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Official discussions on Greece's 5th program review to incept in mid-September

Key items on the agenda

This report takes a close look on a number of quantitative targets and structural benchmarks included in the agenda of the 5th review of Greece's adjustment program, expected to commence in mid-September. It also provides an overview of the progress already made by domestic authorities in fulfilling a set of prior actions for the disbursement of the next EFSF loan sub-tranche. Finally, it presents a timeline of the key dates and events that deserve close monitoring in the period ahead.

Troika mission heads conclude interim assessment; 5th program review expected to incept mid- September

Aiming to prepare the ground for the inception of the 5th review of Greece's adjustment program, the troika mission heads concluded last week an interim assessment on the progress made by domestic authorities in implementing a range of agreed quantitative targets and structural benchmarks (*see section on page 2*). A joint statement issued shortly before their departure read that the meetings with government officials "were productive" and that the full mission should continue discussions in the second half of September. Taking into account the agenda of issues involved, it seems that the next program review will be a challenging one. That said, Greece's Minister of Finance Gikas Hardouvelis has reportedly proposed to have the new program review being split into two sub-reviews. The first one shall concentrate on fiscal issues and the structural reforms agenda, with an intention to have it completed by mid-October *i.e.,* ahead of the scheduled release of the EU-wide stress test results in the second half of that month. The second one should commence shortly after the release of these results, provided that the October 13th Eurogroup gives the green light for the initiation of official discussions on Greece's debt sustainability and the prospect of a new relief package by official lenders. It is yet unclear whether the troika mission heads accepted that proposal. A staff-level agreement on the core issues underlying the next program review is a key precondition for the release of additional official funding to Greece, including €2.9bn from the EFSF, the last loan tranche under the current program, and (reportedly) €3.4bn from the IMF under the Extended Fund Facility (*see Table 2 in Annex*).

Prior actions to the nextEFSF sub-tranche to be completed by early August

Inception of official discussions in the context of the next program review will follow the disbursement of the next EFSF loan sub-tranche (€1bn), which was originally scheduled for release in July.[2] The said release is now expected to take place by mId-August, upon fulfillment of as many as six prior actions. Completion of these milestones should also open the way for the transfer to

[2]The said EFSF sub-tranche consists of the 3rd (and last) installment of the €8.3bn loan disbursement approved by the April 1st Eurogroup following the completion of Greece's 4th program review.

Greece of €2.1bn in ANFA and SMP profits.[3] On the expenditure side, sovereign debt redemptions and coupon payments amounting ca €5.3bn are due in mid-August. To that amount one should also need to add principal and interest payments to the IMF (ca €1.0bn in total) over the same month. As of the time of writing this report, the Greek side has completed one of the six prior actions attached to the next EFSF sub-tranche. This is the approval by the Hellenic Parliament of the relevant legislation for the privatization of the "small Public Power Corporation (PPC)" (*Table 2*). The small PPC will take about 30% of the assets and customers currently hold by the country's state-owned biggest power producer, the Public Power Corporation (PPC).[4] Under the current plan, the small PPC is expected to be privatized by the end of Q1 2015, in line with the EU legislation for the liberalization of the energy market. The coalition government of centre-right New Democracy (ND) and socialist PASOK secured earlier this month parliamentary approval of the said legislation with an absolute majority of the attending lawmakers.[5] The Hellenic Parliament has been in recess since mid-June and will return to its plenary session in the first Monday of October. Until then, the legislative and parliamentary work is exercised by the so-called Recess Section which is composed of one third of the total number of MPs (*i.e.*, 100). That said, passing a bill through parliament during that time requires a majority of at least 50%+1 of attending lawmakers, *i.e.*, at least 51 MPs. A proposal submitted by the majority of opposition parties and a number of independent MPs for a referendum to be held on the legislation for the privatization of the small PPC was rejected by the Hellenic Parliament as unconstitutional.[6] With regard to the remaining five prior actions, Greece's Minister of Finance Gikas Hardouvelis reassured his euro counterparts at the July 7 Eurogroup that they will be completed by early August. According to the local press, a multi-bill containing relevant legislation for the implementation of the remaining five prior actions will be submitted for vote to the Hellenic Parliament by August 8.

