EUROPEAN PARLIAMENT

DIRECTORATE GENERAL FOR INTERNAL POLICIES
ECONOMIC GOVERNANCE SUPPORT UNIT (EGOV)

Committee study on the

The Troika and financial assistance in the euro area: successes and failures

Study on the request of the
Economic and Monetary Affairs Committee

February 2014

The Troika and financial assistance in the euro area: successes and failures

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Abstract

This study provides a systematic evaluation of financial assistance for Greece, Ireland, Portugal and Cyprus. All four programmes, and in particular the Greek one, are very large financially compared to previous international programmes because macroeconomic imbalances and the loss of price competitiveness that accumulated prior to the programmes were exceptional. Yet programmes were based on far too optimistic assumptions about adjustment and recovery in Greece and Portugal. In all four countries, unemployment increased much more significantly than expected. Although fiscal targets were broadly respected, debt-to-GDP ratios ballooned in excess of expectations due to sharp GDP contraction. The GDP deterioration was due to four factors: larger-than-expected fiscal multipliers, a poorer external environment, including an open discussion about euro area break-up, an underestimation of the initial challenge and the weakness of administrative systems and of political ownership. The focus of surveillance of conditionality evolved from fiscal consolidation to growth-enhancing structural measures. The Greek programme is the least successful one. Ireland successfully ended the programme in December 2013, but problems remain in the banking system. Exit from the Portuguese programme in May 2014 appears feasible but it should be accompanied by a precautionary credit line. It is too early to make pronouncements on the Cypriot programme, which only started in May 2013, but it can safely be said that there have been major collective failures of both national and EU institutions in the run-up of the programme.

This policy note was requested by the European Parliament's Economic and Monetary Affairs Committee.

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LANGUAGE VERSION

Original: EN

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Economic Governance Support Unit provides in-house and external expertise to support EP committees and other parliamentary bodies in playing an effective role within the European Union framework for coordination and surveillance of economic and fiscal policies.
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This document is also available on Economic and Monetary Affairs Committee homepage, under section European Semester and Economic Dialogue at:
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Manuscript completed in February 2014.

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Executive Summary

The key findings of the report can be summarised as follows:

- A horizontal analysis of the programmes reveals that in all cases, and in particular the Greek one, the financial envelope of the programme has been very large compared to, for example, major programmes in the Latin American crisis or the Asian crisis. The size of the programmes reflects the magnitude of the imbalances that had built up in the pre-crisis period.

- There are different ways to assess programmes. The first is to judge whether programmes are successful in creating the conditions for regaining market access. From this viewpoint, the Irish programme is successful since the country was able to make a full exit from the programme at the scheduled time, in December 2013, and issue debt at favourable rates. The Portuguese programme is generally judged at the moment (in January 2014) by financial markets to be on track for success when it expires in May. However, there are some lingering doubts because of the structural weakness of an economy that even during the boom years for peripheral countries generated only anaemic growth. The Greek programme cannot be judged as successful at this stage. Not only was the first programme discontinued and replaced by a second programme after a haircut on privately-held government debt, but there is widespread doubt that the country will be able to regain market access without some form of write-down of its publicly-held debt. As far as Cyprus is concerned, it is obviously too early to judge if and how it will be able to regain market access at the end of the programme, in May 2016.

- A second way to assess programmes is to examine to what extent their conditions have been met. Economic adjustment programmes in the euro area involve three types of conditionality: fiscal measures aimed at reducing public debts and deficits; financial measures to restore the health of the financial sector; and structural reforms to enhance competitiveness. All four countries have by-and-large adopted the fiscal consolidation measures prescribed by the Troika. However, debt-to-GDP levels increased more than originally foreseen. This was mostly due to the larger-than-expected fall in economic output. A combination of factors is responsible for this substantial error in judgement: (a) the larger-than-expected fiscal multipliers, (b) the unexpected deterioration in the external environment, including an open discussion about euro area break-up undermining investor confidence, (c) an over-optimistic assessment of the initial conditions, (d) an underestimation of the weakness of some administrative systems and a lack of political ownership. To disentangle the effect of these different factors empirically is difficult. The four programme countries have also implemented the measures that aimed to restore the health of their financial sectors, but the process is not over yet, including in Ireland. The situation in terms of growth-enhancing structural reforms is more complex. Here the four countries divide into two groups. Ireland, and Cyprus to some extent, already enjoyed fairly healthy structural conditions before the crisis. Hence structural reforms are less important in these countries than the need to change their growth models by reducing the importance of the financial sector. Both Greece and Portugal, meanwhile, had already suffered from weak structural conditions for a long time. They implemented reforms but it is difficult to assess whether these reforms are sufficient. Certainly, time is needed to make reforms effective.

- A third criterion by which to judge programmes is to compare expectations and outcomes for a number of macroeconomic indicators, for which expectations are the projections contained in the programme and outcomes are the actual levels since the start of the programme. In Greece, Ireland and Portugal (we leave Cyprus aside since it is too early to look at outcomes), the fall in domestic demand was bigger than anticipated and, as a result, unemployment increased by much more than anticipated. Imports also fell by more than expected in Greece and Portugal, though they actually increased in Ireland. At the same time, the current account deficit improved more than originally forecast. By contrast, export performance was better than anticipated. Altogether, therefore, the trade balance and the current account improved better and faster than expected.

- The report also presents an innovative approach to quantitatively gauge some specific aspects of conditionality. The European Commission documents for the four financial assistance programmes cumulatively exceed 4000 pages in length, and therefore the terms of conditionality are difficult to summarise. We assess the change of the conditionality focus by observing the relative frequency of different terms and their evolution over time. This exercise confirms Pisani-Ferry, Sapir and Wolff (2013) previous finding that conditionality had become more detailed in Greece over time, while in the other programmes the level of detail stayed broadly constant. Fiscal conditionality was emphasised in Greece at the beginning of the programme, but then attention was increasingly devoted to reforms and addressing employment issues. Privatisation's rise to prominence as a central issue of Greek conditionality is identified, in line with previous findings (Pisani-Ferry, Sapir and Wolff; 2013). Fiscal discussions were very prominent at the beginning of the Irish programme, but became less so in the following years. In Portugal, structural reforms were at the core of conditionality at the beginning of the programme but eventually became less important, while fiscal conditionality increased its prominence. Finally, issues of poverty, fairness, and inequality rarely feature in any of the programme documents.

To conclude, with the improvement of the economic climate in the euro area and Ireland's successful programme exit, both market and political sentiment has become more optimistic about the possibility that the other programme countries, and certainly Portugal and Cyprus, will be able to exit assistance when their turn comes. The current mood, which tends to focus on exit as a measure of success, is understandable, but should be partly resisted. It is understandable because politicians in programme countries, in euro-area partners and in European institutions, are naturally rejoicing about the good news which comes after much bad news and before the European and also some national elections. But it should be resisted because many problems remain, even if countries succeed in exiting their programmes. In particular, unemployment rates and (private and public) debt levels are still very high. Growth prospects are still unsatisfactory and far too weak to address the unemployment challenge. Greece is in the worst situation with unemployment at more than 25 percent and public debt at 175 percent of GDP, but the other three countries, with unemployment at about 15 percent and public debt at about 120 percent of GDP, are also not faring well.

High (private and public) debt levels and generally weak growth determinants in programme countries, a fragile global economy, disinflationary tendencies in the EU and the remaining banking problems, suggest that caution should be exercised when considering future exits. Certainly weak structural conditions in Portugal are concerning and indicate that the country should not opt for a clean exit from its programme in May. At the very least it should request a precautionary credit line as a way of insuring against future risks. In the case of Greece, it is hard to see how the country could exit from its programme at the end of this year without some form of further debt relief and an accompanying framework to improve the structural drivers of growth. Finally, the situation of Cyprus may be closer to that of Ireland, owing to its good structural conditions, though exiting from capital controls will be a challenge that will require the structural weaknesses in the banking system to be addressed and ECB acceptance of major liquidity support.

1 Introduction

Almost four years ago, in May 2010, Greece became the first euro-area country to receive financial assistance from the European Union and the International Monetary Fund. The financial assistance was combined with a commitment to implement an economic adjustment programme that was designed in discussions between the national authorities and the so-called Troika, consisting of the European Commission, the European Central Bank and the International Monetary Fund. On 21 November 2010, Ireland became the second euro-area country to request financial assistance, followed by Portugal in April 2011. Roughly two years later, in March 2013, Cyprus also applied for financial assistance.

In May 2013, Pisani-Ferry, Sapir and Wolff (2013) published a comprehensive assessment of the programmes in Greece, Ireland and Portugal. The study also compared the three programmes with other IMF programmes, including those in other regions of the world. The study concluded with a detailed discussion of the institutional set-up of financial assistance and called for the Troika to be abolished in the medium run. Pisani-Ferry, Sapir and Wolff (2013) recommended that the tasks of the European Commission be transferred to a European Monetary Fund, which could emerge as a successor institution to the European Stability Mechanism (ESM), under European Union law. The advantage would be that funding and conditionality instruments would be combined in one institution, while the Commission would be liberated from its ambiguous role as both guardian of the Treaty and agent of the Eurogroup in the Troika. Pisani-Ferry, Sapir and Wolff (2013) also emphasised that the role of the European Central Bank should be reduced to that of a silent partner, because the potential conflicts of interest are substantial. Finally, it was argued that the IMF's know-how was still needed in Europe, but that the Washington-based institution should be less involved in the future.

In December 2013, the European Parliament invited Bruegel to produce a policy note for the Economic Dialogue with the Chair of the Eurogroup on the euro-area programme countries. In particular, we were asked to prepare an updated assessment of financial assistance and conditionality in Greece, Ireland, Portugal and Cyprus. Institutional questions are not to be further analysed in this report.

This report draws on Pisani-Ferry, Sapir and Wolff (2013) and updates its findings with newly available data. Since the preparation of the 2013 assessment, there have been two major developments. First, Ireland exited the financial assistance programme in December 2013: it was the first euro-area country to successfully complete a macroeconomic adjustment programme and return to the financial markets for funding. This report therefore discusses at length the exit of Ireland from financial assistance and the risk outlook. Second, Cyprus agreed to a financial assistance programme in May 2013, but its entry into the programme occurred in a very special and controversial way, triggering major controversies. We scrutinise in detail the initial decision to impose losses on insured bank depositors in Cyprus, and the later decision to introduce capital controls. Finally, discussions about a potential exit of Portugal from the financial assistance programme have intensified in recent months, and this report discusses the risks involved in this operation.

An analysis of the programmes faces numerous methodological challenges, as articulated in detail by Pisani-Ferry, Sapir and Wolff (2013). The most significant is the absence of a clear counterfactual. Financial assistance in the euro area is unprecedented – it is the first substantial incidence of assistance within a monetary union. The Economic and Monetary Union (EMU) determined not only the conditions at the start of the programme, as the severe imbalances were largely endogenous to the way the common currency was constructed, but also the performance of the programmes in the course of the last four years.

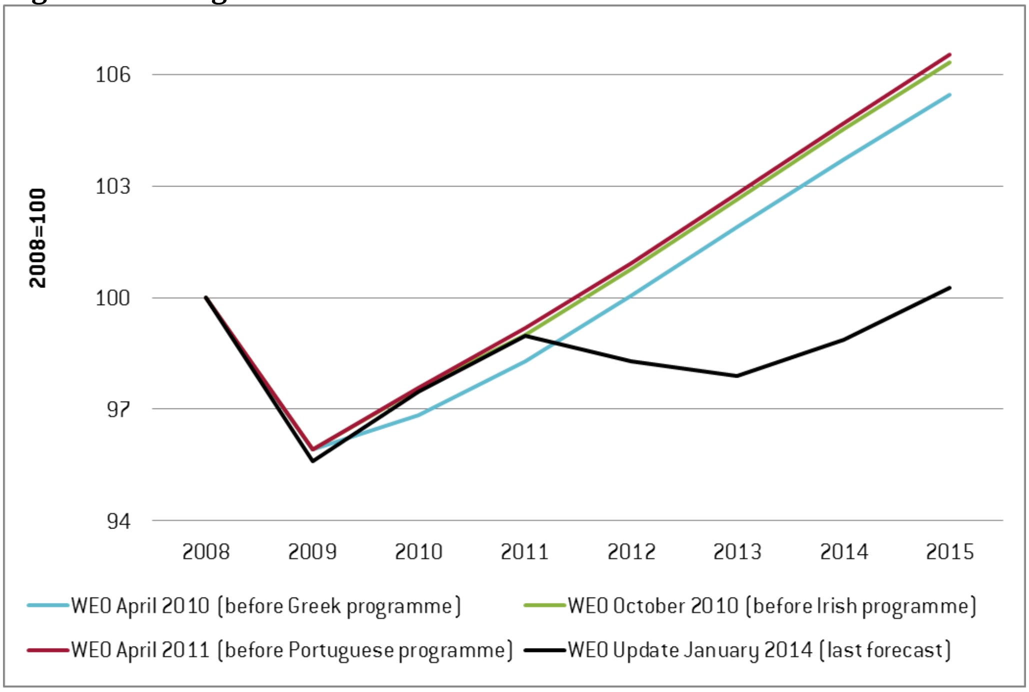
The rest of this policy note will be organised as follows: section 2 will give a brief overview of the macroeconomic and financial context in which euro area programmes were conducted, section 3 will analyse key aspects of conditionality across countries, while section 4 will offer an in-depth country-specific analysis of the adjustment programmes. Section 5 will then offer some concluding remarks.

2 A comparative look at the four programmes

An evaluation of the four euro area financial assistance programmes should be based on a number of methodological issues that are discussed in detail in Pisani-Ferry, Sapir, Wolff (2013). These include forecast errors, changing programme assumptions, policy decisions taken in the programme countries without intervention of the Troika and different degrees of programme implementation. A further important factor is the external growth environment, which arguably is largely outside the control of the Troika.

Figure 1 shows how the IMF growth forecasts for the euro area changed between 2010 and 2014. While at the beginning of the Greek programme forecasts of euro area GDP were broadly appropriate, during the period 2012-14, euro area growth was far below initial expectations. To the extent that financial assistance programmes were counting on the recovery in the euro area to support growth in the programme countries, those bets were disappointed – a responsibility outside the programme countries and the Troika. Adjustment in a contractionary environment proved to be a daunting task.

Figure 1: Changes of the IMF forecast for euro-area GDP between 2010 and 2014



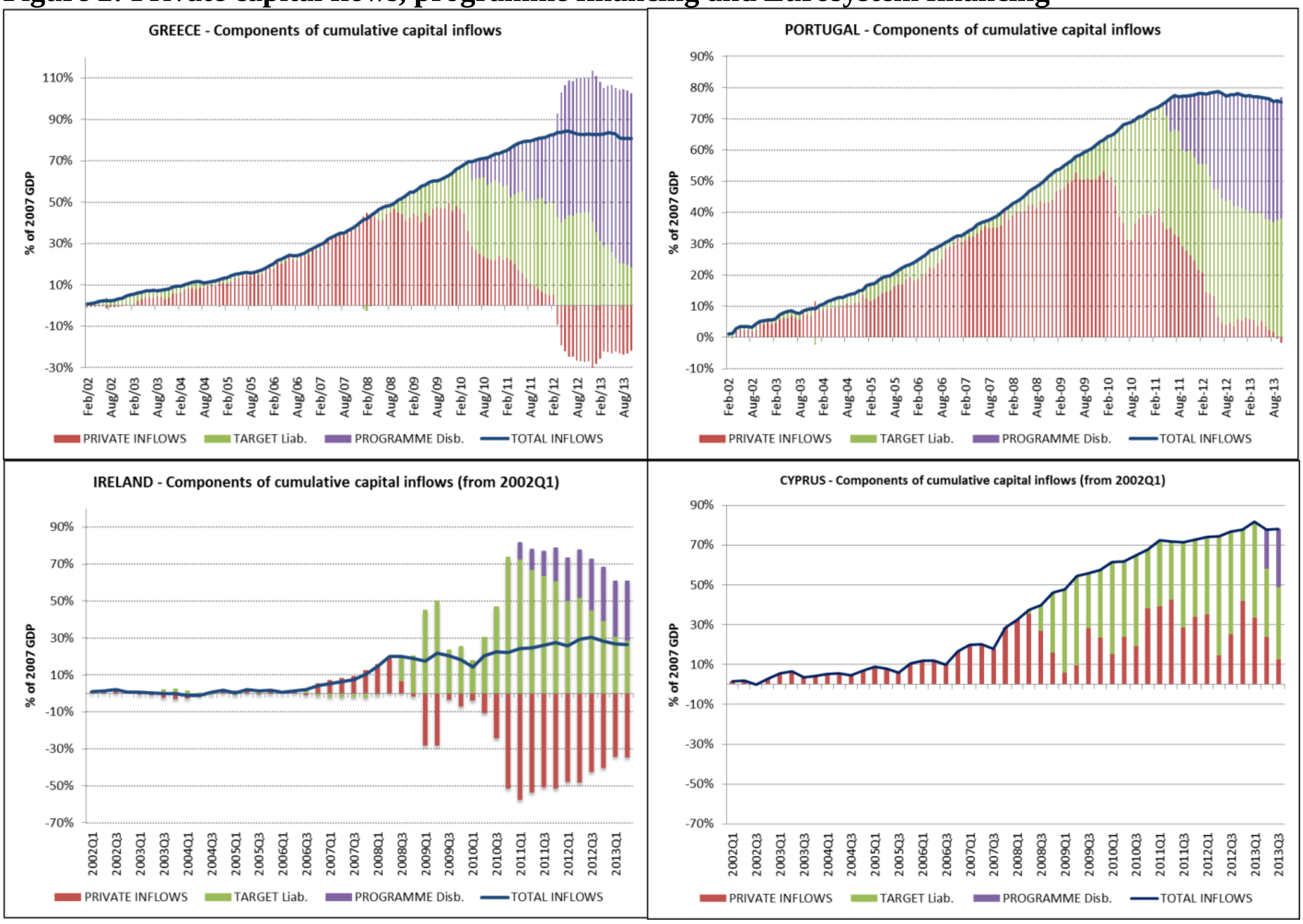
Note: For each line, numbers for years after the release date correspond to GDP forecasts.
Source: IMF, World Economic Outlook Database.

What makes all four programmes special is the fact that they were undertaken within a monetary union. This had a number of important implications. First, the exchange rate was permanently fixed and no competitive devaluation was possible, in contrast to many programmes outside monetary union (see Pisani-Ferry, Sapir, Wolff (2013), p.37) Although potential growth crucially relies on structural competitiveness factors, an initial exchange rate devaluation could have "jump-started" the economy of programme countries (see, for example, Svensson 2000), alleviating the short-term consequences of fiscal retrenchment. Second, the monetary union had led to a large increase in cross-border financial integration and capital flows. The large lending flows via the banking system led to the build-up of larger cross border financial exposures and also permitted the financing of extraordinarily large external debt levels. Average external debt levels of close to 100% of GDP at the beginning of the programmes were more than twice as high as external debt levels in typical IMF programme countries. The resulting financial contagion made debt restructuring more difficult. Third, the common central bank, the ECB, provided large amounts of financing to the banking system and thereby prevented that the balance of payment crisis turned into a full-blown funding crisis and a meltdown of the financial system, which eventually would have meant the introduction of a new currency.

As explained by Merler (2013), in the attempt to cope with the crisis' "unconventional times", the ECB implemented numerous policy measures to enhance the banking system's access to liquidity. Among others, the interest rate was lowered to historical minima, liquidity started to be allocated with a full-allotment procedure (in which demand determines supply), collateral requirements were eased in several waves, the reserve requirement ratio was eased to 1%, swap lines were put in place, and eventually two extraordinarily long-term refinancing operations with maturity of 3 years were conducted, in late 2011 and early 2012.

Figure 2 summarises the balance of payment funding since the beginning of 2002 and shows how a sudden stop of capital inflows and an eventual reversal of capital inflows (private inflows in the graph) was replaced by the different sources of government funding, namely ECB liquidity (Target Liab) and official financial assistance (Programme Disb).

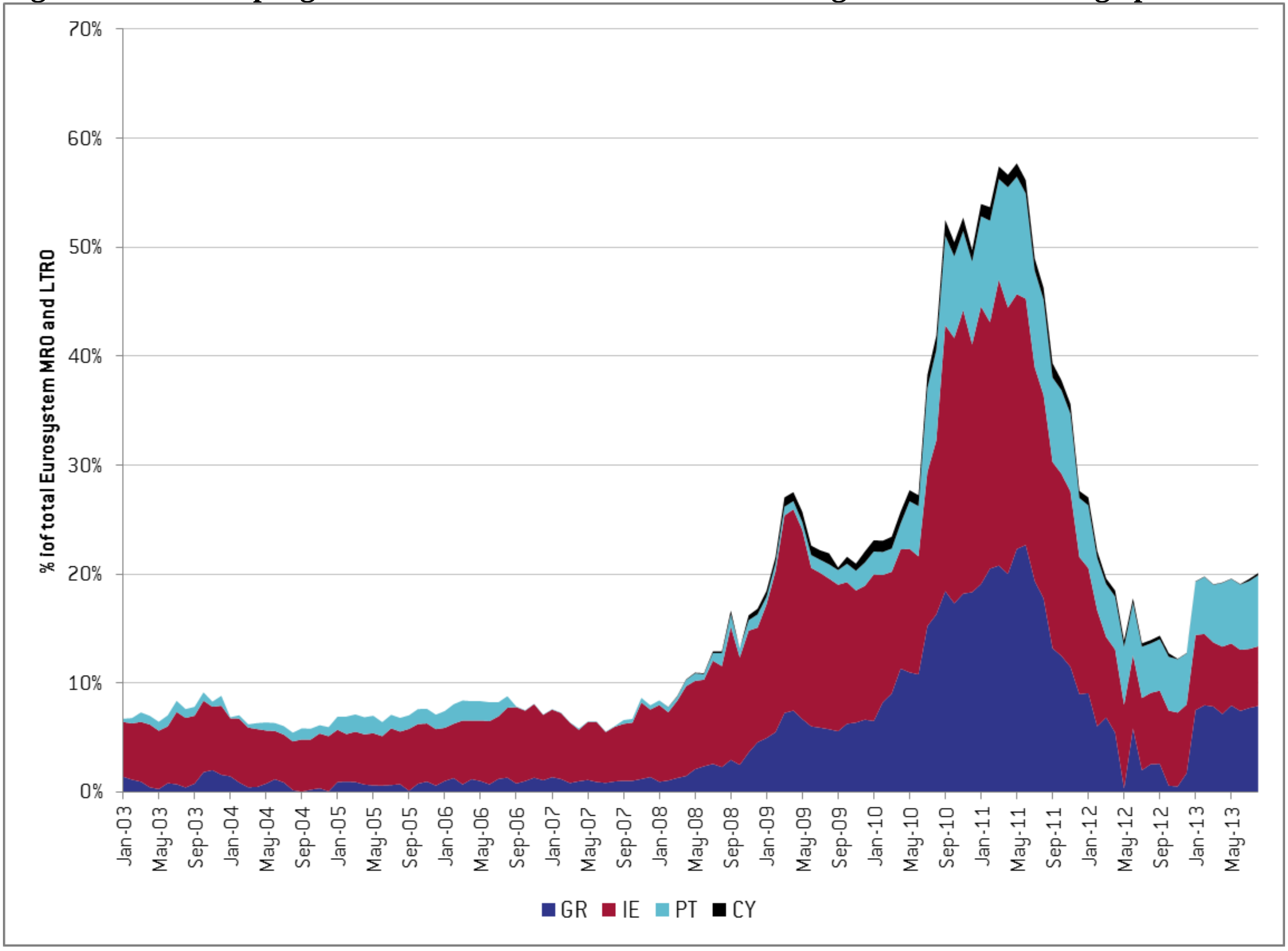
Figure 2: Private capital flows, programme financing and Eurosystem financing



Note: Data for Cyprus and Ireland is only available on a quarterly basis.
Source: National Central Banks, IMF, ESM.

This liquidity waterfall has been essential in preventing a complete collapse of the euro area financial system, at a time when the interbank market had frozen up and financial fragmentation was becoming the new normal of the Economic and Monetary Union. As a result, the share of the periphery banks in the normal ECB liquidity operations increased substantially (see Figure 3).

Figure 3: Share of programme countries in ECB main and longer-term refinancing operations

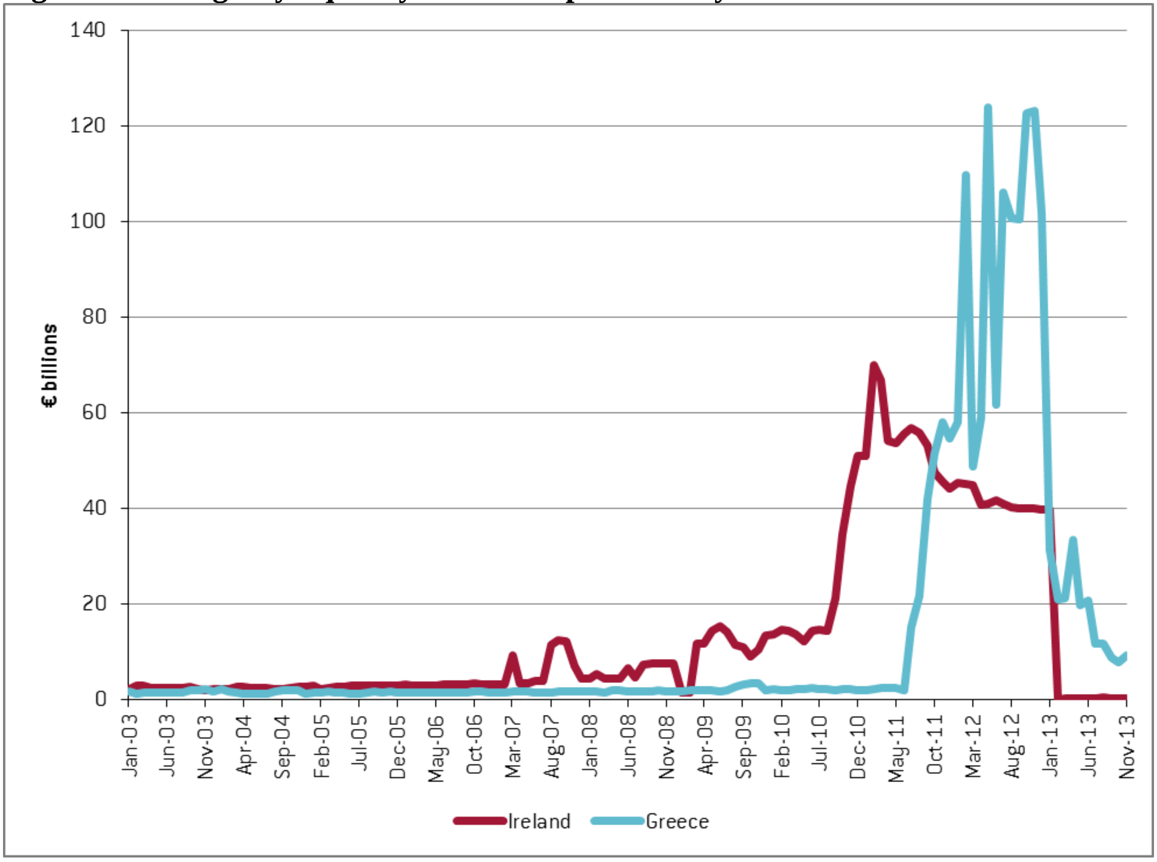


Source: National Central Banks, ECB.

The Eurosystem also provided so-called emergency liquidity assistance (ELA[1]), used in several countries to provide funds to banks that exceptionally and temporarily could not access normal Eurosystem operations. As can be seen in Figure 4, these amounts were substantial, especially when compared to the size of the individual economies concerned.

[1] According to the ECB, ELA consists in the provision by a Eurosystem national central bank of central bank money and/or any other assistance that may lead to an increase in central bank money to a solvent financial institution, or group of solvent financial institutions, that is facing temporary liquidity problems, without such operation being part of the single monetary policy.

