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This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of Greece were reviewed by the Committee on 28 June 2011. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 7 July 2011.

The Secretariat's draft report was prepared for the Committee by Claude Giorno, Vassiliki Koutsogeorgopoulou under the supervision of Piritta Sorsa. Research assistance was provided by Jérôme Brézillon and Ane Kathrine Christensen.

The previous Survey of Greece *was issued in June 2009.*

BASIC STATISTICS OF GREECE (2010)

THE LAND

Area (1 000 km^2)		Major urban areas (2001 census, thousand inhabitants)	
Total	132.0	Greater Athens (including Piraeus)	3 895
Agricultural (2007)	40.8	Greater Thessaloniki	1 084

THE PEOPLE

Population		Total labour force (thousands)	5 017
Thousands	11 305	Civilian employment (% of total)	
Increase 2005-10 (annual average, %)	0.4	Agriculture, forestry and fishing	12.2
Number of inhabitants per km^2	86	Industry and construction	19.6
		Services	68.2

PRODUCTION

Gross domestic product		Gross fixed capital investment	
In billion EUR	230	In % of GDP	14.7
Per head (USD)	26 998	Per head (USD)	3 970

THE GOVERNMENT

Public consumption (% of GDP)	18.9	Composition of Parliament (seats)	300
General government (% of GDP)		New Democracy	91
Current expenditure	48.5	Panhellenic Socialist Movement	160
Current revenue	37.1	Communist Party of Greece	21
Maastricht debt	142.8	Coalition of the Radical Left	13
		Popular Orthodox Rally	15
		Last general elections: 4 October 2009	

FOREIGN TRADE

Exports of goods and services (% of GDP)	21.0	Imports of goods and services (% of GDP)	29.4
Main commodity exports (% of total)		Main commodity imports (% of total)	
Manufactured goods	20.0	Machinery and transport equipment	24.2
Food and live animals	18.8	Mineral fuels, lubricants, related materials	23.5
Chemicals and related products	14.5	Chemicals and related products	15.2
Miscellaneous manufactured articles	9.9	Manufactured goods	10.6

THE CURRENCY

Monetary unit: euro		Currency unit per EUR, average of daily figures	
		Year 2010	0.755
		June 2011	0.694

Executive summary

Greece has embarked on an ambitious adjustment programme *to deal with the deep economic crisis by restoring sustainable public finances, competitiveness and the foundations for healthy and solid long-term growth. The economic adjustment plan is being implemented with the technical and financial support of the IMF, the European Union and the ECB, and – as announced on 21 July 2011 – the participation of Greece's private creditors. It aims at tackling the root causes rather than the symptoms of the crisis.*

The programme can succeed. *Under conservative assumptions regarding growth and interest rates, and if fiscal and structural reforms are fully implemented, the debt-GDP ratio could peak in 2013 and fall below 60% of GDP in the next two decades. The package announced on 21 July 2011 should ensure reasonable interest rates on Greek debt, contains measures to enhance investment and growth, and will give Greece the time needed to implement reforms which will boost competitiveness and export performance. Despite the short term costs, the reforms that have been implemented or planned will benefit Greece for many years to come, as they will raise growth, living standards and equity. A key prerequisite of success is that the burden and benefits of reform be, and be seen to be, broadly and fairly shared. Clearly, the key to success will be in the implementation, which will have to be impeccable.*

The reforms carried out over the past year are impressive. *The cuts in the public deficit were unprecedented. Deep-rooted fiscal reforms have been launched to strengthen the management of the public finances and to revamp the pension system. The statistical system is being improved significantly. Labour market reforms will increase employment and help to restore international competitiveness. Red tape and barriers to competition are being cut, which will boost investment and FDI. Although the economy is still weak and the path to recovery is lengthy, rising exports are a sign that the reforms may be bearing fruit.*

The authorities should continue this vigorous reform process and their efforts to convince markets of their capacity to implement fundamental economic adjustments. *They also should convince the domestic audience of the need to pursue the reforms required to bring public finances to a sustainable path and position the Greek economy for robust growth in the years ahead. Specifically, the authorities should:*

- **Continue deficit reduction to halt and then reverse the rise in public debt.** *Strengthening tax collection is urgent.*
- **Boost privatisation and the development of public assets** *to reduce the debt burden and associated debt-servicing costs, while stimulating growth.*
- **Reinforce structural reforms in the labour and products markets** *to enhance competitiveness and raise welfare and incomes. This is desirable in its own right, but higher growth will also be instrumental in turning around the public debt.*

- **Ensure fair sharing of the burden and the benefits of reforms.** *A firm stance is needed against vested interests trying to protect their rents, and tax evasion needs to be visibly and decisively attacked.*
- **Enhance monitoring of the progress of reform and improve statistical tools.** *Policy makers need high-quality economic data and adequate and accurate information on the implementation of measures to assess the reform process, and to convince international observers and the Greek people that reforms are paying dividends.*

Assessment and recommendations

Greece is taking strong action to deal with its most serious post-war economic crisis

Greece has embarked on an ambitious adjustment programme with financial support from EU/IMF/ECB (Troika), and, as announced on 21 July 2011, with participation of Greece's private creditors. Measures are needed to reverse the debt build-up, to restore competitiveness, reignite sustainable growth based on investment and exports, and to regain access to international capital markets. In 2009, the fiscal deficit had ballooned to over 15% of GDP reflecting uncontained spending, a collapse in tax revenues and the onset of a recession, while public debt reached 140% of GDP in 2010. In addition to fiscal imbalances, external imbalances also widened and total net foreign debt, both public and private, rose to 105% of GDP in 2010.The dire economic situation was magnified by lost credibility as serious deficiencies in statistical monitoring of government accounts were exposed.

In this context, the economic programme supported by the Troika since May 2010 envisaged a sizable fiscal consolidation, cuts in real wages which had been growing at unsustainable rates, pension reductions, and fundamental structural reforms in the public sector and in product and labour markets. OECD simulations show that the programme is feasible under conservative economic assumptions and incorporating some of the elements regarding interest rates, longer maturities and debt relief agreed on 21 July. If such a programme is strictly implemented, public finances could return to a sustainable path with the debt to GDP ratio starting to fall as of 2013 and gradually dropping below 60% of GDP in the next two decades. The programme requires: generating a sustained general government budget balance ranging between –1½ per cent and 1½ per cent of GDP (or a primary surplus of 5-6% of GDP) from 2015 onwards; rapidly implementing the large privatisation plan; and continuing the structural reforms to boost potential growth. Although very challenging, a similar significant consolidation effort has been achieved in the past in Belgium, Denmark and Finland, albeit in more propitious circumstances.

This long overdue reform programme will have long-term benefits despite short term costs. As repeatedly mentioned in past *Surveys*, Greece needs to modernise its economy by adopting structural reforms that move its public sector and labour and product markets closer to international best practice. Waste of public resources must end; tax evasion must be decisively attacked; public services need to improve and confidence needs to be restored between the Greek citizens and their government; employment of youth, women and seniors should increase; effort, efficiency and innovation of workers should be encouraged and rewarded.

So far implementation has been impressive, if less than perfect

Already, the Greek authorities have energetically and resolutely implemented substantial fiscal consolidation and wide ranging structural reforms. The budget deficit were cut by about 5% of GDP in 2010 – remarkable given the difficult economic context –, which means that the structural change was even larger: no other OECD country has achieved such a fiscal improvement in a single year over the past three decades. The 2010 fiscal deficit target was missed by only ½ per cent of GDP, although tax evasion continued and the recession was somewhat deeper than expected. However, despite the impressive record on structural reform, the government has backtracked on reforms related to wage agreements at firm level, the full opening up of the professions of lawyers and pharmacists, and has hesitated on the privatisation programme.

The strong fiscal contraction has undercut domestic demand, as had been expected. Output declined by over 4% in 2010 and the unemployment rate rose to almost 16% in early 2011. Despite moderately positive quarter-on-quarter GDP growth in the first quarter, the recession is set to continue in 2011, albeit at a slower pace. Growth is projected to turn positive in 2012 as investment and exports pick up and structural reforms take hold. Competitiveness gains and a rise in exports in end-2010 and early 2011 are first signs of adjustment and reallocation. Excluding the effects of tax increases, inflation was close to zero in early 2011, much below the euro area average. Higher taxes and tariffs needed to boost fiscal revenues pushed up headline inflation.

Greece needs to convince markets that it can deliver on reforms

The success of the programme is subject to many risks. Confidence has fallen since late 2010, as markets and the domestic audience have doubted the ability of the reforms to deliver growth and sustainable fiscal consolidation. This partly reflects shortcomings in the design of the original programme (especially the cost and maturities of the loans) and the lengthy European debate on the characteristics of the permanent support mechanism, which were subsequently corrected. Together with fiscal austerity and the banking sector's limited capacity to support growth with credit, such lack of confidence could lead to a negative growth spiral. Implementation of the reforms faces political risks. The outlook for the world economy, with rising commodity prices and unsustainable debt burdens in many OECD countries, also poses risks.

On 21 July 2011, European leaders agreed a new financial support package for Greece. The key provisions include reduced interest burdens, a meaningful extension of maturities, some private-sector involvement, protection of Greek banks and measures to foster economic growth in Greece. Initial analysis suggests that the package would decrease the debt burden only slightly, while it would improve Greece's medium-term fiscal prospects in terms of longer maturity and lower interest rates. The simulations presented in the Survey have been conducted using deliberately conservative assumptions relative to this package. The additional official financial support agreed and the maturity extensions, both public and private, provide the time needed for Greece to continue to implement fundamental fiscal and structural reforms, and for those reforms to bear fruit.

For the adjustment programme to be successful, the additional time that Greece now has must be used in the best possible way. The government needs to continue on its current path of fiscal consolidation and structural reform. Given that structural reforms tend to have upfront costs but medium-to-long run benefits, it is of utmost importance to step up the pace of the reform effort to enjoy their fruits, in terms of higher growth, as soon as possible. Moreover, *a firm and unified stance behind the reform programme is essential to enhance credibility. The government should establish clear responsibilities in ministries for monitoring reform implementation more closely on the basis of objective indicators. The results should be published widely under the scrutiny of the social partners to upgrade the diffusion of reliable information about reforms. Thus, improvements in the scope, timing, and quality of economic statistics should continue so as to enhance the diagnostic tools required for monitoring of the economy.* To secure access to markets when the current financial assistance ends, Greece needs to work harder to convince markets of its capacity to implement reforms. The reinvigoration of the government plans, with the adoption of the Medium-Term Fiscal Strategy in June 2011 is an opportunity to reinforce the momentum for reforms. Social acceptability of adjustment also demands a fair burden sharing, *which requires a firm stance against tax offenders, and vested interests of groups of workers or owners of special rights protecting their rents. It is also essential to communicate more widely that the reforms are in the long-term interest of Greece*. There are no easy solutions, nor realistic alternatives to drastic policy changes.

Efforts should continue to preserve the stability of banks and support the recovery by easing constraints on credit supply

While there has been some deterioration in indicators of financial sector health, including rising non-performing loans, financial-sector developments have been broadly consistent with expectations and the stability of the banking system has been preserved. However, the banks' financing capacity was severely damaged by a cut in access to international funding sources and a fall in deposits as households sought to cushion falling consumption. In addition, the recession, the temporary tax hikes and the losses on banks' trading books caused by the fall of Greek sovereign bond prices, have led to a tightening of credit supply. The ECB's exceptional measures have helped to ensure sufficient liquidity, including by accepting non-securitised government-guaranteed bank paper as collateral for refinancing operations, despite the downgrading of Greek sovereign debt by rating agencies. Provisions have also been taken to provide adequate resources to recapitalise Greek banks if needed, in view of the impact on their balance-sheet of the additional assistance package agreed on 21 July 2011.

The banking system, which was sound before the sovereign debt crisis, finds itself in a difficult situation because of the risks attached to public debt in banks' portfolios. The main challenge is thus to loosen the constraint imposed on banks by the public sector crisis, and find a balance between imposing adequate prudential restraints on the banking system and allowing enough credit expansion to fuel an economic recovery. Until greater market confidence can be achieved, continued reliance on ECB facilities to maintain sufficient liquidity seems inevitable. *Attempts to reduce banks' dependence on ECB liquidity thus need to be approached with caution, as they could trigger a liquidity crunch.* Further bank consolidation could be one option to increase access to market liquidity. *The managers and shareholders should, however, explore the option of partnerships or mergers with foreign banks,* *while the authorities should refrain from imposing protectionist impediments. The announced privatisations of ATE and Hellenic Postbank are thus welcome, and could be extended to other public participations in the banking sector.* Ongoing efforts of banks to improve their balance sheets are also welcome and must continue. Discrepancies among banks persist in terms of exposure to bad loans, solvency, liquidity needs and size of their sovereign debt portfolios. The housing market also remains depressed. *The Bank of Greece should thus maintain its attentive supervision of individual credit institutions, while the authorities as a whole should continue their surveillance of the housing sector.*

Structural fiscal reforms and privatisation are key for resolving the public finance crisis

Fiscal adjustment has been impressive so far, but it has also highlighted serious shortcomings in the collection of taxes and limited control over the spending of entities outside central government. Rigorous and continuous control of the primary budget balance is required to maintain credibility, as shown by the experience of other high public debt countries such as Italy and Belgium. The priority is to reduce the deficit from 10½ per cent of GDP to the planned 7½ per cent of GDP in 2011. *Recognising this, the authorities provided for additional measures amounting to about 3% of GDP in the Medium-Term Fiscal Strategy (MTFS), which was enacted into law at end-June, to offset the 2010 fiscal slippage and to compensate for implementation risks of measures included in the 2011 budget.* Achieving the 7½ per cent of GDP fiscal target for 2011 implies an additional fiscal consolidation of 2% of GDP compared to the original design of the programme, because of the upwards revision of the 2009 deficit at the end of 2010.

Structural fiscal reforms are needed going forward, including the ambitious planned privatisation and real estate asset developments. Privatisation and better management of public properties would both reduce government financing needs and generate broader economic gains as private managers take over from what has proved to be an inefficient regime of public management. Although estimates are subject to significant uncertainties, the market value of government-owned properties is likely to significantly exceed the current privatisation programme. The plans to better exploit these potentially vast public assets and boost privatisation to secure some EUR 50 billion (22% of GDP) by 2015, are welcome. To meet this ambitious target, the authorities have recently taken initiatives to address the long-standing deficiencies in the management of public real estate, a large fraction of which is illegally occupied. They have also decided to establish a National Wealth Fund to ensure smooth and transparent management of privatisation. *The new general secretariat for public property should be given clear and quantifiable objectives with adequate technical and human resources to quickly prepare a reliable inventory of public properties, to deal with their illegal occupation, and to select assets to be developed.* Rapid results on this front could play an important role in improving market perceptions of the country's commitment and ability to address its fiscal difficulties in a decisive way. The new impetus given to the privatisation programme in June 2011 to accelerate its implementation and strengthen the government's medium-term fiscal strategy is thus commendable. According to OECD calculations, raising 22% of GDP by 2015 through privatisation and enhanced public properties management would lower the debt/GDP ratio by about 40 percentage points by 2035 relative to the baseline scenario due to the reduction of the cost of debt service associated with the declining debt/GDP ratio.

Improved budget monitoring and a better fiscal framework are being implemented

The authorities have reformed the fiscal framework to address many of its shortcomings. The 2011 budget is under new procedures, which include: annual spending caps; borrowing limits; procedures for controlling expenditure commitments; obligation to regularly publish data on budget execution; and the introduction of a medium-term budget. These reforms are welcome, but could be complemented by a number of *additional measures to ensure, for instance, that all public entities, notably hospitals, meet their obligation of publishing data on budget execution through a strict enforcement of tighter sanctions for non compliance. All laws presented to Parliament should also be adequately costed and integrated in the medium-term fiscal plan.* The Parliamentary Budget Office (PBO), which has been designed in line with international best practices and will be fully operational later in 2011, should reinforce fiscal institutions and the quality of democratic debate about fiscal policy options. The PBO as now envisaged is, however, quite small. *The authorities should ensure that the PBO has adequate resources to carry out the rather broad range of functions it has been assigned. Once the initial consolidation phase now underway is completed, sound fiscal policy would be enhanced by fiscal rules that incorporate an expenditure ceiling and ensure the necessary reduction of public debt/GDP over time.* Switzerland and Germany have gone so far as to put their fiscal rule in the Constitution. Greece could explore this option to demonstrate the strength of its commitment to sound fiscal policy.

Tax evasion should be tackled decisively

The significant fiscal adjustment required will not be achieved without a hefty increase in tax revenues, which will in turn demand meaningful progress in tax collection efficiency. This problem is more serious than in much of the OECD because of the large underground economy and widespread tax evasion. Personal income tax revenues are more than 5% of GDP below the euro area average, although statutory rates are not especially low. If Greece collected its VAT, social security contributions and corporate income tax with the average efficiency of OECD countries, tax revenues could rise by nearly 5% of GDP. A decisive reduction in tax evasion is indispensable for fairness and thus more acceptance of the broader fiscal consolidation effort. For example, the evasion of personal income tax is particularly high for the self-employed. Reduction in tax evasion has become a major yardstick of success of the adjustment programme for many observers. The authorities have adopted a comprehensive set of measures to rationalise the tax system, improve the tools for combating tax evasion, and strengthen the discipline, transparency and functioning of the tax administration.

These developments are critical, but it is hard to tell if they will be sufficient to resolve the country's tax management issues. So far, progress in tax collection has not been satisfactory due to both the deeper than expected recession and tax collection system weaknesses. Given the urgency of making headway on this front, *the authorities should consider taking additional steps, such as developing and publishing indicators for tracking the effectiveness of tax measures taken. Indicators developed and published on a local basis could also encourage emulation among tax offices and urge them on to greater effort, if bonuses were bestowed on best-performing agencies.* To increase the visibility of efforts and progress made against tax evasion, "naming and shaming" tax evaders within the law can play a crucial role. *The* *thresholds for naming evaders (EUR 150 000) could be lowered and made systematic rather than discretionary, as seems currently to be preferred*. But ultimately, such efforts will have to be backed up by visible and successful prosecution of tax evaders, and the enforcement of meaningful penalties. *The scope and use of tax compliance certificates to access certain services should also be widened*. Successive governments have relied on tax amnesties to attempt to clear tax arrears, most recently in 2010. *Tax amnesties should be discontinued, once and for all, as they discourage tax compliance*. The collection of taxes and social security contributions are now done by different agencies, which reduces the possibility of crosschecking and verification. *These functions should be combined*. The tax system is still complicated, and there is considerable scope for simplification and base broadening. *The number of VAT rates should be cut, tax expenditures reduced or abolished, and legitimate social goals met by targeted direct subsidies, not by tax breaks. The tax-free-threshold on personal income tax could be lowered more than currently envisaged to enlarge the tax base.*

Efforts to overhaul the public remuneration system and restructure state-owned enterprises need to continue

The public payroll has grown rapidly over the past decade. Low and middle-rank civil servants have higher wages than similar private sector employees, although they work on average fewer hours and have greater job security. Several measures have been taken to correct these deficiencies, including significant wage cuts and a rise in the number of hours worked in the public sector. Until 2015, hiring will be restricted to only 20% of civil servants who leave (10% in 2011) and also through a significant reduction of fixed-term contract employees. The opaque and fragmented public employee remuneration system will be reformed. *In addition to this welcome set of reforms, the ethics and efficiency of personnel should be improved to enhance quality of public services. It would help to spread a culture of evaluation of staff performance based on clear individual objectives, to end automatic promotions linked to seniority, to sanction unsatisfactory behaviour, corruption in particular, and reward efforts. More fundamentally, the status of newly hired civil servants should be modified, notably by ending life-long job security.*

For many years now, state-owned enterprises (SOEs) have contributed to public debt via persistent losses, in turn reflecting poor business management, lack of real budgetary constraints and weak accountability. The combined losses of SOEs amounted to ¾ per cent of GDP in 2009, and they were largely responsible for the last upward revision of the 2009 general government debt by 11% of GDP in November 2010 (reflecting the reclassification of major loss-making SOE's that brought them within the general government sector). Several measures have been taken, including cuts in pay and non-pay expenses, a substantial increase in prices for services offered by SOEs, limits on subsidisation, and a requirement to submit business plans. *In addition to these welcome steps, meaningful sanctions need to be imposed on SOEs, which should be closed and/or privatised if they make recurrent losses*. At the same time, once reforms to SOEs governance have been put in place, the authorities should avoid micromanaging these firms from the Ministry of Finance. *SOEs need to have clear objectives and sufficient management flexibility, including over employment and prices. This needs to go hand in hand with much increased accountability of managers for achieving results*. The authorities also have to reform the way to implement the public service obligations (PSO) that are now fulfilled by SOEs. *The need and justification for PSO provisions should be reviewed. If they are found to be justified, such obligations should be financed in a transparent way.* For instance, it would be preferable to give specific government subsidies to SOEs for PSOs (itemised in both the budget and the SOE books), rather than cross-subsidising through the internal accounts of SOEs.

A major pension reform has substantially improved the long-term outlook for public finances

EC and ILO long-term projections, carried out in 2008, pointed to a rise of about 12 percentage points of GDP in pension outlays by 2050. The 2010 reform greatly simplified the pension system, and brought its generosity in line with that of most other OECD systems. Conditions for early retirement have been tightened and, as from 2021, the statutory retirement age (65 years) and minimum retirement age (60 years) will be indexed to life expectancy. According to initial actuarial estimates, pension spending is not expected to increase as a share of GDP between now and 2060. Moreover, the authorities are committed to taking any necessary measures to cut pension spending further if the increase exceeds 2½ per cent of GDP. The stronger incentives for seniors to participate in the labour market should also have a positive impact on medium-term growth. *It is important, however, to proceed with the reform of supplementary pension funds and to strictly limit the list of strenuous occupations in order to reduce the number of people eligible for early retirement under preferential conditions.*

The control of public medical spending and the quality of health care services should be further enhanced

As discussed in the previous *Survey*, further reforms are needed in the health sector. Welcome measures have been adopted to better control medical prescriptions, and check hospital expenditure, including through rationalisation of public procurement and the introduction of a global hospital budget system. Further efforts are nevertheless required to control spending and enhance the quality of public services. *First, the structure and governance of the system need to be reviewed to enhance effective planning and allocation of public resources, including by having all public health responsibilities merged under one ministry.* The current distribution of resources favours hospital care at the expense of primary care, with too little funding for prevention. In this context the separation of pension and health insurance management and the creation of a single health insurance fund are welcome steps. *Second, the compensation of health professionals should be based on a hybrid system combining capitation payments and fees for service for physicians working for the health insurance funds.* This would help spur competition and improve the supply of health care. *The current remuneration of pharmacists largely based on profit margins should be replaced by one based, more strongly, on set charges for services rendered to customers, as in Switzerland. Specific incentives to encourage the diffusion of generics should also be introduced.*

Boosting growth and getting people back to work is a high priority

Given the large informal sector, the low labour participation rate, the high level of structural unemployment, and one of the most regulated business environments in Europe, the potential for boosting growth is substantial in Greece. The recession hit employment and wages severely and aggravated the already high structural unemployment among vulnerable groups. Getting people back to work with active labour market policies, and boosting competitiveness and growth over time with product and labour market reforms are high priorities. Recent reforms have improved product market regulation notably, as measured by OECD indicators, and strengthened the adjustment capacity of the labour market, increasing the potential for higher growth and employment. Better functioning labour markets facilitate a reallocation of resources across sectors, necessary for the adjustment of the economy, especially if barriers to product market competition are also lifted. In addition, improving education outcomes, as suggested in the 2009 *OECD Survey*, is essential to enhance productivity and growth.

Reforms to improve labour market outcomes should be implemented rigorously

The economic programme has several measures to improve labour market outcomes. These include measures to make wage setting more responsive to changes in economic conditions, boost part-time work, facilitate more flexible work time, and increase spending on activation and training programmes. *To ensure the unemployed keep close contact with potential employers, participation in labour market programmes should be coupled with job search, with sanctions for non-compliance, in line with OECD best practices. A rigorous and systematic evaluation of the effectiveness of activation programmes is essential.* The new type of firm-level wage agreement, allowing employers and employees to agree on wages that are less favourable than those stipulated in sectoral agreements, promises to boost competitiveness and employment. It is also important that the expansion of these agreements not be restricted by procedural matters. *Announced plans to accelerate the creation of firm-level unions, required for the conclusion of these agreements, are welcome and should be implemented swiftly. To further promote firm-level wage agreements, the administrative extension (subject to ministerial decision) of the sectoral agreements to firms that were not party to negotiations should be eliminated.* The recent introduction of non-subsidised sub-minimum wages for youths, to boost jobs, is a step in the right direction in a stringent fiscal environment. *This needs to be linked to training programmes in the workplace to enhance skills. It will be important to monitor closely the employment effects of the new measure. The Labour Inspectorate's capacity to monitor the enforcement of labour laws and fight informality, especially with regard to the use of informal arrangements such as undeclared overtime work, should be enhanced as envisaged.*

Temporary employment remains subject to various restrictions in Greece. In a positive move, the maximum cumulative duration of successive fixed-term contracts is set to increase. *Additional initiatives to ease employment protection for temporary work are needed, however, by promoting fixed-term contracts, which are little used by comparison with many other OECD countries, by removing restrictions on the use of temporary work agency contracts and time limits on their duration, and by relaxing the cumbersome regulations on these agencies.* OECD research suggests that temporary jobs have the potential to provide a key entry port to the labour market for less experienced workers. Recent measures to reduce the high employment protection enjoyed by white-collar workers are important to enhance the chances of temporary workers to move into permanent jobs. Over the longer term, consideration should be given to bolder options. *Greece could remove employment protection legislation distinctions between blue- and white-collar workers, as is already the case in most OECD countries, and severance pay could be transformed into a system of individual accounts, as pioneered in Austria.*

Reforming product markets is imperative for sustainable jobs, greater competition and more investment

In the late 2000's Greece had one of the most restrictive system of product market regulations, as measured by OECD indicators. Various barriers to entry and/or restrictions on fees or prices in key sectors such as professional services, retail and network industries led to high rents, low innovation and job creation and reduction in competitiveness. Combined with a relatively low trade exposure and poorly designed investment incentives, product market regulations have acted as barriers to investment in Greece. Overall, the inflows and the stock of FDI in relation to GDP are low. The high level of public ownership and vertical integration inhibited competition in the electricity sector. Enforcement of competition law or the EU Services Directive has also been weak.

The new competition law should strengthen enforcement

Competition policy has not been strong in Greece reflecting *inter alia* lack of a competition culture and shortcomings in the institutional framework. A new law in 2011 strengthened the independence of the Hellenic Competition Commission (HCC), including by decoupling the appointment of its board members from electoral cycles. It has also increased the HCC's effectiveness by enabling the authority to prioritise its cases and reject low-priority complaints. It further gives the HCC the power to issue a (non-binding) opinion on new legislative and regulatory measures that may distort competition. *It is essential to ensure that the recently introduced point system to prioritise cases is workable and based on a set of objective and transparent indicators. Information campaigns and political support for HCC are needed to develop a "competition culture" and improve public understanding of the benefits of competition.*

Progress in improving the business environment should continue

Despite measures taken over recent years to improve the business environment, cumbersome business regulations have blunted entrepreneurship, job creation and investment. *The Action Plan for a Business-Friendly Greece, which aims to reduce remaining restrictions to business activity, should be implemented swiftly.* Recent reforms to remove restrictions to business are welcome. These include the creation, in 2011, of a unique Business Registry (GEMI) and the operation of one-stop-shop services consisting of a wide network of contact points, which should bring about important reductions in red-tape costs. Licensing procedures are being simplified, with a focus on manufacturing firms and technical professions. These initiatives are welcome steps forward, bringing Greece closer to OECD best practice. Their effectiveness, however, hinges upon their rigorous implementation and regular assessment through a systematic set of indicators. *Ensuring the implementation of the law on the simplification of the licensing procedures for technical professions and manufacturing activities, is important in this context. To avoid delays, mandatory deadlines should be established for the completion of licensing approvals and tacit approval in the case of non-adherence.* Initiatives such as the introduction of strict time limits for the completion of licensing procedures for technical professions under the new law go in the right direction. *Overcoming obstacles to entrepreneurship also requires setting clear and adequate rules for the spatial planning of private investment and monitoring and frequently evaluating the land-use plans.*

Export and investment frameworks are being revamped

Past investment incentives which subsidised projects had a limited impact on growth. They were marred by heavy bureaucracy and managerial opacity, poor targeting and a lack of evaluation of results. Investments often ended up in low-productivity segments of expanding sectors (such as tourism, wholesale and retail trade and other services). The new framework targets growth-enhancing investments, sets a clear time schedule for the evaluation and approval of projects, and requires better evaluation of projects and their outcomes. The law offers tax incentives equivalent to about 1% of GDP and financial support for around 0.4% of GDP. New financial engineering tools to support SMEs have been established, while fast-track procedures to accelerate the approval and implementation of strategic investments, particularly FDI, were introduced in late 2010. *The impact of the new framework should be monitored systematically, as envisaged, in terms of allocation of resources, value added of the supported projects, and employment creation. The potential budgetary costs of the fiscal incentives should conform to the fiscal consolidation strategy. It is also important to follow closely, with comprehensive indicators, the implementation and effectiveness of the fast-track procedures. Over time investments are best promoted by a good overall business environment.* Recent achievements towards a swifter absorption of the EU structural and cohesion funds are welcome and should continue. This is critical in order for Greece to make the most of the easier access to EU funds agreed under the 21 July package, which also includes exceptional technical assistance to boost investment and growth.

Vigorous implementation of the export strategy is important. The swift approval of the draft law to remove bureaucratic burdens for exporters, which are presently high by OECD standards, is also essential. Setting the necessary conditions for tourism to adapt to changing patterns of international demand and exploit more dynamic segments of the market would boost export and growth potential. The full implementation of the EU Services Directive would enhance competition by facilitating access of foreign providers to the Greek market either *via* direct establishment or through cross-border service provision. *Rapid completion of a one-stop system enabling on-line completion of licensing procedures is key in this regard.*

A wide-ranging reform has opened many closed professions

Closed professions are a major source of large rents and inefficiencies in Greece, as reflected in the relatively high mark-ups compared to other EU countries, with important spillovers across the whole economy. The regulations on professional services were among the strictest in the OECD in the late 2000s, indicating much scope for liberalisation, while enhancing consumer welfare. A comprehensive reform in early 2011 opened up more than 150 closed professions. The legislative changes abolish fixed prices or compulsory minimum fees, reduce geographical restrictions for the lawyers and lower fixed profit margins for pharmacists. *Consideration should be given to fully liberalise the professions of lawyers and pharmacists, for instance by abolishing geographical restrictions for lawyers and further reduce or remove fixed profit margins for pharmacists.* The 2011 legislation also removes, in most cases, the requirement for an administrative license to practice a profession, substituting instead simple notification accompanied by the necessary supporting credentials. The above reforms have large growth potential. By reducing rents of well-off vested interests and curbing price pressures, such reforms also facilitate a fair sharing of the burden of adjustment. *A rigorous implementation of the legislation and close monitoring of its effectiveness in boosting competition and supply, are indispensible, however, for reaping its potential benefits.*

The liberalisation of network industries has progressed

Following the lifting of the cabotage restrictions in maritime cruises in July 2010, the road freight sector – a heavily regulated sector by international standards – was liberalised. If rigorously implemented, the new measures could foster effective competition in the sector, despite the long transition period, with important spillover effects for competitiveness and growth. *The development of implementation and performance indicators is essential to monitor progress.* Overhauling railways would yield additional gains to growth, especially in view of the close link of the sector with tourism. *It is essential that the railway restructuring plan be implemented swiftly, followed by the envisaged privatisation of railway services and the liberalisation of the sector.* In addition to improving management and boosting competition, this would reduce fiscal strains. *It is important to ensure that the business plan includes effective mechanisms to promptly correct any deviations.* Finally more steps towards liberalising the energy sector are needed. While recent progress is notable, the high level of public ownership and vertical integration in the electricity and gas sector still inhibits effective competition. Full compliance with the EC Directives for the energy market should be reached. *Consideration should be given to full ownership unbundling (generation, transmission, and distribution) in the electricity and gas sectors to promote further competition. Strong and effective sector regulators are essential.* As a general rule privatisation, liberalisation and/or appropriate regulation should go hand in hand to avoid the creation of private monopolies and to boost efficiency and growth.

OECD Economic Surveys: Greece

Chapter 1

Restoring fiscal sustainability and promoting sound and solid growth

Over a year after a fiscal crisis and the beginning of IMF/EU/ECB support, Greece is still in a serious recession. The sizeable, but vital, fiscal retrenchment, has significantly reduced its large budget deficit. Considerable advances have also been made with structural reforms both in the public sector and in labour and product markets. Despite this progress, persistent market scepticism concerning the capacity of the country to restore sustainable public finances and to renew economic growth has left sovereign interest spreads at record highs. Against this background, this Survey offers an assessment of the Greek economic situation, its outlook, and the progress achieved with reforms. To understand the source of the problems, this chapter examines the causes and the scope of the macroeconomic imbalances that Greece must correct, including developments after the introduction of the adjustment programme. It then assesses the strategy underlying the economic adjustment plan and discusses the risks associated with the reform process.

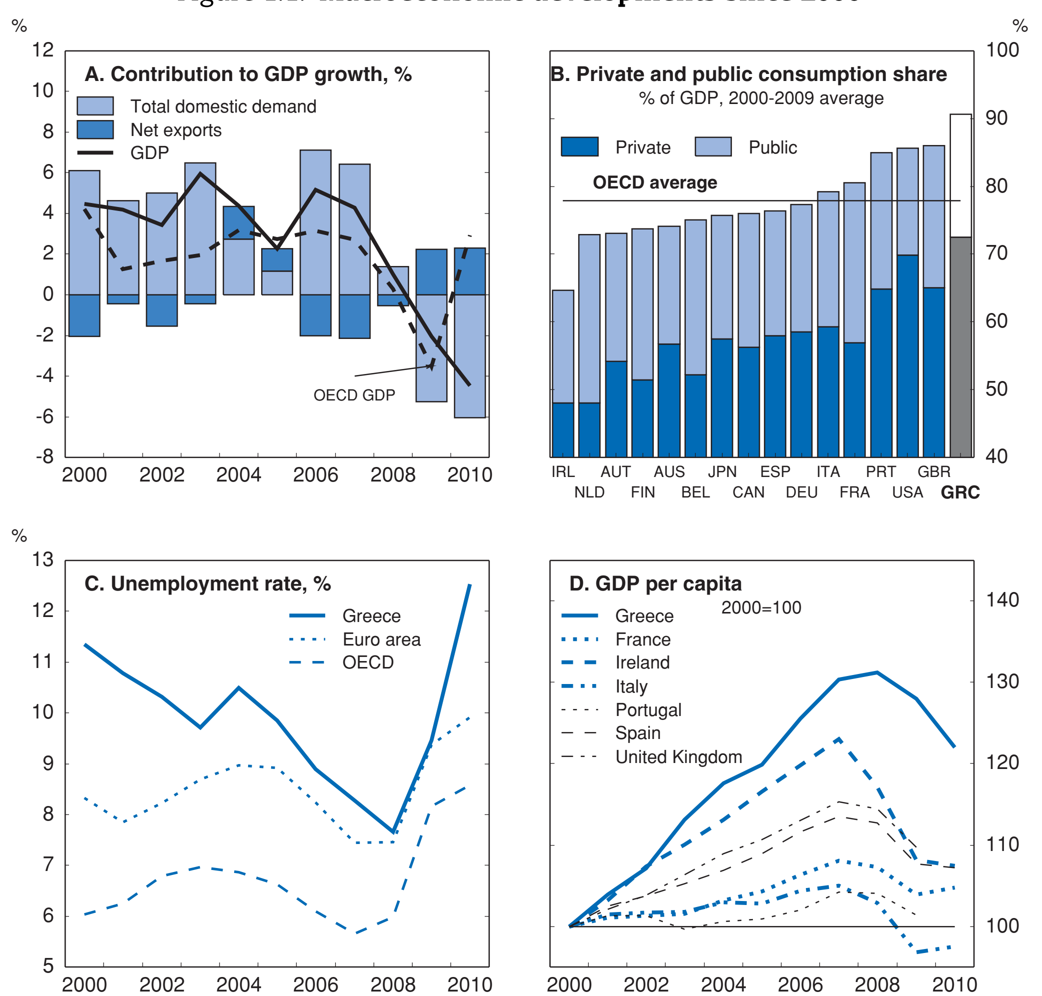
Greece needs to restore conditions for sustainable and robust growth

The economy is in a severe recession in the context of a sizeable, but vital, fiscal retrenchment

Growth was robust in the run-up to the crisis, but marked by large and widening imbalances

Growth from the country's entry into the euro area in 2001 and until the economic and financial crisis broke out in 2008 averaged 4% per annum, double the pace recorded in the euro area. This helped reduce the double-digit pre-euro levels of unemployment significantly and raised living standards nearer to those of the most advanced EU countries (Figure 1.1). This economic dynamism was nonetheless accompanied by unsustainable increases in

Figure 1.1. **Macroeconomic developments since 2000**



Source: OECD, OECD Economic Outlook Database.

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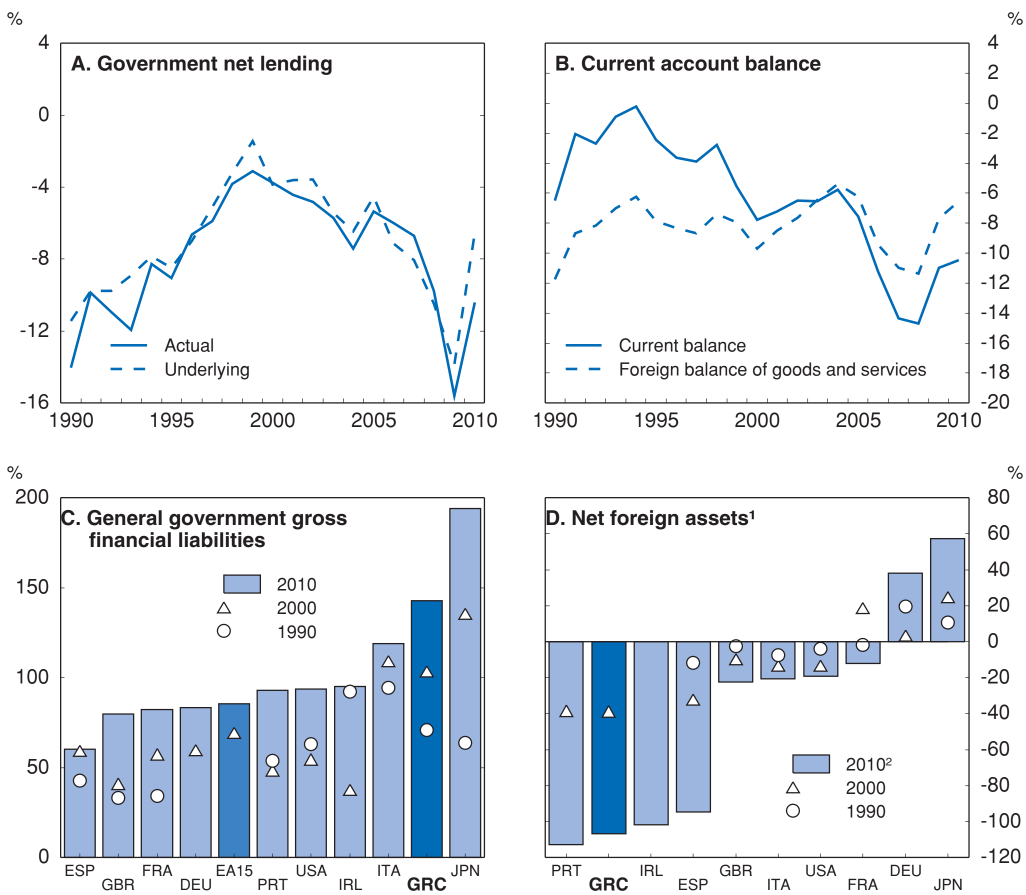
external and fiscal imbalances. Growth was driven by domestic demand, and especially consumption, which on average amounted to over 90% of GDP – or 15 percentage points more than the OECD average – between 2000 and 2009. The general government deficit averaged 6% of GDP between 2000 and 2008, or double the maximum imposed by the Stability and Growth Pact, and the current account deficit exceeded 9% of GDP (Figure 1.2). The external current account imbalances fed through to a doubling of the ratio of net foreign debt to GDP since 2003 to 105% – a high level among OECD countries, as in Ireland and Portugal. The rise in government debt, which had already equalled GDP at the start of the decade, was less pronounced through till 2008 because of high growth. It has since risen sharply to roughly 140% of GDP in 2010 – the highest level amongst OECD countries after Japan.

Figure 1.2. **Public and external imbalances**

% of GDP



1. Total assets minus total liabilities.
2. 2009 for ITA, FRA, PRT, IRL, USA.

Source: OECD, *OECD Economic Outlook Database*; IMF, Balance of payments *Database and Bank of Greece.*

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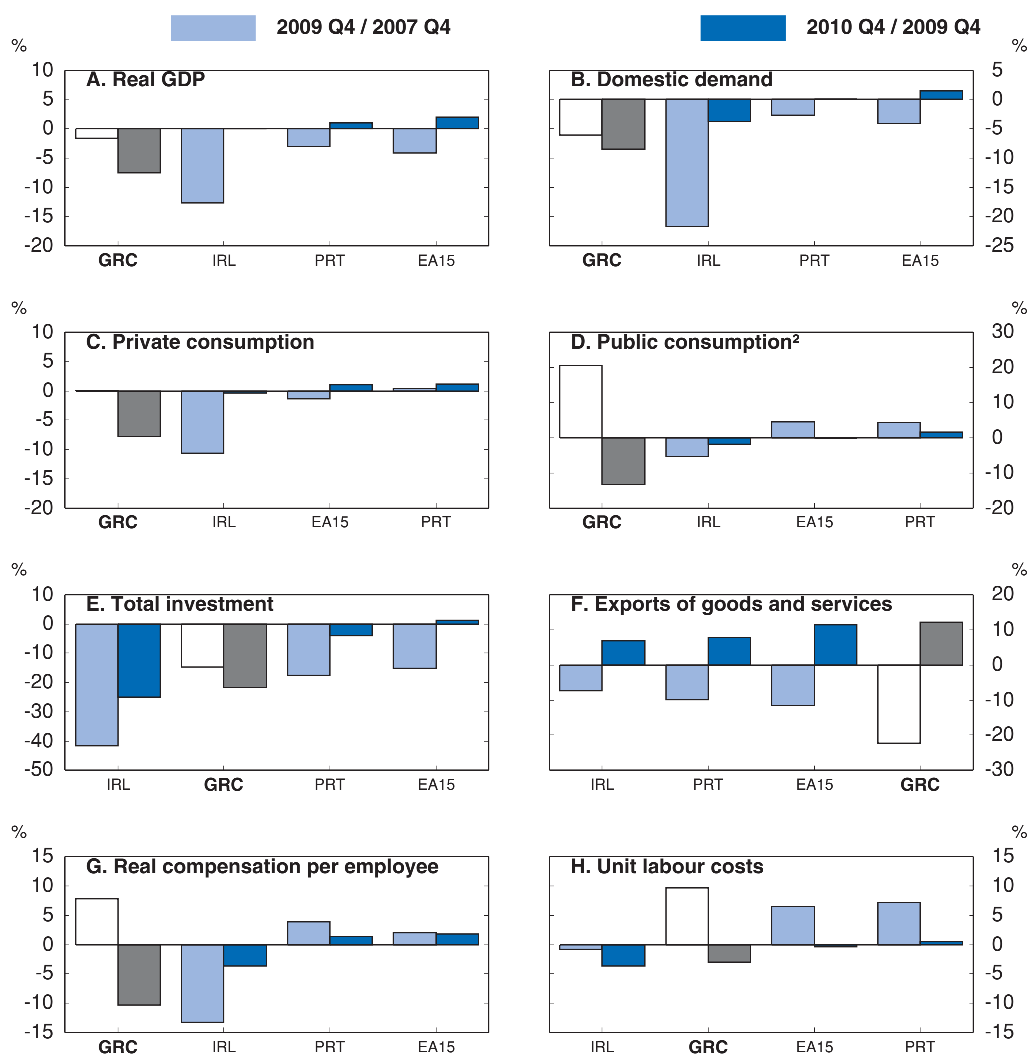
As expected, output contracted sharply in 2010 after a mild decline during the global economic crisis

Output contacted strongly in 2010, as expected in the economic scenario accompanying the economic adjustment program agreed with the IMF/EU/ECB (called "Troika" thereafter) to correct the large macroeconomic imbalances. GDP declined by 4.4%, somewhat more than the 4% projected in this scenario, and production fell 7.4% year-on-year in the final quarter of 2010. This contraction in activity was the sharpest recorded in the OECD countries in 2010, and contrasts with the relatively moderate decline of growth in Greece earlier in the global economic crisis (Figure 1.3).

The impact of budget restrictions included in the economic adjustment programme was especially pronounced on private consumption, which fell year-on-year by 8% in the final quarter of 2010 (Figure 1.3, Panel C)**.** Pay and pension cuts and increases in direct and indirect taxes contributed to a marked drop in household income. At end 2010, the per

Figure 1.3. **Recent macroeconomic developments in the aftermath of the global economic crisis**[1]

Year-on-year growth rate, %



1. Note that the scales used differ widely between the various Panels presented.
2. Because of a break in the quarterly profile of the government consumption time series in 2009, the developments are reported in annual terms: 2007/2009 and 2009/2010.

Source: OECD, *OECD Economic Outlook Database*.

StatLink http://dx.doi.org/10.1787/888932473568

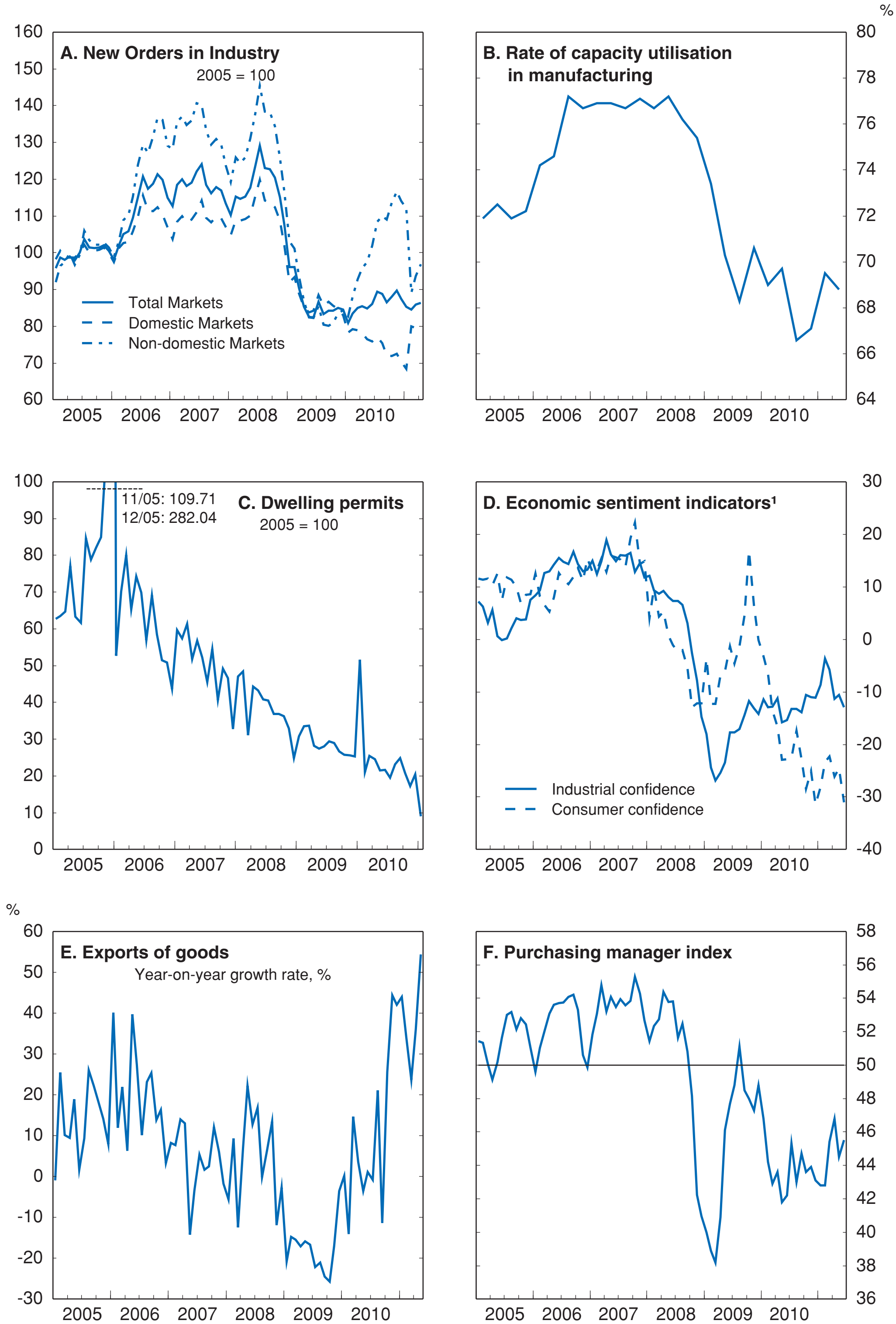
capita salary cut amounted to 4½ per cent in nominal terms and nearly 10% in real terms over the economy as a whole. The reductions (in nominal terms) were larger in the public sector, 8% on average according to the Bank of Greece, than in the private sector (3%). The dip in per capita salaries in the private sector reflects contagion from the public sector, the three-year national salary agreement negotiated in July 2010 with a nominal freeze in the minimum wage until mid-2011, the deterioration of the employment situation and the impact of recent labour-market reforms. The cost of the minimum wage for young people was reduced and overtime bonuses decreased, and, at the end of 2010, new rules for arbitration in pay negotiations were introduced to encourage the spread of company-level agreements, which should foster further wage adjustments going forward (Chapter 3).

Other components of domestic demand have also dropped sharply. The fall of public consumption was however somewhat milder than the other components of demand (Figure 1.3). The contraction in capital investment, although substantial at end 2010, was no more pronounced than in the other peripheral countries. Nevertheless, the capacity utilisation rate in industry is at a historically low level (approximately seven points below its pre-crisis level) (Figure 1.4, Panel B). Businesses are faced with more difficult borrowing terms, the climate of confidence remains morose despite some improvement at end 2010 and early 2011, and the outlook for demand is uncertain. Real estate investment is also depressed, as is shown by the declining number of building permits. The stock of unsold new homes estimated at 70 000, roughly one year of the annual market absorption capacity (National Bank of Greece, 2010), is not being absorbed because of the difficult situation of households, restrictive borrowing terms and the rise in real estate taxes. Confidence is also affected by the still few visible signs of the impact of the implementation of the reforms on economic activity.

The increase in exports, which gathered pace at the end of 2010, constitutes the most positive development in the real economy. Foreign demand rebounded and export order backlogs were restored over the past year (Figure 1.3, Panel F and Figure 1.4, Panel E). In addition, the drop in real wages in 2010, which more than offset the diminishing productivity of labour, fed through to a decline in unit labour costs which slightly improved foreign competitiveness (Figure 1.3, Panel H). These developments, combined with the decrease in non-oil imports caused by slackening domestic demand, reduced the current account deficit only marginally, from 11% of GDP in 2009 to 10.4% of GDP in 2010, compared with the cut recorded on the fiscal balance, as roughly half of the improvement in the trade balance of goods and services was offset by a reduction in the balance of transfers and investment income. Thus, the sharp rise in public saving was to a large extent offset by a drop in private saving.

The deep recession has exacted a heavy cost on jobs, even if the cumulative rise in unemployment since end 2007 has been less than in Spain or Ireland. The unemployment rate stood at 14.9% in Q1 2011 on a seasonally adjusted basis (Figure 1.5), well above its estimated structural level of slightly over 10%, and four percentage points more than a year earlier. It is also probable that the situation will deteriorate further in the coming months before getting better. For example, the 2% drop in public employment in 2010 can be expected to continue over the years ahead, with the application of a rule that only one out of ten civil servants who leave should be replaced in 2011. The downward pressures on wages induced by this situation have nonetheless had positive impact on inflation. Excluding the effects of tax increases, inflation fell below its euro area level for the first time since this statistic has existed. In May 2011, this negative inflation differential reached 1¼ percentage points of GDP.

Figure 1.4. **Recent macroeconomic developments**



1. The series are normalised at the average for the period starting in 2005.

Source: OECD, *Main Economic Database*; ELSTAT; NTC research and Hellenic Purchasing institute.

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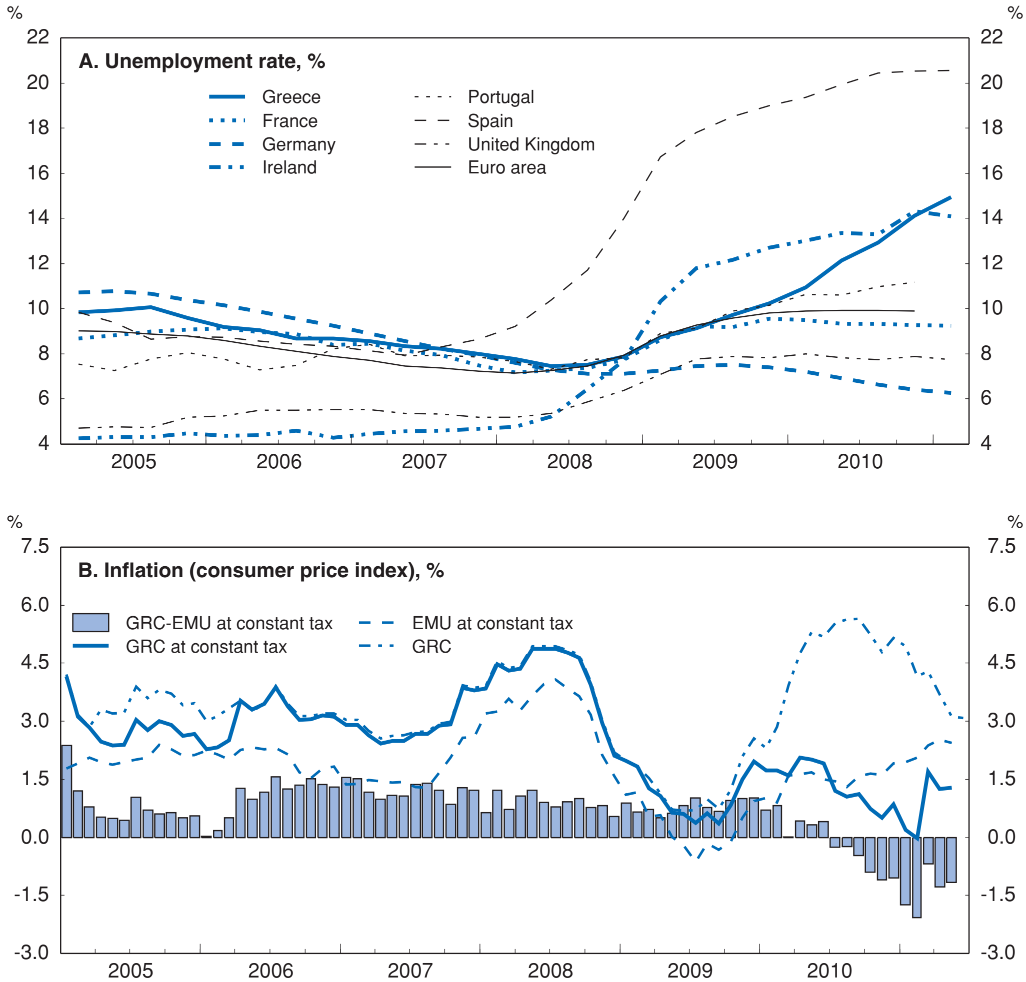
Figure 1.5. **Unemployment and inflation**



Source: OECD, *OECD Economic Outlook Database* and *Eurostat Database*.

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A gradual recovery is expected, but short-term prospects are uncertain

Although activity rebounded in early 2011, with GDP on rising at an annualised rate of 0.7% in the first quarter of the year output is expected to continue declining in 2011 (Table 1.1). On a year-on-year basis, real GDP fell by 5.5% in the first quarter of 2011, as domestic demand remained weak and exports fell somewhat. GDP is projected to rise in 2012, as investment and exports rebound on the back of competitiveness-enhancing structural reforms and strengthening external demand. Faster absorption of the European Union structural funds should also act as a stimulus. Inflation is set to fall over the projection period as the unemployment rate edges up to over 16% in 2012 and substantial economic slack persists. The current account deficit is likely to narrow to around 7% of GDP in 2012, reflecting the positive outlook for exports, especially in tourism and shipping, improvements in competiveness and still-weak domestic demand.

