

**Greece: Report on the Observance of Standards and Codes—
Fiscal Transparency Module—Update**

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GREECE

**Update on the Report on the Observance of Standards and Codes—
Fiscal Transparency Module**

Prepared by the Fiscal Affairs Department

December 21, 2004

This report has been prepared for consideration by the Greek authorities in the context of the 2004 Article IV consultation with the IMF.

Introduction

1. The first fiscal ROSC was issued in October 1999. The report was experimental in character, as the IMF had at that time just started the development of this fiscal surveillance instrument. The report was based on a self-assessment of the authorities and staff commentary provided by the 1999 Article IV consultation mission. During the 2004 Article IV consultation, the IMF staff reviewed developments in the areas pertaining to Greek observance of the fiscal transparency practices assessed in 2004, with a view to updating, where relevant, changes in current practices, or describing the implementation of the earlier ROSC recommendations. In 2001, 2002, and 2003, short updates were produced on recent changes with regard to fiscal transparency practices, progress in implementing the initial ROSC recommendations, and new developments relevant for future observance of good fiscal transparency practices. Pending a complete revision of the 1999 fiscal ROSC planned for 2005, this update gives an overview of the main fiscal transparency issues in Greece, focusing on fiscal reporting and public expenditure issues. It should be noted that the mission often did not have the opportunity of verifying and cross-checking the information provided by the authorities. It should be noted that this update focuses primarily on central government and due to time constraints does not deal with local governments. Unless indicated differently below, the recommendations made in the 2003 ROSC update remain relevant.

Description of Progress

2. The 1999 ROSC made key recommendations principally on: the clarification of the treatment of state enterprises, the investment budget, quasi-fiscal activities, and state financial assets; a clear statement of the accounting basis underlying the budget; and parliamentary hearings on audited financial statements to bolster oversight. The report covered, as does this 2004 update, the four main areas of fiscal transparency:

- Clarity of roles and responsibilities;

- Public availability of information;
- Open budget preparation, execution, and reporting;
- Independent assurances of integrity.

3. The progress made since 1999 in enhancing fiscal transparency practices included: publication of tax expenditures of central government; reporting on guarantees, share participation, and transfers to public entities; limiting the scope of and improving reporting on extra-budgetary funds; and improving the availability of information on the budget, taxes, public debt, and civil service remuneration, through government websites and other channels. Other important steps taken were Greece's subscription to the IMF's SDDS program in November 2002 and participation in the data module of the Report on the Observance of Standards and Codes (the data ROSC) in 2003.

4. A significant development in 2004 towards improving fiscal transparency was the "fiscal inventory" carried out by the government with the cooperation of Eurostat. (See Box below). This inventory has led to significant changes to Greece's fiscal reporting methodology being agreed with Eurostat. The fiscal inventory and subsequent revisions have substantially increased the recorded deficit and debt figures for the 1997–2003 period, and revised upward the no-policy change expectations for the general government deficit for 2004 and future years. The "fiscal inventory" exercise should position Greece to improve its overall standing with financial markets with regard to transparency issues if the new practices agreed with Eurostat are consistently applied over the coming years.

Recent Developments and Key Issues

Clarity of roles and responsibilities

5. As noted in previous updates of the fiscal ROSC, much progress has been made since joining the EU in separating government from non-government functions, and more tightly delineating the boundaries between the government and the rest of the public sector. For this purpose, a consistent legal framework has been developed. However, there are a few areas where roles and responsibilities could be more clearly defined.

6. The various public expenditure management functions in government are still often organizationally fragmented, both between and within institutions. This may give rise to uncertainty over which organization or organizational unit is responsible and accountable for the tasks in question, and could lead to coordination and communication problems. For example, the important task of pre-audit of central government expenditure is divided in Greece between internal line ministry audit units, the General Accounting Office (GAO) deconcentrated control units, and the Court of Audit. All three of these internal audit checks

Greece's 2004 Fiscal Data Revisions

Fiscal data revisions are not uncommon among countries at any development level. However, the magnitude of the recent revisions of the Greek fiscal statistics call into question the adequacy of Greece's public expenditure management systems, and specifically systemic and institutional recording, control and verification mechanisms. In the period 2000 to 2003 the deficit for each year was increased by more than two percentage points (2.9 percent in 2003). General government debt increased by more than 7 percentage points. In the 1997–99 period the deficit revisions have been slightly under two percentage points per year. Over the period 1997–2003 the deficit figures were never below the Maastricht limit of three percent per year. The revisions to the fiscal data were caused by mis- and under-reporting of various expenditure, revenue and debt categories, of which the relative importance has varied over time.

