

Greece: 2004 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Greece

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with Greece, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on September 14, 2004, with the officials of Greece on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 17, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of January 8, 2005, updated information on recent economic developments.
- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its February 2, 2005 discussion of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Greece.

The documents listed below have been or will be separately released.

Report on the Observance of Standards and Codes—Data Module—Update
Report on the Observance of Standards and Codes—Fiscal Transparency—Update
Selected Issues Paper

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

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GREECE

Staff Report for the 2004 Article IV Consultation

Prepared by the European Department

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December 17, 2004

- The Article IV discussions were held September 3–14, 2004. The mission—Mr. Ford (head), Ms. Banerji, Mr. Gagales (all EUR), and Mr. Bouscharain (MFD)—held discussions with the Bank of Greece; the Ministry of Economy and Finance; the economic adviser to the Prime Minister; and other government officials. The mission also met the main labor federation, industrialists, and other private sector participants, especially in the banking sector. Ms. Xafa, Alternate Executive Director, attended the meetings.
- The authorities released the mission’s concluding statement and have agreed to the publication of the staff report.
- An FAD mission was held November 1–9, 2004 to update the 1999 assessment of fiscal transparency, which was a precursor of the ROSCs, and as such was considered experimental and based largely on a self-assessment by the authorities.
- Greece has accepted the obligations of Article VIII, Sections 2, 3, and 4 and maintains an exchange system free of restrictions, apart from those related to UN resolutions (Appendix I). Greece subscribes to the SDDS (Appendix II).
- The center-right New Democracy party won a comfortable parliamentary majority in March 2004, returning to power after a decade in opposition.

Contents		Page
Executive Summary		3
I. Background		4
II. Policy Discussions		7
A. Economic Outlook		7
B. Fiscal Policy		8
C. Financial Sector		12
D. Higher Growth and Convergence with the EU		14
E. Other Issues		16
III. Staff Appraisal		16
Boxes		
1. Policy Recommendations and Implementation		5
2. Revision of General Government Accounts		6
3. Staff Advice on Fiscal Transparency in Greece		9
4. Recommendations of the 2004 Fiscal ROSC Update		10
Figures		
1. Output, 1998–2004		20
2. Cyclical Indicators, 1998–2004		21
3. Labor Market, 1998–2004		22
4. Credit Developments, 1998–2004		23
5. Prices and Competitiveness, 1998–2004		24
6. Unemployment Rates, 2003		25
7. Employment Rates, 2003		26
Tables		
1. Selected Economic Indicators, 2000–05		27
2. Indicators of External and Financial Vulnerability, 1998–2004		28
3. Revisions to the General Government Budget Balances, 2000–03		29
4. General Government Accounts, 2000–05		30
5. Medium Term Baseline Scenario, 2004–10		31
6. Public Sector Debt Sustainability Framework, 2001–50		32
7. Medium Term Staff Policy (Adjustment) Scenario, 2002–10		33
8. Financial Soundness Indicators, 1997–2004		34
Appendices		
I. Fund Relations		35
II. Statistical Issues		36

EXECUTIVE SUMMARY

Background

- Economic growth is set to be strong in 2004 for the fifth year running. Eroding competitiveness and the need to quickly correct high fiscal deficits suggest activity will slow appreciably in 2005 and beyond, although the authorities maintain a more optimistic outlook.
- Data revisions, spending overruns (in part due to the Olympics), and revenue shortfalls pushed the general government deficit to an estimated 5½ percent of GDP in 2004. Indeed, the revisions revealed that the deficit never fell below 3 percent of GDP. The very high debt-GDP ratio (based on revised data, 112 percent of GDP in 2004) has fallen little in recent years.

Policy discussions and assessment

- Fiscal consolidation is the overriding priority. The 2005 budget targets a deficit reduction of 2½ percent of GDP (of which 1¼ percent is due to the end of Olympics spending), which the staff judges feasible and necessary. Staff calculates that the deficit will fall to 3½ percent of GDP in 2005, although it may prove higher.
- Medium and long-term fiscal consolidation is also needed. Structural adjustment of slightly more than ¾ percent of GDP a year would yield near budget balance by 2010, while further adjustment will be required thereafter. This is more than the authorities currently envision, although their plans are not yet firm. Pension reform is off the authorities' policy agenda for now.
- The unreliability of the fiscal data, revealed by the large revisions agreed with Eurostat, has hindered surveillance, policy-making, and credibility. The fiscal ROSC update lays out further desirable improvements to fiscal management.
- The banking system seems in good health, although the rapid rise in private sector credit during the economic boom may hold credit risks if the economy slows.
- Convergence with the EU-15 living standards is a longstanding priority. The government program seems relatively strong on tax reform, and enhancing competition, a thrust welcomed by the staff. However, much less focus is being placed on labor-market reforms.

I. BACKGROUND

1. **Real GDP growth in 2004 is expected to be about 4 percent for the fifth consecutive year** (Table 1, Figure 1). The boom was sustained by accommodative monetary conditions associated with adoption of the euro and subsequent easing by the ECB. Fiscal policy was also markedly stimulative, with revised figures showing the budgetary situation to have deteriorated throughout the boom period. Private consumption and household confidence have been buoyant, reflecting strong wage increases, wealth effects from rising real estate prices, gains in employment and a falling unemployment rate, and deregulation of financial markets that spurred very large increases in consumer credit (Figures 2, 3, and 4). Rising profitability and, in the past two years, the Olympics have sustained investment, especially construction.

2. **However, years of high growth have resulted in inflationary pressures and an erosion of competitiveness, and structural weaknesses have remained largely unaddressed.** There has been progress in implementing Fund recommendations in some areas (notably, the financial sector and, following recent fiscal revisions, data quality), but less has been done elsewhere (Box 1). In particular, limited progress on resolving longstanding supply-side impediments has meant that the output gap has risen and labor markets have tightened as aggregate supply has not been able to meet rising demand. Inflation and unit labor cost increases have been among the highest in the euro area, causing a sustained appreciation of the real exchange rate (Figure 5). Although about half the inflation differential may be due to Balassa-Samuelson effects, international competitiveness has eroded and the export market share has fallen. Strong domestic demand and poor competitiveness underlie large and persistent current account deficits and, in the past three years, a negative contribution of the external sector to aggregate demand.¹ The size of the current account deficit and the fact that it is financed largely by portfolio flows—FDI inflows have been weak—raises issues of longer-term sustainability (Table 2). However, interest rate differentials relative to Germany remain small, reflecting Greece's participation in a monetary union.

¹ Shipping has proved very strong, however, as demand and fares have risen sharply. By contrast, tourism has disappointed as costs exceed those of other Mediterranean competitors and, in 2004, potential Olympic games spectators were dissuaded by security concerns.

Box 1. Policy Recommendations and Implementation

Fiscal policy. The Fund has repeatedly called for a more ambitious fiscal stance, but consolidation stalled in recent years and revisions have revealed that deficits were much larger than reported. Had these numbers been available, staff would have advised a still stronger fiscal effort. The Fund has encouraged multi-year fiscal planning, which has not been adopted.

Data quality. The Fund has called for improvements in statistical data, as identified in the fiscal and data ROSCs. Progress has been made, notably with adherence in 2002 to the SDDS and the recent fiscal revisions, but more needs to be done (Appendix II and the ROSC updates).

Pension reform. The Fund has called for early action to address the high projected costs of population aging. Pension reforms in 2002 consolidated a number of funds, but did not address underlying expenditure pressures.

Financial sector. The Fund has welcomed actions to improve supervision and strengthen banks' risk management, processes which have continued. A law establishing an independent insurance supervisor was passed in February 2004, but has not been implemented.

Structural policy. The Fund has called for further privatization, which continues to be a key government goal. Most recently, divestiture of the remaining stake in the National Bank was announced. Labor market reform, which the Fund has consistently advocated, has been limited.

3. **Fiscal consolidation stalled during the boom, with the situation proving much worse than had been thought even as late as last spring.** Restatement of the fiscal accounts by the authorities and Eurostat resulted in large upward revisions to general government deficits for 1997–2003, which never fell below the 3 percent of GDP Maastricht ceiling (Box 2 and Table 3). The general government deficit remained close to 4 percent of GDP during 2000–02 before expanding to an estimated 5½ percent in 2004; the primary surplus declined precipitously to almost zero. Olympics spending was partly responsible, adding 1 to 1½ percentage points to the deficit-GDP ratio in each of 2002–04 (Table 4). Spending overruns and revenue shortfalls raised the 2003 and 2004 deficits well beyond budget projections. Owing to the lack of fiscal adjustment, the debt-GDP ratio, officially expected to be 112 percent in 2004, has fallen little in recent years. Following these revisions, Greece was downgraded by Standard and Poor's and put on a negative rating watch by Fitch, which however seems not to have widened interest rate differentials. In its report to Parliament and the Council, the EC announced an infringement procedure to prevent future misreporting by Greece, and raised broader issues of ensuring member-country data quality.²

² "Report on the Accountability Issue Related to the Revision of Greek Budgetary Data" CEC, December 1, 2004.

Box 2. Revision of General Government Accounts

From May to November 2004, the authorities and Eurostat agreed to revisions to the public accounts which substantially increased fiscal deficits for 1997-2003. The key sources of the revisions were:

- Corrections for under-recording of military procurement, as well as a change in the method of accounting for this item from a delivery basis (preferred by Eurostat and used by the bulk of euro-area countries, but for which reliable data are not available in Greece) to a cash basis. The latter shifted the recording of some acquisitions to earlier years, but did not increase the total.
- Corrections for over-estimation of social security and other non-central government surpluses, based on a new census of these organizations yielding up-to-date data.
- A reversal of the decision to book January 2004 VAT receipts in 2003, a change in treatment of EU structural funds, and reclassification of a transaction with the postal savings bank from revenue to a financial transaction.
- Debt was also revised up, mainly reflecting the capitalization of delayed interest payments and lower social security assets.

Greece: Revision of Fiscal Figures as of November 2004
(n percent of GDP)

	1997	1998	1999	2000	2001	2002	2003
Deficit							
Unrevised (February 27, 2004)	4.0	2.5	1.8	2.0	1.4	1.4	1.7
Revised 1/	6.6	4.3	3.4	4.1	3.7	3.7	4.6
Difference	2.6	1.8	1.6	2.1	2.3	2.3	2.9
Due to central government	2.4	1.6	1.6	2.2	1.3	1.8	2.1
Revenue	0	0	0	0	0	0	1.3
<i>Booking of VAT revenue</i>	0	0	0	0	0	0	0.9
<i>Revenue from EU structural funds</i>	0	0	0	0	0	0	0.3
<i>Reclassification of Postal Savings Bank revenue</i>	0	0	0	0	0	0	0.2
Military procurement	0.2	0.1	0.9	1.9	1.2	1.7	0.7
Debt assumptions	0.1	0.1	0.1	0	0	0	0
Capitalized interest	1.0	0.3	0.1	0	0	0	0
Capital injections	0.9	1.0	0.7	0	0	0	0
Other expenditure	0.2	0.2	-0.2	0.3	0.1	0.1	0.1
Change in the estimate of public entities' surplus	0.2	0.2	0.1	0.0	0.0	0.0	0.0
Change in surplus of Social Security Funds	0.0	0.0	0.0	0.0	1.0	0.4	0.6
Debt							
Unrevised (March, 2004)	108	106	105	106	107	105	103
Revised 1/	114	112	112	114	115	113	110
Difference	5.8	6.6	7.1	7.9	8.1	7.9	7.3
Capitalized interest	4.9	4.7	4.5	4.5	4.2	3.9	3.4
Consolidating assets of Social Security Funds	1.0	1.9	1.9	3.2	3.8	3.8	3.7
Other	0.0	0.0	0.7	0.1	0.1	0.2	0.1
Stock Flow Adjustment							
As of March 2004	...	3.9	4.1	6.7	6.8	4.2	4.2
As of November 2004	...	3.3	3.4	5.9	5.4	2.2	1.3

Source: Eurostat

1/ For 2000-03 the figures are as of September 2004, and for 1997-99, as of November 2004.

II. POLICY DISCUSSIONS

4. **The discussions focused on three areas: the fiscal situation, medium-term growth, and the financial sector.** Key issues were fiscal consolidation in 2005 and the medium term, and long-term fiscal sustainability in light of population aging. Policies to boost longer-term growth were also discussed extensively, as was the state of the financial sector. At the time of the mission, the new government which had taken office in March was still formulating its economic policies, although the Prime Minister's key economic speech on September 10 provided some direction.

A. Economic Outlook

5. **The authorities were more optimistic than the mission on growth for 2005.** Staff projects GDP growth will slow to 3 percent, while the draft 2005 budget projects 3.9 percent, little changed from 2004.³ Since substantial wage gains and high confidence levels were expected to bolster private consumption, the key differences involved investment and the external sector. The authorities felt that business-tax reform would stimulate investment,⁴ the recovery in Europe would increase exports, and favorable Olympics publicity would boost tourism, offsetting the end of Olympics spending and planned fiscal consolidation. Staff argued that these latter factors would slow investment in the short run, and that losses in competitiveness would limit any advantage of stronger European growth. The authorities and the mission agreed that the key downside risks to the outlook were oil price rises⁵ and a large euro appreciation, which would dampen domestic demand and undercut the European recovery.

6. **The authorities were also more optimistic regarding medium-term growth prospects.** They judged that infrastructure investment associated with the Olympics and other projects in coming years would boost productivity and sustain growth at rates similar to those of recent years. The mission argued that the waning effects of euro adoption, correction of the cyclical imbalances built up during the boom, and the need for continued fiscal consolidation would all weigh on aggregate demand growth (Table 5). Nevertheless, quantifying potential output growth and separating trend from cycle in the recent boom are difficult, and therefore medium-term prospects remain quite uncertain. There was agreement that fundamental structural reform and improving international competitiveness, which would require wage restraint, would be key to boosting medium-term growth.

³ The October EC forecast is 3.3 percent, the November OECD projection is 3.2 percent, and the December Consensus Forecast is 2.7 percent.

⁴ The combination of phased-in business tax cuts and higher depreciation allowances was expected to provide an incentive to bring investment forward.

⁵ Staff estimates suggest a permanent 20 percent rise in oil prices, would cut growth by some 0.3 percentage points in 2005.

B. Fiscal Policy

7. **In the wake of the large revisions, the mission emphasized that accurate and timely fiscal data are a prerequisite for effective surveillance and for the government's own policymaking and credibility.** It stressed that the national authorities were ultimately responsible for ensuring the integrity of the data, and that data shortcomings had hindered surveillance and also policymaking (Box 3). The authorities agreed, noting that they had initiated the revision process and underscoring their firm commitment to transparency. To this end, surveys of the social security funds and local governments would henceforth be conducted every quarter and military expenditures would be recorded on a cash (instead of delivery) basis, which were judged more reliable. Revisions available at the time of the mission covered 2000–03 and for this period the authorities reassured staff that, to the best of their knowledge, there would be no further major changes. However, they did note scope for further improvements in the new quarterly surveys and the accounting practices of local governments.

8. **Staff urged that the integrity of the fiscal accounts be reinforced.** While changes made in the wake of the review by the authorities and Eurostat resulted in major improvements, staff made further recommendations, including in the context of the fiscal ROSC update (Box 4). The authorities welcomed the mission's proposal of a full fiscal ROSC, and have also committed to compiling fiscal financing data from 2005, which should provide an additional check on the budget figures.

9. **The key concern, which the revisions intensified, was the need for fiscal consolidation going forward.** Staff projects a general government deficit of 5½ percent of GDP in 2004, much higher than the 1.2 percent targeted by the 2004 budget, reflecting a much worse starting point in 2003, shortfalls in tax revenues and transfers from the EU, and overruns in Olympics related expenditure, social transfers, and public sector wages. There are risks of a still higher deficit: Olympics costs have yet to be finalized and revenue collection has been weak. Looking ahead, the staff's constant-policy medium-term scenario implies little progress in deficit reduction (Table 5), and its debt sustainability analysis suggests the debt-GDP ratio will fall only gradually through 2010, and increase sharply thereafter as pension and health-care costs rise due to population aging (Table 6).