The outlook is however subject to important, mostly downside risks. Many things could go wrong in the international sphere, including further loss of confidence or a marked weakening in export markets. The outlook for the world economy, although

Table 1.1. **Recent growth and prospects**

Percentage change

	Outcomes		Projections		
	2008	2009	2010	2011	2012
Volumes					
Gross domestic product (GDP)	**1.0**	**–2.0**	**–4.4**	**–3.5**	**0.6**
Private consumption	3.2	–2.2	–4.5	–5.4	–0.2
Government consumption	1.5	10.3	–6.5	–7.1	–4.3
Gross fixed investment	–7.5	–11.2	–16.5	–10.4	0.3
Housing investment	–29.1	–21.7	–18.6	–13.8	–3.5
Business investment	5.5	–9.8	–16.2	–8.7	1.9
Government investment	–0.1	3.1	–14.7	–11.9	–0.5
Stockbuilding[1]	0.5	–2.2	0.8	–0.4	0.0
Total domestic demand	**1.2**	**–4.0**	**–6.1**	**–6.9**	**–0.9**
Exports of goods and services	4.0	–20.1	3.8	6.0	9.4
Imports of goods and services	4.0	–18.6	–4.9	–8.8	2.7
Net exports[1]	–0.2	2.0	1.6	4.0	1.4
Memorandum items					
Potential output	2.4	1.6	0.8	0.4	0.7
Output gap (% of potential GDP)	0.5	–3.1	–8.2	–11.7	–11.8
Consumer price index (harmonised)	4.2	1.3	4.7	2.9	0.7
Employment	1.1	–1.1	–2.7	–3.7	–0.3
Unemployment rate (% of labour force)	7.7	9.5	12.5	16.0	16.4
Government net lending (% of GDP)	–9.8	–15.6	–10.4	–7.5	–6.5
Current balance (% of GDP)	–14.7	–11.0	–10.4	–8.6	–7.2

1. Contributions to changes in real GDP (percentage of real GDP in previous year).

Source: OECD updated EO89 projections.

improving, is not rosy with rising commodity prices and high public debt burdens. Moreover, confidence about the chances of success of the adjustment programme seems to have fallen since the beginning of 2011. Success depends not only on the ability of the current fiscal and structural reforms in achieving growth and consolidation, but also on the delays in the materialisation of the impact of reforms, on the political support for reforms and the outcome of the discussions on economic governance in the EU (see below). Risks are growing that consumers and investors hold off spending in the expectation of tangible signs that the reform process works. Although the situation seems to be changing since May 2010, given the poor track record of the country in terms of implementation of past reforms, there are doubts concerning the speed of implementation of several structural reforms. However, to a significant extent, this reflects insufficient information to the public and markets of the progress actually achieved so far, the outcomes of which will come, as expected, with a lag. Together with the drastic fiscal austerity and limited banking sector's ability to support growth with credit, this entails the risks that a negative spiral could get under way.

The distribution of social costs of the adjustment process is difficult to measure as many social indicators are reported with long lags. Ensuring a fair sharing of the burden of the adjustment is important, however, to facilitate the social acceptability of the reforms needed. Available data so far seems to suggest that much of the adjustment has fallen on labour income in terms of real wage cuts and on workers. For example, the labour share in GDP is projected to decline from its decade long peak in 2009 of 38% to about 33% of GDP in 2012. On the other hand, rents are also being affected in many closed professions, spreading part of the pain. But more action is needed in tackling tax evasion among the well-to-do and self-employed. It is also important to safeguard the social safety net from drastic cuts, to protect the most vulnerable. Social spending should be better targeted and its effectiveness be enhanced. Active labour market policies and training, complemented with the reforms to reduce barriers to entrepreneurship (Chapter 3), would also reduce the pain of adjustment.

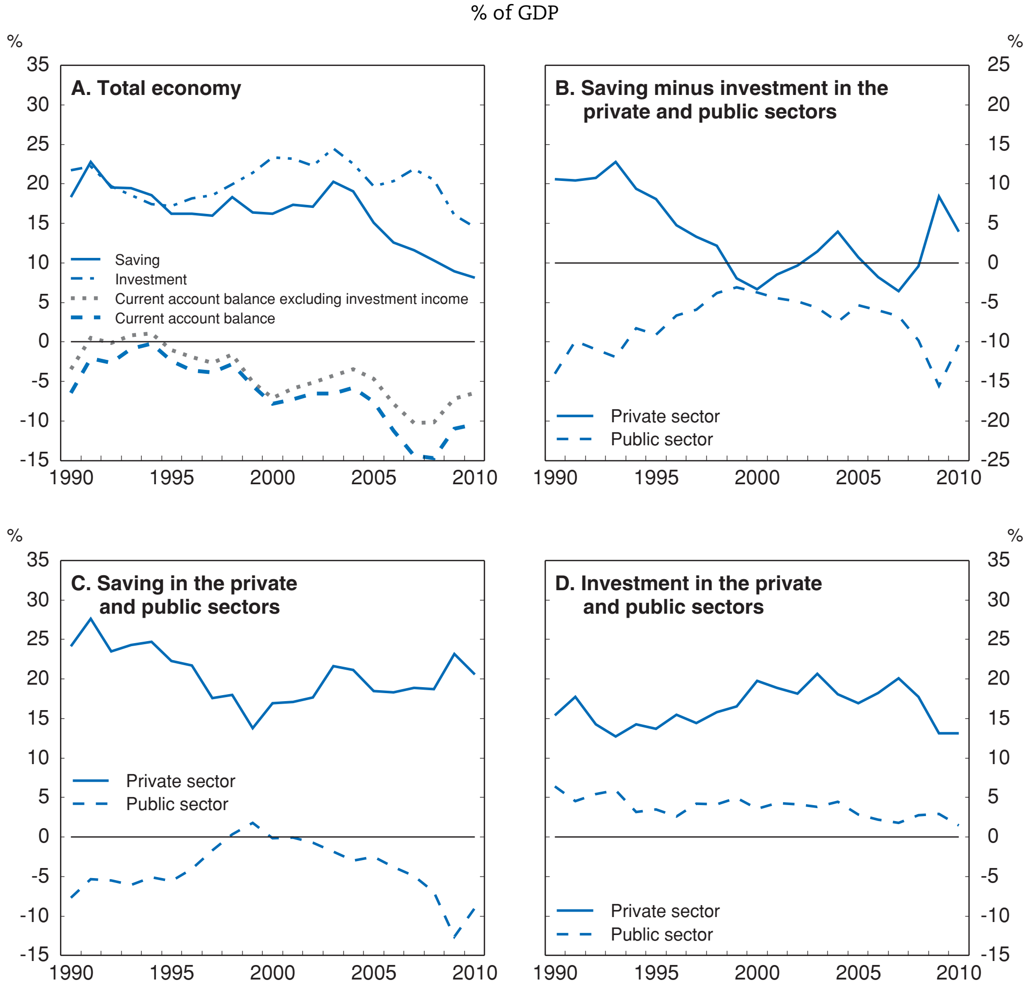
Sources and size of the macroeconomic imbalances leading to the crisis

The external imbalance results from poor macroeconomic management and structural problems

The external imbalances that the current adjustment programme aims at correcting are symptomatic of the shortcomings of macroeconomic management over the past decade. Whereas current-account deficits had been historically low or moderate from the early 1960s onwards, they began to widen sharply in the late 90s following the decline in the national saving rate (Figure 1.6, Panel A) (Brissimis *et al.*, 2010). This was pronounced in the private sector as from the mid-1990s, and can be explained in great part by the

Figure 1.6. **Saving and investment**

% of GDP



Source: OECD, *OECD Economic Outlook Database*.

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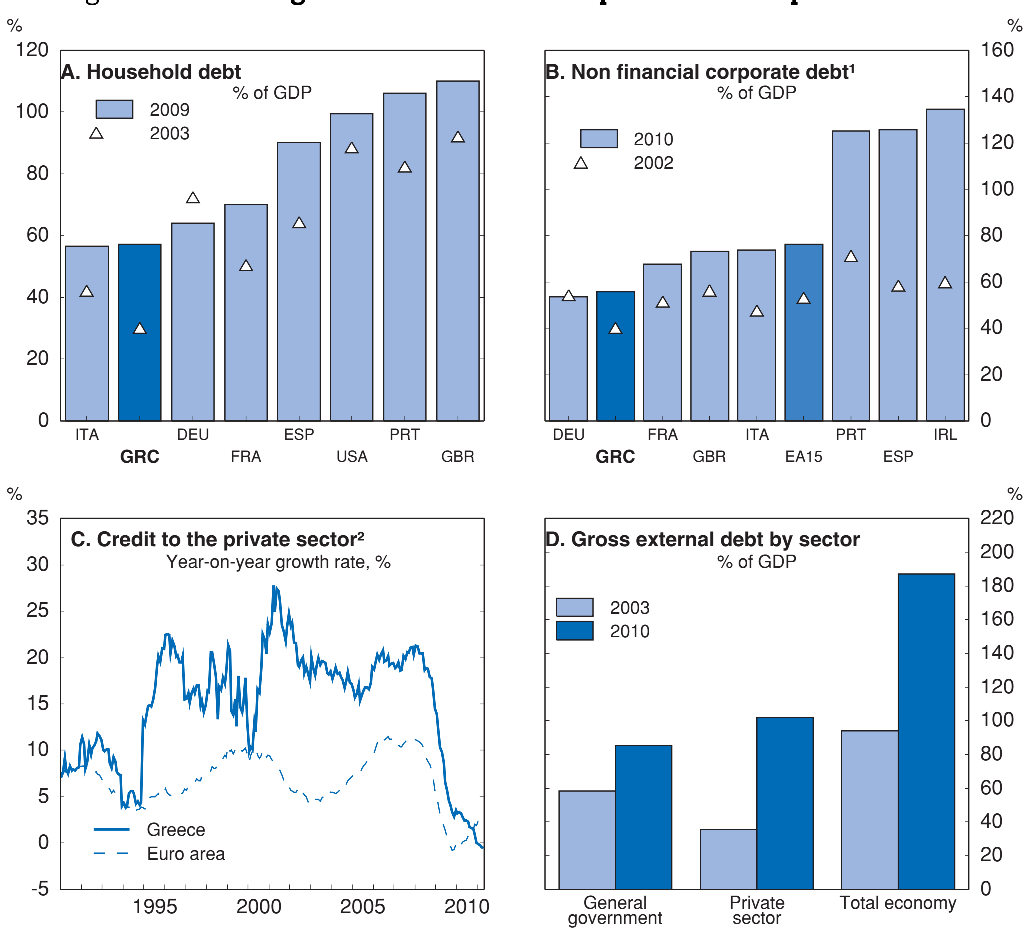
liberalisation of the financial sector and the gradual reduction of real interest rates upon Greece's joining the economic and monetary union (EMU), and its participation in the euro area as from 2001. As in other countries within the euro area, the reduction of liquidity constraints, combined with expectations for a sustained drop in interest rates and strong growth, prompted households and businesses to revise upwards their prospects for consumption and investment. Loans to the private sector grew sharply, especially as from 1995, which expanded indebtedness, primarily *vis-à-vis* foreign creditors (Figure 1.7, Panel C). Nevertheless, in contrast to earlier periods, between 1999 and 2009 the saving behaviour of the public sector did not offset that of the private sector (Figure 1.6, Panels B and C). Despite the precarious state of public finances, fiscal policy was increasingly pro-cyclical. The fiscal consolidation achieved during the 1990s in preparation for entry into the euro area was wiped out.

The deterioration of the external balance also reflected eroding international competitiveness. The cumulative weakening of price competitiveness, while difficult to gauge precisely, has been substantial since the adoption of the euro, with the overvaluation

Figure 1.7. **Credit growth and debt developments in the private sector**



1. Defined as loans, shares and securities by MFIs excluding Eurosystem to non-financial corporations in euro area countries.
2. Loans to Non-MFIs excluding general government (excluding securitised loans).

Source: OECD, *OECD Economic Outlook Database*; ECB, Statistical Data Warehouse and Bank of Greece.

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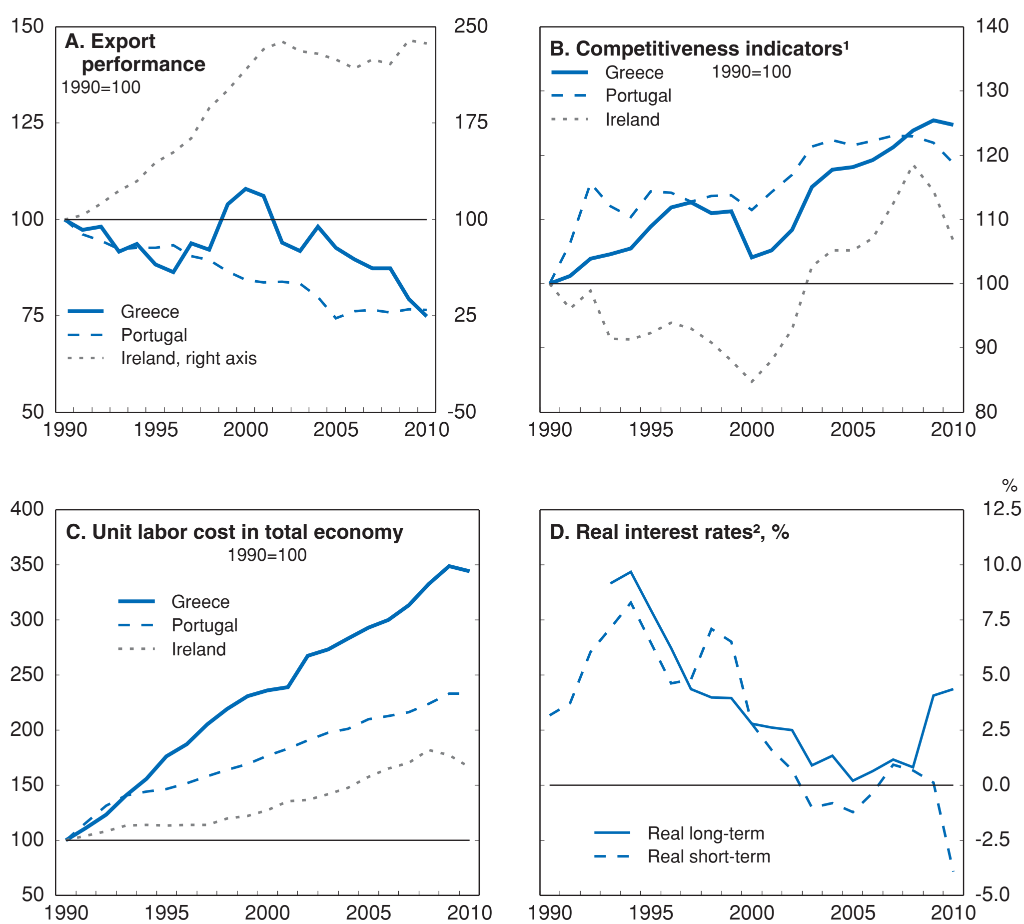
of the real exchange rate estimated at between 10% and 20% (IMF, 2007; IMF, 2011; European Commission, 2010a). The current-account deficit, which had climbed to 7% of GDP at the time of Greece's entry into the euro area, was already a sign of a lack of competitiveness, due in part to the "strong drachma"-based disinflation policy adopted in the mid-1990s (Anastasatos, 2008). The related rise in the real effective exchange rate, which was only partially offset by the final devaluation of the Greek currency in 1999 before EMU participation, continued thereafter with rising inflation in a fixed exchange rate environment. Between 2000 and 2009, the growth of unit labour costs in Greece for the whole economy exceeded the rate recorded in the euro area by 20 percentage points (Figure 1.8).The persistent consumer price inflation differential, which reached roughly one percentage point per year in relation to the euro area, not only eroded the economy's competitiveness, but also heightened incentives for the contraction of private saving. This inflation differential, which can be explained only partly by a Balassa-Samuelson effect,[1] reduced real interest rates and expanded household purchasing power, as measured in terms of imported goods (Figure 1.8, Panel D).

Figure 1.8. **Inflation, interest rates, competitiveness and export performance indicators**



1. Competitiveness indicators are calculated on the basis of the CPI indicator.
2. Long term rates are 10-years government bonds and short-term rates are 3-months rates.

Source: OECD, *OECD Economic Outlook Database*.

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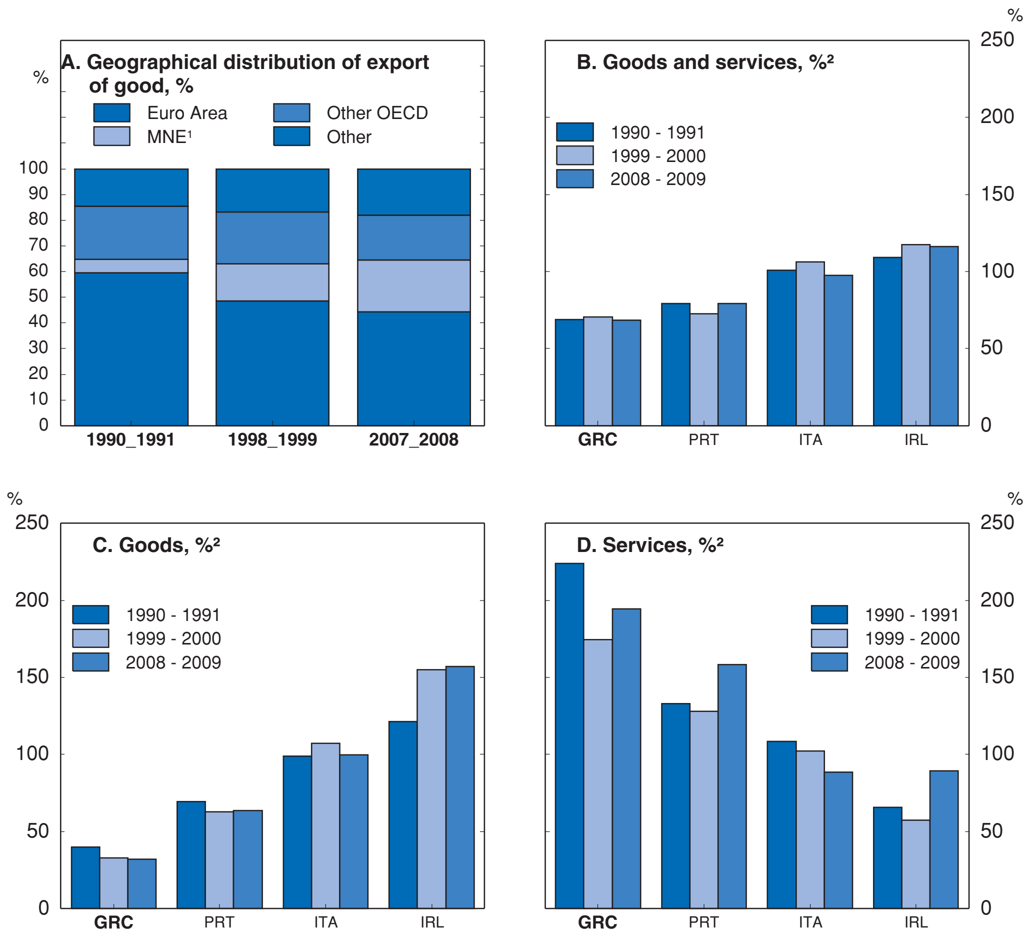
Non-price factors must also be taken into account to restore sustainability to current account trends. In this area, the performance of Greek exports is weak, even if allowances are made for the country's outlying geographic position within the EU (Papazoglou, 2009). Manufacturing exports are dominated by low-tech products for which Greece no longer enjoys any advantage over emerging economies, which have lower labour costs. This partly explains the difficulties faced by Greek exporters trying to break into European markets. Nonetheless, these difficulties have been partially offset by efforts to redirect exports towards the Balkans and South-East European markets, which have expanded sharply in recent years (Figure 1.9, Panel A).

Another sign of poor competitiveness is the low import coverage ratio (*i.e.* ratio of export to imports of goods and services), partly due to the high import content of Greek exports. It has remained lower than in other peripheral EU countries, and has not risen over the past two decades (Figure 1.9, Panels B to D). This coverage ratio is especially low in

Figure 1.9. **Import coverage and export share development of Greece in the EU and non-EU markets**



1. Albania, Bulgaria, Bosnia-Herzegovina, Croatia, FYROM, Montenegro, Romania, Serbia and Turkey. Includes former Yugoslavia.
2. Ratio of exports to imports in per cent.

Source: OECD, *OECD Economic Outlook Database* and IMF, *Trade Database*.

StatLink http://dx.doi.org/10.1787/888932473682

the goods sector, which may reflect the scant proclivity to export of large Greek businesses, which may result from the average small size of Greek firms. In the manufacturing sector, for example, the top 5% of exporters account for only 53% of aggregate Greek exports, whereas the corresponding proportion is roughly 70% in Germany, Belgium, Spain and Italy (European Commission, 2010b). Greece performs better in services, notably shipping and tourism, which account for over 55% of exports of goods and services. Nonetheless, additional efforts to improve the quality of supply would appear necessary to offset growing price competition from other Mediterranean countries (National Bank of Greece, 2010). More generally, the need to restore the trade balance for goods and services is increased by the concomitant need to offset the impact on the external accounts of the diminishing balance of official and private transfers, including those from the EU, and of the decline in investment income from the rising foreign debt service. The cumulative balance of transfers and investment income was positive at around 6% of GDP in the early 1990s, but in deficit by 3¼ per cent of GDP by 2009 (Figure 1.2, Panel B), partly reflecting a deteriorating international investment position. Going forward, official transfers involving EU structural funds can be expected to decrease further because of the entry of new Member States into the Union, while rising immigration should continue to reduce the balance of private funds transferred abroad.

Weak fiscal management compounded with failings of the statistical system exacerbated imbalances

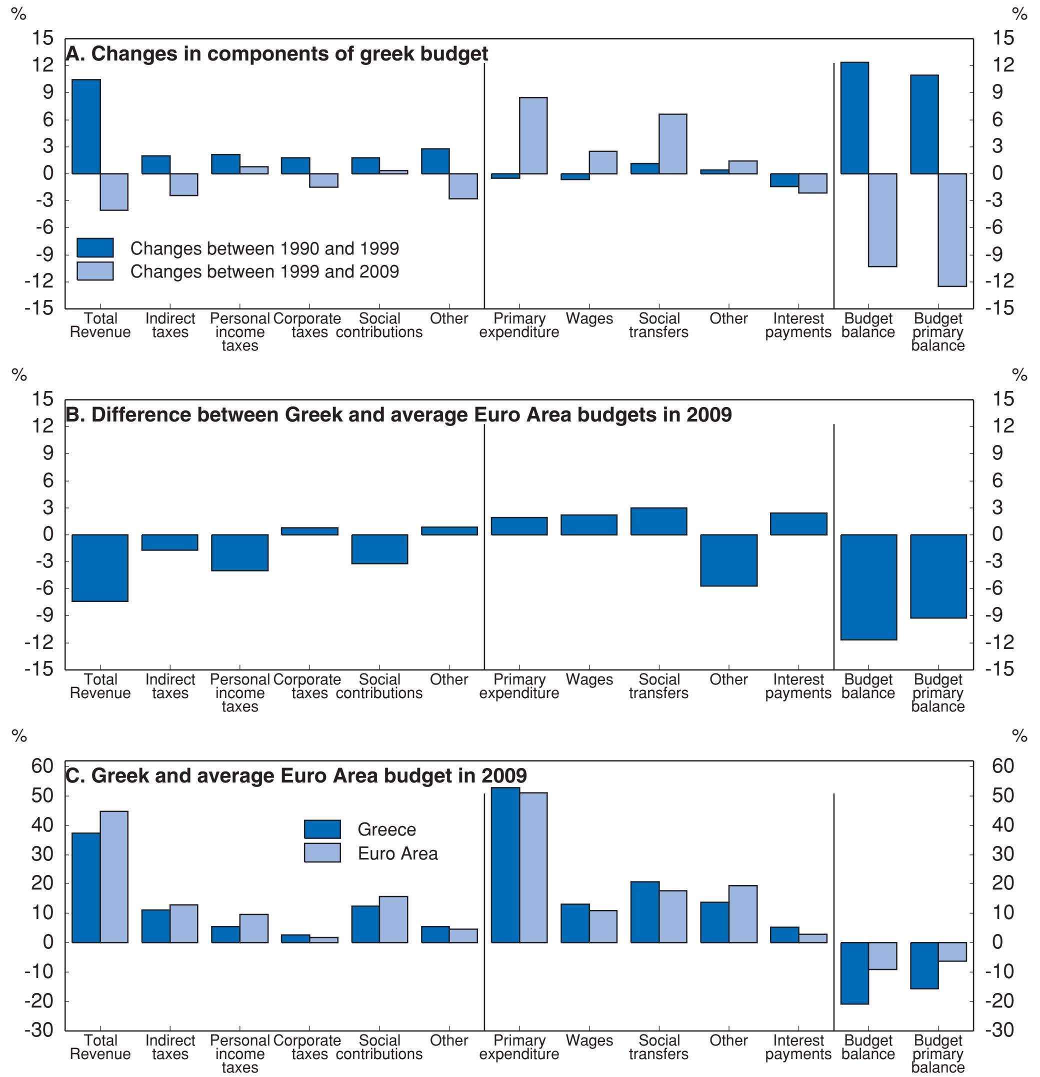
The deterioration of public finances over the past decade reflects major failings in cost control, in contrast to the earlier consolidation period in the 1990's. Primary expenditures rose by 8½ per cent of GDP between 1999 and 2009, whereas they had remained more or less stable during the previous decade (Figure 1.10, Panel A). This shift reveals not only a lack of proper management, but also the lack of mechanisms to monitor and control expenditure, including the outlays of public-sector enterprises. More than half of the rise in expenditures since 1999 stemmed from growth in social transfers, which is only partly attributable to the 2009 recession. Growth in public consumption was also high, reflecting in part a spike in payroll expenditures, which was especially pronounced in the 2009 election year. Greece in 2009 devoted more resources to government salary and social expenditures as a share of GDP than the average of EMU countries (Figure 1.10, Panel B). The decrease in interest payments helped hide somewhat the impact of the rise in primary expenses on the fiscal deficit (Figure 1.10, Panel A).

At the same time, tax revenue in relation to GDP in Greece is low in the European context and it has declined between 1999 and 2009 despite a period of relatively strong average growth driven by consumption. In 2009, aggregate revenue at 37% of GDP was more than 7 percentage points below the euro area average (Figure 1.10, Panels B and C). The tax burden on household income was half as much as in the euro area as a whole, and the social security contributions and, to a lesser extent, indirect taxation were also lower as percentages of GDP. These considerable differentials reflect the substantial shortcomings of the tax system, in particular with regard to tax collection (Chapter 2).

The negative economic consequences of this deterioration of the fiscal situation, the source of which is discussed in greater detail in the next chapter, were amplified by the serious deficiencies in statistical monitoring of government accounts and, more generally, macroeconomic developments. The gravity of these deficiencies, which started to be identified in October 2009, is illustrated by the scope of revisions of general government

Figure 1.10. **Recent fiscal development in Greece in the international perspective**

% of GDP



Source: OECD, *OECD Economic Outlook Database*, and Hellenic Republic Ministry of Finance, Budget 2011.

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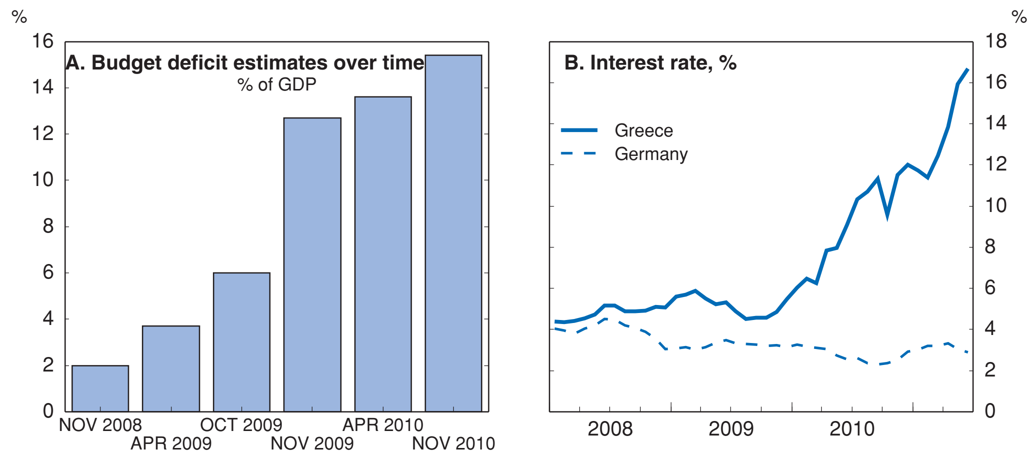
deficit estimates for 2009 (Figure 1.11). Large revisions had also occurred in 2004 in Greece (European Commission, 2010c). These events have deteriorated the credibility of Greece's commitment and ability to carry out sound fiscal policy. As Arghyrou and Kontonikas (2011) note, until recently markets had tended to underestimate the risks of the sovereign debt of euro area countries that, like Greece, had weak macroeconomic and structural fundamentals. The abundance of liquidity available on the market until the economic and financial crisis of mid-2007, and the perception that accession to the euro area would ensure economic convergence were probably conducive to underestimating the risks. When the state of the public finances began to become clear in November 2009, markets began a huge shift away from Greek sovereign debt and, later, that of other euro-area countries judged to have weak fundamentals.

Figure 1.11. **Revisions to the 2009 budget deficit estimates over time and interest rate spread**



Source: OECD, *OECD Economic Outlook Database* and Hellenic Republic Ministry of finance, Budget 2011.

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Since March 2010, major efforts have been deployed to bridge the gaps in the operation of the statistical system, both technically and from an institutional and governance standpoint. An independent statistical authority, Hellenic Statistical Authority (ELSTAT), supervised by Parliament, has been set up and a statistical action plan launched (Box 1.1). These welcome changes are essential to improving the quality, reliability and credibility of statistics. Improvement in the statistical system needs to continue. Particular requirements include quarterly government and household appropriation accounts on a national account basis and more up-to-date and cyclical indicators covering all key economic sectors. The lack of adequate information on public and private sector wage developments is for instance particularly problematic (see Chapter 2). Moreover, when information exists it is often lagging: in mid-May 2011, the last employment and retail sale data available concerned March, whereas April or May figures for these series were already published in the Netherlands and many other European countries.

Box 1.1. **Reform of the Greek statistical system**

Following the major upward revision of the 2009 general government deficit announced by the authorities in the wake of the October 2009 national elections, the European Commission was asked to examine the "renewed problems in the Greek fiscal statistics" (European Commission, 2010c).* The results of this review highlighted two types of problems:

- Problems stemming from statistical shortcomings related to methodological weaknesses and unsatisfactory technical procedures in the Greek statistical institute and in several other units that provide it with data, such as the General Accounting Office and the Ministry of Finance.
- Operational shortcomings of Greek institutions. These shortcomings reflect problems of governance: lack of co-operation between units compiling statistics and a lack of clarity regarding their responsibilities; diffuse personal responsibilities; ambiguous empowerment of officials; and absence of written instructions and documentation. This situation has left Greek fiscal statistics subject to political interference, depending on electoral cycles.

Box 1.1. **Reform of the Greek statistical system** *(cont.)*

To remedy these problems, the authorities restructured their statistical system by adopting legislation, in March 2010, that created an independent Greek statistical authority, ELSTAT, answerable to Parliament alone. In April 2010, a three-pronged statistical action plan was formulated with assistance from Eurostat in order to:

- *Ensure effective improvement of the governance of the new statistical system.* A variety of measures were taken for rapid implementation of the new legislation. In December 2010, an amendment was also adopted to align the code of conduct of ELSTAT staff with practices in force at the European level, and to guarantee effective behavioural changes in statistical management.
- *Bolster the capacities of the Greek statistical system.* A series of actions were taken to overhaul systems, techniques and the organisation of statistical production. In this connection, international experts were invited to submit proposals for improving the quality of Greek statistics. Progress is needed, for example, in the realm of national accounting to develop reliable quarterly household sector accounts and up-to-date cyclical indicators.
- *Improve statistics on government finances.* Major progress was made in this area with the approval by Eurostat in November 2010 of the latest revisions of general government accounts. In addition, publication of quarterly fiscal data based on national accounting and providing good coverage is being phased in.

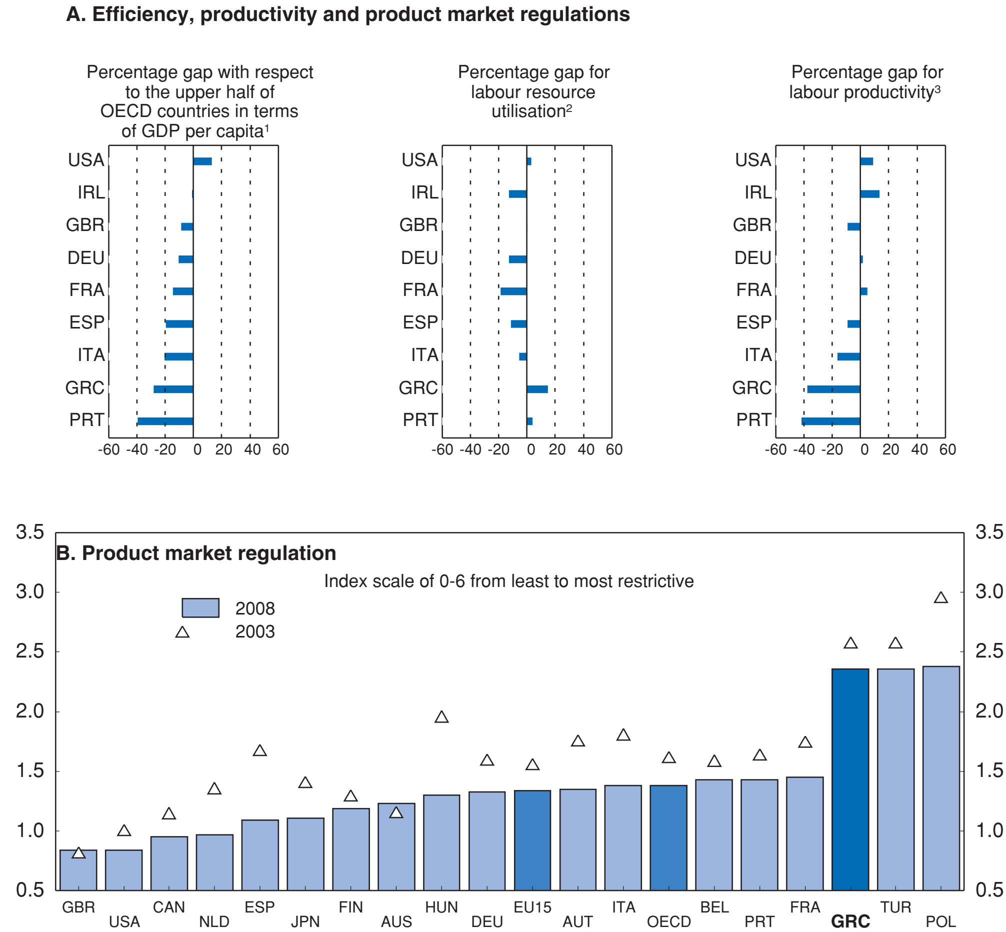
The most recent revisions of fiscal statistics related to the years 2006 to 2009. They entailed an increase in deficits of 1¾ per cent of GDP in 2008 and 2009 and an increase in debt of over 11% of GDP as compared to the previous estimations in April 2010. To a large extent, these changes reflect a reclassification of certain public enterprises within the general government sector insofar as the sales revenue of these firms is equal to less than 50% of their production costs. This reclassification had a pronounced impact on both deficits (+0.8% of GDP in 2009) and government debt (+7.8% of GDP). Statistical adjustments were also made to local government and social security accounts to factor in, *inter alia*, payment arrears in the hospital sector, which had a significant impact on the deficit (+0.8% of GDP in 2009). Lastly, statistical corrections with respect to swap transactions also increased government debt slightly (+2.3% of GDP in 2009).

* In 2004, Eurostat had already expressed reservations on the quality of Greek fiscal figures, and debt and deficit data had been revised substantially for the years 2000 through 2003. Between 2000 and 2002, the deficit had been revised upwards by 2% of GDP and in 2003 by 3% of GDP.

Poor structural policies contributed to major distortions in resource allocation and unbalanced growth

Greece was unable to leverage the favourable economic conditions prevailing in the late 1990s to introduce needed structural reforms. In 2008 for example, regulations on product markets were among the most cumbersome in the OECD area, and progress over the previous decade was limited compared to most other countries (Figure 1.12) Labour market outcomes were also hampered by major regulatory constraints (Chapter 3). These policies and regulations contributed to the development of low value-added non-tradable sectors and low productivity and efficiency by international standards.[2] For example, growth was strong in retailing and wholesaling, which caused their relative size to swell

Figure 1.12. **Efficiency, productivity and product market regulations**



1. Relative to the simple average of the highest 15 OECD countries in terms of GDP per capita, based on 2008 purchasing power parities (PPPs). The sum of the percentage gap in labour resource utilisation and labour productivity do not add up exactly to the GDP per capita gap since the decomposition is multiplicative.
2. Labour resource utilisation is measured as total number of hours worked per capita.
3. Labour productivity is measured as GDP per hour worked.

Source: OECD, *National Accounts Database*; OECD (2010), *OECD Economic Outlook 88 and 89 Databases*; OECD (2010), *OECD Employment Outlook* and OECD (2009), *Product Market Regulation Database*, *www.oecd.org/eco/pmr*.

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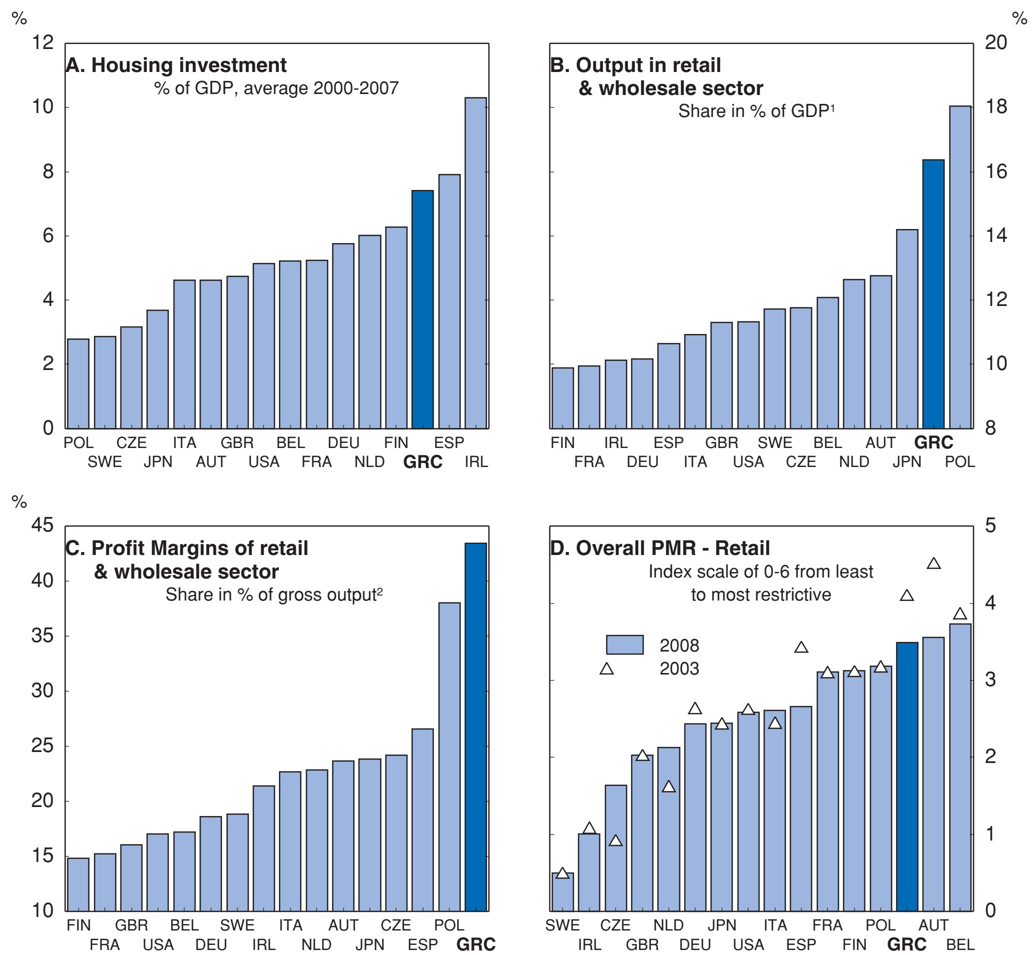
(Figure 1.13, Panel B to D). Limited foreign competition and major regulatory constraints against a backdrop of strong demand contributed to high profits in these sectors, which in turn attracted further resources. Resource allocation was also distorted by the development in the housing market, which, as in other OECD countries, attracted a substantial share of total investment until 2007 (Figure 1.13, Panel A).

Inflows of foreign direct investment to finance the current account deficit remained limited. Their stock as a proportion of GDP is known to be lower than in any other peripheral euro area country (Figure 1.14), or many non-EU countries of Central and South-East Europe, North Africa or West Asia (Nugent and Glezakos, 2011). To date, Greece has been unable to exploit the advantages derived from its accession to the

Figure 1.13. **Selected indicators of resource allocation**



1. GDP of total economy. 2009 for AUT, BEL, CZE, FIN, DEU, GRC, ITA, USA. 2008 for FRA, IRL, NLD, POL, ESP, SWE.
2. Gross output of retail and wholesale sector. 2009 for AUT, BEL, CZE, FIN, GRC, ITA, USA. 2008 for DEU, NLD, POL. 2007 for FRA, SWE, GBR.

Source: OECD, *OECD Economic Outlook Database* and OECD, *STAN Database*.

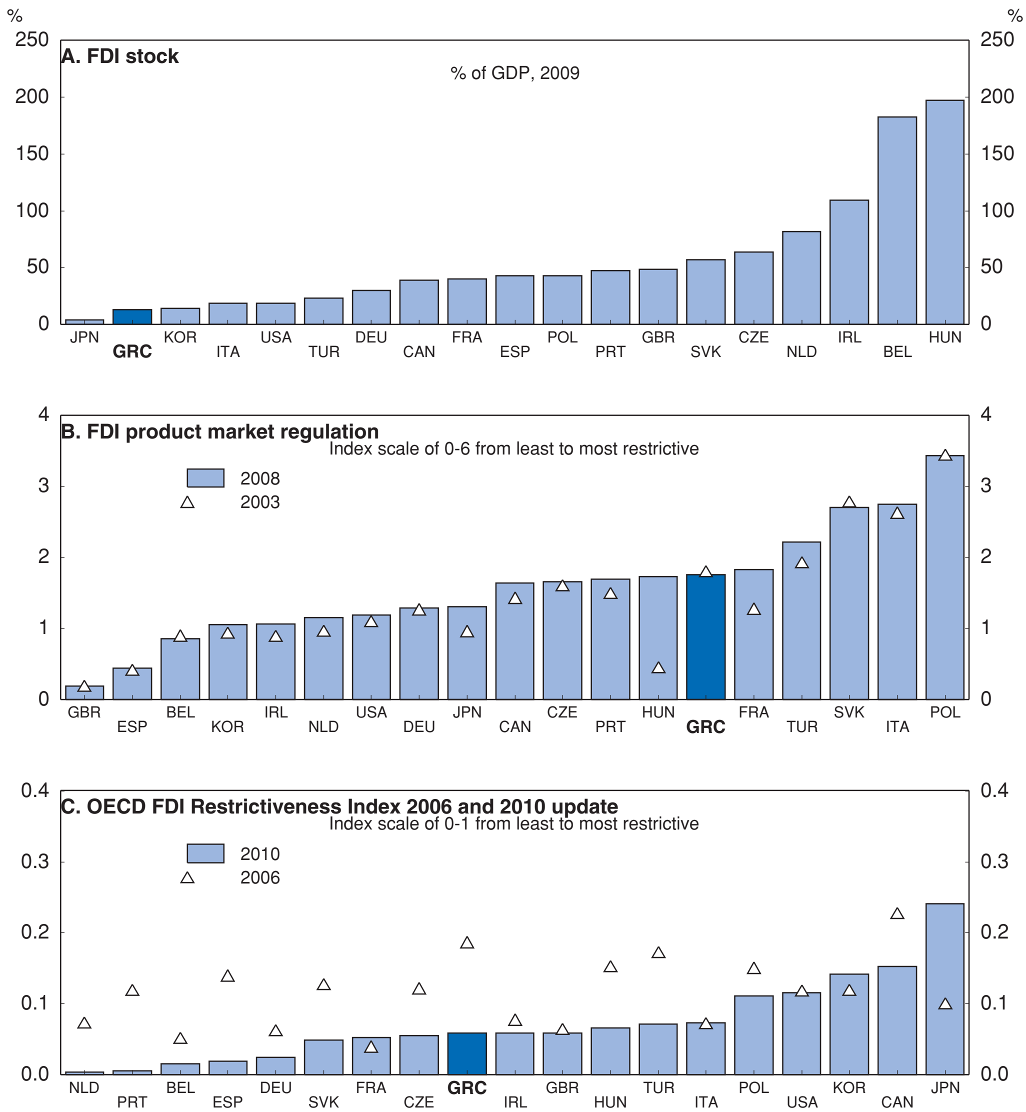
StatLink http://dx.doi.org/10.1787/888932473758

European Economic Community in 1981 (later: European Union), participation in the euro area since 2001 or, more generally, the country's natural tourism resources or privatisation drives, to attract foreign investors.

It is likely that growth in the supply of credit to various sectors of the economy magnified distortions in resource allocation via a financial acceleration phenomenon. For example, consumer credit grew quickly in Greece during most of the last decade (see below). As in other peripheral euro area countries, the sharp growth of real estate loans also reflected an underestimation of the risks arising from the sector's expansion, which probably stemmed in part from an overestimate of the economy's growth potential.

Another major source of resource allocation distortion stems from the failings of general government. Weaknesses in the taxation system, particularly the broad possibilities for tax avoidance by individual entrepreneurs, a cumbersome and inefficient bureaucracy, and high administrative costs for developing and creating large firms tend to

Figure 1.14. **FDI stock and FDI product market regulations**



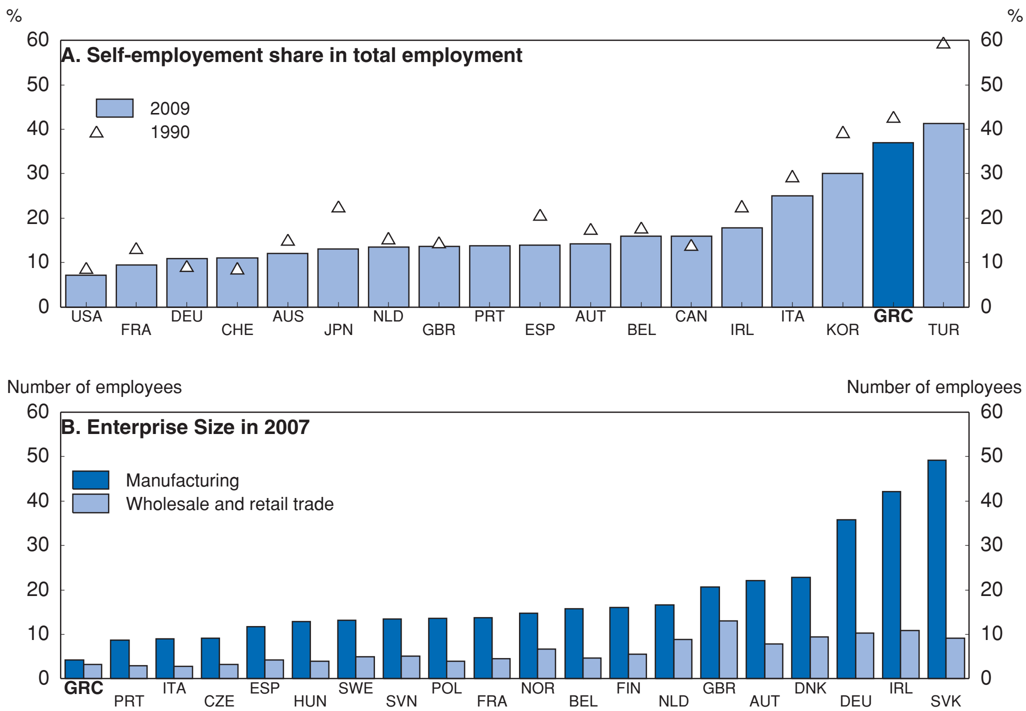
1. The OECD FDI restrictiveness Index is one component of the OECD FDI Product Market Regulation (PMR). The 2008 FDI PMR was based on the 2006 version of the OECD FDI restrictiveness Index. With the 2010 update, the coverage of the FDI Index by sectors has been upgraded, which improves the cross-country comparability of the results.

Source: OECD, *OECD Economic Outlook Database* and OECD (2009), *Product Market Regulation Database*, *www.oecd.org/eco/pmr*.

StatLink http://dx.doi.org/10.1787/888932473777

maintain a productive system dominated by small businesses. Ninety-two per cent of Greek firms have fewer than 10 employees, and the average number of employees at non-financial enterprises is 1.7, *versus* 5.2 on average for the euro area (Figure 1.15). In addition, in contrast to what is observed in other OECD countries, even relatively small ones such as Austria or Portugal, the average size of businesses has not increased since the late 1990s (National Bank of Greece, 2010). Similarly, individual entrepreneurs account for a high proportion of total employment as compared with other European countries. This production structure limits scale economies, access to credit and innovation.

Figure 1.15. **Share of self employed and enterprise size**



Source: OECD, *OECD Economic Outlook Database* and *Eurostat Database*.

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The correction of imbalances has now started, especially in the government sector

The economic adjustment programme adopted by the authorities in May 2010 targets three main objectives: to consolidate public finances on a sustainable basis; to preserve the stability of the financial sector; and to implement the structural reforms that are needed to spur growth and bolster the country's competitiveness. The first phase of this plan focused on trimming the budget deficit to check the sharp rise in government debt, which has risen by roughly 37% of GDP between 2007 and 2010, as quickly as possible. A major and rapid improvement of the primary budget balance is needed to halt this spiral of indebtedness. Accordingly, the May 2010 plan was to improve the balance by 5½ per cent of GDP in 2010, half the total required to bring the deficit to 2.6% of GDP in 2014 (Table 1.2).

The first phase of this fiscal consolidation process, which required the adoption of a wide set of measures (Box 1.2) was largely successful, although not all the targets set were met. The budget deficit was indeed cut by almost 5% of GDP in 2010 (Table 1.2), despite a deteriorating economy. This deficit reduction measured on a structural basis was even more remarkable, since it reached 7¼ per cent of GDP: no OECD country has achieved such a substantial improvement in a single year over the past three decades.[3] Nonetheless, the reduction of the 2010 actual deficit was somewhat lower than the changes targeted initially in May 2010 and later in November 2010, mainly because the recession was deeper than expected. Another reason was the *ex post* revision of the 2009 deficit. As a result, the 2010 deficit reached 10.5% of GDP, instead of the initial objective of 8.1% of GDP. Put into

Table 1.2. **Planned fiscal deficits and initial outcomes**[1]

In % of GDP

	Targeted Fiscal deficit						Fiscal measures needed
	Initial May 2010 programme		Revised November 2010 programme		Outcome and revised June 2011 programme		
	Deficit level	Change in deficit	Deficit level	Change in deficit	Deficit level	Change in deficit	
2009	**–13.6**		**–15.4**		**–15.4**		
2010	–8.1	5.5	–9.6	5.8	**–10.5**	**4.9**	10.2
2011	–7.6	0.5	–7.6	2.0	–7.5	3.0	6.6
2012	–6.5	1.1	–6.5	1.1	–6.5	1.0	3.3
2013	–4.8	1.7	–4.8	1.7	–4.8	1.7	2.6
2014	–2.6	2.2	–2.6	2.2	–2.6	2.2	2.4
2015					–1.1	1.5	1.6
2009-14 Change	11.0	11.0	12.8	12.8	12.8	12.8	25.1

1. Initial and revised estimates of actual level or change in fiscal deficits are in bold

Source: IMF, EC, Ministry of Finance.

Box 1.2. **Main features of deficit-reducing measures adopted for 2010**

The total of deficit-reducing measures adopted for 2010, which were introduced in a number of successive waves between January and September, can be estimated at over 10% of GDP, if one includes in this calculation the expiring one-off measures (evaluated at roughly 1% of GDP) that had temporarily widened the 2009 deficit (Table 1.3). The measures specifically adopted for 2010, totalling some 9% of GDP, made greater use of revenue increases (+5.5% of GDP) than of spending cuts (–3.6% of GDP).

Correction of the 2010 deficit was based essentially on general budgetary saving measures or tax increases. With regard to expenditure, the measures included cuts in pay, jobs and pensions (–2.5% of GDP) and, to a lesser extent, cutbacks on military spending and certain capital investments (–1.1% of GDP). Public sector wages were cut by 15% in nominal terms, and public sector employment reduced by 82 400 people or 10%. Deficits of State owned enterprises (SOEs) declined by 20% with cuts in wages of up to 30% and ceilings on bonuses and wages. Pensions in the public and private sector were cut by 10% while social spending on pensions, illness and pharmaceutical benefits saw an overall reduction of almost 10% (Ministry of Finance, 2011). The revenue increases involved indirect taxes (+2.6% of GDP), including increases in VAT rates across the board by 20% (with the top rate raised from 19% to 23%) and in excise taxes on tobacco, alcohol and fuel (by 33%), whereas tax increases on household income and real estate were more limited (0.7% of GDP). Some of the tax hikes (1.2% of GDP) were temporary, moreover, with for example a tax amnesty adopted in the autumn of 2010 and a temporary increase in levies on the banking sector and profit-making businesses.

The large gap between the total amount of deficit-reducing measures implemented in 2010 (over 10% of GDP) and the actual reduction of the deficit achieved (about 5% of GDP) can be explained by a deficit drift. This means a cyclical worsening of the budget deficit due to the recession and the increase in interest payments. Part of this gap can also be ascribed to the change in the composition of demand, with growing shares of exports and subdued consumption and household incomes, which has negatively weighted on tax receipts. The precise quantification of this gap is however uncertain because of the difficulties to precisely measure the various effects mentioned above and of the inherent uncertainties attached to the quantification of the deficit-reducing measures which have affected 2010 fiscal account.

Table 1.3. **Deficit-reducing measures for 2010**

	EUR Billion	% of GDP
Total Expenditure measures	**–8.2**	**–3.6**
Permanent expenditure cut in 2010	–8.2	–3.6
Of which:		
Cut on salary allowances	–2.5	–1.1
Saving on pensions	–3.0	–1.3
Hiring restrictions	–0.2	–0.1
Cuts of operating costs	–1.1	–0.5
Other (military and hospital expenditure)	–1.5	–0.6
Total revenue measures	**12.8**	**5.5**
Permanent revenue increase in 2010	10.0	4.3
Of which:		
Direct and property tax	1.5	0.7
Excises	3.7	1.6
VAT	2.2	1.0
EU receipt for investment programme	1.4	0.6
Other	1.2	0.5
One-off revenues in 2010	2.8	1.2
Of which:		
Tax amnesty	1.3	0.6
Revenue from banks	0.3	0.1
Special levy on profitable firms	0.9	0.4
Special levy of high income	0.3	0.1
Total measures adopted in 2010	**20.9**	**9.1**
Expiration of 2009 one-offs	2.5	1.1
Total measures including expiring 2009 one-offs	**23.5**	**10.2**

Source: Ministry of Finance (2010), "The economic adjustment programme for Greece", Report submitted in accordance with Council Decision 9443/10 (ECOFIN 250, UEM 171), July.

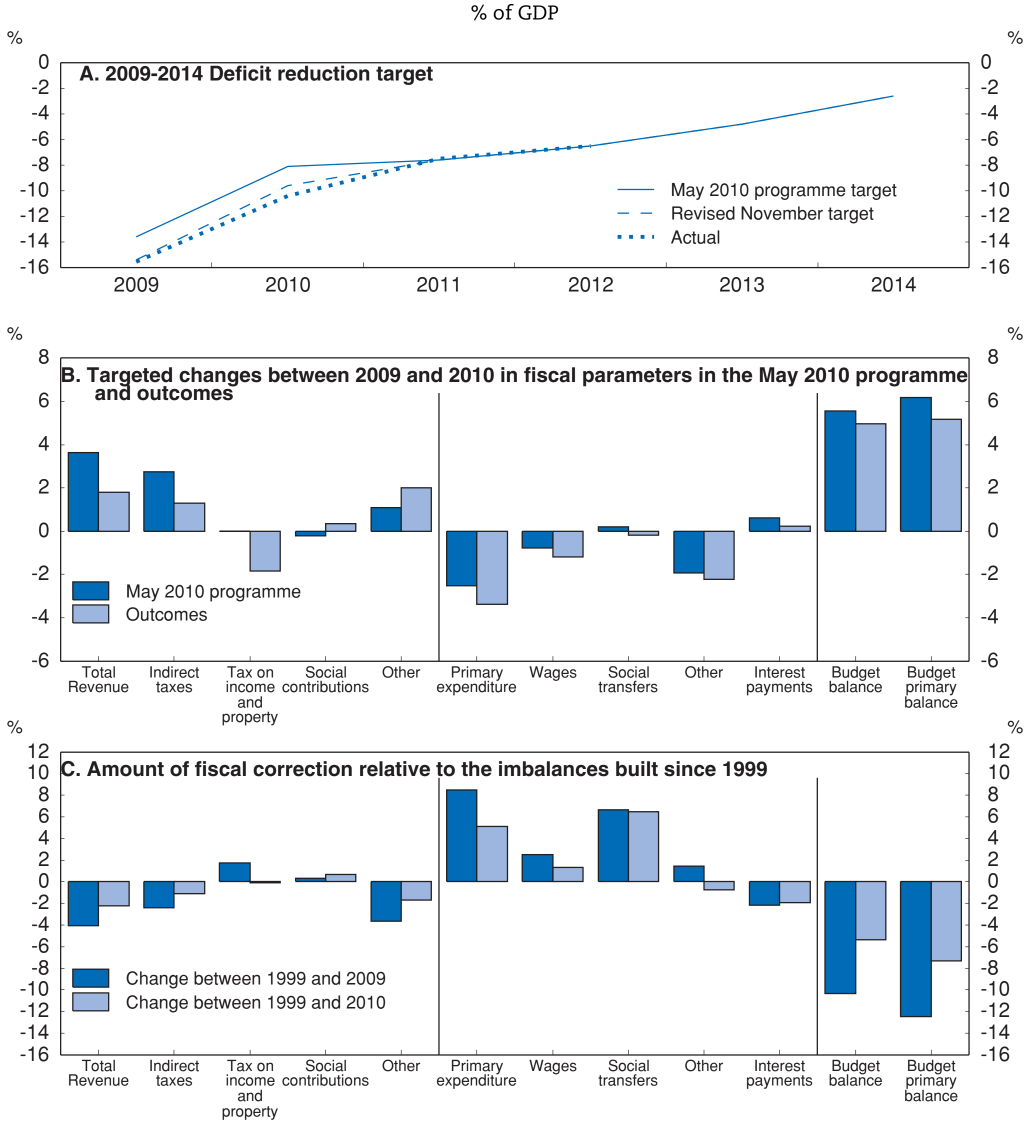
perspective against the deterioration of public finances since 1999, the fiscal adjustment was however substantial, especially on the spending side (Figure 1.16, part C). An improvement, albeit a more modest one, was recorded on the revenue side as well.

