

# **The Hellenic Stability and Growth Programme**

## **Executive summary**

### ***Addressing the challenges that Greece faces today***

The Hellenic Stability and Growth Programme (SGP) represents the response to the challenges that Greece faces today: consolidate the country's fiscal position through effective fiscal and structural policies aimed at drastically reducing the large budget deficit and lowering the public debt to GDP ratio; secure the conditions for economic development in the years to come through addressing long-standing structural weaknesses and thereby putting the economy on a new and sustainable growth path; and address the credibility deficit which the country currently faces regarding budget data, statistics and economic policy.

The challenge is to design and consistently implement a mix of policies that will restore fiscal sustainability and ensure sustainable development. In contrast to the recent past record, growth should be driven by investment and exports in areas where the country has a comparative advantage, thus ensuring its successful development in an environmentally sustainable way. The current stability, growth and reconstruction programme provides the framework for mobilising resources to successfully address this challenge.

The SGP represents a break and a new beginning, a signal of policy intent and a plan of action. It provides a signal of the determination of the Greek authorities and of Greek society to permanently restore the credibility of fiscal management and safeguard the country's economic and social development in the years to come. It is based on an ambitious programme to fundamentally alter the design and conduct of fiscal policy and the means to ensure that the required fiscal adjustment and restoration of Greece's finances will not be short-lived but permanent. It is underpinned by a reform programme to create conditions for sustainable growth and employment, foster private sector development, and transform the public sector.

### ***The starting point: An economic and fiscal crisis***

It is clear that while the financial and economic crisis has had an adverse effect on macroeconomic variables and market sentiment, the current difficulties in the Greek economy are predominately endogenous. They reflect the absence of a commitment to design and implement effectively the policies required to address the chronic fiscal and structural imbalances in the economy and provide the preconditions for Greece's sustainable growth and socio-economic development in the future.

In 2009 the Greek economy entered a recession following a period of sustained output expansion. Growth had been primarily based on increases in aggregate demand fuelled by the easier availability of credit to households, enterprises and the public sector at the lower interest rates which accompanied the expected and ultimately successful adoption of the euro. This expansionary phase co-existed with high and persistent budget and current account deficits. The persistence of the twin deficits in the Greek economy reveals, in turn, the absence of a commitment to maintain a balanced fiscal position and the steady erosion of competitiveness in the recent years which reflects underlying distortions of a structural nature.

The 2009 recession was accompanied with a very significant deterioration in the size of the deficit of the general government to a 12.7% of GDP at end 2009 from an initial 2% of GDP in the 2009 budget, and 3.7% of GDP in the January 2009 SGP submission. This was the result of an “economic cycle” effect, due to the economic downturn and a bigger than expected fall in real GDP; an “electoral or political cycle” effect, due to the laxness of the revenue collection mechanisms and the expenditure overruns; and a “deficiency or structural” effect, due to endemic structural deficiencies on collecting taxes, controlling expenditures and fully recording data in official statistics.

### ***The projected output and fiscal adjustment paths***

The recession is likely to persist in 2010 with a further drop estimated at around 0.3% in the projection upon which the 2010 budget and the SGP are based. The projected output path is based on a prudent assessment of the beneficial impact of the government’s reforms on growth and incorporates the autumn 2010 European Commission’s forecasts on external economic conditions. In the medium term, real output is expected to rebound, growing by 1.5% in 2011 and by 1.9% and 2.5% in 2012 and 2013 respectively, while inflation will remain subdued and decelerate.

The stability and growth programme sets an ambitious but credible path to achieve the targeted level of a general government deficit below 3 % of GDP in 2012. The deficit is projected to follow a downward path from 12.7% of GDP in 2009, to 8.7% of GDP in 2010, 5.6% in 2011, 2.8%, in 2012 and 2% in 2013. This gives rise to a frontloaded fiscal adjustment path in the deficit as a share of GDP, with the fiscal adjustment corresponding to 4% of GDP in 2010, 3.1% in 2011, 2.8% in 2012 and 0.8% in 2013. Debt is forecasted for 2010 at 120.4 % of GDP, and is projected to peak in 2011 at 120.6% and gradually decline to 117.7% and 113.4% in 2012 and 2013.

