



The Second Economic Adjustment Programme for Greece – Third Review

26 July 2013

Compliance Report

Technical report by the Commission Services, in liaison with the ECB, to help the Eurogroup decide on the disbursement of each instalment of the loan.

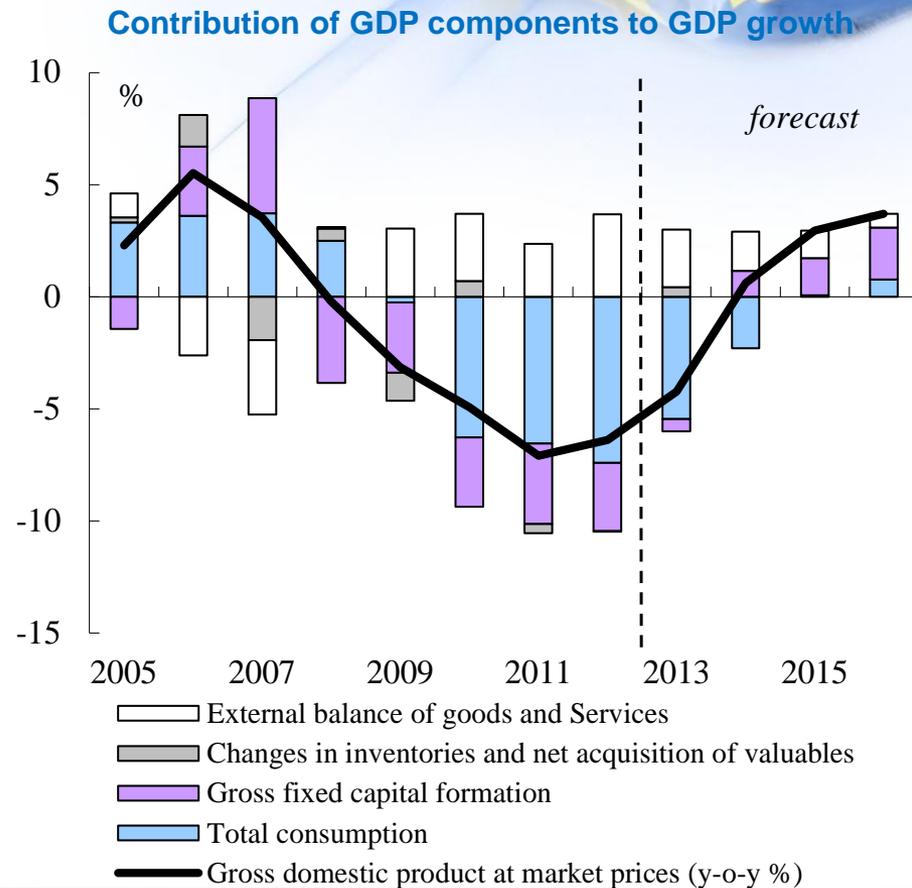
It includes:

- Report : assessment of progress made by Greece
- Compliance table: detailed assessment of compliance with policy conditionality.
- EC/ECB/IMF shared forecasts and projections through 2016.
- New Memorandum of Understanding (MoU) – living document drafted jointly by EC/ECB/IMF and Greek authorities.

Full package and additional information available from 29 July here:
http://ec.europa.eu/economy_finance/assistance_eu_ms/greek_loan_facility/index_en.htm