Despite this significant fiscal consolidation progress, the 2010 fiscal adjustment has revealed serious management deficiencies. First and foremost, revenues were well below expectations (Figure 1.16, Part B). The recession explains only part of this. The 8.6% reduction in direct tax receipts in 2010 relative to 2009 was far larger than the 3.3% drop in the tax base (household income and business profit margins) would have suggested, taking into account the average estimated elasticity (at 1.2) of these taxes. This fall in direct tax receipts would have probably been even larger in the absence of the tax rises included in the 2010 budget. In this regards, the tax amnesty adopted in the autumn of 2010 was most likely detrimental to the routine collection of direct taxes (Baer and Le Borgne, 2008). Measures taken to combat tax evasion fell short of targets, and now need to be strengthened. Although indirect tax increases were also lower than planned, the outcomes were better as their collection rose by 9.4% in 2010 despite flat nominal consumption. It seems however likely that this trend can largely be explained by the increases in the rates of indirect and excise taxes adopted in the budget.

To partly offset the revenue shortfall, spending was cut by more than the initial programme had called for, especially at the central government level (Figure 1.16, Part B). However, a second management shortcoming revealed by the 2010 fiscal adjustment related to the insufficient control over the spending of governmental entities outside the central government. The Ministry of Finance was confronted with the problem of a lack of information and thus of control over the spending commitments of hospitals, local governments and public enterprises. The payment arrears associated with those commitments made in 2010, enter into the calculation of the government deficit in the national accounts, which is based on a transaction rather than a cash basis. The size of

Figure 1.16. **Fiscal deficit reduction targets, detailed objectives and outcomes for 2010**

% of GDP



Source: OECD, *OECD Economic Outlook Database*, and Hellenic Republic Ministry of Finance, Budget 2011.

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these arrears payments, which were estimated at EUR 5.3 billion (2¼ per cent of GDP) in December 2010 and exceeded expectations, partly explains the slippage in the deficit on a transaction basis (even though the cash deficit target over-performed).

The pace of fiscal consolidation remains rapid in 2011, since it aims at reducing by 3 percentage points the deficit to 7½ per cent of GDP. The measures initially included in the budget to achieve this target were based on implementation of structural budget reforms rather than general tax hikes and spending cuts as in 2010. These reforms involved local governments, the health care sector, public enterprises, the civil service pay system and taxation, especially the fight against tax evasion. The set of these deficit-reducing measures, which amounted to 5¼ per cent of GDP, again exceeded the actual targeted reduction of the deficit. The impact of the recession, of the change in the composition of demand and of the rise in interest payment still have to be compensated in addition to the need to cut the actual deficit.

This plan aimed at spreading the adjustment effort equitably, and focused on achieving sustainable improvements to public finances by addressing sources of past slippages and streamlining operations of the public sector. It was exposed to significant implementation risks. *De facto*, a budget slippage was recorded over the first six months of its execution. Between January and May 2011, the state budget deficit was EUR 12.8 billion (5.7% of GDP), compared with a target of EUR 10.4 billion (4.6% of GDP), and a deficit of EUR 10 billion during the same period in 2010. Over the first six months of the year, revenue recorded a shortfall of EUR 3.1 billion (1.4% of GDP) compared to the budget target over this period, which was partly offset by lower than planned expenditure (by EUR 0.6 billion or 0.3% of GDP). Implementation of the planned fiscal measures has also been difficult outside the central government, for example, for hospitals and other social security institutions. Because of these difficulties, in June 2011, the government adopted a new package of additional measures amounting to EUR 6.5 billion (2.9% of GDP) in the context of the Medium-Term Fiscal Strategy (MTFS) to compensate for both these implementation problems and the fiscal slippage recorded in 2010 (Box 1.3).

Box 1.3. **Additional fiscal adjustment measures are needed in 2011**

To comply with the commitment to reduce the fiscal deficit to 7½ per cent of GDP in 2011, the 2011 budget initially included a set of deficit-reducing measures, amounting to almost 6½ per cent of GDP, focusing slightly more on raising revenue than on cutting spending (Table 1.4). However, if one takes into account the end of temporary tax hikes adopted in 2010 representing 1¼ per cent of GDP, the impact of these measures on the government balance should be of the order of 5¼ per cent of GDP. When the 2011 budget was elaborated, this planned fiscal adjustment appeared to be broadly sufficient to cut the budget deficit, by the agreed 2% of GDP, and to offset the rise in interest payments (¾ per cent of GDP), of the cycle (1½ per cent of GDP) and of the change in the composition of demand (1% of GDP).

Box 1.3. **Additional fiscal adjustment measures are needed in 2011** *(cont.)*

After five months of budget implementation in 2011, the size of the fiscal adjustment was however judged to be insufficient to achieve the target. In June 2011, the authorities have thus announced an additional package of measures amounting to almost 3% of GDP. This is indeed required to compensate the fiscal slippage recorded in 2010. Moreover, the authorities recognised the need to offset existing implementation problems of some measures included in the budget, which may be broadly estimated at 2% of GDP. The authorities did not however provide details on what the problematic measures were.

The new package of measures, which was approved by the Parliament at the end of June 2011 as part of the amended Medium-Term Fiscal Strategy (MTFS), is equally shared between spending cuts and revenue increases:

- *Measures to rationalise the government wage bill (0.4% of GDP)*. Hiring rules are to be tightened further, with the replacement of only 10% of civil servants who leave the administration and a 50% reduction of contractual employees in 2011 (between 2012 and 2015, the 20% replacement rule will be used and contractual employment will be cut by 10% a year, see below). Wage drift is to be eliminated (though the MTFS has no specific measures), weekly working hours increased from 37.5 to 40, and the payment of overtime and supplementary compensation reduced.
- *Reduction of non-wage consumption expenditure, subsidies and pharmaceutical spending* (0.4% of GDP). Public entities will be closed or merged. The pricing policy for drugs will be revised and standardised in all social security funds.
- *Rationalisation and reduction of social spending* (0.4% of GDP). Welfare benefits provided by several social security funds will be rationalised. Means testing will be introduced in the provision of pension benefits, and lump-sum pensions will be adjusted in line with contributions. A special 8% contribution will be introduced for pensioners under 60 years with a monthly pension above EUR 1 700.
- *Reduction of capital expenditure and transfers* (0.3% of GDP).
- *Increased revenues of social security funds* (0.3% of GDP). A one-off "solidarity contribution" by public employees and the self employed will be introduced.
- *Reduction of tax exemptions and increases in other revenues* (1.1% of GDP). A "solidarity contribution" of all individuals will be introduced and the level of the presumptive income of the self employed will be raised. Taxes on real estate properties and revenues related to the settlement of zoning infringement will be increased. VAT on catering/restaurants will rise from 13% to 23% as of 1 September 2011 and a higher VAT rate will apply on soft drinks and natural and liquefied gas.

The adoption of this package of new fiscal measures by the Greek Parliament, together with the MTFS for the 2012-15 period, was a prerequisite set by the Troika to disburse the 5th tranche of EUR 12 billion from the EU/IMF package. The adoption of the MTFS, the details of which are discussed below and in Chapter 2, was also needed for Greece to get additional financing beyond March 2012 (the new EU/IMF bailout), since the country is unlikely to regain access to international financial markets by early 2012, as had been expected when the May 2010 adjustment programme was agreed.

Table 1.4. **Deficit-reducing measures for 2011 initially included in the budget**

	EUR Billion	% of GDP
Total Expenditure measures	**–6.5**	**–2.9**
Carry-over of measures initiated in 2010[1]	–1.2	–0.5
Saving measures initiated in the May 2010 programme	–1.5	–0.7
Of which:		
Saving on wage and pensions	–0.2	–0.1
Cuts of operating costs	–0.3	–0.1
Reform of local government	–0.5	–0.2
Cuts in investment	–0.5	–0.2
Saving measures initiated after the May 2010 programme	–3.9	–1.7
Of which:		
State-owned enterprises	–0.8	–0.4
Hospital spending	–2.1	–0.9
Hiring restrictions, transfers and operational spending	–0.5	–0.2
Military equipment	–0.5	–0.2
Total revenue measures	**7.9**	**3.4**
Carry-over of measures initiated in 2010[1]	1.5	0.7
Revenue increase initiated in the May 2010 programme	4.1	1.8
Of which:		
Special levy on profitable firms	0.7	0.3
Property and direct tax	1.2	0.5
VAT and excise	1.1	0.5
Measures against tax evasion	0.3	0.1
Other (green tax, royalties, licenses)	0.9	0.4
Revenue increase initiated after the May 2010 programme	2.3	1.0
Of which:		
Measures against tax evasion	1.6	0.7
Other (concessions, licenses)	0.7	0.3
Total measures for 2011	**14.3**	**6.4**
End of the one-off 2010 measures	–2.8	–1.2
Total measures including expiring 2010 one-offs	**11.5**	**5.2**

1. Measures taken in the course of 2010, the full effect of which should be felt in 2011.
Source: Ministry of Finance (2010), "Budget 2011 Draft Law", November.

The highly restrictive fiscal policy, which has severely dampened domestic demand in 2010, is expected to weaken somewhat in 2011, even after taking into account of the additional package recently announced to meet the 7½ per cent of GDP deficit target in 2011. According to OECD estimates, the tightening of fiscal policy alone reduced GDP growth by approximately 3½ percentage points in 2010, while this tightening could further lower GDP by 2¼ per cent in 2011 (Box 1.4). For 2011, the estimate is based on the assumption that beyond the measures included in 2011 budget, only part of the fiscal package announced in May 2011 (1% of GDP out of a total package of 2.9% of GDP) should further weight on activity, because of the need to offset the 2010 fiscal slippage. The rest of this package (1.9% of GDP) is assumed to compensate for the implementation risks identified by the government rather than impose additional restrictions.

Box 1.4. **Estimating the macroeconomic impact of the fiscal consolidation plan in 2010 and 2011**

According to OECD (2009) estimates, fiscal multipliers vary between 0.2 and 0.8, depending on the type of instrument used. As a rule, these multipliers are fairly high in Greece as compared with similarly sized countries because the economy is relatively closed. They are weaker in the case of changes in indirect taxes (0.2) or direct taxes (0.2 to 0.4) as household saving and corporate profit margin-setting behaviour tend to limit the impact on activity of changes in taxation, although restriction on credit developments might work in the opposite direction. The multiplier effects are slightly higher (0.4) when social transfers, like pensions, are reduced, because recipients of such income have a relatively high propensity to consume. The multipliers are higher for consumption expenses (0.5), and especially for government investment (0.8), because decreases in such outlays directly affect activity and their import content is generally low.

OECD estimates indicate the restrictive fiscal measures reduced GDP by roughly 3½ percentage points in 2010 and 2¼ percentage points in 2011 (Table 1.5).

The magnitude of the effect may be underestimated in 2011, because the calculations factor in only the "instantaneous" impact. For example, the influence of the 2010 budget restrictions is not taken into account beyond 2010, but detrimental effects may persist with regard to growth, even if they tend to wane substantially over time.[1] Conversely, however, the macroeconomic effects may also be weaker than expected because in a recession it is probable, for example, that firms will squeeze their profit margins in the event of an increase in indirect taxes to preserve turnover. Households might also tend to dip more into their savings than in normal times to sustain (admittedly lower) spending. The drop in household bank deposits since the beginning of the crisis seems consistent with this assumption (see below). It is also possible that the widespread underground economy functions as a buffer to the decline in activity. However, this last hypothesis is not supported by the available evidence, which would suggest that there has been a contraction, and not an expansion, of the informal economy.[2] Finally, one cannot exclude that positive non-Keynesian effects on growth of this consolidation process materialise if significant fiscal progress continues and boosts confidence on the ability of Greece to solve its budgetary difficulties.

1. To have a permanent effect on activity a fiscal shock should affect the potential output level, which is not generally the case. Initial detrimental effects on activity of restrictive fiscal policy are generally reversed over time due to the crowding-in effect on the private sector that is induced by public-sector consolidation.
2. A Transparency International report showed that the incidents of graft were down in 2010 for the first time since 2007. The report, which is based on a survey of more than 6 000 respondents, found that the share of households that reported instances of corruption in the state or private sector fell to 10.4% in 2010 from 13.4% in 2009. Hospitals continued to top the list of the most corrupted institutions in the public sector, while tax offices jumped ahead of town-planning offices. In the private sector, doctors and lawyers received the most bribes. Overall some EUR 632 million was paid in bribes last year, down EUR 155 million from 2009 (Transparency International, 2011).

Table 1.5. **Estimated macroeconomic impact of the 2010 and 2011 fiscal adjustment programmes**

Impact in 2010 of fiscal measures taken in 2009 and 2010					Impact in 2011 of fiscal measures taken in 2010 and 2011				
	EUR Billion	% of GDP (1)	Estimated multiplier (2)	Macro impact (1) x (2)		EUR Billion	% of GDP (1)	Estimated multiplier (2)	Macro impact (1) x (2)
Expenditure					***Expenditure***				
One-offs in 2009	–3.2	–1.4			*Carry-over of 2010*	–1.2	–0.5	0.4	–0.2
Spending measures	–0.8	–0.3	0.5	–0.2					
Revenue measures	–2.4	–1.1	0.4	–0.4	*Measures included in the May programme*	–1.5	–0.7		
					Saving on wage and pensions	–0.2	–0.1	0.4	0.0
Permanent cuts in 2010	–8.2	–3.6			Cuts of operating costs, including local government	–0.8	–0.4	0.5	–0.2
Cuts of operating costs	–1.1	–0.5	0.5	–0.2	Investment cuts	–0.5	–0.2	0.8	–0.2
Pension, wage and employment cuts	–5.7	–2.5	0.4	–1.0					
Other spending cuts	–1.5	–0.6	0.5	–0.3	*Measures taken after the May programme*	–3.9	–1.7		
					Hiring restrictions and transfers cuts	–0.5	–0.2	0.4	–0.1
					Other spending cuts	–3.4	–1.5	0.5	–0.8
Total	*–11.4*	*–5.0*	*0.43*	*–2.1*	*Total*	*–6.5*	*–2.9*	*0.50*	*–1.4*
Revenues					***Revenues***				
One-off revenue in 2009	–0.7	–0.3	0.4	–0.1	*Carry-over of 2010*	1.5	0.7	0.3	0.2
					End of one-offs in 2010	–2.8	–1.2	0.4	–0.5
Permanent revenue increase in 2010	10.0	4.3			*Measures included in the May programme*	4.1	1.8		
Non indirect tax	4.1	1.8	0.4	0.7	Direct tax	2.2	1.0	0.4	0.4
Indirect tax	5.9	2.5	0.2	0.4	Indirect tax	1.9	0.8	0.2	0.1
One-off revenue in 2010	1.5	0.6			*Measures taken after the May programme*	2.3	1.0		
Direct tax	1.5	0.6	0.4	0.3	Measures against tax evasion	1.6	0.7	0.4	0.3
One-off tax amnesty	1.3	0.6	0.4	0.2	Other (concessions, licenses)	0.7	0.3	0.2	0.0
Total	12.0	5.2	0.28	1.5	*Total*	5.1	2.2	0.24	0.5
					Unidentified deficit reducing measures to be adopted by the authorities	–2.3	–1.0	0.4	–0.4
Total expenditure and revenue (2010)	**–23.5**	**–10.2**	**0.35**	**–3.6**	**Total expenditure and revenue (2011)**	**–13.8**	**–6.1**	**0.38**	**–2.3**

Source: Ministry of Finance (2010), "The economic adjustment programme for Greece", Report submitted in accordance with Council Decision 9443/10 (ECOFIN 250, UEM 171), July, and Ministry of Finance (2010), "Budget 2011 Draft Law", November.

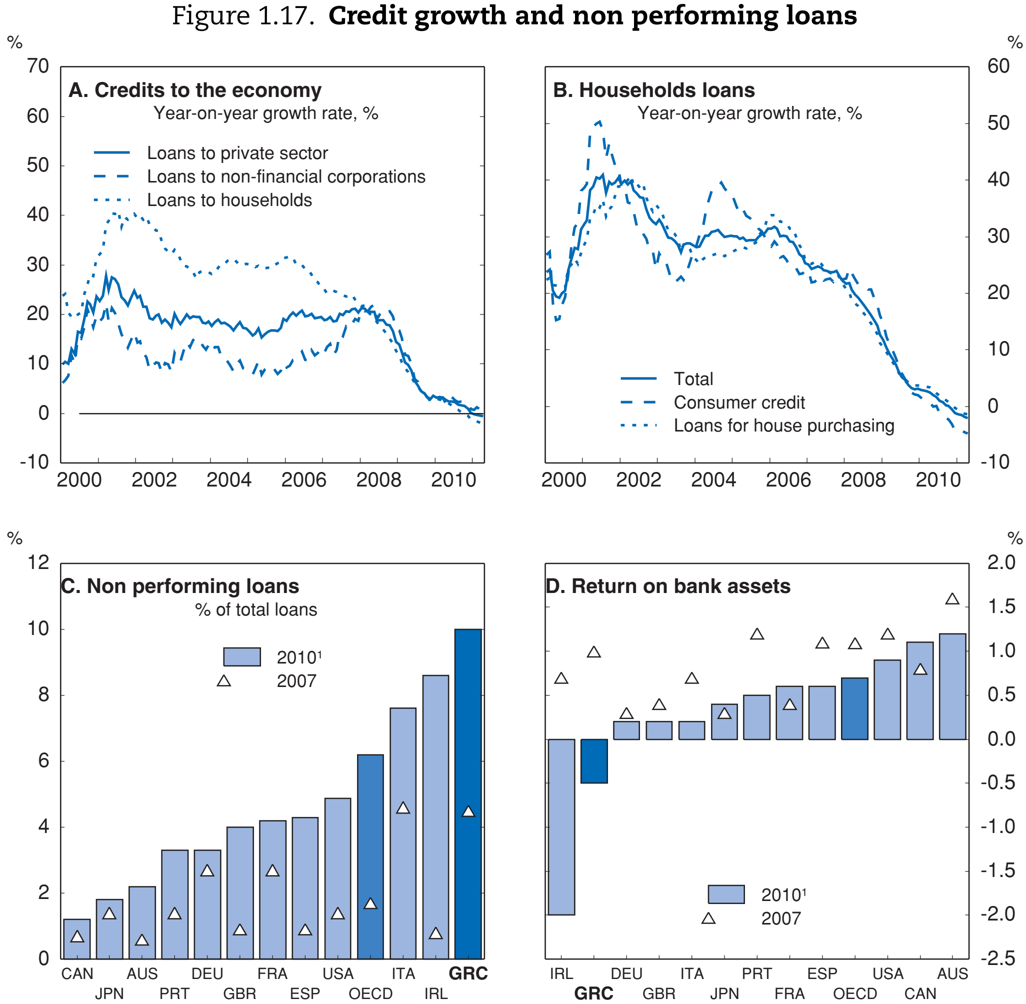
Access to credit is key to the recovery

The economic downturn has been accompanied by a marked weakening in the supply of credit

One of the essential conditions for a return to growth is to have a stable financial sector able to supply the liquidity needed to keep the economy moving. The growth in credit to the private sector slowed sharply in 2010 and turned slightly negative at the beginning of 2011. This reversal, which has been stronger for lending to households and consumer credit in particular, reflects the impact of the recession and uncertainties about the economic and employment outlook on credit demand (Figure 1.17, Panel A and B). The drop in credit demand credit was, however, not sparked by any move to deleverage in the private sector, where the savings rate actually fell. It is nevertheless likely that tighter credit conditions from banks have played a more important role than demand factors on restricting the growth of credit since early 2010.

Banking assets deteriorated sharply upon the onset of the crisis, as indicated by the jump in the proportion of non-performing loans (Figure 1.17, Panel C). This led to a tightening of

Figure 1.17. **Credit growth and non performing loans**



1. Or last available value.

Source: IMF, *Global Financial Stability Report* (April 2011) and OECD, *OECD Economic Outlook Database*.

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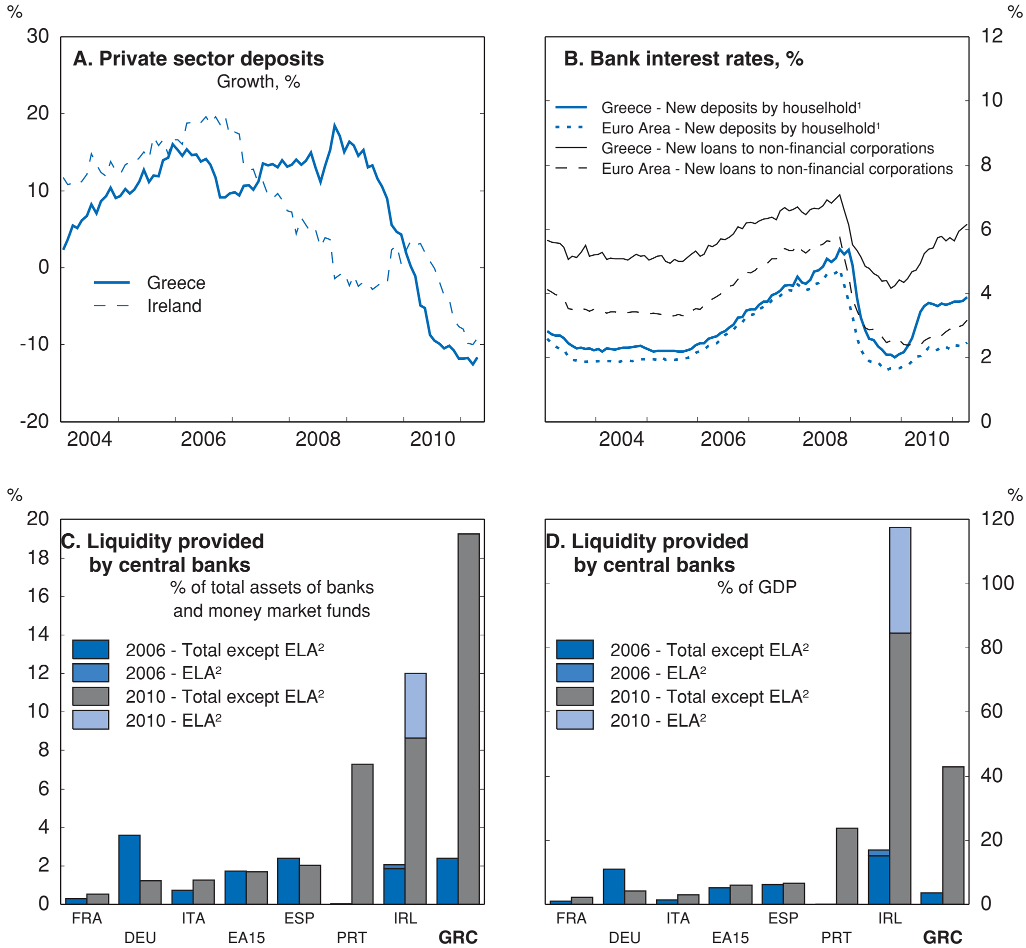
lending criteria. Interest rates also rose, for businesses in particular (Figure 1.18, Panel B), as the remuneration of deposits became more costly and banks sought to improve their falling profitability (Figure 1.17, Panel D). Banking spreads widened in 2010 to offset the impact of higher provisions for non-performing loans on earnings, temporary tax hikes, declining income from commissions, and losses on banks' trading books with the fall in the market value of Greek government debt held in the trading portfolio. Domestic losses by the big banking groups were generally offset by profits from their subsidiaries in South-east Europe.

The banks' financing capacity was also severely undercut by their inability to access international capital markets after end-2009, with the exception of a brief period in the autumn of 2010 just before the Irish crisis erupted. Successive rating cuts for Greek sovereign debt produced a similar downgrading for the banks and led to a sharp increase in the risk premiums demanded on their instruments. Since the end of 2009, the banks have also faced a fall in total deposits, amounting to EUR 36.8 billion (16% of 2010 GDP or 13.2% of the end-2009 deposits level) in April 2011. That retreat lasted more than a year, and was especially severe in the first half of 2010, in the wake of concerns sparked by the crisis. It slowed thereafter and seemed, after mid-2010, to be linked to the effects of the recession and the rundown of savings by households seeking to cushion their falling consumption rather than to concerns about banking solvency (Figure 1.18, Panel A) (National Bank of Greece, 2011). The banks have thus found themselves heavily dependent for liquidity on the Eurosystem, which stabilised at around 20% of banking sector liabilities after May 2010, a high level in comparison to other countries in the euro area (Figure 1.18, Panel B and C). The persisting taxation on the deposit side in early July 2011 led the authorities to announce an extension of the government guarantee for bank deposits up to EUR 100 000 until the end of 2015.[4]

The European Central Bank (ECB) and the authorities have taken exceptional measures to ensure sufficient liquidity. These include: *i)* suspension of the links between the rating agencies' grading of sovereign debt and the eligibility of such instruments as collateral for refinancing operations with the ECB; *ii)* the acceptance of bank paper, non-securitised but government-guaranteed, as collateral for these refinancing operations; and *iii)* direct intervention by the ECB on public debt markets, through the Security Market Programme, to limit price volatility for these instruments. The Greek monetary authorities (in contrast to Ireland) made no use up to time this report was finalised of the option to provide Emergency Liquidity Assistance for healthy credit institutions in case of a major and sudden liquidity need, although they may always resort to such a measure if need be within the Eurosystem framework (Figure 1.18, Panel C).[5] To preserve the banks' ability to refinance themselves through the Eurosystem, the government has extended its guarantee to several tranches of bank bonds, totalling EUR 55 billion (24% of GDP) at end-2010 (Figure 1.19, Panel A).

The government also decided to offer a public guarantee for a supplementary tranche of EUR 30 billion (13% of GDP) in the first quarter of 2011, in response to still-tight liquidity conditions, an expected further decline in deposits, and the adverse impact of new downgrades of Greek debt.[6] By agreement with the Troika, however, this new tranche of guarantees will be offered case-by-case and will require banks' commitment to reduce their dependency on ECB liquidity while their credit provision should remain consistent with the overarching aims of the program. To that end, each bank will have to secure approval from the Bank of Greece and the ECB for a plan that could include the restructuring and eventual sale or pooling of assets not essential to its activities.

Figure 1.18. **Deposits, interest rates and liquidity provided by the ECB**



1. Deposits with an agreed maturity of up to one year.
2. Emergency Liquidity Assistances (ELA) are estimates based on publicly available balance-sheet statistics.

Source: European Central Bank, Statistical data warehouse; National Central Banks.

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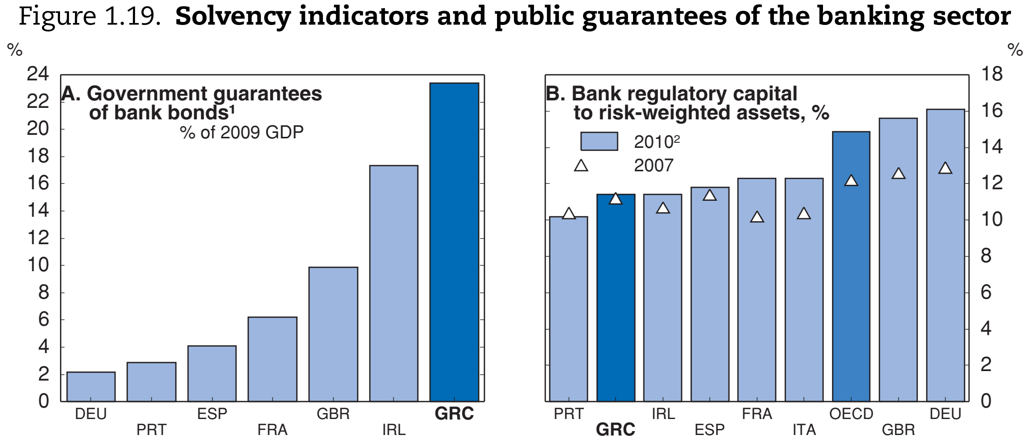
Figure 1.19. **Solvency indicators and public guarantees of the banking sector**



1. Depicted data refer only to the insurance maturing after 2010. For Greece, this does not include 30 billions of Euros of public guarantees granted in the first quarter of 2011.
2. Or last available figure.

Source: OECD, *OECD Economic Outlook Database*; Levy, A. and S. Schich (2010); IMF, *Global Financial Stability Report* (April 2011) and European Central Bank.

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Measures have also been taken to provide a significant capital buffer for the banking sector

The banks' average capital adequacy ratio stood at 11.4% in September 2010, well above the required level of 8% in Basel II or the 6% required by the Europe-wide stress tests conducted in July 2010, but slightly short of the OECD average of around 15% (Figure 1.19, Panel B). To cope with a possible decline in this solvency ratio, a government-financed Financial Stability Fund (FSF) of EUR 10 billion has been created to meet capital needs on the part of solvent banks in difficulty (Box 1.5). There has been no call on that fund to date, however, and many credit institutions have succeeded in bolstering their own funds since autumn 2010. The country's largest financial institution, the National Bank of Greece, for example, raised EUR 1.8 billion in fresh capital in October 2010, allowing it to boost its capital adequacy ratio by 2.5 percentage points to 13.6%. That bank also plans to divest 20% of its Turkish subsidiary to raise a further EUR 1 billion. Other large banks, such as Piraeus and Eurobank EFG, have completed or are now finalising similar transactions. Moreover, the authorities have undertaken the restructuring and recapitalisation of the State-controlled ATE bank, which primarily services the agricultural sector and had failed the July 2010 stress tests. In March 2011, the banks' average capital adequacy ratio rose to 12.3%.

Box 1.5. **The Financial Stability Fund**

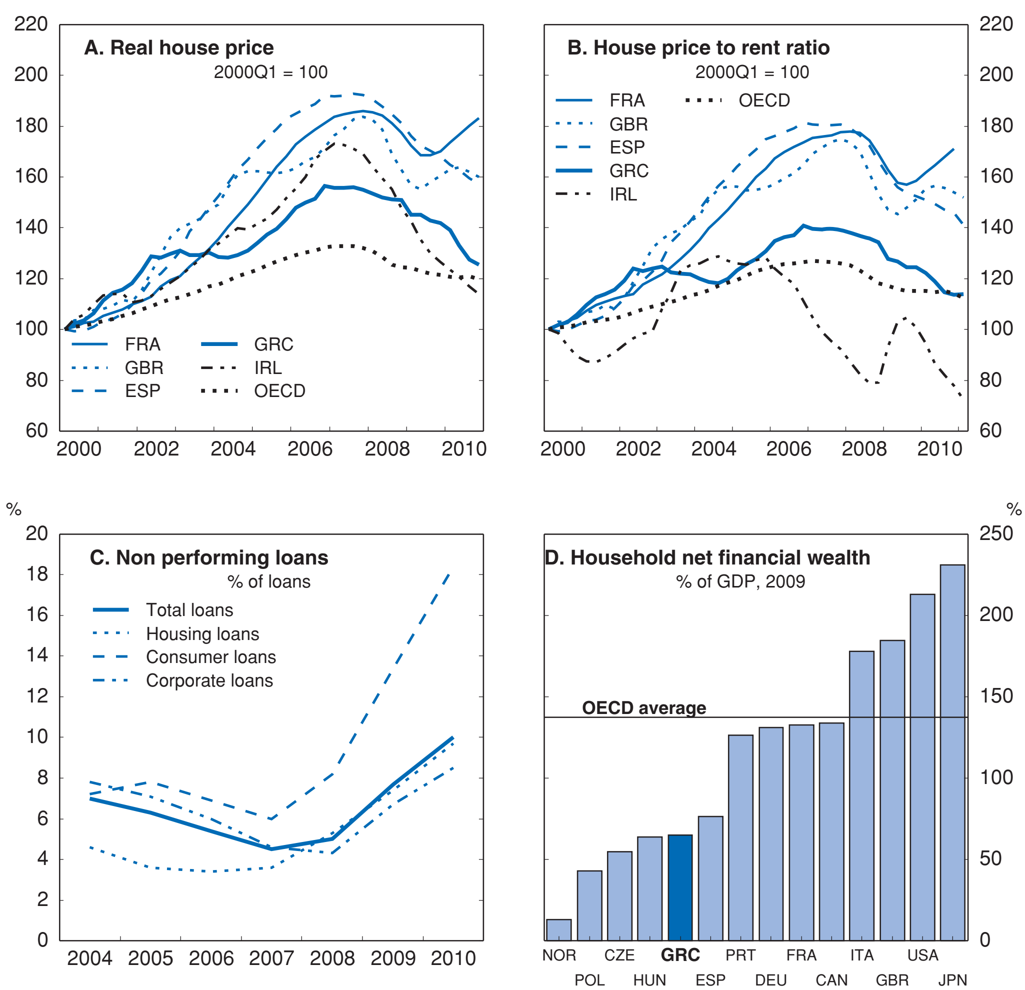
The Financial Stability Fund (FSF) financed through the Troika financial support plan for Greece, was created in July 2010 for a seven-year term. The FSF is intended to sustain the stability of Greek banks, including the subsidiaries of foreign institutions, in case their solvency deteriorates. It has significant assets, equal to about 33% of the banking system's tier 1 capital. With a governance structure that makes it politically independent and ensures its transparency, the FSF has no mandate to guarantee or provide liquidity to the banks, a task that falls to the ECB.

The FSF is to be called upon only after all other possibilities for capital injection by shareholders or other investors have been exhausted and when the capital requirements of a bank in difficulty are no longer satisfied. The FSF may intervene at the request of a bank, with the support of the Bank of Greece, if several preconditions are met, or upon an order from the Central Bank. The capital injection will then be provided as an equity participation in the form of preferred shares that may, in certain circumstances, be converted into ordinary shares.

Apart from the exposure to the sovereign, most Greek banks are in relatively good shape

While there has been some deterioration in the indicators of financial sector health, such as the upward trend of non-performing loans, Greek banks came out of the global financial crisis apparently solvent and efficient. Capital adequacy ratios remain quite comfortable. Cost/revenue ratio of banks (measured on a consolidated basis) was slightly lower than the euro area average in 2009. Developments to date have been consistent with expectations, given the scope of the adjustment programme underway. In the real estate sector, the situation remains difficult but the banks seem able to cope. The collapse of construction activity, which began in 2007, has continued under the crisis-induced fall in housing demand and the tightening of lending conditions. Property prices, which rose significantly, but by less than in many other OECD countries, have fallen 20% in real terms from their peak in 2006, reflecting in particular the large stock of new and unsold dwellings which is only gradually being wound down (Figure 1.20). At their current level, property prices seem fairly low in comparison to rents, and more or less in line with their fundamental determinants (Bank of Greece, 2010). In addition, the banks still have some room to absorb further shrinkage in prices. Loan-to-value ratios, which averaged 72% in 2007, have declined further as terms for new lending have tightened. Moreover, as mortgage loans are geared essentially to the purchase of principal residences rather than investment properties (around 80% of Greek households own their home), the main risk to the banks lies in the capacity of households to repay their loans. With the bulge in non-performing housing loans since the onset of the crisis, the banks have nevertheless alleviated the financial burden on cash-strapped households through renegotiation and restructuring of their debts (Bank of Greece, 2010). This is feasible as households' indebtedness levels are relatively low by international comparison and they have significant net financial assets, even if these are lower than the OECD average (Figure 1.20, Panel D). Among those assets, directly-held government securities constitute only a small portion, but account must be taken of those held indirectly via financial products offered by the banks.

Figure 1.20. **Housing sector development**



Source: OECD, *OECD Economic Outlook Database*; National sources and OECD calculations.

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Credit institutions also seem relatively well placed to adopt Basel III capitalisation rules. As in other countries, this change should prompt the banks to widen their lending spreads to offset their higher financing costs, provoked by stiffer capital requirements (Slovik and Cournède, 2011). The Greek banks' own funds, however, are of good quality, and that should help them withstand these additional pressures. The results from the Quantitative Impact Study, simulating the effect of these new regulations, show for example that, in the case of the four main banking groups in Greece, the decline in the core Tier 1 ratio would be significantly less pronounced (from 9.3% to 7.0%) than for similar European groups, for which it would drop from 10.7% to 4.9%. Similarly, these tests show that the Basel III liquidity rules, which are to be introduced gradually after the end of 2012, should not pose any additional liquidity problems for Greek banks. This might however reflect the fact that Greek banks have a large stock of sovereign debt, which would be considered as "liquid" in the tests.

Maintaining an adequate level of liquidity in the economy is a key challenge for recovery

While the banking sector was the victim rather than the cause of the sovereign debt crisis, it is important to ensure that this sector does not become an obstacle to renewed growth, which is an essential ingredient for resolving this crisis. The measures taken to date have gone in the right direction, either by supporting banks' liquidity or by protecting them against a potential drop in capitalisation. The stability of the banking system has thus been preserved, despite the growing pressures placed on it. Nevertheless, they could face liquidity problems and their solvency position depends importantly on their exposure to Greek government debt.

The perceived risks from the exposure to the sovereign complicate policy responses in the banking sector

The Greek banking sector's exposure to the debt issued by its government, at almost 25% of GDP, is high by international comparison. Most of this exposure is held in their banking book (Table 1.6), which is not marked to market, as these assets are assumed to be kept to maturity. Despite assurances by the government and European institutions that restructuring of the public debt is not an option the risk of a write-down of these assets is of concern to investors (Blundell-Wignall and Slovik, 2010). The stress tests conducted in July 2010 and in July 2011 for most European banks, for example, did not take into account a possible drop in the value of Greek government securities held in the banking portfolio. In the case of a sovereign debt restructuring, entailing for example a 23% cut in the value of those securities (similar to that used in the July 2010 stress tests), the total depreciation of these bank assets (trading and banking portfolios) would be around EUR 13 billion, equivalent to over 5% of GDP or the weighted value of bank assets on the basis of 2009 data.

At the end of 2010 Greek bank exposure to the sovereign had slightly declined and reached EUR 48.4 billion, or 212% of Tier 1 capital. Following the 21 July 2011 agreement of European leaders on enhanced international financial support to Greece, Greek banks will be given access to adequate resources to recapitalise, if needed, in addition to the FSF. It is indeed likely that although the private sector involvement in this new package will be on a voluntary basis, it will imply a selective default, which would affect the valuation of Greek government bonds in banks' balance-sheet. The net contribution of the private sector (both Greek and non-Greek) to the new financing package is estimated at EUR 37 billion for the 2011-14 period and available estimates suggest that, on average, private investors would

Table 1.6. **Banks' sovereign debt exposure, end-2009**

A. Country banking exposure to their own sovereign debt

	EUR billion	% of Tier 1 Capital	% of GDP
Greece	56.1	226	23.9
Spain	203.3	113	19.3
Italy	144.9	157	9.5
Portugal	13.7	69	8.2
Ireland	5.3	26	3.3

B. Sovereign debt exposures: Trading *versus* banking books

	EU average			Greece		
	EUR billion	%	% of GDP	EUR billion	%	% of GDP
Trading book	335.6	17.3	2.8	3.8	6.7	1.6
Banking book	1606.0	82.7	13.6	52.4	93.3	22.3
Total	**1941.6**	**100.0**	**16.5**	**56.1**	**100.0**	**23.9**

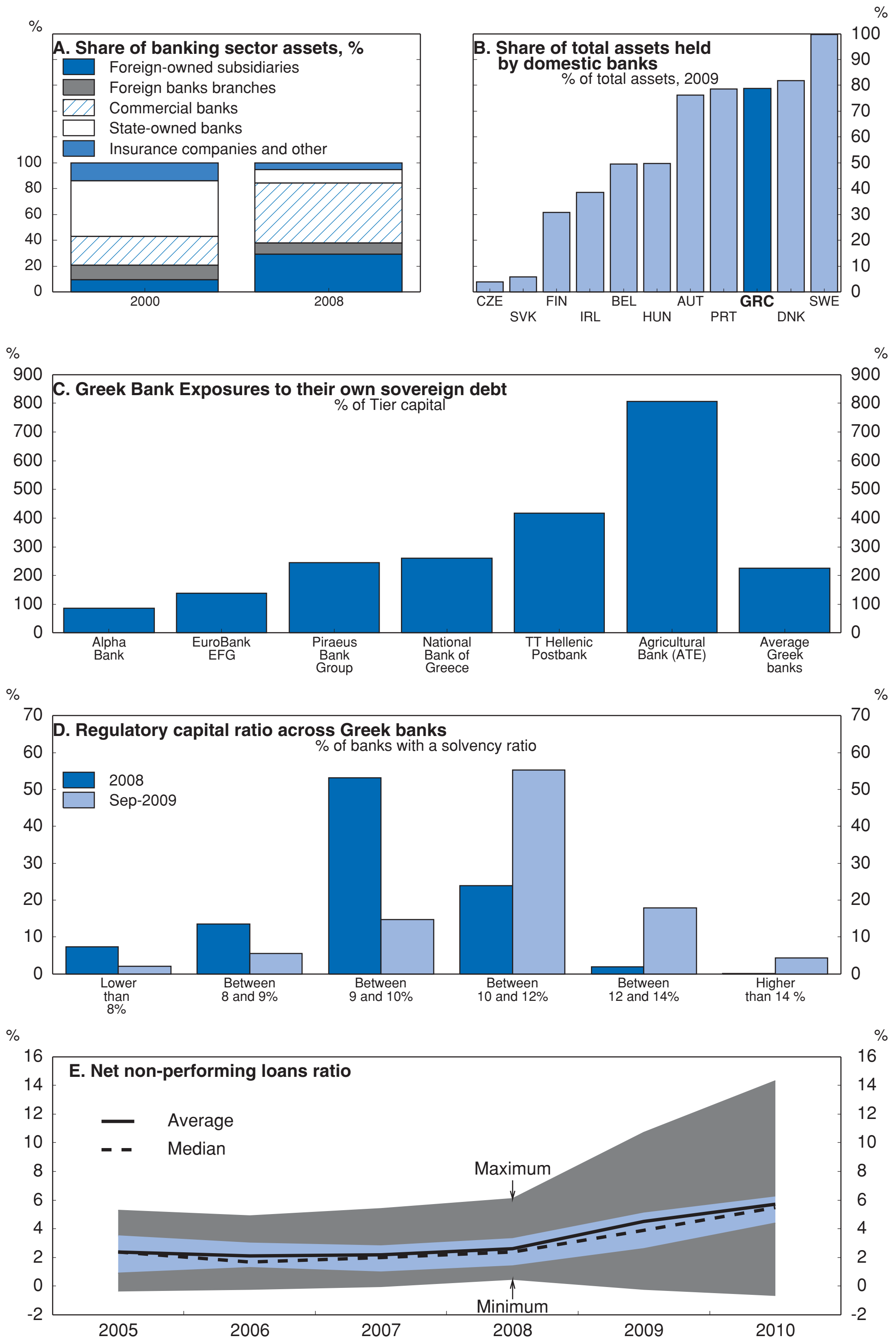
Source: Blundell-Wignall and Slovik (2010), "The EU stress test and Sovereign debt exposures", OECD working paper on Finance, Insurance and private pension No. 4.

take a 21% discount on the net present value of their current Greek bond holdings. The protection granted by the international institutions to Greek banks should reduce their fragility to this partial restructuring and, more generally, the sovereign debt crisis. It is however likely that the functioning of the banking system will remain hobbled until the sustainability of Greek public finances is place on a stronger footing and perceived risks attached to the current economic and financial developments wane. These perceptions are complicated further by the fact that the measures (guarantees at about 37% of GDP) taken to keep the banks operating normally represent an additional liability to the public sector, which in an adverse scenario would add to already high levels of debt.

The most important issue for financial sector management in Greece is to loosen the constraint that the public sector crisis has imposed on the banks. Without market access banks are dependent on liquidity from the ECB, and attempts to reduce banks' dependence on ECB liquidity need to be approached with caution, to avoid a credit crunch that could exacerbate the shrinking of deposits and further curtail lending. Structural adjustment in the financial sector, as has been proposed, is unlikely, in itself, to materially change this situation. There is, of course, still room for rationalising parts of the banking system. The banking sector is not particularly large in comparison with other euro area countries, the degree of concentration is above the average for the euro area,[7] and as mentioned above, the average cost efficiency of banks seems relatively high.

One option worth exploring is partnerships or mergers with foreign banks, perhaps through reducing remaining government stakes. Currently, around 10% of total bank assets are under the direct control of the state – the government holds significant equity interests and exerts indirect control through pension funds over several banks, such as Attica (nearly 28% of its capital) and the National Bank of Greece (around 18% of capital), the head of which is normally a government appointee. Reducing these stakes would extend the trend over the past decade among foreign banks to boost their presence in Greece, which as with other FDI is not large compared with other OECD countries of similar size (Figure 1.21, Panels A and B).

Figure 1.21. **Selected characteristics of the banking sector**



Source: Bank of Greece and OECD, *Bank profitability Database*.

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Strong prudential supervision needs to be maintained while avoiding pro-cyclicality

It will be critical for the Bank of Greece to continue its close surveillance of developments in the financial sector. There are some glaring discrepancies among credit institutions in terms of exposure to bad loans, solvency, liquidity needs, and exposure to Greek government debt (Figure 1.21, Panels C and E). The 2011 EU-wide stress testing exercise of European banks indicated that this test was failed by the ATE Bank and the EFG Eurobank (although by a small margin in this second case). The authorities are aware that this situation demands prompt interventions, as evidenced by the restructuring and recapitalisation now underway at the ATE bank. Additionnal mitigating measures have also been taken or planned and communicated to the Bank of Greece by the EFG Eurobank. If generic provisions and measures taken or announced after 30 April 2011 are taken into account, all banks would have passed the stress test, according to the Bank of Greece. There has also been some improvement in the solvency performance of the weakest banks (Figure 1.21, Panel D). Strict prudential supervision must be continued. The banking sector also has a crucial role to play in helping to redirect the economy towards the more productive sectors with a view, notably, to strengthening the country's export capacity. The reforms now underway in the goods and labour markets should give rise to profitable projects in many sectors that were hitherto hobbled by regulatory constraints (Chapter 3). The authorities also need to be attentive to the needs of the economy and avoid the pro-cyclical tendencies of supervision. Similarly, while maintaining prudent lending practices, banks should avoid being overly conservative on credit supply during downturn.

Returning to fiscal sustainability

Greek debt dynamics have gradually worsened since the mid-1990s (Table 1.7). Between 1995 and 2000, the underlying fiscal position was degraded by successive additions of contingent liabilities, including recognition of liabilities to cover hospital expenses and the recurrent losses of public enterprises, particularly in transportation (OECD, 2005 and 2009). Public debt continued to rise from 2000 to 2008, despite strong growth and the lower real interest rates associated with membership in the euro area.

Table 1.7. **Public sector debt development since the mid-90s**

In % of GDP

	Change in debt public sector debt	Automatic debt dynamic effect	Real interest rates effect	Real GDP growth effect	Primary balance	Other effects[1]	*Memorandum item:*			
	(1) + (2) + (3)	(1) = (1a) + (1b)	(1a)	(1b)	(2)	(3)	*Level of public sector debt (end-of-period)*	*Average real interest rate on govt. debt*	*Average real GDP growth*	*Average primary balance*
Cumulative effect										
							(1995) 97.0			
1995-2000	6.4	–1.2	16.2	–17.4	–14.6	22.2	(2000) 103.4	*3.4*	*3.7*	*2.7*
2000-08	7.3	–17.6	14.7	–32.3	12.1	12.8	(2008) 110.7	1.8	3.8	–1.0
2008-10	32.0	13.8	5.6	8.1	15.6	2.7	(2010) 142.8	2.4	–3.3	–7.8
Average annual effect										
1995-2000	1.3	–0.2	3.2	–3.5	–2.9	4.4		*3.4*	*3.7*	*2.7*
2000-08	0.9	–2.2	2.9	–6.5	2.4	2.6		*1.8*	*3.8*	*–1.0*
2008-10	16.0	6.9	2.8	4.1	7.8	1.3		*2.4*	*–3.3*	*–7.8*

1. Including privatisation, recognition of contingent liabilities, and valuation effects of past debts.
Source: National account and OECD estimates.

The required consolidation is among the largest ever undertaken in the OECD

The fiscal consolidation process that has been launched to curb indebtedness is very ambitious. The programme negotiated with the Troika calls for cutting the deficit to 2.6% of GDP in 2014. In addition, the medium-term fiscal framework, which the parliament passed in end of June, would reduce this deficit further, to 1% of GDP in 2015. This would entail a primary surplus in the order of 6% of GDP, meaning that the cumulative adjustment from 2009 would amount to between 16% and 17% of GDP over a period of six years.

Judging from past experience, other OECD countries have managed such a degree of adjustment. Denmark, for example, improved its primary balance by nearly 17% of GDP in only four years, from 1982 to 1986, and Finland achieved a consolidation of 16½ per cent of GDP between 1993 and 2000. Greece itself strengthened its primary fiscal balance by 9¼ per cent of GDP between 1989 and 1995. A higher interest rate burden, which rose to 6½ per cent of GDP in 2010 in Greece, has also been absorbed successfully in the past. The burden represented by these outlays should remain well below the average level of 9½ per cent of GDP recorded in Greece between 1989 and 1998, or in Italy between 1984 and 1998, or the peaks of close to 12% of GDP observed in those two countries in certain years. Maintaining a large primary surplus on a lasting basis is also a challenge that a number of OECD countries have coped with in the past. Since the early 1980s – and in addition to Norway, which has enjoyed oil income – Belgium, Denmark, Ireland and New Zealand have all run primary surpluses of between 4% and 5% of GDP for some 15 years, most often without a break. In fact, those countries' adjustment needs were not as pressing as the ones now facing Greece. But, by contrast with the current Greek situation, at the time these countries were not part of a monetary union and they could benefit from an exchange rate devaluation to ease their adjustments.[8]

A domestic devaluation will be needed to make the economy more competitive in a situation where the exchange rate is fixed through membership in the euro area. The recent decline in labour costs and the turn-around in consumer prices (excluding the effects of tax rate increases) are encouraging from this viewpoint. These adjustments, resulting from the recession and from the restrictions imposed on the public sector, will be more readily absorbed because labour and goods markets will function better, allowing prices and wages to adjust more flexibly (Chapter 3). Reforms in these areas are thus vitally important, particularly because, by stimulating productivity, they will also dampen inflationary risks.

Simulations on debt sustainability point to room for faster debt reduction with strong reforms

Various scenarios based on these primary deficit reduction targets show that the increase in government debt could be halted by 2012 or 2013, and then reversed more or less swiftly, depending on assumptions about growth rates. Growth in the long term depends on potential output, which is determined by the capital and labour that can be mobilised and the efficiency by which they are used: in short, on structural policies. In the short term, Greece can grow much faster than potential as slack in product and labour markets is taken up. According to the OECD estimates, regardless of the potential impact of the structural reforms now underway, the annual potential growth rate of the Greek economy is likely to be around ¾ per cent between 2009 and 2012, but rise to 1¾-2% on average thereafter (Box 1.6).

Box 1.6. **What is the potential growth rate of Greece?**

The recession and the crisis increase uncertainties about the current and prospective level of potential output. Historical assessments of potential growth are fairly congruent, but have fluctuated over the recent past (Table 1.8). This growth was around 2¼-2½ per cent per year in the 1990s, accelerating thereafter to between 3% and 3½ per cent. It is likely, however, that the current crisis has slowed the pace sharply. The collapse of investment has reduced the contribution of the capital stock to potential output and, judging from past experience; higher unemployment may have induced an increase in its short-term structural component, because of labour market rigidities (Guichard and Rusticelli, 2010).

According to the OECD, the annual trend growth rate for 2009-12 is around ¾ per cent, which is within the range of available estimates. With the sharp retreat in demand caused by the recession and the wide output gap, weakening of supply should not however pose a constraint to growth over the short and medium terms.

A more critical question relates to potential growth beyond that horizon. The assumption in the OECD baseline scenario, which does not take into account the impact of the structural reforms under way, places the annual average rate at between 1¾ per cent and 2%. This estimate, which is subject to considerable uncertainty, is slightly lower than that used by the IMF, and is within the range (1½-2½ per cent) of the few alternative estimates offered by the private sector. The National Bank of Greece estimates that, if policies remain unchanged, the average annual potential growth rate would be around 1½ per cent over the next few years (NBG, 2010). In a detailed analysis of supply conditions in the Greek economy, Balfoussias (2011) estimates this trend growth rate at between 1¾ per cent and 2½ per cent.

Demographic ageing is likely to dampen the long-term trend growth rate. The process of capital accumulation could also be held back by the need to maintain higher interest rates in light of the increased risk premiums demanded by investors (Cournède, 2010). On the other hand, Greece also has some catching up to do in terms of productivity *vis-à-vis* the better-performing economies, and the implementation of badly needed and overdue structural reforms hold great promise. Given the large informal sector, the low labour participation rate, the high level of structural unemployment, and one of the most regulated business environments in Europe, the potential for boosting growth is substantial in Greece.

Table 1.8. **Potential output estimate**

Average annual growth rate in %

	1991-99	2000-08	2009-12	2013-25
Potential growth	**2.3**	**3.5**	**0.8**	**1 3/4-2**
Contribution of which:				
Capital stock	1.3	2.0	0.7	1.0
Labour efficiency	0.5	0.7	–0.1	0.6-0.8
Potential employment	0.6	0.9	0.1	0.1
Contribution of which:				
Working age population	0.4	0.2	0.0	–0.2
Other factors (Participation, structural unemployment and trend hours)	0.2	0.7	0.1	0.2
Other potential growth estimate				
IMF	2.6	2.8	1.1	2 1/4
EC (HP filter)	2.4	2.9	–0.1	
EC (production function)	2.3	3.6	0.2	
Bank of Greece (production function)		2.9	0.6	
Bank of Greece (HP filter)		3.4	0.6	

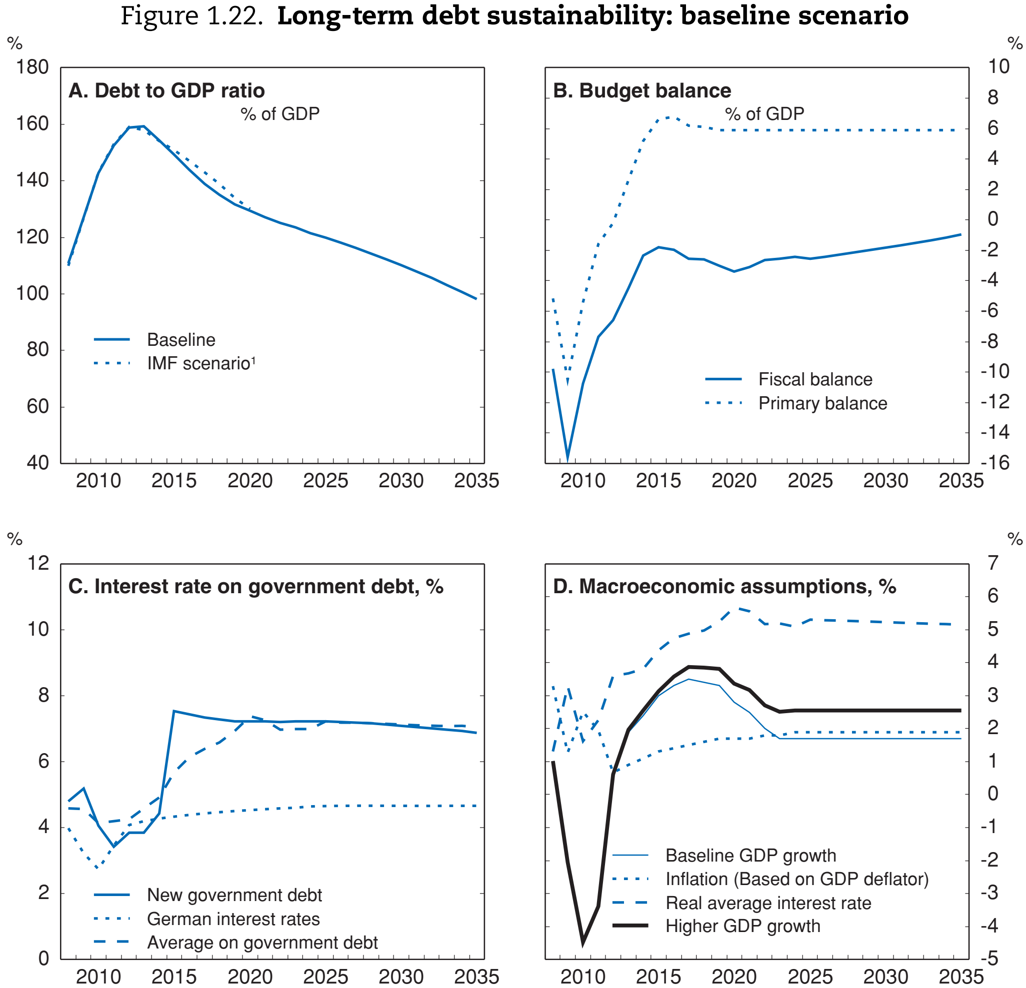
Source: OECD estimate, data provided by the ?ank of Greece, IMF 3rd review (2011), EC (November 2011).