10. **The authorities and the mission agreed that the large adjustment in the 2005 budget—2½ percent of GDP—was necessary and attainable** (Table 4). Fiscal withdrawal would be appropriate in the short term given the large positive output gap and wage and price pressures; and a substantial up-front adjustment would help set a course for a needed sustained consolidation effort in coming years. The planned deficit reductions reflect the end of Olympics spending (1¼ percent), lower pension increases, lower public-sector wage growth (in the wake of large increases in the previous two years), substantial projected revenues from the settlement of old tax cases and the continuation of tax amnesties, and interest savings as some high-interest debt is paid off. The budget projects a deficit of 2.8 percent of GDP, but based on its lower growth projection and a somewhat worse outturn in 2004, staff expects a deficit of 3.5 percent of GDP. Although this would mean breaching the

Maastricht ceiling for yet another year, the authorities agreed with staff that hasty or one-off measures would only compound future fiscal difficulties and should therefore be avoided. However, in this event further measures would be needed to reduce the deficit below 3 percent of GDP in 2006, which is expected to be required by the EU under its excessive deficit procedure.

Box 3. Staff Advice on Fiscal Transparency in Greece

This box summarizes past staff assessment of fiscal transparency in the 1999 report on fiscal transparency, and subsequent updates, the 2003 data ROSC, and various staff reports.^{1/} These documents were on the whole appreciative of the progress the authorities had made on various issues, and urged remedial action to correct remaining weaknesses. Fund staff did not identify the major misreporting issues regarding defense acquisitions and social security surpluses, but did raise questions regarding large below-the-line operations and stock-flow discrepancies.

The 1999 report on fiscal transparency, a precursor of the ROSCs, was based on a self-assessment by the authorities. Relevant recommendations were: clarifying the treatment of state enterprises; integrating ordinary and investment budgets; better reporting on quasi-fiscal activities (or eliminating such activities), and state financial assets; clarifying the accounting basis underlying the budget; bolstering oversight through parliamentary hearings on audited financial statements. Subsequent factual updates recorded improvements in transparency of the management of state financial assets and extrabudgetary funds, increased public availability of fiscal data, and initial steps to improve auditing.

The 2003 data ROSC found government finance statistics to be generally of lower quality than other areas, but was moderately positive on fiscal data integrity in the context of EU standard-setting and control. Identified weaknesses included: lack of reconciliation of fiscal and financial accounts; insufficient resources available to the statistical agency; limitations in the legal and institutional environment; methodological weaknesses; unavailability of financial flows and stocks; lack of consistency between fiscal, monetary, and balance of payments data; inability to establish internal consistency of net lending/borrowing and financing; and lack of metadata. The ROSC recommended measures to strengthen these areas.

The 2000 staff report called for improved statistics in several areas, including the fiscal accounts, to facilitate economic assessment and surveillance. **The 2001 report** focused on the need for greater fiscal consolidation, in particular identifying and discussing the persistent and large below-the-line entries, and noting inadequacies in the accounting of these stock-flow discrepancies. These themes were taken up in **the 2003 report**, which called for further improvements in transparency and accountability.

^{1/} These documents are available at <http://www.imf.org/external/country/GRC/index.htm>.

Box 4. Recommendations of the 2004 Fiscal ROSC Update

The report found considerable progress had been made in improving clarity and accountability, communication with the public, budget preparation, and data integrity. Regarding the last, the new survey agreed with Eurostat should greatly improve oversight of the large social security sector. However, the report also made a number of recommendations for improvement:

Clarity of roles and responsibilities would be improved by eliminating the overlap of pre-auditing, which is now done by three agencies; fully integrating all debt operations in the public debt agency; unifying responsibility for privatization; strengthening the role and mandate of the Court of Audit; and introducing performance evaluation of government activities.

Public availability of information would be improved by developing more descriptive budget documentation illustrating government objectives, policies, activities and targets. This would need to be combined with a programmatic presentation and costing of the budget itself, as has become the norm in OECD countries.

Open budget preparation, execution, and reporting would be enhanced by structuring appropriations by program, moving to a multi-year perspective, consolidating extra-budgetary and off-budget spending, including most importantly defense spending, closing special accounts, and harmonizing Greek and EU fiscal reporting practices.

Assurances of integrity could be strengthened by an independent review of budget assumptions, as well as moving the statistical agency outside the Ministry of Economy and Finance and providing it with a mandate assuring its independence.

11. **There is some risk that the 2005 deficit could prove larger than expected.** The 2004 starting point could be worse: revenues, including from the tax amnesties, may fall short of projections; and public-sector wages may overshoot the budget, as has happened consistently in the past; Olympics spending is not yet finalized; and continuing Eurostat investigation may lead to further revisions (stock-flow discrepancies, though diminished, remain significant). The mission also noted that a number of the measures were not permanent (the tax amnesties and settlements) or were ad hoc (the decisions to slow the pace of pension and wage increases, which are one-time adjustments not linked to deeper civil service or pension reform and therefore may not be sustained), which would complicate the task of needed further consolidation in 2006 and beyond. The authorities concurred on this point, but with the uncertain state of the public finances—at the time of the mission the fiscal outturn for 2003 was still unknown—argued that they had not had time to devise more permanent measures.

12. **The mission stressed that the more difficult tasks—achieving near budget balance in the medium-term and still further adjustment in the longer term—lay ahead.** Staff argued for a substantial and decisive effort to demonstrate the authorities' determination, meet EU commitments to reach near-budget balance, rapidly reduce the national debt, and prepare for rising spending associated with population aging. In the staff adjustment scenario, budget balance is achieved by 2010 by declines in the cyclically adjusted deficit of slightly more than $\frac{3}{4}$ percentage point of GDP annually (Table 7). The authorities, who were still formulating their plans, agreed with the need for sustained consolidation but envisaged slower

adjustment, with further primary spending cuts (especially in the public-sector wage bill) reducing the deficit by about 1 percent of GDP between 2006 and 2008, to 1.8 percent of GDP. They argued that the pace of consolidation would be limited by the tax cuts and infrastructure spending needed to stimulate medium-term growth. While the mission agreed with the need for growth-enhancing initiatives, it stressed that sustained deficit cuts would require compression of primary current spending, which in the staff adjustment scenario grows in real terms by 1½ percent a year on average during 2006–10.

13. **Strong medium-term adjustment is all the more important since population aging will begin to exert fiscal pressure in the next decade and pension reform is off the policy agenda for the time being.** According to current projections, pension outlays will rise by some 12 percentage points of GDP by 2050, the largest in the EU, due to the combination of generosity and one of the largest increases in the dependency rate.⁶ In this context, the mission noted that reforms had been adopted or discussed in other countries (including raising the retirement age, cutting benefits, and indexing to wages rather than prices), and that a number of countries also planned sustained fiscal surpluses to help pay for aging costs. The authorities responded that an electoral commitment not to change the pension system in the government’s first term in office would be honored, although measures would be taken regarding bank pensions (Section C) and to bring the large number of guest workers into the social security system. The mission pressed for a greater sense of urgency and, as a minimum, argued for an early start to a public debate to build social consensus for the substantive reforms that would be required.

14. **The other long-term threat to sustainability is rising health-care costs.** The authorities saw considerable scope for reform of this sector, which is characterized by universal public health-care coverage, one of the highest spending-GDP ratios in the OECD, and a relatively large number of physicians per capita.⁷ Immediate official priorities are to centralize hospital procurement and rein in arrears that have built up despite a legal prohibition.

15. **Containing spending growth in the medium and long term will require strict review of spending management and priorities.**

The mission argued that restraining transfer spending, slimming the public service by taking advantage of computerization and aging-induced retirements, cutting lending to public enterprises, and reducing waste in procurement should be high on the agenda. It also noted that government

	Public Guarantees		
	2001	2002	2003
	In billions of euro		
Total outstanding amount	8.8	9.7	12.1
New guarantees issued	1.0	0.9	1.5
Guarantees called	0.4	0.4	0.3
Percentage of new guarantees called			
Public transport companies	35.7	37.3	22.4
Defense industry	74.6	34.9	61.5

Source: National authorities.

⁶ See “Greece: Selected Issue—An Overview of Pension Reform” (<http://www.imf.org/external/pubs/ft/scr/2002/cr0258.pdf>).

⁷ OECD (2004) “Towards High-Performing Health Systems”.

debt guarantees should be scaled back, as they were frequently triggered and, to that extent, amounted to subsidies. Finally, it warned that overly optimistic medium-term growth assumptions would inflate tax revenues and thus understate the required degree of spending restraint. The authorities have made expenditure management a priority, and are developing an expenditure control unit within the Ministry of Economy and Finance (MEF), although its exact role—a narrow auditing function versus a broader investigative mandate—remains to be determined.

16. **The mission reiterated its recommendation to adopt a medium-term budget framework.** Such an approach, now adopted in many advanced economies, would buttress credibility and help the government resist spending pressures in coming years. The authorities expressed interest in such frameworks, though they argued that the Stability and Growth Plans fulfilled this role. On the latter point, the mission noted that such plans tend not to be very detailed and had typically (and not just in Greece) been revised substantially from year to year, undermining their credibility.

17. **The authorities have introduced legislation to reform personal and business income taxation.** The mission endorsed the thrust of these measures—including phased reductions in profits tax rates; flexibility in choosing depreciation schedules; a unified tax rate on interest income from deposits, bank bonds, and repos; a reduced transfer tax on shares; and improvements in tax administration. More generally, staff urged the authorities to favor base broadening and tax simplification, and eschew special tax breaks. In this connection, it supported the elimination of industry-specific exemptions on retained earnings, which was not in the draft legislation.

C. Financial Sector

18. **The Greek banking system—which dominates the financial sector—appears adequately capitalized and profitable** (Table 8).⁸ The ratio of capital as a percent of risk-weighted assets and after-tax profits compares favorably to the euro area as a whole; average asset quality appears to have improved, with rapid credit growth driving down nonperforming-loan ratios; prudential requirements are largely in line with EU standards; and banking supervision includes coverage of the Balkans, where Greek banks have expanded in recent years.

⁸ See Chapter I of the selected issues paper for a detailed discussion.

Greece: Financial Soundness Indicators for the Banking Sector 1/
(In percent, unless otherwise indicated)

	2002	2003	EU average (end June 2003)
Regulatory capital to risk-weighted assets	10.5	12.0	11.4
Nonperforming loans to total gross loans 2/	5.5	5.1	3.1
Coverage ratio of NPLs by provisions	46.9	49.9	49.0
After-tax return on average assets	0.5	0.6	0.43
After-tax return on average equity	6.8	8.9	11.4
Staff cost to total assets	1.3	1.3	0.9
Interest rate margin 3/	2.6	2.9	...
Real estate lending to private credit	24.5	...	...
Foreign currency loans to total loans	7.4	...	...
Foreign currency deposits to total deposits	16.3	...	...
Liquid assets to total assets 4/	39.2	34.6	...

Source: Bank of Greece and ECB.

1/ Some comparisons with EU averages must be done with caution, in particular for NPL ratios.

2/ The Agricultural Bank of Greece is excluded from the statistics.

3/ Interest rate margin is defined as the difference between the average interest received on interest bearing assets and the average interest paid on interest bearing liabilities.

4/ Liquid assets include bank deposits with the BoG, Government and Other Securities, Claims on Credit Institutions and Fixed Yield Securities with a discount to reflect market price volatility.

19. **Nevertheless, the rapid increase in private sector credit may expose banks to credit risk, especially if the current favorable environment for lending turns sour.** As the market for consumer loans was fully liberalized at the end of the 1990s and interest rates fell sharply with the adoption of the euro, Greek banks expanded lending to households while reducing holdings of government bonds (Figure 4). This portfolio shift raised returns but also increased risk, especially since the credit bureau provides comprehensive information on each customer's borrowing only since June 2003. This increase in private sector credit is part of the broader process of the development of the financial sector and is likely to continue for some time—private debt as a fraction of income is still only about half the European average. Nevertheless, the quality and robustness of banks' risk management have not been tested during an economic downturn or a large rise in interest rates.

20. **The Bank of Greece (BoG), the banking supervisor, has taken measures to meet these risks.** The BoG has increased specific provisions and capitalization levels, and reported that its stress tests suggest that Greek banks are not significantly exposed to market risks. Since banks hold mostly floating-rate assets, their interest-rate risk is also limited. However, as this risk is shifted to borrowers, credit risk may have risen. The BoG has also strengthened its capacity to supervise risk management by recruiting additional specialists. The mission raised the possibility of the credit bureau collecting more comprehensive debt data, but the authorities responded that strong confidentiality laws precluded this. While some state-controlled banks now have large pension liabilities, these will be transferred to IKA, the main public pension fund, by 2007. The mission urged early clarification of the terms of this transfer, especially as banks will have to recognize their pension liabilities under International

Accounting Standards, which are scheduled to come into force at end-2005. The BoG judged the banking system to be well prepared for the introduction of Basel II by end-2006.⁹

21. **Insurance supervision is weak, and the mission urged the independent supervisor be established quickly.** The authorities agreed, and planned to implement the legislation (which had been passed in February, 2004) as soon as possible; in November, inspections were intensified and the head of the independent supervisor was appointed. They also noted that systemic risks were limited because the insurance sector and banks' exposure to it were small.

22. **The authorities agreed to participate in an FSAP,** scheduled for the first half of 2005. An FSAP would be timely in view of the large changes in the financial system in recent years and the BoG's efforts to upgrade its own capacities and banks' risk management practices.

D. Higher Growth and Convergence with the EU

23. **The overarching goal of structural policy is to raise per capita real GDP to the EU average over time.** From the Irish experience, as described in Chapter II of the selected issues paper, the mission distilled two policy priorities: control of spending and budget deficits, as discussed above; and improvement in the business climate by accelerating product and labor market reforms.

24. **The authorities underscored the importance of continued infrastructure investment.** They noted that the budgetary cost could be limited through careful use of funds remaining from the third Community Structural Framework (which must be spent by 2008) and via Private-Public Partnerships (PPPs), for which they were preparing an appropriate legal framework. The mission concurred, but reiterated that fiscal consolidation was the first priority. With regard to PPPs, staff pointed out that the fiscal savings today could result in higher debt in the future, and therefore underscored the need to choose projects with the highest economic payoff, guarantee transparency and independence in project evaluation, shift risks to the private sector to ensure good performance, and clearly account for all explicit and implicit public sector liabilities.

25. **There was agreement that measures to improve the business climate would be key to sustained growth and higher incomes.** Businesses generally face greater impediments in Greece than elsewhere and research suggests that substantial gains would be possible if Greece moved to best practices.¹⁰ Some progress has been made, including the

⁹ According to the Quantitative Impact Study (QIS3), minimum capital requirements would rise by 7.5 percent under Basel II for institutions adopting the standardized approach, but would fall for those, such as the larger Greek banks, expected to use advanced approaches.

¹⁰ S. Scarpetta and T. Tessel (2002) "Productivity and convergence in a panel of OECD countries" OECD Economics Department WP342.

establishment in 2003 of Investment Reception Centers (one-stop shops) for business establishment, which provide useful guidance but have yet to live up to the promise of cutting red tape. Businesses also face high dismissal costs, an eroding competitive position, and increasing labor shortages (recent high immigration notwithstanding). The authorities indicated they intend to move on several fronts, and the structural reform agenda announced by the Prime Minister in September highlighted tax reform, including of tax administration, and streamlined business regulation. The mission supported such initiatives, and called for further privatization to reduce the exposure of the budget to loss-making public enterprises and promote efficiency.

26. **It was agreed that limited domestic competition had resulted in inefficiencies and high prices.** The Competition Commission, which was reformed in 2003, will be a key agency in this regard. Although increasingly active, it remained understaffed owing to difficulties in hiring qualified personnel, and its ability to initiate investigations has been limited relative to best practice. The mission argued that reforms to the energy sector should be accelerated; although Greece generally adheres to EU liberalization timetables, there is scope for more rapid implementation and measures to increase competition in the sector, including by continuing the program of increasing import capacity.

27. **The labor market is characterized by low employment rates, especially among youth and women, and a high, though gradually falling, unemployment rate.** In many respects, performance is near the bottom of the EU (Figures 6 and 7).¹¹ These problems partly reflect mismatches between skills and demands, pointing to a need to reappraise the education and training system and the public employment service. But they also reflect impediments to employment: employment protection legislation, including high severance pay and administrative protections; limited part-time and temporary employment opportunities; and high wages, especially at the entry level.

