INTERNATIONAL MONETARY FUND

Greece: Staff Concluding Statement of the 2019 Article IV Mission

September 27, 2019

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

The new government inherited a tepid economic recovery, one weighed down by crisis legacies and across-the-board policy reversals since program exit that further raised fiscal, financial, and external vulnerabilities. While the government has made a promising start in unblocking structural reforms and privatizations and is advancing the clean-up of bank balance sheets, a stronger effort in all policy areas is urgently needed if Greece is to become competitive within the currency union, eliminate the debt overhang, and achieve more inclusive growth.

1. **The new government is rightly prioritizing growth but faces an uphill battle.** Per capita income remains below pre-Euro Area accession levels, reflecting significant crisis legacies (high public debt, high non-performing loans, over-indebted borrowers), low productivity, a dearth of investment, a weak payment culture, and adverse demographics. Prospects were further dampened by what became a broad-based policy retreat following program exit in August 2018, with program-era reforms put on hold (e.g., fiscal structural reforms), canceled (e.g., the pre-legislated pension and personal income tax (PIT) reform packages), or reversed (e.g., key elements of the 2011-13 labor reforms and efforts to broaden the tax base and strengthen the payment culture).

2. **Growth is expected to be around 2 percent in 2019 and 2020.** Near-term growth is benefiting from a cyclical recovery and improved market and consumer sentiment, which should translate into higher investment. Still, with long-term growth projected at 0.9 percent, it will take another decade and a half for real per-capita incomes to reach pre-crisis levels. Public debt-to-GDP is projected to trend down over the next decade with relatively low

liquidity risks in the medium-term, though long-term sustainability is not assured under realistic macro assumptions. Still-weak banks dampen growth prospects and pose significant fiscal and financial stability risks. These and other factors leave Greece vulnerable to a range of external and domestic shocks. Considering Greece's cyclical position and desirable policies in the medium term, staff assesses there is a substantial overvaluation of the real effective exchange rate. In this context, the new government should use its political mandate and improving investor sentiment to deploy a full range of policy tools and overcome long-standing vested interests, aiming to push long-term growth meaningfully above current projections.

3. **Fixing the banking sector, currently a misfiring engine of growth, is a top priority.** The government's goal of achieving single-digit non-performing exposures ratios by mid-2022 goes in the right direction and the proposed 'Hercules' asset protection scheme could provide significant support (though important details have yet to emerge). However, to fully restore asset quality, along with the quality and levels of bank capital, liquidity, and profitability, the new government should develop a more comprehensive, ambitious, and well-coordinated strategy. These efforts should be primarily market-based, with any public support subject to a dynamic cost-benefit analysis, and supported by further improvements in the legal framework (e.g., more efficient judicial processes and modernization of the insolvency regime). Residential mortgage protection and ad hoc tax and social security installment schemes have prevented meaningful debt restructuring and undermined the payment culture and should be permanently phased out.

4. **Reducing fiscal targets would support the economic and social recovery.** The 2019 fiscal primary surplus is expected to be in line with Greece's 3.5 percent of GDP commitment to European partners—though once again depending on growth-dampening under-execution of public investment. For 2020, staff recommends that the government and European partners build consensus around a lower primary balance path, given ample economic slack and critical unmet social spending and investment needs, and to accommodate spending that would create synergies with stepped-up structural reforms.

5. **The fiscal policy mix should be rebalanced to strengthen growth and social inclusion.** Plans to cut direct tax rates and strengthen compliance are welcome but more could be achieved by broadening the tax base. Greece remains near the EU bottom in terms of the share of workers paying personal income taxes and has one of the largest VAT compliance gaps. Relative to the rest of the EU, too much goes to pensions and the government wage bill, and too little to other social spending. To address critical needs, Greece should significantly scale up social spending (e.g., the means-tested guaranteed minimum income and public health) and investment. To free up fiscal space, pension benefits of existing retirees should be calculated in line with the new benefit formula (and the recent restoration of pre-crisis 'pension bonuses' should be reversed). Accelerating public financial management reforms will help better execute the public investment budget, enhance budget control, and strengthen risk management (including from ongoing court cases), while

continued efforts are needed to strengthen the Independent Authority of Public Revenue and mobilize the Anti-Money Laundering framework to combat tax evasion.

6. **The new government deserves credit for unblocking privatization and pushing through business deregulation and digitalization, but much of the needed structural transformation of the Greek economy still lies ahead.** The economy remains over-regulated and dominated by small and medium-sized enterprises operating in an unwelcoming business climate, and Greece is at or near the bottom of the EA in many cross-country surveys. More is needed to de facto liberalize product markets and closed professions and strengthen competition.

7. **The recent labor market proposals from the government deserve support, though more is needed to support higher employment, growth, and competitiveness**. Staff supports recent legislation to lift new restrictions on dismissals and the intention to limit unilateral appeals to arbitration. Plans to introduce an opt-out mechanism from collective bargaining go in the right direction but should aim at full restoration of the 2011-13 landmark labor reforms. Reducing non-wage costs, linking the adjustment of minimum wages to productivity growth, strengthening active labor market policies, and removing bottlenecks to female labor force participation will be essential to address hysteresis, poverty (including in-work), and social exclusion.

The mission is grateful to the authorities for the constructive discussions.