Baseline – Implementation of the economic adjustment programme as planned

Under the baseline scenario, which assumes an increase in the primary fiscal balance of around 6% of GDP after 2014 and a potential annual growth rate of 1¾ per cent, the government debt would decline by around 40 percentage points of GDP by 2035, to 100% of GDP (Figure 1.22). The most notable features of this scenario are the following:

- This improvement depends on the substantial primary budget surplus needed to offset continuing large interest payments due to the high debt and nominal interest rates that are assumed to be above 7% in the long term (see the third bullet) (Table 1.9, Part A).
- Assuming inflation slightly below 2%, the average growth of nominal output would be on the order of 4½ per cent annually between 2012 and 2025 (2½ per cent in real terms), and 3¾ per cent thereafter (1¾ per cent in real terms). The increase in GDP would at first exceed potential as the large output gap left by the recession is absorbed. However growth on this order will not help very much to bring down the debt/GDP.
- The average nominal interest rate on the public debt, which was close to 5% in 2009, is likely to decline slightly until 2014, thanks to the relatively low rates granted to Greece

Figure 1.22. **Long-term debt sustainability: baseline scenario**



1. Baseline: Long-term potential growth assumption (1.7%). Privatisation and asset development proceeds assumed at EUR 15 billion between 2011 and 2017. IMF projection is based on the debt sustainability analysis included in their 3rd review of Greece reform programme (IMF, 2011).

Source: OECD calculations.

StatLink http://dx.doi.org/10.1787/888932473929

by European countries and the IMF, following the revisions to European loan conditions in March and July 2011.[9] With the financing of the new government debt at market rates after this period, average nominal government interest rates should then gradually rise to around 7%, driven up by the higher risk premium that private investors will no doubt demand and the expected increase in German interest rates. To the extent that this risk premium, measured by the differential with the rate for Germany, reflects the difference in the two countries' indebtedness levels,[10] it should however shrink, marginally, as the effects of this fiscal consolidation are felt.

Table 1.9. **Decomposition of long-term debt dynamic**

In percentage points of GDP, average annual effect

	Annual change in debt public sector debt	Automatic debt dynamic effect	Real interest rates effect	Real GDP growth effect	Primary balance	Privatisation, recognition of contingent liabilities and other effects	*Level of public sector debt (end-of period)*	*Assumptions:*		
	(1) + (2) + (3)	(1) = (1a) + (1b)	(1a)	(1b)	(2)	(3)		*Average real interest rate on govt. debt*	*Average real GDP growth*	*Average primary balance*
							(2010) 142.8			
A. Baseline										
2010-12	8.1	6.3	4.3	2.0	0.9	0.8	(2012) 158.9	*2.9*	*–1.4*	*–0.9*
2012-15	–3.2	2.3	6.2	–3.9	–4.8	–0.7	(2015) 149.4	*3.9*	*2.4*	*4.8*
2015-25	–3.0	3.3	6.9	–3.5	–6.0	–0.2	(2025) 119.8	*5.2*	*2.6*	*6.0*
2025-35	–2.2	3.9	5.8	–1.9	–5.9	–0.1	(2035) 98.1	*5.2*	*1.7*	*5.9*
B. Scenario 1										
2010-12	8.1	6.3	4.3	2.0	0.9	0.8	(2012) 158.9	2.9	–1.4	–0.9
2012-15	–3.3	2.2	6.2	–4.0	–4.8	–0.7	(2015) 148.9	3.9	2.5	4.8
2015-25	–3.9	2.3	6.6	–4.2	–6.0	–0.2	(2025) 109.0	5.1	3.2	6.0
2025-35	–3.9	2.1	4.5	–2.4	–5.9	–0.1	(2035) 70.9	4.8	2.5	5.9
C. Scenario 2										
2010-12	7.0	6.3	4.3	2.0	0.9	–0.2	(2012) 156.7	2.9	–1.4	–0.9
2012-15	–6.3	2.2	5.9	–3.7	–4.8	–3.7	(2015) 137.9	3.9	2.4	4.8
2015-25	–4.2	2.3	5.4	–3.1	–6.0	–0.5	(2025) 95.6	4.7	2.6	6.0
2025-35	–4.0	2.0	3.4	–1.4	–5.9	–0.1	(2035) 56.0	4.2	1.7	5.9
D. Scenario 3										
2010-12	7.0	6.3	4.3	2.0	0.9	–0.2	(2012) 156.7	2.9	–1.4	–0.9
2012-15	–6.5	2.0	5.9	–3.9	–4.8	–3.7	(2015) 137.2	3.9	2.5	4.8
2015-25	–5.0	1.5	5.2	–3.7	–6.0	–0.5	(2025) 87.4	4.7	3.2	6.0
2025-35	–5.0	1.0	2.7	–1.7	–5.9	0.0	(2035) 37.7	4.0	2.5	5.9

Note: Baseline: Potential growth assumption: 1.7%. Privatisation and asset development proceeds: EUR 15 billion between 2011 and 2017.
Scenario 1: Potential growth assumption: 2.5%. Privatisation and asset development proceeds: EUR 15 billion between 2011 and 2017.
Scenario 2: Potential growth assumption: 1.7%. Privatisation and asset development proceeds: EUR 50 billion between 2011 and 2017.
Scenario 3: Potential growth assumption: 2.5%. Privatisation and asset development proceeds: EUR 50 billion between 2011 and 2017.
Source: OECD calculations

Scenario 1 – Stronger structural reform

Ambitious structural reforms would promote employment, investment, exports and growth, which in turn will help solve the fiscal problem. Raising trend growth to 4½ per cent (real growth of 2½ per cent) would speed the process of debt reduction. Reaching such trend growth seems achievable. The market reforms now under way could generate a sustained increase in GDP of at least 10% in the long-term (Box 1.7). This would represent a ½ percentage-point increase in growth, to a horizon of 2035, bringing it to a range of

2¼ per cent to 2½ per cent per year. In this case the level of government debt would decline to 70% of GDP by 2035, or 28 points below the level in the base scenario (Table 1.9, part B). Higher growth reduces the debt/GDP ratio directly, and also reduces the risk premium of Greek debt in this scenario, with average nominal interest rate on government debt dropping from 7% in 2020 to 6½ per cent in 2030-35 (Figure 1.23).

Box 1.7. **How large might be the output gains of structural reforms?**

Structural reforms have an essential role to play in boosting growth. As shown by several recent OECD analyses, the modernisation of the Greek economy through the adoption of reforms in the public sector and labour and product markets will bring important employment, productivity and output gains. Bouis and Duval (2011) conclude that the GDP per capita gain for Greece from undertaking ambitious reforms could be 17% over a 10-year period, compared to about 10% for the OECD on average. This assumes that policies in product and labour markets, and in the benefit, tax, and retirement systems would converge towards the best performers (generally the three best in the OECD). Specifically, a reform of pensions introducing a move towards actuarial neutrality and increasing by two years the effective retirement age would boost the employment rate by 2½ percentage points in Greece over this 10-year horizon. Less constraining employment protection legislation and better product market regulation would also have important positive effects on productivity. Bourlès *et al.* (2010) calculate that multifactor productivity growth would increase by about 0.8 percentage point per year (raising GDP level by almost 9% after 10 years), if the regulatory burden in the upstream sectors of the economy were reduced to the level of the best practice regulation observed in OECD countries. Applying the methodology developed by Arnold *et al.* (2009) to Greece indicates long-term labour productivity gains of about 14% if product market regulation were to follow OECD best practices. Other studies confirm the large potential benefits of structural reforms. According to Zonzilos (2010), product market reforms that reduce profit margins in protected sectors to their average level in the euro area would add more than 13% to GDP after 10 years. Those gains, estimated using the IMF's "GIMF" model, would rise to 17% of GDP, if the labour market were to function better.

As shown in Chapters 2 and 3, substantial progress has been achieved in structural reforms in many domains. Despite this significant progress, there is still further room for doing better as improvements in labour market regulations, in particular the relaxation of employment protection legislation, appear to have been limited, regulation for some professions such as pharmacists or lawyers was eased only moderately, obstacles to entrepreneurship due to inadequate rules for spatial planning and the absence of property register persist, and state control remains pervasive in many areas.

A precise quantification of reforms already adopted or planned is however difficult at this stage. Available information does not yet allow evaluation of the overall impact of current changes, as several of them (such as privatizations) are still underway. The quantification of benefits is also difficult in some domains, such as for the reduction of bureaucracy or the more flexible wage or employment arrangements. The broad range and scope of reforms in product and labour markets and the public sector should however generate positive synergies, with initial positive effects likely to be felt relatively rapidly if reforms are quickly and fully implemented. Activity should be stimulated by new business opportunities opened up in many sectors, the lower administrative burdens, the ability of firms to more easily adjust their workforce and set up working conditions and remunerations in line with their needs and productivity performance. Recent export developments, which seem to partly reflect the current effort of entrepreneurs to find new markets and reorient their activity, illustrate the vitality of the Greek business community which should be helped to adjust to the current difficult environment.

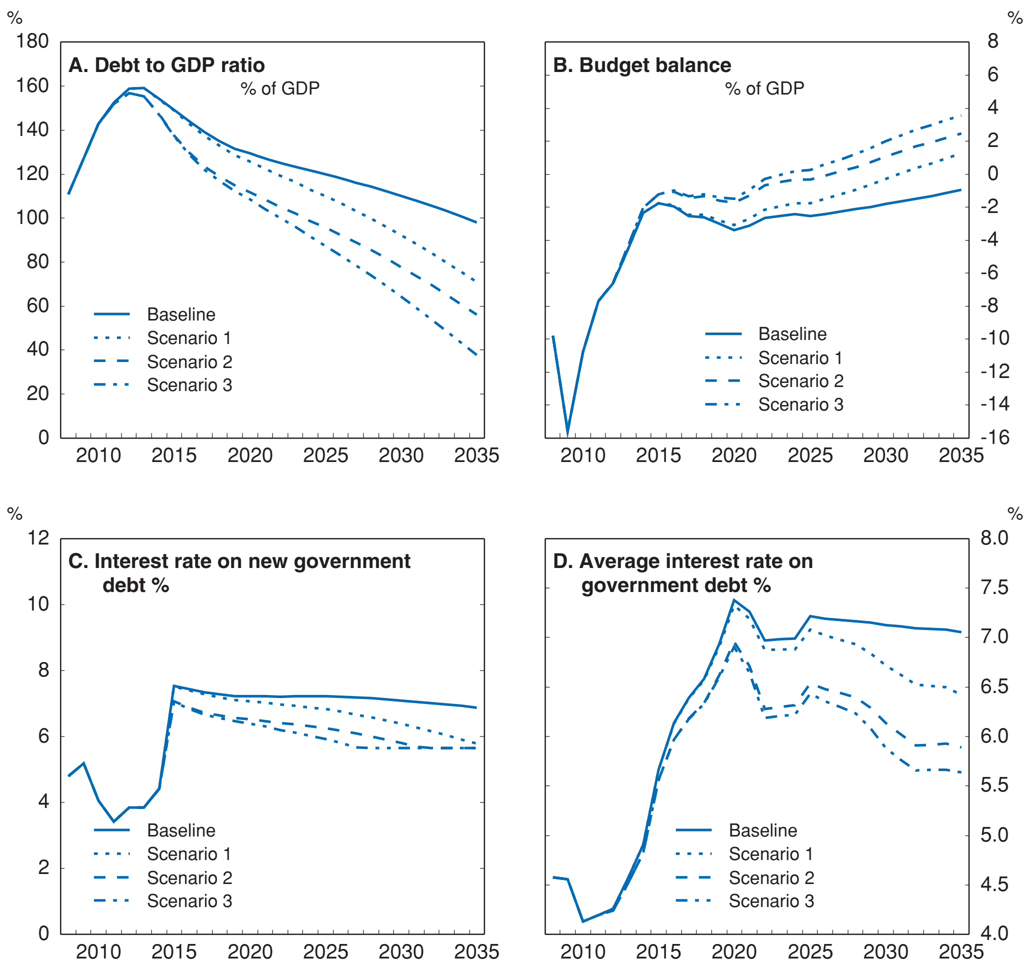
With this general background, an assumption that the current reform process would generate output gains of about 10% of GDP seems reasonable. This is a relatively conservative estimate. It represents a ½ percentage point increase in growth, to a horizon of 2035, bringing it to a range of 2¼ per cent to

Box 1.7. **How large might be the output gains of structural reforms?** *(cont.)*

2½ per cent per year, which is similar to the trend growth rate used by the IMF. Using an alternative sector analysis, National Bank of Greece (2010) estimate that growth could be boosted annually by as much as 1½ percentage points by structural reforms along the lines of those already begun. Such an improvement, which would bring trend growth to 3¼-3½ per cent per year, is thought to be feasible in light of the current productivity gap between Greece and the more advanced economies. The efficiency gains needed to maintain such a growth rate would be just enough for Greek productivity to catch up to the average of the EU countries by 2035.*

* In 2009, the productivity of the Greek economy was 37.5% below the average of the best-performing OECD countries (*i.e.* the average of the upper half of member countries in terms of GDP per capita), while for the average of EU countries the gap was 16% (OECD, 2011). On the assumption that average productivity growth in Greece is maintained at around 3% per year to 2035, *versus* 1.8% for the EU average, the Greek productivity gap with the EU would practically close, and with best-performing OECD countries would be narrowed to just below 20%.

Figure 1.23. **Long-term debt sustainability: alternative scenarios**[1]



1. Baseline: Long-term potential growth 1.7%. Privatisation and asset development proceeds EUR 15 billion between 2011 and 2017.

Scenario 1: Long-term potential growth 2.5%. Privatisation and asset development proceeds EUR 15 billion between 2011 and 2017.

Scenario 2: Long-term potential growth 1.7%. Privatisation and asset development proceeds EUR 50 billion between 2011 and 2017.

Scenario 3: Long-term potential growth 2.5%. Privatisation and asset development proceeds EUR 50 billion between 2011 and 2017.

Source: OECD calculations.

StatLink http://dx.doi.org/10.1787/888932473948

Scenario 2 – Ambitious privatisation and property management

Privatisation and improved management of public assets would also facilitate fiscal adjustment. Large-scale initiatives to sell off or develop public properties will make a substantial contribution to consolidating the public finances. It will also boost credibility. The scenario measuring the impact of this effect on the evolution of the public debt makes assumes that it could take until 2017, somewhat longer than the four years currently planned by the government (see below), to garner EUR 50 billion in revenues.[11] According to this scenario (the other assumptions for which are those of the base scenario), public debt would decline by about 40 points of GDP to 56% of GDP in 2035 (Table 1.9, Part C). The additional revenues from better management of public assets would directly accelerate the build down of debt. Lower debt would also help reduce the risk premium on Greek bonds, which would strengthen the consolidation process. In this scenario, the nominal interest rate would peak at a lower level of 6½-6¾ per cent around 2020 before falling to 6% between 2030-35 (Figure 1.23).

Once again, this seems within reach. In recent months the authorities have quite rightly stepped up their privatisation and public-asset management programme. At end-December 2010 the privatisation plan, which had already been reinforced for the period 2011-13, was geared to bring in EUR 7 billion (2% of gross debt). In March 2011, the government again raised the target to EUR 15 billion. Beyond that, a target for raising EUR 50 billion (15% of gross debt) was set for 2015. In end-June, specific steps have been taken in the context of the adoption of the medium-term fiscal strategy (MTFS) by the Parliament to accelerate this privatisation programme and proceed with the sale of public stakes in listed companies in 2011, including the Hellenic telecommunication organisation (OTE), the Hellenic Postbank, Piraeus and Thessaloniki ports, and Thessaloniki water and sewage company. The revenue targets from this first wave of privatisation are set to EUR 5 billion by end-2011. These privatisation proceeds are then expected to reach EUR 15 billion by end-2012 (cumulatively), and EUR 50 billion (about 20% of GDP) by 2015 (cumulatively). The programme includes a detailed inventory of targeted assets and a quarterly timetable through 2013, and an annual schedule for 2014-15, for divesting each asset. The assets to be privatised include: *i)* shareholdings in listed and non-listed state companies and banks; *ii)* shareholdings in public infrastructure (*e.g.* airports, ports, highways); *iii)* monopoly rights (*i.e.* gaming licences) and *iv)* real estate.

As planned by the MTFS, the government will also establish a privatisation agency, the National Wealth Fund (NWF), to manage privatisation. The NWF will become the sole shareholder of assets to be privatised, and will have a mandate to sell them at prevailing market conditions as soon as technically feasible. It will not be able to transfer assets back to the government unless a transaction is completed, ensuring the irreversibility of the process. It will be provided with quarterly targets for proceeds to be transferred back to the Government, which are then to be used for public debt reduction. The Fund will be established for 6 years, with a Board of Directors appointed by Parliament. The European Commission and the Eurogroup may appoint two observers on this Board. The Board will publish quarterly reports, to be submitted to Parliament, on its activities in which the status of each asset in the transaction process will be described. The Fund may also establish an Advisory Board to benefit from international experience and technical expertise.

Questions have been raised about the authorities' ability to achieve such an ambitious objective, and about whether privatisations are justified if they do not affect net public indebtedness. Between 1998 and 2009, the total proceeds from privatisation were slightly in excess of EUR 23 billion (14.6% of GDP). Although the roster of privatisation candidates has shrunk, there still seems to be ample room for further divestment. In 2009, the stock of government-owned financial assets was estimated at 32.5% of GDP (IMF, 2010), and the value of public sector capital stock at 52% of GDP, although it is likely that the market value of these assets has fallen because of the crisis. According to the national accounts, net government debt was more than 30 percentage points of GDP lower than gross debt in 2010. The privatisation of public enterprises, the value of which is recorded under government financial assets, would reduce the gross debt without affecting the net debt, if those assets are correctly valued. However, such privatisation would reduce the government's financing needs, which would facilitate its access to financial markets. As well, privatisation would reduce subsidies to public enterprises. Finally, it seems almost certain that private owners would be able to manage the assets better than the government has so far, thereby raising GDP.

Rationalising the management of publicly owned real estate, which is not recorded on the government balance sheet, would reduce both gross debt and net debt. In this area, the authorities plan to move swiftly to develop some of these assets through leasing arrangements, public-private partnerships (concessions), or sales.[12] The site of the former Athens international airport at Elliniko, with an estimated value of EUR 5 to 7 billion, could be one of the first candidates. New uses for the 2004 Olympic Games sites are also planned. An initial portfolio of high-quality government properties for redevelopment will be selected by June 2011, and rounded out by steps in December 2011, June 2012 and December 2012. Some estimates have put government-owned properties at between EUR 200 billion and EUR 300 billion (87%-130% of GDP) (IMF, 2010).

The long-standing deficiencies in government property management make it more difficult for the authorities to put these resources to effective use immediately (Maglaras, 2010). Property holdings are fragmented among many ministries, public enterprises, agencies and pension funds. Moreover, there is no coherent inventory of these assets, as data are collected on an individual basis by the various units. Information on the quality of assets, for example, is frequently missing, making their valuation difficult and controversial.[13] The value of around EUR 250 billion that has been roughly estimated for government real estate holdings is thus highly uncertain. Moreover, there is no effective property register and this fact, combined with poor management of these assets, has produced a situation where many of these properties have been illegally occupied by private persons, in some cases for many years.[14] According to Maglaras (2010), 40% of the 71 000 listed public properties are illegally occupied, in whole or in part. With information on many other properties either lacking or unreliable, it is safe to say that only a limited number of sites are likely to be available for immediate development.

The government has taken steps to address the shortcomings in property management. A new General Secretariat was created in April 2011 to centralise management, registration and development of the properties owned by all public entities. In addition to establishing a list of properties suitable for immediate development, efforts are under way to remove administrative obstacles to this end. These are welcome measures: it is time to put a stop to the kind of faulty management that undermines the value of government properties. To succeed in this task, the authorities will need to give the new Secretariat sufficient technical and human resources and set for it clear and measurable objectives so that it can fulfil its mission promptly and transparently. In particular, it must have the power to remedy and prevent illegal occupancy of public property. As this problem could take time to sort out, an interim solution might be to divide the properties (which are often vast tracts) into smaller units that can be developed more quickly. The development of large-scale properties, which requires finding large-scale developers, will also be more difficult than in the case of smaller properties. Although it could take more than four years before rationalised property management can boost government revenues by EUR 50 billion, especially as market conditions will not necessarily produce a favourable valuation of the properties to be developed, it is important to implement as quickly as possible this privatisation programme.

Scenario 3 – Faster structural reforms and privatisation

A consolidation scenario that combines the impact of privatisation and the rationalisation of government asset management with the benefits of stronger long-term growth generated by market reforms is consistent with the announced policy. This combination of the first two scenarios reduces public debt to less than 40% of GDP by 2035 (Figure 1.23 and Table 1.9, part D). Under these circumstances, the authorities could consider easing fiscal restraint around 2020. They could cut their primary surplus by one percentage point, to 5% of GDP as of that time, and still reduce the public debt to below 60% of GDP by 2035.

It should be stressed that all the above scenarios are deliberately based on relatively conservative assumptions. This applies to long-term growth prospects, as discussed in Boxes 1.6 and 1.7. The assumptions retained regarding the pace of privatisations are also slower than government commitments. Moreover, the simulations carried out do not incorporate the full impact of the enhanced international support provided by the 21 July 2011 package agreed by the European Heads of States. This applies to the consequences of the extension of loan maturities, for which the full details of the agreement were not known at the time of writing. Also, the expected net positive effects of debt burden reduction agreed by the private sector on a voluntary basis and the impact of the buyback of Greek public debt on the secondary market are not included in these scenarios, due in part to the uncertainties of the outcomes of these measures.

The success of the program is, nevertheless, subject to many risks

The programme is doable, if fully implemented. However, several factors can affect the realisation of the adjustment programme and attainment of the debt sustainability scenarios. External shocks, a negative growth spiral from substantial consolidation or lack of confidence by consumers and investors postponing spending decisions, weakening political support for reforms or continued difficulties with access to capital markets can derail the programme. Markets remain sceptical of success, as indicated by the persistence of wide spreads on Greek sovereign debt. The agreed reinvigoration of the programme in early June by the Troika and the Greek government with the adoption of the MTFS in end-June 2011, with strengthened reforms in fiscal and structural areas (Chapters 2 and 3) and the acceleration of an ambitious privatisation programme (discussed above), aims to lower some of these risks and provide an opportunity for Greece to reinforce the reform drive.

Access to capital markets at reasonable cost is a major risk

The benign scenarios assume that interest rates on Greek bonds will remain relatively low over the medium-term horizon. This can be violated, for example, by the possibility of a general and stronger-than-expected rise in rates across all bond market (UBS, 2011). More important yet, is the evolution of the longer-term spread over German rates, especially when Greece is expected to regain access to capital markets. The still-high risk premium demanded on Greek government bonds reflects the persistent market perception that Greece is insolvent, even though this is not easy to determine for a sovereign (Box 1.8).

Since the country is unlikely to regain access to international financial markets by early 2012, as had been expected in the adjustment programme agreed in May 2010, an enhanced international financial support plan for Greece has been adopted on 21 July 2011. The key provisions of this package include additional financial support provided by the European countries and the IMF, reduced interest rates, a meaningful extension of loan maturities, voluntary private sector involvement, protection of Greek banks and measures to foster economic growth in Greece.[15] Market reaction was positive just after the announcement of the 21 July 2011 EU package agreement. Such financial package, which improves somewhat Greece's medium-term fiscal prospects, is above all key for providing the Greek government with enough financing until 2014, alleviating the risk of a liquidity problem. This package provides Greece with valuable time, which needs to be used to continue the vigorous reform process. The Greek government should intensify efforts to convince markets of its capacity to implement fundamental economic adjustment and the domestic audience of the need to pursue reforms required to bring public finances to a sustainable path and position the Greek economy for robust growth in the years ahead.

Box 1.8. **The determination of sovereign solvency is not straightforward**

The distinction between solvency and liquidity, which is not easy to sort out even in the case of a private enterprise, is difficult to establish for a sovereign state. The solvency of a state depends on its willingness or ability to impose taxes, to reduce spending, or to dispose of assets. For example, if Greece could raise its tax burden to similar levels as those in the Nordic countries, debt sustainability would look quite different. The above scenarios also show a large impact on debt sustainability from assumed asset sales. A key question from this perspective is the degree of political or social acceptance of reforms needed to clean up the country's financial situation. The answer to that question is necessarily difficult and uncertain.

If a state in difficulty is ready to agree to the reforms needed to rectify its public accounts, it must also consider the dynamics of the adjustment process it plans to pursue. If the adjustment is too abrupt it can generate a vicious circle that will frustrate resolution of indebtedness problems: less growth means lower tax revenues, which then requires a stiffer adjustment programme, thus deepening recession and cutting revenues further. This also runs the risk of unleashing a deflationary spiral that will drive the private sector to increase its savings and pay down its debt, thereby reinforcing the depressing effect on the economy of the higher government savings needed to consolidate the public accounts. This can happen in cases where the private sector is heavily indebted and sees the burden of that debt growing in real terms as a result of deflation induced by the fiscal adjustment programme. These risks must not be underestimated for Greece. Yet, the Greek economy is not now in a downward spiral.

At the same time, assessments of solvency risk over time are sensitive to small changes in key parameters, which can surprise on the upside. Assumptions on growth, ability to achieve and maintain a high primary budget surplus, the time horizon set for public debt, reduction and its level. For example, Belgium, Italy and Japan have long maintained public debt levels comparable to those now in Greece without solvency concerns, at least until recently. The above simulations show that if Greece follows strictly its adjustment programme, sustainability can be achieved over time through strict implementation of the envisaged reforms.

Another risk is that reforms stop for lack of popular or political support

With a large parliamentary majority, the government has been able to legislate major reforms in record time. In the fall of 2010 its ability and willingness to undertake bold and necessary reforms won credibility and led to a substantial decline in spreads. Reforms such as those affecting pensions, the labour market, public enterprises and certain key sectors, including transportation, would have been hard to achieve in most OECD countries. Credibility and the perceptions of fair burden sharing were harmed by some wavering even within the ruling party about the enlarged privatisation program in early 2011. In part this also reflected shortcoming in the design of the original programme (especially the maturities of the loans) and the lengthy European debate on the characteristics of the permanent support mechanism (especially the preferred creditor status granted to official EU lenders), which were subsequently corrected. Despite the street protests often prompted by affected vested interests, most Greeks understand the need for fundamental change. However, waning support for reform is a real risk for the programme. A key issue is fair sharing of the adjustment burden and future benefits of the reforms. Support for reforms could be strengthened, for example, by catching more large tax evaders, adopting a firm stance against vested interests or ensuring that privatisation is carried out in a transparent manner. The government also needs to show and inform the public clearly that the measures are having results with a fair sharing of their burden.

To promote the chance of success and mitigate the risks and uncertainties surrounding of the current adjustment programme, and given the frequent problems that have arisen in the past, the authorities should develop and publish indicators on a regular basis showing how measures are being implemented. Establishing clear responsibilities for monitoring in ministries would be useful as well as involving the social partners in this monitoring exercise to improve the diffusion of information concerning the progress of reforms. There are two advantages to such an approach: *i)* it allows close monitoring of reforms and alerts the government to any additional adjustments needed if the objectives are not achieved; and *ii)* it improves information and makes progress with economic reforms more visible to the public, including the international community.

Consolidation may face external shocks

The authorities will need to assert close control over the primary fiscal balance. The government's willingness and ability to respond to unanticipated shocks, despite the high level of debt, is crucial for persuading markets that the adjustment programme is credible. This includes the capacity to react to temporary interest rate hikes, which will require above all sound medium-term fiscal controls. In the short term, the effect of such rate fluctuations on the average cost of the public debt is cushioned by the relatively long maturity of its stock. For example, a temporary increase of two percentage points in Greek bond rates in 2013 would deepen the deficit by ¼ point of GDP as of 2014, and the public debt by nearly 2 points of GDP in 2020 and 6 points in 2035. In such a situation, the authorities must be ready to take corrective measures: in this hypothetical case, the adverse impact on the debt could be offset by a temporary increase in the primary fiscal balance of 1½ per cent of GDP in 2015 and 2016, which could for example come from an additional boost in non-tax revenues derived from better property management. Such a strategy should reassure markets, as suggested by experience in Italy and Belgium: their public debt remains high after nearly 25 and 30 years respectively (averaging 115% of GDP, with peaks exceeding 130% of GDP in some years) but they have gained good control over their fiscal balance (Chauchat, 2011). The efforts that Greece makes in response to this challenge will have to be all the more determined because in the past it has seldom respected its fiscal targets (OECD, 2009).

Box 1.9. Recommendations for restoring fiscal sustainability and promoting sound and solid growth

Maintaining strict control of the primary budget balance and quickly implementing the privatisation strategy

- Pursue a strict implementation of the programme agreed with the Troika. Continue to react constructively to negative news or unexpected shocks, to convince the markets of the credibility of the commitment. Adopt the necessary budgetary measures, estimated at about 3% of GDP, to guarantee the targeted reduction of the fiscal deficit to the 7½ per cent of GDP in 2011.
- Strengthen efforts to guarantee the rapid and strict implementation of the privatisation and real estate asset development plans. The new general secretariat for public property should be given clear and quantifiable objectives with adequate authority including for dealing with the issue of illegal occupation of public real estate asset.

Ensuring recovery and successful implementation of the programme

- Establish clear responsibilities in ministries for monitoring reform implementation more closely on the basis of objective indicators. The results should be published widely under the scrutiny of the social partners to improve the diffusion of reliable information on progress with reforms.
- Closely monitor the macroeconomic development.
- Ensure fair burden sharing of the current economic adjustments. Adopt a firm stance against vested interests. Put more efforts to explain the benefits of the changes which eventually accrue in terms of growth, employment, opportunities and equity would help. People need to understand however, that there are no easy solutions, nor alternatives to policy changes, including if a restructuring of government debt cannot be avoided.

Preserving the stability of banks and their ability to support the recovery

- Continue liquidity support to banks. Attempt to reduce banks' dependency on ECB liquidity through restructuring operations should be approached with caution, to avoid a credit crunch.
- Promote partnerships or mergers with foreign banks, including by divesting remaining government holdings.
- Continue close surveillance of the financial sector, including in the housing sector and individual credit institutions due to significant disparities of situations.
- Banks should continue improving their balance sheets given the prevailing systemic risks associated with a possible restructuring of the public debt. Monitor closely the development in credit supply as the potential impact of excessive caution in credit supply induced by the recession and the confidence deficit in might prevent financing of profitable projects In the medium term,

Continue improving the statistical system

- Publish quarterly national accounts both for the government and household sectors. Develop more up-to-date and seasonally adjusted cyclical indicators covering all key sectors of the economy, including private and public wage and unit labour cost developments.

Notes

1. The exposed sector, and in particular industry, which traditionally boasts the economy's highest productivity gains, is relatively small in Greece (Tzilianos, 2006; Gibson and Malley, 2007). Salary negotiations in this sector have no knock-on effect on the determination of pay elsewhere in the economy. Here, the public sector has greater influence, but wage decisions in that sector are unrelated to productivity trends.
2. Furthermore, estimates of TFP are probably overstated by estimations based on official statistics because those statistics tend to underestimate the magnitude of undeclared work or the actual number of hours worked but not reported (National Bank of Greece, 2010).
3. According to OECD estimates, until then the greatest structural adjustments of the primary fiscal balance achieved in a single year had been those of Hungary in 2007 (+5.6% of GDP) and Finland in 2000 (+4.5% of GDP).
4. Under the existing framework the guarantees would have expired at the end of 2011.
5. The Emergency Liquidity Assistance facility gives all national central banks in the euro area the ability to support domestic financial institutions, over and above the assistance provided by the Eurosystem. Since ELA is not part of the Eurosystem operations, any profits or losses made using this facility are for the account of the national central banks alone and not shared with the rest of the Eurosystem.
6. Investments by international banks, insurance companies and pension funds in public securities are subject to rules and restrictions linked to rating agency evaluations.
7. In 2009, the total of bank assets represented 210% of GDP. This was below the comparable figure in Portugal, Spain, France and Germany, which ranged between 320% and 390% of GDP. Moreover, the Greek banking system is relatively concentrated: the market share of the five biggest banks (69% of total bank assets) was higher than the average for the euro area (less than 50%).
8. However, it is worth noting that public indebtedness can be substantially brought down without adjustment in the exchange rate as demonstrated by the fiscal adjustment in Belgium during the 1990s. This Belgium experience shows that the participation to a monetary union (as the Belgium franc was then linked to the deutschmark) can help reduce the interest spreads if reforms are adopted and strictly implemented to reinforce economic fundamentals.
9. The 21 July 2011 package agreed by the EU Heads of States includes an extension of official support until 2014 and a reduction of the cost of this source of funding to 3.5%. Together with the revision to the European loan conditions agreed in March 2011, this implies a 2 percentage points reduction of the EU funding cost compared with the lending rate granted previously. According to OECD calculations, this lower funding cost of the European loans, which should apply only to the new government debt issued, should be limited on the average interest rate of total stock of government debt. The new debt issued will be partly used to rollover a debt contracted between 2001 and 2009 at an already relatively low rate: between 2001 and 2009 the long-term interest rate debt reached on average 4½ per cent.
10. Empirically, the level of the public debt seems to exert significant influence on risk premiums for long-term interest rates. Égert (2010) estimates, for example, that each percentage point of this debt beyond 75% of GDP means an increase of four basis points in the risk premium. This rule was applied to assess the long-term interest spread between Greece and Germany. The calculation also considered a minimum risk premium for all euro area countries *vis-à-vis* Germany, regardless of their debt situation.
11. This represents EUR 35 billion more than the base scenario, which includes a privatisation programme of EUR 15 billion, the effects of which are however in part offset by recognition of contingent liabilities, evaluated on the basis of IMF information (IMF, 2011).
12. In Greece, the government often uses long-term leasing operations to collect revenues, as in the case of Athens international airport. This approach involves setting up companies to receive the future state revenues from charging tolls on the long-term lease. These companies are then sold to the private sector. This allows the government to receive advance payments for the long-term concession.
13. These valuation problems are illustrated by the Vatopedi scandal, which involved an exchange of properties between the government and a monastery.
14. A national property register was launched in 1994. This official inventory of public and private properties in the country is to be completed in 2016. According to the work plan, 40% of the inventory is to be compiled by 2012. Introduction of this register is essential for avoiding breaches of the law, including illegal construction or takeover of public properties such as burnt-over forest lands.

15. The 21 July 2011 package agreed by the EU Heads of States includes official support with private sector involvement until 2014. Total official financing of EUR 109 billion will be provided through the EFSF and by the IMF. The EFSF financing will be provided at around its funding cost (around 3.5% at present against 4.5% for previous EU official loans), with a maturity between 15 and 30 years (rather than the current 7½ years), and with the possibility of a 10-year grace period. It was also decided to extend the maturities of the existing bilateral loans, but their borrowing will not be reduced. The euro area governments will also provide support to the Greek financial system by *i)* offering credit enhancement to underpin the quality of collateral so as to allow its continued use for access to Eurosystem liquidity operations by Greek banks; and, *ii)* providing adequate resources to recapitalise Greek banks, if needed. The main features of private sector involvement include a net contribution of the private sector estimated at EUR 37 billion between 2011 and 2014. This takes into account the credit enhancement costs but excludes a debt buyback programme that will contribute to EUR 12.6 billion, bringing the total to EUR 50 billion. For the period 2011-19, the total net contribution of the private sector involvement is estimated at EUR 106 billion. Finally, the 21 July agreement includes a Commission's proposal to create a Task Force to work with the Greek authorities and provide technical assistance to mobilise EU and EIB funds. Greece's access to EU structural funds will also be facilitated by a reduction of its contribution to EU-subsidised projects from 27% currently to 15%.

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ANNEX 1.A1

Progress in structural reform

This table reviews recent action taken on recommendations from previous *Surveys*. Recommendations that are new in this *Survey* are listed in the relevant chapter.

Recommendations	Action taken since the previous *Survey (June 2009)*
FINANCIAL SECTOR	
Monitor closely financial sector developments to ensure that the banking sector support plan is responding adequately to re-capitalisation needs, as the economic situation evolves.	A Financial Stability Fund, with a EUR 10 billion capital, has been created to meet possible capital needs of solvent banks. The Bank of Greece, with ECB help, closely monitors the liquidity situation of banks and stands ready to take the appropriate actions to maintain sufficient system liquidity. The Bank of Greece has become responsible for the insurance sector.
Further improve the dissemination and transparency of information to address market uncertainties about the soundness of the banking system in the face of the crisis. Publish the Financial Stability Report in English: and the results of stress tests tracking the scope of perceived risks. Improve the quality of economic and financial information. Publish the results of the Bank Lending Survey.	Financial stability reports are regularly published, including in English. The results of stress test performed in June 2010 were published. New stress tests are underway. The frequency and speed of data reporting has been increased: the key financial stability indicators are available on a monthly basis and liquidity on a daily basis.
Consider changing the bank provisioning mechanism to limit the procyclical nature of credit supply – drawing on the Spanish experience – in the context of an EU move in that direction.	No action.
TAX REFORM	
Further simplify the tax system. Future reforms should aim at the elimination of the many remaining exemptions and deductions in corporate taxation, and removing the bias in the taxation system in favour of the self-employed.	The April 2010 reform has rationalised the personal income tax by introducing a single rate scale applicable to most sources of income (including dividends) and broadening the tax base. Tax exemptions for certain categories of taxpayers have been abolished; the corresponding income will be taxed as ordinary income Provisions have also been introduced to take into account workers' objective standards of living in assessing their tax rate (in particular for the self-employed).
More stamp duties should be eliminated and the concomitant revenue losses offset by higher VAT revenue. Move to a more uniform VAT rate structure and shorten the list of goods and services that are eligible for reduced rates. End of the preferential VAT treatment of some products, certain professions (*e.g.* lawyers, notaries) and the Aegean islands.	The normal VAT tax rate has been increased from 19% to 23%. VAT tax base has been broadened to cover legal and notarial services, which were previously exempt.
Strengthen tax administration. Improve auditing activities through better qualified personnel. Grant auditors easier access to taxpayers' bank account information. Consider experimenting with the use of private services in tax administration, starting with the collection of arrears. The practice of frequent tax amnesties needs to be discontinued. Consider increasing, or even removing, the legal deadline ("limitation of action by lapse of time") for revenue collection.	A new audit system based on risk analysis, using objective criteria, has been put in place. A transparent procedure was also instituted for segregating tax arrears that are recoverable from those that are not. This has led the government to issue a new amnesty law in 2010. More demanding rules for hiring tax auditors have been created. Several tax inspection offices have been reorganised and new directors have been appointed in most of the offices.
Centralise the administration and collection of taxes and social security contributions under a single authority, to facilitate the cross-checking and verification of information	The authorities have planned to centralise the collection of taxes and of social security contributions by placing them under the control of the same agency.

Recommendations	Action taken since the previous *Survey (June 2009)*
PUBLIC ADMINISTRATION	
The management of public administration should be improved: by 1) focusing on the recruitment of high-quality entrants, 2) improving the incentive structure to encourage better productivity, 3) continuing to only partially replace retirees.	Between 2011 and 2013, hiring restrictions will imply the replacement of only one of every five public servants who leave the service. In 2010, employment cuts amounted to nearly 3% in staffing levels.
Primary spending especially the public wage bill should be reduced. Continue efforts towards containing personnel outlays. Proceed with the planned rationalisation of the special benefits received by public sector employees. This is indispensible if an adequate control over the wage bill is to be achieved.	In 2010, wages per employee were cut by 8½ per cent, and an additional trimming of 3½ per cent to 4% is expected in 2011 and 2012. Overall, general government wage outlays fell by 1¼ percentage points of GDP in 2010 and should decline by an additional point to 2015. A "Single Payment Authority" is to be created to centralise and rationalise wage management. At the end of June 2011, the authorities will submit a reform to simplify, modernise and reinforce control over remunerations. This reform should reduce the component of bonuses and allowances in remuneration, eliminate unjustified wage gaps among workers, and take better account of civil servants' qualifications and performance.
Ensure that policies are implemented fully and efficiently once legislation has been passed.	Efforts are being made with the Troika's help to develop a set of indicators to assess structural reform implementation.
BUDGET FRAMEWORK	
Improve the process of budget preparation, monitoring and evaluation. Indicative expenditure ceilings that extend beyond each fiscal year should be introduced. Move swiftly toward a programme-based budget and a multi-year budgetary framework	In July 2010 the authorities adopted a reform of budgetary management, which includes: *i)* a top-down approach to budgetary preparation, which involves setting a government-wide expenditure ceiling as well as deficit objectives for the various subsectors; *ii)* limitations on borrowing capacity for the various public entities; *iii)* budgeting of contingency reserves; *iv)* the requirement to seek parliamentary approval if expenditures exceed appropriations including reserves; *v)* mechanisms for controlling expenditure commitments; and *vi)* the requirement to publish regular data on budget execution. The budget is also now part of a detailed medium-term framework covering all government activities.
Adopt a stricter and more constraining fiscal rule, perhaps with constitutional rank, imposing expenditure controls, and maintain a structural fiscal surplus.	A Parliamentary Budget Office has been created.
Proceed rapidly with the implementation of reforms for the modernisation of the public accounting system. Fiscal transparency and accountability would be enhanced by concentrating debt management into a single agency.	Information on budgetary execution on a cash basis and on government payment commitments has improved especially at the state level. Controlling expenditures as of the point of commitment rather the point of cash payment is being extended in 2011 beyond the state level, with the creation of commitment registries across all government entities under the control of officers reporting to the Ministry of Finance.
PUBLIC ENTERPRISES AND ENTITIES	
Continue steps towards privatising and restructuring state-owned enterprises. Proceed faster with the implementation of the new framework for the operation of public enterprises. A pricing mechanism that reflects the operating costs of public enterprises and managerial independence are vital for enhancing their financial performance.	In 2010, pay and non-pay expenses were cut by 10% to 15%. In 2011, personnel have been transferred to other sectors of the government. Major increases in prices and fares have been adopted. Salaries in excess of EUR 1 800 per month have been cut by 10%, a ceiling of EUR 4 000 has been set on monthly salaries, and the total of supplementary benefits will not be allowed to exceed 10% of the payroll in these enterprises. Further reductions of 15% to 25% in non-pay expenses are also planned. All public enterprises will see their subsidies limited to a maximum of 40% of total costs, and they will be required to submit business plans that will be subject to close monitoring. To this end, a central register has been created to collect data on their revenues, employment, personnel costs and financial performance. In case of deviation from the business plan, the firms will have to take corrective actions.
Implement forcefully recent legislation to contain expenditure and enhance the transparency of fiscal management of public entities (hospitals, social security funds and local authorities). Separate the administration of pension funds from that of health insurance funds.	All hospitals are to be subject to international accounting standards by end-2011. A separation of pension funds from the health insurance component is being introduced. The local government reform (Kallikratis) has sharply cut the number of local entities, administrations, and elected and appointed officials. The government has also launched independent functional review of the central public administration.

Recommendations	Action taken since the previous *Survey (June 2009)*
PENSION REFORM	
Move quickly to outline reform plans that will contain future pension expenditure. Reduce statutory replacement rates by lowering accrual rates. Link pensions to lifetime earnings, as in the case of self-employed, rather than on the last five years' earnings as at present. Consider revising the system for revaluing pensions. Give consideration to raising accrual rates beyond the official retirement age. Lengthen the contribution periods required for full pensions.	A radical pension reform was adopted in July 2010 (law 3863/2010). Beginning in 2015, all pensions will be calculated as the sum of a basic allowance (EUR 360 per month, 12 months per year) and a contributory pension payable 12 times a year. For the contributory-based scheme, the statutory accrual rate is limited to 0.8-1.5% a year, depending on the years of service (instead of 2% to 3% a year before). Pensions are indexed to prices and to GDP growth. The period over which the pension benefits are calculated is extended from the top 5 years in the last 10 years of earnings to the entire working life, with 40 years of contribution needed for a full pension (instead of 35 years before). The authorities are also committed to further adjusting the system's parameters by simple ministerial decision if the increase in pension spending exceeds 2½ percentage points of GDP between 2009 and 2060.
Increase the normal age of retirement in line with increases in life expectancy.	A mechanism has also been introduced to index the statutory retirement age (65 years) and the minimum retirement age (60 years) to life expectancy, beginning in 2021.
Further encourage private pension arrangements through incentives to employees and employers and strong regulation and supervision based on OECD principles.	No action.
Change the conditions for awarding minimum pensions so that access is limited to persons who have reached the statutory retirement age. Incentives for early retirement should be removed. Proceed with the planned revision of the list of "strenuous" occupations and extend the application of that reform to workers still well below retirement age. Raise the minimum age for drawing a full pension after 37 years' contributions to above 58. Separate family-policy provisions from pension-related measures and raise the minimum age at which women with dependent children can draw a retirement or early retirement pension. Assess the impact of the recent extension of maternity leave and adjust the measure if it has an adverse effect on the employment of women.	A unified statutory retirement age of 65 years is introduced, including for women in the public sector (phased in immediately after adoption of the Law 3863/2010), to be completed by December 2013. Access to early retirement is restricted. The minimum retirement age is raised to 60 years by 1 January 2011, including for workers in heavy and arduous professions. The list of arduous professions, which includes about a third of the labour force, will be revised by July 2011 to cover less than 10% of the working population. Pension benefits are reduced by 6% per year for people entering retirement between the ages of 60 and 65 with a contributory period of less than 40 years.
HEALTH CARE REFORM	
Consolidate all powers within a single ministry. Separate health insurance funds from pension funds, as planned by the government. Separate the functions of insurer and care provider and develop an internal market for health care services. Consolidate the funds and hospitals in one entity, such as the NHS. Make basic medical cover uniform for the entire population.	A recent reform (the law 3918/2011) has established a unified health insurance fund (the EOPYY), which combines the formerly separate health sectors funds of private employees (IKA), liberal professions (OAEE), agriculture (OGA) and civil servants (OPAD). The EOPYY, which covers the vast majority of the Greek population, has a bargaining power in the market for drugs and medical services *vis-à-vis* health care providers or producers. By the end of September 2011, an independent working group of eminent experts, constituted under the auspices of the Minister of Health, is to make concrete proposals for reforming the health system over the medium term.
Tailor the management of medical demography to the population's present and future health care needs. Inter alia, increase the number of nurses and the proportion of general practitioners. Develop a system of referring physicians.	By September 2011, the Ministries of Health and Labour, in cooperation with the Ministry of Finance, will prepare a report presenting the structure (age, specialty, grade, and regional distribution), levels of remuneration (including fees provisions to consultants and doctors) and the employment level and trend in hospitals, health centres, and health funds. This report will be updated annually and be used as a human resources planning instrument. The 2011 report will *inter alia* provide guidance for the education system. It will also specify a plan to reallocate qualified and support staff within the NHS and health funds. "Health Map" is an electronic tool (Web based application) that has already been in place in order to follow this action.
Improve the collection and administration of medical statistics. Rapidly introduce the OECD system of health accounts. Create a body to dispense advice on economic assessment of health goods and services and medical practices.	Steps have been taken to introduce the OECD system of health accounts, thanks to EU financing. An agreement has also been signed between the statistical office and the Health Ministry. ESY.net (NHS.net) has already started to consolidate data from all NHS units (hospitals and health centres) since 1/1/2011.
Introduce portable health record books along with incentives for patients to show them at each medical consultation.	With the consent of the patients in some units, patient medical summaries are maintained and are available at each visit. This methodology will be extended. With the final completion of the implementation of electronic prescribing, provision is made for portable medical summary of the patients. By the end of 2011, the extensive program of hospital computerization will allow for the setting up of a basic system of patient electronic medical records.
Bolster efforts in the realm of prevention, as well as incentives to adopt healthier lifestyles. Further raise the tobacco excise tax.	Excise tax on alcohol and tobacco was sharply increased in 2010.

Recommendations	Action taken since the previous *Survey (June 2009)*
Rationalise the management of public hospital procurement, improve transparency and achieve scale economies. Professionalise hospital administration by appointing qualified managers. Extend the administrative autonomy of hospitals Institute a forward-looking system of hospital funding which would ultimately be based on pathological categories (DRG).	Initiatives have sought to rationalize procurement in the hospital sector. A mechanism for supervising calls for tender has been instituted, along with a price monitoring "watchdog" for drugs and medical supplies. A global budget envelope for hospital financing has been introduced. Authorities have started redrawing the country's hospital map: this will involve the merger of some hospitals and staged introduction of hospital financing by diagnosis-related group. By the end of 2011, in a group of hospitals, a set of the developed DRGs will be piloted, with a view to developing a modern hospital costing system for contracting (on the basis of prospective block contracts). To support the development of DRGs, clinical guidelines will be developed.
Consider reviewing how pharmacists are compensated to reduce incentives to sell the most expensive drugs. Promote the distribution of generic drugs. Review packaging standards for pharmaceutical products so as to limit waste. Restore a positive list of reimbursed drugs, with limited possibilities for derogation.	To rein in the growth of pharmaceutical outlays, a "positive list" of reimbursable drugs has been reintroduced and the pharmacists' margins have been slightly reduced. The electronic prescription monitoring system (e-prescription) will be extended to other insurance funds. Following the 4th review of the economic adjustment program for Greece, the Greek government has agreed that starting from 2012, pharmacies' profit margins will be calculated as a flat amount or flat fee combined with a small profit margin with the aim of reducing the overall profit margin to no more than 15%, including on the most expensive drugs as defined in law 3816/2010 In response of previous policy initiatives, generic drugs already account for about 20% of the drugs used in hospitals. The government has committed to additional measures to promote the use of generic medicines by the end of 2011, such as: ● compulsory e-prescription by active substance and of less expensive generics when available; ● associating a lower cost-sharing rate to generic medicines that have a significantly lower price than the reference price (lower than 60% of the reference price) on the basis of the experience of other EU countries; ● setting the maximum price of generics to 60% of the branded medicine with similar active substance. In addition to that, further measures ensure that at least 30% of the volume of medicines used by public hospitals are generics with a price below that of similar branded products and off-patent medicines, in particular by making compulsory that all public hospitals procure pharmaceutical products by active substance.
EDUCATION	
Increase the supply of early childhood services, especially for children under 3 years.	No action
Consider introducing universal access to early childhood education for four years-old and, if possible, three year-olds.	No action
Develop a more integrated system of early childhood education and care. Ensure consistency of supply and quality for early childhood education and care services. Proceed swiftly with the development of a regulatory framework and the modernisation of the child care sector. Ensure appropriate mechanisms for monitoring policy implementation and performance. Continue strategies to counteract the effects of disadvantaged backgrounds on performance. Reform public-school admittance arrangements, to reduce the risk of socio-economic segregation. Ensure that students residing in sparsely populated and remote regions are provided with adequate teaching and learning conditions, including distance learning.	No action A new policy ("New School") underway aims to overhaul the Greek educational system and improve its performance. The "New School policy" is based on five key principles: all day, inclusive, digital, sustainable and innovative school. This is accompanied by interventions to support vulnerable groups (such as Roma and immigrants) including through the creation of educational priority areas in 20 schools to reduce dropouts in remote areas. The New policy is further being supported by the implementation of the digital school strategy through an educational platform comprised of digital contents for the training of teacher. The digital school is in a pilot phase in 800 primary schools following the integrated programme and in 1250 gymnasiums. Digitalised textbooks are under development.
Change the system of teacher career progression, to increase the attractiveness of the profession. Recognise quality teaching, rewarding good teachers. Lower the comparatively high teacher to student ratio, through the developments in distance learning.	No action
Ensure a better match between the anticipated needs of the education system and the initial education of teachers. Introduce a compulsory year of pedagogical training for secondary teachers. Improve teachers' professional development through minimum requirements for "in service" training,	Establishment of the certificate of pedagogical for teachers.
The school curriculum should better equip students with the competences to succeed in their post-school life. Introduce a nationwide final exam for upper secondary school and separate it from university access exams.	The "New School" policy for primary and secondary level of education focuses, *inter alia*, on the development of new and flexible curriculum. Teaching modules are being streamlined to make school more student-friendly.

Recommendations	Action taken since the previous *Survey (June 2009)*
Make vocational and technical education more attractive. Ensure that the vocational system is broadly based, in addition to delivering specialist skills. Develop a more systematic approach to disseminating information on vocational and technical training and ensure the provision of effective career advice and counselling, in line with international practice. Enhance the role of the social partners in the planning and implementation of vocational training policies and curricula.	An Integrated programme regarding the upgrading of the National Centre of Vocational Orientation was launched, in order to develop modern services of consulting and vocational orientation in the framework of Education and Initial Vocational Training as well as Continuing Training and Employment. The National Qualification Framework is being further developed for the certification of qualification, regardless of whether these skills are acquired during formal or informal education, and for the improved articulation of skill acquisition with labour market developments.
Increase school autonomy, in particular with respect to staff recruitment. Move towards a less centralised management governance structure.	No action
Improve school accountability through nation-wide measurement of student achievements. The outcomes of nationwide based assessments should be used to inform future policy development. Develop efficient evaluation system of teachers.	All primary and secondary schools will be evaluated under the "New School" policy according to their educational work. Establishment of the evaluation of teachers.
Proceed with the amendment of the Constitution to allow private universities.	No action
Implement swiftly a well-performing evaluation system of universities. The funding of institutions could be related to indicators of performance which are simple and transparent. Increase the autonomy of universities in terms of selecting staff.	A public consultation has been conducted on the reform of universities, aiming to enhance the responsiveness, quality and performance of the system through: the introduction of the Administrative Council for university governance; increased financial responsibilities for universities and performance based funding mechanism; assessment of academic excellence; more emphasis on student mobility and focus on research and technology. Based on the results, a draft bill is being formed referring to the National Strategy for the tertiary education.
Given the high number of drop-outs, a rigorous selection of students for entry to tertiary education should be maintained but it should be left to the higher education institutions themselves.	The change in the entry system to the tertiary education is under consideration, and will be part of the draft law referring to the National Strategy for the tertiary education which is currently being formed.
Introduce fees for undergraduate students (which also requires a Constitutional amendment) at a moderate level and provide student loans. If feasible to implement, repayment should be contingent on achieving a threshold salary after graduation. Increase the generosity of the grant system, but limit availability to the period over which the course is officially scheduled.	No action
PROMOTE TECHNOLOGY AND INNOVATION	
Improve support and funding to research and development (R&D) innovation programmes. Timely implementation of the Operational Programme for the Information Society.	A new Framework Law for Research and Technological Development, set to be finalized by end 2011, aims to encourage links between research community and businesses, expands fiscal incentives (fiscal conditions permitting) to support R&D, and improves the quality of research system.
LABOUR MARKET REFORM	
Lower the minimum wage for "vulnerable workers" (especially the young). In setting minimum wages, the social partners should take into account high unemployment rates of youth.	A 2010 law introduced sub-minimum wages for young workers (below 25) entering the labour market for the first time, subsidizing their social security contributions. The law also introduces one-year apprenticeship contracts for youths (15-18 year old), which will pay 70% of the minimum wage. A new law in 2011 provides for non-subsidised sub-minimum wages for youth 18 and 25 years. To acquire work experience, young can be be employed under fixed-term contracts of cumulated duration up to 24 months with wages that are 20% lower than those provided in the prevailing collective agreement (national or specific-level).
Encourage decentralised bargaining by avoiding administrative extension of collective agreements to parties not directly represented in the original agreements.	A new type of collective agreement, the special firm-level agreement, applying to all firms, allows the wages agreed at a firm level to be below the sectoral agreement.
Reduce non-wage costs, in particular social security contributions for the low-paid, financed by spending restraint.	Current arrangements allow the conversion of unemployment benefit payments into subsidies either to an employment subsidy for employers or as an opportunity for training.
Reduce severance costs for white collar workers and align them with those for blue collar workers. Transforming severance pay legislation into a system of individual accounts as in Austria should be considered.	A 2010 law *de facto* lowers total severance costs of white-collar by reducing their dismissal notice period, The law also introduces flexibility in the settlement of severance payments to cushion the impact of the economic crisis on firms.
Child care subsidies should be increased in order to raise female labour supply and family allowances be extended to single parents in charge of children, subject to fiscal constraints.	No action
Enhance the transition from school to working life. Improve further the quality and job-linkage of vocational training. Job-search-assistance or workplace training should be expanded. Encourage training of those already in the labour force.	24 separate programmes were introduced by the Public Employment Services (OAED) since early 2010 aiming to enhance job retention and the adaptability of workers and enterprises, facilitate the integration of unemployed in the labour market, promote entrepreneurship of the unemployed, and provide initial vocational training of young persons.
Establish a comprehensive system for assessing ALMPs.	No action

Recommendations	Action taken since the previous *Survey (June 2009)*
	PRODUCT MARKET REFORM
Enhance the effectiveness of anti-trust policies. Give the Competition Committee more political support to establish a "competition culture". Clarify the Committee's interaction with sectoral regulators.	A 2011 law reforms the legal framework of the Hellenic Competition Commission (HCC) brings about important changes in the structure and appointment procedure for the HCC board members. It also strengthens the independence of the competition authority and increases its effectiveness by enabling HCC to prioritise its cases and reject low-priority complaints, and by providing it with a more reasonable timeframe for the resolution of cases and stricter penal sanctions for cartels.
Facilitate the creation and exit of companies by reducing regulatory burden and monetary costs.	A unique Business Registry (GEMI) has been created in 2011 and one-stop-shops became operational consisting of a wide network of contact points. The number of procedures and/or documents required at the pre-registration or registration stage has been reduced.
Privatisation needs to be continued and privatisation limits should be abolished for all public enterprises.	The Medium-Terms Fiscal Strategy envisages a wide-ranging programme of privatisations for the period 2011-15, including the railway operator (TRAINOSE), Public Gas Corporation (DEPA), and Public Power Corporation (PPC).
Energy. Raise competition through the unbundling of the operations of the incumbents in the electricity and gas markets, and by ensuring a strong and effective sector regulator. Secure non-discriminatory third-party access to the network by giving the Hellenic Transmission Operator System (HTSO) full ownership of the network. Ensure the independence of the network operator by moving HTSO into government or private ownership.	Greece has chosen to adopt under the 3rd EU Energy Package the ITO (Independent Transmission Operator) model for electricity and gas transmission under which the Transmission System Operator remains part of a vertically integrated undertaking, but it is ring-fenced within it. In addition, PPC has set up two separate subsidiary entities for transmission and distribution. The responsibilities and operation of the energy regulator (RAE) are being enhanced as is the economic and administrative independence of RAE.
Ensure that electricity prices reflect marginal costs by removing cross-subsidies and preferential tariffs. Simplify licensing procedures for energy-related infrastructure.	A new system of regulated tariffs has been introduced which is expected gradually to align energy prices to wholesale market prices, except for vulnerable groups. A new social tariff was introduced for this category of consumers.
Consider transferring the Gas Transmission System Operator to full government ownership, or private ownership. Ensure the full operational separation of the existing gas distribution companies from the Public Gas Corporation (DEPA).	No action
Weaken the commercial, operational and/or financial links between major companies in the energy sector. Remove the Public Power Corporation's (PPC) "most-favoured customer" clause for its gas supplies from DEPA.	The existing supply contract between DEPA and PPC is currently under negotiation to reflect the new market conditions. The term of "most-favoured customer" included in the contract is not in effect any longer following the policy of customers' equal treatment that has been adopted by DEPA.
Abolish exclusive rights of PPC to use lignite mines.	The government has proposed EC to sell drawing rights for power generated by lignite-fired power-plants. EC's decision is pending.
Telecommunications. Speed up the unbundling of the local loop in order to stimulate the provision of broadband services by new entrants, reduce prices, and improve Internet penetration.	A comprehensive plan for enabling physical collocation facilitated increases in LLU lines, underpinned further by a national programme to promote broaband in the periphery.
Postal services. Further restructure the Hellenic Post and privatise it. Universal service obligations should be funded in a way that does not distort the market.	The Hellenic Post has proceeded to an internal organisational restructuring and it is now considering to restructure its network The complete opening of the postal market is to be achieved by December 2012.
Transport. The reform of the road freight sector should be speeded up by eliminating price restrictions and barriers to entry for trucks operating freight transport on behalf of a third party.	A law in 2010 provides for a gradual liberalisation (transition period of 2½ years) of the road freight transport, removing licensing re*strictions* that have constrained severely the road haulage capacity and abolishing administratively set prices.
Reforms in the railway industry need to continue to introduce competition in this market.	A business plan for the restructuring of railways has been approved in December 2010, with a 3-year implementation horizon (2011-13) aiming at improving the operation and effectiveness of the network infrastructure manager (OSE) and the railway operator (TRAINOSE) and paving the way for the privatisation of the provision of railway services and liberalisation of the sector.

