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Greece: Overview of latest domestic developments & key deliverables for 1st programme review

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First round of official talks in the context of 1st programme review completed; mission heads expected to return to Athens by mid-February

The EC/ECB/IMF/ESM mission heads arrived in Athens on January 30th for the first round of negotiations with the Greek authorities in the context of the 1st adjustment programme review. Official discussions concentrated on finalizing the relevant prior actions and deciding the timeline for the completion of the review. The mission heads are reportedly expected to depart later today (Friday, February 5th) and return to Athens by mid-February, with an intention to complete the review by late February. In the meantime, discussions on all open issues will continue between the Greek authorities and the Athens-based technical teams representing official creditors. A formal decision on the exact timing of the mission heads' return will be reached at the February 11th Eurogroup after assessing how close the two sides are on reaching a staff level agreement on the required conditionality. According to the local press, it appears that quite diverse views currently exist between the Greek government and official creditors on a number of key deliverables. According to European Commissioner for Economic and Financial Affairs Pierre Moscovici, official negotiations will deal with "difficult issues and time will be needed". On his part, Greece's Minister of Finance Euclid Tsakalotos warned that "time is precious" and unless the review is completed in a reasonable time frame, the new adjustment programme will not succeed.

Greece's 1st programme review- key deliverables

In what follows we provide some analysis on the prior actions that reportedly dominated official discussions between the Greek government and official creditors during the first phase of negotiations in the context of the 1st review of the new adjustment programme.

Overhaul of the social security pension system

After assessing the government's proposal on the social security pension reform, the mission heads have reportedly raised certain objections. As per the same sources, the main parameters of the proposed plan include, inter alia:

Social security contributions: As a means of averting any further cuts in existing main pensions or a horizontal reduction in supplementary pensions, the government has proposed a cumulative increase of 1.5% in social security contributions on a temporary basis of around 2-3 years (= 1% for employers + 0.5% for employees). According to the government's estimates, this measure would secure savings of c. €550mn (c. €375mn + c. €170mn, respectively) out of c. €1.8bn (or 1%-of-GDP) in targeted savings than need to be generated in 2016 through the overhaul of the social security pension system. The remaining amount of €1.1bn has purportedly been covered already through relevant measures that have been penciled in the 2016 Budget. On their side, official creditors appear to oppose any further increase in social security contributions, on the basis that it would harm business competitiveness. According to the local press, although official creditors have not yet explicitly asked for any cuts in existing pensions, the IMF has signaled that the adoption of such a measure might be unavoidable for securing the long-term viability of the system. In more detail, the Fund has reportedly proposed three alternative scenarios: (a) a horizontal cut of 6% in main and supplementary pensions; (b) a cut of 15%-20%, when the total pension amount being granted (by main and/or auxiliary funds) exceeds €800/month; or (c) a cut of 30% for a total pension over €1000/month. In an effort to reach a compromise, the Greek government could reportedly consider: (i) a relatively lower increase in social security contributions (by c 1.0% compared to 1.5% proposed) along with progressive cuts in relatively high supplementary pensions (>€173/month); or (ii) a cut in relatively high supplementary pensions and the establishment of a ceiling at €2.3k/month for new and existing main pensions. [1]

Eligibility criteria for the provision of a national state guaranteed pension.[2] In disagreement with the government's proposal for the provision of a €384/month national state guaranteed pension to all pensioners with 67 years of age or above and at least 15 insurance years, official creditors reportedly argue in favor of the introduction of eligibility income criteria. Furthermore, they propose the pension to be granted to pensioners with 67 years of age, but with at least 20 years of insurance.

Replacement rates. Official creditors argue that the replacement rates for pensioners with total working years between 15 and 25 should be revised lower so as to ensure a closer link between contributions and benefits and to also provide incentives to employees for working more than 25 years.

Pension lump sum payments. Official creditors have characterized the lump sum retirement payment as a "luxury", considering the country's financial position and have proposed its abolishment.

Zero deficit clause on supplementary funds.[3] Official creditors argue for the implementation of the zero deficit clause on supplementary funds (estimated savings of €326mn/annum). Instead, the Greek government has reportedly proposed alternative sources of revenue, including the exploitation of the property of ETEA (Supplementary Insurance Unified Fund).