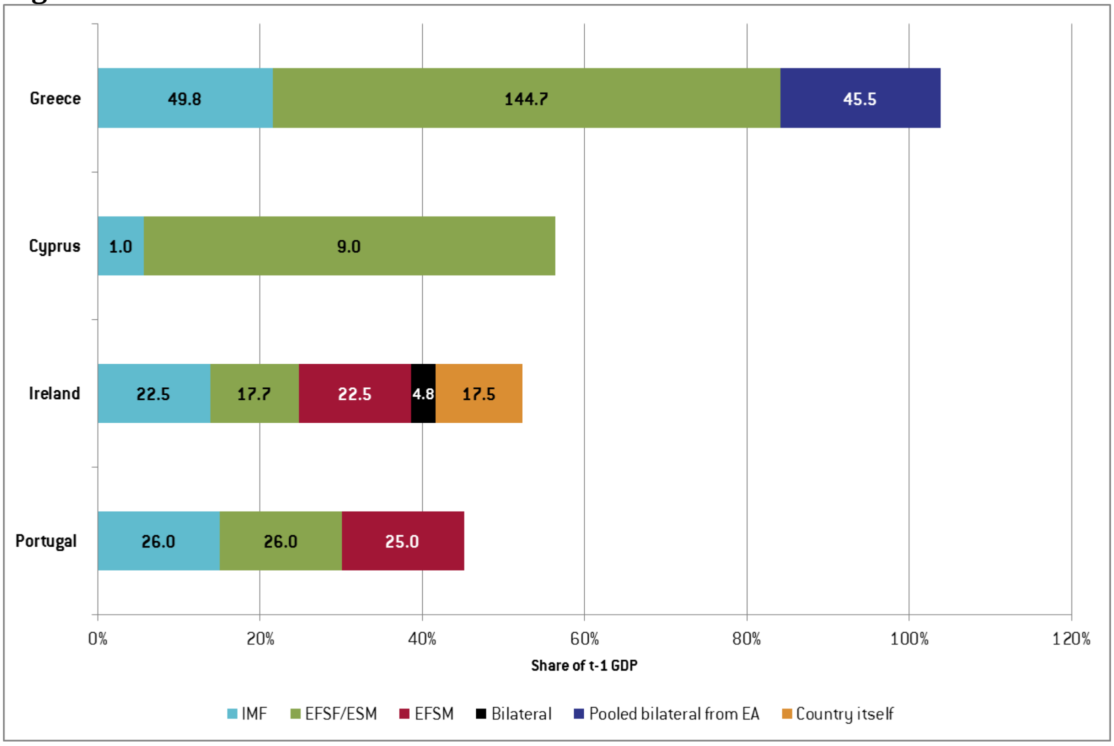
Figure 4: Emergency liquidity assistance provided by the Greek and Irish central banks



Note: Buiter and Rahbari (2012) provide estimates consistent with ours.
Source: Bruegel estimates based on national central bank balance sheets.

Official financial assistance was therefore focussed on the financing of governments, including bank recapitalisations. The computation of the funding need is presented in Annex 1. The different countries received different amounts from different sources. Figure 5 shows the sources of financial assistance programmes in percent of GDP as well as in billion euros. The Greek programme is by far the largest, measured both in absolute terms as well as in percent of GDP.

Figure 5: Sources of financial assistance



Note: Bars measured as percentage of GDP in the year before requesting financial assistance. Numbers shown on bars are € billions. For the IMF, amounts at programme approval are shown. The amount in € can change as the amount is specified in Special Drawing Rights (SDRs).
Source: IMF, DG ECFIN, ESM, AMECO database.

In the first three euro area countries' programmes, roughly a third of the funding came from the IMF while 2/3 was provided by European partners. In the case of Cyprus, these percentages changed and only 10% of the funding came from the IMF. The following table provides a more precise overview of the programmes

Table 1: Overview of the Financial Assistance Programmes in Greece, Ireland, Portugal and Cyprus

	Greece		Ireland	Portugal	Cyprus
	1st programme	2nd programme			
Date	May 2010 until June 2013	March 2012 until end 2014	December 2010 until end 2013	May 2011 until mid-2014	May 2013 until April 2016
Size	€110 bn	€164.5 bn	€85 bn	€78 bn	€10 bn
Nature	IMF: SBA EA: Greek Loan Facility	IMF: part of EFF €28 bn arrangement EA: EFSF	IMF: EFF EA: EFSF EU: EFSM Bilateral Ireland	IMF: EFF EA: EFSF EU: EFSM	IMF : EFF EA : ESM
Contributors	IMF (€30) Pooled bilateral from EA (€80 bn)	IMF (€19.8 bn) EFSF (€144.7 bn)	IMF (€22.5 bn) EFSF (€22.5 bn) EFSM (€22.5 bn) UK (€3.8 bn) Sweden (€0.6 bn) Denmark (€0.4 bn) Ireland: Treasury and National Pension Reserve Fund (€17.5 bn)	IMF (€26 bn) EFSF (€26 bn) EFSM (€26 bn)	IMF (€1 bn) ESM (€9 bn)

Note 1: Euro-area member states and the IMF approved an additional €130 billion for the term 2012-14; this was added to the undisbursed amounts (€34.5 billion) of the first programme (Greek Loan Facility). Hence, the total of the second programme amounts to €164.5 billion.
Note 2: The IMF approved a four-year arrangement under the EFF for Greece in March 2012. €19.8 billion of this arrangement contributed to the second Troika programme for Greece. The other €8.2 billion will be disbursed in the two years after the end of the Troika programme (i.e. 2015 and 2016).
Note 3: The IMF contributions in euros can change, as the amount is specified in Special Drawing Rights (SDRs). For the IMF, the figures show the amounts at programme approval.
SBA: Stand-By Arrangement; EFF: Extended Fund Facility; EFSF: European Financial Stability Facility; ESM: European Stability Mechanism; EFSM: European Financial Stability Mechanism.
Sources: IMF, DG ECFIN, ESM, AMECO database.

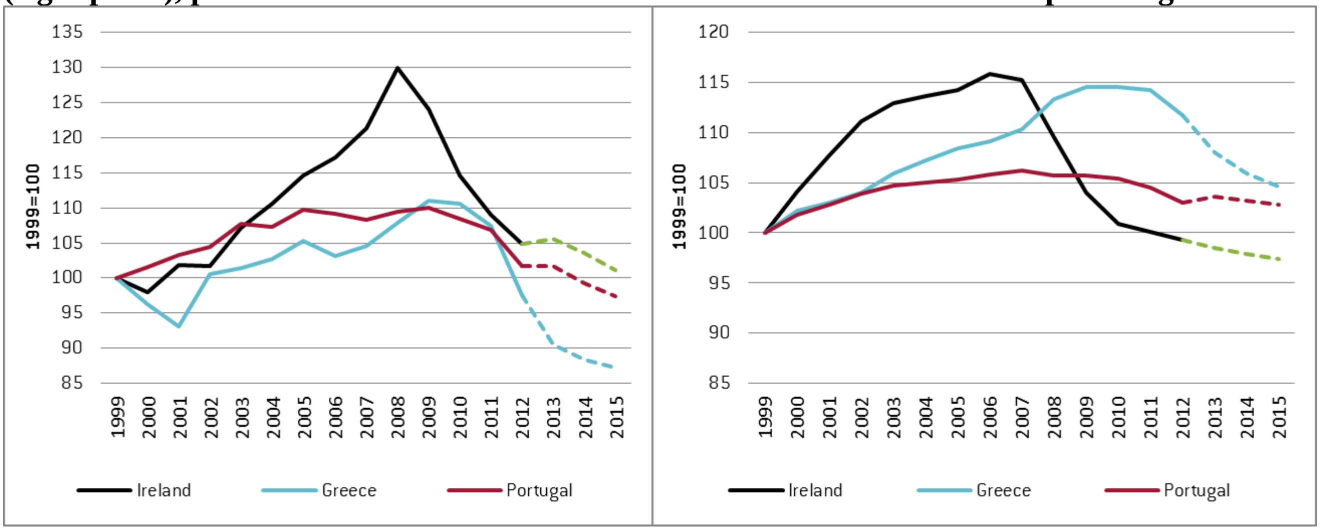
All in all, programme success can be assessed along the lines of three different criteria: the first criterion is whether it succeeded in creating the conditions for the country to regain market access. The second criterion looks at loan conditionality, and whether the latter was optimally timed or framed in a way that allowed and promoted compliance. Finally, the third criterion looks at "expectations and outcomes", or whether the underlying assumptions of the programme proved solid.

Under criterion 1, Ireland comes out as a history of success, given it managed to exit the programme at the end of 2013, and issue public debt on financial markets at favourable rates. Portugal, although still under financial assistance, is believed to be on the right track to exit its programme in 2014 and would thus also qualify as a successful programme when looked through the lenses of criterion 1. While Greece does not look any close to return to financial markets (and therefore to success), it is too early to analyse any prospect of exit for Cyprus.

These findings are reflected in export and price competitiveness indicators. In particular Ireland, but also to some extent Portugal, managed to substantially boost exports, thereby partially compensating for the collapse in domestic demand. Greece is the country in which exports did not pick up and actually performed also much worse than initially hoped. As a result, the correction in the Greek current account can almost exclusively be attributed to the drop in imports (Schöll, 2013).

In terms of regaining price competitiveness, Figure 6 shows that relative price adjustment is well underway in all countries. It started in Ireland and was followed by Portugal and Greece, with the adjustment in the latter starting relatively late: only markedly in 2012.

Figure 6: Real effective exchange rates, based on unit labour costs (left panel), and GDP deflators (right panel), performance relative to the rest of the former EU15: double export weights



Note: Dotted lines correspond to the European Commission November 2013 forecast.
Source: AMECO.

In order to assess whether original programme assumptions were solid, Table 2 compares the forecasts for 2013 at the beginning of the programme with the actual outcomes for 2013, based on the most recently available data. Programme projections were way off in Greece, but far less so in Portugal and in Ireland. In Cyprus, data are reported but obviously only cover around half a year of the programme.

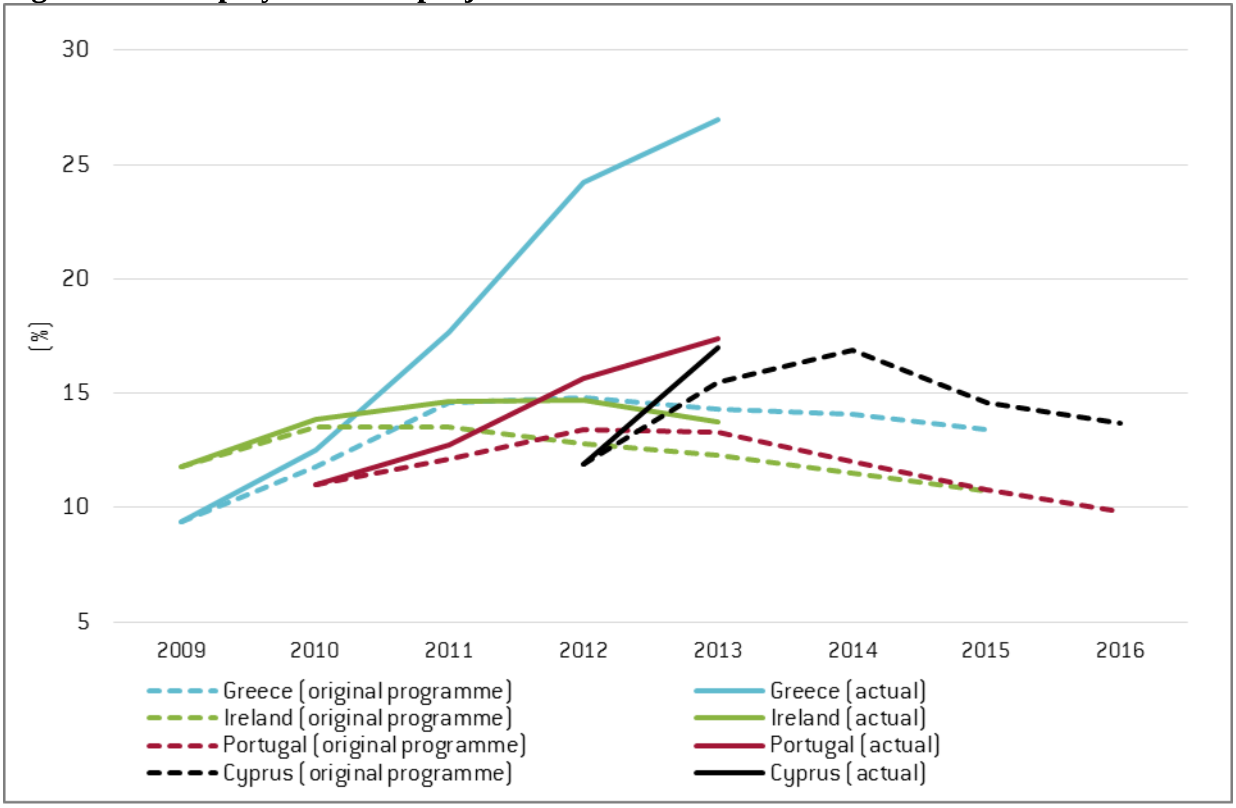
Table 2: Economic indicators for 2013: projections vs. outcomes

	Greece		Ireland		Portugal		Cyprus	
Source	Programme May-10	AMECO Jan-14	Programme Feb-11	AMECO Jan-14	Programme Jun-11	AMECO Jan-14	Programme May-13	AMECO Jan-14
*Projection**	*2009-2013 cumulated*		*2010-2013 cumulated*		*2010-2013 cumulated*		*2012-2013*	
Real GDP (% change)	-3.5	-20.6	5.4	1.5	-2.8	-6.1	-8.7	-8.8
Domestic demand (% change in volume)	-11.8	-27.8	-3.4	-7.7	-10.5	-13.1	-13.9	-13.7
HICP (% change)	3.4	8.3	2.6	2.3	6.9	7.1	1.0	1.0
Projection	*2013*		*2013*		*2013*		*2013*	
General government deficit (% of GDP)	-4.9	-13.6	-7.5	-7.2	-3.0	-5.9	-5.9	-8.3
Current external balance (% of GDP)	-5.6	-2.3	2.6	4.1	-3.9	0.9	-2.0	-2.0
Unemployment (%)	14.8	27.0	11.6	13.3	12.4	17.4	15.5	16.7
General government debt	149.7	176.2	120.5	124.4	108.6	127.8	109.1	116.0

Note 1: The headline general government deficit figure for Greece includes the bank recapitalisation costs of 10.6% of GDP and other factors. In terms of progress with fiscal consolidation, one-off costs should be excluded and the deficit, according to the European Commission Autumn 2013 Forecast is expected to be around 4% of GDP.
Note 2: * The reference period is determined by the year before the programme started.
Source: European Commission programme documents, AMECO.

A striking element of all the programmes is that the increase in unemployment was systematically underestimated, as detailed in Figure 7 below. Even in Cyprus, unemployment is already 1.2 percentage points higher than projected only 6 months ago. In Greece, unemployment was projected to increase to approximately 15%, but was 27% at the end of 2013.

Figure 7: Unemployment rate projections and realisations



Source: IMF WEO October 2013, programme documents.

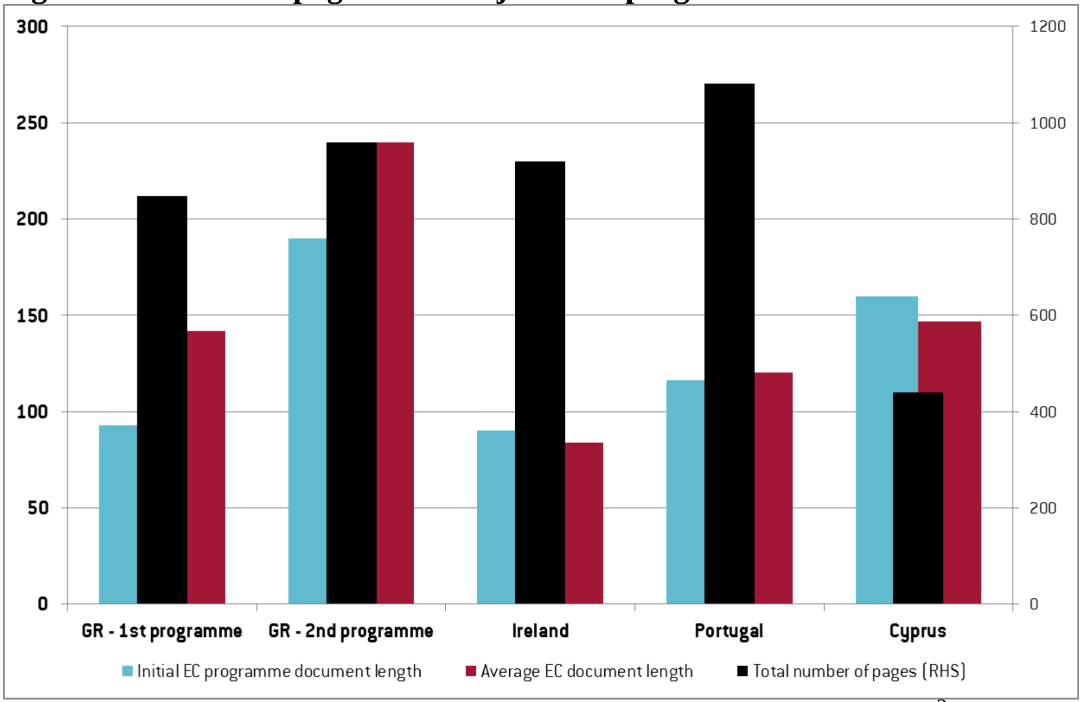
Government debt overshoot in all countries, except Ireland, and, as it will be shown later on, the larger than expected drop in GDP is an important factor explaining the unfavourable debt dynamics. The much larger-than-expected decline in domestic demand, in particular in Greece, has been driving the decline in GDP.

In the country-specific analysis of the programmes (section 4) we will assess whether loan conditionality was optimally timed, or framed in a way that allowed and promoted compliance. However, some general characteristics and trends in conditionality in the euro area programmes can also be gauged; an analysis to which we now turn.

3 The changing focus of surveillance of financial assistance conditionality

It is difficult to undertake a systematic evaluation of the reform measures that the Troika called for in the four programme countries. Figure 8 shows the number of pages of the initial adjustment programme documents, which can be seen as a rough proxy for the extent and detail of conditionality, and the total number of pages that the European Commission staff, in liaison with the ECB, has produced. This includes the initial economic adjustment programme document and its subsequent reviews. These documents are published by DG ECFIN as Occasional Papers.

Figure 8: Number of pages in the adjustment programme documents of the European Commission



Source: Bruegel computations based on European Commission programme documents.[2]

In Greece, in more than 1800 pages, the Commission staff sets out the conditionality and the set-up of the two programmes, and the evolving economic conditions. For Portugal, it is 1000 pages, while in Ireland it is above 900. Finally, in Cyprus the programme document and subsequent reviews comprise more than 400 pages so far – with just two reviews completed.

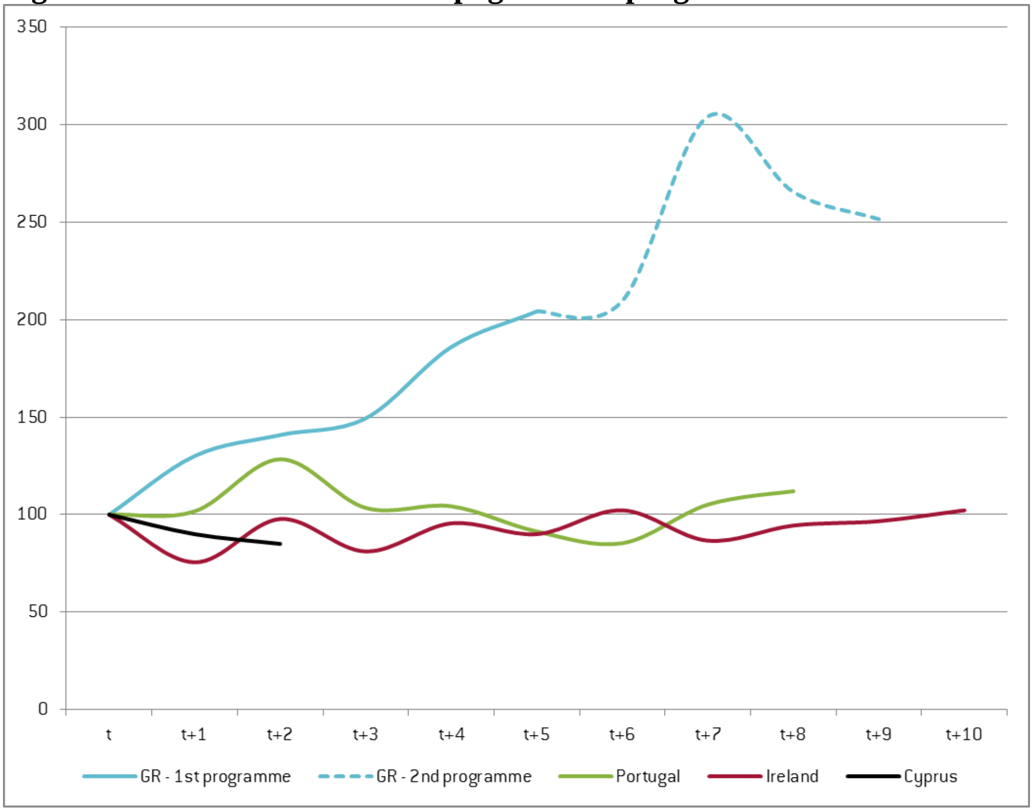
This chapter uses quantitative text analysis to select and describe the key issues at the centre of the conditionality. We have measured and compared the relative frequency of certain key words in the programme documents. A similar approach has been used extensively in political science to quantitatively locate political parties on an ideological spectrum (see, for example, Laver, Benoit and Garry, 2003). A variation of this technique was recently applied in an ECB staff publication to determine the effect of politicians' statements on market sentiment (see Gade *et al*, 2013). Although far from bullet-proof, this approach allows us to display quantitatively and confirm many of the findings of the round of interviews of Troika members and policy-makers conducted by Pisani-Ferry *et al* (2013).

The first finding is on the changing intrusiveness of conditionality. The number of pages of the documents describing the conditions agreed in exchange for financial support is considered as a rough proxy of the level of detail of conditionality. After the Asian crisis, the IMF's conditionality became more parsimonious[3]. In Europe, the level of detail of conditionality remained relatively constant during the programme period in all countries except Greece. For Greece, the number of pages already doubled during the course of first programme. With the second programme, it increased more than threefold compared to the first adjustment programme document. Conditionality thus became much more detailed and specific in the course of the last three and a half years in Greece. This corroborates the finding of Pisani-Ferry, Sapir and Wolff (2013), who reported, based on stakeholder interviews, that conditionality in Greece became increasingly detailed as the Troika realised that implementation of conditionality was

[2] The graphs in this section were taken from forthcoming work by Terzi and Wolff (2014).
[3] In September 2002, the Fund adopted new Guidelines on Conditionality. Parsimony in the application of conditionality is recognised as one of the five key principles, necessary to support ownership and implementation by creating explicit room for national policymakers to formulate and adapt policies (see IMF, 2004).

not working, in part because of the lack of specific guidance to a weak and dysfunctional public administration.

Figure 9: Normalised number of pages of EC programme documents



Note: t corresponds to the first programme document, t+1 to the first review, and so on.
Source: EC programme documents, Bruegel calculations.

But where did the Troika put the emphasis in terms of conditionality? To gauge this question empirically, we compute the relative frequency of a number of key words and its evolution over time (Table 3). The term "fiscal" is the most frequently used for all the selected countries. This is not surprising because the programmes' resources are primarily used to fund the government and fiscal issues are therefore discussed extensively in the programme documents. Interestingly, the term was most used for Cyprus, followed by Portugal (mentioned once per page, on average), while in Greece and Ireland the frequency was almost the same (0.8 times per page). For the terms "reforms" and "business"[4], the frontrunner is Greece, with the Troika using these terms more frequently than for the other countries. "(Un)employment" received most attention in Portugal and Ireland, while in Cyprus and Greece it appears in the document about once every three pages, on average. "Poverty" is barely discussed in any of the EC programme documents, except for the most recent documents on Greece, where the issue had become so acute that it could not be avoided. Finally, "privatisation" was important in Greece, Portugal and Cyprus, but did not receive much attention in Ireland.

[4] The term "business" was chosen to cover such expressions as „creating new business opportunities ", simplified set of business tax accounting rules", business environment, and, creating favourable investment conditions.

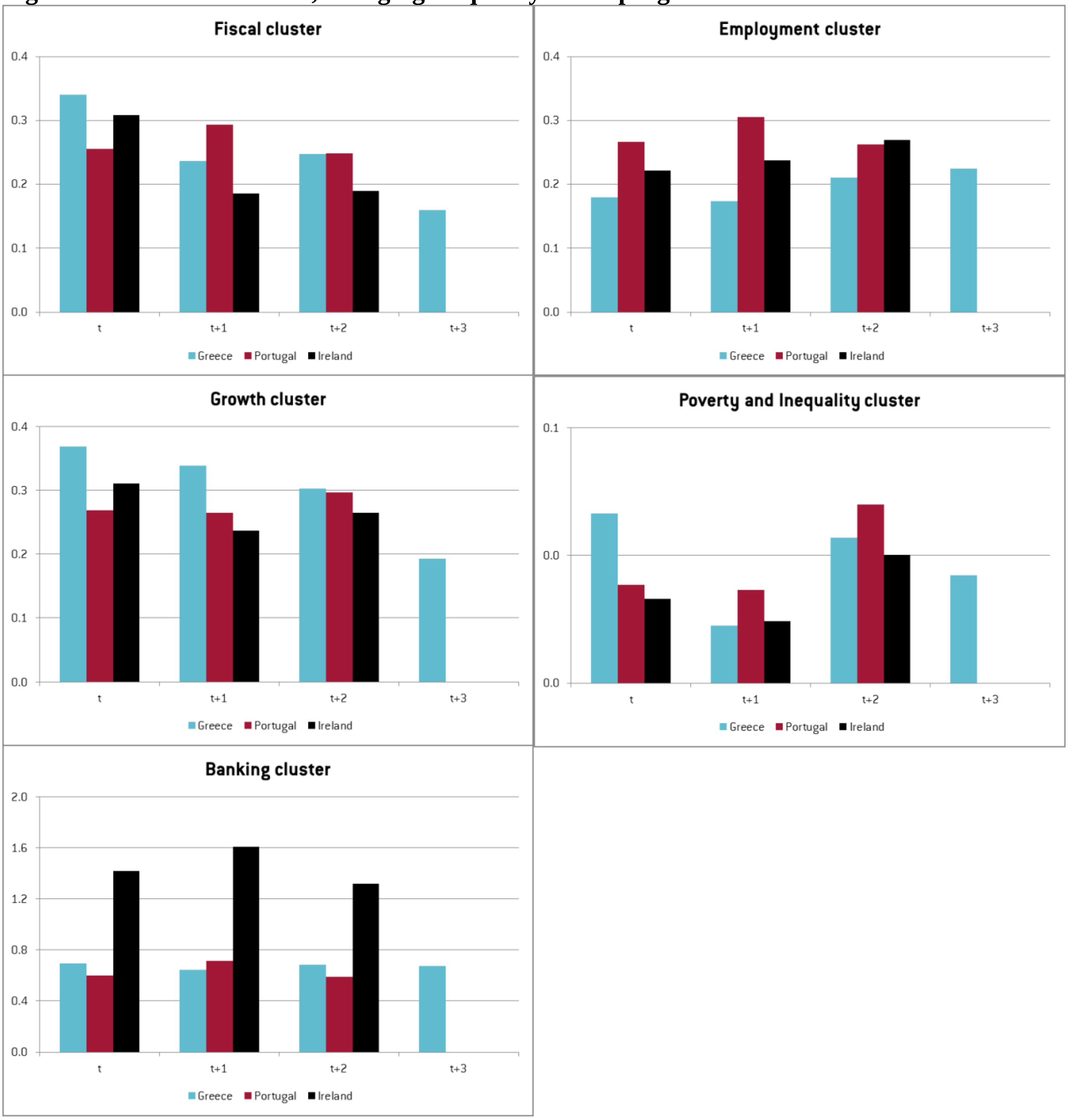
Table 3: Selected terms frequency in EC programme documents

	fiscal	fiscal consolidation	reforms	business	(un)employment	poverty	privatisation
Greece	0.90	0.11	0.62	0.30	0.39	0.03	0.34
Portugal	1.08	0.12	0.36	0.20	0.63	0.00	0.23
Ireland	0.89	0.14	0.49	0.14	0.67	0.00	0.02
Cyprus	1.29	0.16	0.34	0.22	0.35	0.00	0.21

Note: Term frequency is defined as word count over page count.
Source: EC programme documents, Bruegel calculations.