28. **However, labor market reform has been slow.** The authorities concurred that labor market reforms would be key to increasing incomes, especially in the long-term context of population aging. In this regard, they stressed the potential benefits of the large amount of immigration in recent years (mainly from the Balkans) and were making efforts to regularize such guest workers. Nevertheless, the September policy statement said little on labor-market reform. Such reform will face stiff opposition from labor organizations, although the 2004–05 wage agreement—while generous at nearly 6 percent a year—confirmed the change in the previous agreement that eliminated longstanding inflation catch-up clauses, a development the mission welcomed. Also, the decision in the draft 2005 budget to limit public-sector wage growth in 2005 may restrain subsequent private-sector negotiations and help to hold down entry wages.

¹¹ Hours worked, however, appear very high, even by U.S. standards. This may reflect the low amount of part-time work in Greece, which may itself indicate structural rigidities.

E. Other Issues

29. **The authorities supported multilateral trade liberalization.** In particular, they supported efforts to successfully conclude the Doha round, and argued that the end of textile quotas would encourage a welcome restructuring of the Greek industry toward higher value-added products. They felt that reforms of the Common Agricultural Policy were moving in the right direction, but argued for only gradual liberalization of the sugar regime, since economically depressed regions depended heavily on sugar production. The authorities also intend to improve the operation of the National Exports Council to promote Greek exports.

30. **Greece is making progress toward complying with international AML/CFT standards, and the amendment of the 1995 AML law would be a significant step forward.** Further work will then be needed to achieve full compliance with the latest FATF Recommendations of 2003, and in due course with the Third EU AML directive currently being negotiated. The Phase 1 review concluded that Greek legislation implemented in 1998 meets the requirements of the OECD anti-bribery code.

III. STAFF APPRAISAL

31. **Greece has enjoyed an economic boom for some years, which appears to have continued into 2004.** Very supportive monetary conditions, due in part to declining interest rates associated with euro adoption, and an expansionary fiscal stance have underpinned domestic demand. Strong wage increases and an improving labor market have spurred consumption, while rising profits and, in the past two years, the Olympics have sustained investment. This activity has been financed by rapid increases in private-sector credit in the wake of financial market liberalization.

32. **However, the outlook for 2005 and beyond is for weaker growth, and the government needs to formulate and implement a specific policy agenda to address growing imbalances and longstanding structural weaknesses.** The public finances are in very poor condition: budget deficits have risen despite strong economic growth and the public debt-GDP ratio remains high. High inflation and labor cost increases have eroded competitiveness and contributed to large and persistent current account deficits. Labor-market performance remains poor, and excessive government regulation and red tape weigh on the business climate. For 2005, consumption is expected to remain strong, but needed fiscal consolidation, including the end of Olympics spending, will sap domestic demand. Expected further deterioration in international competitiveness will limit the benefits of any pickup in the euro area. Beyond 2005, prospects depend critically on credible fiscal consolidation, policies to boost aggregate supply, and better alignment of real wages with productivity to help restore competitiveness. In the absence of strong measures, there is a significant risk of tepid growth.

33. **The overriding priority is to establish control over the public finances.** The 2005 fiscal adjustment of 2½ percent of GDP is an appropriate start to what will be a long process of fiscal retrenchment. With euro-area monetary conditions expected to remain expansionary and the Greek economy overheated, fiscal constraint would be helpful as a countercyclical

policy. A substantial up-front adjustment is also needed to set the course for medium-term consolidation, although in this regard greater use of permanent measures would have been preferable. In the staff's view, the deficit is likely to remain above the authorities' target (and the 3 percent Maastricht ceiling) in 2005, due to slowing growth and, possibly, a worse outturn in 2004 than officially expected. Nevertheless, the authorities should refrain from taking further ad hoc measures, and instead focus on developing durable adjustment measures in the 2006 budget.

34. Needed medium and long-term fiscal adjustment will require strict control of primary current spending, buttressed by a medium-term budget framework. Decisive and sustained reductions in the structural deficit of some $\frac{3}{4}$ percent a year to achieve budget balance in 2010 would demonstrate the authorities' resolve to correct deep underlying fiscal imbalances and meet EU commitments regarding deficits and debt reduction. Beyond 2010, a surplus position will be required to rapidly reduce very high debt levels and deal with the long-term costs of population aging. In this context, although growth-enhancing policies are needed, tax cuts and infrastructure investment cannot be allowed to delay or undermine deficit reduction. Containing current primary spending will require fundamental review of expenditures on social programs, the public service, defense, procurement practices, and support to industry (including loan guarantees). This long-term effort, and fiscal credibility more generally, would be bolstered by an explicit medium-term budget framework that lays out realistic economic assumptions, specific measures, and expenditure ceilings consistent with deficit objectives.

35. Addressing aging-related fiscal pressures will require reforms to pension and health-care systems, even with sustained fiscal adjustment. Current estimates indicate that aging-related costs will escalate in the next decade and will subsequently rise by more than in any other EU country. The election promise to forgo reform during this government term will delay addressing the problem by at least four years, making the adjustment eventually needed more difficult. Early reform would therefore be desirable, but at a minimum and consistent with their electoral commitment, the authorities should take immediate steps to open a discussion on concrete reforms to build social consensus for change. Measures planned or taken elsewhere in Europe could inform this discussion, and in Greece the transfer of banks' pension liabilities to IKA provides one opportunity to launch a wider debate.

36. While economic statistics have improved, the inaccurate reporting of fiscal data has hindered surveillance and policy-making, and undermined credibility. The revisions, while long overdue, have improved the methodology and accuracy of the fiscal data. Further measures are nevertheless warranted, and every avenue should be pursued to bolster data integrity. Financing data, which is to be published beginning in 2005, should be used to cross-check budget outturns, and surveys of the non-central government sector should continue to be refined. The authorities should also consider strengthening the oversight role of the Court of Audit, reinforcing the independence of the statistical agency by moving it out of the MEF, and establishing an entity to perform independent reviews of budget policies and assumptions. In other areas, the authorities should correct remaining weaknesses identified in the

accompanying fiscal and data ROSC updates. Their decision to undertake a full-fledged fiscal ROSC is welcome.

37. **The banking sector appears to be profitable, well capitalized, and adequately provisioned; the BoG should continue to enhance its assessment and supervision, notably as regards credit quality.** The rapid increase in private-sector lending reflects in part the development of the sector, but also raises risks, especially as banks have not recently faced an economic slowdown or rising interest rates. The BoG has commendably strengthened its supervisory capacity, increased specific provisioning and capitalization levels, and encouraged banks to enhance their risk-management procedures. These initiatives should be continued, especially in the context of the introduction of Basel II. Insurance supervision is a notable weak point, underscoring the need to ensure that the independent insurance supervisor is operational as soon as possible. The authorities' decision to undertake an FSAP is welcome.

38. **The key structural policy priority is to put in place the conditions for sustained increases in real output and living standards, and the authorities' emphasis here is well placed.** To succeed, however, a broad range of weaknesses need to be addressed. Fiscal consolidation would ensure macroeconomic stability and provide room for growth-enhancing tax cuts. The authorities' focus on improving the business climate is welcome, as this will be key to increasing investment, including foreign investment, and productivity. But labor-market reform to raise employment rates, which has so far received less emphasis, is also critical for the sustained expansion of living standards.

39. **Improving the business climate will require reform on several fronts, but the payback would potentially be substantial and rapid.** Tax policy should emphasize base broadening, simplification, and rate reductions. In this vein, the 2002 reform and the proposed reforms beginning in 2005 are welcome. Reducing administrative burdens ("red tape" and excessive regulation) and simplifying tax administration, including by narrowing the discretion now available to tax inspectors, are also critical. Product market reforms should focus on intensifying competition. All relevant EU directives on the liberalization and regulation of network industries should be effectively implemented as soon as possible. The privatization program should be intensified, with the ultimate goal of the government leaving all sectors where commercial forces normally operate. The more active stance of the Competition Commission is welcome, but steps should be taken to increase staff and strengthen its legal powers.

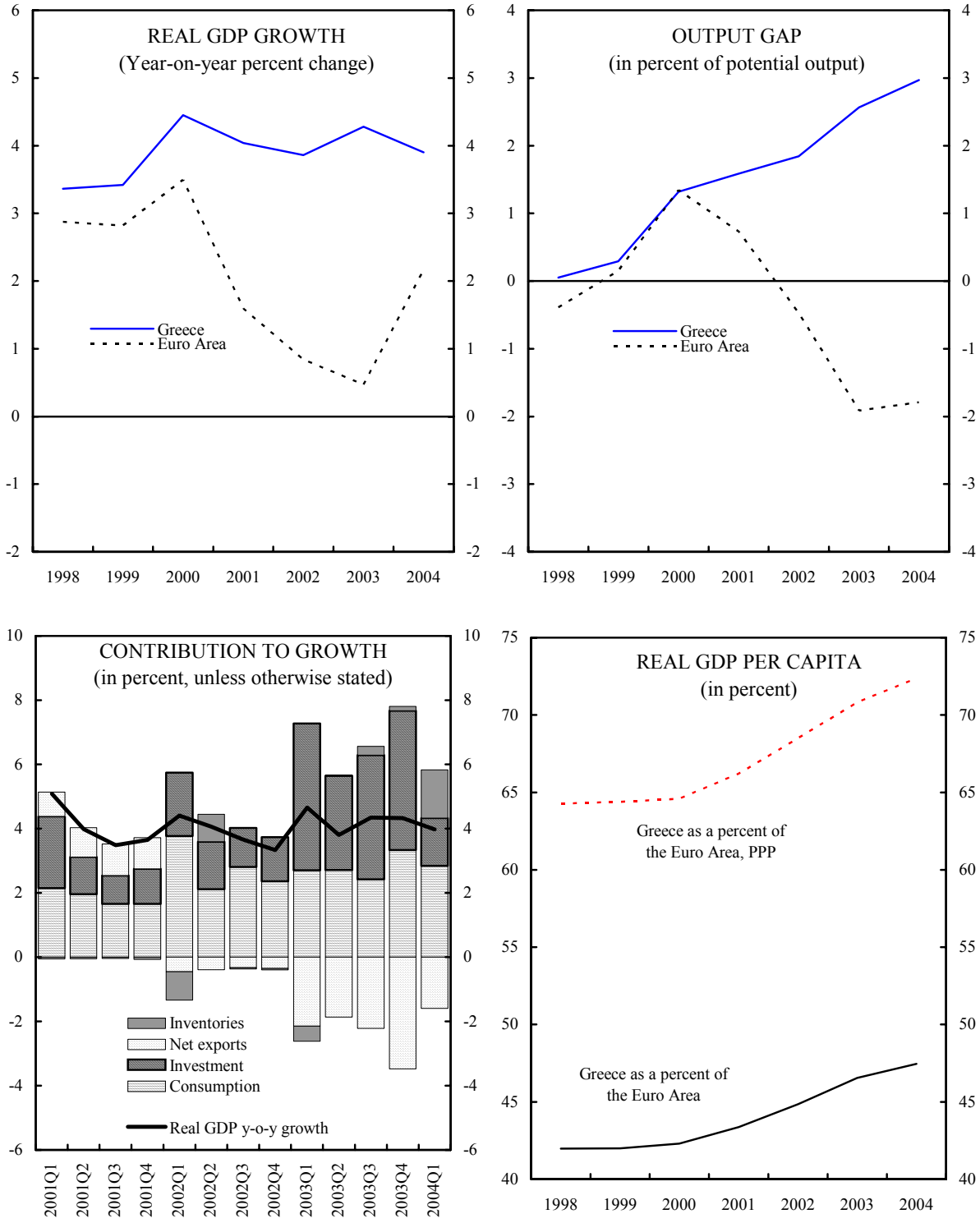
40. **The authorities' emphasis on continuing infrastructure investment is appropriate, but also carries risks in terms of potential future liabilities.** Wise use of European structural funds and the proposed use of PPPs can reduce immediate budgetary costs and provide efficient delivery of services. However, careful attention needs to be paid to the consequences for the future path of the public debt that such arrangements may entail, and full accounting of explicit and implicit public-sector liabilities, transparent project selection and evaluation, and risk transfer to the private sector will therefore be essential.

41. **These initiatives will have limited effectiveness without accompanying reforms in the labor market and wage-setting mechanism.** The significant weaknesses in the labor market should be addressed by: improving the education and training system and the public employment service to reduce the mismatch between skills and demand; amending employment protection legislation to encourage hiring; extending part-time and temporary employment opportunities; and lowering entry wages to allow low-skilled workers to gain a foothold in the market. Regarding wages, the end of inflation catch-up clauses is welcome, but to avoid further erosion of international competitiveness wage increases must be brought in line with domestic productivity growth and the ECB inflation target. National wage bargains should more explicitly acknowledge this constraint, and the public sector has an opportunity to lead by example, especially given the demonstration effect it appears to have on the rest of the economy.

42. **The authorities' support for multilateral trade liberalization is welcome.** Their intention to continue to increase ODA is also welcome, and they are encouraged to raise the current level of 0.26 percent of GNI toward the UN target of 0.7 percent of GNI.

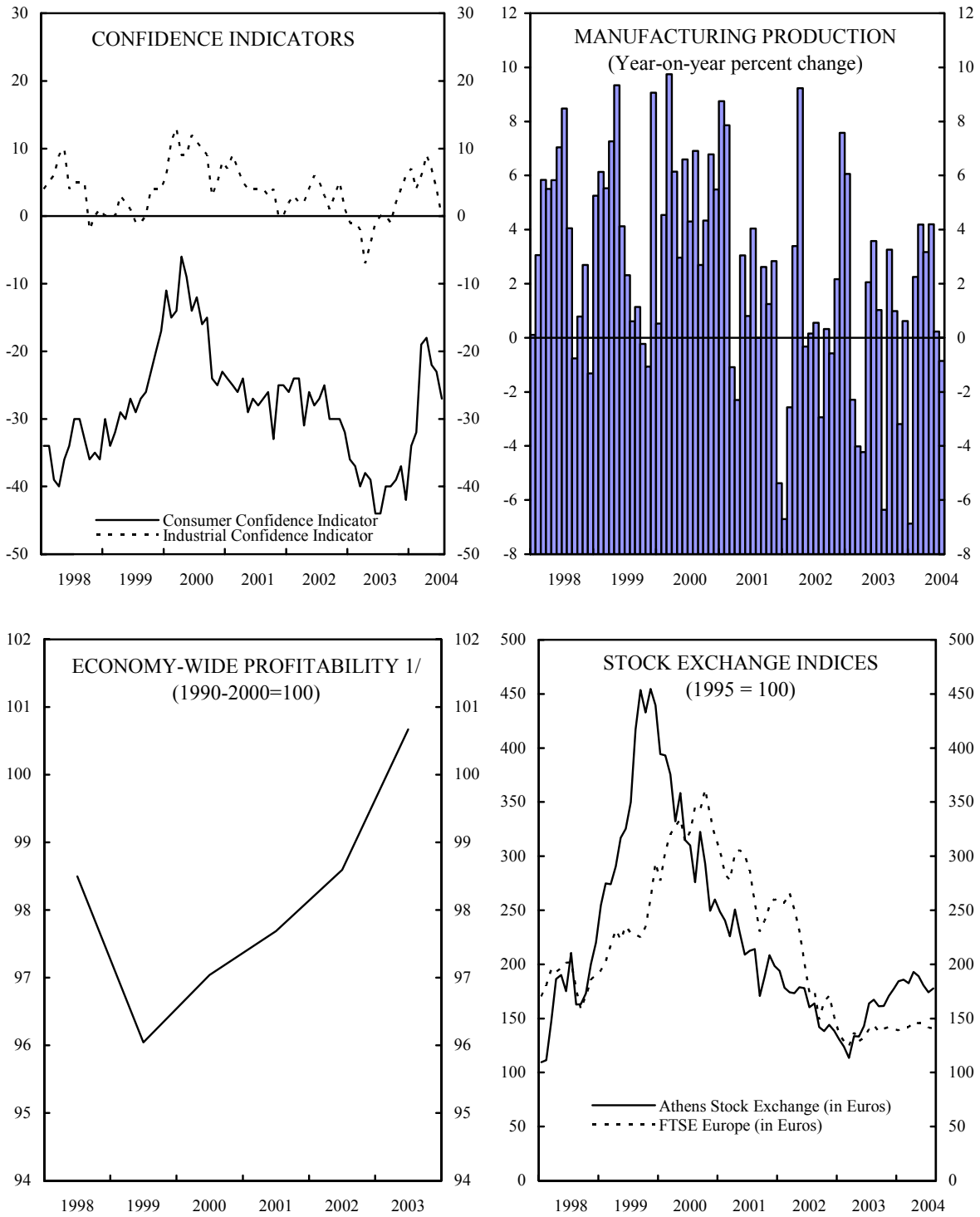
43. It is proposed that the next Article IV consultation be held on the standard 12-month cycle.

