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GREECE

February 2017

EX-POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2012 EXTENDED ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR GREECE

The following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its February 6, 2017 consideration of the Evaluation.
- The **Ex-Post Evaluation of Exceptional Access under the 2012 Extended Arrangement** prepared by a staff team of the IMF for the Executive Board's consideration on February 6, 2017. The staff report was completed on January 24, 2017.
- A **Statement by the Executive Director** for Greece.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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February 6, 2017

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IMF Executive Board Concludes 2016 Article IV Consultation, and Discusses Ex Post Evaluation of Greece's 2012 Extended Fund Facility

On February 6, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Greece. The Executive board also discussed the Ex Post Evaluation of Exceptional Access under the 2012 Extended Arrangement under the Extended Fund Facility with Greece [2].

Background

Greece has made significant progress in unwinding its macroeconomic imbalances since the onset of the crisis. However, extensive fiscal consolidation and internal devaluation have come at a high cost to society, reflected in declining incomes and exceptionally high unemployment. The large adjustment costs, and the considerable political instability that ensued, contributed to delays in reform implementation since the last Article IV Consultation, and culminated in a confidence crisis in mid-2015.

The economic situation has stabilized since then, as the authorities commenced a new policy adjustment program supported by the European Stability Mechanism. The new program aims to strengthen public finances, restore the banking sector's health, and boost

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

[2] The requirement for ex post evaluations (EPEs) was agreed by the IMF Executive Board in September 2002 for members using exceptional access in capital account crisis, and extended to any use of exceptional access in February 2003. The aim of an EPE is to determine whether justifications presented at the outset of the individual program were consistent with IMF policies and to review performance under the program. To do this, EPEs seek to provide a critical and frank consideration of two key questions: (i) were the macroeconomic strategy, program design, and financing appropriate to address the challenges the member faced in line with IMF policy, including exceptional access policy? and (ii) did outcomes under the program meet the program objectives?

(continued…)

potential growth. In this context, the authorities have legislated a number of important fiscal, financial sector, and structural reforms.

Helped by the ongoing reforms and official financing from its European partners, Greece returned to modest growth in 2016. Growth is projected to accelerate in the next few years, conditional on a full and timely implementation of the authorities' adjustment program, including a rapid elimination of the capital controls introduced in mid-2015. On the basis of Greece's current policy adjustment program, long-run growth is expected to reach just under 1 percent, and the primary fiscal surplus is projected to come in at around 1½ percent of GDP. Downside risks to the macroeconomic and fiscal outlook remain significant, related to incomplete or delayed policy implementation. Public debt has reached 179 percent at end-2015, and is unsustainable.

Executive Board Assessment[3]

Most Executive Directors agreed with the thrust of the staff appraisal while some Directors had different views on the fiscal path and debt sustainability. Directors commended the Greek authorities for the significant economic adjustment and unwinding of imbalances since 2010, supported by important reforms. Directors recognized that this adjustment has taken a heavy toll on society that, together with high poverty and unemployment rates, has contributed to a slowdown in reform implementation. Directors urged the authorities to accelerate reform implementation to ensure a return to higher, inclusive growth and debt sustainability. Given still significant downside risks, Directors stressed that efforts should focus on improving public finances, repairing balance sheets, and removing obstacles to growth.

Most Directors agreed that Greece does not require further fiscal consolidation at this time, given the impressive adjustment to date which is expected to bring the medium-term primary fiscal surplus to around 1½ percent of GDP, while some Directors favored a surplus of 3½ percent of GDP by 2018. However, Directors called for rebalancing fiscal policy by broadening the personal income tax base and rationalizing pension spending to make room for targeted social assistance to vulnerable groups and lower tax rates. While most Directors favored a budget-neutral rebalancing, some Directors considered that the reforms could underpin temporarily higher primary surpluses, provided that they are implemented once the output gap closes so that the impact on the recovery is minimized.

Directors called for renewed efforts to combat tax evasion and address the large level of tax debt. They encouraged the authorities to strengthen tax administration, focus auditing efforts on large taxpayers, and strengthen the implementation of the anti-money laundering framework. Directors called for comprehensive tax debt restructuring for viable taxpayers based on capacity to pay, and welcomed plans to establish an independent revenue agency.

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[3] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors stressed the need for reducing non-performing loans (NPLs) decisively to support the resumption of credit growth. They encouraged the authorities to strengthen the legal framework for debt restructuring, including out-of-court solutions, and to fully utilize the supervisory framework to incentivize banks to set ambitious NPL-reduction targets and strategies. Directors noted that ensuring adequate capital and completing the ongoing governance reform are critical for banks' long-run viability. Directors supported the removal of exchange restrictions as rapidly as practicable on the basis of a milestone-based roadmap while preserving financial stability by ensuring adequate liquidity in the banking system.

Directors encouraged the authorities to accelerate the implementation of structural reforms to enhance competitiveness. While recognizing that the burden of adjustment has fallen disproportionately on wage earners, Directors emphasized the need to preserve and not reverse existing labor market reforms and complement them with additional efforts to bring Greece's collective-dismissal and industrial-action frameworks in line with best practices, open up remaining closed professions, foster competition, and facilitate investment and privatization. Directors underlined the need to maintain and ensure the integrity of statistical information and systems.

Most Directors considered that, despite Greece's enormous sacrifices and European partners' generous support, further relief may well be required to restore debt sustainability. They stressed the need to calibrate such relief on realistic assumptions about Greece's ability to generate sustained surpluses and long term growth. Directors underlined, however, that debt relief needs to be complemented with strong policy implementation to restore growth and sustainability.

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

Directors welcomed the ex-post evaluation of the 2012–16 extended arrangement. They broadly agreed that the evaluation provides a useful basis for discussing the lessons from the arrangement. Directors emphasized the importance of developing realistic forecasts and targets, securing adequate financing and debt relief, undertaking fiscal adjustment through high-quality measures at a pace consistent with the country's implementation capacity, and adopting well-sequenced structural reforms based on strong ownership and parsimonious conditionality. Directors looked forward to discussing the operational framework for Fund collaboration with monetary unions.

Greece: Selected Economic Indicators [1/]

Population (millions of people)	10.9	Per capita GDP (€'000)	16.2
IMF quota (millions of SDRs)	1,101.8	Literacy rate (percent)	97.7
(Percent of total)	0.46	Poverty rate (percent)	35.7

Main products and exports: tourism services; shipping services; food and beverages; industrial products; petroleum products; chemical products.

Key export markets: E.U. (Italy, Germany, Bulgaria, Cyprus, U. K.), Turkey, U.S.

	2011	2012	2013	2014	2015	2016 (proj.)	2017 (proj.)
Output							
Real GDP growth (percent)	-9.1	-7.3	-3.2	0.4	-0.2	0.4	2.7
Employment							
Unemployment rate (percent)	17.9	24.4	27.5	26.5	24.9	23.2	21.3
Prices							
CPI inflation (period avg., percent)	3.1	1.0	-0.9	-1.4	-1.1	0.0	1.2
General government finances (percent of GDP)							
Revenue	44.1	45.9	48.0	46.8	47.8	49.3	47.4
Expenditure	54.4	52.4	51.6	50.8	51.2	51.6	49.7
Fiscal overall balance	-10.3	-6.5	-3.7	-4.0	-3.4	-2.3	-2.3
Fiscal primary balance	-3.0	-1.4	0.4	0.0	0.2	0.9	1.0
Public debt	172.1	159.6	177.9	180.9	179.4	183.9	180.8
Money and credit							
Broad money (percent change)	-14.6	-5.3	2.7	-0.4	-16.9	1.6	...
Credit to private sector (percent change)	-3.1	-4.0	-3.9	-3.9	-3.6	-3.1	0.7
3-month T-bill rate (percent)	9.2	9.2	4.8	2.8	4.5	3.1	...
Balance of payments							
Current account (percent of GDP)	-10.0	-3.8	-2.0	-1.6	0.1	0.0	-0.1
FDI (percent of GDP)	0.2	-0.4	-1.5	0.1	0.5	-1.6	-0.8
Reserves (months of imports)	-1.0	-1.1	-0.8	-1.0	-1.3	-1.3	-1.2
External debt (percent of GDP)	188.2	237.0	237.3	238.5	251.1	245.7	239.2
Exchange rate							
REER (percent change)	0.7	-3.1	-0.8	-2.1	-4.9	0.6	0.0

Sources: Elstat; Ministry of Finance; Bank of Greece; Bloomberg; World Bank, World Development Indicators; IMF, International Finance Statistics; IMF, Direction of Trade Statistics; and IMF staff projections.

1/ Data according to ESA-2010 methodology.

GREECE

January 24, 2017

EX-POST EVALUATION OF EXCEPTIONAL ACCESS UNDER THE 2012 EXTENDED ARRANGEMENT

EXECUTIVE SUMMARY

In accordance with Fund policies, this report conducts an ex-post evaluation of a four-year exceptional access extended arrangement under the Extended Fund Facility (EFF) with Greece approved in March 2012. The Fund committed €28 billion under the extended arrangement (SDR 23.8 billion or 2,159 percent of Greece's quota at the time), following the cancellation of the 2010–12 Stand-By Arrangement (SBA). The program was supported by Greece's EU partners, who committed €144.7 billion. Significant private sector debt relief (€106 billion) was completed at the outset of the program and large official debt relief was provided as well. The Fund disbursed SDR 10.2 billion. Only five out of 16 program reviews were completed as the program went off track finally in mid-2014. The arrangement was cancelled in January 2016.

The EFF's broad objectives were to restore competitiveness and growth, fiscal sustainability, and financial stability. The formation of a new coalition government uniting two major political parties in November 2011 provided an opportunity to re-invigorate reforms. Reflecting the strong preferences of the coalition government to remain in the euro area and the financing constraints, the program targeted a 7 percent of GDP fiscal adjustment, based largely on sustainable, equitable measures and a broad range of structural reforms aimed at restoring financial sector stability and supporting competitiveness and growth. While the authorities and their European partners expressed a preference for an ambitious, front-loaded adjustment, staff clearly saw merit in a more gradual adjustment process. The authorities' ambitious program was judged, in the staff report for the EFF request, to be subject to very high implementation risks and substantial macro risks.

A measure of progress toward these program objectives was achieved, but the program ultimately foundered in the face of adverse political developments. During the first two years of the program, despite frequent interruptions, significant fiscal and external adjustment was undertaken, and some structural reforms progressed (e.g., public financial management, elements of pension and labor market reforms, and select financial sector measures). Above all, Greece remained in the euro area, which contributed to a reduction in systemic risks. While the program was launched with broad-based backing from Greece's main parties, political instability subsequently dogged the program, and ultimately derailed it, reflecting fragile ownership and strong opposition from vested interests.

Consequently, growth, competitiveness, and debt sustainability have not been restored. To achieve these objectives, Greece would need to continue with unfinished structural reforms, and additional debt relief from Greece's EU partners is required.

Under such difficult political circumstances, any program, no matter how well-designed, could have failed. However, the program's chances of success could have been greater if the degree of ambition in its targets and the optimism in the macro framework had been tempered. As the program risks started to materialize, staff worked with the authorities and their European partners to revise the initial ambitious program targets, and the program design and policy advice were adjusted accordingly.

With the benefit of hindsight, the report derives a number of lessons, many of which were applied during the EFF and in on-going post-EFF discussions:

- When the political base for reforms is fragile, or insufficient ownership is apparent or likely, program design should be more conservative from the start.
- Delays in addressing non-performing loans (NPLs), private sector insolvency frameworks, and governance issues in the banking sector weighed on the recovery, and steadfast implementation of reforms in these areas should be given high priority.
- Contrary to the initial program design, the quality of fiscal adjustment measures was weak. The initially agreed strong measures were replaced with ad hoc measures. Going forward, broad-based taxes, strong enforcement of tax compliance, pension reform, and development of targeted social safety nets are particularly important for making adjustment more durable and equitable.
- Greece needs to re-invigorate stalled structural reforms, including in the areas of product, service, and labor markets, and regulated professions, to remain a viable euro area member. Securing strong ownership is key.
- Upfront commitments of debt relief which delivers debt sustainability based on a realistic target for the medium-term primary fiscal surplus are a prerequisite for program success in the circumstances faced by Greece.
- There is merit in formalizing the operational framework for Fund collaboration with monetary unions in the program context to clarify a number of issues, including information-sharing and assurances regarding union-wide policies affecting program member countries.
- Certain Fund policies would benefit from a fresh discussion, including risk acceptance guidelines and the requirements for meeting the exceptional access criterion on prospects for program success.

Note on Statistics

The fiscal and national accounts data in the EFF request and in all reviews are based on ESA 1995 accounting standards, while outturns are reported based on ESA 2010 standards. Where applicable, program definitions are used. Program definitions reflect a number of adjustments related to banking sector support, privatization, and ECB-related incomes, among others. For more details on these adjustments, see the Technical Memorandum of Understanding of the Fifth EFF review. This report uses the national accounts and fiscal data that were available prior to January 13, 2017.

Authorized for distribution by **The European Department and the Strategy, Policy and Review Department**

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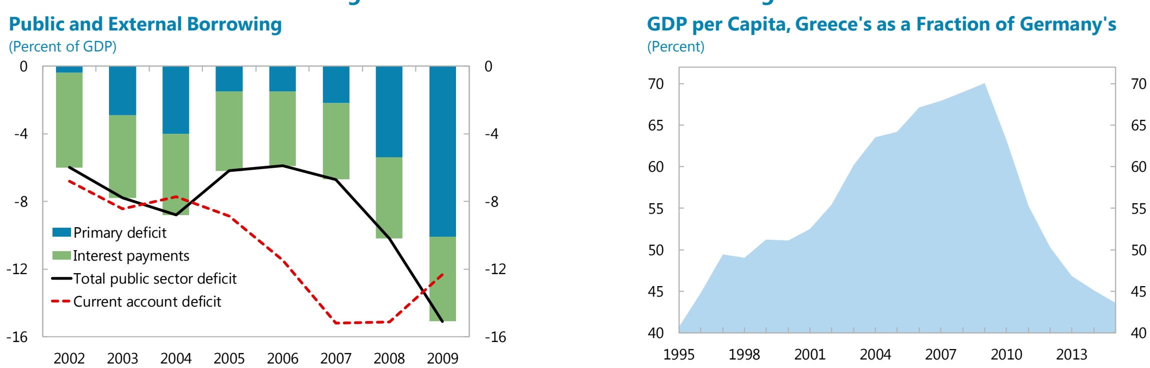
1. This report conducts an Ex-Post Evaluation of Greece's 2012-16 extended arrangement under the Extended Fund Facility (EFF). The Fund committed €28 billion under the EFF (SDR 23.8 billion or 2,159 percent of Greece's quota at the time), following the cancellation of the 2010–12 Stand-By Arrangement (SBA).[1] Similarly to the SBA, the Fund closely collaborated with its Troika partners—the European Commission (EC) and the European Central Bank (ECB). The Fund disbursed SDR 10.2 billion with five out of 16 reviews completed before the arrangement was cancelled in January 2016. The EFF was an exceptional access arrangement, which requires an ex-post evaluation to (i) review performance against original program objectives; (ii) discuss whether program design was appropriate to address Greece's challenges; and (iii) assess whether program modalities were consistent with Fund policies.[2]

2. In the wake of the euro adoption, Greece enjoyed rapid but unsustainable income gains. The availability of easy financing following the euro adoption in 2001 allowed the public sector to borrow extensively, on average 8 percent of GDP per year in 2002–09 with public debt reaching 127 percent of GDP by 2009. In addition, starting in the mid-2000s, the private sector began to rapidly accumulate external debt, which rose to about 175 percent of GDP by 2009. A massive fiscal impulse (28 percent of GDP in 2002–09) and private borrowing generated strong growth, resulting in a rapid but unsustainable nominal income convergence with higher income countries in the EU and significant real effective exchange rate appreciation (Figure 1).[3] The strong economic growth, however, masked the reality of low investment, poor use of labor and capital, a large and inefficient public sector, rising vulnerabilities in the banking system, a cumbersome judicial and legal system, and widespread informality (McKinsey & Company 2012).

Figure 1. Greece: Imbalances and Convergence



Sources: European Commision; Haver Analytics; national statistics office; and IMF staff calculations.

[1] The 2010–12 SBA was reviewed by the Fund staff (Box 1) and the Fund's Independent Evaluation Office (IEO 2016).

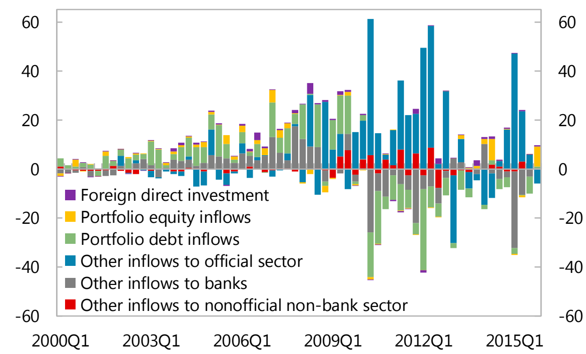
[2] Under the applicable access limits at the time (13th General Review of Quotas), access was considered exceptional when it exceeded 200 percent of quota in a year or 600 percent of quota cumulatively (IMF 2010). In February 2016, Greece's quota was increased from SDR 1.1 billion to SDR 2.4 billion in the context of the 14th General Review of Quotas.

[3] For a narrative of the Greek crisis, see Arghyrou and Tsoukalas (2011), Higgins and Klitgaard (2011), IMF (2014), and Gourinchas et al. (2016).

PRE-PROGRAM: SBA 2010–12

3. The SBA with access of €30 billion (SDR 26.4 billion)[4] was approved in May 2010 and cancelled in March 2012. The European partners provided strong financial support for the program by committing €80 billion.[5] The program was successful in achieving strong fiscal consolidation and implementing labor market reforms. However, the recession was deeper than expected, financial sector fragilities increased, and debt sustainability was not achieved.

Figure 2. Greece: Gross Capital Flows
(Billions of USD)

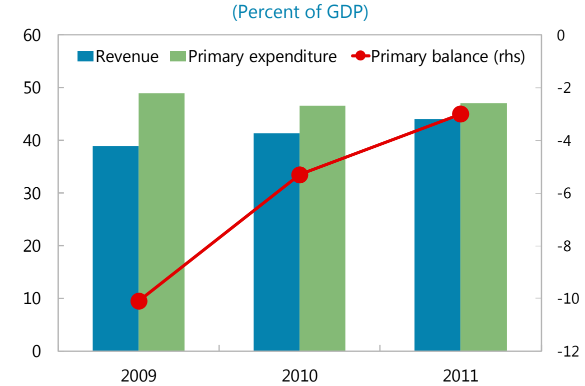


Source: Financial Flows Analytics database.

4. The accumulated imbalances began to be corrected by way of a deep recession during 2010–11. As a result of the sudden stop in private capital inflows (Figure 2), collapsing confidence, a sizable fiscal consolidation, and credit contraction, real output declined by almost 18 percent by 2011 from its pre-crisis peak in 2007, and the unemployment rate approached 18 percent.

5. Greece undertook a significant fiscal adjustment under the SBA during 2010–11. The cumulative improvement in the primary fiscal balance during this period was about 7 percentage points of GDP, but the primary fiscal balance remained in deficit (2.4 percent of GDP in 2011),[6] the overall fiscal deficit stood at more than 10 percent of GDP in 2011, and debt ended on an unsustainable path. The adjustment was mainly revenue-based on the back of various measures, including VAT rate hikes, a new property tax, and income tax base-broadening measures.[7] Investment, other discretionary expenditures, and to a lesser extent wages, bore the burden of adjustment on the expenditure side. Owing to falling GDP, relatively modest decreases in primary expenditure-to-GDP ratios masked substantial nominal expenditure cuts (Figure 3).

Figure 3. Greece: Fiscal Outcomes under the SBA
(Percent of GDP)



Source: IMF staff reports.

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4 Of which SDR 17.5 billion disbursed.

5 Of which €52.9 billion disbursed.

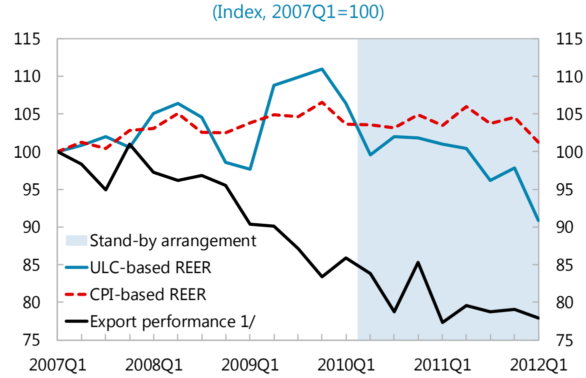
6 At the time of the EFF request in 2012, but revised later to 3 percent of GDP.

7 Nominal revenues, however, fell as the recession deepened.

6. Debt restructuring became inevitable. The possibility of debt haircuts loomed larger after the Deauville Summit of October 2010 where it was envisaged that future crisis resolution would require an "adequate participation of private creditors."[8] The plan for a private sector involvement (PSI) was first announced in July 2011, and the completion of the debt exchange, involving a haircut on private sector creditors of 53 percent, would become a prior action for the March 2012 EFF request (Box 2). Limited debt relief from official creditors (Official Sector Involvement—OSI) was provided as well in the run-up to EFF approval (Box 2).

7. Greece continued to face large external imbalances and low competitiveness during the SBA period (Figures 4 and 5)**.** In 2011, the current account deficit was close to 10 percent of GDP. While unit labor costs declined by 9 percent between March 2010 and March 2012, consumer prices did not follow—mostly owing to significant structural rigidities and VAT increases. Structural factors and non-price competitiveness were constraining export performance further. Greek exports are concentrated in low- and medium-technology sectors in relatively small enterprises, making it difficult to scale them up in response to potentially beneficial changes in relative prices (Athanasoglou et al. 2010). The overall business environment was not conducive to entrepreneurship: Greece ranked 100th in the World Bank's 2012 Doing Business Indicator, and 90th in the World Economic Forum's Global Competitiveness Index. Also, the onset of a recession in the euro area in 2011, where most of Greece's trading partners are located, further weighed on prospects for an export-led recovery. As a result of the above-mentioned factors, Greece's export market share steadily declined from 2008 onward (OECD 2012).

