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Quick take on the outcome of the March 20 Eurogroup, key items & timeline

Anna Dimitriadou
Economic Analyst
andimitriadou@eurobank.gr

Petropoulou Paraskevi
Economic Analyst
ppetropoulou@eurobank.gr

Following the March 20 Eurogroup, the present report aims to provide an update on the state of play in the ongoing negotiations between Greece and its official lenders in the context of the 2nd programme review.

Background and facts

After the February 20 Eurogroup the institutions (EC/ECB/ESM/IMF) mission heads returned to Athens and resumed negotiations in the framework agreed at that Eurogroup. This framework envisioned that aside from the items of the 2nd programme review, Greece would also have to pre-legislate an additional set of measures to be implemented as of 2019 that would address the IMF's concerns regarding the long-term attainability of the agreed medium-term primary surplus target and would open the way for its financial participation in the 3rd Economic Adjustment Programme. At the same time it was agreed that if the primary surplus target beyond 2019 were to be exceeded Greece would be able to use this fiscal space to implement growth-enhancing measures. These measures would also have to be stipulated with official creditors and pre-legislated. In this framework negotiations resumed on February 26 until March 9 while teleconferences on a technical level continued throughout the past week.

According to the official statement, the March 20 Eurogroup was debriefed by the institutions and the Greek authorities on the state of play of the ongoing 2nd review of Greece's 3rd Economic Adjustment Programme. It was acknowledged that a lot of work has been done and progress made but some key issues remain open. As a result talks will continue to intensify and to this end Greece's Minister of Finance, the Alternate Minister of Finance and the Minister of Labour, Social Insurance and Social Solidarity remained in Brussels for intensive talks with official creditors aiming to resolve the outstanding topics and reach a full policy package agreement. During the press conference following the Eurogroup, its President Jeroen Dijsselbloem stated that deliberations in Brussels will be conducted between the institutions, including the IMF, and the Greek Ministers directly involved and will try to resolve the "bigger issues", namely labour, pension and tax reforms. Stressing the importance placed on a swift conclusion of the policy package agreement, he noted that talks will be conducted at the appropriate level and "whatever power is needed will be brought into the room". With regard to the order of things ahead, Eurogroup President stated that first there should be an agreement on a policy package including pension, tax and labour reform as well as a number of other issues. Then the Eurogroup will work towards a political agreement which will also include the issues of the fiscal trajectory (i.e. the primary surplus targets going forward) and debt. Such a discussion could take place at the April 7 Eurogroup although this milestone should not be considered rigid. Asked about the timing of a potential agreement, Mr. Dijsselbloem echoed a cautious tone abstaining from providing a definite timeline. Responding to why the mission heads are not immediately returning to Athens, the Eurogroup President merely noted that they have decided to reverse the order and first resolve the "major issues", leaving the technical details to be discussed in Athens. With regard to the medium-term debt relief measures and the fiscal trajectory in particular, the understanding is that no big surprises should be anticipated as these issues have already broadly been agreed upon at the May 2016 Eurogroup.

Finally, at the press conference all involved parties were urged to accelerate efforts to conclude the review as soon as possible to avoid the cost of the uncertainty on the economy. The Eurogroup President noted that it is his understanding that on behalf of the Greek side there is strong political will and a sense of urgency to conclude the review considering that confidence in the Greek economy is a key factor. In the same wavelength ESM Managing Dierctor Klaus Regling voiced concern that uncertainty about the conclusion of the review could have a cost for the economy and stressed that a deal should be reached ahead of July when Greece's next major debt service repayment is due (over that month, Greece's debt service payments amount to €7.4bn).[1]

In the following section we present a summary of the latest developments in the key issues of the 2nd programme review based on a number of recent press reports.