Chapter 2

Sustainability cannot be achieved without structural fiscal reforms

The 2010 fiscal deficit was reduced mainly through across-the-board tax increases and cuts in civil service pay and pensions. Although these measures still have some role to play, for example in restraining public sector employment, social and equity considerations make their use more difficult going forward. Moreover, as is the case with higher tax rates, such measures cannot induce a lasting shift in government spending and revenue unless they are repeated frequently, which would be harmful for growth. Another drawback of these across-the-board measures is that they are of little use for enhancing the quality of public spending, which is also an important challenge for the authorities. The pursuit of fiscal consolidation must henceforth rely primarily on structural reforms to the public sector, such as those included in the government medium-term fiscal strategy. These are necessary to produce a high and sustainable primary fiscal surplus and to improve public service quality, which is indispensable for resolving the crisis and which will require considerable effort in a great many areas.

The budget adjustment strategy will have to rely on structural fiscal reforms going forward

A better fiscal framework and monitoring mechanisms of budget implementation are needed

Shortcomings in fiscal management have been a major cause of the deterioration in the Greek public accounts in recent years. Budgets have traditionally been prepared through a "bottom-up approach", based on the budgetary wish lists of the various units of the public administration, without any "hard budget constraint" on overall expenditures, or any solid multiyear budgetary framework (IMF, 2010). The financial quantification of these choices has often been weak and control over budget execution has left many loopholes. Moreover, Parliament has had a limited role. For example, its approval is not required for the adoption of supplementary budgets during the course of the year, in contrast to most other OECD countries. More generally, the budgetary consequences of laws voted by Parliament have hitherto been rarely evaluated. The absence of any effectively binding constraint on the borrowing capacity of public enterprises, which enjoy the *de facto* guarantee of the government, has contributed to the budgetary slide, as has the inadequacy of controls over expenditure commitments by various public entities such as the hospitals. These practices explain the sharp increase in indebtedness caused by injections of capital or recognition of contingent liabilities since 1995, quite apart from the accumulation of deficits. The situation has also been made possible by the lack of information on budget execution. Until recently, the authorities had only fragmentary data, measured on a cash basis, for tracking the accounts of government entities during the course of the year, and these were moreover bedevilled by statistical problems.

In July 2010 the authorities undertook an in-depth reform of budgetary management to remedy these problems. Measures included: *i)* a top-down approach to budgetary preparation, which involves setting a government-wide expenditure ceiling as well as deficit objectives for the various subsectors; *ii)* limitations on borrowing capacity for the various public entities; *iii)* budgeting of larger contingency reserves to deal with unforeseen events; *iv)* the requirement to seek parliamentary approval if expenditures exceed appropriations including reserves; *v)* mechanisms for controlling expenditure commitments; and *vi)* the requirement to publish regular data on budget execution. It has also been decided to make budgets part of a detailed medium-term framework covering all government activities, to define and articulate strategic guidelines for the public finances.

The progressive implementation of these measures has already produced some beneficial effects, but problems persist and strict implementation of this reform needs to be accelerated. The 2011 budget is the first to have been prepared and to be executed under these new procedures. In this framework, the monthly appropriations allocated in 2011 to each ministry will be limited to 1/14 of the annual appropriations until September, at which time the Minister of Finance will decide how to allocate the remaining funds. There is now better information available on budgetary execution on a cash basis and on government payment commitments, but progress in terms of the quality and timeliness of publication of data for local governments and the social security system has been slower and should be accelerated. The heavy payments arrears that these sectors experienced in 2010 partly explain why there was slippage in the deficit, measured on a transaction basis, even though the cash target was exceeded. Controlling expenditures as of the point of commitment rather the point of cash payment should be extended in 2011 beyond the central government, with the creation of commitment registries across all government entities under the control of officers reporting to the Ministry of Finance. Penalties are in place and are to be strictly applied for failure to publish this information within the established deadlines, to improve the tracking of budget execution as swiftly as possible.

The authorities have also adopted a medium-term budget plan for 2012-15. The objective is to reduce the public deficit to almost 1% of GDP in 2015, which implies a deficit reduction of about 6½ percentage points of GDP from its expected level of 7½ per cent of GDP in 2011. Achieving this will require measures on the order of 10% of GDP (Table 1.2, above), to, in part, offset the increased burden of interest payments. While large, the overall budget adjustment of about 9% of GDP (or EUR 22 billion) over four years is equivalent to what has already been achieved for the year 2010 alone. To meet this target, the medium-term fiscal strategy (MTFS) adopted by the authorities in end-June 2011 will favour expenditure cuts (4.8% of GDP) over revenue increases (4.2% of GDP).

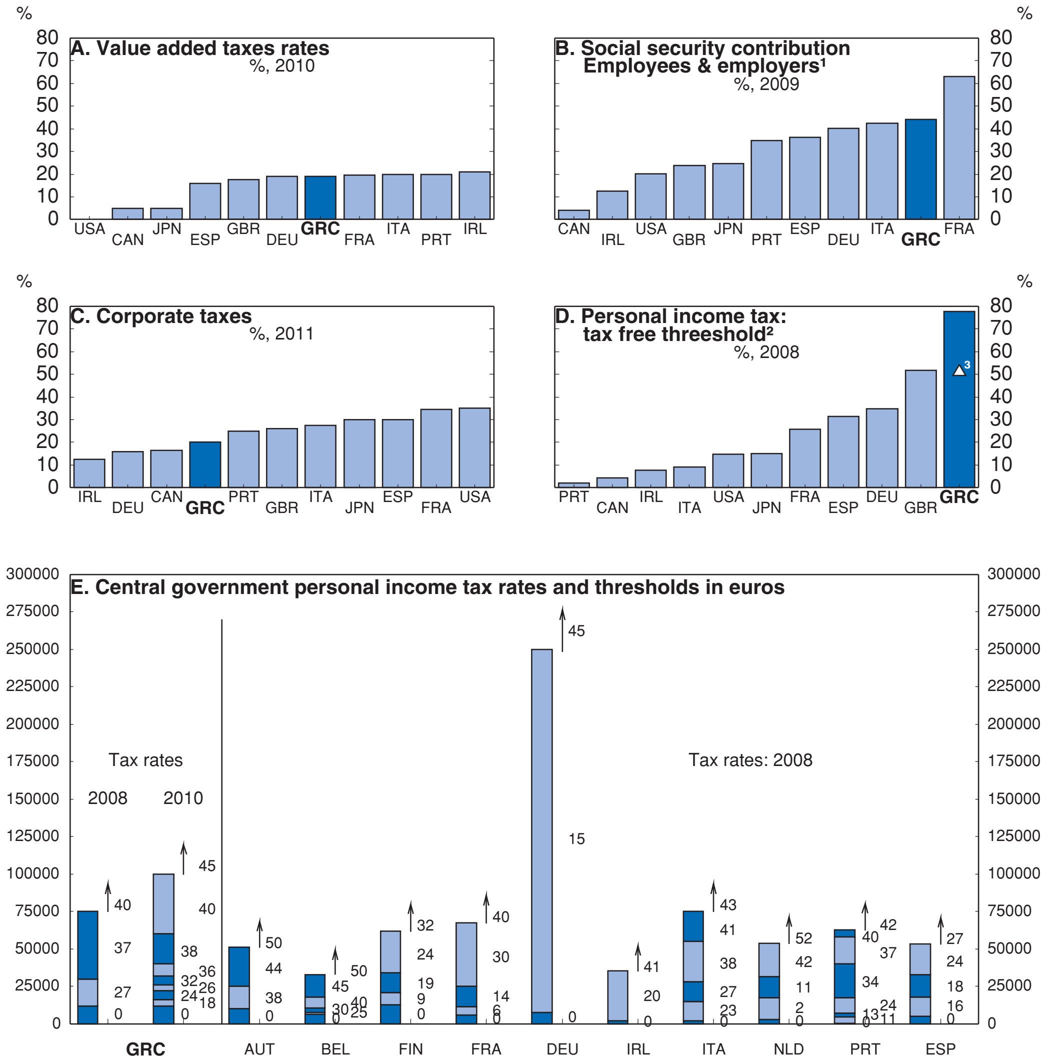
The authorities should pursue these efforts to improve the budgetary framework in several directions. It would be desirable to arrange promptly for publication of quarterly estimates of central and general government financial balances on a transactions basis. The budgetary impact of laws presented to Parliament should also be systematically assessed. The recent measures taken to boost automobile sales by granting cash bonuses for scrapping old cars, for example, do not seem to have been the object of such an evaluation. These assessments should moreover be conducted from a medium-term perspective and then built into the medium-term budget plan to ensure that they are reliable and regularly updated. This is the approach used in many other OECD countries.

Fighting tax evasion and improving the tax system needs to continue

The significant consolidation needed to place the public finances on a sustainable path will not be achieved without a hefty increase in tax revenues, which will require meaningful progress in the efficiency of collection and in combating tax evasion. The tax collection problem is hard to quantify precisely, but there is consensus that it is more serious than in most other OECD countries. This finding is based in part on the relative weight of the underground economy, which is estimated at around 25% of GDP in Greece, or 12 percentage points of GDP higher than the OECD average (Schneider, 2009). This implies significant losses of fiscal resources, of some 2 to 4% of GDP per year.[1] Moreover, the amount of taxes collected in proportion to GDP (the effective rate) is also well below the average for OECD countries and the euro area (Figure 1.10, above), even though statutory rates are not generally lower than in other countries (Figure 2.1, Panels A, B and C).

International comparisons and studies conducted in Greece suggest that the most acute problems of efficiency and evasion relate to personal income tax. Revenues from this tax were more than four percentage points of GDP lower than the average for the euro area between 2005 and 2009, despite comparable statutory rates (Figure 2.1, Panel E), and similar levels of income, measured as a proportion of GDP according to the national accounts. For 2009, 94% of taxpayers reported annual incomes of less than EUR 30 000, and

Figure 2.1. **Comparison of statutory tax rates in selected OECD countries**



1. The contribution rate shown here concern the lowest wage brackets in the countries where these contribution rates vary with wage levels.
2. Measured as a proportion of household disposable income plus personal income taxes per capita.
3. Impact of reduction of the tax-free threshold from EUR 12 000 to EUR 8 000 planned by the medium-term fiscal strategy.

Source: OECD, *OECD Tax Database*; Bank of Greece and Greece, Ministry of Finance.

StatLink http://dx.doi.org/10.1787/888932473967

only 3 000 individuals reported incomes exceeding EUR 200 000 (Ministry of Finance, 2009). The incidence of evasion of this tax was between 2½ per cent and 3¾ per cent of GDP, according to available analyses (National Bank of Greece, 2010; Matsaganis and Flevotomou, 2010), and related to a large extent to the income of self-employed, who are an important part of the Greek economy (24% of GDP on average between 2005 and 2009, compared to 12½ per cent for the euro area average, or of similar size than the informal sector). As in many other OECD countries, they are more likely than employees to under-declare their income. Around 70% of the self-employed declare incomes lower than the minimum taxable threshold of EUR 12 000, which is comparatively high in Greece (Figure 2.1, Panel D). There is also a serious problem in collecting the VAT and social contributions. Around 30% of VAT due is not collected, compared to around 12% on average for the EU (Ministry of Finance, 2009). According to the biggest social security fund (IKA), 10% of enterprises inspected in 2008 were not paying social contributions, and more than a quarter of workers, typically holding insecure jobs in construction, tourism or retail trade, were not declared (Matsaganis and Flevotomou, 2010). International comparisons of efficiency in the recovery of these two taxes highlight the importance of these difficulties (Table 2.1). They also show a relative weak efficiency of the corporate income tax collection. If Greece could collect VAT, social security contributions and corporate income tax with the same efficiency as its main partners do, it could boost its tax revenues by about 4¾ per cent of GDP per year.

Table 2.1. **Efficiency of tax collection**

2008 in percentage

	Effective rates			Statutory rates			Tax efficiency		
	VAT/CP[1]	SSC/WSSS[2]	Corporate/ GDP	VAT	SSC[3]	Corporate	VAT	SSC	Corporate
	[1]	[2]	[3]	[4]	[5]	[6]	[1]/[4]	[2]/[5]	[3]/[6]
Austria	14.79	13.70	2.46	20.00	21.63	25.00	0.74	0.63	0.10
Belgium	13.45	16.38	3.33	21.00	34.55	33.99	0.64	0.47	0.10
Canada	4.80	5.21	3.32	5.00	7.47	19.50	0.96	0.70	0.17
Czech Republic	14.20	22.98	4.18	19.00	35.00	21.00	0.75	0.66	0.20
Finland	16.27	18.32	3.50	22.00	24.00	26.00	0.74	0.76	0.13
France	12.27	21.17	2.91	19.60	41.70	34.43	0.63	0.51	0.08
Germany	12.48	13.28	1.89	19.00	19.51	18.83	0.66	0.68	0.10
Greece	**9.74**	**15.80**	**2.48**	**19.00**	**28.06**	**25.00**	**0.51**	**0.56**	**0.10**
Hungary	14.28	20.12	2.61	20.00	29.00	20.00	0.71	0.69	0.13
Ireland	13.94	7.41	2.82	21.00	10.75	12.50	0.66	0.69	0.23
Italy	10.09	22.01	3.71	20.00	32.08	27.50	0.50	0.69	0.14
Japan	4.27	9.46	3.78	5.00	12.63	30.00	0.85	0.75	0.13
Korea	7.80	5.52	4.23	10.00	9.79	25.00	0.78	0.56	0.17
Netherlands	15.96	9.82	3.16	19.00	12.30	25.50	0.84	0.80	0.12
Poland	12.77	12.72	2.71	22.00	18.43	19.00	0.58	0.69	0.14
Portugal	12.55	15.14	3.63	21.00	23.75	25.00	0.60	0.64	0.15
Spain	9.04	18.07	2.80	16.00	30.15	30.00	0.57	0.60	0.09
Sweden	19.77	16.20	2.99	25.00	32.42	28.00	0.79	0.50	0.11
Switzerland	6.58	5.03	3.31	7.60	11.05	8.50	0.87	0.46	0.39
United Kingdom	9.92	7.42	3.56	17.50	12.80	28.00	0.57	0.58	0.13
Unweighted average of above countries, excluding Greece	**11.85**	**13.68**	**3.21**	**17.35**	**22.05**	**24.09**	**0.71**	**0.63**	**0.15**

1. Ratio of the revenue from value added taxes to private consumption.
2. Ratio of revenue from employers' social security contributions to compensation of employees.
3. Employer's social security contributions.
4. The tax receipt increases are estimated by assuming the tax efficiency reaches above countries average when is it bellow it.

Source: OECD, *OECD Economic Outlook Database*; OECD, *OECD Tax revenue Database* and OECD calculations.

Weak tax collection can be ascribed to many sources, primarily the taxation system and taxpayer attitudes. Tax cheating is facilitated and encouraged by a high tax wedge, a complicated tax system and a lack of precision in the underlying legislation, which increases compliance costs (Katsios, 2006; OECD, 2009). There are numerous exemptions and deductions from most taxes, narrowing the tax base and undermining the perception of tax fairness. This fairness problem is exacerbated, both in horizontal and in vertical terms, by the tax evasion on household income. Tax evasion is more common among the well-to-do than among the middle classes or the poor, and varies substantially between individuals who have similar income levels but are engaged in different activities (Matsaganis and Flevotomou, 2010). This situation stiffens people's resistance to paying taxes, particularly when they feel, as many do, that their funds are being mismanaged and wasted.

The administration's inability to contain tax evasion is another serious impediment to the efficiency of tax collection. The evasive behaviour of taxpayers will depend on their income, their marginal tax rates and, above all, their subjective assessment of whether they will be caught and punished (Yitzhaki, 1974; Matsaganis and Flevotomou, 2010). There are notorious shortcomings in the Greek administration's ability to detect, prosecute and punish tax evaders. At the end of 2009 there were EUR 33 billion (14% of GDP) in hard-to-collect tax arrears owed by 1.3 million taxpayers, more than 4 million tax cases had yet to be audited, and more than 150 000 cases were pending judgment. Moreover, it takes on average between 7 and 10 years to render a definitive verdict in tax cases, severely limiting the government's ability to resolve these cases swiftly and fairly (Ministry of Finance, 2010). Finally, in an effort to clear some of this backlog, the governments have had tax amnesties nearly every year, but this practice is likely to have encouraged people not to pay taxes when due as the expected penalties are low.[2]

Poor performance in tax collection and the burgeoning of the underground economy are also related to the structure of the economy and to excessive market regulation. As noted above, it is difficult to combat tax evasion by self-employed. The specific economic structure of Greece, the dominance of very small firms, is in turn influenced by the incentives stemming from the deficiencies of the tax system and its administration and, more generally, from the invasive government regulations that affect market functioning. The fact that the proportion of self-employed workers and micro enterprises is shrinking more slowly than in similar countries of the OECD (Figure 1.15, above) is another negative spillover from tax evasion on labour supply and demand. Tax evasion in effect acts as a subsidy to the underground economy and small firms which evade taxes, and it imposes a double penalty on firms that obey regulations: it adds to their tax burden and it distorts competition.

The government has adopted a comprehensive approach to improve the tax system and tax collection

The economic adjustment programme rightly places great emphasis on improving tax collection and combating tax evasion and bribery. More than a third of the fiscal consolidation planned over the medium term for reducing the government deficit to around 1% of GDP by 2015 relies on an increase in revenues. That increase, which represents around 5 percentage points of GDP between 2009 and 2015, would come in part from the higher VAT, excise taxes, property taxes, and transfer and succession duties introduced in 2010. In addition, further increases in taxes and social contributions are planned by the MTFS.[3] The reforms adopted in April 2010 and February 2011 have also improved prospect for tax collection by simplifying the tax system and introducing provisions to address various causes of evasion. These measures have been complemented by additional reforms included in the MTFS to enhance tax compliance and reduce contribution and tax evasion.

One thrust of these reforms was to rationalise the personal income tax by introducing a single rate scale applicable to most sources of income (including dividends) and broadening the tax base. Some deductions have been eliminated[4] and certain "perks", such as company vehicles offered to senior staff, have been rolled into taxable income. Provisions have also been introduced to take into account taxpayer's actual standards of living in assessing their taxable income with the view to address, in particular, the issue of under-declaration of taxable income by the self employed workers. In end-June 2011, the MTFS introduced further measures to broaden the tax base and reduce tax exemptions. For instance, the tax-free threshold for the property tax will be reduced from EUR 400 000 to EUR 200 000. Moreover, the personal tax-free threshold (Figure 2.1, Panel D), which seems very high in international comparison, will be reduced from EUR 12 000 to EUR 8 000, with income between EUR 8 000 to EUR 12 000 taxed at a rate of 10%, except for pensioners above the age of 65 and young workers aged below 30. In addition, the VAT tax base has been broadened to cover legal and notarial services, which were previously exempt. To curb VAT evasion, taxpayers are required as of 2011 to present invoices for their goods and services expenditures to qualify for the standard EUR 12 000 tax-free income deductions. The real estate property tax has also been reformed and its rates have increased. Greece has implemented environmental tax reforms and the inheritance tax base has been broadened (the exemption for main residence has been abolished).

A second aspect of the reforms was to improve the tools for combating tax evasion, in particular through the use of audits. Hitherto, the law called for the audit of all tax declarations, which was in practice impossible. Henceforth, the audit system will be based on identifying returns or classes of tax payers most at risk of evasion. A new position has been created, that of the "Attorney General for Economic Crime", with nationwide powers to improve the coordination and conduct of tax fraud investigations. The Financial and Economic Crimes Unit (SDOE) has been re-established with greater powers to issue tax fines on the spot. Penalties for fraud have been increased and appeals filed against the initial decision will no longer have the effect of suspending payment of the penalty. Efforts have also been made to address the problem of the large backlog of tax cases in courts. An independent arbitration board has been created to speed the settlement of tax disputes involving amounts of more than EUR 150 000. Arrangements for administrative cooperation and the exchange of information with other countries in the area of direct taxation have been reinforced. The Minister of Finance also has the right to waive tax secrecy and to disclose the identity of persons who use false documents in their tax declarations and of persons who have a tax debt exceeding EUR 150 000 for which they are more than a year in arrears. A transparent procedure was also instituted for segregating tax arrears that are recoverable from those that are not. Of the stock of EUR 33 billion in tax arrears outstanding at the end of 2009, only EUR 8 billion is judged to be recoverable. On this basis the government issued a yet another amnesty for the balance in the second half of 2010.

Measures have also been adopted to improve compliance in the collection of social security contributions and the control of pension payments. Under the new pension law (see below), all transactions (contributions, benefit payments) to all social security bodies will be made through the banking system. The reform also establishes a pension audit system to cross-check beneficiaries by using their social security number (AMKA). The reform also sets penalties for contribution evasion and conditions for the repayment of overdue contributions.

The last aspect of the reforms was to improve the discipline, transparency and functioning of the tax administration, by raising the bar for hiring tax auditors, and strengthening their supervision. An Internal Affairs Department has been created within the Ministry of Finance to investigate, detect and punish involvement of tax personnel in acts of corruption. Measures have also been taken to limit direct contact between tax inspectors and taxpayers, to avoid possible collusion. Several tax inspection offices have already been reorganised and new directors have been appointed in most of the offices. These offices will now have measurable objectives to meet, and they will be subject to regular supervision. Moreover, as part of a three-year National Action Plan for combating tax evasion, presented in May 2010, the geographic distribution of tax inspection offices will be reviewed, with the objective of merging many of them and reassigning their human resources to focus on priority tasks. The Action Plan also includes a number of measures to make the way the tax administration works more user-friendly and increase voluntary compliance through tax advisory services for citizens and electronic tax declarations.

But more can be done

These numerous reforms are welcome, but it is too early to tell whether they will resolve the country's tax management issues. Their effects are likely to take some time to be felt and, in fact, the initial results of these various measures and initiatives have been rather disappointing. Tax collection, and in particular the proceeds from taxes on individuals, still fall short of expectations. As noted above, VAT revenues did rise in 2010 despite weak consumption, but not by as much as forecasted.

Given the urgency of improving tax collection for resolving fiscal problems, the authorities should develop and publish a series of indicators for tracking the effectiveness of measures taken at the different stages of the taxation process, even before their financial effects are felt. This would allow any additional adjustments needed to be detected up front. Indicators developed and published on a regional or local basis could also encourage emulation among tax inspection offices and urge them on to greater effort, especially if bonuses were bestowed on agencies for good performance. A decisive reduction in tax evasion is indispensable for reasons of fairness and for legitimising the sacrifices imposed on the Greek public through the reductions in public spending and social transfers. Tangible results with the administration's progress in terms of tax collection will constitute for many observers one of the keys to the success of the adjustment programme. From this viewpoint, resort to the "naming and shaming" of significant tax evaders can play a very important role. It could be advisable on this point to lower the thresholds for naming evaders, and considering a systematic rather than the discretionary approach for naming tax evaders. Other countries, such as Ireland and the United Kingdom, have adopted a similar scheme of "naming and shaming", with a lower threshold (£15 000 or about EUR 17 000 in the UK) and a quite narrowly defined discretion given to the Tax Authorities to enforce this provision (OECD, 2010a). Ultimately, such efforts will also have to be backed up by visible and successful prosecution of tax evaders, and the imposition of meaningful penalties. The scope and the use of tax compliance certificates should also be widened. For instance, these tax certificates could be required to access some public services, such as the delivery of a passport, to be eligible to a job in the public sector or to create a business or each time individuals or firms need to obtain insurance or bank credit. The government could also envisage publishing the revenue declaration of all taxpayers, as in some Northern European countries. It is also important to put an end to tax amnesties, once and for all.

As envisaged by the National Action Plan, the authorities should also move to centralise the collection of taxes and of social security contributions by placing them under the control one agency, to facilitate cross-checking and verification of information. The recent creation of a national social security register is a step forward in this regard (OECD, 2009). In general, a wider recourse to IT and information management system to facilitate cross-checking between multiple source of information should be promoted, including for improving the traceability of large assets acquisition by individuals.

Further efforts to simplify the tax system and make it more transparent should be pursued. For example, progress needs to be made in abolishing the large number of the taxes collected on behalf of third parties which, as discussed in previous *Surveys*, distort resource allocation and reduce the transparency of the tax system. The government introduced these levies, which represent a significant cost, to finance various institutions, such as the pension funds of lawyers and engineers. They are usually collected by various intermediaries such as banks and public utilities, and paid to the final recipient, generally without being recorded in the State budget (OECD, 2001). The authorities should also continue to systematically review the remaining exemptions and deductions, as seems envisaged in the MFTS. Those that cannot be justified should be deleted. Some are in place for good social reasons, but they could be replaced by more effective income transfer instruments. The tax-free threshold for income, which will remain high even after taking into account the reduction planned by the MTFS (Figure 2.1, Panel D), could be reduced further to enlarge the tax base.

The VAT should also be simplified by reducing the number of rates from six. The specific rates now applied to the frontier islands should be eliminated and replaced, to the extent necessary, by better targeted direct subsidies. Farming activities should also be subject to the general VAT system and the income tax. Tax exemptions on fuel for agricultural use should be abolished, as they encourage the diversion of tax-free fuel to the black market. Consideration could also be given enhance tax compliance for the self employed through the introduction of withholding taxes, as is the case of Ireland.

An overhaul of the public employment system would enhance service quality and contain costs

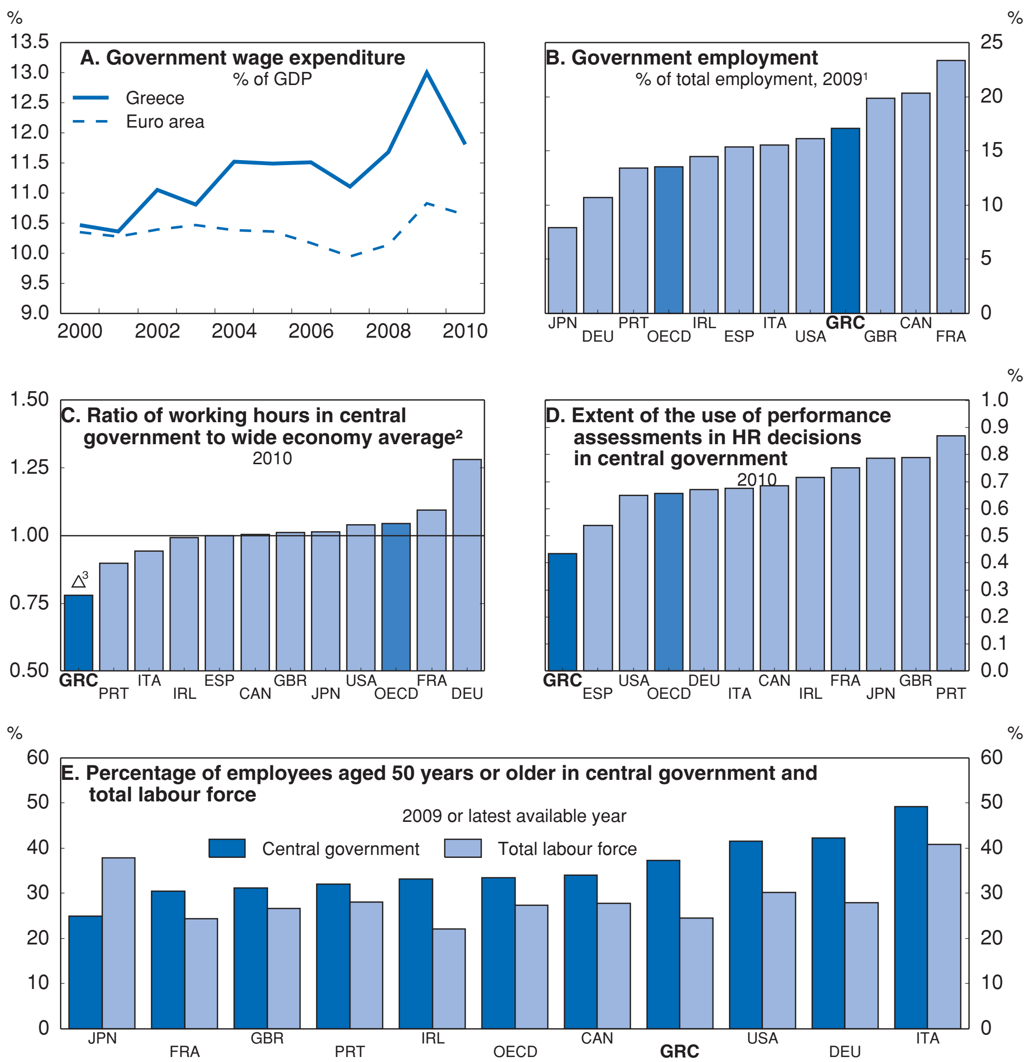
An important issue for fiscal consolidation is better control over the public payroll. Over the past decade, that payroll has grown faster, and is now higher in relation to GDP, than the euro area average (Figure 2.2, Panel A). Gaps in Greek statistics make it difficult, however, to pinpoint how this happened. The only reliable data on government employment, which are for 2009 and 2010, show that civil servants account for a larger portion of total employment in Greece (17%) than the euro area or OECD average (15¼ per cent)[5] (Figure 2.2, Panel B). Wage comparisons are difficult because the pensions paid to retired civil servants are included in the total payroll along with remuneration of those still working. Yet civil servants' wages seem to have risen sharply between 2000 and 2009. A recent survey indicates that wages per employee in the public service are 30% to 40% higher than those in the private sector (Ministry of Employment, 2011). While this reflects, in part, the higher qualifications of public-sector employees, there nevertheless remains a 10% discrepancy for workers with similar characteristics, and that discrepancy is more pronounced for persons with the lowest qualifications. Measured on an hourly basis, the pay gap is wider yet because normal hours are much shorter in the public than in the private sector (Figure 2.2, Panel C).

Inadequate control over the public payroll translates into structural difficulties in managing general government employment and remuneration. The pay system is extremely fragmented, complex and difficult to manage in a coherent manner (OECD, 2009). It differs from ministry to ministry and it includes a multitude of allowances that represent on average more than 40% of total remuneration. This system moreover takes very little account of employees' competence and performance (Figure 2.2, Panel D). There is very little wage differentiation as a function of level of education and wage progression from beginning to end of career is modest.[6] Management of staffing levels is also deficient. Given the lack of staffing data for government departments and ministries, human resource planning is virtually nonexistent (OECD, 2008a), and staff is often not allocated properly. Notwithstanding general overstaffing, some public entities, such as the hospitals, are chronically under-staffed for certain positions. These staffing allocation problems are reinforced by rigidities in human resource management: part-time employment is not allowed and there is little mobility for personnel within the administration. Moreover, because hiring procedures are often extremely slow – they may take several years to complete – positions are often filled through temporary contracts, which are eventually transformed into permanent jobs. A non-transparent recruitment mechanism of this kind is open to abuse and favouritism (OECD, 2008a).

Stricter control over payroll costs has led to the recent adoption of several measures, including a hiring policy that calls for replacing only one of every five public servants who leave between 2012 and 2015 (one for every ten public servants in 2011) and a significant reduction to fixed term contract employees (50% in 2011 and 10% in later years). This comes in the wake of a drop of nearly 3% in staffing levels in 2010, according to Bank of Greece estimates. According to that same source, the new restrictions should produce a cumulative decline of more than 17% in public employment between 2009 and 2013, or around 135 000 positions. In May 2011, the authorities decided to increase the civil service workweek from 37½ hours to 40 hours, bringing it more in line with the private sector. There have also been significant adjustments to remuneration. In 2010, wages per employee are estimated to have been cut by 8½ per cent, and an additional trimming of some 4% is expected in 2011 and 2012. Overall, general government wage outlays fell by 1¼ percentage points of GDP in 2010 and is to decline by an additional point to 2015 according to the authorities' medium-term fiscal plan. This would broadly offset the 2½ percentage point increase between 2000 and 2010.

A number of supplementary measures are now in preparation to improve management of personnel and remuneration in the public sector. Job transfers, representing between 30 000 and 50 000 persons, have been arranged between selected overstaffed public enterprises and local administrations and other sectors of government. Moreover, staff exceeding the number needed in public-sector entities will be assessed on the basis of objective criteria of merit (to be determined by a Presidential Decree) and will be remunerated for 12 months at 60% of their current earnings provided they are not working. Individuals on this list can move to public-sector entities with vacancies (on regular, fixed-term or part-time contracts) or quit on the basis of a "special voluntary retirement program". A "Single Payment Authority" has been created to centralise and rationalise wage management. The authorities plan to submit a reform, in the course of the second half of 2011, to simplify, modernise and reinforce control over remunerations. That reform, which has been discussed with the social partners, should reduce the burdensome component of bonuses and allowances in remuneration, eliminate unjustified wage gaps among workers, and take better account of civil servants' qualifications and performance. Overtime hours have for instance been already limited to a maximum 20 hours per month, which is a reduction of around 67% compared to the limit

Figure 2.2. **Employment and remuneration in the government sector**



1. Greek employment for the government sector in 2009 is obtained from Greek authorities. OECD is aggregated based on available Countries in 2009.
2. Ratio is based on two different years: 2010 for average working hours per year by central government employees and last available figure of average working hours per year by wide economy.
3. Impact of the increase in the working hours from 37½ to 40 in central government.

Source: OECD, *OECD Economic Outlook Database* and OECD (May 2011), *Government at a Glance 2011*.

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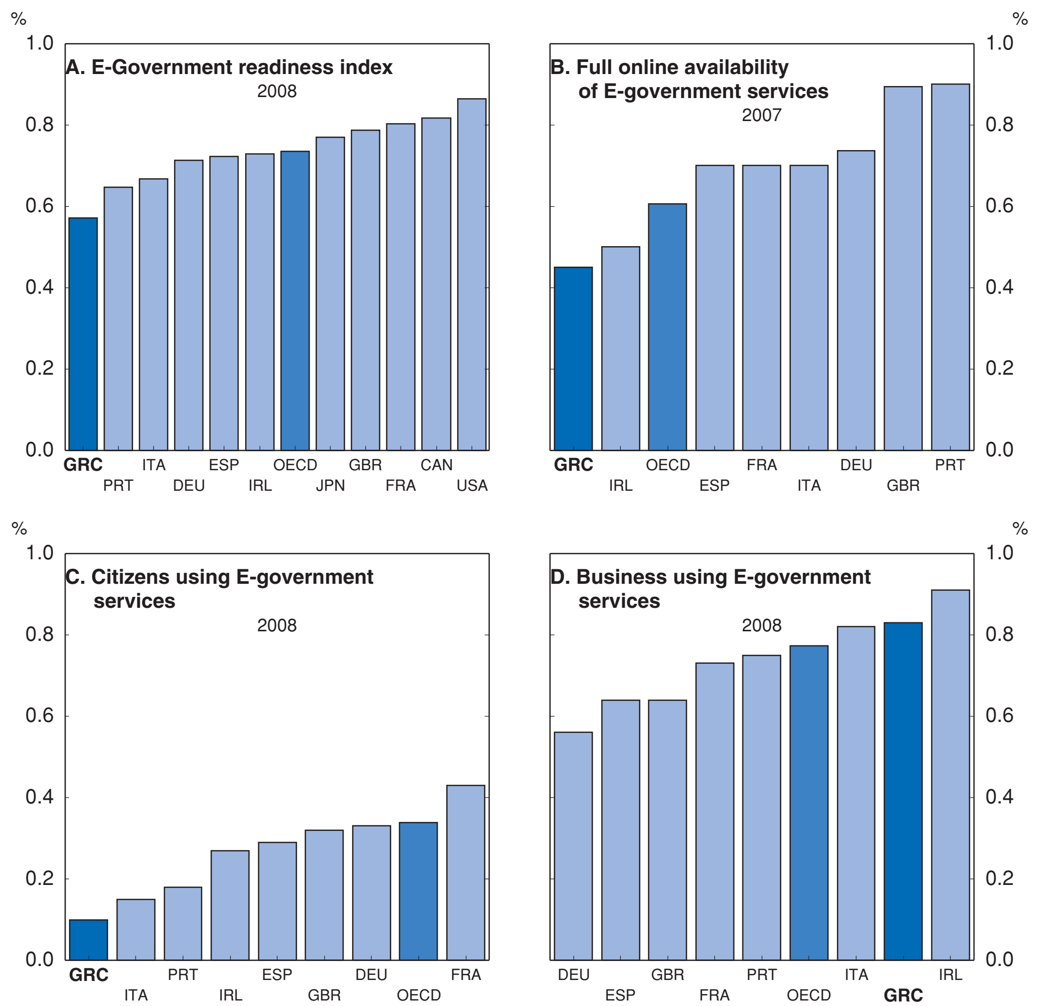
prevailing until March 2010. Lastly, measures accompanying the MTFS have authorised part-time work. More specifically, employees under regular (full-time) contracts in the public sector, entities of public law and local government can now apply for a reduction of hours up to 50% for a maximum period of 5 years with a commensurate reduction in earnings.

The measures announced or planned by the government go in the right direction. They should be implemented and carefully monitored. On this point, the announcement that staffing levels will be tracked and published regularly is a welcome development. The availability of information on the structure and trend of public-sector pay will also be useful in the future. On the statistics front, it will be important to distinguish spending on pensions for retired public servants from remuneration for those still working. The authorities must have proper tools for containing the growth in the public payroll, and in particular the effect of wage drift, which seems to have been rather pronounced in the past (OECD, 2009), and is likely to accelerate in the future, as 80% of retirees will not be replaced as the public service will get older. Employees who wish to move to a part-time basis should have the opportunity to do so. The authorities should also seriously rethink the current lifetime guarantee of employment for new recruits to the civil service, as several OECD countries have done (*e.g.* Australia, Sweden and the United Kingdom), and replace it with open-term contracts, similar to those for private sector employees (OECD, 2008b). This might require substantial legislative changes since public servant positions are protected by the constitution. The MTFS adopted in end-June 2011 has already made a welcome step in this direction. It provides that, under certain conditions, employees in many public enterprises and in state-controlled banks, who currently *de facto* enjoy a virtual lifetime guarantee of employment like the civil servants, will be submitted to the same rules as private-sector employees if their contracts are to be terminated because of an intended dismissal. Another important thrust of the reforms is to improve the way government uses and allocates its human resources, so as to respond more effectively to the needs of the public. This will require a clear strategy for distributing public employment, in light of government objectives and the constraints imposed by the fiscal situation. The current age profile of the civil service offers an opportunity to improve this quickly over the next few years (Figure 2.2, Panel E). It is also important to enhance mobility for employees within the government and to improve the hiring system to make it faster, stricter and more transparent.

Improving the quality of public services will also require a greater commitment to ethics and efficiency on the part of individual employees. It would be helpful in this respect to develop a culture of appraising employees' performance against a clear set of objectives that are determined individually and that are consistent with the authorities' overall strategy. Provisions for recognising and rewarding effort as well as for effectively punishing unsatisfactory behaviour, corruption in particular are now in place in the tax administration and should be extended to all areas of government.

The fact that the civil service will have to be reduced for budgetary reasons offers an opportunity to improve its productivity. From this viewpoint, significant efficiency gains could be achieved through the introduction of e-government. Recent efforts in this direction, with establishment of the "one-stop shop" where businesses can conduct certain administrative procedures, are encouraging (Chapter 3). More should be done as well to facilitate interaction by private citizens with government departments and agencies (Figure 2.3). To improve the efficiency of public services, the authorities should also pursue their effort to ensure a good implementation of the deep local government reform (Kallikratis) adopted in June 2010. The reform slashed the number of municipalities from 1034 to 325, replaced 57 prefectures by 13 elected regional authorities and 13 (appointed) regional authorities by 7 central administrative authorities. In addition, earmarked central government transfers to local governments will be frozen at their 2011 level, according to the MTFS. There is further room for efficiency gains at the central administration level and in the social domain as recognised by the authorities. Two functional reviews have thus been launched with the OECD help, with the first aiming at streamlining the functioning of the administration, including by merger and closure of overlapping public entities. The second review focuses on the need to better target a number of social programmes. Most of them are for instance not means-tested and there is not clear articulation between income support benefits and active inclusion measure, in particular on the labour market (Chapter 3). Initial reports on these functional reviews are due for the end of June 2011. Nevertheless, the MTFS already includes some directions for better targeting of social benefits: unemployment benefits will be means-tested from 2012 onwards and employment subsidization programmes rationalised; social benefits in cash and in kind will be reviewed with the objective of abolishing the least effective ones.

Figure 2.3. **E-government development**



Source: Panel A: United Nations E-Government Readiness Knowledge Base, *www.unpan.org/egovkb*; Data extracted on 30 July 2008. Panel B: EC DGISM (2007) The User Challenge: Benchmarking The Supply Of Online Public Services, 7th Measurement, September. Panel C: Eurostat (2008) *http://ec.europa.eu/eurostat*, Data navigation tree – Information Society Statistics – Information Society: Structural Indicators – E-government usage by individuals (demand side) total and by gender; Data accessed on 5 June 2008. Panel D: Eurostat (2008) *http://ec.europa.eu/eurostat*, Data navigation tree – Information Society Statistics – Information Society: Structural Indicators – E-government usage by enterprises (demand side); Data accessed on 5 June 2008.

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Restructuring the state-owned enterprises is indispensable to cut debt build-up

There are more than 180 state-owned enterprises (SOEs, including those created at the local government level), covering a broad spectrum of activities that includes transportation, telecommunications, energy, real estate management, defence, aviation, culture, leisure and recreation, lotteries and textiles. For many years now they have contributed to the deteriorating fiscal situation and the accumulation of public debt. In 2009 their combined losses amounted to 0.7% of GDP, and when the debts of several of these firms were rolled into the revised general government accounts in November 2010 they increased the public debt by nearly 8% of GDP (see Box 1.1). Their persistent financial problems can be explained to a large extent by a lack of proper business management. The government, for its part, imposes no real budgetary constraints on them, and at the same time it interferes frequently in their management, and particularly in their pricing policy. For their part, many public enterprises make little effort to increase their sales or revenues. It is estimated, for example, that between 20% and 40% of public transit users do not pay for the ride. With the exception of the telecommunications enterprises, these firms pay no dividends to the State. They tend to be overstaffed and their average pay levels are higher than those for public servants and private sector employees. Five of the 11 biggest loss making enterprises in 2009 had a payroll that exceeded their turnover. Labour costs for these 11 firms went up that year by a further 2% on average despite a staffing cutback of 4.5%, while their interest charges amounted to nearly 40% of income.

Remedial measures have been introduced to correct these shortcomings and to rationalise management. In 2010, steps were taken to cut expenses by 10% to 15%, with the result that losses declined marginally, to 0.6% of GDP, despite the recession. Losses are expected to fall to zero in 2011, thanks to additional savings of EUR 800 million; according to the medium-term fiscal plan, pursuit of these rationalisation efforts of SOEs to 2015 would yield savings of EUR 2.3 billion (1% of GDP). To achieve this objective, wage and salary costs will have to fall further. Personnel have been displaced to other sectors of government, which is however likely to only transfer the overstaff problem to other part of the administration rather than solve it, and there have been further pay cuts. Salaries in excess of EUR 1 800 per month have been reduced by 10%, a ceiling of EUR 4 000 (slightly less than about twice the average wage) has been set on monthly salaries, and the total of supplementary benefits and allowances may not exceed 10% of the payroll in these enterprises. Further reductions of 15% to 25% in non-pay expenses are also planned, as well as major increases in prices and fares, especially in the urban transit and rail enterprises to which the government has given priority in its restructuring efforts. All public enterprises will see their subsidies limited to a maximum of 40% of total costs, consistent with EU rules, and they will be required to submit business plans subject to close monitoring. To this end, a central register has been created to collect data on their revenues, employment, personnel costs and financial performance and, depending on the size of the enterprises, these data will be compiled and published on a monthly, quarterly or semi-annual basis. Internal controls have also been reinforced: the number of auditors has been increased, and their powers have been extended to oversee both pay and non-pay operating expenses. If the accounts show any deviation from the business plan, the enterprises will have to take corrective measures.

Beyond these necessary measures, the authorities will need to proceed with their announced intention to restructure or close down enterprises that are not viable and to make better use of the real estate assets. In the first quarter of 2011, the 16 large enterprises required to present monthly earnings statements succeeded in reducing their cumulative losses by 46% on a year-over-year basis. There has, however, been some slippage against the scheduled adjustment plan, especially in the case of the transit firms, because of the "I won't pay" movement that was sparked by the 20% to 40% fare hikes imposed in February 2011. Privatisation, in particular, will require efforts to clean up the finances of public enterprises. While the various provisions made to rationalise and bring greater transparency to public enterprises are welcome, the authorities must resist the temptation to micromanage these firms from the Ministry of Finance. What these firms need instead is clear objectives and sufficient management flexibility, including over such matters as employment and prices. A key corollary is heightened accountability of top managers. The measures adopted will make the management of these enterprises more transparent. As shareholder, the government must assess their performance and ensure that the expected financial improvements materialise. As a general rule, privatisation, liberalisation and/or appropriate regulation should go hand in hand to avoid the creation of private monopolies and to boost efficiency and growth (Chapter 3).

Long-term fiscal sustainability needs reforms in key public services

A major pension reform has substantially reduced the long-term vulnerability of public finances

The far-reaching reforms that the authorities have made in the pensions sector are of special importance. A series of national and international studies over the years had been stressing the need for pension reform to avoid the budgetary pressures that would inevitably result from population ageing (Mylonas and de la Maisonneuve, 1999; Borsch-Supan and Tinios, 2001). There were a number of gaps in the Greek pension system:

- The excessive complexity of the retirement regimes, with multiple pension funds operating according to different rules, made them difficult to manage. Although the 2008 reform simplified the system significantly, reducing the number of funds from 133 to 13, it failed to unify the parameters for calculating the pensions of the merged funds. Thus, the pension fund for private-sector employees, IKA, had some 800 distinct pension scales that varied, for example, according to the pensioner's trade and the date he or she entered the labour market (OECD, 2009).
- Financial penalties for early retirement before the legal age of 65 were not sufficiently dissuasive. A person who had contributed for 37 years, for example, was entitled to a full pension at age 58. A woman with three dependent children could claim full pension rights at some point between 50 and 55 years, after 20 years of contributions. Persons working for 25 years in a strenuous occupation could retire at full rate at age 55, after 35 years of contributions. In fact, a great many workers benefited from this provision: in 2006, 637 trades, covering 37% of new IKA pensioners, enjoyed such a right (OECD, 2007). Over the five-year period 2004-09, the average effective retirement age was at 62 and 59.5 for men and women, compared with 63½ and 63 in the OECD average (OECD, 2011a). The 2008 reform included a revision of this list of strenuous occupations, but it was to be applied only to new labour market entrants.

- The parameters for calculating pensions were very generous (excluding allowances under supplementary regimes). The replacement rate was calculated at between 70% and 80% of the average salary for the best five of the last 10 years worked, which was high by international standards. Moreover, workers had to contribute for only 35 years – five years less than in most other OECD countries – to be eligible for a full pension at the legal age of 65 (Table 2.2).

Table 2.2. **Main parameters of public pension schemes in selected countries**

For employees in the private sector, from 2015 onwards

	Statutory retirement age (men/women)	Contribution period for full pension (years)	Reference period for benefits	Average statutory benefit accrual rate	Indexation of benefits
Greece (New)	**65**	**40**	**Career**	**0.80-1.50**[1]	**Prices and GDP growth**
Greece (Old)	65	35	Last 5 years	2.57	discretionary
Canada	65	40	Best 34 years	0.63	Prices
France	To be raised to 62	To be raised to 42	Best 25 years	1.75	Prices
Germany	65	Not applicable	Career	1.00	Wage less sustainability factor
Italy	65/60	Not applicable	Career	1.75	Prices
Japan[2]	65	40	Career	0.55	Prices
Portugal	65	40	Career	2.00-2.30	Prices with additional adjustments[3]
Spain	To be raised to 67	To be raised to 37	Final 25 years	2.70	Prices
United Kingdom	To be raised to 68	44	Career	Flat-rate	Prices
United States	67	35	Best 35 years	2.57, 0.91 and 0.43 depending on slices of earnings	Prices

1. Estimates provided by the authorities. OECD preliminary estimates suggest that post-reform accrual rate under the main scheme should be 1.2% (without taking into account the supplementary pension funds).
2. Japan has a flat-rate scheme in addition to the earnings-related one
3. GDP growth is also taken into account in the indexation of benefits.

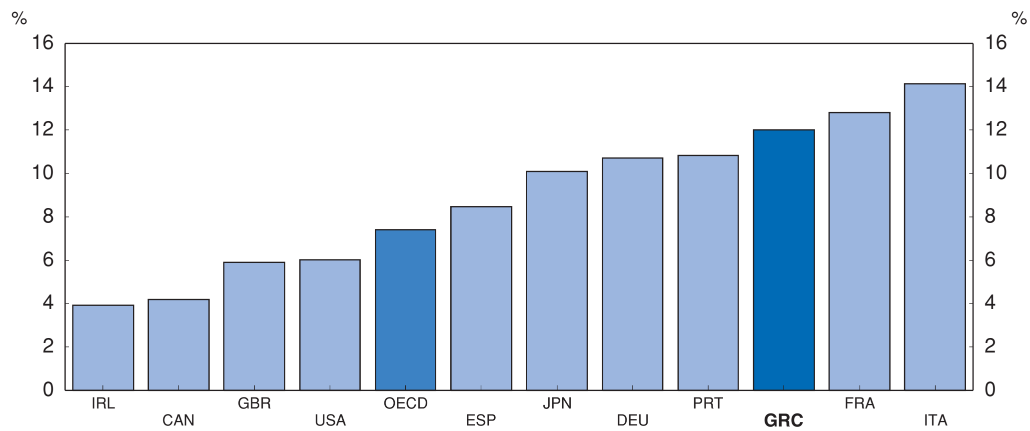
Source: OECD, *OECD Pensions at a Glance*, OECD, 2011.

In light of these parameters and demographic trends, Greece was facing a disturbing long-term financial outlook. While pension outlays, at nearly 12% of GDP in 2009, were already (Figure 2.4), calculations by the ILO and the European Commission, made prior to the 2008 reform, pointed to an increase of nearly 12 percentage points of GDP in those outlays by 2050, well above the forecast European average of 3 percentage points of GDP (ILO, 2008a, 2008b and 2008c; EC, 2009). Moreover, according to the National Actuarial Authority, the 2008 reform would not make a substantial dent in that trend (National Actuarial Authority, 2009; OECD, 2009).

In July 2010, the authorities finally adopted the provisions necessary to ensure long-term financial viability for the pension system, to strengthen its fairness, to simplify its management, and to encourage seniors to participate in the labour market. The pension reform, to be implemented gradually beginning in 2011, requires all pensions to be calculated as the sum of a basic allowance and a contributory pension linked to the amount and duration of contributions, beginning in 2015 (Box 2.1). The generosity of the system has been reduced and brought into line with that of most other OECD countries (Table 2.2). Lastly, the conditions for early retirement have been tightened. The minimum retirement age has been raised to 60 for men and women, and persons who retire before 65 and who have contributed for less than 40 years face an actuarial penalty of 6% for each year by which their retirement age predates 65. The list of strenuous occupations entitling

Figure 2.4. **Public expenditure for old age and survivors pensions**

% of GDP, 2007



Source: OECD, *Social expenditure Database*.

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Box 2.1. **The 2010 Pension Reform**

The pension reform adopted in July 2010 simplifies the structure of the pension scheme and substantially changes its key parameters to reduce the generosity of the system and increases the effective retirement age. The main modifications brought by the reform are the following:

- Simplification
  - Six pension funds remain for the new entrants from 1/1/2011: IKA (most wage and salary workers, including government employees and the military), OAEE (most self-employed workers), OGA (for the agricultural sector), ETAA (for lawyers, doctors, and engineers), ETAP-MME (journalists), and the fund of the Bank of Greece. The new law however equalizes benefit formulas and retirement ages across all funds except for the Bank of Greece fund.
  - A separation of pension funds from the health insurance component is introduced.
  - The new pension system, which will be in force as from 2015, will be composed of a basic pension amounting to EUR 360 per month (12 months per year) and a proportional pension related to workers' contributions payable 12 times a year. The reform will be applied with a pro rata system for the future pension rights of workers who have already started their professional life.
- Generosity
  - The pension award formula in the contributory-based scheme is amended to strengthen the link between contributions paid and benefits received, with the statutory accrual rate limited to 0.8-1.5% a year, depending on the years of service, much lower than the 2% to 3% a year used before.
  - The terms and conditions of granting survivors' pension are tightened, in particular for persons who can cumulate two pensions or a salary and a pension.
  - Pensions are indexed to prices and to GDP growth. Before the reform pensions were adjusted by discretionary rates. Increases were ahead of inflation between 1999 and 2008 inclusive (except 2002). However, in 2001, 2003 and 2004, this applied only to smaller pensions.

Box 2.1. **The 2010 Pension Reform** *(cont.)*

- – The period over which the pension benefits are calculated is extended from the top five years in the last 10 years of earnings to the entire working life, with 40 years of contribution needed for a full pension.
- Retirement age
  - – A unified statutory retirement age of 65 years is introduced, including for women in the public sector (phased in immediately after adoption), to be completed by December 2013.
  - – Access to early retirement is restricted. The minimum retirement age is raised to 60 years by 1 January 2011, including for workers in heavy and arduous professions. The list of arduous professions, which includes about a third of the labour force, will be revised by July 2011 to cover less than 10% of the working population.
  - – Pension benefits are reduced by 6% per year for people entering retirement between the ages of 60 and 65 who have a contributory period of less than 40 years.
  - – A mechanism is introduced to review and adjust the minimum and statutory retirement age every three years as from 2021, in line with the rise of life expectancy at 65. A joint decision of the Finance Minister and Labour and Social Security Minister will be required for such a change.

a worker to a full pension at age 60 is to be narrowed in July 2011. A mechanism has also been introduced to index the statutory retirement age (65 years) and the minimum retirement age (60 years) to life expectancy, as of 2021.