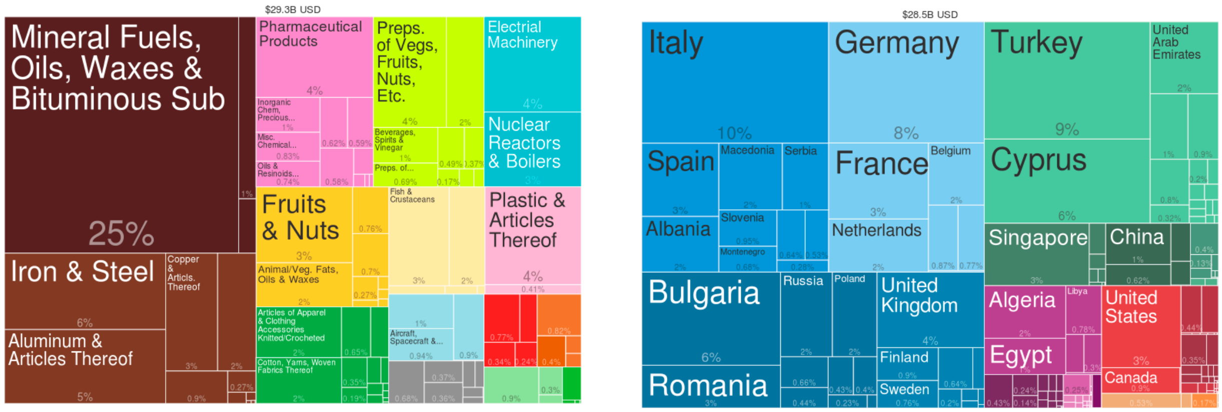
Figure 4. Greece: Competitiveness and Export Performance
(Index, 2007Q1=100)



Source: OECD.
1/ Growth of exports relative to the growth of the country's export market. See Le Fouler et al. (2001).

[8] Franco-German Declaration for the France-Germany-Russia Summit at Deauville on October 18, 2010: http://www.eu.dk/~/media/files/eu/franco_german_declaration.ashx?la=da

Figure 5. Greece: Exports: Composition and Destinations, 2011

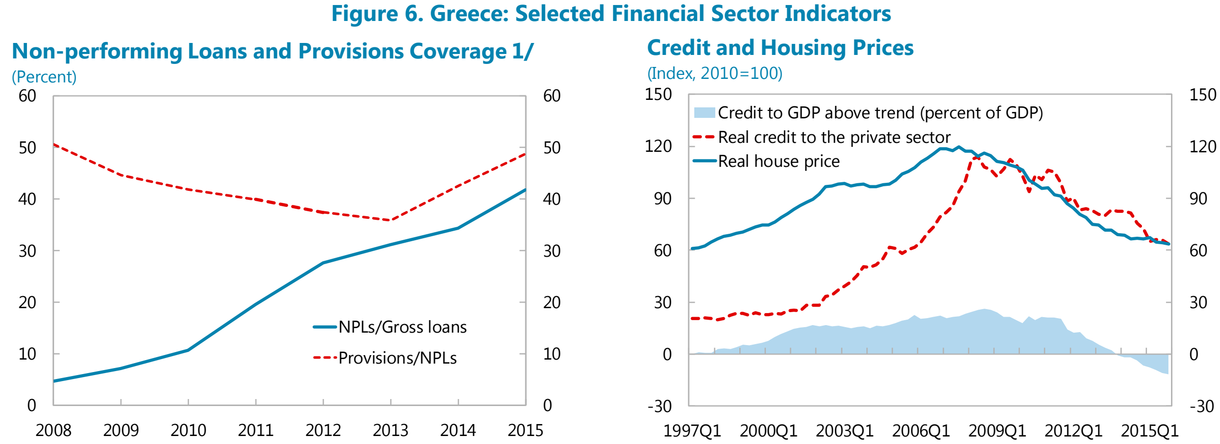


Source: The Atlas of Economic Complexity.

8. Banks came under severe solvency and liquidity pressures due to the PSI and Grexit fears. The proposed PSI exposed the banks to potential losses on their holdings of government debt, which stood at more than twice the banks' Tier 1 capital. At the same time, currency redenomination fears led to deposit and funding outflows. As a result, in the course of 2011, customer deposits fell by 17 percent, foreign bank funding contracted by one-third, the bank equity index collapsed, and the CDS spreads on subordinate bank debt were signaling an imminent default.

9. Vulnerabilities related to private sector indebtedness continued to grow (Figure 6)**.** Rapid credit growth and large increases in property prices pre-2008 contributed to a buildup of the systemic risk. Several years of economic contraction weakened the banking system's asset quality, with the ratio of non-performing loans (NPLs) doubling to 20 percent between 2010 and 2011. The Greek authorities commenced a foreclosure moratorium and debtor-friendly reform of household insolvency rules (the so-called "Katseli Law") in 2010, which contributed to undermining payment culture of borrowers.

Figure 6. Greece: Selected Financial Sector Indicators



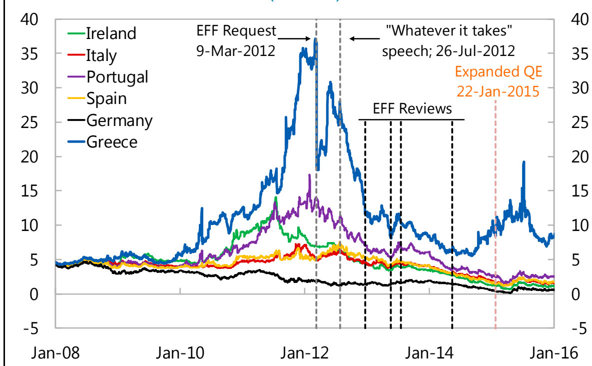
Sources: BIS; IMF World Economic Outlook; and SNL.
1/ NPLs include impaired restructured loans.

10. Ownership of the program supported by the SBA turned out to be limited. Under the SBA, negotiated and implemented by the center-left Pasok government, Greece achieved significant fiscal adjustment. But structural reforms started to face significant opposition from vested interests, and popular discontent was rising, with no strong pro-reform sentiment in the society at large. In October 2011, Prime Minister (PM) Papandreou (of the center-left Pasok) announced a referendum on the rescue package negotiated with the Troika, only to withdraw his referendum plan a month later.

11. Vulnerable countries in the euro area experienced significant market pressures in late 2011–early 2012 (Figure 7)**.** While joint EC-ECB-IMF programs were in place in Ireland and Portugal, the yields on their government securities were close to record highs.

Figure 7. Ten-year Sovereign Bond Yields

(Percent)



Source: Bloomberg.

POLICY TRADE-OFFS AND PROGRAM OBJECTIVES

A. Key policy trade-offs

12. Because the discussions on the EFF unfolded at the time of exceptional fragility in Greece and in the euro area, the Greek authorities and their European partners were facing several acute policy trade-offs:

a. *How to strike a balance between adjustment and financing.* Even with the unprecedented PSI, a further significant fiscal adjustment was unavoidable because of the large scale of imbalances and limited availability of official sector debt relief. The adjustment had to come, however, in the wake of the sharp output decline and rising social pressures. Additional financing could dull the pain of adjustment, but at a cost of raising the high stock of public debt (post-PSI) further. Moreover, there were political constraints on the amount of financing that Greece's EU partners could provide, in part reflecting concerns that these countries were being asked to finance pensions and other expenditures in Greece that were viewed as excessive relative to other member states. As a result, a lengthy and difficult process was required for EU member states to reach agreement on the financing envelope. In addition, Greece's European partners insisted that Greece adhere to the euro area's common economic framework under the EU Stability and Growth Pact as soon as possible.

b. *How to achieve external adjustment and improve competitiveness.* Competitiveness and external balances could be improved either by an outright currency devaluation or by an internal devaluation. The former would be quick but highly disruptive, requiring an exit from the euro area, a likely default on public and private sector debt, and a period of legal uncertainty because the euro exit process had not been codified. The latter would take time and require comprehensive and politically difficult structural reforms.

c. *How to reach an acceptable solution in time to avoid spillovers*. While temporary firewalls were already in place in the euro area, they were by no means perceived as adequate in particular for larger countries. A disorderly exit and/or default could have easily destabilized vulnerable countries and, in the extreme case spread to the core of the euro area. Therefore, timely agreement on a program was essential.

13. The leadership of the main political parties in Greece was coalescing behind commitment to adjustment and reform in the wake of EFF discussions. Following the G-20 summit in Cannes (November 2011), Grexit became a real possibility, as further EU support to Greece was clearly made conditional on progress with reforms. This catalyzed the formation of a technocratic coalition government, including Pasok (center-left party) and New Democracy (center-right party), in November 2011, which appeared to have cemented the emerging political consensus for reforms in support of Greece's choice to remain in the euro area. The newfound domestic consensus raised hopes that the implementation challenges experienced under the SBA could be overcome.

B. Program objectives

14. The EFF's broad objectives were to restore competitiveness and growth, fiscal sustainability, and financial stability (IMF 2012)**.** With the encouragement and endorsement of their EU partners, the Greek authorities committed to rapid fiscal and external adjustment to be accompanied by politically difficult structural reforms in support of their strong preference to remain in the euro area.[9] "The authorities argued that prolonging the adjustment path beyond 2014 would pose risks to credibility and, given resistance from their European partners, worried that this would be seen as a lack of commitment to Stability and Growth Pact targets" (IMF 2012). Political assurances of policy commitment were secured from the main political parties. At the same time, staff argued that "demand effects from the implementation of structural reforms, as well as weaker economic prospects in Europe, called for a longer adjustment period (thus also allowing a more accommodative fiscal policy in the near term)" (IMF 2012). Nevertheless, staff felt that the Greek authorities should be given a chance to implement their preferred policy mix. Staff candidly explained the political and economic risks to the program: "… the new program is a bold step in the right direction but given the challenges and the track record is subject to exceptional risks" (IMF 2012).

15. Competitiveness would be restored by a relatively large and rapid internal devaluation, supported by an ambitious set of labor market reforms (to bring wages in line with productivity and reduce unit labor costs (ULC) by 15 percent) and product and service market

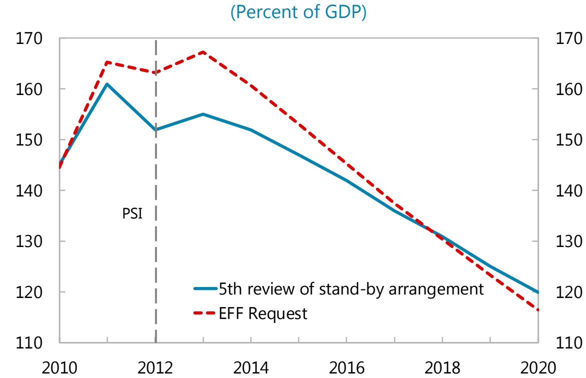
[9] The possibility of an exit from the euro area was discussed only incidentally, given the strong unwillingness of the authorities and the European partners to broach this subject. The pros and cons of an exit are discussed in IMF (2012). This report takes Greece's decision to remain in the euro area as given because each IMF member country has the right to choose its exchange rate regime.

reforms (to translate wage competitiveness into price competitiveness). Privatization was expected to present new investment opportunities and productivity gains, thereby supporting employment and growth. Exports were projected to increase by 17 percent and imports to decline by 3 percent from 2011 to 2015. As a result, the current account deficit was projected to decline to about 3 percent of GDP by 2015, from about 10 percent in 2011.

16. **Restoration of confidence and a relatively quick payoff from structural reforms were assumed to underpin economic recovery.** The economy was projected to contract by almost 5 percent in 2012, in part reflecting a fiscal drag and falling wages. Real GDP growth was projected to be zero in 2013 and to increase to 2.5–3.0 percent over the medium term, as exports and private investment were expected to recover significantly on account of improved investor sentiment and benefits of reforms. The growth rate was projected to eventually converge with the long-run potential growth of 1-1½ percent. Unemployment was projected to peak at 19 percent in 2013.

17. **To reduce the stock of public debt to 120 percent of GDP by 2020** (Figure 8)**, the EFF envisaged an ambitious fiscal adjustment supported by a large privatization program.** To meet that objective under the agreed-upon financing envelope and debt relief, the targeted fiscal adjustment had to be large and fast-paced, with a seven-percentage-point-of-GDP improvement in the primary fiscal balance—comparable to what had already been attained during 2010–11—to be achieved in the course of three years (Table 1).[10] The adjustment would largely rely on primary expenditure cuts (almost 8 percentage points of GDP), primarily in social benefits, including pensions, and wages, although most of the expenditure cuts in 2013 and beyond were expected to come from hitherto unidentified measures. Revenue measures were to focus on equity, efficiency, and enforcement considerations.[11] Privatization proceeds from real estate, financial, and other assets were projected at €46 billion during 2012–20 (unchanged from the last review under the SBA) and were expected to reduce public debt by 20 percent of GDP by 2020. A comprehensive fiscal structural reform agenda was agreed in support of the targeted fiscal adjustment (Table 2).

Figure 8. Greece: Debt Evolution
(Percent of GDP)



Source: IMF staff reports.

[10] The program targeted the primary surplus reaching 4.5 percent of GDP in 2014 and remaining at this level until 2017 and then declining to 3 ½ percent over the long term. The projected combined fiscal adjustment of 14 percent of GDP over 2010–14 (almost 3 percent of GDP per year on average) has been the largest among Fund-supported programs that have been approved since 2008. While the targeted primary surplus of 4.5 percent of GDP in Greece was in line with the targeted levels of some other EU countries in the post-crisis period, the assumed pace of adjustment was much larger in Greece. Also, Greece was assumed to maintain the large primary surpluses for decades.

[11] The program envisaged limited gains from tax administration measures, which were expected to accrue over time.

Table 1. Greece: Program Fiscal Objectives under the EFF (2011–15) 1/

	2011	2012	2013	2014	2015	Cum. change (2011-15)
			Billions of euros			
Revenue	88.3	86.0	85.7	87.5	86.6	-1.6
Primary expenditure	93.4	88.0	89.8	89.8	88.3	-5.0
Additional unidentified measures 2/	...	0.0	7.8	11.7	11.4	11.4
Primary balance	**-5.1**	**-2.0**	**3.7**	**9.4**	**9.7**	**14.8**
			Percent of GDP			
Revenue	41.0	42.2	42.2	42.1	40.1	-0.9
Primary expenditure	43.4	43.2	44.3	43.2	40.8	-2.5
Additional unidentified measures 2/	...	0.0	3.8	5.6	5.3	5.3
Primary balance	**-2.4**	**-1.0**	**1.8**	**4.5**	**4.5**	**6.9**

Sources: IMF staff reports and estimates.
1/ At the time of the EFF request in 2012.
2/ Unidentified measures were assumed to be on the expenditure side at the time of the EFF request.

Table 2. Greece: Focus of Fiscal Structural Reforms under the EFF

Public Financial Management	**Revenue Administration**	**Pension Reform**	**Tax Policy**
Budgeting process Fiscal reporting Spending controls Institutional framework	Enforcement Efficiency of operation and greater autonomy Social security compliance	Address short-term shortfalls Ensure long-term sustainability	Reform property tax Broaden income tax Streamline VAT

18. **With bank capital wiped out by the PSI operation, and the recession weighing on asset quality, recapitalization and resolution became key.** Of the €50 billion earmarked for bank recapitalization costs, one half was allocated to offset the expected PSI-related losses, and the other half—equivalent to 5 percent of banking system assets—was made available to resolve problem banks and deal with the existing and future credit losses. The program envisaged improving supervision and regulation, as well as establishing a stronger governance framework for banks recapitalized with public funds. As the program progressed, strengthening private debt restructuring frameworks and banks' NPL management capacity were identified as higher priorities.

C. EU support

19. European partners committed large financial support in the context of their program with Greece. The European Financial Stability Fund (EFSF) program's commitment of €144.7 billion covered the period of March 2012–June 2015.[12] The EFSF program contained structural conditionality and significant capacity building components. The discussions on the EFF and the EFSF programs were closely coordinated in the context of the Troika arrangements. The ECB showed willingness to provide exceptional liquidity support to Greek banks. Limited debt relief in the context of the OSI was also provided at the beginning of the program (Box 2).

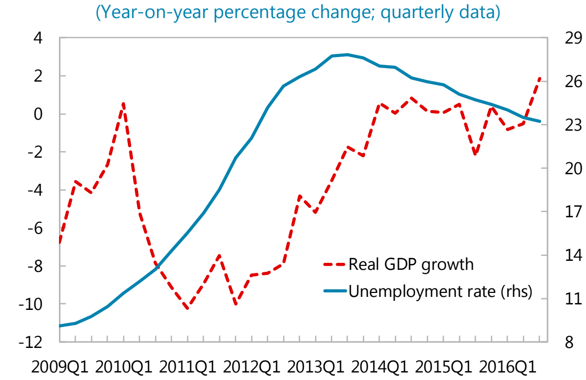
PROGRAM OUTCOMES

A. Timeline and political context

20. Contrary to the assumption of broad political support for the program and the related positive confidence effects, political turbulence prevailed during the program period. The technocratic administration of PM Papademos successfully negotiated the EFF and debt relief, only to be removed from office shortly thereafter. What followed was a period of social pressures and political crises (Table 3). Greece had six Prime Ministers and nine Finance Ministers during the EFF, with some serving as little as a few weeks. The continued deep recession put a severe strain on the social fabric of the country (Figures 9 and 10). Frequent episodes of political instability and the failure of the Greek political system to deliver a broad-based pro-reform coalition, which became increasingly evident, created exceptionally difficult conditions for program implementation.

Figure 9. Greece: Real GDP Growth and Unemployment Rate

(Year-on-year percentage change; quarterly data)



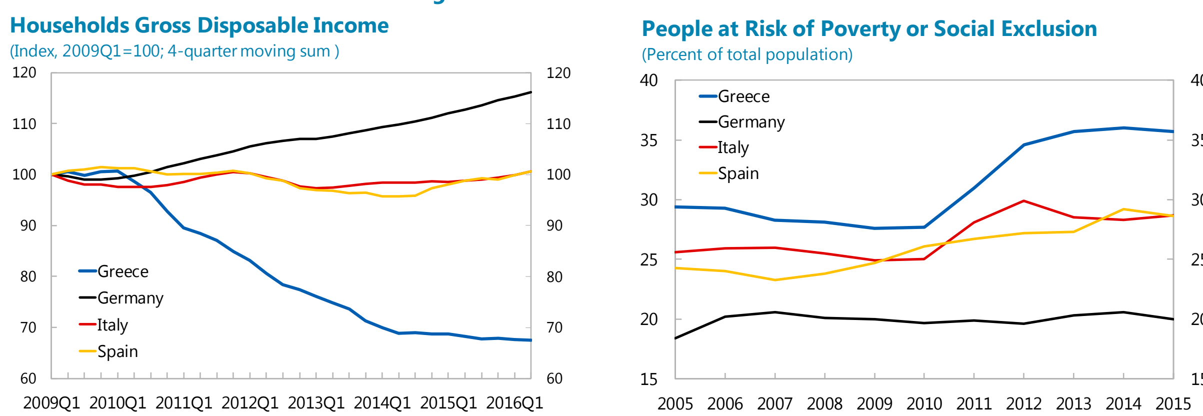
Sources: Hellenic Statistical Authority; and Haver Analytics.

21. Program implementation was strongly correlated with political developments. During a tumultuous 2012 with two parliamentary elections and intense Grexit fears, program implementation was poor. As a result, the assumed confidence effects did not take hold in 2012. There was a period of relative stability during early 2013–early 2014 with stronger program implementation reflected in over-performance on fiscal targets. By mid-2014, green shoots of recovery were clearly perceptible, and the Greek government was able to return to debt markets. However, after a deeper-than-expected 5-year recession and a 30-percent fall in real disposable incomes, the rise of popular discontent was unstoppable. As a result, the parties opposing the agreed adjustment program gained ground throughout this period, culminating in the collapse of support for the traditional political parties and the Syriza government assuming power in early 2015. In the first half of 2015, both public and official opposition to adjustment and reforms ran strong,

[12] The EFSF program was originally scheduled to finish at end-2014, but it was extended to end-June 2015.

leading to an overwhelming rejection of a proposed EU-supported program by the Greek voters in the July 2015 referendum. The resulting interruption of the financial support to the sovereign and of the liquidity support to Greek banks against the background of renewed Grexit fears necessitated a temporary closure of banks and the imposition of deposit withdrawal limits and capital controls. In the midst of the crisis, Greece became the first advanced country to accumulate overdue financial obligations to the Fund between June 30 and July 20, 2015.

Figure 10. Selected Social Indicators



Sources: Eurostat; national statistics offices; and Haver Analytics.

22. The initial phasing of the program had to be revamped significantly. The initial program envisaged 16 quarterly reviews. However, only five reviews (of which two combined reviews) were completed with significant delays during March 2012–June 2014, as significant implementation and macro risks materialized. After June 2014, the program went irretrievably off track. The staff continued discussions with the authorities and provided some TA from June 2014 till the cancellation of the program in January 2016. In July 2015, staff updated and published a DSA that concluded that public debt was unsustainable. A blog post by the IMF Chief Economist at the time, Olivier Blanchard, explained the way forward for the Fund: "The role of the Fund in this context is not to recommend a particular decision, but to indicate the tradeoff between less fiscal adjustment and fewer structural reforms on the one hand, and the need for more financing and debt relief on the other" (Blanchard 2015).

23. Economic outcomes for part of 2014 and the entirety of 2015 cannot be fully attributed to program design because the program was off track during this period. Some program measures that were implemented during 2012–14 continued to impact the economy afterwards, but for the most part, the outcomes of the last 18 months of the program were attributable to the inconsistent policies pursued by the Greek authorities outside the program context, including backtracking on a number of important policies adopted under the EFF. The discussion below regarding outcomes during the program period is subject to this important caveat.

Table 3. Greece EFF: Chronology of Key Events

March 2012	The PSI completed and the EFF approved
May 2012	Parliamentary elections end in deadlock
June 2012	New parliamentary elections; the center-right PM Antonis Samaras assembles a coalition with smaller parties
March-July 2012	The first major Grexit fear episode
January 2013	First/second EFF reviews completed; OSI completed
May 2013	Third EFF review completed
July 2013	The unemployment rate peaks at 27.9 percent
July 2013	Fourth EFF review completed
April 2014	Successful issuance of Greek 5-year bonds
May 2014	Syriza wins European elections
May 2014	Fifth EFF review completed
December 2014	Parliament fails to elect a new President
January 2015	Syriza wins parliamentary elections and Alexis Tsipras becomes the PM
June 2015	The EFSF program expires, having been extended previously
June 30-July 20, 2015	Greece accumulated overdue financial obligations to the Fund
June-July 2015	The ECB limits emergency funding to Greek banks, forcing Greece to close banks and impose capital controls against the background of renewed Grexit fears; voters overwhelmingly rejected the EU bailout terms in a referendum.
July 2015	The staff's DSA concludes that public debt is unsustainable.
July 2015	Greece clears arrears to the Fund
August 2015	European Stability Mechanism (ESM) program agreed between the European partners and the Greek authorities
September 2015	Syriza wins parliamentary elections
January 2016	Greek authorities cancel the EFF

B. Real and nominal growth

24. **Growth fell short of original program expectations and unemployment was well above program projections during the entire period under review.** The recession was much deeper than originally expected during 2012–13, and the nascent recovery of 2014 stalled with the escalation of political tensions. Real growth turned negative again in 2015. Deflators were below projections except in 2012. As a result of lower growth and lower deflators, nominal GDP in 2013 and 2015 was about 12 and 20 percent below the original forecasts, respectively. Unemployment was much higher than projected under the program. The non-seasonally adjusted rate had peaked at about 29 percent in 2013 and then gradually declined to about 25 percent in 2015.

