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Focus notes: Greece

1st review of Greece's new bailout programme: Where do we stand and what's at stake?

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Negotiations between the Greek government and the troika are expected to resume in the coming week

After a one-month hiatus, official talks under the 1st review of the existing bailout programme recommenced early last week. Greek Finance Minister Yiannis Stournaras and the troika representatives met last Wednesday, for the second time in just four days, with discussions being focused on a new austerity package for the coming two years, aiming to facilitate fulfillment of the agreed fiscal targets. A new round of negotiations for the finalization of the additional expenditure measures for 2013-2014 is expected to take place in the week ahead. The austerity package reportedly consists of expenditure-side measures worth **€11.9bn** (in terms of net projected fiscal impact) and ca **€2bn** in additional revenue to be generated by measures to broaden the tax base and increase tax and social security contributions compliance. ***Table 2*** *at the end of this note provides details on the proposed expenditure measures*. The identification of the said package constituted an important structural benchmark for June 2012 under Greece's new bailout programme, but it was apparently delayed due to the prolonged pre-election period.

As things stand at this point, a final agreement on the new austerity package for 2013-2014 has yet to be reached. The local press reported earlier this week that an agreement was reached between the Greek government and the troika technocrats on some €6bn of proposed expenditure measures. These relate primarily to cuts in wages, pensions and preferential benefits. Other reports circulated over the weekend claimed that the troika has already approved ca €7.5bn in expenditure-side measures along with €2bn in projected revenue increases. Yet, none of the aforementioned figures has been officially confirmed yet. As per a number of press reports earlier this week, the troika has out rightly rejected proposed expenditure measures worth ca €2.5bn **(Table 1.1),** asking domestic authorities to replace them with equivalent ones. Among others, these could reportedly include: **(i)** a 10% reduction in OGA pensions (Agricultural Insurance Organisation); **(ii)** an increase in the retirement age to 67 from 65 currently; and **(iii)** additional cuts in wages and pensions. Separately, the troika has reportedly raised reservations over proposed expenditure measures worth ca €3.5bn, requesting additional clarifications. This latter group of measures includes, among other, **(i)** a proposed additional reduction in the Public Investment Programme by €300mn; **(ii)** €476mn savings to be generated from a further rationalization of health care costs (reduction in operation costs of EOPPY, increase in farmers' social security contributions & others); **(iii)** €736mn savings from a reduction in the operational costs of municipalities; and **(iv)** €67mn savings from national defense (closure/commercial utilization of army camps, militarily hospitals and reduction in operations costs).

With regards to revenue-side measures, local press reports suggested that the troika officials proposed, as part for an overhaul of the tax system, the complete elimination of the tax-free threshold, which currently stands at €5k per year. Specifically, they proposed replacing the current tax-exempt threshold with a tax discount up to €2,160 through (retail sale & other) receipts and the reduction in the number of income tax brackets from 8 currently to 4. Reportedly, the troika team proposes the following brackets: 18% income tax rate for those earning up to €22k; 35% tax rate for those earning between €22k and €45k; 40% for annual declared incomes between €45 and €100k; and a 45% tax rate for those earning over €100k. It is reportedly estimated that, if these measures become eligible, they could yield savings ca €1..5bn per year. A bill to overhaul the tax system - initially planned to be submitted in Parliament in September 2011 - is now reportedly expected to be enacted by the end of the next month.

Table 1.1 - Proposed expenditure measures that have been reportedly rejected by the troika

(i) €911mn proposed reduction in pharmaceutical spending of social security funds and public hospitals. ***Comment:*** The outstanding debts of the National Organization of Health Services (the so-called EOPPY) to pharmacists and hospitals have already been skyrocketed. On the other hand, there are serious concerns that a further significant reduction in pharmaceutical expenditure could cause significant disruptions in the provision of healthcare services and a serious deterioration in functioning of the healthcare system.

