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## Restructuring and forgiveness

It has been a torturous year for Greece, even by its own sorry standards, with the political climate becoming almost as desperate as the economic one. As Greeks prepare to vote for the third time in a little over a year on the future of their country, the hope is that the worst is now behind them.

In July, the Greek government finally agreed to a bailout deal that mobilised up to €86bn in financial assistance between 2015 and 2018. The deal will see funds released in increments, as and when Greece meets certain targets on implementing structural reforms, which past governments had struggled to deliver.

Although the details of the latest bailout deal are yet to be formally finalised, a provisional memorandum of understanding recognises some of the mistakes made in former deals. Past agreements had demanded too much, in terms of budget savings that were too front-loaded, weighing too heavily on the Greek economy, said Peter Schaffrik, head of UK and European rates and economics research at RBC. The savings demanded in the new package are therefore lower than last time.

But the MoU is unrelenting in its calls for structural reforms, such as securing the independence of the statistical authority, and labour market reforms. Unsurprisingly, in the aftermath of the bailout agreement being announced, the Greek government tore itself apart and the left wing of Syriza split off to form a new party, Popular Unity.

Greece has endured seemingly endless political turmoil that has seen the electorate called to the polling booths three times in eight months, with the latest election still to be held at the time of writing. But Dimitris Paraskevas, managing partner of Paraskevas Law in Athens, is less concerned about political risk than the economic hardship being thrust on the country.

Paraskevas said: "Tsipras has shown himself to be a pragmatic prime minister. The big risk is the economy and the currency. Companies are seeing their revenues drop by 70% or 90%; many could disappear. Greek banks could fail unless recapitalised."

The state of the banking sector remains a particular concern. Besides high NPLs, Greek banks appear to own a lot of assets linked to the government, so the suspicion is that if the state does go bankrupt, it will take the banks down with it, adding to the chaos. Deposits have drifted away and it will take time for trust to be restored sufficiently for all those assets to come back.

"Low coupons and extended maturities are the most likely options for debt relief, while a haircut is unlikely. In our view, this last option will not be acceptable for most of the parties involved in the negotiations"

Everything therefore hinges on Greece's ability to push through the kind of reforms it has struggled to implement in the past, and to collect more taxes. "It is hard to see it," said Schaffrik, even the IMF now argues that some level of debt forgiveness is necessary for the Greek economy to begin healing.

"Concerns remain regarding the deteriorating economic conditions and the ballooning public debt, which may prevent the IMF from joining the bailout absent some form of relief," said Monica Defend, head of global asset allocation research at Pioneer Investments. Yet the deal is not expected to include any haircut to the debt.

What it will do is ease the repayment schedule, making it easier for Greece to service the debt, although, given that Greeks are not currently repaying any debt, the restructuring is mostly about lengthening maturities, said Schaffrik.

"There could be a plan where the ESM buys the ECB bonds and transfers them into longer maturities," he added.

### Most likely options

Defend said: "Low coupons and extended maturities are the most likely options for debt relief, while a haircut is unlikely. In our view, this last option will not be acceptable for most of the parties involved in the negotiations."



However, even without a haircut, some remain convinced that Greece can turn itself around. Japan has been running a higher debt-to-GDP ratio than Greece has, and has no problem servicing the debt, said Paraskevas.

But Schaffrik believes this comparison is misleading.

"Much of [Japan's] debt is held by the central bank itself, the net holding is much lower than the headline figure. And Japan has savings. Its pension funds and insurance companies hold the JGBs. That is nothing like Greece, where the debt is a liability to the outside world," he said.

Polls suggest that a new, relatively pro-EU government will be elected in Greece, which will get on with implementing the measures in the MoU.

"Any difficulties it experiences will not be sufficient to lead to any new crisis," said Schaffrik. It will take time before disagreements arise. "Eventually there will be more discussion about restructuring the debt – not debt forgiveness, but restructuring – and a solution will probably be found," he said.

### **Privatisation problems**

Schaffrik expects problems to arise when the government gets round to tackling privatisations, probably in the middle of next year.

"Its targets will be hard to achieve. That will take the process off-track," he said.

The government has already approved its first privatisation, originally agreed by the former government, which grants 40-year concessions of a number of Greek regional airports to Germany's Fraport-Sintelabo consortium for €1.23bn. However, having been put on hold once, it could be delayed again, and there will be plenty more arguments over Greece's national treasures ahead.

Assimakis Komninos, a partner at White & Case in Brussels, is more sanguine, saying: "There is more acceptance now that privatisation can be a good thing, and that it is not about raising money but promoting growth. There is still opposition to the privatisation of the energy sector, but it is there in the MoU and the government has already signed off on it, so it is hard to see how it can be avoided."

The other big concern is around tax. The Finance Ministry has made some progress in this area. It has massively scaled up its efforts to collect taxes, with tax inspectors visiting local businesses to check they are paying taxes, issuing receipts and writing invoices and using legitimate VAT documentation. This scattergun approach is encouraging many to get their tax affairs in order.

Yet there is still some concern that the agreement Greece reached with its creditors on tax will hamstring the country.

Paraskevas said: "It is hard to see how Greece can compete with the EU proposal for the 29% rate of corporate tax plus social cohesion tax, especially when neighbours like Bulgaria, Hungary and Cyprus have a rate of approximately 10%."

### **The great exit**

Already, some 14,000 firms have relocated to Bulgaria, according to some estimates, with more heading for Cyprus.

"It is worrying because so many companies are leaving Greece and even if our tax code was brought into line with our neighbours', that will not necessarily make them come back," said Paraskevas.

"We need reasonable tax laws and efficient enforcement, but we also need to change the whole tax culture," he said. "In the past, it has been seen as good to not pay tax, as smart to avoid tax – and dumb to pay it. It was a social thing. But that is already changing, with everything that has happened it is less acceptable to avoid tax, it is dishonourable."

Other social trends are starting to change too, which could make the government's task easier. Controls imposed at the height of the crisis, restricting cash withdrawals to €50 per day, have encouraged greater use of cards for making payments.

This has helped the Greek government implement its policy of requiring payments of above €100 to be made by card, designed to increase transparency for tax authorities and help them collect what they are owed.

Komninos said: "I am not that optimistic about reform of the public sector in the short term, but Greece can do a lot to increase its private sector, which works well. More can be outsourced to the private sector. And Greece must continue to adopt the OECD proposals to open up the economy and liberalise certain professions, which will boost growth. It has already proved itself a good student of liberalisation."

The hope is that these efforts can start to pay off before things get worse for the average Greek. The economic collapse is taking its toll. A study from 2010 found that one in 12 Greeks demonstrated severe psychopathology, while a report from 2011 found there had been a 17% increase in suicides associated with rising unemployment and indebtedness. If austerity continues to impoverish Greeks, these trends will continue.

In fact, things are likely to get worse before they get better.

Schaffrik said: "These measures will be good for the economy eventually, though in the short term making it easier to fire people is likely to be negative for the economy. I don't expect to see a jump in Greek GDP for three to five years, though having dropped so much already in recent years perhaps things will not get too much worse in the meantime."