25. Multiple factors explain growth underperformance. The risks of political turmoil and of incomplete and inconsistent program implementation materialized, undermining investor confidence and growth. Furthermore, repeated downgrades to the WEO outlook for the euro area were an important factor. However, the initial macroeconomic assumptions of the program may have been too optimistic. The short- and medium-term growth payoffs of reforms were in a highly optimistic range,[13] fiscal multipliers may have been underestimated,[14] and the possible negative feedback loops stemming from the rapidly rising insolvency problems in the private sector[15] and the persistence of Grexit fears[16] were not fully factored in. In addition, the assumed strong positive impact of improved confidence on investment growth (largely through retained earnings of exporters) appears too optimistic in light of the challenges facing Greek exporters (para. 30–31) and the financial system (para. 37–39), as well as the large debt overhang in the public and private sectors.[17] Also, political factors may have not been fully exogenous, as the protracted recession and the rapidly falling living standards may have undermined both political support for the program measures and investor confidence.

26. The program had to be substantially re-designed during the combined first/second reviews in early 2013 (Figure 11)**.** This reflected expectations of slower reform progress, substantially weaker investment, and lower payoffs from reforms. Also, fiscal multipliers were raised. These factors led to a much more pessimistic growth forecast. Furthermore, nominal GDP was adjusted down by 3 percent on account of data revisions. In addition to the real growth downgrade, deflators had to be adjusted downward as well. Consequently, by 2015 projected nominal GDP was 12 percent lower than envisaged in the program request. With much lower projected nominal GDP, the initial fiscal objectives became less achievable, warranting a reduction in the primary balance targets, additional fiscal measures, and more debt relief in the context of the OSI. Moreover, the

[13] IMF (2015c) argues that, in general, structural reforms (in particular labor and product market reforms) rarely generate quick growth payoff and may even have short-term output costs. On this basis, IMF (2015c) concludes that the program's implicit assumptions on growth benefits of structural reforms in Greece were over-optimistic, as growth projections exceeded the HP filter trends as early as the second program year. The projected significant increase in exports and investment (largely based on retained earnings from exports) during 2012–14 reflected the assumption of early payoffs from structural reforms (IMF 2012, p. 15–16). The programmed 1–1.5 percentage-point boost to the TFP growth in the medium term (3–5 years) was also large. Although the magnitude of such an increase was broadly consistent with the results obtained by Bouis and Duval (2011), those were predicated on a highly optimistic scenario in which best practice is adopted in all reform areas simultaneously, something that happens rarely, if at all. Furthermore, Varga, Roeger, and Veld (2014) argued that even if the gains from structural reforms in Greece may be substantial, they could be fully realized in the medium to long term only.

[14] The program assumption on the fiscal multiplier of 0.5 in the middle of a recession and tight liquidity constraints may have been too low in light of the more recent research on the topic, e.g., Blanchard and Leigh (2013) and IMF (2015c). However, during 2014–15, the fiscal position was looser than assumed under the program, presumably providing some support to output.

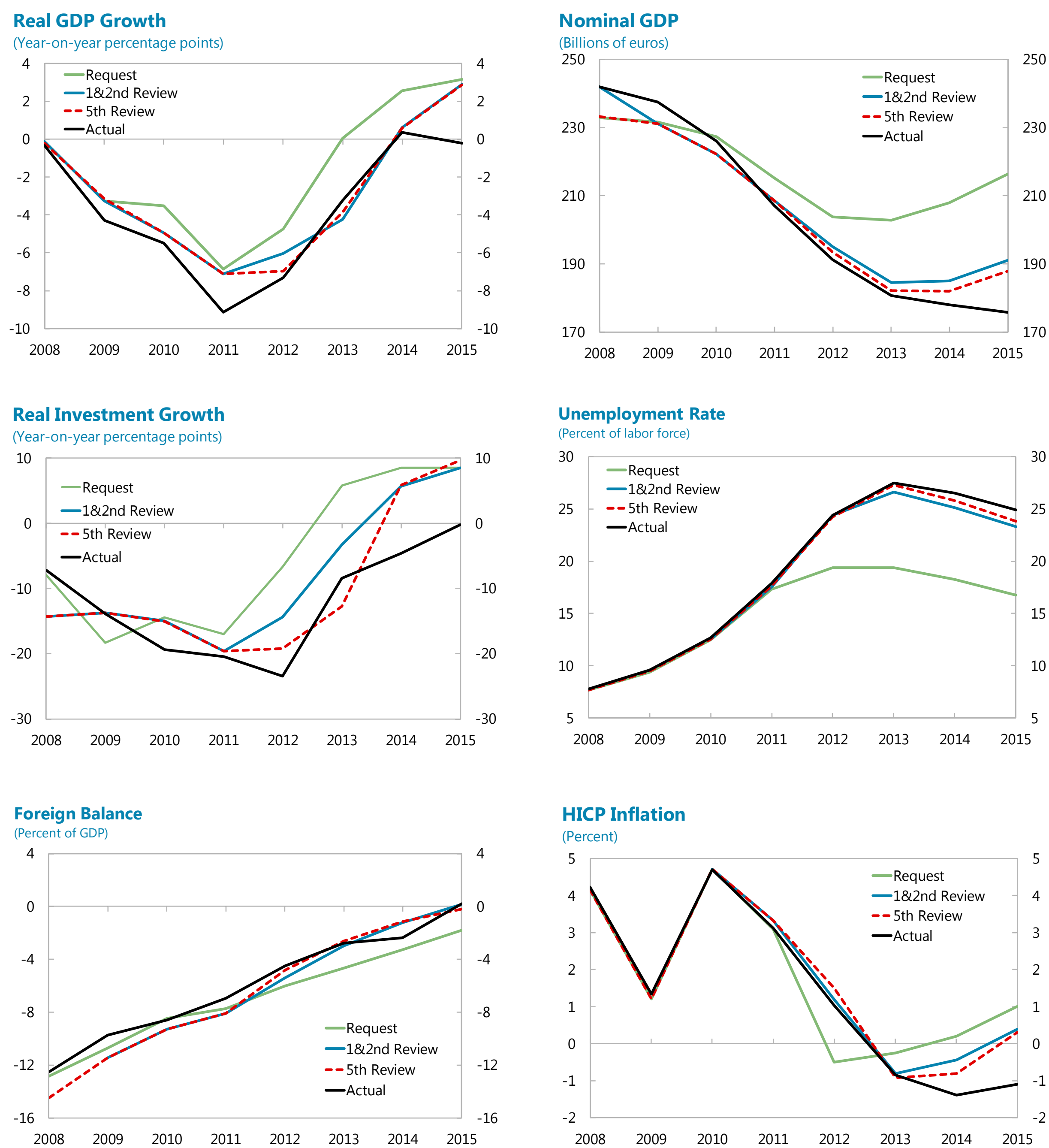
[15] Gourinchas et al. (2016) find evidence that the recovery was hampered by elevated levels and slow resolution of high NPLs, hurting credit growth.

[16] While the major Grexit fear episodes in 2012 and 2015 could not have been foreseen, the tendency for a continued decline in deposits was clearly perceptible in 2011.

[17] Kalemli-Ozcan et al. (2015) show that debt overhang and rollover risks contributed to explaining a significant share of the decline in corporate investment in vulnerable European countries.

revised program framework accounted for a stronger-than-expected external adjustment, and the current account was projected to be in balance by 2015.

Figure 11. Greece: Macroeconomic Projections and Outcomes



Sources: IMF Staff Reports; Haver Analytics; and IMF staff calculations.

C. Fiscal adjustment

27. During 2012–15, fiscal adjustment was significant (3¼ percent of GDP) but fell short of the program objective (7 percent of GDP). The primary fiscal balance improved from a deficit of 3 percent of GDP in 2011 to a surplus of ½ percent of GDP in 2013, exceeding the revised program target. Once the program went off track, the primary surplus fell to ¼ percent of GDP by 2015, below the initial program target of 4.5 percent of GDP and the revised program target of 3.5 percent of GDP. Privatization proceeds were €1.9 billion during the program period, representing about 10 percent of the initial program target.

28. In terms of the composition of fiscal adjustment, the objectives set out in the EFF request were not met (Figures 12a for the period 2012–15 and 12b for the period 2012–14)**.** Staff argued for more equitable taxation (including better enforcement and a broadening of the tax base), improvements in the social safety net, and more sustainable wage and pensions expenditures. In contrast, the actual adjustment on the revenue side (3 ¾ percent of GDP) during 2011–15 largely focused on mostly ad hoc measures, including regressive and distortionary taxation on small bases as revenue administration remained fundamentally weak. Primary expenditure increased slightly (½ percent of GDP) with pensions expenses rising significantly relative to GDP (para. 29).[18] Regarding the social safety net, staff argued for a targeted guaranteed minimum income program, a pilot for which was rolled out only in early 2015. Despite significant misgivings of the staff, this sub-optimal adjustment mix was accommodated in program reviews.

29. Progress on fiscal structural reforms was limited:

- In *PFM,* a measure of progress was achieved, such as better fiscal reporting, a clear assignment of financial management responsibilities and more effective processes in the ministry of finance, and improved cash management operations, including the establishment of a treasury single account for the central administration. Progress, however, was lacking in other areas, including staffing, modernizing payment processes, and halting accumulation of spending arrears (Box 3).

- In *revenue administration*, although some compliance initiatives have been successfully implemented, fundamental weaknesses in core operations remain, and as a consequence overall progress on enforcement and compliance was limited, in part reflecting still-insufficient autonomy of the General Secretariat for Public Revenues (GSPR) due to political interference (Box 4).

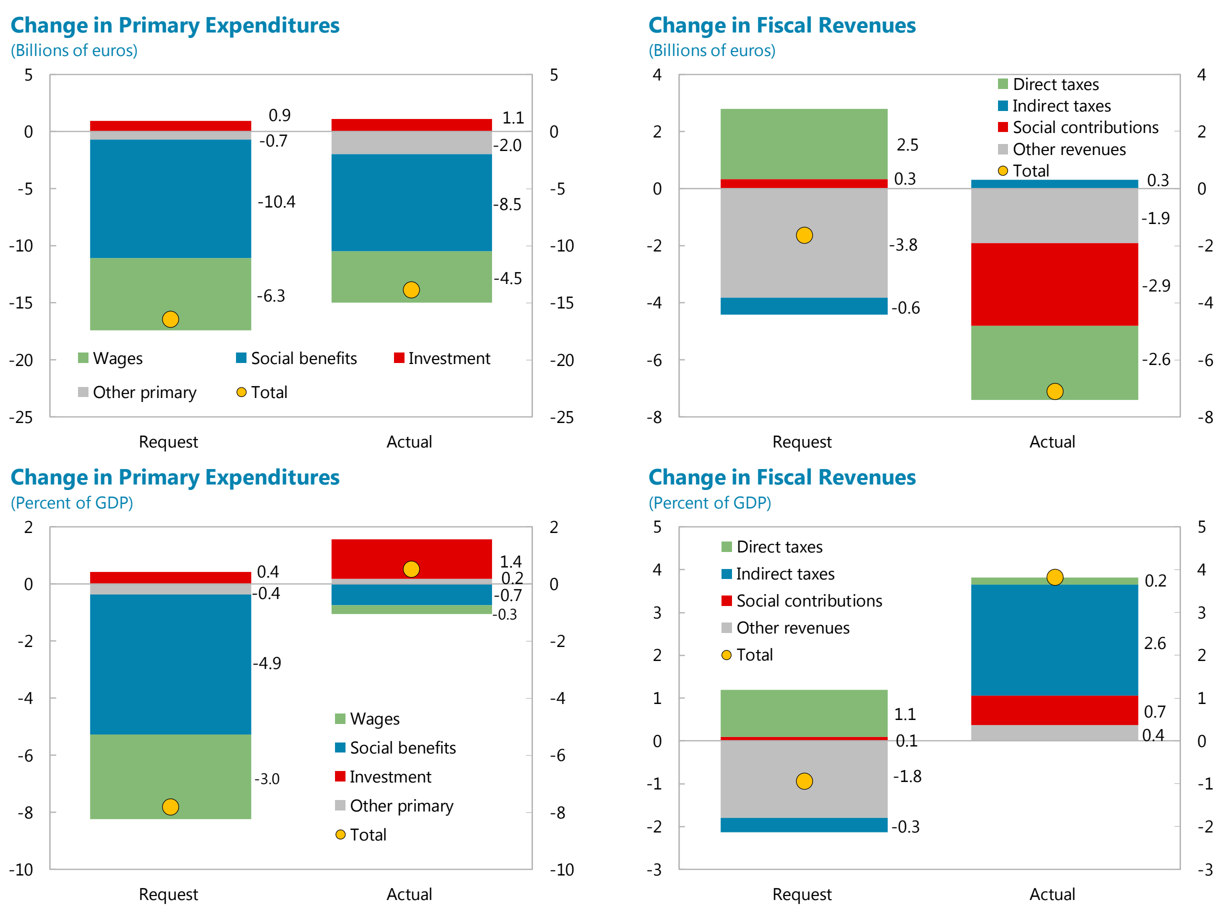
- As part of the *pension reform*, immediate overruns were not contained despite cuts in pension benefits and a reduction of the number of payments per year from 2012. The long-

[18] While nominal primary expenditure cuts were a substantial €14 billion (85 percent of the initial program objective) during the program period, it is more appropriate to analyze total revenue and expenditure trends and fiscal sustainability in terms of GDP, which reflects the actual capacity of the economy to sustain fiscal operations.

term sustainability was not addressed, either, with the deficit of the pension system amounting to 11 percent of GDP at end-2015, the highest level in the EU (Box 5).

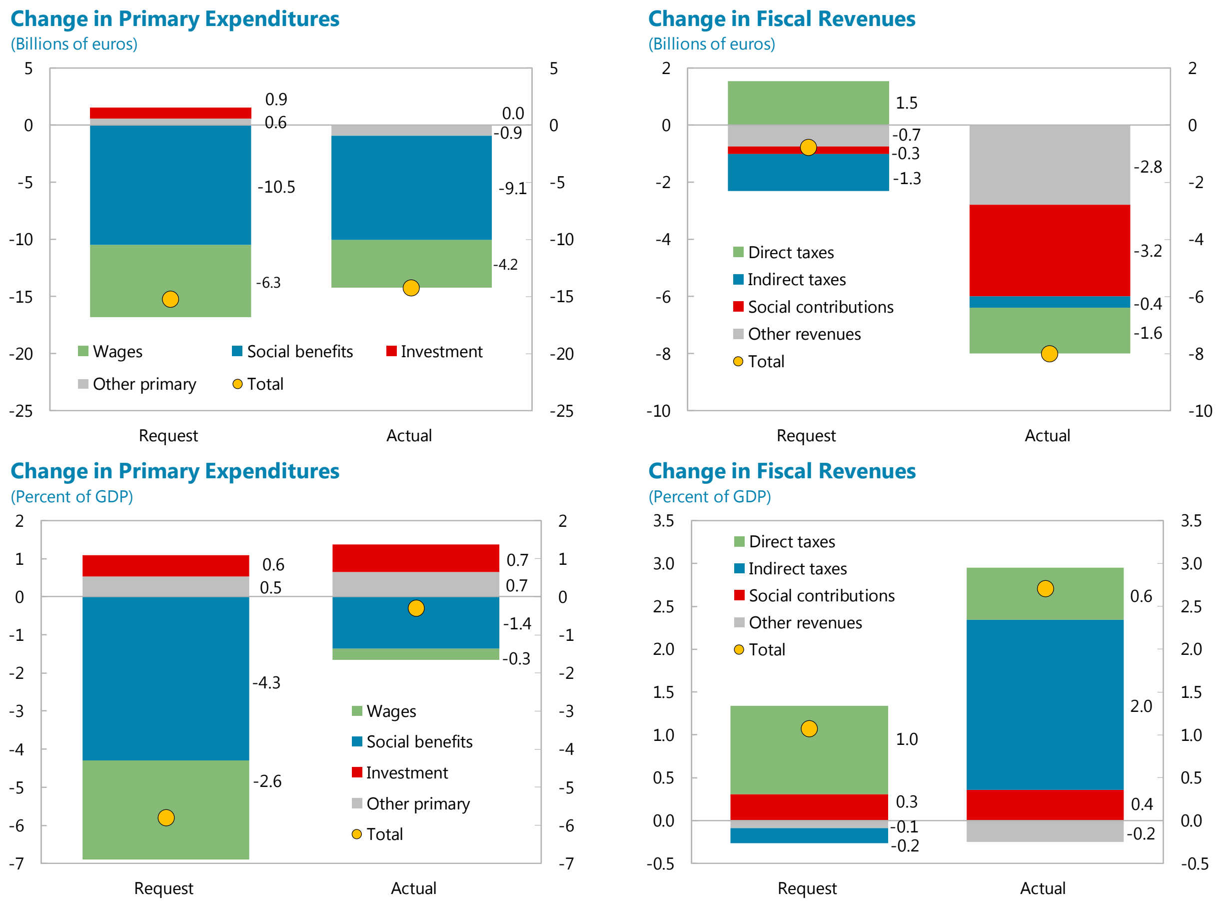
- In *tax policy*, the new property tax ENFIA was introduced but reforms on property valuation stalled. Backtracking occurred with the implementation of the 2013 income tax code (which streamlined tax rates and tax expenditures), as some policies introduced originally were reversed and a generous tax credit was introduced (Box 6).

Figure 12a. Greece: Fiscal Objectives and Outcomes, 2011–15 1/ 2/



Sources: IMF staff reports and calculations.
1/ Request: the difference between the 2015 outcome projected at the time of the EFF request and the 2011 outturn estimated at the time of the EFF request. Actual: the difference between the 2015 and 2011 actual outturns estimated in 2016.
2/ Actual data are based on ESA2010, and in program definition; whereas EFF request data are based on ESA1995. Request data includes unidentified measures assumed at the time of the EFF request.

Figure 12b. Greece: Fiscal Objectives and Outcomes, 2011–14 1/ 2/



Sources: IMF staff reports and calculations.

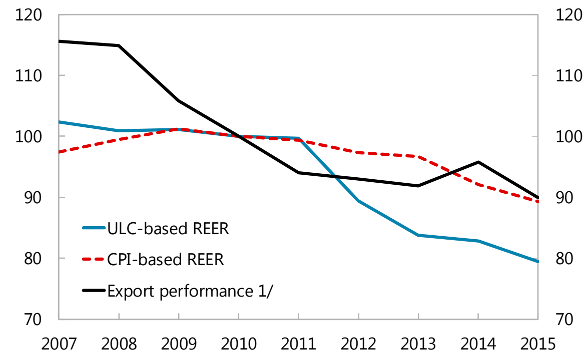
1/ Request: the difference between the 2014 outcome projected at the time of the EFF request and the 2011 outturn estimated at the time of the EFF request. Actual: the difference between the 2014 and 2011 actual outturns estimated in 2016.

2/ Actual data are based on ESA2010, and in program definition; whereas EFF request data are based on ESA1995. Request data includes unidentified measures assumed at the time of the EFF request.

D. External adjustment

30. The external current account adjusted rapidly. Despite the weaker fiscal adjustment, the external current account balance in 2015 turned positive, exceeding the original program objective. Most of the adjustment was due to falling imports, which declined by nearly one fifth between 2011 and 2015, while exports remained broadly stable. The ULC-based REER declined by about 25 percent, while the CPI-based REER declined by about 10 percent between 2011 and 2015 (Figure 13). This difference is in part explained by persistent rigidities in product and service markets. Even though it is uncertain whether the planned product and service market reforms (if fully implemented) could have reduced these rigidities with a positive impact on competitiveness during the program period, insufficient implementation progress on these reforms (para. 33–34) negatively affected medium- and long-term prospects for improving competitiveness.

Figure. 13. Greece: REER and Export Performance
(Index, 2010=100)



Sources: IMF INS database; and OECD.
1/ Growth of exports relative to the growth of the country's export market.

31. Exports underperformed, despite the significant adjustment in labor costs (Figure 14)**.** By 2015, exports did not exceed their 2008 peak, and Greece's market share did not improve during the program period.[19] Delays and inconsistent implementation of program reforms and weaker-than-envisaged activity in the euro area contributed to the weak export performance.[20] Also, a relatively low share of easily scalable tradable outputs, severe liquidity constraints (which were not foreseen at the program inception) and lack of investment impeded the re-allocation of resources in support of export growth.

E. Structural reforms

32. Initially, progress was achieved on a number of structural reforms. At the program's outset, collective bargaining was made less rigid, the setting of the minimum wage reformed, and—with a view to liberalizing the regulated professions and product markets—the relevant legislation was screened and amended. In the course of the program, the authorities undertook steps to strengthen the framework for privatization, reform barriers to competition, create a more business-friendly environment, and make administration of justice quicker and less costly.

[19] After a steep drop in 2008, exports of goods and services started to recover in nominal terms, mainly on account of oil exports and tourism receipts. A gradual recovery in goods exports to a large extent reflected a significant increase in the volumes of oil products (as domestic consumption declined). In the service account, a gradual increase in tourism receipts was more than offset by a decline in shipping receipts.

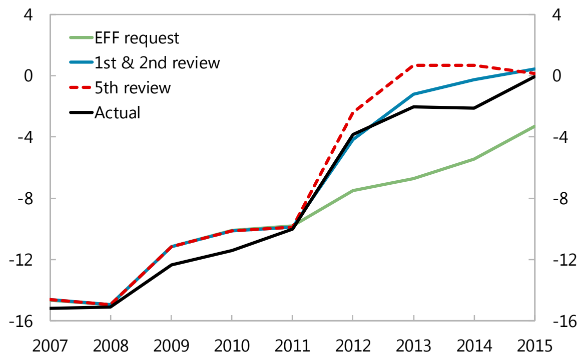
[20] An inadequate business environment has been a significant constraint to entrepreneurship and export performance: Bower et. al. (2014) show that export value-added in Greece is one third below potential, and measures of non-price competitiveness and governance explain most of this gap.

Figure 14. Greece: Export Performance and Competitiveness

Greece undertook a massive external adjustment: the current account improved from a deficit of 15 percent of GDP to a balance in 2015.

