GREECE—MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

May 3, 2010

I. RECENT DEVELOPMENTS

1. **The economic downturn accelerated coming into 2010.** Greek real GDP declined by 2 percent in 2009 and indicators suggest that activity will weaken further in 2010. Following the Greek elections in October, the realization that the fiscal and public debt outturn for 2008 and 2009 were significantly worse than had been reported by the previous government caused confidence to drop, financing costs to increase, and growth and employment to suffer.

2. **The crisis exposed the weak fiscal position.** The deficit of 5.1 percent of GDP in 2007, at the top of the cycle, shows that Greece entered the downturn with a large underlying public deficit. With weak revenue policies and tax administration, especially leading up to the 2009 elections and aggravated by the recession, revenues declined notably. Spending, meanwhile, increased significantly, especially on wages and entitlements, reflecting weak spending discipline and monitoring and control, which also led to new arrears. The deficit jumped to an estimated 13.6 percent of GDP while the public debt rose to over 115 percent of GDP in 2009. The monitoring and control deficiencies delayed the implementation of corrective fiscal policies.

3. **The financial system has been adversely affected.** With the deteriorating fiscal results came downgrades of government bonds by rating agencies, and investors started backing out of Greek bonds, driving up their yields. Furthermore, it is clear that the deep macroeconomic and structural problems combined with unavoidable strong fiscal adjustment over the medium term are likely to weigh on activity for some time. This combination of factors affects negatively the banking system. Impaired loans are rising while borrowing costs in the interbank and wholesale markets have increased, putting pressure on bank profitability.

4. **Despite the recession, the external deficit is declining only gradually.** Inflation and domestic costs have increased well above those of Greece's euro partners over the last decade and Greece has lost competitiveness. As a result, the external current account deficit at end 2009 was still over 11 percent of GDP, and the net international investment position is over negative 83 percent of GDP. The external interest bill on the foreign debt has increased to over 5 percent of GDP, so it will take a surplus in trade of goods and services to return the current account to a more sustainable position. This will require a strengthening of economic policies and competitiveness to lay the foundations for a growth model that relies more on investment and exports.

II. KEY OBJECTIVES AND THE OUTLOOK

5. **The main objectives of the program are to correct fiscal and external imbalances and restore confidence.** Without regaining confidence in the sustainability of fiscal and economic developments, the cost of funding the economy is bound to stay high if not increase further. The fiscal and the external imbalances need to be corrected. Facing these two tasks at the same time is challenging, requiring a major reorientation in the economy. Growth is unlikely to be buoyant as the initial corrective fiscal measures are implemented, but with financial sector policies to preserve the soundness of the banking sector and strong medium-term fiscal and structural policies, the economy will emerge from this experience in better shape than before with higher growth and employment.

6. **The government foresees an extended adjustment period:**

- **Real GDP growth** is set to contract significantly in 2010–2011, but should gradually recover thereafter. The economic program assumes negative growth of 4 percent in 2010 and 2½ percent in 2011. While fiscal consolidation is bound to weigh on economic activity at first, it is expected that confidence effects from the front-loaded fiscal measures and the strong medium-term economic program in combination with comprehensive structural reforms will create the conditions for a return to growth from 2012 onward.

- **Inflation** needs to be reduced significantly below the euro area average for Greece to regain swiftly price competitiveness. Domestic demand tightening, both through fiscal adjustment and efforts to moderate wages and pensions, together with cost-cutting measures in the economy, will be essential to bring inflation down in a meaningful way. In this regard, addressing oligopolistic structures to reduce high markups in some sectors will also be important.

- **The external deficit** is projected to decline gradually over the medium term as domestic demand and inflation moderate and the economy responds to structural reforms to improve the supply of exports and reduces the dependence on imports. This process will naturally take several years, while the interest costs on the substantial external debt will pressure the current account for some time.

III. ECONOMIC POLICIES

7. **To achieve the program objectives, all available fiscal, financial, and structural policies will be used.** The economy needs a strong and sustained adjustment program to correct fiscal imbalances and place debt on a downward path in the medium term, maintain banking sector stability, and restore competitiveness:

- **Fiscal adjustment will have to be the cornerstone of the program.** The government is committed to put in place durable adjustment measures, on top of those already announced in March this year, of 11 percent of GDP in cumulative terms through 2013, with additional remedial measures in 2014 to reduce the deficit to well below 3 percent of GDP. This large adjustment is needed to put the debt-GDP ratio on a downward trajectory from 2013 onward, which will be sustained after the program by keeping primary balances in a sizeable surplus (at least 5 percent of GDP) up to 2020. To sustain fiscal consolidation over the medium term, the government also is committed to strengthening the fiscal policy framework and fiscal institutions.

- **Incomes and social security policies need to buttress the fiscal adjustment effort and restoration of competitiveness.** Realigning incomes to sustainable levels is necessary to assist fiscal correction, support a reduction in inflation well below the euro area average, and improve price and cost competitiveness on a lasting basis. Social security programs need to be strengthened to confront underlying structural imbalances that result from the ageing of the population, where growth in entitlement costs for Greece is projected to be among the highest in the European Union with current policies. As the largest annual overruns in the budget consistently come from the social security funds, reforms cannot be postponed any longer to safeguard the viability of the system.

- **Financial sector policies need to maintain stability.** While currently capital buffers in the banking system are reasasuring, bank supervisors will need to monitor closely liquidity and nonperforming loans at individual banks. The Bank of Greece and the government will further strengthen and clarify the key elements of Greece's supervisory and financial crisis framework to assist the banking system through this period of lower growth.

- **Structural reforms that boost the economy's capacity to produce, save, and export will be critical for the medium-term recovery.** Greece's openness is lagging euro-area peers. The government is determined to implement an ambitious program of reforms to modernize the public sector and render product and labor markets more efficient and flexible, create a more open and accessible environment for domestic and foreign investors, and reduce the state's direct participation in domestic industries.