The most important categories affecting the deficit were:

- the off-budget recording of military expenditure financed through special defense borrowing
- overestimation of the surpluses of social security funds (previously estimates were based on antiquated and partial survey methodology)
- the misreporting of EU funded capital transfers as capital injections
- non-reporting of capitalized interest payments
- misclassification of the expenditure of the Greece's privatization agency, DEKA
- assignment of tax revenues to the wrong year (a factor in 2003)

General government debt was revised upward reflecting mainly:

- non-recording of capitalized interest obligations
- inadequate debt consolidation over government
- misclassification of social security funds¹
- non-recording of debt after calling of guarantees²

In its recent report of November 22, 2004, Eurostat indicates that all the major issues have now been resolved with the Greek authorities, but that a number of smaller, technical issues still require further clarification.

¹ A number of social security funds had inadvertently been classified as part of the private
(continued)

are largely procedural and legalistic in approach.³ A proposal for a fourth control organization, situated in the GAO, of a more investigative nature, is presently being prepared. It is not clear that an effective internal control system is in place nor that the proposed remedy would improve overall clarity and effectiveness of controls. It is clear that a fourth expenditure control service would only be useful if it fulfills a clearly different function from the other audit functions in the public sector, for example, by focusing on an evaluation of the efficiency and effectiveness of government operations. Even then it may be preferable to expand the responsibilities of one of the existing services.⁴

7. In the area of debt management, Greece has developed a modern and well-respected Public Debt Management Agency (PDMA), which has considerably improved maturity and risk management of the Greek debt portfolio. However, the accounting and reporting functions for debt management have been retained by the GAO, as well as some of the responsibilities for debt issuance. Although the GAO sees little problem in coordination, the fact remains that the component of the debt managed separately by the GAO was one source of the misreporting confronted in the recent Eurostat data revisions. The conclusion could be drawn, therefore, that the lack of clarity of roles in this area has led to weaknesses in reporting.

8. Privatization is another area where responsibilities have been fragmented. As indicated in the original ROSC, policy development in this field is carried out by the directorate for privatization of the Ministry of Economy and Finance (MEF), while privatization implementation is carried out both by this directorate and through DEKA, a public corporation. Reporting on privatization is done by the GAO. For accountability and transparency of privatization policy and processes, a concentration of all related tasks in the privatization field would be beneficial. The one agency or directorate for privatization should

sector.

² Loan guarantees to public sector companies are called on a regular basis. Reportedly, when the assumption of debt occurred, this was not recorded and/or the debt was swapped for a capital injection in the company in question.

³ The Court of Audit has responded that its pre-audit activities are targeted to the most risky 10 percent of expenditure of spending agencies and is more external and judicial in nature than other pre-audit activities. The focus on this ten percent nevertheless means that for non-regular expenditure a very substantial part is pre-audited by the Court of Audit. Also, despite the somewhat different focus of the pre-audit activities, the control processes are broadly similar and executive in nature, potentially conflicting with the independence of the Court's oversight of executive functions.

⁴ Placing such a function in the GAO may give rise to a constitutional issue if targeted at autonomous public sector entities, such as local government and universities.

be responsible for all reporting to the minister and parliament. These reports should be audited by the Court of Audit.⁵

9. Certain tasks explicitly part of the mandate of the Court of Audit, as well as some that should be part of its mandate and are not, presently are not being carried out. For example, the Court does not audit public debt reporting nor does it check on the appropriate translation of Eurostat fiscal reporting methodology into GAO practices when approving the central government's annual account.⁶ Such activity could have discouraged misreporting practices as they existed in the 1997–2003 period. While these issues are indeed sensitive, national audit offices in other EU countries do see it as part of their mandate to review and assess the Executive with regard to its EU reporting obligations. This situation suggests the Court of Audit's institutional position still needs to be strengthened in this regard. If a decision is taken to expand the Court's activities, a review of the Court's required resources for any new tasks, and the issue of the efficient use of its present resources, would seem warranted.

10. An area where almost no progress has yet been made in Greece, and where no institutional roles and responsibilities have been assigned, is that of performance measurement and the value for money evaluation of government policies and activities. In other OECD countries progress in this field has been extensive over the past 15 years and has been very important for fiscal transparency. To develop this institutional capacity in performance measurement and analysis would require measures to build up this expertise in line ministries, the GAO and in the Court of Audit. Given the urgent need for fiscal consolidation in Greece, performance measurement and analysis should perhaps be initiated in the GAO where it could play an important role in supporting allocative decision-making and reducing inefficiencies. In due course, the Court of Audit should undertake the full range of public sector external audit activities, covering both regularity and performance audit, for all entities in the public sector, and those substantially financed or directed by the public sector entities.

