OECD Economic Surveys
GREECE

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OVERVIEW

Summary

Main Findings

Economic recovery

Greece, which has been under an internationally coordinated adjustment programme since 2010, has made impressive headway in cutting its fiscal deficit and implementing structural reforms to raise labour market flexibility and improve labour competitiveness. Shrinking domestic demand has also led to a substantial reduction of the current account deficit. Slow product market reforms held back price competitiveness and exports in the recent past, but there are signs that the fall in unit labour costs has started to pass through to export prices and competitiveness. The depression has been much deeper than expected, which has undermined debt sustainability, induced a dramatic rise in unemployment, which affected more than 27% of the labour force at mid-2013 and raised social tensions, especially in the first years of the programme. Economic growth is held back by weak domestic and global demand, difficult access to credit and limited macroeconomic policy room for manoeuvre. The fiscal stance will remain restrictive, although less so in 2014 than in recent years. Encouraging economic developments in mid-2013 related, *inter alia*, to a good tourism season, which are expected to continue through 2014, mitigate the risks to growth. However, these risks are still on the downside. Together with the additional adjustment needed on the fiscal side and price competitiveness, the need for further assistance to achieve fiscal sustainability cannot be excluded.

Dealing with growth obstacles through further structural reforms

Major structural reforms have been introduced in several domains, but more needs to be done. A rapid, sustained and inclusive recovery is key to debt sustainability, employment creation and easing the social costs of the crisis. Major restructuring and recapitalisation of banks have provided the basis for credit provision to the economy. However large portfolios of bad assets continue to weigh on credit supply, especially to small and medium enterprises (SMEs). Although administrative burdens have been already somewhat reduced, remaining product market impediments continue to hinder further improvements in price competitiveness, and further reallocation of resources towards exports is needed. Reform of the public administration has been slow, however efforts to address the serious inefficiencies of the large public service have recently accelerated. Tax evasion remains a key concern. The judicial process is improving, but it is still slow and costly. Important reforms in legislation and procedures have taken place, but their effectiveness can only be appreciated in the next few years. Continuous monitoring and evaluation of the reform process is of crucial importance.

Fairly sharing the costs and benefits of adjustment

Despite fiscal measures which cushioned the impact on inequality, the recession and fiscal consolidation have worsened income distribution and poverty as unemployment has risen and real incomes have declined. The social impact has been aggravated by the lack of a general safety net and low and poorly targeted non-pension social spending. Recent and proposed measures, including a pilot programme of means-tested minimum income and a change in the scheme for long-term unemployment benefits, should improve the targeting of support to the neediest. The governance of social programme is a challenge. Health care has suffered in the crisis and, despite reform measures that rationalised spending, inefficiencies remain. The sharp rise in the unemployment rate, especially for the young, has not been adequately matched by activation policies. At the same time, it is important to strengthen the effectiveness of the labour inspection to ensure that the labour market liberalisation, implemented to promote competitiveness, does not risk a deterioration of working conditions.

Key Recommendations

Economic recovery

- Accelerating and broadening the structural reform programme is essential for sustainable recovery. In this respect, stronger reform ownership by all line-ministries, a better coordination of reform implementation and enhanced monitoring and evaluation of reform outcomes are essential. Evaluation results should be disseminated.
- Implement fiscal consolidation measures as planned. If growth is weaker than expected, let the automatic stabilisers operate.
- If negative macroeconomic risks materialise and nominal growth proves weaker than expected, even with full and timely implementation of structural reforms, serious consideration should be given to further assistance to achieve debt sustainability.
- Enhance management of troubled assets and maximise recoveries in order to increase banks' ability to grant credit in the medium term.

Dealing with obstacles to growth

- Further reduce administrative burdens to promote investment. Continue streamlining administrative procedures for exports and imports and simplifying licensing procedures.
- Accelerate the privatisation programme, in particular in energy, railways, regional airports, ports and real estate. This should be accompanied by swift progress in liberalisation to avoid the creation of private monopolies and to boost efficiency and growth.
- Step up the fight against tax evasion by stopping tax amnesties, identifying and punishing evaders, and improving the effectiveness of audits. Improve the judicial system by overhauling and streamlining the civil code and making more use of out-of-court mediation systems.
- Further enhance the efficiency of public administration, *inter alia*, through the development of e-government and the evaluation of staff performance based on clear individual objectives.

Fairly sharing the costs and benefits of adjustment

- Enhance governance of social programmes by speeding up the consolidation of the management of social insurance funds and accelerating harmonisation of information systems across the funds, which is essential for targeting benefits to protect the most vulnerable.
- Target selected social benefits more efficiently and introduce a properly targeted minimum income scheme.
- Focus health care cuts on reducing inefficiencies, while avoiding cuts on efficient and critical programmes.
- Tackle high unemployment, especially among youth, by strengthening activation programmes and evaluating their effect in promoting employment to focus on the successful ones. Strengthen the effectiveness of the labour inspection system, as planned, to ensure full enforcement of the labour code, and step up inspections and sanctions.

Assessment and recommendations

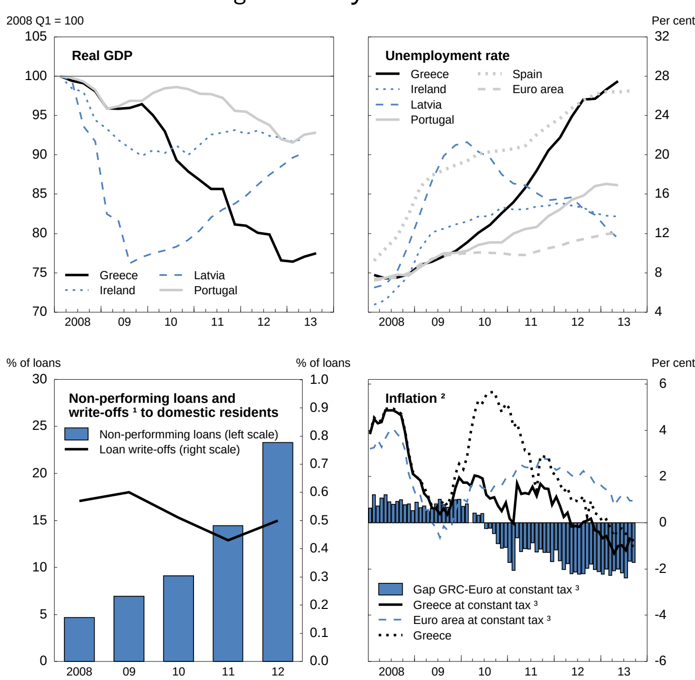
Greece has made substantial progress in reforming its economy in a short period of time. A record fiscal consolidation by OECD standards has reduced the deficit, pension and health care reforms have enhanced longer-term fiscal sustainability, and structural reform has improved labour market flexibility and cost competitiveness. However, the adjustment programme agreed in 2010 between the Greek authorities, the International Monetary Fund, the European Commission and the European Central Bank has not yielded the expected results in restoring activity, which has been hit much harder than in other euro zone countries with adjustment programmes, such as Ireland, Portugal or Latvia (which has a euro peg). This has worsened the debt problem, despite the debt restructuring that took place in 2012, while unemployment has sharply increased. Restoring growth, making it sustainable and dealing with social costs are essential to the success of the adjustment programme.

Fostering an economic recovery

Weak private sector balance sheets and exports dim the outlook

GDP has fallen again in 2013, although by less than had been expected a few months ago (Figure 1). The very large fiscal consolidation has cut domestic demand. Lower disposable income has pushed up non-performing loans, while losses from the sovereign debt restructuring have substantially weakened banks' balance sheets. The sharp drop in nominal wages is likely to continue as high unemployment persists (Table 1). Moreover, sluggish price adjustment resulting from product market rigidities despite recent reform progress, increases in non-wage costs, including raw materials and direct taxes, and hikes of indirect taxes is likely to further weigh on households' real incomes and demand.

Figure 1. **Key indicators**



1. Write-offs expressed as annual flows; non-performing loans include restructured loans.
2. Year-on-year growth rate of the harmonised consumer price index.
3. HICP at constant tax rates mean indices that measure changes in consumer prices without the impact of changes in rates of taxes on products over the same period of time.

Source: Bank of Greece; Eurostat; IMF, *Financial Soundness Indicators database*, OECD, *OECD Economic Outlook database*.

Table 1. **Macroeconomic indicators and projections**
Annual percentage change, volume (2005 prices)

	2010 current prices, EUR billions	2011	2012	2013	2014
GDP	222.2	**-7.1**	**-6.4**	**-3.5**	**-0.4**
Private consumption	163.1	-7.7	-9.1	-6.4	-2.6
Government consumption	40.7	-5.2	-4.2	-4.9	-4.0
Gross fixed capital formation	39.2	-19.6	-19.2	-9.6	-1.2
Final domestic demand	243.0	-9.2	-9.7	-6.5	-2.7
Stockbuilding[1]	-0.2	0.6	0.1	0.3	-0.2
Total domestic demand	242.8	-8.7	-9.4	-5.7	-2.8
Exports of goods and services	49.4	0.3	-2.4	2.3	6.6
Imports of goods and services	70.0	-7.3	-13.8	-7.9	-1.7
Net exports[1]	-20.6	2.4	4.0	3.1	2.4
Other indicators (growth rates, unless specified):					
Potential GDP		-0.9	-1.1	-2.3	-1.1
Output gap[2]		-7.6	-12.6	-13.6	-13.1
Employment		-6.8	-8.0	-4.7	-1.5
Unemployment rate		17.7	24.2	27.2	27.1
GDP deflator		1.0	-0.8	-2.2	-1.9
Harmonised consumer price index		3.1	1.0	-0.7	-1.6
Underlying consumer prices		1.1	-0.3	-2.1	-1.7
Current account balance[3]		-9.9	-3.4	-0.4	1.3
General government financial balance[3]					
Based on EAP methodology[4,5]		-9.6	-9.0	-4.1	-3.6
Based on ESA95 methodology[4,5]		-9.6	-9.0	-2.4	-2.2
General government primary balance[3]					
Based on EAP methodology (EC definition)[4, 5, 6]		-2.4	-4.1	0.0	1.2
Based on ESA95 methodology (EC definition)[4,5, 6]		-2.4	-4.0	1.7	2.5
Based on ESA95 methodology (OECD definition)[4,5, 6]		-2.8	-4.5	1.3	2.2
Underlying government primary balance (OECD definition)[2,6]		-0.5	3.4	4.6	5.3
General government gross debt[3] (Maastricht)		170.3	157.0	176.6	181.3
General government net debt[3]		142.5	102.5	123.0	129.5
Three-month money market rate, average		1.4	0.6	0.2	0.1
Ten-year government bond yield, average		15.7	22.5	9.8	8.4

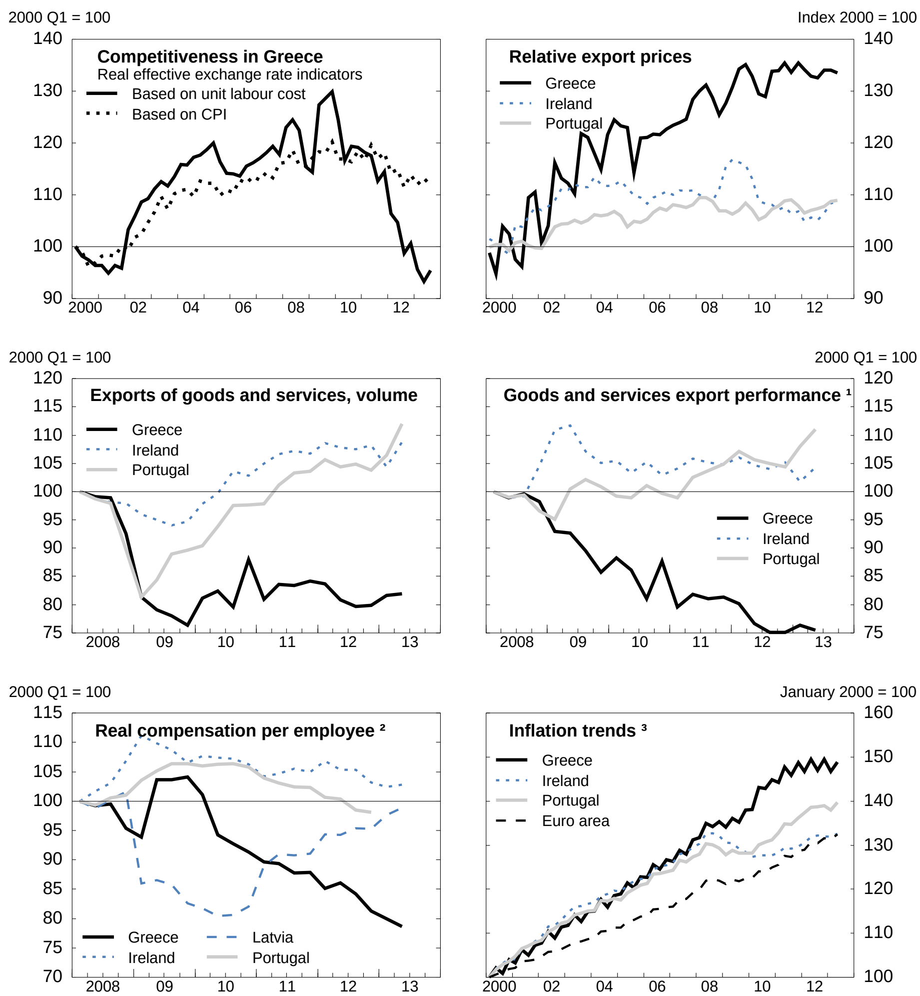
1. Contributions to changes in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of GDP.
4. The data for 2012 include the capital transfers of 2.8% of GDP made by the government as a result of bank resolution. Estimates for 2013 do not include capital transfers.
5. Estimates based on the Economic Adjustment Programme (EAP) methodology exclude Eurosystem bank profits on Greek government bonds remitted back to Greece. These profits are included in the estimates based on ESA95 methodology. Estimated repatriated profits for 2013 and 2014 are based on the Greek Draft Budget for 2014 (October 2013).
6. OECD definition of the government primary balance excludes net interest payments from the total balance while EC definition excludes gross interest payments.