Table 1- Prior actions to the next EFSF sub-tranche

	Completed	*Pending*
Adoption of legislation on political parties' funding and on declarationi (and monitoring) of their assets		√
Adoption of administrative burden legislation		√
Abolishment of third tax parties recorded as auxiliary funds revenue		√
Clearance of State arrears to PPC and adoption of law for the establishment of "Small PPC"	√	
Adoption of forestry law		√
Adoption of legislation allowing merger of all supplementary pension funds into the Unified Supplementary Insurance Fund (ETEA)		√
Legislation for the implementation of the "No Deficit Clause" & sustainability formulas ato all funds that are not currently in ETEA		√

Source: EU Commission, 'The Second Adjustment Program for Greece- 4th Review" (April 2014), Local Press, Eurobank Global Markets Research

Greece's 5th program review: key items on the agenda

In what follows, we provide some analysis on the issues expected to dominate the agenda of the 5th review of Greece's adjustment program.

[3] According to the November 29, 2012 Eurogroup statement, Member States committed "*to pass on to Greece's segregated account, an amount equivalent to the income on the SMP portfolio accruing to their national bank as from budget year 2013*".

[4] The PPC currently generates about two-thirds of the country's electricity output and controls almost 100% of the retail markets. Its sales are reportedly estimated at about €6bn/annum.

[5] Out of the 98 attending MPs, 51 voted in favor (42 ND + 9 PASOK), 46 casted a negative vote and 1 voted present. Two Golden Dawn MPs abstained.

[6] According to Article 44, paragraph 2 of the Constitution of Greece "*The President of the Republic shall by decree proclaim a referendum on crucial national matters following a resolution voted by an absolute majority of the total number of Members of Parliament, taken upon proposal of the Cabinet. A referendum on Bills passed by Parliament regulating important social matters, with the exception of the fiscal ones shall be proclaimed by decree by the President of the Republic, if this is decided by three-fifths of the total number of its members, following a proposal of two-fifths of the total number of its members*".

Public administration reform agenda

(i) Mandatory exit of ca 7k public employees by the end of this year, so as to fulfil the agreed target of 15k layoffs in 2013-2014.[7]

(ii) Individual evaluations of public employees for the year 2013, under a newly established system for assessing performance (*September 2014 structural benchmark*).

(iii) Identification in a fiscally neutral way of issues related to the implementation of a new wage grid reform and the public sector wage structure[8] (July *2014 structural benchmark*).

Source: Updated MoU conditionality, local press

Comments

- In a meeting with the troika staff, Greece's Minister of Administrative Reform and E-Governance reportedly proposed the target for ca 7k mandatory exits by the end of this year[9] to come from the following pools: (i) 1,050 redundant positions resulting from the merging, downsizing or closing down of certain private law entities; (ii) contractual staff, estimated at ca 1,850, who lost their legal appeal against the non-renewal of their temporary contracts; (iii) 3.6k who were placed in the mobility scheme for eight months and they failed to be reappointed in the broader public sector to fill in vacant positions[10]; and (iv) the remaining from perjurer employees[11].
- Public sector employee evaluations -planned for completion in September 2014- are reportedly behind schedule after the Civil Servants' Confederation (ADEDY), in protest to that scheme, asked its members not to take part in the evaluation process.[12] According to the latest IMF report on Greece, mandatory exits so far "have been based on performance and constitutional restrictions", while "performance-based dismissals remain an impediment".
- The required review on a new wage grid reform is reportedly expected to be completed in the coming weeks. According to the updated MoU, the said reform should be legislated by October 2014, so as to come into effect in January 2015.

Labor market reform agenda

(i) Re-assessment of existing framework for collective dismissals (*September 2014 structural benchmark*).

(ii) Review of the existing industrial action framework against best practices in other EU countries (*June 2014 structural benchmark*), including, among others, the potential re-introduction of employers' right to stage lockouts, after its abolishment in 1983.

(iii) Identification of necessary legal changes in the regulatory framework dictating labor unions' operation (*September 2014 structural benchmark*).

