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Focus notes: Greece

3rd programme review concluded; projected shortfall in 2013-2014 to be fully covered without new austerity measures

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This note provides a detailed overview on the policies agreed between the EC/IMF/ECB troika of official lenders and the Greek authorities, in the context of negotiations leading to the successful completion of the 3rd economic adjustment programme review. With a final agreement having been reached, the next hurdle Greece's coalition government needs to overcome is the Parliament's approval of a multi-bill containing the required legislation for the implementation of a number of agreed prior actions. Given the Greek government's determination to deliver on its commitment, we expect the multi-bill to easily pass through Parliament, paving the way to the release of €8.8bn in official funding over the next few weeks.

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3rd programme review concluded

According to a joint troika statement issued on April 15, the 3rd review of Greece's economic adjustment programme was successfully completed following a staff-level agreement on the economic and financial policies required to facilitate fulfillment of the agreed programme targets. The agreement paves the way for the release of €8.8bn of official financing to Greece over the coming weeks, consisting of: (i) the last EFSF sub-tranche (€2.8bn) of the 2nd loan disbursement (€49.1bn) that was approved last December and was originally scheduled for March 2013; and (ii) the next loan tranche of €6bn that was originally scheduled for Q1 2013, consisting of €4.2bn in EFSF funding and €1.8bn from the IMF under the Extended Fund Facility. The €6bn loan tranche is reportedly expected to arrive in State coffers before May 20, 2013 when four Greek sovereign bonds mature for a total notional amount of €5.6bn.

A key precondition for unlocking the additional €8.8bn of official financing is the Hellenic Parliament's approval of a multi-bill containing the required legislation for the implementation of a number of agreed prior actions (see *Table 2.1* in the Annex section). After managing to overcome certain objections by the two junior ruling coalition partners, the government submitted the said bill to Parliament on April 25, with a vote scheduled to take place on April 28. Conditional on a positive vote in parliament, the Euro Working Group of April 29 is expected to give the green light for the release of the €2.8bn EFSF sub-tranche. As laid out in the revised MoU, the release of the said tranche is conditional on the fulfillment of the following two milestones: (i) downward revision in the price of medicines, based on the three EU countries with lowest prices (*already fulfilled*); and (ii) the completion of staffing plans for line Ministries, the identification of ensuing redundant job positions and the submission of quarterly targets of mandatory exits through end-2014 (*related provisions are incorporated in the aforementioned multi-bill*).

Given the Greek coalition government's determination to deliver on its commitment, we expect the multi-bill to easily pass through Parliament. As things stand at this point, there are no clear indications that any deputy from the three political parties supporting the coalition government would oppose the multi-bill. The government currently controls 167 seats in the 300-seat Parliament; the main ruling party New Democracy (ND) occupies 125 seats, PASOK 28 and Democratic Left 14.

Provided that the multi-bill is endorsed by Parliament, the May 13th Eurogroup is expected to approve the disbursement of the €4.2bn EFSF loan tranche to Greece. On its part, the IMF's Executive Board will convene in the second half of May to approve its €1.8bn share of Greece's next loan installment. The head of the European Stability Mechanism, Klaus Regling, said earlier this month that, apart from the latter amount, Greece is also due to receive €7.2bn in the form of short-term EFSF notes required for the completion of the domestic bank recapitalization programme. The latter is part of the (already approved) January 2013 EFSF sub-tranche, which the Greek side decided not to receive before the recapitalization process nears completion so as to avoid being burdened with additional interest charges.

With regards to the next EFSF/IMF loan tranche of €6bn, it is worth noting that a number of press reports suggested recently that Greece may receive it in a number of monthly installments subject to fulfillment of certain programme milestones rather than in a lump sum. As per the same sources, potential milestones could include, among others, the following:

(i) Completion of a certain number of audits of high wealth individuals and larger taxpayers.
(ii) Adoption of certain measures aiming to speed up the disciplinary process against ca 4k public employees who are currently being investigated for a range of various offenses.
(iii) The newly established General Secretariat of Revenues to become fully autonomous. According to local press, the troika requests the Financial Crimes Squad (SDOE) and the General Secretariat for Information Systems (GSIS) to come under the jurisdiction of the General Secretariat of Revenues in an effort to improve tax administration effectiveness and bolster tax revenues.
(iv) Completion of liberalization of a host of still-regulated professions/businesses e.g., tourist agencies, real estate brokers, accountants & tax consultants, lawyers, kiosks and cantinas in pubic buildings, press distribution agencies, energy inspectors.