Current Account Balance 1/

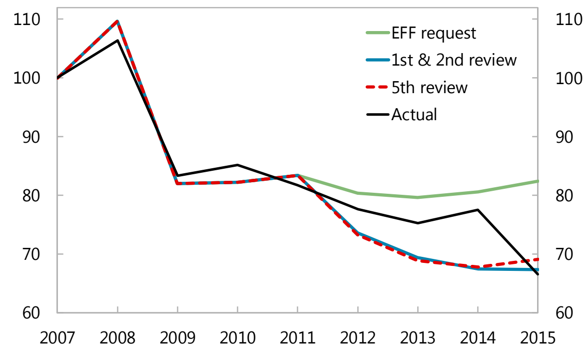
(Percent of GDP)



The adjustment was stronger than programmed, mostly because of a greater import compression ...

Imports of Goods and Services 1/

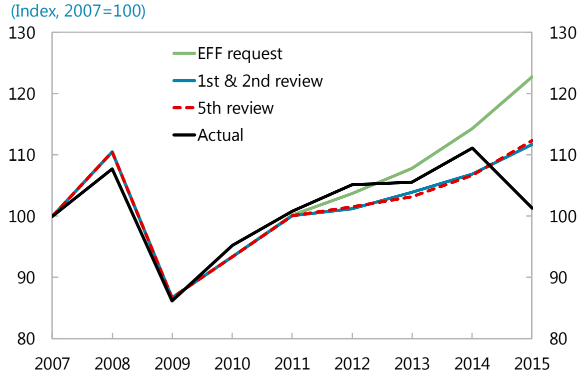
(Index, 2007=100)



... while export performance was worse than expected at the time of the EFF request.

Exports of Goods and Services 1/

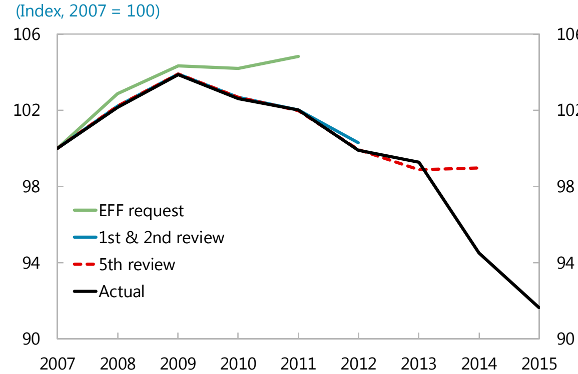
(Index, 2007=100)



The real effective exchange rate started declining only in 2014 and 2015.

CPI-based Real Effective Exchange Rate

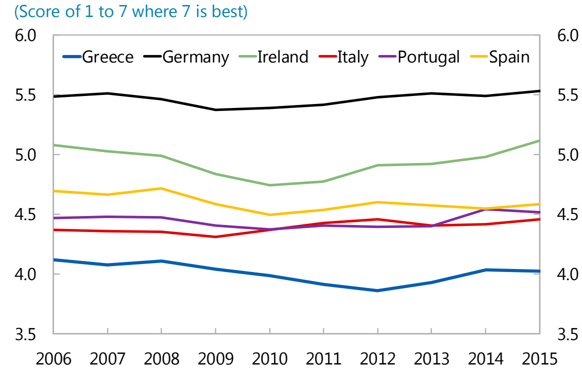
(Index, 2007 = 100)



Also non-price competitiveness measures improved only in recent years, even though Greece remains distant from other EU countries ...

Global Competitiveness Index

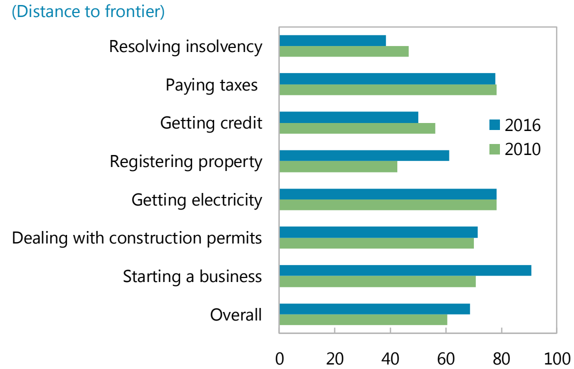
(Score of 1 to 7 where 7 is best)



... but progress have been made in a few areas.

Doing Business Indicators

(Distance to frontier)



Sources: IMF staff reports; World Bank; and World Economic Forum.

1/ Actual numbers are in BPM6.

33. However, reform momentum weakened, as further program implementation faced strong opposition from vested interests. Even though labor market reforms bore fruit early on—with a noticeable decline in unit labor costs—significant restrictions regarding collective dismissals, industrial actions, and the setting of minimum wages remained in place. Moreover, the authorities began reversing these reforms (by restoring temporarily the pre-program collective bargaining framework and then re-instating some of the aspects of the program framework, among other steps) even before the EFF was cancelled. Product market reforms—including opening up the regulated professions—were noticeably less successful, with the legislation passed but not meaningfully implemented. By the time of the 5th review, some results were achieved in reducing case backlog in administrative courts, but implementation stalled after that.

34. With only limited improvements, Greece failed to catch up with other euro area countries. There have been improvements in a few areas (for instance, the ease of starting a business and trading), but in others—such as registering property, access to credit, and enforcing contracts—the distance to best practice has increased (World Bank 2016). The country still scores low in key areas of contract enforcement, insolvency resolution, and access to credit, and its ranking in the Global Competitiveness Index has not improved significantly (Schwab 2016). Moreover, Greece stands out among other euro area program countries for the poor quality of its institutions prior to the crisis and a further deterioration in the governance indicators during the program (Alcidi *et. al.* 2016).

F. Debt sustainability

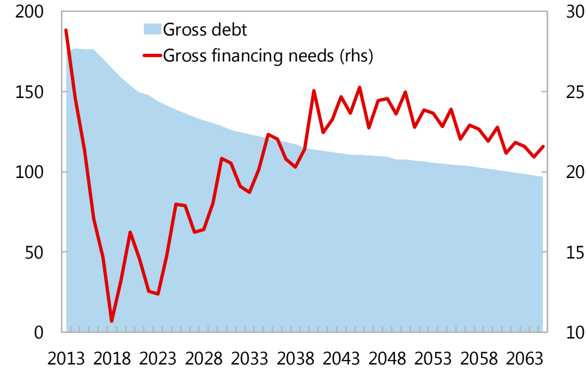
35. PSI and OSI were exceptionally large by international comparisons,[21] but they achieved a relatively modest immediate decline in the stock of public debt. Public debt declined to €305 billion (160 percent of GDP) at end-2012, from €356 billion (172 percent of GDP) at end-2011. This is explained by a number of factors. First, Greece's EU partners excluded from the debt restructuring the Greek bond holdings by EU institutions (i.e., the ECB, national central banks, and the EIB), which amounted to more than 16 percent of total public debt. Second, domestic banks represented around 40 percent of the bond holders (or 24 percent of total public debt), and the resulting PSI-related losses needed to be debt financed. Third, the terms of the bond exchange had to be attractive (e.g., acceptable haircut and near-cash sweetener) to ensure wide participation, as Greece's EU partners saw significant merit in a voluntary exchange to avoid contagion. Fourth, there were constraints on the OSI related to existing official EU loans (15 percent of total public debt). In light of the large amount of official financing already given to Greece, there was strong political resistance in some EU countries on outright reductions of official debt (para. 12). Fifth, the delay of debt restructuring reduced private bond holdings subject to restructuring, as amortization payments to the private sector amounted to about €50 billion during 2010–early 2012. Sixth, nominal GDP declined by almost 8 percent in 2012.

[21] The haircut to private bond holders amounted to €106 billion, the highest amount in modern history (Zettelmeyer et al. 2013).

36. Despite the PSI and OSI, and some progress in fiscal adjustment, debt was assessed as unsustainable in June and July 2015 (Figure 15)**.** When the program was on track, at the time of all completed reviews, debt was assessed as sustainable but not with high probability. This assessment was predicated on the assumptions that Greece could maintain fiscal primary surpluses in a 3.5–4.5 percent of GDP range in the medium and long terms and that Greece's European partners would follow through with their commitment to further support Greece if needed as long as the program was implemented. After the program had gone off track, the published DSAs (IMF 2015a and IMF 2015b) were adjusted based on important lessons learnt from EFF implementation. The macro framework was overhauled, with lower growth, primary fiscal surpluses, and privatization proceeds[22] over the medium and long terms. Attaining a debt level of 120 percent of GDP by 2020 was deemed no longer possible (Figure 15). In light of the highly concessional nature of Greece's debt, the 2015 DSAs appropriately suggested reframing the sustainability assessment around the gross financing needs (GFN) metric rather than a specific debt level. The GFN benchmark to be used would be 15-20 percent of GDP, consistent with the Fund's framework for debt sustainability analysis for market-access countries (MAC DSA). To attain this new goalpost, yet more debt relief from the European partners would be needed.

Figure 15. Greece: Gross Debt and Financing Needs 1/

(Percent of GDP)



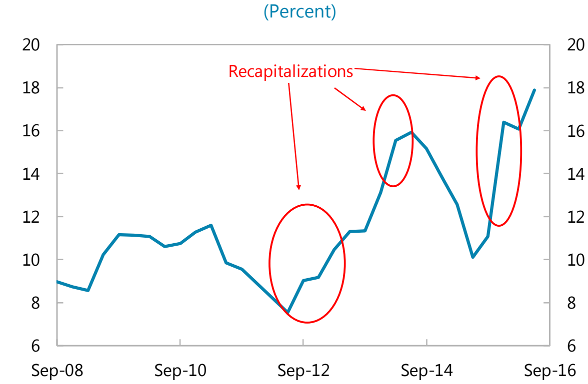
Source: IMF's June 2015 Debt Sustainability Analysis.
1/ Projections without concessional financing.

G. Financial sector

37. Despite progress in banking system consolidation, the financial system remained vulnerable, and banks were poorly positioned to support economic expansion by end-2015 (Figures 16 and 17)**.** Between 2012 and 2015, banks had some success in cutting costs and increasing efficiency, with the number of bank branches reduced by a third and the number of staff by nearly a quarter, which is in the top quintile of declines seen in the European Union during that period. Three rounds of recapitalization, totaling some €68 billion (€85 billion including deferred tax credits) brought the Tier 1 capital adequacy ratio to about 15 percent by end-

Figure 16. Greece: Tier 1 Capital Ratio 1/

(Percent)



Source: IMF staff calculations.
1/ Public sector funds for recapitalization were commited in 2012 but disbursed over 2012 and 2013.

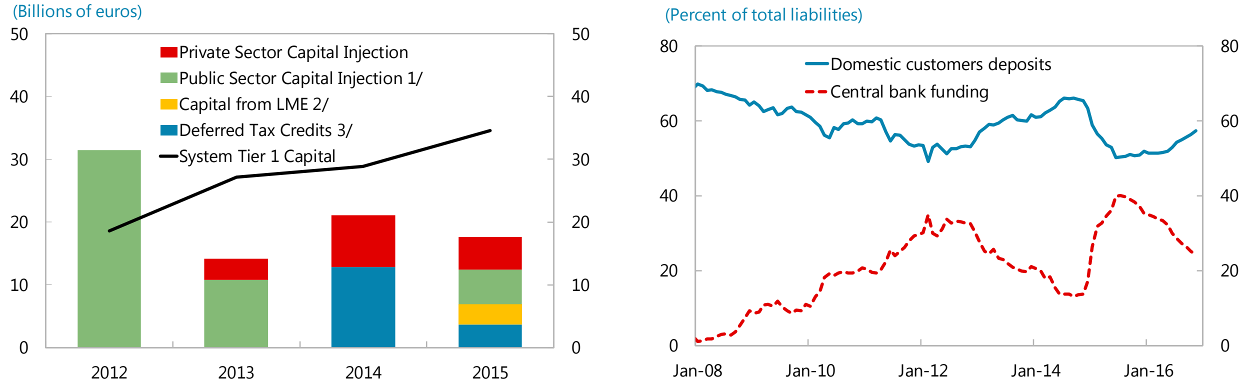
[22] The projected privatization proceeds were reduced to about €0.5 billion per year on average in the medium term in the 2015 DSA from about €5 billion per year on average at the time of the EFF request.

2015. However, Greek banks still suffered from fragile balance sheets (an NPL ratio of 45 percent) and extraordinary dependence on central bank funding at end-2015. The bank-sovereign nexus continued to be a problem due to the banks' exposure to the Greek government via holdings of deferred tax credits.[23]

Figure 17. Greece: Selected Banking System Indicators

Select Sources of New Capital in the Banking System
(Billions of euros)

Selected Liabilities
(Percent of total liabilities)



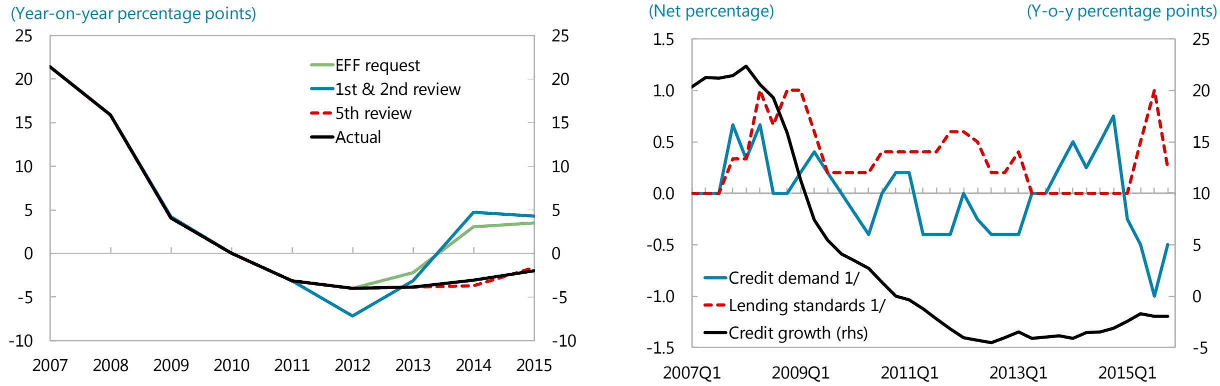
Sources: Bank of Greece; Haver Analytics; and IMF staff calculations.
1/ Includes €7.2 billion of resolution costs for non-core banks in 2012; €9.2 billion in 2013.
2/ Liability management exercise: net assets created through buyback of debt and hybrid capital instruments below par.
3/ Data for 2013 show increase in deferred tax assets eligible towards Core Tier 1 equity due to Bank of Greece's removal of the 20 percent prudential filter; deferred tax credits introduced beginning in 2014.

38. Credit to the private sector has continuously contracted since 2011, contributing to the poor growth performance (Figure 18). The contraction of credit, still evident in 2015, was particularly relevant for SMEs, which play a large role in the Greek economy. Credit demand was weak during the entire duration of the program, with the temporary exception of 2014, in line with the economic recovery. On the supply side, banks almost continuously tightened their lending standards (with the exception of 2014), making access to credit more difficult and therefore amplifying the economic contraction. Chances for a creditless recovery in Greece are uncertain because its economy is dominated by credit-dependent SMEs.

Figure 18. Greece: Credit Developments

Private Credit Growth
(Year-on-year percentage points)

Credit Conditions and Credit Growth
(Net percentage) (Y-o-y percentage points)



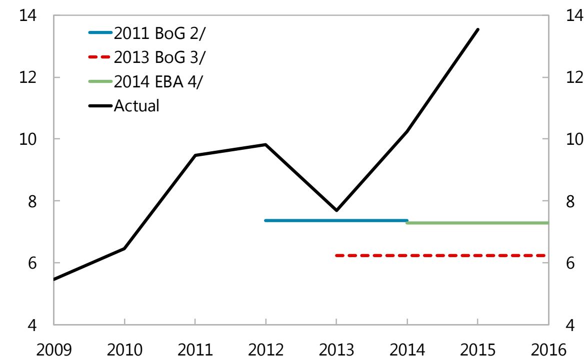
Sources: ECB (Bank Lending Survey); IMF staff reports and calculations.
1/ Positive values indicate tightening lending standards and higher credit demand.

[23] Deferred tax credits (DTCs) are claims on the sovereign whose value may not be realized if the sovereign's creditworthiness is in question. DTCs effectively increase the sovereign's contingent liabilities, as well as the banks' exposure to the sovereign.

39. With the benefit of hindsight, the program could have done more to address several potential vulnerabilities in a timely manner. Bank capital needs assessment exercises could have used more conservative estimates for the scale and severity of credit losses (Figure 19), reducing the need for subsequent re-capitalizations.[24] Furthermore, while certain measures on private debt restructuring and NPLs management were introduced early in the program, a comprehensive strategy to tackle NPLs and insolvency frameworks was only adopted relatively late (during the 5th Review) and largely in reaction to poorly-designed government initiatives,[25] when rising household and corporate bankruptcies made insolvency reform even more politically difficult. Finally, while conditionality on governance of the banks and of the state-owned recapitalization vehicle (the Hellenic Financial Stability Fund, or HFSF) was nominally met after the PSI, close links between the senior leaders of the banks, political parties, and large corporations were not broken for political reasons. This may have negatively affected banks' ability to attract capital and cope with rising asset quality problems. Imposition of a stringent "fit and proper" standard for board members and management and other strict governance rules immediately after the PSI might have improved banks' governance faster, avoiding the need to police governance problems on a case-by-case basis.[26]

Figure 19. Greece: Banking System Impairment Charges 1/

(Billions of euros)



Sources: Bank of Greece; European Banking Authority; SNL; and IMF staff calculations.

1/ Does not include impairments related to losses on Greek debt holdings under the PSI scheme.

2/ Annualized unprovisioned credit losses projected by the Bank of Greece in 2012 capital needs assessment (based on end-2011 data).

3/ Annualized unprovisioned credit losses projected by the Bank of Greece in 2014 stress test for the period from end-June 2013 to end-2016 (based on end-June 2013 data).

4 /2014 EBA stress test's projected cumulative impairments under the adverse scenario for 2014-2016 period, annualized (based on end-2013 data).

[24] With the establishment of the SSM in late 2014, the staff's ability to formulate advice was constrained by lack of access to data (see para. 44).

[25] Certain foreclosure moratoria were extended, with the authorities estimating that 20 percent of delinquent loans are strategic defaults. The 2010 Household insolvency law operated more like moratoria for applicants than a proper personal insolvency law with a fresh start due to design flaws and institutional weaknesses. This evident deterioration in the payment culture appears to be one reason why the NPL ratios remain so high.

[26] Stricter "fit and proper" standards were made key deliverables in the 2015 ESM program.

H. Conditionality

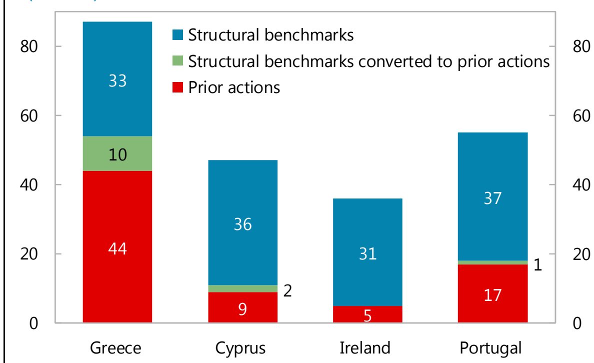
40. Performance with respect to quantitative fiscal targets, especially the quarterly performance criteria (QPCs) was generally strong, in line with other euro area programs (Figure 20)**.** Between March 2012 and December 2013, 79 percent of the QPCs were met, reflecting strong performance on cash primary balance targets. The QPCs on government guarantees were missed in the early phase of the program, while those on arrears were missed frequently. Performance with respect to the ITs was much weaker (15 percent of targets were met), particularly for those on arrears and privatization.[27]

41. The structural conditionality, however, was much more detailed in Greece vis-à-vis comparable programs, and with lower implementation rates (Figures 21 and 22). The number of structural conditions per review in Greece was much higher than in comparable countries. This reflected two considerations. First, Greece had weaker starting conditions requiring a larger number of conditions to meet ambitious program objectives. Second, the detailed approach to conditionality was meant to ensure substantive implementation of structural measures. The formulation of structural

Figure 21. Program Conditionality and Performance

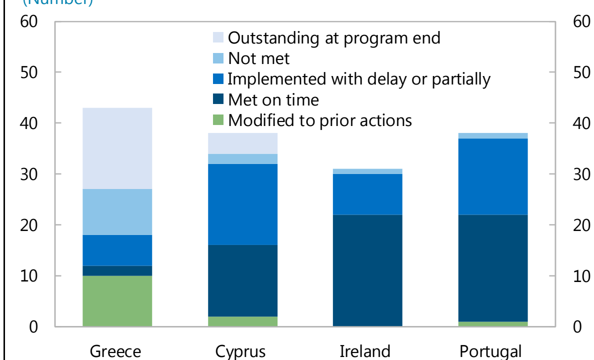
Conditionality

(Number)



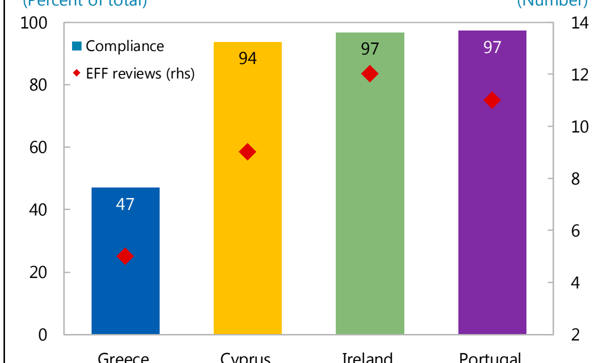
Performance: Structural Benchmarks

(Number)



Compliance with EFF Structural Benchmarks 1/

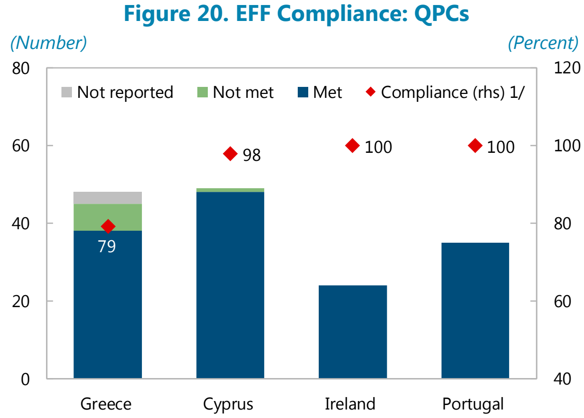
(Percent of total) (Number)



Sources: IMF MONA database and staff calculations.

1/ Calculated as ratio between number of benchmarks which were met, implemented with delay or partially to the total numbers of benchmarks. This calculation excludes benchmarks that were: a) converted to prior actions; and b) outstanding at the end of the program.