Public availability of information

11. There have been substantial improvements in government reporting to the public. Over the years, Greece has increased its reporting on various aspects of the government's relationship with the public sector: the publication of the tax expenditure budget, the reporting on guarantees, share participation and transfers to public entities. Fiscal reporting has improved in its timeliness and the government's adherence to its release calendars has improved noticeably over the last two years. The MEF has also improved its website and

⁵ The Court of Audit has indicated its strong support for this proposal.

⁶ In addition, the Court of Audit does not, or only to a limited extent, perform audits of social security funds and local government.

attempted by ministerial directives to improve its responsiveness in providing information to the public.

12. While some basic data has improved in quality and timeliness, the recent Eurostat revisions have pointed to important past weaknesses in some key areas. At the same time, there are concerns that there has been little improvement in providing information of a policy and program nature. In particular the policy statements in the budget are rather general, and ministries do not give detailed policy based descriptions of their spending plans. This, combined with the input cost nature of the budget figures, causes the budget to be rather uninformative to the general public. Presentation of the budget according to a programmatic structure and its associated costing, with accompanying detailed description of policy-based targets for each program, has become the norm in most OECD countries at least at the central government level.

Open budget preparation, execution, and reporting

13. Currently, the Greek budget presentation lacks clarity and does not support policy analysis and accountability. While the budget has recently become more comprehensive and each category of spending is itemized in great detail, the purposes of this spending are not apparent. Thus, the budget cannot give a comprehensive picture of how the government's policy objectives are represented in its spending plan. In addition, without some indication of the objectives underlying this spending, it is basically impossible to judge how efficiently and effectively the budget is accomplishing its objectives. Current reporting on the execution of the budget is now nothing more than a statement of how closely actual spending complies with the amounts budgeted. It does not provide an assessment of how much is being achieved by that spending. This limits the audit function to one dominated by considerations of financial regularity and legality but not value for money.

14. There are two important weaknesses in the current Greek budget that result in a lack of clarity: it lacks both a program structure and a multi-year perspective. Appropriations are not made by program and they do not contain any statements, even of a generalized nature, of the objectives or the goals of the spending. Without a clear declaration of the purposes of the spending and a legislative connection between the funds provided to each specific program, a real assessment of the programmatic value of the spending—as well as of the efficiency and effectiveness of the spending—is not possible. Secondly, despite the recognition that many of its spending programs have multi-year impacts, and despite the fact that the European Union's Stability and Growth Pact requires fiscal projections for three years beyond the budget year, the budget lacks a multi-year budgetary framework. The MEF does publish multi-year macro-fiscal forecasts on a semi-annual basis. These forecasts are also provided in the context of EU fiscal policy coordination. They are, however, top-down forecasts at an aggregated level, with minimal if any connection to the annual budget formulation process. These two weaknesses also apply to other parts of general government, such as social security funds and local government.

15. The accounting, classifications, and reporting used in the Greek budget should be changed in several ways to improve the budget's consistency, comprehensiveness and also its transparency.

16. In recent years, the MEF has been studying moving the basis of government accounting from cash to accruals. Although no final decision has been made, the authorities are aware that a complete change to accruals will take time and thus are considering a move to something less than full accrual accounting. At the same time, the GAO is implementing a new chart of accounts on a pilot basis using a domestically-produced software package. In the pilot phase the system links the line divisions of the Budget and Treasury in the MEF. This new structure is intended to eventually link the main ministries and automate the present, slow (sometimes even manual) procedures.

17. The budget could be made more comprehensive. At present it excludes a substantial part of defense spending and other off-budget spending through extrabudgetary special accounts. The ordinary and investment budgets, while presented in great detail, are not integrated to give a transparent view of the government's overall spending plans. Reporting on preparation, execution and completion of investment projects is weak. Expenditure data is presented in the budget at an aggregated level providing insufficient insight into the purpose of investment projects and expected societal impact. Efficiency and cost-effectiveness of implementation also remains difficult to gauge. Finally, investment projects are not objectively screened in a standardized way by the MEF during the selection process with modern methodologies, such as cost-benefit analysis.