According to the analyses of the National Actuarial Authority, these measures will do much to strengthen the long-term financial viability of the pension system. Studies conducted for the principal retirement regimes, covering private and public sector employees, the self-employed and agricultural workers, point to stabilisation of pension outlays at the current level (9¼ per cent of GDP in 2009) between now and 2060 (National Actuarial Authority, 2011a and 2011b). This trend will mean a reduction in total benefits paid to agricultural workers and, to a lesser extent, to public-sector employees, which will offset an increase of 2¼ percentage points of GDP in pension outlays for private-sector employees and the self-employed.

The preliminary assessment from the European Commission (EC) about the effects of the pension reform is positive. However, the EC noted that, since only part of the system has been adjusted, a comprehensive review will only be possible when the outstanding reforms concerning the supplementary pension funds and the list of hazardous occupation are legislated. This comprehensive review is scheduled to start in the autumn 2011, when the remaining reforms are completed. In this context, in end-June 2011 the authorities adopted a provision in the MTFS freezing the supplementary pensions through 2015, once they are adjusted to be financially sound over the long term. There are however uncertainties over some aspects of the quantification of the reforms completed so far on the main pension funds, concerning for example, the trend in public service pensions due to information gaps concerning the number of these workers and their salary level (due to the impending wage bill reform in the public sector). As well, recent estimates by the NAA of the increase in pension outlays to 2060 in the absence of reform, placed at 4¾ per cent of GDP for the principal regimes analysed, are well below estimates of the previous studies, a situation that requires some clarification.

The authorities are, however, committed to taking the necessary measures to cut pension spending further if the projected increase between now and 2060 exceeds 2½ percentage points of GDP. The law voted in July 2010 allows the government to adjust the system's parameters by simple ministerial decision to respect this commitment. Moreover, as of 2011, the new law requires updated actuarial studies of the pension regimes every two years by the National Actuarial Authority of Greece, and the Minister of Labour must report to Parliament every six months on the performance of the accounts for these regimes.

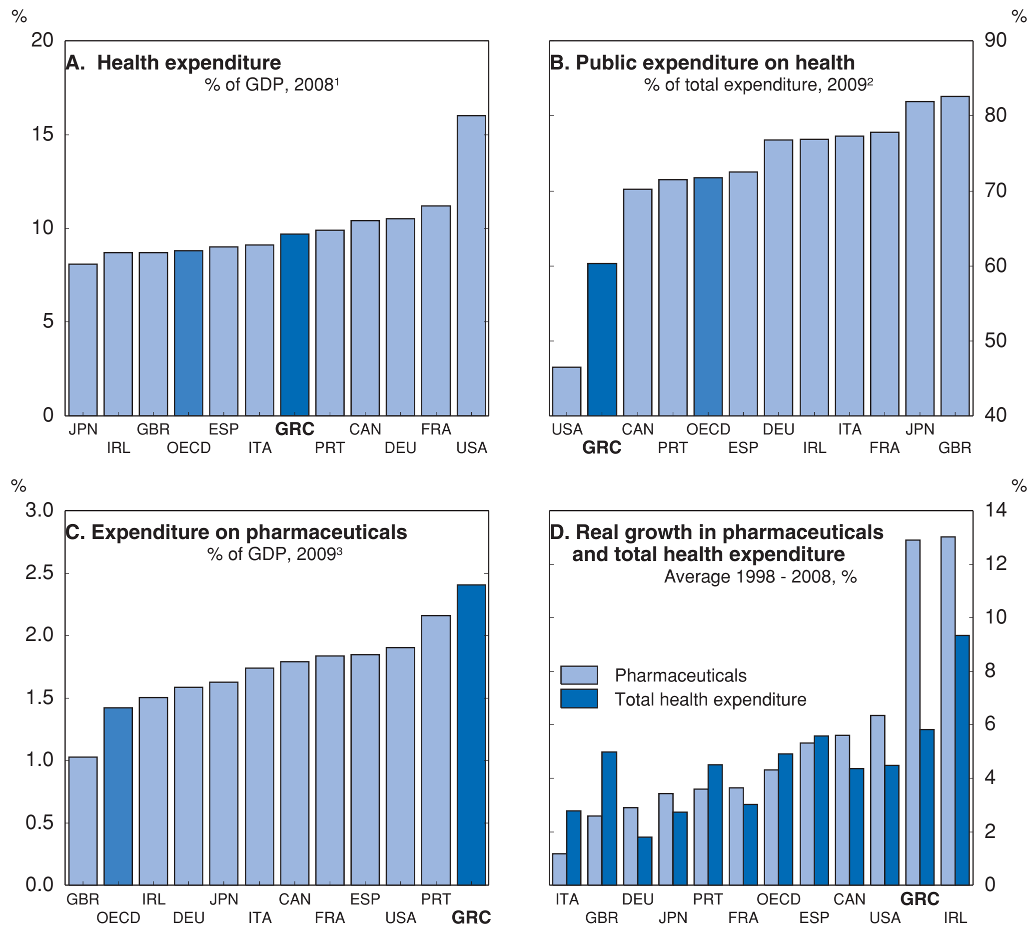
The reforms adopted are welcome. They should make a decisive contribution to the long-term financial viability of the pension system. These positive effects would be further reinforced by the planned reform of the system of disability pensions, as indicated in the context of the MTFS. The new system is fairer and more transparent. The benefits of these reforms should also make themselves felt in terms of growth, for they will reinforce the incentives for seniors to participate in the labour market, raising employment and output over time. To ensure both effectiveness and fairness, they must in particular take a strict stance in limiting the list of so called strenuous occupations, consistent with the commitments undertaken, and in this way reduce the number of people eligible for early retirement under preferential conditions. The mechanism of adjustment of the retirement age with life expectancy could also become more rule-based than currently planned, with the role of Ministries restricted to perhaps override a normal increase in retirement age, if the long-term financial viability of the system is not threatened.

Health care reform needs to improve control over spending and the quality of services

Reforms are needed in the health sector not only to improve control over expenditures, which are subject to upward pressures as in other OECD countries, but also to boost the quality and efficiency of public medical care services. Total health spending, which was running at 9¾ per cent of GDP in 2010, is relatively high by international comparison (Figure 2.5, Panel B), with public health expenditure (financed through taxes and social insurance contribution) reaching almost 6% of GDP. Another feature of the Greek system is that spending on private medical services is also relatively high, reflecting user frustration with the public system's inability to meet expectations, particularly with respect to the quality of primary care (OECD, 2009). The health care system can be unfair – patients frequently find themselves making "under-the-table" payments to access public services that are supposed to be free (OECD, 2009; Kyriopoulos, 2004; Liaropoulos *et al.*, 2008; Siskou *et al.*, 2008). It is also extremely fragmented, which increases administrative costs and reduces its effectiveness. The potential for efficiency gains in public health spending from 2007 to 2017 has been estimated at more than 2% of GDP (OECD, 2011b). Soaring hospital costs need to be brought under control as well: the hospitals have repeatedly accumulated significant arrears, which then must be cleared by the government. Pharmaceutical consumption is also high, and is rising faster than in most other OECD countries (Figure 2.5, Panels C and D), reflecting the lack of incentives to control costs.

The authorities have launched a series of reforms to address these shortcomings. Recent initiatives have sought to achieve budgetary savings in the hospital sector, for example, by rationalising procurement procedures. A mechanism for supervising calls for tender has been instituted, along with a price monitoring "watchdog" for drugs and medical supplies. A global budget envelope for hospital financing has been introduced and

Figure 2.5. **Selected indicators of health expenditure**



1. 2007 for GRC, JPN. 2006 for PRT.
2. 2008 for FRA, DEU, IRL, ESP, GBR, USA, OECD. 2007 for GRC, JPN. 2006 for PRT.
3. 2008 for CAN, FRA, DEU, IRL, ESP, GBR, USA, OECD. 2007 for GRC, JPN. 2006 for PRT.

Source: OECD, *Health data 2010*.

StatLink http://dx.doi.org/10.1787/888932474043

all hospitals are to be subject to international accounting standards by the end of 2011. Steps have also been taken to rein in the growth of pharmaceutical outlays, with the reintroduction of a "positive list" of reimbursable drugs and a reduction in pharmacists' margins, which was however limited (Chapter 3). An electronic prescription monitoring system (e-prescription) is now being used with promising results by the health insurance fund for the self-employed (OAEE),[7] and should be extended to other insurance funds. Thanks to these measures, the 2011 budget projects savings of 0.9% of GDP, and the authorities foresee additional budgetary savings of 1.2% of GDP by 2015. With this in mind, they are planning to redraw the country's hospital map. This will involve the merger of some hospitals, staged introduction of hospital financing by diagnosis-related group, and greater coherence in managing the provision of primary care through the various health insurance funds, by strengthening their bargaining power *vis-à-vis* suppliers. By the end of September 2011, an independent working group of eminent experts, under the auspices of the Minister of Health, is to make concrete proposals for reforming the health system over the medium term.

These various measures and initiatives are welcome and are in line with recommendations from the previous *Survey of Greece*. The real issue in the health field in Greece is not merely to improve control over expenditures but also, and above all, to enhance the quality of public medical services. The government must regain public confidence and demonstrate the capacity to use budgetary funds efficiently to offer public health services that meet people's needs. Beyond the measures already taken or planned, important additional areas for reforms must be considered in two main directions over the medium term. First, the health care system's highly fragmented governance structure must be overhauled, for it impedes the effective planning and allocation of public resources. It would be desirable, for example, to place under one ministry all those health responsibilities that are now scattered across government. This would help, for example, in the management of human resources in the health sector, where there are now too few general practitioners and nurses and too many specialists (OECD, 2009). In this context the separation of pension and health insurance management and the creation of a single health insurance fund are welcome steps.[8] In the absence of choice among funds, their multiplicity which prevailed so far and their differences of coverage created problems of fairness and efficiency. Resource allocation should thus benefit greatly in the future by having all public funds devoted to health – whether they come from the budget or from social contributions – managed by a single agency responsible for financing all health care providers. The current distribution of these resources favours hospital care at the expense of primary care, while too little funding seems to be devoted to prevention. Separating the health insurance function from the provision of health care by providers – who would then be in competition – could also be helpful in identifying the relative prices of medical services and improving resource allocation.

Second, the way health professionals are compensated and other related incentives should be reviewed. Introducing a hybrid system combining capitation payments and fees for service for physicians working for the health insurance funds would help spur competition in this sector and increase physicians' activity rate (Simoens and Hurst, 2006). Changing how practitioners are paid might also help scale back the prevalence of informal payments, which is one of the biggest problems in the Greek health care system (OECD, 2009). In the hospital sector, salary differentiation between specialities might be necessary to attract more doctors to fields facing shortage. Another possibility would be to increase co-payments, with provisions for exemptions if need be, in the hope that it would reduce informal payments in particular for outpatient care. At the same time, supervision of medical practices and effective sanctions against these illegal remuneration practices must be strengthened. The way pharmacists are compensated should also be changed, to provide better incentives. Their remuneration is currently largely based on their margins and this encourages them to sell products that are more expensive. That system should be replaced by one based, more strongly, on set charges for services rendered to customers (dispensing fees), as in Switzerland (OECD, 2009). This system could also include specific incentive to encourage the distribution of generic drugs by authorising pharmacists to replace branded prescription products with generics, which are little used in Greece.

Further institutional changes should be envisaged

Beyond the many structural reforms required to guarantee lasting consolidation of the public finances, an important issue for budgetary strategy is to address the underlying institutional inadequacies that have led to the crisis in which Greece finds itself today. In the final analysis, the difficulties flowing from the inadequacies in tax collection and expenditure control reflect the weaknesses of institutions. Informed public debate and democratic oversight of fiscal policy by Parliament and, more broadly, by the citizens should in principle have prevented the drift in the public accounts. To help correct this gap and improve the institutional framework, the authorities created in 2010 a Parliamentary Budget Office (PBO), following the example of other countries such as the Netherlands and Sweden, Canada, the United Kingdom. In Greece, a small body of some 10 members has been given the task of evaluating government expenditure and revenue projections and economic forecasts underpinning the budget, supervising budgetary implementation, performing long-term sustainability analyses of fiscal policy, and working with the parliamentary committees responsible for overseeing the public accounts.

The creation of this institution, which is to be operational within the next few months, is welcome. It seems to have sufficient financial means and adequate access to government budgetary and fiscal data. It should have broad freedom of action in exercising its mandate, including the possibility of disseminating and communicating its analyses without restriction, meaning that it will be protected from the risk of political interference. The PBO should therefore be in a position to play a useful role. If it can acquire sufficient credibility through the strength of its analysis, it will be able to improve the quality of democratic debate and give the public meaningful information about actual implementation of the budget and the consequences of the various options for fiscal policy (Rapanos and Kaplanoglou, 2010). However, the quite small size of this institution, and in particular its fairly reduced staff, could be an obstacle to perform the broad range of tasks it is responsible for. The authorities should thus ensure that the PBO has access to adequate resources to carry out the rather broad range of functions it has been assigned.

To round out this initiative, the authorities should adopt a medium-term fiscal rule to support sustainable consolidation of the public finances. International experience shows that fiscal rules can play a useful role, particularly in countries that need to consolidate (OECD, 2007). To be effective, a fiscal rule must be carefully defined to combine simplicity, transparency and flexibility. This argues in favour of rules that incorporate constraints on expenditure growth, and ensure the necessary reduction of public debt/GDP over time. An expenditure ceiling would have helped to limit the increase in spending that was in part responsible for the deterioration in the deficit, while allowing the automatic stabilisers to work. At the same time, the rules must be sufficiently flexible to cope with exceptional events. In such cases, a temporary exception may have to be granted. Germany allowed for such a provision, for example, subject to parliamentary approval (OECD, 2010b).

In the Greek case, such a fiscal rule could enhance the visibility of the government's commitment to pursue, on a lasting basis, a fiscal policy that meets the need for bringing down government debt, once the initial consolidation phase now underway is completed. As noted in the last *Survey,* a fiscal rule could also bring greater coherence to government revenue and expenditure decisions, which have often betrayed a degree of political expediency in the past. It would encourage better preparation and quantification of budget provisions. Moreover, its role in making the broader public aware of the importance of respecting fiscal constraints and resisting the lobbies that are regularly vying for subsidies should not be underestimated (OECD, 2009). To be effective, this instrument must also have mechanisms to ensure that any transgressions carry a high political cost. A strict obligation to report to and accept *ex post* review by an independent body such as the PBO may be useful, particularly if failure to respect the rule entails obligations to correct the situation. Empirical analyses suggest that fiscal institutions of this kind can bolster a government's capacity to respect a fiscal rule (Hagemann, 2010). Switzerland and Germany have gone so far as to put their fiscal rule in the Constitution. Greece could explore this option to demonstrate the strength of its commitment to change the course of its fiscal policy and rise above its political cleavages.

Box 2.2. **Recommendations to improve the efficiency of the public sector**

Enhancing the fiscal framework and the monitoring of budget implementation

- Pursue efforts to rapidly get timely and good quality data on budgetary execution on a cash basis and payment commitments from local governments and the social security system. Publish quarterly estimates of the budget execution on a transaction basis at the central and general government level.
- If needed, the sanctions with non compliance by public entities to publish data in the requested timeframe should be tightened and strictly enforced.
- All laws presented to Parliament should include an evaluation of their budgetary impact, and be systematically integrated in the medium-term fiscal plan to update it and maintain its reliability

Fighting tax evasion and improving the tax system

- Develop and publish indicators for tracking the effectiveness of measures taken at the different stages of the taxation process, even before their financial effects are felt. Indicators developed and published on a local basis could also encourage emulation among tax offices to reduce the bias in taxation in their favour compared with employees.
- Tax amnesties should be discontinued.
- A policy of naming and shaming significant tax evaders should become the rule. Consider lowering the thresholds (EUR 150 000) for naming evaders, and, making it systematic rather than the discretionary. Ultimately, these measures have to be backed up by visible and successful prosecution of tax evaders and the imposition of meaningful penalties. As in some Nordic OECD countries, the government could envisage to publish the revenue declaration of all taxpayers.
- Combine the collection of taxes and social security contribution in a single authority.
- The scope and use of tax compliance certificates should be widened.
- Further broaden the tax bases and simplify the tax system. Reduce the number of VAT rates, in particular the specific rates applies to the frontier islands and replace them by direct subsidies, if necessary. Submit farming activities to the general VAT system and the income tax. Abolish tax exemptions on fuel for agricultural use. Abolish the large number of the taxes collected on behalf of third parties.
- The high tax-free-threshold on personal income tax could be lowered more than currently envisaged. Existing tax expenditures should be further cut or abolished and replaced by direct subsidies, if needed.

Improving the public employment and remuneration system

- Improve statistical information on the structure of public sector pay, in particular, separate spending on pensions for retired public servants from remuneration for those still working data. Better employment data would help to enhance human resource planning in the public sector.
- As planned, introduce a culture of evaluation of staff performance based on clear individual objectives, putting an end to automatic promotions linked to seniority. Allow part-time work to increase the public employment flexibility. Improve the hiring system to make it faster, stricter and more transparent.
- Consider changing the status of civil servants for new employees putting an end to life-job security guarantee and replacing it with open-term contracts, similar to those for private sector employees.
- Further develop e-government to boost public sector productivity and facilitate private citizen interaction with government department and agencies.

Box 2.2. **Recommendations to improve the efficiency of the public sector** *(cont.)*

Continuing restructuring the state-owned enterprises

- Proceed with the current restructuring programme of SOEs. Avoid however micromanaging these firms from the Ministry of Finance, once the current adjustment process is completed. SOEs need to have clear objectives and sufficient management flexibility, including over employment and prices, which must depend on their costs and not on macroeconomic or social considerations.
- Meaningful sanctions should be imposed on SOEs if their management and performance do not improve. Public firms making recurrent losses should be closed and/or privatised.

Consolidating pension reform

- As agreed, limit the list of strenuous occupations to reduce the number of people eligible for early retirement under preferential conditions.
- Consider setting an automatic rule for adjusting in the future the retirement age in line with life expectancy, with a possible ministerial override.

Pursuing health care reform

- Consider overhauling the structure and governance of the health care system to enhance effective planning and allocation of public resources: place all health responsibilities under a single ministry; as planned, separate the management of pensions and health insurance.
- Bolster supervision of medical practices to limit the spread of informal payments. Introduce formal co-payments for outpatient care. Differentiate the compensation of hospital doctors between specialities. Review how doctors are paid: introduce a hybrid system combining capitation payments and fees for service.
- Consider reviewing the current remuneration mode of pharmacists based on profit margins by one based on, at least in part, on set charges for services rendered to customers, as in Switzerland, with specific incentives to encourage the diffusion of generics.

Considering adopting further fiscal institutional changes

- Ensure that the PBO has access to adequate resources to carry out the rather broad range of functions it has been assigned.
- Consider adopting a well-designed spending rule, perhaps with constitutional rank, once the initial consolidation phase now underway is completed to enhance the visibility of government commitment to stick to a sound fiscal policy in the future. The PBO could be given a role to assess its proper implementation.

Notes

1. Part of the "black" economy funds returns to the official economy through consumption, which probably reduces the government's losses of revenue due to the shadow economy.
2. Christodoulakis and Skouras (2009), for example, offer empirical evidence for increased tax evasion and forest fires during election years. In those years fires burn on average 2½ times more land area than in non-election years, which according to the authors constitutes a hidden and targeted way of making transfers to specific groups. In the absence of a land registry, burnt-over areas are often used for subsequent development.
3. These increases in taxes and social contributions planned by the MTFS include: *i)* the introduction of a "solidarity contribution" from 1% to 5%, depending on the income level above EUR 12 000; *ii)* a rise in excise tax for heating oil; *iii)* a small tax on businesses of, on average, EUR 300 per year; *iv)* an increase of private-sector employees' and employers' unemployment contributions (from 1.33% to 1.83% and from 2.67% to 3.17% respectively as of 1 August 2011); *v)* the introduction of a flat contribution on the self-employed set at EUR 10 per employed person as of 1 August 2011;

vi) the introduction of 2% unemployment contribution on total earnings of all public sector employees. Up to now, the public sector employees and the self-employed did not contribute as they were not eligible for unemployment benefits.

4. In particular tax exemptions for certain categories of taxpayers have been abolished and their corresponding income will be taxed as ordinary income (*e.g.* income of members of Parliament, judges, football players, tax officers, etc.).

5. It should be noted that international comparisons of the number of public sector employees in general suffer from comparability problems regarding the definition of the general government. This specific problem is however more acute for Greece than most other OECD countries.

6. The pay ratio between persons who have completed only compulsory education and those who have a university degree is 1:1.3, and that between persons at the beginning and at the end of their career is 1:1.7. These ratios are very compressed by international comparison (Ministry of Labour).

7. According to a press release: "The pilot introduction of an e-prescription system has slashed spending on pharmaceuticals at the OAEE social insurance fund for the self-employed by roughly 70%, OAEE governor G. Voudouris told a Parliamentary committee. Until the introduction of the system in October 2010, doctors collaborating with OAEE had been writing out roughly 300 000 prescriptions a month with a monthly cost of EUR 25 million. Between October and December 2010, by contrast, spending on pharmaceuticals had dropped by 73.4% relative to the same period in 2008 and a reduction in prescription medication had resulted in a 70% reduction in the sums received by pharmaceutical companies." (Athens New Agency, 2011).

8. A recent reform (the law 3918/2011) has established a unified health insurance fund (the EOPYY), which combines the formerly separate health sectors funds of private employees (IKA), liberal professions (OAEE), agriculture (OGA) and civil servants (OPAD). The EOPYY, which covers the vast majority of the Greek population, has a bargaining power in the market for drugs and medical services *vis-à-vis* health care providers or producers.

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Chapter 3

Structural reforms to support growth

Generating jobs and growth are key goals of the adjustment program. The recent decline in wages indicates some responsiveness of the labour markets to economic conditions, but persistent and large structural unemployment, especially among vulnerable groups, and loss of competitiveness, point to important impediments. Productivity is also undermined by weak competition, high rents and red tape. A wide range of structural reforms are now underway which promise to raise living standards and employment, and to make labour and product markets more inclusive and fair. Active labour market policies are improving job-search possibilities. Lower minimum wages for youth, improved wage bargaining, and revamped employment protection rules should enhance job creation. Reforms in product markets are improving the competition framework and the business environment, and barriers to exports and investment are being reduced. Deregulation, now underway in a long list of closed professions and the road freight sector, should increase economic dynamisms and end unfair restrictions. The reforms undertaken are improving notably Greece's ranking in OECD product market indicators and strengthen the adjustment capacity of the labour market, and estimates show a potentially large impact on growth over time (Chapter 1). It is important to systematically monitor the implementation of the reforms and their impact. High-quality data to assess the reform process are essential in this regard. Such data are also needed to convince international observers and the Greek people that reforms are paying dividends.

The potential benefits of labour and product market reforms are impressive

Greece has ranked poorly in international comparisons of labour and product market institutions, which is likely to have contributed to weak international competitiveness, high structural unemployment and low investment levels. To create jobs and conditions for export- and investment-led sustainable growth, the economic programme of the government includes reinforced active labour market policies and wide ranging structural reforms to strengthen labour and product markets.

The impact of these reforms is illustrated by improvements in OECD's product market regulation (PMR), and to a lesser extent, employment protection legislation (EPL) indicators for Greece. The latter, however, does not capture the impact of all recent labour market measures, including making wage setting more responsive to changes in economic conditions and boosting flexible working time arrangements. Assuming that the structural reforms in the labour and product markets are fully implemented, they should facilitate Greece's recovery from the crisis and sustain growth of living standards. As discussed in Chapter 1, on relatively conservative estimates the reforms underway could generate output gains of about 10% of GDP, representing a ½ percentage point increase in growth to a horizon of 2035.

This chapter discusses the labour and product market reforms in the government's adjustment programme, and when possible benchmarks them to progress in OECD relevant indicators. It is also emphasised that effectiveness of these measures hinges upon the quality of their implementation. The development of a comprehensive set of indicators to demonstrate progress and to permit assessment of outcomes is essential. Given empirical evidence on the sizeable interaction between labour and product market reforms (Berger and Danninger, 2006), and strong synergies within and between sectors, reforms need to be implemented simultaneously, rather than sequentially, to achieve best outcomes (Chapter 1). Such a broad reform policy will of course be difficult, both administratively and politically. However introducing reforms on a broad front would demonstrate the authorities' determination that the burden and the benefits of necessary adjustments will be widely shared.

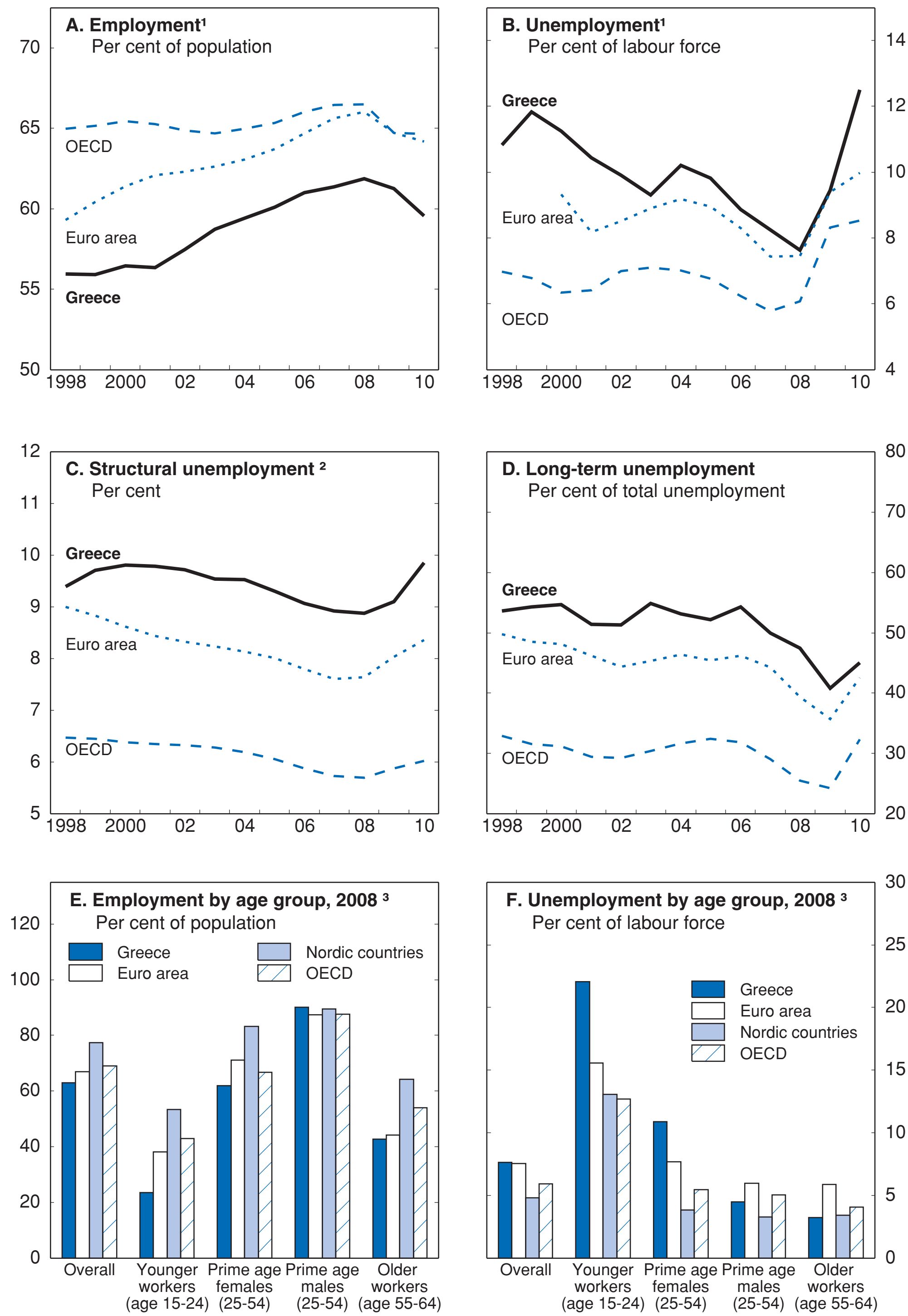
Getting people back to work and boosting longer term growth

The crisis has worsened the already high structural and youth unemployment

Although actual labour market outcomes improved considerably over the decade of strong growth in the run-up to the crisis, many structural problems remained. While the unemployment rate declined to the euro area average (Figure 3.1), structural and long-term unemployment remained high in international comparison, and employment rates were low for the young, women and the elderly.

The crisis hit employment severely, increasing the estimated structural unemployment and the long-term unemployment further (Figure 3.1). The sharp fall in activity has affected all age groups and educational levels, with the young and less educated bearing

Figure 3.1. **Employment trends: an international comparison**



1. Refer to 15-64 year olds.
2. The structural unemployment refers to OECD estimates of NAIRU (non-accelerating inflation rate of unemployment).
3. Employment and unemployment by age group are computed relative to respective population and labour force of the same age group.

Source: Eurostat and OECD.stat, *Database on Labour Force Statistics.*

StatLink http://dx.doi.org/10.1787/888932474062

the largest burden (Figure 3.2, Panels A and B). Youth unemployment reached a staggering 37% in the first quarter of 2011, 17 percentage points above the euro area average. Among industries, the strongest impact on employment was seen in construction, which explains the sharp rise in unemployment among immigrant workers (Figure 3.2, Panels C and D). As in other OECD countries, immigrants are often sensitive to downturns as they tend to be disproportionally employed in cyclical industries and on temporary contracts. For example, in 2008, the share of immigrants in temporary employment in Greece exceeded that of the native-born by at least 50% (OECD, 2010a).

Apart from overall downward wage adjustment (see Chapter 1), necessary to help Greece recouping its competitiveness in a situation where the exchange rate is fixed, the recession has increased the use of more flexible forms of working arrangements, including temporary and part-time work (Figure 3.2, Panels E and F). This outcome represents a considerable reduction in labour input in addition to the decline in employment. It also implies a further fall in average wages (Gatos, 2011).[1] There also appears to be a shift in the private sector towards individual contracts that sometimes are illegal if collective agreements are still in force (Papadis, 2011a).

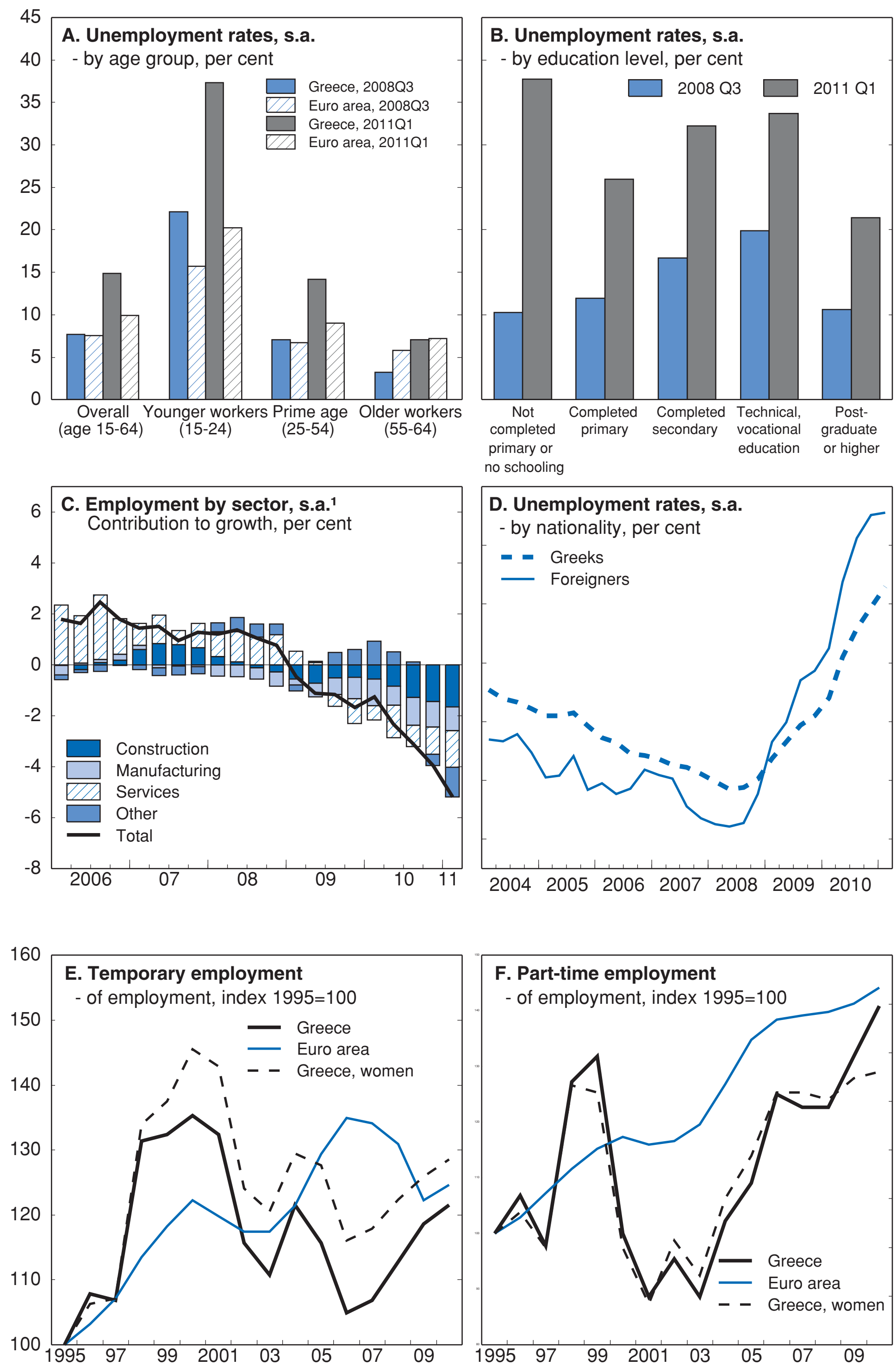
More effective activation policies can aid the recovery and reduce the social pain of adjustment

Apart from a cyclical rebound in employment, the challenge for Greek labour market policies is to reallocate labour in line with the new growth model that requires a transition from domestic consumption and house building to investment and exports. A recent OECD study re-emphasised the well known fact that getting people to work can be facilitated by active labour market policies and maintaining or enhancing the quality of labour by training during unemployment spells (OECD, 2011a). There is much scope to boost the employment potential of activation policies through increasing the take-up rates of existing programmes and improving the job matching capacity of the Public Employment Services (OAED). Available data show, for example, that in 2006/07 only 5% of youth and adults in Greece found their job through Public Employment Services compared to approximately 8% European average of 20 countries (OECD, 2010b).

A number of active employment policies and vocational training programmes have been launched by the OAED since the onset of the crisis. OAED estimates that the unemployment rate would have been at least 3 percentage points higher in the absence of such initiatives (Kikilias, 2011). Take-up rates could be further boosted by a better information network about the job subsidy programmes offered, although it is true that uncertainty about job prospects may make employers reluctant to participate. This is because eligibility for an employer for such programmes hinges upon retaining the same number of employees, without proceeding to dismissals.

An important shortcoming of the Greek activation framework is the lack of a rigorous evaluation of adopted policies (OECD, 2010b). This is essential to identify what works and what doesn't, and to make the necessary changes to improve efficiency and outcomes. A comprehensive assessment is even more necessary in light of the large share of subsidies in activation spending (with employment subsidies accounted for 41% of total active labour market expenditure in 2006), including in the package of measures in response to the crisis, and to avoid deadweight losses (arising when employers tend to hire individuals they would have hired even in the absence of subsidy).

Figure 3.2. **The crisis hit severely the labour market**



1. Contributions to year-on-year percentage growth of total employment. Break in series in first quarter of 2008 due to a change in activity classification.

Source: OECD, OECD.stat, Labour Force Statistics; EL.stat, Labour Market, Employment-Unemployment Statistics and Eurostat.

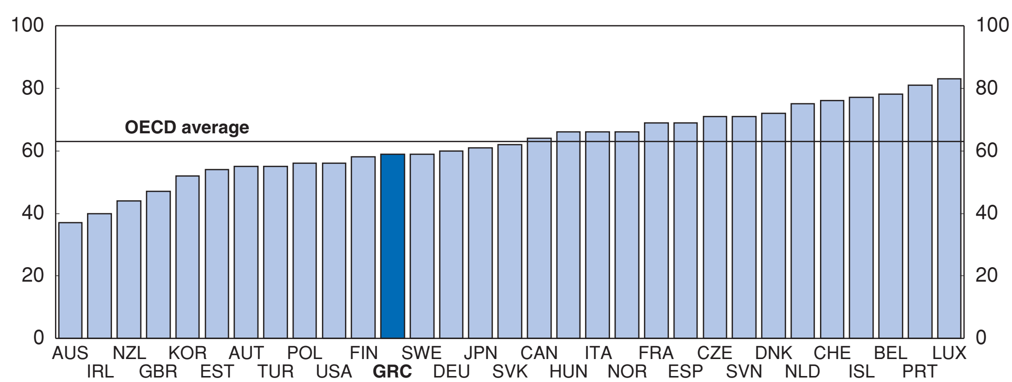
StatLink http://dx.doi.org/10.1787/888932474081

Outcomes could be further improved by making unemployment benefits conditional on job-search requirements, which would align Greece to OECD best practice. Application of the mutual-obligations principle would help to direct the unemployed to programmes best suited to their needs and help to offset disincentives to work, even though these are relatively weak in Greece (Figure 3.3). While a legal framework linking unemployment benefits to sanctions in case of non-compliance already exists, no benefit withdrawals were recorded since the sanctions were introduced in 1985 (OECD, 2010b). The completion of the merging of offices responsible for the payment of unemployment benefits with those responsible for activation measures is a welcome step towards effective application of the mutual-obligation principle – although the relatively small share of hires (below 15%) arising through advertisements and public or private agencies, may make either monitoring or assisting job search somewhat more difficult (OECD, 2010b; Pellizzari, 2010). In parallel, efforts are needed to improve the job matching efficiency of the training programmes to avoid the risk of skill erosion among the unemployed, especially as stepping up the programmes is difficult under current budgetary constraints.

In addition to effective labour market programmes, an education system that ensures a smooth transition to the labour market is essential to combat high rates of unemployment, as discussed in the previous *Survey*. Recent reforms at the school and tertiary level are welcome (Annex 1.A1).

Figure 3.3. **Net unemployment benefit replacement rates, OECD countries, 2009**[1]

Per cent of pre-unemployment wage



1. These data are net replacement rates, *i.e.* they are adjusted for the effects of taxation. They refer to the average of net replacement rates faced by single persons without children with pre-unemployment earnings of 67% and 100% of the average wage. They relate to the initial phase of unemployment after any waiting period. No social assistance "top-ups" are assumed to be available in either the in-work or out-of-work situation. Any income taxes payable on unemployment benefits are determined in relation to annualised benefit values (*i.e.* monthly values multiplied by 12), even if the maximum benefit duration is shorter than 12 months.

Source: OECD, Tax-Benefit Models: Benefits and Wages Indicators.

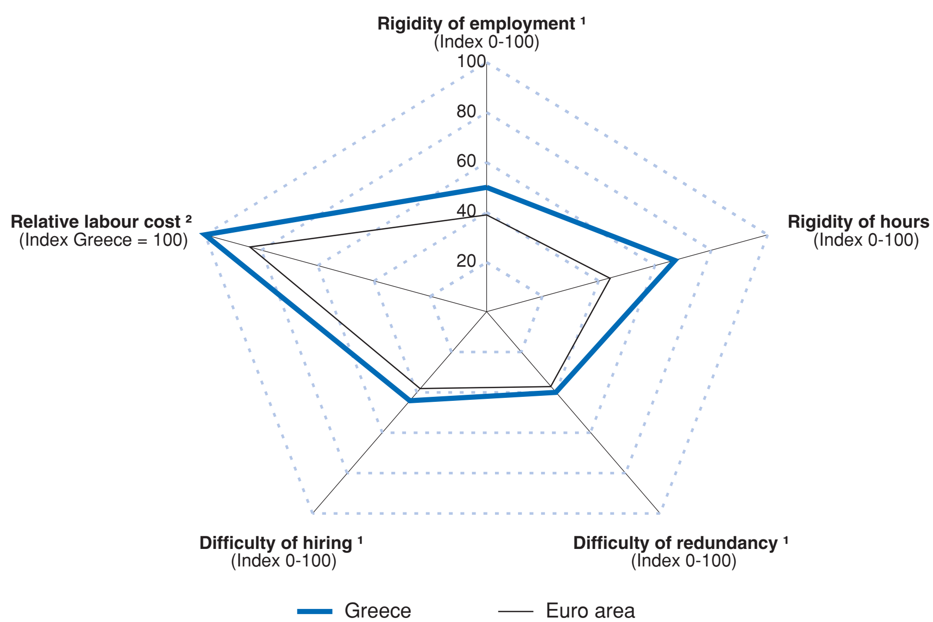
StatLink http://dx.doi.org/10.1787/888932474100

Reforms in the labour market would also facilitate the recovery, job creation and reallocation

Given the high structural unemployment and reallocation needs, getting people back to work is likely to require fundamental reforms. The labour market is currently adjusting to the crisis but there is a risk that the high unemployment rate will persist. Previous OECD *Surveys* (OECD, 2009a) have shown that high structural unemployment in

Greece is likely to reflect policies that weaken the functioning of the labour market, including relatively strict employment protection legislation (EPL). Business surveys also indentify such impediments as a constraint on investment (World Bank, 2010) (Figure 3.4). Recent OECD analysis also suggests that cyclical unemployment has a strong tendency to become structural in Greece which can make it harder to get people back to work after the recession (OECD, 2010c; Guichard and Rusticelli, 2010). The importance of labour market reform for sustainable growth was also recognized in the programme agreed with the Troika. Problems were identified in particular in the wage bargaining system, minimum wages for the young, employment protection and flexible working time arrangements (European Commission, 2010a; International Monetary Fund, 2010).

Figure 3.4. **Greek labour market functioning indicators**



1. Index scale of 0 to 100 from least to most restrictive.
2. Comparative index based on unit labour cost for 2010 (index 2000 = 100) relative to unit labour cost in Greece.

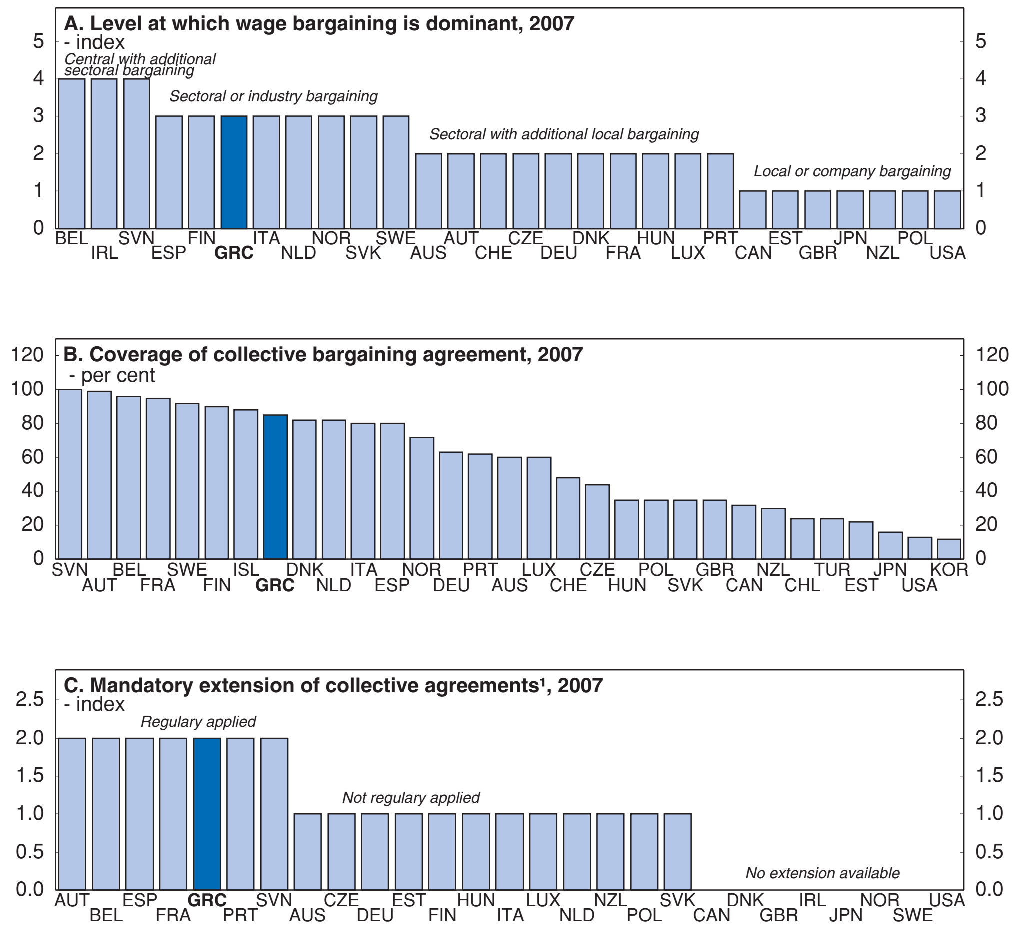
Source: World Bank (2009), *Doing Business 2010: Reforming Through Difficult Times* and OECD Economic Outlook Database.

StatLink http://dx.doi.org/10.1787/888932474119

The wage-setting system is likely to have eroded competitiveness

Greece has a multi-layered system of wage bargaining, with a predominance of intermediate-level bargaining (Figure 3.5, Panel A). Collective bargaining takes place at national, sectoral, occupational (national or local level) and company level (OECD, 2007). The coverage of collective agreements is high, despite relatively low union density (24% of employees in 2008 compared to 70% in Nordic countries) (Figure 3.5, Panel B). In such bargaining systems, sectoral negotiations can hinder the matching of wages and productivity at the company level, creating gaps between the two that must ultimately be filled by reducing labour. Likewise the process has not helped in adapting wages to regional imbalances in the labour market, aggravating differences in unemployment rates among regions. Moreover, until recent reforms, wage bargaining at a lower level could only increase wages above those negotiated at higher level of negotiations (the so called

Figure 3.5. **Main features of the collective bargaining system**



1. Mandatory extension of collective agreements is measured as: 2 = legal or organisational provision extension available, regularly applied and affecting significant share of the workforce (more than 10 per cent); 1 = legal provision for mandatory extension available, but not regularly or widely used (affecting less than 10 per cent of the workforce); 0 = legal provision for mandatory extension not available.

Source: Venn, D. (2009), "Legislation, Collective Bargaining and Enforcement: Updating the OECD Employment Protection Indicators", OECD Social, *Employment and Migration Working Papers*, No. 89, OECD Publishing; and for Panels A and C: the *ICTWSS Database* (Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts in 34 countries between 1960 and 2007).

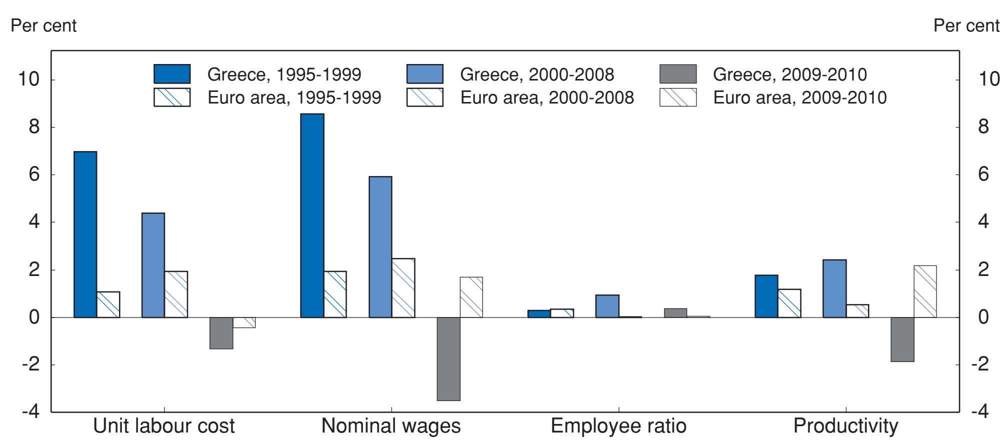
StatLink http://dx.doi.org/10.1787/888932474138

favourability principle), and in that sense the sectoral negotiations acted as a floor for enterprise-level negotiations. Furthermore, firm-level agreements could only be signed by firms with at least 50 employees, which limited their use. In 2010 only a fifth of eligible firms applied firm-level agreements. The administrative extension of sectoral or occupational agreements to those not involved in the negotiations (with no opt-out possibility until recently) aggravated the problem (Figure 3.5, Panel C). More specifically, whenever employers' party to an agreement provide work for 51% of the workforce in a sector or occupation, agreements become legally binding (subject to ministerial decision) for the whole sector or occupation. While the aim of administrative extension is to safeguard collective bargaining, it overlooks the need for regional wage differentiation of sectoral agreements in line with variations in the cost of living or productivity.

Wage developments have also been shaped by the arbitration system. Until recently, unions had privileged access to arbitration which made agreements for wage moderation more difficult. Under the 1990 legislation, in particular, the right to recourse to arbitration in the case of differences between the two parties over sectoral or occupational agreements was granted solely to trade unions. Frequent recourse to arbitration, despite low union density, implies that a small number of insiders can influence wage levels for much larger groups, making negotiations less responsive to market needs (European Commission, 2010b).

These institutions are likely to have contributed to the rise in unit labour costs compared to the euro area average (European Central Bank, 2009), which has undermined competitiveness (Figure 1.8 and Figure 3.6). In addition to the wage bargaining process as such, the signalling role of public wage settlements on private wage negotiations is also likely to have contributed to the wage inflation in the pre-crisis period (Holm-Hadulla *et al.*, 2010) (Figure 3.6). A recent reform of the wage bargaining system holds promise for better performance and, ultimately, stronger growth and employment. The introduction of a new type of collective agreement, the special firm-level agreement (SFLCA), applying to all firms, allows firm-level wages to be below the sectoral agreement (Box 3.1). By opening the possibility of an opt-out from the administrative extension of collectively agreed wages to non-negotiating parties, the new law helps firms to adjust more rapidly to changing conditions. Revisions to the arbitration system, aiming to guarantee equal access to procedures of all parties involved, should also help (Box 3.1).

Figure 3.6. **Unit labour costs grew fast**



Note: Unit labour cost is decomposed using the following identity expressed in logarithm:

$$\frac{\text{Total compensation of employees}}{\text{GDP volume}} = \frac{\text{Total compensation of employees}}{\text{Total employees}} + \frac{\text{Total employees}}{\text{Total employment}} + \frac{\text{GDP volume}}{\text{Total employment}}$$

The "first" term represents nominal wages, the "second" the employee ratio and the "third" productivity.

Source: OECD, *OECD Economic Outlook Database*.

StatLink http://dx.doi.org/10.1787/888932474157

Box 3.1. **Recent reforms in the collective bargaining and arbitration systems**

Legislation passed in December 2010 (Law 3899/2010) introduced important changes for collective bargaining and arbitration:

Collective bargaining

- The new law introduces an additional type of collective agreement – the special firm-level collective agreement (SFLCA)* – that allows employers and employees to agree on levels of wage earnings that are less favourable than those stipulated in sectoral agreements, with a view to preserving jobs. The special firm-level agreements can be signed by any firm. There are no restrictions as to the size of the firms or whether they are members of the employers' organisations that signed the sectoral agreements. The new law therefore abolishes the favourability principle for the special firm-level collective agreement and offers an opt-out from the administrative extension of collectively agreed wages to non-negotiating parties. The level of wages agreed in the national labour collective agreement constitutes the floor for earnings.
- In terms of procedural matters, the two sides (employer and employees) jointly submit a report to the Labour Inspectorate (which gathers representatives of the government, social partners, and local authorities), documenting the reasons for which a special firm-level agreement is to be signed. The evaluation of the Inspectorate is non-binding. The special agreement is valid as soon as it is signed by the two sides. In cases that no labour union exists or can be formed in the firms (as in the case of firms with less than 20 employees) the employers can reach agreement with the sectoral union or federation.

Mediation and arbitration procedures

- The 2010 law equally enhances the role of the mediator and arbitrator to investigate the competitiveness and economic performance of the sector or firm to which collective bargaining is referring.
- The arbitration system is also reformed under the new law so that both negotiating parties – rather than only labour unions – can resort to arbitration, if mediation fails. If the mediator's proposal is not accepted, then both parties together or one of them on its own can ask for arbitration. The two parties can still (as in the previous Law) jointly agree to proceed to arbitration without going through mediation. Arbitrators are selected by a unanimous decision of the members of the Board of Directors of the "Mediation and Arbitration Organization" (OMED) (comprising an equal number of members from employment associations and unions and a chairman selected unanimously) to serve for a period of three years. They are appointed to handle mediation or arbitration cases either by consensus between the bargaining parties (unions and employers), or in case of disagreement, by draw. To ensure more impartial mediation and arbitration outcomes, a government representative participates in the board meetings but only with observer status, with no voting right. To encourage bargaining and mediation, arbitration is limited to basic pay disputes.

* The "regular" firm-level collective agreement continues to exist.

Recent reforms are welcome but could proceed further

These reforms are welcome. The special firm-level agreement is an important instrument for wage decentralisation with a large potential to boost competitiveness and employment. Its use therefore should be encouraged both for firms in financial difficulty and for those looking to expand. There have already been a large number of applications for the formation of firm-level unions and queries from firms concerning the proper procedure for the new type of agreements. In particular, approximately 600 applications for forming firm-level unions had been filed with First Instance courts (as required by the civil code) in early 2011 (Papadis, 2011b). A recent survey covering 145 enterprises suggests that a third of them are ready to proceed with special firm-level agreements in 2011 (Athens News Agency, 2011).

It is important to ensure that procedural matters do not unduly restrict the use of SFLCAs, especially as the economy recovers. Special firm-level agreements, in particular, may not be readily available to small firms that usually lack firm-level unions, which are required to sign the agreement. If a firm does not have a union, the agreement needs to be signed by sectoral unions, which might complicate matters. Agreements may also be delayed by the time needed to process (by the First Instance courts) the applications for forming firm-level unions, which can take several months. Moreover, approval of the special firm-level agreements requires the submission of an explanatory report to, and an opinion (not binding) by the Labour Inspectorate, which has the potential to give rise to bureaucratic delays. Indeed, a negative opinion by the Inspectorate could undermine public support (European Commission, 2011). This was the case, for example, of the first special firm-level agreement signed after the new law was passed, where employers and employees had originally agreed to a 9% cut but finally signed a new agreement stipulating instead a 2-year wage freeze. The first SFLCA providing for wage cuts (12%) was signed in April 2011, and five more SFLCAs were signed by early June. The government's intention to monitor the implementation of SFLCAs and assess their outcomes in terms of increasing employment and preserving jobs is therefore welcome. The development of a comprehensive set of performance indicators is essential. The authorities need also to proceed swiftly with announced plans to accelerate the procedure underpinning the creation of firm-level unions, so that court decisions ratifying the setting-up of a firm-level union will be issued within 20 days. Such a measure would not only facilitate the signing of SFLCAs but also ensure that the current adjustment in wages proceeds within an orderly framework, avoiding informality (see above) (Bank of Greece, 2011). An effective Labour Inspectorate is needed to monitor informality, and the reforms under way to strengthen it and increase its effectiveness in law enforcement are welcome.

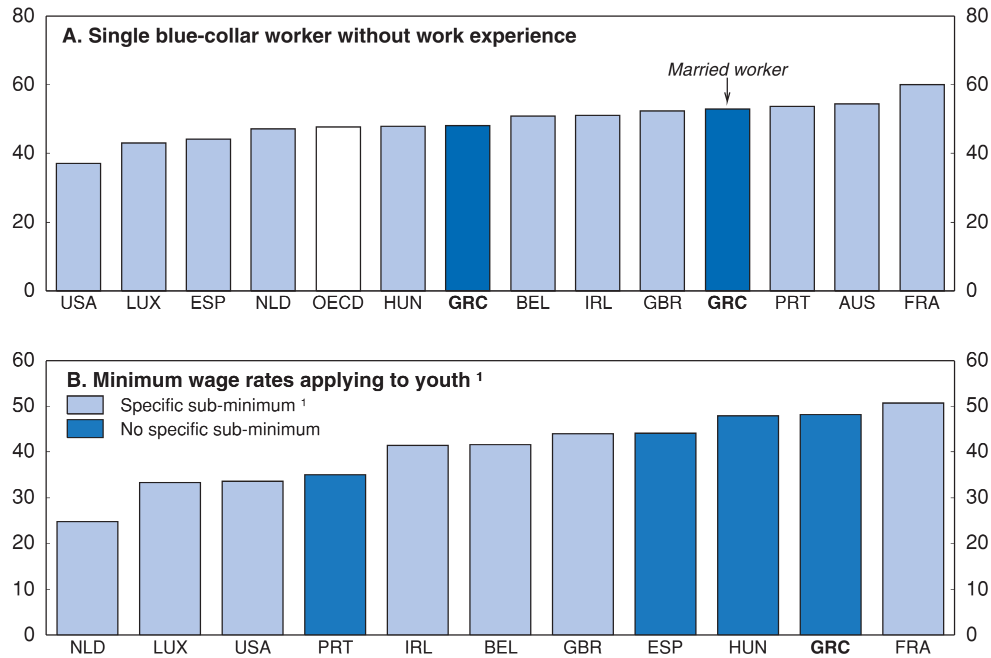
Looking ahead, to further promote firm-level wage agreements, the practice of administrative (subject to ministerial decision) extension of the sectoral agreements to firms not represented in the negotiations should be eliminated. The introduction of stricter criteria or guidelines for the approval of the extension, currently under discussion with the social partners, is welcome. A simpler overall structure of collective bargaining would also be desirable. Consideration could be given in the longer term to abolishing occupational agreements, as they create an unnecessary layer of wage negotiations on top of the national agreement. They do not take into account the fact that the same occupations/ skills are used in different sectors or firms operating under different conditions (Bank of Greece, 2011). The government and social partners could further consider abolishing over the longer term sectoral agreements to ensure adequate wage differentiation and an efficient allocation of workers across sectors, which should contribute to sustainable growth.