Key issues of 2nd programme review: latest developments

Items on which an agreement has been reached

Projected 2018 fiscal gap & sources of funding for its coverage

During the last round of official discussions in the context of the 2nd programme review official creditors reportedly acknowledged that, assuming no major divergence from the official macro figures, a number of measures/strategies proposed by the Greek government are adequate to fully cover a projected fiscal gap for FY-2018 of around 0.15%- 0.2%-of-GDP (or c. €300-€400mn). The aforementioned measures, aiming to address the projected shortfall and secure attainability of the 3.5%-of-GDP primary fiscal target in FY-2018, are said to include the following: (i) imposition of a tax on short-term rental accommodation via online platforms like Airbnb-style vacation rentals; (ii) imposition of a tax levy on hotel accommodation subject to star ranking; (iii) reduction of certain welfare benefits (e.g., heating oil allowance) that will be integrated into the Social Solidary Income welfare program (SSI); and (iv) permanent savings identified by the spending review.[2] The projected shortfall mainly relates to the lack of adequate funding for the nationwide implementation of the SSI welfare programme (also referred to as Minimum Guaranteed Income), scheduled to be launched in the second semester of this year[3] to provide a safety net to vulnerable social groups hardest hit during the crisis.[4]

NPLs and Out-of-court workout

The legal framework for the out-of-court workout (OCW) has been agreed between Greece and its official lenders and the relevant bill will be reportedly submitted for voting to the Hellenic Parliament by the end of March. Although the bill has not been finalised yet, according to the most recent press reports, its main provisions reportedly are: a) it concerns small and large businesses but also private citizens under special circumstances, b) debts are eligible for OCW as long as they are overdue by at least three months by the end of 2016, c) debts to the State – including VAT and payroll taxes – are also eligible for OCW, excluding the withheld insurance contributions and non-tax penalties, i.e. fines levied by the State in favour of third parties, and d) the law will be valid until the end of 2018. As regards the legal immunity of public entities' and banks' representatives that will carry out OCWs, a separate bill will reportedly be submitted by the Ministry of Justice. Finally, a bill was submitted last week for the treatment of the deferred tax assets of Greek financial institutions in a manner consistent with the write-offs and restructuring of their debtors' loans. The bill complements the legal framework that is being constructed with the aim to address the serious NPLs problem.

Pending items

Size of additional measures

In line with the February 20th Eurogroup agreement, the Greek side has committed to legislate upfront an additional package of structural reforms with effect as of January 2019, pertaining to income tax reform and pension reform. The said package, aiming to address the IMF's concerns regarding the long-term attainability of the agreed 3.5%-of-GDP medium-term primary surplus target and open the way for its financial participation in the 3rd Economic Programme, is said to accommodate: (i) the IMF's proposal for a broader personal income base via a decrease in the tax-free threshold from €8,636 currently to €7,000 or lower (dependent on the taxpayers'

[1] "*Greece- State financing needs and sources in 2017 and beyond; evaluation of the agreed short-term debt relief measures & updated DSA*", P. Monokroussos, February 2017, https://www.eurobank.gr/Uploads/Reports/201701GR%20DSA_Jan_2017.pdf

[2] The spending review is reportedly scheduled to be completed by June 2017 so as the relevant findings to be incorporated in the Budget 2018.

[3] According to the existing MoU, the cost of the aforementioned scheme is estimated at 0.5%-of-GDP annually and has to be covered through permanent savings in areas of non-discretionary spending identified either by the World Bank (i.e., elimination or/and reduction of certain welfare benefits & tax deductions) or by spending reviews.

[4] The Social Solidarity Income welfare programme is based on three pillars: (i) income support, (ii) connection with social integration services; and (iii) connection with activation services aimed towards the integration or reintegration of beneficiaries into the labor market.

family status); and (ii) the IMF's demand for a significant rationalization of pension spending, via the abolishment of the so-called "personal difference" (i.e. the difference between the level of main pensions issued before and after mid – May 2016 when the latest social security reform in the context of the 1st programme review was adopted envisioning relatively lower replacement rates). During the latest round of official discussions, the two sides have reportedly reached an in principle agreement on the two measures to equi-proportionally secure savings/revenues of €1%-of-GDP each (or €1.8bn) taking the size of the whole package to 2%-of-GDP (or €3.6bn). However, the Greek side is pushing for measures worth less, arguing that the expected outperformance of the FY-2016 official primary surplus target mostly comes from measures of sustainable nature. According to government sources, the general government balance is projected to yield a primary surplus of c3.4%-of-GDP against the 0.50%-of-GDP official target in FY-2016 purportedly mostly thanks to strengthened efficiency of the tax collection mechanism (Eurostat's next EDP report is scheduled for April 24th).