Figure 1. Greece: Output, 1998-2004



Source: IMF, *World Economic Outlook*.

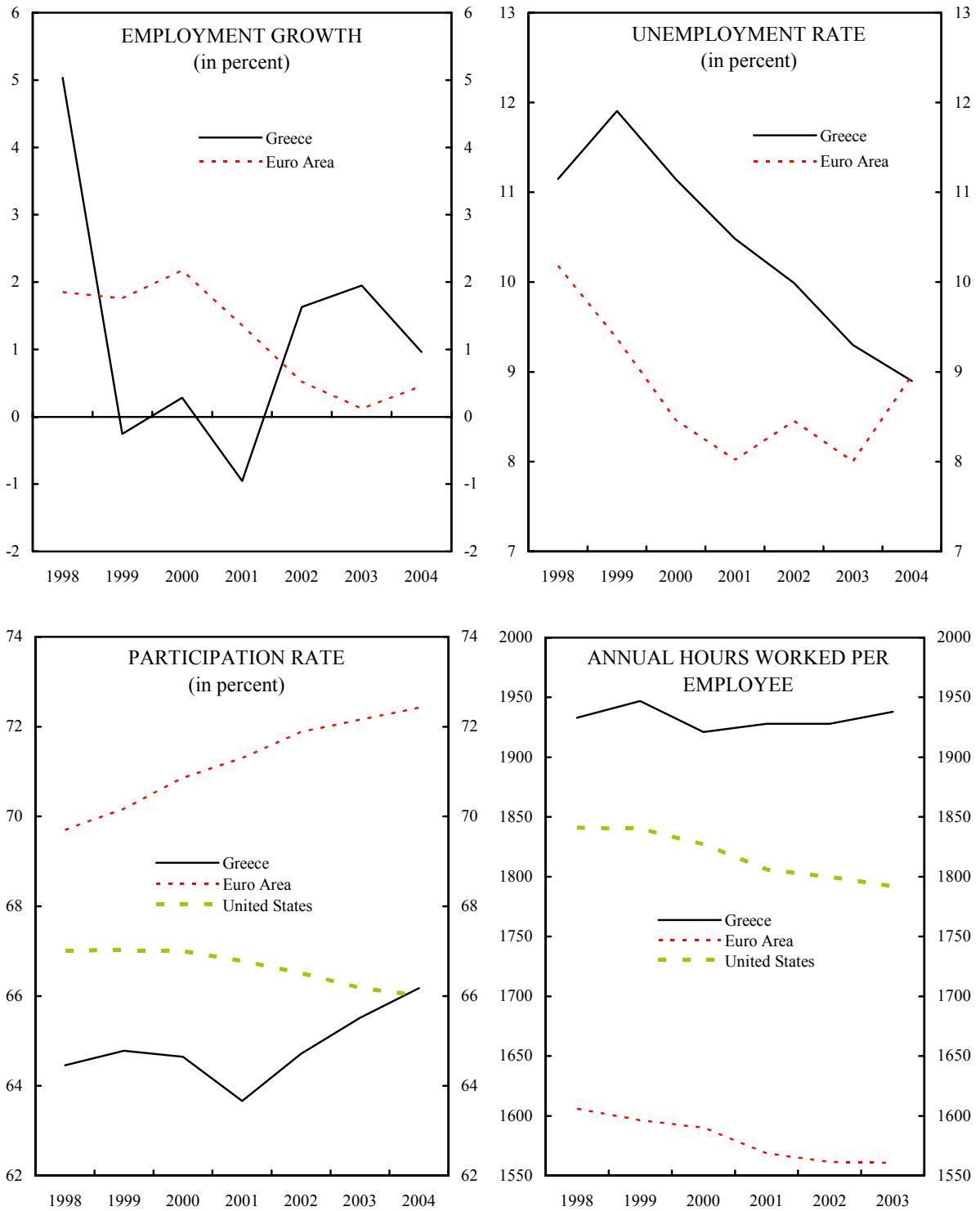
Figure 2. Greece: Cyclical Indicators, 1998-2004



Sources: IMF, *International Financial Statistics*; OECD; and Bloomberg.

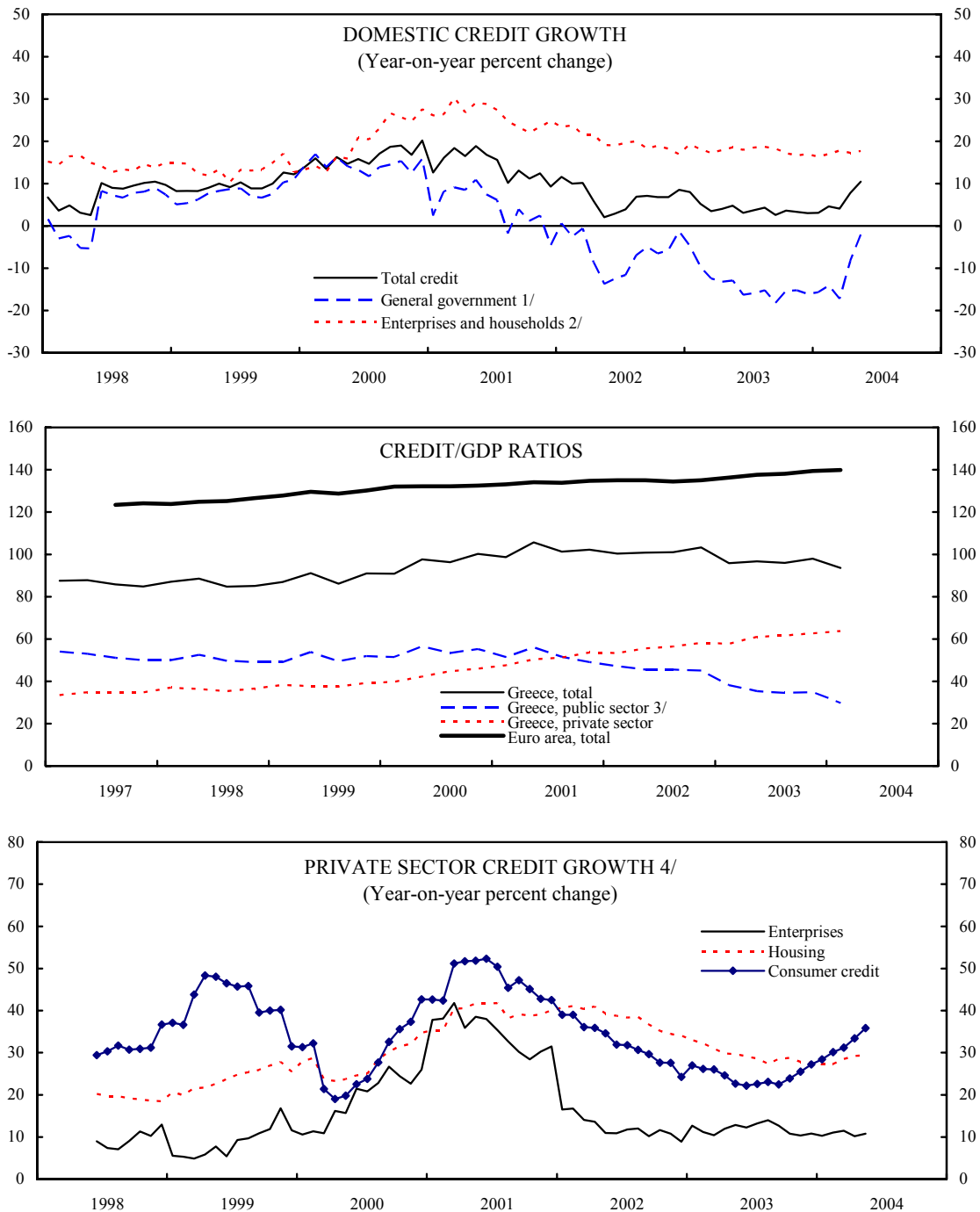
1/ Ratio of GDP deflator to economy-wide unit labor costs.

Figure 3. Greece: Labor Market, 1998-2004



Sources: IMF, *World Economic Outlook*; Eurostat; and OECD.

Figure 4. Greece: Credit Developments, 1998-2004
(In percent)



Sources: Bank of Greece, *Bulletin of Conjunctural Indicators*, and *Monthly Statistical Bulletin*.

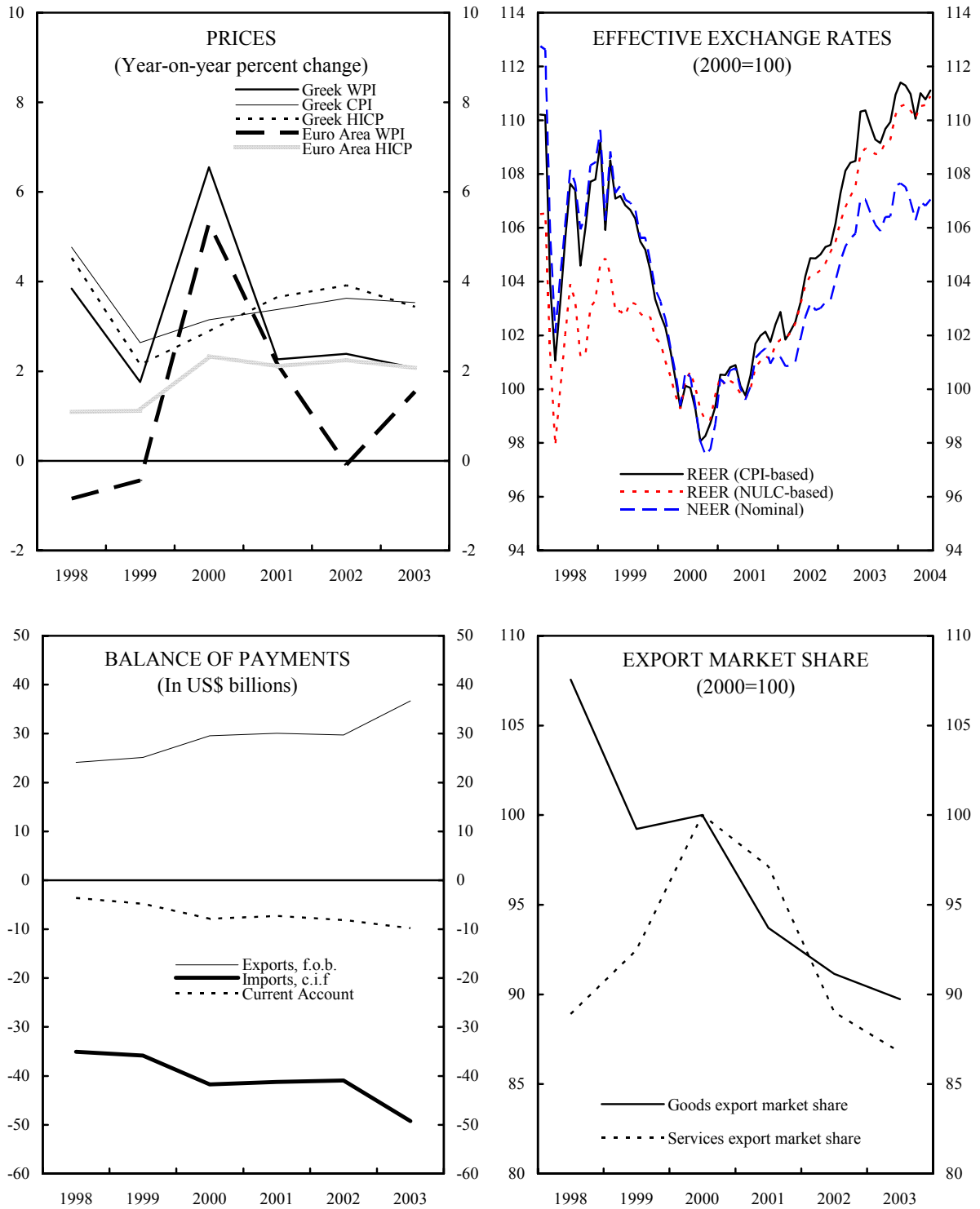
1/ Data prior to 1999 refer to public sector.

2/ Data prior to 1999 refer to private sector.

3/ Excludes banks' holdings of government securities.

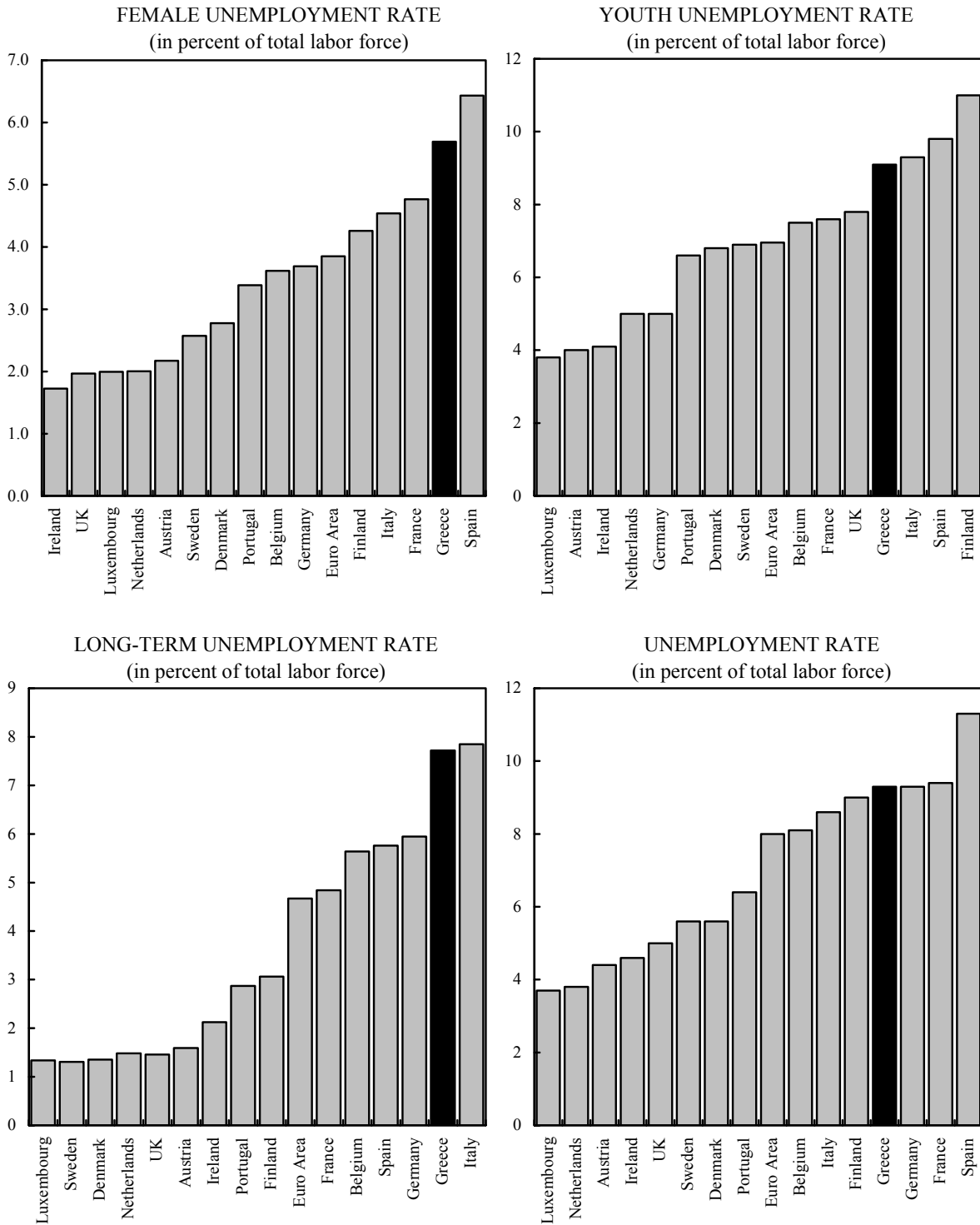
4/ Data prior to 2000 refers to commercial bank credit.

