-term Fiscal Framework

Since the adoption of the Stand-by arrangement in May 2010, a key emphasis of the program has been on achieving the fiscal consolidation targets; by the end of 2012 the general government primary deficit is estimated at 1.5 percent of GDP, down from 2.2 percent in 2011 and 10.4 percent in 2009; this cumulative adjustment of 8.9 percentage points within three years is an unprecedented performance among OECD countries. Given that the target in the adjustment program calls for a government primary surplus of 4.5 percent of GDP by 2016, the estimated 2012 deficit suggests that, already by the end of last year, Greece had already covered 60 percent of the distance, i.e. a cumulative 8.9 percentage points reduction out of 14.9 percentage points of GDP expected by 2016.

The achievement of the 2016 target is predicated on a series of new front-loaded revenue and expenditure measures amounting to 7 ¼ percent of GDP, of which 5 percent of GDP are part of the 2013 Budget that has already been approved by parliament. The core of the measures affect the most sensitive areas of public spending: further consolidation in pensions, wages, salaries and social benefits, and substantial cuts in wasteful health and education spending, coupled with further consolidation in defense and public administration expenditures.

B. Revenue Administration and Public Financial Management

The Greek authorities recognize that policies may be inadequately implemented unless there is a parallel strengthening of the underlying administrative procedures. Ownership of the program by the Greek citizens is a fundamental ingredient for its success. In turn, ownership hinges on a sense of justice in the distribution of the burden of adjustment. To achieve this goal, far reaching changes have been set in motion to root out tax evasion and to ensure a fair allocation of expenditure cuts across ministries.

- In **Revenue Administration,** several improvements in the internal workings of the tax offices have been advanced, but two major initiatives stand out. First, the establishment of a new Secretary General of Public Revenues, with a five–year tenure, who will be overseeing the internal revenue service (tax and customs) with a great degree of autonomy. The Secretary General will have the authority, *inter alia,* to develop, update and supervise the tax administration's strategic planning; set goals and assessment criteria; appoint the heads of organizational units; and take measures to combat corruption. This reform is of utmost importance in order to improve the tax administration's effectiveness and enhance its independence from political pressure. Second, the pursuit of potential major tax evaders by cross checking bank deposits outside Greece with the corresponding tax returns of the owners in the past several years. If a major and inexplicable discrepancy is identified between the tax returns and the remittances abroad, the taxpayers will be liable to surcharges and penalties. It is the first time in the history of Greece that a systematic action against tax evasion is taken on such large scale.

- In **Public Financial Management** several continuing improvements are set in place aiming at strengthening commitment control and budget execution. Among several initiatives, the establishment of General Directorates of Financial Services and the extension of commitment registers to the National Health Service are key measures to stem the creation of arrears. Another important reform, aimed at effective budget execution, is the introduction of a new rule that would impose automatic cuts in entities' expenditures (other than wages, pensions and social benefits) whenever expenditure targets are missed due to non-cyclical factors.

C. The privatization program

The government is committed to energize the privatization program, which effectively stalled in 2012. The government's priorities include:

- ✓ Speeding up privatization in the energy sector and the state-owned railways;
- ✓ Promoting long-term concessions for regional airports and ports;
- ✓ Facilitating strategic and private investment, including the development of the former Athens International Airport site.

The Hellenic Republic Asset Development Fund (HRADF) has made progress with the privatization of six state assets and has started the privatization process of the State Lottery, infrastructure investments, notably port authorities, and real estate assets. Due to both delays in the initiation of the process and the globally unfavorable economic climate, the expected yields from the privatization program will be about €2.6 billion in 2013, €2.4 billion in 2014, €1.1 billion in 2015 and about €3.4 billion in 2016. These are below the targets set during the approval of the EFF-supported program, but the government is committed to strengthen the governance of the HRADF, which will additionally remain fully accountable to parliament on an ex-post basis for the integrity of every privatization sale.

D. Bank recapitalization and restructuring

The banking sector has benefitted greatly from financial assistance under the Fund-supported program, following the adverse effects of the PSI on its balance sheets. The authorities are determined to enhance confidence in the banking system, by creating a leaner, well-capitalized and viable banking sector. The completion of this process would be the first step towards encouraging repatriation of deposits to Greek banks and reversing the adverse financing conditions for enterprises and households.

