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Update on official negotiations in the context of the present program review

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Following a two-week-long pause, the heads of the troika mission returned to Athens last week to resume discussions with the Greek government in the context of the current program review. The present round of negotiations focuses on the progress made by domestic authorities on, inter alia: (i) a restructuring plan of Hellenic Defense Industry (HDS), the only remaining prior action for the unlocking of the next EU loan installment[2] ; and (ii) the rest of outstanding quantitative program targets and structural benchmarks. Under the current planning, the present round of negotiations is expected to conclude middle this week. The two sides are reportedly close to reaching an agreement on the restructuring plan for Hellenic Defense Systems (HDS). Should this be the case, the Euro Working Group, which convenes on Tuesday, December 17 is expected to give the green light for the release of the next EU loan installment (€1bn). According to the local press, official discussions on the HDS restructuring are based on a revised plan submitted recently by the Greek government. The plan envisages a split of the company into a military and a civilian part. The latter will reportedly close down after absorbing all State subsidies granted to HDS over the period 2004-2011 (estimated at ca €1.1bn). As per the same sources, the military part will remain in operation for a trial period of 12 months, employing about 1/3 of the company's current workforce.[3] The rest of HDS's labor force will be removed either through a voluntary redundancy scheme or outright dismissals. Should it fail to return to profitability after the expiration of the 12-month trial period, HDS will be downsized further, with its operation being focused solely on covering the needs of the Greek armed forces. As a reminder, €1.85bn worth of Greek sovereign bonds matures on January 11, 2014.

Negotiations in the context of the present program review expected to expend into early 2014

Notwithstanding expectations for an imminent approval of the next EU loan disbursement to Greece, a diversion of view reportedly continues to exist between the domestic authorities and the troika as regards a range of important issues underlying the present program review (see relevant analysis in the next section of this report). As a result of the still-inconclusive negotiations, the time required for the completion of the present review may well extend into early next year. Addressing the press conference which followed the conclusion of the

[1] Under the current planning, the (next) second sub-tranche of the EU loan approved by the July 2013 Eurogroup will amount to €1bn (=€0.5bn from the EFSF and €0.5bn from the income on the SMP portfolio accruing to euro area national central banks (NCBs). The first EFSF loan sub-tranche amounting to €2.5bn was disbursed in late July, along with €1.5bn from the profits accruing to the SMP portfolio of NCBs.
[3] HDS has currently ca 813 employees

December 9 Eurogroup, President Jeroen Dijsselbloem said that the Greek government has been working constructively with the troika, though further progress is still needed and thus, it may be "very hard, if not impossible" to finalize the present review by the end of this year. Along similar lines, a statement issued last week by Simon O' Connor, the European Commission Spokesman for Economic and Monetary Affairs read that, although some troika inspectors returned to Athens, negotiations will not likely conclude until January 2014, at the earliest. The said statement mentioned that "a full negotiating team" is expected to come back next month "after the (domestic) authorities have made further progress in implementation with the objective of reaching a staff level agreement". A compromise on all issues underlying the current review is a key precondition for the release of the €4.9bn EFSF/IMF loan installment that was originally scheduled for Q4 2013. The installment consists of €3.1bn in EFSF funding and a €1.8bn tranche from the IMF under the Extended Fund Facility.

Outstanding issues in the context of the current program review

With nearly two weeks to go before Greece resumes the rotating presidency of the European Union on January 1, 2014, domestic authorities and the troika have reportedly increased their efforts to reach an agreement on a number of outstanding issues underlying the current program review. The main stumbling blocks in the agenda of the current negotiations reportedly include: (i) the implementation framework of the new single property tax, expected to come into effect on 1.1.2014; (ii) a (gradual) suspension of the existing moratorium on home forecloses; (iii) a review of certain indirect tax rates; (iv) the current legal framework underlying professional rentals; (vi) measures to induce additional flexibility to the domestic labor market; (vii) social security contributions; (viii) third-party taxes; and (vi) the size of projected fiscal gap in FY-2014 (as well as a budgetary shortfall for 2015-2016) and sources/strategies to cover it. In what follows we provide some analysis on the aforementioned items:

Implementation framework of the new single property tax (ENFA). The Greek government submitted to Parliament late last week an omnibus bill incorporating, among others, the operational framework of the new single property tax (ENFA) to be into effect as of 1.1.2014.[4,5] The said bill, expected to come for vote under an emergency procedure by December 20 when the Parliament recesses for Christmas, was filed in without the troika's consent.[6] The government's implementation framework assumes assessed taxes of €3.28bn/annum for €2.65bn/annum of projected receipts compared to expected revenues of €2.9bn/annum envisaged in the latest IMF assessment of Greece's adjustment program (July 2013). The government is reportedly planning to bridge the aforementioned shortfall through a reduction of the Public Investment Program as well as other structural measures that are yet to be identified. On its part the troika argues that ENFA cannot secure revenues more than €2.5bn and the projected shortfall of €400mn needs to be covered mainly through offsetting budgetary cuts.

