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Focus notes: Greece

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Progress in meeting adjustment programme targets

Where we currently stand and what lies ahead

This note takes a close look at the progress made so far in meeting the adjustment programme targets, in the context of the upcoming troika assessment. Greece has already fulfilled the bulk of prior actions to the 3rd programme review and, as such, we expect no major delays in the next loan disbursement. Looking further ahead, we expect the 5th and the 6th reviews (August 2013 and November 2013, respectively) to be particularly challenging, not only on the basis of their quantitative targets and structural benchmarks, but also because by that time we will have a clearer picture as to the pace of current year's GDP contraction and the progress made in certain key arrears, including tax administration and the privatization program.

Heads of troika mission expected in Athens in early March for the 3rd programme review

A technical team of troika officials arrived in Athens on February 24 to prepare the ground for the upcoming discussions with domestic authorities in the context of the 3rd review of the present adjustment programme. The first high-level meeting between finance minister Yiannis Stournaras and the heads of the troika mission is scheduled on March 3 and, according to the current planning, the EC/ECB/IMF officials are expected to stay in Athens until March 10. High on the agenda of the upcoming discussions will reportedly be, among others: **(i)** staffing plans for line Ministries, identification of redundant positions and employees as well as specification of quarterly targets for mandatory exits through to end-2014; **(ii)** restructuring of the tax collection and monitoring mechanisms; **(iii)** progress towards completion of the bank capitalization program; **(iv)** progress made so far with respect to the agreed privation plan; **(v)** review of the current framework of indirect taxes; **(vi)** new framework for the settlement of overdue tax payments; **(vii)** adoption of a single property tax; and **(viii)** incentives for the repatriation of undeclared bank deposits. With the Greek government having already made good progress in meeting the agreed prior actions to the upcoming (3rd) troika review, we expect the latter to be completed without major delays. This is necessary for the timely release of the next EFSF/IMF loan installment of €8.8bn (= last sub- tranche of the €49.1bn disbursement approved last December, amounting to €2.8bn + €6bn earmarked for Q1-2013). The said installment, which is expected to be released by late March, will comprise of €4.2bn in the form of short-term EFSF paper and €1.8bn in IMF funding under its Extended Fund Facility.

Key issues to dominate the agenda of upcoming discussions with the troika
In what follows, we provide a more detailed analysis of the key issues to be discussed between the government and the troika in the context of the 3rd programme review.

I. ***Staffing plans for line Ministries, identification of redundant positions and employees, specification of quarterly targets for mandatory exits through to end-2014***

<u>Comments</u>

- The above item constitutes a key MoU milestone that needs to be completed by end-February as a prior action to the release of the March 2013 EFSF loan disbursement (€2.8bn).
- As laid out in the MoU conditionality, the target is to reduce public sector employment by 150k over the period 2010-2015, mainly via:
    - the application of an agreed attrition rule (only 1 new hire per 5-10 retiring employees);
    - reduction of temporary contracts;
    - outright dismissals of public employees who have been found guilty of serious discipline offense or have an administrative inquiry ordered against them; and
    - transfer to a special mobility scheme of employees of closed or merged state entities who will score poorly in regular evaluation tests or/and have limited qualifications.

  Under the latter scheme, transferred employees will be receiving 75% of their basic monthly salary for a year before being subject to permanent separation. That is, in case they fail to be reappointed in the broader public sector to fill in vacant positions.
- Some 1,981 public employees had been transferred to the special mobility scheme as of the end of 2012 and, according to the conditionality laid out in the revised MoU, an additional 25k need to be transferred to the said scheme by the end of this year (i.e., 6,250 per quarter).
- Staffing plans for line ministries were completed last week. Following their completion, the Ministry of Administration Reform and e-Governance announced a number of vacant public-sector posts that need to be filled, *subject to special evaluation procedures*, by public servants who have been moved to the special mobility scheme. According to the ministry's announcement, there are currently 2,423 vacant positions, most of them in the Ministries of Public Order, Labour, Social Security & Welfare, Justice and Health.
- According to the local press, the government intends to fulfill the agreed target of reducing public sector employment by 150k until the end of 2015, mostly via natural attrition and outright dismissals of civil servants who have seriously breached the code of conduct, or/and have and administrative inquiry ordered against them. In addition, and as specified in a recent circular from the Ministry of Interior, personnel hiring in municipalities, regional authorities and public sector entities of private law will be frozen until 2016. As a final point to this section, we note that in a number of discussions we held recently with high–ranking government officials, it was transpired to us that the overall public sector workforce is estimated to have been reduced by 75k over the last three years, mainly via natural attrition and by applying the agreed hiring rules.

