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Greece: 2001 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Greece

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2001 Article IV consultation with Greece, the following documents have been released and are included in this package:

- the staff report for the 2001 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **November 19, 2001,** with the officials of Greece on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on January 31, 2002.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF;

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its February 22, 2002 discussion** of the staff report that concluded the Article IV consultation;

- a statement by the Executive Director for Greece.

The document(s) listed below have been or will be separately released.

Selected Issue—An Overview of Pension Reform;
Selected Euro-Area Countries—The Determinants of Growth—
The Experience in the Southern European Economies of Greece and Portugal;
Update to the Report on the Observance of Standards and Codes.

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

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GREECE

Staff Report for the 2001 Article IV Consultation

Prepared by the Staff Representatives for the 2001 Consultation with Greece

Approved by Alessandro Leipold and G. Russell Kincaid

January 31, 2002

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I. INTRODUCTION AND KEY ISSUES

1. At the conclusion of the last consultation on February 23, 2001, Directors commended the Greek authorities for impressive economic gains achieved in recent years. They also stressed that euro-area entry added urgency to addressing the remaining formidable economic challenges (http://www.imf.org/external/np/sec/pn/2001/pn0125.htm). These considerations—against the background of a weaker world economic outlook—guided the 2001 Article IV consultation discussions, held in Athens during November 8–19, 2001.[1]

2. **The discussions focused on two policy issues**:

- **The appropriate pace of fiscal consolidation in the face of weaker growth prospects**: There was broad agreement that economic prospects had deteriorated, with the authorities somewhat more sanguine than staff concerning the near-term growth outlook for Greece. The 2002 budget incorporates a broadly neutral fiscal stance (in terms of the structural primary balance); on the back of a smaller-than-budgeted surplus in 2001—and in light of high public debt and monetary conditions that are quite accommodative (in view of Greece's advanced cyclical position)—staff advocated a moderately stronger stance.

- **Fiscal and structural policies to accelerate real convergence**: The need for far-reaching pension reform was generally accepted, but many measures remain to be decided. Fundamental tax reform is planned for 2003, and the discussions covered plans for improving expenditure efficiency and control. On the financial sector, steps were reviewed to strengthen its resilience in light of rapid credit growth. Privatization is at the center of the authorities' drive to raise efficiency; staff emphasized steps to ensure effective competition.

II. ECONOMIC DEVELOPMENTS

3. **The Greek economy continues to benefit from stability-oriented policies and euro-area entry, but unemployment remains high**. Despite the global economic slowdown, growth in Greece has remained robust and well above the euro-area average (Table 1; and Figures 1 and 2)—benefiting from macroeconomic stability and the euro-entry-

Selected Economic Indicators, 2000-01
(Growth rates, in percent, unless otherwise indicated)

	Greece	Euro area	Greece	Euro area
	2000		2001	
Real GDP	4.3	3.4	4.0	1.5
Output gap 1/	1.2	-0.1	1.5	-0.9
Total domestic demand	4.4	2.8	4.0	0.9
Employment	0.0	2.0	0.9	1.1
CPI	2.9	2.4	3.7	2.7

Sources: National Statistical Service; Fund staff estimates; and for the euro area, IMF, *World Economic Outlook*, December 2001.

1/ In percent of potential GDP.

[1] The mission—comprising Messrs. Krueger, Kent, Lutz, and Vamvakidis (all European I)—met with Ministers Christodoulakis (Economy and Finance), Reppas (Labor and Social Security), Papadopoulos (Health), and Tsohatzopoulos (Development); Governor Papademos; other senior officials and representatives of regulatory agencies; and labor and business leaders. Mr. Vittas, Alternate Executive Director, participated in the meetings. Greece has accepted the obligations of Article VIII, Sections 2, 3, and 4 (Appendix I).

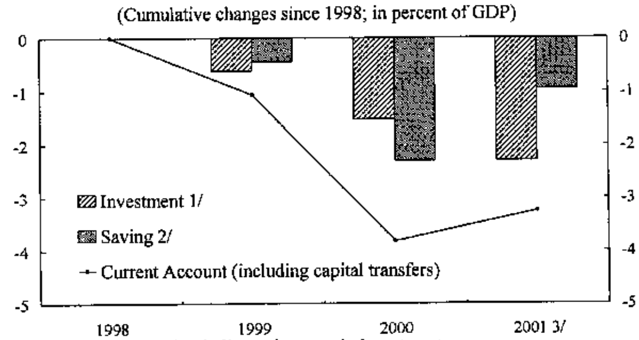
related decline in interest rates. Employment gains, however, have been disappointing and the unemployment rate is the second highest in the euro area.

4. **Although growth has remained high, at least up until the fall of 2001, the economy has not been immune from the global slowdown.** A number of factors helped to support robust growth through most of 2001. Lower interest rates and strong demand growth have boosted private investment—including for construction, pushing up real property prices (Figure 3)—and public investment (supported by EU funds) has also risen strongly (Figure 4). A brisk expansion of consumer loans has supported private consumption growth (at around 3 percent per annum in real terms), while strong merchandise exports benefited from the depreciation of the drachma prior to euro entry (Figure 5), the weakness of the euro, and improved prospects in some neighboring countries. Despite these strengths, signs of weaker growth have become increasingly apparent since spring 2001. In the tourist sector—an important engine of growth in recent years—receipts plateaued at the high level of 2000. In line with developments in the rest of Europe, the manufacturing sector has weakened, with industrial production almost flat since the spring. Also, consumer confidence fell markedly after September 2001.

5. **The economic expansion in 2001 was supported by strong credit growth, which moderated toward the end of the year—concurrently with some narrowing of the sizeable current account deficit.** Credit growth—around 30 percent in the first half of 2001, falling back toward 20 percent in the latter part of the year (Figure 6)—reflected the combined effects of lower interest rates and greater competition among banks, as well as the removal of some credit controls and the reduction in reserve requirements (to align bank reserve requirements with euro-area levels). Household and enterprise indebtedness remain low, however, compared with other advanced economies. The credit expansion contributed to strong demand-led growth, and the external current account deficit (including capital transfers) more than doubled during 1998–2000, to almost 7 percent of GDP (Table 2). The ½ percentage point reduction in the deficit in 2001 reflected in part lower oil prices and the dissipation of a tax-induced surge in auto imports. In terms of saving-investment behavior, the deterioration in the current account during recent years was principally due to rising investment (relative to GDP). The current account deficit was predominantly financed by portfolio inflows, with concerns about the volatility of these flows mitigated by Greece's participation in monetary union.

CURRENT ACCOUNT - THE CONTRIBUTION OF SAVING AND INVESTMENT

(Cumulative changes since 1998; in percent of GDP)



1/ Negative number indicates increase in investment.
2/ Includes statistical discrepancy between settlements- and national accounts-based current account ratios.
3/ Fund staff projection.

6. **Core inflation has remained well above the euro-area average, notwithstanding continued high unemployment.** Falling energy prices have led to a declining trend for consumer price inflation, in line with the rest of the euro area (Figure 7). However, the core inflation differential versus the euro area rebounded from tax-cut related lows in 2000 to average around 1½ percentage points in 2001. Nominal wage growth in Greece—estimated by the authorities at above 5 percent in 2001—was well above the euro-area average, but also accompanied by relatively high productivity growth. The core inflation differential exceeds the staff estimate of the likely Balassa-Samuelson effect (about 1 percentage point, see SM/99/255, 10/6/99). The differential is affected by relatively buoyant cyclical conditions in Greece, with staff estimates suggesting a positive output gap of around 1½ percent. However, rapid economic growth has not translated into robust employment growth; the authorities attributed this to difficulties in absorbing a declining agricultural labor force, as well as a reliance on overtime and poor data quality (see Appendix II). The fall in the unemployment rate to 10.9 percent in the first quarter of 2001 (the latest available data)—about 1¼ percentage points below the rate of the same period a year earlier, but still the second highest in the EU—was driven largely by declining labor force participation.

7. **The overall fiscal balance recorded a surplus in 2001—but it was smaller than budgeted and the envisaged strengthening of the fiscal stance did not materialize** (Table 3). The authorities estimate a general government surplus of 0.1 percent of GDP in 2001, against a 0.5 percent target, with the public debt-to-GDP ratio declining by 3 percentage points to just below 100 percent.[2] The undershooting of the surplus target came despite additional receipts from universal mobile telecommunications system (UMTS) license sales—0.4 percent of GDP, not anticipated in the budget and treated as revenues under Eurostat rules—and was principally due to higher-than-budgeted goods and services expenditures. As a result, staff estimates that the fiscal stance, as indicated by the structural primary surplus, remained constant at 5.6 percent of GDP (excluding UMTS receipts, which have no demand effects), compared with a tightening to above 6 percent implied by the original budget. **For 2002**, the overall surplus target was revised down to 0.8 percent of GDP (compared with 1.5 percent in the *2000 Stability Program*), reflecting tax reductions and lower-than-previously expected growth. The structural primary surplus (excluding UMTS receipts) would remain broadly unchanged relative to the 2001 outturn.

III. Policy Discussions

8. **With stability-oriented macroeconomic policies having secured Greece's euro-area entry, the authorities were determined to address the remaining policy challenges, which they—and staff—viewed as considerable.** A broad consensus existed on the areas in need of reform, and the debate focused on the speed of such reforms—and, in some cases, on specific reform steps. On fiscal stabilization policies, the authorities' *Stability Program*

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[2] Some uncertainty surrounds the 2001 fiscal outturn: central government revenue data through October suggest a possibly larger surplus than currently projected.

stressed the importance of nominal balance targets; in practice, policy implementation has been more responsive to the economic cycle, and the staff saw room for rules-based fiscal stabilizers, around sufficiently ambitious targets. On structural issues, a consensus regarding elements of a potential pension reform was emerging—but the final outcome remained uncertain. Notwithstanding a view on general reform principles, plans were at best nascent in other fiscal areas, including on tax reform and on strengthening expenditure evaluation, monitoring, and control. It was agreed that the fiscal reforms could support structural changes in other areas aimed at accelerating output and employment growth—where the authorities placed strong emphasis on privatization and financial sector performance.

A. Economic Outlook

9. **The discussions concerning economic prospects were influenced by uncertainty about the extent to which growth in recent years reflected temporary, euro-entry related effects, rather than more fundamental improvements in potential growth.** The rate of capital accumulation had clearly increased in the last few years, benefiting from a sounder macroeconomic environment as well as lower costs of capital (Box 1). The latter was also boosting residential investment. The staff's analysis suggested that the decline in interest rates as well as the drachma's earlier depreciation had played an important role in accelerating growth. These effects on growth (albeit not on the income *level*) would, however, be largely temporary—absent further reforms, potential growth was likely to revert from around 3½ percent in 2002 to some 2¾ percent over the medium term. The authorities expected more persistent effects: while cyclical and other factors may have also boosted productivity growth, they viewed much of the recent increase in the growth rate as permanent in nature, reflecting macroeconomic stability and structural reforms already in place.

10. **Somewhat divergent views on potential growth as well as on competitiveness contributed to different projections for 2002.** The *2001 Stability Program* update envisaged GDP growth of 3.8 percent in 2002, and 4 percent annually in 2003–04 (versus some 5 percent in the previous *Stability Program*, and Consensus Forecasts' 3.3 percent for 2002). This was premised on rapid investment growth, in light of continued effects from the recent easing of monetary conditions (Figure 8)—which the authorities agreed were relatively accommodative from a purely domestic perspective—as well as special factors (preparations for the Olympics and an acceleration in EU-supported infrastructure projects). The staff concurred that growth was likely to remain well above the euro-area average, but saw real GDP growth limited to around 3 percent in 2002—based in part on a more cautious view on investment activity (decelerating after the very rapid, euro-entry-related pace of recent years) and on tourism prospects. Moreover, growth projections were affected by somewhat divergent views on competitiveness, which the authorities regarded as broadly adequate, as nominal exchange rate movements (related to drachma convergence and the euro's depreciation) had cushioned the impact of relative labor cost increases vis-à-vis the euro area.

Box 1. Convergence of the Greek Economy Before and After Euro-Area Entry

This box explores the role of temporary and permanent factors behind Greece's recent strong economic growth performance. The staff's analysis[1] suggests that the growth acceleration after the mid-1990s reflected to an important extent euro-entry related factors, notably interest rate convergence and macroeconomic stabilization, and structural reforms. Unless further structural reforms are undertaken, however, the recent growth performance is unlikely to be sustained over the medium term.

Growth in Greece since the mid-1990s has been supported in part by macroeconomic and structural reforms, which allowed convergence forces to take effect. Real GDP in Greece expanded by an average of 3 percent during the second half of the 1990s, compared with 2 percent in the euro area. Greece has about two-thirds the euro-area per capita GDP (at purchasing power parity rates) and, provided a supportive policy framework is in place, convergence forces could be expected to underpin faster growth in Greece than in the euro area. Indeed, declining inflation, fiscal consolidation, and progress in market liberalization and privatization in the second half of the 1990s supported investment and productivity growth. The investment share increased from 19 percent of GDP in the mid-1990s to 23 percent by the end of the decade, while total factor productivity (TFP) growth is estimated to have increased from a small negative rate to about 2 percent during the same period (Table 1). With little progress on labor market reform, however, the contribution of employment growth was relatively small during this period.

Table 1. Growth Accounting, 1981–2000

	1981–85	1986–90	1991–95	1996–2000
Real GDP Growth	1.3	1.9	1.3	3.3
Contributions				
Capital	1.4	1.0	0.9	1.2
Labor	-0.5	0.5	0.4	0.2
TFP	0.3	0.4	-0.1	1.9

The acceleration of growth in Greece has been partly driven by temporary factors. Growth has been supported by the decline of interest rates to euro-area levels—the three-month T-bill rate declined from above 10 percent in 1998 to less than 4 percent in 2001, while the 10-year government bond rate declined from above 10 percent to less than 6 percent during the same period (real interest rates fell by similar magnitudes). The depreciation of the drachma prior to euro-entry—and the relative weakness of the euro—also supported economic growth in recent years. Staff estimates (based on the Oxford Economic Forecasting Model) indicate that interest rate convergence and exchange rate effects added about 1½ percentage points in 2001. The impact of interest rate convergence and exchange rate depreciation on growth is estimated to be largely complete by the end of 2002 (although reductions in ECB intervention and market rates in 2001 could be expected to support growth in 2003, as elsewhere in the euro area).

The rise in potential output growth in Greece is unlikely to be sustained over the medium-term without further progress in structural reforms. As detailed in the background study, standard growth regressions suggest that potential growth would revert to just above 2½ percent per annum in the long run—based on the current values of the growth determinants in Greece (Table 2). Production function estimates are broadly consistent with this view.[2] The exception is the case where the recent TFP growth acceleration (to close to 2 percent per annum) would continue. However, as noted above, a considerable portion of the recent growth performance was probably due to temporary factors, captured in the residual TFP estimate. Indeed, if TFP growth were to revert to its historical average of some ¾ percent per annum, potential growth would decline to around 2½ percent—still well above the average growth rate recorded over the past two decades (reflecting recent progress in structural reforms). These results suggest that growth may not continue at the recent pace, unless complemented by structural reforms in coming years—with key reform areas discussed in the main text.

Table 2. Potential Real GDP Growth of the Greek Economy

Based on:	
Growth regression 1/	2.6
Cobb-Douglas production function (without structural break in TFP)	2.5
Cobb-Douglas production function (with structural break in TFP in mid-1990s)	3.7

1/ See growth model estimates in the background study, controlling for the main growth determinants.

[1] A more detailed discussion of the issues is provided in a background study.

[2] For production function estimates in Greece during 1960–98, see SM/98/194, 7/22/98.