Implementation timeline & certain modalities of the aforementioned measures. Despite progress on some fronts, differences on a number of items related to the aforementioned structural measures remain. These reportedly include, among others:

(i) *The size of the tax free threshold reduction*. The institutions reportedly favour a drop of the tax-free threshold to €5.900 from €8.363 currently whereas the Greek government opts for a reduction to no lower than €7.000. Reportedly, a tax-free threshold at c. €6,000 would mean that 1.3 million taxpayers who are currently exempt from any tax obligation will be added to the system. With respect to the timing of implementation, the two sides have reportedly agreed the decrease in the tax-free threshold to be effective from January 2020 and applicable on 2019 incomes.

(ii) T*he timing and size of the pensions' reduction*. Creditors insist the personal difference be eliminated one-off in 2019 or 2020 at the latest, whereas the Greek government argues in favour of gradual elimination, preferably in 3-4 years starting from 2020. Reportedly, the abolishment of the personal difference would affect around 1.2mn pensioners triggering a reduction of 7% up to 30%, dependent on the level of pension. In addition, the Greek government opts for the exclusion of relatively low pensions of up to €600-€700 while for all other pensions above that level, the personal difference to be reduced by a certain percentage, i.e., up to 50%. As a means of securing the remaining savings required from the pension reform, the Greek government is said to have tabled a number of counterproposals including, among others, "freezing" until 2021 new pensions issued after May 2016.[5] Its main argument is that, due to an effective lack of a social state in Greece, pensions act as a safety net covering also other crucial social needs (e.g. health and housing) and supporting not only the pensioners themselves but also other family members with no other source of income.

Nature of offsetting measures

According to press reports, the Greek government opts for a more "socially-friendly" package of offsetting measures, including among others: (i) reduction of the Unified Property Tax (ENFIA) by 15% via the decrease of the relatively low rates of the supplementary tax imposed on owners whose properties are valued at more than €300k; (ii) a decrease in the health contributions of freelancers; (iii) reduction of the 3% solidarity surcharge tax currently applied to annual income from €12,001 to €20,000 (the said tax envisions a tax-free threshold at €12k); (iv) transfer of certain goods and services to a lower VAT rate (i.e., electricity, transport); (v) a decrease in the corporate tax from 29% currently; (vi) rent allowances; (vii) employment allowances; (viii) free school meals; and (vx) employment programs to incentivize young Greek scientists that live abroad to return to Greece. On their part, it is understood that the institutions favour a package of more "growth-enhancing" measures, including, inter alia, reduced tax rates applied to the higher personal income tax brackets and a targeted relief towards low-income citizens primarily through the Social Solidarity Allowance. As things stand, among the aforementioned measures proposed by the Greek side, official creditors have reportedly approved a decrease in the corporate tax by 2% to 27%.

[5] Under the existing law, as of May 2016, annual changes in pension payments are linked equi-proportionally to a coefficient formed by two components: the GDP growth rate and the inflation rate. Any annual change in pension payments should not exceed the annual inflation rate. On the assumption of improved growth prospects in Greece in the years ahead, the said linkage suggests that pension payments should rise.