Figure 20. EFF Compliance: QPCs



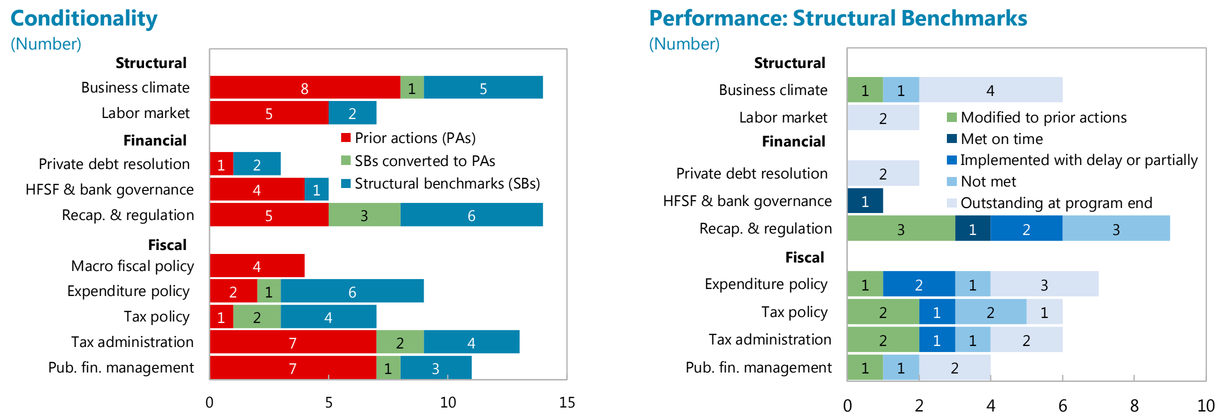
Sources: IMF MONA database and staff calculations.

1/ Calculated as ratio of met to total number of QPCs; excludes criteria that were cancelled.

[27] There was also change in the status of privatization conditionality (between PC and IT) for the September 2013 test date.

conditionality was broadly consistent with intended structural reforms. However, the prevalence of prior actions, including the conversion of a large number of structural benchmarks into prior actions, frequent implementation delays, and a significant number of non-implemented benchmarks across all structural areas suggest weak ownership. In addition, backtracking on a number of structural measures and nominal implementation of conditionality reflected lack of political consensus in the face of strong opposition of vested interests.

Figure 22. Greece: Conditionality and Performance by Sector



Sources: IMF MONA database and staff reports.

I. Collaboration with the Troika partners

42. The support of Greece's European partners exceeded the initial program commitments. The EFSF program was fully disbursed despite the EFF going off track. Significant debt relief was provided in the context of the OSI (Box 2). The ECB provided sizeable liquidity support to Greek banks, which experienced deposit outflows. The amount of ECB liquidity support peaked at about €150 billion in 2015 and declined to about €100 billion by the end of the EFF in January 2016. A new ESM program (€86 billion) covering the period of August 2015 to August 2018 was agreed between the EU and Greece in August 2015. The off-track EFF program and the ESM program overlapped during August 2015–January 2016 (with no reviews under the ESM program completed during this period). The dialogue between staff and the Troika partners continued during August 2015–January 2016 but there was a disagreement on key DSA parameters. Compared with staff, the EC had a more optimistic view on the long-term economic outlook, the country's capacity to sustain primary fiscal surpluses of 3.5 percent of GDP over the medium and long term, and debt sustainability. Greece's EU partners were also concerned about moral hazard associated with upfront commitments of debt relief.

43. Significant changes in the EMU institutional framework and policies were implemented during the EFF program period. Firewalls were strengthened through the establishment of the ESM in late 2012. A Single Supervisory Mechanism (SSM) was implemented in 2014, and a Single Resolution Mechanism (SRM), which was based on the Bank Recovery and Resolution Directive (BRRD), became operational in 2015. Regarding monetary policy, in 2012, the ECB made it clear that it would do whatever it takes to preserve the euro. Furthermore, with the increasing risks of entrenched deflation and weak activity, the ECB started a quantitative easing program in early 2015. All these measures and policies reduced systemic concerns in the euro area, benefitting Greece as well.

44. The staffs of the three Troika partners were of the view that there is room for improving collaboration. The EC staff felt that the following issues need to be addressed in a more systematic manner: the reconciliation of technical analysis, the division of labor in terms of design and monitoring of conditionality, communication strategies, and information-sharing. The Fund staff raised the issues of sharing confidential information and modalities of assurances regarding euro area-wide policies affecting member countries with Fund-supported programs. These two issues have intensified since the establishment of the SSM in 2014. Staff were not guaranteed sufficient confidential supervisory information on Greece. In addition, in the future, it is not clear how to reconcile potential tensions between the staff's financial sector advice specific to Greece and relevant EU directives and the EC's and SSM's views or to secure EC's and SSM's assurances for implementation of agreed measures.

PROGRAM DESIGN ISSUES

45. Drawing on the analysis of the program outcomes, this section raises issues related to the program design strategy. In the case of this EFF, it is difficult to ask hypothetical questions on whether modifying certain program design features at the margin would have delivered materially different outcomes because counterfactual analysis is notoriously speculative in highly volatile crisis situations amidst significant political instability. With the benefit of hindsight, this section focuses on the critical elements of the program design, which in their totality might have helped deliver better outcomes. But better outcomes would not have been guaranteed as political instability and fragile ownership may have doomed any program regardless of its design.

46. Were political economy considerations given sufficient weight in program design? The ambitious reform and adjustment agenda agreed in 2012 required strong ownership and support across the political spectrum. The coalition government that negotiated the EFF made a promising start on reforms. At the same time, the destabilizing political economy implications of the fourth year of the deep recession, falling real incomes, and rising unemployment and poverty, the strong opposition of vested interest to structural reforms, and a significant deterioration in payment culture were recognized as important risks. With the benefit of hindsight, a more gradual pace of fiscal adjustment and a more focused approach to structural reforms within a longer time horizon potentially stood better chances of success. However, it should be recognized that at the time of program discussions, the Greek authorities' stated commitment to frontloaded fiscal adjustment and a more comprehensive reform agenda, as well as political constraints on official financing, significantly reduced the likelihood of reaching consensus on such an approach quickly.

47. Was the program too optimistic about payoffs of structural reforms? The program implicitly assumed early growth payoffs from structural reforms. Lessons from this approach are threefold. First, it is advisable to use more conservative estimates of the growth benefits of structural reforms, including significant implementation lags.[28] Second, there should be a more realistic assessment of the government's ability to pursue multiple politically difficult reforms simultaneously with the large fiscal consolidation. Third, weak ownership cannot be entirely mitigated through detailed conditionality, regardless of the number of prior actions. Going forward, ownership could be fostered by focusing on a smaller number of reforms with a clear implementation sequencing. Assisting the authorities in devising a supportive communication strategy may also promote ownership.

48. Did delays in financial sector reforms exacerbate output decline? Signs of rising risks to asset quality stemming from previous rapid credit growth and precipitous increases in real estate prices did not receive sufficient attention in 2012. This could be in part explained by the benign growth forecast at the time of the program request, as well as emerging political opposition to removing foreclosure moratoria, political instability, and significant capacity constraints. As a result, many financial sector reforms, including private sector insolvency frameworks and NPL reduction measures, were initiated with a significant delay. The slow pace of balance sheet repair contributed to high NPLs, which in turn created headwinds to credit and real activity.

49. Were programmed fiscal adjustment and the long-term primary surplus targets realistic? Based on panel data for 27 countries, IMF (2015c) argues that fiscal adjustment of more than 5 percent of GDP within three years (or 1.7 percent per year on average)[29] has an increasingly adverse impact on the medium-term debt-to-GDP dynamics. In Greece, this threshold was substantially exceeded during 2010–13 with the cyclically adjusted primary balance improving by 17.3 percent of GDP or 4.3 percent per year on average,[30] which most likely contributed to a deterioration of the debt-to-GDP ratios. Also, the pace of Greece's fiscal adjustment (2010–13) was well above the pre-2008 episodes of large fiscal adjustments in Europe, such as Denmark, Sweden, and Finland, which relied on exchange rate and interest rate instruments to promote export and investment growth.[31] It seems that the realized fiscal adjustment in the context of internal devaluation in Greece may have exceeded a "speed limit," beyond which the economy's capacity to support a given debt burden is reduced and investor confidence and social cohesion are

[28] There is a substantial body of literature on the timing and magnitude of payoffs from structural reforms. In addition to the sources listed in footnote 13, Duval and Furceri (2016) and Bouis, Duval, Eugster (2016) note the slow materialization of gains from structural reforms, Gal and Hijzen (2016) find that the positive impact of reforms can be weakened by credit constraints, and IMF (2015d) and Dabla-Norris et al. (2014) show evidence that the short-term impact of labor market reforms on growth is uncertain.

[29] In IMF (2015c), fiscal adjustment is measured as a change in the cyclically adjusted primary balance.

[30] Based on the data presented in IMF (2016a). This was the highest pace of adjustment in the post-2008 period for the sample of countries in IMF (2015c).

[31] In Europe, large fiscal adjustments (measured as changes in the cyclically adjusted primary balance) include Denmark—3.1 percent of GDP on average per year during 1983–86, Sweden— 1.9 percent of GDP on average per year during 1994–2000, and Finland— 1.9 percent of GDP on average per year during 1994–2000 (IMF 2009).

undermined.[32] It should be recognized, however, that determining this speed limit ex ante is very hard, owing to the complexity of interaction between economic and political factors. Regarding the long-term level of the primary surplus, IMF (2016b) provides evidence that in a sample of 55 countries in the last 200 years, there have been only 15 episodes of recessions of longer than 5 years, and no country sustained a primary surplus of larger than 2 percent of GDP after such a period of negative growth.[33] [34] It is questionable whether Greece could set a historic precedent by maintaining primary surpluses in the range of 3.5–4.5 percent of GDP over the medium and long term as assumed under the program—especially in light of the high structural unemployment.

50. Was debt relief sufficient? In light of cross-country evidence (para. 49) and institutional constraints in Greece (para. 46–47), it appears that the program's objectives for the pace of fiscal adjustment and the long-term primary surplus were in a highly ambitious, virtually unprecedented range with arguably low chances of being achieved. Therefore, a more gradual pace of fiscal adjustment (as staff argued initially) and a lower long-term primary surplus target may have been justified from the outset. This in turn would have required more financing and more upfront debt relief. It is doubtful that additional debt relief in the context of the PSI could have been advisable because a larger haircut could have diluted PSI participation and resulted in greater losses for the domestic banking sector. More debt relief and more financing could have only been provided by official creditors. More debt relief under the OSI was eventually provided in January 2013 and a commitment was made to provide additional debt relief in the future if needed. However, this contingent debt relief was conditional on maintaining the large primary surpluses over the medium and longer terms.

51. Should the Fund insist on the composition of fiscal adjustment? In retrospect, the deviation of the composition of fiscal adjustment from the initial program assumptions reflected political economy and capacity constraints on pursuing higher quality but more difficult reforms. Ultimately, the lower-quality adjustment strategy may have negatively affected growth and social cohesion. Significant increases in regressive taxation (e.g., VAT rate hikes) may have contributed to the decline in political support for the program. Large increases in corporate taxes, with exemptions in place, may have undermined the growth potential of the taxpaying corporations. Also, tax evasion, in particular by the self-employed, contributed to the shift of the burden of adjustment to the poor. In light of this experience, there is merit for the Fund to insist on structural benchmarks

[32] See IMF (2013b) and Cottarelli and Jaramillo (2012) for the discussion of a view that frontloading of adjustment can hurt growth to the point that it undermines social and political cohesion, and weakens rather than strengthens market confidence.

[33] For similar evidence see Eichengreen and Panizza (2016), who show that large and persistent primary surpluses are extremely rare events that are relatively more likely when growth is strong and the current account is in surplus.

[34] At the time of the EFF requests, it was acknowledged that there were only 3 precedents of maintaining large primary surpluses for 14–15 years, but because the depth of the recession in Greece was under-estimated at the time, the precedents were not linked to growth performance.

and prior actions that would improve the composition of fiscal adjustment while ascertaining that there is strong ownership for the recommended fiscal measures.

52. Are there alternative approaches to assessing debt sustainability in Greece? In retrospect, targeting a specific long-run level of debt as a criterion for debt sustainability might not have been well-founded in Greece's particular circumstances. Despite uncertainties related to long-term forecasts, the analysis of debt sustainability based on flows (gross financing needs), as well as the trajectory of the stock of debt, as staff proposed in the 2015 DSA, may have been a more suitable framework for Greece since the beginning of the EFF, when long-term concessional official debt replaced private debt.[35]

53. Staff already began to address these design issues during the EFF, with the work continuing in the course of on-going discussions on a possible follow-up program. As EFF program implementation encountered increasing difficulties under challenging political circumstances, staff was learning from experience and adjusting the program design and policy dialogue accordingly. A more realistic growth and a slower pace of fiscal adjustment were adopted at the time of the first/second reviews. The issues of NPLs and insolvency frameworks started to be addressed from the fifth review and reflected in the staff's advice after mid-2014. The discussions of the ability of the Greek political system to deliver required reforms quickly, the rationale for a further slowdown in fiscal adjustment, and the re-prioritization of structural reforms gained in prominence after mid-2015. In addition, the EPE on the SBA (2010–12), which was concluded in June 2013 with a delay, covered many of the same issues, and its lessons were progressively incorporated into the EFF program design (Box 1).

COMPLIANCE WITH FUND POLICIES AND PROCEDURES

A. Justification for exceptional access

54. According to the Fund policies in force at the time of the program request, any exceptional access arrangement had to satisfy four criteria:

- **Criterion 1—presence of exceptional balance of payment pressures.** This criterion was clearly met during the entire program period. While the current account pressures subsided during the program period, the absence of sustained access to capital markets and large capital outflows during the entire duration of the program were prevalent (Figure 2).

- **Criterion 2—debt sustainability with high probability.** Staff concluded that debt was sustainable but not with high probability, invoking the systemic exemption[36] at the time of the program request and all completed reviews. The 2015 DSA concluded that debt was

[35] The MAC DSA framework was not available until 2013.

[36] The systemic exemption was eliminated from Fund policies in 2016.

unsustainable, but by that time the program was off track and so this assessment was made outside the context of an EFF review. The overly optimistic macro forecast and the realization of the very high program implementation risks explain why Greece could not achieve debt sustainability under the EFF program. The systemic exemption was referred to but not justified in detail except at the time of the first/second reviews.[37] The systemic exemption claim was finally abandoned, outside the review context, in the standalone 2015 DSA. That DSA recognized that even though the systemic exemption applied in the past, there was "no rationale for continuing to invoke it when debt relief was needed now on the official sector (rather than private) claims." Had this judgement been reached earlier, it is not clear that a case could have been made for invoking the systemic exemption throughout the EFF, as official debt had largely replaced private claims since the beginning of the program.[38]

- **Criterion 3—re-accessing capital markets.** At the time of the EFF request, Greece had no market access. Program documents argued that market access was expected to be restored only gradually in the post-program period, at short maturity and relatively high interest rates, and conditional on a full implementation of the program. By the time of the fifth review, Greece accessed markets for the first time in four years, taking advantage of the relatively benign macroeconomic situation and the global search for yield. That episode, however, proved to be a fleeting respite, which staff correctly identified as such. In retrospect, the program's failure to restore debt sustainability and growth, as well as establishment of capital controls, explain why market access was not restored in the post-program period. Nevertheless, given that the judgement underpinning the justification of this criterion at the time was based on the assumption that the program would be implemented, the conclusion that market access could be regained by the end of the program appears reasonable.

- **Criterion 4—the policy program of the member provides reasonably strong prospects of success, including not only the member's adjustment plans but also its institutional and political capacity to deliver that adjustment.** At the time of the program request and in subsequent reviews, staff argued that despite implementation problems, the authorities had demonstrated ownership and policy resolve through the completion of multiple prior actions and were benefitting from significant capacity-improving technical assistance provided by the EC and the Fund (Boxes 3–6). While willing to give the authorities the benefit of the doubt on this basis, staff nevertheless acknowledged the very high implementation risks, stressing that the program would continue to "test political and social resolve … and the authorities' administrative capacity." (IMF 2012, page 40). The staff's emphasis on the very high program implementation

[37] In that analysis, the systemic exemption argument pivoted towards potential indirect spillover effects on the euro area output in the event of a Greek exit (Box 2 of IMF 2012).

[38] At the time of the EFF request and the subsequent reviews, staff appears to have interpreted the systemic exemption as applying to Greece on the grounds that, if it were not invoked, the Fund would be barred from lending and this could create significant international spillovers. In the absence of a policy paper underpinning the creation of the systemic exemption, such an interpretation had not been excluded at the time. However, as subsequent policy papers made clear, the logic of the systemic exemption was more strictly related to the spillover risks stemming from a restructuring of private claims on the sovereign, as would be required to meet the debt sustainability requirement if the exemption were not invoked.

risks against the requirement of "reasonably strong prospects of success" suggests that the bar for meeting Criterion 4 was set too low. In retrospect, despite the large number of prior actions and capacity-building efforts, the implementation risks materialized after each review, undermining the achievement of program objectives.

B. Mix of adjustment and financing

55. Available financing required significant fiscal adjustment in the context of optimistic macroeconomic and political economy assumptions. The amount of financing committed to Greece during the EFF period was unprecedented and required arduous political efforts by EU creditor countries: €144.7 billion from the EU (with actual disbursements amounting to €163.2 billion), SDR 23.8 billion from the Fund (of which SDR 10.2 billion disbursed), a haircut on private debt of €106 billion, and ECB liquidity support of up to €150 billion. At the time of the EFF request, the Fund was faced with a stark choice between a program, the virtually unprecedented ambition of which had to match the available financing, and a disorderly Grexit with possibly deep systemic implications against the background of the incomplete architecture of firewalls in Europe. The Fund took a high risk to support the pro-reform coalition government, considering that the alternatives for Greece and the euro area were much worse at the time.

56. Even then, the level of Greece's access to Fund resources was very high. The proposed access of SDR 23.8 billion (2,159 percent of quota at the time) was the fourth largest in the Fund's history, after Greece's SBA, and Ireland's and Portugal's EFFs. Despite greater financing needs compared with the SBA, access and phasing under the EFF would be more conservative. The EFF would account for only 16 percent of total (post-PSI/OSI) financing needs, with evenly phased disbursements—17 purchases of SDR 1.4 billion (127 percent of quota) each—to link use of Fund resources to program performance. Nevertheless, under the approved EFF access, the peak access level[39] was projected to be the highest in the Fund's history in terms of quota and the second highest (after Iceland) in terms of GDP. In light of the exceptionally high exposure of the Fund's balance sheet and program implementation risks, the report for the EFF request could have discussed in more detail the rationale for burden sharing between the Fund and European partners. The use of Fund resources for budget financing purposes was consistent with the Fund's mandate because Greece had a balance of payment need and fiscal need.

C. Capacity to repay the Fund

57. The Fund's exposure to Greece was substantial, and staff was candid about the major risks to the country's repayment capacity from the beginning.[40] Despite the significant PSI and OSI, Greece's external debt service burden was projected to remain high. With SDR 17.5 billion (of the planned SDR 26.43 billion) purchased under the SBA, Greece's pre-EFF credit outstanding was already equal to 1,592 percent of quota prior to the EFF. Under the EFF, credit outstanding was

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[39] The peak access under the EFF was projected at SDR 1.9 billion higher than the approved access under the SBA.

[40] *Greece—Assessment of the Risks to the Fund and the Fund's Liquidity Position* (IMF 2012).

projected to peak at 2,570 percent of quota, the highest in the Fund's history. The program would contribute to the liquidity and concentration risks resulting from the large outstanding amounts of resources used by a few members.

58. Greece accumulated overdue financial obligations to the Fund of SDR 1.6 billion due on June 30 and July 13, 2015, becoming the first advanced country to be in arrears on a payment to the Fund. The missed payments constituted the largest amount of overdue financial obligations from a member country in the Fund's history. Greece's non-payments more than doubled the arrears to the Fund's General Resource Account (GRA) at the time. While the Fund's balance sheet was sufficiently strong to meet its own financial obligations and potential financing needs by other members, a prolonged period of nonpayment could have had significant implications for the Fund's finances. If Greece had fallen into protracted arrears (i.e., overdue for more than six months) the carrying value of credit outstanding may have needed to be adjusted, which, would have raised the possibility of the recognition of an impairment loss and a loss of Fund income. Greece made debt service payments to other creditors while having overdue financial obligations to the Fund, which risked undermining the Fund's preferred creditor status. In the event, Greece's arrears were short-lived. The Greek government agreed to a new ESM program with additional adjustment measures (para. 42), which helped secure bridge financing to repay the Fund on July 20, 2015.

59. As foreseen by staff, Fund resources were to a large extent safeguarded by the European partners, although the nature of such financing assurances was not well defined. The staff stated that full program implementation and the willingness of the European partners to continue to backstop Greece's payments capacity to the Fund after the program period (IMF 2012, ¶53) were key to ensuring Greece's repayment capacity. The EU assurance was in the form of a commitment to "continue providing support to all countries under programs until they have regained market access, provided they fully implement those programs" (Euro Summit Statement, October 26, 2011). The European support, however, was not clearly defined. It was made conditional on Greece fully complying with the requirements and objectives of the program. It was unclear, therefore, what assurances would remain if Greece were to fail to comply with EU-related program objectives after the end of the EFF. Given these considerations, it is evident that such contingent assurances to ensure the capacity to repay the Fund in the future cannot be a substitute for debt sustainability.

CONCLUSIONS AND LESSONS

60. The EFF with Greece posed exceptional challenges to the Fund. After strong pressures from the international community, Greece's main political parties united behind a technocratic government in late 2011, raising hopes that the mounting implementation problems evident under the 2010 SBA could be overcome. On the strength of this consensus, and reflecting the insistence of Greece's European partners on adhering to the EU Stability and Growth Pact as soon as possible, the new government proposed an ambitious program. While indicating the advantages of a more gradual fiscal adjustment, staff decided to support the authorities' ambitious targets in view of the newfound political consensus, a welcome commitment by European partners to stand by Greece, and the still notable systemic risks. However, staff was seriously concerned about downside risks from the outset, and the staff report accompanying the request for the EFF presented the Executive Board with a frank and explicit assessment of such risks, notably those stemming from the ambitious primary surplus targets and the high indebtedness. The Executive Board approved the EFF fully cognizant of the risks. This decision revealed a high risk tolerance by the institution, recognizing that the risks of not continuing to support Greece at the time were greater for Greece and for the euro area.

61. A measure of progress toward the EFF objectives was achieved, but the program ultimately foundered in the face of adverse political developments. During the first two years of the program, despite frequent interruptions, significant fiscal and external adjustment was undertaken, and some structural reforms progressed (e.g., public financial management, elements of pension and labor market reforms, and select financial sector measures). Above all, Greece remained in the euro area, which contributed to a reduction in systemic risks. While the program was launched with broad-based backing from Greece's main parties, however, political instability subsequently dogged the program, and ultimately derailed it, reflecting fragile ownership and strong opposition from vested interests. In the summer of 2015, Greece became the first advanced economy to accumulate temporary overdue financial obligations to the Fund—the largest in the Fund's history.