In an effort to detect major themes and track them through time, we have clustered several terms together around grand topics: fiscal, growth, employment, and poverty and inequality (P&I). This methodology thus controls for the possibility that different programme teams use different expressions for the same concept (e.g. fiscal consolidation rather than fiscal adjustment, and so on). We have then grouped reviews by year to read through individual quarterly volatility.

Figure 10: Clusters of terms, changing frequency in EC programme documents

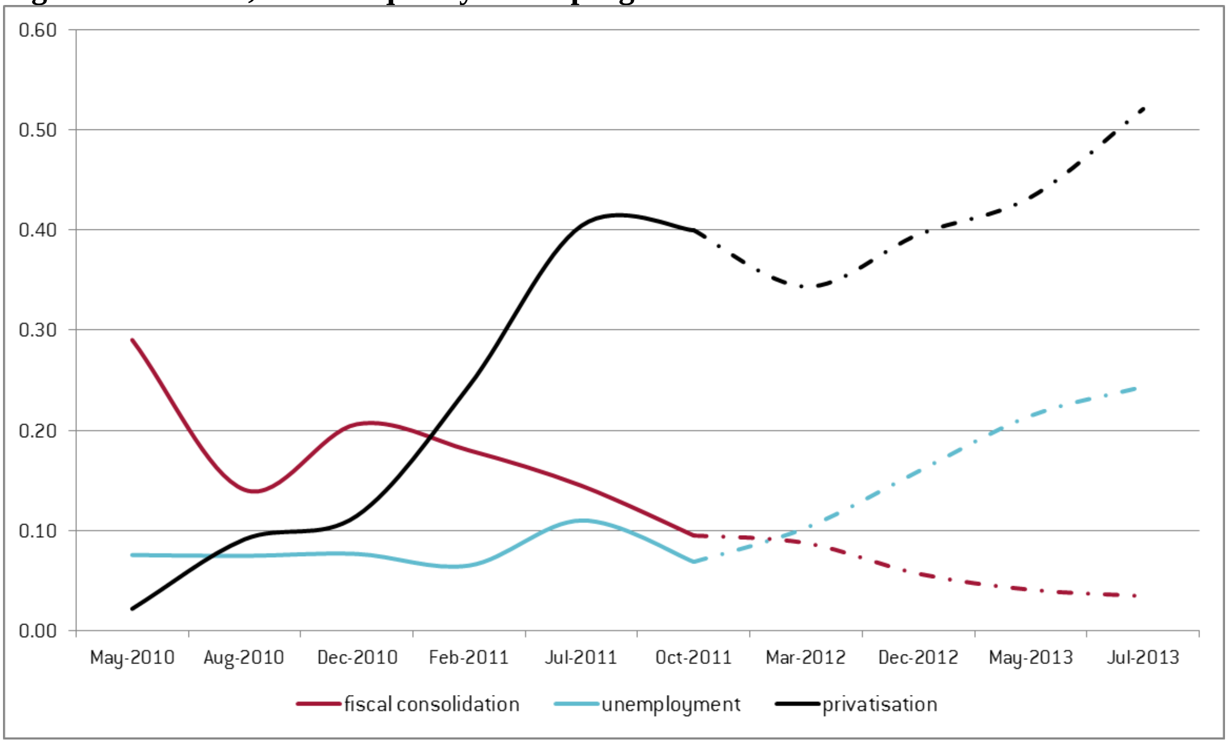


Note: t is the first adjustment programme document, followed by its reviews.
Term frequency is defined as word count over page count.
Source: EC programme documents, Bruegel calculations.

This cross-country perspective provides a number of insights. First, fiscal issues became less important for all countries over time, except for Portugal, where there was a slight increase in the second year. In particular in Ireland, fiscal issues became much less prominent in the second and third year. Second, "employment" tended to gain importance as did "growth", with some exceptions. Third, "poverty" became more relevant over time, especially in the third year of the programme. Fourth, banking issues were clearly very prominent in Ireland and continue to receive significant attention over time in all countries.

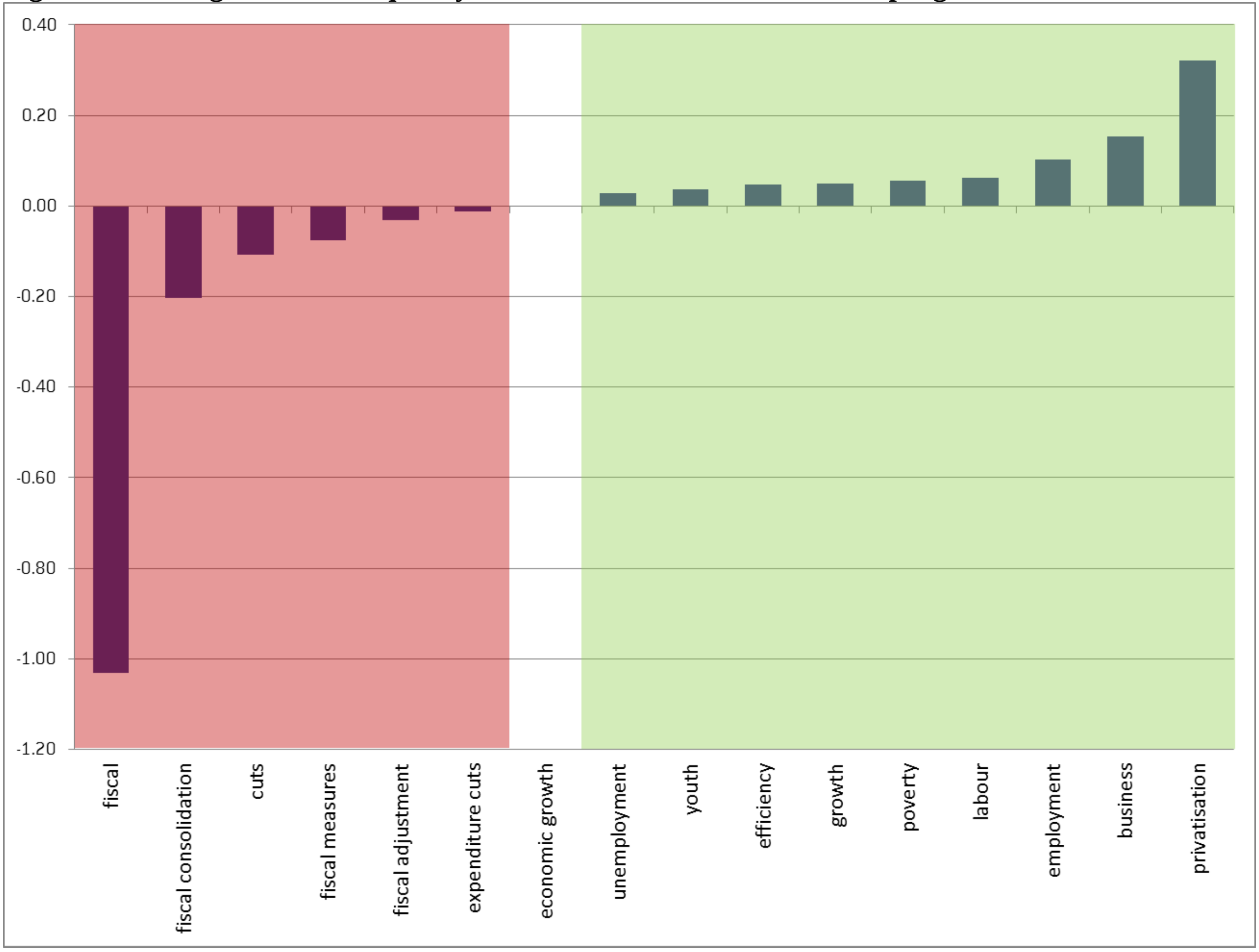
A cross-country perspective, however, misses out on important country specificities, and on significant changes over time triggered by the evolving economic and political situation in Europe and in the programme countries.
Starting with Greece, Figure 11 shows that the programme initially focused mainly on consolidation, but the importance of the term "fiscal consolidation" gradually declined during the programme. In contrast, "privatisation" became increasingly important. This is in line with the numbers reported in Pisani-Ferry, Sapir and Wolff (2013, p.61), who showed the increasing revenues that were expected from this source, but which never materialised. In the second programme for Greece, issues such as business, employment, unemployment, growth and youth also received increased attention.

Figure 11: Greece, term frequency in EC programme documents



Note: Dotted lines represent documents belonging to the Second Adjustment Programme for Greece.
Source: EC programme documents, Bruegel calculations.

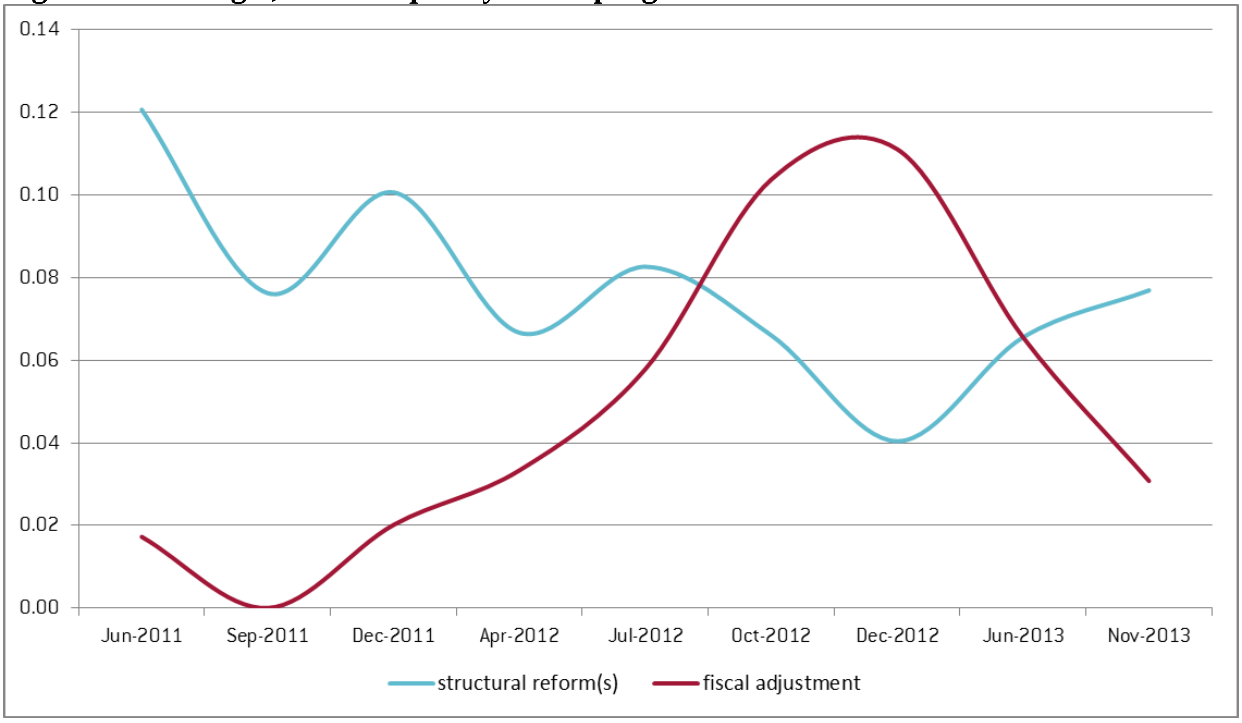
Figure 12: Change in term frequency between the first and the second programme for Greece



Note: the comparison is between the First Adjustment Programme for Greece (European Economy, n61) and the Second Adjustment Programme for Greece (European Economy, n94).
The vertical axis indicates how many times more (or less) the term is used per page count in the second programme in comparison with the first.
Source: EC programme documents, Bruegel calculations.

For Portugal, Figure 13 shows that the emphasis on fiscal adjustment and structural reforms was most striking: the programme began with greater attention on the latter, and then this pattern was reversed, with fiscal adjustment at its peak in the 6th Review, by which time there was a greater preoccupation with the achievement of the 2012 fiscal targets. Since then, consolidation has become less prominent and "structural reforms" has become more prominent.

Figure 13: Portugal, term frequency in EC programme documents



Source: EC programme documents, Bruegel calculations.

Finally, since greater economic and social cohesion is a major EU objective, as delineated in Articles 2 and 3 of the Treaty, we study how often issues such as poverty, fairness and inequality are discussed in the documents. Table 4 shows that, except for Greece, the issue received practically no attention in the Commission programme documents. However, the focus we have discussed on employment and unemployment could be interpreted as an attempt to indirectly tackle poverty, fairness and inequality.

Table 4: Absolute terms frequency in EC programme documents

	poverty	inequality/ies	fairness	number of pages
Greece	59	1	25	1806
Portugal	0	0	10	1081
Ireland	4	9	1	920
Cyprus	1	1	4	440

Note : Absolute term frequency indicates the number of times a specific term appears in the document.
Source: EC programme documents, Bruegel calculations.

The results of our empirical exercise should be interpreted cautiously. First, a simple term frequency analysis does not weight terms according to their position in the paper. The word “poverty” in the executive summary could signal greater attention to the theme than a note in the annex. Second, several different expressions can also be used interchangeably, which may underplay the relevance of certain terms. Furthermore, this method does not distinguish whether the programme is commenting on developments which have taken place and been successful, or if it is demanding that further actions be taken under a certain heading. We also did not carry out a statistical significance test on the terms relative to a random use of key words. Keeping these caveats in mind, one may draw a number of preliminary conclusions on the conditionality of EU-IMF assistance.

1) Conditionality has become much more detailed in Greece, while the level of detail has remained broadly constant in the other countries.

2) Fiscal issues receive the greatest attention in the programme documents, which can be explained by the fact that financial assistance is given to governments and therefore fiscal issues are in focus.
3) A further important conditionality issue is the financial sector. In all programmes, but especially in Ireland, banking system reforms were central and remained central throughout the three years.
4) Economic reform issues are important for all countries and their importance has increased. However, poverty issues are barely considered in the programme documents and have received only marginally increasing attention in the last year of the programmes.
5) In Greece, the second programme emphasises growth, jobs and structural reforms much more than fiscal issues, which decreased in importance. Privatisation became a central theme. In Portugal, structural reform issues were extremely prominent at the beginning of the programme and became less important. Fiscal issues, in contrast, became more important as doubts about sustainability and the implementation of fiscal measures increased. In Ireland, employment and business matters became much more important in 2012, when unemployment had increased significantly.

4 Country evidence

4.1 Greece

The starting point of the evaluation of the Greek programme should be the extraordinary macroeconomic imbalances at the start of the programme. Public debt had reached 129.7% of GDP at the end of 2009 and this now-certified figure was not even fully known at the time. Sizeable corrections in the debt and deficit numbers announced previously dealt a blow to the credibility of Greece and trust in its ability to follow international agreements. As market sentiment turned against the country, it became clear that Greece had to apply for a financial assistance programme. Yet, this option was fiercely resisted by different institutions and governments[5]. In May 2010, Greece entered a stand-by agreement and was therefore the first euro area country to fall under a "Troika" financial assistance programme.

The performance of the programme disappointed in many respects and it can be rightly considered as the least successful one. In Pisani-Ferry, Sapir and Wolff (2013), the following dimensions have been highlighted. An update of the data corroborates those findings summarized below, even though, in some regards, recent developments have somewhat changed the overall picture.

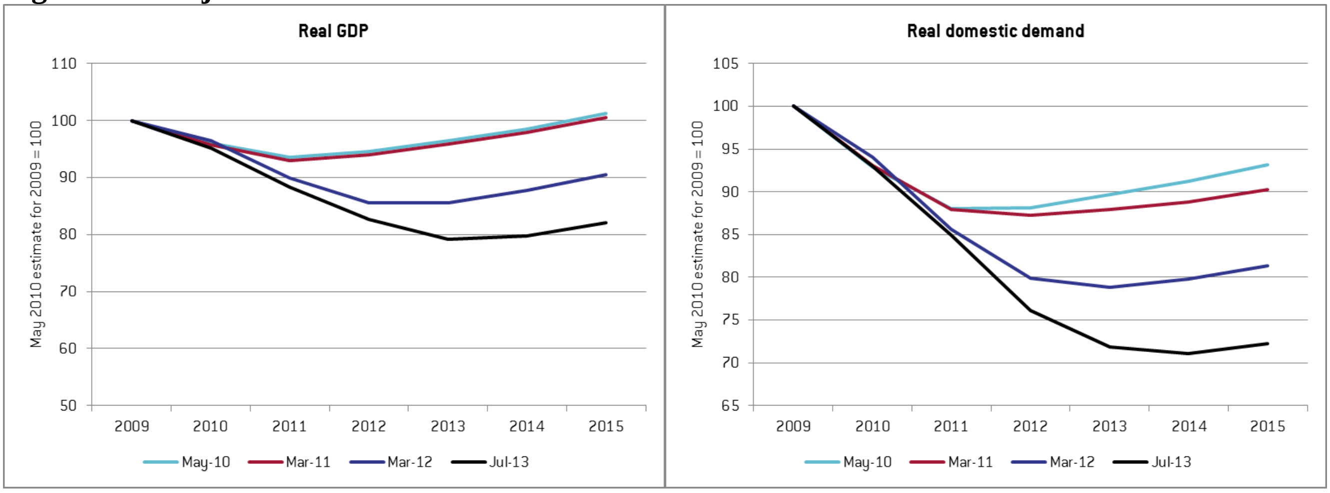
Empirical findings

The first and most striking finding is that reality proved the initial programme assumptions largely wrong. When financial assistance was granted in 2010, it was expected that growth would resume in 2012, unemployment would peak at 14.8% in 2012, no debt restructuring was needed, the debt ratio would peak

[5] During the run-up to the Greek financial assistance programme, the FT quoted several officials denying the possibility of an EU-IMF bailout: On December 2, 2009 Giorgos Papakonstantinou, then Greece Minister of Finance, was quoted saying that it is "out of the question" that Athens would turn to the IMF. "The new government is determined to put the economy back on a path of fiscal sustainability in the context of the EU rules". On December 9, 2009, Axel Weber, then Germany's Bundesbank president, was quoted stating: "Within the stability and growth pact there is no role for the IMF – rightly". On January 11, 2010, the FT claimed that the Greek authorities were adamant that they could fix their public finances without IMF money and had told the Fund they did not want it to get involved in negotiations with European partners pressing for tougher actions to cut the deficit. On January 13, George Papandreou, then prime minister of Greece stated: "There's no issue of leaving the euro or of asking for help from the IMF".

in 2013 at 149 percent of GDP and that the government would recover market access in 2013. None of these assumptions proved nearly close to correct.

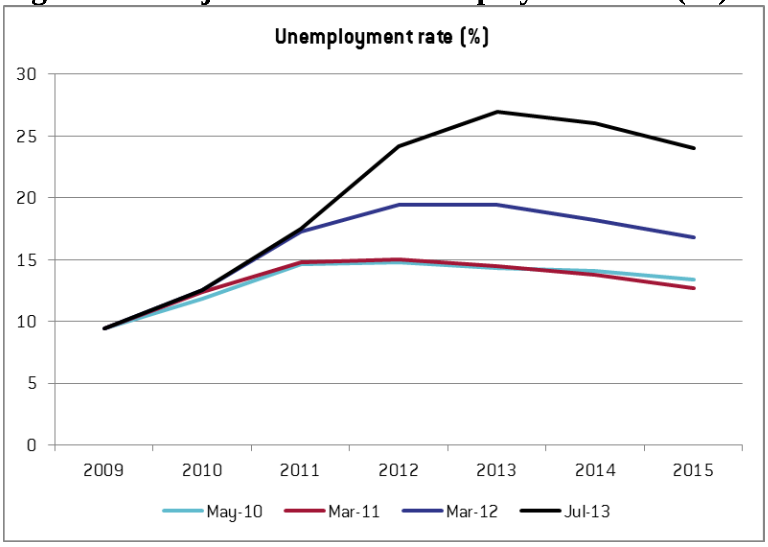
Figure 14: Projections of real GDP and domestic demand



Source: IMF programme documents.

Real domestic demand collapsed by around 30%, the unemployment rate rose to over 25%, while real GDP fell by more than 20% (see Figures 14 and 15).

Figure 15: Projections of the unemployment rate (%)

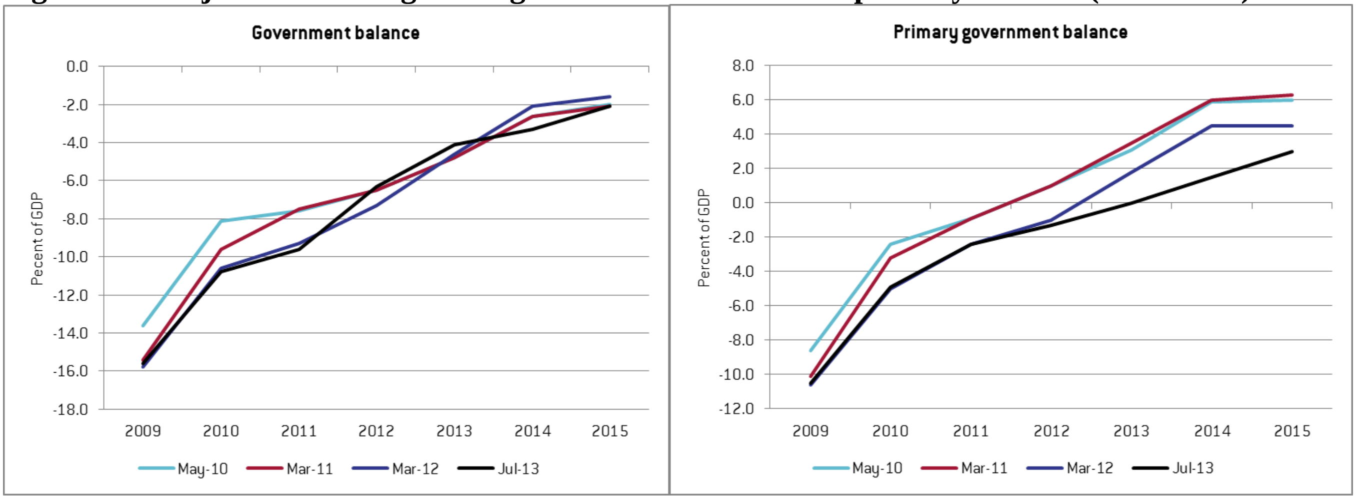


Source: IMF programme documents.

The European Commission had estimated the size of the competitiveness problem, and the subsequent price adjustment need, to amount to around 20-30%. The baseline assumption of the programme was that price developments, as well as unit labour costs, would be less than the euro area average by 2011, thereby leading to a relative price adjustment. However, price rigidities in the economy proved to be very severe and relative price levels did not start to correct until 2013.

As regards public finances, and the deficit in particular, the Greek government implemented to a large extent the initial requests made by the Troika. In particular, the general government balance and the primary balance improved precisely along the lines of the original programme design, if one accounts of the worse-than-expected 2009 initial conditions (see Figure 16). This is an extraordinary achievement of the government as GDP, and therefore the revenue base, shrank much more significantly than was originally foreseen. The drop in revenues had therefore to be compensated by further cuts in public spending.

Figure 16: Projections of the general government balance and primary balance (% of GDP)



Source: IMF programme documents.

Yet, despite the steep consolidation carried out, debt-to-GDP levels expanded much more significantly than forecast in the debt sustainability analysis. A simple breakdown of the factors driving the gap between the initial and the actual fiscal outcomes shows that the effect of lower GDP is by far the most important factor explaining the worse debt dynamics (see Table 5). An additional important factor was the worse than expected initial debt level, which was in fact corrected after the start of the programme by more than 14% of GDP. The debt restructuring only partially off-set these negative developments so that by 2013, the Greek debt-to-GDP ratio turned out to be significantly above the initial forecast of the first programme.

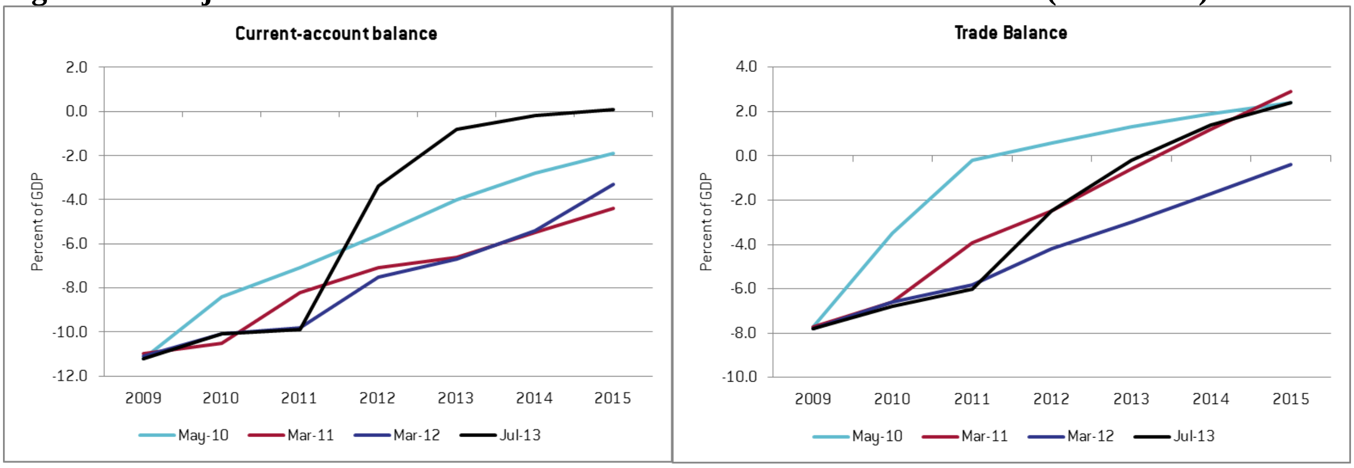
Table 5: Breakdown of gap between initial and actual fiscal targets for Greece, 2010-2013

(All variables expressed as % of GDP)	Primary balance	Overall balance	Gross debt
2013 target as set in the May 2010 SBA programme	3.1	-4.8	149
- Worse 2009 initial conditions	-1.9	-2	15
- Revenue shortfall due to larger than expected output gap	-9.2	-9.2	
- Effect of lower nominal GDP		-0.9	38.5
- Interest rate on public debt		4.9	
- Larger than expected overall deficits			0.9
- Fiscal consolidation effort (balances) and residual (debt)	8.0	7.9	-0.6
- Debt restructuring			-27.0
2013 outturn as forecasted in the January 2014 review	0	-4.1	175.7

Note: see Pisani-Ferry, Sapir and Wolff (2013) for a detailed description of the methodology.
Source: Bruegel calculations, IMF programme documents.

As regards the current account, the improvement was significantly more rapid than initially foreseen and Greece is expected to virtually reach a balanced current account already by 2014. This rapid improvement, however, was largely determined by factors other than the trade balance and rather led by the lowering of interest payments. The trade balance has improved, but this was almost exclusively driven by the collapse in imports. Exports hardly rebound, dampening hopes for a rapid pick-up in exports similar to that observed in other programme countries.

Figure 17: Projections of the current-account balance and the trade balance (% of GDP)



Source: IMF programme documents.