Source: Updated MoU conditionality (June 2014), local press

Comments

- In the context of Greece's last program review, an agreement was reached on the adoption of a new procedure for the approval of collective company redundancies in the excess of the current layoff limit for a trial period of six months.[13,14]

[7] The overall headcount in the public sector has been reportedly reduced by ca 267k in the period 2009-2013 to ca 591k.

[8] According to the latest IMF report on Greece (June 2014), high-skilled and high-performance public servants are paid less well, while low-skilled ones are relatively well paid compared to the private sector.

[9] Reportedly, around 3,500 layoffs were recorded in 2013 and an additional 4.5k in Q1 2014 including: (i) 2,650 employees of the Hellenic Broadcasting Corporation (ERT); (ii) 1,500 employees from the Ministry of Internal Affairs (school crossing guards); (iii) 2,500 doctors in the public healthcare system who chose to be fired rather than accept full-time public sector jobs; (iv) 230 municipal police officers; and (v) ca 1k who quit for health reasons or were found guilty of breaking the code of conduct.

[10] Under the agreed plan, public employees transferred to the mobility scheme will be receiving for eight months 75% of their basic monthly salary before they are fired, in case, they fail to be reappointed in the broader public sector. The rationale behind the establishment of that scheme was the creation of the space needed for the hiring of new staff, particular young and highly qualified in several priority areas.

[11] According to the local press, since the beginning of 2013, 524 perjurer employees have been fired for violating the code of conduct or using false certificates

[12] A court ruled the union's protest against individual evaluations illegal earlier this month, but ADEDY has appealed.

[13] 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.

[14] According to the existing procedure for the approval of collective company redundancies which is in line with the relevant Council Directive 98/59 and has been approved by Greece's main employer organizations (SEV, ESEE, GSEVEE, SETE) and the General Confederation of Greek Workers (GSEE), final decisions on collective company redundancies rest with the Supreme Labour Council (which is headed by the General Secretary of the Labor & Social Security Ministry).

Upon expiration of that period (September 2014), the effectiveness of that procedure will have to be re-assessed. The Greek side reportedly argues that under the existing procedure, the Labor & Social Security Minister's veto power has effectively been eliminated. On its part, the troika reportedly insists that the Labor & Social Security Minister's veto power has to be abolished through a statutory law.

- The troika reportedly argues in favor of reintroducing employers' right to stage lockouts.[15] Other issues under consideration that relate to the functioning of trade unions include, among others: **(i)** the procedure applied for engaging in a strike; and **(ii)** sources of their funding.[16] Under the updated MoU conditionality, the relevant legislation with respect to a revised operational framework for trade unions should come for approval in the Hellenic Parliament by end-October 2014.

Assessment of the privatization program

(i) Adoption of reforms for speeding up the privatization program.
(ii) Adoption of new measures for boosting privatization receipts (*i.e.,* securitization/monetarisation of future revenue).

Source: Updated MoU conditionality, 14/151 (June 2014), local press

Comments

- As per the latest European Commission report on Greece (April 2014), even with delays, a number of steps have already been taken in fulfilling privatization targets. These include, among others: (i) completion of 16 privatization projects worth €4.9bn cumulatively, out of which €2.9bn has already been received (against a target for cumulative privatisation revenue of €22.3bn in the period 2011-2020)[17]; (ii) the transfer of nearly 1,000 commercially-viable real estate assets to the Hellenic Republic Asset Development Fund (HRADF); (iii) completion of an initial assessment of more than 80,000 real estate assets, currently under the management of line ministries and the Public Properties Company (ETAD); and (iv) certain amendments to the relevant law, aiming to enhance the governance of the privatization program.
- Yet, persisting administrative bottlenecks, sluggishness in the licensing process and the approval of contracts have altered the implementation plan of several privatization projects in recent months. Against this background, an agreement was reached in the context of Greece's 4th program review to adjust the 2014 privatization proceeds target to €1.5bn from €2.5bn previously. In its *Credit Outlook Report* released late last month, Moody's expressed optimism that "the Greek privatization program looks to exceed this year's revenue target, a credit positive for the sovereign". This assessment was based on the privatization agreements reached so far, projected to generate revenues of up to €1.3bn this year, just €0.2bn short of the 2014 revenue target.[18]
- Certain concerns remain as regards the attainability of longer-term privatization revenue targets. Indicatively, the Hellenic Republic Asset Development Fund (HRAD) announced recently that it freezes the privatization process for the majority stake in the Thessaloniki Water Company (EYDATH) after the Council of State (the country's highest administrative court) ruled that the privatization of the Athens Water Company (EYDAP) is unconstitutional.[19,20]
- Against this background, domestic authorities are mulling the adoption of a number of steps aiming to speed up the privatization program. To this end, the HRADF has committed to complete an assessment on the management and board members of companies in its portfolio and to proceed with all necessary actions required to strengthen the governance