Source: OECD, *Provisional Economic Outlook 94 database*.

Exports of goods and services have underperformed because Greece's export markets have been weak and its price competitiveness has not improved nearly as much as its cost (wage) competitiveness. Since the beginning of the crisis, labour costs have declined to levels last seen in the early 2000s, but the same is not true of prices (Figure 2), even though inflation became negative in March 2013 for the first time in over 50 years and, once the effect of tax increases is removed, inflation has been lower in Greece than in the rest of the euro area since mid-2010.

Based on prices, the real exchange rate is probably overvalued although the estimates vary across studies. This partly reflects the high price level in Greece prior to the euro (Anastasatos, 2008), and especially the cumulative effect of persistently high inflation in Greece since euro adoption (OECD, 2011a). As a result, in contrast to Ireland and Portugal, Greece's export market share of goods and services has shrunk, although export performance for goods, especially in non-EU markets, has improved (Aiginger, 2013). Greek goods exports are concentrated in low-tech products for which price competitiveness is important. However, there is a clear trend for Greek companies to become export-oriented over the last two years, with an increased focus on more innovative products. The slow price adjustment seems to be one of the important reasons for the difference in export performance between Ireland, Portugal and Greece. Some specific factors, including heightened uncertainties, also contributed to poor growth of service exports (especially tourism), although they have dissipated since mid-2013. Weak global trade and oversupply in the shipping sector have significantly reduced transport receipts, which account for more than half of exports of services. Until recently, large uncertainties, weak demand, lack of credit and high financial costs have weighed on domestic and foreign direct investment and limited the broadening of the export sector.

Figure 2. **Price competitiveness and exports**



1. The export performance measures the gain (increase) or loss (decrease) in export market share.
2. Deflated by the implicit price of the private consumption expenditure.
3. As measured by the harmonised consumer price index.

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

Positive growth is projected only in the course of 2014, reflecting a slower decline of domestic demand and a pickup in exports. Although the budget deficit will continue to shrink, consumption and investment demand will be bolstered by a moderating pace of fiscal consolidation and the planned repayment of government arrears. Better access to credit, thanks also to additional support provided by the European Investment Bank and greater use of European Union structural funds, should strengthen the currently low investment. Export supply is likely to materialise slowly as structural reforms boost competitiveness further and the fall in relative prices of non-tradables to tradables progressively reorients resources towards the export sector. However, in a context of high unemployment with a large output gap, substantial deflation may well persist, maintaining nominal GDP growth in negative territory.

The outlook remains subject to a number of significant downside risks related to developments in the global economy and the prospects for achieving needed domestic adjustment to stabilise activity. Thanks in part to action by the ECB, global financial markets have become calmer, though this could reverse with potentially serious repercussions for Greece. Weakness in several emerging markets, uncertainty in the US recovery related to tapering by the Federal Reserve and the US budget outlook, and slower-than-expected progress towards the EU banking union could add to the risks. The implementation of indispensable structural reforms may be jeopardised by the resistance of vested interests, social strains and weak administrative capacity, and those reforms may not produce results fast enough to increase exports. Tight credit conditions still pose a risk to business expansion and exports. On the other hand, if the observed sharp improvement in cost competitiveness translates into export prices, exports may prove stronger than projected. Confidence may also strengthen further if new investment projects, such as the recently announced Trans-Adriatic gas pipeline, materialise and the economy could again surprise on the upside.

Fiscal policy will remain tight with limited room for manoeuvre

Between 2010 and 2012, the total and primary government deficits fell by more than 9 percentage points of GDP. Despite weaker-than-expected growth (Table 2), the government outperformed its deficit target by around ¾ per cent of GDP in 2012, abstracting from one-off capital transfers of 2.8% of GDP for bank resolution. In structural terms, the adjustment is estimated by the OECD at nearly 14 percentage points of GDP between 2009 and 2012 (Figure 3), which is 9 percentage points more than had been envisaged in the initial May 2010 adjustment programme. In the 2014 draft budget, the general government primary surplus for 2013 is estimated at EUR 344 million or 0.2% of GDP according to the methodology of the Economic Adjustment Programme (or 1.9% of GDP if central banks' capital transfers are included, in line with ESA95 methodology).

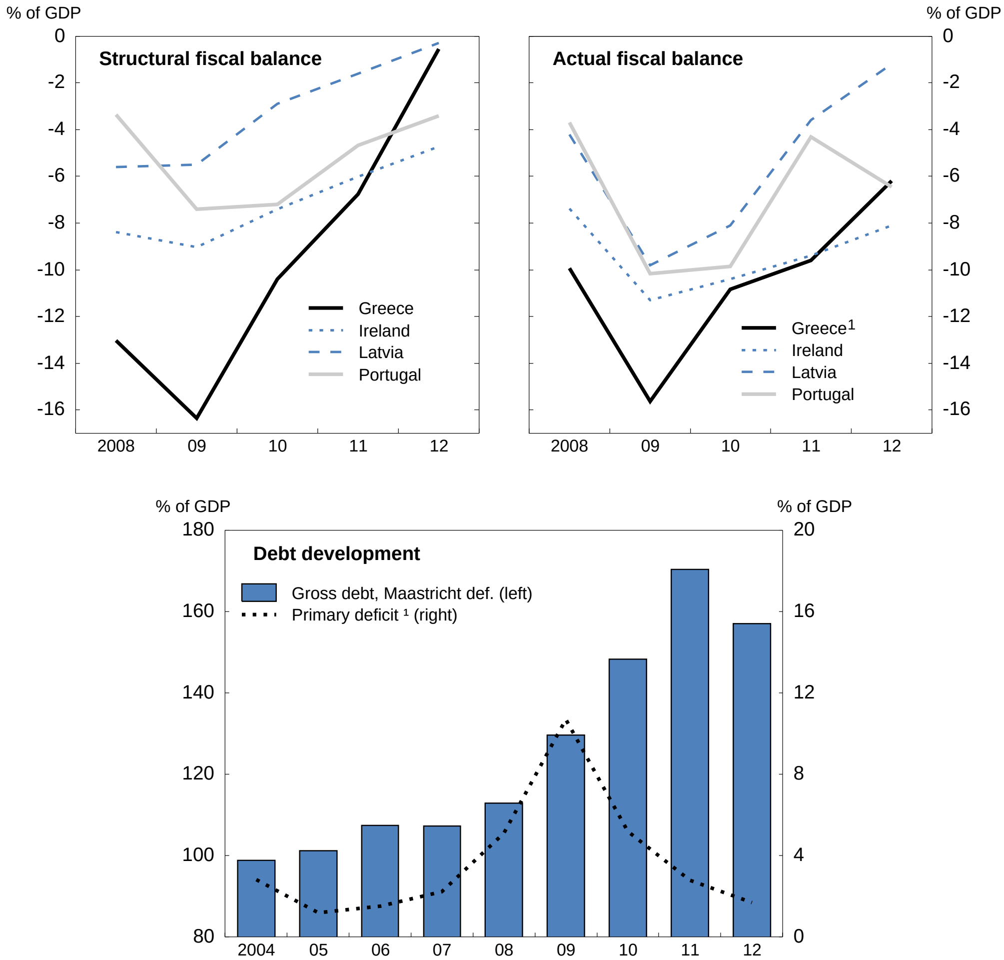
Table 2. **Official GDP projections and outcomes for Greece**[1]

	Real GDP		Nominal GDP	
	Official projections	Outcomes	Official projections	Outcomes
2010	-4.0	-4.9	-2.8	-3.9
2011	-3.0	-7.1	-1.5	-6.1
2012	-3.0	-6.4	-2.8	-7.2
2013	-4.2	-3.5[2]	-5.4	-5.9[2]
2014	0.6	-0.4[2]	0.2	-2.3[2]

1. For 2010 and 2014, the May and June IMF projections, as released in their quarterly report on Greece are used. For 2011, 2012 and 2013, the December IMF projections released in these quarterly reports are used.
2. OECD projections.

Source: OECD, *OECD Economic Outlook database 94;* Consensus forecast; IMF programme quarterly report on Greece.

Figure 3. **Fiscal and debt developments**



1. Data for Greece do not include the one-off capital transfers of 2.8% of GDP made by the general government in 2012 through the Hellenic Financial Stability Fund, as a result of banks' resolution. Data for Ireland do not include the capital transfers made by the general government for banks' recapitalisation, which amount to 2.5% of GDP in 2009, 20.2% in 2010 and 3.6% in 2011.

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

Apart from being larger than initially envisaged, this consolidation has had a larger impact on activity than had initially been estimated even though other factors, most notably the surge in political uncertainty and fears of an exit from the euro area also contributed to the lower-than-previously-forecast growth. Until the end of 2012, tax revenues have fallen persistently below expectations and reforms have proven difficult to implement, resulting in major slippage in areas such as health. This has required greater spending cuts to meet targets, depressing domestic demand. The general government had also built up sizable payments and to a lesser extend tax-refund arrears, which stood at 4.6% of GDP at end-2012. This reduced private sector liquidity in a context of very tight credit conditions. However, since the beginning of 2013, visible improvements have been made in tax revenue collection, providing fiscal stability and the prospect of primary surplus for 2013. Since the beginning of 2013, and in contrast to previous years, tax revenue has been growing in line with the targets agreed with the Troika. There has also been a substantial increase in the number of full-scope audits and in the assessed revenues of large tax payers.

The November 2012 Eurogroup agreement on a slower pace of fiscal retrenchment put off targets from 2014 to 2016, thereby reducing the fiscal drag on domestic demand. The revised programme cut the target for the primary fiscal deficit by about 1½ percentage points of GDP per year from 2013 onwards, to reach a primary surplus of 4½ per cent of GDP in 2016 and a total deficit of ¾ per cent of GDP. Steps have also been taken to eliminate all arrears by the end of 2013 and to further improve expenditure transparency and controls.

For 2013-14, fiscal policy continues to deliver strong adjustment, which remains necessary against the background of a very high public debt, and to improve the prospects for a return to capital markets. Indeed, the total, frontloaded, consolidation for 2013 and 2014 of about 7¼ per cent of GDP is ambitious but feasible. Expenditure cuts account for nearly three-quarters of the total adjustment (Table 3). Easy-to-implement measures, such as changes in parameters for calculating pensions and salaries, were favoured for reducing the risks of fiscal slippage (EC, 2012). The authorities also decided to press ahead with various taxation changes, including a welcome income tax reform and a new unified real estate taxation.

Table 3. **Planned fiscal adjustment for 2013-14**

In per cent of GDP

	2013	2014	Total
Expenditure measures	**4.0**	**1.3**	**5.3**
Of which:			
Pensions	2.6	0.2	2.8
Wage bill	0.6	0.1	0.8
Health spending	0.2	0.3	0.6
Social benefits	0.0	0.0	0.0
Education	0.0	0.0	0.1
Defence	0.2	0.1	0.2
Local governments	0.0	0.1	0.1
Rationalisation of state-owned enterprises	0.1	0.1	0.2
Public investment	0.1	0.1	0.2
Public administration restructuring	0.1	0.1	0.3
Revenue measures	**1.2**	**0.8**	**2.0**
Of which:			
Direct taxes	0.3	0.7	1.0
Indirect taxes and sales	0.6	0.1	0.7
Social security contributions	0.3	0.0	0.3
Total	**5.2**	**2.1**	**7.3**

Source: Greek Ministry of Finance.

To enforce budgetary objectives, quarterly spending ceilings were set for all ministries, which are to suffer reductions in appropriations if targets are not met. However, while budget execution was well within target in the first ten months of the year, reductions in arrears were behind schedule. These arrears fell by EUR 2.2 billion (1.2% of GDP) between December 2012 and September 2013 instead of a target of EUR 6.5 billion over the period, although the pace has recently accelerated. The privatisation target of EUR 2.6 billion (1.4% of GDP) for 2013 has been revised down to EUR 1.6 billion (0.9% of GDP).

