Achieving an inclusive and sustainable recovery in Greece

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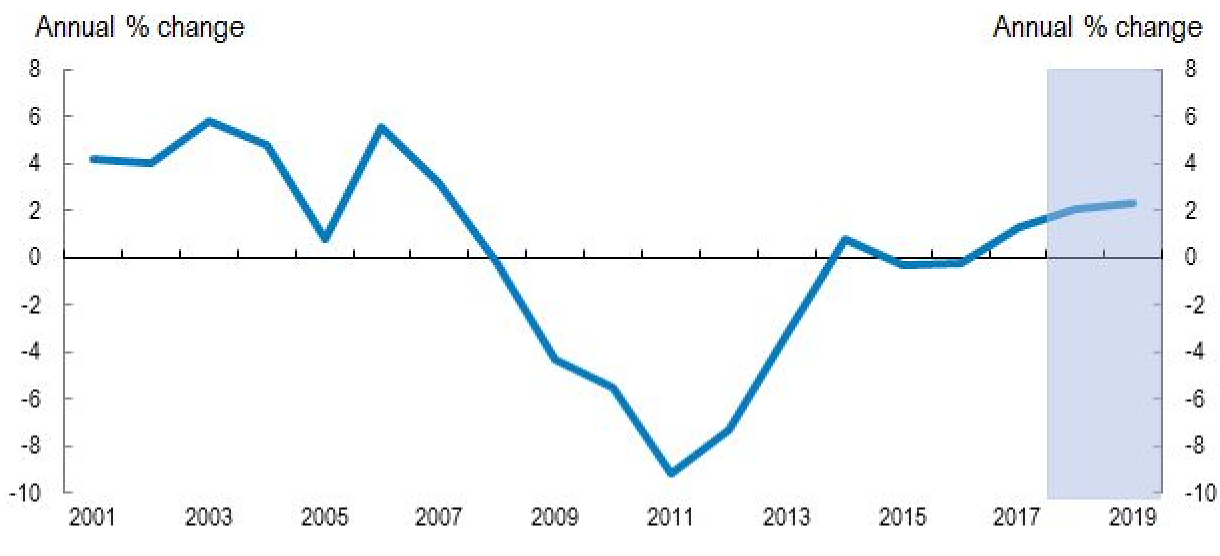
Greece is finally recovering from a deep depression. In 2017 GDP expanded by 1.3%, according to initial estimates, and is projected to accelerate to 2% in 2018 and 2.3% in 2019 (Figure 1). Labour market reforms have improved competitiveness and exports are leading the expansion. Overall the economy is becoming more open. Exports rose from 24% of GDP in 2008 to 34% in 2017. Employment is rising strongly while the external and fiscal imbalances are being addressed. Public finances are outperforming European Stability Mechanism (ESM) Stability Support programme's targets, helping to restore fiscal credibility. Financial markets are taking notice, with bond spreads falling and agencies upgrading their ratings of Greece's public debt.

Figure 1. The economy is recovering



Source: OECD (2018), OECD Economic Outlook: Statistics and Projections (database).

Despite these positive developments, the long crisis has left deep scars in the society that have yet to heal. GDP per capita is still 25% below its pre-crisis level. The public debt is still high. Wages are low. Though poverty has stabilised, it remains near a record high, especially among the young and families.

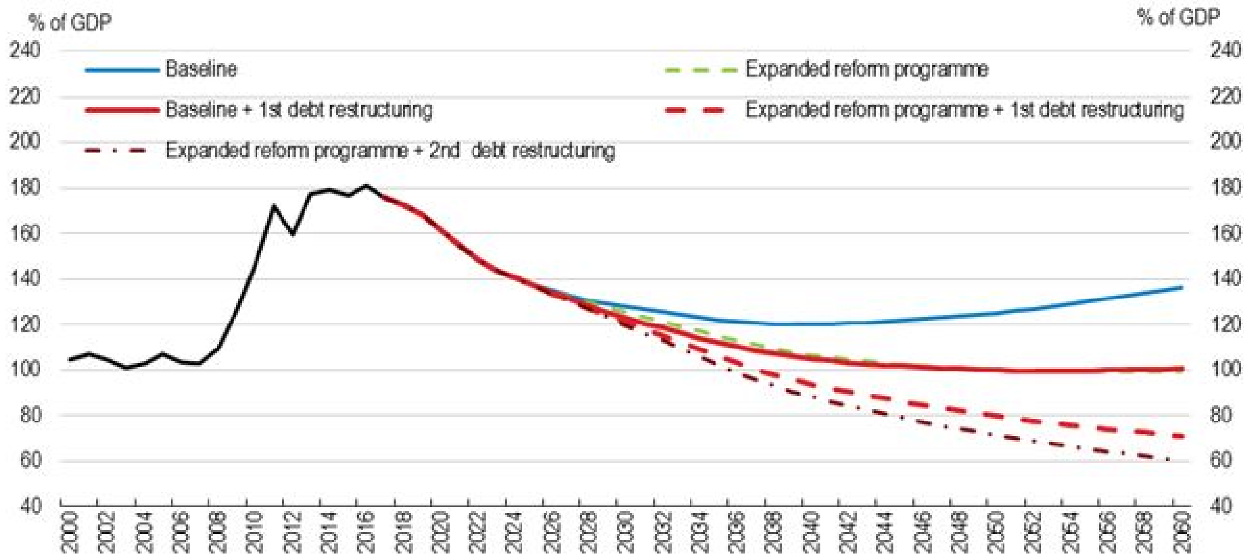
The OECD's 2018 Economic Survey of Greece suggests that maintaining the reform momentum and strengthening reform ownership will be essential to sustaining the recovery and moving towards a more inclusive and prosperous society. Keeping the reform momentum is crucial to tackle the three key challenges highlighted in the 2018 Survey: Improving debt sustainability, sustaining job growth and reducing poverty, boosting investment.