High entry minimum wages are one factor behind high youth unemployment

Labour market outcomes for the young Greeks are much worse than in most of their OECD counterparts. The unemployment rate of the 15-24 year olds was already almost double the OECD average before the crisis (Figure 3.1, Panel D). The wage bargaining system has also resulted in relatively high minimum wage levels for new entrants to the labour market. While basic minimum wages (as a share of the median wage) in Greece do not stand out internationally, this has not been the case for the young (Figure 3.7). Work experience and marital and professional status add to the basic minimum wage rate for

Figure 3.7. **Minimum wages: an international comparison**

Per cent of median wage, 2009



1. For young workers aged 15 to 18 or 21, depending on the country concerned.

Source: OECD, OECD.stat, Labour, Earnings.

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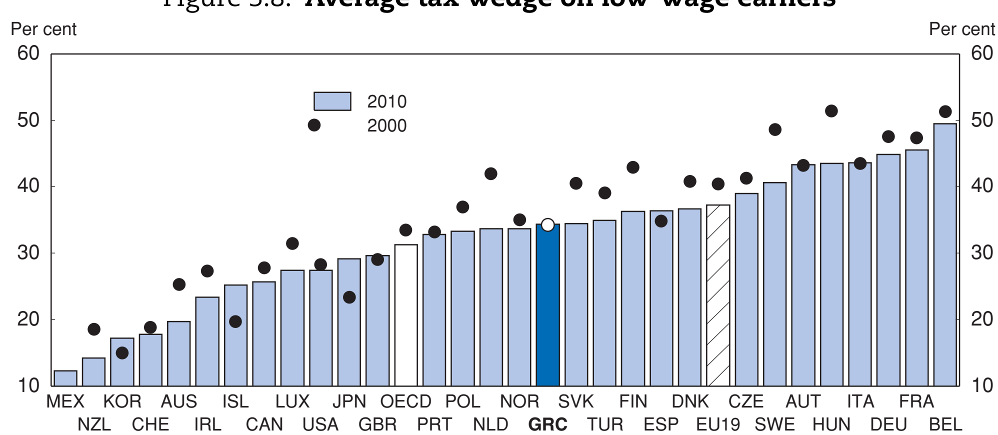
Figure 3.8. **Average tax wedge on low-wage earners**[1]



1. Tax wedge including employers' mandatory social security contributions for a single worker with no children earning 67% of the average wage.

Source: OECD, *OECD.stat, Database* on Public Sector, Taxation and Market Regulation, Taxing Wages.

StatLink http://dx.doi.org/10.1787/888932474195

single blue-collar workers. The relatively high minimum wage at entry may have penalised youths, whose job opportunities are also affected by the weak tailoring of the education and training system to labour market needs (OECD, 2009a). The impact of minimum wages on jobs has been much debated in the empirical literature, but the balance of evidence suggests that, if too high, minimum wages can hurt employment prospects of the young (Bassanini and Duval, 2006; Nelms and Tsingas, 2010). Therefore, while setting a relatively high minimum floor may reduce in-work poverty and increase incentives to work, it may lead to exclusion from the labour market of those who are the least productive or less experienced. This can be the case especially when the cost of employing a minimum-wage worker is high compared to that of employing an average-wage worker, as it is in Greece (OECD 2010b – Figure 3.6). Indeed, the combination of a relatively high minimum wage at entry and high non-wage costs for low-paid workers (Figure 3.8) can discourage hiring of low-skilled workers, and encourage informal employment in certain sectors.

Recent reforms go in the right direction but their employment effects should be closely monitored

Legislation in 2010 provided social security subsidies for young workers (below 25) entering the labour market for the first time (*i.e.* those who worked in the labour market fewer than 150 days in total), effectively introducing a sub-minimum wage. Specifically, under the 2010 law, the gross wage of younger employees was to be 84% of the basic wage agreed at the national level. Employees' take-home pay nevertheless remained the same as their social security contributions were covered by the Manpower Employment Organisation (OAED). In addition, the law introduced one-year apprenticeship contracts for youths between 15-18 years, which would pay 70% of the minimum wage.[2]

A new law in 2011 provides for non-subsidised sub-minimum wages for youth. To acquire work experience, young workers between 18 and 25 may be employed, in particular, under fixed-term contracts of cumulated duration up to 24 months with wages that are 20% lower than those in the prevailing collective agreement (national or specific-level).[3] The new measure, unlike the 2010 law described above, reduces take-home pay for the youth, and thus eliminates the related fiscal costs. At the same time, the coverage of the new provision is wider as it includes all young people between 18 and 25 and not only those entering the labour market for the first time and employable at the national minimum wage.[4]

The introduction of non-subsidised sub-minimum wages for youth is a step in the right direction in a stringent fiscal environment. The potential adverse impact of this initiative on hardship can be cushioned, at least in part, by the extended family network in Greece. The new scheme needs to be linked to a training provision in the workplace to enhance skills. It will be important to monitor closely the employment effects of the new measure. While the wider applicability of the new provision is welcome, some features of the youth sub-minimum wage scheme might need to be reconsidered. Given the urgency to reduce the high youth unemployment, the social partners and the government could consider linking the sub-minimum wage for all youth between 18 to 25 to the national minimum wage, while allowing firm-level agreements to set higher wages wherever appropriate. This would require a fast move to a firm-level bargaining system for young workers, *i.e.* eliminating specific-level wage agreements. In addition, it would be advisable that the sub-minimum wage scheme applies to all young people for the period needed to ensure labour market integration, rather than to be subject to time limitations. In addition to being less complex, such a scheme could be more effective in reducing potential obstacles for hiring low qualified and/or inexperienced young workers, as the wage floors negotiated at sectoral levels are higher than the national minimum wage. The sub-minimum wage could be scaled according to age as in most EU countries applying such schemes for youth.

Employment protection rules have been eased but scope for improvement remains

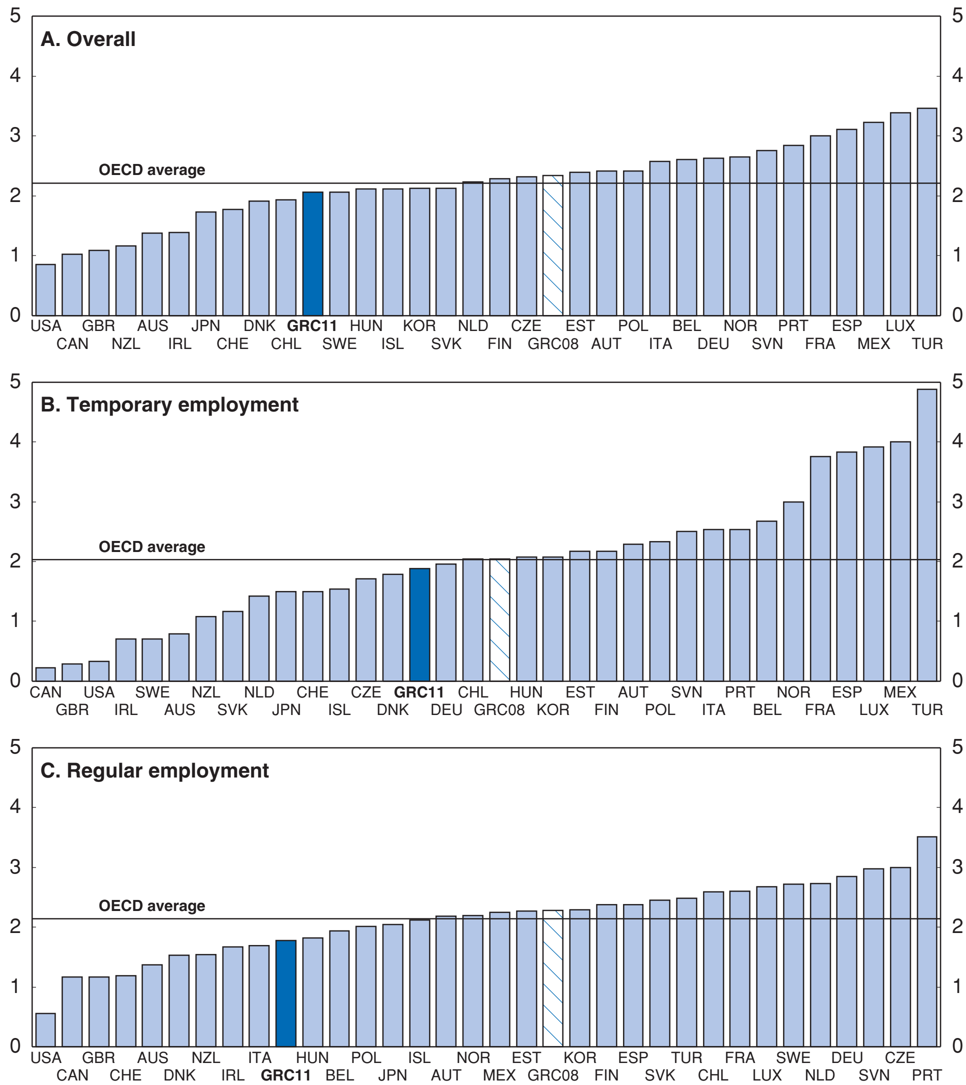
Overall employment protection legislation (EPL) in Greece is around the OECD average (Figure 3.9, Panel A). However, there is room for lesser regulation for temporary workers and white-collar workers compared to blue-collar workers. High EPLs tend to discourage both layoffs and hires (Bassanini and Duval, 2006). However, evidence suggests that strict EPLs increase the average duration of unemployment, which may be reinforced by limited mobility of workers, as in the case of Greece. By restricting labour turnover, tight EPLs may also slow worker reallocation to more productive jobs, hampering productivity growth and delaying the return of employment and output to their potential (Duval *et al.*, 2007; Furceri and Mourougane, 2009; and Bassanini *et al.*, 2009). Hence, while in the short run a strict EPL may protect workers from a sharp slowdown in activity, its adverse implications tend to become apparent during the recovery phase when workers need to be reallocated among sectors. In addition, tight employment protection legislation is likely to increase informality through the use of forms of employment that offer less protection and social coverage than permanent contracts (Venn, 2009; OECD, 2010b).

Temporary employment remains subject to various restrictions with potentially adverse effects on employment (Figure 3.9, Panel B). While the law does not establish a reason for the initial fixed-term contract or specific conditions for setting a term to the employment relationship, an unrestricted renewal of such contracts is permissible only if they can be justified for objective reasons.[5] Otherwise, a fixed term contract is converted into an indefinite one after three renewals, or after a cumulative duration of 24 months (see below for a recent revision of this provision). Relatively tight regulations also apply to the use of temporary work agency (TWA) contracts, and authorisations and reporting requirements for the setting up of temporary work agencies. These restrictions, though not out of line in international comparisons, appear to have restrained the incidence of temporary work in Greece, which, despite a fast rise since the onset of the current crisis (Figure 3.2, Panel E), remains below the euro area average (12% of employment in 2010 *versus* 16% in the euro area). This is a surprising finding given the importance of highly seasonal activities in Greece, such as tourism, agriculture and construction. To boost temporary employment, the maximum work under temporary work agencies (TWA) was raised in 2010 from 18 months to 3 years (Box 3.2). However, the recent reforms have restricted, compared to previous provisions, the types of work for which temporary work agency employment is permitted. Moreover, as noticed earlier, some limitations in the use of fixed-term contacts in terms of renewals remain as contracts cannot be renewed unlimitedly without objective reasons. In a positive move, a law in 2011 provides an extension of the maximum cumulated duration of successive fixed-term contract to 36 months (from 24 months). An additional factor that may explain the limited use of temporary employment contracts in Greece, which however is not captured by the OECD EPL indicators, regards the cost of early termination of these contracts. According to the European Commission (2011), these costs are substantially higher than elsewhere in the EU. A fixed-term employment contract can be terminated before the agreed time, only if there is a serious reason, otherwise the employer is obliged to pay to the employee the wages of the time left until the agreed termination time.

Concerning the employment protection of permanent workers, Greece is placed around the OECD average (Figure 3.9, Panel C). Dismissal rules (notice period and severance payments) for white collar workers are, however, well above the OECD average. Among the few OECD countries that have differentiated EPL rules for white- and blue-collar workers,

Figure 3.9. **Employment protection legislation in OECD countries**[1]

Index scale of 0-6 from least to most restrictive



1. The reference year is 2008 for all countries. The EPL indicators for Greece for 2011 are based on an intermediate update conducted in the context of the current *OECD Economic Survey of Greece*, rather than on a full update for all countries.

Source: OECD, *OECD.stat, Database on Labour Employment Protection.*

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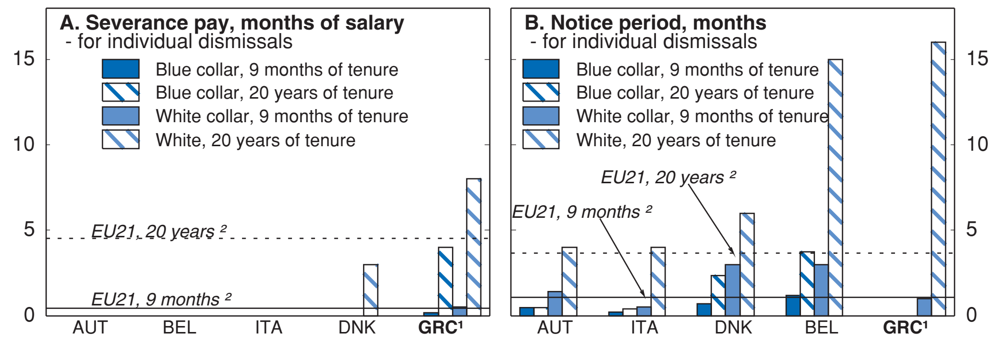
the distinction appears most marked in Greece (Figure 3.10), though recent reforms (discussed below) have reduced the gap. In Austria, Belgium and Italy, in particular, no worker had the right in 2008 to receive severance payment upon dismissal, while in Denmark white-collar workers were entitled to 3 months of severance pay after 20 years of service. Both blue- and white-collar workers are entitled for severance payment in Greece, though provisions are much more generous for the latter. In all these countries, as in Greece, white-collar workers benefits from longer notice period than blue-collar ones. Severance payments for blue collar workers in Greece are low in international comparison (Figure 3.10).

Figure 3.10. **Employment protection legislation for blue- and white-collar workers**

2008



1. A new legislation was introduced in Greece in 2010.
2. Average for both blue and white collar workers.

Source: OECD, "Detailed Description of Employment Protection in OECD and Selected Non-OECD Countries", 2008.

StatLink http://dx.doi.org/10.1787/888932474233

Reforms in 2010 eased employment protection legislation (EPL) for white collar workers. Their dismissal notice period was reduced, *de facto* lowering total severance costs for such workers (Box 3.2). While severance payments are unchanged by the reform, a large reduction in the length of notice periods makes it more attractive for firms to give notice and thus incur a severance payment half the size of that which would apply without notice. The 2010 reforms also make it possible for severance payment to be paid in instalments to cushion the impact of the economic crisis on firms. The introduced reforms for white collar workers have improved Greece's ranking in OECD's EPL indicators for regular employment (Figure 3.9, Panel C). The recent legislative changes also increased the threshold for collective dismissals for firms employing 20 persons and over. The maximum effect of the new provisions is for enterprises with 600 employees, where the number of lay-offs per month that can be made without incurring additional costs for collective dismissal increased from 12 to 30 people.

If rigorously implemented, the less strict EPL rules could speed up the pace of the recovery and resource reallocation, especially combined with a better functioning product market and other reforms that strengthen labour market performance (Furceri and Mourougane, 2009). Reducing the restrictiveness of EPL has two effects in terms of adjusting labour market outcomes following negative shocks: the immediate rise in unemployment is likely to be greater (as dismissals are easier for the firms), but the persistence of unemployment is reduced (because employers are willing to hire again as the commitment is less costly) (OECD, 2009b). Job reallocation is further expected to be facilitated by the increase of the probationary period in a job to 1 year (from 2 months) as such measure could make the employees more willing to hire inexperienced workers since no compensation is required in the event of dismissal within the probationary period.

Additional initiatives to ease EPL would be nevertheless welcome, especially with regards to temporary employment (Figure 3.9, Panel B). OECD research suggests that temporary jobs have the potential to provide a key entry port to the labour market for youth (Quintini and Martin, 2006). Although it is important to avoid a two-tier labour market, temporary contracts should be well adapted to the circumstances of some employers and workers. Promoting the use of fixed-term contracts, through reducing their early termination costs is needed to help workers during the crisis. Consideration could also be given to further

Box 3.2. **Recent reforms in EPL**

The following measures were introduced in 2010 (Laws 3863/2010 and 3899/2010) to facilitate job reallocation:

- *Reduction in notice period.* The notice period prior to dismissal of white collar workers has been reduced substantially. For an employee working 28 years or more, for example, notification is reduced to 6 months from 24 months. The new provisions lower total severance costs for white collar workers with long tenure. Employers now have a clear incentive to provide notice of dismissal for workers with long tenure, in which case their severance payments are halved. No changes have been made to notice periods or severance payments for blue collar workers. Dismissal compensation of blue collar workers have increased gradually over time through the terms of national collective agreements.
- *New rules for the settlement of severance payments.* The new provisions make it possible for severance payment, when it exceeds two months' pay, to be paid in installments. Part of the compensation, corresponding to two months' remuneration should be paid immediately at the time of the dismissal and the rest of the amount in installments paid every two months. These installments are legally qualified as wages and they enjoy the same legal protection as the payment of wages.
- *Redefinition of collective dismissal rules.* The threshold for collective dismissals has been increased for firms with 20 workers and over. As under the existing law, collective dismissals entail more notification and negotiation requirements than individual dismissals. The new law increases the threshold above which dismissals are characterised as collective to 6 employees for enterprises with 20-150 employees and 5% or 30 employees (whichever is smaller) for those with more than 150 employees. This compares with thresholds of 4 employees per month for enterprises with 20-200 employees and 2-3% or 30 employees for enterprises with more than 200 employees under the 2000 law. The 30-person threshold for collective dismissals is in accordance with EC Directive on collective redundancies. As was previously the case, the legislation does not to apply to firms with less than 20 employees.
- *Extension of probationary period.* The probationary period in a job was extended from 2 months to 1 year.
- *Temporary work agency contracts.* The maximum duration of fixed-term contracts for employees hired through temporary work agencies was extended to 36 months from 18 months previously and limits on the number of times that a temporary work agency contract could be renewed have been abolished.

A new law in June 2011, in the context of the implementation of the Medium Term Fiscal Strategy (MTFS), provided for an extension of the maximum cumulated duration of successive fixed-term contracts to 36 months from 24 months previously.

relax existing time limits for such contracts. Moreover, there is also need that firms avoid misuse of probationary period as a substitute for short-term fixed contracts to meet temporary labour needs (European Commission, 2011). Abolishing temporal limits on the maximum duration of temporary work agency contracts and removing restrictions on their use, as well as relaxing the cumbersome regulations governing the establishment and operation of these agencies, would also be advisable. A policy that supports the opening of more temporary jobs also depends on the strictness of EPL for permanent jobs, as rigid provisions may trap youth in temporary jobs. Measures to ease employment regulation for permanent workers, discussed above, are a positive step in this regard.

In the longer term, bolder options could be considered for reforming EPL. Greece could remove, in this context, employment protection legislation distinctions between blue- and white-collar workers, as in most OECD countries. Apart from avoiding segmentation of the labour market, such an initiative would help simplify a very complex EPL system. As some groups, however, may have their protection against dismissal reduced, the reform should be accompanied by more effective re-employment services (see above). Consideration could be also given by the government and social partners, as noted in previous *Surveys*, to transforming severance pay legislation into a system of individual savings accounts as pioneered in Austria[6] (OECD, 2007, Box 4.2). Such a system has the advantage of smoothing dismissal costs for both employers and employees. Employers' contributions to the individual accounts tend, however, to increase labour costs, unless they are compensated for by lower wages.

Flexible working time arrangements are not used extensively in Greece

The share of employees working long hours (48 hours or more)[7] accounted for 22% of male employment and 13% of female in 2007, well above the EU average at 12% and 5%, respectively (Plantenga and Remery, 2009). Part-time work, on the other hand, is low accounting for 6% of employment compared to around 19% in EU27 area on average, although it increased during the crisis (Figure 3.2, Panel F). Both demand and supply factors combine to reduce the attractiveness of part-time work. These include, on the employers' side, additional compensation for overtime for those on part-time work (in place before the recent reforms) and red-tape costs. Part-time jobs may also not be attractive because they tend to be poorly paid and offer limited job security and career opportunities. Inadequate child care support services also affect decisions for part-time work (OECD, 2009a).[8] At the same time, the percentage of involuntary part-time employment – that is employees who were unable to find full time employment – is among the highest in EU (52% in the third quarter of 2010 compared to an EU average of 25% in 2009), although there may be also a significant time of full-time workers who would prefer a part-time job, especially in the case of working mothers (OECD, 2010c – Figure 4.2).

Recent reforms will preserve employment and boost competitiveness

Policy initiatives in 2010 sought to promote the use of more varied work arrangements. These reforms reduce overtime pay and introduce pro-rata pay for part-time employees working less than 4 hours a day, while allowing, in the case of a slowdown in activity, the use of short-term (intermittent) work *in lieu* of dismissals and an averaging of working time to increase flexibility in working-time management (Box 3.3). More recent policy reforms, under the Medium Term Fiscal Strategy, facilitate the use of averaging of working time in small firms (Box 3.3). International evidence highlights the importance of adjustment in hours worked to preserve jobs and worker welfare during the global economic crisis (OECD, 2011a). Besides enhancing firms' adjustment capacity, more flexible working arrangements can boost participation of marginal groups such as women and the young, and reduce early retirement. Part-time work is a case of point, but appropriate incentives are needed, as part-timers still face penalties in terms of job quality and training opportunities relative to full-timers (OECD, 2010c).

The legislated reforms should be implemented swiftly and their effectiveness in boosting employment monitored thoroughly, especially regarding the vulnerable groups affected most by the crisis. Previous legislation has not been successful in promoting

Box 3.3. **Recent measures to increase the flexibility of working arrangements**

Policy initiatives in 2010 sought to promote the use of flexible working arrangements and reduce labour costs, through:

- A reduction in overtime pay by 20% across the board.
- Amending part-time remuneration. Part-time employees are remunerated on an equal basis as the comparable full-time employee. The excess payment of 7.5% for less than 4 hours employment per day as well as the 10% premium on pay for the overtime employment of the part-timers have been abolished
- Intermittent employment. In the event of a slowdown in activity, the employer can, instead of dismissals, introduce (following consultation with the unions or works councils) short-term (intermittent) working on daily, weekly or other basis, for a period up to 9 months (from 6 months previously).
- An averaging of working time. Recent legislative changes permit – through agreements at the firm- or sectoral level – working time to be averaged over different intervals, than those specified in the law, depending on the specificities of the industry of firm. The increased hours of work are "returned" to workers either in the form of equivalent reduced hours or as a daily rest period, or a combination of both.

A new law in June 2011, in the context of the implementation of the MTFS, introduced three changes in the averaging of working hours *i)* the reference period is changed from a calendar year to 12 months; *ii)* within this reference period the number of months during which working time can deviate from regular hours is extended from 4 to 6 months; *iii)* certain limitations in the use of averaging have been lifted by relaxing the conditions for approval of the employer's proposal. The latter element will facilitate the use of averaging in small firms (with less than 20 employees).

part-time employment or creating incentives for the widespread use of other types of flexible working settings (OECD, 2005). A reduction in red-tape associated with the use of flexible working arrangements through the simplification of the legal framework is of crucial importance. Informal practices, such as unpaid overtime work, also reduce the need for formal flexible working time arrangements (Karamessini, 2009). The government's commitment to strengthen the capacity of the Labour Inspectorate to monitor the enforcement of labour law and fight undeclared work is in the right direction. It would be preferable to have greater variety in formal arrangements rather than informal working time arrangements, such as unpaid overtime. Finally, extensive information for employers and employees on the possibilities offered in terms of flexible working arrangements could boost their use.

Reform of product market will boost growth

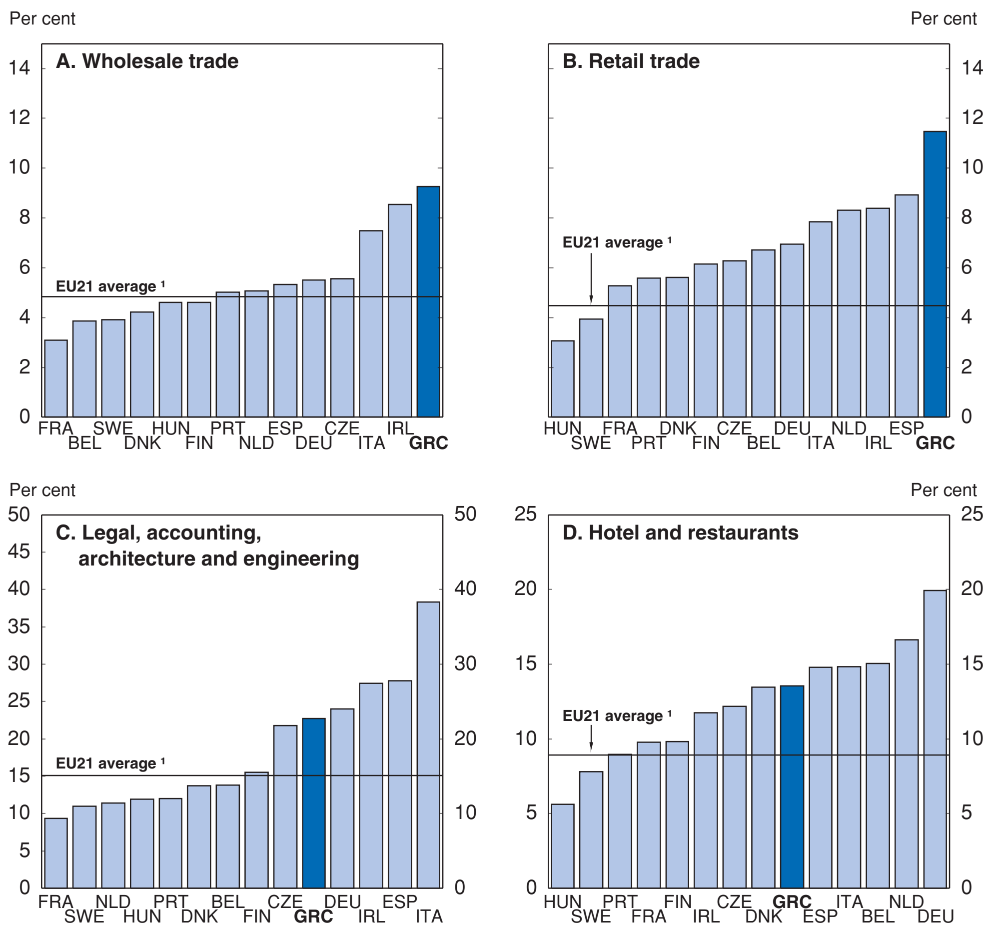
There is enormous scope to raise competition and improve the business environment in Greece

Barriers to entry and/or restrictions on fees or prices have been particularly cumbersome in professional services, retail and network industries. The high level of public ownership and vertical integration has inhibited effective competition in the electricity sector. Enforcement of competition law (OECD, 2005) and the EU Services Directive has also been weak (European Commission, 2010b).

The resulting lack of competition is reflected in relatively high mark-ups in Greece (Figure 3.11). Profit margins exceed the EU average in many key sectors, especially retailing, which may explain the resource pull into this sector discussed in Chapter 1. They are also high in hotels and restaurants, relative to other important tourist destinations such as France and Portugal.

Figure 3.11. **Mark-ups are relatively high**

Gross operating surplus/Turnover: average 2003-07



1. EU21 are EU member countries also members of the OECD: Austria, Belgium, Czech Republic, Denmark, Estonia, France, Finland, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden and United Kingdom.

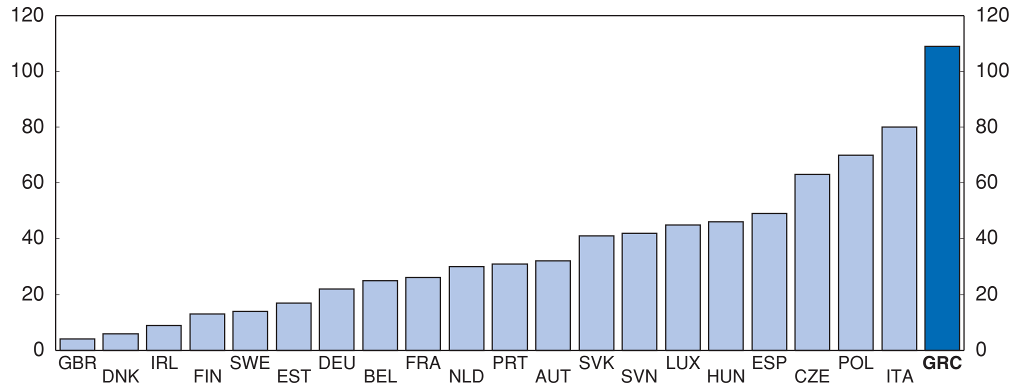
Source: OECD, OECD.stat, Industry and Services, SDBS Structural Business Statistics.

StatLink http://dx.doi.org/10.1787/888932474252

Regulations have also created obstacles to investment and entrepreneurship. Greece ranks poorly in the World Bank "Doing Business" 2011 indicators, in particular in ease to form a business, enforce contracts and access to credit (Figure 3.12). Combined with a relatively low trade exposure and poorly designed investment incentives, restrictive product market regulations have acted as barriers to investment in Greece. Overall the inflows and the stock of FDI in relation to GDP are low (Figure 1.14, Panel A).

Figure 3.12. **Barriers to business remain**

Overall "Ease of Doing Business" rank of 183 economies[1], 2011



1. Overall "Doing Business" indicator of the following sub-indicators: Starting a Business, Dealing with Construction Permits, Registering Property, Getting Credit, Protecting Investors, Paying Taxes, Trading Across Borders, Enforcing Contracts, Closing a Business.

Source: World Bank (2010), *Doing Business 2011: Making a Difference for Entrepreneurs*.

StatLink http://dx.doi.org/10.1787/888932474271

The product market reforms launched since late 2009 address many of the above issues, and have a large potential to boost growth. According to a recent OECD study, aligning regulations in upstream sectors to best practice could raise multifactor productivity growth by 0.8 points per year, increasing the GDP level by approximately 9% after 10 years (Bourles *et al.*, 2010). Indeed, some reforms, such as the removal of the bureaucratic barriers to investment and exports, and the swift opening up of closed professions, could raise growth relatively quickly by opening up new market opportunities. In addition, by reducing the rents of vested interest groups, such reforms demonstrate a fair sharing of the growth gains among all groups.

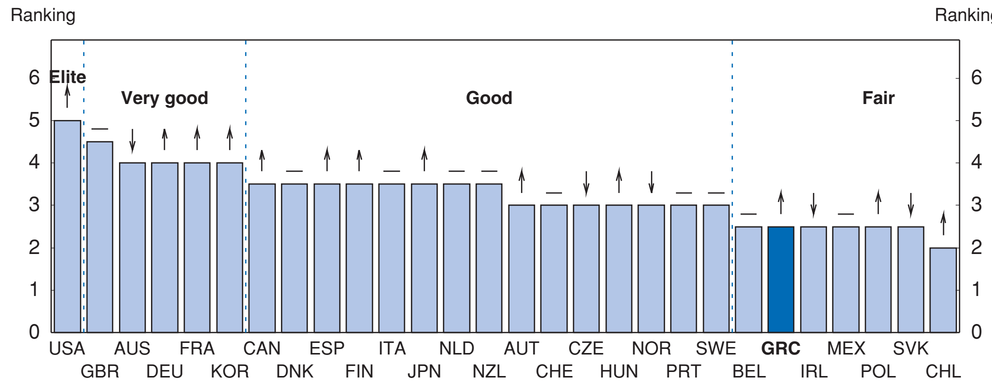
The competition framework and its enforcement have been weak

Competition policy has not been strong in Greece. This reflects a number of factors, including the lack of a competition culture and the strong tradition of extensive state regulation and price controls (OECD, 2001). The weaknesses have been reinforced by shortcomings in the existing institutional framework for competition. The first general competition law (Law 703) was adopted in 1977, as part of Greece's preparation for EU membership. In practice, however, it had little influence over policy-making, despite the frequent amendments during the 1990s. It tended to focus on merger review control, which was not among the most pressing competition policy issues in Greece (OECD, 2005). The time and resources consumed by the Hellenic Competition Commission (HCC) to review even minor merger applications reduced its efficiency to deal with anti-competitive agreements and abuses of dominance (OECD, 2001).

Policy initiatives over the past decade have strengthened the role and independence of the Greek competition authority, improving its enforcement record[9] (Box 3.4). Nevertheless, international comparisons suggest that its performance could be improved further. HCC still occupies a low position in terms of antitrust enforcement on the basis of a recent evaluation by the *Global Competition Review* (Figure 3.13). Comparisons with similarly resourced, but more favourably ranked, competition authorities, such as the German and the UK ones, suggest that the HCC could deliver "better" annual results.

Figure 3.13. **Greece ranks low on the basis of Global Competition Review**[1, 2]

2009



1. Based on the opinions of competition law practitioners.
2. The competition review evaluates the performance according to the following scale: 5 = Elite; between 5 and 4 = Very good; between 4 and 3 = Good; between 3 and 2 = Fair.

Source: Global Competition Review, June 2010.

StatLink http://dx.doi.org/10.1787/888932474290

Effectiveness has been also reduced by shortcomings in the HCC legislative framework. Strict constraints have been placed on the authority's discretion to set priorities and reject complaints on (lack of) public interest grounds. The law also imposed strict deadlines for the investigation and issuance of decisions. For example, until recently, the HCC had 6 months between the opening of proceedings and the issuance of a statement of objections. This can be very tight, especially in the case of more complex cases. The frequent amendments of the competition regime can be another explanatory factor for the internationally low performance of HCC as, in addition to contributing to institutional instability, such changes often resulted in a premature expiry of the mandate of HCC board members (including the president). On two occasions (in 1995 and 2000) the HCC president was removed with a ministerial decision. Shortcomings in the judicial system may also have reduced effectiveness of enforcement through its effect on the implementation of sanctions imposed by the HCC. Decisions by the HCC were reviewed by the administrative courts (Athens Administrative Court of Appeal), rather than by specialised competition courts. The general attitude of the court of appeals was to reduce the imposed fines. In the review of the merits, the court has appeared rather reserved, often chose to annul HCC decisions on merely procedural grounds.

The long tradition of "gentlemen's agreements" to control inflation has also weakened competition policy institutions in Greece (OECD, 2001). In December 2010, for example, a price decrease was agreed between the government and producers/sellers of consumer products under the corporate social responsibility policy (Mitroulia, 2010). While "gentlemen's agreements" may halt temporary price increases, they cannot have long lasting effects as they are not underpinned by competitive pressures. Rather, they can facilitate cartels and constrain free price competition with potential harmful effects on consumers. A better approach to moderate price increases would be to promote competition in sheltered sectors, as noted by the 2001 *OECD Regulatory Review for Greece* (OECD, 2001).

The new competition bill is a positive step forward

A new bill was enacted in 2011 to reform the legal framework of the Hellenic Competition Commission (HCC) (Box 3.4). It brings about important changes in the structure and appointment procedure for the HCC board members, while decoupling their

Box 3.4. The legislative framework for the competition authority has been amended frequently

Greece has been active in the last decade in seeking to ensure the effectiveness of its system of competition enforcement. In recognition of the misplaced emphasis on mergers, legislation passed in 2000 reduced the merger review burden, enabling the Commission to invest more time in investigating cartel and abuse cases. Moreover, the 2000 law gave the HCC more advocacy (allowing it to deliver opinions on its own initiative) and granted the Commission financial (a 0.001 percent charge on new listings and capital raisings) and budgetary independence. It also authorised a substantial increase in HCC's staff, with the total number of employees almost doubling between 2000 and 2005 (from 27 to 59). Greece's enforcement effort however, remained among the lowest of OECD countries (OECD, 2005).

To achieve a better supervision of competitive conditions, the government assigned in 2005 more responsibilities and monitoring powers to HCC. These included the possibility for the agency to take properly justified regulatory or corrective measures to prevent infringements of the competition law, and reinforced its independence through the selection of the Commission's Chairman by the Cabinet.* Moreover the law brought about a simplification of the merger control procedure, reducing HCC's workload. The introduced changes also aimed at bringing the Greek competition enforcement system more in line with that of the other EU countries. Further reforms to the legal framework of competition in 2009 sought to enhance HCC's investigatory powers, improve its ability to prioritise on important cases, and bolster the independence of its decision-making process through, for example, the appointment of full-time independent members (Hellenic Competition Commission, 2010). The 2009 provisions also accelerated the examination process of HCC by introducing time limits for the adoption of a decision, which until then it could have dragged for years, and enabled HCC to impose stricter fines (including imprisonment) for violations of the competition law (KGDI, 2009). Burdensome notification requirements, however, remained in force.

Building on previous efforts, new legislation in 2011 has focused on six key areas that could promote the independence and effectiveness of HCC. In particular, the new law revolves around: *i)* the strengthening of HCC independence; *ii)* the efficiency of enforcement action; *iii)* the efficiency of judicial review; *iv)* criminal penalties; *v)* the evaluation of new legislative and regulatory measures; and *vi)* promoting harmonisation with EU competition law and practice (the specific measures are discussed in the text).

* In addition, the 2005 legislation (Law 3351/2005) increased the members of the Commission, granting them a 3-year term contract that can be renewed only once for reasons of transparency. The law further reinforced HCC's staff with expert personnel (Hellenic Competition Commission, 2006).

mandate from electoral cycle. The independence of the competition authority is further strengthened by the creation of a disciplinary body for HCC board members and the limitation of the government's information requesting power (Ministry of Finance, 2011a). The recent reform also aims at increasing the effectiveness of the competition authority by enabling HCC to prioritise its cases and reject low-priority complaints. The introduction of a points-based system for the prioritisation of cases reduces the risk of an arbitrary enforcement of competition law that could arise from the possibility under the new law of rejecting complaints for lack of public interest. Moreover, the 2011 law provides HCC with a more reasonable timeframe for the resolution of cases and stricter penal sanctions for cartels. The positive effects of such provisions are reinforced by the envisaged creation of specialised competition chambers at the court of appeal, which increases the effectiveness of judicial review. It is also important for effective competition to ensure neutral treatment by the HCC of public or private enterprises when applying the new competition law. The power given to HCC under the new law to issue a (non-binding) opinion on new legislative and regulatory measures that may distort competition is a positive move. The checks and balances of regulations could be improved further through the adoption of rigorous and comprehensive system for Regulatory Impact Assessment, as is the case in many OECD countries (OECD, 2010d). The current draft law on better regulation is a positive step in this regard. A centrally-led review of laws and regulations governing competition, focusing on both, a systematic review of the original regulatory aim of the measure and its possible unintended consequences with follow-up revisions if necessary, would be advisable. It could significantly improve competition and the competitiveness of the Greek economy. The OECD Competition Assessment Toolkit represents a useful methodology for screening regulation as to its repercussions on competition (OECD, 2010e).[10]

It is also essential to ensure the immediate elaboration and implementation of the points system, to be used by the competition authority to prioritise cases. To be effective, the new system needs to be workable and based on a set of objective and transparent indicators. Specific deadlines within the administrative courts on the decision on appeals before them would be welcome, but these are currently prohibited by the Greek Constitution. Finally, it would be important to change the public's perception about the role of the HCC. Although the Commission has become more and more active over the recent years in enforcing competition, its poor public image remains. Information campaigns and political support for HCC to allow it a more proactive approach in establishing a "competition culture" and improving the understanding by the public of the longer-term benefits of effective competition would be needed.

Cumbersome business regulations have reduced investment and entrepreneurship

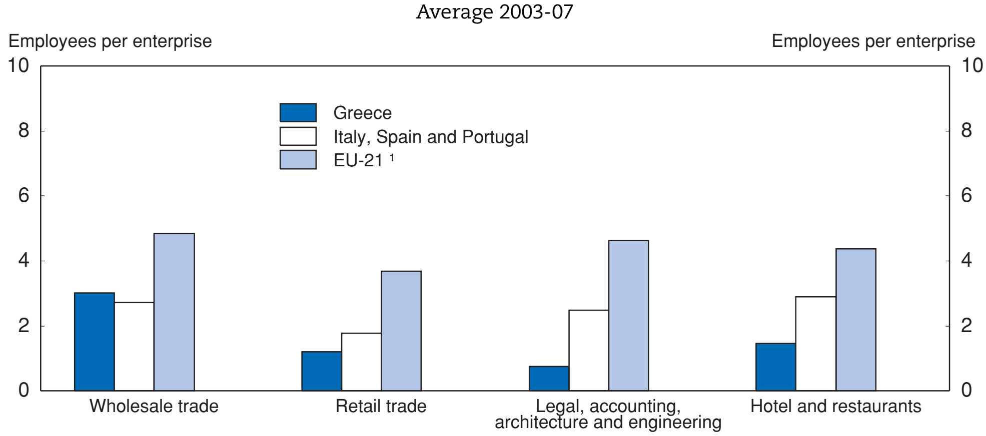
Despite measures taken over recent years to improve the business environment, Greece still ranks poorly in international comparison (Figure 3.12). Two recent studies, conducted respectively, by the Federation of Hellenic Enterprises (SEV) and the Foundation for Economic and Industrial Research (IOBE), identify a large number of remaining obstacles to entrepreneurship in Greece (SEV, 2010; Vassiliadis *et al.*, 2011). These include high barriers to entry and the expansion of firms and complex and lengthy licensing procedures, as well as transport restrictions, bureaucratic burdens for exporters, public sector inefficiencies, labour market impediments, and low R&D and innovation.

Land-use problems stemming from a lack of appropriate spatial planning regulations seem to be among the key obstacles to establishment and investment (IOBE 2010a). While land-use plans have been compulsory for all primary local authorities since 1997, the relevant procedures have been delayed, rendering the plans outdated in many cases. Overlapping land-use regulations at different planning levels, rigid provisions included in the land-use and urban design plans, and the existence of many special land-use provisions increase uncertainty and investment costs.

Another major barrier relates to burdensome start-up requirements and complex and lengthy licensing procedures. Starting a small-to-medium size company in Greece in late 2000s required double the number of procedures compared to peers (Austria, Belgium, France, Germany and Italy) (World Bank, 2009). Real and financial costs were also higher. In particular, until recent reforms (discussed below), starting up a business required the completion of 15 procedures, took 19 days, and the cost was 11% of income per capita. This compares with an average of 6.2 procedures, 13.4 days and a cost of 7% of income per capita in "comparable" countries, and just one day and minimal cost in best practice ones. The licensing procedures for the establishment of manufacturing firms are particularly long, lasting up to 24 months (or more) for firms with higher emission levels (Ministry of Regional Development and Competitiveness, 2010a). Delays in the issuance of environmental permits have been a critical factor contributing to the long time required for starting up a business. This has also affected investment by established companies. This is due to the overlap of responsibilities among many agencies for issuing these permits, reinforced by the lack of specialized staff and the absence of binding deadlines concerning the issuance (SEV, 2010; Vasiliadis *et al.*, 2011). Obtaining a building permit adds significantly to costs incurred by a new firm, as it can be a long process as there is no differentiation between manufacturing or other units (for example, houses) in terms of priority for the granting of construction permits. In addition, the cost of a building permit can be high as it is calculated on the basis of the compulsory legal fees of the engineers (at least until recent reforms), in turn based on the value of the project. Regulations can also affect adversely the dynamism of firms. For example, in the case of manufacturing firms in Attica, a pole of development in Greece, strict rules apply not only with regard to establishment but expansion and modernisation of the enterprises and the development of new products. This may be another contributing factor to the high incidence of small size enterprises in Greece (Figure 3.14).

Figure 3.14. **The average size of enterprises is small**

Average 2003-07



1. EU21 are EU member countries also members of the OECD: Austria, Belgium, Czech Republic, Denmark, Estonia, France, Finland, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden and United Kingdom.

Source: OECD, OECD.stat, Industry and Services, SDBS Structural Business Statistics.

StatLink http://dx.doi.org/10.1787/888932474309

Reforms to remove restrictions to business are welcome and need to be implemented rigorously

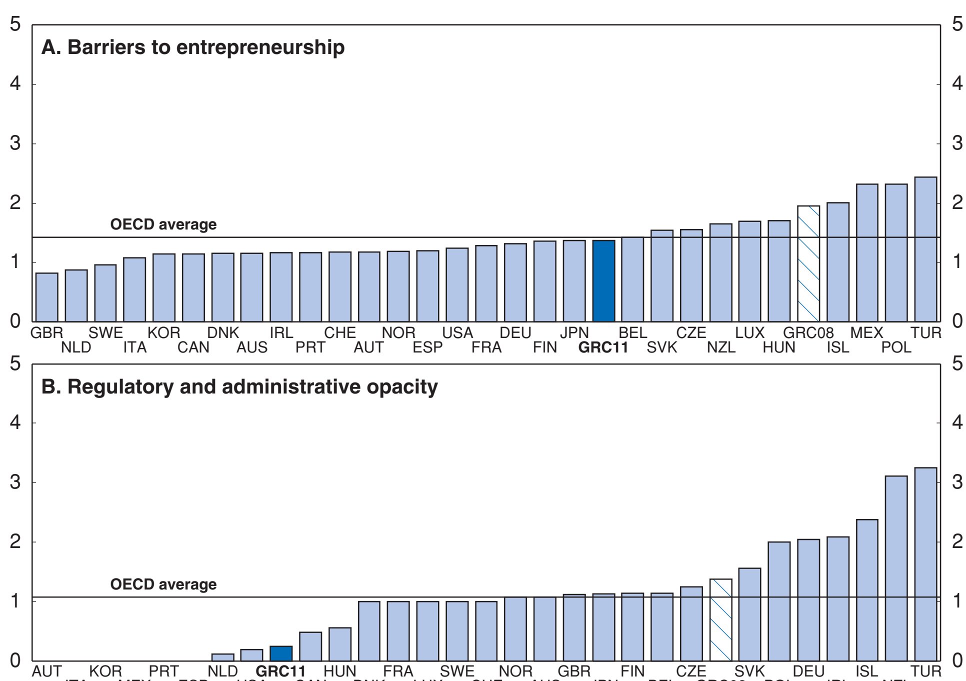
An efficient business environment is a high priority for the government. The creation, in 2011, of a unique Business Registry (GEMI) and the operation of one stop services consisting of a wide network contact points are notable initiatives in this regard. For the majority of companies, all registration procedures are now accomplished in one procedure (instead of 15), in one day (instead of 19) and at a single contact point (instead of 8). The expected time for the procedure to be completed is one hour. The estimated reduction of cost from the simplified procedures can reach to 62% in the case of limited liability companies (Ministry of Regional Development and Competitiveness, 2011).

A new law (3982/2011) reduces the complexity in the licensing system of technical professions and modernises qualifications and certification requirements. Until recently, for example, the law specified 68 categories of licenses for machine operators, which will be limited to 16. In manufacturing, licenses for activities with low emission levels will be issued immediately, with inspection of adherence to the requirements following at a later stage. For high levels of emissions inspection continues to precede licensing in view of the high risk level entailed in such activities (Ministry of Finance, 2011a). Efforts also focus on accelerating the licensing process of manufacturing activities through a reduction in the number of required support documents and the establishment of an almost equivalent one-stop shop.[11] An action plan is currently being prepared by the government for a business-friendly Greece, based on the findings and proposals of the above mentioned studies by SEV and IOBE, which aims to remove the 30 most important remaining restrictions to business activity investment and innovation. Most of the government's commitments for the removal of the identified obstacles are frontloaded in 2011.

The recent reforms are welcome steps towards an improved business environment, as is also depicted by Greece's better international ranking on OECD product market regulation (PMR) indicators (Figure 3.15). According to official data, 1837 firms were established through the one-stop shop services between early April and mid-June 2011. It

Figure 3.15. **Regulatory barriers to entrepreneurship have eased**[1]

Index scale of 0-6 from least to most restrictive



1. The reference year is 2008 for all countries. The PMR indicators for Greece for 2011 are based on an intermediate update conducted in the context of the current *OECD Economic Survey of Greece*, rather than on a full update for all countries.

Source: OECD, *Database on Product Market Regulation*.

StatLink http://dx.doi.org/10.1787/888932474328

is important to continue monitoring the effectiveness of the new measures through a systematic set of indicators. Previous attempts to simplify the registration and licensing procedures for new businesses (for example, laws 2941/ 2001 and 3325/2005), did not yield the expected results, as they were not fully implemented (OECD, 2005). Strict mandatory deadlines for the completion of licensing approvals and tacit approval in the case of non adherence are essential. Initiatives such as the introduction of strict time limits for the completion of licensing procedures for technical professions under the new law go in the right direction. Reducing further the gap *vis-à-vis* the best performing countries also hinges upon the swift implementation of the comprehensive action plan for a business-friendly Greece, including, among others, a further simplification of establishment procedures and environmental permits. The extension of the one-stop services for business start-ups to all firms would add to gains. Overcoming obstacles to entrepreneurship is also subject to improvements in the spatial planning system to address problems related to land-use. The adoption of a "fast track" legal framework for large-scale investments (discussed below) is a welcome step towards increasing planning flexibility, but does not address the root of the problem as it does not cover all investment projects. Two important issues relate to the frequency at which land use plans should be reviewed and their maximum validity period (IOBE, 2010a). The monitoring and evaluation of these plans should take place at regular intervals and become compulsory for all plans to ensure that they are not outdated and inhibit investment. A more simplified planning procedure would speed up the spatial arrangements and the licensing process for investment projects.

The framework for investment support has been fragmented and ineffective

Past efforts at boosting investment with subsidies have not been successful. Around 21 000 enterprises (many of them new) were funded over the 30 year period resulting in the creation of 150 000 employment positions, a relatively poor outcome for an economy of 1 million businesses and a labour force of 5 million people (Ministry of Regional Development and Competitiveness, 2010b). The measures were characterised by heavy bureaucracy and managerial opacity, poor targeting and a lack of evaluation of results. Funds were often granted to the majority of the submitted business plans, even those of a low quality. This has contributed to a misallocation of investment towards low-productivity segments of expanding sectors such as tourism, wholesale and retail trade and other services (Chapter 1). In addition, past laws failed to achieve their objective of regional convergence and cohesion, as activity in the poorest regions has fallen considerably. The limited impact of public expenditure on growth through the application of investment laws is further indicative of the limited synergy between these laws and other development instruments and funding tools, such as EU funds, and poor co-ordination of the public policy for private investments and other sectoral policies (Ministry of Regional Development and Competitiveness, 2010b).

A new investment law aims at facilitating large investment by removing obstacles to business

The law targets growth-enhancing investments, sets a clear time schedule for the evaluation and approval of projects, and allows for a better evaluation of projects and their outcomes in terms of activity and employment, thereby increasing transparency and accountability. The law offers tax incentives worth around 1% of GDP and financial support worth around 0.4% of GDP. At the same time, new financial engineering tools to support SMEs have been established (Box 3.5). As a further stimulus to growth-enhancing investments, the government introduced in late 2010 fast-track procedures to accelerate the approval and implementation of strategic investments, particularly FDI. The new legislation sets a 2-month time-limit for the issuance of licenses, after which it shall be presumed that the license has been granted. The definition of strategic investments under the new law is based upon qualitative and quantitative criteria, while applications for investment should be accompanied by a detailed business plan and an impact assessment study on the Greek economy (Invest in Greece Agency, 2011). Moreover, to accelerate the approval process for Public-Private Partnerships (PPP), the government reactivated the Inter-ministerial Committee responsible for the approval of PPP projects, with a number of projects (including concessions) currently underway. Current projects regard social sectors, such as education and transport management systems, as well as concessions, for example, for the construction of new motorways in Attica (Ministry of Finance, 2010).

Box 3.5. **The new investment law and other initiatives to support business investment**

The new investment law (Law 3908/2011) targets projects promoting economic openness, competitiveness, technology upgrading and the reduction of regional inequalities. The law provides for three general and four special categories of investment schemes, corresponding to different investment regimes.

The law also entails more rigorous project selection criteria and simpler submission and evaluation procedures than past frameworks (Invest in Greece Agency, 2011). It sets a clear time schedule of six months for the evaluation and approval of projects and provides for a better monitoring of disbursements and the outcomes achieved through specific annual budgets for the total amount of disbursements and other items. Moreover, the new law stipulates the submission to Parliament of an annual report detailing the resources disbursed and expected results on growth and employment. All applications of investment proposals are required to include a complete and detailed business plan and an impact assessment study on the Greek economy (Invest in Greece Agency, 2011).

Unlike the focus of past policies on explicit subsidies, investment incentives under the new law rely on tax allowances and other instruments such as favourable loans.

The launching of ETEAN (Hellenic Entrepreneurship and Investment Fund) in early 2011, with a starting capital of EUR 1.7 billion, also aims to support business investment plans by facilitating access to credit of all enterprises, particularly small, medium, innovative and export oriented enterprises, through bank guarantees and new financial products, mainly low cost loans.* Only enterprises that have met their tax and social security obligations are eligible in participating in the programme. ETEAN is co-funded by programmes supported by the EU funds.

* A programme on "Saving Energy at Home" is already in the market since November 2010, with a budget of EUR 800 million, with 20 000 applications and 8 000 approvals by mid-April 2011. In addition, a large scale ETEAN programme with a budget of 1.2 billion euro and a wide coverage of eligible sectors was announced in April 2011.

A close monitoring of the new investment law in terms of allocation of resources and the value added of the financially supported projects is important. The potential budgetary costs of the fiscal incentives should also be followed up carefully, ensuring that they conform to the fiscal consolidation strategy. Moreover, caution is needed concerning the feasibility of choosing growth-enhancing investments *ex ante*. Impact investment studies have of course some merit in this regard, but they cannot ensure *ex ante* that only appropriate projects are picked. Overall, government supported schemes for investment can only be seen as a complement to improved business environment. Intense competition between firms and the permanent threat to incumbents posed by innovative entrants is a far better engine of growth than industrial policies (OECD, 2009c). It is also important to follow closely, based on comprehensive sets of indicators, the implementation and effectiveness of the fast-track procedures. The law should subsequently be extended to non-strategic investments, while retaining a rigorous evaluation of the submitted plans. Changing the scope of the fast track law alone is not sufficient of course by itself to achieve positive results, if lengthy administrative procedures to obtain licenses and lack of legal certainty are not addressed. Recent measures to improve the business environment (discussed above) go in this direction. As noted earlier, boosting investment also hinges upon addressing land-use problems firms face during start up by setting clear and adequate rules for the spatial planning (IOBE, 2010a). The government also needs to continue efforts to improve the quality of the education system and on a comprehensive strategy to boost R&D and innovation given past underperformance in international benchmarking, discussed in previous *Surveys* (Annex 1.A1).

Recent achievements towards a swifter absorption of the EU structural funds, amounting to around 9% of GDP over 2007-13, are welcome and should continue. This is important for Greece to make the most of the easier access to EU funds under the new financial package agreed by Troika in July 2011, which implies both a reduction of national contribution to projects subsidised with EU structural funds from 27% to 15%, and an exceptional technical assistance to boost investment and growth. At the end of 2010 the absorption rate rose to 18%, compared to less than 4% in 2009, reflecting the progress achieved so far in addressing regulatory and organisational obstacles to absorb the EU funds. Further improvements are possible, however, especially through reducing the suboptimal use of resources (European Commission, 2010c). A good level of absorption is one dimension, but even more important is the appropriate allocation of the EU funding, and in particular, the priorities and policy-mix for the use of such funding. The creation of a Task Force in the July 21 package to work with the Greek authorities to target the structural funds on competitiveness and growth, job creation and training is welcome (Council of the European Union, 2011). It is important that the design of the programmes better targets local needs and priorities.

The low level of openness points to problems in export incentives and economic structures

There is also much scope to increase growth through exploiting the potential of stronger exports, which have underperformed (Figure 1.9, Panels B to D). Besides price competitiveness, the dynamics of Greece's pattern of specialisation play an important role in constraining export performance, according to a recent study by the Bank of Greece (Athanasoglou *et al*, 2010). Despite improvements, the composition of Greek exports remains tilted towards low- and medium- technology products, making it difficult to exploit the rapidly growing foreign demand for high-technology products. Papazoglou (2009) concludes that Greece has not taken full advantage of the opportunities arising from its entry to the EU.[12] The substantial presence of marginal exporters, especially in the manufacturing sector, constitutes an additional weakness of the export sector in Greece (Chapter 1). A recent analysis by the European Commission suggests that in most sectors Greek exporters sell abroad only a small fraction of their output (European Commission, 2010d).