The adjustment will be achieved through a mix of revenue and expenditure measures which are quantified and presented along with implementation information in the SGP, in particular, the measures to achieve the front-loaded deficit reduction in 2010. On the expenditure side the expected evolution of total resources as a share of GDP follows a downward trend from an estimated 52% of GDP in 2009 to 47.3% in 2013. On the revenue side total revenues as a share of GDP follow an upward trend from 39.3% of GDP in 2009 to 45.3% in 2013.

### ***The fiscal and reform strategy***

The government’s short and medium-term fiscal and reform strategy is based on five key pillars, which incorporate the lessons learned to date. The strategy includes actions to:

- Restore credibility in statistics by making the National Statistics Service an independent legal entity and phasing in, during the first quarter of 2010, all the necessary checks and balances that will improve accuracy and reporting of fiscal statistics.
- Improve transparency in fiscal management, by changing the process of budgeting, monitoring and evaluating its implementation, and moving towards a programme-based budget.
- Reform the tax system in order to make it simple, stable, transparent and fair, and to effectively fight tax evasion by improving auditing activities and exchanging of information between auditing agencies.

- Achieve control of primary expenditures by containing personnel and other current outlays and reallocating expenditures more effectively.
- Implement the necessary structural reforms to enhance competitiveness and the efficient functioning of the economy, foster private sector development, and create a more transparent and effective public administration.

### ***Addressing the issue of credibility***

Of paramount importance is the restoration of trust in the government's ability to manage its finances and more generally be held accountable for its actions. A component of this effort concerns credibility in Greece's statistics. Legislation in the first quarter of 2010 will render the National Statistics Service independent of the policy process and safeguard the compilation of reliable data and their wide and timely dissemination. In parallel it will phase-in all the necessary checks and balances that will improve the accuracy and reporting of fiscal statistics and improve fiscal management. To this end a Parliamentary Budget Office will be created while "fiscal rules" will be designed to ensure the effective medium-term execution of the budget and anchor the expectations of stakeholders, including holders of government debt, regarding the conduct of fiscal policy, with legislation by mid-2010.

### ***Reforming the budget process and monitoring***

Reforms to strengthen the monitoring of the budget implementation and introduce a fundamental change in the budget process include: legislation in 2010 to set specific monthly reporting requirements for all line ministries; online access to the evolution of the budget execution to increase transparency and public accountability; bilateral inter-ministerial working groups between Ministry of Finance officials and all line ministries to follow and enforce budget targets; utilising a "zero basis" methodology for the 2011 budget process, and introducing elements of programme budgeting in the preparation of the 2011 budget, with the aim of moving fully to programme budgeting in the following year.

### ***Expenditure side reforms***

Expenditure side reforms include among other: setting up a 10% contingency reserve to assist in the cost-reduction efforts of the government in 2010; a reduction in civil service employment through a hiring freeze in 2010 and a 5:1 rule from 2011 onwards (one new hire for every five retirements); a 10% cut in salary entitlements coupled with no nominal wage increases for monthly salaries exceeding 2000 Euro in the public sector for 2010; a 10% reduction in operating expenditures in line ministries for 2010; the requirement for line ministries to submit by end-January three-year budgets incorporating expenditure reductions; a significant consolidation in public sector institutions; the operation of a Single Payment Authority, through which all public servants will be paid; and an improved public procurement system which increases transparency and cuts down costs.

### ***Tax reform***

Of fundamental importance is a tax system that is simple, stable, transparent and fair. The main elements of the tax reform bill currently under public consultation and expected to be voted by Parliament in March 2010 include: the introduction of a unified progressive tax scale for income from all sources; the abolition of autonomous taxation and tax exemptions in personal income and corporate profits; the treatment of distributed profits as personal income

coupled with lower tax rates on company profits that are reinvested; the reintroduction of a progressive tax on large property, inheritances and bequests; the introduction of a capital gains tax and the effective taxation of off-shore companies; new transfer pricing and "thin capitalization" rules; the codification and drastic simplification of tax statutes; a comprehensive system of tax declarations which includes income from all sources as well as assets; and a move to obligatory full electronic tax declaration for all physical persons and companies.

Changes in the tax system will be complemented by a sustained effort to radically change tax administration structures and practices in order to increase collection effectiveness and reduce tax evasion and avoidance. Elements of this effort include: the unification of tax collection and social security collection mechanisms; the adoption of a risk-based approach in tax audit processes; the obligation for enterprises to maintain professional accounts with commercial banks; a revision of existing cross-matching checks in tax data; a shift in focus from formal checks on books and documents into in-depth audits; an incentive scheme for issuing transaction receipts; the elimination of bargaining in the penalty assessment process through a shift to a point-system based on objective criteria; a centralized dispute resolution process and minimizing the contact of individuals with tax officials.