Reasons underlying the bad performance

So which reasons can be identified for the worse performance of the Greek programme? Greece started from a very high deficit of above 15% and an underestimated true debt level in May 2010, when financial assistance was first requested. The programme kicked off to an impressive start, according to the IMF itself. However, the situation took a turn for the worse in 2011 and, against the background of heightened market concern, domestic demand and GDP growth plummeted, investments collapsed, and exports stagnated. In Pisani-Ferry, Sapir and Wolff (2013), we discuss a number of important factors that contributed to the macroeconomic setback of the Greek programme. An exact identification of the contribution of each factor is, unfortunately, not feasible.

- The external macroeconomic environment turned out to be more adverse than initially expected, as the euro area entered a double-dip recession. However, during 2010 and early-2011 the environment was in line with expectations. Therefore, this factor cannot explain why the Greek government and economy underperformed expectations in its early stages of the programme. In its later phase, however, increasing external political calls for a termination of the programme or even an exit of Greece from the euro undermined confidence and weighed on growth.

- European policy indecision can be indicated as a more significant aggravating factor in the performance of the programme. The unclear European stance on debt restructuring in general, and on its application in Greece in particular, left many investors in a state of high uncertainty. This uncertainty weighed on sentiment and on investment decisions.

- Inadequate and insufficient programme implementation was a problem throughout 2011, also due to the general elections and broader political factors, and even until the fall of 2012, according to the quarterly reviews and press releases of the Troika. The Troika in particular overestimated the effectiveness of the Greek government machinery to follow through on policy recommendations and priorities. As a result, the Troika eventually became much more detailed and less parsimonious in its policy recommendations to Greece. This is quantitatively visualised in Figure 9, as described in our term frequency exercise (section 3) and qualitatively appreciated in Annexes 2 and 3, of which Table 6 is only an illustrative excerpt.

- The debt restructuring took place too late, so that the debt relief it brought was too limited to ultimately solve the debt sustainability issue in Greece.

- Excessive austerity is evoked as a principal factor for the worse-than-expected GDP performance in Greece by many (see, for example, Krugman 2013). Clearly, the budget consolidation had a negative impact on GDP. And one cannot doubt that the fiscal adjustment in Greece has been very marked. Public deficit came down from a level of above 15% of GDP in 2009 to around 4 % at the end of 2013. However, as the extensive debate (known informally within policy circles as "battle of the boxes") between the Commission[6] and the IMF[7] showed, it is difficult to assess the precise level of the fiscal multiplier at a time of effective structural break in the economy and erratic market sentiment. It is also impossible to establish a clear counterfactual and its broader consequences. Clearly, with less front-loaded fiscal adjustment, the EU-IMF financing envelope for Greece would have needed to expand, in what is already the largest financial assistance programme in percent of GDP in recent global history. On the other hand, a less rapid fiscal adjustment may have helped to preserve some of the productive capacity that, in the course of the adjustment, was destroyed.

- A fundamental problem of the programme – and incidentally of all countries adjusting to high debt levels and prices - was the inconsistency between attempting to re-gain price competitiveness while, at the same time, trying to reduce the debt-to-nominal GDP ratios. If the assessment of a 20-30% price competitiveness adjustment need was right, debt sustainability would prove even more illusionary than it did. A downward adjustment in prices mechanically implies a worsening of the debt sustainability conditions (Darvas 2013). To address this problem, the programme was emphasizing the need for growth-enhancing structural reforms that would boost the economy's capacity to produce and export. However, the reforms initially envisaged were fairly general, and a weak administrative and languishing political capacity meant that implementation was slow. Even with fast implementation, though, it would have taken time for structural reforms to meaningfully change real economic growth.

[6] 'Forecast errors and multiplier uncertainty', European Commission Autumn 2012 Forecast, Box 1.5, page 41.
[7] 'Are we underestimating short term fiscal multipliers?', IMF WEO, Box 1.1, page 41.

Table 6: Summary of main measures (illustrative excerpt) taken as part of programme macroeconomic conditionality

Heading	Major actions required	To be completed by	Evaluation	Date of evaluation	Note
Fiscal consolidation	Reduction in the public wage bill by reducing the Easter, summer and Christmas bonuses and allowances paid to civil servants	Q2-2010	Observed	Aug-2010	
Growth and competitiveness	Government takes measures, in line with EU competition rules, to facilitate FDI and investment in innovation in strategic sectors (green industries, ICT etc...) through a revision of the Investment Law, the adoption of measures to facilitate PPPs, action to fast-track large FDI projects and measures to strengthen export promotion policy	Q3-2010	Observed	Nov-2010	
Financial stability	The Bank of Greece, on behalf of the Government, establishes an independent Financial Stability Fund, with a strong governance structure, to deal with potential solvency issues and to preserve the financial sector's soundness and its capacity to support the Greek economy, by providing equity support to banks as needed	Q2-2010	Observed	Aug-2010	

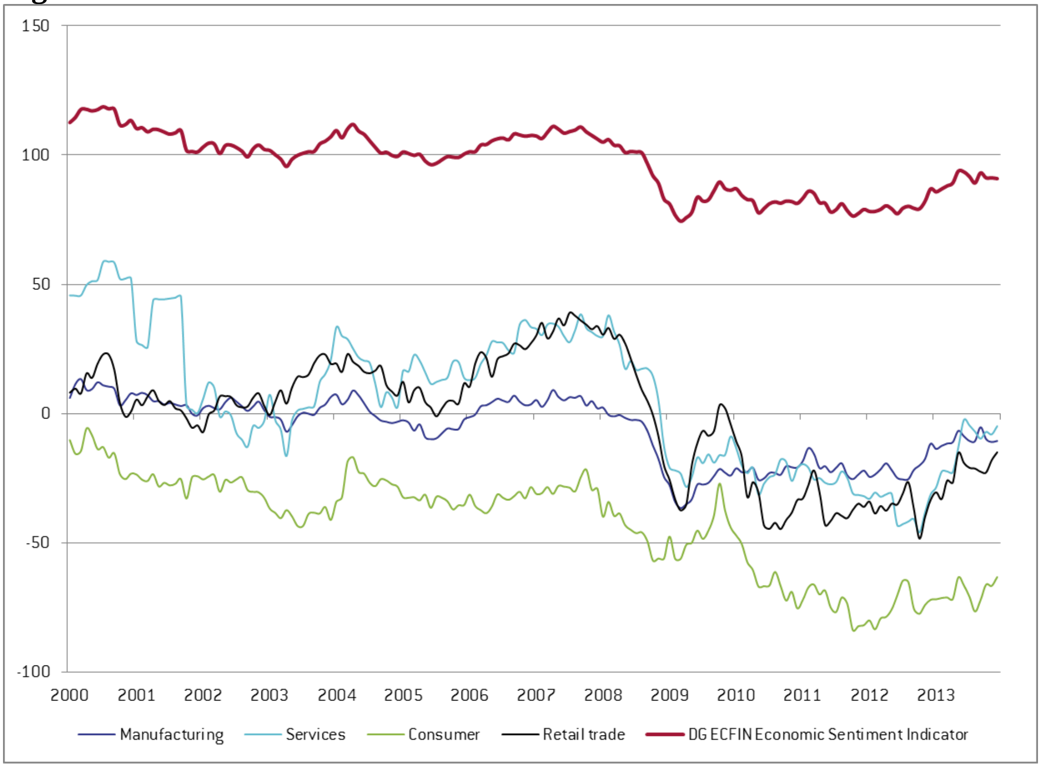
Note: This table is only an illustrative excerpt. For the complete tables (first and second programme), please refer to Annex 2 and 3, respectively.
Source: EC programme documents.

Recent developments

Given the amount of attention it has received, both within policy-circles and the media, a short discussion should be devoted to the green-shoots of growth that appear to be materialising in Greece. For example, Markit's purchasing managers' index (PMI) for manufacturing rose to 51.2 in January from 49.6 (scores above 50 indicate an expansion in the sector), posting the first above 50 measure in this index since August 2009. However, the Commission's in-house Economic Sentiment Indicator (ESI) is still below 100 points, indicating that the economy is still in the contractionary phase of the cycle (see Figure 18 below). Both total and youth unemployment rates show no sign of abatement, while consumer sentiment (and thus consumption) is deep in the red.

A cautious stance is thus warranted; given Greece's state of economic malaise, and the strong headwinds that threaten the fiscal and financial stability of the Hellenic republic, overly optimistic conclusions should be avoided. As such, it is hard to see an end of some sort of financial assistance programme, or the reacquisition of sovereign market access, as close at hand.

Figure 18: Short-term economic sentiment indicators



Note: For ESI, 100=long-term average; for the individual components values above 0 indicate expansion.
Source: DG ECFIN, accessed on 20 January 2013.

Overall assessment

Correcting the major disequilibria in the Greek economy was bound to be a titanic challenge. The combination of excessively large public and private debt, an overvalued real exchange rate, a fragile government apparatus, languishing political ownership, and a weak and closed business sector meant that adjustment was going to prove challenging. The policy conundrum was further aggravated by the initial European indecision as to how to deal with a debt crisis in monetary union, the increasing hostility vis-à-vis further assistance to Greece, and even threats to push Greece out of the euro. Given these circumstances, the fact that Greece managed to stay in the euro can be considered a success.

The Troika was not responsible for the extraordinary circumstances. Yet, it is clear that the programme was not robustly designed. This fact was already well-known at the beginning of the programme: internal IMF documents made public by the Wall Street Journal show that from the beginning, very serious concerns were raised on the debt sustainability and the fragility of the programme.[8] The Troika and European political leaders did not err on the side of caution and did not allow for a programme to be calibrated with greater chances for success, including accepting an early debt restructuring. The misreporting of Greek public finance should have been an early warning that should have led to more caution. Pisani-Ferry, Sapir and Wolff (2013, p75) concluded: *"Political reluctance in Europe to start debt restructuring, the fear of potential moral hazard effects and the absence of effective mechanisms to contain its possible financial fall-out made this option unappealing. The alternative, nearly-concessional lending within the framework of a large and long-lasting assistance programme, was not politically palatable either. This conundrum led the IMF and the EU to bet on the materialisation of optimistic tax revenue and privatisation assumptions. Instead of formulating a robust programme capable of*

[8] IMF, office memorandum May 9, 2010, Board meeting on Greece's request for an SBA.

withstanding adverse economic, political and financial developments, they did just the opposite. It is no surprise that these optimistic assumptions were not vindicated by events."

Under all the three criteria outlined at the end of section 2 as measures of programme success, financial assistance to Greece cannot be deemed successful at this stage: price and non-price competitiveness seems far from being restored, financial market access will most likely not be re-gained in the near future, structural reforms are progressing only at slow pace, and Troika programme assumptions were amply proved wrong.

Greece stayed in the euro, a return to the markets may become eventually possible, but certainly the programme can be considered as the least successful one within the euro area. The issue of social fairness has become more important, both in the Troika documents as well as in the public discourse, yet little progress on reducing the fundamental unemployment problems, especially for the young, has been made to date. Overall, the path to a successful exit from the programme is not yet fully chartered and visible.

4.2 Ireland

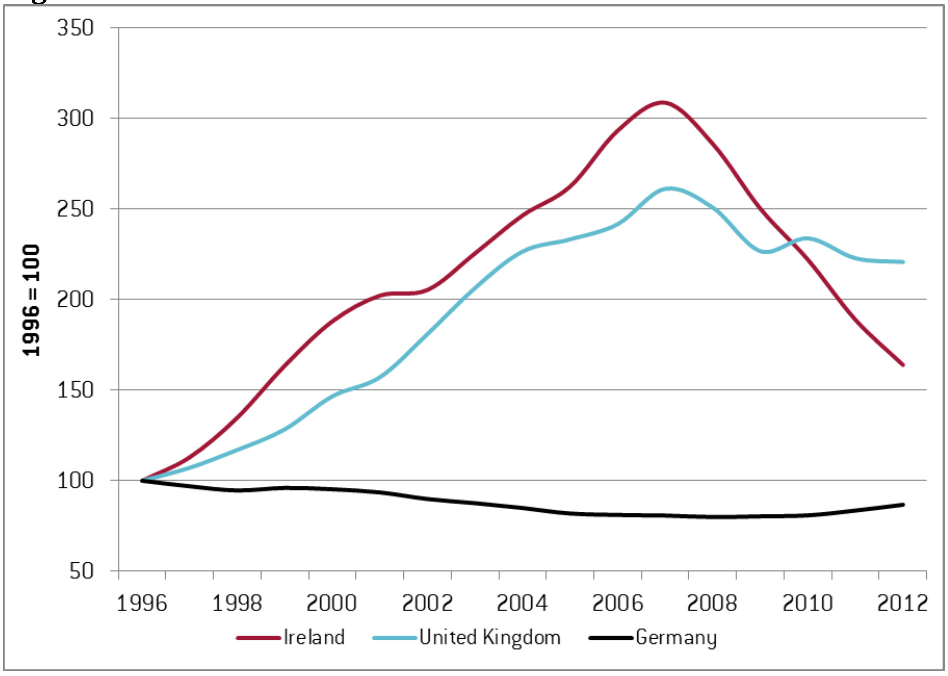
The Irish programme: a success with costs

On 21 November 2010, Ireland became the second euro area country to request financial assistance. Three years later, on 14 November 2013, the Eurogroup concluded that the Irish economic adjustment programme had been successful and that Ireland would be able to exit it by the end of the year[9]. Since January 2014, Ireland is in the post-programme surveillance. Ireland is the first country of the euro area that has left a financial assistance programme. How can the performance of the programme, which included a financing package of €85 billion, be assessed overall?

A study of the Irish financial assistance programme needs to start with a description of the pre-programme period and the extraordinary macroeconomic developments which took place before the housing bubble burst in Ireland at the end of 2007. When the euro was introduced, the "Celtic Tiger" had already done a large part of the catching-up and was among the top European economies in terms of GDP per capita and other economic indicators of prosperity. However, in the first years of the euro, up until 2007/8, Ireland experienced a massive credit-driven housing boom and house prices increased very substantially compared to, for example, the neighbouring UK (see Figures 19 and 20).

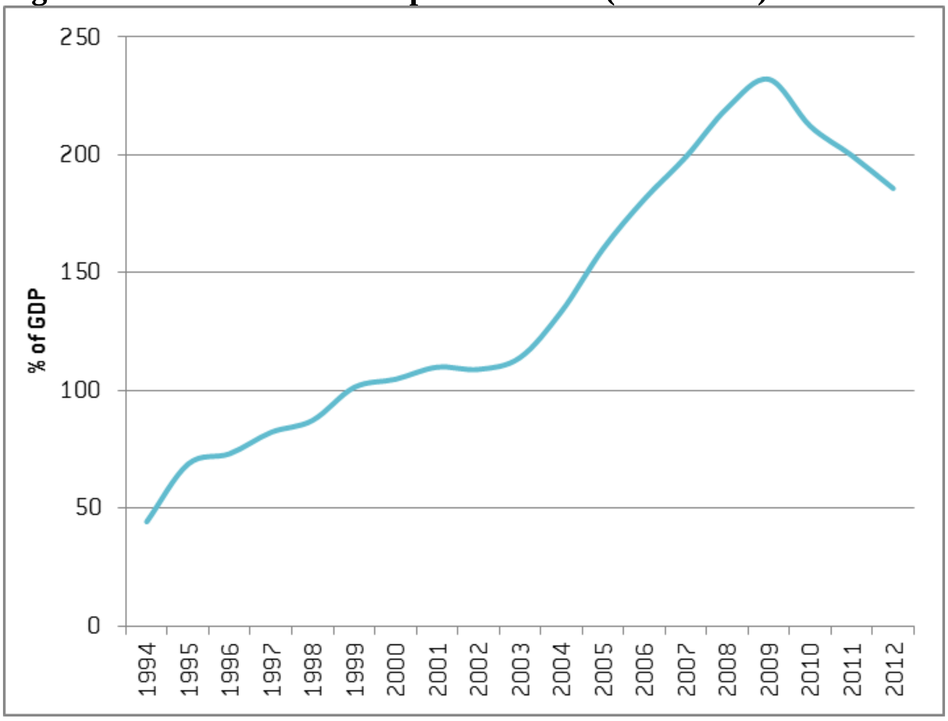
[9] Statement by the Eurogroup on Ireland, 14 November 2013.

Figure 19: Real House Price Index



Note: Nominal house prices deflated by the private consumption deflator.
Source: OECD.

Figure 20: Domestic credit to private sector (% of GDP)

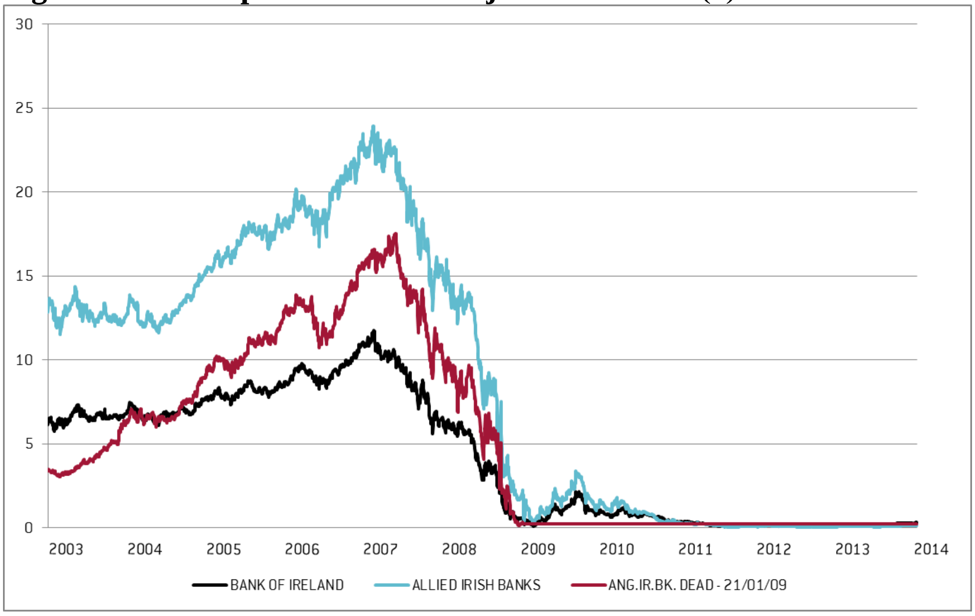


Source: World Bank Development Indicators.

The reasons for this boom are manifold and have been discussed extensively in the literature and certainly include expectations, interest rates, but also regulatory measures in the banking system and tax incentives. The credit expansion, according to Nyberg (2011) has been concentrated in speculative property lending.

The fiscal performance before the crisis looked very good with debt ratios falling to very low levels (24.6% of GDP in 2006). Yet, when the surge in real estate prices came to an end, public revenues collapsed dramatically as they had relied heavily on the housing boom. The result was a steep increase in the deficit. Even more dramatic was, however, the significant downward spiral setting off in the financial system. With the global interbank markets coming to a cardiac arrest, Irish banks were shut off the international capital markets which they had tapped before the crisis. The share prices of the major Irish banks collapsed (see Figure 21) and there was a genuine fear that the banking system would collapse on the back of a liquidity crunch.

Figure 21: Share prices of three major Irish banks (€)



Source: Datastream.
Note: Anglo Irish Bank was nationalised on 21 January 2009.

Confronted with this dramatic situation, the Irish government adopted a blanket guarantee protecting the creditors of all domestic Irish banks at the end of September 2008. The guarantee was given for a period of 2 years by the government on its own account. The view at the beginning of the period was that this would have been a temporary measure to address an acute liquidity crisis, but that eventually the situation would have stabilised and the guarantee would have had no lasting fiscal consequences (see Laeven and Valencia, 2008). Since the guarantee came from one of the healthiest governments of Europe, it initially led to a reversal of capital outflows and some of the EU partner countries were even concerned about losing their deposit base to Irish banks.

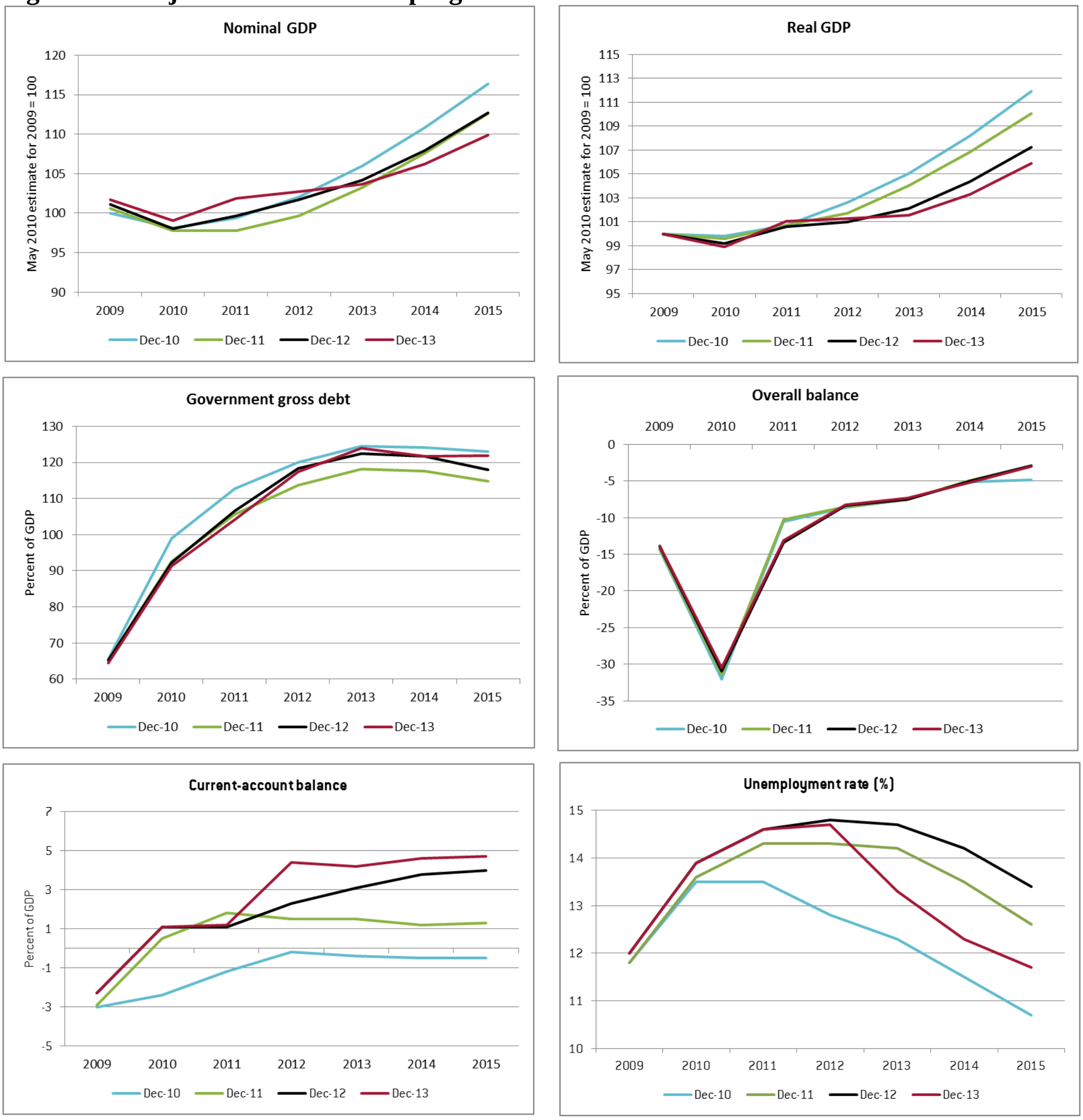
Yet, as the economic fundamentals in Ireland deteriorated and the housing market continued to fall, doubts about the solvency of the banks, which were heavily exposed to the housing sector, increased. With rising doubt about the banks, also the solvency of the government was increasingly put into question and sovereign yields started to rise significantly throughout 2010. The Irish government had to eventually ask for a financial assistance programme.

The design of the programme

The Irish programme consisted of €85 billion of which €35 billion was foreseen for the financial system while the remainder was for the funding of the government directly. The Irish government committed to conditionality in the area of fiscal policy and reform, both in the financial sector and the economy more in general.

On the fiscal and macroeconomic side, the major measure decided was a significant reduction in the fiscal deficit with a slight bias towards a reduction in expenditures. In Pisani-Ferry, Sapir, Wolff (2013, p.83), we report that the fiscal adjustment was slower than what the Irish government initially intended to carry out. Indeed, the initial national recovery plan foresaw a reduction of the deficit to 3% by 2014, while the Troika argued that an extension of the goal until 2015 would give more space to breath. The fiscal plan was fully implemented and the final outcome only slightly deviated from the initial programme design. This was due not only to the rigorous implementation by the Irish government of the fiscal plans but also to the relatively realistic programme assumptions on economic growth. When read through the lenses of our criterion 3 for programme success (expectations vs. outcomes), the Irish programme can thus be seen as broadly successful.

Figure 22: Projections for the Irish programme



Source: IMF programme documents.

Figure 22 shows the developments of real and nominal GDP as well as the fiscal performances, the current account and the unemployment figures. As it is visible, nominal GDP is "only" 2% below the initial projection for the end of 2013, while the debt to GDP ratio, as well as the overall balance, developed almost exactly as initially projected. The current account balance improved much more markedly than originally foreseen. Interestingly, unemployment rates were decreasing much faster than previously expected: as late as November 2013, the European Commission was forecasting for unemployment to hit 13.3% at the end of 2013. On the other hand, the figure came in as low as 12.4%, the lowest level since June 2009.

Table 7: Breakdown of gap between initial and actual fiscal targets for Ireland (2010-2013)

(All variables expressed as % of GDP)	Primary balance (incl. bank support)	Overall balance	Gross debt
2013 target as set in the Dec 2010 EFF programme	-1.4	-7.5	124.5
- Changed 2009 initial conditions	0.5	0.6	-1.2
- Revenue effect due to adverse GDP developments	-0.9	-0.9	
- Effect of lower nominal GDP		-0.2	2.7
- Interest rate on public debt		-1.4	
- Larger than expected overall deficits			2.4
- Fiscal consolidation effort (balances) and residual (debt)	-0.9	2.0	-4.5
2013 outturn as forecasted in the Dec 2013 review	-2.7	-7.3	123.9

Note: see Pisani-Ferry, Sapir and Wolff (2013) for a detailed description of the methodology.
Source: Bruegel calculations, IMF programme documents.

A simple accounting exercise presented in Table 7 shows that the slightly worse macroeconomic performance was compensated with stronger fiscal consolidation efforts, so that the overall debt outcome was exactly in line with the plan. Since the fiscal consolidation effort in turn had a negative effect on output, the very good external sector performance prevented a more dramatic deterioration of the GDP figures. The relatively quick fiscal adjustment was possible in Ireland as the economy benefited from its large degree of economic openness and flexibility. The numbers therefore suggest overall that the macroeconomic assumptions underlying the programme were sufficiently robust.

Financial system reform

Besides the fiscal adjustment, the second core issue in the focus of the financial assistance programme was financial sector reform. Clearly, before the crisis erupted, the Irish financial system was one of the largest financial systems in the euro area, measured in relation to GDP. With the changing fundamentals in the housing market, it became apparent that the business model had to change and also the size of the financial system was too large. In the years preceding the programme, a significant overhaul took place and an asset management agency (NAMA) was created to purchase loans and thereby help clean the balance sheets of banks. Pisani-Ferry, Sapir and Wolff (2013) document that the pre-programme bank recapitalisation commitments, according to finance minister Noonan, amounted to 46.3 billion euros.

At the start of the programme, the most controversial issue was the treatment of senior bond holders. However, when compared to the pre-programme numbers that the Irish government reported, the issue of senior bond holders was relatively small. The controversy was really about the imposition of losses on €19 billion of senior unsecured and unguaranteed debt[10]. Assuming a haircut of around 50% and

[10] Information note of the Central Bank of Ireland and Updated Information Release of the Central Bank of Ireland. Both documents retrieved 12 April 2013.

distinguishing between banks in going and gone concern, the numbers would be amounting to “only” €1.9billion or €9.5 billion as the maximum that could have been saved for the tax payer.