Moderate recovery projected for 2014

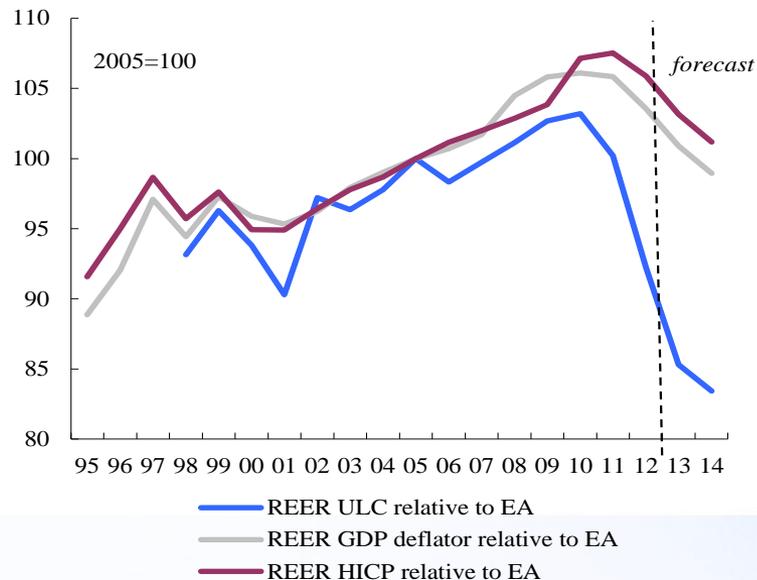
- Macroeconomic outlook **broadly unchanged**. The economy contracted by -5.6% y-o-y in Q1 2013. Growth projected to resume in 2014, accelerating beyond.
- A positive tourism season, repayment of government arrears and increased public investment forecast to support the economy, **preparing the ground for the recovery**.
- Important downside risks remain, but there are **early signs of a bottoming out of the economy**: in May the Economic Sentiment Indicator reached its highest level since the start of the crisis, and broadly maintained it in June.
- The **unemployment rate is still very high** and reached 26.9% in April.



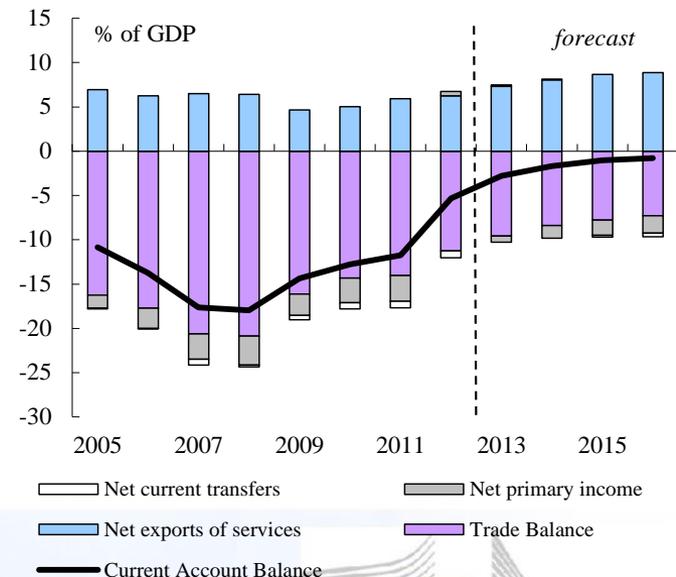
Improvement of cost competitiveness and current account deficit

- The Greek economy is quickly **regaining external competitiveness**.
- **Unit labour costs** relative to trading partners fell by -13.7% in 2009-2012. As a result **Real Effective Exchange Rates** are dropping significantly relative to the Euro Area.
- **The Greek current account deficit improved** from -11.7% of GDP in 2011 to -5.3% in 2012; further adjustment expected.

