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Focus notes: Greece

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Key Challenges the New Greek Government Will Face in the Period Ahead

Key points

- **June 17 election produces a tripartite governing coalition**
- **Ruling coalition reaches programmatic agreement**
- **Composition and key policy priorities of the new government**

June 17 election produces a tripartite governing coalition

Antonis Samaras, the leader of *New Democracy (ND)*, was sworn in last Wednesday as Prime Minister to head a tripartite ruling coalition, putting an end to a prolonged period of domestic political uncertainty that fuelled market worries over the country's euro area membership. The new governing coalition comprising of *ND*, *PASOK* and *Democratic Left*, cumulatively received 48.2% of the total vote and currently controls 179 seats in the 300-seat Parliament. New Democracy secured 129 parliamentary seats, after incorporating the 50-seat bonus that goes to the party that receives the highest share of votes. However, this was short of the minimum number of seats (~151) required to attain absolute parliamentary majority and form a single-party government. Coalition partner *PASOK*, the next biggest pro-bailout party after ND, came third, winning 33 parliamentary seats. Finally, Pro-European *Democratic Left*, ranked sixth, garnering 17 seats.

During their pre-election campaign, the leaders of *ND* and *PASOK* vowed to try to amend certain terms of the present bailout programme, provided that this would not jeopardize the country's euro area membership. On his part, Fotis Kouvelis, the leader of *Democratic Left*, laid down, among others, the following two key preconditions for his party's participation in a post-election coalition government: **(i)** Greece's uninterrupted membership in the euro area; and **(ii)** a gradual "disengagement" from the terms of the existing Memorandum of Understanding (MoU) through renegotiation.

Antonis Samaras held coalition talks with the leaders of the rest of political parties that made it into Parliament, except Nikos Michaloliakos, the head of the far-right *Golden Dawn*, and Aleka Papariga, the General Secretary of the *Communist Party of Greece (KKE)*. The latter had repeatedly ruled out the possibility of participating in a coalition government, irrespective of the political parties that may join it.

On its part, anti-bailout *Coalition of the Radical Left (SYRIZA)*, the runner up in the June 17 election, turned down Mr. Samaras's overture for participating in a broad coalition government, choosing instead, to assume the role of the main opposition in Parliament. As a reminder, SYRIZA's pre-election campaign was primarily based on the promise to: **(i)** annul the existing Memorandum of Understanding (MoU) with official lenders; and **(ii)** stage a radical renegotiation for the development of a new "national recovery plan". The anti-bailout *Independent Greeks* party, which is headed by ex-ND parliamentary member Panos Kammenos, also rejected Mr. Antonis Samaras's call, arguing that there is not enough common ground to form an alliance.

Composition of the new government

The leaders of the tripartite ruling coalition decided the new cabinet to comprise of 17 ministers, 7 alternate ministers, 14 deputies and a government spokesman. This amounts to a leaner cabinet - *i.e.,* by 10 members - relative to that served under Lukas Papademos's interim government. As Prime Minister Antonis Samaras had promised before the election, the Ministries of Tourism and Merchant Marine were resuscitated. During the tenure of George Papandreou's government, the said ministries were absorbed by the Development Ministry. The Ministry of Macedonia-Trace was also re-established, while the Ministries of Education and Culture merged, as was also the case with the Ministries of Development and Infrastructure.

Speaking to his ministers shortly after the new cabinet was sworn in, Antonis Samaras announced a 30% cut in their monthly salary and stressed that the main responsibility of the new government would be to bring Greece out of the current crisis. The new Parliament is scheduled to convene on June 28, 2012. A three-day plenary debate on the programmatic commitments of the new government will take place afterwards. The debate will be concluded with a confidence vote. According to the Constitution of Greece (Article 84, paragraph 6), the confidence vote requires an absolute majority of the Members of Parliament attending the vote, which can not be less than 120 MPs (i.e. 2/5 of the total number of parliamentary deputies). Understandably, the new government is expected to comfortably win the confidence vote in Parliament.