As discussed in last year's report (SM/01/25, 1/31/01), staff remained concerned, however, that the current account deficit would stay above a level it considered as "normal" for Greece, indicating a need for some strengthening in competitiveness. On inflation, weather-related factors contributed to a temporary increase in late 2001/early 2002, but both staff and the authorities thought that lower energy prices would reduce the average inflation rate for consumer prices (HICP) to below 3 percent in 2002.

11. **There was agreement on the high level of uncertainty surrounding projections for near-term growth and, to a lesser extent, inflation**. On growth, this concerned importantly the external sector—including the timing of recovery in other advanced economies. The authorities agreed that the economy was also vulnerable to a sudden euro appreciation. Uncertainty surrounding the outlook for inflation related in part to the upcoming wage round. Higher-than-expected inflation in 2001 will trigger a 1.1 percentage point catch-up, payable under the two-year agreement; and labor representatives had little sympathy for the staff's suggestion to eliminate backward-looking catch-up clauses in future multi-year agreements.

B. Fiscal Consolidation

12. **The fiscal policy discussions focused on a strategy centered on two core principles: a transparent medium-term orientation, and well-defined rules that would allow for flexibility in addressing short-run challenges**. The authorities placed the Stability and Growth Pact at the center of fiscal policy's medium-term orientation—calling for a strong medium-term fiscal balance, and supplemented by their goal of reducing the public debt-to-GDP ratio to 60 percent by 2010. The latter target was seen as crucial given Greece's presently high debt ratio, and the need to progress on consolidation during a "window of opportunity" prior to the onset of aging-related expenditure pressures. Thus, the primary surplus would have to be maintained at a sufficiently high level to meet the debt ratio goal. The authorities were considering complementing the deficit and debt targets with well-specified expenditure ceilings, which staff considered most effective if set at the general government level. These ceilings could send a clear and easily monitorable signal to market participants, including on the future size of government, and ultimately the tax burden. The authorities pointed to initial efforts toward multi-year budgeting, which were to include ministry-specific expenditure limits. They accepted that medium-term deficit targets, together with expenditure ceilings, could in principle provide a framework for short-term policy responses to unanticipated shocks—allowing the full and symmetric play of automatic fiscal stabilizers (on the role of expenditure ceilings, see also SM/01/307, 10/5/01).

13. **While the need for further fiscal consolidation was not in dispute, views differed to some extent regarding the appropriate pace for near-term consolidation and on expenditure restraint.** The discussions focused on three issues:

- Pace of fiscal consolidation: The 2001 budget had (based on staff estimates) implied a structural primary surplus above 6 percent of GDP. Subsequent revisions of fiscal targets went beyond the full play of automatic stabilizers: the structural primary surplus (excluding

UMTS receipts) was limited to slightly over 5½ percent of GDP in 2001, and was targeted to remain broadly constant in 2002. Instead, staff saw a case for returning to the previous, more ambitious structural fiscal path, in light of accommodative monetary conditions and the strong cyclical position, and to secure a more rapid decline in the public debt ratio.

- Below-the-line, debt-creating transactions (for details, see below): the size of such operations—that is, operations that are not included in the Eurostat-based fiscal deficit but affect public debt—was jeopardizing the medium-term target of lowering the public debt-to-GDP ratio to 60 percent by 2010. The authorities concurred that this called for a careful reexamination of some below-the-line, debt-creating activities; and, in the interim, for sufficiently ambitious surpluses to safeguard the public debt reduction target.

- Expenditure restraint: Greece has been the only EU country (aside from Portugal) where current primary spending has steadily increased (in relation to GDP) since the mid-1990s. The authorities agreed that stabilizing the expenditure ratio was indispensable for sustained progress on fiscal consolidation. The 2002 budget included a moderate decline in current primary expenditure (in relation to GDP)—with staff seeing room for additional reductions, given earlier increases. Staff also called for using any revenue overperformance for debt reduction rather than additional expenditure, as had often been the case in the past.

14. **In all, the authorities viewed the 2002 budget as addressing the different demands on fiscal policy**. They underscored that some deviation from earlier fiscal targets was appropriate in view of weaker growth prospects. The staff expressed concern, however, that the revisions had gone beyond the play of fiscal stabilizers, implying a weakening of the structural effort envisaged earlier. With monetary conditions accommodative in view of Greece's cyclically advanced position, it argued for a moderate fiscal withdrawal to rebalance the policy mix: sufficient expenditure restraint during 2002 could restore the structural primary surplus at the level previously envisaged already for 2001—that is, a surplus above 6 percent of GDP. Under the authorities' growth scenario, this would call for an overall budget surplus of some 1¼ percent of GDP, versus the 0.8 percent budget target.

15. **The authorities were somewhat ambivalent concerning the appropriate fiscal policy response, should growth ultimately deviate from expected levels—with staff supporting the full play of revenue stabilizers around sufficiently ambitious targets**. In the discussions, the authorities were generally supportive of adjusting fiscal targets to changing macroeconomic circumstances; indeed, as indicated, past adjustments went at times beyond the full play of stabilizers. Nevertheless, the *Stability Program* that was issued after the mission's discussions committed to unchanged surplus targets (and expenditure cuts) in an alternative, slower growth scenario.

16. **Over the longer-term, the authorities remained committed to reducing the public debt-to-GDP ratio to 60 percent by 2010—a target that may prove difficult to achieve if sizable below-the-line, debt-creating transactions continue**. In the updated *Stability Program*, the debt ratio will only moderate to 90 percent of GDP by 2004, from close to 100 percent at end-2001 (Table 4). Staff noted that the decline in the debt ratio would be

much smaller (by about 13 percent of GDP) than implied by the robust growth and sizable primary surplus projections alone (see Box 2 for details). The slow decline indicated significant debt-creating transactions that are not included in the Eurostat-based fiscal deficit. In recent years, these transactions included, for example, sizable capital injections into state-owned enterprises, debt assumptions by the state, valuation losses on foreign currency denominated debt, and military debt issuance. The overall size of these activities is considerably larger in Greece than in other euro-area countries (Figure 9). As a result, the reduction in the public debt-to-GDP ratio observed in recent years has relied in part on privatization revenues and the securitization of some future receipts. The authorities noted that the statistical treatment of these transactions was in compliance with Eurostat requirements and argued that the activities were transparent: data on central government deficit-debt linkages were included in the annual budget and often discussed in parliament. Such linkages were, however, not produced for general government debt and deficits, and it proved difficult to assess the details—and thus to determine the GFS classification—for some of the operations. The authorities acknowledged that these transactions have hindered a more rapid public debt reduction. Indeed, as the following table indicates, the 60 percent debt target for 2010 may only be attainable with primary surpluses of some 9 percent of GDP (that is, well above current levels), should these activities continue on the scale envisaged in the *Stability Program* for 2002–04. It was agreed that some of these activities—for example, capital injections and debt assumptions—could be curtailed over time, with the receding role of the state in economic activity under the authorities' privatization program.

Meeting the 60 Percent of GDP Public Debt Target in 2010

(In percent of GDP; period average, except where otherwise indicated)

	2001	2002-04	2005-10
Public debt (end-of-period)	99.6	90.0	60.0
Below-the-line, debt-creating activities (net) 1/	4.2	4.4	4.4
Primary surplus needed to meet the 2010 debt target 2/	6.6	6.2	9.2

Sources: *The 2001 Update of the Hellenic Stability and Growth Program: 2001-2004*; and Fund staff calculations.

1/ Activities as implied by the *Stability Program* for 2002-04.

2/ *Stability Program* for 2001-04; for 2005-10, stable surplus needed to meet 2010 debt target.

C. Pension Reform and Structural Fiscal Issues

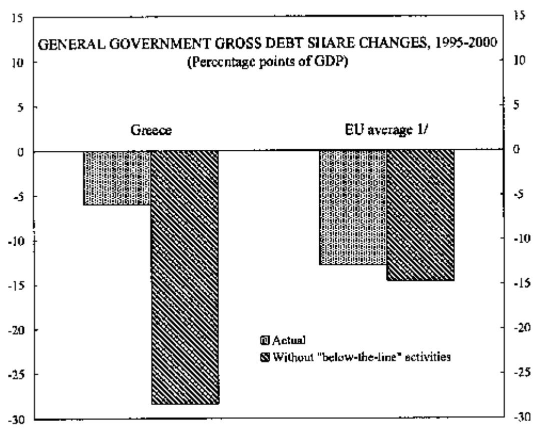
17. **The discussions covered key areas for structural fiscal reforms**. These included pensions, at the center of the current policy debate in Greece, and a fundamental tax reform, planned for 2003. Some steps are also underway to reform the health care system, and the staff underscored the need for further progress on strengthening expenditure management.

18. **Considerable consensus existed among the social partners on the need for—and even some elements of—a substantive pension reform, a major change from one year ago**. Absent reforms, pension expenditure—already among the highest in the EU—may increase by some 12 percentage points of GDP over the next five decades, the highest projected increase for any EU country (see Box 3). It was well recognized that this would either result in unsustainable debt dynamics, crowd out other spending priorities, or require large tax and contribution increases that could sharply reduce potential growth. A broad consensus was emerging on several issues: contribution rates should not be increased further;

Box 2. Whither the General Government Debt-to-GDP Ratio?

Despite a significant improvement in the general government overall balance in recent years, sizable below-the-line, debt-creating developments have slowed the rate of decline in the debt-to-GDP ratio. If continued at the recent pace, this would jeopardize the authorities' target of lowering the debt-to-GDP ratio from around 100 percent to 60 percent by 2010, unless the budget balance strengthens well beyond currently envisaged levels.

While Greece's public finances have improved significantly in recent years, the improved fiscal balance has not been fully translated into a reduced debt position because of significant below-the-line, debt-creating factors. Other things equal, the debt-to-GDP ratio should be reduced by the primary (net of interest payments) surpluses that the budget records, and would be further reduced if the nominal economic growth rate exceeds the average effective nominal interest rate paid on government debt. Greece has run primary surpluses since 1994, and, with nominal convergence accompanied by an accelerating rate of growth, the interest rate/growth interaction has further acted to reduce the debt ratio. In fact, these two factors are estimated to have reduced Greece's debt ratio by over 28 percentage points of GDP during 1995–2000. However, the debt ratio actually declined by only 6 percentage points of GDP. Thus, Greece has experienced significant amounts of stock-flow discrepancies, of a magnitude in excess of that experienced by the EU on average and, indeed, by any other European Union economy (see below; and Figure 9).



1/ Simple average, excluding Greece.

General Government Gross Debt Changes
and Underlying Factors, 1995-2000
(Percentage points of GDP)

	Greece	EU 1/
Actual change	-6.0	-12.9
Of which:		
Cumulative primary balance	-24.4	-19.3
Interest/growth rate effect	-4.0	4.6
Other "below-the-line" factors	22.4	1.8
Memorandum item:		
Privatization and securitization revenues	6.5	...

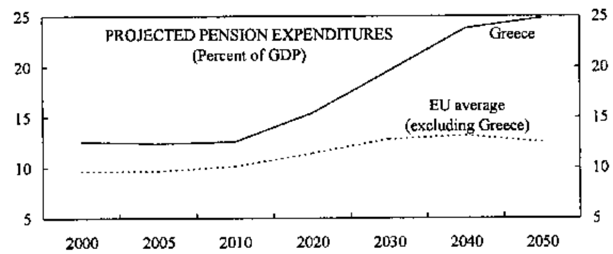
Sources: IMF, *WEO database*; Greek authorities; and Fund staff calculations.
1/ Unweighted average, excluding Greece.

Below-the-line, debt-creating developments reflect a number of factors. These include valuation changes from foreign currency denominated debt, which increased the debt ratio by a cumulative 6 percentage points of GDP during 1995–2000 but, with the adoption of the euro, are no longer expected to be significant. Also, the general government's overall balance will not result in identical changes in the stock of government debt to the extent that a portion of the social security funds' surpluses is used to acquire assets other than government debt; this has been the case in Greece on the order of about 1 percent of GDP in recent years. Other activities, including capital injections to and restructuring costs of state-owned enterprises, calling of debt guarantees, assumptions of debt and military acquisitions have varied in importance in recent years, with the latter equivalent to about 2 percent of GDP in both 2000 and 2001. Although the annual budget provides a detailed listing of total extrabudgetary activities that have central government debt implications, such linkages have not, however, been produced for the general government level. The net Greek general government stock/flow discrepancies totaled over 22 percent of GDP during 1995–2000. The gross discrepancies were even larger, as receipts equivalent to some 6½ percent of GDP (and by an additional 3.4 percent in 2001), raised through privatization of state-owned assets and securitization of specific government revenue streams, were used to retire government debt.

Continued below-the-line, debt-creating activities on the scale that has occurred in the past endangers the authorities' goal of reducing the general government debt ratio to 60 percent of GDP by 2010. The *2001 Update of the Hellenic Stability and Growth Program: 2001–2004* envisages a reduction in the debt ratio from 99.6 percent in 2001 to a still-high 90 percent of GDP in 2004. However, the debt ratio should decline to about 77 percent of GDP, absent these activities and given the authorities' projections for primary surpluses, nominal economic growth rates and nominal effective interest rates, implying a continuation of sizable stock/flow discrepancies. Were these to persist on the same scale beyond 2004, the authorities' debt ratio target would be endangered unless there was a significant increase in the primary deficit to about 9 percent of GDP, as discussed in the text, compared to an already-high 5½ percent at present.

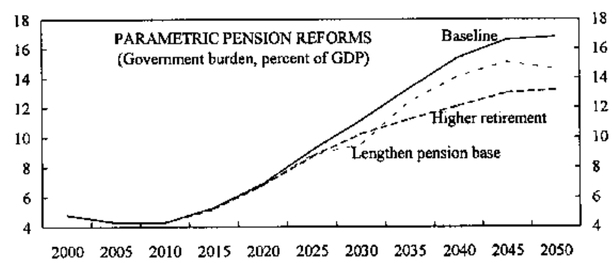
Box 3. Pension Reform in Greece

The need to reform Greece's pension system is becoming increasingly recognized. Absent reforms, already high pension expenditures are projected to increase by more than in any other EU country. It is likely that changing a combination of parametric variables in the present system, and introducing more fundamental structural changes to the basic system, will be required to ensure fiscal sustainability.



Sources: Economic Policy Committee, EU; and Greek authorities.

Despite reform efforts at both the beginning and end of the 1990s, the public pension system in Greece is in a parlous state.[1] Pension benefits far exceed the actuarial value of corresponding contributions and, at more than 12 percent of GDP in 2000, expenditures are already among the highest of EU economies. Moreover, projections (reported in a government-commissioned study) suggest a roughly doubling of pension expenditure (in relation to GDP) by the middle of the century—clearly the largest among EU economies. At the same time, the government's pension burden (i.e., total expenditure net of contributions and asset income) would rise from almost 5 percent to close to 17 percent of GDP. The system's financial weaknesses reflect to some extent incentives to retire early and widespread contribution evasion. Large differences across employment categories also characterize the exceedingly complex and poorly administered system, with over 200 separate funds.



Source: Greek authorities.

Against this background, the government and social partners agree on the need for reform—and ongoing discussions focus on specific reform steps. A government-commissioned study, issued in 2001, analyzed the future finances of the existing system as well as the implications of various reform options (including the impact of parameter changes in the existing system as well as more fundamental changes to the structure of the pension system). A conference in the fall of 2001, sponsored by the labor unions, also highlighted the need for reform. Given the magnitude of the pension expenditure increase and related fiscal burden, plausible changes to any single parameter of the existing system would, by themselves, not sufficiently address the policy challenges (see, for example, simulations reported in the second chart, which are detailed in the background study). Under these circumstances, a combination of changes in parametric variables is likely to be indispensable, including raising retirement ages, extending pension bases (which would also combat contribution evasion), reducing replacement rates, and changing the pension indexation.[2] In addition, structural changes of the pension system could be envisaged, including introducing fully funded individual accounts and consolidating the presently fragmented pension funds. In some cases, more fundamental reform would entail sizable transition costs, which would need to be covered within the constraints of the Stability and Growth Pact.