II. Restructuring of the tax collection and monitoring mechanisms

As per the last IMF report on Greece[1], tax administration reform has stalled in recent months, with tax discipline and collections falling short of performance targets, especially in areas such as audits of large taxpayers and high net-worth individuals. Meanwhile, problems related to understaffing, inadequate operating procedures and weak internal controls were not being adequately addressed, partially due to bureaucratic resistance. Indicatively, the latest quarterly report by the EU Task Force for Greece (December 2012), revealed that only 88 major taxpayers, including corporations, were subject to full-scope audits by the end of October 2012, well short of a respective full-year target of 300. Similarly, just 467 audits of high-wealth individuals were completed, compared to a full-year target of 1,300. Moreover, about €1.1bn in overdue taxes was collected in 2012, less than a respective full-year target of €2bn. According to the said report, tax arrears to the State rose by ca €13bn to ca €55bn last year, with only 15-20% of the latter amount being regarded as actually collectable. For the current year, the agreed MoU targets are for 750 full-scope audits and 2,600 audits of high net-worth individuals. In addition to the aforementioned, the size of the shadow economy is estimated at 25%-of-GDP with tax evasion being particularly pronounced among self-employed *e.g.* doctors, lawyers, engineers and accountants. According to the said report, empirical estimates suggest that the actual annual income of these taxpayers is 1 ½ -2 ½ times higher than their declared income.

[1] IMF Country Report No. 13/20, "Greece: First and Second Reviews Under the Extended Arrangement Under the Extended Fund Facility, Request for Waiver of Applicability, Modification of Performance Criteria, and Rephasing of Access—Staff Report; Staff Supplement; Press Release on the Executive Board Discussion; and Statement by the Executive Director for Greece", January 2013.

The revised MoU (December 2012) spells out explicit steps the Greek government needs to take so as to strengthen revenue administration, improve tax collections and ensure a more socially-just distribution of tax burdens. Against this background, the Greek government has committed to implement a number of relevant prior actions to the next (3rd) programme review, including among others:

— appointment of a new General Secretary for State Revenues (*completed*);
— adoption of legislation specifying the degree of autonomy of the newly established General Secretariat for State Revenues, its governance framework, accountability and legal powers (*near completion*). From now on, managers and auditors will be subject to performance targets and regular assessment, with the General Secretary for State Revenue having the capacity to replace managers who fail to observe performance targets;
— development of an action plan for facilitating tax collections and exploring ways to deal with tax arrears (*completed*);
— implementation of the revised Code of Books and Records (*near completion*). According to the new code, data of overdue debts to the State will be published at the finance ministry's internet site, provided that these debts exceed the amount of €150k and due payments are behind schedule for a period exceeding one year,
— replacement of payments in cash and via cheques in tax offices with bank transfers (*near completion*)
— adoption of the appropriate legal framework for the creation of a secure central register of bank accounts (*near completion*);
— creation of specialized units in large tax offices and allocation of at least 10% of their staff to tax and revenue collection posts (*pending*)

Notwithstanding the progress made thus far in strengthening revenue administration and tax collections, a number of important hurdles and challenges still lie ahead, incorporating, among others:

— the creation of specialized units to deal with specific taxpayers groups, including a large taxpayer unit, a high-wealth individual unit and a large debtor unit (prior action for 4th programme review, May 2013). To make these units operational, the government is planning to appoint some 200 tax auditors by March 2013; and
— restructuring of local tax offices, 150 small local tax offices to close or merge by the end-March 2013 (prior action for 4th programme review, May 2013);

Looking further ahead, the 5th programme review (August 2013) will put a greater emphasis on the overall progress made in strengthening revenue administration and fighting tax and contributions evasion. Important prior actions to the said review will include, among others: (i) adoption of a new Income Tax Code (focusing, primarily, on further tax system simplifications) and a new Single Tax Procedure Code, aiming to tighten installment schemes as well as introducing modern audit, collection and enforcement methods; and (ii) parliamentary approval of the so-called "maxi" national tax bill. The latter will incorporate measures aiming to improve tax collections and strengthen the fight against tax evasion. According to local press, the latter reform is expected to be submitted to Parliament by May.

