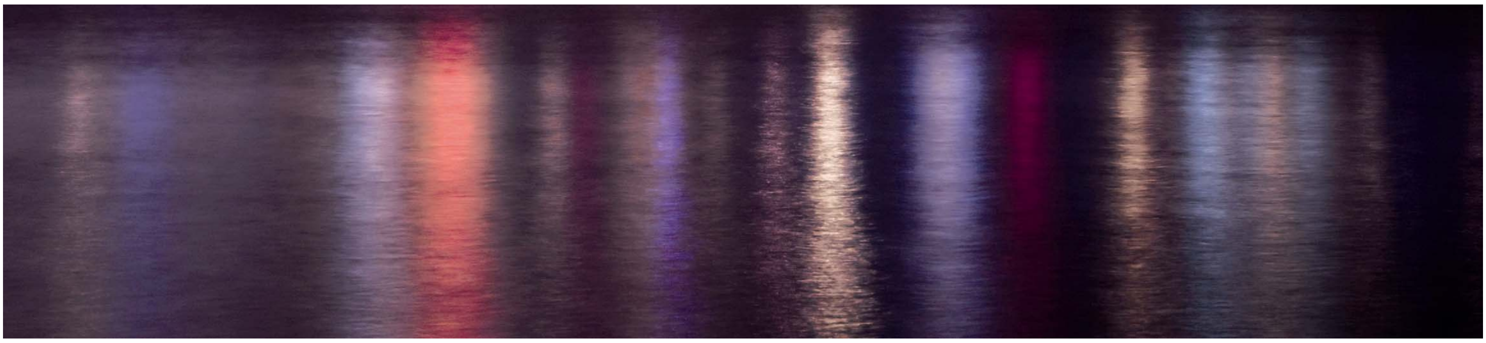
OECD Economic Surveys
GREECE

AUGUST 2011

OVERVIEW



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Summary

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

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

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

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

- **Continue deficit reduction to halt and then reverse the rise in public debt**. Strengthening tax collection is urgent.
- **Boost privatisation and the development of public assets** to reduce the debt burden and associated debt-servicing costs, while stimulating growth.
- **Reinforce structural reforms in the labour and products markets** to enhance competitiveness and raise welfare and incomes. This is desirable in its own right, but higher growth will also be instrumental in turning around the public debt.
- **Ensure fair sharing of the burden and the benefits of reforms.** A firm stance is needed against vested interests trying to protect their rents, and tax evasion needs to be visibly and decisively attacked.
- **Enhance monitoring of the progress of reform and improve statistical tools.** Policy makers need high-quality economic data and adequate and accurate information on the implementation of measures to assess the reform process, and to convince international observers and the Greek people that reforms are paying dividends.