(ii) €437mn proposed savings from an extension of payment schedules of armament programs (National Defense). ***Comment:*** The troika insists that this target is not feasible as many armament contracts signed in the past incorporate penal clauses for delayed payment. Moreover, this particular measure would simply lead to a deferral of relevant payments, *not* permanent savings.

(iii) €974mn proposed savings from an overhaul of public administration. ***Comment***: The troika representatives have reportedly expressed doubts over the feasibility of this target, especially in the absence of outright public sector layoffs. However, the latter comes against the ruling coalition's programmatic agreement and, arguably, the Greek Constitution.

(iv) €167mn savings from new measures to reduce public sector employment. ***Comment:*** In an effort to avoid outright public sector layoffs, the Greek government has instead proposed voluntary redundancies and the creation of a new labor reserve. As per the former proposed scheme (dubbed as "maturing pension"), the government would provide incentives to civil servants who are within three years of claiming pension to take early retirement. Such incentives could include, among others, the recognition of university studies, military service and working years in the private sector. As per this specific scheme, employees would receive 60% of their basic wage as an early retirement incentive. In parallel, the government would place in redundancy status those employees of closed or merged state entities who: (i) scored poorly in a series of regular evaluation tests (the first is expected to be completed in early 2013); (ii) have limited qualifications; and/or (iii) have been found guilty of serious discipline offenses or have an administrative inquiry ordered against them. Regarding the latter scheme, public-sector employees transferred to the new labor reserve would be receiving either 60% of their basic salary for a three-year period or 70% for 12 months before being subject to permanent separation. According to the government's proposal, the aforementioned schemes would result in the removal of around 35k-45k civil servants over the next three years so as to facilitate fulfillment of an earlier agreed target of reducing public sector employment by 150k in the period 2010-2015. Administrative reform ministry spokesman, Antigoni Fakou, said recently that the official lenders' demand for a 15k reduction in the number of civil servant in 2012 would be covered fully by regular retirements and by observing the present recruitment rate of 1:5.

Source: Local press

Troika said to insist on new structural measures to induce more flexibility in the domestic labor market

According to local press, the troika is demanding additional structural reforms aiming to induce more flexibility in the domestic labor market and further compress wage costs. The new package of related measures was reportedly discussed during a meeting earlier this week between the troika heads of mission and Greece's labour minister Yiannis Vroutsis (**Table 1.2**). Reportedly, Mr. Vroutsis argued that no new issues in labor relations should be raised at this point, especially as the Ministry has yet to fully assess the effects of recent changes in the labor market.

Recall that, as a prior action to the signing of the 2nd EU/IMF rescue programme, the Greek Parliament passed earlier this year legislation intended to compress wage costs and further liberalize the domestic labor market via i) removal of the permanent employment status from all labor contracts and freeze of maturity coefficients (i.e., automatic salary increases irrespective of productivity or cyclical conditions); ii) limit the length of the so-called "after effects" of collective contracts to three months from six previously, so as three months after the contract expires, and in the absence of a new contract, wages fall close to the minimum wage; iii) resource to arbitration to settle negotiation dispute to be allowed only if both parties (employee and employer representatives) agree to it; iv) collective agreements can only be concluded for a maximum duration of 3 years, v) a 22% reduction in the minimum wage at all levels and a further 10% decline for new entrants under the age of 25.

In a move interpreted as a compromise to the troika's latest labor reform demands, the Labour Ministry is reportedly expected to announce new legislation aiming to determine by law the wage floors of the National General Collective Agreement (NGCA). That is, after taking into consideration relevant proposals submitted by social partners. Note that, in reality, the said legislation constituted an important structural benchmark under Greece's new bailout agreement that was originally intended to have been fulfilled by July, 2012. Specifically, the new MoU stated that "the government will engage with social partners in a reform of the wage-setting system at national level. The proposal shall aim at replacing the wage rates set in the NGCA with a statutory minimum wage rat legislated by the government in consultations with social partners".