8. **The government is committed to fairness in the distribution of the adjustment burden.** Our resolve to protect the most vulnerable in society from the effects of the economic downturn was taken into account in the design of the adjustment policies. In consolidating government finances, larger contributions will be raised from those who have traditionally not carried their fair share in the tax burden. With regard to the reduction in public wages and in pensions, the minimum earners have been protected:

- Pension reductions: The elimination of the 13th and 14th pensions is compensated, for those receiving less than €2500 a month, by introducing a new flat bonus of €800 a year. The benefit reduction is weighted toward the higher pension earners.

- Wage bill reductions. The 13th and the 14th wage payments will be eliminated for all employees. To protect the lower income segment, here too, for those receiving less than €3000 a month, a flat bonus payment of €1000 a year per employee will be introduced, which will be financed through cutting salary allowances for higher income segments.

Further, minimum pensions and family support instruments will not be cut, and the most vulnerable will be compensated for the possible adverse impact of policies. To explain and forge consensus on policies to overcome the crisis, the government will invite representatives of businesses and labor to sign a social pact for the duration of the program. The spirit of the above considerations is to maintain strong social cohesion, fight poverty, and maintain employment.

A. Fiscal Policies

9. **The Greek government recognizes the need to implement a frontloaded multiyear adjustment effort given Greece's very high and still growing debt ratio and large fiscal deficit**. All the necessary measures to strengthen market confidence and convince creditors that Greece will regain control over the debt dynamics will be taken. A difficulty is that policies to restore external price competitiveness, which in a monetary union have to rely on reductions in domestic costs and prices, will initially weigh on economic activity, government revenue and debt dynamics. Therefore, the effort has to take place in a period of contracting economic activity, naturally slowing revenues, and cyclically high expenditure. However, it is imperative to place fiscal policies, and the economy, on a sound path for future growth. It is clear that the public sector has become too large and costly and has to become smaller, more efficient and agile, and oriented to providing better services to citizens.

10. **The fiscal strategy is anchored in placing the debt-GDP ratio on a declining path from 2013 onward and reducing the general government deficit to well below 3 percent of GDP by 2014**. To avoid reform fatigue and boost market confidence, the government's strategy is strongly to frontload the fiscal adjustment. All the fiscal measures for the remainder of 2010–2012 have been identified, and most of them will be adopted in the coming weeks. Fiscal measures for 2013 have also been identified with some residual gap remaining that will need to be addressed in coming reviews.

11. **A very strong start has already been made leading to a significant reduction in the 2010 first quarter deficit. For the remainder of 2010 additional measures will be implemented beyond those stipulated in the EU Council Decision and Recommendation**

of 16 February 2010 and those announced in March 2010 (Table 1**).** The three biggest upfront measures are an immediate cut in the public sector wage bill, and in pension outlays, and further increases in the VAT and selected excises (together with other steps yielding 2½ percent of GDP in further savings already in 2010). This will assure that the deficit, notwithstanding the recession, drops from an estimated 13.6 percent of GDP in 2009 to 8.1 percent of GDP in 2010. These very large upfront efforts show the government's resolve in responding to the recent deterioration in market sentiment and the large fiscal challenges, and will help overcome the adverse developments on revenue and support payments such as higher unemployment outlays. These large measures come on top of those already undertaken, which include the first installment of lowering the government's wage bill and selected social security benefits (while safeguarding the minima), the substantial reductions in operating expenditures in all ministries, and significant permanent revenue measures and special taxes on highly profitable enterprises and large properties, and on luxury goods. Thus, the government's resolve is unwavering and every effort will be made to distribute the burden equitably.

12. **For 2011 and beyond, further revenue and expenditure measures have been identified to secure fiscal targets**. Together with the full-year effect of the advance measures taken in mid-2010, these will cover the adjustment needs for 2011 projected at 4 percent of GDP. Adjustment measures in 2012 will continue at a pace of 2½ percent of GDP and in 2013 they are projected to be 2 percent of GDP. Given the expected weakness in GDP, the headline deficit in percent of GDP is expected to drop to 7½ percent in 2011, with more significant headline declines in subsequent years when economic growth resumes.

- **Expenditures will be cut by the equivalent of around 7 percent of GDP through 2013.** Since adoption of the euro, Greece has increased its noninterest expenditures by 8 percentage points of GDP, including with public wages, consumption, and social transfers imposing an overly large burden on the state. This needs to be reversed. As a result, wage and entitlement program costs need to be curtailed as they represent the bulk of the primary budget expenditures, and thereafter wages and pensions will be subsequently frozen in nominal terms for the duration of the program. The government has also planned other reductions in government spending, including by replacing over time only 20 percent of retiring employees, and by consolidating municipalities and local councils. It is essential that the burden of the adjustment on the expenditure side be distributed over multiple programs, so even investment spending will need to be rationalized and shifted to more intensive and efficient use of EU structural and cohesion funds, as feasible. Independent reviews will be launched, conducted by internationally renowned experts, of the public administration and of existing social programs to help identify actions to rationalize the organization of public administration and improve targeting of social programs so that resources are channeled to the most vulnerable.

- **Revenues will be increased by the equivalent of around 4 percent of GDP through 2013.** Revenue from higher income segments of society will include a boost in (presumptive) taxation on liberal professions, an increase in luxury goods taxation, and (temporary) surcharges on highly profitable entities and high valued properties as well as other measures to combat tax evasion included in the recently adopted tax reform legislation. Other revenue increases will include broadening the VAT base, increasing rates and raising excise taxes where Greece is below the euro area average and collection efficiency is low. Green taxes and "health" taxes (such as on consumption of alcohol and tobacco) will also play a part in the revenue raising effort.