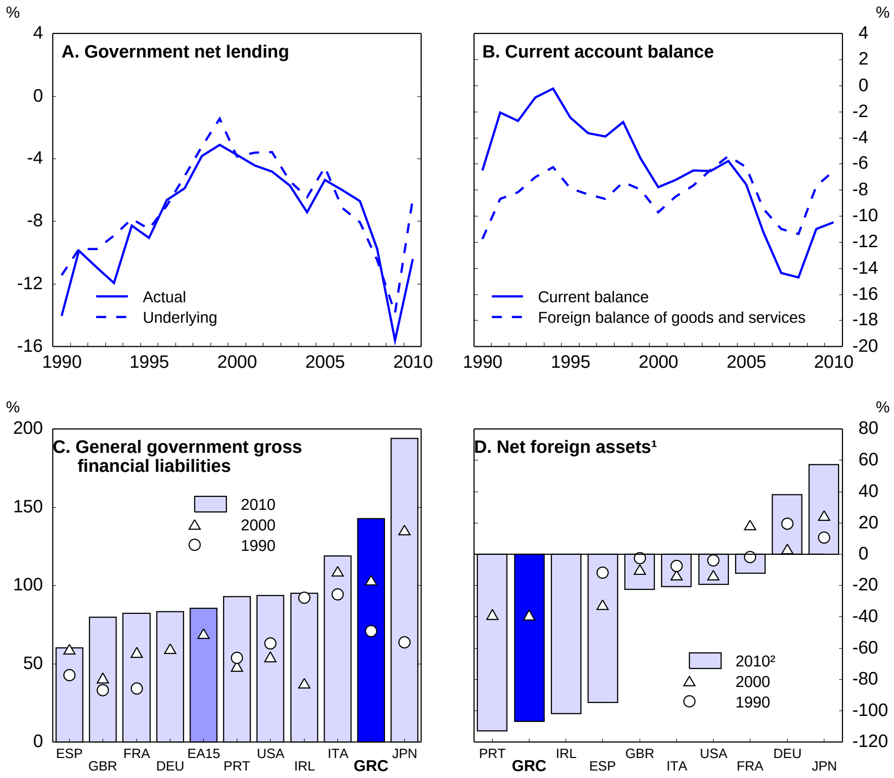
Assessment and recommendations

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

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

Figure 1. Public and external imbalances

% of GDP



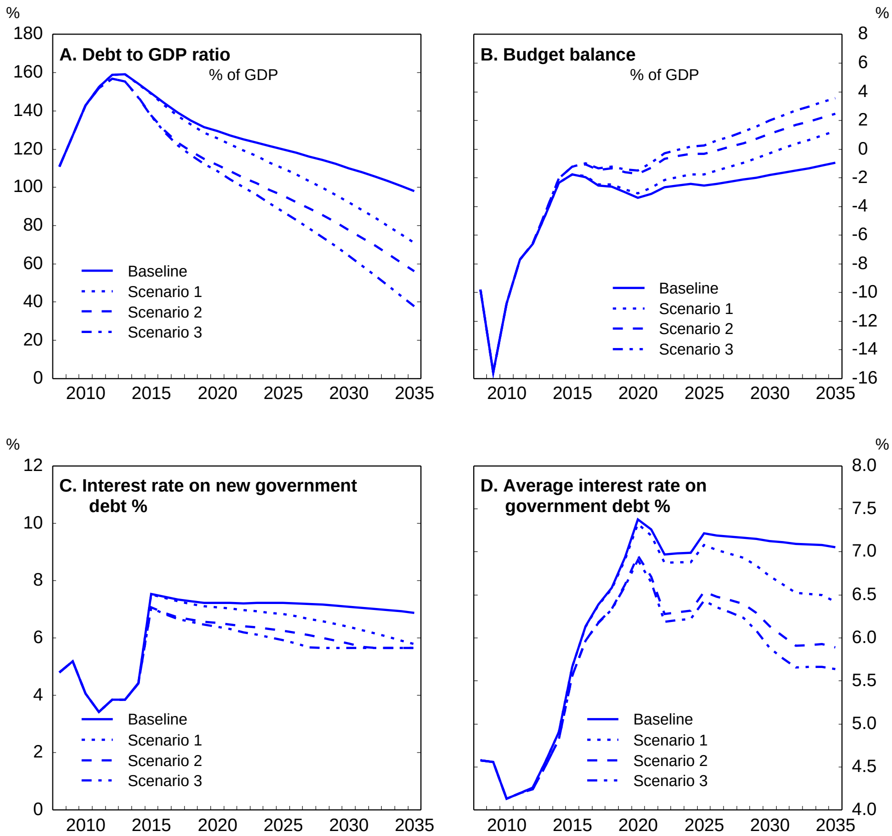
1. Total assets minus total liabilities.
2. 2009 for ITA, FRA, PRT, IRL, USA.

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

2. In this context, the economic programme supported by the Troika since May 2010 envisaged a sizable fiscal consolidation, cuts in real wages which had been growing at unsustainable rates, pension reductions, and fundamental structural reforms in the public sector and in product and labour markets.

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

Figure 2. Long-term debt sustainability: alternative scenarios[1]



1. Baseline: Long-term potential growth 1.7%. Privatisation and asset development proceeds €15 billion between 2011 and 2017.
   Scenario 1: Long-term potential growth 2.5%. Privatisation and asset development proceeds assumed at €15 billion between 2011 and 2017.
   Scenario 2: Long-term potential growth 1.7%. Privatisation and asset development proceeds €50 billion between 2011 and 2017.
   Scenario 3: Long-term potential growth 2.5%. Privatisation and asset development proceeds €50 billion between 2011 and 2017.

Source: OECD calculations.