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[1] A background paper will provide an overview of public pension reform issues in Greece.

[2] The reforms depicted in the figure above reflect an increase in the retirement age to 67 years for those entering the labor force after 1992, or lengthening the pension base to lifetime earnings (and indexing past earnings to wage inflation).

flexible retirement ages should be allowed, with incentives for later retirement (though disagreement remained over appropriate retirement ages); and fully funded supplementary pensions should be introduced. Views still differed regarding replacement rates for basic pensions, and the degree to which the presently highly fragmented and differentiated system could be unified. The authorities were seeking to forge a consensus on the issues and viewed 2002 as a critical year for reaching a pension reform agreement. They were considering the staff's suggestion of aiming at an overall envelope for future pension expenditure growth in relation to GDP, possibly similar to increases in other euro-area countries. In the staff's view, this would likely require steps in all major areas being discussed by the social partners.

19. **Over the past year, the authorities have begun to implement reforms in the health care system, where most observers saw vast room to improve service delivery and expenditure control.** The reforms included a substantial devolution of decision-making authority and responsibility to 17 regional systems, to be managed by trained professionals. Improved record-keeping, monitoring, and control are expected to raise efficiency and service quality. Nevertheless, it was agreed that efforts to improve the supply of services would need to be complemented in the future by steps to contain demand. In addition, improved administration required an adequate supply of appropriately trained health-care managers, a field for which Greek universities presently did not have degree programs.

20. **The authorities remained committed to strengthening budgeting procedures and expenditure management, but acknowledged little progress to date.** For example, a "one-for-five" hiring limitation had excluded many government sectors, making it largely ineffective in curtailing public employment.[3] To introduce a medium-term perspective, spending ministries were instructed to prepare three-year budgets for the first time as part of the 2002 budget preparation (see also Supplement 1, the authorities' updated self assessment against the *IMF Code of Good Practices on Fiscal Transparency*). The authorities noted, however, that ministries had been insufficiently prepared for the exercise; the results were ultimately not laid out in a binding, medium-term budget framework, but included as projections within the 2002 budget. Improved training would form part of future steps in this area, with a view to reinforcing expenditure efficiency and control—considered necessary for a stronger commitment to public expenditure ceilings.

21. **Preparations were underway to introduce a systematic tax reform, to take effect in 2003.** The 2002 budget already included tax reductions of around ½ percent of GDP (corporate and personal income tax cuts, and an elimination of a stamp duty on wages, offset in part by the imposition of a tax on the income from repos to reduce tax differentials across financial assets); the authorities hoped that these reductions would support activity and facilitate a moderate wage agreement in 2002. While it was too early to discuss specific steps,

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[3] For civil servants, existing regulations limit hiring to one person for every five that depart. This rule does not apply, however, in the education, healthcare, and security sectors, which account for about 75 percent of civil servants.

the authorities outlined the broad objectives of their tax reform agenda: simplifying the presently very complex system; distributing the tax burden more equitably; strengthening competitiveness; improving tax administration; and further reducing tax evasion. To this end, a committee of experts is to present a report by March 2002. It is to be discussed by the social partners, with the implementing legislation to take effect in 2003. It remained to be decided if the reforms would also include a reduction in the overall tax burden (in relation to GDP); not least in view of sizable reductions underway in partner countries, this was favored by staff, provided that adequate expenditure restraint could be secured.

D. Structural and Financial Sector Policies for Strong Growth

22. **Further structural reforms were seen as critical to enhance growth prospects and accelerate real convergence**. While the need for additional labor market reforms was widely recognized, attention had shifted for the time being to other areas (including pension reform). Product market liberalization continued, but lagged significantly behind Greece's euro-area partners. The rapid evolution of the financial sector also posed important policy challenges.

Labor market reform

23. **It was widely agreed that the recent labor market measures had not achieved a fundamental improvement of the labor market's poor performance.**[4] In this area, data deficiencies continue to severely hamper an assessment of developments. In the discussions, labor representatives argued that extensive use of overtime work was the principal reason why employment had failed to increase. Employers, in contrast, attributed the lack of job creation to continued high firing costs, and thought that recent reforms had in fact increased labor costs and worsened competitiveness. Staff stressed that labor market reforms may prove indispensable to achieve a decisive reduction in unemployment and the needed strengthening of competitiveness. However, further reforms in this area, including to facilitate labor market entry, improve training, and eliminate backward-looking wage indexation, were on the back burner, while a consensus on pension reform was being sought.

Product markets

24. **Deregulation and liberalization of some product markets have advanced considerably in recent years, and discussions focused on ways to ensure competitive outcomes across a broader range of markets**. The benefits of existing reforms are evident in a number of areas, including telecommunications and banking, where liberalization combined with privatization has led to efficiency gains, improved services, and lower prices. The authorities emphasized efficiency gains that would flow from their invigorated

[4] Labor market issues and reform attempts were discussed in detail in last year's report (see also Chapter III in IMF Staff Country Report No. 01/57, April 2001).

privatization plan, which includes asset sales in the tourism, banking, energy, and transport sectors. The staff cautioned, however, that slow progress on other structural reforms may hinder increased competition. Notably in the electricity sector, the benefits of privatization and liberalization may accrue to end users very slowly—given the time needed to add new capacity—unless there is substantial divestiture of generation capacity by the dominant company and separate ownership of the national grid. The authorities stated, however, that divestiture would be difficult, in part because of the close link between mines and generators in Greece. Also, they pointed to the expected increase in competition from the natural gas sector. In other areas, market participants highlighted continuing bureaucratic inefficiencies as a significant impediment for new businesses. Regulatory authorities, including the Competition Commission, have been granted greater powers and resources, although they noted that hiring qualified staff would take time.

25. **In an attempt to help Greek companies attain a size needed to expand their activities in the euro area and elsewhere, the authorities introduced temporary merger incentives**. This was to be effected through a 10 percentage point reduction in the corporate profit tax in the first post-merger year, and a 5 percentage point reduction in the second year. The staff cautioned that this introduced new distortions and ran counter to the planned tax simplification and harmonization; the activities, if economically viable, would be best promoted by a suitable overall business environment. The authorities replied that the measures were temporary, bringing forward tax rate reductions planned for the general reform in 2003.

Financial markets

26. **Concerning financial markets, discussions focused on the implications of rapid credit growth over the past 1½ years**. The authorities viewed the euro-entry-related declines in interest rates, banking sector liberalization, and buoyant economic activity as the key driving forces behind the rapid credit expansion, and noted that it had begun to slow to some extent in recent months (Figure 6). Supervisors and financial institutions did not see significant imminent risks to the banking system—in part because indebtedness (as a share of GDP) remained low compared with other euro-area countries, and a significant portion of lending was backed by conservatively valued collateral. Nevertheless, the authorities acknowledged the need to carefully manage the risks posed by rapid credit growth in a newly liberalized banking system. In this context, they pointed to tighter provisioning rules that came into effect in 2000, helpful also in light of relatively high, albeit declining, nonperforming loans (Table 5). Since these rules could not fully address the risk of future losses posed by rapid credit expansion, the Bank of Greece was exploring other measures to strengthen the combination of provisions and capital; the details remained to be decided, but may include forward-looking provisioning rules, perhaps similar to Spain's. The Bank had delayed the removal of some restrictions on consumer lending, awaiting at least the imminent establishment of a central credit registry—which would help banks monitor borrowers' total exposures.

27. **Liberalization and reduced government control have led to increased competition in the banking sector and promoted market discipline, but further mergers could provide new challenges**. Improved market discipline, together with some supervisory guidance, have contributed to strengthened risk and cost management. More recently envisaged mergers and acquisitions—including a merger between Greece's two largest banks (discussed at the time of the mission but ultimately abandoned)—could raise concentration to relatively high levels, even by small-country standards. The implications for market efficiency and financial system stability were not clear cut. The authorities and some market participants thought that consolidation could lead to efficiency gains. Staff, however, argued that benefits were likely to accrue only gradually in the face of prevailing labor market practices, and in some areas—particularly lending to small- and medium-sized enterprises—a merger among large domestic financial institutions may not leave sufficient competitive pressures to ensure that efficiency gains are passed on to banks' customers. To protect the stability of the financial system, the Bank of Greece highlighted the need to be even more vigilant when supervising banks in control of a sizeable share of the banking system's assets and liabilities. It was widely acknowledged that stability concerns also called for strengthening the role and independence of the insurance supervisor, and intensifying its links with other financial market supervisors.

E. Other Issues

28. **The authorities were committed to strengthening anti-money laundering efforts and steps against the financing of terrorism activities**. Greece complies with all of the Financial Action Task Force's recommendations for anti-money laundering measures, and has adopted the OECD's anti-bribery convention. Domestic implementation of initiatives developed at the EU and international level would be pursued vigorously.

29. **The Greek statistical system requires significant improvements, but progress was expected in the coming year**. Limited quarterly national accounts data are now published, but delays persisted in the processing and release of other data, including labor force surveys. Efforts were underway to meet all the requirements for subscription to the Special Data Dissemination Standards (see Appendix II).

30. **The authorities were sympathetic to accelerating the liberalization of least developing countries' imports, except in areas viewed as critical for Greek producers**. In the latter areas, including for textiles and agricultural products, liberalization would be best pursued on a multilateral basis. Official development assistance (ODA) was substantially increased in 2000; it was set to remain broadly stable in coming years, at around 0.2 percent of gross national income—still relatively low compared with most advanced economies.

IV. Staff Appraisal

31. **The policy strategy that secured euro-area entry at the beginning of 2001 has continued to underpin the strong performance of the Greek economy**. Over the past year, the most impressive accomplishments included a further catch-up in living standards—with

real income growth remaining well above the euro-area average; and progress in consolidating the public finances—where the double digit deficits prevailing through the mid-1990s have given way to the prospect of continued fiscal surpluses. In certain areas, structural reforms have also advanced, including in financial markets and telecommunications. The successful introduction of euro bank notes and coins at the beginning of 2002 marked a further milestone toward successful economic integration with European partner countries.

32. **The challenge now is to broaden and deepen the efforts undertaken to date—to stem the risks of a prolonged economic slowdown and lay the groundwork for rapid convergence in living standards**. Further steps remain imperative to place fiscal consolidation on a sustainable medium-term footing, in the face of anticipated aging-related expenditure pressures and still very high public debt levels; and to strengthen competition and efficiency in factor and product markets, essential to ensure real convergence. This will also require an adequate level of competitiveness—where wage settlements need to prevent, at a minimum, a further deterioration in cost competitiveness vis-à-vis euro-area partner countries.

33. **A transparent medium-term orientation of fiscal policy, with well-defined rules for addressing short-run developments, would be particularly effective in the present environment of high economic uncertainty**. The authorities' commitment to the Stability and Growth Pact, and specifically to the target of lowering the public debt-to-GDP ratio to 60 percent by 2010, is rightly at the center of their medium-term fiscal strategy. The fiscal surpluses needed to achieve the debt reduction will depend importantly on the extent of below-the-line, debt creating transactions, which have so far precluded a sharper decline in the public debt ratio. If these transactions are not curtailed decisively—and the opportunity to cut back, for example, capital injections and debt assumptions in the wake of privatizations should be seized—the envisaged debt reduction would require considerably higher-than-planned primary surpluses. It would be useful to complement the fiscal deficit and debt objectives with a commitment to well-specified expenditure ceilings, most effective if set for the general government level. Within this framework of sufficiently ambitious medium-term fiscal surplus and expenditure targets, revenue stabilizers should be allowed to operate fully and symmetrically in response to cyclical developments.

34. **For 2002, adequate progress toward the medium-term fiscal objectives would call for somewhat more ambitious fiscal targets than envisaged in the budget**. While the budget aims at some primary current expenditure decline (in relation to GDP)—a welcome break from past trends—additional restraint in executing the budget should be feasible in view of considerable increases in recent years. Moreover, some fiscal withdrawal would be warranted to rebalance the policy mix, as monetary conditions remain accommodative in view of Greece's advanced cyclical position. Assuming growth unfolds as envisaged in the budget, an adequate policy stance should be achieved by a budget surplus of about 1¼ percent of GDP, setting public debt reduction more decisively on a path toward the government's medium-term objectives. Around this target, it would fall on fiscal revenues to

stabilize activity, should growth ultimately turn out weaker (as seems likely) or stronger than anticipated in the budget.

35. **The emerging consensus among social partners should provide a basis for much-needed pension reform**. The emphasis on securing a social consensus is rightly given a central role, but the strategy must be mindful of the critical time dimension. As a guidepost in considering reform options, it may be useful to determine an overall envelope for future pension expenditure growth in relation to GDP, perhaps equal to that in other euro-area countries facing similar demographic pressures. Incentives for a more flexible and higher effective retirement age, reductions in some excessive replacement rates, and a more unified, equitable treatment of pensioners within a much less fragmented system could constitute part of a reform agenda, as could fully funded supplementary and private pension funds.

36. **Expenditure reform would benefit from more effective multi-year budgeting, and recent—albeit still limited—initiatives are welcome**. The authorities' effort to draw up multi-year budgets was a first step in this direction. Strengthened efforts in this regard need to be combined with improved expenditure evaluation, monitoring, and control. This is particularly needed in health care, where increased regional responsibility for service providers needs to be accompanied by effective budgetary constraints. Medium-term budgets would also provide a vehicle for planning rational public employment reductions.

37. **Recent measures to provide selective tax relief, and plans for implementing a fundamental tax reform, could improve social equity and boost growth prospects**. The emphasis is well placed on simplifying the tax system, and reforms should also seek to strengthen tax administration and further reduce tax evasion. However, some recent tax incentives (for mergers and employment growth) will introduce new distortions, running counter to the general reform intentions. It will also be important to reassess the overall tax burden in light of developments in other European economies, with consideration given to broadly similar reductions in the tax burden, with corresponding expenditure cuts to safeguard fiscal surplus targets.

38. **The labor market's performance remains disappointing, with unemployment rates among the highest in the euro area and relatively low employment growth**. Recent reforms have not achieved a marked turnaround—a necessary condition for rapid convergence in living standards. There remains foremost a need to facilitate labor market entry and to improve training; and the practice of backward-looking wage indexation should be eliminated. Progress on labor market reform could also have important beneficial effects on other areas, including for pension reform.

39. **In product markets, the authorities' plan to invigorate the privatization process is welcome, but it should be combined with broader measures to ensure competitive market outcomes across the economy**. This is particularly true in the electricity sector, where the previous state monopoly will retain a dominant position for many years unless forced to divest. Further efforts to reduce bureaucratic inefficiencies are required to lift

impediments to new businesses—including foreign direct investment. Also, a pivotal role falls to the Competition Commission, which has to gain the stature and enforcement commitment required to make it a champion of competition.

40. **In the financial sector, credit is expected to continue to rise (as a share of GDP) as part of the broader process of convergence—with the authorities rightly addressing ensuing risks**. The plan to strengthen the combination of provisions and capital is welcome, and the authorities should proceed promptly, as rapid credit growth sustained over a long period tends to increase system-wide risks. Prudent risk management could also benefit from enhancing market discipline through mandatory, timely disclosure by banks of a comprehensive set of asset quality and risk indicators.

41. **Statistical data weaknesses remain pervasive, hampering the assessment of economic conditions and some aspects of Fund surveillance**. Enhanced efforts are needed to improve statistics in many areas, including the labor market and the fiscal sectors. Initiatives to meet the SDDS requirements are welcome.