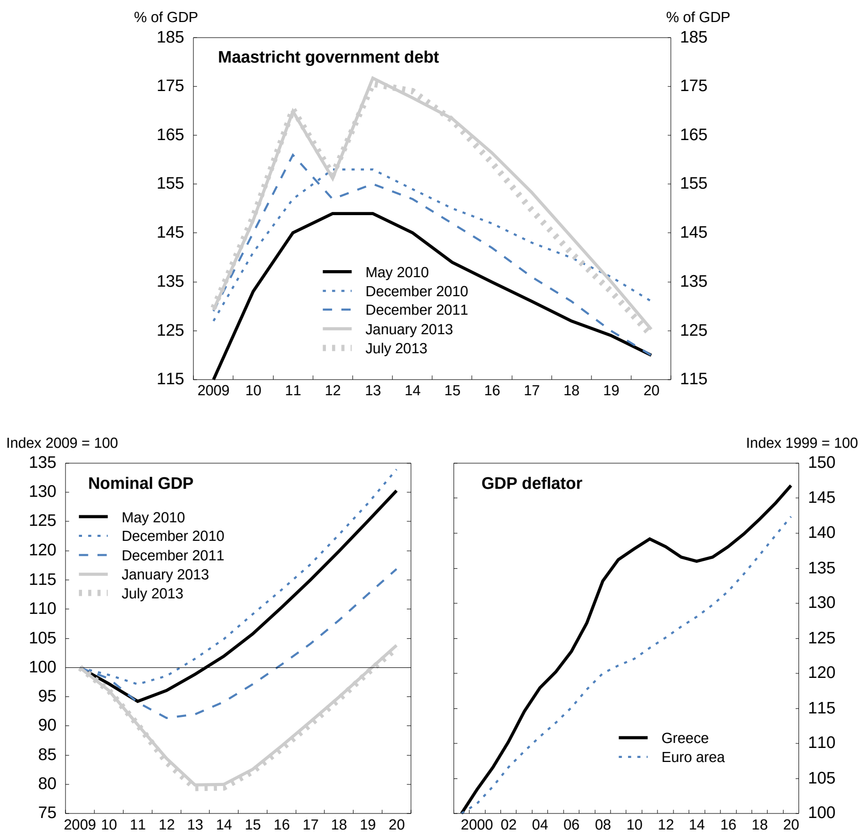
These developments could increase the financing gap of the current adjustment programme between 2014 and 2016, which is currently estimated to be around EUR 10 billion (IMF, 2013a). This gap would widen further if the programme assumption of 0.6% real GDP growth and 0.2% nominal growth in 2014 proves too optimistic. In such a case, the automatic stabilisers should be allowed to play, as introducing further measures to offset the budgetary effects of weaker growth risks aggravating again the depression and exacerbating the already dire social conditions.

Public debt sustainability

The most recent debt sustainability analysis (DSA), published by the European Commission and the IMF in July 2013, projects that the debt-to-GDP ratio will peak at 176% in 2013, and then fall steadily to 124% in 2020 (Figure 4). This peak is much higher than had been envisaged in May 2010, essentially because growth projections made at that time proved over-optimistic. As suggested by the official projections, growth could be positive in 2014 and strengthen further in the following years as the benefits of the supply-side reforms materialise. In such a scenario, the debt-to-GDP ratio would reach 124% by 2020 (taking into account measures which could be adopted as agreed by the Eurogroup). This is still high, but debt would be on a clear declining trend due to the large primary budget surplus which is assumed to be maintained.

This scenario is subject to a number of downside and upside risks. Major upside risks include a stronger effect of structural reforms on real GDP growth, thus lowering the debt burden faster than expected. For example, recent economic data suggest that in 2013 the economy is likely to contract by less than initially anticipated. In addition, a more rapid return of confidence and foreign capital, attracted by low assets prices, and privatisation, could support domestic demand through both investment and consumption.

Figure 4. **Official projections of Maastricht debt and nominal GDP**

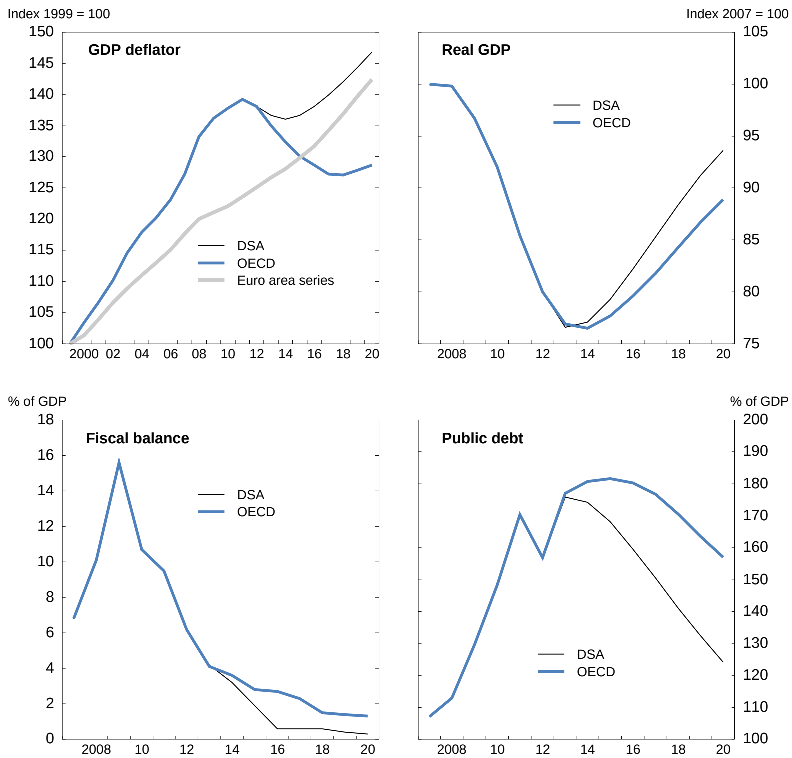


Source: OECD, *OECD Economic Outlook 93 database*; IMF, *Quarterly Report on Greece*; IMF (2013), "Greece: Fourth Review Under the Extended Arrangement Under the Extended Fund Facility", *Country Report*, No. 13/241, July.

However, the downside risks are significant. As noted by the IMF (IMF, 2013a), *"…the programmed path entails still very high debt well into the next decade, leaving Greece accident prone for an extended period.*", "*If investors are not persuaded that the policy for dealing with the debt problem is credible, investment and growth will be unlikely to recover as programmed.*", "*Debt path is particularly vulnerable to growth and [budget] primary surplus shocks…*". A key parameter in this respect is nominal growth, which drives tax receipts and the denominator of the debt-to-GDP ratio. As described above, risks to real growth are still on the downside even if the programme is fully and rigorously implemented. Continuing high unemployment combined with greater flexibility in labour markets may put further pressures on nominal wages while product market liberalisation may lead to lower prices. As a result, deflation pressure may be stronger and last longer than expected.

Figure 5 shows an alternative DSA constructed by the OECD, which is less optimistic than the Troika scenario. It illustrates the effects of alternative assumptions regarding real GDP and inflation developments. This analysis includes a medium-term OECD growth projection, which is more pessimistic than in the July 2013 DSA and results in a level of real GDP that is about 6% lower in 2020. A less favourable than expected international environment and a slower pace of investment recovery, due to persistently tight credit conditions, cannot be ruled out. More importantly, this scenario also assumes that stronger price adjustment takes place as a result of high unemployment, large slack in the economy and more flexible labour and product markets thanks to the progress of structural reforms. Although the potential amount of the resulting downward inflation pressures is subject to high uncertainty, it is assumed in this scenario that prices decline by about 12% more than projected in the July 2013 DSA between 2013 and 2020, implying a total improvement of the price-based real exchange rate by almost 20% over this period. This would correct the overvaluation of this real effective exchange rate as estimated by the OECD and would improve price competitiveness (Chapter 1). This scenario also assumes that automatic stabilisers operate partially and, as a result, the fiscal targets in the programme are not met over the 2015-17 period, with a 4¼ per cent primary surplus reached by 2018 only. Under these assumptions, the debt ratio continues to rise until 2015, and only falls to below 160% of (nominal) GDP by 2020, almost 35 percentage points more than in the July 2013 DSA (Table 4). About two thirds of this difference reflects the assumed larger deflation. Another way to illustrate this vulnerability of Greek debt sustainability in case of a stronger-than-expected deflation is to estimate what real GDP growth would have to be, to achieve the July 2013 DSA target debt of 124% of GDP, under the OECD assumptions. Real GDP would have to rise by 4.8 % a year between 2014 and 2020. Such a rapid and sustained pace of growth is very unlikely, even in the presence of a substantial output gap, given both the historical performance of the Greek economy and the weakening of its potential growth since the beginning of the crisis.

Figure 5. **Alternative long-term debt sustainability scenarios**[1]



1. Compared to the 2013 debt sustainability analysis (DSA), by 2020 the OECD scenario assumes that the price level has fallen by 12% more, real GDP is 6% lower, there is a slippage in the fiscal balance relative to target as from 2014, amounting to about half the size of the automatic stabilisers.

Source: OECD calculations and IMF (2013), "Greece: Fourth Review Under the Extended Arrangement Under the Extended Fund Facility", *Country Report*, No. 13/241, July, http://www.imf.org/external/pubs/ft/scr/2013/cr13241.pdf.

Table 4. **Debt sustainability analysis: scenario assumptions and outcomes**[1]

2014-20 average

	IMF DSA July 2013	OECD scenario 1[2]
Real GDP growth	2.9	2.1
Inflation rate (GDP deflator)	1.0	-0.6
Nominal GDP growth	4.0	1.5
Privatisation proceeds (% of GDP)	1.4	1.4
Average nominal interest rate on public debt (%)	3.1	3.1
Primary budget balance (% of GDP)	3.8	3.2
Total budget balance (% of GDP)	-1.1	-2.2
Primary budget balance (% of GDP) (end of period)	4.3	4.3
Maastricht debt (% of GDP) (end of period)	124	157

1. See the footnote 1 in Figure 5 for additional information concerning the assumptions retained in these scenarios.
2. To achieve the July 2013 DSA target debt of 124% of GDP, under the OECD assumptions, real GDP would have to rise by almost 5% a year between 2014 and 2020.

Source: OECD estimates.

If negative inflation risks materialise, assistance from Greece's euro area partners may need to be considered, provided the programme has been fully implemented. In the 27 November 2012 the Eurogroup stated that "*Member states reiterated their commitment to provide adequate financial support throughout and beyond the programme, until Greece regains access to financial markets, so long as it complies with its obligations. This includes considering further measures if necessary to achieve debt sustainability*" (Eurogroup, 2012). In practice a key condition for Greece to benefit from these further measures is to achieve a primary balance in 2013, which seems likely even though the final budget outcome will only be officially known around April 2014.

Under the OECD scenario of full implementation of reforms, but stronger deflation, assistance would need to be large enough to reduce uncertainties and revive demand, although sustainability as such is difficult to determine precisely. Beyond the reduction of the large debt overhang that such assistance would provide, it would also significantly reduce the need for further fiscal tightening, without widening the overall deficit much, and boost growth given the large fiscal multipliers, currently estimated at somewhat above 1 (Blanchard and Leigh, 2013).

The debt sustainability issue implied by the OECD scenario may, however, be overstated by the debt-to-GDP ratio indicator. Following the debt restructuring which occurred in 2012, Greek debt is now mostly in official creditors' hands (Table 5). The average maturity of the Greek debt is 16.4 years, far longer than that of any other European country. Moreover, the average interest rate on the Greek debt is expected to remain around at 2½ per cent in 2013-15, which is almost 1 percentage point lower than the EU average and it should stay at a relatively low level beyond this period. On this basis, Greece's debt thus appears to be more sustainable than what is suggested by the debt-to-GDP ratio indicator alone. If the November 2012 decision of the Eurogroup to provide Greece with further measures and assistance, if necessary, when a primary surplus is achieved and all other components of the programme conditionality are fully met, translates into another extension of maturities and grace periods, as well lower interest rates on existing loans, it will ease further the corresponding debt financing needs. Furthermore, such an action would provide additional "breathing space" to the economy to grow faster in the coming years and, hence, improve the debt-to-GDP ratio.

It should be stressed that any kind of assistance should not be a substitute for structural reforms, and indeed such reforms would be needed for the Greek economy to contain the risks to debt sustainability and take full advantage of the space for growth created by this breathing space. Therefore, structural reforms need to be fully implemented and extended, in particular in the areas of public administration and product markets, including privatisations (as discussed below).

Table 5. **Greek government debt decomposition**

Estimates at mid-2013

	EUR billion	% of total	% of GDP
Official creditors	270	84	148
IMF	31	10	17
Euro member states	205	64	112
European Central Bank	35	11	19
Private sector	50	16	27
T-bills	16	5	9
Bonds	34	11	19
Greek pension funds	8	3	4
Other	26	8	14
Total	320	100	175

Source: OECD estimates based on IMF, Bloomberg, Citi research and Greek Ministry of Finance.

Fiscal reforms to strengthen medium-term growth

Improving tax collection and reducing evasion

Tax evasion is notoriously high, and shows little sign of diminishing. Underreporting of income by the self-employed is estimated to cost the state around 1¾ per cent of GDP in foregone revenues every year (Artavanis *et al.*, 2012). The collection of employers' social contributions and the VAT seems to have become less efficient during the crisis, perhaps reflecting higher taxes in the context of declining demand. As the Bank of Greece (BoG, 2013) has shown, a 1% decline in real GDP lowers VAT revenue efficiency by about 0.4 percentage points. VAT revenue efficiency has thus decreased substantially in recent years due to the recession. According to the same Bank of Greece report, the decline in economic activity impacts VAT revenue efficiency both directly and indirectly, through the shifts towards necessity goods (that are usually taxed at a lower VAT rate) and the increase in tax evasion. If tax collection efficiency had been similar to the OECD average, at existing VAT and employers' social contribution rates, the level of Greek government revenues in 2011 could have been about 6 percentage points of GDP higher, according to OECD estimates.

Since end-2012, the authorities have intensified efforts and adopted welcome measures to fight tax evasion. The tax system, including personal income taxes, has been simplified, and a fiscally neutral property tax reform, put in place in 2013, will continue in 2014 with a broader tax base and a lower rate achieved by unifying the multiple property taxes. Key changes have been adopted to enhance the efficiency of tax inspection and tax debt collection, increase the autonomy of the tax administration, modernise working techniques, and expand risk-based audits (EC, 2013a).

