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## Background

**Greece has been integrated into the European Semester for economic policy coordination following the completion of the ESM stability support programme.** To cater for the specific needs and challenges facing Greece, the Commission also activated enhanced surveillance under Regulation (EU) No 472/2013,[1] effective from 21 August 2018 and extended for a further six months by a Commission Decision of 20 February 2019[2].

**Enhanced surveillance provides a comprehensive framework for monitoring economic developments and the pursuit of policies needed to ensure a sustainable economic recovery.** It provides for a regular assessment of recent economic and financial developments in Greece, as well as for monitoring sovereign financing conditions and updates of the debt sustainability analysis. Enhanced surveillance also provides the basis for assessing the general commitment given by Greece to the Eurogroup of 22 June 2018 to continue and complete reforms adopted under the ESM stability support programme and to safeguard the objectives of the reforms adopted under that programme and its predecessors. In that context, it provides the basis for monitoring the implementation of specific reform commitments annexed to the Eurogroup statement of 22 June 2018 in the areas of (i) fiscal and fiscal-structural policies, (ii) social welfare, (iii) financial stability, (iv) labour and product markets, (v) privatisation and (vi) public administration.[3]

**This is the second enhanced surveillance report for Greece and it is adopted alongside the European Semester country report for Greece.** In the context of enhanced surveillance, the Commission, in liaison with the European Central Bank (ECB)[4] and, where appropriate, the International Monetary Fund (IMF), conducts regular review missions to verify the progress made; the ESM participates both in the context of its Early Warning System and in line with the Memorandum of Understanding of 27 April 2018 on working relations between the Commission and ESM. In preparation of that report, a joint mission to Athens took place on 21 to 25 January 2019.

**This report could serve as a basis for the Eurogroup to decide on the release of the first set of policy-contingent debt measures worth EUR 970 million.** The Eurogroup of 22 June 2018 agreed that the package of debt relief measures for Greece should include incentives to ensure a strong and continuous implementation of the reform measures agreed in the programme. To that end, certain policy-contingent debt measures are made available to Greece on a semi-annual basis up to mid-2022, subject to compliance with its commitments on reform continuity and completion, based on positive reports under enhanced surveillance. Those debt measures include: (i) the return of income equivalent amounts stemming from central banks' holdings of Greek government bonds under the Securities Markets Programme and the Agreement on Net Financial Assets and (ii) a waiver of the step-up interest rate margin for certain loans provided by the European Financial Stability Facility.

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[1] The Commission published its first assessment under enhanced surveillance on Greece on 21 November 2018. See Enhanced Surveillance Report – Greece, November 2018, Institutional Paper 90, November 2018.

[2] The Commission activated enhanced surveillance for Greece under Regulation (EU) No 472/2013 (OJ L 140, 27.5.2013, p. 1), effective as from 21 August 2018 for a duration of six months (Commission Implementing Decision (EU) 2018/1192 of 11 July 2018 on the activation of enhanced surveillance for Greece, OJ L 211, 22.8.2018, p. 1). Enhanced surveillance was prolonged for further six months on 20 February 2019 (Commission Implementing Decision (EU) 2019/1481 of 20 February 2019 on the prolongation of enhanced surveillance for Greece).

[3] https://www.consilium.europa.eu/media/35749/z-councils-council-configurations-ecofin-eurogroup-2018-180621-specific-commitments-to-ensure-the-continuity-and-completion-of-reforms-adopted-under-the-esm-programme_2.pdf

[4] ECB staff participated in the review mission, and in accordance with the ECB's competences, provided expertise on financial sector policies and macro-critical issues, such as headline fiscal targets and sustainability and financing needs.

## Economic outlook

**The Commission expects real GDP to grow at a rate of 2% in 2018 and to accelerate to around 2.2% and 2.3% in 2019 and 2020, respectively.**[5] Domestic drivers of growth (private consumption and investment) should strengthen, while contributions from the external sector may moderate because of the EU's projected economic slowdown and increasing imports.

**Labour market conditions continued improving in the second half of 2018.** The unemployment rate dropped to 18.5% in November 2018, down from its peak of 27.9% in mid-2013 and from 20.8% at the end of 2017. However, long-term unemployment (13.5% in the third quarter of 2018) and youth unemployment (39.1% in November 2018) remain high. Wage developments so far have been subdued.