Yet, despite the comparatively low numbers, a very fierce public debate emerged on this issue. The focal point was the initial disagreement between the IMF, which was favourable to the haircut, and the ECB, which was vocal in its opposition for fear of the stability of the Irish and the European financial system. As the US treasury reportedly changed its position, so did the IMF eventually concede to the ECB and no haircut was imposed on senior unsecured creditors (for details, see Pisani-Ferry, Sapir, Wolff, 2013, p87-89).

A further important policy controversy was about the speed of deleveraging in the financial system. The first programme agreement pushed for a very rapid asset disposal. However, this resulted in fire sales which aggravated the balance sheet situation of credit institutions rather than restoring confidence in the financial sector. The Troika therefore attenuated its deleveraging demands, implicitly acknowledging that the speed had been too high hitherto.

A resume of measures foreseen by the Troika

In order to analyse Ireland’s success through the lenses of compliance with conditionality (i.e. our criterion 2 for programme success), we scrutinised the country’s compliance tables in the European Commission’s programme documents. Annex 4, of which Table 8 only represents an illustrative excerpt, provides a summary of the central measures agreed by the Irish government as part of the macroeconomic conditionality of its programme. In line with the Troika’s wording, measures are grouped according to their aim: fiscal consolidation, structural reforms aimed at increasing the potential growth of the country or restore its financial stability. Moreover, every single measure is tracked in time through later Troika reviews, to illustrate whether it was actually implemented.

This approach has clearly several caveats: first, we identify major measures based on their projected fiscal impact or effect on growth, based on the literature and the structure of the Irish economy. However, this is not strictly quantifiable ex-ante and only a future assessment will be able to clearly identify the reforms that were successful in boosting long-term growth. Second, in an attempt to preserve market access, the Irish government had already enacted austerity measures before agreeing to the Memorandum of Understanding: the latter will not be in our tables which rely on the programme’s compliance tables. Finally, as already highlighted in Pisani-Ferry et al. (2013), the Irish programme was characterised by a high degree of domestic ownership, especially when compared to the Greek one. The Troika preferred to set the macroeconomic targets and let the government decide on the measures necessary to achieve such goals. Although agreed in liaison with the Troika missions, these reforms were not part of macroeconomic conditionality *stricto sensu* and are thus only partially accounted for in Annex 4.

All in all, it can be stated that Ireland complied by and large with the conditions attached to its international loan. However, it must also be noted that, given the Irish economy displayed a high degree of flexibility before the crisis, the structural reform effort required was sizeably smaller than the one to which Greece or Portugal were called. The pith of conditionality therefore verged on restoring banking sector soundness and profitability, as hinted by our term frequency analysis in section 3.

Table 8: Summary of main measures (illustrative excerpt) taken as part of programme macroeconomic conditionality

Heading	Major actions required	To be completed by	Evaluation	Date of evaluation	Note
Fiscal consolidation	Effective pay freeze in the public sector until 2014		Observed		Not mandated but as part of the achievement of fiscal targets
Growth and competitiveness	Reduce by €1.00 per hour the nominal level of the current national minimum wage.	May-2011	Observed	May-2011	Later reversed as considered unjust by the government
Financial stability	Banks are required to maintain at least a 10.5% core tier 1 ratio for three years and identify EUR73 billion of non-core assets for disposal and run-off so as to meet the targeted loan-to-deposit ratio (122.5%) by end-2013	Apr-2011	Ongoing Ongoing	Mar-2012 Sep-2012	

Note: This table is only an illustrative excerpt. For the complete table, please refer to Annex 4.
Source: EC programme documents.

The programme exit – an assessment

In April 2013, Pisani-Ferry, Sapir and Wolff (2013) concluded that the Irish programme was broadly on track and that the exit from the programme was likely, even though associated with important risks, especially as regards the macroeconomic conditions in the global economy and the financing costs in the bond markets. On 14 November 2013, the Eurogroup agreed to conclude the financial assistance programme. Since the beginning of 2014, Ireland is in post-assistance phase and the key aim of the programme, namely a return to the market, has been achieved. A number of factors were jointly instrumental in achieving this positive result:

1) The tremendous success in the export sector helped to compensate for the loss in employment in the non-tradable sector and substantially reduced the impact of the fiscal adjustment on the economy.

2) Fiscal adjustment was done in a balanced way which, while having short-term negative GDP effects, contributed to restore trust in the long-run sustainability of Irish public finances.

3) The financial sector adjustment was very significant, yet risks remain as outlined below.

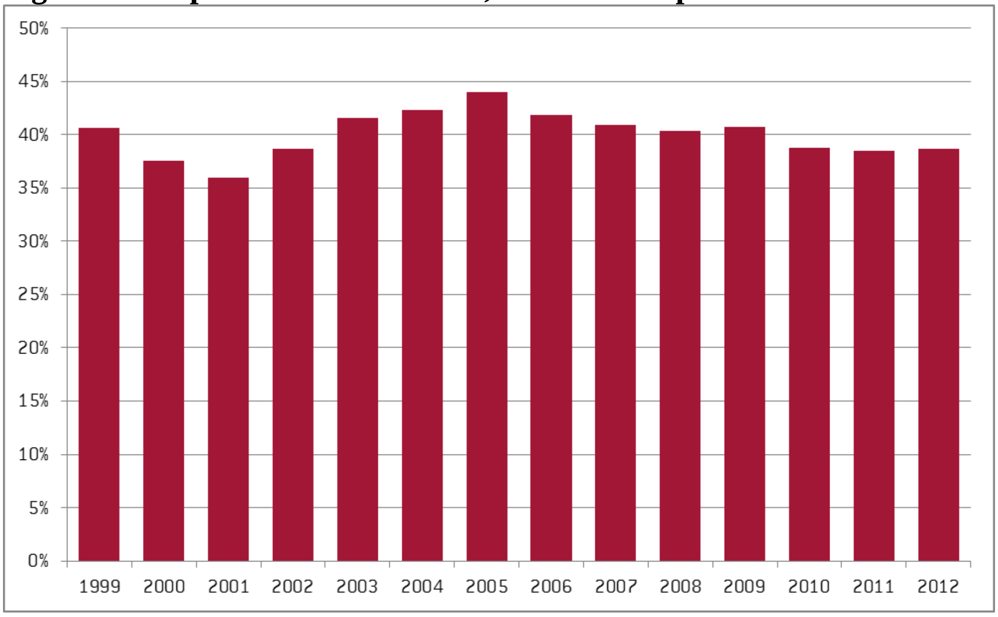
4) The terms of the financial assistance were significantly improved in favour of the Irish government. In particular, according to the European Commission (2013), the lending rate margins on the EFSM and EFSF were eliminated and the average maturity extended from 7.5 to 12.5 years in 2011 and again to 19.5 years in 2013. Furthermore, the agreement of the promissory notes for the banking sector came to a substantial benefit to the Irish treasury.

According to the Commission (2013), the successful completion of the economic adjustment programme implies that Ireland will return to the regular cycle of EU economic surveillance. "As a result, it will be fully subject to the procedures that had been suspended under the programme (as per Articles 11 to 13, in Regulation (EU) 472/2013). Fiscal surveillance under the excessive deficit procedure, which was embedded in the economic adjustment programme, will continue as Ireland is expected to correct its excessive deficit by 2015. In addition, and in line with the two-pack provisions (i.e. Regulation (EU) 473/2013), Ireland will have to submit draft budgetary plans to the European Commission starting with Budget 2015." (Commission 2013, p 40). There is also an additional post-programme surveillance (PPS) mechanism, adopted under Article 14 of Regulation (EU) No 472/2013. PPS will apply until at least 75% of the financial assistance received under the programme has been repaid and there will be regular review missions to the country. The missions will make an assessment, which is communicated to the European and Irish parliaments but only the Council, acting upon a recommendation of the Commission, may adopt a recommendation that Ireland take a policy measure to correct a development. Ireland will thus remain under significant scrutiny of the European Commission, in liaison with the ECB, for an extended period of time.

Although Ireland's can be deemed as a broadly successful macroeconomic adjustment programme through the lenses of all the three criteria outlined in section 2, we identify a number of key risks and challenges going forward.

1) The good external performance relies heavily on economic growth in the main trading partners. The structure of Irish trade has changed from almost 45% of exports going to the euro area to less than 40% going there by end-2012. With the global recovery still proceeding at subdued pace, significant risks emanating from the weak pick-up in trade and the likely inversion in the global monetary policy stance, there is a possibility of a slowdown, in particular in those markets to which Ireland exports. Weaker growth in the euro area would further weigh on Irish export performance.

Figure 23: Exports to the euro area, % of total exports



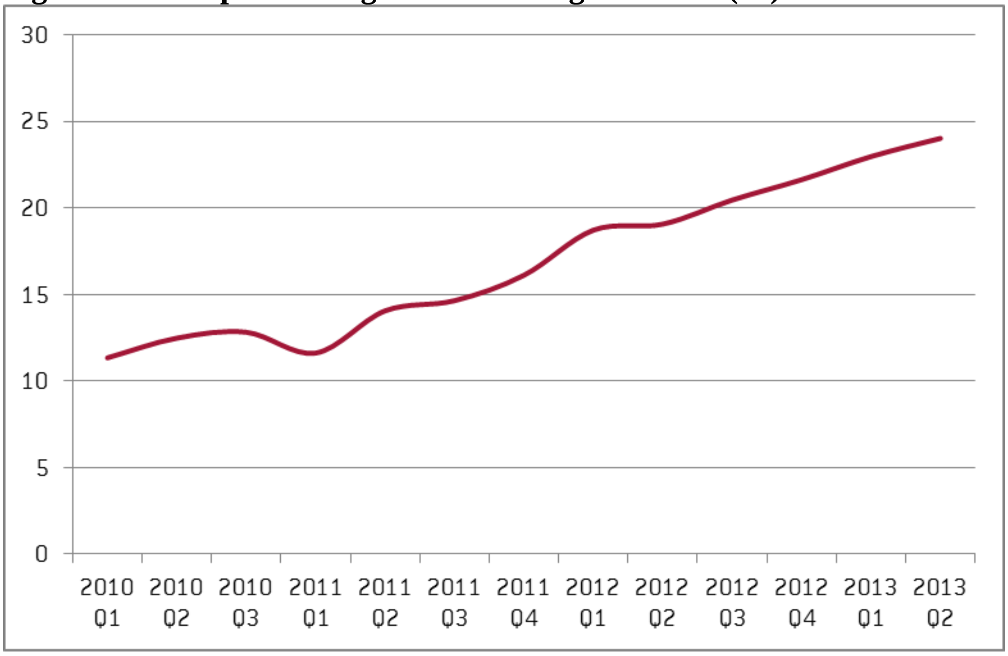
Source: IMF DOTS, Bruegel calculations.

2) The second major risks concern the Irish financial sector. Non-performing loans have been increasing almost steadily since 2010. Although the European Commission[11] reports that data on the last quarters of 2013 shows a stabilisation of NPLs, these remain at very high levels. To further clean the banking system from those loans will be a central task for the ECB, also in the framework of the upcoming comprehensive assessment (Merler and Wolff 2013). If weak balance sheets lead to an ever-greening of loans and a zombification[12] of the banking system, then the

[11] Economic Adjustment Programme for Ireland, Autumn 2013 Review, Occasional Papers 16, December 2013, p. 9 and 45.
[12] The term "zombie bank" refers to financial institutions with a negative net worth that continue to operate as government guarantees, bailouts or any kind of explicit or implicit government support allows them to meet their financial obligations and thus avoid or postpone bankruptcy. The term is attributed to Edward Kane's 'The S&L Insurance Mess: How Did It Happen?'

recovery will prove illusionary. Changes in the personal insolvency law are ongoing, as well as institutional changes in the mortgage markets, so that there is hope that the issue of NPL will be addressed effectively. However, this could turn out to be more hope than reality.

Figure 24: Non-performing loans to total gross loans (%)



Source: IMF Financial Soundness Indicators.

3) There is also a risk that too much hope is put in bank profits to achieve the recapitalisation of banks. The Commission (2013, p 29) argues that a "return to profitability is essential for banks to meet their future capital thresholds…". This can become a risky strategy as bank profitability is far from being secured.

4) There is also a risk that market sentiment will turn again against Ireland, following any potential macroeconomic shock or the discovery of substantial recapitalisation needs. This would result in rising yields and a renewed difficulty of the sovereign to tap the markets. The relatively large cash-buffers of €20 bn can be regarded as a significant insurance against this risk, as they would cover about one year of funding needs for Ireland. Yet, the decision to avoid a pre-cautionary credit line was heavily criticised (see, for example, Whelan 2013[13]). Indeed, the programme exit would have been made more robust by a pre-cautionary credit line of the ESM, for a period of 2 years or more. However, political forces were unanimous in their desire to at least formally re-establish political and financial independence.

Although the Irish programme can be considered a success, it is clear that the citizens of Ireland had to make very significant sacrifices in the course of the programme. This was to a large extent unavoidable, given the significant imbalances that had built up. The burden on citizens could have been made somewhat easier with the imposition of losses on senior unsecured creditors, but this would also have meant risks to the European financial system. The terms of the financial assistance have been eased very significantly so that the exit of the programme was made possible. A precautionary credit line would have made the exit more robust, especially as there are still substantial risks in the financial sector and in the global growth environment.

(1989), where the author wrote about the zombification of insurance institutions in the US and later about the banking system zombification in Japan.

[13] 'Ireland Exits Bailout With No Backstop: A Good Story?', accessed on 10 January 2014.

4.3 Portugal

Having lost affordable market access and facing sizeable bond repayments, the Portuguese government decided in April 2011 to make a formal request to the IMF and to European authorities for financial assistance.

The programme negotiated with the Troika covers four separate areas: (1) fiscal policy; (2) structural fiscal reform; (3) financial and corporate sectors reforms; and (4) competitiveness reforms. It is backed by €78 billion of international financial assistance over three years, corresponding to about 50 per cent of Portugal's GDP in 2011.

Programme design

Portugal has long suffered from weak structural conditions and endured low growth and rising imbalances after joining the euro. As a result, it was highly vulnerable to the financial crisis that started in 2008.

The Troika programme was fairly well designed but made a number of over-optimistic assumptions[14]:

- Real GDP was anticipated to contract in 2011 and 2012 due to fiscal adjustment and private deleveraging, but to subsequently rebound.
- Unemployment was anticipated to rise in 2011 and 2012 but then to decline.
- Inflation was anticipated to be high in 2011 and 2012 because of tax increases but low afterwards.
- The fiscal deficit was anticipated to reach 3 percent of GDP by 2013 in line with the Excessive Deficit Procedure objective. Public debt was expected to peak at 115.3 percent of GDP in 2013 and then to decline.
- The current account deficit was anticipated to decrease gradually thanks to both decreasing imports, due to lower domestic demand, and increasing exports associated with rising supply.
- The net international investment position (IIP) was anticipated to reach a peak of -123.4 percent of GDP in 2013 and improve thereafter.

Projections for the period 2011-14 are shown in the left-hand panel of Table 9.

Table 9: Portugal, selected macroeconomic indicators, 2011-14 (% of GDP unless otherwise specified)

	Programme June 2011				Projected November 2013			
	2011	2012	2013	2014	2011	2012	2013	2014
Real GDP (percent change)	-2.2	-1.8	1.2	2.5	-1.6	-3.2	-1.8	0.8
Consumer prices (percent change)	3.5	2.1	1.4	1.5	3.6	2.8	0.6	1.0
Unemployment (percent)	12.1	13.4	13.3	12.0	12.9	15.9	17.4	17.7
General government deficit	5.9	4.5	3.0	2.3	4.4	6.4	5.9	4.0
General government debt	106.4	112.2	115.3	115.0	108.0	124.1	127.8	126.7
Current account deficit	9.0	6.7	4.1	3.4	7.2	1.9	-0.9	-0.9
Net IIP (negative)	116.9	123.3	123.4	121.4	n.a.	n.a.	n.a.	n.a.

Source: IMF programme request (June, 2011) and European Economic Forecast, Autumn 2013.

[14] See Pisani-Ferry et al (2013) for details and similar argument.

Programme execution during the first two and a half years

The major macroeconomic developments of Portugal's economy since 2011, according to the autumn Commission forecasts of November 2013, are as follows:[15]

- There was a lower contraction of real GDP in 2011 than originally expected, but the contraction was 3.2 percent instead of the predicted 1.8 percent in 2012 and 1.8 per cent, instead of an anticipated growth of 1.2 per cent in 2013. A shallow recovery is now anticipated only in 2014. For the period 2011-14, the accumulated loss of GDP growth compared to the initial expectation will therefore be 5.5 percentage points.
- Partly as result of this poor growth performance, unemployment is now expected to rise until 2014 instead of 2012, and to reach a much higher peak of 17.7 percent in 2014 compared to an earlier predicted peak value of 13.4 per cent in 2012.
- Inflation is more or less according to expectation.
- The fiscal deficit was lower than expected in 2011, but thereafter Portugal has underperformed compared to the programme. The country could not meet the EDP objective of 3 percent of GDP by 2013, which was therefore postponed.
- The lower than predicted growth performance has resulted in higher debt levels. Instead of reaching a peak of 115.3 percent of GDP in 2013 as originally predicted, the Commission now predicts that Portugal's public debt peaked at 127.8 percent of GDP in 2013.
- The current account deficit has reduced faster than expected. It was 7.2 percent of GDP in 2011 instead of the originally predicted 9 percent and turned into a surplus already in 2013 (driven by both decrease in imports and increase of exports).

Table 9 shows the details of these developments and their comparison with the programme forecasts.

Figure 25 shows the differences between the initial (June 2011) projections and the revised projections by the time of the third (April 2012), sixth (January 2013) and the combined eighth and ninth (November 2013) review missions. The main features are again the poor debt and unemployment performance and the good current account performance, all three indicators having been once again revised upwards in November 2013.

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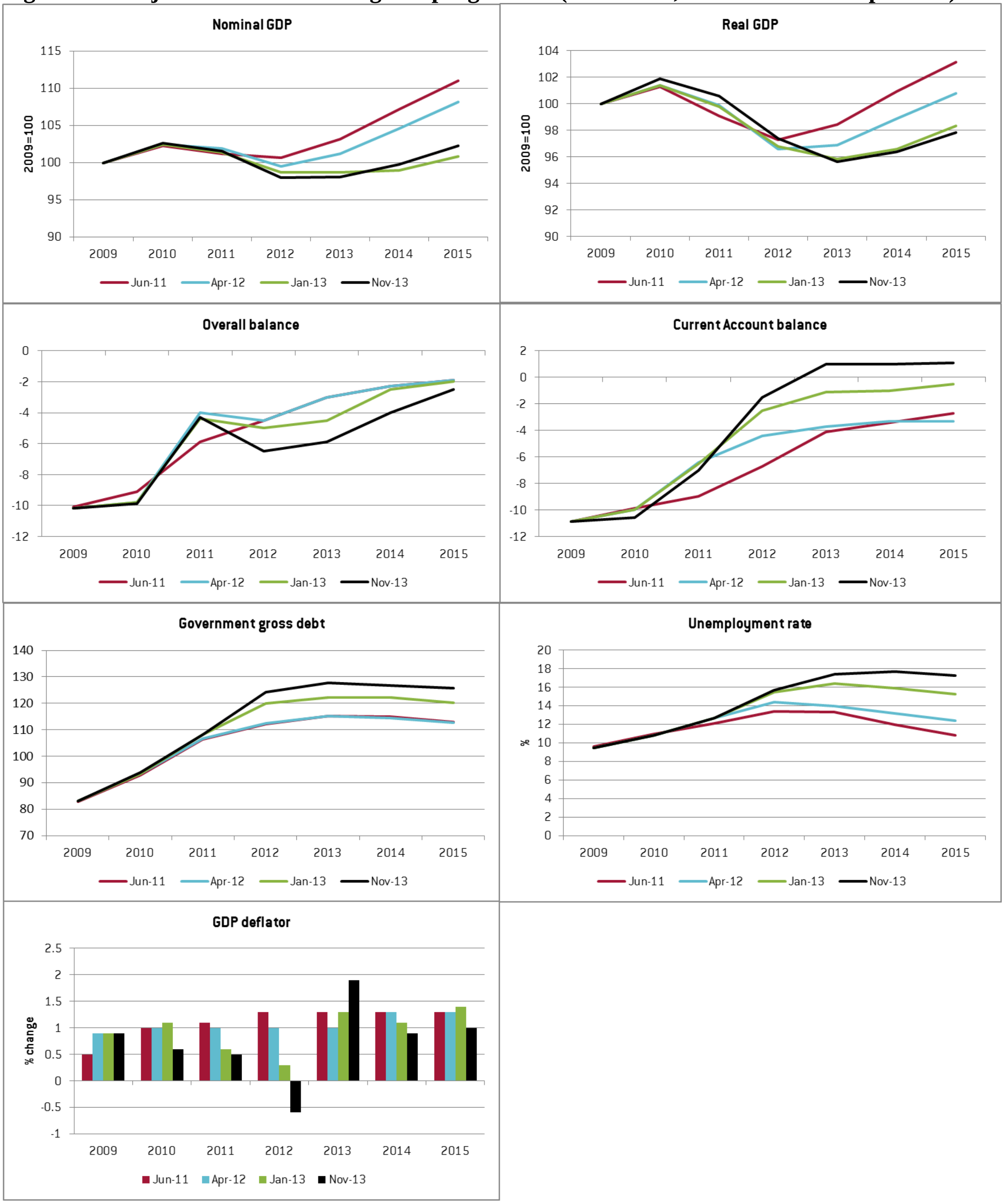
[15] The following points again update Pisani-Ferry et al (2013).

Figure 25: Projections for the Portuguese programme (% of GDP, unless otherwise specified)



Source: IMF programme documents.

Overall, Portugal's macroeconomic performance justifies the 3 October 2013 Troika statement, following its combined eighth and ninth review mission to Portugal, that implementation of the programme is *"broadly on track"*. After two and a half years of programme implementation, the situation in Portugal exhibits two contrasting trends compared to expectations. First, the recession in 2012 and 2013 has been much deeper than expected. As a result, unemployment reached more than 15 per cent in 2013 and is expected by both the IMF[16] and the European Commission[17] to rise further in 2014.

One of Portugal's main problems continues to be the sharp decline in investment since 2008, which the programme has not succeeded in reversing so far. Investment declined by more than 10 percent in 2011 and again in 2012, and suffered a further contraction of nearly 9 percent in 2013. The November 2013 Commission forecasts however predict a (very) small increase of investment in 2014.

Disappointing growth has made the deficit targets unachievable. The government was obliged to ask for an upward revision of the deficit targets in 2013 and 2014, which was granted by the ECOFIN Council in April 2013. The originally-agreed 2013 deficit target of returning below the 3 percent excessive deficit mark, which had already been postponed to 2014 the year before, was further postponed to 2015. The new target for 2013, a fiscal deficit of 5.5 percent of GDP, is likely to be reached according to news published in Portugal in mid-January 2014. Nonetheless, the public debt will have continued to increase in 2013. But according to the November 2013 Commission forecasts, the public debt will have peaked at 127.8 percent of GDP in 2013. The Commission also expects a slight decline of the debt in 2014 (to 126.7 percent of GDP). This should come in part from the agreement of the ECOFIN Council to reschedule some EU loans.

On the other hand, external adjustment has been much faster than expected, thanks to improved export performance (a cumulative +9.6 percent in 2012 and 2013) and a fall in imports (a cumulative -6.7 percent in 2012 and 2013).

Similarly to the other country chapters, Annex 5 (of which Table 10 is a snapshot) provides a detailed account of the main measures enacted by the Portuguese government under the headings of fiscal consolidation, growth, and financial stability.

[16] IMF WEO, October 2013.
[17] European Commission, Autumn 2013 Forecast

Table 10: Summary of main measures (illustrative excerpt) taken as part of programme macroeconomic conditionality

Heading	Major actions required	To be completed by	Evaluation	Date of evaluation	Note
Fiscal consolidation	Raise VAT revenues by reducing VAT exemptions; moving categories of goods and services from the reduced and intermediate VAT tax rates to higher ones	end-2012	Observed	Feb-2012	
Growth and competitiveness	Eliminate "golden shares" and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state	Jul-2011	Observed	Sep-2011	
Financial stability	Direct all banking groups subject to supervision in Portugal to reach a core Tier 1 capital of 9 percent by end-2011 and 10 percent by end-2012 and maintain it thereafter	Jun-2011	Met	Jun-2011	prior action
			Observed	Dec-2012	10% CT1

Note 1: This table is only an illustrative excerpt. For the complete table, please refer to Annex 6.
Note 2: "Met" indicates that the 9% Tier 1 target was met in June 2011 instead of December 2011 (early achievement).
Source: EC programme documents.

Despite a number of political and judicial setbacks, Portugal has faithfully implemented the Troika's budgetary recommendations. Overall, as it can be seen on Annex 5, Portugal complied with most of the agreed programme conditionality, though with some delays on structural reforms where there is still work to be done. Thus, according to our criterion 2, we assess the Portuguese programme as fairly successful in this sense.

Prospects for exiting the programme

Portugal's deficit will not return below 3 percent of GDP in 2013, as originally foreseen by the programme, nor in 2014, but it is on track to do so in 2015. As far as the debt-to-GDP ratio is concerned, it may have peaked on schedule in 2013, but by that time it was 13 points higher than initially foreseen. The main reason for the slippage in public debt is the continuing growth under-performance. As already indicated, the cumulated loss of GDP growth for the period 2011-14 was estimated to be 5.5 percentage points by the Commission's November 2013 forecasts. This is also the main reason why unemployment has reached nearly 18 percent.

Despite its high debt level and its poor growth performance, markets continue to be well disposed towards Portugal. The country's National Debt Agency successfully issued 3- and 12-month treasury bills in January and February 2013, and even returned to the bond market with a 5-year issuance at a yield of 4.9 percent.

A year later, in January 2014, the situation has further improved. On January 9, Portugal successfully issued €3.25 billion of 5-year debt at a yield of 4.657 percent. And 10-year bond yields are now below 5.5 per cent, but still 175 basis points above Ireland, 130 points above Spain and 120 points above Italy.

The positive market sentiment towards Portugal comes from three factors. First, there is increased market confidence in the stability of the euro area in general and towards programme countries in particular, which improved further with the exit of Ireland from the Troika programme and its successful issuance of 10-year government debt on January 7.

Second, there has been all along the programme a high degree of mutual understanding and close cooperation between the Portuguese authorities and not only the Troika, but also institutional market participants. Third, and because of the trust that Portugal has managed to build, market participants feel, rightly in our view, that Portugal will receive all the necessary support to be able to exit the programme on schedule in May 2014.).

Despite, or even because of, this positive sentiment, our view is that it would be unwise for Portugal, and for the euro area, to exit the programme in June 2014 without having secured precautionary financial assistance from the ESM via its enhanced conditions credit line (ECCL, see below for details) facility, which would then probably qualify the country for the ECB's OMT. The reason is that the Portuguese economy will remain weak and vulnerable to potential shocks for some time to come.

Portugal's predicament can be judged by comparing the situation where it will be in 2014-15, according the combined eighth and ninth programme review of November 2013, and where it was in 2004-08, when according to Blanchard (2006) *"Portugal faced an unusually tough economic challenge: low growth, low productivity growth, high unemployment, large fiscal and current account deficits"* (See Table 11). In other words, unlike other euro area programme countries, Portugal did not experience and economic boom before the crisis and its medium-term growth trend is projected to remain basically unchanged unlike for most of the euro area. This highlights how the macroeconomic problems of the country were deeply rooted before the crisis and only exacerbated by financial market jitters.

Table 11: Portugal, selected macroeconomic indicators, 2004-08 and 2014-15 averages (in percent of GDP, unless otherwise specified)

	Actual (2004 – 08)	Projected (2014 – 15)
Real GDP (% change)	1.2	1.1
GDP deflator (% change)	2.4	1.1
Nominal GDP (% change)	3.6	2.2
Nominal LT interest rates (%)	4	6
Productivity (% change)	1.1	1.2
Unemployment (%)	8.4	17.5
General government balance	-4.4	-3.3
Primary balance	-1.6	-1
General government debt	70	126.2
Current account	-10.4	1

Source: European Commission, 2013.