62. Growth, competitiveness, and debt sustainability have not been restored. To achieve these objectives, Greece needs to continue with unfinished reforms and its EU partners need to provide more debt relief.

63. It is possible that any program, no matter how well-designed, could have failed in such difficult circumstances. However, the program's chances of success might have been somewhat greater if the degree of ambition in its targets and the optimism of its macro assumptions had been tempered. A less ambitious approach would have required more financing and more debt relief from the outset.

64. Staff's approach evolved as the program risks started to materialize. Staff worked with the authorities and their European partners to revise the initial ambitious program targets, provide additional financing and debt relief, and find ways to re-invigorate stalling reforms. The significant re-design of the program in reviews, and a further recalibration of policy advice once the program was irretrievably off-track, demonstrated that the Fund can learn from experience and adapt its approach to evolving circumstances. It was appropriate for the Fund to interrupt the program when there was growing evidence of insufficient policy commitment or financing to achieve broad program objectives. The program relationship was instrumental for staff's close engagement with the authorities and their European partners in analyzing policy options and tradeoffs.

65. With the benefit of hindsight, the report derives a number of possible lessons, most of which were applied during the EFF and in the subsequent discussions with the authorities:

- **When the political base for reforms is fragile, program assumptions and design should be more conservative from the start.** Political economy constraints, and the impact of the pace and composition of fiscal adjustment, as well as macro-financial linkages, on growth should be better reflected in program design. The staff should resist understandable pressures from the authorities (and in the euro area context, their EU partners) for more optimistic assumptions.

- **Financial sector reforms are essential for economic recovery.** Delays in addressing NPLs, private sector insolvency frameworks, and governance issues in the banking sector weighed on the recovery. Steadfast implementation of reforms in these areas should be given high priority.

- **The composition of fiscal adjustment matters for fiscal sustainability and social cohesion.** Contrary to the spirit of the program and despite persistent efforts by staff, the composition of fiscal adjustment was not socially equitable, raising concerns about the political sustainability of the achieved fiscal consolidation. Enforcement of tax compliance, development of targeted social safety nets, and pension reform are particularly important for making the adjustment more durable and equitable.

- **Structural reforms require time and strong ownership to bear fruit.** Greece needs to restart the stalled reforms, including in the areas of product, service, and labor markets, and regulated professions, to remain a viable euro area member. Securing strong ownership and adopting a more parsimonious approach to structural conditionality are also key. Assumptions regarding the growth payoff from structural reforms need to be conservative.

- **Upfront debt relief commitments consistent with debt sustainability based on a realistic target for the medium-term primary fiscal surplus are a prerequisite for program success in the circumstances faced by Greece.** In light of the uncertain nature of conditional assurances of third parties to ensure the capacity to repay the Fund, securing debt sustainability based on realistic assumptions is called for from the outset.

- **There is merit in formalizing the operational framework for Fund collaboration with monetary unions in the program context.** A possible agreement should cover the issues of information-sharing, the reconciliation of technical analysis, the division of labor in terms of design and monitoring of conditionality, communication strategies, modalities of assurances regarding union-wide policies affecting program member countries, and financial assurances to be provided to the Fund.

- **Certain Fund policies would benefit from a fresh discussion.** In light of the very high risks explicitly documented at the time of the program request and their subsequent realization, including temporary overdue financial obligations to the Fund, there is merit in reviewing Fund risk acceptance guidelines and the exceptional access criterion on prospects for program success.

Box 1. Conclusions of the EPE on the SBA (2010–12)

The ex post evaluation of the SBA (IMF 2013a), which was concluded in June 2013, identified the following lessons:

- **Better tailoring of Fund lending policies to the circumstances of monetary unions.** The report saw merits in an EFF arrangement in light of the structural nature of challenges facing Greece and criticized the baseline macro assumptions as overly optimistic.
- **Avoiding undue delays in debt restructuring.** The report argued that earlier debt restructuring could have eased the burden of adjustment and contributed to a less dramatic contraction in output.
- **More attention to the political economy of adjustment.** The report emphasized the importance of fighting tax evasion to achieve a more equitable distribution of adjustment costs.
- **More parsimony in fiscal structural reforms.** The report underscored that detailed conditionality would not be able to substitute for political ownership.
- **More effective risk-sharing arrangements within the euro area.** The report stated that the Greek crisis brought to the fore shortcomings in the euro area related to risk sharing and crisis response.

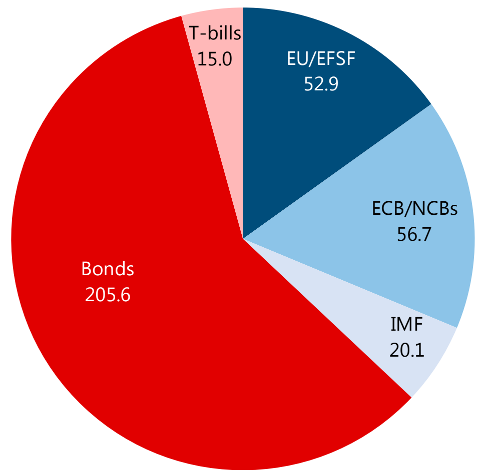
The 2013 EPE was conducted 15 months after EFF approval. As a result, its conclusions and recommendations could not influence the design of the 2012 EFF. Nevertheless, some lessons of the EPE were accounted for even before its publication: a shift to an EFF in the case of Greece in 2012, debt relief at the outset of the EFF (although it was not sufficient in retrospect), and an intensification of discussions on more effective risk-sharing arrangements within the euro area as part of Fund regional surveillance. Other lessons, including the need for realistic forecasts,[1] the importance of political economy factors, more parsimony in structural reform, and the criticality of sufficient debt relief, were only addressed as the EFF implementation encountered significant difficulties. This experience suggests that EPEs should be concluded prior to approval of successor programs even if a compressed production schedule is required.

[1] The forecast errors for the EFF at the time of the request were somewhat larger than those for the SBA at the time of the request for the first two program years. The forecast errors declined significantly from the time of the first/second reviews under the EFF.

Box 2. PSI, OSI, and Debt Sustainability

The Greek debt restructuring of March 2012, the largest in history, was calibrated to bring Greece's public debt down to 120 percent by 2020. First announced in June 2011, the private sector involvement (PSI) followed months of negotiations among the Greek authorities, Euro group representatives, and the creditor group led by the Institute for International Finance (IIF), with staff participating as observers. The IIF's PSI proposal that came in July 2011 provided insufficient debt relief and had to be recalibrated, driven partly by the deepening recession.[1] Once the terms of the debt exchange were announced in February 2012, however, the PSI took place swiftly. Under the PSI, €197 billion of Greek government bonds (GGBs) were exchanged for €62 billion of new debt and €30 billion in short-term EFSF notes, resulting in a debt write-down of €106 billion or 52 percent of 2012 GDP, a haircut of 53.5 percent in nominal terms.

Composition of Greek Sovereign Debt 1/
(Billions of euros)



Source: Zettelmeyer, *et. al.* (2013).
1/ Shows Greek government and government-guaranteed debt owed to private and official creditors as of February 2012, i.e. before debt exchange. ECB/NCB debt refers to ECB SMP holdings as well as holdings by national central banks in the Euro area. EU/EFSF loans include the bilateral Greek Loan Facility loans as well as the EFSF loans. T-bills are privately held short-term debt instruments.

Delays in PSI negotiations reduced the stock of debt eligible for the debt exchange. The decision not to restructure debt at the outset of the Greek crisis, grounded in international spillover concerns, had already allowed some €40 billion in maturing bonds to be fully repaid in the first year of the SBA.[2] Once the PSI was deemed necessary, the drawn-out negotiations meant that some further €10 billion continued to be repaid in full (Zettelmeyer, Trebesch, and Gulati 2013). By the time of the debt exchange, Greece's debt was largely held by Greek and European banks, and by the ECB (through Securities Markets Program (SMP)-related bond purchases). The ECB, as well as European national central banks, and the EIB, as official creditors, would be excluded from the PSI.

Several factors ensured the near-universal participation in the PSI. The most important was the retrofitting of "collective action clauses" (CACs) to the outstanding bonds to allow a qualified majority of creditors to legally bind all others to the terms of a debt restructuring. With the vast majority of GGBs issued under local law, this significant contract modification simply required a change in the domestic law. Banks were encouraged to participate in the debt exchange through

[1] Under the IIF's original proposal, debt relief for Greece in NPV terms ranged between zero and 11.5 percent, for discount rates between 5 and 9 percent. Using the prevailing "risk free" rate of around 3.5 percent would have resulted in an NPV *increase* in Greece's debt (see Zettelmeyer, Trebesch, and Gulati 2013).

[2] Staff's estimate, based on Bank of Greece's gross external debt data and European Commission (2010).

Box 2. PSI, OSI, and Debt Sustainability (concluded)

a combination of moral suasion and official sector pressure, helping to further ensure the activation of CACs. The debt exchange also offered generous near-cash sweeteners in the form of EFSF notes and upgrading the new GGBs to English law bonds to strengthen the incentive for participation. In the end, 97 percent of eligible bonds were tendered for the exchange.

Involving the banking sector in the PSI was inevitable but controversial. Carving out the banking sector from the PSI was not an option given the amount of public debt held by Greek banks. But the PSI further weakened a system that was already impaired by heavy deposit outflows. To contain the fallout on the financial sector, therefore, €50 billion from the program was set aside for bank recapitalization with the capital requirements to be gradually phased in.

At the outset of the program, the envisaged official sector involvement (OSI) was relatively narrow in scope. Interest on the existing Greek Loan Facility (GLF) would be lowered from 300 bps to 150 bps, and national central banks would repatriate the profits on their holdings of Greek bonds back to Greece. New financing through the EFSF would be provided at lower cost and at longer maturities. These concessions, however, would prove inadequate in the ensuing months.

By the first/second EFF reviews, a revised DSA showed that further debt relief would be needed from the European partners. With a significantly worse macroeconomic outlook, the scope of the OSI was expanded to include further lowering of the interest rates on and lengthening of the maturities of GLF and EFSF loans. Around €11 billion in EFSF funding was used upfront to buy back €32 billion of the new GGBs, taking advantage of the low prices. To ensure that the program is financed, the European partners reiterated their commitment to support Greece "as necessary during and beyond the program" contingent upon program implementation.

Box 3. PFM Reforms

PFM reforms under the EFF focused on budgeting and budget monitoring, spending controls, fiscal reporting and the institutional and legal framework. Substantial reforms to PFM systems have been implemented since 2012 with extensive Fund technical assistance:

- Legal and institutional reforms, including amendments to the Organic Budget Law and a reorganization of functions in the Ministry of Finance, have strengthened responsibility, accountability and processes for effective financial management.
- Creation of financial management capacity aimed at devolving budget and financial management responsibility through the creation of General Directorates of Financial Services (GDFS) has been legislated and is at an advanced stage of implementation (expected to be completed by January 2017).
- Monthly published fiscal data covering general government facilitates frequent monitoring of sizeable fiscal activities taking place beyond the State. The coverage of monthly reports is now at a level comparable or better than most advanced countries.
- Government payment processes have been streamlined and automated to a point where compliance with the requirements of the EU late payment directive is now technically in sight.
- Cash management operations have been strengthened with the unification of this function in the Public Debt Management Agency.
- A spending review process has been institutionalized in the Ministry of Finance and pilot reviews have been conducted.

Nevertheless, progress is lacking in a number of areas, such as increasing the staffing and capacity of the GDFS, modernizing payment processes against the resistance of the Hellenic Court of Auditors, the ongoing difficulties to ensure coordination among different stakeholders in fiscal reporting, and the challenges to halt accumulation of new spending arrears.

Box 4. Reforms of Revenue Administration

At the time of the program request, the reforms were aimed at overhauling tax administration, improving its efficiency and effectiveness, strengthening its enforcement and compliance operations, and enhancing the collection of social security contributions. Extensive Fund TA was provided in support of these objectives.

Greater autonomy of tax administration was a key component of fiscal institutional reforms—including the strengthening of its headquarters, governance, organization, and management—alongside with the revamping of core tax administration operations. Key milestones in revenue administration autonomy were the creation of the General Secretariat for Public Revenues (GSPR) in end-2012 and the first fixed-term (5 years) Secretary General (SG) appointment in January 2013. Substantive reforms were implemented in 2013 and the first half of 2014 due to the strong commitment from the SG in progressing the reform agenda. However, political commitment to respect the fixed-term appointment and provide leadership stability to the revenue administration was absent from mid-2014 to early 2016, when reform progress slowed significantly.

Although some compliance initiatives have been successfully implemented, fundamental weaknesses in core operations remain. Positive initiatives include targeted compliance controls in some taxpayer segments and taxes, and new procedures for monitoring return filing and payment to facilitate immediate action in cases of non-compliance. Tax revenues have stabilized as a percent of GDP, despite the economic contraction that could have increased non-compliance. The most recent results of EC TAXUD's study of VAT gaps in EU member states (CASE, 2016) shows a decline in Greece's compliance gap from 36 percent of potential VAT in 2011 to 28 percent in 2014, which is equivalent to a net annual revenue gain of 1.3 percent of GDP. However, these improvements require further consolidation. There are still problems of poor auditing practices and weak recovery of debts that have not been fully modernized yet. Furthermore, ad-hoc schemes, such as amnesties, that may generate short-term revenues but run high moral hazard risks have been counterproductive. As a result, the level of tax arrears continued to grow significantly. Measures to better use Greece's anti-money laundering framework have generated large numbers of suspicious transaction reports to the Financial Intelligence Unit, but this easily actionable information has received no priority in the tax administration.

Box 5. Pension Reform

The pension reform focused on long-run sustainability and short-term needs of the pension system. The Fund provided extensive technical assistance on pension reform.

The pension reform started in 2010 with the aim to ensure long-run sustainability of the "main" pensions, equalize rules across pension funds, increase labor force participation, and provide a safety net for the elderly. The pension law of 2010 was scheduled to take effect in 2015, yet it was only partially implemented.

As the fiscal situation deteriorated, pension expenditure reached close to 18 percent of GDP and complexities of the pension system became evident in 2012, the focus shifted from long-term reforms towards measures yielding more immediate savings. In 2012, main pension benefits were reduced by 12 percent above €1,300, and supplementary pension benefits by 10 percent under €250, 15 percent over €250-300, and 20 percent above €300. The supplementary pension system was consolidated. In 2013, the 13th and 14th payments were abolished. Besides benefit cuts, other measures included raising the retirement age by two years, increasing the health care contribution by retirees, and gradual phasing-out of grandfathering rules for retirement. Reversal of reforms occurred with the Council of State's verdict of the unconstitutionality of progressive pension cuts.

Despite reform measures, the pension system remains highly imbalanced and pension spending stays at 17-18 percent of GDP, up from 14 percent at the onset of the crisis, partly due to the deep recession and deflation. Pension deficits also rose to 11 percent of GDP at end-2015, by far the highest in the Euro Area.

Box 6. Tax Policy Reforms

The reforms in tax policy focused on revamping tax legislation. The reform of the income tax law (ITL) aimed at the codification of the 'income tax'-related provisions scattered in the Greek legal system, the simplification of the—often very legalistic—language, closing loopholes by introducing modern anti-avoidance concepts, and broadening the tax base by eliminating personal deductions and streamlining remaining incentives. A new legal framework (Tax Procedure Code—TPC) was needed to enable the modernization of tax administration. The property tax reform began in 2013, with the aim of replacing the outdated wealth tax with a modern property tax system. The objective of the VAT reform was to streamline the system.

With FAD/LEG's technical assistance, a new income tax law was drafted addressing the issues mentioned in the previous paragraph. In July 2013, lawmakers adopted a new ITC which incorporated many recommended provisions. Over the last three years, successive governments, however, have backtracked substantially on the tax policies that were introduced in the ITC in 2013. The current ITC reversed a number of deductions and incentives, re-introduced complex legalistic language, and contains additional measures—sometimes addressing administrative shortcomings and/or perceived 'fairness' issues—that re-introduced new tax planning opportunities.

The TPC, drafted with FAD/LEG's technical assistance, was passed in July 2013 almost unchanged. Since its passage, the TPC has not been influenced substantially by political interference and still forms a good legal basis for the modernization of the Greek tax administration.

The VAT reform reduced the number of rates and thus broadened the base, but it stopped short of eliminating the intermediate rate and relied on a further hike of the top rate. The special reduced rate applicable on the islands was removed, however.

There was some progress on real estate taxation. The new property tax ENFA was legislated at end-2013, but the reform of the property valuation was stalled due to the lack of political will.

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Annex I. Authorities' Views on the EPE Report[1]

The authorities broadly agreed with most lessons identified in the report. They highlighted that the stakeholders faced the extraordinary challenges of engineering a sizeable fiscal adjustment and internal devaluation simultaneously in a relatively closed economy belonging to a monetary union.

The authorities agreed with the general principle that the program should have a realistic macroeconomic framework and targets from the outset. They saw the initial program macroeconomic framework as excessively optimistic and the program targets as too ambitious. They argued that program underperformance is mainly explained by underestimation of fiscal multipliers, the lack in the initial program design of an appropriate sequencing of structural reforms, and the underestimation of the implementation challenges and negative political repercussions of recommended policies (both of which ultimately undermined ownership). However, the former authorities in charge of the initial program discussions indicated that there was no alternative to the frontloaded adjustment in light of political constraints on available financing and debt relief and the need to strengthen credibility; and their preference for the ambitious program should be understood in this context. At the same time, the Bank of Greece representatives indicated that, at times (e.g., in 2013), the staff was excessively pessimistic regarding expected yields of fiscal measures, which resulted in budget over-performance, leading to an excessive fiscal tightening.

The authorities disagreed with the report's analysis of the composition of fiscal adjustment during the program. While the ministry of finance acknowledged that previous governments agreed that fiscal adjustment should have been implemented mainly on the expenditure side and through permanent measures, the current position of the government is that most of the adjustment should have occurred on account of revenue measures aimed at reducing tax avoidance and tax evasion, as well as governance improvements in tax administration. The government believes that there has been a large compliance gap, the elimination of which should be given the utmost priority. The expenditure-to-GDP ratio in Greece is broadly consistent with the EU averages and does not require further adjustments, in their view. In addition, the Bank of Greece representatives argued that the composition of fiscal adjustment should be supplemented by an analysis of revenue and expenditure in terms of nominal values rather than solely based on the changes in the ratios of total revenue and total expenditures to shrinking GDP. According to the Bank of Greece, the country achieved a very sizeable decline in nominal primary expenditure (excluding recapitalization costs,

[1] The EPE report was discussed with the authorities during Mr. Kramarenko's visit to Athens from January 19 to January 20, 2017. Mr. Botman, the IMF's Senior Resident Representative in Greece, participated in the discussions. Meetings were held with Minister of Finance Tsakalotos and Bank of Greece Governor Stournaras, as well as representatives of previous Governments involved in program design and implementation.

Figure 12b) in large part through nominal reductions in wages and pensions. The Bank of Greece is also of the view that the program should have focused on structurally adjusted fiscal targets, but acknowledged that this approach would have been constrained by lack of additional financing.

The authorities broadly agreed with the lessons from implementation of the financial sector measures under the program. They felt that the mounting problems with the insolvency frameworks and rising NPLs required earlier attention. Furthermore, the Bank of Greece representatives stated that the incidents raising potential questions with respect to banks governance are currently being addressed based on the new regulations that are consistent with the report's recommendations. Finally, the Bank of Greece maintained that the report's assessment that initial recapitalizations should have relied on more conservative assumptions is only possible with the benefit of hindsight, as the stress tests had to rely on official program forecasts. While acknowledging that three rounds of recapitalization turned out to be necessary during the program period, the Bank of Greece representatives underlined that the total need for public funds had been over-estimated by the staff by about €10 billion.

The authorities argued that the program had failed to incorporate the appropriate sequencing of structural reforms and to take into account their political feasibility and the capacity constraints facing the government. For example, some product market reforms, with an uncertain impact on alleviating the economy-wide supply bottlenecks or benefitting consumers, generated strong political backlash, thereby eroding the successive governments' political capital. Also, the large number of reforms overwhelmed the available administrative capacity. Furthermore, the Bank of Greece stated that the report downplayed progress in structural reforms. In their view, implemented labor market and other reforms contributed to reducing ULCs and improving cost competitiveness, which explains the nascent recovery in exports, excluding shipping. Nevertheless, the authorities agreed that there was a need for further progress in improving price and non-price competitiveness, while more work needed to be done to tailor the necessary reforms to Greece's circumstances. Regarding the EU context for structural reforms, the authorities felt that there was a need for stronger progress on positive integration (i.e., promoting union-wide institutions) before intensifying negative integration (i.e., reducing barriers).

The authorities agreed that sufficient upfront debt relief and adequate financing are important pre-requisites for program success. They also stated that a piecemeal approach to providing debt relief is counterproductive. Furthermore, the Bank of Greece representatives argued that there was a missed opportunity to request higher OSI in the first half of 2014.

The authorities agreed with the recommendation that there is merit in formalizing the operational framework for Fund collaboration with monetary unions. In their view, the frequent disagreements among the Troika partners complicated program discussions and implementation.