42. **The authorities are encouraged to support the full liberalization of imports from the least developed countries, and to raise ODA toward the UN target**

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

Table 1. Greece: Selected Economic Indicators, 1996-2002
(Percentage changes, unless otherwise indicated)

	1996	1997	1998	1999	2000	Est. 2001	Proj. 2002
Domestic economy							
GDP	2.4	3.6	3.4	3.4	4.3	4.0	3.0
Output gap	-1.3	-0.3	0.1	0.3	1.2	1.5	0.9
Domestic demand	3.3	3.5	4.6	2.6	4.4	4.0	3.1
Private consumption	2.4	2.7	3.5	2.9	3.2	3.1	2.7
Public consumption	0.9	3.0	1.7	-0.1	2.3	1.8	0.5
Gross fixed capital formation	8.4	6.8	10.6	6.2	7.8	8.5	5.7
Private	9.7	5.6	11.0	4.3	8.1	8.7	5.5
Public	2.0	13.4	8.2	15.7	6.2	7.5	6.5
Change in stocks (contribution)	0.1	0.0	0.0	-0.6	0.4	-0.1	0.0
Foreign balance (contribution)	-1.1	-0.1	-1.6	0.6	-0.4	-0.3	-0.4
Exports	3.5	20.0	5.3	8.1	18.9	5.8	3.6
Imports	7.0	14.2	9.2	3.6	15.0	7.0	4.0
Unemployment rate	10.3	10.3	11.1	11.9	11.1	10.9	10.9
Employment 1/	1.3	-0.5	2.6	-0.5	0.4	0.9	0.6
Average compensation of employees (economy wide)	8.2	13.8	5.4	5.9	6.1	5.5	5.0
Unit labor costs (economy wide)	7.0	7.3	6.1	1.6	1.5	2.3	2.6
Consumer prices, end of period	6.9	4.7	3.9	2.7	3.9	3.0	2.4
Consumer prices, period average	8.2	5.5	4.8	2.6	3.2	3.4	2.9
Consumer prices (HICP), period average	7.9	5.4	4.5	2.1	2.9	3.7	2.9
GDP deflator	7.4	6.8	5.2	3.0	3.4	3.2	3.0
External sector							
Trade balance (in percent of GDP, settlements basis)	-12.5	-14.2	-13.6	-14.3	-17.8	-16.5	-16.2
Current account (including capital transfers; in percent of GDP, settlements basis)	-3.7	-4.0	-3.0	-4.0	-6.8	-6.2	-6.1
Nominal effective exchange rate	-1.8	-2.1	-6.3	-0.5	-6.2	0.2 2/	...
Real effective exchange rate (consumer prices)	4.2	0.8	-2.7	0.1	-6.5	2.5 2/	...
Real effective exchange rate (manufacturing ULCs)	2.6	3.5	-3.4	0.7	-3.3	1.2 2/	...
Public finances (general government, in percent of GDP) 3/							
Current revenues	36.9	38.8	40.3	42.1	43.0	43.7	43.5
Current expenditures	42.2	40.2	40.2	40.1	40.4	40.3	39.5
Primary expenditures	31.7	32.0	32.3	32.6	33.3	33.8	33.8
Interest expenditures	10.5	8.2	7.8	7.5	7.1	6.5	5.7
Net capital spending	2.2	2.6	2.5	3.8	3.7	3.4	3.5
Overall balance	-7.4	-4.0	-2.4	-1.8	-1.1	0.1	0.5
Primary balance	3.1	4.2	5.3	5.7	6.1	6.6	6.1
Structural primary balance 4/	3.6	4.3	5.3	5.6	5.6	5.6	5.7
Structural overall balance 4/	-6.9	-3.9	-2.5	-1.9	-1.6	-1.0	0.0
Debt	111.3	108.2	105.0	103.9	102.7	99.6	98.6
Financial variables							
Greek contribution to euro area M3 5/	15.3	7.8	9.8	5.6	11.5	5.5 6/	...
Total credit	8.1	11.0	9.7	12.2	20.2	16.4 6/	...
3-month treasury bill rate (average)	11.9	10.1	11.9	9.8	7.2	3.8	...
12-month treasury bill rate (average)	12.8	10.4	11.6	8.9	6.2	3.8	...
Short-term bank lending rate (average)	21.0	18.9	18.6	15.0	12.3	7.9 7/	...

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

1/ Data for 1998 affected by registration of previously illegal foreign workers.

2/ October 2001 compared with December 2000.

3/ For 2002, fiscal projections are based on the authorities' draft budget, adjusted for differences in the macroeconomic outlook.

4/ For 2001, excludes UMTS revenues equivalent to 0.4 percent of GDP.

5/ Data prior to 2000 refer to growth of Greek liquidity measure M4N.

6/ 12-month change in October.

7/ November.

Table 2. Greece: Balance of Payments, 1996–2001
(In billions of Greek drachma)

	1996	1997	1998	1999	2000	2001 Proj.
Current account 1/	-1,096	-1,360	-1,145	-1,567	-2,820	-2,774
(In percent of GDP)	-3.7	-4.0	-3.0	-4.0	-6.8	-6.2
Trade balance	-3,732	-4,723	-4,937	-5,506	-7,383	-7,343
Exports	1,418	1,751	1,962	2,617	3,740	4,107
Oil	...	165	215	355	816	757
Non-oil	...	1,586	1,747	2,262	2,923	3,349
Imports	5,150	6,474	6,900	8,123	11,123	11,450
Oil	...	764	598	825	1,822	1,789
Non-oil	...	5,710	6,301	7,298	9,300	9,661
Services	1,230	1,760	2,007	2,231	2,938	3,062
Receipts	2,250	2,766	3,302	5,078	7,070	7,509
Travel	896	1,414	1,829	2,704	3,391	3,514
Transportation	91	510	640	1,590	2,913	3,219
Other services	1,263	842	833	785	766	776
Payments	1,020	1,006	1,295	2,847	4,132	4,447
Travel	291	364	518	1,226	1,867	1,608
Transportation	305	101	143	740	1,503	1,833
Other services	424	541	634	881	962	1,006
Income	-525	-433	-458	-204	-321	-582
Receipts	278	341	451	786	1,024	819
Compensation of employees	45	77	111	188	213	216
Investment income	234	265	340	599	811	603
Payments	803	774	910	990	1,345	1,400
Compensation of employees	77	93	107	75	92	98
Investment income	726	681	803	915	1,253	1,302
Transfers	1,931	2,036	2,244	1,911	1,946	2,088
Receipts	1,938	2,047	2,389	2,214	2,272	2,418
Official	1,217	1,248	1,414	1,384	1,330	1,391
Other sectors	721	799	975	830	942	1,027
Payments	7	11	144	303	326	330
Official	0	3	4	62	70	55
Other sectors	7	8	141	240	255	274
Financial account	1,070	1,598	1,012	1,558	2,820	1,627 2/
Direct investment	255	446	103	1	-375	344 2/
Portfolio investment	0	426	3,491	1,848	3,003	3,361 2/3/
Other investment	1,829	-921	-1,162	-164	-1,633	-4,102 2/3/
Reserve assets	-1,014	1,647	-1,419	-128	1,942	1,980 2/3/
Errors and omissions	27	-238	132	10	0	346 2/

Sources: Bank of Greece; and Fund staff projections.

1/ Includes capital transfers.

2/ January-October 2001.

3/ Affected in offsetting amounts by the release of commercial bank foreign exchange redeposits with the Bank of Greece resulting from the harmonization of reserve requirements upon entry into the euro area.

Table 3. Greece: Summary of General Government Accounts, 1996-2002
(In percent of GDP)

	1996	1997	1998	1999	2000	Budget 1/ 2001	Estimate 2001	Budget 2/ 2002
Current Revenues	36.9	38.8	40.3	42.1	43.0	42.5	43.7	43.5
Direct taxes	7.1	7.8	9.5	9.9	10.4	10.7	9.6	9.7
Indirect taxes	14.0	14.3	14.4	15.1	15.4	15.2	15.2	15.0
Social insurance contributions	12.9	13.3	13.6	13.7	13.5	13.9	13.5	13.5
Other current revenues	2.9	3.4	2.8	3.5	3.7	2.7	5.4	5.4
Current expenditures	42.2	40.2	40.2	40.1	40.4	38.5	40.3	39.1
Primary expenditures	31.6	32.2	32.4	32.6	33.3	32.0	33.8	33.5
Interest expenditures	10.5	8.2	7.8	7.6	7.1	6.5	6.5	5.6
Current balance	-5.2	-1.5	0.1	2.0	2.6	4.0	3.4	4.3
Capital balance	-2.2	-2.6	-2.5	-3.8	-3.7	-3.5	-3.4	-3.5
Capital transfers received	3.7	3.4	3.4	3.1	3.4	3.2	3.5	3.7
Gross fixed capital formation	3.2	3.4	3.6	4.0	4.1	4.5	4.2	4.3
Other capital expenditures	2.6	2.5	2.4	3.0	2.9	2.2	2.7	2.8
Overall balance	-7.4	-4.0	-2.4	-1.8	-1.1	0.5	0.1	0.8
Memorandum items:								
Total revenue	40.6	42.2	43.7	45.2	46.4	45.7	47.2	47.2
Total expenditure	48.0	46.1	46.2	47.1	47.4	45.2	47.2	46.2
Structural balance 3/4/	-6.9	-3.9	-2.5	-1.9	-1.6	-0.1	-1.0	...
Structural primary balance 3/4/	3.6	4.3	5.3	5.6	5.6	6.4	5.6	...
Primary balance	3.1	4.2	5.3	5.7	6.1	7.0	6.6	6.4
General government gross debt	111.3	108.2	105.0	103.9	102.7	98.9	99.6	97.3

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

1/ Ministry of National Economy projection, which, given subsequent national accounts revisions, is not fully comparable with estimates for 2001 and with data for other years.

2/ Ministry of Economy and Finance projection.

3/ Fund staff estimates.

4/ For 2001, excludes UMTS revenues equivalent to 0.4 percent of GDP.

Table 4. Greece: Stability and Growth Program and Staff's Medium-Term Scenario, 2001-07 1/
(In percent of GDP, unless otherwise indicated)

	Projections						
	2001	2002	2003	2004	2005	2006	2007
Stability and Growth Program							
GDP (percent change)	4.1	3.8	4.0	4.0	...	...	...
Private consumption deflator (percent change)	3.1	2.8	2.7	2.8	...	...	...
Gross domestic investment	23.0	24.0	25.3	26.0	...	...	...
General government balance	0.1	0.8	1.0	1.2	...	...	...
General government primary balance	6.6	6.4	6.2	6.0	...	...	...
General government debt	99.6	97.3	94.4	90.0	...	...	...
Staff projections (unchanged policy scenario)							
GDP (percent change)	4.0	3.0	3.0	3.0	2.9	2.9	2.9
Output gap (percent of potential output)	1.5	0.9	0.5	0.2	0.1	0.0	0.0
Consumer prices (HICP, period average, percent change)	3.7	2.9	2.7	2.7	2.8	2.8	2.8
Gross domestic investment	23.1	23.6	23.9	24.2	24.3	24.4	24.5
Current account balance (settlements basis) 2/	-6.2	-6.1	-6.1	-6.0	-5.9	-5.8	-5.7
General government balance	0.1	0.5	1.0	1.5	1.6	1.9	2.2
General government primary balance	6.6	6.1	6.2	6.2	6.3	6.3	6.4
General government debt 3/	99.6	98.6	97.2	93.9	87.3	80.9	74.2

Sources: Ministry of Economy and Finance, "*The 2001 Update of the Hellenic Stability and Growth Programme: 2001-04*" (December 2001); and Fund staff estimates and projections.

1/ Authorities' figures are based on December 2001 Stability Program, and therefore may differ from fiscal data contained in Table 1.

2/ Includes capital account.

3/ The staff assumes that the amount of below-the-line capital injections and other spending, net of privatization and other receipts used to retire government debt equals the amounts implicit in the authorities' *Stability and Growth Program* for 2002-04, and zero thereafter.

Table 5. Greece: Indicators of External and Financial Vulnerability, 1991-2001 1/

(In percent of GDP, unless otherwise indicated)

	1991-94	1995	1996	1997	1998	1999	2000	2001 Latest Estimate	2001 Date
External indicators									
Exports (annual percent change, in U.S. dollars)	4.2	10.8	-0.2	11.4	3.8	28.1	19.4	7.0	Oct-01
Imports (annual percent change, in U.S. dollars)	0.8	22.3	5.3	-1.9	-1.5	13.7	14.9	-1.4	Oct-01
Terms of trade (annual percent change)	4.1	-0.9	0.7	1.0	0.1	0.8	-3.0	…	…
Current account balance (settlements basis)	-2.3	-2.4	-3.7	-4.0	-3.0	-4.1	-6.9	-4.5 2/	Oct-01
Capital and financial account balance	4.6	2.7	3.6	5.0	3.1	4.0	6.9	3.7 2/	Oct-01
Of which: Inward portfolio investment (debt securities etc.)	0.6	0.4	1.3	1.3	7.6	4.6	9.5	7.8 2/	Oct-01
Inward foreign direct investment and other investments	1.9	3.7	4.2	1.3	-2.3	0.0	-3.4	-2.3 3/	Oct-01
Official reserves (in U.S. dollars, millions, period average)	7,918	14,611	17,337	12,441	17,188	17,726	13,156	6,689 4/	Oct-01
Central Bank short-term foreign liabilities (in U.S. dollars, millions)	788	860	796	1,337	0.0	…	…	…	…
Official reserves in months of imports GS	4.0	6.0	6.9	5.2	6.9	6.0	3.8	2.3	Oct-01
Total external debt 5/	32.6	30.7	29.9	30.8	31.4	33.7	35.8	…	…
Of which: General government debt 5/	24.0	24.2	24.2	25.1	25.4	26.6	22.1	6.2	…
Total external debt to exports GS (ratio)	2.0	2.3	2.4	2.3	2.1	1.7	1.3	…	…
External interest payments to exports GS (in percent)	13.3	13.5	14.4	12.6	14.3	11.1	10.3	10.9 6/	…
External amortization payments to exports GS (in percent)	24.4	25.9	31.7	34.9	34.0	12.4	…	…	…
Exchange rate (per U.S. dollars, period average)	211.2	231.6	240.7	273.1	295.5	305.7	365.4	382.7	…
Financial market indicators									
Public sector debt (Maastricht definition)	98.3	108.7	111.3	108.2	105.0	103.9	102.7	99.6	…
Greek contribution to euro area M3 (percent change, 12-month basis) 7/	18.5	13.0	15.3	7.8	9.8	5.5	10.4	5.5	Oct-01
Private sector credit (percent change, 12-month basis)	14.7	22.0	17.0	15.3	15.0	14.2	28.5	22.1	Oct-01
3-month T-bill yield	18.2	14.3	12.0	9.5	12.0	9.4	7.2	3.8	…
3-month T-bill yield (real)	2.7	4.9	3.5	3.8	6.9	6.6	3.9	0.4	…
Stock market index	827	914.2	933.5	1,480	2,738	5,535	3,389	2,592	…
Share prices of financial institutions	965	1,160	1,414	2,303	5,799	10,165	7,307	4,929	11/30/01
Spread of 3-month money market rate with Germany (percentage points, end of period	14.1	12.3	10.4	8.1	9.8	7.6	0.2	0.0	…
Spread of 10-year bond with Germany (percentage points, end of period)	…	…	…	4.1	3.8	1.8	0.6	0.3	…
Financial sector risk factors									
Foreign exchange loans to the private sector (in millions of U.S. dollars)	2,698	5,685	8,785	9,138	10,398	10,989	13,312	7107	Aug-01
Share of foreign exchange loans in total lending to the private sector 8/	10.0	22.8	30.3	30.6	29.8	32.0	32.7	11.9	Aug-01
Deposits in foreign exchange (in millions of U.S. dollars)	16,619	21,090	21,290	29,240	38,611	31,118	27,161	19,002	Aug-01
Share of foreign deposits in total deposits	22.7	24.1	22.6	29.5	35.2	30.9	29.8	19.6	Aug-01
Share of real estate sector in private credit	15.1	14.6	16.1	17.3	18.2	20.0	20.4	21.2	Aug-01
Commercial Banks' Return on Assets (after tax)	…	0.9	0.5	0.7	0.8	2.4	1.4	…	…
Interest rate margin	8.8	7.3	7.5	8.8	7.9	6.3	6.2	5.1	Sep-01
Share of nonperforming loans in total loans 9/	10.8	19.5	19.0	16.5	13.6	14.7	12.3	10.6	Jun-01
Share of nonperforming loans in total assets 9/	…	…	6.4	5.9	5.4	5.8	4.7	4.4	Jun-01
Risk-based capital asset ratio 10/	12.6	12.8	10.3	10.3	10.2	16.2	13.5	…	…
Foreign currency debt and banking sector rating									
Standard & Poor's	Mar-90	Jul-90	Jan-93	Mar-94	Mar-97	Dec-98	Nov-99	Mar-01	
Long term	BBB	BBB-	BBB-	BBB-	BBB-	BBB-	A-	A	
Outlook	Negative	Stable	Positive	Stable	Positive	Positive	Positive	Positive	
Short term	A-2	A-3	A-3	A-3	A-3	A-3	A-1	A-1	
Moody		Jul-90		May-94	Dec-96	Jul-99	Jan-00	Aug-01	
Bonds and notes		Baa1		Baa3	Baa1	A2	A2	A2	
Bank financial strength rating 11/							D to D+	D+	
IBCA				Oct-95	Jun-97	Oct-99	Jul-00	Jun-01	
Long term				BBB-	BBB	BBB	A-	A	

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

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

2/ Data for January-September in percent of annual output.