III. Bank recapitalization program[2]

<u>Comments</u>

— Recent comments by domestic bank officials suggested that the bank recapitalization program should offer more attractive incentives to private investors to ensure coverage of the minimum required 10% participation in the new common equity capital so as to keep credit institutions privately run. Such incentives could reportedly include lower subscription price to the common equity capital increase for private shareholders compared to that of the HFSF and/or lower annual coupon on CoCos. Responding to these calls, Greek finance minister Yiannis Stournaras was quoted last week as saying that there is little scope for any changes in the terms of the bank recapitalization program.

[2] See Greece Macro Monitor, "*Greek banking sector recapitalization and restructuring ; Program modalities, progress already made and next steps*", January 25, 2013, *http://www.eurobank.gr/Uploads/Reports/GREECE%20MACRFOCUS%20%20January%2025%202013.pdf*

— Yet, according to press reports, an extension in the April-2013 deadline for the completion of the recapitalization program should not be entirely ruled out. As per the conditionality laid out in the revised MoU, the legal framework for bank recapitalization entails that share capital increases for core banks will have to be completed by end-April 2013, (MoU structural benchmark). Similarly, non-core banks should also be fully recapitalized with private resources by end-April 2013. Alternately, their capitalization programme can be completed by end June-2013 through purchase and assumption (P&A) transactions with well capitalized banks or, as a second best, through the establishment of a bridge bank.

IV. Observance of the agreed privatization targets

<u>Comments</u>

— Progress in privatizing State assets has been slow so far mainly due to, among others, prolonged economic and political uncertainty ahead of the June 2012 general election, difficult market conditions and a multitude of implementation hurdles (administrative, bureaucratic, legal and other). Yet, significant efforts have been made in recent months in preparing assets for sale. More specifically,

— 3,150 real estate properties with estimated value of €10bn have already been identified and pre-valued to provide the basis for sales over the next 2-3 years. Out of these, 1,000 will be transferred to the Hellenic Republic Asset Development Fund (TAIPED) by end-2013, targeting 250 transfers per quarter. Some 10,000 additional real estate assets with an estimated value of €8bn have also been identified for later privatizations.

— Currently, eight privatization projects are in progress. Out of these, two are related to the privatization of DEPA (Public Gas Corporation)/ DESFA (Gas Transmission Network Operator) and OPAP, the largest gaming operator. The remaining six are related to the usage of public property via long-term leasing contracts (Afantou area in Rhodes, Hellinikon, Xenia Hotel in Halkidiki, Astir Vouliagmenis, State properties abroad and properties suitable for commercial facilities). Out of ca €1.6bn in privatization proceeds secured by the Greek State over the last three years, only ca €0.1bn was generated from leasing contracts on public property (International Broadcasting Center of the 2004 Olympic Games in September 2012 & Kassiopi area in Corfu in February 2013). The remaining came from right concessions agreed with OPAP (€1.3bn) as well as the renewal of Mobile Telephony Licenses which expired in September 2012 (€0.3bn).

Separately, TAIPED decided earlier this month to launch the privatization process of the Thessaloniki Water Company (EYATH), the country's second-biggest water utility (sale of its majority stake of 51%), which is expected to be completed by Q4 2013. Binding offers will have to be submitted by April 19th 2013, while the respective concession contract will be valid for 50 years. The government aims to have 28 estate properties tendered by June 2013, with most of them being completed by end-2014.

— Expected privatization proceeds over the period 2013-2020 have been adjusted lower to reflect lingering implementation hurdles and adverse market conditions. Cumulative proceeds are now set at €4.2bn by the end of this year (including ca €1.6bn realized up to date), €11.1bn by 2016 and €25.6bn by 2020 with the main bulk expected to be generated from concession contracts on public sector property. The full (earlier envisaged) amount of €50bn in privatization revenue proceeds remains valid, though, it is now expected to take longer than initially expected to be realized. As per the revised MoU, privatization proceeds are paid directly to a special segregated account in the Bank of Greece. Disbursements to this account cannot be used for any other purposes than debt servicing to official creditors (law 4063/2012).