**Overall, the balance of risks is tilted to the downside.** Consumption growth may be higher than expected in 2019, should the recent increase in the minimum wage translate into higher consumption spending. However, downside risks dominate the forecast. Possible wage pressures pose downside risks both on investment recovery and on export performance due to losses in competitiveness. Risks to investment are exacerbated by the high level of non-performing loans which continues to weigh on the intermediation capacity of banks. Finally, the global and in particular the EU slowdown, may further hamper Greece's recovery.

## Fiscal and fiscal structural policies

**Greece is likely to have over-achieved the primary surplus target of 3.5% of GDP in 2018, which would be the fourth year in a row when targets have been exceeded.** This takes account of wage refunds paid to uniformed personnel and other public officials following a court ruling and the payment of a means-tested transfer ('social dividend'), both implemented at the end of 2018. Based on latest available information, the primary surplus may exceed the level of 3.7% projected in the Commission's Autumn 2018 forecast. Outturn data for 2018 will be available in April 2019, and the scale of the overshooting relative to the primary surplus will, *inter alia*, depend on the underspending on the public investment budget, a trend which is undesirable as it holds back growth potential.

**The 2019 budget adopted in December 2018 is projected to ensure the achievement of the primary surplus target of 3.5% of GDP, thus completing an end-2018 specific commitment.** The impact of measures taken since the adoption of the 2019 budget will need to be factored into the Medium-Term Fiscal Strategy (MTFS) to be updated in May 2019, which will be assessed as part of the third enhanced surveillance report. While the legislated increase in the minimum wage as of February 2019 raises some concerns in terms of its broader impact on the economy, it is expected to have a short-term positive net fiscal impact in 2019. In contrast, the authorities extended the VAT discount on five Aegean islands hosting refugee centres, linking its future elimination to the easing of migration pressures. While the elimination of the discount was an ESM programme commitment, the fiscal cost of the extension is limited at just over EUR 50 million. Moreover, there are signs of upward pressures on the public sector wage bill through excess hirings, which need to be addressed.

**The government has informed the European institutions that they do not intend to proceed in the near future with revisions to instalment schemes for tax debt and social security debt, as they need to undertake further technical analysis and reflection.** It is important to avoid negative risks

[5] The Commission's most recent forecast was published on 7 February 2019: European Economic Forecast, Winter 2019 (Interim), Institutional Paper 096, February 2019. https://ec.europa.eu/info/publications/european-economic-forecast-winter-2019_en

to public revenues and to safeguard the payment culture, as these were core objectives of the reforms in public revenue collection enacted during the financial assistance programmes.

**The Greek authorities have initiated preparatory work on assessing the fiscal impact and risks stemming from court rulings on reforms enacted under the financial assistance programmes.** Based on information provided by the authorities, the 2015 Council of State ruling against important elements of the 2012 pension reform implies negligible fiscal cost in view of the very small number of eligible claimants; however, the question is not yet finally settled as some lower courts have ruled against the restricted eligibility for the compensatory payments and the final ruling on the key elements of the 2016 pension reform is still pending. Another important ruling related to the restoration of seasonal wage bonuses to civil servants is also still pending at the Council of State. Should the Council of State rule in favour of the restoration, this could result in a significant fiscal cost amounting to 1.3% of GDP, of which 1.1% of GDP relates to the retroactive liability and 0.2% of GDP to recurrent costs. Notwithstanding the welcome recent efforts by the Greek authorities, continued efforts and vigilance are required. The Greek authorities should continue to monitor fiscal risks, including court rulings, and are invited to take offsetting measures as needed to meet the medium-term fiscal targets in the context of the Medium-Term Fiscal Strategy (MTFS) and its annual updates. In the event of court rulings overturning key structural elements of reforms agreed under the programme, the recurrent fiscal implications of such rulings would need to be largely addressed by reforms/actions within the same policy field.

**Greece has continued to make progress in the reform of the unified property tax (ENFIA) valuation in line with its mid-2019 specific commitment.** The legal framework for the new system of property valuation has been established, a Property Tax Valuation Unit has been set up, and two key IT projects have been initiated to map electronically zonal boundaries and to systemise the collection of real estate data.