On the plus side, the current account deficit will be much lower in 2014-15 than it was before the crisis, and public deficits will also be somewhat lower. On the negative side, unemployment and public debt will be about double of what they were in 2004-08.[18] Debt and social sustainability will, therefore, be crucial going forward. And sustainability depends on growth. The problem that Portugal faces is that it needs to change its pre-crisis growth model, which produced stagnation after the country joined the euro, and that

[18] According to Tortus, a New York based hedge fund, Portugal's public debt in 2013 was not 128 percent of GDP but 147 percent if one accounts for the debt of state owned enterprises and other public or semi-public bodies. See the blog post by Dan McCrum in FTAlphaville of 9 January 2014 entitled "The Tortus sell is Portugal".

such change takes time. Otherwise the combination of high debt levels, high nominal interest rates and low nominal GDP growth would render the debt unsustainable, making a restructuring inevitable.[19]

A major weakness of the Portuguese economy is the low degree of competition in non-tradable activities that makes them relatively more profitable than tradable activities, which are also affected by the small size of firms and the difficulty of obtaining appropriate financing. The structural reform agenda of the Troika programme aims at boosting competitiveness and redirecting economic activity from non-tradable to tradable activities. These measures, however, take time to implement and bear fruit. A major question, therefore, will be the capacity of the government to pursue the necessary reforms, in both product and labour markets, after the end of the programme.

According to the ESM Guideline on Precautionary Financial Assistance, such assistance aims to support ESM Members whose economic conditions are still sound to maintain continuous access to market financing by reinforcing the credibility of their macroeconomic performance while ensuring an adequate safety-net.

Precautionary financial assistance may be provided via a Precautionary Conditioned Credit Line (PCCL) or via an Enhanced Conditions Credit Line (ECCL). Countries need to fulfill more conditions to be eligible for a PCCL than for an ECCL, in exchange of which less conditions are imposed to PCCL than to ECCL beneficiaries.

The criteria for judging whether an ESM country is eligible for a PCCL are as follows: (a) respect of the commitments under the stability and growth pact; (b) a sustainable general government debt; (c) respect of the commitments under the excessive imbalance procedure (EIP); (d) a track record of access to international capital markets on reasonable terms; (e) a sustainable external position; and (f) the absence of bank solvency problems that would pose systemic threats to the stability of the euro area banking system.

Although Portugal may be meeting some of these criteria by the time it plans to exit the Troika programme in May 2014, it is unlikely to meet all of them, and therefore to be eligible for a PCCL. If it decided to apply for precautionary financial assistance it would therefore need to seek an ECCL whose eligibility only requires that the country’s general economic and financial situation remains sound.

The advantage of having an ECCL precautionary arrangement in place before Portugal exits the Troika programme is that – in addition to providing an insurance against potential shocks to which the country is exposed due to its high debt level – it would keep in place a powerful framework to help pursue the necessary growth-enhancing structural measures.

Countries that are granted an ECCL (and those that are actually drawing on a PCCL) are subject to enhanced surveillance by the European Commission for the availability period of the credit line. Such surveillance is less strict than under a regular (as opposed to a precautionary) assistance programme, but stricter than post-programme surveillance that applies in any event to all countries exiting an EFSM, ESM or EFSF programme as is already the case for Ireland and will be the case of Portugal when it also exits the Troika programme.

In conclusion our view is that Portugal and its euro area partners should be cautious when the issue of exiting the Troika programme comes on the agenda of the ECOFIN Council next April, one month before

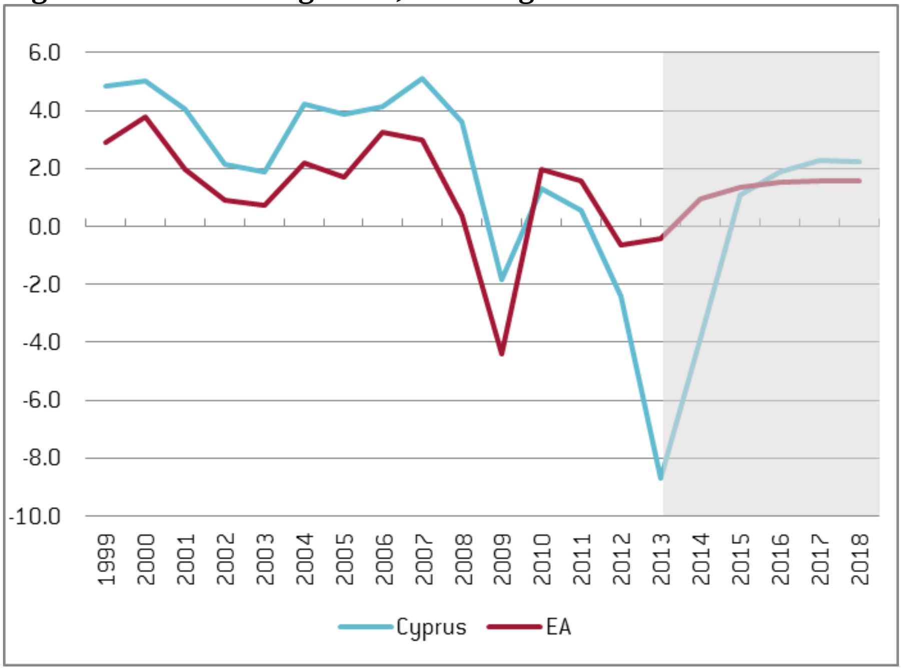
[19] According to both Tortus and Dan McCrum, a debt restructuring with private sector losses plus an extension of maturity and a lowering of borrowing cost on official sector loans is inevitable given the current debt level and the poor prospect of sufficient nominal GDP growth or primary budget surplus.

the 3-year programme expires. While both parties may be tempted to go for a "clean exit" in order to claim political success, the fragile situation of Portugal, with a high public debt level and relatively low nominal GDP growth and high long-term interest rates, makes it desirable that exit be accompanied by a precautionary programme to avoid macroeconomic difficulties and to continue implementing growth-enhancing structural measures.

4.4 Cyprus

After a mild recovery in the two years following the 2009 global financial crisis, the Cypriot economy fell back into recession in 2012 along with the euro area as a whole. Yet, its deep linkage with the Greek economy alongside a particularly large banking system, a heavily leveraged private sector and delayed actions from the government to safeguard the stability of the financial system, dragged its economy further down than that of the rest of the euro area.

Figure 26: Real GDP growth, % change



Source: IMF WEO October 2013, figures for 2013 and onwards based on IMF forecasts.

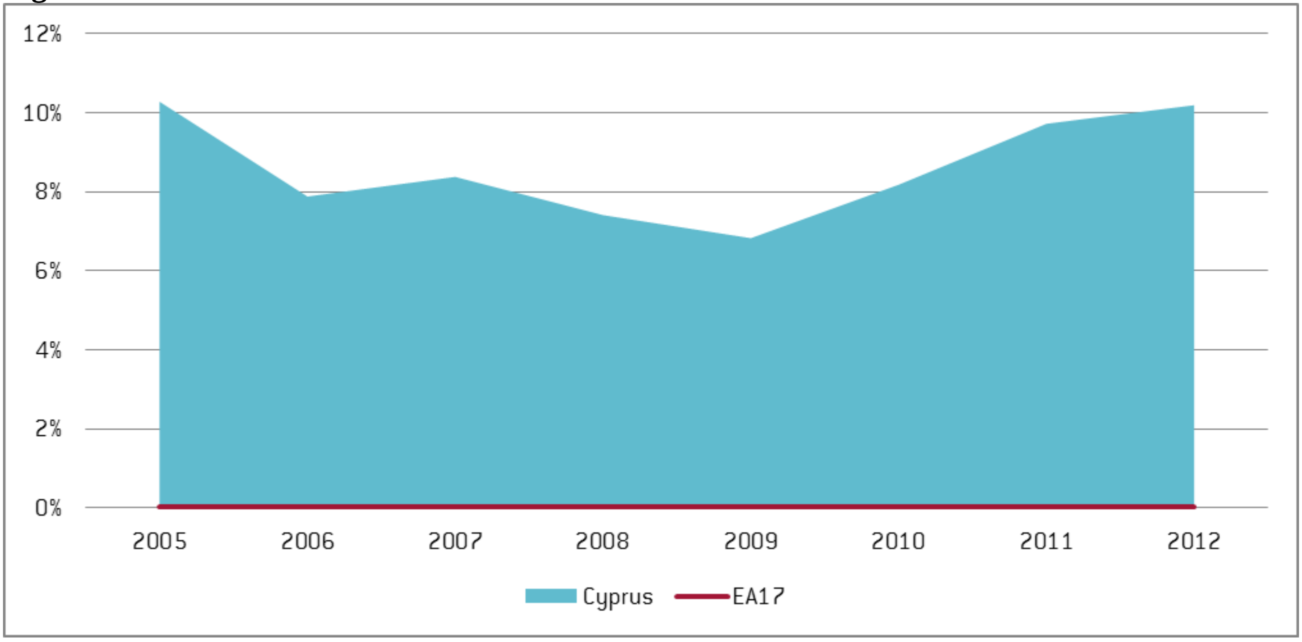
Exposure to Greece

The Cypriot banking system was deeply exposed to Greece, not only through holdings of Greek sovereign debt, but also through claims on Greek banks and loans to Greek households and corporations through Cypriot bank branches in Greece. To illustrate the magnitude of the Cypriot exposure to Greece the following graph shows that the total consolidated financial claims[20] of Cypriot banks on Greece (i.e. on

[20] The BIS defines foreign claims as loans, deposits placed, holdings of debt securities, equities and other on-balance sheet items. Note that foreign claims do not include other exposures, such as derivative contracts, guarantees and credit commitments. We make use of the reported consolidated foreign claims on an ultimate risk basis: "Unlike the BIS consolidated international banking statistics on an immediate borrower basis, they are adjusted for net risk transfers", thus when a branch or subsidiary of a Cypriot bank in Greece lends to a Greek resident the ultimate risk resides on Cyprus. For more information about the BIS consolidated international banking statistics on an ultimate risk basis see '[Measuring banking systems' exposures to particular countries]'.

public sector, banks and non-bank private sector[21]) represented almost 10% of all Cypriot consolidated financial assets, while for the euro area 17 the share of financial claims on Greece over the total consolidated financial assets is not even 0.1%.

Figure 27: Claims on Greece as a share of total consolidated financial assets

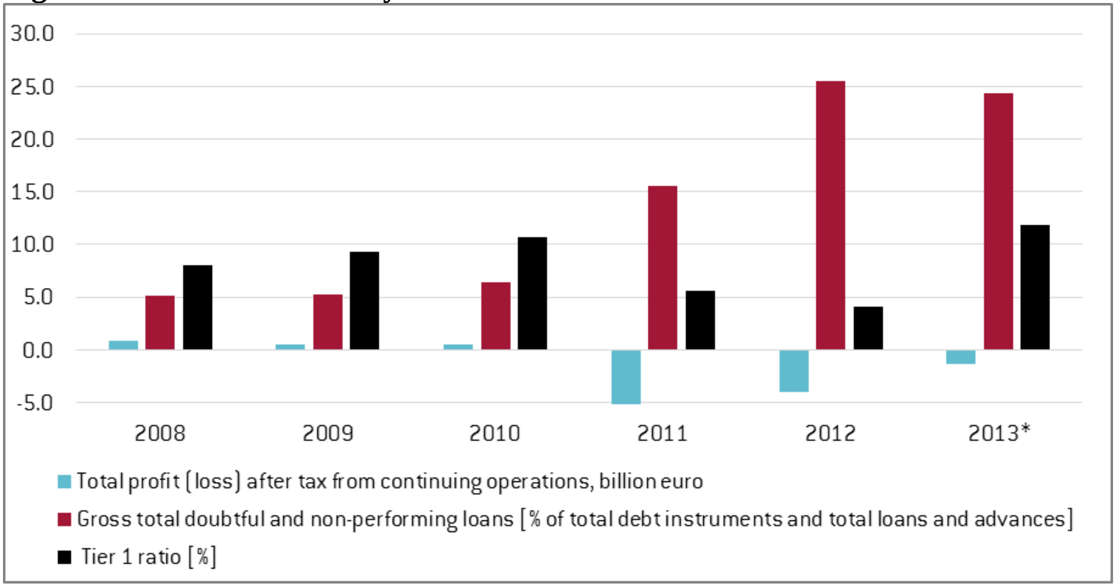


Note: The share corresponds to the ratio of consolidated foreign claims on an ultimate risk basis as reported by the BIS on Table 9D over the total consolidated financial assets as reported by Eurostat on the euro area financial accounts.
Sources: Eurostat, BIS and Bruegel calculations.

A haircut of at least 74% was applied to the nominal value of Greek government bond holdings at the end of June 2012. Bank of Cyprus and Cyprus Popular Bank (the two largest banks in Cyprus) lost 1.8[22] and 2.3[23] billion euro, respectively. The total bank losses in Cyprus as a consequence of the Greek PSI are estimated at 4 billion euro (around 22% of GDP) according the European Commission[24]. This, combined with a rapid increase in NPL (from both Cypriot and Greek borrowers) and a general worsening of all a major financial soundness indicators, turned net bank profitability negative, as can be seen in the following figure.

[21] The Economic adjustment programme reports that "In September 2012, domestic banks' direct loans to the Greek economy amounted to EUR 19 billion, which was the equivalent of about 111% of Cypriot GDP", The Economic Adjustment Programme for Cyprus, Occasional Papers 149, May 2013, p. 15
[22] See 'Insight: Why did Cypriot banks keep buying Greek bonds?', accessed on 18 January 2014.
[23] See 'Insight: Inside Laiki – Countdown to catastrophe', accessed on 18 January 2014.
[24] The Economic Adjustment Programme for Cyprus, Occasional Papers 149, May 2013, p. 31

Figure 28: Financial stability indicators

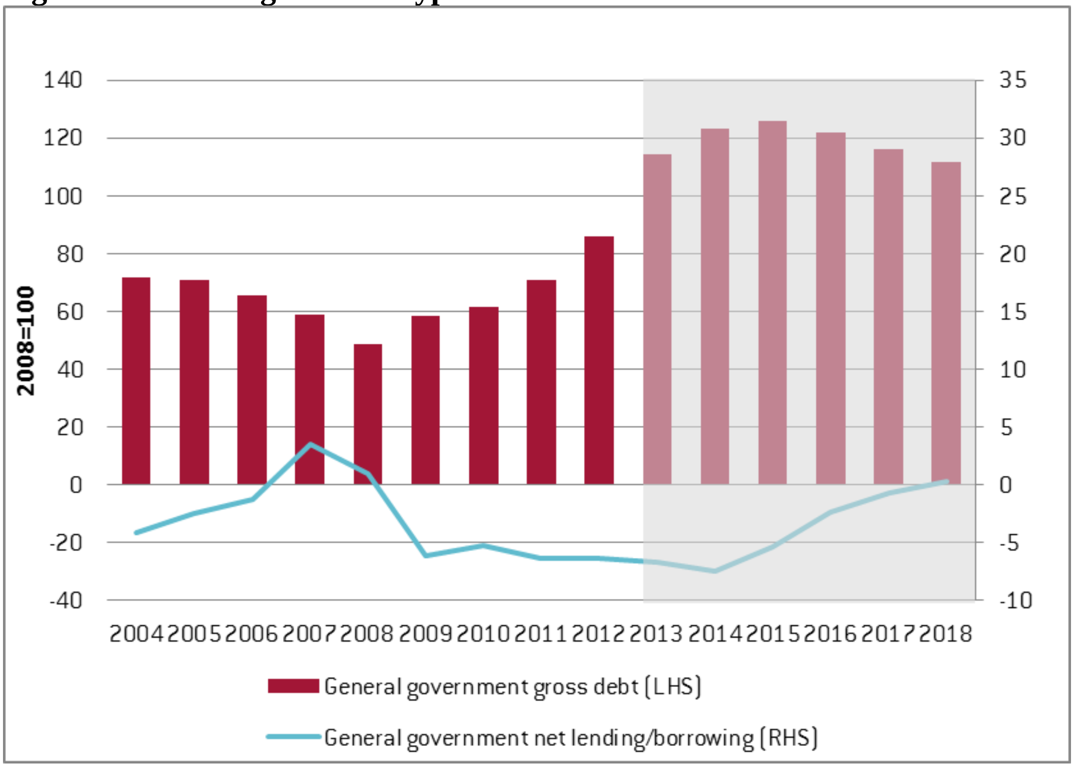


Note: Data corresponds to total domestic banking groups and stand-alone banks. 2013 figures correspond to the first semester, thus total losses are not strictly comparable, for instance the total losses of the first semester of 2013 were only 0.6% smaller than during the first half of 2012.
Source: ECB data warehouse: monetary and financial statistics, consolidated banking data.

The fiscal side

Despite the fact that when the global crisis struck, Cyprus had healthy public finances (a gross debt to GDP ratio below 60% and a general government surplus in 2008), the numbers quickly deteriorated and debt started to pile up rapidly. The deficit widened despite the mild economic recovery experienced in the 2010-2011 period.

Figure 29: Fiscal figures for Cyprus



Source: IMF WEO October 2013.

Athanasios Orphanides, governor of the Central Bank of Cyprus between 2007 and 2012, stated at an event at London School of Economics and an interview for The Economist[25] that in May 2010, he had sent a letter to the president warning about the unsustainable fiscal situation; he stated that given the "large size of the banking sector compared to GDP", and the high public and private indebtedness, "unless there is a change in direction with meaningful fiscal consolidation, primarily on the expenditure side, the consequences for the Cypriot economy will be catastrophic". Later, in December 2010, the ECB sent a letter to the Cypriot president, Demetris Christofias, co-signed by the then president of the ECB Jean-Claude Trichet and Anasthasios Orphanides with a similar statement.[26]

On the 31 May 2011 Cyprus was downgraded by S&P and Fitch ratings, as there were increasing rumours about the upcoming Greek PSI and the large exposure of Cypriot banks to Greece was well known; consequently Cyprus lost access to international capital markets, but instead of seeking for financial assistance from the EU and undergoing a macroeconomic adjustment programme, the Cypriot government made a bilateral deal with Russia for a 2.5 billion-euro loan on 23 December 2011[27] to cover the government's 2012 financing needs. The repayment was originally foreseen for 2016 at an interest rate of 4.5% but its terms were improved in August 2013[28].

A week before the agreement of this bilateral loan with Russia, the Cypriot parliament approved the 2012 budget law incorporating fiscal consolidation measures aimed at reducing the general government deficit from 6.3 to 2.5 percent of GDP in 2012. But despite the fiscal consolidation efforts, estimated at 4 percent of GDP by the European Commission, the deficit remained at 6.3 in 2012, as the government had to recapitalise Cyprus Popular Bank when it failed to raise 1.8 billion euro on the markets.

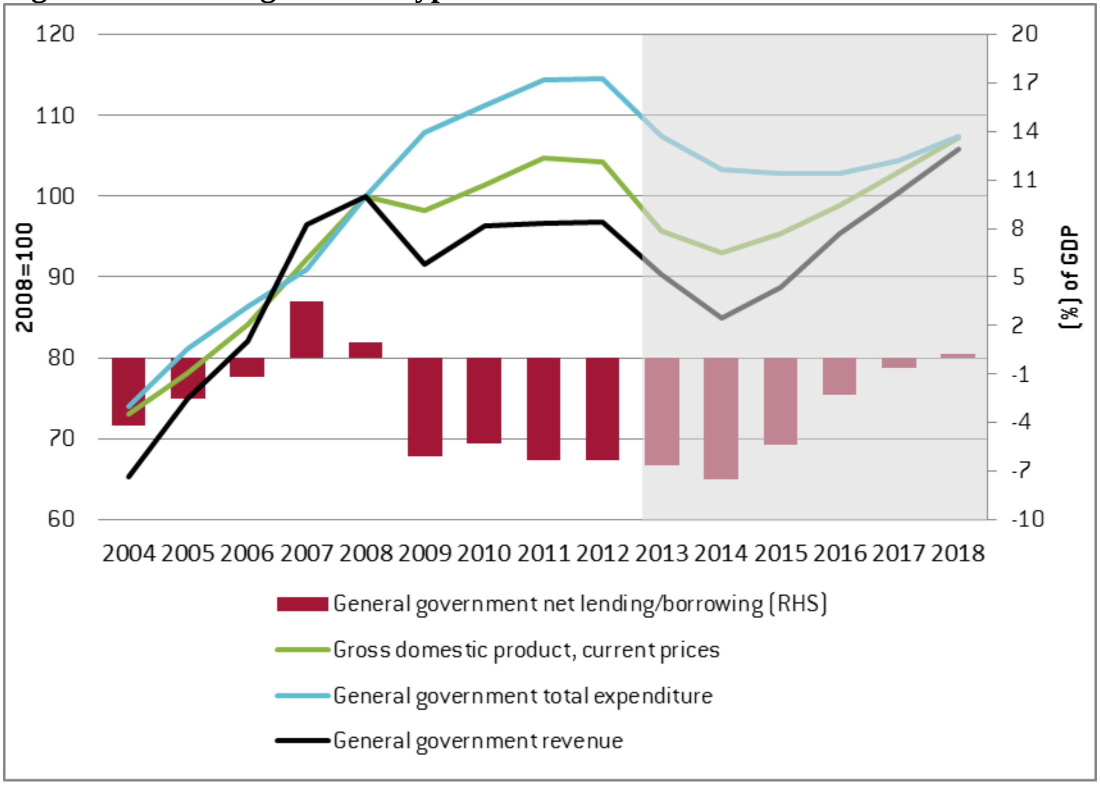
[25] The politics of the euro area crisis and Cyprus, May 15, 2013: Athanasios Orphanides and David Marsh What happened in Cyprus: An interview with Athanasios Orphanides, The Economist, March 28, 2013

[26] "In light of recent market concerns about public debt sustainability, it is more important than ever that every country benefiting from the common currency takes prompt and effective steps to ensure that its public finances are on a sound footing. Experience has shown that waiting for market pressures before acting exacerbates tensions and ultimately increases the needed adjustment size. Although Cyprus' sovereign debt market has a limited size, significant concerns exist. These concerns are particularly relevant in view of the large size of the Cypriot banking system, which may produce negative feedback loops between the financial sector and public debt. […]The challenges faced by the Cypriot economy require prompt corrective action. We are confident that the Government will rapidly take the needed measures." See 'Christofias had been warned from 2010 of looming disaster', accessed on 12 January 2014.

[27] The Economic Adjustment Programme for Cyprus, Occasional Papers 149, May 2013, p. 38

[28] According to the state owned Cyprus news agency Cyprus Mail to eight equal biannual payments between 2018 and 2021 at an interest rate of 2.5%. This information was later confirmed on Economic Adjustment Programme for Cyprus, First Review, Summer 2013, Occasional Papers 161, May 2013, p. 45

Figure 30: Fiscal figures for Cyprus



Source: IMF WEO October 2013.

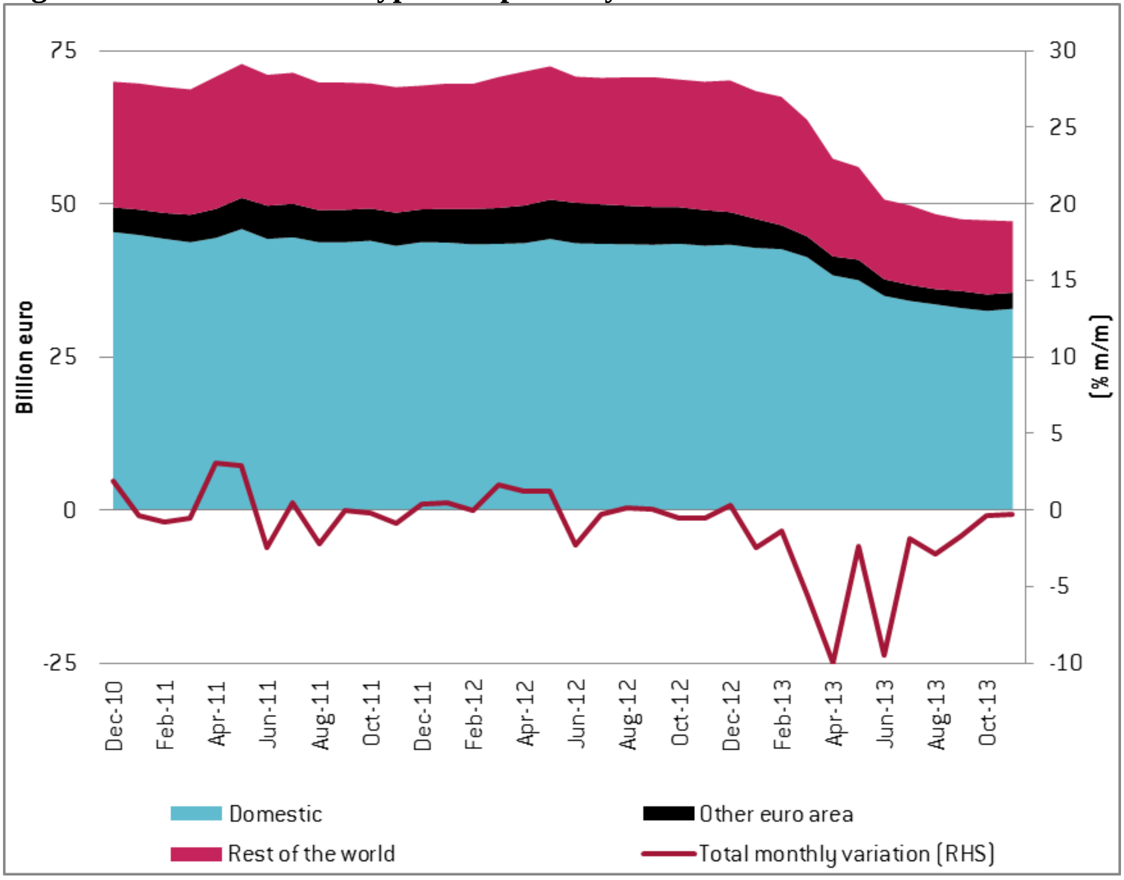
As the recession deepened and fiscal revenue further deteriorated, Cyprus presented a formal request to euro-area Member States for external financial assistance from the EFSF/ESM on 25 June 2012, but the political environment delayed the final approval of the programme for 10 more months, until after the elections and the formation of a new government. According to the Cypriot Minister of Finance in response to the questionnaire sent by the EP, “Negotiations regarding the MoU did not proceed in a timely and effective manner”[29].

The introduction of capital controls in Cyprus

As financial soundness indicators kept deteriorating, a deposit flight began in January 2013; almost 4% (2.7 billion euro) of total deposits were lost during the first two months of the year, and as the rumours of an upcoming bail-in on depositors spread, the deposit flight intensified in March. Total deposits in Cyprus had remained very stable at 70 billion euro during the previous 24 months (see Figure 31).

[29] Questionnaire sent by European Parliament to Minister of Finance, question 4, p. 2

Figure 31: Breakdown of Cypriot deposits by holder



Source: Central Bank of Cyprus.

The financial assistance programme

On Saturday morning March 16, the Eurogroup reached an agreement with the Cypriot authorities to apply a one-off "stability levy" on deposits of residents and non-residents in order to limit the size of the financial assistance programme to €10 billion. The initial agreement entailed a one-off wealth tax of 6.75% on deposits below €100,000 and 9.9% on deposits above this threshold. This agreement was supported by most European leaders including the Cypriot president Nicos Anastasiades.

The agreement was rejected by the Cypriot House of Representatives on March 19. The ECB's Governing Council announced on March 21[30] its decision to stop the Emergency Liquidity Assistance (ELA) provision as of March 25, unless an EU/IMF programme was in place. To avoid an outright bank run, Cyprus declared a bank holiday until March 28.

The rejection of the bail-in of insured depositors by the Cypriot House of Representatives was the right call, as bailing-in insured depositors would have undermined the credibility of the deposit insurance schemes in the entire EU. Verón (2013[31]), for example, stated that "the plan displayed a remarkable disregard for the lessons of financial history about the high importance of deposit safety". Yet, the Cypriot parliament did not propose an alternative solution as to how and where the necessary resources could be collected.