13. **Besides these direct fiscal steps for the budget, the government also has initiated a series of important structural fiscal reforms**. These will boost sustainability by helping to strengthen control over revenues and expenditures:

- **Pension reform.** The current pension system is unsustainable and will become insolvent if responsible measures are not taken to place it on a sound footing. The government has initiated a reform which should be adopted before end-June 2010. The National Actuarial Authority will produce a report to verify that the parameters of the new system ensure long-term actuarial balance. The existing pension funds will be merged in three funds. The reform will introduce a new system to strengthen the link between contributions and benefits, with uniform rules that will apply pro-rata to all current and future workers. The normal retirement age will be set to 65 years, increasing in line with life expectancy. Benefits will be indexed to prices. The reform will also restrict early retirement, including for those insured before 1993, and reduce the list of heavy and arduous professions. The new system will also include a means-tested social pension for all citizens above the normal retirement age so that an important safety net is provided, consistent with fiscal sustainability.

- **Health sector reform.** The government will implement double-entry accrual accounting in hospitals, the regular publication of audited accounts, and improvements in pricing and costing mechanisms. The government also plans to separate health funds from administration of pensions, merge the funds to simplify the overly fragmented system, and bring all health-related activities under one ministry.

- **Tax reform.** The government has obtained passage of a tax bill that includes important components to make the tax system more efficient and equitable. The income tax system has become more progressive; exemptions and deductions have been reduced to broaden the tax base; and a number of reforms have been introduced to fight tax evasion, including the tightening of obligations to issue receipts for VAT and to document living expenses, and the introduction of presumptive taxation. The government will further review the tax system to simplify it and increase efficiencies as necessary.

- **Tax administration.** Tax administration improvements are being implemented for which technical assistance has already been received from the IMF. In the short run, the government's strategy will focus on safeguarding revenue from the largest taxpayers, stronger enforcement and auditing of high-wealth individuals and self-employed (where risk of evasion is largest) and prosecuting the worst offenders, strengthening enforcement of VAT filing and payment, and collecting on the large stock of tax arrears. For the medium-term, the government will design a program of structural reforms in key tax compliance and administration areas, including: developing and maintaining a comprehensive compliance risk management framework (notably preparing a compliance strategy for 2012); developing taxpayer service capacity to support compliance improvement efforts; substantially improving enforcement operations, particularly in audit, using risk-based approaches; and building headquarters strategic management and planning capabilities in tax and customs administration.

- **Public financial management and fiscal framework.** Technical assistance from the IMF and the European Commission on public financial management and longer-term budgeting reforms will be re-prioritized to address the short-term challenges we are facing. In this context, the General Accounting Office (GAO) will be responsible for monitoring and reporting of general government data; the government will introduce standardized commitment control procedures for all public entities to prevent the re-emergence of arrears; ensure that all budgets are prepared within a medium-term fiscal strategy for the general government and presented before the start of the fiscal year; introduce top-down budgeting with expenditure ceilings, a sufficient contingency reserve, and a medium-term expenditure framework for the State budget; require a supplementary budget for any overruns above this contingency provision; and amend the 1995 budget management law to give effect to the above. The government will continue to work with the technical assistance teams of the IMF and the European Commission to implement the recommendations already received, and to make further improvements over the course of the program, including the creation of an independent fiscal agency attached to parliament.

- **Debt management framework.** The government will update its debt management strategy and the tools to ensure that risk is adequately managed. To enhance market confidence and communication, the government plans to review the operational and risk management framework for debt management to ensure the transparency and predictability of our actions. The government has already sought technical assistance in this area from the IMF.

- **Fiscal and other public sector reporting of information, including statistical aspects.** Upon taking office in October 2009, the new government immediately disclosed that the fiscal deficit for 2008 was under-reported and needed to be revised. Working closely with Eurostat on fiscal data processing and reporting, the government has already taken remedial measures to prevent the reoccurrence of such problems and has designed jointly with the European Commission an action plan to address outstanding statistical issues. Among these, full independence has been granted to the Greek Statistical Office and sufficient resources will be devoted in the coming years to improve statistical systems and seek appropriate resident technical assistance to ensure rapid progress. To that end, the measures in the joint Greek government and European Commission Statistical Action Plan will be fully implemented. Going forward, we feel confident that we are in a position to provide accurate fiscal data to the Fund and our European partners Further, since January 2010, timely monthly central government budget reports on a cash basis have been published. The GAO will also start publishing monthly data on expenditures pending payment, including arrears, from July 2010. Efforts will also be intensified to improve the collection and processing of general government data compiled according to the European System of National and Regional Accounts (ESA) required under the existing EU legal framework, and compile comprehensive data on employment in the general government. Detailed information will be furnished to the European Commission, the ECB and the Fund on the operating accounts and balance sheets of key public enterprises.

14. **The program will be closely monitored and measures will be taken as necessary.** There are risks to the program from lower revenue, higher social transfers, further downward revisions of growth, additional fiscal liabilities from the public and financial sector, and higher interest costs. However, these can be managed and the government stands ready to take appropriate measures to preserve the program objectives, including by reducing discretionary spending, as necessary. At the same time, there is some upside potential. Our 2010–2011 projections include cautious estimates of the measures taken, positive confidence effects could boost GDP growth and reduce market risk premia, and our revenue administration efforts could start to yield more revenue gains than currently assumed in the program. Should confidence rebound and the market support Greece earlier than expected, or the supply response from reforms comes in more vigorously, these benefits will be saved and the intended deficit will be brought forward to achieve a speedier return to fiscal sustainability.