Gradual suspension of a moratorium on home forecloses. Domestic authorities and the troika have reportedly reached an agreement on the introduction of a 1-year transitory period (*i.e.*, until December 31, 2014) before a more aggressive approach to home foreclosures takes hold.[7] During the said transitory period, primary residences will not be subject of foreclosure, provided thatdebtors: (i) face temporary payment difficulties, but are considered to be fundamentally solvent; and (ii) are willing to collaborate with their bank(s) so as to reach an agreement on a minimum monthly payment. Yet, certain aspects of the aforementioned proposal remain a source of contention especially as regards the primary residence value up to which banks are not empowered to proceed with foreclosure. Reportedly, the Greek side proposes a limit at €180-€200k while the troika favors a lower threshold of €120-€140k. As per the same sources, it is yet unclear whether additional criteria will also be taken into

[4] The new single property tax (ENFA) is reportedly scheduled to come into force on January 1, 2014. The new tax will replace (i) the special levy (EETHDE) currently collected via electricity bills; and (ii) the wealth tax on property (FAP), in case that the value of total property assets does not exceed €300k. Taxpayers with properties valued in excess of the said amount will have to pay both the new single property tax and a supplementary tax. ENFA effectively targets properties and will be calculated based on 12 different price zones for commercial properties and 25 for agricultural properties. The supplementary tax will instead target individuals on a progressive scale. Owners with properties valued over €300k are estimated to account for just 5% of all taxpayers.

[5] Besides the implementation framework of the ENFA, the said omnibus bill reportedly incorporates a number of additional items including, among others, an imposed transaction tax on the Athens Stock Exchange, the modalities of the Fiscal Council (an independent body empowered to monitor the execution of the State budget), technical amendments regarding income tax and a reduction of the property transaction tax. According to the current legislation, the property transfer tax stands at 8% for the first €20k of the property's value and goes up to 10% for the amount above that level.

[6] As things stand at this point, there are no clear indications that any of the 127 ND deputies or the 27 PASOK MPs would oppose the said omnibus bill.

[7] The two sides have reportedly reached an agreement for the adoption of the so-called Irish model from January 1, 2015 onwards. The said scheme reportedly envisions suspension on foreclosures based on, inter alia, the following criteria: (i) the primary residence value does not exceed €150k; (ii) the debtor is willing to collaborate with the bank(s) so as to reach an agreement on a minimum monthly payment; and (iii) the debtor can prove based on "a minimum acceptable rate of decent living" that he or she cannot service his loan.

account. Such criteria could reportedly include, among others, the debtor's total wealth and the amount of the outstanding mortgage. In addition to the aforementioned, domestic authorities and the troika are said to have agreed to annul the so-called Papathanasiou insolvency law (3790/2009). Under the said law, there is ban on auction for all debtor assets (including primary residence) provided that overdue debt payments do not exceed €200k**.** Furthermore, the two sides reportedly agreed to maintain the so-called Katseli household insolvency law (3869/2010). According to the said law, debtors can reach an agreement on a mandatory minimum monthly payment until the court hearing date, provided that the respective home value does not exceed €300k. Note that the latter amount may increase up to €450k depending on the debtor's marital status and number of children. Yet, recent press reports suggest that the respective limit regarding primary residence value may be reduced to ca €180-€200k. Domestic authorities and a technical team of troika inspectors are currently hammering out the details of a foreclosures suspension plan. Regardless of whether consensus is finally reached, the Greek side is reportedly determined to proceed, even unilaterally, with the submission to Parliament of the related legislation. The latter will reportedly tagged onto the omnibus bill incorporating the implementation framework of ENFA. The current moratorium of forecloses for primary residences, first applied in 2009 and renewed each year since then, expires on December 31, 2013. Speaking to reporters last week, European Economic and Monetary Affairs spokesman Simon O' Connor said that the heads of the troika mission have not asked the Greek government to fully lift the moratorium on foreclosures. The EU spokesman clarified that the troika is in favor of a solution that would protect the "truly vulnerable" social groups and prevent debtors "systematically abusing" the protection offered by the existing moratorium on primary residences. According to recent comments by Deputy Minister of Development Thanassis Skordas, if the current moratorium on primary residence foreclosures were to be fully lifted, it would result into ca 66k properties being either auctioned or seized. The same official also said that the number of "strategic default" cases is currently estimated at ca 15k.