Real Effective Exchange Rates



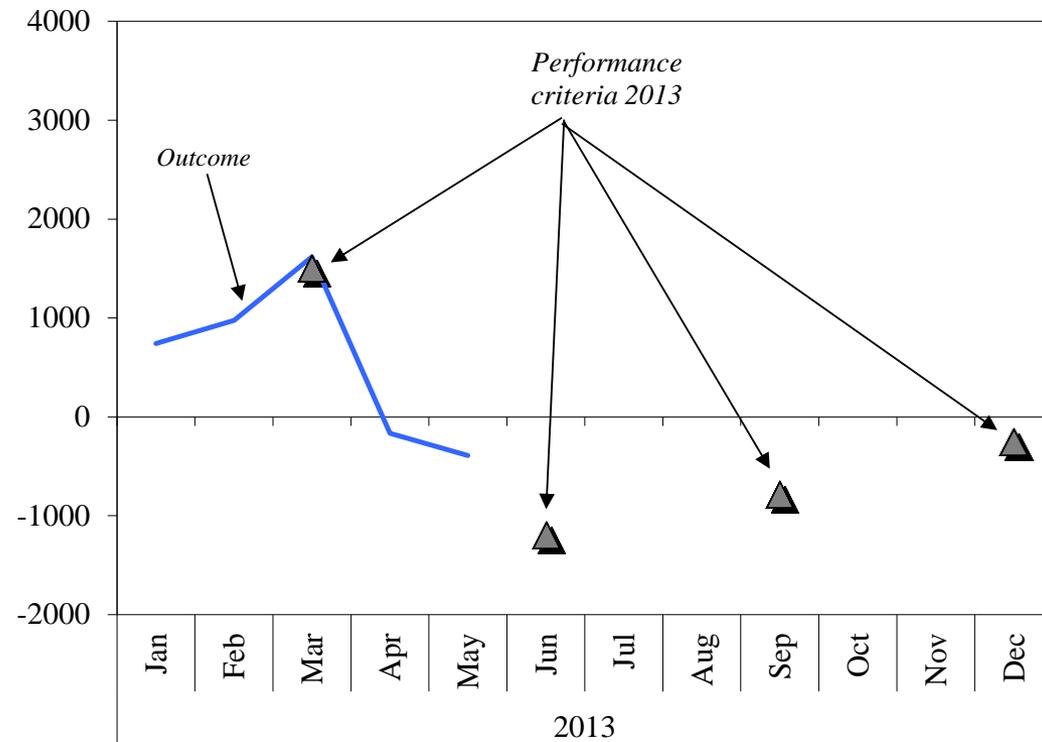
Current account components (% of GDP)



Fiscal consolidation continues as planned...

- With the fiscal adjustment in 2012, the **structural balance has improved by over 13 percentage points since 2009**
- **2012 primary balance** according to programme definition reached -1.3% of GDP, **over-performing** the -1.5% of GDP target.
- **Fiscal developments up to May broadly on track**, despite some shortfalls in state revenues and delays in sending out tax bills. Significant under-execution of state expenditures.
- The main **healthcare** fund (EOPYY) recorded significant **overruns** in spending on diagnostics and private clinics, which led to arrears accumulation and shortfall in transfer to public hospitals.

Government primary balance 2013 (cash basis, cumulative balance, EUR million). Outcomes and quarterly criteria



Source: GAO and European Commission



...with measures being adopted to secure the fiscal targets

- Corrective measures to tackle **healthcare expenditure** overruns through a mechanism which will bring expenditures in line with the budget ceilings, and a set of structural measures to rationalise healthcare provision and prevent waste and misuse of public services.
- **Frontloading** of some measures planned for 2014, such as the **luxury tax** and an increase in **court fees** for lawsuits. A **docking fee for leisure boats** will be applied from October 2013.
- Additional revenue from fiscal measures related to the income tax reform, such as a **special solidarity surcharge on income from interests and dividends**.
- **VAT reduction on restaurants and catering from 23% to 13%**, from 1 August to 31 December 2013. Revenue shortfall offset by **rationalisation of defence expenditure**.

Far-reaching reforms in taxes and revenue administration, but results still to be seen, as for privatisation

- Significant efforts are needed to make the **new revenue administration** more efficient in order to improve tax collection.
- **Simpler and less distortive taxation system** being introduced to reduce evasion, combat fraud and corruption and stimulate investment:
 - The **Income Tax Code** and the **Tax Procedure Code** have been adopted in July.
 - A **reform of real estate taxation** planned for September will reduce distortions. A new tax should replace PPC tax and wealth tax on property from 2014.
- Limited progress in selling assets through **privatisations**, despite substantial effort to prepare and transfer assets.
- 2013 **privatisation targets** most likely missed, but it will be possible to recoup them in 2014 if efforts are redoubled. Targets have been maintained until 2020, based on current policy commitments and additional measures that will improve process functioning. Governance of privatisation process will be reviewed during autumn.