Table 1.2 - New troika proposals to further compress wage costs, induce more flexibility in the domestic labor market

i) increase in the number of maximum workdays from 5 currently to 6 per week;

ii) minimum daily rest time to 11 consecutive hours between shifts;

iii) delink working hours of employees from the opening hours of establishments;

iv) eliminate restrictions on minimum/maximum time between morning and afternoon shifts;

v) allow the two-week consecutive leave to be taken anytime during the year in seasonal sectors;

vi) reduce required period of redundancy notice employers have to provide to employees from 4,or 5 or 6 months currently (dependant on the number of years of working experience) to 3 months;

vii) reduce lay-off compensation by 50%;

viii) raise retirement age from 65 years currently to 67 years. ***Comment:*** The troika reportedly demands the increased retirement age to be effective immediately, meaning that employees who were due to retire in 2013 or 2014 would now have to wait another two years. This measure is reportedly estimated to save ca €1bn over the next two years.

ix) Decrease in employers' contributions to social security funds. ***Comment:*** this measure has been reportedly accepted by the Greek government. The Finance Minister announced earlier this month a cumulative 5% cut in non-wage labor costs as of next year, a structural benchmark under Greece's new bailout agreement. Yet, it is yet unclear how the ensuing insurance contributions gap will be financed. As per the conditionality attached to the new MoU "the government will enact legislation to reduce social contributions to IKA by 5 percentage points and implement measures to ensure that this is budget neutral".

Source: Local press

Leaders of junior ruling coalition partners set "red lines" in identifying the new austerity measures

In view of the objections raised by the troika for some of the measures proposed by the Greek finance ministry, the coalition party leaders convened again earlier this week (September 12). The heads of the two junior coalition partners reportedly set certain "red lines" as regards the details of the new austerity package. From his part, PASOK leader Evaggelos Venizelos expressed his staunch opposition to civil service layoffs, adding that there can be no further change in labor relations beyond the general framework that applies in the rest of the European Union. Mr. Venizelos also emphasized that a 2-year time extension in Greece's fiscal adjustment programme should be considered as a foregone conclusion, repeated the need for the establishment of a national negotiating team and warned that the measures currently demanded by official lenders "will not pass, will trigger social upheavals, political instability and will reinforce extreme social behavior".

Speaking to reporters shortly after the conclusion of the said meeting, Democratic Left leader Fotis Kouvelis highlighted that no new fiscal measures can be imposed on a society that is disintegrating, adding that his party opposes civil service layoffs as well the new troika demands aiming to induce more flexibility in the domestic labor market. The Democratic Left party also appears to object to certain austerity measures proposed by the finance ministry, including: (i) the annulment of the 13th and 14th installments in the main and supplementary pensions; (ii) reduction of the 13th and 14th installment for public servants; (iii) cuts in disability benefits and family allowances; (iv) reduction in university textbook supplies; (v) proposed 25% rise in public transport fees; (vi) elimination of seasonal allowances; (vii) elimination of tax exemptions for special social groups; and (viii) abolishment of Social Welfare Benefit (EKAS) to pensioners under the age of 65. The leader of Democratic Left has instead proposed 10 alternative measures estimated that yield savings of ca €1.23bn. The bulk of these measures concerns cuts in defense spending through the reorganization and extension of payment schedules of armament programs (€613mn), reductions in health care expenses (€370mn) and cuts in subsidies to certain energy products (€250mn).

The coalition party leaders will reportedly meet again in the coming week, probably on Wednesday on Thursday.

Updated timeline of key dates and events in the crucial weeks ahead

In our previous Greece Macro Monitor (September 4, 2012), we presented a detailed timetable of the key dates and events investors need to closely monitor in the crucial period leading to a successful conclusion of the 1st programme review and the timely disbursement of the next EU/IMF loan tranche. In what follows, we provide an update based on the most recent information we managed to collect from a number of press reports and other reliable sources.