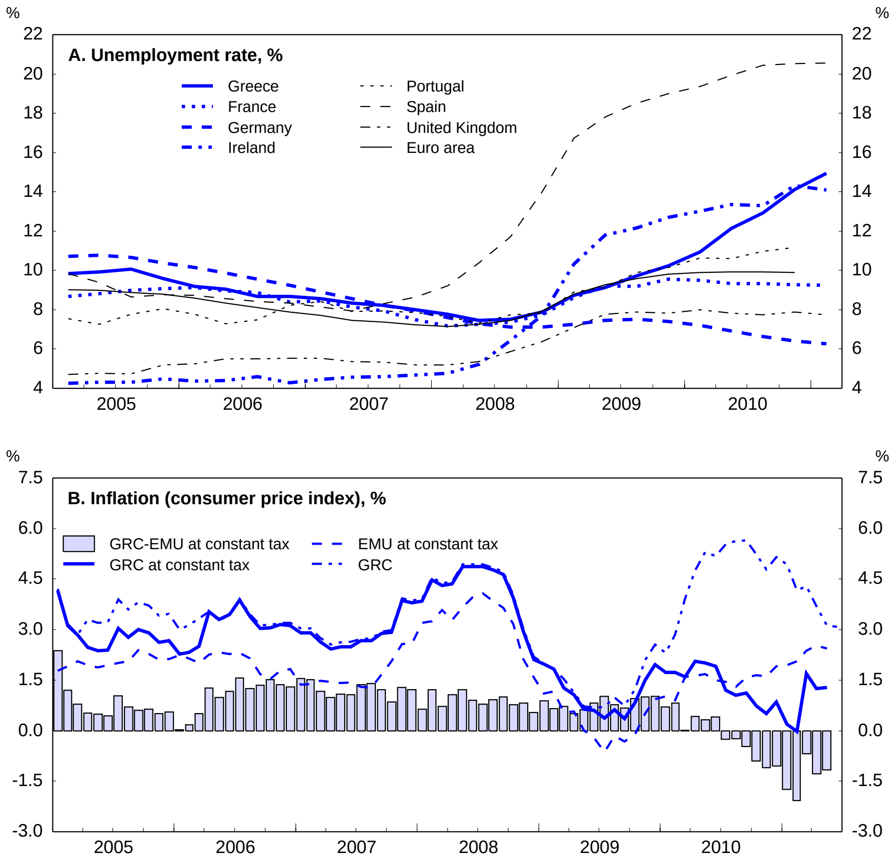
3. This long overdue reform programme will have long-term benefits despite short term costs. As repeatedly mentioned in past *Surveys*, Greece needs to modernise its economy by adopting structural reforms that move its public sector and labour and product markets closer to international best practice.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

So far implementation has been impressive, if less than perfect

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

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

Figure 3. Unemployment and inflation



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

Greece needs to convince markets that it can deliver on reforms

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

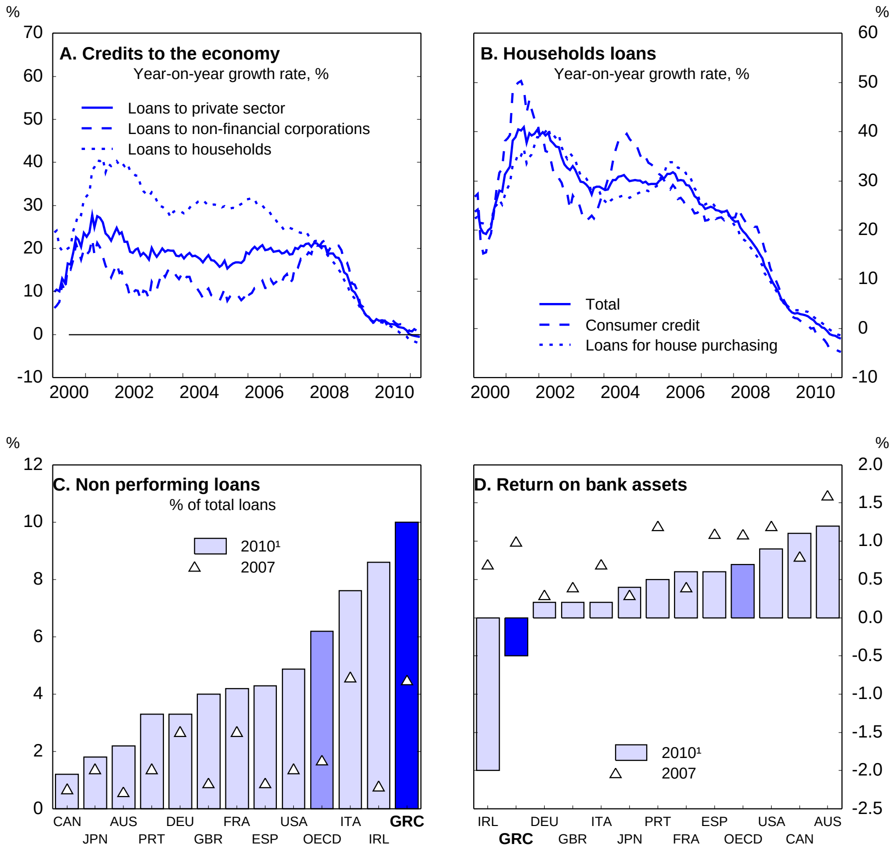
7. On 21 July 2011, European leaders agreed a new financial support package for Greece. The key provisions include reduced interest burdens, a meaningful extension of maturities, some private-sector involvement, protection of Greek banks and measures to foster economic growth in Greece. Initial analysis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