B. Financial Sector Policies

15. **Despite a strong solvency position, at present, the Greek banking system is facing challenges**. The system's equity base was substantially strengthened in 2009, jumping from €24 to €33 billion, including through capital injections from the government, for €3.8 billion, capital increases from the owners, and retained earnings. All banks are in

compliance with the capital adequacy requirement of 8 percent, and the average capital adequacy ratio rose to 11.7 percent at end 2009. However, the fiscal crisis and a weakening economic environment resulted in a reversal in credit growth and an increase in non-performing loans, which reached 7.7 percent at end-2009 while profitability declined and might become negative this year.

16. **The immediate challenge for the banks is to manage carefully the current tight liquidity conditions.** In the general context of the turbulence affecting the debt markets for the Greek government, the Greek banks have lost wholesale market access to fund their operations since end-2009. Maturing interbank liabilities have not been renewed, or only at high costs, and some moderate deposit outflows were noted during the first months of 2010, which has put pressure on the liquidity position of many Greek banks. As a result, the banks have increasingly relied on Eurosystem credit operations. To assist the banks in these difficult times the government has extended the banking assistance package of early 2009 (€28billion of which €11 billion had been used by end-2009)), to provide a substantial €17 billion in additional liquidity and the government is implementing another extension of this support facility subject to approval by decision of the European Commission. Within the existing Euro system framework, national central banks may give support to temporarily illiquid, but solvent institutions. In the event that such support is given by the Bank of Greece, it will be fully guaranteed by the Greek state in a manner that is consistent with relevant ECB and EU requirements.

17. The government and the Bank of Greece are also putting in place a new safety net to preserve the sound level of bank equity, and thus improve conditions to support the real economy. Anticipating that banks profits may decline further, possibly impacting their equity position, the government will establish (by June 30, 2010, as a structural benchmark), through specific legislation and in consultation with the IMF, the European Commission, and the ECB, a fully independent Financial Stability Fund (FSF). The FSF's key decision makers will be persons of recognized standing in financial matters, appointed by the government and the Governor of the Bank of Greece (who will make most of the appointments).

18. **The primary purpose of the FSF is to preserve the financial sector's soundness and thus its capacity to support the Greek economy, by providing equity support to banks as needed.** Whenever supervisory assessments conclude that a bank's capital buffer might fall below adequate levels, the shareholders will be required to immediately bring additional capital or take bridging capital support from the FSF. If banks are then not able to expeditiously raise additional capital on their own and repay the FSF, a restructuring process will take place under the lead of the FSF, in line with EU competition and state aid requirements.

19. **Other elements of the safety net for the financial sector will also be strengthened.** Corporate debt restructuring legislation, and the current proposal for a personal debt

restructuring law, will be in line with international best practices, to ensure that credit discipline is maintained, that creditor and consumer rights are protected, and that relevant information concerning borrowers' track record is preserved.

20. **The Bank of Greece will implement intensified supervision and increase the resources dedicated to banking supervision.** This will include an increase in the frequency and speed of data reporting, and the further development of a comprehensive framework for regularly stress-testing financial institutions. Staffing will be increased both for on-site inspections and off-site review, also taking into account the new responsibilities of the Bank of Greece with respect to insurance supervision. Additional flexibility will be introduced in the management of human resources, and all Bank of Greece staff will be granted strong legal protection for actions performed in good faith.

21. **Close coordination will be maintained with home and host country supervisors within the EU framework for cross-border bank supervision.** In this context, the authorities are fully aware of the significant presence of Greek banks in South Eastern European (SEE) countries; a number of MoUs with the host supervisory authorities (both EU and non-EU) have been signed. Communication with regulators in SEE regarding risk assessments and liquidity contingency plans are also intensifying.

C. Structural Policies

22. **Structural policies are strengthened in order to boost competitiveness and emerge from the crisis quickly**. These will enhance the flexibility and productive capacity of the economy, ensure that wage and price developments restore and then sustain international competitiveness, and progressively alter the economy's structure towards a more investment and export-led growth model. The Greek government will work closely with the European Commission and the ECB to pursue reforms as specified in the MoU attached to this MEFP. In particular:

- **Modernizing public administration.** Fragmented employment practices will be reformed by reorganizing recruitment procedures and finalizing the single payment authority for wages. A simplified remuneration system will be introduced, in a cost-saving manner that will cover basic wages and all allowances which apply to all public sector employees. Procurement practices will be strengthened to generate efficiency gains and ensure transparency. The health care system, where there have been major expenditure overruns, will be overhauled through reforms in management, accounting and financing systems. A reorganization of sub-central government will be implemented to reduce the number of local administrations and elected/appointed officials. The government will collaborate with the EC to launch an independent external functional review of public administration at the central government level. These reforms will help prioritize government activities and, strengthen the fight against waste and corruption throughout the public administration.

- **Strengthening labor markets and income policies.** In line with the lowering of public sector wages, private sector wages need to become more flexible to allow cost moderation for an extended period of time. Following consultation with social partners and within the frame of EU law, the government will reform the legal framework for wage bargaining in the private sector, including by eliminating asymmetry in arbitration. The government will adopt legislation for minimum entry level wages in order to promote employment creation for groups at risk such as the young and long-term unemployed. In parallel, the government will implement the new control system for undeclared work and modernize labor market institutions. Employment protection legislation will be revised, including provisions to extend probationary periods, recalibrate rules governing collective dismissals, and facilitate greater use of part-time work. The scope for improvements in the targeting of social expenditures will be revised in order to enhance the social safety net for the most vulnerable.