While the rest of the new cabinet was sworn in last Thursday, the ceremony for initially nominated Finance Minister Vassilis Rapanos was pushed back to the following day to allow outgoing Finance Minister George Zannias to attend the June 21st Eurogroup. However, Rapanos's swearing-in ceremony was postponed anew, as he was hospitalized due to health problems. The prime minister's office announced yesterday that Vassilis Rapanos resigned from his new post and Yiannis Stournaras, Athens University Economics Professor and General Director of the Foundation for Economic and Industrial Research (IOBE), was appointed as Greece's new Finance Minister.

Tripartite rulling coalition reached programmatic agreement

In an official document released to the press late last week, the three partners of the ruling coalition laid out their agreed policy priorities. These priorities are categorized under five broader strategic goals the new government will try to achieve during its term in office. The first major goal is to renegotiate with official lenders certain aspects of the existing bailout agreement. Separately, the collation leaders decided to form an informal cross-party committee. The latter will discuss the details of the new government's policy framework on a daily basis and facilitate a more efficient cooperation between the parties in the coalition. (***Table A*** at the end of this document provides a detailed summary of these policy objectives).

Key challenges to be faced by the new Greek government in the period ahead

Persisting domestic recessionary pressures, increased social tensions and recent delays in the implementation of the agreed structural reforms programme leave little doubt the new government's term will not be an easy sail. In what follows we comment on some of these challenges, focusing, primarily, on the issues the tripartite ruling coalition vowed to renegotiate with official lenders.

Negotiate time extension of fiscal adjustment programme

Market speculation over a time extension in Greece's fiscal adjustment programme has intensified recently, with local media reporting that caretaker Finance Minister George Zannias discussed the issue with his EU-17 colleagues at June 21st Eurogroup. According to the same sources, Zannias asked a 2-year lengthening of the envisaged fiscal adjustment horizon, a move that would reportedly necessitate some €16-20bn in additional financing to bridge the ensuing borrowing gap. ***Comment:*** As a reminder, the existing programme provides adequate financing for covering the general government's borrowing need for the period 2012-2014. That is, assuming real GDP growth, privatization revenue and the government's primary fiscal position will evolve in line with the troika's latest baseline scenario (March 2012), which may well prove optimistic. Note also that additional funding of €8.2bn is earmarked in the new IMF programme for 2015. In our June 21, 2012 *Greece Macro Monitor* titled *"How realistic is a 2-year extension in Greece's fiscal adjustment programme?"* we provided a detailed analysis of the general government's financing requirement & sources of funds for the period 2012-2016. Our analysis suggests that the financing gap ensuing from a 2-year extension in Greece's fiscal adjustment programme would be over and above that already projected in the troika's latest baseline scenario for the period 2015-2016 (ca €12.1bn specified as "unidentified official financing/market access"). In turn, that would mean that the additional funding required to fully-cover the government's borrowing needs in 2012-2016 could exceed the amounts reported thus far. As to the required financing to cover the ensuing borrowing gap, that could in theory come from: (i) additional official funds; (ii) a further improvement in the terms of existing and future EA/EFSF loans (e.g. extension of interest & amortization payments); and/or other sources *e.g.* higher privatization revenue and revised assumptions with respect to short-term government borrowing. In any case, any decision to extend the time horizon of Greece's fiscal adjustment programme would not come before the completion of the 1st review of the existing programme or the production of an updated debt sustainability analysis (DSA) by the troika staff.

Renegotiate certain additional aspects of the existing MoU

Besides a time extension in the country's fiscal adjustment programme, the new government is expected to try to renegotiate with official lenders certain additional aspects of the existing MoU. These are highlighted in Table A at the end of this document. At this point, it remains unclear whether an agreement could be reached on some of these proposed changes.