3/ Public sector.

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

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

6/ January-September.

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

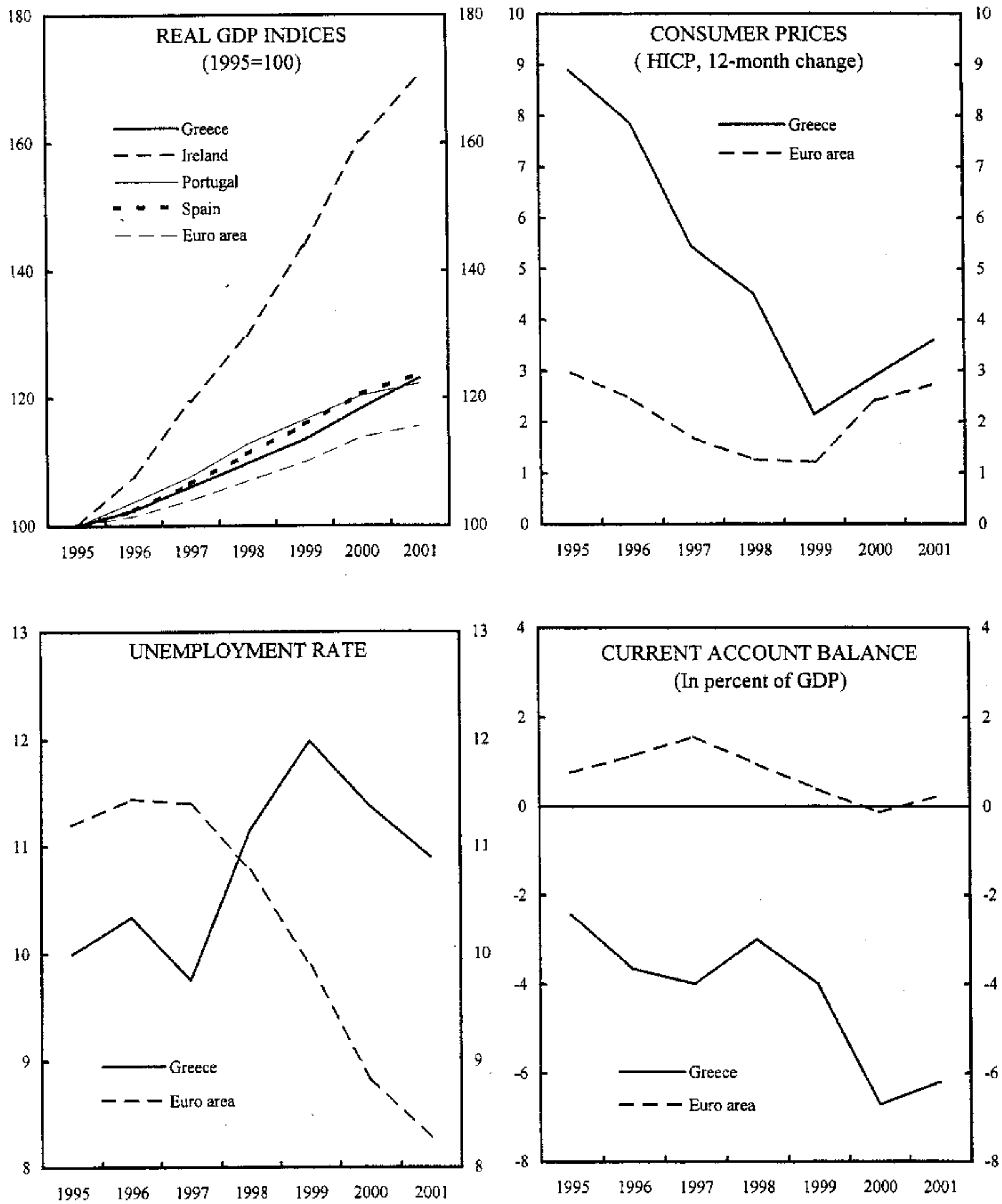
8/ As from 2001, loans and deposits in euro and its national denominations are not included in foreign exchange loans and foreign exchange deposits respectively.

9/ Data refer to all commercial banks incorporated in Greece. Nonperforming loans are defined as all loans with interest and/or principal payments in arrears for three months or more, and include all loans classified as doubtful by the banks themselves.

10/ Data refer to all commercial banks incorporated in Greece. Starting in 1998, data take also into account market risks.

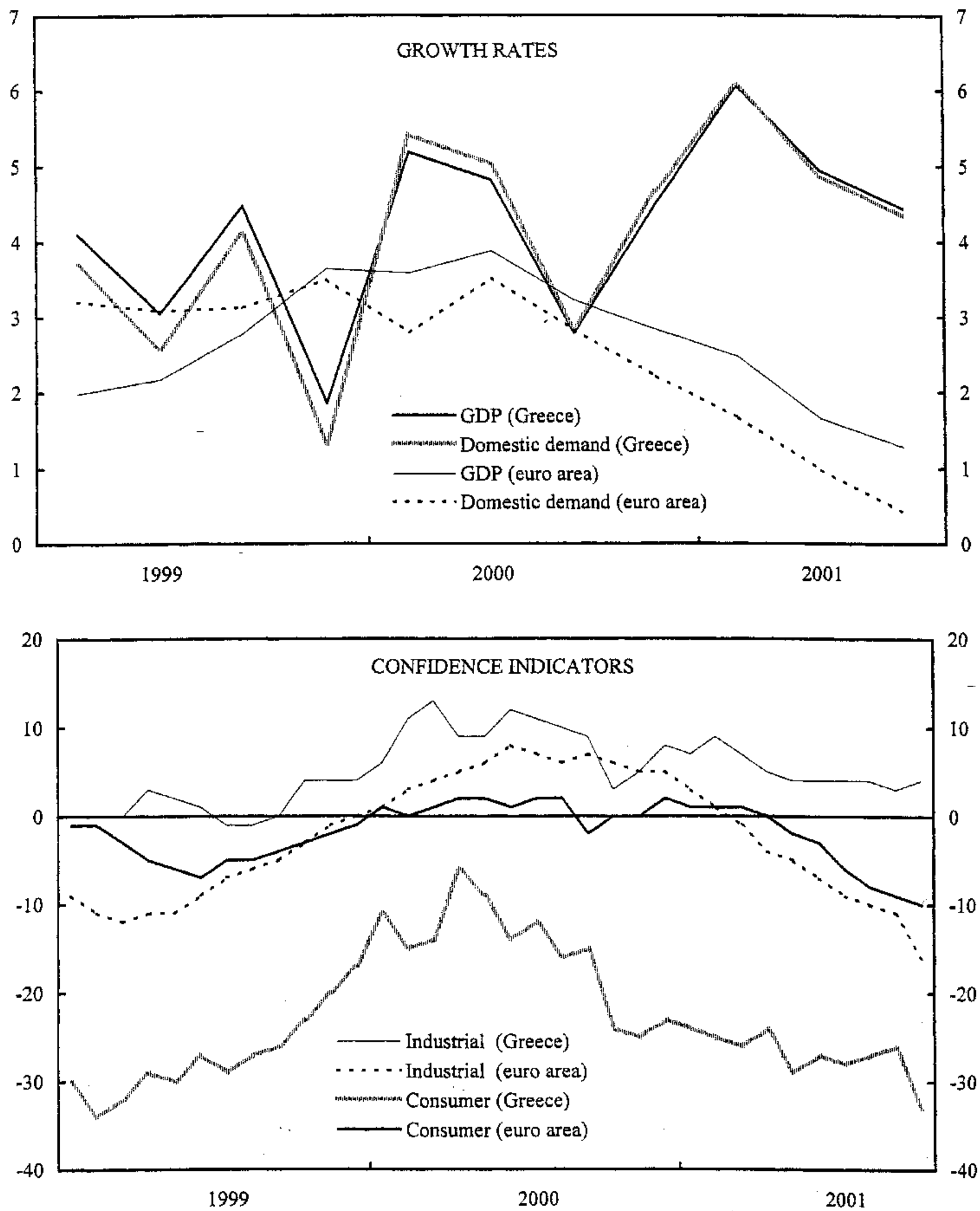
11/ Data are from January in 2000 and September in 2001.

Figure 1. Greece: International Comparisons of Macroeconomic Performance, 1995-2001



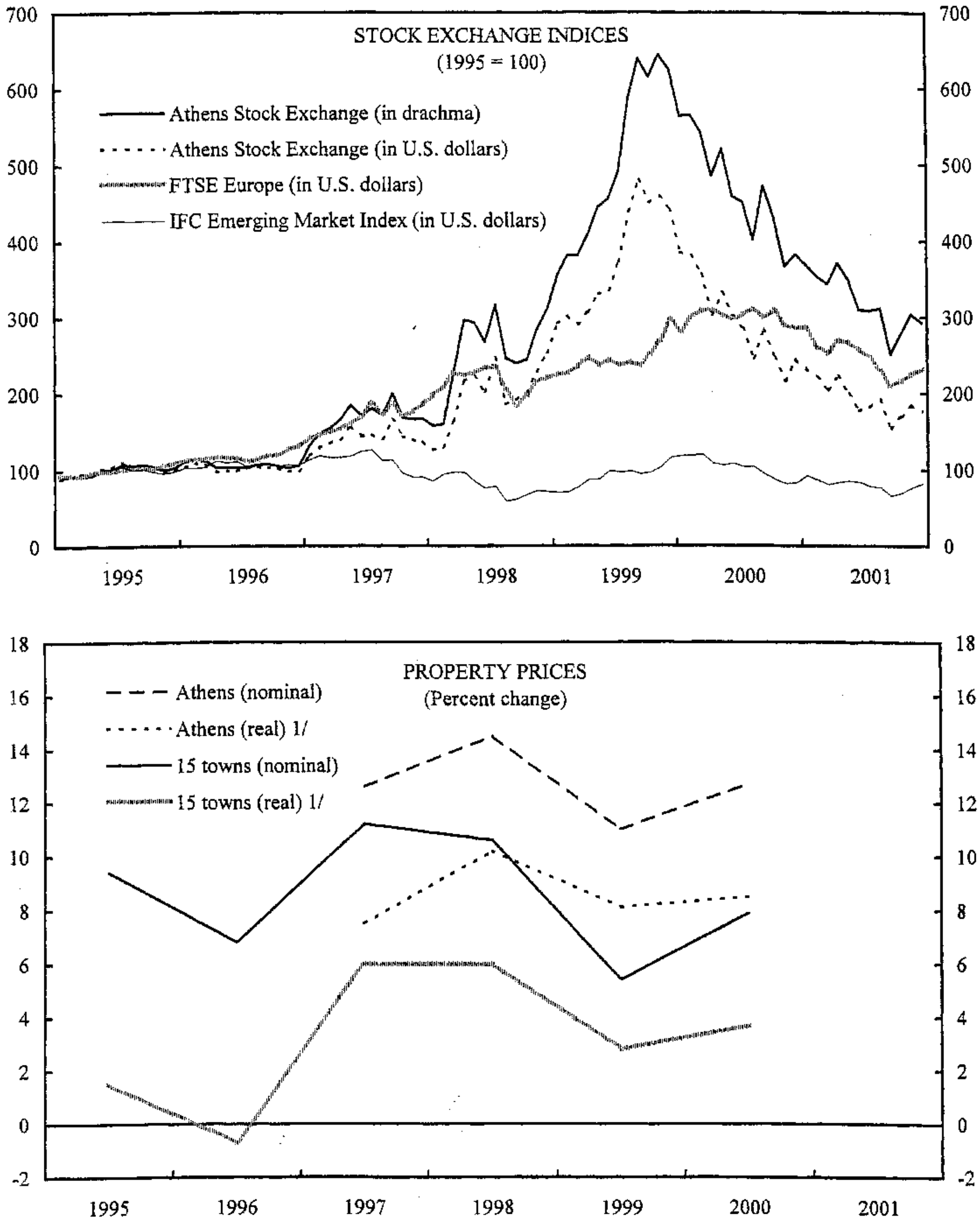
Source: IMF, *World Economic Outlook*.

Figure 2. Greece: Short-Term Growth and Confidence Indicators, 1999-2001



Sources: National Statistical Service; Ministry of National Economy; EU1 database; and Fund staff calculations.