<u>Week commencing September 17</u>

The leaders of Greece's ruling coalition are expected to convene again in the coming week in an effort to reach a final agreement over the new austerity package for 2013-2014. According to reports, the government expects the new package to be finalized by for the end of the coming week. <u>Comment</u>: *Reportedly, the heads of the troika mission are willing to reach a compromise with the Greek government on the new measures, provided that (i) 2/3 of the austerity package will come from cuts in wages, pensions and allowances; and (ii) their proposal for the complete elimination of the tax-free threshold is being adopted.*

<u>Early October- Greek Parliament to vote on FY-2013 budget, new austerity programme for 2013-2014</u>

According to local press, the Greek government intends to have the budget for FY-2013 and the new austerity package for 2013-2014 being voted in Parliament on October 1st as one single article so as to reduce the risk of dissenting votes among coalition partner MPs.. <u>*Comment*</u>*: We expect the Parliament to endorse the 2013 budget and the new package of expenditure measures in a move that would open the door for the disbursement of the next EU/IMF loan tranche. As a reminder, the tripartite ruling coalition controls 179 seats in the 300-seat Parliament- New Democracy controls 129; socialist PASOK 33 seats and Democratic Left 17. Yet, surprises in the form of a few dissenting votes should not be entirely ruled out. In a brief statement inaugurating the 77th International Trade Fair in Thessaloniki late last week, Greek Prime Minister Antonis Samaras acknowledged that the saving measures for 2013-2014are unfair, painful and may cause justifiable social reaction. Though, he insisted that they are essential for the country to restore its credibility and ensure that it will continue to receive official funding under the current EU/IMF bailout agreement. The Greek Premier reiterated that the new austerity package will be the last one and noted that, when the economy returns to growth, these harsh cutbacks will slowly begin to be restored.*

Early October-Completion of 1st review of Greece's stabilization programme

According to recent press reports, the troika's new report on Greece's stabilization programme will likely be finalized in early October so as to domestic authorities enough time to show some further progress in implementing the agreed reforms and privatization agenda. Comment: *In an effort to accelerate implementation of the delayed privatization programme, Greece's state privatization agency, the Hellenic Republic Asset Development Fund, took a number of steps earlier this week in its first meeting since the appointment of the new management. Specifically, the agency: i) listed four groups of potential investors for a 70% stake in Hellinikon SA, the holding company of the vast 1,500-acre seafront property that was until 2001 the site of Athens's airport; ii) short-listed two investors to bid for a prime coastal property on the tourist island of Corfu; iii) cleared six other bidders for a select real estate site of Rhodes island, iii) approved the contract for a 90-year lease on the International Broadcasting Center with final bids now awaited from preselected investors, iv) opened the way for the first phase in the tender process for Greece's natural gap company DEPA and announced an agreement with electric utility Public Power Corp. under which the latter would waive its right to acquire up to 30% stake in the former, and, vi) approved a memorandum of understanding with National Bank of Greece SA, owner of the luxury Astir Palace hotel in an upscale coastal suburb south of Athens to jointly develop the property. Greece's state privatization agency also announced that the board meeting will take place next week to launch international tender process for the sale of 20% shares in gambling monopoly OPAP SA. Separately, as per a legislative act signed last week, the State is now authorized to sell 100% of its shares in state-owned enterprises.*

October 8/9 Eurogroup/Ecofin - next loan disbursement to Greece to top the agenda

This is supposed to be the Eurogroup/Ecofin where finance ministers will hold their fist official discussion on the disbursement of the next EU loan tranche to Greece. Comment: *This holds provided that the Greek government will have secured parliamentary approval of both the new austerity package for 2013-2014 and the budget for FY-2013, in an effort to convince official lenders of its determination to accelerate implementation of the agreed adjustment programme. However, as Eurogroup President Jean-Claude Juncker suggested at the press conference that followed the conclusion of the September 14 Eurogroup, the final decision is expected to be reached at the upcoming EU Summit in mid-October.*

October 18-19 EU Summit- Proposed lengthening of the duration of Greece's fiscal adjustment programme to dominate discussions