Successfully complete 1st review of the new bailout programme

In a sign of goodwill following the formation of the new Greek government, Eurozone finance ministers gave last week the green light for the disbursement of the remaining amount (€1.1bn) that was unexpectedly withheld from the last EU loan installment. The said amount is expected to arrive in state coffers by the end of this month, somewhat helping to alleviate worries over an imminent depletion of state cash reserves. However, a number of high-level EU officials have lately clarified that any additional disbursement of official loans to Greece would be subject to the successful completion of the 1st review of the new bailout programme. Thankfully, Greece's first major sovereign liability settlement does not come before August 20, when two old GGB issues mature (€3.1bn cumulatively). According to some reports, the government could temporarily utilize a number of funding sources to cover its imminent budgetary needs, in case of a further significant delay in the release of the new EU-IMF loan trance. Specifically, the government could temporarily tap the Hellenic Financial Stability Fund for some €2-3bn. According to the same sources, an alternative could be higher T-bill issuance in July (i.e., beyond the €4.0bn expected to be rolled over that month), contingent on the troika's approval. ***Table 1*** *below shows the agreed calendar of past and future EU-IMF loans disbursements under the new bailout programme.* As to the expected timeline of the 1st programme review, a team of high-level troika is expected in Athens next Monday to hold talks with the Prime Minister and other high-ranking Greek officials. Mid-next week, a troika technical team is also expected to arrive to initiate the 1st programme review that will be reportedly completed by late July.

Schedule of EFSF/IMF loan disbursments under the 2nd financing programme

(in € bn)	2012				2013				2014				2015	
	Q1*	Q2**	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4		*(Total)*
EFSF	74.0	29.6	3.4	5.6	8.2	3.2	0.6	5.1	10.7	1.9	1.9	0.4		***144.6***
IMF	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65	1.65	8.2	***28.0***
														172.6

Source: European Commission

(*) Among other items it includes (i) the already-disbursed 1st tranche of €25bn for the bank recapitalization program, and (ii) €1.1bn withheld from the latest EU disbursement (to be released by the end of June 2012).

(**) Among other items it includes the second (and final) installment for the bank recapitalization program (€23.5bn).

Restore Greece's policy credibility

Even though Greece is not anticipated to dominate the official agenda in the upcoming EU Summit (June 28/29), the Greek delegation is expected to try to reassure European officials that the government will honor its agreed commitments with official lenders and speed up the implementation of its structural reforms and privatizations programme. A number of high-level EU officials have lately struck a largely uncompromising tone, suggesting that Greece should first make further progress on its reforms agenda before official lenders consider giving it more leeway to meet its fiscal targets. Along these lines, the spokesman for German Chancellor Angela Merkel commented earlier this week that no decision on the Greek bailout is expected to be taken at this week's EU Summit and that any decisions on the issue will be taken only after the troika completes the 1st review of the adjustement programme. Note that the official delegation representing Greece at this week's EU Summit will be led by President of the Hellenic Republic Karolos Papoulias, replacing Prime Minister Antonis Samaras who is not allowed to travel due to health problems.

Prevent serious deviations from the 2012 fiscal targets

The deeper than expected economic recession and prolonged political uncertainty ahead of the June 17 national election have reignited worries over the attainability of this year's fiscal targets. As a reminder, Greece's 2012 supplementary budget targets a reduction in the general government deficit to 6.7%-of-GDP, from 9.1%-of-GDP in 2011. Separately, the IMF's latest country report on Greece (March 2012) forecasts a slightly higher overall deficit this year (7.3%-of-GDP) along with a general government primary shortfall of 1.0%-of-GDP. According to the most recent budget execution data, ordinary budget net revenues in the first five months of this year underperformed the respective offiсlal target by ca €660mn (or 0.3%-of-full-year GDP). However, the said slippage was more than offset by lower-than-targeted primary expenditure and further significant cut back in the public investment program. As a result, the overall central government deficit in January-May 2012 was lower by ca €2bn (ca 1%-of-GDP) relative to the corresponding budget target for the first five months of the year.

