Greece: Priorities for a Return to Sustainable Growth

Greece has succeeded in reining in its fiscal and current account deficit, but the deficit of the pension system remains at a record high (Photo: Keith Levit/Newscom)

February 7, 2017

Greece should deepen and accelerate reforms, which, together with further debt relief, are needed to allow the economy to return to a sustainable growth path, the IMF said in its latest annual assessment of the Greek economy.

The IMF's Article IV report notes that the country has made progress in reining in its fiscal and external deficits, although this has taken a heavy toll on society. The report identifies a path to sustainable growth and prosperity that requires a two-pronged approach: ambitious policies on the part of the Greek authorities and significant debt relief on the part of Greece's European partners.

The Q&A below highlights some of the key issues about the country's progress and its reform priorities for the period ahead.

Related Links

IMF News: ***Greece had its last Article IV Consultation in mid-2013. How have the Greek economy and policies evolved since then?***

Greece reduced its fiscal and current account deficits significantly since the onset of the crisis. In particular, the fiscal primary and current account deficits declined from 11 and 15 percent of GDP, respectively, to around zero at the end of 2015. This is an impressive adjustment for a country that is part of a currency union and does not have access to monetary and exchange rate policy tools.

But extensive fiscal consolidation and internal devaluation have come with substantial costs for society. The unemployment rate is still unacceptably high at 23 percent (October 2016), and Greece has suffered a prolonged recession, with output 25 percent below its pre-crisis level. The high societal costs have weakened support for ongoing reforms.

The government renewed its reform effort since mid-2015 with a new adjustment program supported by the European Stability Mechanism. Specifically, they legislated a number of important fiscal (e.g. pensions, VAT, income tax), financial (e.g. insolvency legislation, nonperforming loan servicing and sales loans, bank governance) and structural reforms (e.g. privatization, actions to facilitate competition in key sectors). So, in all, there have been some setbacks but also some progress since the last Article IV consultation.

IMF News: ***Greece now has a new set of policies in place. Are these reforms sufficient for Greece to embark on a sustained recovery?***

While Greece has recently made progress with carrying out reforms, challenges remain**.** In particular, fiscal policies are still not conducive to growth. Half of wage earners are exempt from personal income tax, while the deficit of the pension system remains at a record high (10.5 percent of GDP, almost four times as high as the euro-area average). At the same time, overdue bank loans make up 45 percent of total loans and unpaid taxes to the state amount to 70 percent of GDP. As a result, investment and growth remain weak. For Greece to return to sustainable growth and exit successfully from official financing, it needs to deepen and accelerate reforms.

IMF News: ***The report mentions that fiscal policies are not growth-friendly. What policies does the IMF recommend?***

Greece does not require further austerity at this time (see recent blog). Accounting for ongoing reforms, Greece is expected to achieve a primary fiscal surplus of 1.5 percent of GDP over the medium and long term. Greece does not need to run a higher primary surplus than that.

But if Greece decides aim for a fiscal surplus higher than 1.5 percent of GDP, it needs to show how it can credibly achieve this higher target. In this case, additional structural reforms will be needed. However, these reforms should be implemented only once the recovery is well underway.

Regardless of fiscal target, Greece should seek more growth-friendly and equitable policies. Specifically, Greece needs to broaden its personal income tax bases to allow for a more equitable distribution of the tax burden. The revenue this would generate can be used to reduce the high tax rates that are now sending jobs into the informal economy or to neighboring countries. At the same time, further pension reforms are needed to improve the viability of the system and allow for a better and more targeted welfare system to protect those who are most vulnerable.

Greece also needs to address tax evasion and the large tax debt owed to the state by restructuring tax debt for viable taxpayers based on their capacity to pay, and by strengthening enforcement for those who can afford to pay but choose not to do so. The full establishment of the new independent revenue agency will be critical in this regard.

IMF News: ***You also mentioned that the financial sector is still burdened by very high nonperforming loan ratios. What can Greece do to address this issue?***

Nonperforming loans should be reduced rapidly and decisively to allow for a resumption of credit and growth. As long as banks' balance sheets remain burdened by such nonperforming loans, they will be unable to direct resources to the more productive parts of the economy. Addressing this problem requires the full implementation of the debt restructuring legal framework, with stronger enforcement and an out-of-court mechanism to deal with both bank and tax debt.

At the same time, supervisory tools need to be strengthened to provide incentives to banks to reduce their nonperforming loan stock. Finally, bank governance needs to be further strengthened and capital controls eliminated as soon as prudently possible, while preserving financial stability.

IMF News: ***Any other reforms that the IMF recommends to support growth?***

Labor and product market reforms are essential to support Greece's long-term growth potential. The labor market reforms of 2011 helped improve the labor-cost competitiveness of the country. However, lagging implementation of product market reforms means that, so far, wage-earners have been bearing the burden of adjustment. But it would be wrong to conclude that Greece should return to the previous, less flexible labor market framework. Instead, existing reforms should be complemented with measures to bring the collective dismissal and industrial action rules in line with best practices and with more decisive efforts to open up remaining closed professions and remove barriers to competition and investment.

IMF News: ***Can we conclude that with these reforms, Greece will finally overcome the deep downturn and return to growth and prosperity?***

Even with full implementation of these policies, Greece cannot grow out of its debt problem. European partners need to provide further debt relief, in addition to the generous relief provided thus far, to put Greece's debt on a sustainable downward path. This need not involve an upfront haircut and could include instead further extensions of maturity and grace periods, as well as fixing the interest rate on Greece's official loans to ensure that interest costs remain manageable as global interest rates normalize.

But debt relief alone is also not sufficient to address Greece's policy challenges. This is why a two-pronged approach is required for Greece to return to sustainable growth and prosperity: ambitious policies on the part of the Greek authorities and ambitious debt relief on the part of Greece's European partners.