### ***Long run sustainability of public finances***

Improved fiscal management will be complemented by actions to safeguard the long run sustainability of public finances, most notably in the critical areas of health expenditures and, especially, pension reform. Health expenditures will be contained through the re-introduction of restrictions in the list of medicines provided by the health care branches of the social insurance funds and through wider reforms in the operation of the NHS which strengthen public regulation and reinforce accountability. They involve asking providers, including hospitals, to operate under fixed budgets; setting overall cash limits and allocating resources in a transparent fashion, consistent with objective criteria; and reorganizing public procurement.

The Greek government intends to tackle the issue of today's unsustainable pension spending through two kinds of measures: policies which rationalize expenditure and increase the revenue base, such as containing social security contributions evasion; and an institutional reform of the pension system, involving inter alia the restoration of the link between the level of pensions and of accumulated social security contributions. The ongoing public consultation process on pension reform will be completed in April 2010.

### ***Growth and employment enhancing policies***

Improving the quality of public finances will be underpinned by the government's reform programme in areas critical for successfully addressing the Greek economy's productivity and competitiveness challenges and raise welfare. In this context growth and employment enhancing policies promoting a green economy agenda include: redirecting public sector investment priorities and private-sector investment incentives; restructuring expenditures and increasing public investment; revising and effectively implementing the National Strategic Reform Framework (NSRF); revising the investment law in 2010; promoting public private partnerships; establishing a Hellenic Development Fund; and promoting active labour market policies through the reduction of non-wage costs, the introduction of modern training and apprenticeship schemes, the implementation of specific regional and local integrated employment plans, and by improving labour market transparency.

### ***Policies to foster private sector development***

Improving the business environment, enhancing competitiveness and promoting productive restructuring and a green growth and development agenda through investment promotion will critically depend on the active pursuit and timely implementation of a major regulatory reform agenda to radically simplify procedures for starting, licensing and operating a business in the country. In this context, the first legislative initiative for the simplification of business start-up procedures is expected to be submitted to Parliament in the first quarter of 2010. It will be complemented by initiatives strengthening competition and enhancing the quality of regulation including opening up of closed profession during 2010, promoting external competitiveness (institutional changes, capacity building, export promotion), and providing adequate liquidity and development financing.

### ***A more efficient and transparent public administration***

The main parameter of the "Greek problem" is the functioning of the state and of the wider public sector. Fundamental issues relate to recruitment procedures, increasing transparency and accountability, and streamlining local administration. In addition to decisions already announced regarding limiting public sector personnel (hiring freeze in 2010, a rule limiting hiring to one new hire for every five retirements as of 2011, reduction in short-term contracts), the government has also already committed to important initiatives aimed at transparency and accountability. Among these is the obligation to post on the internet all decisions involving disbursement of public funds taken by any public official, as a legal prerequisite for the validity of the action.

Of particular importance for ensuring the emergence of a streamlined but effective wider public sector is the new legislation on the local administration. A draft law recently approved by the Council of Ministers and shortly to be presented to the parliament adopts a new "institutional architecture" for regional and local government. It reduces the number of municipalities from the current number of 1034 to only 370; replaces the second layer of prefectures by elected regional authorities and reduces the number of institutions from 76 to a number corresponding to the existing 13 regions; introduces 7 regional general authorities to replace the current 13 regional authorities; and drastically reduces the number of legal entities from 6000 to 2000, thereby reducing total operating costs of the local administration.

### ***In conclusion***

The stability, growth and reconstruction programme is a roadmap of ambitious but credible reforms that together address the underlying causes of existing problems in the Greek economy. It is also a call for action to effectively mobilising resources and the Greek society for the country's development and the welfare of its citizens. Its implementation is a matter which involves all ministries and layers of government. Its success is based on a careful assessment of reform needs, a clear setting of priorities, a quantification of immediate measures to be undertaken, and a clear description of medium-term reform initiatives in areas ranging from budget design and implementation, expenditure control, overhaul of the tax system, health and social security reforms, and initiatives to create conditions for sustainable growth, foster private sector development, and reform the public administration.