18. Transparency is also compromised by the existence of extrabudgetary and special purpose accounts. Some of these accounts are independent of the budget, and while the cash position of the other accounts is reported in budget documents, there is no detailed reporting of the revenue and expenditure flows going through these accounts. The Court of Audit, moreover, indicated that the number of special purpose accounts involving public funds was substantially greater than that reported in the budget documentation. These accounts may contain small amounts of funds and used infrequently, however, their use is quite widespread and this runs counter to the spirit of a consolidated single government account.

19. While Greece has obligations to provide government accounts data according to *ESA95* guidelines, there are areas where national fiscal data deviate from these standards. Examples where this harmonization could be improved are the definition of capital transfers versus equity participation, the classification of guarantees to loss-making enterprises, the treatment of EU funds in the investment budget, and inclusion of all defense expenditure in the budget.

20. Transparency through in-year reporting on budget execution of the central government is improving, but more could be done especially with regard to the social security sector.

Independent assurances of integrity

21. Although the fiscal data provided by many of the Greek agencies has improved greatly over the years, the agencies providing these data need to be as independent as possible to enhance the credibility of the data to those both inside and outside Greece. The politicization of top technical administrative functions has worked against the technical independence of key institutions. For example, the credibility of the data provided by the National Statistical Service of Greece (NSSG) would be enhanced if it were made an independent agency outside the MEF. In a related way, the credibility of the budget data reported by the MEF could be enhanced, say by an independent review of the underlying assumptions by an independent agency.

22. The Court of Audit in Greece plays a very important role in the Greek public administration in providing assurances on regularity and legality of the budgetary process. The Court's functioning is modeled on the French auditing system where the Court is part of the judicial system. However, there are a number of potential weaknesses in this auditing system which should be reviewed. The Court of Audit is heavily involved in the pre-audit of all non-regular expenditure of central government. To some extent, this compromises the ex-post audit of the Court, as it implies an assessment of the Court's own actions. Many countries have done away with the external pre-audit of expenditure, making it the sole responsibility of the Executive. If it is felt that external pre-audit is still needed in the present balance of powers in the Greek public administration, there should be some assurances that the Court of Audit is able to maintain adequate independence between its pre- and post-audit activities.⁷

23. Greece has a large social security sector absorbing more than 12 percent of GDP. The monitoring, control, and consolidated reporting on this sector are shared by the Ministry of Labor and Social Security (MLSS), the GAO and the NSSG. Monitoring by the GAO is limited to those Funds that receive grants from the central government. The MLSS reports on the social security sector with a considerable time-lag, and only on an annual basis. Until recently, the NSSG provided estimates of this sector's operations to Eurostat based on an inappropriate survey methodology. Greater fiscal transparency and specifically EU reporting requirements for general government require that monitoring and control of this sector should be substantially improved. This would involve a regular consolidated report of the operations of all social security funds, at least quarterly, both to the MLSS and the MEF. In this way, developments in this sector, which is under full regulatory control of central government, could be incorporated in fiscal and expenditure management decisions.

⁷ The Court of Audit maintains that the pre-audit, focusing on the legality of the payment obligation, is only an extension of its post audit function, which focuses on the execution of the payment order, implying no duplication of its scrutiny.

IMF Staff Commentary

24. Undoubtedly, there have been major recent efforts to improve fiscal transparency, in line with EU requirements. However, there are still important processes and institutional issues in Greece which hinder the attainment of fiscal transparency comparable to other EU countries. Previous ROSC updates have noted a number of important and worthwhile initiatives: medium-term budget frameworks; improved budget preparation procedures; analysis of fiscal risks; an improved accounting system; and strengthened audit procedures. Admittedly, many of these reforms take time to implement. However, in Greece their adoption has been protracted, and the objectives of these initiatives are still far from being achieved. The current update suggests that some of the more fundamental barriers to progress be reexamined. The full ROSC reassessment proposed for 2005 will provide an opportunity to examine these issues in greater depth. In the meantime, the following recommendations could be taken into consideration by the authorities.

25. Various aspects of the budget process work against fiscal transparency. These arise from the very traditional and highly centralized system of budget management practiced in Greece. The presentation of the budget concentrating on economic categories of spending does not allow a clear view of the underlying policies. Control procedures emphasize the correct use of very detailed line items of expenditure, and this works to mask the underlying policies and programs, and diverts attention from the efficiency of the expenditures being made. To clarify the performance of government, operations will require a fundamental reorientation of budget management. In this respect, the importance of introducing a program structure is emphasized.