Table A1.1. Greece: Selected Economic Indicators 1/

	2010		2011		2012		2013		2014		2015	
	Request	Actual	Request	Actual	Request	Actual	Request	Actual	Request	Actual	Request	Actual
Domestic economy	(Percentage change, unless otherwise indicated)											
Real GDP	-3.5	-5.5	-6.9	-9.1	-4.8	-7.3	0.0	-3.2	2.5	0.4	3.1	-0.2
Output gap (percent of potential output)	2.9	4.0	-2.4	-3.1	-6.7	-7.9	-6.7	-8.7	-4.7	-6.4	-2.6	-5.3
Total domestic demand	-6.0	-8.4	-8.9	-10.9	-6.7	-9.8	-1.4	-4.1	1.3	-0.5	1.9	-0.2
Private consumption	-3.6	-6.5	-7.2	-9.7	-5.7	-8.0	-1.1	-2.6	0.9	0.4	0.5	-0.2
Public consumption	-7.1	-4.2	-9.5	-7.0	-11.0	-6.0	-9.5	-6.4	-4.7	-1.4	1.0	0.0
Gross fixed capital formation	-14.5	-19.3	-17.0	-20.5	-6.6	-23.5	5.8	-8.4	8.5	-4.6	8.5	-0.2
Change in stocks (contribution)	0.1	2.0	0.3	-0.1	0.0	0.1	0.0	-0.1	0.0	1.0	0.0	-1.0
Foreign balance (contribution)	3.3	2.0	3.0	2.9	2.5	3.1	1.5	1.1	1.2	-0.1	1.2	0.9
Exports of goods and services	4.2	10.6	3.0	5.9	3.2	4.3	5.5	0.4	7.0	5.3	7.5	-8.9
Imports of goods and services	-7.2	2.1	-7.0	-3.9	-5.1	-5.0	0.0	-3.1	2.4	3.1	3.2	-14.3
Unemployment rate (percent) 2/	12.5	12.7	17.3	17.9	19.4	24.4	19.4	27.5	18.2	26.5	16.8	24.9
Employment	-2.7	-3.6	-6.6	-7.6	-4.8	-8.9	-0.3	-4.9	1.5	0.7	1.8	2.1
Unit labor costs	-0.4	15.0	-2.8	-3.8	-8.6	-13.3	-1.6	-12.4	-1.9	6.2	-0.7	3.6
Consumer prices (HICP), end of period	5.1	5.2	2.2	2.2	0.8	0.3	0.0	-1.8	0.6	-2.5	1.1	0.4
Consumer prices (HICP), period average	4.7	4.7	3.1	3.1	-0.5	1.0	-0.3	-0.9	0.2	-1.4	1.0	-1.1
GDP deflator	1.7	0.7	1.6	0.8	-0.7	-0.4	-0.5	-2.4	-0.1	-1.8	0.8	-1.0
Monetary survey	(Percentage change, unless otherwise indicated)											
Credit to the private sector	-0.2	0.0	-3.2	-3.1	-4.0	-4.0	-2.2	-3.9	3.1	-3.1	3.5	-2.0
Private sector deposits	-12.1	-12.4	-16.5	-17.0	-10.5	-7.3	-2.7	1.4	4.4	-2.0	8.5	-22.9
Liabilities to the BoG (billions of euros)	97.8	...	76.9	128.7	41.4	121.2	41.4	73.0	38.9	56.0	35.5	107.6
Balance of payments	(Percent of GDP)											
Current account	-10.1	-11.4	-9.8	-10.0	-7.5	-3.8	-6.7	-2.0	-5.4	-2.1	-3.3	0.0
Trade balance	-6.6	-8.1	-5.8	-6.1	-4.2	-3.8	-3.0	-2.8	-1.7	-2.2	-0.4	-0.2
Export of goods and services	20.0	21.9	22.7	25.3	24.8	28.6	25.9	30.4	26.8	32.5	27.7	30.0
Export of goods	7.5	9.3	9.4	11.5	10.5	14.2	11.0	14.9	11.4	15.1	11.7	14.1
Exports of services	12.5	12.6	13.3	13.8	14.3	14.4	14.9	15.5	15.5	17.5	16.0	15.9
Imports of goods and services	26.7	30.0	28.5	31.5	29.1	32.4	28.9	33.2	28.6	34.7	28.1	30.2
Imports of goods	20.0	22.7	22.0	24.2	22.6	25.2	22.4	26.4	21.9	27.6	21.4	23.9
Imports of services	6.7	7.3	6.5	7.3	6.5	7.2	6.6	6.8	6.6	7.2	6.7	6.3
Total transfers	0.1	-0.8	0.3	-0.7	0.3	-0.5	0.3	1.0	0.3	-0.2	0.2	-0.3
Net income receipts	-3.6	-2.5	-4.2	-3.2	-3.6	0.4	-4.0	-0.3	-4.0	0.3	-3.2	0.4
Net international investment position	-99	-99	-113	-89	-125	-116	-131	-130	-134	-132	-130	-133
Gross external debt	179	185	192	188	193	237	200	237	200	239	193	252
Private sector capital flows (net)	-19	-10	-19	-9	-41	-1	1	13	1	6	2	-42
General government public finances	(Percent of GDP)											
Total revenues	39.5	41.3	41.0	44.1	42.2	45.9	42.2	48.0	42.1	46.8	40.1	47.8
Total expenditures	50.1	52.5	50.3	54.4	49.5	52.4	46.8	51.6	44.2	50.8	41.7	51.2
Primary expenditures	44.6	46.6	43.4	47.1	43.2	47.3	40.4	47.6	37.6	46.8	35.6	47.6
Overall balance	10.6	-11.2	9.3	-10.3	7.3	-6.5	4.6	-3.7	2.1	-4.0	1.6	-3.4
Primary balance	5.0	-5.3	2.4	-3.0	1.0	-1.4	1.8	0.4	4.5	0.0	4.5	0.2
Memorandum items	(Billions of euros, unless otherwise indicated)											
Gross financing needs (percent of GDP)	24.0	26.9	29.0	28.6	73.0	58.1	23.0	27.3	21.0	24.4	17.0	22.4
Gross financing needs	54.0	60.8	63.0	59.2	149.0	111.0	47.0	49.4	43.0	43.4	36.0	39.3
Deposit accumulation	...	...	2.0	2.7	7.4	1.1	0.6	2.3	2.9	-2.1	0.2	-0.9
New private sector borrowing (MLT)	...	19.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	6.1
Privatization receipts (percent of GDP)	0.0	0.0	0.5	0.5	1.6	0.1	2.1	0.6	2.1	0.3	2.6	0.1
Gross debt (percent of GDP)	145	146	165	172	163	160	167	178	161	181	153	179

Sources: Bank of Greece; Eurostat; Hellenic Statistical Authority; Ministry of Economy and Finance; and IMF staff estimates.

1/ Actual data for 2010 and 2011 differ from the EFF Request data due to revisions by Hellenic Statistical Authority. Fiscal data starting in 2012 onwards are based on EFF program definition.

2/ Based on the Labor Force Survey.

Table A1.2. Greece: Quantitative Performance Criteria and Indicative Targets (2012–13)

(Billions of Euros, unless otherwise indicated)

	2012										
	March		June			September			December		
	Target	Actual	Target	Revised	Actual	Target	Revised	Actual	Target	Revised	Actual
Performance criteria:											
Floor on the modified general government primary cash	-2.5	1.0	-6.0		-2.9	-6.3		-2.0	-7.0	-3.8	-3.3
Ceiling on state budget primary spending	13.9	13.3	29.2		26.8	44.4		38.3	60.4	56.8	55.4
Ceiling on the overall stock of central government debt	340.0	289.9	340.0		308.0	340.0		308.0	340.0		311.4
Ceiling on the new guarantees granted by the central government	0.0	0.0	0.0		0.2	0.0		0.2	0.0	0.2	0.1
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by general government	0.0	0.0	0.0		0.0	0.0		0.0	0.0		0.0
Ceiling on the accumulation of new domestic arrears by hospitals and line ministries	0.0	0.5	0.0		0.7	0.0		0.9			
Ceiling on the stock of domestic arrears of the general government (narrow definition)									3.6		2.9
Indicative targets:											
Ceiling on the accumulation of new domestic arrears by the general government	0.0	0.6	0.0		0.7	0.0		1.3	0.0		0.0
Ceiling on the stock of domestic arrears of the general government									8.0		7.6
Floor on privatization receipts 1/	0.03	0.0	0.0		0.0	1.2		0.0	3.2		0.0
Mandatory exits (head count, in thousands)											
Transfers to the Mobility Scheme (head count, in thousands)											
Floor on the stock of employees in the Mobility Scheme that will exit (head count, in thousands)											

	2013										
	March		June			September			December		
	Target	Actual	Target	Revised	Actual	Target	Revised	Actual	Target	Revised	Actual
Performance criteria:											
Floor on the modified general government primary cash	1.5	1.8	0.5	-0.3	...	-0.8		3.0	-0.3		0.4
Ceiling on state budget primary spending	13.9	11.8	26.0		24.1	38.8		36.1	53.2		52.4
Ceiling on the overall stock of central government debt	347.0	313.3	347.0	335.0	...	335.0		321.9	335.0		326.6
Ceiling on the new guarantees granted by the central government	0.2	0.2	0.2	0.0	0.0	0.0		0.0	0.0		0.0
Ceiling on the accumulation of new external payments arrears on external debt contracted or guaranteed by general government	0.0	0.0	0.0		0.0	0.0		0.0	0.0		0.0
Ceiling on the accumulation of new domestic arrears by hospitals and line ministries											
Ceiling on the stock of domestic arrears of the general government (narrow definition)	3.0	2.6	2.0		...	1.0		2.0	0.0		1.3
Indicative targets:											
Ceiling on the accumulation of new domestic arrears by the general government											
Ceiling on the stock of domestic arrears of the general government	4.5	7.1	3.0		...	1.5		5.8	0.0		3.9
Floor on privatization receipts 1/	0.1	0.1	1.1		0.1	1.8	1.5	0.2	2.5	1.6	1.0
Mandatory exits (head count, in thousands)						2.0		3.2	4.0		3.5
Transfers to the Mobility Scheme (head count, in thousands)			12.5		0.0	12.5		8.4	25.0		15.9
Floor on the stock of employees in the Mobility Scheme that will exit (head count, in thousands)						5.0		2.1	11.0		5.0

Sources: IMF MONA database and staff reports.

1/ For September 2013, the target on privatization was set as an indicative target (IT) at the time of the EFF request in the amount of €1.2 billion. At the 1st and 2nd Review, its status was changed to a quantitative performance criterion (QPC) with a target of €1.8 billion (but only for the September 2013 test date, while remaining an IT for December 2013 and afterwards). This September 2013 QPC was subsequently revised (while remaining as a QPC) to €0.9 billion at the 4th Review. At the same time, the IT for December 2013 was revised to €1.6 billion (down from the initial target of €2.5 billion, as shown in the table). At the 5th Review, for the September 2013 test date, this measure was assessed as an IT against a target of €1.5 billion.

Table A1.3. Greece: Structural Conditionality 1/

	Program conditions	Set	Target	Status 2/
	Prior actions: Fiscal Sector			
1	Government to fully implement all overdue MTFS measures	Request	PA	MT
2	Government to enact and implement measures needed to reach the fiscal deficit target in 2012	Request	PA	MT
3	Government to implement measures to strengthen tax administration operations	Request	PA	MT
4	Government to implement measures to strengthen the tax administration	R1&R2	PA	WV
5	Government to adopt and publish the 2013 budget and the medium-term fiscal strategy (2013-16)	R1&R2	PA	MT
6	Government to enact and implement measures needed to reach the 2014 fiscal deficit targets	R1&R2	PA	MD
7	EOPYY to report, using commitment registers, 2 consecutive months of fiscal data	R1&R2	PA	MT
8	Adopt legislation to extend collection of the real estate tax through 2013 via PPC	R3	PA	MT
9	Government to adopt staffing plans, approve quarterly targets on mandatory exits, approve annual overall employment ceilings for the general government through 2016; and adoption of legislation to streamline and accelerate the disciplinary procedure, and remove restrictions for placing in the mobility scheme personnel of legal entities of private law whose positions are abolished	R3 3/	PA	MT
10	Adopt legislation to introduce measures to eliminate by end-2014 the debt in the RES account	R3	PA	MT
11	Government to meet end-April quantified key performance indicators for revenue administration	R3 3/	PA	MT
12	Government to meet end-March quantified key performance indicators for public financial management	R3 3/	PA	MT
13	Adopt legislation on key tax administration procedural reforms to: suspend collection activities on uncollectable debt, remove the legal requirement to audit all tax declarations for the previous 10 years; and implement indirect audit methods	R3	PA	MT
14	Issue a ministerial decision that regulates the conditions of the existing basic and a new transitional installment scheme for tax and social security contributions debt	R3	PA	MT
15	Adopt legislation to achieve a semi-autonomous revenue administration	R3 3/	PA	MT

	Table A1.3. Greece: Structural Conditionality (continued)			
	Program conditions	**Set**	**Target 2/**	**Status 2/**
16	Government to take steps to ensure full implementation of the fiscal program for 2013–14	R4	PA	MT
17	Adopt legislation to reform income tax code and government to submit to parliament a tax procedure code	R4 3/	PA	MT
18	Government to take steps to prevent accumulation of debt in the renewable energy account	R4	PA	MT
19	Government to issue all necessary legal acts so as to place at least 4,200 ordinary employees in the mobility scheme by end-July	R4	PA	MD
20	Government to issue ministerial decisions for the transfer to the revenue administration of IAD, and the Directorates for Computer Applications, and for Computer Data Entry and Controls of the GSIS	R4	PA	MT
21	Amend legislation to close effective August 1, 2013 for new entrants any installment or deferred arrangements for payment liabilities arising from audit assessments other than entry into the fresh start and basic installment schemes	R4	PA	MT
22	Government to lock in lower spending of €320 million from permanent savings in 2013 by revising binding expenditure ceilings in the 2015-18 MTFS	R5	PA	MT
23	Implement several measures to eliminate RES debt by end-2014	R5	PA	MT
24	Government to place additional public sector employees in the mobility scheme to reach 25,000 employees, and to achieve 5,000 exits in the public sector	R5	PA	MT
25	Adopt secondary legislation to the Income Tax Code and the Tax Procedure Code	R5 3/	PA	MT
26	Government to submit presidential decree to consolidate revenue administration functions, and to transfer to SGPR all revenue-related functions of SDOE, and SGPR to adopt the final organizational structure of the revenue administration	R5	PA	MT
27	Implement an interim borrowing framework within the general government	R5	PA	MT
	Prior actions: Structural Reforms			
28	Government to legislate measures to level the playing field in collective bargaining, including: (i) removal of the 'after effects' of contract expiration; (ii) removal of 'tenure' in all existing legacy contracts; (iii) a freeze of 'maturity' in all private contracts; (iv) elimination of compulsory arbitration	Request	PA	MT
29	Government to legislate a realignment of the minimum wage level determined by the national collective agreement by 22 percent; freeze it until the end of the program period,	Request	PA	MT

Table A1.3. Greece: Structural Conditionality (continued)

	Program conditions	Set	Target 2/	Status 2/
	and a further 10 percent decline for youth, which will apply generally without any restrictive conditions			
30	Government to close small social security funds and reduce other non-priority social security spending to allow a fully-funded reduction in social security contribution rates.	Request	PA	MT
31	Government to enact secondary legislation establishing license prices for road-haulage in line with administrative costs, and to screen specific service sector legislation and repeal or modify unnecessary and outdated regulations for an additional 20 high value and/or highly restricted professions to ensure full consistency with the law liberalizing restricted professions (3919).	Request	PA	MT
32	Government to take measures to liberalize key product and service markets	R1&R2	PA	MT
33	Government to adopt measures to enhance labor markets including by establishing a timetable to overhaul the setting of minimum wage and by reducing labor market exit costs and non-wage costs	R1&R2	PA	MT
34	Government to adopt steps to strengthen the institutional framework for privatization, transfer ownership of assets to the Privatization Fund balance sheet, and eliminate legal obstacles for privatization	R1&R2	PA	MT
35	Authorities to remove obstacles in the privatization program	R4	PA	MT
36	Adopt law to strengthen HRADF's control in companies in which it is majority shareholder, and implement pending government actions in support of the 2014 privatization program	R5	PA	MT
37	Reduce IKA's SSC rates by the equivalent of 3.9 pp effective July 1, 2014	R5 3/	PA	MT
38	Abolish 40 charges with an annualized cost of €245 million	R5	PA	MT
39	Adopt 237 of the OECD recommendations to remove barriers to competition in four sectors (tourism, retail, building materials, and food processing)	R5	PA	MT
40	Adopt legislation to open mediator's professions to non-lawyers, repeal provision on severance pay of lawyers upon voluntary separation, and clarify the reference on the minimum wage for lawyers	R5	PA	MT
41	Adopt legislation to reduce minimum wage for long-term unemployed	R5	PA	MT
	Prior actions: Financial Sector			
42	Bank of Greece to undertake a comprehensive assessment of banks' capital needs.	Request	PA	MT

	Table A1.3. Greece: Structural Conditionality (continued)			
	Program conditions	**Set**	**Target 2/**	**Status 2/**
43	Ministry of Finance to complete a detailed study on how to address ATE, based on work by the commissioned external audit firms.	Request	PA	MT
44	Government to enact legislation to improve the framework for resolution and recapitalization to: (i) enable the Bank of Greece to set new bank capital standards through regulation, and to use this power to establish new Core Tier 1 requirements; (ii) remove impediments to a flexible management of employment contracts in the context of bank resolutions; (iii) ensure the use of conservative asset valuations for failed banks; (iv) allow the use of contingent convertible bonds in recapitalization; (v) introduce the possibility of restrictions on HFSF voting rights; and (vi) vest resolution responsibilities in a separate department in the BoG and systemic restructuring responsibilities in the HFSF.	Request	PA	MT
45	Government to enact legislation to improve the financial oversight framework. In particular, covering reforms to: (i) establish two departments in the HFSF mandated, respectively, to manage the government's ownership of banks and interim credit institutions; (ii) revise the HFSF's governance structure to include a General Council and an Executive Board; and (iii) address HDIGF funding arrangements, and to eliminate possible conflicts of interest within the HDIGF.	Request	PA	MT
46	A ministerial decree shall be issued to provide the technical details of the banks' recapitalization framework	R1&R2 3/	PA	MD
47	Government and Bank of Greece to communicate capital needs to banks, and request that they finalize the process by end-April 2013.	R1&R2	PA	MT
48	Government and Bank of Greece to finalize the design of the program for bank recapitalization and resolution and communicate this to banks.	R1&R2	PA	MT
49	HFSF to take steps to strengthen governance in the financial system	R1&R2	PA	MT
50	Add 2 independent members to the HFSF General Council	R3	PA	MT
51	Complete sale of the New Hellenic Postbank and Nea Proton Bank	R4 3/	PA	MD
52	Authorities to complete a comprehensive banking sector strategy to ensure a banking sector based on four viable core banks	R4 3/	PA	MT
53	Adopt legislation governing the injection of public resources into banks via the HFSF	R5	PA	MT

Table A1.3. Greece: Structural Conditionality (continued)

	Program conditions	Set	Target 2/	Status 2/
54	Government Council for the Management of Private Debt to take steps to enhance corporate and personal debt resolution frameworks	R5	PA	MT
	Structural benchmarks: Fiscal Sector			
1	Government to adopt a budget-neutral tax reform package, including: (i) the repeal of the Code of Books and Records and its replacement by simpler legislation; (ii) the elimination of several tax exemptions and preferential regimes; (iii) simplification of the VAT and of the property tax rate structure; (iv) a more uniform tax treatment of individual capital income; and (v) a simplified personal and corporate income tax schedule	Request	end Jun-2012	NM
2	Government to complete the reviews of social spending programs to identify 1 percent of GDP in savings, while at the same time making proposals to strengthen core safety net programs	Request	end Jun-2012	MD
3	Government to complete the reviews of public administration to identify 1 percent of GDP in savings	Request	end Jun-2012	MD
4	Government to meet quantified quarterly performance indicators for revenue administration	Request 4/	end Jun-2012	NM
5	Government to meet quantified quarterly performance indicators public financial management	Request 4/	end Jun-2012	NM
6	Government to complete the strategy for strengthening social security collections	Request	end Sep-2012	MD
7	Government to adjust pensions, with protections for low income pensioners, and the social security contribution base, to permit a fully-funded reduction in rates (cumulatively 5 percent from January 1, 2012)	Request	end Sep-2012	NM
8	Adopt a law establishing a new semi-autonomous tax agency, which will specify the degree of autonomy, the governance framework, accountability, and initial staffing of the organization	R1&R2 4/	end Feb-2013	NM
9	Government to complete staffing plans for line Ministries and utilize these to identify redundant positions and employees, and on this basis to set quarterly targets for mandatory exits through end-2014	R1&R2 4/	end Feb-2013	NM
10	Adopt a new Tax Procedures Code and simplify income tax legislation	R1&R2 4/	end May-2013	NM
11	Adopt legislation on a new property tax regime	R4	end Sep-2013	MD

Table A1.3. Greece: Structural Conditionality (continued)

	Program conditions	Set	Target 2/	Status 2/
12	Approve the new organizational structure of the Revenue Administration, staffing numbers, grading system, and classification, and qualification and appointment processes of the revenue administration	R3	end Oct-2013	NM
13	Adopt all secondary legislation needed to implement the tax procedures code	R4 4/	end Oct-2013	NM
14	Adopt legislation to reform the system of social security contributions to: (i) broaden the contribution base; (ii) simplify the contribution schedule across the various funds; (iii) shift funding away from nuisance taxes and onto contributions; and (iv) reduce contribution rates by 4 percentage points. The reforms will be fully phased in by January 1, 2015 and will be revenue neutral and preserve the actuarial balance of the various funds	R1&R2	end Nov-2013	NM
15	Ministry of Finance to complete a targeted audit of general government accounts payable, to verify whether any arrears remain, and to review compliance with the conditions set for clearing arrears	R1&R2	end Dec-2013	NM
16	Adopt legislation to integrate into ITC the taxation of collective investment vehicles as well as all income tax expenditures (eliminating inefficient or inequitable ones)	R5	end Sep-2014	SB
17	Adopt legislation to broaden definition of tax fraud and evasion, and repeal Article 55 ¶s 1 and 2 of TPC	R5	end Sep-2014	SB
18	Align public sector's non-wage benefits with EU best practices	R5	end Sep-2014	SB
19	Adopt VAT reform to streamline rates and simplify administration	R5	end Oct-2014	SB
20	Adopt wage grid reform to become effective January 1, 2015	R5	end Oct-2014	SB
21	Adopt amendments to the Organic Budget Law	R5	end Oct-2014	SB
22	Adopt pension reform package based on actuarial studies completed in September on the whole pension system including supplementary and lump-sum funds	R5	end Nov-2014	SB
23	Adopt revisions to the government Chart of Accounts	R5	end Mar-2015	SB
	Structural benchmarks: Structural Reforms			
24	Government to complete the screening and cleaning of existing legislation covering the list of professions and economic activities covered in Annex II of KEPE's "Second Report on the Impact of Liberalizing Regulated Professions."	Request	end Dec-2012	NM
25	Ministry of Finance to produce a comprehensive list of nuisance taxes and levies, and eliminate them or transfer them (and the associated spending) to the central government budget	R1&R2 4/	end Sep-2013	NM

Table A1.3. Greece: Structural Conditionality (continued)

	Program conditions	Set	Target 2/	Status 2/
26	Adopt changes to the Code of Civil Procedure	R5	end May-2014	SB
27	Address recommendations of the OECD study on administrative burdens	R5	end Jun-2014	SB
28	Adopt legislation to align framework on collective dismissals with EU best practices	R5	end Oct-2014	SB
29	Adopt legislative changes to bring Greece's framework on industrial actions in line with EU best practice	R5	end Oct-2014	SB
30	Adopt legislation to address all identified issues in the follow-up OECD report on legislative barriers to competition in wholesale trade, manufacturing, telecommunications, and ecommerce	R5	end Nov-2014	SB
31	Adopt all secondary legislation on investment licensing law	R5	end Dec-2014	SB
	Structural benchmarks: Financial Sector			
32	A ministerial decree shall be issued to provide the technical details of the banks' recapitalization framework	Request 4/	end Mar-2012	NM
33	Bank of Greece to complete a strategic assessment of banks' business plans	Request	end Mar-2012	MD
34	Government to reform the governance of the BoG, to provide for collegial decision-making at the level of executives (Governor and Deputy Governors) and expanded internal oversight by nonexecutives of the existing General Council, and to revise the structure and rights of BoG shareholders to eliminate possible conflicts of interest in the Bank of Greece's public policy role	Request	end Dec-2012	MT
35	Hellenic Postbank to be resolved with the transfer of its good assets, all deposits and ECB/ELA financing to a core bank (via P&A), and weak assets to be left in a bad bank	R1&R2 4/	end Jan-2013	NM
36	All 4 core banks to meet the capital requirements set by the Bank of Greece	R1&R2	end Apr-2013	NM
37	Bank of Greece will complete an additional assessment of capital needs based on end-2012 data	Request	end Jun-2013	NM
38	Complete resolution of all undercapitalized or insolvent non-core banks	R1&R2	end Jun-2013	NM
39	Complete a comprehensive banking sector strategy	R3 4/	mid Jul-2013	NM
40	Banks to update their restructuring plans and submit them for validation by DG-Competition	R3	end Jul-2013	MD
41	Bank of Greece to complete a follow-up stress test for all banks based on end-June 2013 data, using a methodology designed in consultation with the EC, ECB, and the IMF, and to update banks' capital needs on this basis	R1&R2	end Dec-2013	MT

	Table A1.3. Greece: Structural Conditionality (concluded)			
	Program conditions	**Set**	**Target 2/**	**Status 2/**
42	Government to introduce a new Code of Conduct for banks	R5	end May-2014	SB
43	Government to enhance the personal and corporate insolvency framework	R5	end Oct-2014	SB

Sources: IMF MONA database and staff reports.