Greece needs to take action to boost trade competitiveness through structural reforms. Apart from broader competitiveness problems, weak trade performance has been affected by cumbersome procedures, high transport costs because of various sheltered activities, and other red tape. The structural reforms undertaken could boost export performance relatively quickly, according to a recent study by the European Commission, given that a high proportion of firms is being involved in – and therefore is responsive to – export activity. In other words, while the prevalence of marginal exporters can partly explain the poor past export performance, it can also contribute considerably to future export growth (European Commission, 2010d). Measures introduced so far to improve the business environment, boost investment and reduce labour costs for firms, go in the right direction of improving export performance, as do announced reforms to improve the quality of the education system and its links with the labour market (Annex 1.A1).

Export incentives are being revamped

The government has presented a national export strategy to improve the marketing of Greek products abroad. These include the development of a national brand, new financing tools to improve market liquidity and the establishment of an information network for exporters. While it is very important for firms to develop their own initiatives with regards to export activity, such a strategy could help smaller firms that predominate the Greek market to get more visibility abroad, at least at the first steps of their outward expansion. Ongoing initiatives also aim to establish an electronic facility ("Single Window" for International Trade) that allow parties involved in trade and transport to lodge standardised information and documents in a single entry point. These are complemented by efforts to remove procedural burdens on promoting exports, focusing on the revision and modernisation of the underlying legislative framework for exports and the codification of all existing legislation (Ministry of Finance, 2011a). Steps towards simplifying export procedures are welcome and should be intensified. The number of documents, time, and cost (per container) to export, as well as import, are well above OECD average according to World Bank "Doing Business" 2011 indicators (World Bank, 2010). The burden-of-custom-procedure index, which measures business executives' perceptions of their country's efficiency of customs procedures, indicates much room for improvement (World Bank, 2011). Exploiting the potential of tourist industry would add significantly to exports and growth (see below).

Swift implementation of sectoral reforms should also enhance growth

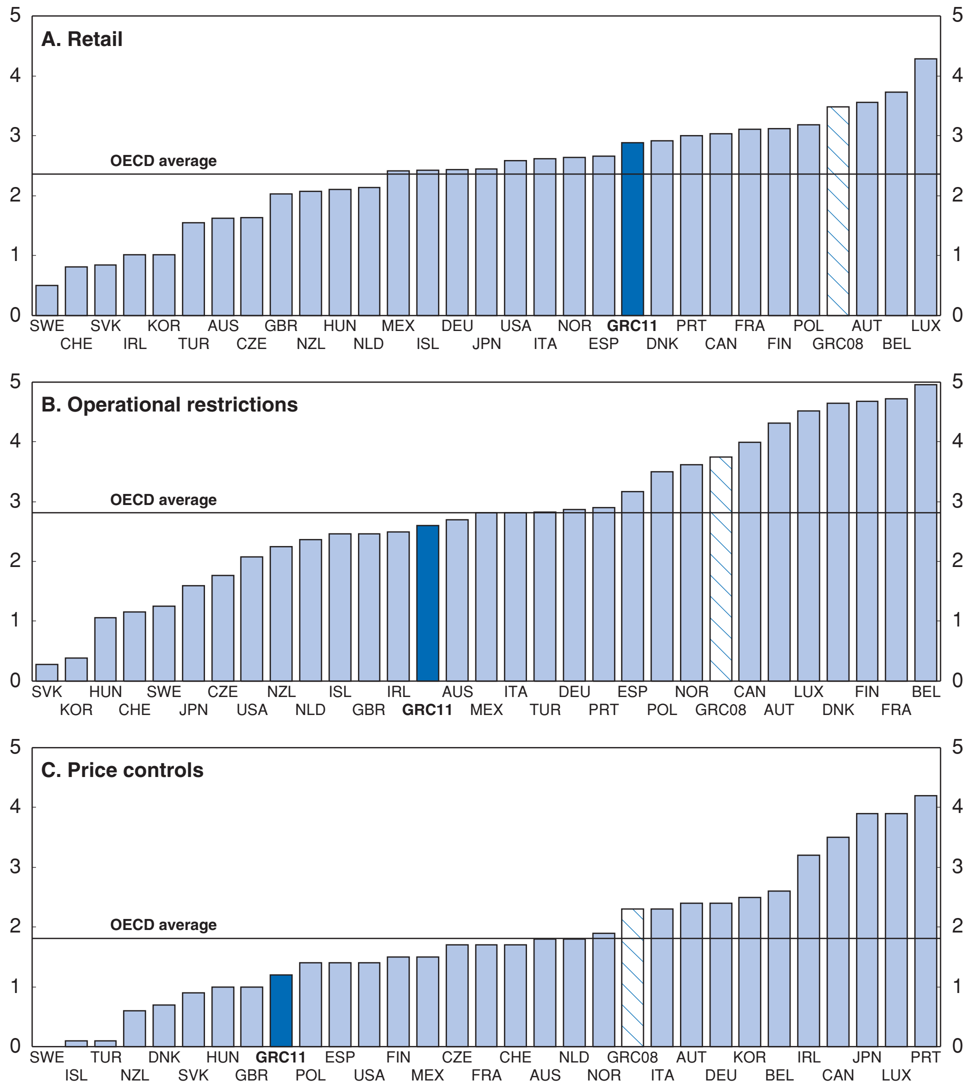
Welcome progress is being achieved in deregulating the retail sector but efforts need to continue

Competition-restraining regulations have increased costs and reduced dynamism in the retail sector, which contributes about 7% to GDP and accounts for over 10% of total employment. PMRs in retail were among the strictest in the OECD in 2008, due to licensing requirements, specific regulations relating to large outlets, protection of existing firms, and price controls (Figure 3.16). Strict regulations in retailing appear to have curbed the dynamism of the industry and weakened competitive pressures, as reflected in the predominance of the small firms in the sector (Figure 3.14) and the relatively high mark-ups (Figure 3.11, Panel B).

Welcome progress has been achieved towards deregulating the retail sector in the context of implementing the EU Services Directive. It aims to facilitate cross-border provision of services and the freedom of establishment. Initiatives include the

Figure 3.16. **Regulatory barriers in retail sector**[1]

Index scale of 0-6 from least to most restrictive



1. The reference year is 2008 for all countries. The PMR indicators for Greece for 2011 are based on an intermediate update conducted in the context of the current *OECD Economic Survey of Greece*, rather than on a full update for all countries.

Source: OECD, *Database on Product Market Regulation*.

StatLink http://dx.doi.org/10.1787/888932474347

simplification of the licensing procedures, the abolition of certain requirements for the location of retail outlets and prior application for a site,[13] and the introduction of shorter deadlines for the issuance of relevant decisions. However, the principle of licensing for retail outlets is maintained for reasons of environmental protection. In addition, the government has lifted restrictions on the fresh product wholesalers' right of establishment outside central markets, in response to the European Commission's request, while it is currently amending the renting criteria of premises inside the central markets, making them objective and more transparent.[14] As an additional step, the authorities have abolished state price control over several goods (vegetables, infant food), but intervention remains possible as an exceptional measure for fuel products and goods sold in places where competition is restricted, or does not exist.

These measures go in the right direction. The retail sector, for example, has improved its international ranking in the OECD product market regulation indicators (Figure 3.16). The simplification of licensing procedures in retail trade, including for large outlets, should help to modernise the industry and make it more competitive. Adherence to strict deadlines for licensing approval is essential in this regard. The reduction of state price controls is an additional important legislative initiative for the deregulation of the retail sector (Figure 3.16, Panel C). Further reforms would be welcome and could effectively be introduced by systematically applying a competition assessment screen on new and old regulation. Without putting the regulatory goal of environmental protection into question, one consideration could be to abolish the principle of licensing for retail outlets by addressing the environmental issues through more efficient instruments.[15] Remaining state price controls in retail sector should also be abolished, allowing the competition authority to pursue cases where it suspects inappropriate behaviour.

Competition is also being boosted in tourism

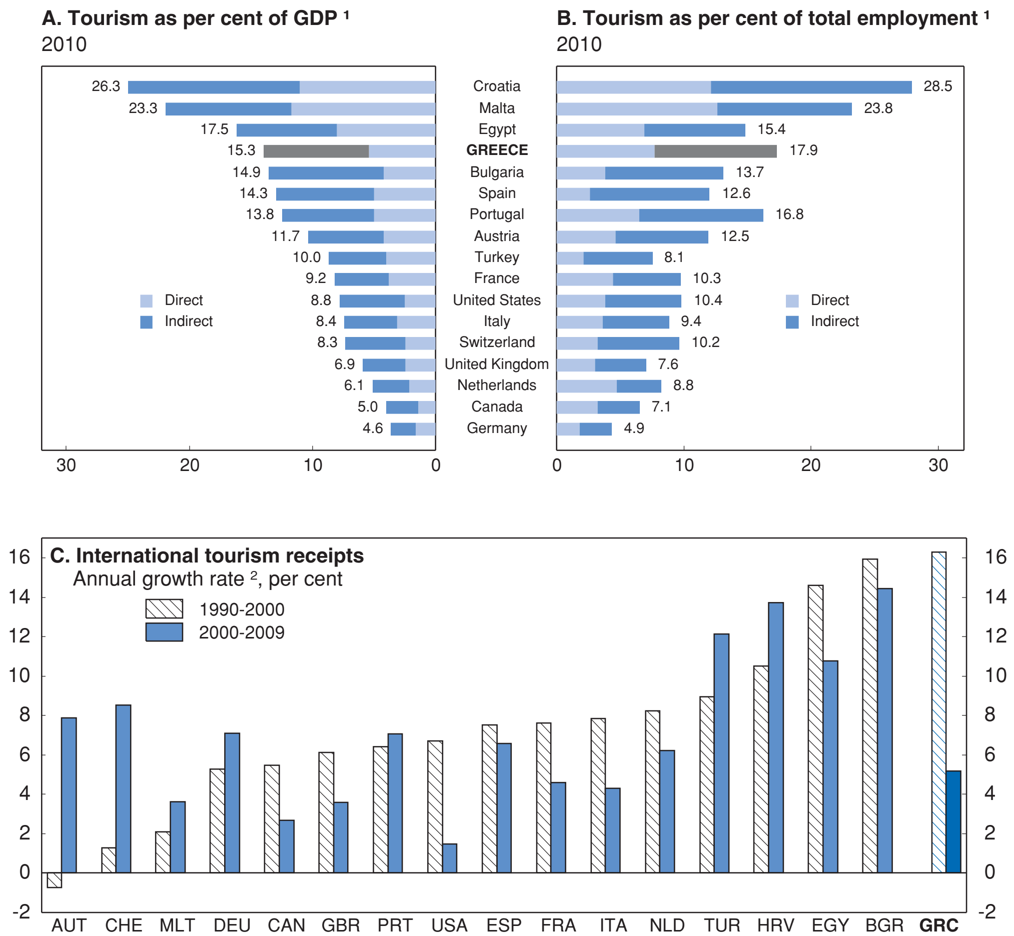
The regulations underpinning the tourism sector are complex discouraging investment in higher added value services (such as recreation and marinas) and upgraded accommodation (National Bank of Greece, 2010). Non-regulatory barriers arising from shortcomings in the design of tourism strategy *per se* (see below) and limited connections with low-cost transport networks and with long-haul emerging market countries also hinder a fast expansion of the sector (European Commission, 2011).

Recent legislative changes under the EU Services Directive to deregulate the tourism sector include the abolition of the fixed minimum tariffs for tourist accommodation and simplification of the authorisation schemes of tourism enterprises. In addition, a Ministerial decision was published on cross-border provision of services, allowing tourism enterprises established in another EU member state to provide services in a provisional way in Greece.

These initiatives go in the right direction. Setting the necessary conditions for tourism to adapt to changing patterns of international demand and exploit more dynamic segments of the market would boost exports and potential growth. The contribution of the sector to GDP (over 15%) compares favourably internationally, but Greece's tourism receipts grew over the past decade at a slower pace than that of its most important competitors (Figure 3.17). The removal of bureaucratic barriers to tourism investment, including through a swift completion of the land registration system and less complex planning laws and real-estate development regulations, along with a more stable tax regime for real estate property, would facilitate development of large integrated resorts, which contribute to higher value added tourism, and increase the attractiveness of the secondary residential market for foreign citizens in Greece (holiday or retirement). Estimates by the National Bank of Greece reveal sizeable potential gains in terms of gross fixed capital formation from boosting foreign demand in the Greek residential market (National Bank of Greece, 2010).[16]

Considerable room exists for a more differentiated tourism strategy. The sector is characterised by an over-concentration (65%) of supply in only four geographical regions and strong seasonality of arrivals (50% of arrivals within a 3 month-period) (European Commission, 2011). More emphasis on business tourism would also reduce seasonality of demand. This could add more than 0.2% to GDP within the next 5 years, if Greece attains gradually a seasonality pattern similar to that of Italy and Spain (National Bank of Greece,

Figure 3.17. **The growth of international tourism receipts has slowed down but the potential of the sector is large**



1. The total contribution of tourism to GDP includes its direct contribution to economic activity (that is GDP generated by industries that deal directly with tourists, such as hotels, travel agents airlines, restaurants and leisure industries), and the indirect and induced contributions (including contribution of capital investment spending by travel and tourism industries). The total employment impact is measured by the number of jobs generated directly in the travel and tourism industry plus the indirect and induced contributions.
2. Annualised compound growth rate.

Source: World travel and tourism council; and World Tourism Organisation, UNWTO WORLD Tourism Barometer.

StatLink http://dx.doi.org/10.1787/888932474366

2010). Higher-value added services and upgraded accommodation are indispensible for a more diversified strategy, helping Greece to move gradually the mix of visitors to higher-income segments. Investing in technology and human resources are also essential to enhance tourism quality. Two additional key factors for the promotion of the industry include a better connectivity and low transportation costs.

Recent measures to support tourism activity, including the lifting of the cabotage in marine cruises (permitting non-EU flagged vessels to perform cruises departing/arriving at Greek ports) and a reduction in costal shipping tickets, through the abolition of dues for third parties, as well as a reduction in the charges for the Athens airport in the winter months, go in the right direction. A comprehensive strategy to reduce remaining barriers to tourism is also under preparation, based on the findings of the diagnostic studies commissioned by the government. A swift progress in this regard is advisable. The tourism and other services sectors would be further benefit from the full implementation of the EU Services Directive, as this would facilitate access to the Greek market either *via* direct establishment or cross-border service provision, enhancing competition. Steps so far towards making the point of single contact (Hermis) operational are welcome. It is a user friendly webpage portal providing relevant information on a specific service and procedures to be complied with by a service provider, and enables an on-line completion of procedures.[17] Its completion is pending however.

Closed professions are a major source of large rents and inefficiencies in Greece

Professional services represent a particularly important sector in Greece, with a 2½ per cent of output contribution and 7% of employment. However, the sector's influence on output performance goes beyond its direct impact, as it provides key inputs for business. Domestic regulations that affect the supply, quality and price of professional services can have important spill-over effects across the whole economy. Many of these regulations serve the public interest, either by addressing market failures, or pursuing non-economic objectives. Some qualification-related entry rules, for instance, may be legitimate and even efficient to ensure the competence of service providers, and hence protect consumers or market integrity. However, regulations may also have unintended anti-competitive consequences. A systematic screening of the impact of new and existing regulation on competition should help identify those regulations that go further than necessary to achieve their policy objectives and unnecessarily restrict competition. If a certain regulatory measure does not pass the test, alternative, less restrictive means can be devised.

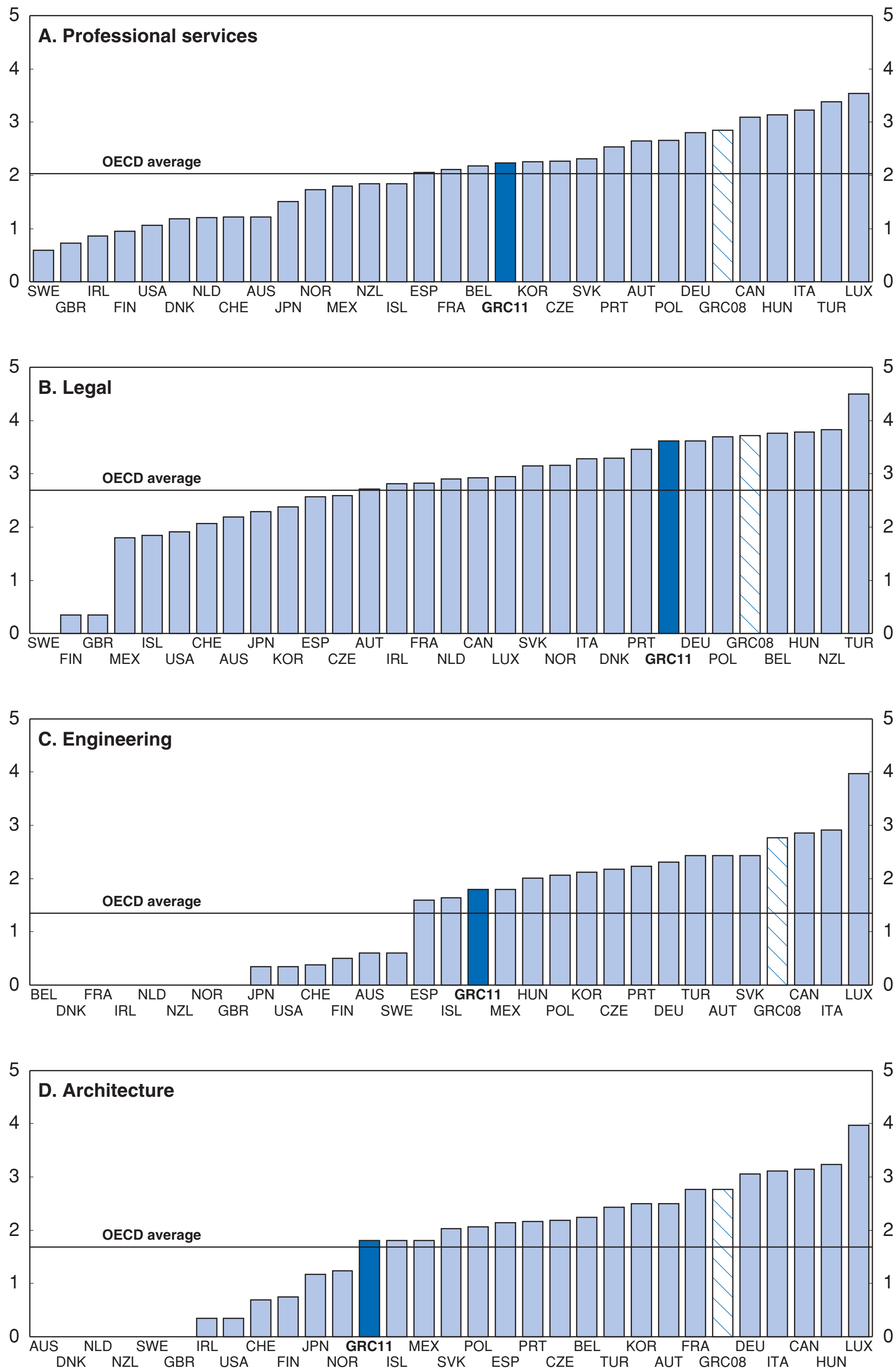
Greece had in the late 2000s among the strictest regulations in the OECD regarding professional services. This indicates a wide scope for lifting requirements without jeopardising consumer protection (Figure 3.18). Restrictions in the form of barriers to entry (fixed number of licenses), geographical requirements and/or fixed tariffs were applied to a long list of professions protecting vested interest groups and curbing competition, as reflected in the relative high mark-ups compared to other EU countries (Figure 3.11, Panel C). For example, Greece has the highest legal costs for property transfers in the EU area mirroring, to a large extent, the compulsory minimum fees for lawyers and their obligatory presence in most of these transactions, unlike practices in most other advanced countries (Ministry of Finance, 2011b). Pharmaceutical prices are also burdened by tight regulations, and in particular high fixed gross profit margins for pharmacists and licensing restrictions based on population.

A wide-ranging reform has opened closed professions

A comprehensive reform in early 2011 opened up more than 150 closed professions. The legislation (Law 3919/2011) is divided in two parts. The general part establishes the principle of professional freedom rather than explicitly abolishing each of the unnecessary restrictions in force; it provided for a 4-month period (until 2 July 2011) during which restrictions that are justified on public policy grounds may be reinstated by decree (Ministry of Finance, 2011c). It also removes, as from that date, the requirement for an administrative license to practice a profession, substituting instead simple notification accompanied by the necessary supporting credentials. The specific part of the law focuses on high economic impact professions, namely lawyers, notaries, engineers, architects, auditors and (in a specific act) pharmacists.

Figure 3.18. **Professional services have been deregulated**[1]

Index scale of 0-6 from least to most restrictive



1. The reference year is 2008 for all countries. The PMR indicators for Greece for 2011 are based on an intermediate update conducted in the context of the current *OECD Economic Survey of Greece*, rather than on a full update for all countries.

Source: OECD, *Database on Product Market Regulation.*

StatLink http://dx.doi.org/10.1787/888932474385

The 2011 law introduces a new method of calculating remuneration. For notaries, a pro-rata fee is now based on a regressive scale, and the fixed prices or compulsory minimum fees for other professions (*e.g.* lawyers and engineers) are removed. It also abolishes geographical restrictions for lawyers and provides for an increase in the number of notaries between 10% and 20%. Certain restrictions remain however. Legal fees, in particular, will continue to apply in the absence of a written agreement between the service provider and client, and as a reference for tax and social security collection reasons, which are likely to behave as minimum prices (European Commission, 2011). In the case of lawyers, their presence in selling/transferring a property continues to be obligatory, while some territorial restrictions were retained with regards to the setting-up of law companies.[18] As for pharmacists, the recent legislative changes provide for a reduction by 3.5% (to 20%) in the fixed profit margins and in the population criteria for opening up new pharmacies – though they do not abolish such restrictions. The opening hours of the pharmacies are set to increase.

The reforms bring Greece closer to the practice of other OECD countries as regards the regulation of professional services (Figure 3.18), with more improvements to come when pending acts for certain provisions come into force (for example, amendment or abolition of advertising restrictions for legal professions). Completing this reform can have an important macroeconomic impact in terms of increasing the supply capacity of the economy and boosting competitiveness. According to a recent study by IOBE, the deregulation of a number of services in Greece could yield GDP gains of over 10% in the long-term (IOBE, 2010b). In addition, by reducing the rents of vested interest groups and curbing price pressures, this reform has the potential to facilitate a fair sharing of the growth gains among all groups.

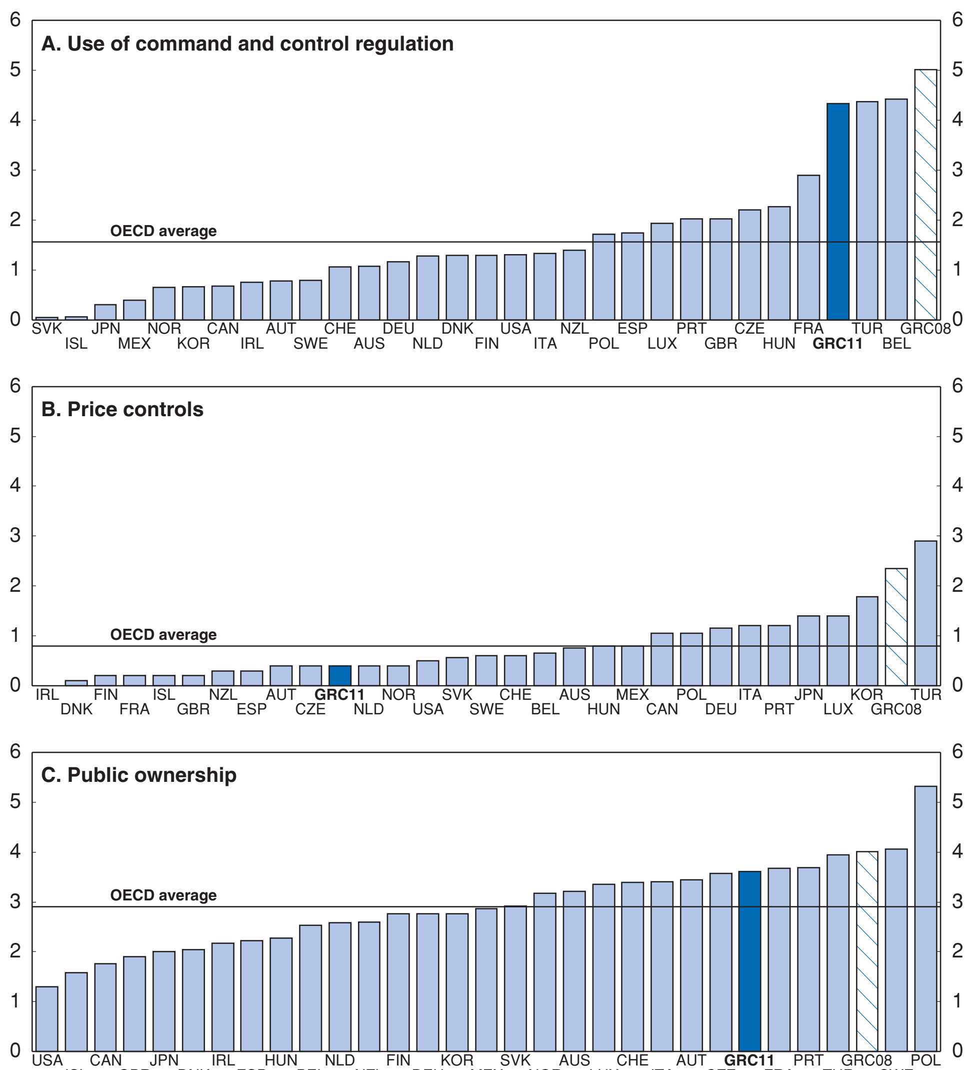
The rigorous implementation of the new legislation however is indispensable for reaping its potential benefits. Of major importance is to ensure that the possibility of reinstatement of restrictions, entailed in the 2011 law, is limited to public interest cases only, as envisaged by the legislation. In addition, the new framework needs to be monitored closely for possible delays in implementation arising from the legal complexity surrounding professions not explicitly addressed in the new law. At the same time, a close follow up is needed of the impact on competition of restrictions retained for the professions that the law addresses explicitly. Consideration should be given to abolishing legal fees and geographical restrictions for lawyers and fixed profit margins for pharmacists (Chapter 2). The Competition Commission has also signalled that the requirement for lawyers to make an advance payment to the law society they are registered in, for their participation in court hearings and the drafting of documents in any type of legal transaction could, indirectly, lead to the fixing of minimum fees.

The restructuring of public enterprises is underway

Reforming public enterprises (SOEs) is essential, not only to reduce the drain on public finances (Chapter 2), but also for boosting competitiveness as most public enterprises are found in "strategic" sectors on which the rest of the business sector rely for its commercial activities. Lack of managerial independence and weak accountability, due to government support and interference, have contributed to their weak performance. Recent measures to fight mismanagement and improve their financial supervision in the context of fiscal consolidation are important, but should not come at the expense of management flexibility with regard to operational and investment decisions. The recent legislative amendments (Law 3899/2010) to expand the scope of a 2005 law on corporate governance in the majority state-owned (non-listed) public enterprises to all public enterprises and legal entities classified in the general government is welcome. The 2005 law provided, in particular, for the introduction of terms of employment more akin to those prevailing in the private sector, preparation of annual business plans and improved corporate governance (*e.g.* establishment of internal audit committees, designation of board members as executive, non-executive and independent ones) (OECD, 2007). However, the implementation of the 2005 law has been weak, as government interference has remained strong according to the OECD PMR indicators for 2008 (Figure 3.19).

Figure 3.19. **State control could be reduced further**[1]

Index scale of 0-6 from least to most restrictive



1. The graphs present data for year 2008. The PMR indicators for Greece for 2011 are based on an intermediate update conducted in the context of the current *OECD Economic Survey of Greece*, rather than on a full update for all countries.

Source: OECD, *Database on Product Market Regulation.*

StatLink http://dx.doi.org/10.1787/888932474404

Welcome steps were also taken recently to ease state price controls. For example, prices of road freight were liberalised and the regulated electricity tariffs were adjusted to better reflect costs (see below). A price setting that reflects costs, rather than macroeconomic or social considerations, is vital to enhance the financial operation of these enterprises. Social needs are met more efficiently by direct transfers to low income groups. These reforms improved Greece's international ranking in the use of command and control regulation, and especially price controls, though there is still scope for improvement on the basis of the updated PMRs for 2011 (Figure 3.19, Panels A and B). Further gains in reducing state control over business activity will be achieved by the implementation of the announced privatisation plan, as public ownership remains high compared to peers (Figure 3.19, Panel C). As a general rule, privatisation, liberalisation and/or appropriate regulation should go hand in hand to avoid the creation of private monopolies and to boost efficiency and growth.

In restructuring SOEs, the authorities have to decide how to implement public service obligations (PSO) fulfilled by these enterprises. Examples of PSO include highly under-used trains or postal services in remote regions and, until recently, the Public Power Corporation's (PPC) obligation to apply the same tariffs to the inhabitants of island communities as in the rest of Greece, despite much higher cost. The need and justification for PSO provisions should be reviewed. If they are found to be justified, such obligations should be financed in a transparent way. For instance, it would be preferable to give specific government subsidies to public enterprises for PSOs (itemised in both the budget and SOEs books), rather than cross-subsidisation through the internal accounts of SOEs, which distorts incentives by driving a wedge between prices and marginal costs (OECD, 2007). Alternatively, the provision of PSO could be offered by tenders. Finite period contracts can improve the providers' incentives to perform well.

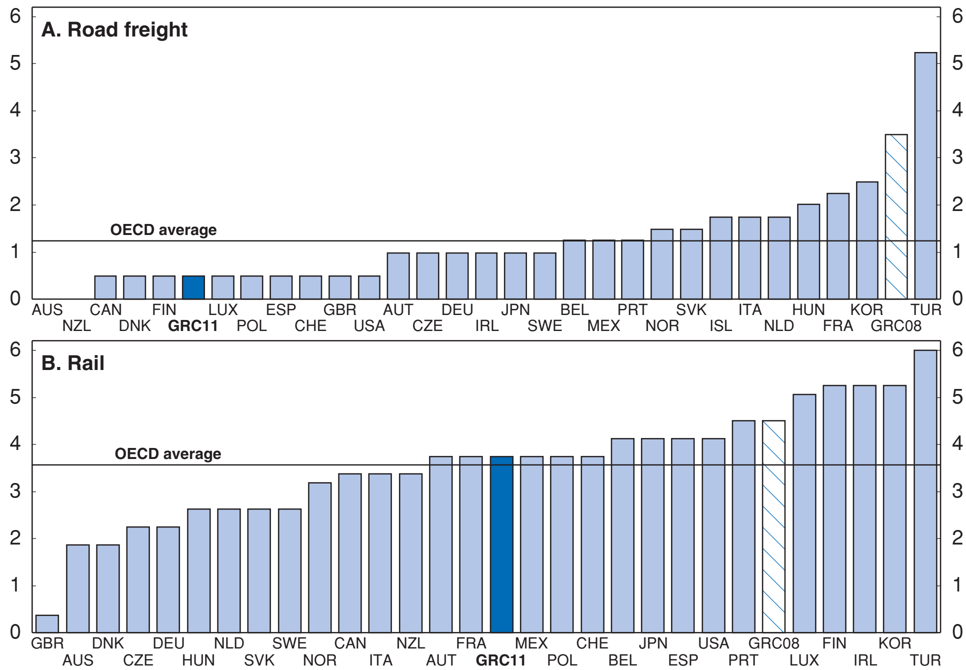
The opening up of the road freight sector should boost competitiveness…

The road freight transport sector, which accounts for 98% of transportation of goods by land, had until recently one of the strictest regulatory frameworks in the OECD. The high 2008 PMR reflects numerical restrictions on entry (in the case of trucks operating freight transport on behalf of a third party) and pricing regulations (Figure 3.20, Panel A). The government granted licenses to haulage operators (license for vehicle for public use) and set minimum tariffs. No new licenses have been issued since early 1970s which meant that the only way to enter the sector was to purchase an existing license at a significant cost in the secondary market, with prices varying between EUR 30 000 and EUR 300 000 (European Commission, 2010b). The restrictiveness of the legal framework for road freight resulted in high rents for incumbents, inhibited competition, and has affected adversely the modernisation of the sector. It further constrained the development of outsourcing of trucking services, while forced Greek truckers to compete with liberalised foreign truckers (OECD, 2007).

A new law in 2010 provides for a gradual liberalisation of road freight transport (Box 3.6), bringing Greece in line with OECD best practice, according to updated PMRs (Figure 3.20, Panel A). It is too early to assess the economic impact of the 2010 law, which is likely to be reduced by the long transition period of 2½ years. If rigorously implemented, however, the new measures could foster effective competition in the road freight sector with important spillovers for competitiveness and growth. Well developed implementation and performance indicators are essential in this regard, including monitoring of the number of new licenses issued and the impact of the reforms on employment and transportation fares.

Figure 3.20. **Regulations in transport were eased**[1]

Index scale of 0-6 from least to most restrictive



1. The reference year is 2008 for all countries. The PMR indicators for Greece for 2011 are based on an intermediate update conducted in the context of the current *OECD Economic Survey of Greece*, rather than on a full update for all countries.

Source: OECD, *Database on Product Market Regulation.*

StatLink http://dx.doi.org/10.1787/888932474423

Box 3.6. **Road freight reform: main features**

The September 2010 law (Law 3887/2010) liberalises road freight transport:

- Removes licensing *restrictions* that have constrained severely the road haulage capacity. Licenses will be granted automatically under the new regime upon meeting certain administrative criteria related to certificates of professional qualifications, tax clearance and social security certificates, and criminal record.
- Abolishes administratively set prices. Transportation prices are, instead, to be negotiated freely between the seller and the buyer of the transportation services, depending on the freight volumes and distance. However, restrictions remain for fuel transportation where the administration can still set maximum prices.
- Grants a transition period of 2.5 years (until June 2013) to adjust to the new regime. During this period licenses are granted on payment of a levy, which will decrease by 30% in 2011, and 35% in 2012 and 2013, respectively. After mid-2013, new entrants will not be burdened by entry fee but only by administrative costs relating to the issuance of the license. Existing license owners have the right to either participate in the capital formation of a transportation company by the value of their license, or through renting their trucks. There are no quantitative restrictions for the establishment of transport enterprises
- To foster the development of the road freight sector, public transportation firms can fall within the provisions of the investment law, which foresees, among other things, the acquisition or refurbishment of equipment, the utilisation of modern logistics applications and the replacement of trucks (Ministry of Finance, 2010).

… with additional gains from a planned restructuring of the railway and urban transport sectors

The state-owned railway company is the most heavily loss-making public enterprise in Greece, with an accumulated debt of approximately EUR 10 billion. This reflects pricing and service supply policies driven by macroeconomic or social considerations rather than cost, and excessive personnel outlays. There has been no increase in the prices for passenger transport for over a decade, while around 20% of passengers enjoy free travelling, according to European Commission estimates. Moreover, many routes in passenger transport are not financially viable, while the freight transport is characterised by low market share (around 1% of total freight transport) and high discounts policy (70%-80%) (European Commission, 2010c). As for the high personnel costs, these reflect to a large extent excessive overtime and allowances which in the case of railway operator (TRAINOSE) amounts to approximately 50% of base salary – around 30% of total personnel costs.

Greece is currently overhauling its railway and urban transport sectors in the context of the economic programme agreed with the Troika. A business plan for the restructuring of railways was approved in December 2010, with a 3-year implementation horizon (2011-13) aiming at improving the operation and effectiveness of the network infrastructure manager (OSE) and the railway operator (TRAINOSE). This should pave the way for the privatisation of the provision of railway services and the liberalisation of the sector (Box 3.7), in which OSE should operate under optimal cost principles, through organisational reform and streamlining of employees, recovering operational costs by updating access fees to the operators, and making decisions on the basis of business planning and predefined financial goals (Figure 3.20, Panel B). The regulatory framework should be assessed thoroughly ahead of privatisation to ensure effective competition and ease the task of regulators. The restructuring plan further aims to open the railways market, in line with the provisions of EU law, establishing independent authorities to deal with regulation, licensing, complaints management and accidents investigation. A business plan to restructure the urban transport sector, which has also been a heavy burden for public finances, has also been finalised and approved in 2011 (Box 3.7).

Moves towards a cost-efficient operation of transport sectors are welcome and necessary to improve service quality, in addition to alleviating fiscal strains. As with other reforms, it is important to ensure that business plans to restructure transportation industries include effective monitoring mechanisms to inform the public about reforms and promptly correct deviations from the plan. The speed of the implementation of the reforms has been slow so far. Completing the restructuring is an essential element for the financial viability of transport industries and to instil competition in the sector. Transport is also linked to the tourism sector, with high potential to enhance productivity. Again direct means-tested government assistance could be a more efficient and cost-effective method of providing help to those in need, subject of course the fiscal constraints, rather by adjusting railway tariffs (Mylonas and Papaconstaninou, 2001). Going forward, it is also essential to ensure in the liberalised system that the infrastructure directed to the railway sector and the services provided are adequate to meet the public needs. A modernised rail network is of great importance to attract foreign investors.

Box 3.7. **Restructuring the railways and urban transport sectors**

Railways

Until 2005, all railway services were provided by a single state-owned company, the Hellenic Railways Organisation (OSE), which had also responsibility for the maintenance and improvement of the rail network. Railway operations were unbundled in 2005, in line with the first EC Railway Package (implemented with a two-year delay). In this context, OSE was transformed into a holding company and its activities were passed on to four distinct subsidiaries: TRAINOSE (operator of railway services for passenger and freight transport), EDISY (infrastructure management and maintenance), ERGOSE (infrastructure construction) and GAIOSE (asset management). In 2008, TRAINOSE was separated from OSE (but remained state-owned) to enhance the physical separation between infrastructure management and railway services, and also to open up the market to competition. However, vast accumulated liabilities and unprofitable operations made restructuring indispensible.

The business plan on reforming OSE and TRAINOSE law builds on the recently adopted railway reform law (Law 3891/2010) aiming at a financial and operational restructuring of the sector and its alignment to the provisions of the EU law. The main provisions of the law are:

- *Restructuring.* TRAINOSE will obtain financial and operational autonomy, with a possible transfer of its full share capital (with no return) from OSE to the state; OSE and ESIDY will merge and undertake the infrastructure management and maintenance. The law improves the functioning of ERGOSE and GAIOSE.
- *Management of OSE debt.* OSE's accumulated debts will be written off and transferred to the state. In return, the ownership of OSE's infrastructures and real estate will be transferred to the state.
- *Personnel issues.* Surplus personnel, as a result of the restructuring, will be transferred to other public services within 3 months. Payroll cost will be further reduced by rationalising the payroll structure and reducing overtime payments and allowances.
- *Restoring revenue growth.* A new pricing policy for passenger transport will be adopted for both passenger transport and freight transport and loss-making passenger networks and routes will be suspended, accompanied by a cap of euro 50 million annually over the period 2011-13 for the provision of public service obligations (PSO).
- *Compliance with EU directives:* Establishment of an independent authority, the Railway Regulatory Authority, to support opening up of the railway market and monitor the application of competition rules in the system, ensuring a transparent of the Greek railways system to European regulatory framework.

Urban transport sector

A business plan to restructure urban transport sector was approved in 2011, focusing in particular on OASA – the organisation that is responsible for all means of regular passenger transport in the Greater Athens. The objective is to provide better services to the public and achieve better financial results for the company, reducing budgetary burden. To this end:

- The organisational structure of OASA will be reformed by merging the five operators for regular transport (carried out by busses, cable-busses, light rail, metro and tram) into two groups in order to achieve economies of scale and improve efficiency.
- The supply of transport will be aligned better with passenger needs and management will be improved, with decisions based on business plans.
- Revenue will be enhanced though an approved increase of the tariff by 20-40% (effective from February 2011).

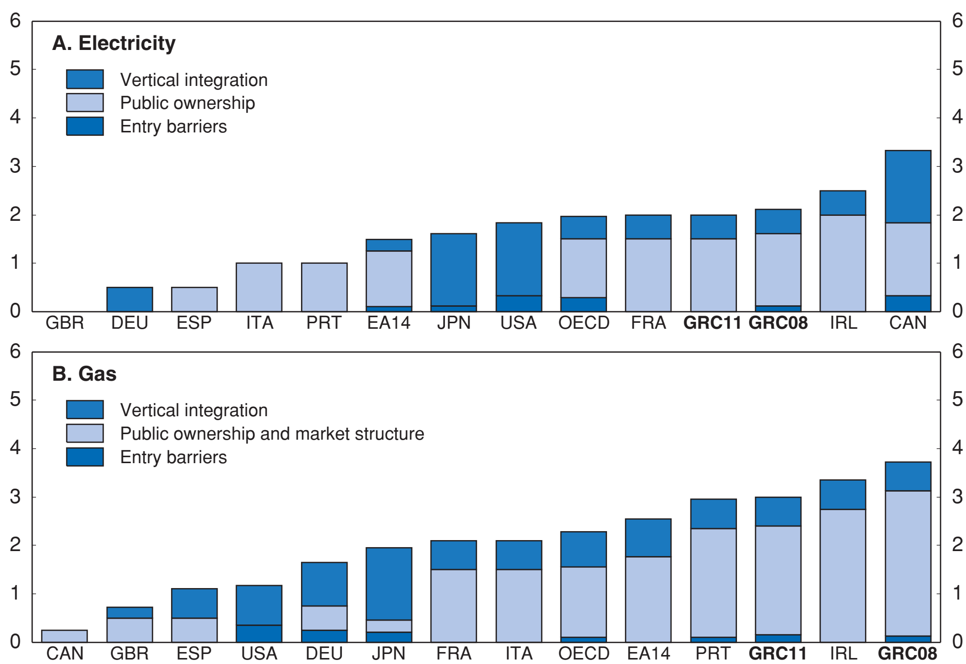
The strategic plan for OASA, will set the targets, priorities and operational options for the whole urban transport system.

Reforms in the energy sector have been speeded up, although further progress is needed

The electricity sector is characterised by a high level of public ownership and vertical integration, inhibiting effective competition (Figure 3.21, Panel A). In 2008, the majority state-owned Public Power Corporation (PPC) held 87% of the wholesale market and bulk of the retail market. Besides being a key market player, PPC also retains control over important access issues. In particular, PPC owns 49% of HTSO – the Hellenic Transmission System Operator – and has ownership of the transmission and distribution networks. The incumbent also has exclusive rights to exploit and use low-cost lignite mines, which allows it to be profitable, despite relatively low prices (OECD 2007, Figure 6.5). Along with a price setting that does not reflect fully the cost of electricity supply, these factors discouraged entry in the electricity market. In 2008, PPC owned 95.3% of generating capacity, despite the issuing of licenses.

Figure 3.21. **The regulatory stance in the electricity and gas sectors**[1, 2]

The scale of indicators is 0 to 6, from least to most restrictive



1. The reference year is 2008 for all countries. The PMR indicators for Greece for 2011 are based on an intermediate update conducted in the context of the current *OECD Economic Survey of Greece*, rather than on a full update for all countries.
2. The EA14 and OECD aggregates are unweighted averages. EA14 covers the following member countries: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Slovak Republic, Spain and the OECD covers 30 countries. For the gas sector OECD excludes Iceland.

Source: OECD, *Database on Product Market Regulation.*

StatLink http://dx.doi.org/10.1787/888932474442

Notable progress was achieved, on the other hand, over the past 3 years towards liberalising the gas sector.[19] Over 10% of the imported gas to Greece in 2010 was provided to eligible customers by suppliers other than the Public Gas Corporation (DEPA), which is state-owned apart from an equity stake of 35% held by Hellenic Petroleum (which is also publicly-owned). However, the market remains dominated by the vertically integrated incumbent – an issue that needs to be addressed if the legal opening of the market is to foster competition (Figure 3.21, Panel B). At the moment, DEPA's fully-owned, but legally unbundled, subsidiary Transmission System Operator (DESFA), owns the gas transmission network and is responsible for the network's operation, maintenance, management and development. Through its subsidiary EDA, DEPA owes 51% of the regional gas distribution companies.

Reforms underway aim to bring Greece in line with the requirements of the 3rd EU Energy Package (Box 3.8). Steps were also taken in the area of the liberalization of the lignite-fired electricity generation. Currently 55% of electricity in Greece is produced through lignite, controlled by the Public Power Corporation. The government has submitted a proposal to the EC for the sale of drawing rights agreements, primarily in the form of swaps – instead of selling existing plants. This would provide access to 40% of the lignite generated power by the PPC to third parties. EC's decision on the issue is still pending, however. Finally, an important reform of a new system of regulated tariffs has been introduced which is expected gradually to align energy prices to wholesale market prices, except for vulnerable groups. A new social tariff was introduced for this category of consumers (European Commission, 2011).

Box 3.8. **Implementing the 3rd EU Energy Package**

The relevant draft law has already been submitted to Parliament, and is expected to be voted soon. Two focal points of the draft law are the transmission unbundling and the increase in the powers of the energy regulator (RAE):

- Regarding the transmission unbundling, of the alternatives under the EU Directive, Greece has chosen to adopt the ITO (Independent Transmission Operator) model under which the Transmission System Operator (HTSO) remains part of a vertically integrated undertaking, but is ring-fenced within it, to make it independent in terms of decision making and management. The authorities have decided in favour of this model on the grounds that it can be implemented in an easier and faster way compared to the alternatives, such as ownership unbundling,* given the particular characteristics of the Greek electricity market. In addition, PPC has set up two separate subsidiary entities for transmission and distribution. As with the electricity sector, the draft law foresees the ITO model for the gas transmission operator DESFA.
- Concerning the energy regulator (RAE), the draft law foresees essential reforms in its responsibilities and operation, in line with the provisions of the relevant Directives. The regulator will be equipped, in particular, with increased responsibilities in security of supply, licensing, network development programme, network usage tariffs, monitoring of the market and consumer protection. The economic and administrative independence of the RAE is also enhanced. In particular, the draft law foresees that RAE has its own budget, and that the members of its board are appointed to by the Special Permanent *Committee* on Institutions and Transparency of the Greek Parliament. The board members cannot be recalled during the term for which they have been appointed while they cannot be controlled or supervised by governmental and other administration bodies.

* This option would require the sale of system assets from PPC to HTSO as well as changes in the organisation and shareholding of HTSO (Kolia and Chatzigiannidou, 2010).

The recent reforms go in the right direction. An increase in the decisive responsibilities of the energy regulator and its independence are indispensable to promote competition. This is particularly so for the electricity market where, so far, RAE's role was mainly advisory. The benefits in terms of competition and transparency could be larger, if deeper steps were taken regarding separating the operations (generation, transmission, and distribution) in the electricity and gas markets, as was recommended by previous *Surveys*. In light of several antitrust cases in energy on the European level in recent years,[20] the European Commission has reservations as to the appropriateness of models such as ITO adopted by the Greek government (Box 3.8) in comparison to full ownership unbundling, at least from a competition policy point of view. These concerns are shared by the 2001 OECD Council Recommendation on Structural Separation, and in particular the discussions in the context of the 2011 Report on the 2001 Council Recommendation (OECD, 2011c). The social tariffs should also be removed, and replaced by targeted income transfers, to ensure that electricity prices reflect the costs of additional supply. Further increasing interconnection capacity is essential to meet the growing demand for electricity. Greece is already interconnected with Balkans, but capacity could increase (through an inter-connection with Turkey, for example) as imports became a significant source of electricity supply over the past decade. Important steps were taken in this regard in the gas sector, with Greece being involved in a number of international pipeline projects. The rapid development of a competitive gas industry is also critical for securing energy supply as it provides for diversification of supply sources.

Box 3.9. **Recommendations for supporting growth with structural reforms**

Getting people back to work and boosting longer term growth

Areas where the implementation of reforms needs to be closely monitored:

- Ensure that the use of the special firm-level wage agreements or their rapid expansion, especially after the economy recovers, is not restricted by procedural matters. Implement swiftly announced plans to accelerate the procedure for the creation of firm-level unions required for the conclusion of these agreements.
- The recent introduction of non-subsidised sub-minimum wages for youth to boost jobs is a step in the right direction in a stringent fiscal environment. This needs to be linked to a training provision in the workplace to enhance skills. It will be important to monitor closely the employment effects of the new measure.
- Proceed with the implementation of the announced measures to enhance the capacity of the Labour Inspectorate to monitor the enforcement of labour law and fight informality, especially with regard to the use of informal arrangements such as undeclared overtime work.

Areas where further reform action is needed:

- To promote firm-level wage agreements the administrative extension of the sectoral agreements to firms that were not party to the negotiations should be eliminated. To further promote wage differentiation and ensure reallocation of resources, consideration could be given in the longer term to eliminate occupational and sectoral agreements.
- The social partners and the government could consider linking the sub-minimum wage for all youth between 18 to 25 to the national minimum wage. It would be advisable that the sub-minimum wage scheme applies to all young people for the period needed to ensure labour market integration, rather than to be subject to time limitations. The sub-minimum wage could be scaled according to age as in most EU countries applying such schemes for youth.
- Ease further employment protection for temporary work by promoting the use of fixed-term contracts, through a reduction in the early termination costs. Consider relaxing further existing time limits on the

Box 3.9. **Recommendations for supporting growth with structural reforms** *(cont.)*

renewal of such contracts. Abolishing temporal limits on the maximum duration of temporary work agency contracts and removing restrictions on their use, as well as relaxing the cumbersome regulations governing the establishment and operation of these agencies, would also be advisable.

- Over the longer term, Greece could remove employment protection legislation distinctions between blue- and white-collar workers, as in most OECD countries, and severance pay could be transformed into a system of individual accounts, as pioneered in Austria.
- Make unemployment benefits conditional on job-search requirements, with sanctions for non-compliance. Evaluate rigorously and systematically the effectiveness of activation programmes in promoting employment.

Reforming product markets is imperative

Areas where the implementation of reforms needs to be closely monitored:

- Ensure the immediate elaboration and implementation of the point system, to be used by the competition authority (HCC) to prioritise cases. To be effective the new system needs to be workable and based on a set of objective and transparent indicators. Ensure neutral treatment by the competition agency of public or private undertakings when applying the new competition law.
- Proceed with the implementation of the law on the simplification of the licensing procedures for technical professions and manufacturing activities.
- Implement swiftly, the action plan for a business-friendly Greece, which aims to reduce remaining restrictions to business activity.
- Monitor systematically, as envisaged, the impact of the new investment law in terms of allocation of resources and the value added of the financially supported projects, as well as in terms employment creation and growth. The potential budgetary costs of the fiscal incentives should conform to the government's fiscal consolidation strategy.
- Follow up closely, based on comprehensive sets of indicators, the implementation and effectiveness of the fast-track procedures. The law should subsequently be extended to non-strategic investments, while retaining a rigorous evaluation of the submitted plans.
- Continue efforts towards increasing the absorption rate of the EU structural and cohesion funds. This is critical in order for Greece to make the most of the easier access to EU funds agreed under the 21 July package, which also includes exceptional technical assistance to boost investment and growth.
- Implement with vigour the export strategy, particularly, to improve the marketing of Greek products abroad, and proceed accordingly with the reduction of the bureaucratic barriers to exports.
- Pursue the implementation of the new law on opening up closed professions, monitoring closely its effectiveness in boosting competition and supply. The possibility of reinstatement of restrictions entailed in the new law needs to be limited to public interest cases only, as envisaged by the legislation.
- Implement swiftly the restructuring plan of the railway sector, followed by the envisaged privatisation of the provision of railway services and the liberalisation of the sector. Ensure that the business plan includes effective mechanisms to promptly correct any deviations. As a general rule privatisation, liberalisation and/or appropriate regulation should go hand in hand to avoid the creation of private monopolies and to boost efficiency and growth.

Areas where further reform action is needed:

- Adopt a rigorous and comprehensive system for Regulatory Impact Assessment, as is the case in many OECD countries, to improve further the checks and balances of regulations. An institutionalised centrally-led review of the stock of laws and regulations assessing their competitive effects, with follow up revisions if necessary, should be considered. Such a systematic screening of regulations allows the

Box 3.9. **Recommendations for supporting growth with structural reforms** *(cont.)*

identification of unintended negative consequences on competition and thereby fosters more effective and efficient regulation. The OECD Competition Assessment Toolkit represents a useful methodology for screening regulation as to its repercussions on competition and also provides suggestions on how to implement such a review institutionally.

- Promote information campaigns and political support for HCC to develop a "competition culture" and improve public understanding of the benefits of competition.
- Establish mandatory deadlines for the completion of licensing approvals and tacit approval in the case of non adherence to avoid delays. Initiatives such as the introduction of strict time limits for the completion of licensing procedures for technical professions under the new law go in the right direction.
- Address land-use issues firms face during start-up by setting clear and adequate rules for the spatial planning of private investment and monitoring and evaluating frequently the land use plans.
- Remove identified regulatory restrictions to entry in tourism, retail and wholesale sectors. Remaining controls on prices in retailing should be abolished.
- Progress rapidly towards the completion of a one-stop system enabling the on-line completion of licensing procedures under the implementation of the EU Services Directive.
- Remove remaining barriers in the form geographical restrictions for lawyers, and fixed profit margins for pharmacists.
- Consideration should be given to separate the operations (generation, transmission, and distribution) in the electricity sector to promote further competition. Ensure strong and effective sector regulators. Preferential tariffs should be removed, to ensure that the electricity prices reflect the electricity costs of additional supply, and should replaced by targeted income transfers.

Notes

1. There are two opposing forces on average wages: the use of flexible forms may reduce the wage bill (but it does not reduce per hour pay – unless it does away with overtime premia), whereas the withdrawal of unskilled labour would increase average hourly pay.
2. To avoid age discrimination, the 2010 law entailed a number of special provisions to protect workers over 55 years including the requirement for employers to cover 50-80% of the cost of self-insurance for dismissed persons aged 55-60 (60-64) for three years, a 10% limit on the share of workers aged 55-64 in total layoffs, and subsidised employment programmes.
3. The above provision refers to additional hiring by firms. Such agreements may be signed only if employers have not dismissed employees in the three months preceding the agreement. Employers are also constrained not to reduce their staff while the special youth fixed-term agreements are in force.
4. The 2010 reform provided for sub-minimum wages only for skilled young workers covered by the national minimum wage. These provisions did not cover young people who could be remunerated under the terms of specific-level agreements (that is sectoral or occupational agreements) due to their skills and/or the requirements of a particular job.
5. An objective reason exists in particular if the renewal is justified on the basis of the nature or form or activity of the employer or the undertaking, or if it is justified on the basis of special reasons or needs, provided these factors arise directly or indirectly from the contract in question.
6. Austrian employers contribute 1½ per cent of the payroll to an individual account from the first day until the last day of employment. When dismissed by the employer, an employee has the option of either receive severance payment from the account at once, or save the entitlements towards a future pension. Whenever the employee quits (or job tenure is shorter than three years), the accumulated amount will not be paid out but the entitlement remains and is carried over to the next employer (OECD, 2007).

7. Overtime work of up to five hours per week (40-45) on a five-day working week and up to eight hours per week (40-48) on a six-day working week does not require approval from labour market authorities and employees received a 20% premium (under the 2010 law) on top of their regular wage. Overtime work above 45/48 hours requires the approval of authorities and entails a 40% wage premium within a limit of 120 hours and a 60% premium above this limit.
8. Additional factors cited by existing studies include the large share of small-size firms in Greece, the resistance of unions and the extended family network supporting youth (Karamessini, 2009).
9. In 2009, for example, the HCC imposed cartel fines of around EUR 100 million, comparing with EUR 55 million a year ago (Global Competition Review, 2010).
10. In addition to the Competition Assessment Toolkit, available also in Greek, see also the 2009 OECD Council Recommendation on Competition Assessment. Information on both, the Competition Assessment Toolkit and the Council Recommendation are available under *www.oecd.org/competition/toolkit*.
11. The 2011 Law changes the licensing structures by: enabling the Chambers and the Technical Chamber of Greece to act as licensing authorities equivalent to the Regional Unity Directorates for Development; setting up certified bodies to monitor business compliance with the operational requirements; and providing for the creation of a Project Management Team mechanism aimed to deal with requests needed to be addressed urgently.
12. Based on a "gravity model", Papazoglou (2009) concludes a shortfall of the actual exports relative to potential ones, reflecting to a large extent the limited convergence of Greece's trade patterns towards the EU average, in addition to geographical factors.
13. Certain permanent residency requirements for providers, geographical limitation requirements, provision for the participation of the trade union in the licensing process and exclusivity rights have been abolished.
14. Under the previous regime, wholesalers in the Athens and Thessaloniki regions should establish themselves within the central markets, though in practice there is no more space available inside the central markets.
15. Examples of efficient economic instruments used in other OECD countries, such as Norway, include, taxes on waste land filling and incineration, and on SOx and NOx emissions (OCED, 2011b).
16. According to the National Bank of Greece (2010) estimates, if the Greek residential market had attracted foreign demand equivalent to ¼ of the cumulative investment in Spanish real estate assets in the period 2004-08 (measured in terms of housing units), this would have boosted gross fixed capital formation by 6% of GDP cumulatively over the period, adding about ½ percentage point to annual growth.
17. Information about 430 services is already uploaded at Hermis portal (PSC), along with 60 cross-border services.
18. Specifically, only lawyers registered with the same law society are entitled to establish such a company, with the exception of lawyers registered with the Athens Bar and Piraeus Bar who can join forces.
19. Two important pieces of legislation passed in 2010. These include the establishment a new legal framework for third-party access to gas transmission system (Network Operation Code) and the publication of the Natural Gas Supply License Code, breaking the monopoly of the state-owned incumbent as a sole importer of natural gas in Greece.
20. See for example, Chauve *et al.* (2009) and Koch *et al.* (2009).

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