26. There would also seem to be advantages for Greece in adopting a multi-year budget framework as a way to assess the sustainability of current fiscal policies and as a way to judge how much room there is for future spending measures or tax cuts. In addition, while most EU countries have found multi-year projections based on current policies useful, this approach would seem particularly relevant to Greece given its requirement to chart a path of fiscal consolidation from present deficit levels to levels that are sustainable and acceptable to the EU. In this context, a fiscal risk analysis—including realistic specifications of the risks inherent in Greece's many types of loan guarantees as well as of the risks that might surface if Greece undertakes a program of public-private partnerships—would also be very useful, and should be published with the budget.

27. The budget should be made more comprehensive. In particular, as is the case in other OECD countries, all spending on defense should be included in the budget, although in a manner that does not compromise national security considerations. In addition, all other off-budget spending should be included in the budget totals. Similarly, there should be gradual integration of the ordinary and investment budgets, which will make the government's expenditure plan in various areas more transparent. Investment expenditure should in any case be managed with more attention paid to criteria for selection, to monitoring, and to performance assessment.

28. Transparent and efficient budget execution requires the closing of all special accounts and the existence of a Treasury Single Account (TSA) that truly captures the government's overall cash position. Providing an overview in the budget documentation of the liquidity held in the special accounts is a very useful first step, but does not reveal the size or nature of the gross inflows and outflows of these accounts.

29. As indicated above, transparency would also benefit from a mid-year report on the implementation of the budget. In addition, there should be enhanced and more timely reporting on the Social Security Sector. Regarding reporting, improved arrangements have now been agreed between Eurostat and NSSG for surveying annual and quarterly realization figures of the sector. These data should be shared with GAO and MLSS to substitute for their limited monitoring of the sector. In addition, fiscal transparency would be enhanced if a comprehensive, prospective report on the social security sector would be added in the budget documentation, and a consolidated picture of the general government for the coming year would be presented to Parliament.

30. There should be a move away from internal controls focused on the legality of resource use, to more emphasis on efficiency and effectiveness in using resources. This points to a need to reform the internal control structure that is characterized by layers of detailed input controls. This overlap in pre-audit functionality is wasteful and inefficient, and is not in line with OECD best practice. Similarly, there is a need for the Court of Audit to extend the scope of its work into policy sensitive areas, including value for money audits.

31. As indicated, the MEF has been studying moving the basis of government accounting from cash to accruals, and at the same time the GAO has begun to implement a new chart of accounts. While a new accounting structure is undoubtedly an important intermediate step, there appears to be a strong case for adopting a more integrated approach that can accommodate accruals if required. While national fiscal data will probably need to remain on a cash basis for the time being, *ESA95* data is specified on an accrual basis, requiring the GAO to make greater efforts to harmonize national fiscal data with Eurostat definitions and instructions. This would improve the understanding and comparability of data provided to the EU and included in state budget documents.⁸

32. Debt management and reporting is a function clearly delineated from fiscal management and reporting. Most OECD countries have found it useful for coordination of the work, concentration of expertise, and transparency in accountability, to integrate all tasks related to debt management in one functional agency. These tasks would range from policy development and debt issuance to accounting and reporting, and it appears this integration

⁸ Examples where this harmonization could be improved are the definition of capital transfers versus equity participation, the classification of guarantees to loss-making enterprises, the treatment of EU funds in the investment budget, and the inclusion of all defense expenditure in the budget.

was the original intention behind the legislation creating the present PDMA. Data integrity would also be an important reason to concentrate the debt management function in one agency, such as the PDMA. If supported by legislation establishing PDMA's independent position, such a move should provide a very positive signal for financial markets and Eurostat.

33. There are also indications that, at least in part, the problem of relatively slow implementation of transparency-enhancing reforms may lie in the institutional structure of agencies. In particular, the fragmented organizational structure within the MEF exhibits a less than full integration of two previously separated ministries. Often, different units share functions, obscuring individual roles and giving rise to coordination problems. However, perhaps more importantly, the sharing of functions implies a sharing of responsibility for results, which in turn makes the enforcing of accountability difficult. There appears a case of examining the need for further rationalization of the organizational structure of the MEF.

34. Another institutional problem is the politicization of top technical administrative functions that has the potential of undermining the technical independence of key institutions. For example, given the fiscal data problems in the past, Greece would be better served if the NSSG was granted independence from the MEF.

35. Finally, the credibility of the budget data reported by the MEF would be enhanced if an independent agency—perhaps one that reported directly to the parliament—reviewed the assumptions, inputs, and models used by the various agencies within the ministry to provide its own independent assessment of the status of the budget estimates.⁹

⁹ An alternative would be a private agency or university that could supply some independent evaluation of budget assumptions.