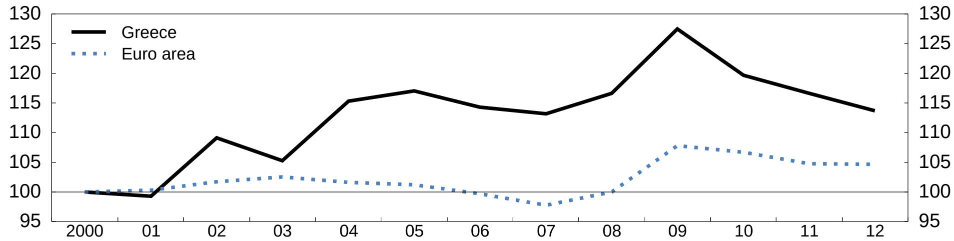
Given the still widespread tax evasion more needs to be done. Better cross-checking on information on taxpayers' bank accounts, social contributions and wealth would narrow opportunities for evasion. Improving further the judicial system and speeding up court proceedings would strengthen enforcement (Vasardani, 2011; OECD, 2013a) and the on-going simplification of the code of civil procedure is therefore welcome. Greater use of specialised out-of-court mediation systems hold the promise of speeding up resolution of tax cases. Websites and online facilities would help lawyers to follow up cases more easily and accelerate judicial procedures (OECD, 2013a). Amnesties, which have been used in the past in an attempt to boost revenues, only encourage further evasion and should be definitively renounced.

In-depth reform of the public administration

Reforms to reduce waste, boost efficiency and improve the allocation of resources within the public sector can somewhat mitigate the growth impact of consolidation. But a more efficient public sector is especially important for longer term growth as better quality public services create trust with public servants, increase willingness to pay taxes, improve competitiveness, create better conditions for business environment and attract more foreign investment. A more efficient civil service is also essential to implement the structural reforms that are the key to restoring growth.

Reforms have been put in place to arrest and reduce the growth in the public-sector wage bill. A significant part of the slippage recorded in this domain between 2000 and 2009 compared to the euro area average has been corrected (Figure 6). A single salary grid was introduced and then extended to the whole civil service in November 2012, which rationalised the pay structure and reduced average pay levels by nearly 20%. The authorities are likely to meet their employment reduction objective of 150 000 between 2011 and 2015 by replacing only one in five retirees. To address inadequate staff allocation, a new "mobility scheme" has been developed. By end-2013, 25 000 persons are to be transferred to this programme, which lasts for eight months with reduced pay. It allows for retraining with intention to find a placement, without guarantee, in another public or private sector job. Moreover, 15 000 employees will be laid off by the end of 2014 to make room for new qualified staff.

Figure 6. **Government wage expenditure**
As a percentage of GDP, index 2000 = 100



Source: Eurostat.

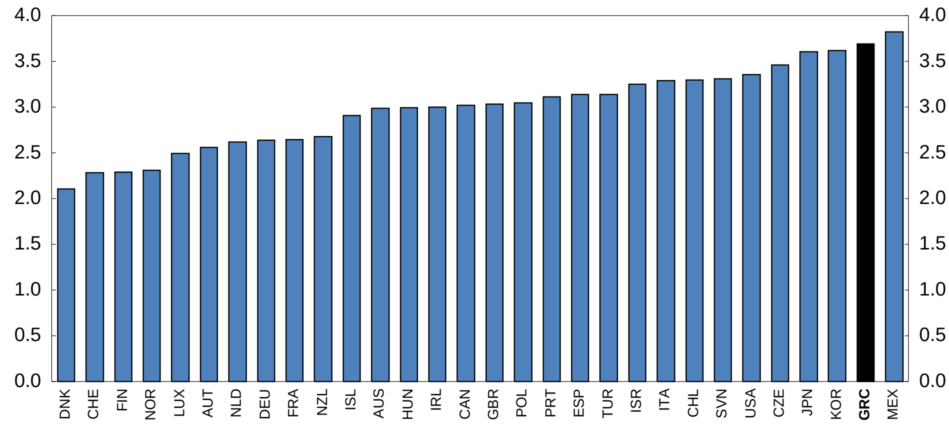
Beyond the welcome measures, the modernisation and effective functioning of public administration could be enhanced by a number of additional actions, as suggested in the *2011 OECD Survey* (OECD, 2011a). For instance, it would help to further spread a culture of evaluation of staff performance based on clear individual objectives, to end automatic promotions linked to seniority, to sanction unsatisfactory behaviour and reward efforts. This would stimulate the efficiency and enhance the quality of public services. Significant efficiency gains could also be achieved through further development of e-government to boost public sector productivity and facilitate private citizen interaction with government department and agencies. The government actually plans to take steps in several of these domains.

There is a glaring contrast between the extensive means deployed for overseeing budget implementation and the modest efforts made to date to check that structural reforms are properly carried out. Better data collection and dissemination are still required to verify and monitor concrete reform outcomes, as stressed in the previous OECD *Survey* (OECD, 2011a). If necessary, this task could be entrusted to an independent agency.

A General Secretariat reporting directly to the Prime Minister has been created to co-ordinate the work of the ministries and to supervise implementation of reforms. In 2012, the Parliament introduced the OECD Principles of Better Regulation in the legislation, with the view to cut the heavy administrative costs associated with the Greek approach to regulation. More recently, with the OECD support, the authorities have embarked on a project to reduce by 25% the administrative costs entailed by existing regulations in 13 important sectors of the economy, including energy, public procurement, company law, VAT and environment. However, providing more adequate financial and regulatory means to the office responsible for applying OECD Better Regulation Principles would be needed. More active government participation in the assessment and streamlining of the legislation in the 13 sectors of the economy could also be a useful platform for a more comprehensive implementation of the 2012 law on Better Regulation. More generally, increased ownership of structural reforms by the Greek authorities would be welcome.

A welcome draft law is to be submitted to Parliament soon to address the serious problem of government corruption (Figure 7). However, beyond the indispensable fight against corruption, there is also a need for more transparency and accountability in the government sector. This is particularly important for the justice administration, the deficiencies of which seriously hamper on-going efforts against tax evasion and several other areas of key significance for economic efficiency, including the insolvency framework (see below). International comparisons show that reliable and detailed statistics on the work and outcomes of justice administration improve efficiency of its services, and thus proper functioning of the rule of law (Palumbo *et al.*, 2013).

Figure 7. **International perception of corruption**[1]



1. Average perception of corruption across six public institutions. 1 = not at all corrupt, 5 = extremely corrupt.

Source: Transparency International, *Global Corruption Barometer 2010/11* (http://gcb.transparency.org/gcb201011/).

Box 1. Recommendations for fiscal policy and government reform

- Accelerating and broadening the structural reform programme is essential for sustainable recovery. In this respect, stronger reform ownership by all line-ministries, a better coordination of reform implementation and enhanced monitoring and evaluation of reform outcomes are essential. Evaluation results should be disseminated.
- Implement fiscal consolidation measures as planned. If growth is weaker than expected, let the automatic stabilisers operate.
- If negative macroeconomic risks materialise and nominal growth proves weaker than expected, even with full and timely implementation of structural reforms, serious consideration should be given to further assistance to achieve debt sustainability.
- Step up the fight against tax evasion by stopping tax amnesties and identifying and punishing evaders, and improving the effectiveness of audits. Improve the judicial system by overhauling and streamlining the civil code and making more use of out-of-court mediation systems.
- Further enhance the efficiency of public administration, *inter alia*, through the development of e-government and the evaluation of staff performance based on clear individual objectives.
- Provide adequate financial and regulatory means to the office responsible for applying the OECD Better Regulation Principles. The government should participate more actively in the on-going assessment and streamlining of legislation in 13 sectors of the economy to reduce the administrative costs.

Easing financial conditions more rapidly

Greek banks have paid a heavy toll during the crisis. Markets have linked them to Greek public finances, Private Sector Involvement (PSI) to restructure the public debt imposed heavy losses (estimated at EUR 37.7 billion, or 20% of GDP), and the deep recession has greatly weakened their assets and eroded their capital. Net interest income has decreased sharply as a result of increasing NPLs, rising funding costs in a context of deposit outflows, closure of the interbank market and the subsequent dependence on costly Emergency Liquidity Assistance (ELA) to bridge the funding gap (Figure 8).

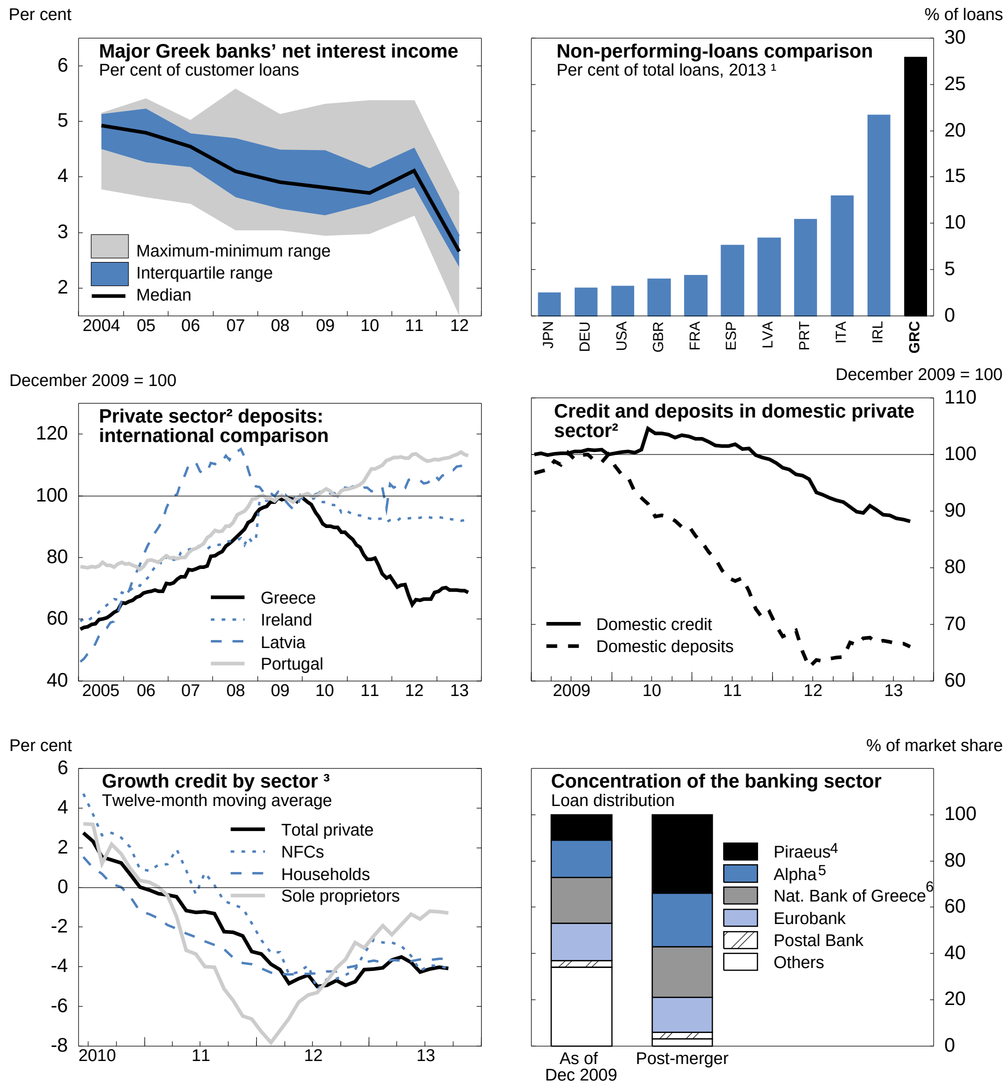
Credit contraction has been severe, and credit was still falling in 2013, although the pace of decline seems to be slowing somewhat (Figure 8). Credit contraction has partly reflected lower demand for loans because of the depth of the recession, but also bank deleveraging and supply restrictions. Banks curtail new lending to economise on scarce liquidity and capital. The resulting funding constraint has been particularly harmful for the productive sector because it is dominated by SMEs, for which bank loans are the most attractive and widely available source of finance. Bank deposits have only partially recovered after the large capital outflows which took place between 2010 and mid-2012, despite relatively high deposit interest rates.

The authorities have preserved the stability of the banking sector, fully protecting depositors and avoiding bank defaults. They have also adopted specific provisions to improve SMEs' access to credit, amounting to about EUR 2 billion, thanks to the development of new financing facilities sponsored by the European Investment Bank and the European Investment Fund. The recapitalisation and resolution plan, following the implementation of the PSI in March 2012, aimed to restore the capital base of the four core (systemic) banks and resolve all other non-core banks unable to recapitalise themselves through the private capital market, with the large part of EUR 50 billion in debt securities that had been earmarked for this purpose in the economic adjustment programme. The process has been managed by the Hellenic Financial Stability Fund (HFSF), a temporary institution with a governance structure designed to ensure that banks are run on a commercial basis at an arm's length from the state even after they have been taken over as part of recapitalisation. As this structure is key to the health of the banking system, the plan to reinforce HFSF governance and its independence *vis-à-vis* the political influences is welcome (EC, 2013b).

After the completion of this plan, one core bank is under HFSF control, but the other three have retained private management, even though more than 80% of their capital is owned by HFSF. Core banks, which have been able to raise at least 10% of the new shares issued for the recapitalisation, have been allowed to avoid a full HFSF control. To attract private investors, new shares issued by the core banks have received free warrants to buy all HFSF's shares at a predetermined price at regular points in time over the next 4½ years. This provides a way for the HFSF to exit from core banks' capital. A resolution framework has been applied to six non-core banks, with their healthy units being absorbed by the core banks, and to three co-operative banks with their deposits being transferred to a core bank. Overall, the restructuring process has been smooth, all depositors were protected, and shareholders suffered substantial losses.