- **Improving the business environment and bolstering competitive markets.** The government will shortly adopt legislation establishing one-stop shops for starting new enterprises to cut procedures, costs and delays. Legislation will be introduced to cut licensing and other costs for industry. The government will fully implement key steps of the EU Services Directive in 2010, especially in priority areas such as tourism, education and retail. Over the course of next year, restricted professions will be opened by reducing fixed tariffs and other restrictions in the legal, pharmacy, notary, engineering, architect, road haulage, and auditing professions. The role of the Hellenic Competition Commission (HCC) will also be strengthened. Network industries will be progressively liberalized, especially in the transport and energy sector while strengthening regulators in these sectors in line with EU policies.

- **Managing and divesting state enterprises**. These need to be subject to greater transparency to increase efficiency and reduce losses. As a first step, 2009 financial statements audited by chartered accountants of the ten largest loss makers will be published on the internet. A time table and action plan for improving the financial performance of main loss-makers, most notably in the railway and public transportation companies will be produced. This action plan will include concrete steps to reduce costs, including by streamlining the networks serviced and increasing tariffs. The government will review the role for divesting state assets, including of land owned by public enterprises or the government. The government will further review the scope for improving corporate governance, and enhancing oversight of state-ownership.

- **Improving the absorption of EU structural and cohesion funds.** The government will work closely with the EC to raise the absorption rate of Structural and Cohesion Funds, including by establishing targets for payment claims based on Management Information System (MIS) data every six months to be measured by certified data and a system of "fast track project production" which includes deadlines for each step of the approval and implementation of projects. A minimum of ten major projects per annum will be submitted. Within the overall public investment envelope agreed in this program, a central account will be established to be used for budgetary appropriations for the national co-financing of Structural and Cohesion Funds. A specific Task Force will be established with the Commission to ensure the faster delivery of high-quality projects.

IV. PROGRAM FINANCING

23. **We anticipate covering the program's financing requirements with financial support from euro-area member states and the IMF while strengthening access to the private capital markets**. Notwithstanding the significant fiscal adjustment, we project a public financing gap of around €110 billion, for the program period, which we expect to cover through matching bilateral lending support from euro area member states (€80 billion) and through IMF support (€30 billion). Greece will draw on these resources in parallel throughout the program period, drawing on the bilateral and IMF financing in a ratio of 8 to 3 in each disbursement (measured at the program exchange rate). We are confident that resolute implementation of our economic program will help our economy recover and bolster market sentiment. If fiscal consolidation proceeds faster than expected or if market conditions improve significantly during the program period, we would refrain pari passu from drawing on the full bilateral and IMF support.

V. PROGRAM MONITORING

24. Progress in the implementation of the policies under this program will be monitored through quarterly (and continuous) quantitative performance criteria (PCs) and indicative targets, structural benchmarks, program reviews and consultation clauses. These are detailed in Tables 2 and 3. The attached TMU contains definitions. Quantitative targets up to December 2010 are PCs. Targets for 2011-2013 are indicative and for 2011 will be converted into PCs at the time of the second review before end-2010. A joint EC/ECB MoU specifies, notably, the structural policies recommended in the MEFP, and sets a precise time frame for their implementation.

25. In the context of the arrangement, the Bank of Greece will undergo a safeguards assessment in accordance with the IMF safeguards policy. In this regard, and to facilitate a timely completion of the assessment, the authorities have provided the information requested for the assessment to commence, and have also authorized the external auditors to provide information to and hold discussions with the staff of the IMF. As a related matter, and given that financing from the IMF will be used to provide direct budget support, a memorandum of understanding between the government and the Bank of Greece will establish a clear framework on the modalities for the repayment of IMF financing and the servicing of interest payments and other charges. As part of these arrangements, Fund disbursements will be

deposited into the government’s single treasury account at the Bank of Greece pending their use.

Table 1: Greece: Fiscal Measures included in the Program 1/
(in millions of Euros)

	2010	2011	2012	2013	Cum	% GDP
I. Revenue measures						
VAT rates increase by 10 percent (10% to 11%; 21% to 23%)	800	1,000	0	0	1,800	0.8
Broadening VAT base	0	1,000	500	0	1,500	0.7
Excise tax on fuel	200	250	0	0	450	0.2
Excise tax on cigarettes	200	300	0	0	500	0.2
Excise tax on alcoholic beverages	50	50	0	0	100	0.0
Excise goods on non-alcoholic beverages	0	0	300	0	300	0.1
Excise tax on luxury goods	0	100	0	0	100	0.0
Green taxes	0	300	0	0	300	0.1
Gaming royalties	0	200	400	0	600	0.3
Gaming licenses	0	500	225	-725	0	0.0
Special levy on highly profitable firms	0	600	0	0	600	0.3
Presumptive taxation of professionals	0	400	100	0	500	0.2
Taxation of wage in kind (cars)	0	150	0	0	150	0.1
Book specification of incomes	0	50	0	0	50	0.0
Increase legal value real estate	0	400	200	100	700	0.3
Amnesty land use violations	0	500	0	0	500	0.2
Taxation of unauthorized establishments	0	800	0	0	800	0.3
II. Expenditure measures						
Reduce wage bill by cutting bonuses/allowances	1,100	400	0	0	1,500	0.7
Workforce reduction beyond 5:1 (add. 20,000)	0	0	600	500	1,100	0.5
Savings from introduction of unified public sector wages	0	100	0	0	100	0.0
Eliminate pension bonuses (except for minimum pensions)	1,500	500	0	0	2,000	0.9
Additional pension reduction above a certain threshold	350	150	0	0	500	0.2
Nominal pension freeze	0	100	250	200	550	0.2
Means test unemployment benefit	0	0	500	0	500	0.2
Cancel second installment of solidarity allowance	400	0	0	0	400	0.2
Cut intermediate consumption	700	300	0	0	1,000	0.4
Kalikrates	0	500	500	500	1,500	0.7
Cut in transfers to public enterprises	0	0	1,500	0	1,500	0.7
Cut domestically funded investment spending	500	500	500	0	1,500	0.7
Yet to be quantified yield from structural reform initiatives	0	0	0	4,200	4,200	1.8
Total annual measures	**5,800**	**9,150**	**5,575**	**4,775**	**25,300**	**11.0**
Revenue measures	1,250	6,600	1,725	-625	8,950	3.9
Expenditure measures	4,550	2,550	3,850	5,400	16,350	7.1
Total measures (in percent of GDP)	**2.5**	**4.1**	**2.4**	**2.0**		**11.0**
Revenue measures	0.5	3.0	0.8	-0.3		3.9
Expenditure measures	2.0	1.1	1.7	2.3		7.1
Memorandum item:						
Nominal GDP	231	224	228	235		229

Source: Greece authorities, and IMF staff estimates.
1/ Yield of measures relative to the previous year.