Figure 5. Greece: Prices and Competitiveness, 1998-2004



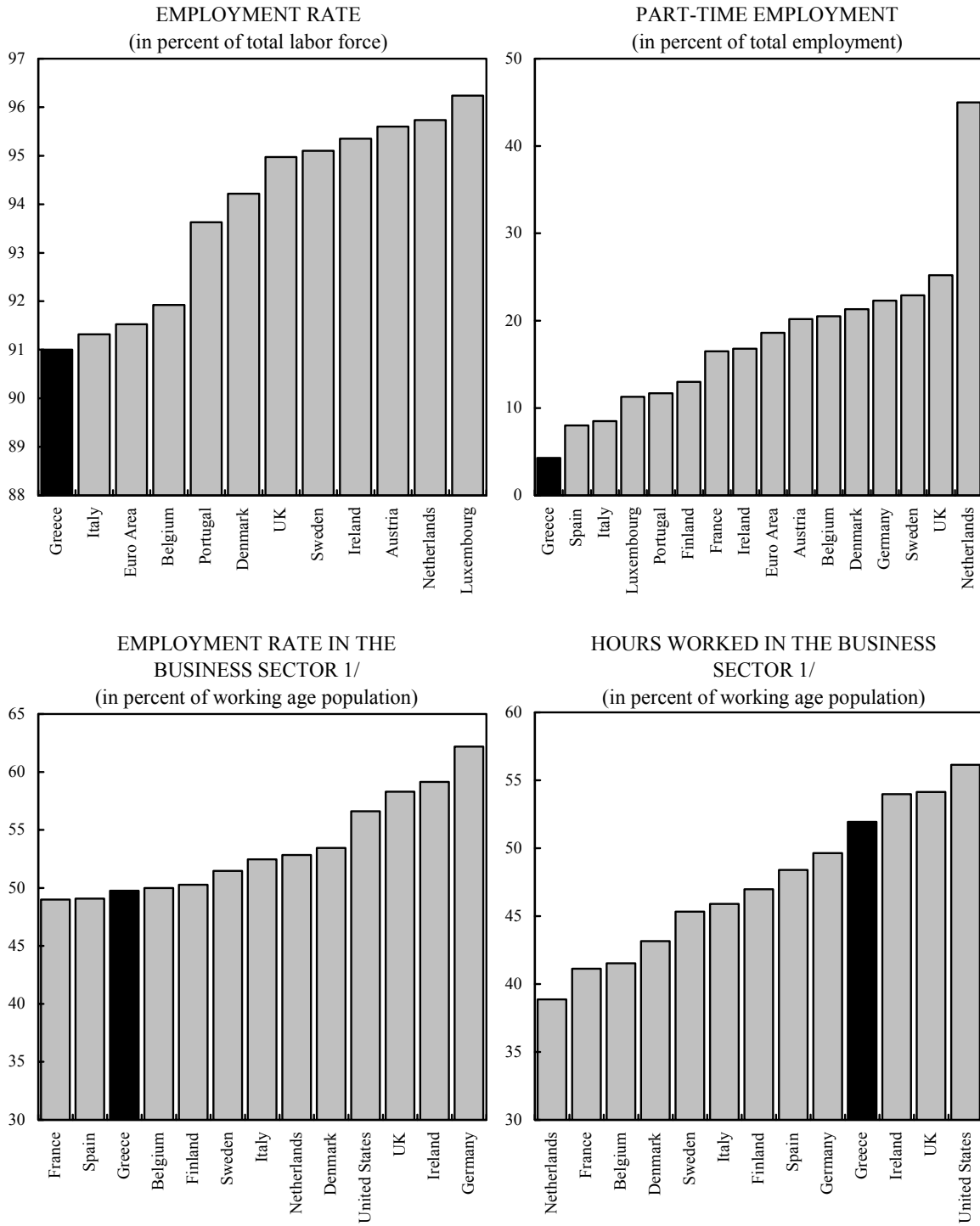
Sources: IMF, *International Financial Statistics*; and IMF, *World Economic Outlook*.

Figure 6. Greece: Unemployment Rates, 2003



Source: Eurostat; and IMF, *World Economic Outlook*.

Figure 7. Greece: Employment Rates, 2003



Source: Eurostat; IMF, *World Economic Outlook*; and OECD, Analytical Database.

1/ Last cycle and 3 year averages, 2000 to 2002.

Table 1. Greece: Selected Economic Indicators, 2000–2005

	2000	2001	2002	2003	2004	2005
				Est.	Proj.	
Domestic economy						
(Percentage changes, unless otherwise indicated)						
GDP	4.5	4.3	3.6	4.5	3.9	3.0
Output gap	-0.8	0.2	0.6	1.5	2.2	1.9
Domestic demand	5.5	2.4	4.2	5.4	4.3	2.9
Private consumption	2.2	2.8	3.1	4.2	2.9	4.4
Public consumption	14.8	-3.1	5.3	-2.5	11.6	0.7
Gross fixed capital formation	10.0	4.9	6.6	13.2	4.1	0.6
Change in stocks (contribution)	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance (contribution)	-1.7	1.7	-0.9	-1.3	-0.8	-0.2
Exports	14.1	-1.0	-7.7	1.0	3.3	3.5
Imports	15.1	-5.2	-2.9	4.8	4.9	3.0
Unemployment rate 1/	11.1	10.5	10.0	9.3	8.9	8.8
Employment	0.3	-1.0	1.6	1.9	1.0	0.6
Unit labor costs (economy wide)	1.7	2.8	3.0	2.4	3.2	3.3
Consumer prices (HICP), end of period	3.7	3.5	3.5	3.1	3.9	3.4
Consumer prices (HICP), period average	2.9	3.7	3.9	3.4	3.3	3.4
GDP deflator	3.4	3.5	4.0	3.5	3.2	3.1
(In percent of GDP, settlements basis)						
Current Account	-6.9	-6.2	-6.1	-5.7	-5.9	-5.7
Trade balance	-18.0	-16.5	-16.0	-14.8	-15.2	-15.5
Export of goods	9.1	8.8	7.4	7.3	6.9	6.4
Exports of services	17.2	16.8	14.9	14.0	14.2	14.9
Imports of goods and services	37.2	35.1	30.8	28.5	28.6	28.4
Imports of goods	27.1	25.2	23.4	22.1	22.1	21.9
Imports of Services	10.1	9.8	7.3	6.5	6.5	6.4
Balance on capital account	-0.2	5.2	7.3	6.3	5.9	5.7
Of which: Direct investment inflows	1.0	1.4	0.0	0.4	0.5	0.3
Portfolio investment inflows	8.2	7.6	9.3	13.8	9.0	9.4
Change in reserves (- is an increase in reserves)	-2.5	4.7	-1.4	2.9	0.0	0.0
Public finances (general government)						
(In percent of GDP, settlements basis)						
Total revenues	46.7	45.3	44.0	42.2	43.1	43.5
Total expenditures	50.8	49.0	47.7	46.7	48.6	47.1
Primary expenditures	42.7	41.7	41.4	41.0	43.3	41.9
Overall balance	-4.1	-3.7	-3.7	-4.6	-5.5	-3.5
Primary balance	4.0	3.6	2.6	1.2	-0.2	1.6
Structural overall balance	-3.8	-3.8	-4.0	-5.2	-6.4	-4.3
Gross debt	114	115	112	110	112	109
Memorandum items:						
Nominal effective exchange rate 2/	-6.2	0.7	1.7	3.6	0.7	...
Real effective exchange rate (consumer prices) 2/	-6.1	1.0	2.9	4.9	2.5	...
Real effective exchange rate (manufacturing ULCs) 2/	-3.1	0.5	3.1	4.2	1.9	...
Nominal GDP (in billions of euros)	122	131	142	153	164	174

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

1/ Data from OECD. The authorities recently revised their methodology to produce new estimates for 2003.

2/ Latest data is for October (real effective exchange rate (consumer prices), nominal effective exchange rate); and July (real effective rate (manufacturing ULC)).

Table 2. Greece: Indicators of External and Financial Vulnerability, 1998–2004 1/
(In percent of GDP, unless otherwise indicated)

	1998	1999	2000	2001	2002	2003	2004	
							Estimates or latest data	Date
External indicators								
Exports (annual percent change, in U.S. dollars)	4.0	-32.0	19.5	1.0	-5.0	27.7	19.3	Aug-04
Imports (annual percent change, in U.S. dollars)	7.3	-14.2	14.6	-2.5	5.1	22.1	38.3	Aug-04
Terms of trade (annual percent change)	-1.0	-0.6	-3.7	0.6	2.6	11.1	0.7	...
Current account balance (settlements basis)	-3.0	-3.8	-7.3	-6.9	-6.0	-5.7	-6.6	Jun-04
Capital and financial account balance	0.0	7.7	11.4	2.3	9.8	4.4	6.6	Jun-04
Of which: Inward portfolio investment (debt securities etc.)	7.6	5.4	8.1	7.7	9.2	13.6	14.7	Jun-04
Inward foreign direct investment and other investments	-2.3	3.7	-2.2	-5.0	6.7	-1.8	6.7	Jun-04
Official reserves (in U.S. dollars, millions, end of period)	17,458	18,122	13,424	5,154 2/	8,083	4,361	2,516	Sep-04
Official reserves in months of imports GS	6.0	6.1	3.9	1.5	2.4	1.1	0.0	Aug-04
Total external debt	55.4	55.5	73.3	69.6	68.2	...	...	...
Of which: General government debt 3/	25.4	26.6	27.7	6.5	3.3	2.4	...	...
Total external debt to exports GS (ratio)	2.6	2.5	2.3	2.1	2.2	...	...	...
External interest payments to exports GS (in percent)	14.3	11.7	10.4	10.4	9.7	10.3	8.4	Jul-04
External amortization payments to exports GS (in percent)	34.0	12.4	13.2	8.6	15.2	...	...	...
Exchange rate (per U.S. dollar, period average) 4/	295.5	305.7	365.4	1.1	1.1	0.9	0.8	Sep-04
Financial market indicators								
Public sector debt (Maastricht definition) 5/	112.4	112.3	114.0	114.7	112.5	109.9	112.0	...
Greek contribution to euro area M3 excluding currency in circulation (percent change, 12-month basis) 6/	9.8	5.5	10.4	8.3	-2.1	5.2	6.3	Aug-04
Private sector credit (percent change, 12-month basis)	15.0	14.2	27.6	24.8	16.9	17.0	15.0	Aug-04
12-month T-bill yield	12.0	9.4	6.6	4.1	3.5	2.3	2.4	Sep-04
12-month T-bill yield (real)	6.9	6.6	3.7	0.4	-0.4	-1.0	-0.9	Sep-04
Stock market index	2,738	5,535	3,389	2,592	1,748	2,264	2,328	Sep-04
Share prices of financial institutions	5,799	10,165	7,307	4,788	2,688	4,247	4,758	Sep-04
Spread of 12-month treasury bill rate with Germany (percentage points, end of period)	6.9	5.4	1.9	0.4	0.5	0.4	0.3	Aug-04
Spread of 10-year bond with Germany (percentage points, end of period)	4.1	2.0	0.9	0.6	0.5	0.5	0.5	Aug-04
Financial sector risk factors								
Foreign exchange loans to the private sector (in millions of U.S. dollars) 7/	11,022	11,693	14,225	7,865	6,723	6,983	7,201	Mar-04
Share of foreign exchange loans in total lending to the private sector 7/	24.3	26.2	27.6	9.7	7.4	5.5	5.6	Mar-04
Deposits in foreign exchange (in millions of U.S. dollars) 7/	38,611	31,118	35,661	19,603	17,858	22,268	23,133	Mar-04
Share of foreign deposits in total deposits 7/	35.2	30.9	39.3	21.8	16.3	15.6	16.8	Mar-04
Share of real estate sector in private credit	17.8	19.5	19.9	21.9	24.5	26.2	26.5	Mar-04
Commercial banks' return on assets (after tax)	0.8	2.4	1.4	1.0	0.5	0.6	0.6	Jun-04
Interest rate margin	7.9	6.3	6.2	6.0	5.7	5.7	4.8	Aug-04
Share of nonperforming loans in total loans 8/	8.7	11.2	7.2	5.6	5.5	5.1	5.0	Jun-04
Share of nonperforming loans in total assets 9/	2.7	4.0	3.2	2.7	3.0	3.0	3.2	Jun-04
Risk-based capital asset ratio 10/	10.2	16.2	13.6	12.5	10.6	12.1	11.7	Jun-04
Regulatory capital to risk-weighted assets 11/	10.2	16.2	13.6	12.4	10.5	12.0	11.7	Jun-04
Foreign currency debt and banking sector rating								
<i>Standard & Poor's</i>	Mar-97	Dec-98	Nov-99	Mar-01	Jul-02	Jun-03	Nov-04	
Long term	BBB-	BBB-	A-	A	A	A+	A	
Outlook	Positive	Positive	Positive	Positive	Positive	Stable	Stable	
Short term	A-3	A-3	A-1	A-1	A-1	A-1	A-1	
<i>Moody's</i>	Dec-96	Jul-99	Jan-00	Aug-01	Nov-02	Nov-02	Nov-02	
Bonds and notes	Baa1	A2	A2	A2	A1	A1	A1	
Bank financial strength rating	...	...	D to D+	D+	C-	C-	C-	
<i>BCA</i>	Jun-97	Oct-99	Jul-00	Jun-01	Jun-02	Oct-03	Oct-03	
Long term	BBB	BBB	A-	A	A	A+	A+	

Sources: Bank of Greece, *Monthly Statistical Bulletin*; data provided by the authorities; and IMF, *International Financial Statistics*.

1/ The interpretation of some indicators is affected by participation in EMU in 2001.

2/ Official reserves declined in 2001 with EMU participation, due in large part to the redefinition of foreign exchange reserves and the fall in foreign exchange reserve requirements for commercial banks.

3/ From 2001, foreign debt includes only liabilities in non-euro area currencies.

4/ Euros per U.S. dollar from 2001.

5/ Data provided by Eurostat.

6/ Data prior to 2001 refer to growth of Greek liquidity measure M4N.

7/ As from 2001, loans and deposits in euro and its national denominations are not included in foreign exchange loans and foreign exchange deposits respectively.

8/ Data refer to all commercial banks incorporated in Greece excluding the Agricultural Bank of Greece. If Agricultural Bank of Greece is included, then the relevant ratios for the past years become 7.3 for 2002, 7.0 for 2003 and 7.1 for June 2004.

9/ Data refer to all commercial banks incorporated in Greece excluding the Agricultural Bank of Greece. If Agricultural Bank of Greece is included, then the relevant ratios for the past years become 4.1 for 2002, 4.3 for 2003 and 4.5 for June 2004. Nonperforming loans are defined as all loans with interest and/or principal payments in arrears for three months or more, and include all loans classified as doubtful by the banks themselves.

10/ Data refer to all banks operating in Greece.

11/ Data refer to all commercial banks incorporated in Greece.

Table 3. Greece: Revisions to the General Government Budget Balance, 2000-03 1/

	2000		2001		2002		2003		
	Mar	Sep	Mar	Sep	Mar	Sep	Mar	Sep	
Central Government	-5203	-7830	-5350	-7017	-6711	-9483	-8171	-10371	-11808
of which Public Entities	8	8	445	406	486	562	506	506	660
Local Government	-6	-6	12	64	14	75	70	70	216
Social Security Funds	2805	2805	3441	2093	4671	4132	5455	5455	4595
General government	-2404	-5031	-1897	-4860	-2026	-5276	-2646	-4846	-6997
					<i>Millions of Euro</i>				
Central Government	-4.3	-6.4	-4.1	-5.3	-4.7	-6.7	-5.3	-6.8	-7.7
of which Public Entities	0.0	0.0	0.3	0.3	0.3	0.4	0.3	0.3	0.4
Local Government	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.1
Social Security Funds	2.3	2.3	2.6	1.6	3.3	2.9	3.6	3.6	3.0
General Government	-2.0	-4.1	-1.4	-3.7	-1.4	-3.7	-1.7	-3.2	-4.6
					<i>In percent of GDP</i>				
<u>Memorandum items (in percent of GDP):</u>									
Military expenditure		2.3	...	1.7	...	2.0	...	...	1.4
Capital transfers to social security funds		0.3	...	0.5	...	1.3	...	...	1.3
Gross debt	106	114	107	115	105	112	102	103	110

Source: National authorities and Eurostat.