Measures and policies agreed in the context of 3rd programme review

In the course of the latest round of negotiations between the troika and the government, the two sides agreed on a number of new measures and policies aiming to facilitate fulfillment of the agreed programme targets. These included, among others:: **(i)** one-year extension of the special real estate levy collected via electricity bills as well as implementation of the single property tax as of 2014; **(ii)** greater degree of autonomy for the General Secretariat of Revenue; **(iii)** adoption of a new installment scheme for overdue tax payments and social security contributions; **(iv)** adoption of a restructuring scheme for mortgage loan payments (upon EU approval); **(v)** development of a comprehensive strategy for the domestic banking sector; **(vi)** adoption of certain public administration reforms, aiming to improve the quality of the public sector; and **(vii)** progress in strengthening the social safety net. In more detail:

One-year extension of the special real estate levy collected via electricity bills: The two sides agreed the special real estate levy (EETHDE) collected in 2011 and 2012 via electricity bills to remain in place for another year (i.e., in 2013). This decision was based on the expectation that the general implementation framework of the planned single property tax - that will replace both the special Property Tax (FAP) applied to all real estate holdings and the special levy (EETHDE) - will not be ready for introduction in H2-2013, as envisaged in the revised MoU. The special real estate levy for FY-2013 will be calculated based on the existing objective values of asset properties, but its rates will be 15% lower compared to those applied in 2011-2012, so as to somewhat reduce the burden on taxpayers. Reduced rates are reportedly estimated to result in a revenue shortfall of ca €0.2bn relative to the amount generated by the implementation of the special levy in the last two years (€1.3bn/annum). According to local press, the two sides agreed the ensuing shortfall to be covered via: (i) upwards adjustment in the rates applied to several municipalities that were found to be unreasonably low; (ii) an increase in the tax rates applied to properties that fall outside urban planning or city limits; and (iii) application of the special levy on properties rented by the State (these properties are currently exempted). The special Property Tax

(FAP) will also remain in force for another year (the extension of the said tax does not require approval by Parliament). The new single property tax is now scheduled to come into force as of 2014 and will reportedly be based on revised objective property values, so as to be better aligned with current commercial price levels. Aiming to broaden the tax base, the new single property tax will be imposed on properties which are currently exempted, such as farmland and fields that fall outside urban planning, city or settlement limits.

Greater degree of autonomy for the General Secretariat of Revenue: In a move aiming to improve tax collection, strengthen revenue administration and support the fight against tax evasion, the two sides also agreed the newly-established General Secretariat of Revenues to gain a greater degree of autonomy. Under this agreement, the General Secretariat of Revenues will assume additional legal power and responsibilities including some that used to be under the jurisdiction of the Financial Crimes Squad (SDOE) e.g. VAT fraud, fuel smuggling. Moreover, experienced auditors will be transferred to taxpayer units responsible for large taxpayers and high-wealth individuals, while 500 new auditors will be hired this year to facilitate fulfillment of the agreed 2013 target for 750 full-scope audits and 2,600 audits of high wealth individuals.

Adoption of an installment scheme for overdue tax payments and social security contribution: According to press reports, overdue taxes and social security contributions are estimated at ca €70bn while only €20bn out of this amount is currently deemed as collectible. As per the same sources, the General Accounting Office expects that the implementation of the agreed installment scheme will generate budgetary revenues up to €5.5bn in the period 2013-2016 out of which ca €1.5bn this year (ca €1bn by the implementation of the agreed settlement for overdue social security contributions and ca €0.5bn for tax arrears (*Table 2.2* in the Annex section)

Adoption of a restructuring scheme for mortgage loan payments*:* Non-performing bank loans (NPLs) reportedly stood at 24.6% in December 2012, up from 22.5% in September 2012 and 16% in end-2011. Amid expectations for a further contraction in domestic economic activity this year, one should not rule out a further rise in NPLs in the coming quarters, entailing the risk of higher bank credit losses and additional pressures on their profitability. Against this background, the Greek government and the troika agreed on the adoption of a new scheme that would allow heavily indebted households, businesses and self employed to restructure their mortgage loan with more favorable terms provided that certain criteria are met (*Table 2.3* in the Annex section of this document).

Adoption of public administration reform aiming to improve the quality of the public sector. In more detail, the agreement reached entails the following:

(i) Placement of 25k public employees to a special labor reserve (i.e., the so-called mobility scheme) by the end of this year, as laid out in the revised MoU conditionality (December 2012). Transferred employees to the said scheme would be receiving 75% of their basic monthly salary for a year, before being subject to permanent separation in case they fail to be reappointed to fill in vacant positions in the broader public sector.