The issue of a 2-year time extension to Greece's fiscal adjustment programme and the release of the next EU/IMF loan aid are expected to dominate discussions at the October 18/19 EU Summit, conditional on the timely and successful conclusion of the 1st troika review. The EU Commission's proposals on the single supervisory mechanism for euro area banks are also expected to be in the agenda of discussions. Comment: *Greek Prime Minister Antonis Samaras has repeatedly stated that the economy, mired in recession for five consecutive years, needs a bit of "air to breath" to get back on track. He also said in a recent interview to German Bild newspaper that more time for the fulfillment of the agreed terms would not necessarily involve more official funding. Recall that, as per the Article 5 of the 2nd bailout plan, the Greek government "will consult with the European Union, the ECB and the IMF in case of a significantly deeper than expected recession to assess whether the fiscal adjustment should be extended beyond 2014".*

Table 2
Greek government's proposed austerity package for 2013-2014;
Key components & expected impact (EURbn)

Overhall of Public Administration	**1,274**
25% reduction in non-salary expenses of ministries and other public sector entities	750
Electronic procurement system in public sector	104
Full implementation of the "SYZEFXIS" project	35
Rationalisation of Public Investment Programme (PIP) expenditure	300
Reduction of subsidies to political parties; cuts in parliamentary deputies' privileges	47
50% reduction in special benefits to department heads, directors, general directors	21
Abolishment of parliamentary committees, horizontal reduction in rent payments by state	17
Municipalities	**736**
Closure/merger of local government legal entities	18
Outsourcing garbage collection to private companies	30
Internal quality control systems	25
Photovoltaic installation in 500 primary schools	18
Better utilisation of municipal property	123
Other	522
Health Care	**1,387**
Reduction in pharmaceutical spending of social security funds	800
Reduction in operation costs of EOPPY	195
Reduction in pharmaceutical spending of public hospitals (greater usage of generic drugs)	111
Increase in farmers' social security contributions (Agricultural Insurance Organisation)	131
Other	150
National Defense	**504**
Extention of payment schedules of armament programs	437
Closure/commercial utilisation of army camps, military hospitals	32
Reduction in operating costs	35
Education	**389**
Merging of Technological and Higher Education Institutions	40
Reductions in texbook supplies	34
Imposition of annual tuition fees to certain student categories	65
Reduction in teaching staff	22
Increase in teaching hours; other	148
Reduction in operating costs for central and regional education services	30
Reduction in State subsidies & grants	50
Public enterprises (DEKO)	**274**
25% rise in public transport fees	40
Restructuring of public entities & reduction in operating costs	179
Sale of non-strategic activities	5
Rationalisation in subsidies provided via the state budget	50
Taxation	**450**
Increase in lawsuit fees	100
Recuction in VAT refund to farmers from 11% to 7%	121
Other	229

Pensions	4,598
Annulment of 13th & 14th installment in main & supplementary pensions (all)	2,240
Cuts in *main* and *supplementary* pensions cumulatively exceeding €1,000 gross per month (€1,000-€1,500:2%, €1,500-€2,000:5% and above €2,000:10%)	640
Rationalisation of lump sum payments to retirees	211
Retrospective rationalisation of lump sum payments already granted	402
Reduction of pensions to military and police personnel due to the annulment of promotional salary increases	300
Reduction in pensions due to cuts in special wage regimes	400
Other	405
Wages	**1,333**
Rationalisation of special wage regimes	360
Rationalisation of pay scale system (with the exception of DEKO)	128
Reduction of the 13th and 14th installment for pubilc servants	339
Labor reserve	167
Elimination of automatic promotion salary increases in security forces	165
Implementation of the Single Salary System to public enterprises (DEKO)	75
New pay scale for parliamentary employees	13
Other	86
Preferential benefits	**930**
Rationalisation of family allowances	352
Rationalisation of disability benefits	272
Medical re-examination of current recipients of disability benefits	94
Adjustments in pensions received by the uninsured elderly	26
Abolishment of social welfare benefits (EKAS) to pensioners under the age of 65	114
Elimination of seasonal allowances	50
Elimination of special unemployment allowances	30
Other	82
Provision of special allowance for long-term unemployed	-35
Other	-55
Total	**11,875**

Source: Local press

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