1/ Estimates as of March 2004 versus September 2004. For 2003, the data are as of March, May, and September 2004.

Table 4. Greece: General Government Accounts, 2000–2005

	2000	2001	2002	2003 Est.	2004		2005	
					Authorities Estimate	Staff Projection	Authorities Estimate	Staff Projection
<i>(Billions of Euro)</i>								
Revenues	56.8	59.4	62.2	64.5	71.1	70.7	77.1	75.9
Taxes on production and imports	18.5	19.3	20.7	21.6	24.0	23.1	25.7	24.6
Taxes on income and property	13.2	12.5	13.4	13.5	14.7	14.5	15.9	15.4
Social insurance contributions	17.0	18.5	21.2	23.3	25.7	25.4	28.4	27.6
Other	4.3	5.6	4.3	3.2	2.8	3.8	2.7	4.0
Capital transfers	3.9	3.5	2.5	2.9	4.0	4.0	4.4	4.4
Expenditures	61.9	64.3	67.5	71.5	79.8	79.8	82.1	82.0
of which: wage bill	14.3	15.2	17.1	18.1	20.0	20.0	21.2	21.2
Consumption	21.5	22.0	24.2	24.5	26.9	26.9	28.2	28.1
Social transfers, excl. those in kind	20.2	22.5	24.0	26.4	29.4	29.4	32.1	32.1
Interest	9.9	9.5	8.9	8.8	8.7	8.7	9.0	9.0
Subsidies	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Other current expenditure	1.4	1.4	1.7	2.4	4.0	4.0	4.1	4.0
Investment expenditure	8.7	8.6	8.4	9.2	10.5	10.5	8.7	8.7
of which: Olympics related expenditures	0.1	0.2	1.2	1.7	2.7	2.7	0.6	0.6
Overall balance	-5.0	-4.9	-5.3	-7.0	-8.7	-9.0	-5.0	-6.1
Primary expenditures	51.9	54.8	58.6	62.7	71.1	71.0	73.2	73.1
Primary balance	4.9	4.7	3.6	1.9	0.0	-0.3	3.9	2.8
<i>(In percent of GDP)</i>								
Revenues	46.7	45.3	44.0	42.2	43.2	43.1	43.7	43.5
Taxes on production and imports	15.2	14.7	14.6	14.1	14.6	14.1	14.6	14.1
Taxes on income and property	10.8	9.5	9.5	8.8	8.9	8.8	9.0	8.8
Social insurance contributions	14.0	14.1	15.0	15.3	15.6	15.5	16.1	15.8
Other	3.6	4.3	3.1	2.1	1.7	2.3	1.6	2.3
Capital transfers	3.2	2.7	1.8	1.9	2.4	2.4	2.5	2.5
Expenditures	50.8	49.0	47.7	46.7	48.5	48.6	46.5	47.1
of which: wage bill	11.7	11.6	12.1	11.8	12.2	12.2	12.0	12.1
Consumption	17.7	16.8	17.1	16.0	16.4	16.4	16.0	16.1
Social transfers, excl. those in kind	16.6	17.1	17.0	17.2	17.9	17.9	18.2	18.4
Interest	8.2	7.3	6.3	5.8	5.3	5.3	5.1	5.1
Subsidies	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Other current expenditure	1.1	1.1	1.2	1.6	2.4	2.4	2.3	2.3
Investment expenditure	7.2	6.6	5.9	6.0	6.4	6.4	4.9	5.0
of which: Olympics related expenditures	0.1	0.2	0.8	1.1	1.6	1.6	0.3	0.3
Overall balance	-4.1	-3.7	-3.7	-4.6	-5.3	-5.5	-2.8	-3.5
Primary expenditures	42.7	41.7	41.4	41.0	43.2	43.3	41.5	41.9
Primary balance	4.0	3.6	2.6	1.2	0.0	-0.2	2.2	1.6
Structural primary balance	4.4	3.5	2.3	0.6	....	-1.1	....	0.8
Structural overall balance	-3.8	-3.8	-4.0	-5.2	....	-6.4	....	-4.3
Structural overall balance (net of expenditure on Olympics)	-3.7	-3.6	-3.1	-4.1	....	-4.8	....	-4.0
Memorandum items								
Gross debt	114	115	112	110	112	112	110	109
Real primary expenditure (excluding Olympics)	52	53	53	55	60	59	61	61
Growth rate	....	1.6	1.2	2.7	8.7	8.6	3.0	2.9
Nominal GDP (in billions of euros)	122	131	142	153	164	164	176	174

Sources: National Statistical Service; Ministry of National Economy; Bank of Greece; and Fund staff projections.

Table 5. Greece: Medium Term Baseline Scenario, 2004-10
(Percentage changes, unless otherwise indicated)

	2004	2005	2006	2007	2008	2009	2010
	Projections						
Domestic economy							
GDP	3.9	3.0	3.0	2.9	2.9	2.8	2.7
Output gap	2.2	1.9	1.5	1.0	0.5	0.0	0.0
Domestic demand	4.3	2.9	2.9	2.8	2.7	2.7	2.6
Private consumption	2.9	4.4	3.7	3.2	2.8	2.7	2.3
Public consumption	11.6	0.7	0.8	1.2	2.8	2.6	3.6
Gross fixed capital formation	4.1	0.6	1.8	2.5	2.5	2.6	2.7
Change in stocks (contribution)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance (contribution)	-0.8	-0.2	-0.2	-0.2	-0.2	-0.2	-0.1
Exports	3.3	3.5	3.4	3.4	3.4	3.4	3.4
Imports	4.9	3.0	3.0	2.9	2.9	2.8	2.7
Unemployment rate	8.9	8.8	8.8	8.7	8.8	9.0	8.9
Employment	1.0	0.6	0.5	0.6	0.4	0.3	0.6
Unit labor costs (economy wide)	3.2	3.3	3.0	3.0	3.0	3.0	3.0
Consumer prices (HICP), end of period	3.9	3.4	3.4	3.4	3.3	3.2	3.2
Consumer prices (HICP), period average	3.3	3.4	3.4	3.4	3.3	3.2	3.2
GDP deflator	3.2	3.1	3.0	2.9	2.8	2.8	2.8
External sector (in percent of GDP)							
Current account (national accounts; settlements basis)	-5.9	-5.7	-5.5	-5.3	-5.1	-5.0	-4.9
Trade balance (in percent of GDP, settlements basis)	-15.2	-15.5	-15.9	-16.2	-16.5	-16.9	-17.2
Exports of goods and services	21.1	21.3	21.4	21.6	21.7	21.9	22.0
Imports of goods and services	28.6	28.4	28.2	28.1	28.1	28.0	28.0
Total transfers	3.1	2.9	2.8	2.6	2.5	2.3	2.2
Net income receipts	-1.6	-1.5	-1.4	-1.3	-1.3	-1.2	-1.1
Capital account	5.9	5.7	5.5	5.3	5.1	5.0	4.9
Direct investment (net)	0.2	0.0	0.2	0.1	0.1	0.1	0.1
Portfolio investment (net)	6.6	6.5	6.2	5.8	5.5	5.2	4.9
Other investment	-0.9	-0.9	-0.9	-0.6	-0.5	-0.3	-0.2
Change in reserves	0	0	0	0	0	0	0
Public finances (general government, in percent of GDP) 1/							
Total revenues	43.1	43.5	43.8	43.6	43.7	43.7	43.8
Total expenditures	48.6	47.1	47.3	46.5	46.5	46.4	46.5
Primary expenditures	43.3	41.9	42.2	41.6	41.7	41.8	41.9
in percent of potential GDP	44.2	42.7	42.8	42.0	41.9	41.8	41.9
Interest expenditures	5.3	5.1	5.1	4.9	4.8	4.7	4.6
Overall balance	-5.5	-3.5	-3.5	-2.9	-2.8	-2.8	-2.7
Primary balance	-0.2	1.6	1.6	2.1	2.0	1.9	1.8
Structural primary balance	-1.1	0.8	1.0	1.6	1.8	1.9	1.8
Structural overall balance	-6.4	-4.3	-4.1	-3.3	-3.0	-2.8	-2.7
Structural overall balance (net of Olympics expenditure)	-4.8	-4.0	-3.5	-2.6	-1.8	-1.0	-0.1
Structural overall balance (net of investment expenditure)	-0.1	0.6	1.8	2.1	2.7	3.3	4.0
Gross debt	112	109	106	103	100	98	95
Memorandum item							
Nominal GDP (in billions of euros)	164	174	185	196	207	219	231

Source: Fund staff estimates and projections.

1/ Assumes broadly constant ratio of revenue and primary expenditures to GDP as in 2005, and full utilization of EU structural funds.

Table 7. Greece: Medium-Term Staff Policy (Adjustment) Scenario, 2002–10
(In percent of GDP)

	2002	2003	2004	2005	2006	2007	2008	2009	2010
			Proj.						
Total revenues	44.0	42.2	43.1	43.5	43.8	43.6	43.7	43.7	43.8
Total expenditures	47.7	46.7	48.6	47.1	46.7	45.9	45.3	44.6	43.8
Primary expenditures	41.4	41.0	43.3	41.9	41.6	40.9	40.4	39.9	39.3
Interest expenditures	6.3	5.8	5.3	5.1	5.1	4.9	4.8	4.7	4.6
Overall balance	-3.7	-4.6	-5.5	-3.5	-2.9	-2.2	-1.6	-0.9	-0.1
Primary balance	2.6	1.2	-0.2	1.6	2.2	2.7	3.2	3.7	4.5
Structural primary balance	2.3	0.6	-1.1	0.8	1.6	2.3	3.0	3.7	4.5
Structural overall balance	-4.0	-5.2	-6.4	-4.3	-3.5	-2.6	-1.8	-1.0	-0.1
Structural balance (net of investment)	2.0	0.8	-0.1	0.6	1.8	2.1	2.7	3.3	4.0
Gross debt	112	110	112	111	109	105	101	96	91

Sources: National Statistical Service; Ministry of National Economy; and Fund staff estimates and projections.

Table 8. Greece : Financial Soundness Indicators

	1997	1998	1999	2000	2001	2002	2003	Mar-04
In Euros bn								
Structure								
Banks	93	100	125	146	159	166	174	n.a
Private commercial	18	26	42	43	45	47	52	n.a
State-owned	72	70	74	84	93	92	91	n.a
Foreign-owned subsidiaries	3	4	9	18	21	27	30	n.a
Branches of foreign banks	18	16	18	22	18	17	19	n.a
Insurance companies	4	5	7	8	8	8	n.a	n.a
Other credit institutions	12	12	13	14	15	17	18	n.a
In Percent								
Capitalization								
Regulatory capital to risk-weighted assets	10	10	16	14	12	11	12	12
Regulatory Tier I capital to risk-weighted assets	9	10	15	14	11	9	10	10
Asset quality								
Nonperforming loans net of provisions to capital 1/	40	29	24	23	17	19	16	17
Nonperforming loans to total gross loans 2/	11	9	11	7	6	6	5	5
Share of non performing loans to total assets 3/	3	3	4	3	3	3	3	3
Profitability								
Return on assets (after taxes)	1	1	2	1	1	1	1	n.a
Return on equity (after taxes)	14	14	29	15	12	7	9	n.a
Interest margin to gross income	56	55	45	55	63	73	74	n.a
Noninterest expenses to gross income	64	62	48	53	59	69	63	n.a
Liquidity								
Liquid assets to total assets 4/	55	53	51	46	42	39	35	33
Liquid assets to short-term liabilities 5/	n.a	n.a	n.a	n.a	n.a	n.a	34	36
Risk exposure								
Net open position in foreign exchange to capital	n.a	n.a	n.a	n.a	n.a	n.a	7	4
Large exposures to capital 6/	n.a	n.a	n.a	n.a	n.a	191	155	n.a
Spread between reference lending and deposit rates	10	10	7	7	6	6	6	6
Foreign currency-denominated loans to total loans	24	23	24	26	9	7	5	5
Foreign currency-denominated liabilities to total liabilities	30	35	31	39	22	16	16	17
Interest rate margin	2	2	2	2	3	3	3	n.a
Real estate prices (Urban areas)	10	14	9	11	15	13	6	5
Residential real estate loans to total loans	17	18	20	20	22	25	26	26

Source: Bank of Greece.

1/ Excludes the Agricultural Bank of Greece. If ABG is included, the ratio becomes 29 for 2002 and 27 for 2003 respectively.

2/ Excludes the Agricultural Bank of Greece. If ABG is included, the ratio becomes 7,3 for 2002 and 7,0 for 2003 respectively.

3/ Excludes the Agricultural Bank of Greece. If ABG is included, the ratio becomes 4,1 for 2002 and 4,3 for 2003 respectively.

4/ Liquid assets as appear in the balance sheet comprising of Cash & Deposits in Central Bank, Government and Other Securities, Claims on Credit Institutions and Fixed Yield Securities with a discount in order to reflect market price volatility

5/ Short term liabilities include all liabilities coming due over the next 12 months.

6/ Exposures are considered large whenever they exceed 10 percent of own funds. The prudential limit for large exposure is 80 percent.

GREECE: FUND RELATIONS
(As of November 30, 2004)

- I. **Membership Status:** Joined December 27, 1945; Article VIII
- II. **General Resources Account:**
- | | SDR Million | % Quota |
|---------------------------|--------------------|----------------|
| Quota | 823.00 | 100.00 |
| Fund holdings of currency | 546.44 | 66.40 |
| Reserve position in Fund | 276.56 | 33.60 |
- III. **SDR Department:**
- | | SDR Million | % Allocation |
|---------------------------|--------------------|---------------------|
| Net cumulative allocation | 103.54 | 100.00 |
| Holdings | 17.41 | 16.81 |
- IV. **Outstanding Purchases and Loans:** None
- V. **Financial Arrangements:** None
- VI. **Projected Obligations to Fund (SDR million; based on existing use of resources and present holdings of SDRs):**

	Forthcoming				
	2004	2005	2006	2007	2008
Principal					
Charges/Interest	1.91	1.91	1.91	1.91	1.92
Total	1.91	1.91	1.91	1.91	1.92

VII. **Implementation of HIPC Initiative:** Not Applicable.

VIII. **Exchange Rate Arrangements:**

Greece entered the final stage of European Economic and Monetary Union on January 1, 2001, at a rate of 340.750 Greek drachmas per 1 euro. Greece maintains restrictions on the making of payments for current international transactions vis-à-vis Iraq. These restrictions were notified to the Fund under Decision 144-(52/51) in EBD/90/304, 9/21/90.

IX. **Article IV Consultation:** Greece is on a 12-month consultation cycle; the last Article IV consultation discussions were concluded on May 16, 2003 (EBM/03/45).

X. **ROSCs**

Standard Code Assessment	Date of Issuance	Country Paper
Fiscal Transparency	October 6, 1999	No. 99/138
Fiscal Transparency	February 8, 2001	No. 99/138
Fiscal Transparency	March 15, 2002	No. 02/57
Data Module	September 17, 2003	No. 03/318

XI. **Technical Assistance:**

Year	Dept.	Purpose	Date
1993	FAD	Treasury Reform	June
1993	MAE	Central Bank Independence in the Context of the Maastricht Treaty	June
1994	MAE	Development of Primary and Secondary Markets in Government Securities	September
2002	STA	Action plan and time frame for SDDS subscription	June
2004	FAD	Tax Policy and Tax Administration Reform	July

XII. **Resident Representative:** None

GREECE: STATISTICAL ISSUES

Greece has made substantial progress in recent years in statistical methodologies and compilation practices aimed at fulfilling its responsibilities as a member of the European Union and the euro area. Greece became the fifty-first country to subscribe to the International Monetary Fund's Special Data Dissemination Standard (SDDS) on November 8, 2002—it has taken flexibility options on the periodicity and timeliness of central government operations data on financing, which are released annually. In addition, there have been recent difficulties in meeting SDDS timeliness for other data categories. Greece has undertaken a data module of the Report on the Observance of Standards and Codes (ROSC).