Review of certain indirect tax rates. According to the local press, the Greek government is planning to submit to Parliament later this week a draft bill envisaging a one-year extension of the 13% VAT rate currently applied on food catering and restaurants[8]. As things stand at this point, the troika reportedly argues that the proposed extension will cause a budgetary shortfall of ca €200-300mn in 2014, the coverage of which will require offsetting budgetary measures. As a reminder, domestic authorities and the troika agreed in July 2013 on a temporary decrease of the said VAT rate to 13% from 23% in the mainland (and to 9% from 13% in the islands). The reduced rate was meant to be applied (on a pilot basis) over a 6-month period, commencing on August 1, 2013.

Legal framework underlying professional rentals. The troika reportedly insists on the full liberalization of lease terms on professional rental contracts, arguing that the current legal framework imposes restrictions that hinder the proper functioning of the domestic property market. On its part, the Greek government appears to support a more gradual approach to liberalization, envisaging: (i) a minimum lease of three years for new professional rental contracts; and (ii) no change in the lease terms of existing professional rental contracts (under the existing legal framework, professional rental contracts envision a minimum 12-year lease period).

Domestic labor market conditions. In its latest assessment of Greece's economic adjustment program (July 2013), the IMF claims that employment protection rules in Greece remain very rigid, especially as regards collective dismissals. To this end, the troika has reportedly requested: (i) the abolition of the Labor & Social Security Minister's veto power on collective company redundancies in excess of the current layoff limit (Law 1387/83, Article 5); and (ii) an increase in the 5% monthly limit of layoffs. According to the current labor regulation in Greece, the monthly limit of layoffs stands at: (i) 5% of staff for companies with more than 150 employees (with an upper limit of 30 employees); and (ii) 6 employees for companies with 20-150 employees. The Greek government has reportedly agreed in principal to change the legal framework on collective redundancies, but it insists that any changes should be adopted through a Ministerial Decision rather than a statutory law (which requires parliamentary approval).

Social security contributions. As per the revised MoU (July 2013), Greece is committed to adopt legislation to reform the social security contributions system. The reform should aim to inter alia reduce contribution rates by a cumulative 3.9ppts over a three-year period in a revenue-neutral manner (November 2013 structural benchmark). The Greek side has reportedly requested a postponement of the implementation of the said reform, amid concerns that it could cause a shortfall of ca €800mn in social security funds in 2014.

[8] The relevant legislation is expected to be tagged onto the omnibus bill incorporating the implementation framework of ENFA.

Third-party taxes[9]**.** The troika reportedly requires third-party taxes to be either abolished or incorporated in the State budget. As per the same sources, there are currently ca 199 third-party taxes in Greece, with nearly half of them being accounted as social security funds revenue. A Greek technical team is currently working on the troika's proposal and a final report is reportedly due in late December.

Size of a projected fiscal gap in FY-2014 & sources of funding for its coverage. According to recent press reports, the troika now projects a fiscal gap of ca €600mn in FY-2014, lower compared to a €2.9bn shortfall they estimated in September 2013 when official discussions in the context of the current troika review commenced. The *downwardly revised* projection was partially the result of specific strategies/measures proposed by the Greek side aiming to facilitate fulfillment of the agreed fiscal target for 2014 (*i.e.,* 1.5%-of-GDP general government primary surplus). As a means of covering the said shortfall, the troika has reportedly proposed: (i) a reduction of the main pension, the supplementary pension or the lump sum amount paid by the so-called noble funds; and/or (ii) a reduction of the salaries and pensions of the armed forces. Responding to related press reports, Greece's Minister of Finance reiterated last week the government's strong opposition to new horizontal austerity measures, as a means of addressing any projected fiscal shortfalls.

Projected fiscal gap in 2015-2016. As per the latest update of the macroeconomic framework underlying Greece's adjustment program (July 2013), a cumulative fiscal gap worth ca 2%-of-GDP is expected to arise in 2015-2016. The Greek government has reportedly adopted a relatively more optimistic projection in view of, among others, the improved GDP growth dynamics and the expected financial benefit from the overhaul of the public sector. Specifically, the Greek side reportedly projects an overall fiscal gap no higher than €2.5bn over the period 2015-2016. In an effort to cover the said shortfall the government has reportedly proposed a number of structural measures, including, among others, the closure or merging of universities, hospitals and arm camps.

[9] In most cases, third-party taxes take the form of billing surcharges that customers pay, usually as a percentage of the total bill.

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