Downsizing of public administration continues, but reforms are delayed

- Efforts to modernise the Greek economy require **improving the efficiency and effectiveness of the public sector**.
- **Significant progress** towards the targeted **reduction of public employment** by at least 150,000 in 2011-2015: number of public sector employees has dropped from around 835,000 by end-2010 to 713,000 by end-2012.
- **Staffing plans for 374,000 employees** adopted up to July; plans for the whole public administration to be in place by end-2013.
- On **mobility of staff**, legislation has been adopted placing over **4,200** employees in the mobility scheme by end-July. A cumulated 12,500 will be placed by end-September, **reaching 25,000** by end-2013.
- A **strategy for the re-allocation and hiring of staff** will align staffing with the government priorities.

Tackling the unemployment and social challenge

The programme includes measures to fight unemployment and poverty:

- A **short-term public works scheme** targeted to **50,000 long term unemployed** and financed with EU funds is being prepared to start in the second half of 2013.
- A **Youth Action Plan** backed by a EU funding of EUR 517 million has been adopted to promote youth employment, training and entrepreneurship and targets nearly **350,000 young people**.
- The authorities are designing a **minimum income scheme** on a pilot basis and **unemployment assistance for the long term unemployed** targeted to the poor, to be in place as of January 2014.
- Past labour market reforms should **facilitate new hirings**.

Creating favourable conditions for economic activity – business environment, retail and trade

- Concrete measures to **improve the business environment**:
 - 10 measures adopted in May **to ease doing businesses** in: starting a business, registering property, construction permits, protection of investors.
 - With OECD support, screening of legislation and regulation with potential harmful effects on **competition**. Legal changes in November.
 - With World Bank support, streamlining of **investment licenses**. Roadmap in September and proposals for legal changes by end-2013.
- With a view to increase **competition and price flexibility in retail trade**, the government liberalised sales periods and opening hours in July.
- **Simplified export procedures** for selected products and **extended opening hours** in pilot customs offices. **Risk assessment systems for exports** to be aligned with EU averages in September, fully-fledged e-customs systems in November .

Creating favourable conditions for economic activity – judiciary, professions and energy

- Important **progress in judicial reform**, where efforts to put in place a court data system show that past reforms have increased outflow/inflow of cases in courts. The stock of cases remain important.
- The new **Code of Lawyers** will remove unjustified restrictions on legal services.
- In June the government opened **access to professions**, including accountants and actuaries. The authorities intend to reduce or eliminate reserved activities for key professions, including engineers, by the end of the year.
- **Electricity prices fully liberalised** in July and the plan to reform the electricity market has been adopted, with immediate steps already underway.
- **Restructuring and privatisation of incumbent electricity company** progressing, with the ultimate objective of improving the functioning of the electricity market.

Banking sector consolidation well advanced

- The **re-capitalisation of the four core banks has been completed** and will help support economic recovery and maintain the protection of depositors.
- Three of the core banks attracted **private funds** of about €3 bn. (over 10% of the required capital-increase of €27,5 bn.) and will remain under private control. Private investments much higher than expected.
- **HFSF** injected about €25 bn. of capital into the four core banks and has signed relationship framework agreements with these banks.
- Three cooperative banks and five commercial **banks resolved** during the last two years at a cost of about €15 bn.