— The most important privatization projects, not only for this year but probably for the entire program, are those of *OPAP* and *DEPA/ DESFA*. According to TAIPED, binding offers for OPAP will be submitted by April 5th 2013 and for DEPA/ DESFA by April 12th 2013 with the wining bids to be chosen by the end of that month. These sell-offs are reportedly expected to yield ca €2.5bn in revenues cumulatively (ca €1.9bn from DEPA/ DESFA and the remaining €0.6bn from OPAP), an amount equal to 100% and 25% respectively of the projected privatization proceeds for FY-2013 and the 2013-2016 period.

— In case that privatization proceeds fall short of targets, the pace of the fiscal adjustment will need to accelerate. According to the *corrective mechanism on the primary surplus* laid out in the revised MoU, the primary surplus target should be raised by an amount equivalent to 50% of the shortfall in privatisation proceeds, with the required incremental adjustment achieved via additional general government expenditure cuts. The adjustment within any year would be capped at €1bn.

— According to the conditionality laid out in the revised MoU, the overall progress made in the privatization program will be the main focus of the 6th programme review (November 30, 2013).

V. ***Review of the current framework of indirect taxes***. Comment: According to the final January 2013 data for the execution of the State budget on a modified cash basis, central government net revenues amounted to €4,433mn, just 0.1% or €4mn lower than the corresponding target. This was mainly thanks to higher than expected receipts from income and property taxation, which exceeded monthly targets by €151mn and €109mn respectively. Yet, revenues from VAT and consumption taxes came in short of monthly targets (by €161mn and €295mn, respectively). According to local press reports, the government will propose to the troika a reduction in the VAT of food catering to 19% from 23% currently. A reduction in the special consumption tax on heating oil may also be discussed with troika officials.

VI. ***New framework for the settlement of overdue tax payments***. Comment: The government will reportedly propose to the troika a new regulation for overdue debts so as payment plans to be adjusted to the specific financial profiles of debtors.

VII. ***Adoption of a single property tax.*** Comment: The new single property tax will be reportedly come into force in H2 2013, replacing the special Property Tax (FAP) that was applied in 2010-2012 to all real estate holdings as well as the special levy that was collected through electricity bills (2011-2012). The government reportedly intends to impose the new tax also on properties which are currently exempted, such as farmland and fields that fall outside urban planning, city or settlement limits. Local press reports suggested that there will probably be an exemption for agricultural land owned by people whose main occupation is farming. Moreover, by the end of this month, a special working group will reportedly submit to the Minister of Finance its conclusions on the new system determining the so-called "objective value" of asset properties. As per the revised MoU, the Greek government should revise legal values of real estate to better align them with market prices by March 2013.

VIII. ***Offering incentives to attract undeclared funds from abroad.*** Comment: Local press reports suggested that the Greek government is planning to table once again a proposal offering incentives to Greeks with undeclared bank deposits and other funds abroad to repatriate them, paying a relatively small tax as long as these funds will be used for investment purposes. Yet, it is unclear whether the troika will accept such a proposal. According to the said reports, the troika turned down in November 2012 a previous request by the Greek government, aiming to make repatriation of undeclared funds more appealing (a fine amounting to 8% without any further legal action or penalties).

EWG approved the release of the February 2013 loan tranche to Greece

Earlier this month, the Euro Working Group approved the release of the February EFSF loan disbursement to Greece (€2.8bn). This came on the heels of the parliamentary endorsement of the country's updated Medium-Term Fiscal Strategy (MTFS) for 2013-2016 (see Table 1). Notably, the new update incorporates 3-year binding expenditure ceilings for general government entities, a key prior action to the release of the February 2013 loan disbursement. According to the revised MoU, the expenditure ceilings for the first two years (2014-2015) will be fixed, while these for the third year (2016) will be subject to revision in each of the next MTFS updates.