IMF Managing Director Christine Lagarde has repeatedly stressed that securing Greece's public debt sustainability and progress on the social security pension system are key prerequisites for the Fund's (financial) involvement in Greece's new bailout programme. Meanwhile, the local press quoted unnamed high level government officials suggesting that the government does not intend to proceed with any unilateral action on the social security pension system reform.

Fulfilment of agreed fiscal targets for fiscal years 2016, 2017 and 2018

Official creditors are said to be concerned that some of the measures already approved by Parliament are either not properly implemented or their projected fiscal impact has been overestimated. Against this background, they reportedly project that the fiscal target for a primary shortfall of 0.25%-of-GDP in FY-2015 may not be met and that the government may also have to adopt additional measures - beyond those already agreed under the existing MoU- so as to secure fulfillment of the agreed fiscal target for a primary surplus of 0.5%-of-GDP in FY-2016, 1.75%-of-GDP in FY-2017 and 3.5%-of-GDP in FY-2018. As per the same sources, they anticipate a fiscal gap of 0.5-1%-of-GDP to arise in FY-2016 and up to 3%-of-GDP cumulatively by FY-2018.[4] On its part, the Greek side is reportedly optimistic that, in view of the satisfactory execution of the State budget in the 12-month period to December 2015[5] and amid expectations for a milder than initially expected GDP contraction last year,[6] the fiscal target for FY-2015

[1] It is reportedly estimated that for around 50% of households, the pension constitutes the main source of revenue compare to c. 42% in 2012.

[2] According to the government's plan, the level of new pensions will be determined as the sum of two components: (a) the basis pension that will depend on total working years and the (revised)replacement rates + (b) a national state guaranteed pension of €384/month.

[3] A law envisioning the implementation of the zero-deficit clause on auxiliary pensions was approved by the Hellenic Parliament in June 2014 in the context of the 2nd adjustment programme but has yet to be fully implemented.

[4] According to the European Commission's Winter 2016 Economic Forecast that was released on February 4th, "further measures will be needed in 2016 and 2017 in order - for Greece-to reach the programme's primary surplus target of 0.5% of GDP in 2016 and 1.75% of GDP in 2017".

[5] According to official figures on the execution of the State Budget on a modified cash basis, the overall central government deficit in the 12-months to December 2015 presented a deficit of €3,530mn compared to a budget target for a shortfall of €2,573mn and a deficit of €3,697mn in the same period a year earlier. The State Budget Primary Balance amounted to a surplus of €2,270mn against a primary surplus target of €3,257mn and a surplus of €1,872mn recorded in the same period a year earlier. State Budget net revenues amounted to €51,421mn, recording an underperformance of €1,670mn or 3.1% against the respective target mainly due to the non-receiving of the ANFA & SMP revenues of €3,591mn. On the spending side, State Budget expenditures stood at €55,063mn, €714mn lower than the respective target.

[6] In its Winter 2016 Economic Forecast, the European Commission revised higher Greece's GDP growth forecast for 2015 and 2016 to 0.0% and -0.7% respectively compared to -1.4% and -1.3% previously.
http://ec.europa.eu/economy_finance/publications/eeip/pdf/ip020_en.pdf)

will probably be outperformed and the general government primary account will record a meagre surplus of c. 0.4%-of-GDP (Table 1-Annex). Reportedly, the Greek government also foresees that, under such a scenario and assuming that all measures penciled in the 2016 Budget will be fully implemented, the agreed fiscal target for FY-2016 will also be attained without adopting additional measures. Under the MoU conditionality, the Greek government has committed to implement additional fiscal measures for 2017 and 2018, projected to yield at least 0.75%-of-GDP and 0.25%-of-GDP respectively, so as to help attain the medium term primary balance target of 3.5%-of-GDP.[7]

Income tax system reform

According to the local press, the Greek government's draft of the planned income tax code reform essentially maintains different tax scales depending on the origin of income, projecting to secure at least c. €300mn/annum. Specifically, the proposed plan envisions, inter alia:

(i) Unified taxation system for wage earners, pensioners, self-employed and freelances. Four income tax scales will be applied, compared to three currently; 22% for annual income between 0-€25,000, 32% for €25,001-€42,000, 42% for €42,001-60,000 and a top tax rate of 50% (vs. 42% currently) for declared annual income above €60,000.