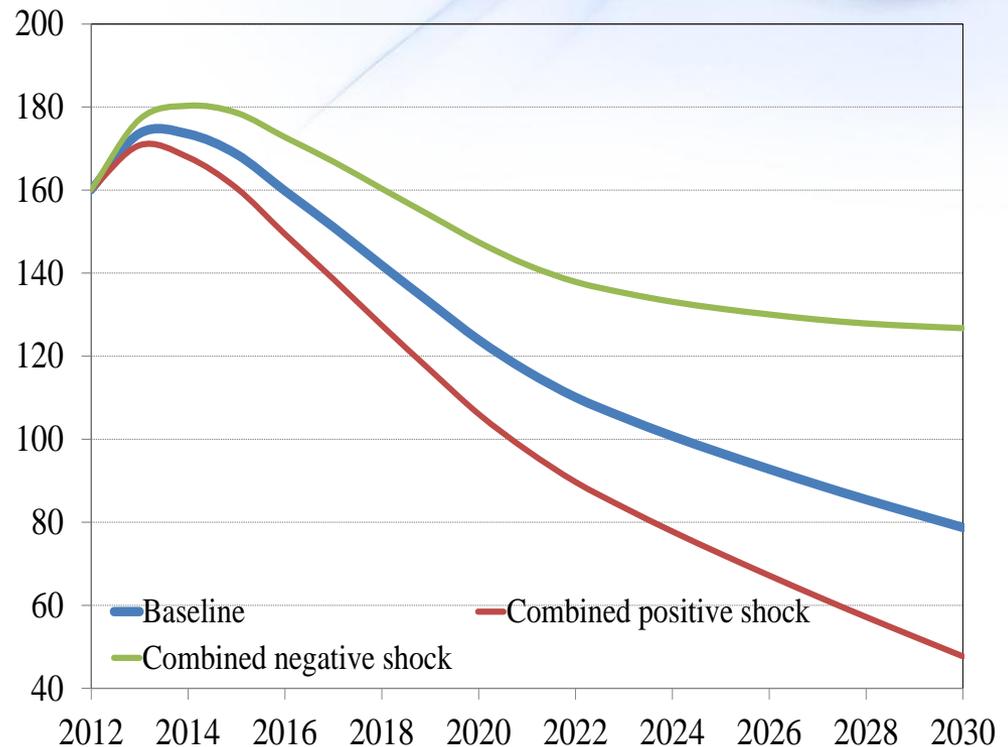
Banking sector to increase efficiency before privatisation

- The four core banks to submit **restructuring plans** by end September 2013.
- **Monitoring trustees** have been appointed for all core banks to monitor the implementation of the restructuring plans and ensure that decisions are taken on commercial terms.
- A **comprehensive banking sector strategy has been developed** to create a leaner, cost efficient, competitive and well capitalised banking sector with local focus.
- The **capital needs assessment** will be updated by early 2014 based on an asset quality review and a new stress test in cooperation with EBA.
- The fourth core bank will be gradually **privatised** as soon as possible preferably to a long term, strategic investor.

Debt sustainability continues to be ensured

- The assessment of debt dynamics broadly unchanged compared to December 2012.
- The **debt-to-GDP ratio** forecast to resume a **declining path in 2014** and should become **lower than 120% by 2021**, assuming full programme implementation.
- The **debt would perceptibly decline** from its current levels in **most stress-test scenarios**.
- Under a combined negative shock the debt would decline initially, but stabilise at a very high level.

Greece-general government debt (% GDP)



Source: European Commission services

Programme financing

- Until **June 2013**, disbursements under the programme amounted to **EUR 210.2 billion**. **The programme is fully financed until the end of July 2014.**
- The Eurogroup decided on 8 July that the **disbursement related** to the completion of the **third review** would amount to **EUR 3 billion** in two tranches:
 - First tranche of **EUR 2.5 billion** disbursed end-July, following fulfilment of all prior actions.
 - Second tranche of **EUR 0.5 billion** in early October, linked to implementation of milestones related to privatisations, public administration reform and liberalisation of regulated professions.
- ***For the first time under November 2012 Eurogroup agreement, profits obtained by Central Banks on Greek bonds will be transferred to Greece.***
- The SMP income transfer amounts to **EUR 2 billion** and will also be paid in two tranches, of EUR 1.5 billion end-July and EUR 0.5 billion in October.

Conclusions

- **The programme remains on track and Greece continues to make progress, albeit at a slow pace in some areas.**
- Reforms have already led to an improvement of **cost competitiveness**, the implementation of a **bold fiscal consolidation** and a far-reaching **banking sector recapitalisation**.
- **Structural reforms are crucial** to underpin fiscal adjustment, tackle the unemployment challenge and enhance growth prospects, and **must be fully implemented**.
- **Delays** in revenue administration reform, public administration reform and privatisations **have to be tackled**.
- **Risks** to programme implementation **remain high**, but there are also **upside risks**.
- The **next programme review** is scheduled to start in September.