The updated MTFS also incorporates:

(i) re-assessment of the expected yield of certain measures incorporated in the previous MTFS update (2013-2016) as well as of specific measures included in the income tax reform ('mini-tax") approved by Parliament earlier this year;

(ii) re-calculation of government interest expenditure, so as to take into account the December 2012 debt buyback and the other relief measures decided at the 26/27 November 2012 Eurogroup (10bps reduction in EFSF gurantee fee, 100bps reduction in the interest rate charged on EU bilateral loans, deferral of EFSF interest payments by 10 years, extention of the maturities of the EU bilateral and EFSF loans by 15 years, return of profits to Greece equivalent to the income of the investment portfolio of GGBs accruing to euro system NCBs and increased T-bills issuance); and

(iii) re-calculation of gross public debt evolution post the December 2012 buyback and the relief measures announced at the 26/27 November Eurogroup.

Table 1: Updated MTFS (2013-2016)

Expenditure measures	2013	2014	2015	2016	2013-2016
Overhall of Public Administration	388.5	378.0	50.1	0	816.5
25% reduction in non-salary expenses of ministries and other public sector entities	202.5	78.5	0	0	281.0
Rationalisation of Public Investment Programme (PIP) expenditure	150.0	150.0	0	0	300.0
Reduction in grants provided to no general government entities	17.0	63.1	0	0	80.1
Electronic procurement system in public sector	0	50.1	50.1	0	100.2
Reduction in grants provided by the Ministry for Shipping and the Aegean Sea (grid lines)	15.0	2.8	0	0	17.8
Other	4.0	33.5	0	0	37.5
Municipalities	**50.0**	**160.0**	**0**	**0**	**210.0**
Health Care	**455.2**	**619.7**	**38.0**	**0**	**1,112.9**
Reduction in pharmaceutical spending of social security funds	390.0	410.5	0	0	800.5
Increased contribution of insured	0	115.0	0	0	115.0
Reduction in operating costs of hospitals	29.3	56.2	0	0	85.5
Other	36.0	38.0	38.0	0	112.0
National Defense	**303.0**	**99.8**	**-193.5**	**37.0**	**246.3**
Cancelation of new armament contracts	223.0	69.0	-201.0	33.0	124.0
Reduction in operating costs	22.0	13.0	0	0	35.0
Closure/commercial utilisation of army camps	10.0	13.8	3.5	0	27.3
Further reduction in amament contracts	44.0	0	0	0	44.0
Limiting 30% new entrants to the Academy	4.0	4.0	4.0	4.0	16.0
Education	**86.3**	**33.5**	**9.6**	**0**	**129.5**
Reduction in operating costs for central and regional education services	23.1	0	0	0	23.1
Reduction in grants provided to public entitites in General Government and outside (culture, sports)	39.0	0	0	0	39.0
Reduction in operation cost via merging of Technological and Higher Education Institutions	24.3	33.5	9.6	0	67.4
Rationalisation of Public enterprises (DEKO)	**246.2**	**180.1**	**85.0**	**14.0**	**525.4**
Restructuring of public entities & reduction in operating costs	132.0	85.9	56.0	0	273.9
Implementation of the Single Salary Scale	73.5	0	0	0	73.5
Rationalisation in subsidies provided to public entitites in General Government and outside	40.7	23.7	15.0	0	79.4
Increased revenues	0	13.7	14.0	14.0	41.7
Other	0.0	56.8	0.0	0.0	56.9
Pensions	**4,781.0**	**422.7**	**-41.5**	**84.5**	**5,246.6**
Annulment of 13^{th} & 14^{th} installment in main & supplementary pensions (with the exception of OGA)	1,668.0	31.8	30.1	36.8	1,766.7
Annulment of 13^{th} & 14^{th} installment in main OGA pensions	673.2	14.9	13.9	13.9	715.8
Increase in the retirment age to 67 from 65	631.0	264.0	0	0	895.0
Staggered cuts in *main* and *supplementary* pensions cumulatively exceeding €1,000 gross per month (€1,000-€1,500:5%, €1,501-€2,000:10% and above €2,001:15%)	1,080.4	23.6	17.8	20.0	1,141.7
Reduction in pensions due to cuts in special wage regimes	99.7	2.4	6.3	7.9	116.2
Rationalisation of lump sum payments due in 2013 & 2014	167.4	15.3	0.0	0.0	182.7
Reduction in pensions due to new scale payment for uniformed	0.0	161.8	5.1	5.9	172.8
Annulment of pensions already granted without proper documentation (already identified)	91.2	0	0	0	91.2
Increase in farmers' social security contributions (Agricultural Insurance Organisation)	86.0	0	0	0	86.0
Imposition of a monthly cap to pensions received by unmarried daughters of deceased justice and military officials	41.7	0	0	0	41.7
Annulment of special pensions granted to labour unionists	6	0	0	0	0
Other	242.4	-91.1	-96.9	0	36.8
Wages	**1,110.5**	**260.4**	**-9.5**	**9.7**	**1,371.2**
Reduction of the 13^{th} and 14^{th} installment for pubilc servants	430.6	0	0	0	430.6
Rationalisation of special wage regimes (with the exception of uniformed)	83.4	0	0	0	83.4
Rationalisation of special wage regimes for uniformed	78.0	0	0	0	78.0
New pay scale for uniformed	0	88.2	0	0	88.2
Rationalistion of general pay scale (with the exception of DEKO & special wage regimes)	5.3	0	0	0	5.3
Reduction in wage cost for minicipalities	45.8	4.2	4.2	4.3	58.5
Implementation of the Single Salary Scale for Parliamentary employees	14.0	0	0	0	14.0
Recruitment freeze in the Ministry of Public Order	0.4	2.2	2.3	5.4	10.3