(ii) 4k public employees will be dismissed gradually by the end of this year and an additional 11k by the end of 2014. According to the Minister of Administrative Reform and E-Governance Antonis Manitakis, half of the planed layoffs for this year will need to materialize by June.

(iii) In an effort to improve public service quality, all dismissed civil servants will be replaced by new recruits, through a totally meritocratic process (i.e., the Supreme Council for Personnel Selection). According to an updated MoU draft that was linked to the press earlier this month, the aforementioned 1:1 hiring rule will be "altered" should it risk violating the agreed target for a 150k reduction in the public sector workforce in the period 2010-2015. The government estimates that the overall public sector workforce stood at around 668k in October 2012, having declined by 75k over the past 1½ years.

(iv) Civil servants subject to permanent separation will come from the following pools:

- Merged or closed down public organizations and private-law entities resulting in redundant positions. As was underlined by Greek Prime Minister Antonis Samaras, the Constitution of Greece does not prohibit the outright dismissal of pubic servants whose positions are abolished through the merging or closure of state entities.
- Public employees who are found guilty of breaching the code of conduct, upon completion of legal procedures.
- Voluntary early retirements of public employees who are within up to three years of retirement and want to buy out the remaining social security credits.
- Employees who will score poorly in planed evaluation tests or/and have limited qualifications.
- Employees who have been appointed with false documentation or/and have been unjustifiably absent from their

work for a long period.

(v) Completion of staffing plans for 400k public servants by the end of June 2013 (e.g. identification of the public sector entity that they are currently employed, job description, estimated savings from redundancies etc.). Staffing plans for the broader public sector will need to be completed by the end of this year.

Strengthening the social safety net: According to an updated MoU draft that has been linked to local press, the Greek government and the troika agreed on a programme providing elementary medical services to 100k long-term unemployed. The programme, to be funded by the European Social Fund, will reportedly be extended to additional groups of citizens who are seriously affected by the domestic economic crisis.

Indirect taxes: In his recent televised national address, Greek Prime Minister Antonis Samaras said that the troika accepted the government's proposal to discuss again in June the possibility of reducing certain indirect tax rates, including, among other, the rate of a special consumption tax on heating oil and on the VAT on food catering (from 23% currently to 13%).

Projected budgetary shortfall in 2013-2014 fully covered; no additional austerity measures are required

According to Greek Prime Minister Antonis Samaras, an agreement has been reached with the troika as regards the coverage of "any projected budgetary shortfall" in 2013-2014, without the need for additional austerity measures *i.e.,* over and above those envisaged in the December 2012 revised MoU (€13.3bn over the corresponding period). According to local press, the troika had earlier projected a budgetary shortfall of ca €4bn in 2013-2014 that was agreed to be covered by the following sources:

(ii) dividend payment for FY-2012 by the Bank of Greece, amounting to ca €1bn;

(iii) projected budgetary revenues of ca €2bn in 2013-2014 from the implementation of the new payment plan for overdue tax payments and social security contributions; and

(iv) additional budgetary revenues of ca €0.8bn by the extension for another year of both the special real estate levy and the FAP. Total revenues from these two sources are expected to amount to ca €4bn.

Primary deficit target for FY-2012 outperformed

A Eurostat press release issued earlier this week in the context of the Excessive Deficit Procedure (EDP)[1], revealed a 2012 full-year general government primary deficit for Greece of 1.0%-of-GDP (after subtracting one-off State support to the domestic financial institutions), outperforming a revised deficit programme target of 1.5%-of-GDP (*Table 1).* Along similar lines, the latest Greek FinMin data on the execution of the State Budget in January-March 2013 revealed a primary surplus of €520mn compared to a targeted shortfall of €2.338mn and a deficit of €334mn recorded in the same period of last year. This outperformance was mainly the result of lower than expected primary budget expenditure. According to recent comments by Minister of Finance Yiannis Stournaras, Greece's main goal is achieving a primary general government surplus this year (against the programme target for a balanced primary position this year) so as to open the door for additional debt relief measures by official lenders. As explicitly spelled out in the 26/27 November 2012 Eurogroup statement, official lenders committed themselves to consider further measures and assistance to Greece, if necessary, until the country regains market access to international markets, conditional upon a vigorous implementation of the requirements and objectives of the agreed adjustment programme. The same pledge was repeated in the joint statement issued by the EC/IMF/ECB troika of official lenders on April 15th, 2013, following the completion of the 3rd programme review.