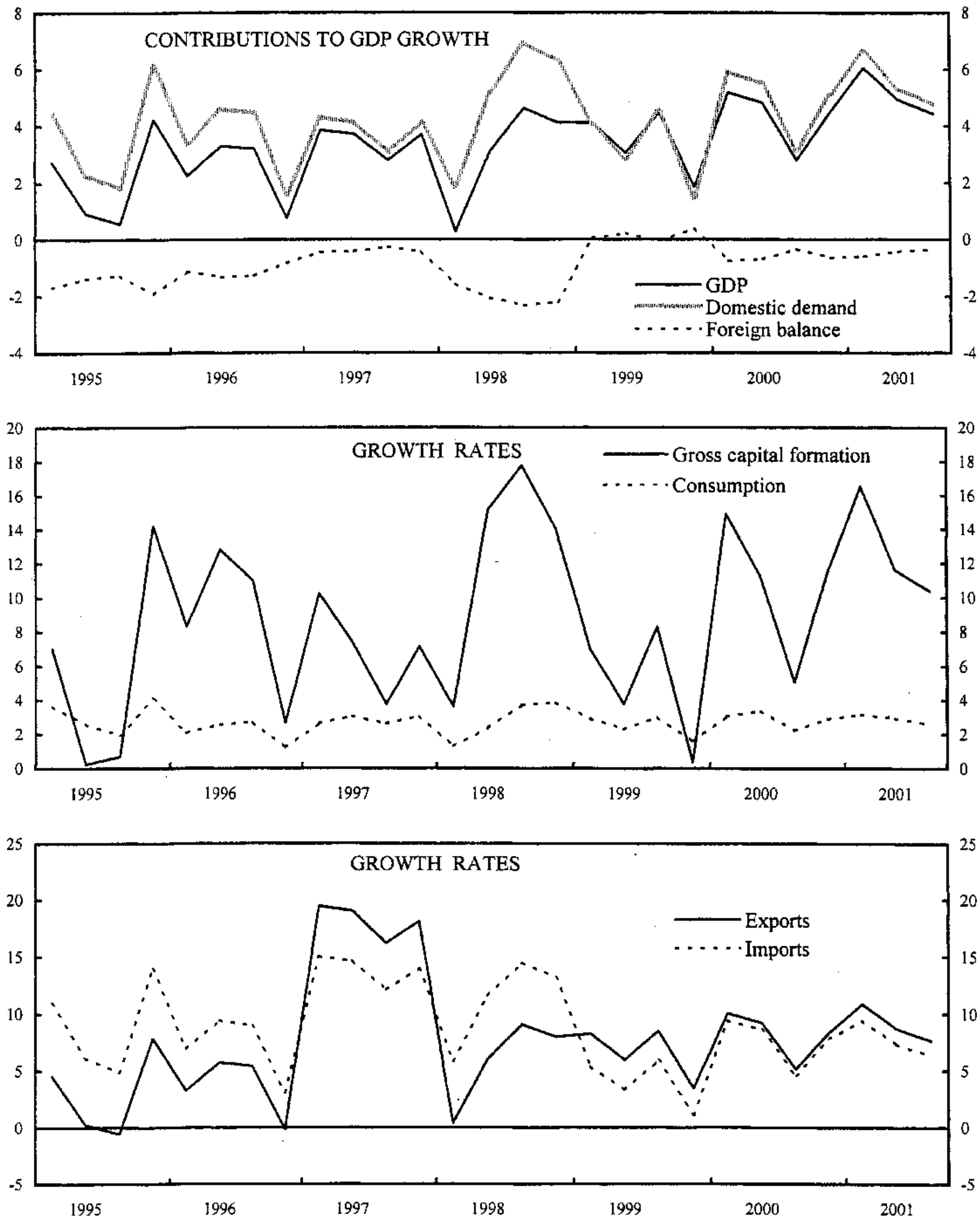
Figure 3. Greece: Asset Market Developments, 1995-2001



Sources: Bank of Greece; and Bloomberg.

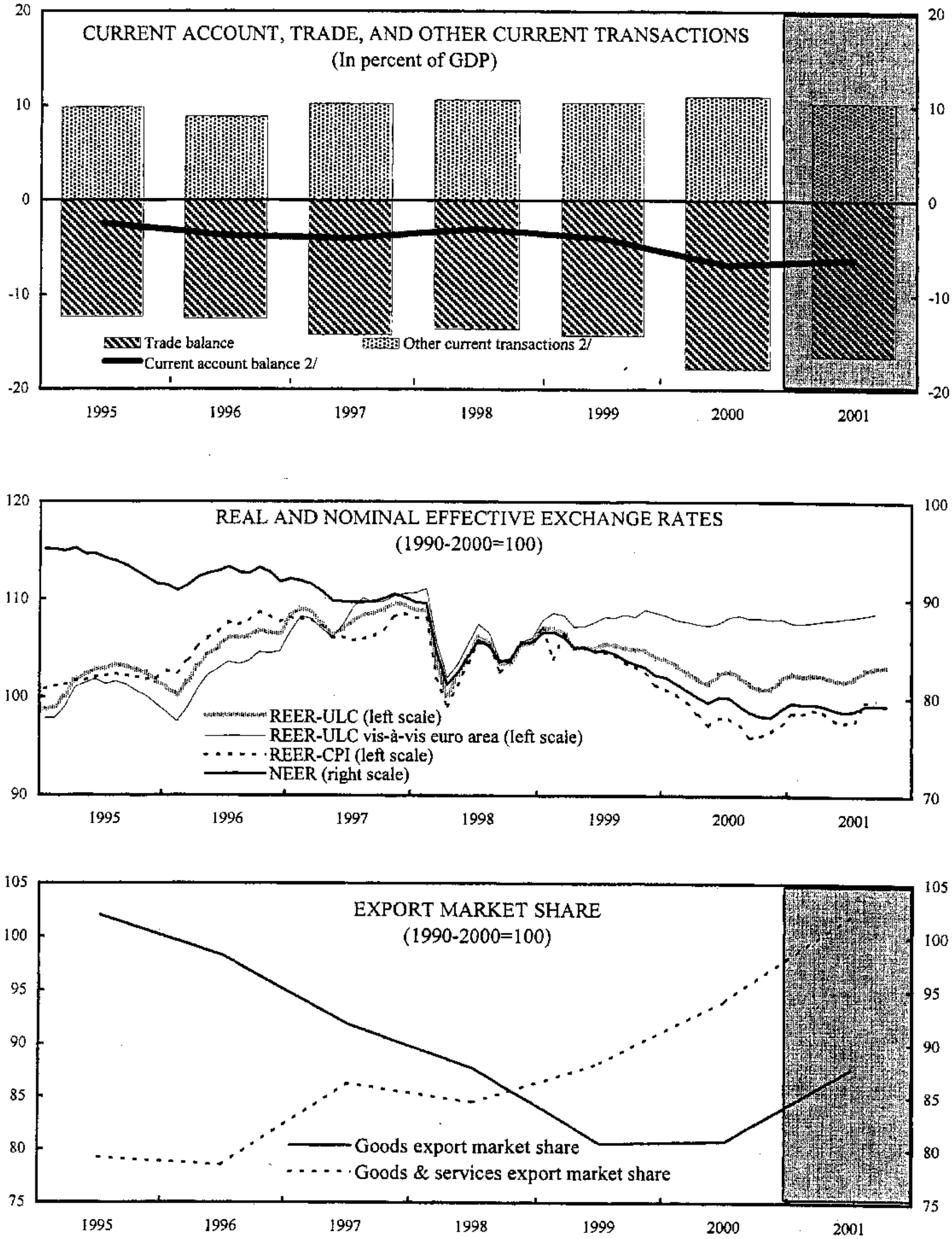
1/ Deflated by consumer price inflation.

Figure 4. Greece: GDP and Components' Contributions and Growth, 1995-2001
(Year-on-year change, in percent)



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

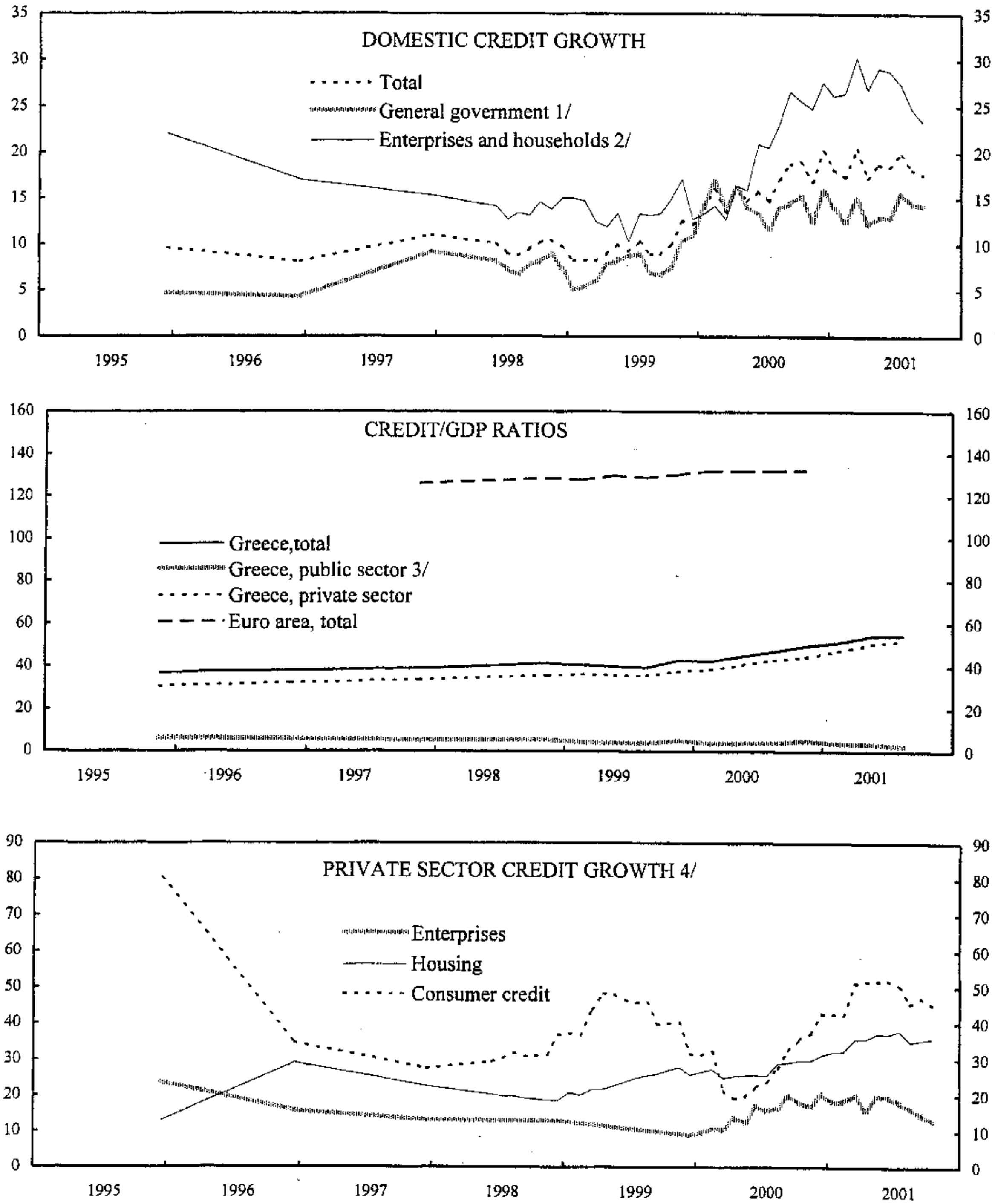
Figure 5. Greece: External Developments, 1995-2001 1/



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

1/ Shaded areas show Fund staff projections.
2/ Including capital transfers.

Figure 6. Greece: Credit Developments, 1995-2001
(In percent)

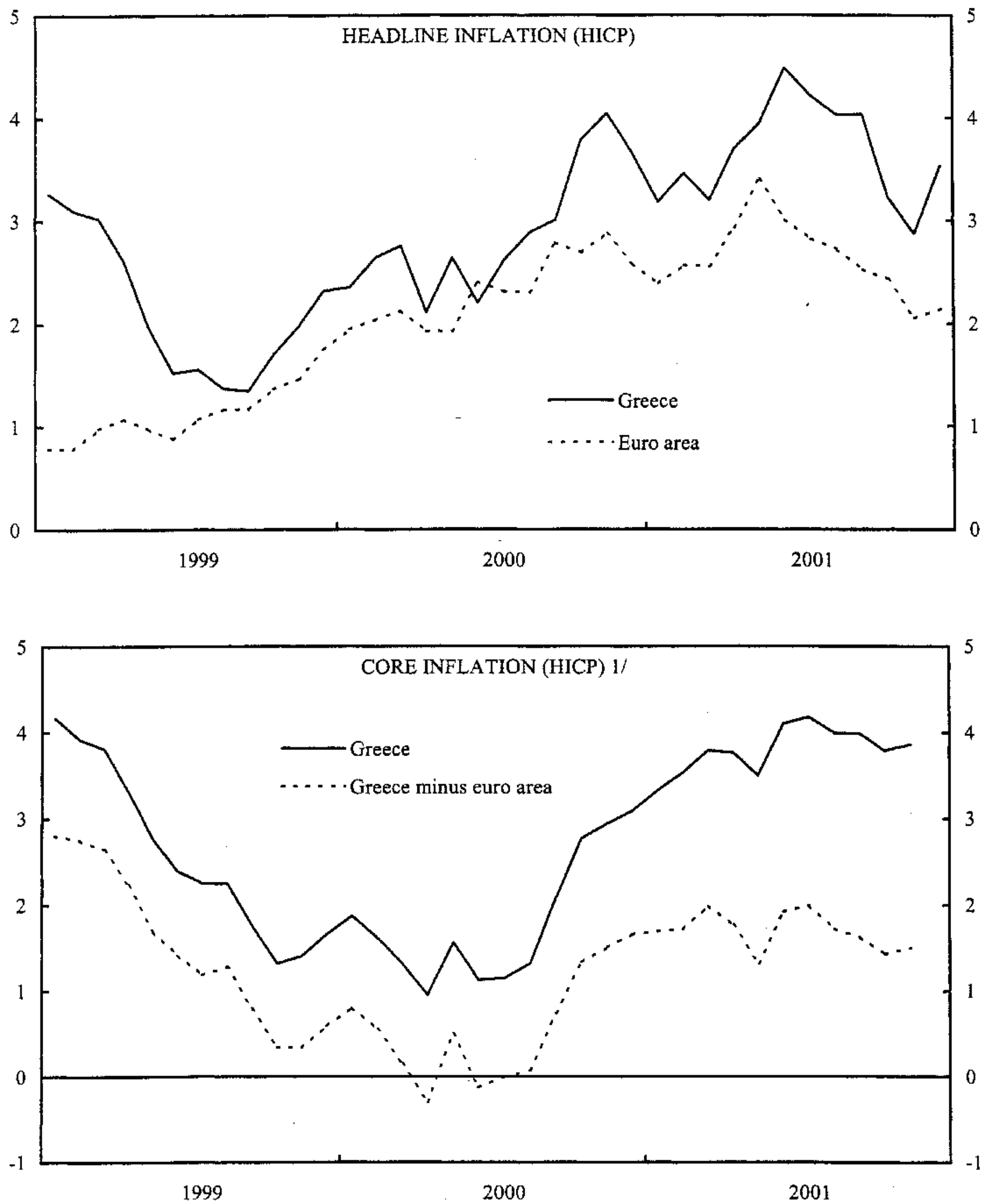


Sources: Bank of Greece, *Bulletin of Conjunctural Indicators,* and *Monthly Statistical Bulletin*.

1/ Data prior to 1999 refer to public sector.
2/ Data prior to 1999 refer to private sector.
3/ Excludes banks' holdings of government securities.
4/ Data prior to 2000 refers to commercial bank credit.