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

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

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

Figure 4. Credit growth and non performing loans

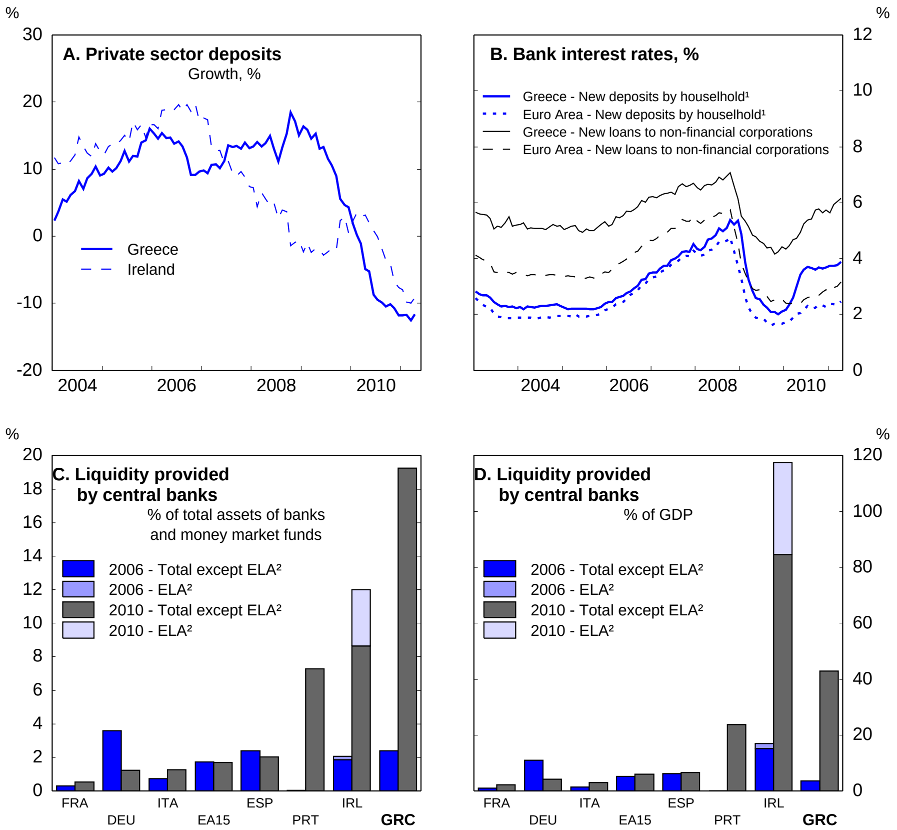


1. Or last available value.

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

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

Figure 5. Deposits, interest rates and liquidity provided by the ECB



1. Deposits with an agreed maturity of up to one year.
2. ELA is an estimate of Emergency Liquidity Assistances, based on publicly available balance-sheet statistics.

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

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

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

12. Structural fiscal reforms are needed going forward, including the ambitious planned privatisation and real estate asset developments. Privatisation and better management of public properties would both reduce government financing needs and generate broader economic gains as private managers take over from what has proved to be an inefficient regime of public management. Although estimates are subject to significant uncertainties, the market value of government-owned properties is likely to significantly exceed the current privatisation programme. The plans to better exploit these potentially vast public assets and boost privatisation to secure some €50 billion (22% of GDP) by 2015, are welcome. To meet this ambitious target, the authorities have recently taken initiatives to address the long-standing deficiencies in the management of public real estate, a large fraction of

which is illegally occupied. They have also decided to establish a National Wealth Fund to ensure smooth and transparent management of privatisation. *The new general secretariat for public property should be given clear and quantifiable objectives with adequate technical and human resources to quickly prepare a reliable inventory of public properties, to deal with their illegal occupation, and to select assets to be developed.* Rapid results on this front could play an important role in improving market perceptions of the country's commitment and ability to address its fiscal difficulties in a decisive way. The new impetus given to the privatisation programme in June 2011 to accelerate its implementation and strengthen the government's medium-term fiscal strategy is thus commendable. According to OECD calculations, raising 22% of GDP by 2015 through privatisation and enhanced public properties management, could lower the debt/GDP ratio by about 40 percentage points by 2035 relative to the baseline scenario due to the reduction of the cost of debt service associated with the declining debt/GDP ratio.

Improved budget monitoring and a better fiscal framework are being implemented

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

Tax evasion should be tackled decisively

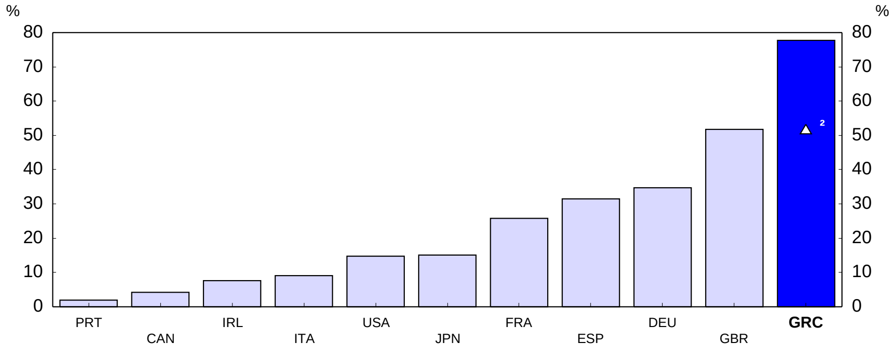
14. The significant fiscal adjustment required will not be achieved without a hefty increase in tax revenues, which will in turn demand meaningful progress in tax collection efficiency. This problem is more serious than in much of the OECD because of the large underground economy and widespread tax evasion.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

