

# OPPORTUNITY GREECE



# NATIONAL REFORM (LISBON) STRATEGY

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The Greek National Reform Program outlines a comprehensive and ambitious set of policies which aim to give new impetus to economic growth in Greece. It marks a departure from debt-financed fiscal expansion and aims at delivering a more solid foundation for current and future prosperity. Significant results have already been attained regarding fiscal consolidation, while the implementation of a broad set of structural reforms promises to effectively redefine the role of the State, providing more room for private initiative and enabling Greece to solidify its leading role in South-eastern Europe.

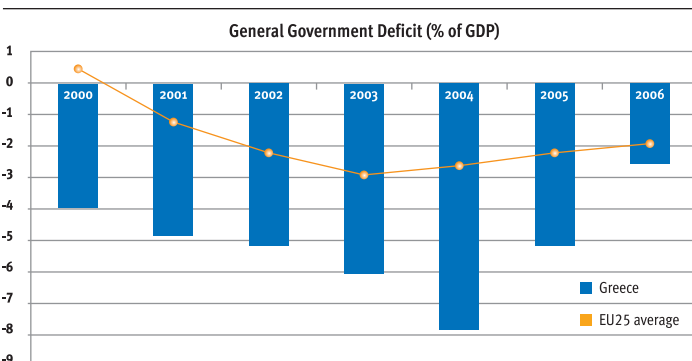
Over the past 15 years, Greece has had an impressive record of economic growth and has made significant progress in closing the income gap with its more advanced international partners. However, despite the rapid economic growth rates, a number of important structural deficiencies had not been addressed effectively, resulting in a prolonged period of debt accumulation, persistently high unemployment and eroding competitiveness.

In response to the renewed European ambition within the Lisbon Strategy, the Greek National Reform Program (NRP) 2005-2008 highlights the government's commitment to face these deficiencies head-on. The program outlines a consistent strategy based on two pillars: (a) the pursuit of sustainable economic growth through the consolidation of public finances and (b) the rigorous implementation of an ambitious structural reform agenda aimed at unlocking the economy's growth potential. Particular emphasis is placed on productivity-raising measures, along with interventions to improve the business environ-

ment and the outward orientation of the economy. These ought to facilitate the dynamism of the private sector. A key aspect of the reform agenda is to enable Greece to reap the full benefits from the opportunities presented in the newly emerging economies of South-eastern Europe.

**Fiscal consolidation** is a necessary condition for accelerating growth in Greece and has been a top policy priority. The government has opted to address the sizeable fiscal imbalances through an approach of gradual adjustment, in order to minimize the risks to economic growth. The gamble has paid off. Over the past two years the general government deficit has been reduced from a high of 7.8% of GDP in 2004 to 5.2% in 2005 and it is estimated to reach 2.6% in 2006, in line with the target set in the 2006 Budget.<sup>1</sup> The medium-term goal is to reach a budget which is balanced or in surplus by 2012 at the latest.

Despite the very significant fiscal adjustment during 2005 and 2006 (in the order of 5.2 percentage points), the Greek economy has



Source: Eurostat and European Commission

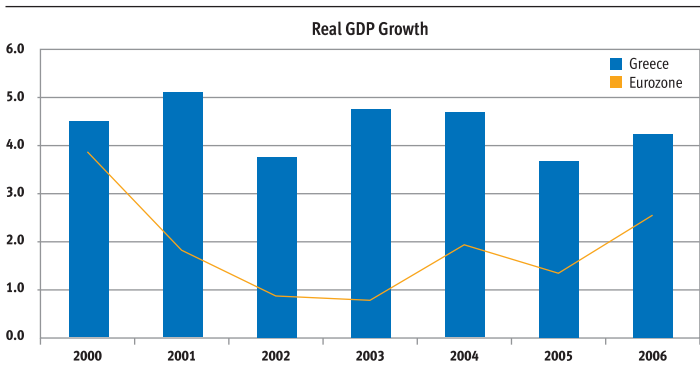
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sustained robust **economic growth** rates, contrary to widespread expectations for an economic slowdown in the post-Olympic Games period, and despite rising oil prices. Real GDP growth was 3.7% in 2005, which was more than double the eurozone average growth of 1.4%. In 2006 real GDP growth accelerated further and exceeded initial estimates, reaching 4.25%.