**Although the end-2018 specific commitment to reach a staffing level of 12,000 permanent employees at the Independent Authority for Public Revenue (IAPR) has not been reached, there is scope for further recruitments of staff in the next months.** Overall staffing levels in the IAPR decreased during 2018, from 11,682 to 11,492. The reasons for the shortfall include delays in ongoing recruitment of tax/customs officials and higher than expected exits (mainly through retirements), but also due to a relatively high rejection rate of offers extended by IAPR to successful candidates. In addition, the recently established mobility scheme has not yet resulted in the expected number of transfers to IAPR. The authorities have provided assurances on specific actions to be taken to ensure that the end-2019 specific commitment for 12,500 permanent employees is reached. They include measures to further facilitate the transfers of staff to IAPR from the mobility scheme and proceeding to finalise the human resources reform that will allow for IAPR to attract and maintain its staff.

**In order to ensure that the staffing commitment will be met, the broader reform of revenue collection is further strengthened and with a view to enhancing the overall operational capacity and efficiency of the IAPR across a number of dimensions, the authorities have adopted a set of complementary measures**:

- The IAPR has adopted its reform action plan ("Blueprint") for the period 2019-2021. The Blueprint sets out specific measures and investment that will be required to continue the transformation of the IAPR into a modern, flexible and effective organisation. The authorities committed to cover the additional funds needed for all actions to be delivered (a lump sum EUR 75 million and EUR 5 million as an annual recurring cost).

- The General Secretariat of Information Systems (part of the Ministry of Finance) and the IAPR have reached an agreement on an annual envelope (EUR 5 million in 2019) for procuring IT infrastructure/tools for IAPR.

**However, the authorities need to complete the remaining complementary measures to strengthen the IAPR:**

- The introduction of grading, remuneration and performance assessment tailored to the IAPR is seen as essential in order to enhance IAPR's prospects to attract highly-qualified staff and to allow for their development and progression. Currently intensive discussions are ongoing with the authorities. Provided that these are successful concluded, a legislative amendment to IAPR's enabling legislation is expected to be adopted by the Parliament by early March 2019. Subsequently, that amendment will allow the adoption of secondary legislation to introduce a new grading scheme directly linked with the job descriptions. The final step to introduce a specific remuneration scheme for IAPR will require primary legislation setting out the provisions for a supplementary wage grid and should be adopted by end-2019. This reform is closely connected to the public administration reform area, and in particular the appointment of senior managers in the public sectors.
- Legislative amendments on liability protection and facilitating mobility have been agreed and will be adopted by early March 2019.
- A Joint Ministerial Decision on the procurement of fuel markers is expected to be adopted by early March, which will provide an important tool in the fight against smuggling.

**Greece has continued to reduce its stock of net arrears since the end of the ESM stability support programme (the non-accumulation of arrears is a <u>continuous specific commitment)</u>, but the pace of reduction has slowed significantly and new arrears continue to be created.** The end-December 2018 stock of net arrears stood at EUR 1.4 billion, thus EUR 0.3 billion lower than the end-August 2018 stock of arrears, which is the benchmark for the assessment of the non-accumulation of arrears in net terms. Programme financing and own resources have been utilised to clear arrears. However, the original ESM programme objective of full clearance was not achieved by the end of the programme and new arrears have continued to be created since August 2018, slowing down the progress in the clearance of the stock. Although reforms to address the structural bottlenecks of arrears management and clearance are progressing, efforts need to continue in strengthening the system for arrears clearance, while tackling the causes behind the creation of arrears.

## A modern and sustainable social welfare system: progress with reform commitments

**The rollout of the primary health care system is progressing, despite the pace being slightly slower than envisaged.** Based on the latest reports, around 112 primary health care units (TOMYs) were opened across the territory, just below the nominal target of 120 which is an <u>end-2018 specific commitment</u>. This represents significant progress in what is a critical but very complex reform; the slight shortfall is not material and is largely due to the need to address difficulties and concerns raised by external stakeholders. The authorities are maintaining efforts towards further rolling out TOMYs across the country, including by addressing the need to recruit additional family doctors.

**Centralised procurement activity has resumed as, in line with the <u>end-2018 specific commitment,</u> the main body responsible for central procurement, EKAPY, is operational, though it remains to be fully staffed.** Based on available information, the authorities have achieved the first results in terms of savings, albeit by completing old tenders from 2014. Measures are being taken to enhance the staffing level and the capacity of EKAPY with a view to meeting its procurement targets for the coming years.

**Progress on other aspects of health care reform is uneven, as the authorities have revised some measures adopted under the ESM stability support programme, with an uncertain impact on the efficiency of the system.** These concern the frequency and design of pharmaceutical repricing, which may reduce the efficiency of the framework to contain prices and an amendment to the clawback scheme for past years, which risks reducing the efficiency of clawback collection. As spending still considerably exceeds the legislated ceilings, late collection of the excess in the form of revenues through the clawback may deteriorate the liquidity of the national health insurance, EOPYY.