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[30] See ECB Press Release, accessed on 10 January 2014.
[31] See the Bruegel blog entry: 'Europe's Cyprus Blunder and Its Consequences'.

On March 22 the Cypriot government established restrictive measures on capital movements (read it capital controls). These measures were supported by the ECB and the European institutions in the hope to avoid uncontrolled capital outflows that could threaten financial stability in Cyprus. Yet, this step set a dangerous precedent in a monetary union and was arguably the single most important mistake in the Cyprus crisis management. Wolff (2013[32]) argued that "the most important characteristic of a monetary union is the ability to move money without any restrictions from any bank to any other bank in the entire currency area. If this is restricted, the value of a euro in a Cypriot bank becomes significantly inferior to the value of a euro in any other bank in the euro area."

Arguably, the imposition of capital controls de-facto meant that Cyprus had left the euro. Wolff (2013) argued that the proper way of dealing with the situation would have been to impose deep losses on bank creditors and restructure the banking system fundamentally. The remainder of the banking system should have then been able to enjoy the trust of the ECB. In other words, the capital flight, which could have happened after the restructuring, could have been fully compensated by ECB liquidity via the Target2 system. This would have been the appropriate liquidity provision to a solvent banking system.

Whether applying the restrictive measures was avoidable or not is now secondary, but abolishing them as soon as it can possibly be done without creating major financial disruptions must be a priority of the financial assistance programme. Historically, capital controls have proven extremely difficult to lift once in place; several studies (Rogoff 2002, Forbes 2007, Ewards 1999, Danielson 2013) have shown that controls on capital outflows are not only ineffective, but also generate incentives to corruption as they create price distortions, misallocation of resources and arbitrage opportunities.

The Troika recognised that "temporary restrictions required to safeguard financial stability will hamper international capital flows and reduce business volumes in both domestic and internationally oriented companies"[33]. Yet, there was no clear plan for the abolition of the restrictive measures on capital movements when the original Economic Adjustment Programme for Cyprus was approved.

It was not until August 2013 that the Cyprus Ministry of Finance published a "Roadmap for the Gradual Relaxation of the Restrictive Measures"[34]**.** The roadmap presented four clear stages to abolish the capital controls, and their respective milestones are in line with the financial sector objectives described in the first review of the programme[35]. The roadmap was later integrated on the second review[36]. But the roadmap lacks a specific time frame, which is in line with historical experience that capital controls remain in place longer than usually intended (see for example Danilsson 2013[37], who discusses the Iceland experience.) In a monetary union, the lifting of capital controls is in principle easier to achieve, as the common central bank can stand ready to replace outflowing liquidity. The fundamental issue is thus about addressing the solvency problems in the banking system and the restructuring of banks where necessary. Still, significant problems remain in the banking system, as the key banking sector indicators (see figure 29 above) suggest.

[32] See the Bruegel blog entry: 'Capital controls in Cyprus: the end of Target2?'.
[33] The Economic Adjustment Programme for Cyprus, Occasional Papers 149, May 2013, p. 40
[34] See the Press Release: 'Roadmap for the gradual relaxation of the restrictive measures'.
[35] Economic Adjustment Programme for Cyprus, First Review, Summer 2013, Occasional Papers 161, May 2013, section 3.1 p. 25-30
[36] Economic Adjustment Programme for Cyprus, Second Review, Autumn 2013, Occasional Papers 169, December 2013, p. 21 and 23
[37] See 'The capital controls in Cyprus and the Icelandic experience', accessed on January 15 2014.

The financial sector reforms were judged as partially compliant in the programme's second review. A delay in "the submission of the restructuring plan of the cooperative sector"[38] (originally intended to be delivered by the end of September 2013) is highlighted among the non-compliant measures and it is now expected to be submitted to the European Commission by the end of January 2014. The restructuring plan entails the merge of 93 CCI into 18 institutions under the management of the Central Cooperative Bank, which will be under State control after a capital injection of EUR 1.5bn, a process that is stipulated for completion by the end of March 2014.

The rest of the scheduled financial reforms are on track according to the programme second review and the latest developments. Hellenic Bank completed its capital raising plan to cover a capital shortfall of EUR 300m without relying on State aid. The restructuring plan for Bank of Cyprus was already submitted to the Central Bank of Cyprus and the reorganisation of the bank into a smaller, safer and more profitable bank is progressing: 50 branches have been closed, an active programme to handle NPLs has been launched and EUR 950m in fixed term were released at the end of January from a total of EUR 2.9bn of deposits that were blocked when the bank was recapitalised[39].

The programme entails permanent measures of fiscal consolidation equivalent to 6.5% of GDP for the years 2013-2014, and some additional 2.5% of GDP over the period 2015-2016. This fiscal adjustment, along with a massive downsizing of the banking system[40], resulted in a projected GDP contraction of 12.3% over the 2013-2014 period, followed by a slow recovery towards a 2% growth trend during the following two-year period.

An increase in the corporate income tax from 10 to 12.5 percent, raising the bank levy rate from 0.11 to 0.15 percent, raising the tax rate on interest from 15 to 30 and the property tax reform have an expected immediate fiscal consolidation effect of 2 percent of GDP from the before mentioned 6.5% in fiscal measures expected for the years 2013-2014. All these fiscal consolidation measures were successfully observed as of September 2013 (see table below and Annex 6) but the presentation of a privatisation plan aiming to raise EUR1bn throughout the programme duration is still pending and was assessed as non-compliant as of December 2013.

During 2013, GDP shrank 6 percent according to preliminary estimates[41], 2.7 percentage points less than originally expected. This positive surprise was attributed in the second programme review to a better than expected performance of private consumption, which proved to be resilient thanks to relatively large precautionary savings of Cypriot residents. Nevertheless, the projected GDP growth during 2014 was revised downwards to -4.8% (from the previous -3.9%) in the second programme review, resulting in a projected cumulative GDP retrenchment of 10.5% during the 2013-2014 period (previously 12.3%).

[38] The Cooperative Credit Institutions (CCI) had 22.3% of market share in deposits and 19.1% in loans in Cyprus. Economic Adjustment Programme for Cyprus, Occasional papers 149, May 2013, p. 16
[39] See 'Evidence of improving banking sector stability', accessed on 14 January 2014.
[40] The EC estimated an immediate deleveraging of 200 percentage points of GDP as a consequence of selling of the Greek operations of Bank of Cyprus and Cyprus Popular Bank and the subsequent restructuring of these two banks. The Economic Adjustment Programme for Cyprus, Occasional Papers 149, May 2013, p. 42
[41] See 'Statement by the European Commission, ECB and IMF on the Third Review Mission to Cyprus', accessed on 15 January 2014.

Table 13: Summary of main measures (illustrative excerpt) taken as part of programme macroeconomic conditionality

Heading	Major actions required	To be completed by	Evaluation	Date of evaluation	Note
Fiscal consolidation	Increase the statutory corporate income tax rate to 12.5%Increase the tax rate on interest income to 30%	Sep-2013	Compliant	Sep-2013	
Growth and competitiveness	The Cypriot authorities will adopt the remaining necessary amendments to the sector-specific legislation in order to ease the requirements related to entry and establishment. In addition, requirements concerning minimum tariffs should be eliminated unless they are justified according to article 15(3) of the Services Directive. Minimum tariff requirements without justification will be abolished by Q2-2013.	Jul-2013	Partially compliant Non compliant	Sep-2013 Dec-2013	
Financial stability	Develop a strategy to recapitalize and restructure the Credit Cooperative Institution sector with public money as needed	Jul-2013	Compliant with delay Compliant	Sep-2013 Dec-2013	The CBC has finalised by July 2013 a strategy for restructuring and recapitalising the sector, including a plan to merge individual cooperative credit institutions into a maximum of 18 entities by March 2014. These mergers are designed to achieve viability, efficiency and profitability.

Note: This table is only an illustrative excerpt. For the complete table, please refer to Annex 7.
Source: EC programme documents.

The original programme projected the general government gross debt to peak in 2015 at 128% of GDP and to start declining during 2016. In the second programme review, the debt trajectory was revised, as the figure for 2013 overshot to 113.7% from the forecast of 109.5% due to the postponement of the Central Bank of Cyprus loan-asset swap (now to be undertaken in mid-2014). Nevertheless, gross government debt is still projected to peak in 2015, at 126.2% and decrease to 105% in 2020.

In the debt sustainability assessment of the second programme review (box 4.1[42]), it can be seen that in the worst case scenario of a combined negative macro, fiscal and market's interest rates shock, the debt to GDP ratio would peak in 2016 at 140% and then begin a slow decline from 2017 onwards. With the worst case scenario only postponing the debt peak by one year and some 14 pp of GDP larger, we can at least predict that the possibility of a Greece-like explosive debt path is a fairly unlikely scenario.

Unemployment, like in all macroeconomic adjustment programmes in the euro area, has increased more than initially projected. The unemployment rate was originally forecasted to be 15.5 percent in 2013 and peak at 16.9 percent, but the latest figures from Eurostat already show an unemployment rate of 17.3 percent at the end of November 2013, overshooting even the forecasts published in December on the second review. The unemployment rate is now forecasted to peak at 19.8 percent at the end of 2014.

Most of the employment was lost in the construction sector. The Eurostat employment figures by economic sector indicate that (on an annual basis, y/y) 25,700 jobs were destroyed while 11,700 were created; from those jobs destroyed 47.9% came from the construction sector.

[42] GDP growth reduced by one standard deviation -2.45pp-, an annual deterioration of the primary balance of 1pp over the programme horizon, with an additional interaction impact on primary balance coming from the worse GDP developments and a 2pps shock on market interest rates for new debt issuance and roll over. The Economic Adjustment Programme for Cyprus, Second Review, Autumn 2013, Occasional Papers 169, May 2013, p. 46

As a result of collective bargaining, wages in Cyprus have been generally indexed to inflation. To address this lack of flexibility that would have hampered the speed of adjustment in the labour market, the programme has proposed a few major reforms in the wage indexation system, among some other labour market reforms:

- The adjustment frequency of the wage indexation was lowered from biannual to annual wage indexation.
- The indexation was brought down from full indexation over the price index variation of the previous year to 50% indexation.
- Wage indexation is now automatically suspended if the GDP growth rates during the second and third quarter of the previous year are negative.
- Wage indexation is completely suspended in the wider public sector until the end of the programme.
- A plan to support youth employment is currently being drafted and is expected to be implemented during the course of 2014, according to the programme second review.
- The minimum wage was frozen at 870 euro a month for new hires and 924 after 6 months on the job.

Overall the country has been compliant with the proposed labour market reforms as of September 2013 (see annex 6). The programme does not deem a minimum wage reduction as necessary.

As in the case of the Irish programme, ownership for the agreed measures seems to be high, as significant fiscal consolidation effort in 2012 (4% of GDP) and further consolidation measures were already agreed for 2013 (5% of GDP) before the programme started. The Cypriot Minister of Finance also claimed programme ownership in the questionnaire recently sent by the European Parliament. This has proven to be a very important feature for the success of a financial assistance and macroeconomic adjustment programme, as shown in the Irish and Greek cases. Yet, with the banking system still in need of adjustment and the construction sector weak, there remains the question as to which sectors will generate new growth in Cyprus.

Overall, it is obviously too early to tell whether Cyprus will be a successful programme country, especially when attempting to forecast whether or not the country will regain market access in a timely manner for a clean exit. So far, despite some minor delays, the programme is broadly on track with respect to conditionality compliance and the macroeconomic outcomes have been better than expected with the exception of the labour market, as it has been the case with all four euro area financial assistance programmes.

Cyprus also enjoys two important assets: a skilled workforce and stable institutions, including the legal system. Yet, the country faces significant problems in the banking system and a new growth model is yet to be defined. The handling of the Cypriot problems can be rightly considered a collective failure of both national and European authorities. In Cyprus, the main responsibility lies with the previous government that refused to act for a full year after the Greek PSI, which severely damaged the health of Cypriot banks. The European policy system was also too slow in addressing the problem heads-on. The European Commission could have used the Macroeconomic Imbalance Procedure already in early 2012 to declare excessive imbalances and force an economic adjustment on Cyprus, including with review missions. Also the European Systemic Risk Board (ESRB) could have issued public warnings about the systemic problems in the banking system, which were well- known.[43] If it issued confidential warnings, they were ineffective. The eventual introduction of capital controls, as well as the clumsy initial attempt to bail-in insured depositors, will be remembered as an important failure of European economic policy making.

[43] Wolff (2011), '[ESRB should act on sovereign risk]', argued already in May 2011 that the ESRB should make an assessment of the systemic implications of a Greek debt restructuring. The Cypriot case was the most immediate fall-out.

5 Conclusions

In assessing, as of the end of January 2014, the economic adjustment programmes for Greece, Ireland, Portugal and Cyprus, it is important to recall that the different programmes are at different stages:

- In Greece, a first programme was initiated in May 2010, and superseded in March 2012 by a second programme that runs till the end of 2014.

- In Ireland, the programme was started in December 2010 and ended in December 2013. Ireland was the first country to exit a Troika programme. The exit was ‘clean’ or ‘full’ in the sense that Ireland did not request any further financial assistance from its official creditors in the form of a precautionary credit line.

- In Portugal, the programme started in May 2011 and is due to end in May 2014. With less than four months before the end of the programme, the big question at this stage is whether Portugal will be able to emulate Ireland and make a clean exit from its programme, or if it will need a precautionary credit line or even a second programme.

- In Cyprus, the programme only started in May 2013 and runs until May 2016. It is too early, therefore, at this stage to assess the implementation of this programme, let alone to evaluate the prospect of Cyprus exiting the programme when it ends. What can be done now, however, is an assessment of the circumstances that led to the programme and the quality of its design.

In section 2, we proposed three criteria to assess whether programmes are successful.

According to criterion 1, programmes are successful if they create the conditions for regaining market access, which had been lost at the time when countries had to be rescued by official lenders. From this viewpoint, the Irish programme can surely be labelled as fully successful since the country was able to make a full exit from the programme at the scheduled time, in December 2013, and issue debt at favourable rates. The Portuguese programme is generally judged at the moment (in January 2014) by financial markets to be on track for success when it expires in May. However, there are some lingering doubts because of the structural weakness of an economy that even during the boom years for peripheral countries generated only anaemic growth. The Greek programme cannot be judged as successful at this stage. Not only was the first programme discontinued and replaced by a second programme after a haircut on privately-held government debt, but there is widespread doubt that the country will be able to regain market access without some form of write-down of its publicly-held debt. As far as Cyprus is concerned, it is obviously too early to judge if and how it will be able to regain market access at the end of the programme, in May 2016.

According to criterion 2, programmes are successful if countries have adhered to their conditionality. Economic adjustment programmes in the euro area involve three types of conditionality: fiscal measures aimed at reducing public debts and deficits; financial measures to restore the health of the financial sector; and structural reforms to enhance competitiveness.

All four countries have by-and-large adopted the fiscal consolidation measures prescribed by the Troika. They had no alternative because official lenders were loath to offer more financing or to accept debt relief. It is a matter of complex judgement as to whether earlier and bigger debt restructuring for Greece, the bail-in of senior unsecured bondholders of Irish banks and further debt relief in Greece, Ireland, Portugal and Cyprus would have been (and perhaps still are) desirable. The judgement depends on considerations of moral hazard, signalling effects to other indebted countries and financial stability considerations. Pisani-Ferry, Sapir and Wolff (2013) argued that debt restructuring in Greece should have come much earlier. Recent evidence from the first IMF Board discussion on the Greek programme on 9 May 2010 confirms that policymakers were aware of the extraordinary fragility of the programme and the risks to debt sustainability[44]. In the case of Ireland, the involvement of senior unsecured bond holders could have brought around €10 billion, but there were euro-area financial stability concerns that prevented such bail-in.

Official-sector involvement has not yet been practiced on the face value of debt, but lending conditions to programme countries have improved both in terms of maturity and interest rate. There have also been announcements that public loans are *pari passu* or even subordinate (instead of superior) to private creditors' claims. As the second Greek programme is due to expire at the end of 2014, further discussions on the conditions of official assistance, which now constitutes by far the largest part of Greek debt, will be on the table.

The four programme countries have also implemented the measures that aimed to restore the health of their financial sectors, but the process is not over yet, including in Ireland.

The situation in terms of growth-enhancing structural reforms is more complex. Here the four countries divide into two groups. Ireland, and Cyprus to some extent, already enjoyed fairly healthy structural conditions before the crisis. Hence structural reforms are less important in these countries than the need to change their growth models by reducing the importance of the financial sector. Both Greece and Portugal, meanwhile, already suffered from weak structural conditions prior to their entry into the euro area. They accumulated further problems thereafter as the euro and access to cheap credit allowed them to retain antiquated models rather than forcing them to make the required structural changes that a modern economy, in particular one belonging to a monetary union, needs. A legitimate question is whether the length of the adjustment programme is sufficient to remedy a situation that has lasted for so long or, if not, how the necessary structural reforms could be pursued with sufficient intensity and determination after the programme is terminated. An answer to this question will need to be given soon for Portugal and Greece since their programmes expire, respectively, in May 2014 and at the end of 2014 (for the EU part).

Our third criterion to judge whether programmes are successful is to compare expectations and outcomes for a number of macroeconomic indicators, for which expectations are the projections contained in the programme and outcomes are the actual levels since the start of the programme.

In Greece, Ireland and Portugal (we leave Cyprus aside since it is too early to look at outcomes), the fall in domestic demand was bigger than anticipated and, as result, unemployment increased by much more than anticipated. Imports also fell by more than expected in Greece and Portugal, though they actually increased in Ireland. At the same time, the current account deficit improved more than originally forecast. By contrast, export performance was better than anticipated. Altogether, therefore, the trade balance and the current account improved more and faster than expected.

The greater-than-anticipated contraction of domestic demand was due to several factors. The first was the massive fear about a break-up of the euro area that led to increased capital outflows and a freezing of investment because of increased risk aversion. The second was fiscal consolidation measures, the macroeconomic impact of which was underestimated in some programmes, as pointed out in the discussion on fiscal multipliers. The third factor was credit constraint, which was more severe than expected despite massive injection of liquidity by the ECB. Probably the responsibility lies not only on

[44] IMF, office memorandum May 9, 2010, Board meeting on Greece's request for an SBA.

the supply side and the weak situation of banks, but also on the demand side and the over-indebtedness of households and non-financial corporations. Fourth, the depressed situation in partner EU countries was not anticipated and weighed heavily on programme countries.

The improved macroeconomic situation in the euro area, the significant reduction in interest rates and the extending of the maturity of public loans, as well as the general policy of reducing the ranking of public loans to that of private claims, greatly helped Ireland exit its adjustment programme and explains the current market optimism about Portugal. Fiscal deficits, which were at unsustainably high levels, have been reduced to more sustainable levels. In particular in Ireland, the collapse of the housing bubble left the state and the economy in the need of a deep structural adjustment that has been successfully managed.

To conclude, with the improvement of the economic climate in the euro area and Ireland's successful programme exit, both market and political sentiment has become more optimistic about the possibility that the other programme countries, and certainly Portugal and Cyprus, will be able to exit assistance when their turn comes. The current mood, which tends to focus on exit as a measure of success, is understandable, but should be partly resisted. It is understandable because politicians in programme countries, in euro-area partners and in European institutions, are naturally rejoicing about the good news which comes after much bad news and before the European and also some national elections. But it should be resisted because many problems remain, even if countries succeed in exiting their programmes. In particular, unemployment rates and (private and public) debt levels are still very high. Growth prospects are still unsatisfactory and far too weak to address the unemployment challenge. Greece is in the worst situation with unemployment at more than 25 percent and public debt at 175 percent of GDP, but the other three countries, with unemployment at about 15 percent and public debt at about 120 percent of GDP, are also not faring well.

High (private and public) debt levels and generally weak growth determinants in programme countries, a fragile global economy, disinflationary tendencies in the EU and the remaining banking problems, suggest that caution should be exercised when considering future exits. Certainly weak structural conditions in Portugal are concerning and indicate that the country should not opt in favour of a clean exit from its programme in May. At the very least it should request a precautionary credit line as a way of insuring against future risks. In the case of Greece, it is hard to see how the country could exit from its programme at the end of this year without some form of further debt relief and an accompanying framework to improve the structural drivers of growth. Finally, the situation Cyprus may be closer to that of Ireland, owing to its good structural conditions, though exiting from capital controls will be a challenge that will require the structural weaknesses in the banking system to be addressed and ECB acceptance of major liquidity support.

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Annex 1: Financing needs and sources

	Greece	Ireland	Portugal	Cyprus
	10Q2-13Q2	2010-2013	2011-2014	2013-2016
A) General Government deficit	53		22	3.6
B) Debt amortisation	138.3		80.9	9.4
C) Adjustment	1.5		2.1	2.4
D) Gross financing need (A+B+C)	192.8	98.9	105	15.4
E) Debt issuance/Roll-over	93.5	48.9	47	5.2
F) Privatisation	0	0	5	1
G) Net Financing need (D-E-F)	99.2	50	53	9.2
H) Bank support	10	35	25	1.2
I) Total Financing need (G+H)	109.2	85	78	10.4
J) Contribution IMF	30	22.5	26	1
K) Contribution EFSM, EFSF, ESM, EU countries	80	45	52	9
Memo 1: Use of country's financial buffers		*17.5*		
Memo 2: Allocation of central bank profits				*0.4*

Source: European Commission programme documents.

A detailed in Pisani-Ferry, Sapir and Wolff (2013), the financing needs of a country consist of the gross financing needs (A+B+C) of the general government, minus the expected debt roll-over and privatisation receipts, plus the resources needed for bank recapitalisation, and, in the case of Portugal, an additional liquidity buffer. Total financing needs then must be matched by external funding sources (IMF, EFSF, ESM, etc.) and, in exceptional cases, by the use of a country's financial buffers or the national central bank's profits.

Annex 2: Summary of main measures taken in Greece as part of programme macroeconomic conditionality (1st programme)

Heading	Major actions required	To be completed by	Evaluation[45]	Date of evaluation	Note
Fiscal consolidation	Reduction in the public wage bill by reducing the Easter, summer and Christmas bonuses and allowances paid to civil servants	Q2-2010	Observed	Aug-2010	
Fiscal consolidation	Elimination of the Easter, summer and Christmas bonuses paid to pensioners, while protecting those receiving lower pensions	Q2-2010	Observed	Aug-2010	
Fiscal consolidation	Reduce the highest pensions	Q2-2010	Observed	Aug-2010	
Fiscal consolidation	Abolish most of the budgetary appropriation for the solidarity allowance (except a part for poverty relief)	Q2-2010	Observed	Aug-2010	
Fiscal consolidation	Parliament adopts, as planned in the stability programme of January 2010, a Law introducing a progressive tax scale for all sources of income and a horizontally unified treatment of income generated from labour and assets	Q2-2010	Observed	Aug-2010	
Fiscal consolidation	Parliament adopts, as planned in the stability programme of January 2010, a Law abrogating exemptions and autonomous taxation provisions in the tax system, including income from special allowances paid to civil servants.	Q2-2010	Observed	Aug-2010	
Fiscal consolidation	Increase in VAT rates	Q2-2010	Observed	Aug-2010	Subsequent reviews have then progressively moved more and more goods from the reduced rate to the standard rate category
Financial sector regulation and supervision	The Bank of Greece, on behalf of the Government, establishes an independent Financial Stability Fund, with a strong governance structure, to deal with potential solvency issues and to preserve the financial sector's soundness and its capacity to support the Greek economy, by providing equity support to banks as needed	Q2-2010	Observed	Aug-2010	
Financial sector regulation and	Review the private sector bankruptcy law to ensure consistency with ECB observations.	Q2-2010	Observed	Aug-2010	

[45] The terms used match those appearing in the compliance tables of the EC programme documents.

supervision					
Structural reforms	Parliament adopts legislation reforming public administration at the local level, notably by merging municipalities, prefectures and regions	Q2-2010	Observed	Aug-2010	
Structural reforms	Government adopts law to simplify the start-up of new businesses	Q2-2010	Observed	Aug-2010	
Fiscal consolidation	Implement the rule of replacing only 20 percent of retiring employees in the public sector (central government, municipalities, public companies, local governments, state agencies and other public institutions)	Q3-2010	Observed	Nov-2010	
Fiscal consolidation	Freeze in the indexation of pensions	Q3-2010	Observed	Nov-2010	
Fiscal consolidation	Incentives to regularise land-use violations	Q3-2010	Partially observed	Nov-2010	
Structural fiscal reforms	Parliament adopts a reform of the pension system to ensure its medium- and long-term sustainability.	Q3-2010	Observed	Aug-2010	
Structural fiscal reforms	Government takes measures, in line with EU competition rules, to facilitate FDI and investment in innovation in strategic sectors (green industries, ICT etc...) through a revision of the Investment Law, the adoption of measures to facilitate PPPs, action to fast-track large FDI projects and measures to strengthen export promotion policy	Q3-2010	Observed	Nov-2010	
Fiscal consolidation	Government prepares a privatization plan for the divestment of state assets and enterprises with the aim to raise at least 1 billion euros a year during the period 2011-2013.	Q4-2010	Observed	Jan-2010	Later upscalded by the 3rd review Government privatises assets worth at least EUR 390 million, and adopts a privatisation programme [Q2-2011] with the aim of collecting at least EUR 15 billion by end-2012, and at least EUR 50 billion by end-201

			Not observed	Jul-2013	Securing privatisation receipts which, cumulatively since June 2011, should be at least EUR 1.6 billion by end-2012, EUR 4.2 billion by end-2013, EUR 6.5 billion by end-2014, EUR 7.7 billion by end-2015, EUR 11.1 billion by end-2016.
Fiscal consolidation	Temporary crisis levies on highly profitable firms for 2011-2013	Q4-2010	Observed	Jan-2010	
Fiscal consolidation	Changes in the management, pricing and wages of public enterprises	Q4-2010	Observed	Jan-2010	
Structural fiscal reforms	Creation of a fiscal agency attached to Parliament providing independent advice and expert scrutiny on fiscal issues, and reporting publicly on the budgetary plans and execution of the spending entities of the general government, and on macroeconomic assumptions used in the budget law.	Q4-2010	N/A	N/A	
Structural reforms	Following dialogue with social partners, the government proposes and parliament adopts legislation to reform wage bargaining system in the private sector, which should provide for a reduction in pay rates for overtime work and enhanced flexibility in the management of working time. Allow local territorial pacts to set wage growth below sectoral agreements and introduce variable pay to link wages to productivity performance at the firm level.	Q4-2010	Observed	Jan-2010	
Structural reforms	Following dialogue with social partners, government adopts legislation on minimum wages to introduce sub-minima for groups at risk such as the young and long-term unemployed, and put measures in place to guarantee that current minimum wages remain fixed in nominal terms for three years.	Q4-2010	Observed	Aug-2010	

Structural reforms	Government amends employment protection legislation to extend the probationary period for new jobs to one year, to reduce the overall level of severance payments and ensure that the same severance payment conditions apply to blue- and white-collar workers, to raise the minimum threshold for activation of rules on collective dismissals especially for larger companies, and to facilitate greater use of temporary contracts and part-time work.	Q4-2010	Observed	Jan-2010	Not for what concerns the use of fixed-term contracts or part-time work
			Ongoing	May-2011	Provisions on working-time management and fixed-term contracts are expected to be adopted shortly. There have been administrative actions accelerating the establishment of firm-level trade unions.
Growth-enhancing structural reforms	Government reforms legislation on fixed-term contracts (including by establishing specific fixed-term contracts for youth at sub-minima wages) and on working-time management, and simplifies the procedure for the creation of firm-level trade unions.	Q2-2011	Observed	Oct-2011	Passed in July 2011
Structural reforms	Government adopts changes to existing (sectoral) legislation in key services sectors such as tourism, retail and education services. New legislation should facilitate establishment, by significantly reducing requirements relating to quantitative and territorial restrictions, legal form requirements, shareholding requirements, fixed minimum and/or maximum tariffs and restrictions to multidisciplinary activities.	Q4-2010	Ongoing with delay	Jan-2010	
			Ongoing	May-2011	
Structural reforms	Government proposes legislation to remove restrictions to trade in restricted professions including the legal, pharmacy, notary profession, architects, engineers, and auditors.	Q4-2010	Partially observed	Jan-2010	The reform was adopted by Law 3919/2011. However, the Greek government should take steps in the next few months to ensure effective implementation / correct

			Partially observed	May-2011	deficiencies in the law.
Structural reforms	Parliament adopts legislation unbundling electricity and gas activities.	Q1-2011	Ongoing	May-2011	The new energy law will be passed by end-July 2011
Structural fiscal reforms	Government adopts legislation to streamline the administrative tax dispute and judicial appeal processes, centralises filing enforcement and debt collection, indirect audit methods and tax return processing, and adopts the required acts and procedures to better address misconduct, corruption and poor performance of tax officials, including prosecution in cases of breach of duty and a more flexible recruitment process to appoint and promote good performers (based on principles of meritocracy, objectivity and transparency).	Q1-2011	Largely observed	May-2011	
Structural fiscal reforms	Government has taken measures yielding savings on pharmaceuticals of at least EUR 2 billion relative to the 2010 level, of which at least EUR 1 billion in 2011.		Ongoing	May-2011	
			Partially observed	Mar-2012	
			Observed	Dec-2012	
Fiscal consolidation	Reduce public employment on top of the rule of 1 recruitment for each 5 retirements in the public sector	Q3-2011	N/A	N/A	
Fiscal consolidation	Make unemployment benefits means-tested	Q3-2011	N/A	N/A	
Structural fiscal reforms	Government adopts an act enabling the promotion of investment in the tourism sector (tourist resorts and secondary tourist housing). This act, together with the bill on land use will allow for accelerating the privatisation process of land plots managed by the Greek Tourist Real Estate Agency	Aug-2011	Observed	Oct-2011	

Structural fiscal reforms	Excess staff that cannot be removed by the hiring rule of 1 recruitment for 5 exits (1 for 10 in 2011) will be dealt with through non-voluntary redundancies and furlough (labour reserve). This rule is without sectoral exceptions; it also applies to staff transferred from public enterprises to other government entities after screening of professional qualifications by ASEP under its regular evaluation criteria. Staff in the labour reserve will be paid at 60 percent of their wage (excluding overtime and other extra payments) for not more than 12 months, after which they will be dismissed.	Q3-2011	Partially observed	Oct-2011	The law that establishes the labour reserve has been adopted in Parliament. However, so far, no public entity has released staff to the labour reserve. The recruitment rules have not been respected.