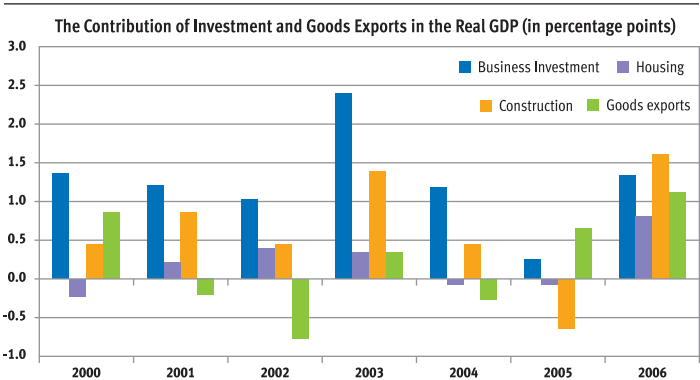
The **qualitative aspects of growth** have improved notably, with real GDP growth being primarily driven by **investment** and **exports**. In-

vestment is estimated to contribute 2.35 percentage points to economic growth in 2006 (1.37 p.p. due to business investment), while goods exports' contribution is estimated at 1.04 p.p. It is also worth noting that **foreign direct investment** inflows in the first 11 months of 2006 amounted to over 4 billion euros, representing an approximately ten-fold increase over the same period in 2005.

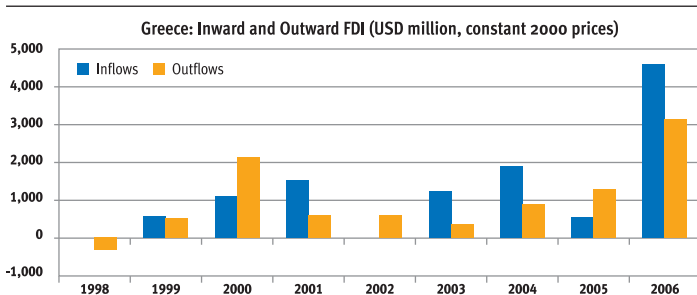
The significant fiscal consolidation and the robust economic growth are bearing fruit in terms of lowering the **debt-to-GDP ratio**. Since



Source: Eurostat and Ministry of Economy and Finance



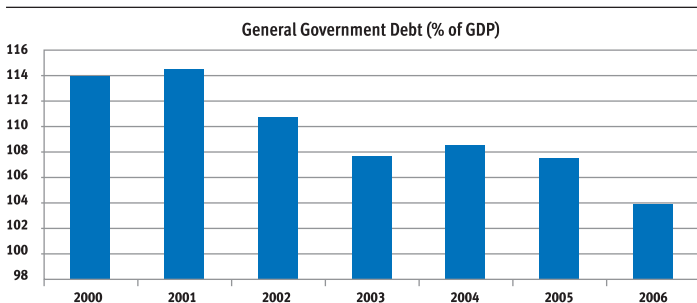
Source: Ministry of Economy and Finance



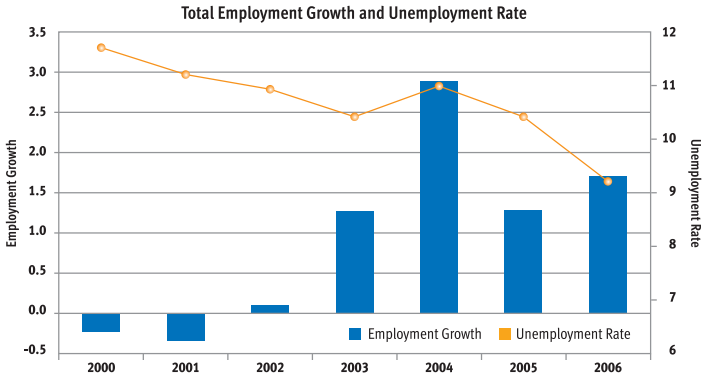
Sources: OECD and Bank of Greece. The values for 2006 refer to the Jan.-Nov. period.

2005 the debt-to-GDP ratio has been moving downwards steadily, from an average of 111.6% of GDP over the 2000-2004 period to 107.5% in 2005, while it is estimated to reach 104.1% of GDP in 2006. According to the European Commission's autumn forecasts, the debt-to-GDP ratio is expected to fall below 100% in 2008, for the first time since 1992. Reflecting largely on the robust growth performance and the ongoing decline in the debt ratio, but also on the government's commitment to the reform agenda, the international **credit rating outlook** of Greece has improved. In December 2006 R&I changed the rating outlook from stable to positive, with Moody's Investors Service following suit in January 2007.

