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Focus notes: Greece

Official discussions on the 3rd programme review to resume this week: What's on the agenda?

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After a temporary pause, talks between the Greek government and the troika in the context of the 3rd programme review are scheduled to resume this week. The present note takes a look at some important issues on which a compromise is needed so as to facilitate disbursement of the next EFSF/IMF loan tranche (€6bn) that was originally due in Q1 2013.

Heads of troika mission to arrive in Athens this week

The heads of the EC/ECB/IMF troika mission to Greece are expected to arrive in Athens on April 3 to resume talks with the government in the context of the 3rd adjustment programme review. A statement issued by the troika shortly after the mission heads last departed from Athens (mid-March) read that "significant progress" was made as regards the finalization of the said review and that a short break in bilateral discussions was necessary for the completion of technical work on a few outstanding issues. According to local press, the latter include, among others **(i)** the bank recapitalization program; **(ii)** progress made on the so-called mobility scheme for civil servants; **(iii)** a special real estate levy, currently collected through electricity bills; **(iv)** new regulation on overdue tax payments and social security contributions; **(v)** a proposed restructuring scheme for mortgage loan payments by indebted households; **(vi)** changes in certain indirect taxes; and **(vii)** a possible budgetary shortfall in 2013-2014.

A final agreement between the Greek government and the troika on the aforementioned issues is a key prerequisite for the unlocking of the next loan tranche that was originally scheduled for Q1 2013 (€6bn, consisting of €4.2bn in EFSF funding and €1.8bn from the IMF under the Extended Fund Facility). The release of the said tranche is expected to dominate the agenda of the April 12 Eurogroup and, according to a number of press reports, it will take the form of a number of monthly installments, subject to the fulfillment by the Greek side of certain programme milestones. On its part, the IMF will reportedly wait for the completion of the 3rd programme review before deciding on its contribution to the said loan tranche. The next IMF Broad meeting is scheduled for April 25.

As regards the last (still-undisbursed) installment (€2.8bn) of the €49.1bn EFSF loan tranche approved in December 2012, an EU Commission spokesman said that its release will be subject to approval by the upcoming Euro Working Group, which is scheduled for April 4. This will be 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 the staffing plans for line Ministries and the identification of ensuing redundant job positions as well as the submission of quarterly targets of mandatory exits through end-2014 (*still pending).*

3rd review Issues on which a compromise has yet to be reached

Domestic bank recapitalization. In late March, Bank of Greece (BoG) reportedly sent letters to the managements of systemic domestic banks requesting a speeding up of the agreed recapitalization process. According to the same sources, BoG has requested General Shareholders Meetings to be held by the end of the current week so as to approve share capital increases in the context of the domestic bank recapitalization program. Moreover, BoG reportedly asked major domestic credit institutions to detail by mid-April, at the latest: (i) whether and how they can raise private funds to cover at least 10% of new common equity capital so as to remain privately-run[1]; (ii) to finalise the terms of the capital increases (e.g. amount to be raised via existing shareholders and via the HFSF in the form of common shares / subscription price to the common equity capital increase for the private sector/ amount of CoCos/ rights issue terms); and (iii) to submit the relevant Information letter to the Capital Market Commission. As regards the deadline for the completion of the banks' capital raising process, Bank of Greece Governor George Provopoulos suggested earlier this week that it may be extended by one month to end May 2013.

Staffing plans for line Ministries, identification of redundant positions and specification of quarterly targets for mandatory exits through to end-2014. As laid out in the revised MoU conditionality, 25k of public employees must be transferred to a special labor reserve (i.e., the so-called mobility scheme) by the end of this year. Under the said 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 to fill in vacant positions in the broader public sector. This is part of a broader commitment by Greece to reduce public sector employment by 150k over the period 2010-2015. According to local press, the troika rejected an earlier proposal by the Ministry of Administrative Reform & e-Governance to reach the above target via (i) natural attrition (and the application of the existing 1:5 or 1:10 hiring rules); and (ii) outright dismissals of civil servants who have seriously breached the code of conduct or have an administrative inquiry ordered against them. The Ministry defended its position by arguing that the overall public sector workforce is falling faster than expected earlier, mainly thanks to natural attrition, early retirements and the non-renewal of fixed-term contracts. Specifically, the government estimates that the overall public sector workforce stood at around 668k in October 2012, having declined by 75k over the past 1½ year. In an effort to reach a compromise with the troika on the aforementioned issues, the Greek side reportedly proposed the removal of 5k public servants by the end of 2014 out of the 25k expected to be placed into the mobility scheme by the end of the current year. According to the same sources, the latter figure consists of perjurer employees as well as of civil servants who have been appointed with false documentation or/and have been unjustifiably absent from their work. As per the same sources, the troika also rejected this proposal requesting, instead, the immediate dismissal of all perjurer employees.

Special real estate levy currently collected through electricity bills. According to local press, the general implementation framework for a planned single property tax - to replace both the special Property Tax (FAP) currently applied to all real estate holdings and a special levy collected via electricity bills - is not likely to be ready for introduction in H2-2013 as envisaged in the revised MoU. As a result, the troika has instead proposed the special levy to remain in place for another year. They have also requested the single property tax - once it comes into force - to be paid through electricity bills so as for the government to secure revenues of ca €3.2/annum i.e., the total amount currently collected via all property taxes. Reportedly, the troika believes that without extending the present special levy for another year would eventually result to a revenue shortfall of ca €1bn in 2013-2014. This issue appears to represent a source of contention within the government. Both junior coalition partners, PASOK and Democratic left, have publicly voiced their objection to a possible extension of the controversial property tax paid through electricity bills, with the latter warning that it will cast a negative vote should a related bill be submitted to Parliament.