Labour market reform

The labour market reform constitutes a central issue of the 2nd programme review. Although European partners have in various occasions appeared to be more flexible on the subject, the IMF favours further deregulation and strongly opposes any possible reversal of the reforms implemented in the context of the previous adjustment programmes. For the Greek government the labour market reform is an issue of high political sensitivity. For this purpose, the Greek side may reportedly attempt to either resolve this issue at a political level or move it to the 3rd review but it is highly unlikely that the official lenders will consent to either of these options. Discussions on labour market reform at this point revolve around the following topics:

– *Collective bargaining*. The Greek government favours the reinstatement of the previous regime whereby the most favourable for the employee collective agreement, be that sectoral, occupational or other, should have precedence (favourability principle). Given that this is unlikely, however, the Greek government is said to be now opting for changing the duration of the aftereffect of collective agreements from three to six months and the extension of a sectoral contract to all enterprises in a sector, if at least 51% of employers is represented. European partners are said to not have strong objections on that.

– *Minimum wage*. The Greek government opts for a switch back to a national collective bargaining system for determining the minimum wage (with automatic erga omnes effect). The minimum wage currently stands at €683.76/month in 12 payments or €586 per month in 14 payments. According to the existing legislation (4172/2013) the level of the minimum wage is determined by a ministerial decree based on a number of criteria including the evolution of domestic economy, productivity, competitiveness, employment & unemployment rates, annual income and wages.

– *Collective dismissals*. Official creditors push for an increase in the monthly limit of collective layoffs to 10% (from 5%, currently) for companies with more than 150 employees, the abolishment of the Labour, Social Insurance and Social Solidarity Minister's veto power on such dismissals and the establishment, instead, of the Highest Board of Employment, which will be entitled to perform a legality assessment of dismissals. The Greek government strongly opposes such proposals. A recent (21 December 2016) judgement of the European Court of Justice[6] (ECJ) on a case of collective redundancies by a Greek company acknowledged the right of the Greek competent authority to intervene and even ban collective layoffs provided that certain conditions are met. In Greek legislation these conditions, according to the ECJ, are vague and need to change. With regard to the level of the threshold above which collective dismissals need ministerial approval the ECJ makes no reference.[7]

– *Industrial conflict: strikes & lock-outs.* The official lenders request stricter rules on strikes and the legal framework for trade unions. With respect to strikes, they request that the strike notice be increased from 24 to 48 hours, that express procedures be adopted for assessing the legality of a strike and that employers be granted the right to lock-out. As regards trade unions, the institutions request the revision of the current regime governing trade unionists' leaves and dismissals. At this point it should be noted that the Expert Group that was mandated to advise on the Greek labour market reform in September 2016 came to the conclusion that as things stand there is a balance of power between employers and employees and recommended that no stricter rules be applied.

Energy market reform

According to the Memorandum of Understanding, the Greek energy markets need wide-ranging reforms to bring them in line with EU legislation and policies, promote competition and innovation, favour a wider adoption of renewables and gas and ultimately transfer the benefits of these changes to consumers. In this context, the Greek authorities have already carried out a number of actions but more remains to be done in a number of areas. At this stage of the negotiations, however, our understanding is that the key issue at this stage is the Public Power Corporation and the means to lower its retail and wholesale market share by 20% by end-2017 and below 50% by 2020. The selected mechanism to achieve this objective has been the NOME type auctions and so far two such auctions have been carried out. Nevertheless, the effectiveness of this mechanism is highly disputed as data by the Operator of Electricity Market (LAGIE) point to a very slow drop in PPC's market share[8]. If the NOME mechanism is to be deemed unsuitable and is abandoned, the Memorandum of Understanding requires that the Greek authorities agree with the institutions structural measures to be immediately

[6] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62015CJ0201
[7] It should be noted that according to the Directive 98/59/EC, "collective redundancies" means dismissals over a period of 30 days of: a) at least 10 in establishments normally employing more than 20 and less than 100 workers, b) at least 10% of the number of workers in establishments normally employing at least 100 but less than 300 workers, and c) at least 30 in establishments normally employing 300 workers or more.
[8] According to LAGIE PPC's market shares were 88.6% in November 2016, 89.83% in December 2016, 89.59% in January 2017 and 88.58% in February 2017.