The HFSF exit strategy, with the "free" equity-linked warrants granted to private shareholders, helped raise the part of capital from the private sector. However, it sets a cap for the upside potential for privatisation proceeds, which may prove costly to the public sector. This strategy keeps the public debt low, but if the banks recover as expected, early private investors will make substantial capital gains given the low purchase price of their shares and free warrants. Incentives for an early exercise of warrants are of course desirable from a macroeconomic point of view, since the sooner banks recover, the better for the growth prospects of the economy. However, if the core bank shares do not rebound and remain in HFSF's hands until the end of 2017, an alternative HFSF exit strategy could be considered. It would simply be to sell shares over time as the banks recover. This may increase privatisation proceeds for the government compared to a warrant-based plan.

Figure 8. **Financial market indicators**



1. Or latest available data.
2. Private sector includes non-financial corporations and households.
3. Growth rates are derived from the differences in outstanding amounts corrected for loan write-offs, exchange rate valuations and reclassifications
4. Also includes Hellenic Bank, Bank of Cyprus, Geniki Bank, CPB, HB and Millennium after merger.
5. Includes Emporiki Bank after merger.
6. Includes 1FBBank after merger.

Source: Bank of Greece; Datastream; ECB, *Money, Banking and Financial Markets database*; IMF, *Financial Soundness Indicators database*; OECD, *OECD Economic Outlook database;* Published accounts (pro forma) and OECD calculations.

The recapitalisation plan and enhanced political stability have boosted depositors' confidence and market sentiment. Despite the deepening recession, bank deposits rose by EUR 13.5 billion between June 2012 and March 2013 before broadly stabilising up to August 2013. This has partly offset the EUR 87 billion fall between end-2009 and mid-2012. The Greek banks' dependence on expensive ELA financing has also been drastically reduced in 2013. While increased banking sector concentration upon resolution and acquisitions could improve the stability of the sector and increase its efficiency by reducing banks' branches, it will also make close monitoring of competition more important.

Notwithstanding these measures, and despite heavy provisioning and rapid increases in non-performing loans (NPLs) (Figure 1), banks are not writing off significant amounts of bad debt. As a result, banks may be monitoring and managing relationships with companies with low probability of survival and thereby slowing the necessary reallocation of resources toward exports and higher productivity sectors. Compared to the pre-crisis period, the sectoral allocation of credits has not substantially shifted towards the export-oriented sectors since 2010 (Chapter 1).

Bolder debt-workout by the core banks and amendments in the legal framework to help improve the payment culture are needed to ease the persistent credit supply restrictions. Although banks are best placed to deal with their customers, they face difficulties when the deterioration in loan quality becomes systemic and the value of collateral falls sharply (IMF, 2013b). Establishing informal and more flexible debt-restructuring procedures, possibly under the auspices of the Bank of Greece, could accelerate debt-workouts, especially when financially distressed companies face a large number of claimholders with divergent interests. Some initial steps have been taken in this direction. Following their recapitalisation, core banks will need to develop key performance indicators (KPIs) and prepare a strategy to deal with troubled assets, which will encourage more efficient management of NPLs (BoG, 2013). Moreover, a stress test exercise is underway and is expected to be completed by end-2013.

Regarding NPL management, the trend in Greece currently appears to be for each core bank to establish its own "bad bank". Another approach would be for the government to establish a "bad bank" to assume, restructure and liquidate troubled assets in the core banks, as was done for the resolved non-core banks. This approach, which should accelerate debt workouts and thereby improve the supply of credit, has been used in a number of countries facing banking crises, and would help to address issues of fairness, necessity and transparency (Jonung, 2009). The value of bad assets transferred to the bad bank should be carefully evaluated to reduce the risk of overburdening the public accounts when they are ultimately sold. Inevitably, however, this approach will translate into a higher public debt and possibly higher government deficits. Moreover, given that a substantial fraction of delinquent credits represent loans to SMEs, characterised by great heterogeneity, it might not be the most suitable approach in the Greek case.

The insolvency framework has been inadequate. Over-indebted households have been allowed to petition the court for debt restructuring, which most often gave them the right for a break on payments (both the principal and interest) until a court decision was taken. This could take 4 or 5 years because of the backlog of cases (EC, 2013b). Measures have recently been taken to amend this deficient legislation, which weakened the debt-servicing culture and increased moral hazard, which in turn reduced the supply of credit. Reforms were adopted at end-June 2013 to address this deficiency, in part by tightening the eligibility criteria for accessing the insolvency framework. In addition, the implementation of a "facilitation programme" at end-June 2013, as in Portugal and Spain, to provide households under financial stress with debt relief proportionate to their current income for a period of up to 4 years is welcome. The authorities recognise the need to reform the insolvency framework for the corporate sector and the self-employed, in part to accelerate the restructuring of NPLs (especially regarding SMEs) (IMF, 2013a).

Box 2. Recommendations for financial policy

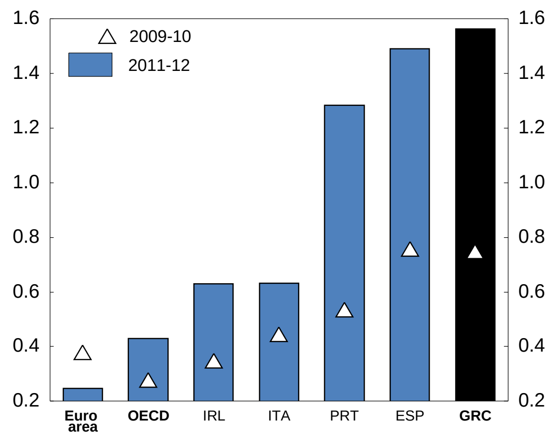
- Enhance management of troubled assets and maximise recoveries in order to increase banks' ability to grant credit in the medium term.
- Proceed with the planned evaluation of the insolvency framework for the business sector, with a view to lifting the obstacles that hinder effective debt resolution of firms.

Market reforms to foster growth

Returning rapidly to positive and sustained growth is essential to the success of the reform programme and its social sustainability. Impressive progress has been achieved in reforming labour and product markets since the beginning of the crisis, albeit from a low starting point. Since 2009-10, Greece has the highest OECD rate of responsiveness to structural reforms recommended in the *Going for Growth* publication (Figure 9). A crucial factor in Greece's growth strategy is the successful implementation of the much needed product market reforms. Full implementation of measures already legislated and a number of additional initiatives would open the way for the expansion of more productive sectors, especially for exports. The resulting job creation would avoid loss of human capital, defuse social tensions and avoid a large rise in structural unemployment with a related decline in potential output.

Figure 9. **Responsiveness to OECD structural reforms recommended in *Going for Growth***

Adjusted for the difficulty of undertaking reform[1]

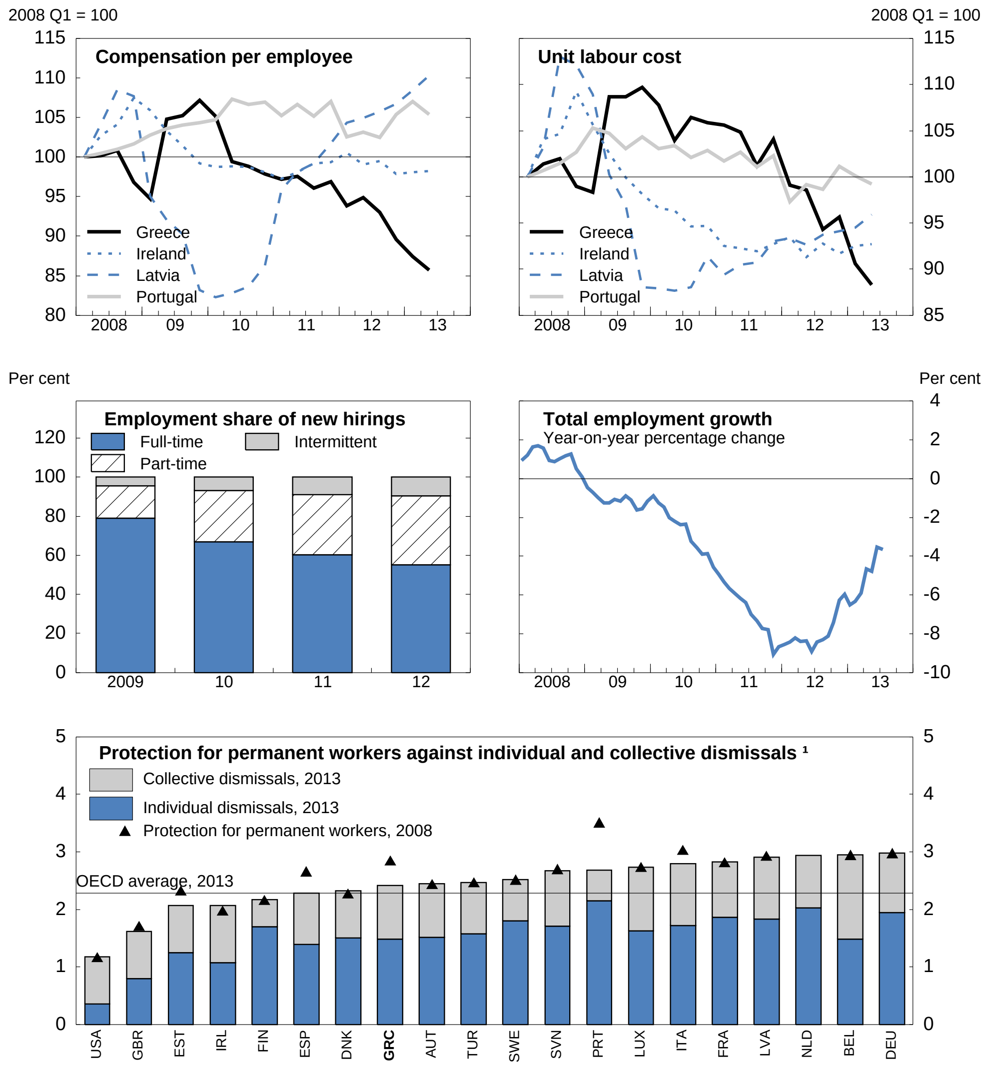


1. The adjusted responsiveness rates are calculated as the share of recommendations in *Going for Growth* for which "significant" action has been taken, where each recommendation is weighted by the inverse of average responsiveness to priorities in this area in non-crisis circumstances, in order to reflect the fact that some areas of reform are more difficult than others. The euro area and OECD rates are calculated as an unweighted average; the OECD rate is not adjusted.

Source: OECD (2013), *Economic Policy Reforms 2013: Going for Growth*, OECD Publishing, Paris.

In the initial stage of the crisis, labour costs failed to adjust despite the prior loss of international competitiveness and the sharp rise in unemployment. The authorities therefore stepped up the pace of labour market reform at end-2011 in four directions: *i)* decentralising the wage bargaining system; *ii)* softening employment protection (EPL); *iii)* reducing the minimum wage; and *iv)* increasing working time flexibility. These reforms are now changing labour market behaviour. Labour costs have fallen sharply since end-2011 and flexible working arrangements have become more common, with an increased share of part-time and intermittent employment (Figure 10). The softening of EPL has been more pronounced than in other OECD countries since 2008, except in Portugal, and is now close to the OECD average for permanent jobs. Although the labour market has continued to deteriorate as the economy has shrunk, the decline in employment has slowed since mid-2012.

Figure 10. **Labour market**



1. The figure shows the contribution of employment protection of permanent workers against individual dismissal (EPR) and additional provisions for collective dismissal (EPC) to the employment protection for permanent workers against individual and collective dismissals (EPRC). The height of the bar represents the value of the EPRC indicator.

Source: Eurostat; ELSTAT; Greek Labour Inspectorate (SEPE); OECD, *Employment Protection database*, 2013 update and *OECD Economic Outlook database*.

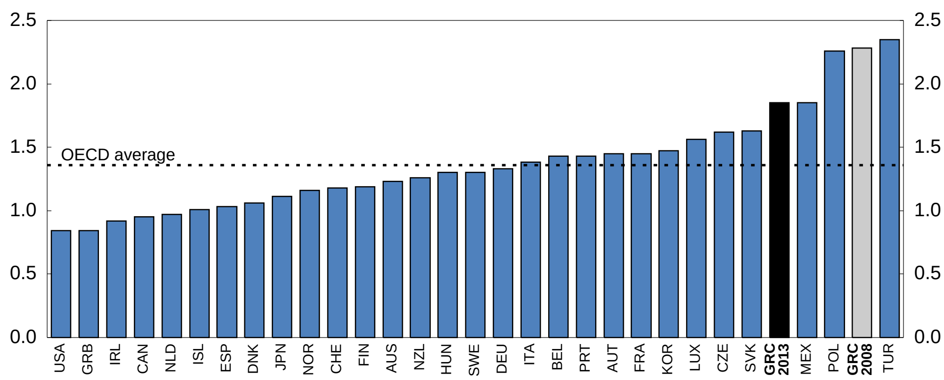
Product markets must work better to boost competitiveness and growth

Despite greater progress in liberalising product market regulations than in other OECD countries (OECD, 2013a), as of early 2013 such regulations were still among the most restrictive in the OECD (Figure 11). They appear to be a major factor in the sluggish price adjustment, as indicated by widening profit margins (Figure 12). More progress in improving the overall business climate and in resolving sector-specific roadblocks remains key in this regard. Despite progress, administrative burdens for creating start-ups were still high at end-2012 (Figure 13); licensing procedures, including land-zoning are complex and burdensome (OECD, 2011a); and the cost and the time involved in export procedures are excessive.