Table 2. Greece: Quantitative Performance Criteria (in billions of euros, unless otherwise indicated)

	Performance Criteria			Indicative Targets					
	Jun-10 Progr. 1/	Sep-10 Progr. 1/	Dec-10 Progr. 1/	Jun-10 Progr. 1/	Sep-10 Progr. 1/	Dec-10 Progr. 1/	Dec-11 Progr. 2/	Dec-12 Progr. 3/	Dec-13 Progr. 4/
1. Floor on the modified general government primary cash balance	-5.0	-4.0	-5.7	..	..	..	-2.1	2.4	7.4
2. Ceiling on State Budget primary spending	34	50	67	..	..	..	67	68	69
3. Ceiling on the accumulation of new domestic arrears by the general government 5/	..	..	..	0	0	0	0	0	0
4. Ceiling on the overall stock of central government debt	342	342	342	..	..	..	365	..	..
5. Ceiling on the new guarantees granted by the central government	2.0	2.0	2.0	..	..	..	1.0	0.0	0.0
6. Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by general government from multilateral or bilateral official creditors 5/	0	0	0	..	..	..	0	0	0

1/ Cumulatively from January 1, 2010 (unless otherwise indicated).
2/ Cumulatively from January 1, 2011 (unless otherwise indicated).
3/ Cumulatively from January 1, 2012 (unless otherwise indicated).
4/Cumulatively from January 1, 2013 (unless otherwise indicated).
5/ Applies on a continuous basis from April 30, 2010 onward.

Greece. Table 3. Greece: Structural Conditionality for 2010 1/

Measures	Date	Macrocritical relevance
	Prior actions	
1. Reduce public wage bill by cutting bonuses/allowances; and pension bonuses (except minimum pensions).		Improves fiscal sustainability; has signaling effect for private sector wage setting.
2. Increase standard VAT rate from 21 to 23 percent and reduced rate from 10 to 11 percent and excise tax rates on alcohol, tobacco, and fuel with a yield of at least €1.25 billion in the remainder of 2010.		Improves fiscal sustainability.
3. Appoint staff team and leader in GAO responsible for general government in-year cash reporting.		Establishes in-year oversight responsibilities of general government fiscal policy.
Structural benchmarks	**End-June 2010**	
1. Establish the independent Financial Stability Fund (FSF) to preserve the financial sector's soundness and thus its capacity to support the Greek economy by providing equity support to banks as needed.		Enhances financial stability.
2. Adopt and start to implement a reorganization of sub-central government with the aim to reduce the number of local administrations and elected/appointed officials (Kalikrates).		Improves fiscal sustainability.
3. Submit to parliament amendments to Law 2362/1995 to (i) require the MoF to present a three-year fiscal and budget strategy, (ii) introduce top-down budgeting with expenditure ceilings for the State budget and multi-year expenditure estimates by line ministry, (iii) introduce standard contingency margins, (iv) require a supplementary budget for any overspending above the contingency, (v) and introduce commitment controls. The amended law should be immediately effective, including in the context of the 2011 budget.		Improves credibility of the budget and fiscal consolidation program.
4. The National Actuarial Authority to produce a report to assess whether the parameters of the new system significantly strengthen long-term actuarial balance.		Reduces budgetary costs of ageing and improves long-term fiscal sustainability. Increases labor force participation.
	End-September 2010	
1. Adopt a comprehensive pension reform that reduces the projected increase in public spending on pensions over the period 2010-60 to 2½ percent of GDP.		Improves fiscal sustainability.
2. Establish a commitment register in all line ministries and public law entities. Begin publishing monthly data on general government in-year fiscal developments (including arrears).		Reduces budget overruns.
3. Publish 2009 financial statements of the ten largest loss-making public enterprises, audited by chartered accountants, on the official website of the Ministry of Finance.		Increases transparency of fiscal risks to fiscal sustainability.
4. Put in place an effective project management arrangement (including tight MOF oversight and five specialist taskforces) to implement the anti-evasion plan to restore tax discipline through: strengthened collection enforcement and recovery of tax arrears—coordinated with the social security funds—of the largest debtors; a reorganized large taxpayer unit focused on the compliance of the largest revenue contributors; a strong audit program to defeat pervasive evasion by high-wealth individuals and high income self-employed, including prosecution of the worst offenders; and a strengthened filing and payment control program.		Achieves revenue targets and enhances sustainability of the consolidation by increasing burden sharing of the adjustment.
	End-December 2010	
1. Publish a detailed report by the ministry of finance in cooperation with the single payment authority on the structure and levels of compensation and the volume and dynamics of employment in the general government.		Reduces wage escalation. Improves transparency of public sector employment.
2. Adopt new Regulation of Statistical Obligations for the agencies participating in the Greek Statistical System.		Enhance confidence in fiscal reporting and support the formulation of fiscal policy.
3. Prepare a privatization plan for the divestment of state assets and enterprises with the aim to raise at least 1 billion euro a year during the period 2011-2013.		Reduces state intervention in the real economy; improves market efficiency; and cuts fiscal contingencies.