Annex 3: Summary of main measures taken in Greece as part of programme macroeconomic conditionality (2st programme)

Heading	Major actions required	To be completed by	Evaluation[46]	Date of evaluation	Note
Fiscal consolidation	A reduction in tax exemptions, in particular the tax-free personal income thresholds	Dec-2011	Observed	Mar-2012	
Fiscal consolidation	A permanent levy on real estate, collected through the electricity invoices	Dec-2011	Observed	Mar-2012	
Fiscal consolidation	A cut in main, and supplementary, pensions, as well as in lump sums paid on retirement	Dec-2011	Observed	Mar-2012	
Fiscal consolidation	The Ministry of Finance ensures a tight supervision of expenditure commitments by the government departments, including extra-budgetary funds, public investment budget, social security funds and hospitals, local governments and state-owned enterprises, and an effective tax collection	Dec-2011	Observed	Mar-2012	
Structural reforms	The Government stands ready to offer for sale its remaining stakes in state-owned enterprises, if necessary in order to reach the privatisation objectives. Public control will be limited only to cases of critical network infrastructure.	Dec-2011	Observed and Ongoing	Dec-2012	
			Partially observed	Mar-2012	
			Observed	Dec-2012	All PAs have been respected. However, cumulative receipts did not add up to EUR 5200mn by end-2012

[46] The terms used match those appearing in the compliance tables of the EC programme documents.

Structural reforms	To advance the reforms of revenue administration, the Government: - activates a large-taxpayers unit; - removes barriers to effective tax administration by implementing the key reforms of the new tax law, including replacing managers who do not meet performance targets, reassessing tax auditors' qualifications and hiring new auditors in the course of 2012 - makes operational the newly created fast-track administrative dispute resolution body to deal rapidly with large dispute cases (i.e. within 90 days). - centralises the functions of, and merges, at least 31 tax offices , and merges, 31 transfers competences, eliminates management positions and closes some 200 local tax offices identified as inefficient	Dec-2011	Partially observed	Mar-2012	31 tax offices closed or merged and key functions consolidated Performance-based contracts for auditors have been approved. Reassessment of tax auditors' qualifications is ongoing. The large taxpayer unit has been established, but not yet fully staffed.
			Partially observed	Dec-2012	
Structural reforms	The Government prepares a tax reform that aims at simplifying the tax system, eliminating exemptions, including and broadening bases, thus allowing reductions in tax rates in a prudent and fiscally-neutral manner. This relates to the personal income tax, corporate income tax and VAT, as well as social contributions. The reform will also simplify the Code of Books and Records.	Mar-2012	Not observed, progress made	Dec-2012	
			Observed	May-2013	
Structural reforms	About 15 000 staff currently employed by various government entities are transferred to the labour reserve, while about 15 000 will be placed in pre-retirement. Staff in the labour reserve, and in pre-retirement, will be paid at 60 percent of their basic wage (excluding overtime and other extra payments) for not more than 12 months, after which they will be dismissed. This period of 12 months may be extended up to 24 months for staff close to retirement. Payments to staff while in the labour reserve are considered part of their severance payments.	Dec-2011	Not observed	Mar-2012	Approximately, 10 000 employees left the public sector under the pre-retirement scheme. As a result of merges and closers, 630 employees were shifted in the labour reserve.
			Not observed	Dec-2012	
			Observed	May-2013	

Structural reforms	Additional redundant staff will be transferred to the labour reserve in the course of 2012, in connection with the identification of entities or units that are closed or downsized, and in case the recruitment rule is violated. Staff transferred to the Government from either state-owned enterprises or other entities under restructuring are considered as new recruitments. The same applies to staff in the labour reserve that is transferred to other government entities, after screening of professional qualifications by ASEP under its regular evaluation criteria. The overall intake in the professional schools (e.g. military and police academies) is adjusted in line with the staffing plans.	Over the course of 2012	Observed and Ongoing	Dec-2012	
Structural reforms	The list of heavy and arduous professions is revised and its coverage is reduced to less than 10 percent of employment. The new list of difficult and hazardous occupations (Law 3863/2010) is published and applies immediately to all workers. No profession will be added to the list after its revision.	Oct-2011	Observed	Mar-2012	
Growth enhancing structural reforms	Based on a dialogue with social partners, the Government adopts further measures to allow the adaptation of wages to economic conditions. In particular: −the extension of occupational and sectoral collective agreements is suspended until end-2014; −the so-called favourability principle is suspended throughout the MTFS period, in such a manner that firm-level agreements take precedence over sectoral and occupational agreements; −firm-level collective contracts can be signed either by trade unions or, when there is no firm-level union, by work councils or other employees' representations, irrespective of the firms' size.	Dec-2011	Observed	Mar-2012	

Growth enhancing structural reforms	The Government publishes a plan for a "Business-Friendly Greece" tackling 30 remaining restrictions to business activities, investment and innovation. The plan identifies hurdles to innovation and entrepreneurship - ranging from company creation to company liquidation - and presents the corresponding corrective actions.	Oct-2011	Partially observed	Mar-2012	
Public sector modernisation	The Government publishes and updates on a quarterly basis its medium-term staffing plans per department, for the period up to 2015, in line with the rule of 1 recruitment for 5 exits. The recruitment/exit rule applies to the general government as a whole. The staffing plans should be consistent with the target of reducing public employment by 150 thousand in end-2010–end-2015. If necessary, the Government will enact temporary hiring freezes.	Continuous	Observed and Ongoing	Mar-2012	
Financial sector	All banks will be required to achieve a core tier 1 capital ratio set at 9 percent by Q3-2012, reaching 10 percent in Q2-2013. The Bank of Greece, with the support of external consultants, will undertake a comprehensive assessment of banks' capital needs prior to disbursement. This assessment will be based on, inter alia, the results from the Black Rock loan diagnostic exercise, the PSI impact, and the business plans banks have submitted. In addition, banks' capital needs will be determined on the basis of a requirement to maintain a 7 percent core tier 1 capital ratio under a three-year adverse stress scenario (pillar II requirements), Based on these capital needs identified by the Bank of Greece, banks will revise their business plans and submit capital raising plans by Q1-2012.	N/A	Observed	Dec-2012	
			Observed	May-2013	

Financial sector	Banks will be given time to raise capital in the market. Based on an assessment of their viability and capital raising plans, by end-April 2012, the Bank of Greece will communicate to banks specific deadlines to raise capital in the market. The deadlines to raise capital will be set for each bank on a case by case basis, with a maximum duration by to Q3-2012. Banks that do not submit viable capital raising plans and do not raise the capital needed to meet the regulatory requirements within the deadline set by the Bank of Greece will be resolved in an orderly manner and at the lowest cost to the State, in a way that ensures financial stability and which follows the overall strategic plan for resolved banking system assets. Resolution options will include the tools available under the law such as, inter alia, purchase and assumption (transfer order), interim credit institution (bridge banks), and orderly wind down.	Apr-2012	Ongoing	Dec-2012	
Labour market	Prior to the disbursement, the following measures are adopted: - The minimum wages established by the national general collective agreement (NGCA) will be reduced by 22 percent compared to the level of 1 January 2012; for youth (for ages below 25), the wages established by the national collective agreement will be reduced by 32 percent without restrictive conditions. - Clauses in the law and in collective agreements which provide for automatic wage increases, including those based on seniority, are suspended.	Mar-2012	Observed	Dec-2012	
Labour market	Prior to the disbursement, clauses on tenure (contracts with definite duration defined as expiring upon age limit or retirement) contained in law or in labour contracts are abolished.	Mar-2012	Observed	Dec-2012	
Fiscal consolidation	Reducing hospital operating costs by 8 percent in 2012 and an additional 5% in 2013 and reducing beds substantially	2012 and 2013	Observed	May-2013	
			Under review	Jul-2013	
Structural reforms	Ensure that cumulatively 12,500 employees have been placed in the labour mobility scheme;	Sep-2012	Not observed	Jul-2013	

Growth enhancing structural reforms	Takes additional measures at the latest, to reduce by 50% the cost of starting a business, as measured by the World Bank's Starting a Business sub-indicator. The results will be monitored in the World Bank's 2014 edition of Doing Business.	Jun-2013	Observed	Jul-2013	
Growth enhancing structural reforms	The Government reviews and amends the Market Policing Code. This should include (i) removal of restrictions in order to permit more freely discounts, promotions, and offers outside and during sale periods, more sales periods combined with more flexibility in the duration of the sales, (ii) increased flexibility in retailers' opening hours by, inter alia, giving all shops the option to remain open at least seven Sundays per year, especially during holiday seasons.	Jun-2013	Observed	Jul-2013	

Annex 4: Summary of main measures taken in Ireland as part of programme macroeconomic conditionality

Heading	Major actions required	To be completed by	Evaluation[47]	Date of evaluation	Note
Fiscal consolidation	A lowering of personal income tax bands and credits or equivalent measures	Q1-2011	N/A	N/A	
Fiscal consolidation	Effective pay freeze in the public sector until 2014		Observed		Not mandated but as part of the achievement of fiscal targets
Fiscal consolidation	2 percentage points increase in the standard VAT rate to 23%		Observed		Not mandated but as part of the achievement of fiscal targets
Fiscal consolidation	Public service employment is expected to be reduced by 23,500 (full-time equivalents) between end-2010 and 2015		Observed		Not mandated but as part of the achievement of fiscal targets
Fiscal consolidation	Revenue measures will be introduced, including: - A lowering of personal income tax bands and credits. - A reduction in private pension tax reliefs. - A reduction in general tax expenditures. - A property tax. - A reform of capital gains tax and acquisitions tax. - An increase in the carbon tax.	Q4-2011	Partially observed	Dec-2011	
Structural reforms	Reduce by €1.00 per hour the nominal level of the current national minimum wage.	May-2011	Observed	May-2011	Later reversed as considered unjust by the government
Structural reforms	Draft law reforming the sectoral wage setting arrangements in line with the programme objectives, i.e. making wage-setting systems (which cover some 23% of private sector employment) more flexible.		Observed		Not mandated but as part of the achievement of fiscal targets
Structural reforms	The Authorities undertake to introduce legislation to increase the state pension age. Under the Government's National Pension Framework the age at which people will qualify for the State Pension will be increased to 66 years in 2014, 67 in 2021 and 68 in 2028.	Q2-2011	Observed	Sep-2012	

[47] The terms used match those appearing in the compliance tables of the EC programme documents.

Structural reforms	Government will introduce legislative changes to remove restrictions to trade and competition in sheltered sectors including: - the legal profession. - medical services, eliminating restrictions on the number of GPs qualifying and removing restrictions on GPs wishing to treat public patients as well as restrictions on advertising. - the pharmacy profession, ensuring that the recent elimination of the 50% mark-up paid for medicines under the State's Drugs Payments Scheme is enforced.	Q3-2011	Observed and Ongoing	Dec-2011	
			Ongoing	Jun-2012	
Structural fiscal reforms	Pension entitlements for new entrants to the public service will be reformed with effect from 2011. This will include a review of accelerated retirement for certain categories of public servants and an indexation of pensions to consumer prices. Pensions will be based on career average earnings. New public service entrants will also see a 10% pay reduction. New entrants' retirement age will also be linked to the state pension retirement age.	Q3-2011	Partially observed	Sep-2011	
Financial sector	Banks are required to maintain at least a 10.5% core tier 1 ratio for three years and identify EUR 73 billion of non-core assets for disposal and run-off so as to meet the targeted loan-to-deposit ratio (122.5%) by end-2013	Apr-2011	Ongoing	Mar-2012	
			Ongoing	Sep-2012	
Financial sector	The Central Bank will direct the recapitalisation of the principal banks (AIB, BoI and EBS) to achieve a capital ratio of 12 percent core tier 1.	Feb-2011	Not observed	May-2011	
			Not observed	Sep-2011	
			Not observed	Dec-2011	
			Not observed	Mar-2012	
			Not observed	Jun-2012	

Annex 5: Summary of main measures taken in Portugal as part of programme macroeconomic conditionality

Heading	Major actions required	To be completed by	Evaluation[48]	Date of evaluation	Note
Financial stability	Direct all banking groups subject to supervision in Portugal to reach a core Tier 1 capital of 9 percent by end-2011 and 10 percent by end-2012 and maintain it thereafter	Jun-2011	Met[49]	Jun-2011	prior action
			Observed	Dec-2012	10% CT1
Competitiveness	Eliminate "golden shares" and all other special rights established by law or in the statutes of publicly quoted companies that give special rights to the state	Jul-2011	Observed	Sep-2011	
Competitiveness	Submit to Parliament a law, already agreed with social partners, to align and reduce severance payments on all new contracts (fixed term and open-ended).	Jul-2011	Observed	Sep-2011	
		Feb-2012	Observed	Feb-2012	Alignment of severance payment entitlements of current employees in line with the reform for new hires.
		May-2012	Partially observed	Jul-2012	Prepare legislative proposal to: i) align the level of severance payments to the EU average; and ii) allow the severance pay entitlements financed from the fund agreed in the Tripartite agreement to be transferable to different employers.
			Delayed	Dec-2012	
			Observed	Jun-2013	
Competitiveness	Finalize calibration of fiscal reform to reduce unit labour costs via deficit-neutral reduction in labour taxes.	Jul-2011	Ongoing	Sep-2011	

[48] The terms used match those appearing in the compliance tables of the EC programme documents.
[49] Met indicates that the 9% Tier 1 target was met in June 2011 instead of December 2011 (early achievement).

Fiscal consolidation	Suspend application of pension indexation rules and freeze pensions, except for the lowest pensions, in 2012.	N/A	N/A	N/A	
Fiscal consolidation	Reduce pensions above EUR 1,500 according to the progressive rates applied to the wages of the public sector	N/A	N/A	N/A	
Fiscal consolidation	Limit staff admissions in public administration to achieve annual decreases in 2012-2014 of 1% per year in the staff of central administration and 2% in local and regional administration	Q3-2011	Observed	Dec-2011	
Fiscal consolidation	Freeze wages in the government sector in nominal terms in 2012 and 2013 and constrain promotions.	N/A	N/A	N/A	
Fiscal consolidation	Reduction of corporate tax deductions and special regimes in 2012[50]	end-2012	Observed	Feb-2012	
Fiscal consolidation	Reduction of personal income tax benefits and deductions	end-2012	Observed	Feb-2012	
Fiscal consolidation	Raise VAT revenues by reducing VAT exemptions; moving categories of goods and services from the reduced and intermediate VAT tax rates to higher ones	end-2012	Observed	Feb-2012	
Fiscal consolidation	Increase excise taxes raising car sales tax and cutting car tax exemptions; raising taxes on tobacco products; indexing excise taxes to core inflation; introducing electricity excise taxes	end-2012	Partially observed	Feb-2012	
Structural reforms	The Government will review the framework for the valuation of the housing stock and land for tax purposes and present measures to (i) ensure that by end 2012 the taxable value of all property is close to the market value and (ii) property valuation is updated regularly (every year for commercial real estate and once every three years for	Q3-2011	Observed	Dec-2011	

[50] i. abolishing all reduced corporate income tax rates;
ii. limiting the deductions of losses in previous years according to taxable matter and reducing the carry-forward period to three years;
iii. reducing tax allowances and revoking subjective tax exemptions;
iv. curbing tax benefits, namely those subject to the sunset clause of the Tax Benefit Code, and strengthening company car taxation rules;
v. proposing amendments to the regional finance law to limit the reduction of corporate income tax in autonomous regions to a maximum of 20% vis-à-vis the rates applicable in the mainland.

	residential real estate as foreseen in the law).		Observed	Nov-2013	Finalise the appraisal of the taxable value of the housing stock.
Fiscal consolidation	The Government will accelerate its privatisation programme. The existing plan, elaborated through 2013, covers transport (Aeroportos de Portugal, TAP, and freight branch of CP), energy (GALP, EDP, and REN), communications (Correios de Portugal), and insurance (Caixa Seguros), as well as a number of smaller firms. The plan targets front-loaded proceeds of about €5.5 billion through the end of the program, with only partial divestment envisaged for all large firms. The Government commits to go even further, by pursuing a rapid full divestment of public sector shares in EDP and REN, and is hopeful that market conditions will permit sale of these two companies, as well as of TAP, by the end of 2011. The Government will identify, by the time of the second review, two additional large enterprises for privatisation by end-2012.	end-2012	Ongoing	Feb-2012	
			Ongoing	Jul-2012	
Fiscal consolidation	Reduce management positions and administrative units by at least 15% in the central administration.	Q4-2011	Largely observed	Dec-2011	
		Feb-2012	Partially observed	Feb-2012	Reduce management positions and administrative units by 27% and 40%, respectively, in central government
		May-2012	Broadly observed	Jul-2012	as above

Fiscal consolidation	There are currently 308 municipalities and 4,259 parishes. The government will develop and implement a consolidation plan to reorganise and significantly reduce the number of such entities. The changes will come into effect with the next local electoral cycle.	Q2-2012	Observed	Oct-2012	Law No. 49/2012 of 29 August defines the criteria to reduce the number of managers positions in local entities. The process is expected to yield a reduction between 23 percent and 36 percent of management positions.
		Jul-2012	Observed	Jul-2012	The law on the administrative reorganisation of local entities entered into force, allowing for the reduction in the number of parishes by at least 25 percent
			Ongoing	Dec-2012	
Fiscal consolidation	Improve efficiency and effectiveness in the health care system, inducing a more rational use of services and control of expenditures; generate additional savings in the area of pharmaceuticals to reduce the public spending on pharmaceutical to 1.25 per cent of GDP by end 2012 and to about 1 per cent of GDP in 2013	end-2012	Ongoing	Dec-2011	
			Largely observed	Feb-2012	
Fiscal consolidation	Provide detailed description of measures aimed at achieving a reduction in the operational costs of hospitals in 2012 (EUR 100 million in 2012 in addition to savings of over EUR 100 million already in 2011), including reduction in the number of management staff, as a result of concentration and rationalisation in state hospitals and health centres.	Q3-2011	Observed and Ongoing	Dec-2011	
Fiscal consolidation	Introduce rules to increase mobility of healthcare staff (including doctors) within and across health regions. Adopt for all staff (including doctors) flexible time arrangements, with a view of reducing by at least 10% spending on overtime compensation in 2012 and another 10% in 2013. Implement a stricter control of working hours and activities of staff in the hospital.	Q1-2012	Observed and Ongoing	Jun-2013	

Structural reforms	The government will adopt a plan aimed at reducing the maximum duration of unemployment insurance benefits to no more than 18 months. The reform will not concern those currently unemployed and will not reduce accrued-to-date rights of employees; capping unemployment benefits at 2.5 times the social support index (IAS) and introducing a declining profile of benefits over the unemployment spell after six months of unemployment (a reduction of at least 10% in the benefit amount). The reform will concern those becoming unemployed after the reform; reducing the necessary contributory period to access unemployment insurance from 15 to 12 months;	Q1-2012	Largely observed	Feb-2012	
Structural reforms	The Government will prepare and submit a reform proposal aimed at introducing adjustments to the cases for fair individual dismissals contemplated in the Labour Code with a view to fighting labour market segmentation and raise the use of open-ended contracts.	Q1-2012	Observed	Feb-2012	
Structural reforms	Regulated electricity and gas tariffs will be phased out	Jan-2013	N/A	N/A	
Growth-enhancing structural reforms	Review and reduce the number of regulated professions and in particular eliminate reserves of activities on regulated professions that are no longer justified. Adopt measures to liberalize the access and exercise of regulated professions by professionals qualified and established in the European Union.	Q1-2012	Ongoing	Dec-2011	
			Ongoing	Feb-2012	
			Ongoing	Jul-2012	
			Observed	Oct-2012	
Fiscal consolidation	Present initiatives needed for each region for the presentation of a plan aiming at reducing the management positions and administrative units by 15 percent.	May-2012	Broadly observed	Jul-2012	

Competitiveness	Ensure wage moderation by using the available discretion in the current legislation of not extending collective contracts until clear criteria is defined.	May-2012	Not observed	Jul-2012	
			Observed	Dec-2012	The Council of Ministers Resolution 90/2012 limits extensions of collective agreements to those subscribed by employers' associations that employ more than 50 percent of workers in a sector. In addition, the request for extension must be asked by both unions and employers' associations. The quantitative criterion is waived when the request for extension concerns only firms that employ more than 249 workers.
Competitiveness	Prepare new draft Code of Civil Procedure	Q2-2012	Observed	Oct-2012	
Competitiveness	Eliminate the court backlog	Q1-2013	Observed	Nov-2013	All enforcement cases pending on 17 May 2011 have been analysed. Efforts were made to diminish the number of backlogged cases with the result of closing 45% of the cases pending on 17 May of 2011.

Annex 6: Summary of main measures taken in Cyprus as part of programme macroeconomic conditionality

Heading	Major actions required	To be completed by	Evaluation[51]	Date of evaluation	Note
Fiscal consolidation	Adopt legislation and Council of Minister decisions, as needed, implementing measures consistent with the program targets. Measures include: increasing the CIT rate from 10 to 12.5 percent, raising the bank levy rate from 0.11 to 0.15 percent, raising the tax rate on interest from 15 to 30 percent, and reforming the property tax (for a total consolidation of 2 percent of GDP with immediate effect); and rationalizing the housing benefits (savings of 0.2 percent of GDP).	May-2013	Observed	May-2013	Prior action
Financial stability	Develop a strategy to recapitalize and restructure the Credit Cooperative Institution sector with public money as needed	Jul-2013	Compliant with delay	Sep-2013	
			Compliant	Dec-2013	The CBC has finalised by July 2013 a strategy for restructuring and recapitalising the sector, including a plan to merge individual cooperative credit institutions into a maximum of 18 entities by March 2014. These mergers are designed to achieve viability, efficiency and profitability.
Structural reform	Revise the anti-money laundering legal framework	Sep-2013	Compliant with delay	Sep-2013	
			Compliant with delay	Dec-2013	
Structural reform	Submit to Parliament a law on fiscal responsibility and budget systems	Dec-2013			
Structural reform	Adopt measures to improve the targeting of social assistance, consolidate welfare programs, and streamline administration costs.	Dec-2013			
Financial stability	Bank Resolution. Adopted legislation putting in place a modern bank resolution framework	May-2013	Observed	May-2013	Prior action

[51] The terms used match those appearing in the compliance tables of the EC programme documents.

Fiscal consolidation	Ensure additional revenues from property taxation by: (i) updating the 1980 prices through application of the CPI index for the period 1980 to 2012; and/or (ii) amending tax rates and/or (iii) amending value bands.	Sep-2013	Compliant	Sep-2013	
Fiscal consolidation	Increase the statutory corporate income tax rate to 12.5%. Increase the tax rate on interest income to 30%.	Sep-2013	Compliant	Sep-2013	
Fiscal consolidation	Increase the bank levy on deposits raised by banks and credit institutions in Cyprus from 0.11% to 0.15% with 25/60 of the revenue earmarked for a special account for a Financial Stability Fund.	Sep-2013	Compliant	Sep-2013	
Fiscal consolidation	Abolish all exemptions for access to free public health care based on all non-income related categories (except for persons suffering from certain chronic diseases depending on illness severity). Introduction of a compulsory health care contribution for public servants and public servant pensioners of 1.5% of gross salaries and pensions.	Sep-2013	Compliant	Sep-2013	
Labour market	The Cypriot authorities will reform the wage-setting framework for the public and private sector in such a way as to improve real wage adjustment. This reform acts on relevant elements of the indexation system, as follows: - A lower frequency of adjustment, with the base period for calculating the indexation (COLA) being lengthened from the current period of six months to twelve months. - A mechanism for automatic suspension of application and derogation procedures during adverse economic conditions, such that if in the second and third quarters of a given year negative rates of growth of seasonally adjusted real GDP are registered, no indexation would be effected for the following year; - A move from full to partial indexation, with the rate of wage indexation being set at 50% of the rate of increase of the underlying price index over the previous year.	Sep-2013	Compliant	Sep-2013	
Labour market	Suspension of wage indexation in the wider public sector will remain in place until the end of the programme.	Ongoing	Compliant	Sep-2013	

Growth enhancing structural reforms	The Cypriot authorities will adopt the remaining necessary amendments to the sector-specific legislation in order to ease the requirements related to entry and establishment. In addition, requirements concerning minimum tariffs should be eliminated unless they are justified according to article 15(3) of the Services Directive. Minimum tariff requirements without justification will be abolished by Q2-2013.	Jul-2013	Partially compliant	Sep-2013	
			Non-compliant	Dec-2013	
Structural reform	Measures have been adopted to ensure that total annual public pension benefits do not exceed 50% of the annual pensionable salary earned at the time of retirement from the post with the highest pensionable salary of the official's career in the public sector and broader public sector.	Q3-2013	Compliant with delay	Dec-2013	
Growth enhancing structural reforms	Put in place an adequate legal and institutional framework for public investment projects, including PPPs, to assess fiscal risks and to monitor their execution	Q4-2013	Compliant	Dec-2013	
Fiscal consolidation	A privatisation plan will be based on the report reviewing and assessing the operations and finances of state-owned enterprises, as well as the inventory of assets. The privatisation plan will be finalised after consultation with programme partners, including asset-specific timelines and intermediate steps, with the aim of raising EUR1bn throughout the programme duration.	Nov-2013	Non-compliant	Dec-2013	

CAT QA-01-14-106-EN-C

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PE 497.764
ISBN 978-92-823-5382-0
doi: 10.2861/52615