15. These developments are critical, but it is hard to tell if they will be sufficient to resolve the country's tax management issues. So far, progress in tax collection has not been satisfactory due to both the deeper than expected recession and tax collection system weaknesses. Given the urgency of making headway on this front, *the authorities should consider taking additional steps, such as developing and publishing indicators for tracking the effectiveness of tax measures taken. Indicators developed and published on a local basis could also encourage emulation among tax offices and urge them on to greater effort, if bonuses were bestowed on best-performing agencies.* To increase the visibility of efforts and progress made against tax evasion, "naming and shaming" tax evaders within the law can play a crucial role. *The thresholds for naming evaders (€150 000) could be lowered and made systematic rather than*

discretionary, as seems currently to be preferred. But ultimately, such efforts will have to be backed up by visible and successful prosecution of tax evaders, and the enforcement of meaningful penalties. *The scope and use of tax compliance certificates to access certain services should also be widened.* Successive governments have relied on tax amnesties to attempt to clear tax arrears, most recently in 2010. *Tax amnesties should be discontinued, once and for all, as they discourage tax compliance.* The collection of taxes and social security contributions are now done by different agencies, which reduces the possibility of crosschecking and verification. *These functions should be combined.* The tax system is still complicated, and there is considerable scope for simplification and base broadening. *The number of VAT rates should be cut, tax expenditures reduced or abolished, and legitimate social goals met by targeted direct subsidies, not by tax breaks. The tax-free-threshold on personal income tax could be lowered more than currently envisaged to enlarge the tax base.*

Figure 6. Personal income tax: tax free threeshold[1]

%, 2008



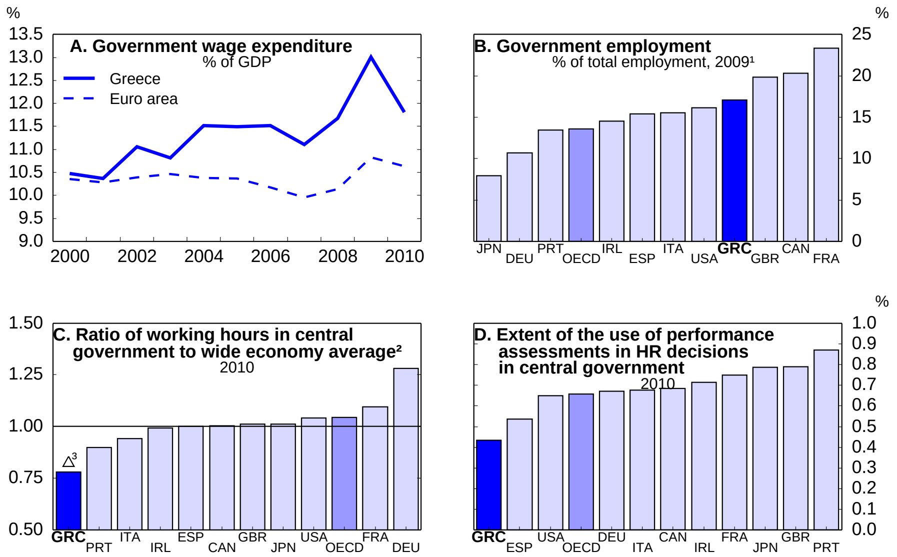
1. Measured as a proportion of household disposable income plus personal income taxes per capita.
2. Impact of reduction of the tax-free threshold from €12 000 to €8 000 planned by the medium-term fiscal strategy.