Recent progress could form a sound basis from which further improvements can be achieved. Improvements in the quality and coverage of general government public finances are urgently required; large and frequent revisions in these data undermine policy-making. More staff resources are needed to develop financial accounts of the government and achieve cross sector data consistency. There is scope for bringing government finance and balance of payments statistics closer to internationally acknowledged methodologies. Further progress is needed in providing short-term national accounts data, with reconciliation across datasets of data for government finance, monetary, and balance of payments statistics. Even though all statistics are readily available to the public, statistical presentations could be improved in most cases to facilitate analysis and understanding. Service to users could be further enhanced by dissemination of more detailed metadata including wider identification in press releases, and by publicizing contact persons. Most statistics do not provide the public with a clear statement of the revision policy.

National accounts

The scope of the national accounts produced by the National Statistical Service of Greece (NSSG) based on the 1995 *ESA* extends beyond the recommended range of annual tables, and includes regional accounts, simplified provincial accounts, accounts for agriculture, detailed tables relating to environmental issues, and a Social Accounting Matrix (for 1997). In some cases, there is reliance on benchmark ratios that are old and estimates of unrecorded activities that are residuals of balancing procedures. In addition, limited quarterly national accounts estimates are available from the first quarter of 1970 to the third quarter of 2002, which rely more on econometric estimation than on actual data.

Balance of payments and external trade

The Bank of Greece (BoG), in cooperation with several European central banks, has been engaged for a number of years in a comprehensive revision of balance of payments data on a settlements basis consistent with the fifth edition of the *Balance of Payments Manual (BPM5)*. Data for 1999 are the first available under the new system, with the BoG also providing estimates for 1997–98 (collected under the previous system, but compiled in the new categories). Monthly balance of payments data are reported to both the European Central Bank (ECB) and the IMF according to the timetable set by the ECB. Greece's balance of

payments monthly data series present some departures from *BPM5*, including: data do not include reinvested earnings nor undistributed branch profits; the basis for recording departs from accrual accounting as is typical with the use of bank settlements-based reporting systems; and data on interest payments for government debt are also reported on a cash basis. Greece reports to STA data on quarterly balance of payments and the annual international investment position (IIP) for publication in the *International Financial Statistics (IFS)* and the *Balance of Payments Statistics Yearbook*. As an SDDS subscriber, Greece started to disseminate quarterly data on the SDDS prescribed external debt data category, with a one-quarter lag, in end-September 2003. The BoG is disseminating monthly data on the template on international reserves and foreign currency liquidity within 21 days after the end of the reference month. Despite the new settlements-based reporting system, significant differences remain in comparison to national-accounts-based current account data, with sizable differences in changes (and even in direction) of the current account and its components in recent years.

Government accounts

Monthly data for the budgetary central government are very aggregated. Revenue, expenditure, and financing definitions are broadly in line with the 1986 GFS Manual. The quality and timeliness of the data on other public entities, including social security funds and local governments, are poor.

The NSSG compiles data on general government revenue, expenditure, and deficit on an accrual basis in the context of the ESA95 Transmission Program and the Excessive Deficit Procedure. The absence of financing data (Greece has a derogation for financial accounts reporting until 2005) impedes elementary checking of the consistency of the data, including reconciliation between the government deficit and debt, and between government statistics and the statistics of other economic sectors. Greece traditionally carries out substantial capital injections, whose nature must be carefully monitored in order to determine the proper statistical treatment (above or below the line).

Recently, the fiscal accounts for 1997-2003 were significantly revised following a review by Eurostat, reflecting lower tax receipts, lower payments received from EU institutions, a reclassification of payments from the Saving Postal Bank to the government as a financial transaction, higher expenditures on military equipment, and lower surpluses of the Social Security Funds and other non-central government entities. Government debt was also increased after properly accounting for capitalized interest obligations and lower assets of social security funds.

Greece's annual government finance statistics on an accruals basis were published in the Supplement to the 2002 *GFS Yearbook*, which contains the statistics of selected countries according to the *GFSM 2001* methodology. These data were extracted from Greece's submission to Eurostat. Greece did not report data for publication in the 2003 *GFS Yearbook*. No sub-annual GFS data are reported for publication in *IFS*.

Monetary accounts

Upon Greece's participation in the euro area, the BoG successfully transitioned to compiling monetary statistics in accordance with ECB requirements. Monetary statistics for publication on Greece's *IFS* page have been revised for consistency with the other euro-area countries. Data reporting is timely. However, reporting discrepancies among banks' bilateral positions suggest improvements could be made in the accuracy and reliability of the source data used to compile monetary statistics. Interbank reporting discrepancies in Greece's monetary statistics are not only large in stock terms, but also volatile. In addition, systematic cross-checks between monetary statistics and other data sets are not undertaken. The data ROSC module for Greece noted the following additional areas where Greece's monetary statistics are not fully in line with the IMF's *Monetary and Financial Statistics Manual*: (i) positions in financial derivatives and claims on the central government are not separately identified; (ii) some deposits are not accurately classified; and (iii) accrued interest is excluded from outstanding amounts for loans and deposits recorded in the balance sheet.

Labor market

A more detailed quarterly labor force survey, with an enlarged sample size and capable of generating data on an EU-harmonized basis, has been used since the fall of 1998. However, the interpretation of labor market developments continues to be hampered by difficulties in covering immigrants, which constitute, compared with other EU countries, a relatively large fraction of the Greek labor market. Data on earnings have not been produced since 1998.

Short-term data

The recent publication of quarterly national accounts is an important improvement in this area. However, other high-frequency indicators for economic surveillance (including retail sales, industrial production, wholesale prices, and other indices) are at times based on out-of-date benchmark ratios and reporting delays seriously undermine the usefulness of these data. Source data and statistical techniques could be strengthened for prices, and source data improved for government finance statistics.

Advance release calendars

The NSSG has announced an advance publications schedule for all statistical releases.

Greece: Core Statistical Indicators
(As of November 18, 2004)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Central Government Balance	GDP/GNP	External Public Debt/Debt Service
Date of Latest Observation	11/18/04	Aug. 2004	Aug. 2004	Aug. 2004	Aug. 2004	11/18/04	Oct. 2004	Aug. 2004	Aug. 2004	Aug. 2004	3 rd qtr. 2004	2003
Date Received	11/18/04	10/29/04	10/29/04	10/29/04	10/29/04	11/18/04	10/29/04	10/29/04	10/29/04	10/29/04	11/11/04	2/16/04
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Annually
Frequency of Reporting	Daily	Monthly; or when requested	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Annually
Source of Update 1/	Reuters/ Bloomberg	BoG	BoG	BoG	BoG	Reuters/ Bloomberg	NSSG	BoG	BoG	MEF	Bloomberg	BoG
Mode of Reporting	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic/ statistical bulletin
Confidentiality	None	None	None	None	None	None	None	None	None	None	None	None
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

1/ BoG = Bank of Greece; MEF = Ministry of Economy and Finance; NSSG = National Statistical Service of Greece.

INTERNATIONAL MONETARY FUND

GREECE

**Staff Report for the 2004 Article IV Consultation
Supplementary Information**

Prepared by the European and Policy Development and Review Departments

Approved by Alessandro Leipold and Liam Ebrill

January 28, 2005

1. This supplement to the staff report for the 2004 Article IV consultation with Greece provides an update on recent developments. The new information does not change the thrust of the staff appraisal. However, the authorities' medium-term fiscal path, as laid out in its Stability and Growth Program (SGP) update, falls well short of the adjustment path advocated by staff.
2. **Macroeconomic indicators are broadly in line with expectations.** Third-quarter growth remained robust at 3.8 percent (year-on-year). Looking forward, growth prospects have improved with the reduction in world oil prices (although these remain volatile), but have also been undermined by the more subdued recovery now expected in the euro area. The January Consensus Forecast for 2005 real GDP growth remained at 2.7 percent. Inflation has been somewhat lower than expected due to the stronger euro, weaker oil prices, and a moderation in food prices due to favorable weather conditions. Estimates of the 2004 general government budget deficit are not yet available. However, the cash deficit of the central government rose to 6½ percent of GDP by end-November, and preliminary reports indicate that large revenue shortfalls have continued in December. In a press interview on January 16 the central bank governor said the central government cash deficit for 2004 as a whole was 9.4 percent of GDP. As a result, the risks for a general government deficit higher than the 5½ percent of GDP estimated in the staff report may have materialized. Having been placed on a negative rating watch, Greece was downgraded by Fitch on December 16, 2004.
3. **In its report to ECOFIN, the European Commission concluded that the Greek authorities have not taken effective action to correct the excessive budget deficit.** The Commission judged that the measures put in place last year and in the 2005 budget would not reduce the deficit below 3 percent of GDP, and estimated that the 2004 budget deficit will be 5½ percent of GDP. Both of these conclusions are in line with the projections in the staff report, although the Commission projects a more or less unchanged debt-GDP ratio in 2005, whereas the staff foresees a modest decline. In its meeting on January 18, ECOFIN, while acknowledging measures put in place by the Greek government for 2004 and 2005, decided that Greece is not in compliance with the Council recommendations issued on July 5, 2004 and considered that the excessive deficit may persist in 2005.

4. **The authorities have submitted an updated Stability and Growth Program for 2004-07 to the Commission** (Table 1). The macroeconomic framework assumes that output growth will exceed 4 percent by 2007, due to strong private consumption demand, underpinned by rapid real wage growth, and continued investment activity. The contribution of the external sector is expected to rise due to the global recovery and improved competitiveness.

Table 1. Greece: Authorities' Medium-Term Program
(In percent, unless otherwise indicated)

		2003	2004	2005	2006	2007
Real GDP growth	SGP 2003	4.0	4.2	4.0	3.8	...
	SGP 2004	4.5	3.7	3.9	4.0	4.2
GDP deflator growth	SGP 2003	3.5	3.4	3.2	3.0	...
	SGP 2004	3.5	3.6	3.3	3.2	3.0
Employment growth	SGP 2003	1.5	1.7	1.3	1.1	...
	SGP 2004	1.3	2.0	1.5	1.5	1.6
General government overall balance (In percent of GDP)	SGP 2003	-1.4	-1.2	-0.5	0.0	...
	SGP 2004	-4.6	-5.3	-2.8	-2.6	-2.5
Public debt (In percent of GDP)	SGP 2003	102	99	95	91	...
	SGP 2004	110	112	110	106	103

Source: The 2003 and 2004 Update of the Hellenic Stability and Growth Programme.

5. **The SGP envisages only a modest decline in the overall general government deficit to 2½ percent of GDP in 2007.** Revenue collection is expected to remain strong due to robust growth, improved tax collection, and a broader tax base. These factors are expected to offset losses from a continued decline in the tax burden of enterprises and households after 2005. Despite the government's plans to restrict hiring, allow only modest wage increases, and reduce current operating expenditure, primary spending is projected to accelerate after 2005.

6. **The new SGP's medium-term fiscal path is not very ambitious and is subject to significant risks should growth falter** (Table 2). Given the authorities' growth and inflation assumptions, but using staff's estimate of potential output growth (¾ percent a year), the cyclically adjusted deficit, after falling significantly in 2005, remains unchanged in 2006 and rises slightly in 2007, in contrast to staff's recommendation of continued reductions in the structural deficit of some ¾ percent a year. Were the staff's medium-term output and inflation projection to materialize, actual deficits would increase substantially in 2006-07.

7. **While details remain sketchy in many areas, the structural reform priorities laid out in the SGP are a step in the right direction.** These include: improving tax administration and expenditure management; establishing an Independent Body of Fiscal Inspectors to improve the effectiveness of the fiscal auditing system; implementing a new

framework to improve the financial operation of public enterprises; and, health care reform to improve financial viability in the short run and long-run sustainability. The government intends to continue improving product market competition by putting in place the pending secondary legislation to open up the electricity market, and speeding up the opening of the natural gas market. The government also hopes to attract investors by simplifying, updating, and codifying legislation, rationalizing the tax system, reducing red tape, and providing incentives to investors. No new initiatives have been announced in the areas of labor-market or long-term pension reform (although tripartite discussions are taking place to settle details on the transfer of pension obligations from the formerly state-owned banks to the public sector).

Table 2. Greece: Staff Analysis of Stability and Growth Program (2004-07)
(In percent of GDP)

	2003	2004	2005	2006	2007
		<i>Stability and Growth Program 1/</i>			
Overall balance	-4.6	-5.3	-2.8	-2.6	-2.5
Primary balance	1.2	0.0	2.2	2.5	2.6
Cyclically adjusted overall balance 2/	-5.2	-6.1	-4.0	-4.0	-4.2
Cyclically adjusted primary balance 2/	0.6	-0.8	1.1	1.1	0.8
Public debt	110	112	109	106	103
		<i>Low Growth Scenario 3/</i>			
Overall balance	-4.6	-5.4	-3.4	-3.7	-4.3
Primary balance	1.2	-0.1	1.7	1.5	1.0
Public debt	110	112	109	108	107
		<i>IMF Estimates (Staff Report) 4/</i>			
Overall balance	-4.6	-5.5	-3.5	-3.5	-2.9
Primary balance	1.2	-0.2	1.6	1.6	2.1
Cyclically adjusted overall balance	-5.2	-6.4	-4.3	-4.1	-3.3
Cyclically adjusted primary balance	0.6	-1.1	0.8	1.0	1.6
Public debt	110	112	109	106	103

1/ Revenue, expenditure and nominal GDP as reported in the Stability and Growth Program (SGP), 2004-07.

2/ Calculations are based on IMF staff estimates of potential output.

3/ The SGP fiscal outcome in the event nominal GDP were as estimated in SM/04/423.

4/ Revenue, expenditure and nominal GDP as estimated in Tables 4-5 in SM/04/423.

Statement by Miranda Xafa, Alternate Executive Director for Greece
February 2, 2005

I would like to express the appreciation of my authorities for the high quality of the staff papers. The exchanges between the staff and the Greek government have been frank and productive, and staff's recommendations on fiscal issues have been particularly useful. My authorities broadly agree with staff's analysis and recommendations, including on the challenges in the years ahead, which can be summarized as follows:

- **Fiscal policy** is the most difficult challenge. The recent restatement of the public finance figures brought a welcome improvement in fiscal transparency, but also served to highlight the size of the needed fiscal adjustment. Persistent efforts will be needed to achieve a sustainable fiscal position over the medium term.
- Policies are geared to maintaining the high **growth rate** achieved in recent years, but the risks are skewed to lower growth following the completion of major infrastructure projects and other temporary growth-boosting factors.
- Sustained increases in living standards require fundamental **structural reform** to improve competitiveness and efficiency.

Fiscal consolidation is the most urgent priority

Upon taking office in March, the new Greek government undertook a wide-ranging fiscal audit which resulted in significant upward revisions of the deficit and debt figures in the period 1997-2004. The main elements explaining the revisions -- detailed in Box 2 of the staff paper and in the December 2004 update of Greece's Stability and Growth Program (SGP) -- were the under-recording of military expenditures and the over-estimation of the surplus of social security funds. In addition to the fiscal audit, fiscal developments in 2003-04 were impacted by the acceleration of expenditure related to the Olympic games and by the electoral cycle, which led to a strong acceleration in public consumption in 2004. The combined effect of the above factors was an increase in the general government deficit from 4.6 percent of GDP to an initial estimate of 5.3 percent in 2004, with Olympics-related spending adding 1 to 1.5 percent of GDP to the deficit in each year.

Looking back, fiscal consolidation efforts over the past five years failed to secure a primary surplus sufficient to reverse the dynamics of rising debt. Thus, general government debt remained broadly stable as a percentage of GDP from 112.3 percent at end-1999 to 112.1 percent at end-2004, despite above-potential GDP growth averaging 4.1 percent during this five-year period. Moreover, there was a gradual relaxation of the fiscal stance since Greece joined the Euro area on January 1, 2001, as evident from the decline in the primary surplus from 4 percent of GDP in 2000 to zero in 2004. This deterioration was masked by the significant decline in debt service costs as interest rates fell, which limited the deterioration in the overall general government deficit to just over 1 percent of GDP over this period, from 4.1 percent of GDP in 2000 to an estimated 5.3 percent in 2004.