As part of the ongoing restructuring efforts, in July the Agricultural Bank, a large state-owned bank, was merged with Piraeus Bank, a private bank. In October the acquisition of Emporiki bank by Alpha Bank, and of Geniki Bank by Piraeus Bank were also agreed. In addition, the National Bank of Greece, the largest commercial financial institution, has offered a voluntary share swap to Eurobank, the second largest commercial bank in Greece, aiming to create the largest regional bank in South East Europe. Looking forward, the Greek government and the Bank of Greece have established a framework to ensure continued restructuring and strengthening of the banking system after the recapitalization process is complete.

E. Attracting foreign investment

Since March the government has been making a strong effort to encourage growth-promoting policies. The rate of absorption of EU structural funds has been constantly increasing and in the period up to May 2012 it was above the EU average for the first time. Most priority projects, whose cumulative budget through end-2015 is nearly 6 percent of GDP, are on schedule. In support of SME development, in July and September the Greek government signed agreements with the European Investment Bank concerning the operation of a Guarantee Fund, which will support lending to small and medium enterprises, and the deployment of a Risk-Sharing Instrument aimed to support infrastructure projects and investments in the energy sector.

F. Liberalization of Labor, Product and Services markets

While labor reforms took center stage early in the Fund-supported program, reforms in other areas were considerably delayed in 2011 and early 2012. Now the Greek government is determined to forge ahead with further reforms in the labor market and to initiate fundamental reforms in the product and services markets. In particular:

- ✓ **Strengthening labor market institutions.**

Following recent reductions in severance pay, the government will promote an efficient wage-setting mechanism, reduce non-wage labor costs (e.g. through steps to reduce the administrative burden posed by various regulations of the Labor Inspectorate), and create more options for the adaptability of working hours, especially for small- and medium-scale enterprises. These reforms will further restore cost-competitiveness and boost employment over the medium term.

- ✓ **Promoting an efficient and competitive business environment**

Building on the improvement in the Doing Business in Greece ranking noted earlier, a new “road map” released in November reduces the administrative burden of (a) creating a company, (b) obtaining licenses for manufacturing activities, and (c) setting-up import and export companies.

These measures are accompanied by corresponding initiatives to improve the functioning of the judicial system.

- ✓ **Liberalizing energy policy**

The government is designing a comprehensive energy policy, the main pillars of which are (a) a restructuring of the Public Power Company, (b) reforming the renewable energy support schemes, (c) introducing measures to have effective competition in generation and supply of electricity, and (d) facilitating the import and trade of oil and oil products.

- ✓ **Reforming transport services**

Government priorities reflect measures to (a) remove restrictions in limousine and shuttle services, (b) improve the operation and connectivity of ports, (c) restructure the Civil Aviation Authority, and (d) gradually restructure public railways with the aim of eventual privatization. The comprehensive reform of transport services is expected to reduce operating costs of service providers while increasing consumers' choice.

- ✓ **Liberalizing "regulated" professions**

For many years "protected" or "regulated" professions in Greece led to inefficient practices and oligopolistic pricing at the expense of consumer choice. Under a comprehensive plan of liberalization, several "regulated" professions have been reformed, including the elimination of mandatory use of services, the streamlining of minimum fees and the simplification of recognition of professional qualifications. Such initiatives are expected to both increase the supply of services and enhance their quality and effectiveness.

V. CONCLUSION

The current economic crisis has brought about severe economic and social dislocations, the effects of which are without precedent in modern Greek history. But with a challenge comes an opportunity, and the Greek authorities are resolved to change the economy's structure and orient it towards high-productivity sectors, which will produce internationally tradable goods and services that would be competitive in both the domestic and the external markets. The crisis is also a chance to modernize public administration by reducing the size of the public sector, while at the same time rendering it more efficient and more business- and citizen-friendly.

The Greek authorities broadly agree with the staff analysis, recommendations and appraisal, and look forward to continuing the close cooperation with the Fund staff; they have asked me to convey their deep appreciation for the policy advice, the constructive dialogue and the extensive technical assistance that have been provided in the past two-and-a-half years. With the completion of all prior actions, the introduction of correction mechanisms to safeguard the achievement of the fiscal targets, and, more generally, the enhancement of governance of the program that will help it remain on track, my authorities are confident that Greece is about to turn a new page on the long and arduous road towards growth and broad-based economic prosperity. Although the Government is fully aware of the risks involved in this major endeavor, no less because it will strain the capacity of an already burdened civil service, it is also hopeful that 2013 will be the year when the sacrifices of the Greek people will begin to bear fruit. In support of the continuing efforts by the government and the people of Greece, my authorities are requesting the Board's approval of the completion of the first and second reviews and associated waiver, modification of performance criteria and rephasing of access of the EFF-supported program.