(ii) With respect to rental income[8], three tax scales will be implemented, compared to two currently; 15% (from 11% currently) for annual rental income up to €12.000, 35% (from 33% currently) for income up to €40,000 and 40%-45% above €40,000.

(iii) Establishment of a tax-free threshold of €9.500 per year solely for pensioners and wage earners.

As per the same sources, official creditors received the government's draft with some skepticism arguing that, after the planned integration of the solidarity surcharge into the income tax, the top income tax rate could rise to nearly 60%, a development that could potentially boost tax evasion. Meanwhile, farmers continue to escalate their protest actions against the planned overhaul of the social security pension system setting up road blocks on several national highways. Against this background, the government is reportedly mulling to postpone for H2 2016 the planned overhaul of the agricultural income tax system. As per the same sources, the government is also considering various compromises including, inter alia, an increase in the income tax rate for farmers from 13% currently to 26% eventually in 2019, two years later than the MoU envisions.

Finalization of outstanding issues related to the NPL resolution framework

This refers to the NPLs regulatory framework dictating the legal framework for the licensing of non-banking institutions that will be authorized to offer NPL management services and repurchase of certain portfolios including mortgages pertaining to first residence, consumer loans, SMEs' loans and State-guaranteed loans. Under an agreement reached between the Greek government and official creditors late last year, the existing NPLs regulatory framework bans the management and potential repurchase of these particular categories of portfolios until February 15th. According to some press reports, official creditors have accepted the government's proposal for a one-month extension of the existing regulation. Yet, as per the same sources, they rejected the government's proposal that NPLs pertaining to first residence are fully exempted from potential repurchase.

Government spokesperson rules out scenarios of snap election

Addressing a press briefing last week, government spokesperson Olga Gerovasiili rebuffed scenarios of early elections or an ecumenical government underlying that the government has a "strong and consistent" parliamentary majority. Furthermore, she made clear that the aim of the government is the speedy completion of the current review and the initiation of official discussions on additional debt relief measures. On his part, speaking to a local TV station earlier this week, the newly elected President of main opposition New Democracy (ND), Kyriakos Mitsotakis, revealed that his party will not support the relevant social security reform at its current form when it comes for vote in Parliament. He stated that ND does not share common values with the coalition government SYRIZA/ANEL and ruled out the possibility of supporting an ecumenical government. Furthermore, with the last general election taking place just four months ago, he made clear that his party does not intend to trigger an early ballot. As a reminder, the parliamentary majority of the SYRIZA/ANEL coalition government has been reduced to 153 in the 300-seat Parliament, two less compared to the January 25th general election outcome.[9] (Graph 1 in Annex depicts the current composition of the Hellenic Parliament).

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[7] Under the MoU conditionality, the Greek government has also committed to take further structural measures in October 2016 if needed to secure fulfillment of the agreed fiscal targets for 2017 & 2018. These may include a reduction in defense expenditure, reforms to the personal income tax (PIT) and freezing of statutory spending.

[8] According to the Ministry of Finance, around 33% of taxpayers declared taxable income less than €5,000 in 2015 while just 6.2% declared income higher than €60,000.