The full review of the licensing procedure for investment and business operations planned with the support of the World Bank is therefore a welcome initiative. The 2013-15 "Trade Facilitation Strategy and Roadmap" to create a national "single window for exports" with the support of international organisations is on track and important, especially for helping SMEs to turn more easily to foreign markets. This plan is set to be extended to import procedures, which are also tied up in red tape, and since imports are often intermediate products, this hinders growth and competitiveness. Both imports and exports are critical for integrating Greece more thoroughly into global value chains and for attracting badly needed foreign investment (OECD, 2013b). The authorities are now completing an evaluation of regulations using the OECD competition toolkit. Once this is done, they should move to strengthen competition and lift barriers to entry in the retail, manufacturing, building materials and tourism industries.

Figure 11. **Overall product market regulation**[1]

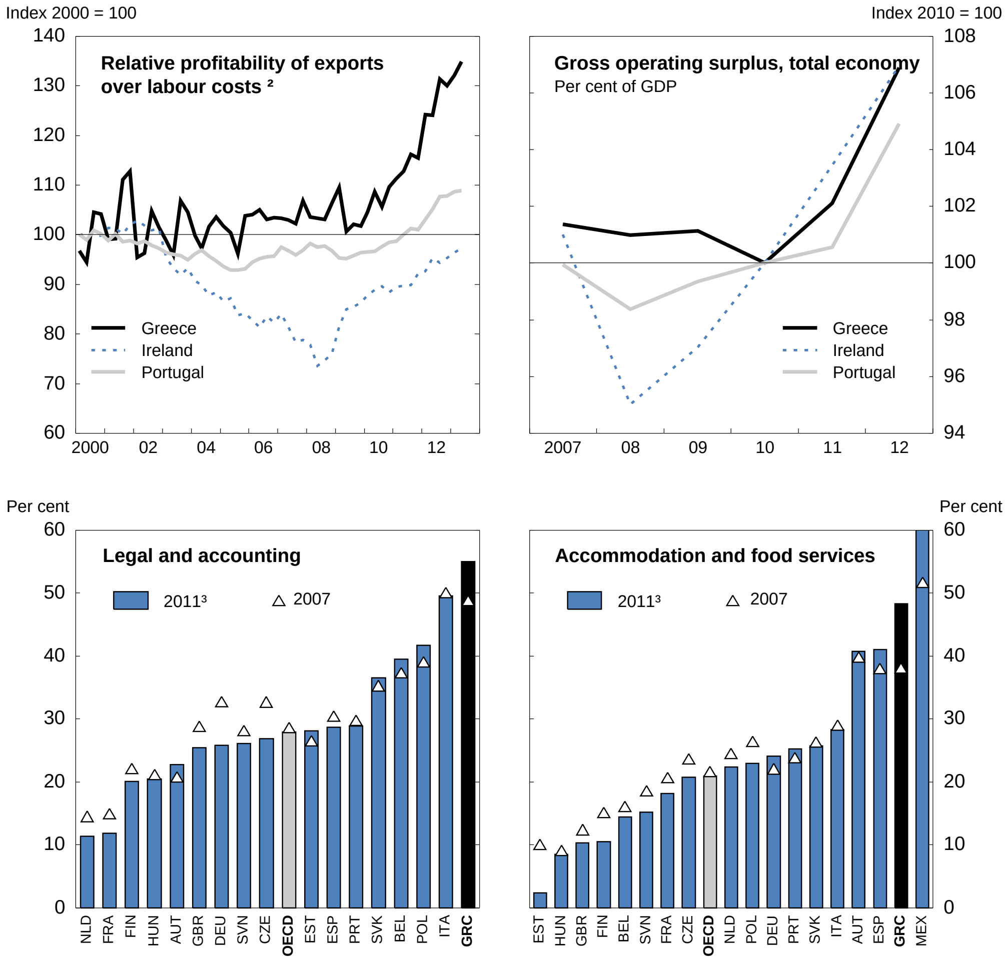
Index scale from 0 (least restrictive) to 6 (most restrictive)



1. The reference year is 2008 for all countries. The PMR indicator for Greece for 2013 is preliminary and for purposes of comparability is calculated on the basis of the 2008 methodology. For more details, see *Source*.

Source: OECD (2014), "The 2013 Update of the OECD Product Market Regulation Indicators: Policy Insights for OECD and non-OECD Countries", *OECD Economic Policy Papers*, forthcoming.

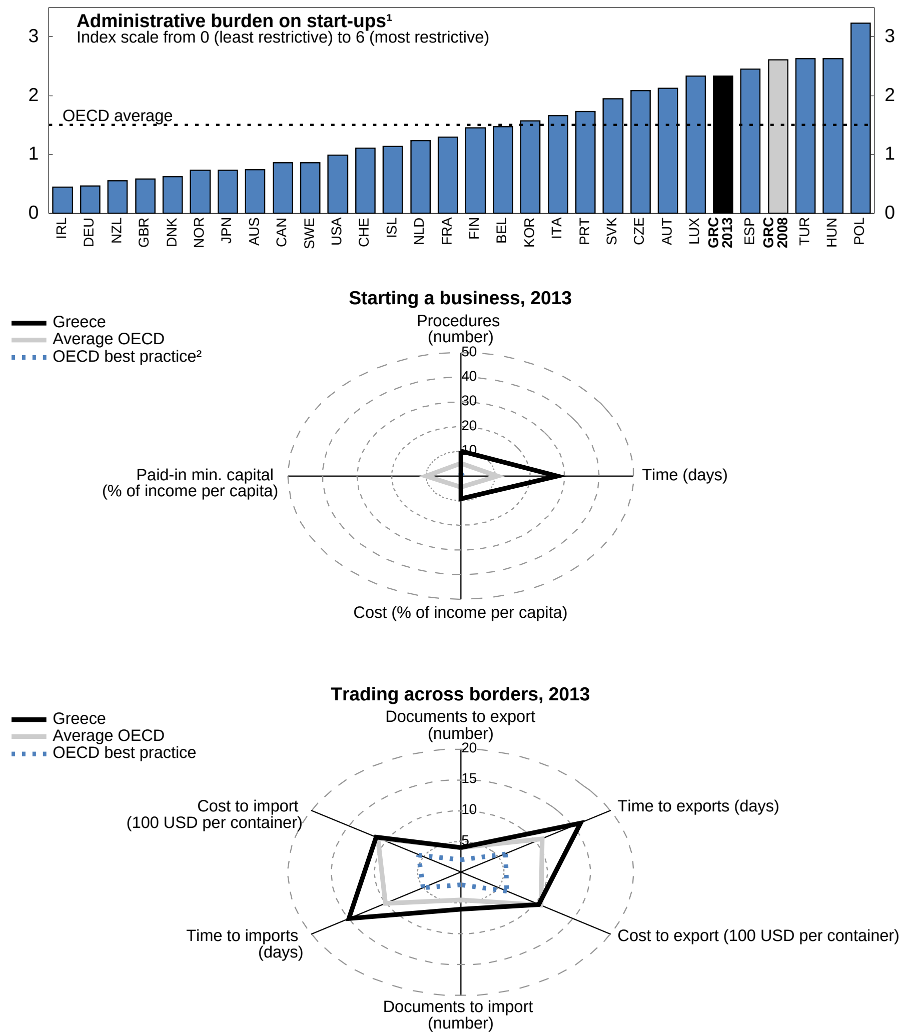
Figure 12. **Profit margins**[1] **in selected sectors**



1. Gross operating surplus as a percentage of the value added of the sector.
2. Defined as the ratio of relative export prices over relative unit labour costs.
3. Or latest available data.

Source: OECD, *Quarterly National Accounts and STAN databases.*

Figure 13. **Barriers to starting a business and to trade**



1. The reference year for the data on regulations is 2008 for all countries. The PMR indicator for Greece for 2013 is preliminary and for purposes of comparability is calculated on the basis of the 2008 methodology. For more details, see OECD (2014).
2. The OECD best practices for starting a business is difficult to identify in the panel, as it only requires one procedure performed in one day at zero cost and without minimum capital.

Source: World Bank, *Doing Business database* (http://www.doingbusiness.org/data); OECD (2014), "The 2013 Update of the OECD Product Market Regulation Indicators: Policy Insights for OECD and non-OECD Countries", *OECD Economic Policy Papers*, forthcoming.

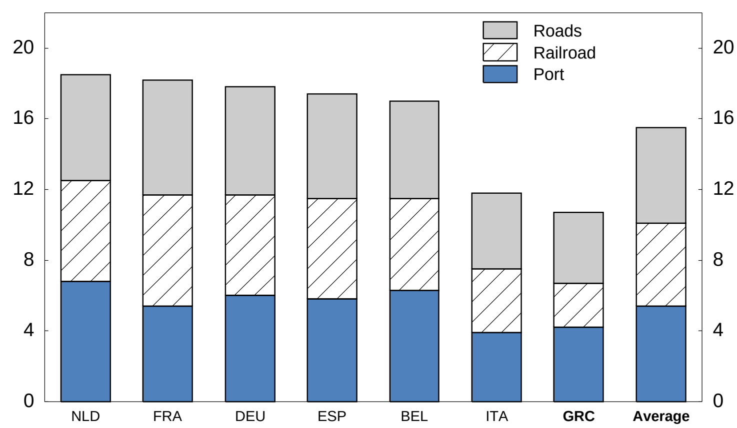
In professional services, which represent a third of private employment in Greece, around 75% of nearly 350 regulated professions had been opened to competition by the beginning of 2013, in line with the Hellenic Competition Commission recommendations. The replacement of administrative licenses by notification procedures for the majority of professions has simplified business creation in many sectors and is expected to increase competition. However, much work remains to be done on implementation, for certain professions. The forthcoming assessment of the measures adopted in the 20 most important regulated professions is welcome, and should be used to develop tools and indicators for an on-going assessment of reform outcomes.

Reforms have been put in place to enhance the weak transportation sector, but the results have been mixed. Restrictions to enter road haulage were lifted, but very few new operators entered because the economy is so weak, and prices did not fall much. They are more promising in the maritime (both cruise and freight) sector, with the successful partial privatisation of the Piraeus port. However, there is still considerable scope for developing port activities as a gateway to the land transportation network of not just Greece but for the entire region. To exploit Greece's geographical advantage at the crossroads of three continents, Greek ports need to further raise their own productivity. If port activities were well managed, GDP could rise by 2.5% by 2018 (NBG, 2013). But taking full advantage of better ports will require filling the gaps in land-based infrastructure as well (Figure 14).

The government initiative to promote a strategy of development and modernisation of the logistics with the support of the World Bank is welcomed. In this regard, the use of EU resources to improve the transportation network, including inter-modal links between maritime, rail and road transport will be important. The planned privatisation of railways, regional airports and ports hold the potential for further improvement. Better regulation holds the promise of attracting significant investment and bringing private sector know-how to infrastructure management.

In the current context, Greece needs to operate all the available levers at its disposal to stimulate demand and restore investor confidence. The privatisation of public enterprises and the transfer of a portion of state property holdings will lay the basis for new investments to boost demand in the short run and will also have a positive medium-term impact on supply and productivity. It should be accompanied by swift progress with liberalisation of certain sectors for consolidating market confidence in the authorities' determination to stimulate private sector efficiency and growth. Proper regulation would also allay market fears of future competition issues in privatised sectors.

Figure 14. **Quality of transport infrastructure**[1]



1. Each type of infrastructure is ranked between 1 and 7 according to executive opinion survey. A higher value indicates a higher quality.

Source: World Economic Forum, *The Global Competitiveness Report 2012-13*.

Electricity and gas markets are still dominated by two public enterprises, Public Power Corporation (PPC) and Public Gas Corporation (DEPA), despite the efforts made to respond to the Third EU Energy Package. Welcome reforms have recently been announced to restructure and privatise public utilities. This includes the creation and privatisation of a new electricity company, expected to be operational in 2015, through divestiture of 30% of PPC's production and distribution capacity. The gas sector is also to be privatised, and the recently approved Trans-Adriatic Pipeline project should be used to ensure competition from more gas suppliers, while such investment is expected to enhance the prospects of the economy in general.

Greece has a comparative advantage in several sectors associated with green growth (for instance, renewable energy and waste management). Nevertheless, subsidy schemes to producers of renewable energy need to be reviewed, especially in the case of photovoltaic energy. Financing problems of Renewable Energy Scheme (RES) resulting from too generous feed-in tariffs have been addressed to prevent a deficit which could otherwise increase to EUR 1.7 billion (1.0% of GDP) by 2014. It is important to better take into account the technological and commercial developments which lower production costs for these forms of energy, to preclude the creation of rents for green energy producers - while avoiding abrupt changes - jeopardising investments made. The authorities' decision to regularly review the RES financing system is thus welcome. A better consistency of RES across EU countries would also be desirable.