Restore economic growth, boost employment, secure social cohesion

With the domestic economy being mired into recession for five consecutive years and unemployment hitting a fresh record high in the first quarter of this year, one of the key challenges the new government will face in the period ahead is to restore economic growth and put the country on a sustainable footing. Growth enhancing measures that could be potentially pursued include, among others: (i) a quicker and more effective absorption of EU structural funds; (ii) European Investment Bank funding to small and medium-sized enterprises; (iii) implementation of the agreed privatizations agenda, with a view to attract foreign investment and create new jobs; (iv) introduction of a more stable and efficient tax system; (v) securing funding for the settlement of outstanding government arrears (estimated at around €6.3bn as of the end of April 2012); and (vi) successful completion of the bank recapitalization program, so as to gradually restore liquidity conditions in the real economy. The aforementioned strategies are, more or less, aligned with the framework of a growth-enhancing package EU leaders are expected to discuss at the June 28-29 Summit. Reportedly, growth-boosting measures that will be included on the Summit's agenda include (i) a €10bn increase in the paid-in capital of the European Investment Bank with a view to enhance much-needed liquidity in the private sector and support job creation, especially for small and medium-sized enterprises; (ii) establish a special Fund to softer the impact of austerity measures on weak social groups; (iii) redirect funds from the EU budget (as much as €80bn) to finance growth and competiveness-enhancing measures; and (iv) speed up the disbursement of EU development funds to low income regions. As a reminder, at the informal May 22 Summit, EU leaders agreed on the issuance of EU common "project bonds" aiming to finance, over the next two years, key cross-broader projects in transport, energy, communications sectors.

Table A
Programmatic Agreement of Greek Coalition Government

Goal 1 – Renegotiate certain aspects of the existing bailout programme

The new government will try to negotiate with official lenders a time extension to the existing programme's fiscal adjustment horizon by *at least* 2 years. As it is stated in the official document that lays out the key policy priorities of the ruling coalition, such a time extension would aim to ensure fulfillment of the agreed fiscal targets in a more gradual fashion, without necessitating additional cuts in wages and pensions or in the public investment program. Instead, the new government's primary objective will be to correct the excessive deficit and accomplish the agreed fiscal targets via further cut backs in public overspending, targeted strategies to reign in tax and contributions evasion as well as the completion of the necessary reforms in the State and the broader public sector.

Other aspects of the existing programme the new government wants to negotiate with official lenders include:

— settlement of the current year's outstanding taxpayer debts to the State, so that payments do not exceed an amount equivalent to 25% of income (remaining amount to be paid in two annual installments);
— extension of the tenor of unemployment benefits by 1 year to 2 years (to be accommodated by EU sources);
— extension of unemployment benefits to also cover self-employed who have lost their jobs, provided that they satisfy the necessary income criteria (to be accommodated by EU sources);
— gradual increase in the tax-exempt threshold (currently 5k/annum) towards the respective EU average;
— targeted reductions in certain tax rates, including, among others, the VAT on food catering services (from 23% currently to 13% or 9%);
— as well as on agricultural supplies, seeds, fertilizers and pesticides;
— no new layoffs in the public sector;
— a number of recently applied "unjust" measures affecting vulnerable social groups (e.g. low pensioners, large families) to be replaced with other, fiscally-equivalent measures;
— recapitalization and restructuring of the Agricultural Bank of Greece (ATE);
— replacement of a recently imposed property levy (collected via electricity bills) and a number of other real estate taxes with a unified progressive property tax;
— restoration of domestic collective wage agreements, so as to harmonize them with the European Social Law. *As per Article 155 of the Treaty on the Functioning of the European Union (TFEU) , collective agreements are concluded between single employers or their organisations on the one hand, and organisations of workers such as trade unions on the other and "are not subject to any explicit restriction either as to substantive content or legislative procedure".*
— employers and unions to be allowed to set the private sector minimum wage autonomously. Recall that the minimum gross monthly wage in Greece was reduced earlier this year by a 22% weighed average as a prior action to the new bailout programme.

Goal 2 –Economic development and social protection strategies not related to the existing MoU

The policy priorities detailed below do not directly relate to the existing MoU; they constitute measures aiming to boost domestic economic growth and facilitate a shift to new, more sustainable, development paradigm.

— development of a national plan aiming to facilitate a shift to a new model of economic development, with particular emphasis on competitive economic advantages (energy, tourism, shipping and mineral wealth) as well as key areas of strategic importance (agricultural production, foodstuff and manufacturing);
— full utilization of available EU structural funds and other sources, so as to attract foreign investment, resume a number of *currently-frozen* infrastructural projects and facilitate a better utilization of State assets;
— aligning of spatial planning laws with economic development priorities;
— equitable and efficient distribution of available resources under the EU's Common Agricultural Policy to the domestic agricultural sector, with particular emphasis on livestock and foodstuff production;
— special support measures to farmers;
— support to entrepreneurship and innovation via new financial instruments and in collaboration with the EIB;