Table 1- Greece: Time series of General Government Deficit, General Government Primary Deficit, General Government debt

(%-of-GDP)	2009	2010	2011	2012
General Government deficit ***(incorporating the impact of the state support to domestic finanical institutions)***	15.6	10.7	9.5	10.0
General Government deficit ***(excluding the impact of the state support to domestic finanical institutions)***	15.8	11.1	9.8	6.0
General Government Primary Deficit **(including the impact of the support to domestic financial institutions)**	10.5	4.9	2.4	5.0
General Government Primary Deficit **excluding the impact of the support to domestic financial institutions)**	10.6	5.2	2.7	1.0
General Government debt	129.7	148.3	170.3	156.9

Source: Eurostat

Annex

Table 2.1- Provisions incorporated in the multi-bill

(i)	Streamlining of the public sector including the gradual dismissal of 15k public employees by the end of 2014.
(ii)	Measures for speeding up the disciplinary process (administrative inquiry orders) against perjurer public employees.
(iii)	The agreed regulation on overdue tax payments and social security contributions.
(iv)	One-year extension of the special real estate levy (EETHDE) collected via electricity bills.
(v)	15% reduction in the rates of the special real estate levy.
(vi)	Implementation of the single property tax as of 2014.
(vii)	Greater degree of autonomy for the Ministry of Finance’s General Secretariat of Revenues.
(viii)	Development of a program ensuring the supply of primary health care to 100k long-term unemployed.
(ix)	Liberalization of a number of (still) regulated businesses aiming at strengthening the domestic economy’s competitiveness; e.g., tourist agencies, accountants, tax consultants (still unfulfilled December 2012 benchmark).

Source: Local press, Eurobank Research

Table 2.2- Modalities of the new installment scheme for overdue tax payments and social security contribution

(i) Tax arrears up to €5k, will be paid in 100 monthly installments with a minimum monthly amount of ca €50

(ii) Employees and pensioners with total arrears exceeding the amount of €5,001, will be able to pay off their debt in 48 monthly payments, subject to certain restrictions (the number of the total monthly installments does not currently exceed 36). In more detail: (i) debtors with overdue payments from €5,001 up to €74,999k, will be qualified for the new scheme provided that they can submit certain documentation attesting that they have the financial ability to pay off their debt; (ii) debtors owning from €50k to €299,999, will be qualified for the new scheme under the condition that they can provide specific safeguards (i.g., co-guarantors and/or confirmation from an accountant for the veracity of their total wealth); and (iii) debtors owning more than €300k will be allowed to join the new scheme should they be able to provide bank guarantees or/and real estate asset guarantees.

(iii) Penalties will be cut by 20% for debtors who will honor the new payment plan agreement and will pay off their debt in 48 monthly installments. Penalties will be cut by 50% for the debtors who will be able to pay off their debt in a lump sum.

(iv) The new payment plan for overdue payments exceeding €5,000, will involve an annual interest rate linked to the ECB main refinancing rate plus an 8% spread.

(v) Businesses and self-employed will be able to pay off their overdue payments in more than 48 monthly payment installments irrespective of the amount of debt (no upper limit is set)

(vi) Businesses, employees and pensioners that had failed in the past to keep up with previous payment plans will be excluded from the new scheme. The agreed scheme is reportedly expected to be in force as of June, 2013, provided that the related legislation will pass through Parliament by May-end.

(vii) The aforementioned scheme involves total capitalized debts until December 31st, 2013, Total capitalized debts generated as of January 1st 2013, will be paid in 12 monthly installments, instead.

Source: Local press, Eurobank Research

Table 2.3- Modalities of the restructuring scheme for mortgage loan payments:

(i) The mortgage loan has been provided for primary residence purchase.
(ii) The respective home value does not exceed €180k. This amount rises up to €200k for critically ill persons, disable and households with more than three children.
(iii) The total amount of their outstanding loans does not exceed 150k.
(iv) They have lost at least 20% of their income since January 1st, 2010.
(v) Their annual net income is no higher than €25k.
(vi) The total value of their real estate does not exceed €250k.
(vii) Their bank deposits do not exceed €10k.
(viii) Loan payments are less than 90 days overdue.

Should the aforementioned conditions be met:
(i) loan debtors will be qualified for a four-year grace period during which the monthly installment will not exceed 30% of their net income;
(ii) the monthly installment will be adjusted every time the financial position of each loan debtor changes, under the condition that the "30% of net income" rule will not be jeopardized;
(iii) with regards to unemployed, the new scheme envisions zero monthly payments under the condition that they do not have other income sources;
(iv) loan debtors with annual net income up to €15k, the scheme will involve an interest rate linked to the ECB main refinancing rate plus a 0.75% spread. Yet, for loan debtors with annual income in excess of €15,001, the interest rate will be the same to the original bank loan agreement.

Source: Local press, Eurobank Research

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