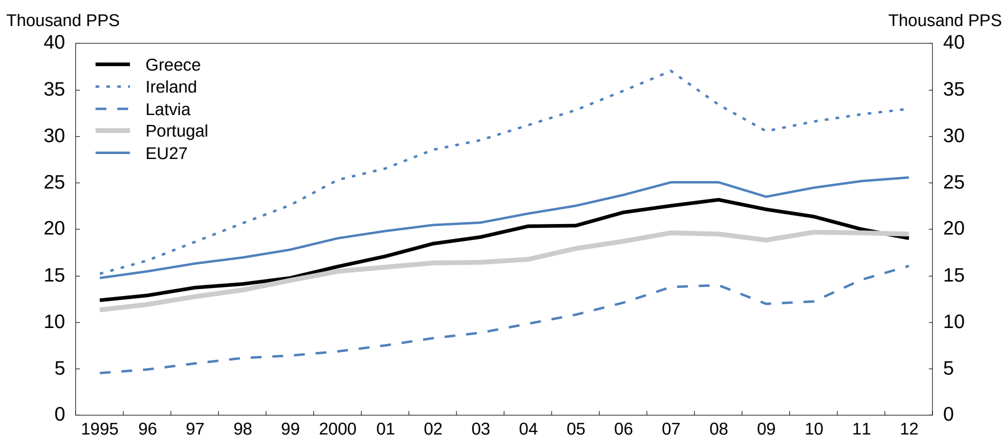
Box 3. Recommendations to improve the functioning of markets

- Further reduce administrative burdens to promote investment. Continue streamlining administrative procedures for exports and imports and simplifying licensing procedures.
- Accelerate the privatisation programme, in particular in energy, railways, regional airports, ports and real estate. This should be accompanied by swift progress in liberalisation to avoid the creation of private monopolies and to boost efficiency and growth.
- Channel available EU funds to improve the transportation network.
- Further promote competition in the energy sector.

Fairly sharing the costs and benefits of adjustment

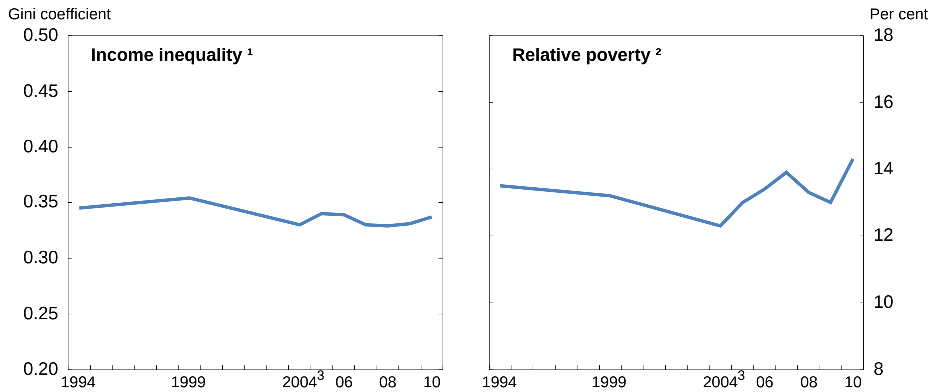
The crisis is having severe social consequences. After narrowing steadily in the decade before the crisis, the income gap *vis-a-vis* the EU average has widened sharply in recent years (Figure 15). While data for income distribution and poverty are only available with long lags, the latest actual data (2010) point to a rise in relative poverty. Inequality remained broadly unchanged (Figure 16).

Figure 15. **GDP per capita**



Source: Eurostat.

Figure 16. **Income inequality and relative poverty**



1. Gini index of household disposable income (market income after taxes and transfers), total population.
2. Relative poverty rates after taxes and transfers (threshold of 50% of the median income).
3. Annual data from 2004 onwards.

Source: OECD, *Income Distribution database,* via www.oecd.org/social/inequality.htm.

More recent estimates of inequality and poverty are based on micro-simulation models, which use economic conditions, tax and spending policy changes and aggregate income developments to infer changes in income distribution and poverty (Koutsogeorgopoulou *et al.*, 2013). These models suggest that inequality rose in 2011 and 2012 as the recession deepened and unemployment rose to high levels (Table 6). Relative poverty also seems to have increased in 2012, after remaining broadly unchanged in the previous two years (Table 6). According to OECD estimates, the rise in relative poverty affected especially the unemployed, children, young adults (30-44 years) and students, while public and bank employees, liberal professions and the elderly (where relative poverty actually fell) were less affected (Chapter 2).

Other indicators also point to worsening social conditions. The number of households in arrears on mortgage or rent payments doubled between 2008 and 2011, increasing vulnerability to homelessness. Unmet health care needs may have risen, notably among the poorest, and health outcomes may have been affected. The economic crisis has also resulted in a large increase of the uninsured population. Around 10% of the population is currently not eligible for health insurance, including the longer-term unemployed and many self-employed workers in arrears with social contributions, although they can use the emergency services of the public hospitals. Life satisfaction declined by more than 20% between 2007 and 2012, according to OECD subjective well-being indicator, exceeding the fall in other euro area countries for which comparable data are available (OECD, 2013c).

Table 6. **Estimated inequality and poverty indices over the period 2009-12**[1]

	2009	2010	2011	2012
Income inequality				
Gini index	0.351	0.349	0.354	0.368
S80/S20 income decile ratio	6.1	6.2	6.5	7.6
S90/S10 income decile ratio	10.3	10.4	12.3	17.4
Relative poverty[2]	13.6	13.8	13.7	15.2
"Anchored" poverty[3]	11.9	15.8	19.7	25.5

1. Based on micro-simulation analysis.
2. The poverty line is 50% of median equivalised disposable income in each year.
3. The poverty line is fixed at 50% of median equivalised household disposable income in 2005 and adjusted for inflation.

Source: Koutsogeorgopoulou, V. *et al.*, (2013), "Fairly Sharing the Social Impact of the Crisis in Greece", *OECD Economics Department Working Papers*, forthcoming.

The social impact of the crisis was influenced both by the worsening economic conditions and policy changes. Data limitations preclude direct measurement of these effects, but the micro-simulation provide estimates (Koutsogeorgopoulou *et al.*, 2013). These simulations quantify the relative impact of fiscal measures across income deciles, with the residual being attributed to economic conditions. Unlike the general public perception that the measures adopted led to a significant increase in inequality, the OECD estimates show that, despite sizeable fiscal consolidation, austerity policies initially reduced inequality (Table 7). As consolidation intensified in 2012, the measures appeared to have made the income distribution slightly more unequal, and, almost inevitably given the depth of the recession, worsened absolute poverty.

Changes in income taxes, cuts in public sector pay and, to a lesser extent, pension reforms, were progressive, both by design and because those mostly affected were at the top of income distribution (Koutsogeorgopoulou *et al.*, 2013). Policies affecting low income households, on the other hand, such as the cut in unemployment benefits in 2012 were regressive. By 2012 income losses for the poorest 10% of the population were considerable and more than in Portugal and Latvia (Avram *et al.*, 2013) (Figure 17). These cross-country estimates exclude more recent fiscal measures (after mid-2012), and do not assess the distributional impact of structural policies.

Table 7. **Disaggregating the redistributive effects of austerity and the wider recession**[1]

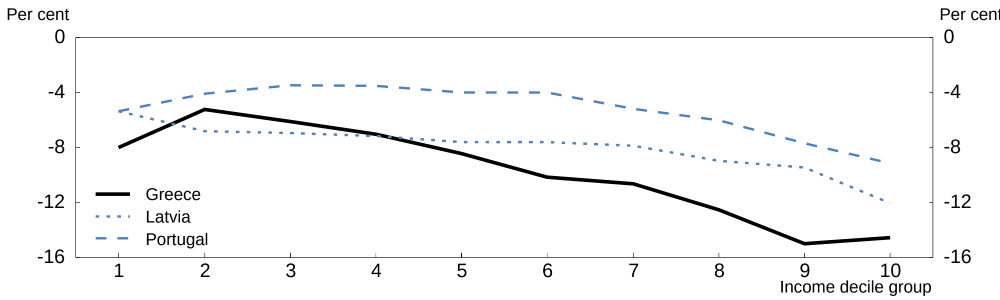
	2009	2010		2011		2012	
		Austerity alone[2]	Austerity + recession	Austerity alone[2]	Austerity + recession	Austerity alone[2]	Austerity + recession
Income inequality							
Gini index	0.351	0.347	0.349	0.346	0.354	0.355	0.368
Δ[3]		-0.005	-0.003	-0.002	0.005	0.001	0.014
S80/S20	6.1	6.0	6.2	6.1	6.5	6.6	7.6
Δ[3]		-0.1	0.0	-0.1	0.4	0.0	1.0
S90/S10	10.3	10.1	10.4	10.5	12.3	12.6	17.4
Δ[3]		-0.2	0.1	0.0	1.8	0.3	5.1
Relative poverty[4]	13.6	13.3	13.8	13.4	13.7	13.7	15.2
"Anchored" poverty[5]	11.9	14.0	15.8	17.8	19.7	21.0	25.5

1. Based on micro-simulation analysis.
2. The impact of austerity policies in year t is assessed relative to the state of the economy in t-1. For example, on the basis of the Gini index, austerity policies (alone) made income distribution somewhat less unequal in 2010 compared to 2009 (0.347 versus 0.351). However, they increased slightly inequality in 2012 compared to 2011 (0.355 versus 0.354). The S90/S10 measure shows a larger rise in inequality in 2012.
3. Change relative to the state of the economy in t-1.
4. The poverty line is 50% of median equivalised disposable income in each year.
5. The poverty line is fixed at 50% of median equivalised household disposable income in 2005 and adjusted for inflation.

Source: Koutsogeorgopoulou, V. *et al.*, (2013), "Fairly Sharing the Social Impact of the Crisis in Greece", *OECD Economics Department Working Papers*, forthcoming.

Figure 17. **The impact of consolidation on household income**

Change in household disposable income due to fiscal consolidation measures up to 2012[1]



1. The measures included here are limited to those having a direct effect on household disposable income. Deciles are based on equivalised household disposable income in 2012 in the absence of fiscal consolidation measures and are constructed using the modified OECD equivalence scale to adjust incomes for household size.

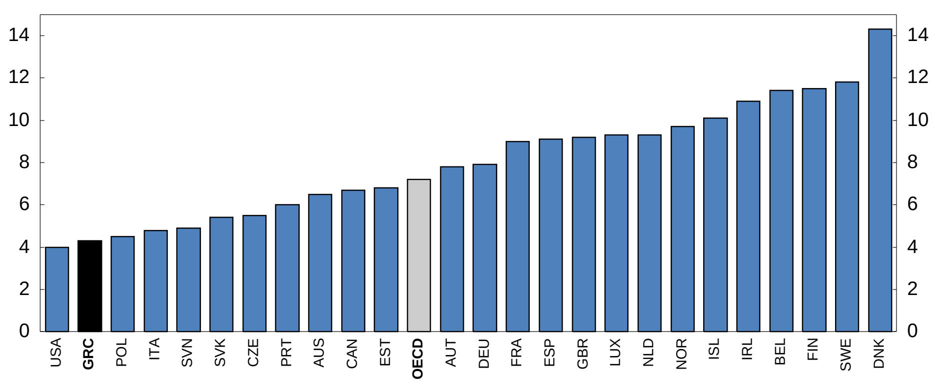
Source: Avram, S. *et al.* (2013), "The Distributional Effects of Fiscal Consolidation in Nine Countries", *EUROMOD Working Paper*, No. EM 2/13, January.

Better targeting of the welfare system resources can cushion the recession

Social spending, excluding pensions and health, accounted for only about 4¼ per cent of GDP at the start of the crisis in 2009, well below other European countries (Figure 18), and was poorly targeted. Nevertheless, part of the pension spending in Greece simply substitutes social assistance, although this regards only the elderly (Leventi *et al.,* 2013). The social protection system was also highly complex, had inequalities in the generosity of benefits and lacked a means-tested general income support (OECD, 2013d). Some of the most vulnerable groups, such as the young unemployed and a large number of poor families in need of housing support, were not covered because, to a large extent, benefits were conditional on social insurance, for which they are not eligible. On the other hand, some benefits, such as family allowances, were not targeted at all. Only 50% of the beneficiaries belonged to the poorest 30% of the population, making coverage for the neediest inadequate (OECD, 2013d). In addition, key benefits, such as unemployment insurance, were low in terms of minimum or median wage in international comparison, lasted for up to one year and were not available to the self-employed. Moreover, the welfare system suffered from poor administration and unequal standards and provisions across social funds.

Figure 18. **Social welfare benefits (excluding pensions and health) are low**

As a percentage of GDP, 2009



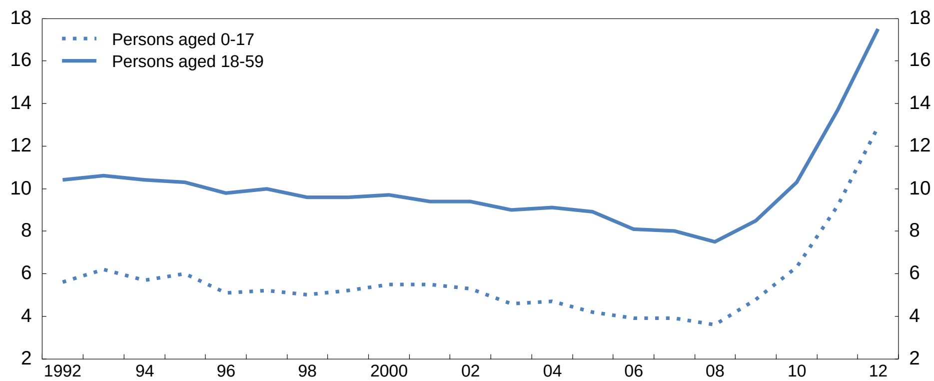
Source: OECD, *Social Expenditure database*.