Figure 7. Greece: Evolution of Consumer Prices, 1999-2001

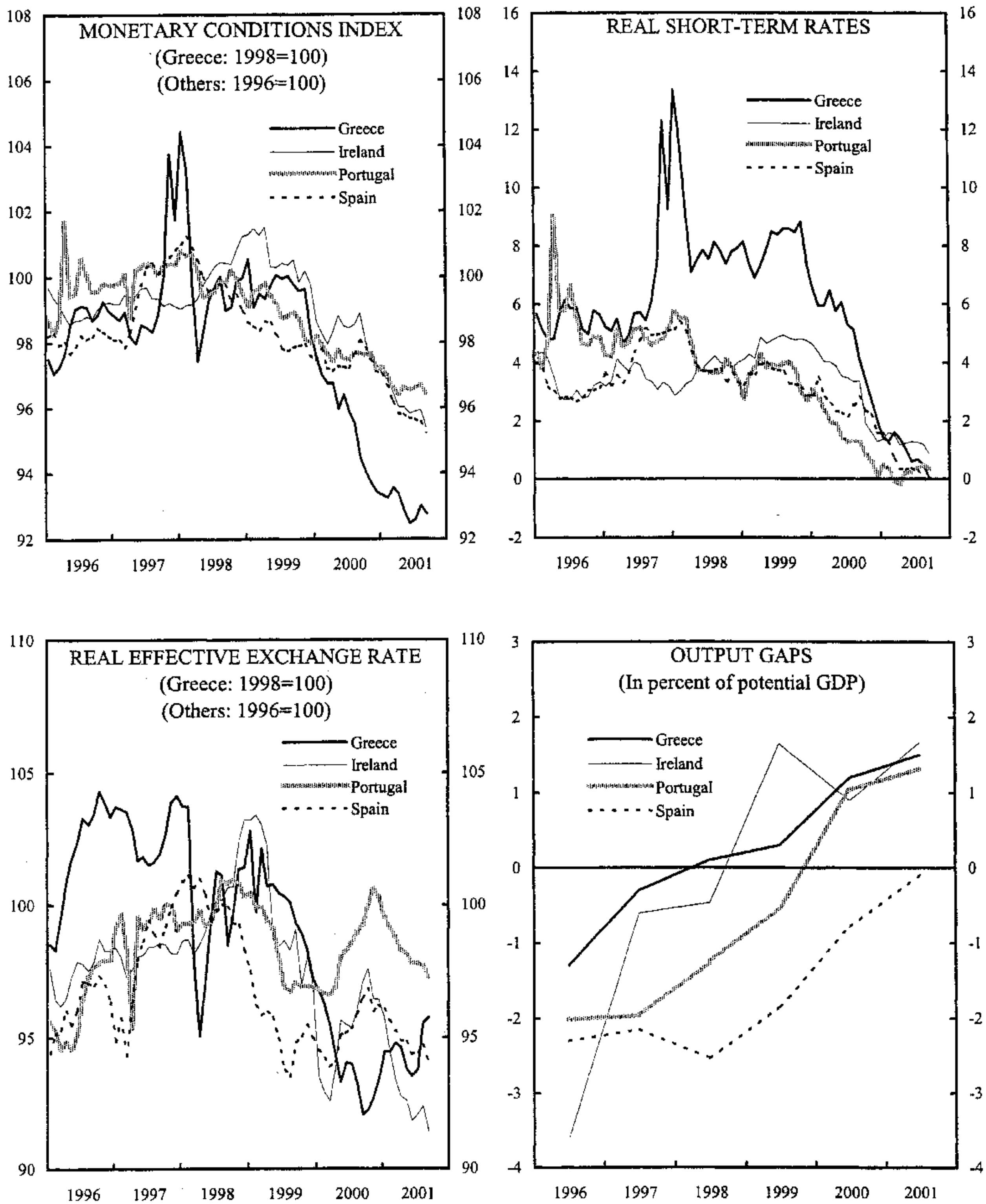
(Year-on-year growth rate, in percent)



Sources: National Statistical Service; Bank of Greece; Eurostat; and Fund staff calculations.

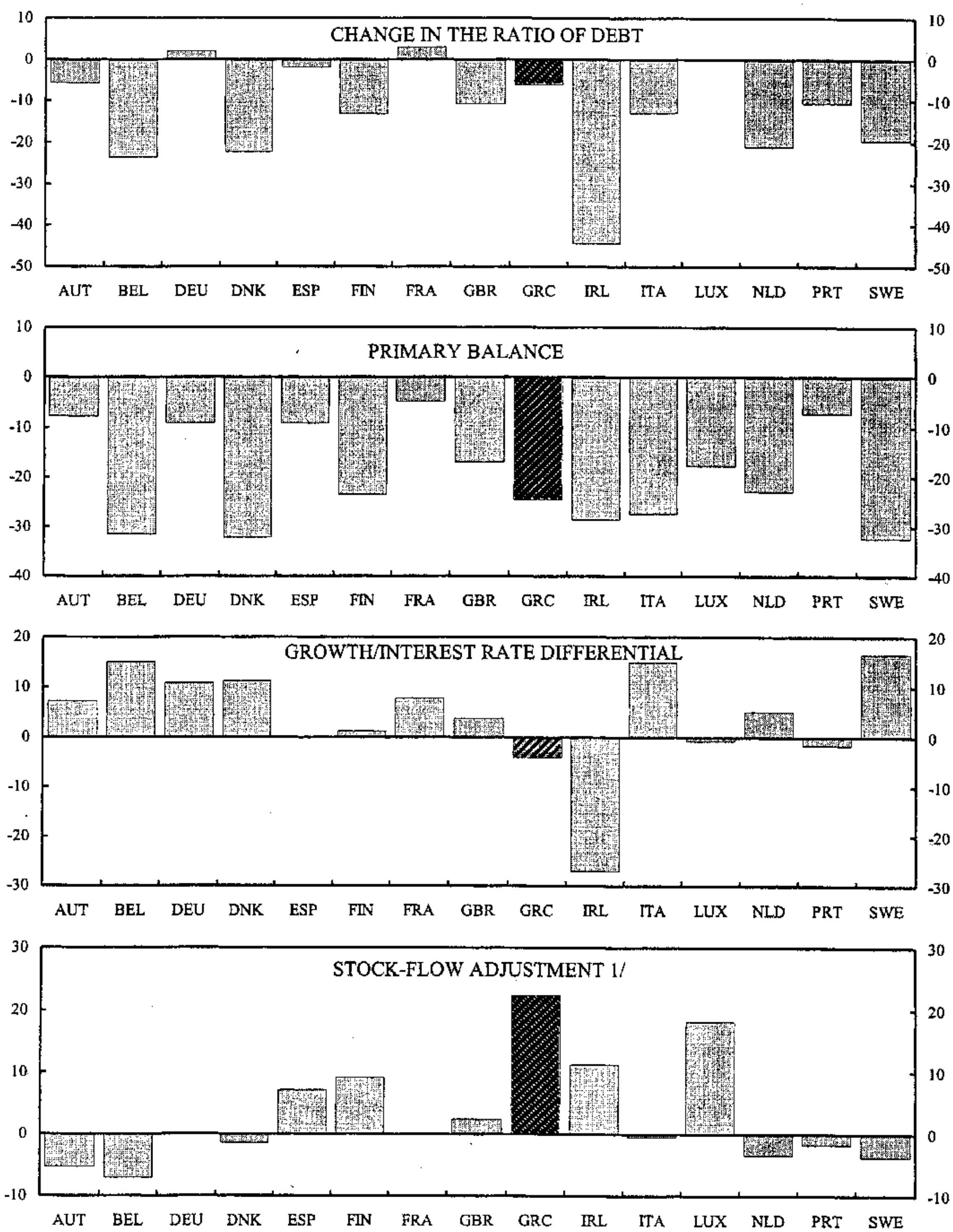
1/ Excluding energy and unprocessed food.

Figure 8. Greece: Entering Monetary Union—A Comparison of Monetary Conditions and Output Gaps, 1996-2001 1/



Sources: IMF, *World Economic Outlook, International Financial Statistics,* and *Information Notice System*.
1/ Reflecting their earlier euro entry, data for countries other than Greece are lagged two years (for example, 2000 corresponds to 1998, etc.).

Figure 9. Greece: General Government Gross Debt Changes and Contributing Factors, 1995-2000
(Percent of GDP)



Source: IMF, *World Economic Outlook.*

1/ The stock-flow adjustment in a number of countries, including Finland, Ireland, and Luxembourg, largely results from the purchase of nongovernment securities by government entities.

Greece: Fund Relations
(As of December 31, 2001)

I. **Membership Status**: Joined 12/27/1945; Article VIII

II. **General Resources Account**:	**SDR Million**	**% Quota**
Quota	823.00	100.00
Fund holdings of currency	538.69	65.45
Reserve position in Fund	284.31	34.55

III. **SDR Department**:	**SDR Million**	**% Allocation**
Net cumulative allocation	103.54	100.00
Holdings	7.71	7.44
Designation Plan	0.00	

IV. **Outstanding Purchases and Loans**: None

V. **Financial Arrangements**: None

VI. **Projected Obligations to Fund** None

VII. **Exchange Rate Arrangements**:

Greece entered the final stage of European Economic and Monetary Union on January 1, 2001, at a rate of 340.750 Greek drachmas per 1 euro.

Greece maintains restrictions on the making of payments for current international transactions vis-à-vis Iraq. These restrictions were notified to the Fund under Decision 144-(52/51) in EBD/90/304, 9/21/90.

VIII. **Article IV Consultation**: Greece is on a 12-month consultation cycle; the last Article IV consultation discussions were concluded on February 23, 2001 (EBM/01/52).

IX. **ROSCs**

Standard Code Assessment	**Date of Issuance**	**Document Number**
Fiscal Transparency	October 6, 1999	SM/99/255
Fiscal Transparency	February 8, 2001	SM/01/25, Sup. 1

X. **Technical Assistance**:

Year	**Dept.**	**Purpose**	**Date**
1993	FAD	Treasury Reform	June
1993	MAE	Central Bank Independence in the Context of the Maastricht Treaty	June
1994	MAE	Development of Primary and Secondary Markets in Government Securities	September

XI. **Resident Representative**: None

Greece: Statistical Issues

Efforts have been under way for several years to improve the quality and timeliness of Greece's economic data. However, important weaknesses persist in a number of areas. The authorities have an open publication policy and have indicated their intention to subscribe to the Special Data Dissemination Standards (SDDS). A significant amount of work remains to be done, particularly in the areas of government accounts and labor market data. These issues would most likely be addressed during the normal SDDS subscription process.

National accounts

National account data were available only on an annual basis until recently. Limited quarterly National Accounts data produced by the National Statistical Service of Greece (NSSG) based upon the ESA95 system of accounts are now available, from the first quarter of 1970 to the second quarter of 2001. However, the quarterly data are very volatile and large revisions raise concerns about their reliability.

Balance of payments/external trade

The Bank of Greece (BoG), in cooperation with several European central banks, had been engaged for a number of years in a comprehensive revision of balance of payments data on a settlements basis consistent with the fifth edition of the *Balance of Payments Manual (BPM5)*. Data for 1999 are the first available under the new system, with the BoG also providing estimates for 1997–98 (collected under the previous system, but compiled in the new categories). Monthly balance of payments data are reported to both the ECB and the IMF according to the timetable set by the ECB. A full international investment position—external assets/liabilities—for all sectors of the economy has been submitted to the IMF for the years 1998–2000. Despite the new settlements-based reporting system, significant differences remain in comparison to national-accounts-based current account data, with sizable differences in changes (and even in direction) of the current account and its components in recent years. After several years, Greece resumed reporting balance of payments data to the Statistics Department (STA) in 2001. In October 2001, the BoG remitted to STA quarterly data on the balance of payments for 1999–2000 and annual data on the international investment position for 1998–2000, with the presentation recommended by the *BPM5*.

Customs-based external trade statistics are prepared by the NSSG, but with significant lags (there is no detailed implementation timetable regarding their EMU commitment of shortening the time lag to 40 days).

The Bank of Greece has been submitting to the ECB since December 2000 reserves and foreign currency liquidity data according to the Eurosystem definitions. However, the provision of data to the Fund in the areas of reserves and foreign currency liquidity and external debt, does not meet the established benchmarks with regards to coverage, periodicity, and timeliness. The authorities are attempting to address these shortcomings through their efforts to subscribe to the SDDS.

Government accounts

Reliable data exist for the budgetary central government, but the quality and timeliness of the data on other public entities, including social security funds and local governments, are poor. This also affects the quality of the data for the general government. The problem arises from inadequate accounting practices and weaknesses in reporting. A law adopted in 1997 introduced penalties for agencies that do not supply the required data on a timely basis, but no fines have yet been imposed.

Monetary accounts

Upon Greece's participation in the euro area, the BoG successfully transitioned to compiling monetary statistics in accordance with European Central Bank requirements. Monetary statistics for publication on Greece's *International Financial Statistics (IFS)* page have been revised for consistency with the other euro-area countries. Data reporting is timely.

Labor force survey

A new more detailed quarterly labor force survey, with an enlarged sample size and capable of generating data on a EU-harmonized basis, has been used since the fall of 1998. However, the data are available only with significant reporting delays, seriously undermining their usefulness. Moreover, the data display sizable quarter-to-quarter volatility.

Short-term data

The recent publication of quarterly national accounts is an important improvement in this area. Other high-frequency indicators for economic surveillance (including retail sales, industrial production, wholesale prices, and other indices) are at times based on out-of-date samples and component weights. In addition, reporting delays seriously undermine the usefulness of these data.

Advance release calendars

The NSSG has announced an advance publications schedule for most statistical releases. However, this calendar is not always followed.

Greece: Core Statistical Indicators
(as of January 18, 2002)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Central Government Balance	GDP/GNP	External Public Debt/Debt Service
Date of Latest Observation	01/18/02	11/30/01	11/30/01	November 2001	November 2001	01/18/02	December 2001	October 2001	October 2001	October 2001	3rd quarter 2001	2000
Date Received	01/18/02	12/10/01	12/10/01	12/28/01	12/28/01	01/18/02	1/10/02	1/16/02	1/16/02	01/04/02	12/11/01	9/15/01
Frequency of Data	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Annually
Frequency of Reporting	Daily	Monthly; or when requested	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Monthly	Monthly	Quarterly	Monthly
Source of Update 1/	Reuters/ Bloomberg	BoG	BoG	BoG	BoG	Reuters/ Bloomberg	NSSG	BoG	BoG	MEF	Bloomberg	BoG
Mode of Reporting	Electronic	Fax	Fax	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic	Electronic/ statistical bulletin
Confidentiality	None	None	None	None	None	None	None	None	None	None	None	None
Frequency of Publication	Daily	Monthly	Monthly	Monthly	Monthly	Daily	monthly	Monthly	Monthly	Monthly	Quarterly	Monthly

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

Statement by Harilaos Vittas, Alternate Executive Director for Greece
February 22, 2002

Key Points

- *The Greek economy continued to perform well in 2001, with real GDP growth more than twice as high as the EU average, unemployment declining and the current account deficit narrowing. Core inflation has also tended to moderate, although it remains higher than in the rest of the euro area.*
- *The outlook is generally favorable as the impact of the global economic slowdown is mitigated by other positive factors, including the accelerated absorption of generous EU community support funds. There are, however, downside risks.*
- *The public finances continued to strengthen in 2001, with the general government balance moving into a slight surplus and the public debt ratio dropping below 100 percent. Both are targeted to improve further in the years ahead.*
- *Rapid convergence of real per capita income to the EU average remains a key medium-term policy objective. The authorities are aware that its attainment will require rigid adherence to prudent financial policies, wage moderation, social cohesion and an accelerated pace of productivity-enhancing structural reforms.*
- *Reforms focus at present on revamping the tax system, strengthening budgeting and control procedures, the further opening up of product markets and the privatization of public enterprises. The longer-term issues of healthcare and pension provision are also beginning to be addressed.*
- *While the financial sector is generally in good shape, it is recognized that the recent rapid credit expansion reinforces the need for vigilance and adequate provisions.*

On behalf of my authorities, I would like to thank staff for the constructive discussions in Athens, a balanced and insightful consultation report and the helpful background studies. The staff report documents the continuing good performance of the Greek economy and identifies important policy issues that remain to be addressed. Its conclusions and recommendations are fair and broadly shared by my authorities.

Recent developments and short-term prospects. Macroeconomic developments in 2001 were in general satisfactory. For the 6th consecutive year, real GDP growth (at about 4 percent) was significantly higher than the euro area average. Moreover, the differential widened considerably in 2001 as Greece was less severely affected by the global slowdown than most other EU countries. While growth was driven mainly by consumer and investment demand, an encouraging development was the strong performance of exports, which (together with the decline in the price of oil and a weakening of the demand for imported automobiles) contributed to a narrowing of the current account deficit. Trends in the labor market were also satisfactory and certainly more positive than suggested in the staff report. Dependent employment increased by 2.3 percent in the year to the second quarter of 2001 and the unemployment rate declined to just over 10 percent, more than 2 percentage points below its peak in late 1999.

After declining during the course of 2001, the *headline* rate of inflation has accelerated sharply over the last 2 months, but largely on account of a dramatic increase in the prices of fresh fruits and vegetables caused by severe weather. *Core* inflation has tended to ease, although it remains considerably higher than in the rest of the euro area, reflecting Balassa-Samuelson and other convergence-related factors. It is noteworthy that the increase in unit labor costs in 2001 was **not** higher than in the rest of the euro area and remained lower than the increase in prices; since financing and energy costs eased in 2001, the profitability and competitiveness of the business sector is likely to have improved.