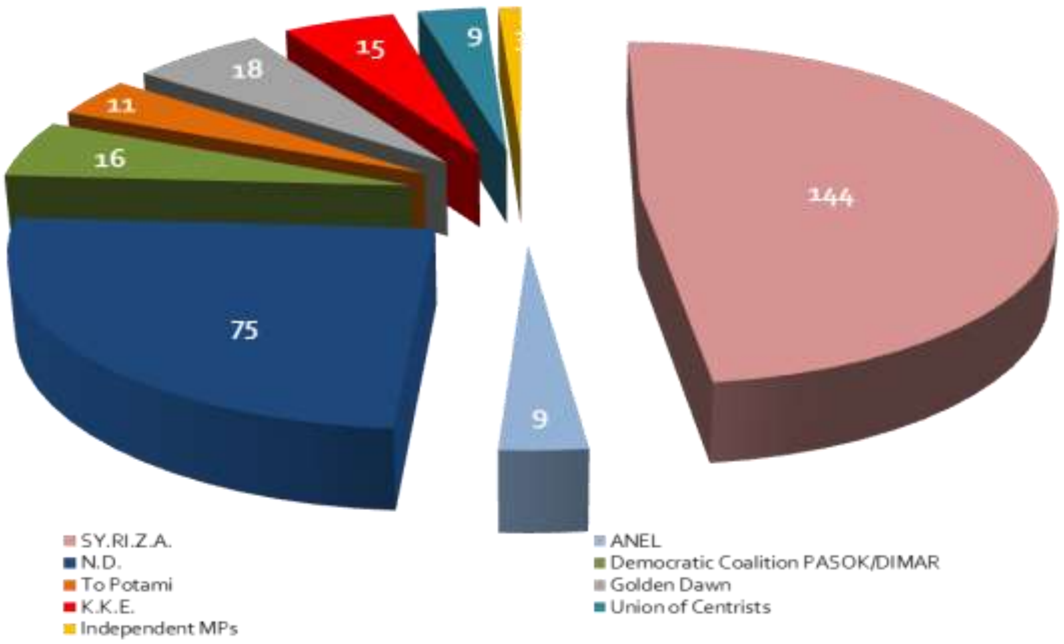
[9] In a key parliamentary vote on November 19th 2015 for the endorsement of the prior actions to the release of the €2bn ESM loan installment as well as the funds earmarked for the recapitalization of Greek banks, two coalition lawmakers (ANEL MP Nikos Nikolopoulos & SYRIZA MP Stathis Panagoulis)

Annex

Table 1- Budget Execution January-December 2015

	Realization (€mn)	Realization (€mn)	Budget 2016 Estimates (mn)	Deviation (€mn)	Realisation (€mn)	Budget estimates (as depicted in Budget 2016, €mn)	Budget estimates (as depicted in Budget 2015, €mn)
	(1)	(2)	(3)	(4) = (2)-(3)	(6)	(7)	(7)
I. Ordinary Budget Balance (A-B)	-1,818	-1,955	-646	-1,309	-1,821	-646	1,566
State Budget Net Revenue (A+C1)	51,370	51,421	53,091	-1,670	51,367	53,091	55,603
A. Ordinary budget net revenue (A1+A1-A3)	46,653	46,589	48,618	-2,029	46,650	48,618	50,871
A1. Revenue before tax returns	49,639	49,257	51,720	-2,463	49,636	51,720	53,171
A2. Privatisation proceeds	384	254	268	-14	384	268	577
A3. Tax returns	3,370	2,922	3,370	-448	3,370	3,370	2,877
State Budget Net Expenditure (B+C2)	55,063	54,950	55,664	-714	55,063	55,664	55,705
B. Ordinary budget expenditure (B1+B2+B3+B4+B5)	48,471	48,544	49,264	-720	48,471	49,264	49,305
B1. Primary expenditure	41,928	41,298	41,924	-626	41,928	41,924	41,887
B2. Military procurement (on a cash basis)	345	565	590	-25	345	590	700
B3. Guarantees called	587	703	720	-17	587	720	818
B4. Net interest payments	5,569	5,800	5,830	-30	5,569	5,830	5,850
B5. Loan disbursement fee tobanks, EFSF & other governmevт debt expenses	42	178	200	-22	42	200	50
II. Public Investment Budget (PIB) (C1-C2)	-1,875	-1,574	-1,927	353	-1,875	-1,927	-1,668
C1. PIB net revenue	4,717	4,832	4,473	359	4,717	4,473	4,732
C2. PIB expenditure	6,592	6,406	6,400	6	6,592	6,400	6,400
III. Central Government Budget Balance (I+II) (+ surplus, - deficit)	-3,693	-3,529	-2,573	-956	-3,696	-3,709	-3,709
IV. Central Government Primary Balance (III+B4) (+ surplus, - deficit)	1,876	2,271	3,257	-986	1,873	2,121	2,141

Graph 1- Allocation of seats in the Hellenic Parliament



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