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

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

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

Figure 7. Employment and remuneration in the government sector



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

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

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

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

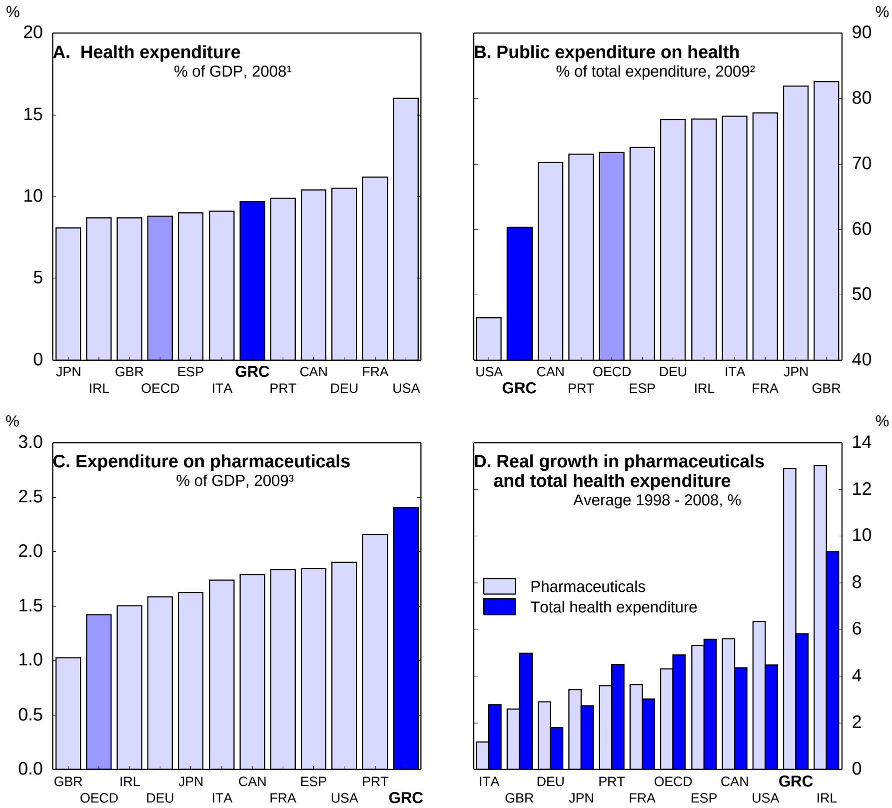
18. EC and ILO long-term projections, carried out in 2008, pointed to a rise of about 12 percentage points of GDP in pension outlays by 2050. The 2010 reform greatly simplified the pension system, and brought its generosity in line with that of most other OECD systems. Conditions for early retirement have been tightened and, as from 2021, the statutory retirement age (65 years) and minimum retirement age (60 years) will be indexed to life expectancy. According to initial actuarial estimates, pension spending is not expected to increase as a share of GDP between now and 2060. Moreover, the authorities are committed to taking any necessary measures to cut pension spending further if the increase exceeds

2½ per cent of GDP. The stronger incentives for seniors to participate in the labour market should also have a positive impact on medium-term growth. *It is important, however, to proceed with the reform of supplementary pension funds and to strictly limit the list of strenuous occupations in order to reduce the number of people eligible for early retirement under preferential conditions.*

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

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

Figure 8. Selected indicators of health expenditure



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

Source: OECD, Health data 2010.

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

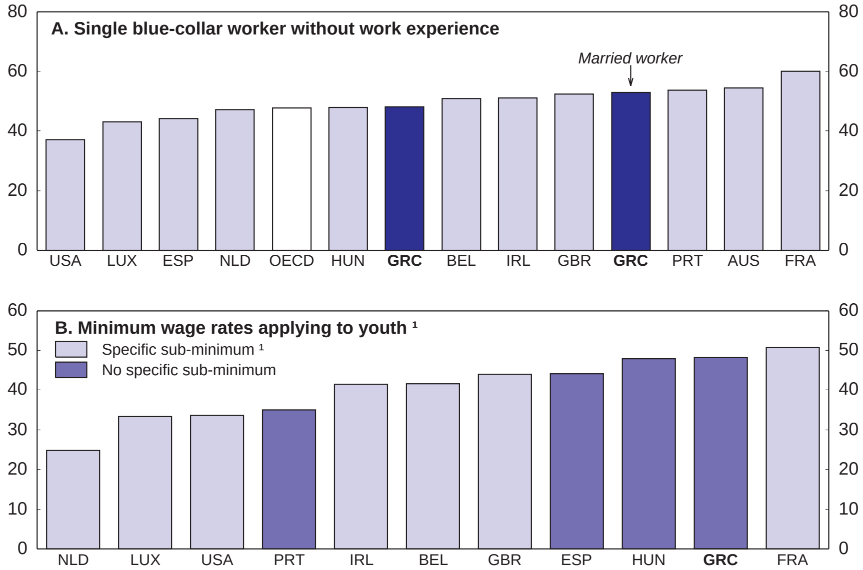
20. Given the large informal sector, the low labour participation rate, the high level of structural unemployment, and one of the most regulated business environments in Europe, the potential for boosting growth is substantial in Greece. The recession hit employment and wages severely and aggravated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