Looking forward, the government has taken some measures to bring the deficit of the general government down to below 3 percent of GDP in 2005. However, it is clear that achievement of this target hinges crucially on sustaining the strong GDP growth of recent years. More importantly, it is also clear that these measures are insufficient to achieve a sustainable fiscal position over the medium term. With the fiscal audit now completed, the authorities are therefore focusing on carefully elaborated, longer-term reforms, including privatization and health care reform, to contain costs and raise revenue. They are fully aware of the need to eventually tackle the pension problem, but have decided to give priority to structural reforms with a more immediate payoff in terms of both expenditure reduction and growth.

The medium term fiscal strategy needs to be supported by reforms on both the expenditure and revenue sides, and by improvements in budgetary management. To this effect, my authorities have requested technical assistance from the Fund on tax administration and public expenditure management to help improve tax compliance and the efficiency of public spending. They are in the process of considering the recommendations of the recent mini-ROSC mission (summarized in Box 4) and look forward to the full fiscal ROSC scheduled for later this year.

Growth prospects are good but uncertain

As discussed in the staff report, Greece's above-potential growth in recent years was boosted by temporary factors, including Olympics spending, lax fiscal policy, and rapid credit growth following interest rate convergence and Euro adoption in 2001. The authorities share with staff the view that sustaining this growth momentum will be a challenging task. Nevertheless, they are considerably more optimistic than staff regarding growth prospects, with key differences relating to investment and the external sector. In particular:

1. The authorities expect private investment to take up much of the slack generated by the end of Olympics spending. They expect a rebound in business investment in 2005-07 to be supported by lower corporate taxes, new investment incentives, and an improvement in the business climate through cuts in red tape and streamlined business regulation. Legislation on Private-Public Partnerships under preparation also is expected to help promote private investment in infrastructure, while efforts are under way to improve the absorption of EU funds.
2. The erosion of international competitiveness is an issue of concern to the authorities. Balassa-Samuelson effects do not fully account for the positive inflation differential between Greece and the Euro area, as is evident from the growing current account deficit and loss of market shares. Nevertheless, the successful completion of the Olympic games is expected to boost tourism revenues, projected in the SGP to grow by 7.5 percent in real terms annually in 2005-07. Shipping revenues, which were very strong in recent years, also are expected to boost export receipts. On the import side, investment-related imports are expected to decline due to the completion of the Olympic games.
3. Based on the above arguments, the SGP projects GDP growth to remain at about 4 percent a year in 2005-07, with fixed investment growth averaging 5.3 percent over this period. By

contrast, staff projects GDP growth to fall to about 3 percent annually in 2005-07, with fixed investment growth averaging just 1.6 percent during this period (Table 5). The external sector is expected to have a negligible impact on growth in the SGP, compared with a small drag on growth in staff projections.

4. The differences in the growth assumptions underlying the two scenarios obviously have an impact on the respective fiscal projections. Based on unchanged policies, the staff does not expect the deficit to fall below 3 percent of GDP in 2005-06, while the SGP projects a sub-3 percent deficit in each of these years.

5. The authorities are fully aware of the downside risks to growth, as well as to higher oil prices and interest rates than currently assumed in the baseline scenario. The SGP thus includes an alternative scenario where GDP growth falls to 3.3 percent a year in 2005-07. Under this scenario, the general government deficit remains above 3 percent of GDP in 2005 and only falls below that benchmark in 2006. Admittedly, the Greek and Euro area data flow has been generally softer in recent weeks, including the disappointing EC economic sentiment survey for December; at the same time, however, the oil bubble continues to deflate. In our view, the correct way to read recent leading indicators is to temper, rather than abandon, optimism about sustained high growth heading into 2005.

Structural reform is essential to sustain growth, reduce deficit

Supply-side reforms to improve efficiency are essential in raising potential growth and reducing the external imbalance. The government's structural reform agenda includes measures to open up markets previously sheltered from competition from new entrants (even if liberalized on paper, e.g. electricity) and to reduce the state's involvement in the economy and the distortion caused by having state-owned firms compete with private firms (e.g. air transport). In particular, there is significant scope for privatization, deregulation and restructuring to increase competition and reduce costs in sectors dominated by the public sector (transport, telecoms, energy, defense, education and health). Reforms in these areas can help achieve a leaner, more efficient economy and boost private investment.

Labor market reform has been very slow indeed. Steps in the wrong direction have been taken in the past, including raising the cost of overtime pay in the hope of increasing hiring. Increased labor participation is the key to increasing potential output (as happened in Ireland), but also to improving the finances of the pension system. However, amending employment protection legislation – especially in the public sector – or lowering entry-level wages to encourage hiring are likely to meet strong resistance from labor unions. Current reform plans therefore focus on increasing labor market flexibility by expanding part-time and temporary employment opportunities, and by reducing the high cost of overtime pay which impacts competitiveness.

The staff paper comparing Greece to Ireland provides a useful road map for future reform efforts. However, there are powerful **obstacles to reform** in Greece. The legacy of state intervention fuels political patronage and contributes to the dominance of interest group politics. Interest groups include public sector unions opposing privatization on grounds that the

needed restructuring would entail a loss of jobs and benefits; and suppliers reaping monopolistic profits when selling goods and services to the state. Additional impediments to the implementation of reform are poor public administration, soft budget constraints on public enterprises and entities, and limited consensus for privatization based on the belief – often cultivated by special interest groups – that a sell-off in state assets is not in the national interest. The above factors have constrained reform efforts, as compromises were often made to preserve social cohesion or appease politically powerful groups. The room for improvement is significant provided that political capital is wisely used.

The authorities are focusing on financial sector issues

Rapid credit growth following liberalization of consumer credit and interest rate convergence in the run-up to EMU may tend to increase the banking sector's risk exposure over time. While stress tests confirm that Greek banks are adequately protected from market risk, credit risk may rise further as the ratio of household debt to GDP catches up with the EU average. As outlined by staff, the Bank of Greece has taken steps to address this concern by raising specific provisions and capitalization levels. Moreover, comprehensive credit information on each individual borrower is now available for loans contracted since June 2003.

Banks are currently well capitalized and profitable, and their risk management systems have improved. However, an upcoming challenge for state-controlled banks is the need to include large unfunded pension liabilities in their balance sheets under International Accounting Standards that will enter into force at year-end. While these liabilities will be transferred to the main pension fund, IKA, by 2008, the terms of this transfer have not been made clear and it cannot be ruled out that a fiscal cost may be incurred. This issue will be discussed, *inter alia*, by the upcoming FSAP mission requested by the authorities.



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700 19th Street, NW
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IMF Executive Board Concludes 2004 Article IV Consultation with Greece

On February 2, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Greece.¹

Background

The several years of strong economic growth continued in 2004, buoyed by supportive monetary conditions, an expansionary fiscal stance, and the Olympics. Rising incomes and a falling, though still high, unemployment rate underpinned strong household consumption, while increased profitability spurred investment spending, especially construction. However, imbalances have emerged and many longstanding structural impediments persist. Inflation has been above the euro-area average, eroding international competitiveness and export market shares. This, and the cyclical divergence with the rest of Europe, has resulted in large current account deficits and a negative contribution of the external sector to aggregate demand. On the supply side, a number of impediments have led to poor labor-market performance, while regulation and weak competitive forces weigh on product markets.

The fiscal position has deteriorated sharply. Following very large data revisions which significantly raised recorded fiscal deficits for 1997-2003, the general government deficit is expected to be some 5½ percent of GDP in 2004 and the primary surplus to fall to about zero; there is a risk of a still worse outcome. The public debt, at about 112 percent of GDP in 2004,

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

has fallen little in recent years. The 2005 budget aims for significant fiscal consolidation, with the deficit falling by 2½ percent of GDP to (under the budget's growth assumptions) 2.8 percent of GDP. The end of Olympics spending is an important, and permanent, factor accounting for 1¼ percentage points of the improvement. The budget also contains temporary (tax amnesties and the collection of arrears) and ad hoc (containment of pension and public-sector wage increases) measures.

In 2005 and beyond, fundamentals point to slower growth and a gradual easing of inflationary pressures. Although household consumption is expected to remain strong, the fiscal adjustment planned for 2005 will dampen domestic demand, including investment, and the erosion of competitiveness may limit the benefit from any pickup in growth in Europe. The key risks to the outlook are external: sustained high oil prices and further rises in the value of the euro will undercut growth, both in Greece and in its major trading partners.

In the long-term, population aging threatens fiscal sustainability. On current estimates, pension and health-care costs will rise by more than in any other EU country between now and 2040, while high public debt and the weak budget position leave little room for fiscal maneuver. Regarding structural policy, the authorities, recognizing that Greece still lags significantly behind the EU in real per capita income despite the economic boom, have announced substantial reforms focused on improving product market performance.

Executive Board Assessment

Directors noted that past reforms, notably financial market deregulation, interest rate declines associated with euro adoption, and, more recently, stimulus from Olympics spending had all contributed to strong growth of the Greek economy in the past several years. This economic boom has been reflected in labor-market gains, with rising employment and a decline in the unemployment rate.

However, Directors also noted that widening economic imbalances threaten future growth prospects. The public finances have deteriorated sharply—only in part because of the Olympics—and the high debt-GDP ratio has fallen very little, with recent data revisions revealing that the fiscal position is much worse than earlier thought. Deteriorating competitiveness, due to sustained inflation differentials with the rest of the euro area, and strong domestic demand are reflected in poor export performance and a large current account deficit. Against this backdrop, Directors agreed that the key priorities for the Greek authorities are a strong and sustained fiscal consolidation effort along with further improvements in fiscal transparency, and structural reforms to put in place the conditions for sustained increases in output and living standards.

Regarding the revisions to the fiscal data, Directors welcomed the initiative by the new government to launch a fiscal audit immediately upon taking office. They regretted the significant past understatements of the deficit and public debt. Directors noted that the lack of accurate data has hindered surveillance and emphasized that complete, timely, and accurate fiscal data are essential for sound policy making. They supported the ongoing efforts of the authorities, working with Eurostat, to improve reporting, and the decision to compile financing-side fiscal data beginning in 2005. They urged the authorities to implement further reforms to

bolster credibility and ensure the integrity of the data. This should include improving the independence and effectiveness of auditing, ensuring the independence of the statistical agency, developing a more comprehensive budget, closing special treasury accounts, and implementing a mid-year budget report. Directors welcomed the authorities' decision to undertake a full assessment of fiscal policy transparency in 2005. All these actions are essential to preserve the government's credibility and the confidence of investors, which in turn are essential for long-term growth.

Directors stressed that the first priority of economic policy is to restore the health of the public finances. They welcomed the appreciable adjustment aimed for in the 2005 budget, given the large fiscal deficit, high debt level, and the requirements of the Maastricht treaty. Directors felt, however, that greater reliance on permanent measures would have been preferable, and many expressed concern that the deficit targeted in the budget might be difficult to achieve, given the optimistic growth assumptions. Looking forward, Directors stressed that further durable adjustment measures will be needed to cut the deficit and reduce the public debt, especially in view of the large anticipated costs of population aging. They supported the authorities' intentions to introduce further tax reforms, but stressed that the fiscal costs of such initiatives would have to be offset by savings elsewhere in the budget. Directors urged the authorities to make strong and sustained efforts to contain current primary spending growth with a view to achieving budget balance over the medium term.

Directors agreed that fiscal adjustment will require restraint, prioritization, and strengthened expenditure management. They pointed in particular to the potential for containing the public sector wage bill, cutting government loan guarantees, stronger controls on health care, and a review of defense outlays. Directors urged the authorities to move expeditiously on implementing proposals to reform the health care sector and public procurement. To reinforce the process of fiscal adjustment, Directors recommended that the authorities develop an explicit medium-term budget framework laying out a consistent and realistic set of economic assumptions, deficit objectives, expenditure ceilings, and specific policy measures. They supported the authorities' request for Fund technical assistance on tax administration and public expenditure management.

Directors noted that population aging poses a key long-term threat to the public finances. Since pressures are expected to begin to be felt during the next decade, they expressed disappointment that pension reform is not part of the government's immediate priorities. Directors stressed the importance of early pension reforms and urged the authorities, as a minimum, to begin as soon as possible the public debate needed to develop a social consensus for change, including by laying out the cost of unduly delaying the reforms.

Directors welcomed the authorities' actions to ensure a robust banking system, including the strengthening of the Bank of Greece's supervisory capacity. Noting the risks from the rapid increase in private sector credit growth should the economic climate take a turn for the worse, Directors encouraged the authorities to monitor the situation closely and take prompt corrective action as needed. In light of weaknesses in the insurance sector, Directors welcomed the decision to establish an independent insurance supervisor. They looked forward to Greece's participation in the Financial Sector Assessment Program (FSAP) planned for this year.

Directors stressed the need to address structural weaknesses to promote sustained increases in output and living standards in the years ahead. They welcomed the authorities' plans to improve the business climate, including through tax simplification, improved tax administration, further privatization, and bolstering product market competition, and urged that the relevant measures be put in place as soon as possible. It will also be important to simplify judicial procedures, including those related to bankruptcy. Directors supported the authorities' intention to continue infrastructure spending, but stressed that public-private partnership arrangements should be accompanied by a full accounting of explicit and implicit government liabilities, transparent project selection and evaluation, and appropriate risk transfer to the private-sector partners.

Directors emphasized that faster progress is needed on labor market reform, and they urged the authorities to make strong efforts to build the necessary consensus for moving forward in this area. Enhanced labor market performance should be achieved through easing strict employment protection measures, extending part-time and temporary employment opportunities, improving education and training, and ensuring that wage settlements are in line with productivity and euro area inflation objectives.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Greece: Selected Economic Indicators, 2000–05

	2000	2001	2002	2003	2004	2005
					Proj.	Proj.
Real economy (change in percent)						
Real GDP	4.5	4.3	3.6	4.5	3.9	3.0
Final domestic demand	5.5	2.4	4.2	5.4	4.3	2.9
Private consumption	2.2	2.8	3.1	4.2	2.9	4.4
Public consumption	14.8	-3.1	5.3	-2.5	11.6	0.7
Gross fixed capital formation	10.0	4.9	6.6	13.2	4.1	0.6
Foreign balance (contribution)	-1.7	1.7	-0.9	-1.3	-0.8	-0.2
Unemployment rate (in percent)	11.1	10.5	10.0	9.3	8.9	8.8
Employment	0.3	-1.0	1.6	1.9	1.0	0.6
Unit labor costs (economy wide)	1.7	2.8	3.0	2.4	3.2	3.3
GDP deflator	3.4	3.5	4.0	3.5	3.2	3.1
CPI (year average)	2.9	3.7	3.9	3.4	3.0	3.4
Public finance (percent of GDP)						
General government balance	-4.1	-3.7	-3.7	-4.6	-5.5	-3.5
General government primary balance	4.0	3.6	2.6	1.2	-0.2	1.6
General government structural balance	-3.8	-3.8	-4.0	-5.2	-6.4	-4.3
General government gross debt	114	115	112	110	112	109
Money and credit (end of year, percent change)						
Domestic credit 1/	20.2	9.3	8.5	3.0	9.9	...
Interest rates (percent)						
Deposit rate 1/	6.1	3.3	2.8	2.5	2.3	...
Government bond yield 1/	6.1	5.3	5.1	4.3	4.3	...
Balance of Payments (in percent of GDP, unless otherwise noted)						
Exports of goods and services	26.4	25.6	22.3	21.2	21.1	21.3
Imports of goods and services	37.2	35.1	30.8	28.5	28.6	28.4
Trade balance	-18.0	-16.5	-16.0	-14.8	-15.2	-15.5
Current account	-6.9	-6.2	-6.1	-5.7	-5.9	-5.7
Exchange rate						
Exchange rate regime					Euro area	
Present rate (January 11, 2004)					1.31	
Nominal effective exchange rate (2000=100) 2/	100.0	100.7	102.3	106.2	107.6	...
Real effective exchange rate (2000=100) 2/	100.0	101.1	104.0	109.3	112.0	...

Sources: National Statistical Service; Ministry of National Economy; Bank of Greece; IMF, *World Economic Outlook*; and Fund staff estimates and projections.

1/ Latest data is for September (domestic credit); August (government bond yield); and July (deposit rate).

2/ As of October 2004.