[1] The remaining 90% capital requirement that is necessary for banks to meet a core Tier 1 target of 6% will be covered through the issue of common shares to the Hellenic Financial Stability Fund (HFSF) with restrictive voting rights. Yet, should the Fund's participation exceeds 90% of the common equity capital increase, the HFSF shares will carry full voting rights, implying an effective nationalization of the credit institution. The remaining capital requirement - i.e., above the 6% Core Tier 1 ratio - that is necessary to meet the BoG's core Tier 1 target (estimated at 9%) will be covered through the issue of contingent convertible bonds by the credit institution, such as CoCos, taken up by the HFSF, upon approval of the respective general shareholders meeting.

New regulation on overdue tax payments and social security contributions. Aiming to boost budgetary revenue, the troika and the government have reportedly agreed on a new framework for the settlement of unpaid taxes and social security contributions. Tax arrears are currently estimated at ca €56.5bn but, according to the Ministry of Finance, only €11-12bn of the latter amount is deemed as collectible. Similarly, no more than 1/3rd of outstanding social security contributions (ca €14bn) is considered to be recoverable.

Yet, the troika and the government have not reached an agreement on certain aspects of the aforementioned framework. Among others, these include the maximum number of monthly installments and the interest rate charged. Specifically, the troika insists that: (i) the total number of monthly installments does not exceed 36 as opposed to the Greek side, which is in favor of 46; and (ii) the new scheme involves an interest charge of 8.7%, which is deemed by the Greek government to be too high. According to local press, the two sides agreed that uncollected debts will enter a special file for 20 years, before being written off, unless debtors are found to own assets. The General Accounting Office reportedly estimates that the implementation of the proposed framework for the settlement of overdue taxes and social security contributions may generate revenues up to €5.2bn this year (€3.7bn from tax arrears and €1.5bn from overdue social security contributions).

Proposed restructuring scheme for mortgage loan payments. According to the latest available BoG data, non-performing loans (NPLs) stood at 22.5% in September 2012, up from 16% in end-2011, a development that reveals the problems domestic households and businesses currently face in servicing their bank debts. According to local press, one in four households is at risk of losing their homes, as they cannot afford to meet their monthly payments, despite loan restructurings (e.g. lengthening of loan tenors) offered by banks. Against this background, a proposal made by the Greek government as regards the introduction of new legislation that would allow heavily indebted households to restructure their mortgage loans with more favorable terms was reportedly approved by official lenders. According to the same sources, both sides agreed that households qualified for the new scheme should meet the following criteria:

(i) be first time home buyers;
(ii) respective home value does not exceed €180k;
(iii) they have lost 35% of their income over the last 3 years;
(iv) their annual income is no higher than €25k; and
(v) their total wealth does not exceed €300k.

Yet, certain aspects of the aforementioned proposal remain a source of contention, especially as regards the duration of the effective loan payment moratorium and the interest rate applied. Reportedly, the troika favors:

(i) a two-year period of interest-only payments, while the Greek side proposes four years;
(ii) new scheme to involve an interest rate linked to the euribor plus a spread, opposing the government's proposal for a fixed rate of 1.5%; and
(iii) the outstanding mortgage should not to exceed €125k, an amount deemed by the Greek side to be too low.

According to local press reports, the troika mission insists on relatively more strict criteria amid concerns that a more generous mortgage restructuring plan may need additional bank recapitalization funds.

Proposed changes in certain indirect taxes. According to local press, the troika is concerned that a government proposal to reduce the current VAT rate on food catering from 23% to 13% may jeopardize the agreed fiscal targets. Moreover, a decision is still pending on an earlier proposal by the Greek government to reduce the special consumption tax on heating oil. Both sides agreed to discuss the latter issue again in late May, in the context of the 4th programme review.

Possible budgetary shortfall in 2013-2014. According to a number of press reports, the troika projects a budgetary shortfall as high as €2.7bn in 2013-2014 as a result of:

(i) the government's reluctance to impose a 2‰ annual tax on business turnover in favor of Freelancers Insurance Organization, as envisaged in the updated Medium-Term Fiscal Strategy (MTFS) for 2013-2016. Specifically, the MTFS envisions cumulative budgetary revenues of €600mn via the imposition of the aforementioned measure in the period 2013-2014 (€150mn in 2013 and €450mn in 2014);
(ii) overestimation (by €200mn) of certain expenditure-side measures incorporated in the updated MTFS;

(iii) failure of domestic banks to distribute dividends on the preferred shares they issued to the Greek State under the 3723/2008 Law in return of capital injection. The FY-2013 Budget projects revenues of €900mn by the aforementioned source. Domestic banks argue that they can not pay dividends to the State in view of the heavy losses they suffered as a result of the sovereign debt crisis;

(iv) potential decision by the Greek government not to extend the special property tax collected via electricity bills for another year. As was mentioned earlier, the troika has reportedly warned that, should this be the case, a budgetary shortfall of ca €1bn in 2013-2014 would eventually resulted.

Note that, the Greek Parliament endorsed in late 2012 two Legislative Acts incorporating a number of safeguards aiming at strengthening the Budget execution and enhancing the fiscal management. Among others, the aforementioned Acts envision the implementation of automatic expenditure cuts (in line ministries, public enterprises, local municipalities and other general government entities) when the fiscal performance deviates from the officially agreed target, while ensuring that arrears are not increasing.

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