Reforms to improve labour market outcomes should be implemented rigorously

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

Figure 9. Minimum wages

Per cent of median wage, 2009



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

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

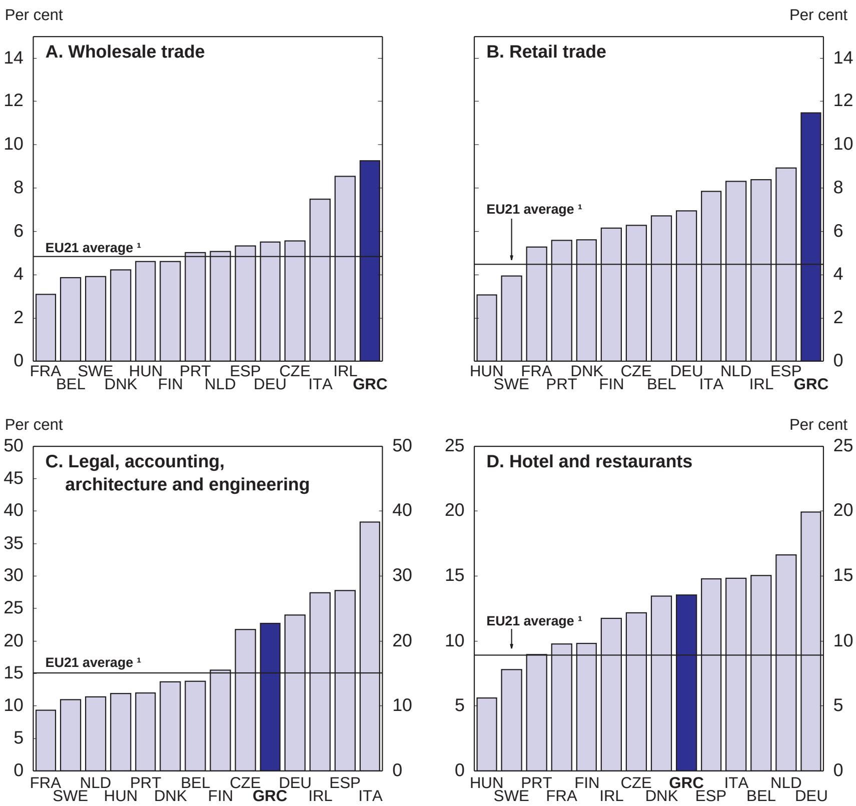
22. Temporary employment remains subject to various restrictions in Greece. In a positive move, the maximum cumulative duration of successive fixed-term contracts is set to increase. *Additional initiatives to ease employment protection for temporary work are needed, however, by promoting fixed-term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

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

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

Figure 10. Mark-ups are relatively high

Gross operating surplus/Turnover: average 2003-2007



1. EU-21 are EU member countries also members of the OECD: Austria, Belgium, Czech Republic, Denmark, Estonia, France, Finland, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden and United Kingdom.

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

The new competition law should strengthen enforcement

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

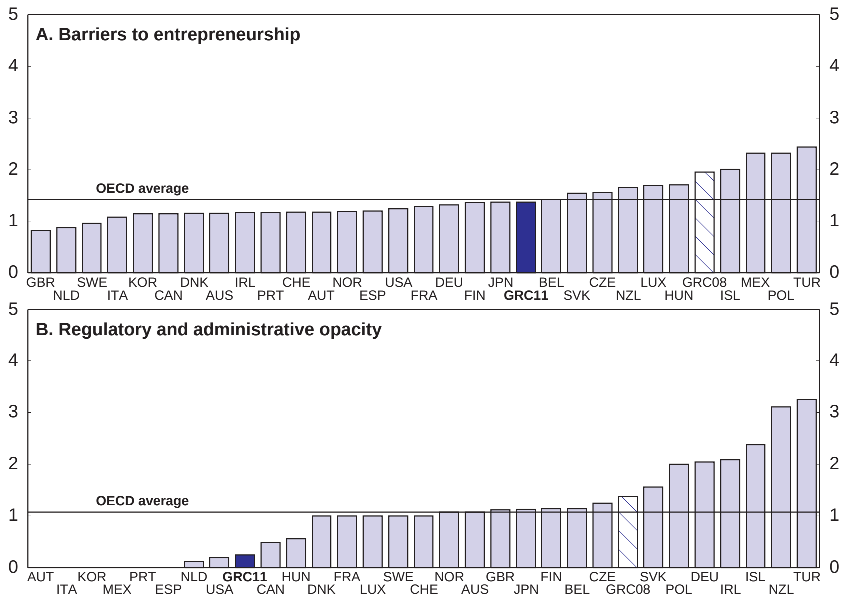
Progress in improving the business environment should continue

25. Despite measures taken over recent years to improve the business environment, cumbersome business regulations have blunted entrepreneurship, job creation and investment. *The Action Plan for a Business-Friendly Greece, which aims to reduce remaining restrictions to business activity, should be implemented swiftly.* Recent reforms to remove restrictions to business are welcome. These include the

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

Figure 11. Regulatory barriers to entrepreneurship have eased[1]

Index scale of 0-6 from least to most restrictive



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

Source: OECD, database on Product Market Regulation.