- completion of the domestic bank recapitalization program and improvement of liquidity conditions in the real economy;
- settlement of outstanding government debts to various suppliers and other parties;
- rehabilitation of the portfolios of domestic social security funds - *with new government bonds and State property assets* - after the heavy losses they incurred as a result of the Greek debt exchange (PSI);
- Strengthened of social protection mechanisms and universal healthcare for everyone (without preconditions);
- measures to alleviate over-borrowed households and small family businesses (monthly bank payments should not exceed 30% of total monthly income);

Goal 3 –Immediate economic priorities

- establishment of a new National Tax System that will enjoy broad-based support from social partners and remain in place for at least 10 years; the new tax system should aim to broaden out the tax base, promote a more equitable distribution of fiscal burdens, facilitate the fight against tax evasion and eventually lead to the gradual reduction of social security contribution and tax rates (especially, for VAT and other indirect taxes);
- acceleration of privatization projects, especially in cases where private-sector participation can boost employment and infrastructural investment; privatization program should serve as a growth engine and not merely as a revenue generating mechanism;
- closure or merger of unproductive public entities; the target here would be to avoid layoffs of permanents staff, but, instead, generate significant savings from lowering operational and other non-labor costs;
- urgent measures to restore the regular supply of pharmaceuticals to hospitals and patients;
- immediate measures to fight overspending and corruption in the national health system (national system of electronic procurements and inventory management);

Goal 4 –Changes to the political system and reorganization of public administration

- Cleaning up of the domestic political system
  - parliamentary approval of a law for the inspection of assets and property owned by those who served as ministers and senior civil servants since 1974; penalties and confiscation of property to be imposed should their belongings can not be justified by their legitimate income;
  - changes to the legal framework governing ministers' immunity; cases of misuse of state funds and money laundering to be treated as financial crimes;
  - parliamentary deputies to lose their immunity if they commit offenses not related to their political activity;
  - ministries to lose extra payment for taking part in parliamentary committees,
  - imposition of a limit to pension payments received by parliamentary deputies; new MPs will not receive a pension after serving two terms in Parliament (i.e. eight years), as it is currently the case; they will, instead, receive a pension from their insurance fund, as every ordinary citizen, should they are entitled to;
  - revision of all terms and preconditions for the provision of subsidies to major political parties; subsidies will be reduced and the finances of political parties and parliamentary deputies will be subject to inspection by a independent institutional body;
  - radical reduction in the number of special consultants and collaborators that ministers, parliamentary deputies and general secretaries employ;
  - establishment of an institutional framework for the regulation of media and the provision of operational permits; public television will be running independently and it will be accountable to the Institutions and Transparency Committee of the Hellenic Parliament;
  - reform of the Judicial system to ensure timely court decisions and eliminate backlog of court cases via out-of-court settlement mechanisms;
  - strategic plan for tackling tax evasion;
  - strategic plan for tackling red tape;
  - strategic plan for energy and water resources management.

- Restructuring of public administration
  - establishment of a more efficient operational framework for the government and ministries

- safeguarding of the independence of public administration from changes in the political system
- adoption of anti-corruption measures
- objective and transparent civil servant promotion procedures

— Deal with illegal migration and public security threats

- upgrading of border guards;
- upgrading of responsibilities and jurisdictions of FRONTEX (European Agency for the Management of operational Cooperation at the External Borders of the Member States of the European Union);
- assume initiatives, at an EU level, for the change of The Dublin Accord-II; adoption of a common immigrant repatriation policy;
- dispersal of illegal immigrants in special hospitality shelters until their repatriation;
- fast-track procedures for the examination of asylum claims;
- aligning of the institutional framework for the provision of Citizenship with that currently applied in other European countries facing acute illegal immigration problems;
- safety for Greek citizens to be a top priority for the new government.

Goal 5 –Foreign policy issues

- systematic preparation for the declaration of the EEZ (Exclusive Economic Zone) so as to accelerate the exploitation of the country's hydrocarbon reserves and energy wealth;
- active promotion of a common European policy on important regional issues in south Europe;
- strengthening of relations with traditional allies and search for new regional alliances for promoting national interests;
- upgrade of the country's role as a pole of stability in the broader region.

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