[15] A lockout is usually implemented by refusing the admission of employees onto company premises , e.g. via the change of locks.
[16] Currently, the majority of the largest unions in Greece are reportedly funded by the State.
[17] According to the updated MoU, in case of a shortfall in privatization proceeds (relative to program targets) for two consecutive quarters, the pace of the fiscal adjustment will need to accelerate. That is, in case no other adjustments are agreed with official lenders. According to the agreed fiscal policy reaction mechanism, the primary surplus target would need to be raised by an amount equivalent to 50% of the shortfall in proceeds and the required incremental adjustment will have to be achieved via additional expenditure cuts. The adjustment within any year will be capped at €1bn.
[18] Agreements on the privatization of assets worth €1.3bn so far this year include: (i) the sale of Hellenikon (former Athens airport) which concluded in end-March generating €915mn; and (ii) the privatisation plan for Piraeus Port Authority (OLP) and Thessaloniki Port Authority (OLTH) that are currently at an advanced stage. For the sale of a 67% stake in OLP (ca €308mn), five investment groups have qualified for the second phase of the tender process. In addition, eight investment groups submitted offers in early June for the sale of a 67% stake in OLTH (€197mn).

[19] According to the court verdict, the state has the responsibility to take care for the health of citizens and "the effective transformation of the state company to a private one which operates on a for-profit basis renders uncertain the continuation on its part of accessible services for the common good of a high quality as they will be no longer comprehensively secured by State oversight".

[20] The privatization process of EYDATH was launched in February 2013 and was already at the second phase of the tender. Under the privatization plan, the two (out of a total of four) prequalified parties were expected to submit binding offers by Q2 2014. The HRAD was not public announced how it intends to cover the shortfall that is projected to arise after the suspension of the privatization plans of EYDAP and EYATH.

regime of the privatization program (*June 2014 structural benchmark*). Furthermore, domestic authorities have committed to proceed with alternative sale methods of real estate assets, including asset securitization and monetarisation, in an effort to boost privatization revenue.[21] Under the updated MoU conditionality, a report on such possible transactions that could take place in a 12-month horizon is expected to feature high on the agenda of the next program review (*June 2014 structural benchmark*).

Social Security System reform agenda

(i) Adoption of additional reforms required to secure the long-term viability of the Social Security System.
(ii) Measures to improve social security contribution receipts.
(iii) Identification of offsetting measures for the coverage of a shortfall in the budget of social security funds projected to arise after the abolishment of all nuisance charges that were earlier recorded as auxiliary funds revenue

Source: Updated MoU conditionality (June 2014), local press

The continuous increase of arrears in Social Security Funds combined with high unemployment and reduced State subsidies, undoubtedly cast a doubt over the long-term viability of the Social Security System. Against this background, the Greek side has committed to undertake a number of initiatives aiming to safeguard the sustainability of the system, including among others, the adoption of legislation: (i) allowing merger of all supplementary pension funds into the Unified Supplementary Insurance Fund (ETEA); and (ii) involving the implementation of the "No Deficit Clause" and sustainability formulas to all funds that are currently in ETEA. In line with the updated MoU conditionality, the relevant legislation should be submitted for approval to parliament by October 2014. A review on nuisance charges that were earlier recorded as auxiliary funds revenue will also be a key issue of discussions in the 5th program review.