1/ Structural benchmarks for 2011 will be determined in the reviews for end-September and end-December 2010.

GREECE: TECHNICAL MEMORANDUM OF UNDERSTANDING

May 3, 2010

1. This Technical Memorandum of Understanding (TMU) sets out the understandings regarding the definitions of the indicators subject to quantitative targets (performance criteria and indicative targets), specified in the Letter of Intent (LOI). It also describes the methods to be used in assessing the program performance and the information requirements to ensure adequate monitoring of the targets. We will consult with the Fund, European Commission and ECB before modifying measures contained in this letter, or adopting new measures that would deviate from the goals of the program, and provide the European Commission, ECB and the Fund with the necessary information for program monitoring.

2. For program purposes, all foreign currency-related assets, liabilities, and flows will be evaluated at "program exchange rates" as defined below, with the exception of the items affecting government fiscal balances, which will be measured at current exchange rates. The program exchange rates are those that prevailed on April 30, 2010. In particular, the exchange rates for the purposes of the program are set €1 = 1.3315 U.S. dollar, €1 = 125.81 Japanese yen, €1.135 = 1 SDR.

General Government

3. **Definition**: For the purposes of the program, the general government includes**:**

- The entities covered under the State Budget as defined in Chapter 2 of the Law 2362/1995 regarding "Public Accounting, Auditing of Government Expenditures and Other Regulations."

- Local authorities comprising municipalities, prefectures, and regional governments including their basic and special budgets, including all agencies and institutions attached thereto, which are classified as part of local authorities according to ESA 95.

- Social security funds comprising all funds that are established as social security funds in the registry of the National Statistical Service.

- This definition of general government also includes any new funds, or other special budgetary and extra budgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's *Manual on Government Finance Statistics 2001*. The authorities will inform IMF, European Commission and ECB staff of the creation of any such new funds or programs immediately.

4. **Supporting material:** The Ministry of Finance (MoF) will provide to the European Commission, ECB and IMF detailed information on monthly revenues and expenditures, domestic and foreign debt redemptions, new domestic and foreign debt issuance, change in

the domestic and foreign cash balances of the central government at the central bank of Greece, all other sources of financing including capital transactions, and arrears of the general government. Data will be provided within 30 days. The Bank of Greece will provide detailed monthly data on assets and liabilities of local authorities and social security funds in line with monetary survey data.

I. Quantitative Performance Criteria, Indicative Ceilings, and Continuous Performance Criteria: Definitions and Reporting Standards

A. Floor of the Modified General Government Primary Cash Balance (Performance Criterion)

5. **Definition**: The modified general government primary cash balance (MGGPCB) is defined as the modified general government cash balance (MGGCB) minus interest payments by the state budget. The MGGCB is defined as the sum of the cash balances of the ordinary state budget, the cash balance of the investment state budget, the change in net financial assets of local authorities and the change in net financial assets of social security funds. Privatization receipts will be excluded from cash receipts. Net lending operations by the state budget will be recorded as cash expenditures.

- **The cash balance of the ordinary state budget.** The cash balance of the ordinary state budget will be measured from above the line, based on ordinary budget revenues (recurrent revenue plus non-recurrent revenue minus tax refunds) minus ordinary budget expenditures (ordinary budget expenditures will exclude amortization payments and capital transfers to social security funds by bonds but include salaries and pensions; grants to social security funds, medical care and social protection; operational and other expenditure; returned resources; payments in exchange of claims of insurance fund for the personnel working in the Public Electricity Company; interest payments; payments for military equipment procurement; and NATO expenses) of the ordinary state budget as published monthly on the official website of the General Accounting Office of the Ministry of Finance, and in line with the corresponding line items established in the ordinary state budget.

- **The cash balance of the investment state budget.** The cash balance of the investment state budget will be measured from above the line, based on investment budget revenues minus investment budget expenditures of the investment state budget as published monthly on the official website of the General Accounting Office of the Ministry of Finance, and in line with the corresponding line items established in the investment state budget.

- **Net financial assets of local authorities** are defined as financial assets minus financial liabilities of local authorities. Financial assets include deposits of local authorities in the Bank of Greece and deposits of local authorities in the commercial domestic banking sector. Deposits will be measured at face value excluding accrued interest in line with recording for monetary survey data. Financial liabilities include short and long term loans from the domestic banking system to local authorities, measured at face value, consistent with recording for monetary survey data.

- **Net financial assets of social security funds** are defined as financial assets minus financial liabilities of social security funds.

    - Financial assets include

        - Deposits of social security funds in the Bank of Greece and direct deposits of social security funds in the domestic commercial banking system and indirect deposits held by the IKA mutual fund. Deposits are measured at face value excluding accrued interest, consistent with reporting requirements for monetary survey data.

        - Holdings of direct shares or indirect shares (through the IKA mutual fund), held by social security funds quoted on the Athens Stock Exchange. Holdings of shares will be measured at the end-of-month market value.

        - Direct or indirect holdings of Mutual Fund units issued by Greek management companies (other than the IKA mutual fund). Holdings of holdings will be measured at the end-of-month market value.

        - Holdings of central government bonds, including short and long-term securities issued domestically, long-term securities issued abroad operated from Bank of Greece accounts, and indirect holdings through the IKA mutual fund. Holdings will be measured at nominal value.

    - Financial liabilities include the short and long term loans from the domestic banking system to the social security funds, measured consistently with monetary survey data.

6. **Adjustments.** For the purpose of the program, the primary expenditure of the central government that is monitored excludes payments related to bank support, when carried out under the program's banking sector support and restructuring strategy. Costs that may be excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchases of troubled assets. However, any financial operation by central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff. Further, this performance criterion will be adjusted upward for any possible revenue overperformance in the central government against the current projection as indicated below:

7. Central government revenue (Cumulative from January 1, 2010)

8. June 2010: €25,056 million

9. September 2010: €41,232 million

10. December 2010: €58,382 million.

11. **Supporting material**.