Although the Greek economy is not immune to the global economic slowdown and the uncertainties engendered by the September 11 events, their impact is mitigated to a considerable extent by several other factors. These include: the improved economic fundamentals resulting from the successful completion of the nominal convergence process and the implementation of significant market-opening and productivity-enhancing structural reforms; the accelerated disbursement of very large EU Community support funds, which is leading to a marked improvement in economic infrastructure; the intensification of the preparations for the 2004 Olympic Games in Athens; and the growing openness and export orientation of the economy, including vis-à-vis the economies of Central and Eastern Europe (which is also fostering their own stabilization and integration efforts).

Taken together, these factors have led to a high level of business investment (which has grown by more than 75 percent over the past 7 years) and a marked acceleration in TFP growth. In the opinion of my authorities, they justify optimism that growth will be sustained at a satisfactory pace during 2002 and over the medium term. The authorities recognize, however, that there are considerable short-term uncertainties and downside risks. While these stem mainly from the external environment, it is also crucial to avoid any escalation of domestic wage costs. The authorities will use all their persuasive powers to ensure that the upcoming collective wage bargaining will result in moderate settlements, consistent with the need to preserve external competitiveness and reduce inflation further.

Fiscal Policy. Although economic growth was not as buoyant as expected when the 2001 budget was introduced, the strengthening of the public finances continued in 2001. Two important milestones were reached: the general government balance moved into surplus, albeit a very small one; and the public debt ratio fell below 100 percent of GDP. The surplus, however, was lower than budgeted due in part to revenue shortfalls.

Fiscal policy in 2002 and over the medium term will be guided by Greece's updated Stability and Growth Program which is in conformity with the SGP. A key objective is the further consolidation of the public finances. Specifically, the general government surplus is targeted to increase further (to 0.8 percent of GDP in 2002 and 1.2 percent of GDP by 2004) in order to speed up the reduction in the public debt ratio. In view of the very high priority they attach to the rapid reduction of the public debt, the authorities consider it premature to commit themselves to allowing the revenue stabilizers to operate fully, as the staff recommends. However, cyclical conditions are taken into account in the formulation and conduct of policy.

Indeed, the scaling down of the official short- and medium-term growth projections, prompted in part by the less propitious than previously expected external environment, has led to a small downward revision of the fiscal targets for 2002 and subsequent years.

In assessing the fiscal stance, staff focuses on the change in the structural component of the *primary* balance, rather than that of the *overall* balance. This focus is inappropriate, in my view. First, it ignores the fact that (broadly speaking) a reduction in debt interest payments has the same impact in restraining domestic spending as a reduction in any other component of public outlays (or increase in taxes). Second, it conveys the impression that the authorities do not deserve credit for the substantial improvement in the public finances stemming from the lower cost of servicing the public debt, even though this is clearly not a fortuitous or conjunctural development but rather a lasting accomplishment made possible by painful fiscal retrenchment over a protracted period of time. Third, the focus on the structural primary balance is not in line with the practice being followed by staff in assessing fiscal policy in most other advanced countries, including other countries with a high public debt. Thus, for the sake of analytical rigor and uniform treatment, the policy stance should be judged by reference to the evolution of the structural component of the overall balance. On this basis, it can be seen that the fiscal stance in both 2001 and 2002 is moderately contractionary. This is consistent with the need for continued fiscal consolidation and may also be viewed as desirable from a cyclical perspective given the comparatively advanced stage of the business cycle in Greece.

The staff report draws attention to the unusually large size of below-the line items in Greece's fiscal accounts. Apart from valuation changes resulting from currency movements, these items include various transactions of a financial nature, such as capital injections to public enterprises to facilitate their privatization and the state's equity participation in joint ventures with the private sector (e.g. new airport in Athens). These transactions are classified below the line, in conformity with EUROSTAT and GFS principles, as they do not have any direct impact on demand. In fact, often they do not even entail the "creation" of new debt but rather the assumption by the state of contingent liabilities (i.e. liabilities incurred by other entities with an explicit or implicit state guarantee) which is accompanied by reforms to prevent the reemergence of such liabilities in the future. To that extent, they contribute over time to a healthier and more transparent fiscal position.

It is worth noting that despite the large size of the below-the-line items the debt ratio has been reduced by some 11 percentage points since its peak in 1996. This reduction has been possible only thanks to Greece's exceptionally large primary surplus. In the medium term, the below-the line items will tend to fall as the privatization program is completed and the stock of contingent claims on the state declines. In the meantime, however, the primary surplus will be maintained at a high level to ensure an adequate pace of debt reduction.

Structural Reform. As noted in the staff report, further structural reforms are viewed by the authorities as critical to enhance growth prospects and accelerate real convergence. They are being pursued on a number of fronts and with increased urgency. In the fiscal area, preparations for a major overhaul of the tax system, including the necessary draft legislation, are at an advanced stage and will be completed in time for implementation next year. Efforts are also being made to improve the medium-term framework within which fiscal policy is conducted and to strengthen procedures for the evaluation, monitoring and auditing of public expenditures. In the healthcare sector, an ambitious plan intended to contain the growth in spending, improve administration and control and upgrade service delivery has begun to be implemented. In view of the social consensus that has emerged, one can be reasonably confident that it will be followed soon by far-reaching reforms of the pension system. The government is also making good progress in implementing its privatization program, notwithstanding occasional setbacks associated with weak market conditions and other adverse shocks, and is moving ahead rapidly with the deregulation and liberalization of product markets.

The financial sector remains among the most dynamic and well-managed sectors of the Greek economy. Profitability and capitalization are high, lending practices are generally conservative and internal risk management systems are of good quality and constantly being upgraded. Nevertheless, in view of the recent and prospective rapid growth in bank credit, the supervisory authorities recognize the need for increased vigilance. Provisioning requirements have already been tightened and may be tightened further, if need be. It is also worth noting that draft legislation has recently been submitted to Parliament requiring all listed companies, including those in the financial sector, to adopt internationally agreed accounting and disclosure standards.

Other issues. While data weaknesses persist, the report understates somewhat the substantial recent improvements in the quality, frequency and timeliness of key statistics, including the national accounts, the balance of payments and the labor market. Admittedly, however, the results of these improvements are not yet fully evident due in part to teething problems and the diversion of scarce resources to the completion of the 2001 population census.

Greece has for long been in compliance with FATF recommendations for combating money laundering and, in conjunction with its EU partners, has strongly supported recent international initiatives to discourage the financing of terrorism.

Conclusion. The Greek economy continues to do well, in a less than fully propitious international environment. This can be attributed to a significant extent to its successful (monetary and real) integration into the EU economy and the good use of EU structural funds to augment longer-term growth potential. While major challenges remain to be addressed to sustain a rapid pace of real convergence, the authorities' strong commitment to prudent financial policies and structural reforms is likely to ensure that these challenges will be met.

INTERNATIONAL MONETARY FUND
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EMBARGOED
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UNTIL 2:00 PM WASHINGTON TIME (1900 GMT)
March 1, 2002

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2001 Article IV Consultation with Greece

On February 22, 2002, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Greece.[1]

Background

Strong economic growth continued in 2001, but the economy was not immune from the global slowdown. GDP increased by about 4 percent, led by robust domestic demand. Investment growth accelerated, following interest rate convergence with euro-area rates, and further easing by the ECB, while private consumption was buoyed by rapid credit growth. The strong growth performance failed, however, to stimulate overall employment gains; and the unemployment rate, while declining through the first half of 2001 (the latest period for which data are available), remained the second highest among European Union countries. The sizable external current account deficit narrowed somewhat to 6.2 percent of GDP (including capital transfers), in part also reflecting lower oil prices. In line with developments in the rest of the euro area, the manufacturing sector weakened, with industrial production almost flat since the spring.

Core inflation has remained well above the euro-area average. Falling energy prices have lowered headline inflation, as in the rest of the euro area. However, the core inflation (that is, headline inflation, excluding energy and unprocessed food prices) differential versus the euro

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

area rebounded from tax-cut-related lows in 2000 to average 1.6 percentage points in 2001. This reflected in part relatively buoyant cyclical conditions, with the staff estimating a positive output gap of around 1½ percent.

Fiscal consolidation continued in 2001 and the general government recorded a surplus for the first time in decades—but the tightening of the fiscal stance implied by the original budget was not achieved. The fiscal surplus was smaller than budgeted (0.1 percent of GDP against a 0.5 percent target) and the shortfall principally reflected higher-than-budgeted expenditures for goods and services. The undershooting of the surplus target came despite additional receipts from universal mobile telecommunications system (UMTS) license sales, not anticipated in the budget and treated as revenues under Eurostat rules. Staff estimates that the structural primary surplus remained constant at 5.6 percent of GDP (excluding UMTS receipts, which have no demand effects) compared with a tightening to above 6 percent implied by the original budget. For 2002, the overall surplus target was revised down to 0.8 percent of GDP, from 1.5 percent in the *2000 Stability Program*, reflecting lower-than-expected growth and tax reductions. The structural primary surplus would remain broadly unchanged relative to the 2001 outturn.

The near-term outlook is subject to a heightened degree of uncertainty, but growth prospects remain considerably more favorable than in most partner countries. Notwithstanding a weaker external environment and the waning of some of the euro-entry-related effects on investment, the staff expects GDP growth of around 3 percent (somewhat below the 2002 budget assumption of 3.8 percent). The growth outlook depends importantly on a recovery in external markets during the course of 2002, and on developments in the tourism sector. On inflation, prospects are subject to the outcome of the pending wage agreements, with higher-than-expected inflation in 2001 triggering a 1.1 percentage point catch-up payment in 2002.

Executive Board Assessment

Executive Directors commended the authorities for their policy strategy that had secured euro-area entry at the beginning of 2001, and had continued to underpin strong performance of the Greek economy. The economic benefits were visible in many areas: real income growth remained well above the euro-area average; the fiscal position had improved strongly; and structural reforms had progressed in a number of areas.

In order to lay the groundwork for continued rapid convergence in living standards to EU levels, Directors called for a broadening and deepening of the efforts undertaken to date. To secure durable, strong growth, steps are needed, first, to place the fiscal position on a sustainable basis, in the face of anticipated pension pressures and very high public debt levels. Second, competition and efficiency in factor and product markets should be strengthened. Third, wage settlements should, at a minimum, prevent an erosion of cost competitiveness, and contribute, over time, to a narrowing of Greece's relatively large external current account deficit.

Directors stressed the advantages of a medium-term orientation of fiscal policy, characterized by transparency as well as well-defined rules for addressing short-run developments. They supported the authorities' goal of reducing the public debt-to-GDP ratio to 60 percent by 2010, but noted, however, that the size of fiscal surpluses needed to bring about this debt reduction will depend importantly on the extent of debt-creating transactions, which do not affect the budget deficit. Many Directors therefore suggested that such transactions be curbed. In addition, some Directors considered it useful to complement the deficit and debt targets with a commitment to well-specified expenditure ceilings at the general government level. Within the framework of ambitious medium-term fiscal surplus and expenditure targets, Directors agreed that revenue stabilizers should be allowed to operate fully and symmetrically in response to cyclical developments. For 2002, Directors recommended a more ambitious fiscal target than that envisaged in the budget, resulting in additional fiscal withdrawal, in order to rebalance the policy mix, as monetary conditions remain accommodative in view of Greece's advanced cyclical position.

Directors welcomed the emerging consensus among social partners for much-needed pension reform. They called for early and decisive progress in this field, with simultaneous efforts in a number of areas, including incentives for a higher effective retirement age, reductions in some excessive replacement rates, and more uniform, equitable treatment of pensioners within a much less fragmented system. Fully funded supplementary pension funds could also contribute to the reform agenda.

Directors emphasized that expenditure controls would benefit from more effective multi-year budgeting. They welcomed the recent initiatives in this respect, and urged a strengthening of these efforts, combined with improved expenditure evaluation, monitoring, and control. Noting that the authorities' early plans for fundamental tax reforms are focused on simplifying the system, strengthening tax administration, and further reducing tax evasion, Directors called for progress in these areas in the coming year. A few Directors cautioned that some recent tax incentives (for mergers and employment growth) are likely to introduce new distortions and run counter to the authorities' own reform intentions.

Directors expressed concern about the labor market's continued disappointing performance, with the unemployment rate among the highest in the euro area and relatively low employment growth. They urged the authorities to implement comprehensive reforms that would facilitate labor market entry and improve training. Directors also called for the elimination of catch-up clauses in future wage agreements.

Directors welcomed the authorities' plan to reinvigorate the privatization process, and recommended that this be combined with measures to promote competition throughout the economy, including in the electricity sector, and the removal of impediments to new businesses.

Turning to the financial sector, Directors recognized that the ratio of credit to GDP is likely to continue to rise as part of the broader convergence process. They welcomed the authorities' commitment to address the ensuing risks, and supported the steps to strengthen the combination of provisions and capital. Directors also thought that prudent risk management could benefit from mandatory and timely disclosure by banks of a comprehensive set of asset quality and risk indicators. They welcomed Greece's efforts to combat money laundering and the financing of terrorism.

Directors urged the authorities to support the full liberalization of imports from the least developed countries, and to raise official development assistance to the UN target.

Directors recommended that the authorities strengthen efforts to improve Greece's statistical system—where persistent weaknesses are hampering the assessment of economic developments—and called on the authorities to take steps to meet the SDDS requirements in the near future.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Greece: Selected Economic Indicators

	1998	1999	2000	2001	2002 1/
Real economy (change in percent)					
GDP	3.4	3.4	4.3	4.0	3.0
Domestic demand	4.6	2.6	4.4	4.0	3.1
EU harmonized consumer inflation (period average)	4.5	2.1	2.9	3.7	3.2
Unemployment (in percent)	11.1	11.9	11.1	10.3	10.3
Public finance (general government, in percent of GDP)					
Overall balance	-2.4	-1.8	-1.1	0.1	0.5
Primary balance	5.3	5.7	6.1	6.6	6.1
Structural primary balance 2/	5.3	5.6	5.6	5.6	5.7
Debt	105.0	103.9	102.7	99.6	98.6
Of which: external debt 3/	25.4	26.6	22.1	6.2	...
Money and credit (end-period, percent change)					
Greek contribution to euro area M3 4/	9.8	5.6	11.5	5.5	...
Domestic credit 5/	9.7	12.2	20.2	16.4	...
Interest rates (year average)					
3-month treasury bill rate 6/	11.9	9.8	7.2	3.8	3.1
12-month treasury bill rate 6/	11.6	8.9	6.2	3.8	3.2
Balance of payments (settlements basis, in percent of GDP)					
Trade balance	-13.6	-14.3	-17.8	-16.5	-16.2
Current account balance (including capital transfers)	-3.0	-4.0	-6.8	-6.2	-6.1
Foreign exchange reserves (US$ billions) 7/	17.2	17.7	13.2	7.4	...
Exchange rates					
Exchange rate regime			Euro area member		
Present rate (February 22, 2002)			US$0.88 per 1 euro		
Nominal effective rate (1995=100) 8/	90.5	90.0	84.8	84.0	...
Real effective rate (1995=100) 8/	102.9	103.7	100.4	101.3	...

Sources: Data provided by the Greek authorities; and IMF staff estimates and projections.

1/ IMF staff projections, except where indicated otherwise.

2/ For 2001, excludes UMTS revenues equivalent to 0.4 percent of GDP.

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

4/ Data prior to 2000 refer to growth of Greek liquidity measure M4N. Data for 2001 correspond to the 12-month change to end-October.

5/ Data for 2001 correspond to the 12-month change to end-October.

6/ Data for 2002 correspond to the auction of February 5, 2002.

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

8/ Data for 2001 refer to November.