Size of projected fiscal gap in FY-2015 and sources of funding for its coverage

As per the latest update of the macroeconomic framework underlying Greece's adjustment program (June 2014), a fiscal gap worth ca 1.1%-of-GDP (or ca €2bn) is expected to rise in 2015, lower compared to a €1.8bn shortfall estimated at the end of the 3rd program review in July 2013. On its part, the Greek side has adopted a more optimistic view, reportedly arguing that any fiscal gap for 2015 will be contained to ca 0.5%-of-GDP (or €0.9bn). According to the updated MoU conditionality, Greek authorities have committed to cover any projected fiscal gap in 2015, mainly through the extension of expiring measures, including the solidary surcharge (which reportedly generates revenue of ca €1.4bn/annum). Yet, in view of the satisfactory execution of the State budget so far this year[22] the Greek government is considering a gradual reduction of certain tax rates in the context of the preparation of the 2015 Budget, providing that the agreed fiscal targets are not jeopardized.[23] According to press reports, the government's plan includes, inter allia; (i) a reduction of the solidarity tax; (ii) a one-year extension of the 13% VAT rate applied on food catering and restaurants; and (iii) a 15-20% reduction of the special consumption tax on heating oil.[24] As per the same sources, the troika has expressed certain reservations on the prospect of reduced taxation, especially in view of a verdict reached by the Supreme Administrative Court of Greece earlier this year that the 12% wage and salary cut imposed on unformed personnel and judges in 2012 (as part of the extension of the new wage grid to special wage regimes) was unconstitutional. The troika has reportedly asked the Greek government to identify offsetting measures for the coverage of the ensuing financing shortfall. This should amount to ca €800mn should salary and pension cuts are fully reimbursed plus €300mn/annum from 2015 onwards.

[21] As laid out in the updated MoU, such transactions have to meet three constraints: (i) not to raise the public debt of the Hellenic Republic; (i) not to entail any financial risk to the Hellenic Republic: and (iii) to be targeted at the international investor community.
[22] According to the latest data for the execution for the State budget, the primary balance recorded a surplus of €0.707bn in the first six months of 2014 compared to a shortfall of €1.511bn realized in the same period a year earlier and a deficit target of €0.635bn envisioned in the 2015-2018 Medium Term Fiscal Strategy (MTFS). State budget net revenue stood at €22.6bn, outperforming by €0.242bn the corresponding 6-month target in the MTFS.
[23] According to the updated MoU conditionality "if there is sustained over performance of revenue, contingent on the fiscal targets being met, the Authorities will in consultation with the EC-ECB-IMF consider a reduction in the high statutory tax rates while aiming to broaden the tax bases".
[24] Longer-term, the government plans a gradual reduction in the corporate and income tax rates, depending on the room provided by the fiscal envelope.

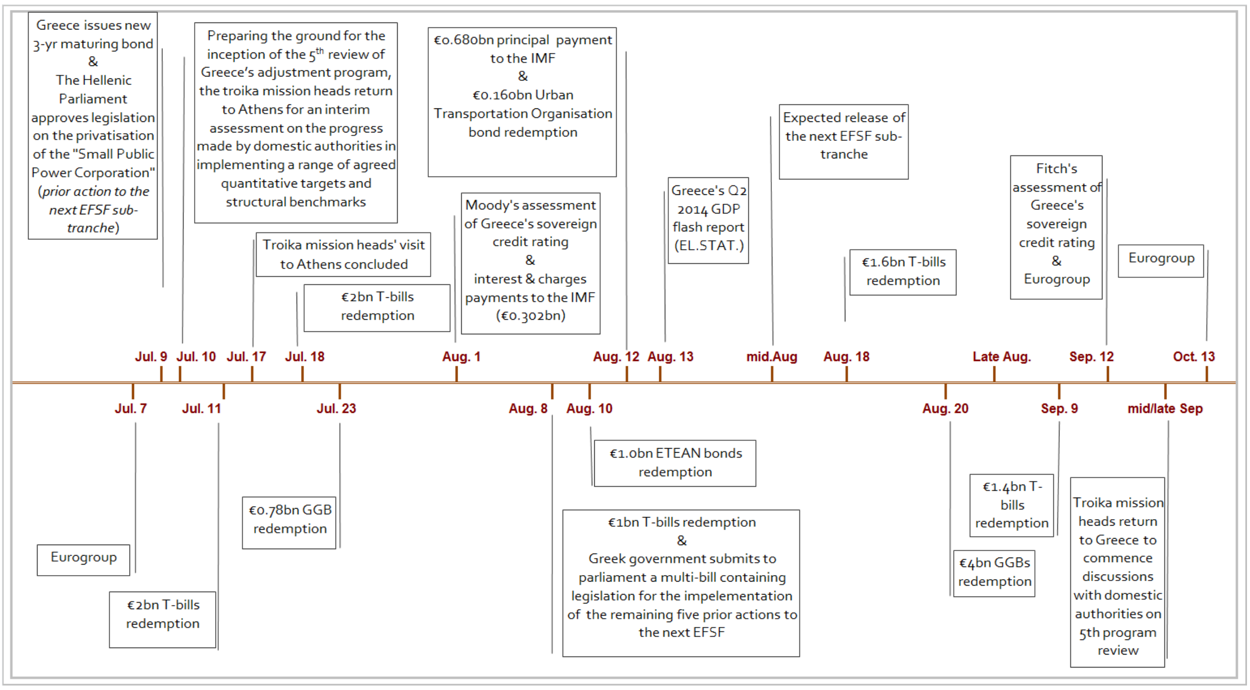
New installment scheme for overdue tax payments and social security contributions