An important dimension of the strong economic growth experienced in 2005 and 2006 is the accelerated **employment growth** and the reduction in the **unemployment rate**. These developments are in sharp contrast with previous years, when high GDP growth failed to translate into increased employment, and when it did (primarily due to Olympic Games preparations) the employment inflow did not seem to be associated with re-employment of unemployed workers. It is worth noting that the average annual employment growth in the period 2005-2006 (1.5%) was twice as high as during the period 1996-2004 (0.76%), while the unemployment rate in 2006 is estimated to have reached its lowest value since 1995.



Source: Eurostat and Ministry of Economy and Finance



Source: Ministry of Economy and Finance

Although the Greek economy has undoubtedly benefited from the more general economic upswing in the EU and the eurozone, the recent economic performance of Greece is by no means coincidental. It is in significant part the outcome of a set of carefully planned and rigorously implemented structural interventions across the board.

As regards **public finances**, measures have been put in place for the streamlining and restraint of government spending, particularly in areas that do not contribute directly to social welfare and do not enhance the country's productive capacity. During the term of this Government, savings of approximately 13 billion euros have been made, of which 3 billion euros are returned in the form of targeted social transfers. New legislation has been voted in regarding fiscal audits and controls, establishing a General Directorate for Fiscal Audits with internal auditing agencies within Ministries, local authorities and public entities in general.

Legislation aiming at rationalizing spending by public enterprises and achieving a more efficient performance level is already in place.

In parallel, a number of structural reforms are being implemented, aiming at improving the business environment, raising productivity, enhancing the country's outward orientation and deepening its integration with the global economy.

- A top priority is to provide a stable and predictable **tax environment**, while lowering the tax and administrative burden. The corporate tax rate has been gradually reduced from 35% in 2004 to 25% in 2007. In addition, tax audits have been rationalized, reducing the uncertainty faced by taxpayers. In 2007 the second stage of the tax reform was launched, focusing on the taxation of personal income. The tax-free threshold is being raised and income tax brackets are progressively being low-

ered, in a program set to continue until 2009, thus broadening the tax base and effectively reducing the tax wedge on labor income.

- The **Hellenic Competition Commission**, long hampered by lack of staff and financial resources, has been revitalized and is becoming a major instrument in the development of a competition culture in the Greek economy.
- Increased emphasis is placed on the implementation of an extensive **privatization program**, aiming at enhancing the competitiveness of the economy, at opening up markets to competition, improving resource allocation, and attracting foreign direct investment. Privatizations in 2006 focused on the reduction of the State's participation in the financial sector. It resulted in revenues of €1.74 billion, against an annual target of €1.65 billion and set the ground for enhanced competition in the banking sector.
- A new and innovative framework for **Public-Private Partnerships** has been legislated, which is expected to prove an important tool for providing quality infrastructure and services at minimum cost for the State Budget. Eight projects have already been approved, with a budget in excess of 800 million euros.
- The **Investment Incentives Law** enacted in 2004 has contributed a great deal towards supporting private entrepreneurial activity, regional convergence and employment growth. It is co-financing investment projects worth more than €3.4 billion, directly creating more than 10,000 new full-time jobs. New legislation became effective in 2007, incorporating the maximum aid limits allowed by the EU. These limits reach up to 60% of the cost of investment projects. Special attention is devoted to small and medium-sized enterprises.
- The institutional and regulatory framework of the Greek **capital market** has improved significantly over the years. A number of legislative interventions have been made in order to act against systemic risks, speculative behavior and market abuse. In addition, all EU directives pertaining to the Financial Services Action Plan have been incorporated into national legislation, in order to safeguard the efficient functioning of the market and its smooth integration into the European framework.
- The barriers to business start-ups are being reduced through simplified and quicker **licensing procedures**. The relevant legislation has been enacted for manufacturing entities and will be complemented appropriately for the service sector, while a draft law on "**Sociétés Anonymes**" has already been completed. In addition, the existing and outdated **bankruptcy legislation** is in the process of being overhauled.