In the wake of the crisis, benefits for the unemployed were strengthened. Eligibility conditions for unemployment assistance (provided to long-term unemployed having exhausted their one-year insurance benefit) were broadened and means-testing tightened. A means-tested unemployment insurance scheme was introduced for the self-employed. Benefit coverage remains low, however; less than 50% of short-term unemployed received an unemployment insurance benefit in 2012, down from 65% in 2010. Extending coverage will depend on the fiscal situation, but the unemployment insurance benefit would be closer to European norms if its duration were extended to two years, with benefits tapering over time to maintain work incentives. The net replacement rate of unemployment insurance benefits is also still below the international average.

Other social benefits have also become better targeted. The family benefit became means-tested in 2013, and EUR 20 million have been set aside for a means-tested minimum income pilot project, to take place in 2014. The scheme will be targeted to the population living in extreme poverty, providing income assistance in combination with initiatives to combat social exclusion. If this pilot proves successful, a full scale minimum income programme should be put in place. This is particularly important given the sharp rise in the number of jobless households since the onset of the crisis (Figure 19). International evidence suggests that minimum income schemes are very efficient in alleviating extreme poverty (Atkinson, 1998; Farinha-Rodrigues, 2004). Over the longer term, once such a programme is introduced and the duration of unemployment insurance benefit has been increased, the means-tested unemployment assistance could be abolished to avoid increasing the complexity of the social welfare system. Plans have been announced for the introduction of broader-based, means-tested housing assistance, although details of the design of the benefit, or the timetable for its implementation, are not yet known. In order to tackle the problem of homelessness, and in view of the underdevelopment of social programmes for the homeless and social housing in Greece, a well targeted housing assistance programme is of high importance.

Figure 19. **Jobless households increased**

Share of persons by age group living in households where no-one works



Source: Eurostat.

The authorities could also consider the introduction of a national programme of subsidised school meals, subject to means-testing, at first perhaps on a pilot basis, to address increases in food insecurity among children from poor households. Such programmes exist in a number of OECD countries, for example, France, the United Kingdom and the United States (Matsaganis, 2013). The costs for such a programme would, however, have to be met from savings elsewhere.

The government has also further strengthened controls on welfare programmes. Close monitoring of beneficiaries of the disability benefit, which have been plagued by fraud, has already yielded some savings (EC, 2013b). The government's commitment to proceed further by increasing the number of re-assessments in the near term is welcome. Effective monitoring and timely data are essential for efficient implementation.

The successful move to a better targeted social welfare system requires stronger administrative capacity and control mechanisms, assessment of administrative tools, and timely and accurate information on applicants' incomes. This is particularly important given the significant incidence of undeclared work. The 2013 *OECD Reforms of Social Welfare Programmes for Greece* highlights the need for a more effective system of governance of such programmes. This can be achieved through the acceleration of the rationalisation of social security funds and further consolidation of the remaining ones, and a swift harmonisation of information systems across the funds (OECD, 2013d). Reducing complexity and overlap at both central and local levels is essential for efficient targeting.

The crisis also triggered further changes in the pension system, which was highly complex and unequal with regards to benefits. A comprehensive reform in 2010 strengthened the long-term viability of the system by reducing generosity and certain elements, including the increase and equalisation of the retirement ages, enhanced equity (Rawdanowicz *et al.*, 2013). The reform also introduced a means-tested basic pension for the uninsured or those with insufficient years of contributions, enhancing the safety net. However, inequalities remain as some professional groups, such as liberal professions, kept their independent and more generous schemes. In addition, although the 2010 reform simplified the structure of the system, leaving only 6 pension funds (not long ago, there had been well over 100), there are still 93 sectoral systems under these broad funds with different social security contributions.

Removing remaining pension exemptions applying to specific groups would promote distributional fairness, besides contributing to fiscal consolidation. Subject to budgetary constraints, reforms could also seek to harmonise and rationalise the contributions rates to the various pension and sickness funds, as benefits seem to have been equalised to a large extent. The pension contributions of many professionals – engineers, for example face flat contributions regardless of earnings – could usefully be rationalised.

Box 4. Recommendations for a more effective welfare system

- Enhance governance of social programmes by speeding up the consolidation of the management of social insurance funds and accelerating harmonisation of information systems across the funds, which is essential for targeting benefits to protect the most vulnerable.
- Target selected social benefits more efficiently and introduce a properly targeted minimum income scheme.
- Intensify controls on recipients of welfare benefits, especially of disability benefits, by increasing the frequency of re-assessments, as envisaged, and by ensuring effective monitoring and timely data.
- Introduce a national programme of subsidised, means-tested school meals.
- Consider over the longer term and the fiscal situation allowing, increasing the duration of unemployment insurance benefits by another year, but tapering the benefits over time.
- Harmonise contribution rates to pension and sickness funds.

Ensuring access to healthcare services, while containing costs

Access to good public health care can improve equity and longer-term growth (OECD, 2011b; Hoeller *et al.*, 2012). Health spending in Greece, at around 10% of GDP, was relatively high before the crisis but the sector was characterised by many inefficiencies, as discussed in the special chapter on health in the 2009 *Economic Survey* (OECD, 2009) and by Economou and Giorno (2009). Cuts in health spending should focus on inefficient spending, and as far as possible reduced service levels should be avoided. Recent evidence of deteriorating health indicators in mental health and infectious diseases (for example, HIV and malaria) highlight the need for maintaining critical preventive public healthcare services, which will tend to benefit more the low-income groups who are likely to be more prone to these diseases (Vakali *et al.,* 2012; Karanikolos *et al.*, 2013).

The loss of health insurance for a large number of workers and their families since the onset of the crisis is of major concern. In Greece, the long-term unemployed lose both unemployment benefits and health coverage after two years (Economou *et al.*, 2013). Self-employed people who have not paid social insurance fees also have no coverage. There has been a large increase of the uninsured population since the crisis begun. Based on official estimates, around 10% of the population is currently not eligible for health insurance. Some of them benefit from means-tested access to limited basic health care services, but certain vulnerable groups – such as illegal immigrants, the self-employed who closed down their businesses but do not have a tax clearance certificate, and households whose income exceeds the means test (threshold EUR 5 000 per year) – are excluded from coverage. Nevertheless, they are able to use the emergency services of public hospitals.

Recent policy initiatives to reduce the health insurance gap include a reduction in the days of insurance payments required for full medical coverage, and a temporary extension of health coverage for the unemployed from two to three years. A new Health Voucher Programme, underwritten by the European Social Fund, was launched in 2013 aiming to provide access to primary healthcare services for 230 000 long-term uninsured. These initiatives are important to cushion the recession, and assuming it remains fiscally possible, they should be continued until the economy improves substantially in order to provide adequate basic level coverage to those unprotected.

Box 5. Recommendations for health care services

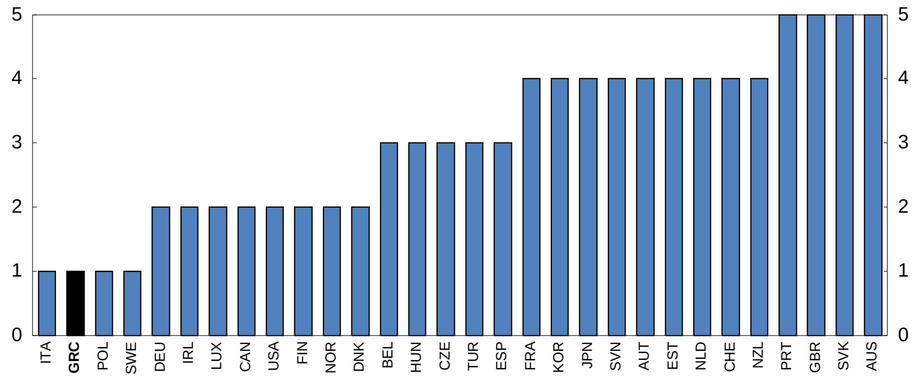
- To the extent it is fiscally possible, continue to extend measures to ensure health care access for unprotected and vulnerable groups until the economy improves.
- Monitor closely the health impact of the crisis on the population and, if required, take further actions to protect public health.
- Focus health care cuts on reducing inefficiencies, while avoiding cuts on efficient and critical programmes.

Enhancing activation policies

Unemployment, especially among youth (with an unemployment rate around 60%), is very high. Labour market integration of young people is essential to avert long-term adverse effects as a consequence of prolonged unemployment and low-income spells early on in their careers (OECD, 2013e). Reducing unemployment and avoiding its high social and fiscal costs require activation policies, which will be costly at a time when fiscal resources are very tight. The Public Employment Service (OAED) has launched a number of active employment policies and vocational programmes since the crisis. So far, fully implemented programme spending accounts for 0.3% of GDP, and an additional 1.7% of GDP has been allocated for this purpose. Rigorous and systematic evaluation of the programmes is essential, however, to identify what works and what doesn't and to ensure spending is as effective as possible. Those that work should be expanded, and the others wound down. An action plan adopted in 2013 to assess the programmes is therefore welcome. A plan is in place to modernise OAED, and if possible it should be brought forward.

The reach of training, counselling and employment services can be extended by subjecting stricter obligations on unemployment benefit recipients, more intensive monitoring and by imposing sanctions. Extending this approach to active job search, where monitoring is now low (Figure 20), as the economy improves would help direct the unemployed to activation programmes best suited to their need (OECD, 2010; OECD, 2011a). A legal framework for such "mutual obligations" has existed since 1985. However, monitoring is weak and there is no record kept of benefits actually having been withdrawn. To be effective the law needs to be enforced and its outcomes monitored closely, in line with best OECD practice (Figure 20).

Figure 20. **Job-search monitoring**
Scored from 1 (least strict) to 5 (most strict)[1]



1. The score reflects criteria for job search monitoring in place in early 2011. For more details, see *Source*.

Source: Venn, D. (2012), "Eligibility Criteria for Unemployment Benefits: Quantitative Indicators for OECD and EU Countries", *OECD Social, Employment and Migration Working Papers*, No. 131, OECD Publishing (http://dx.doi.org/10.1787/5k9h43kgkvr4-en).

Strengthening the role of labour inspection to safeguard social outcomes

The authorities should closely monitor the impact of the recent labour market reforms (discussed above) for unintended social outcomes. Individual contracts are spreading fast, outpacing the rise in firm-level collective agreements. This is welcome, as it is essential for economic adjustment, but 98% of firms have fewer than 10 employees, and the majority of workers have no bargaining experience (Voskeritsian and Kornelakis, 2011).

Strengthening the role of labour inspection to ensure full enforcement of the labour code, including for health and safety rules, would be important. As a positive step, a recent law reinforces the capacity of the labour inspectorate, providing for closer co-operation with the financial police. To combat undeclared work, it further imposes fines on firms that employ unemployment benefit recipients. An Action Plan has been elaborated by the government, on the basis of ILO findings, to strengthen the overall function and effectiveness of labour inspection system. Its timely implementation is essential. The adoption of a single Labour Code, as envisaged by the government, would reduce complexity and increase enforceability (IMF, 2013c).

Box 6. **Recommendations for labour market policy**

- Tackle high unemployment, especially among youth, by strengthening activation programmes and evaluating their effect in promoting employment to focus on the successful ones. Strengthen the effectiveness of the labour inspection system, as planned, to ensure full enforcement of the labour code, and step up inspections and sanctions.
- Condition access to unemployment benefits on stricter obligations for participation in training and employment service programmes. Extend this principle to active job search as the economy improves. Strengthen sanctions for non-compliance.

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Chapter summaries

Chapter 1. How to get growth going

The radical adjustment programme initiated in 2010 based on a strong fiscal consolidation, deep structural reform and an internal devaluation to restore international competitiveness has sharply reduced Greece's fiscal deficit, increased labour market flexibility and reduced labour costs. Shrinking domestic demand has also led to a substantial reduction of the current account deficit. Pension and health care reforms have strengthened longer-term fiscal sustainability. However, despite several revisions, the programme has failed to restore price competitiveness, growth and public debt sustainability. The fiscal contraction has deepened the depression. Economic recovery has been held back by the inability of the banking sector to supply credit and by persistent uncertainties related to the large public debt. Given the time it takes for structural reforms to bear fruit, robust and sustainable growth would be underpinned by faster product market reforms to accelerate price adjustment and foster the reallocation of resources towards more productive and export sectors. Moreover, a more efficient and modernised civil service is essential to improve the quality of and trust in public services, increase willingness to pay taxes, and to strengthen the rule of law, competitiveness, and foreign investment.

Chapter 2. A fair sharing of the costs and benefits of adjustment

Poverty and income inequality have worsened since the onset of the crisis. While the design of fiscal measures has mitigated the burden sharing of fiscal adjustment, as the recession has deepened unemployment has risen, earnings have declined and social tensions have increased. Getting people back to work and supporting the most vulnerable remain priorities for inclusive growth and distributing the costs of adjustment equitably. Within the limited fiscal space this calls for continued reforms in targeting social support, especially housing benefits, extending unemployment insurance and introducing a means-tested minimum income. Sustaining universal access to good health care is also essential. Well-designed activation policies are important to bring the unemployed, especially the young, to work. At the same time, it is important to strengthen the effectiveness of the labour inspection to ensure full enforcement of the labour code. Decisive steps to contain tax evasion are also critical to social fairness. Reforms by the government in many of these areas are welcome and need to continue.

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

The economic situation and policies of Greece were reviewed by the Committee on 21 October 2013. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 14 November 2013.

The Secretariat's draft report was prepared for the Committee by Claude Giorno, and Vassiliki Koutsogeorgopoulou, with contributions from Manos Matsaganis, Spyros Pagratis and Jan-David Schneider, under the supervision of Piritta Sorsa. Research assistance was provided by Isabelle Duong.

The previous Survey of Greece was issued in August 2011.

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