1/ Structural benchmarks (SBs) that were subsequently modified to prior actions (PAs) are classified as "not met". PAs from the EFF Program Request are indicated as "met on time" although they are noted as "proposed" in the respective staff report (Table 2, page 134).

2/ “MT” stands for “met on time”; “MD” – “met with delay”; “NM” – “not met”; “SB” – “outstanding at review completion”; “WV” – “waived”.

3/ Prior actions that were previously set as structural benchmarks.

4/ Structural benchmarks that have been converted to prior actions.

Statement by Mr. Psalidopoulos, Alternate Executive Director on Greece
February 6, 2017

The Greek authorities thank the mission teams for their hard work on the Article IV and EPE reports as well as the accompanying documents. They appreciate the candid dialogue with staff on a wide range of issues. Acknowledgments are also extended to the technical missions that are constantly in close touch in all relevant ministries in Greece, providing support and assistance on the spot.

The previous Article IV board meeting on Greece took place in May 2013. Due to the time that passed between that meeting and the one on February 6, 2017, the Greek authorities deemed necessary to address the Executive Board directly. Their notes are attached to this statement.

The following statement provides an overall assessment and background.

The Greek authorities agree in general with some of staff's findings. They have, however, a different view on how the Greek economy is developing. They particularly don't agree with staff's hypotheses and conclusions regarding the DSA (please see Minister Tsakalotos' statement below).

The Greek authorities remain committed to pursue policies in line with those agreed in the MoU signed with the Institutions in August 2015, in a way that will safeguard macroeconomic stability and growth and will assist the country to get back on a sustained and sustainable growth trajectory.

I. On the Article IV Report

Macroeconomic outlook

According to the most recent data, the Greek economy turned a corner in 2016: Q2 and has now shown two consecutive quarters of positive GDP growth. This fragile recovery was supported by the successful conclusion of the first review of the ESM program in May 2016 that strengthened confidence and was accompanied by the disbursement of €3.5 bn for arrears clearance that has injected liquidity into the real economy.

Real GDP, after falling in Q1 2016, rose by 0.4 percent q-o-q in Q2 and 0.8 percent q-o-q in Q3. For the first nine months of the year, growth was 0.2 percent and is estimated to reach 0.8 percent in 2016. Economic activity is being driven by private consumption and gross fixed capital formation

During the first nine months of 2016, **real exports of goods** increased by 7.6 percent, while real receipts from tourism decreased by 5.2 percent and receipts from shipping continued to decline.

Industrial Production increased in the January-November 2016 period (2.3 percent y-o-y), due mainly to the performance of manufacturing production (4.6 percent y-o-y).

Employment in the private sector registered a positive cumulative net balance of 136,260 new jobs in 2016, exceeding net inflows in 2015 by 36,560 new jobs. As a result of the increased net inflows, **dependent employment stock in the private sector** registered a 5.1 percent y-o-y increase in 2016. Job creation in 2016 continued to rely on **flexible forms of employment**, which accounted for 54.7 percent of new hirings.

Over recent years, **Greece has benefited significantly from improved competitiveness.** In part, this development reflects the effect of structural reforms in the labor market, allowing more flexibility in the process of wage bargaining. As a result, the cumulative loss in labor cost competitiveness recorded between 2000 and 2009 has been recovered.

Economic sentiment increased to a year high in December due to improved consumer confidence and more optimistic expectations in manufacturing and construction sectors.

Financial indicators – sovereign bond yields, yields on bonds issued by non-financial corporations and share prices – were volatile during 2016, reflecting investor concerns about the review process of the Greek program as well as about the prospects for economic activity. The decrease in volatility in international financial markets, during the July-October 2016 period, led to a significant decline in the volatility of the prices of Greek bonds and equities. Investor sentiment towards Greece significantly affected the market value of sovereign bonds and equities; sovereign yields fell after the conclusion of the first review. Currently, investor attention is focusing on the prospects for concluding the second review.

Openness has improved substantially and Greek exporters have managed to maintain, if not increase, their shares in world exports, despite adverse liquidity and financing conditions.

Qualitative indices reflecting the **business environment** suggest that Greece is still ranked relatively low. However, it is the country with some of the largest improvements in recent years. Policy is now focused on improving non-price competitiveness.

Deflationary pressures are still present but in the last months they have been overshadowed by indirect taxation increases. The recent increase in the special consumption tax on heating oil in October 2016 has already added further upward pressure on HICP inflation.

Looking forward, Greek authorities expect positive growth rates in 2017 and 2018 of the order of 2.5–3.0 percent supported by the expected amelioration of credit conditions and economic sentiment.

Risks to the projections: Downside risks exist and are related to delays in the conclusion of the second review of the program, the impact of increased taxation on economic activity and reform implementation. Some downside risks related to the international environment also exist, such as renewed pressures from the refugee crisis, increased uncertainty associated with forthcoming elections in several EU countries, the rise of protectionism worldwide and a slowdown in global trade. Upside risks are related to the inclusion of Greek sovereign debt in the ECB's quantitative easing program (QE).

Taking a **longer-term perspective**, the rebalancing of the Greek economy is on-going since a number of years. **Flow imbalances** have been eliminated with both the current account and fiscal balances being in equilibrium.

The reduction of these imbalances has come, however, at a **high cost**. Real GDP is now more than a quarter lower than its pre-crisis levels.

Additionally, large stock imbalances still remain. Unemployment, though falling, is high. The general government debt to GDP ratio has risen substantially – in 2009, it stood at 126.7 percent; it reached 177.4 percent at end-2015. Indebtedness of the private sector has generated significant NPLs which are hampering banks' ability to support recovery through the granting of new credit. Measures to deal with this problem have been legislated. Finally, a rebalancing between private consumption (which stands at 70 percent of GDP) and investment (11 percent of GDP) is required, if future growth is to prove more sustainable.

The Memorandum of Understanding (MoU)

The MoU signed between the Institutions and Greece on 19 August 2015 envisages ESM financing of up to €86 bn over the three years 2015-18.

The MoU places emphasis on four pillars: (i) the restoration of fiscal sustainability; (ii) the safeguarding of financial stability; (iii) the implementation of structural policies to enhance competitiveness and growth; and (iv) the modernization of the state and public administration.

In line with these pillars, most structural reforms agreed have already been legislated.

Following the legislation on 8 and 22 May 2016 on pension and income tax reform, indirect taxation, the NPL strategy, privatizations and an automatic contingent fiscal correction mechanism, agreed by the European Institutions and the IMF, the Eurogroup on 24 May 2016 agreed to a package of short-term debt measures to be phased in progressively and subject to the pre-defined conditionality of the ESM program, in order for making Greece's public debt and gross financing needs sustainable.

The agreement allowed the Board of Directors of the ESM to authorize the second tranche of €10.3 bn of ESM financial assistance. On 23 January 2017, **the ESM and EFSF Boards of Directors adopted the rules implementing a set of short-term debt relief measures for Greece**. The measures are designed to reduce interest rate risk for Greece, by, inter alia, exchanging some debt to fixed from floating rates, and to ease the country's repayment profile. The ESM estimated that the full implementation of short-term debt relief measures should lead to a cumulative reduction of Greece's debt-to-GDP ratio of around 20 percentage points (pps) until 2060, while the country's net financing needs are expected to decrease by 5 pps in that time.

The Eurogroup of 26 January 2017 welcomed the faster than expected recovery of the Greek economy as well as the strong dynamics on the fiscal side, with better than expected revenues. The Greek authorities and the Institutions were encouraged to conclude the second review which will support the positive trend in the economy.

Fiscal policy and management

The 2015 primary fiscal outcome (program definition) recorded a surplus of 0.25 percent of GDP, significantly outperforming the program target of -0.25 percent of GDP. The improvement compared to the previous year reflected mainly spending containment and, to a lesser extent, revenue over performance. Available data for 2016 indicate that **the outcome will outperform the program's target** for a primary balance of 0.5 percent of GDP by a large margin (the balance will be probably around 2 percent)

Banking sector

An effective management of the high stock of non-performing loans is already underway and will bear fruit in 2017 . Success in this regard would impact favorably on economic activity via two channels: a) by increasing bank loan supply; and b) by restructuring production. The decrease in non-performing loans would contribute to a reduction in banks' financial risk and lower their funding costs, while also boosting their capital adequacy. This, in turn, would lead to a gradual increase in loan supply and a decline in borrowing rates for businesses and households.

Structural reforms

The reforms implemented since 2015 are expected over the long term to boost the Greek economy's growth potential through faster productivity and employment growth.

According to the OECD, the reforms implemented in the period 2010-2016, in combination with the ones to be implemented as part of the current program, are expected, *ceteris paribus*, to increase real GDP by 13 percent over the next ten years. Similar analyses by the Bank of Greece indicate that structural reforms in the labor market leading to a permanent reduction of 10 percent in employers' wage costs are expected, over a 10-year horizon, to result in increases of 4.5 percent in real GDP, 3 percent in employment and 4.5 percent in private investment.

Conclusion

Based on the above-mentioned encouraging indications and estimates, it is safe to assume that the Greek economy has the potential to move onto a new and sounder growth path. The Greek authorities are determined and committed to implement the current program and avoid past mistakes and backsliding.

They call on the IMF to take stock of what has been achieved thus far, of the restrictions and limitations stemming from a 7-year ongoing Greek crisis and to stay engaged so that these achievements are not jeopardized.

Furthermore, at the current juncture, the Greek authorities are ready to proceed to the closing of the second review with the Institutions in order to sustain growth, participate in ECBs QE, lift capital controls and move toward sustainable growth.

II. On the Ex Post Evaluation of 2012-16 Program

The Greek authorities believe that despite its merits, the EPE study is short on accomplishments and long on missed opportunities. The Greek authorities hold the view that an approach that could distinguish between two distinct periods, 2012-mid 2014, mid 2014-August 2015 would have more lessons to teach for the success of future programs.

Despite the obstacles, the high cost of adjustment and the frequent setbacks, the economic adjustment programs implemented from 2010 onward, and the one from 2012 to 2016 in particular, which is the object of the particular report, succeeded to a large extent in reversing many of the prevailing adverse trends up to 2010 and in improving the economy's growth potential. More specifically, the following have been achieved:

- Unprecedented fiscal consolidation. Over the period 2013-16, the primary deficit was eliminated and, for the first time since 2001, general government primary surpluses were recorded. Moreover, the improvement in the "structural" primary budget balance by more than 17 percentage points of potential GDP between 2009 and 2016 was more than double the one achieved in other cases under similar programs.
- A recouping of the sizeable cumulative loss in labor cost competitiveness vis-à-vis Greece's trading partners between 2000 and 2009.
- An elimination of the external deficit, which exceeded 15 percent of GDP in 2008.
- An increase in the share of exports from 19 percent of GDP in 2009 to 32 percent today.
- A recapitalization and a restructuring of the banking system, enabling it to withstand the crisis and the flight of deposits, and ensuring that it now has adequate capital, provisions and collateral, i.e. that the necessary conditions are in place for the banking system to address the major problem of non-performing loans.

- A halting of the increase (and even a slight decrease) in the volume of non-performing loans in the second and third quarters of 2016, for the first time since 2014.
- Structural reforms, notably in the labor market, but also in the product markets and in public administration.
- A rebound of the economy in the second and third quarters of 2016, making it reasonable to anticipate a positive growth rate for the year as a whole, for the first time since 2014.

These stabilization policies inevitably came at an economic and social cost: a deepening of the recession, job and income losses. To some extent, these effects were to be expected, as with nearly every stabilization program implemented elsewhere in the world. In Greece though, the cost was, according to all estimates, higher. The causes have been discussed at length: no participant in these efforts stands uncorrected.

Factors that didn't allow the program to bring full results include shortcomings in the design of the programs, a misjudgment of the consequences, frequent course changes due to the absence of a unifying consensus and more. This consensus was finally materialized when in August 2015, 222 out of 300 members of parliament in Greece, belonging to five different political parties, voted Yes for the implementation of the MoU 2015-18.

Statement by the Minister of Finance Mr Euclid Tsakalotos

The Greek economy is currently moving from a state of prolonged economic crisis to a state of solid economic recovery. Following years of protracted recession, the first signs of robust growth, declining unemployment rate and increasing confidence in the economy have begun to appear and clear signs of changing winds are within reach. With the ESM economic adjustment programme in mid-way, the Greek Government has made significant progress to implement an ambitious and comprehensive reform programme, which will form the basis for a competitive economy in years to come. On top of this, recently agreed short-term debt relief measures will contribute significantly in reducing gross-financing needs and in making debt sustainable. It is, thus, certain, given the recent growth projections and fiscal over-performance being significantly better than expected, that economic stability and enhanced reform efforts are paying off. Against this background, the Staff Report for the 2016 Article IV consultation is welcomed; however, despite evidence and the analysis presented, we observe that the report fails to do justice in several areas, while many of the conclusions made are not consistent with recent and well-documented empirical evidence.

Firstly, the report presents an overall picture of reform effort not representative of the actual effort exerted by the Greek Government during the ESM programme. The implementation of structural reforms has accelerated significantly, particularly those of deep reforms such as the consolidation of social security funds into a single fund, the comprehensive pension reform, the establishment of an independent tax authority, several product market reforms (including significant progress in the introduction of OECD recommendations) and a wide-ranging privatisation programme. In contrast, the report cites a slowed reform momentum, which is not evident from what has already been done in fiscal policy, in the financial sector and in many areas of structural reforms.

A corollary to the misleading representation of reform-effort is the effect of structural reforms to economic growth not being duly accounted for in the Debt Sustainability Analysis (DSA). The renewed effort should, in principle, lead to increased potential growth in the future. Yet, the steady state of economic growth has been reduced in the DSA from 1.25 percent to 1 percent of GDP since the May 2016 DSA; this is a second consecutive reduction of growth projections. Given numerous legislated reforms since August 2015 and the successful conclusion of the first review of the ESM programme in June 2016 accompanied by the significant acceleration of reform effort which that entailed, reducing future economic growth as a response to more reforms is, by itself, an oxymoron.

Secondly, the fiscal outturn of 2015 and fiscal outcome of 2016 are significantly better than initially expected. IMF staff have projected a primary fiscal deficit of -0.5 percent of GDP in 2016 raising to 1.5 percent in 2018 with the current legislated measures. Preliminary indications show that the primary surplus for 2016 will be in the territory of 2 percent of GDP, instead, with the difference in estimated versus actual arising from the overly-pessimistic assumptions in the yield of the legislated measures. Despite the significant fiscal over-performance, the analysis does not proceed to a substantial revision of primary surpluses at 2018 and beyond, remaining at the projected level of 1.5 percent, despite overwhelming evidence for the opposite.

In addition to the need for fiscal revisions, the significant fiscal surplus in 2016 puts into question three important arguments made in the report. Most importantly, the argument that Greece cannot sustain high fiscal surpluses that surpass 1.5 percent of GDP is in contradiction to recent developments. Equally important, the gap in fiscal surplus estimates between the IMF and other institutions should be reduced, in light of the latest evidence on fiscal over-performance. Lastly, the results of the debt sustainability analysis are doubtful, since they rely neither on the most recent evidence of fiscal performance nor on the most up-to-date evidence on the ability of the Greek economy to produce fiscal surpluses.

Thirdly, the report argues for a growth-friendly policy-mix, but insufficient or misleading evidence is presented on the impact of the current policy mix and the effects of the proposed re-balancing. While we agree that the tax base should be widened, this should occur through the increase of tax compliance and not through a reduction in the tax credit. In making the argument for lower tax credit the report wrongly compares actual tax declarations in Greece with household budget survey data from other countries. The different unit comparison used without appropriate adjustment, produces misleading results. While, the household data used are compiled for individuals “leaving under the same roof”, in the Greek Income Tax Code only couples, couples with dependent minors, file taxes together, all other individuals file taxes separately, including minors with property or any type of income. Indicatively, the number of tax returns in 2016 has been above 6 million, corresponding to a population of 10.8 million, significantly less than the average household number. Similarly, the proposed re-balancing does not account for taxation in income from other sources or for effects on the tax wedge which will have a negative effect on competitiveness.

Several other gaps can be observed in the analysis in the policy-mix. For instance, in pensions, the report's analysis does not include the effects of the recent pension reform and consolidation of pension funds. Moreover, the data concerning state-transfers to the pension system for Greece include also the "official-statutory" contributions of the state (as part of the three-parties' contribution scheme), as well as the contribution of the state as employer of public servants plus the expenditure of certain welfare benefits. On the other hand, for other Member-States the state-transfers have been defined as the difference between the total amount of expenditures and contributions, resulting in completely incomparable figures. In addition, the adjustment due to the large GDP reduction and the unprecedented unemployment, which results in reduced contributions, are not taken into account in the analysis. Thus, a more thorough analysis of the economic, social and distributional impact is warranted to make such important re-balancing proposals credible.

Lastly, the DSA results rely on overly-pessimistic assumptions. Among many factors, the reduction in long-term growth from 1.25 percent to 1 percent of GDP despite numerous reforms, the decrease of steady state inflation to 1.9 percent instead of the 2 percent at ECB target, the increase of interest rates for external financing, the fiscal surpluses at 1.5 percent in the medium and long-term and the partial incorporation of short-term debt relief measures, all contribute to extremely negative results for debt sustainability. All in all, both recommendations in the report and assumptions in the DSA analysis are not in line with the most recent, evidence-based and pragmatic analysis of the Greek economy.

Statement by the Governor of the Bank of Greece Mr Yannis Stournaras[1]

On the Staff Report for the 2016 Article IV Consultation for Greece

This report is a useful account of economic developments in Greece since 2010. We agree with the thrust of the argument that Greece has achieved an impressive fiscal and current account adjustment. However, we disagree with certain of its findings regarding the adjustment of various components of aggregate demand such as exports, as well as supply, such as the shift of resources from non-tradable to tradeable sectors.

In addition, the report downplays the progress on the financial sector and is unduly pessimistic on its macroeconomic and fiscal projections, as well as on future financial developments, including banks' further needs for recapitalization. As the general government primary surplus of 2016 is likely to reach 2 percent of GDP compared to a target of 0.5 percent of GDP, the Fund's fiscal projections raise many questions. Likewise, despite the better than expected 2016 GDP outcome, which is acknowledged in the report, there is an

[1] Mr Stournaras is the Governor of the Bank of Greece, since June 2014.
He was Finance Minister from July 2012 until June 2014

unexplained 0.25 percent reduction in the long term growth projection compared to the previous Article IV Report. In general, it is not clear why long term TFP growth in Greece lags behind the rest of the euro area, despite the fact that there is still a lot of upside stemming from further structural reforms and catching up opportunities. As far as banks are concerned, the Fund assumes that they will need a further €10 billion capital buffer without explaining why this is the case. It should be reminded that according to the supervisors' assessment (ECB, SSM, Bank of Greece) the current CET1 ratio is 18 percent. Additionally, according to Bank of Greece estimates, the achievement of NPLs medium term targets will further increase the CET1 ratio substantially.

All of the above lead to the conclusion that the Fund's long term projections seem to have incorporated only substantial downside risks rather than being a baseline scenario.

On the Ex-Post Evaluation of Exceptional Access under the 2012 Extended Arrangement

This report contains very useful information for the period it examines regarding economic, fiscal and financial developments. It also contains useful conclusions and lessons for the future such as the need for less severe financing constraints, upfront debt relief measures, stronger ownership of the programme by the authorities, better cooperation and coordination among the institutions, a smaller number of milestones when reviewing the programme's implementation etc.

However, at its present form, it misses the opportunity to be fair to history since it criticizes everybody else except the IMF. As far as this point is concerned, being Finance Minister between July 2012 and June 2014, I can confirm that during this period

(a) the IMF pressed for more and more parametric fiscal policy (austerity) measures ignoring even its own research regarding the size of fiscal multipliers and tax buoyancy, thus consistently underestimating progress in the reduction of the primary general government deficit,

(b) the IMF is partly responsible for delays in closing the 2013 review since it was unjustifiably (given the final outcome) asking for additional parametric fiscal policy measures even when it was more than clear that 2013 fiscal developments were pointing to a primary surplus large over-performance,

(c) the IMF insisted on additional recapitalization of banks disregarding the views of the authorities, the Bank of Greece and the ECB, and it turned out that it grossly overestimated capital needs and underestimated the impact to the economy of excess bank capital,

(d) the IMF consistently played down the progress on structural reforms, ignoring, among others, OECD's assessments (see, for instance, "Going for Growth" OECD Reports).

In addition, the repeated references that the authorities preferred an upfront-loaded fiscal programme are not correct (they are actually misleading). The IMF repeatedly ignored the cyclically adjusted primary surplus (or deficit) as a relevant fiscal target, by not taking into account its own Fiscal Monitoring Report, and insisted that financing constraints cannot accommodate for this. Hence, instead of referring misleadingly to the authorities' preferences, it would have been much more accurate to say that financing constraints (and the lack of upfront debt relief) determined fiscal targets.