Export and investment frameworks are being revamped

26. Past investment incentives which subsidised projects had a limited impact on growth. They were marred by heavy bureaucracy and managerial opacity, poor targeting and a lack of evaluation of results. Investments often ended up in low-productivity segments of expanding sectors (such as tourism, wholesale and retail trade and other services). The new framework targets growth-enhancing investments, sets a clear time schedule for the evaluation and approval of projects, and requires better evaluation of projects and their outcomes. The law offers tax incentives equivalent to about 1% of GDP and financial support for around 0.4% of GDP. New financial engineering tools to support SMEs have been established, while fast-track procedures to accelerate the approval and implementation of strategic investments, particularly FDI, were introduced in late 2010. *The impact of the new framework should be monitored systematically, as envisaged, in terms of allocation of resources, value added of the supported projects, and employment creation. The potential budgetary costs of the fiscal incentives should conform to the fiscal consolidation strategy. It is also important to follow closely, with comprehensive indicators, the implementation and effectiveness of the fast-track procedures. Over time investments*

are best promoted by a good overall business environment. Recent achievements towards a swifter absorption of the EU structural and cohesion funds are welcome and should continue. This is critical in order for Greece to make the most of the easier access to EU funds agreed under the 21 July package, which also includes exceptional technical assistance to boost investment and growth.

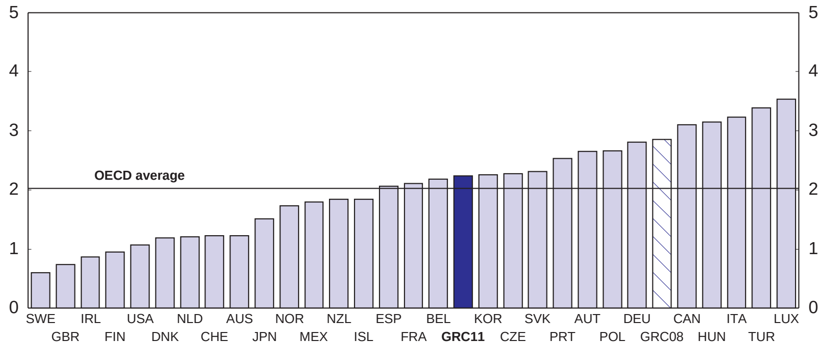
27. *Vigorous implementation of the export strategy is important. The swift approval of the draft law to remove bureaucratic burdens for exporters, which are presently high by OECD standards, is also essential.* Setting the necessary conditions for tourism to adapt to changing patterns of international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

A wide-ranging reform has opened many closed professions

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

Figure 12. Professional services have been deregulated[1]

Index scale of 0-6 from least to most restrictive



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

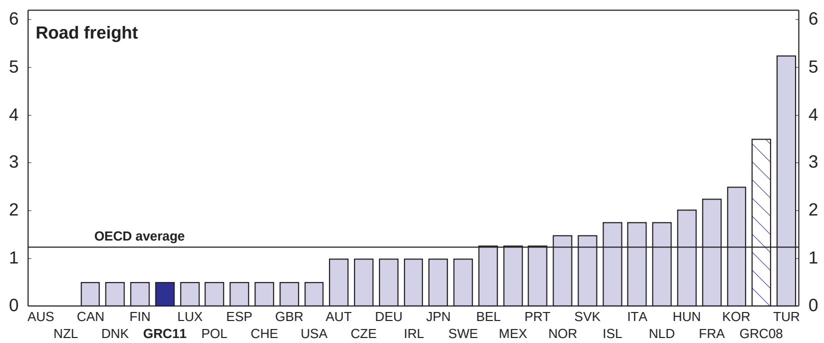
Source: OECD, database on Product Market Regulation.

The liberalisation of network industries has progressed

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

Figure 13. Regulations in transport were eased[1]

Index scale of 0-6 from least to most restrictive



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

Source: OECD, database on Product Market Regulation.

Chapter summaries

Chapter 1. Restoring fiscal sustainability and promoting sound and solid growth

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

Chapter 2. Sustainability cannot be achieved without structural fiscal reforms

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

Chapter 3. Structural reforms to support growth

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

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

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

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

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Further information

For further information regarding this overview, please contact:

Piritta Sorsa, e-mail: piritta.sorsa@oecd.org; tel.: +33 1 45 24 82 99; or
Claude Giorno, e-mail: claude.giorno@oecd.org; tel.: +33 1 45 24 91 11; or
Vivian Koutsogeorgopoulou,
e-mail: vivian.koutsogeorgopoulou@oecd.org; tel.: +33 1 45 24 80 92 .

See also *http://www.oecd.org/eco/surveys/Greece*.

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