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Reduction in the temporary staff of Higher and Technological Education Institutions	41.2	61.8	0	0	103.0
New type of labor mobility early retirement for public servants	49.4	59.5	-2.1	0	106.8
Staff reduction in the Ministries of Education, Culture, Sports	3.1	6.7	0	0	9.7
Rationalisation of wage cost for public hospital managers	10.7	0	0	0	10.7
Reduction in MPs' compensation and other allowances	2.0	0	0	0	2.0
Other	346.6	37.8	-13.9	0	370.7
Preferential benefits	**-34.3**	**77.7**	**12.5**	**12.5**	**68.3**
Rationalisation of family allowances	-103.0	0	0	0	-103.0
Abolishment of social welfare benefits (EKAS) to pensioners under the age of 65	0.0	114.0	0	0	114.0
Rationalisation of compensation for the provision of travel allowance to disabledEq	20.0	0	0	0	20
Reduction to special programmers for Agriculture	25.0	0	0	0	25.0
Rationalistion of pensions received by the uninsured elderly	18.7	18.7	12.5	12.5	62.4
Elimination of special unemployment allowances	30.0	0	0	0	30.0
Provision of special allowance for long-term unemployed	0.0	-35.0	0	0	-35.0
Other	-25.0	-20.0	0	0	-45.0
Total	**7,386.4**	**2,231.9**	**-49.3**	**157.7**	**9,726.7**

Revenue measures	2013	2014	2015	2016	2013-2016
Elimination of family allowances	202.2	176.8	0.0	0.0	379.0
Increase in the special consumption tax on certain tobacco products	186.7	0.0	0.0	0.0	186.7
Reduction in VAT returns to farmers	152.1	0.0	0.0	0.0	152.1
Reduction of subsidyfor the special consumption for LDG fuel for farmers	129.5	0.0	0.0	0.0	129.5
Increase in the annual tax levy paid by self-employed	59.0	0.0	0.0	0.0	59.0
Doubling the annual tax levy by businesses	140.0	0.0	0.0	0.0	140.0
Imposition of a luxury tax	0.0	141.7	0.0	0.0	141.7
Equalisation of the special consumption tax for gas and oil	23.0	0.0	0.0	0.0	23.0
Change in taxation for ships (based on the tonnage)	80.0	60.0	0.0	0.0	140.0
Imposition of a 10% tax on turnover of sports lottery OPAP	221.5	-14.9	0.0	0.0	206.6
Imposition of a 10% tax on sports lottery OPAP players' profits	87.7	2.0	0.0	0.0	89.7
Other	868.7	1,103.0	12.0	0.0	1,983.7
Total	2,150.4	1,468.6	12.0	0.0	3,631.0
TOTAL (expenditure + revenue measures)	9,536.8	3,700.5	-37.3	157.7	13,357.7

Source: MTSP 2013-2016

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