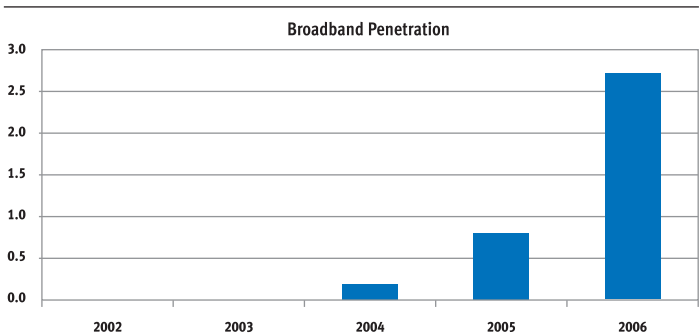
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- Further legislation regarding **commercial entities** promotes the healthy operation of the market by taking steps against unrecorded economic activity and competition distortions, while also reforming the framework for **shop opening hours**.
- **Network industries** are being opened up to competition, especially in the energy and telecommunications sectors. Large-scale cross-border interconnection projects are progressing, aiming at transforming Greece into an **energy hub**



in Southeastern Europe. Plans are underway for the construction of the Burgas-Alexandroupolis oil pipeline in collaboration with Russia and Bulgaria. Various other interconnection projects, concerning both natural gas and electricity are underway or are being contemplated, creating new investment opportunities.

- The lack of **zoning and land-use** legislation at a national level has been a serious obstacle for greenfield investment in the past. This is being addressed through the development of the National Spatial Plan and the specific plans for Tourism, Industry and Renewable Energy Sources.
- **External openness** is actively being promoted, including through an active promotion strategy for Greek products. The results are already reflected in the recent pickup in export activity. During 2005-2006, approximately one fifth of the economic growth originated in the growth of goods exports, which is four times



Source: Eurostat

greater than the average contribution of goods exports in the preceding decade.

A focal aspect of the structural reform agenda is to increase productivity and raise the economy's growth potential through the **promotion of innovation** and the establishment of an inclusive **knowledge-based society**. A draft Legislative Framework for R&D has been prepared, aiming at establishing clear mechanisms for the preparation, adoption and implementation of research policy. The new **Digital Strategy** was put into effect in January 2006, aiming at effectively promoting the spread and use of ICT and at facilitating the development of e-services. A number of initiatives are under full implementation for the development of broadband services and infrastructure. In 2006, the **broadband penetration rate** increased markedly to 2.7%, up from 0.8% in 2005 and 0.2% in 2004. Significant action is being taken for the development of **e-government**. Despite the fact that on-line serv-

ices available are still limited, e-government usage by enterprises is among the highest in the EU and is rising. In 2006 it reached 81%, up from 75% in 2005, compared to an EU average of 64%.

These actions are complemented by a number of **labor market reforms**, aiming at reducing unemployment, mobilizing the unused labor input and improving the adaptability of the labor market. New working-hours arrangement schemes have been introduced and the cost of overtime payments has been reduced. More flexible forms of employment are being promoted, such as part-time, including in the public sector. Specific measures are being taken to strengthen **female participation** by improving the social care infrastructure, adjusting the institutional framework for parental leave and promoting equal opportunities at work. **Geographical and professional mobility** are being improved through the introduction of financial incentives for relocation and the removal of disincentives in the pension system concerning changes of occupation. Further reforms are being implemented in order to address **structural unemployment**, including the increased competence of the Public Employment Services and the ongoing reforms in the training and educational systems.

The accelerated restructuring of the Greek economy and the rapid improvement of the business environment is turning Greece into a more attractive destination for foreign direct investment. Greece already serves as a **business hub** for some of the biggest multinational



companies. Being the only country in the region that is both an EU and eurozone member, Greece provides foreign investors with monetary and exchange rate stability, while offering the most advanced infrastructure and sophisticated work force in the region. Business giants such as the AIG Group, the Coca-Cola Co, Diageo, Ernst & Young, Kodak, Siemens, Toyota, and UPS have established in Greece their regional headquarters for Central and Eastern Europe, the Mediterranean and/or the Middle East. The Government's reform agenda actively promotes the external orientation of the Greek economy and aims at transforming Greece into a major center of entrepreneurial and investment activity in Southeastern Europe.

The National Reform Program outlines a comprehensive and ambitious set of policies which aim to give new impetus to economic

growth. It marks a departure from debt-financed fiscal expansion and aims at delivering a more solid foundation for current and future prosperity. Significant results have already been attained regarding fiscal consolidation and there is clear political commitment for continuing on the path of fiscal prudence. In parallel, the implementation of broad-based structural reforms promises to effectively redefine the role of the State, providing more room for private initiative. Greece is embracing globalization and aspires to solidify its leading role in Southeastern Europe, providing more investment opportunities than ever before.

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<sup>1</sup> This adjustment has been achieved while also enhancing the transparency of fiscal accounts. Eurostat, in its October 2006 EDP release as well as in a letter to the National Statistics Service of Greece, withdrew all reservations on Greek budget data.