- Data on cash balances of the ordinary and state budgets will be provided to the European Commission, ECB and IMF by the General Accounting Office in the Ministry of Finance within three weeks after the end of the month. Data will include detailed information on revenue and expenditure items, in line with monthly reports that are published since January 2010 on the official website of the Ministry of Finance.

- Data on net financial assets of local authorities and social security funds will be provided to the IMF, European Commission and ECB by the Statistics Department of the Bank of Greece within four weeks after the end of the month.

B. Ceiling of State Budget Primary Spending (Performance Criterion)

12. **Definition**: The state budget primary spending consists of state budget spending (spending of the ordinary state budget plus spending of the investment budget) minus interest expenditures paid by the state budget, in line with the definitions provided above. Primary expenditure of the central government that is monitored for the PC excludes any cash payments related to bank restructuring, when carried out under the program's banking sector restructuring strategy. Costs that may be excluded from the balance include loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by central or general government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to European Commission, ECB and IMF staff.

13. **Supporting material**. The General Accounting Office of the Ministry of Finance will provide data on monthly expenditure data of the ordinary state budget, as defined above.

C. Non-accumulation of Domestic Arrears by the General Government (Continuous Indicative Target)

14. **Definition**. For the purpose of the program, domestic arrears are defined as accounts payable to domestic suppliers past due date by 90 days. Data will be provided within four

weeks after the end of the month. The stock of arrears as of end-April stood at 5.6 billion euro.

15. **Supporting material.** The General Accounting Office of the Ministry of Finance will provide data on monthly expenditure arrears of the ordinary state budget, as defined above. Data will be provided within four weeks after the end of the month.

D. Ceiling on the Overall Stock of Central Government Debt (Indicative Target)

16. **Definition**. The overall stock of central government debt will refer to debt that corresponds to the activities of the state budget and will be defined for the purposes of the program as the total outstanding gross debt liabilities of the central government. It will include, but not be limited to, liabilities in the form of securities and loans. The program exchange rate will apply to all non-euro denominated debt. For the purposes of the program, the ceiling on the stock of central government debt will exclude debt arising from payments for bank restructuring, when carried out under the program's banking sector restructuring strategy. This includes loans to financial institutions and investments in equity of financial institutions (requited recapitalization); unrequited recapitalization; and purchase of troubled assets. However, any financial operation by the central government to support banks, including the issuance of guarantees or provision of liquidity, will be immediately reported to IMF, European Commission and ECB staff.

17. **Adjusters**. The ceiling on the overall stock of central government debt will be adjusted upward (downward) by the amount of any upward (downward) revision to the stock of end-December 2009 central government debt.

18. **Supporting material**. Data on the total stock of central government debt will be provided to the European Commission, ECB and IMF staff by the General Accounting Office consistent with the debt published in the public debt bulletin no later than 30 days after the end of each month**.**

E. Ceiling on New Central Government Guarantees (Performance Criterion)

19. **Definition**. The ceiling on the new central government guarantees shall exclude guarantees to support banks and exclude guarantees related to EIB financed loans.

20. **Supporting material**. All new central government guarantees, excluding from public banks, will be reported in detail, identifying amounts and beneficiaries. The General Accounting Office will provide the data on a monthly basis within three weeks after the end of each month.

F. Non-accumulation of External Debt Payments Arrears by the General Government (Continuous Performance Criteria)

21. **Definition**. For the purposes of the program, an external debt payment arrear will be defined as a payment by the central government, which has not been made within seven days after falling due. The performance criterion will apply on a continuous basis throughout the program period.

22. **Supporting material**. The stock of external arrears of the general government system will be provided by the General Accounting Office with a lag of not more than seven days after the test date.

G. Overall Monitoring and Reporting Requirements

23. Performance under the program will be monitored from data supplied to the EC, ECB and IMF by the Ministry of Finance, the General Accounting Office, and Bank of Greece. The authorities will transmit promptly to the IMF, EC and ECB staff any data revisions in a timely manner.

H. Monitoring of Structural Benchmarks

24. **Pension reform**. The government has initiated a pension reform which should be adopted by the end of September 2010. In preparing this reform, the authorities will consult with EC/IMF/ECB experts and the National Actuarial Authority will produce a report to assess whether the parameters of the new system significantly strengthen long-term actuarial balance. The draft law for the new and actuarially-balanced system should be available by the end of June, 2010.

25. **Expectations for the Pension Reform**. The reform will:

- Merge pension funds in three funds by 2018.

- Introduce a new system to strengthen the link between contributions and benefits, with uniform rules that will apply pro-rata (as a sum of the accrued rights under the old system and the benefits accrued under the new system) to all current and future workers. Workers retiring in and after 2015 will collect benefits from this system.

- Set the normal retirement to age 65 across all systems, including for those insured before 1993 and women in the public sector, by 2015. After 2020, the normal retirement age will increase in line with life expectancy.

- Restrict early retirement to age 60 by 2011, including for those insured before 1993, workers in heavy and arduous professions, and those with 35 or more years of contributions.

- Index benefits to changes in the consumer price index, starting in 2014 (benefits will be frozen 2010–2013).

- Include a means-tested pension for all citizens older than the normal retirement age so that an important safety net is provided, consistent with fiscal sustainability.

- Lengthens the years over which the pensionable earnings base is calculated from the top 5 out of the last 10 years of earnings to lifetime earnings.

- Review conditions for disability pensions by the end of March of 2011 and introduce stricter conditions for eligibility by December of 2011, including periodic re-examination of those with disability pensions.