Aiming to boost budgetary revenue, the government reportedly proposed the troika a new framework for the settlement of tax arrears and overdue social security contributions. For debtors that have entered into the so-called "Fresh Start" scheme (*i.e.*, outstanding stock of debt legally verified after January 1, 2013), the Greek side reportedly proposed an increase in the maximum number of monthly settlements to 48 compared to 12 currently. With respect to the so-called "basic schemes" (*i.e.*, outstanding stock of debt legally verified up to December 31, 2012), domestic authorities proposed an increase in the maximum number of monthly settlement from 48 currently to 72 (or even more than 100 for certain SMEs that have been severely hit by the prolonged domestic recession). Note that cumulative tax arrears accrued up to end-May 2014, stood at ca €66.5bn, out of which €4.5bn was accumulated in the first five months of this year. According to the local press, the troika rejected the new proposed framework but the Greek side intends to bring the issue again for discussion in the next program review.

New framework to deal with private sector indebtedness

Aiming to address private sector indebtedness, the Greek authorities are reportedly preparing a resolution scheme that involves, among others: (i) an out-of-court debt restructuring framework for enterprises (*July structural benchmark*); (ii) a review of the personal and corporate insolvency laws to address hurdles that inhibit the rapid rehabilitation of viable entities (*June structural benchmark)*; and (iii) a binding Code of Conduct for banks that will specify the terms of their engagement with debtors as well as alternative restructuring tools (*May 2014 structural benchmark*). The said resolution scheme, which will also address domestic banks' large stock of non-performing loans (NPLs), will be reportedly completed by mid-August. According to recent comments by BoG Governor Yiannis Stournaras, NPLs reached 33.5% of total loans in end-Q1 2014 (or €77bn) up from 31.9% in end-December 2013 with 55% (or €42bn) of them attributed to the corporate sector, 13% (€10bn) to the consumer sector and 32% (or €25bn) to the housing sector.

Greece - Timeline of key data & events



Source: PDMA, local press, Eurobank Global Markets

Annex

Table 2- EFSF/IM disbursements to Greece under the 2nd adjustment program (EURbnk)

	Loan tranches disbursed so far under 2nd adjustment program	Pending EFSF loan tranche following completion of 4th program review (*subject to fullfilment of certain milestones*)	Future disbursements	Total disbursements under 2nd adjustment program
	March 2012-mid-July 2014	August 2014 *(initially scheduled for July 2014)*	September 2014-March 2016	March 2012-March 2016
EFSF	140.9	1.0	2.9	144.8
IMF	11.9	0.0	16.1	28.0
Total	152.8	1.0	19.0	172.8

Source: EU Commission, 'The Second Adjustment Program for Greece- 4th Review" (April 2014), Eurobank Global Markets Research

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