The public debt has stabilised but at about 175% of GDP is still one of the largest in the world. A three-pronged strategy would place this on a downward path for the long-term (Figure 2). This includes: additional pro-growth reforms; large but realistic primary surpluses; and additional debt restructuring, as needed:

- Pro-growth reforms, focusing on improving the functioning of public administration and product markets as well as boosting labour force participation, will do most to bolster long term GDP growth.
- Maintaining the primary surplus above 2% of GDP into the long-term will be challenging but can be achieved through further broadening the tax base – by improving tax collection and reducing the informal economy – and improving spending effectiveness – by using spending reviews regularly and continuing the ambitious public administration reform.
- As concerns debt restructuring, locking-in the currently low interest rates on concessional loans would reduce public debt below 80% of GDP by the 2050s, under prudent assumptions, if combined with additional pro-growth

reforms.

Figure 2. Pro-growth reforms, high but realistic primary surplus and appropriate debt restructuring will reduce the debt ratio



Note: The historical data and projections to 2019 follow the Economic Outlook No. 102 and updates (for the forecast). In all scenarios, the primary budget surplus is projected to be 3.5% of GDP until 2022, then decrease to 2.2% of GDP by 2025 and remain at that level. The GDP deflator growth is expected to gradually rise to 2% by 2023. The effective market interest rate is projected to gradually rise to 5.3% by 2029. The effective interest rate of official creditors' loans (EFSF, ESM and GLF) is projected to rise to 4.2% by 2029. The baseline assumes the near-complete implementation of the current reform programme (Table 6); this raises annual real GDP growth to average 1.7% from 2020 to 2029, slowing to 1.3% over 2030 to 2039, then to 1% over the subsequent period, largely due to demographic factors. The 'Expanded reform programme' assumes implementation of the current and additional reforms (Table 6). This raises average growth rates to 2.2% by 2027, before gradually slowing after 2031 to 1.4% by 2043. In the 1st debt restructuring scenario the effective interest rates of official creditors' loans is fixed at 2% from 2020 onwards. In the 2nd debt restructuring scenario the effective interest rates of official creditors' loans is fixed at 2% from 2020 onwards and the EFSF repayments are postponed until 2031. The projections consider the short-term relief measures described in the May 2016 and June 2017 Eurogroup statements. These include: smoothening the EFSF repayment profile under the current maximum weighted average maturity; waiving the step-up interest rate margin on the EFSF debt-buyback tranche for 2017; diversifying the ESM funding strategy to reduce interest rate risk (the ESM has started implementing this measure through interest rate swaps; these projections assume that this measure will set the interest rate of EUR 50 billion in EFSF loans to 1.6% for 34 years). All scenarios include privatisation receipts of EUR 10 billion in total from 2020 to 2040.

Source: Calculations based on OECD (2017), OECD Economic Outlook: Statistics and Projections (database).

For Greece's recovery to be inclusive, it must be rich in jobs. Greece's recent labour market reforms have improved flexibility and supported job creation. However, over 1 million people are still unemployed, three-quarters for over a year. New jobs often pay the minimum wage, and are part-time or temporary. Reintroducing sectoral collective wage agreements should aim at maintaining the flexibility of the current system, ensuring wages align with productivity and better protecting individuals from labour market risks. They should cover broad working conditions and have no automatic extensions. Since small firms employ most workers, wage agreements need also to be flexible enough to take into account their specific circumstances.

The number of Greeks suffering from poverty doubled between 2010 and 2016, to almost 2.4 million on some measures, harming families with children the most. Recent reforms have already started to address this problem by better targeting social programmes. However, the many small and poorly targeted programmes and cumbersome administrative processes lower the effectiveness of and access to the welfare system. Progress towards better targeting social programmes and simplifying administrative processes should continue so as to create a fairer and more effective welfare system.

Investment has dropped by 60% since the onset of the crisis and has yet to recover, because of a mixture of weak demand, tight financial conditions and structural problems. The productive stock capital is now falling, dragging down GDP growth.

Recent reforms have already improved important areas of the investment climate, but Greece’s business environment still lags other countries. Further addressing product market restrictions, improving regulatory quality and transparency through Regulatory Impact Assessments, completing the land registry, and fully implementing the legislated insolvency reforms are priorities the OECD survey highlights.

Greece also needs to continue tackling the challenges facing its banking sector. Governance standards have improved drastically but these still need to become entrenched practices. Addressing the large stock of non-performing loans will require fully implementing out-of-court workout procedures and e-auctions, and strengthening temporary tax incentives to encourage the disposal of banks’ non-performing loans. Carefully phasing out capital controls, while preserving financial stability, will also be needed to restore access to finance.

References:

OCDE (2018) OECD Economic Surveys: Greece 2018 OECD Publishing.