adopted leading to the same results in terms of market shares and timelines. To this effect official lenders are reportedly pushing for the break-up of the PPC and require that this option be explicitly stipulated with the Greek government as a pre-requisite for the 2nd programme review. Under such a scenario the PPC would have to sell 40% of its lignite and hydroelectric capacity adhering to a strict timetable which would reportedly comprise the following steps: 1) by July 2017 the procedure by which the sale will take place needs to be finalised, 2) by September 2017 the PPC is to perform a "market test" to identify potential buyers and determine which units will be sold, 3) by November 2017 prospective buyers are to submit non-binding offers, 4) by February 2018 prospective buyers are to submit binding offers, 5) by March 2018 sale agreements are to be signed, and 5) by the end of Q1 2018 the whole procedure must be completed. It should be noted that under this plan, the prospective buyers should not be related to the Greek State in any direct or indirect way whereas PPC itself cannot collaborate with nor have a minority stake in the prospective buyers' business ventures. It is understood that the aforementioned plan is highly undesirable by the Greek government, which favours sticking to the NOME auctions mechanism for the time being and re-evaluating the issue at a later stage.

Potential timeline for the completion of the review

– 7 April Eurogroup. If a policy package has been agreed by then, the April 7 Eurogroup could endorse it and address the issues of the fiscal trajectory and the medium-term debt relief measures that will eventually lead to a political agreement. In the meantime Greece should be legislating all the agreed measures.

– 21-23 April. IMF/World Bank Spring Meetings where there will be discussions at the highest level between the Fund and the European partners (reportedly also between German FinMin Wolfgang Schaeuble and IMF Managing Director Christine Lagarde) regarding the medium-term debt relief measures for Greece to be implemented after the completion of the 3rd Economic Adjustment Programme in 2018.

– 24 April. The Eurostat's excessive deficit procedure (EDP 1st notification) statistics are due for release, which could open the way for the IMF's participation in the programme. Additionally, according to sources close to the negotiations, the measures beyond 2018 – both fiscal and growth-enhancing ones – may be specified and quantified in more detail at this stage, if this has not been done by then already.

– 22 May Eurogroup. Provided that the IMF will have consented to financially participating in the programme, the completion of the 2nd review could take place then.

– 8 June ECB monetary policy meeting. The ECB could decide Greece's inclusion in its quantitative easing programme at that meeting.

Alternatively, if more time is needed, the above two last steps could take place at the 15 June Eurogroup and the 21 June ECB non-monetary policy meeting.

Eurobank Economic Analysis and Financial Markets Research

Dr. Platon Monokroussos: *Group Chief Economist*
pmonokrousos@eurobank.gr, + 30 210 37 18 903

Dr. Tassos Anastasatos: Deputy Chief Economist
tanastasatos@eurobank.gr, + 30 210 33 71 178

Research Team

Anna Dimitriadou: *Economic Analyst*
andimitriadou@eurobank.gr, + 30 210 37 18 793
Ioannis Gkionis: *Research Economist*
igkionis@eurobank.gr + 30 210 33 71 225
Stylianos Gogos: *Economic Analyst*
sgogos@eurobank.gr + 30 210 33 71 226
Olga Kosma: *Research Economist*
okosma@eurobank.gr + 30 210 33 71 227
Arkadia Konstantopoulou: *Research Assistant*
arkonstantopoulou@eurobank.gr + 30 210 33 71 224

Paraskevi Petropoulou: *G10 Markets Analyst*
ppetropoulou@eurobank.gr, + 30 210 37 18 991
Galatia Phoka: *Research Economist*
gphoka@eurobank.gr, + 30 210 37 18 922
Theodoros Stamatiou: *Senior Economist*
tstamatiou@eurobank.gr, + 30 210 33 7 1 228
Elia Tsiampaou: *Economic Analyst*
etsiampaou@eurobank.gr, +30 210 3337871

Eurobank Ergasias S.A, 8 Othonos Str, 105 57 Athens, tel: +30 210 33 37 000, fax: +30 210 33 37 190, email: EurobankGlobalMarketsResearch@eurobank.gr

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