

# The Second Economic Adjustment Programme for Greece

## Fourth Review – April 2014

*This report provides an assessment of the progress made by Greece with respect to its Second Economic Adjustment Programme, based on the findings of a four-part joint Commission/ECB/IMF mission to Athens between 16-29 September 2013, 28 October-8 November 2013, 2-15 December 2013 and 24 February-17 March 2014. The report examines current macroeconomic, financial and fiscal developments and assesses compliance with programme conditionality.*

Greece has made delayed, but eventually substantive progress since the last review completed in July 2013. Building on the impressive fiscal consolidation effort in recent years, Greece has exceeded its fiscal target in 2013, as a primary surplus in programme terms has been recorded. On the back of several measures taken recently to assure achievement of its fiscal target for 2014, the scope was created for temporary support to the socially most vulnerable.

Concerning the macroeconomic outlook, both soft indicators and hard data point to a bottoming out of the protracted economic recession, and confirm the programme expectation that Greece should return to economic growth in 2014. The current account deficit has disappeared, with a surplus of 0.7% of GDP in 2013, a significant improvement compared to a deficit of 2.4% of GDP in 2012 (balance of payment definition). The significant import contraction is expected to reverse once the economy picks up. Overall, uncertainties about the extent and speed of the economic recovery in 2014 remain significant, but are now more balanced than seen in July 2013.

Financial conditions are steadily improving. Reflecting a gradual improvement in sentiment towards Greece, government bond spreads and the stock exchange index (ATHEX) continued to recover throughout the second half of 2013 and Q1 2014, the spread is now back to the pre-May 2010 level and the government issued in April 2014 a new 5-year bond returning to the international bond market after four years. With regard to the financial sector, the authorities remain committed to taking all necessary actions to ensure that banks are healthy and adequately capitalised and are in a position to support the economic recovery.

The taxation system and the revenue administration have been greatly reshaped over the last year, and further reforms are being introduced in 2014. Key reforms include the Income Tax and Tax Procedures Codes that have broadened the tax base and modernised the rules of tax administration. The new unified Property Tax has replaced both the PPC tax and the FAP wealth tax and allowed a substantial reduction in transaction taxes.

Privatisation proceeds continue to come in, but again with some delays. Steps are being taken to reinforce the governance and effectiveness of the privatisation process, including of real estate assets.

The crucial reforms of the Greek public sector, notably the rationalisation and modernisation of the public administration, progress further. The strong reduction of public administration staff is proceeding ahead of plans.

With solid fiscal performance and the stabilisation of the banking system, it is now crucial to ensure that a wide range of ambitious structural reforms is implemented to quickly restore and promote growth and support employment. An important part of the structural policy package is the reform of product markets. The Greek government has committed to implement, starting from April 2014, almost in their entirety the OECD recommendations resulting from an in-depth study of legislation and practices in the key sectors of tourism, retail trade, food processing and construction materials, launched in 2012 as part of the programme. It has also launched a number of other reforms, including of the energy markets, to be implemented over the coming quarters.

The programme has a strong focus on social welfare and reducing unemployment. Besides, the one-off "social dividend" planned for 2014, efforts have been made to widen the scope of unemployment benefits to the long-term unemployed and to widen access of the uninsured to health services through health passports.

Implementation risks to the programme remain high. The macroeconomic recovery now seems to be more firmly established than it was expected in July 2013, but risks remain considerable, in particular in relation to perseverance in confronting vested interests. Sustained and determined reforms in the areas of product (goods and services) market, public administration and anti-corruption could clearly reduce costs for businesses and households and underpin a recovery in investment, while postponement of such reforms and incomplete implementation could perpetuate a heavy drag on the economy, making it difficult to achieve a substantial improvement in employment and productivity growth, and thus also a steady reduction of the debt-to-GDP ratio.

On the basis of this analysis of compliance with the MoU, and conditional on continued implementation by the Greek authorities of the revised MoU, notably of the prior actions, the programme is now broadly on track and the Commission services recommend disbursement of the instalments originally scheduled for Q4 2013 and Q1 2014 of the EFSF funds under the second programme.