**The reform of social safety nets has continued.** The review of the system of disability benefits (a specific commitment for mid-2019) is progressing, albeit with some delays with the implementation of the pilot project due to some initial bottlenecks which had to be overcome. The Social Solidarity Income (SSI) scheme is reaching its maturity, with progress being made in the implementation of its social inclusion and labour market (re-)integration elements, to be achieved by end-2019 (specific commitment). The design of the housing benefit has been revised compared to original plans, to only cover rental subsidies. A separate subsidy to support mortgage-holders in difficulty is being considered under a new household insolvency protection framework. Although its design has not yet been specified, from preliminary discussions it seems that such subsidy would target only non-performing mortgages. This would penalise low-income households who still manage to service their mortgage, possibly creating disincentives for regular loan servicing.

## The financial sector

**Despite progress made in the context of the financial assistance programmes and the improved liquidity situation of Greek banks, Greece's financial system still faces important challenges, in particular the very high levels of non-performing loans (NPLs).** Taking into account *inter alia* the high level of deferred tax assets on bank balance sheets, the sovereign-bank nexus remains strong and capital controls are still in place, though they have been gradually relaxed (implementation of the agreed roadmap is a continuous commitment, which has been met). Financial sector reforms are a dominant focus of enhanced surveillance given its critical role in creating the conditions needed for sustainable growth.

**The reduction of NPLs has continued, although the take-up of tools for their resolution lags behind expectations.** The stock of NPLs has been gradually decreasing, but remains elevated and according to the latest available data amounted to EUR 85 billion or some 47% of total exposures in September 2018. Banks meet their NPL reduction targets, which will become increasingly challenging over the next years. At the same time, banks' profitability is under pressure and, combined with the high level of deferred tax credits on their balance sheet, constrains the pace of NPL reduction. The number of e-auctions continued to rise in the fourth quarter of 2018 and the coverage of the territory is almost complete; however, the failure rate of the auctions remains high and a large share of successful auctions still leads to the purchase of the asset by the bank that launched the auction. Further efforts are needed in order to address these shortcomings, as part of the measures to fulfil the end-2018 specific commitment to support the resolution of NPLs. Further progress in addressing impediments which may include both legislative measures and operational improvements of the system will be essential in this respect. Moreover, the recent major reform of the corporate insolvency law has not yet contributed to the expected increase in take-up by stakeholders. Given their importance in the efforts of banks to accelerate NPL reduction, it would be warranted for the authorities to further investigate the need to improve legal clarity and certainty regarding the scope of each of the NPL servicing/sales and securitisation laws and to facilitate a wider take-up of these tools.

**The use of the out-of-court workout (OCW) mechanism is showing signs of progress after a slow start.** The infrastructure is being upgraded to ensure an unhindered and increasingly automated operation. In December 2018, the authorities prolonged the OCW law by one year, until end-2019. While this prolongation is welcome, the authorities have also adopted some amendments to the framework which raise concerns as regards their impact on multilateral restructuring and on the duration of public-sector restructuring procedures and which would need to be reassessed.

**The low processing rate of called State guarantees related to bank loans is in urgent need of improvement.** The backlog in processing guarantees puts a significant burden on the banks. The authorities have acknowledged the issue and should take concrete actions to speed-up the processing and repayment. The authorities have also passed a legislative provision to remove uncertainty as regards the enforceability of guarantees; the provision is currently under assessment.

**The expected expiry of primary residence protection under the household insolvency law and speculations about possible new debtor protection schemes led to a sharp increase of new filings of applications in the fourth quarter of 2018.** While the rate of processing cases also increased, the spike in applications implied that the backlog of cases did not materially diminish in the fourth quarter. This is bound to adversely affect the pace of processing pending cases by courts. In that respect, the action plan to reduce the number of pending cases in the context of the household insolvency law would need to be further updated and specified with concrete elements which would support the credibility of a well-identified trajectory leading to the elimination of the backlog by end-2021, as included in Greece's post-programme commitments. At the same time, some progress has been made in enhancing the case-processing capacities of courts through new staff appointments and through the financial training of judges, the latter being a <u>specific commitment for end-2018</u>).

**The authorities shared their legislative proposals for a new scheme for the protection of primary residences, but a large number of important open issues remain.** The protection of primary residences under the household insolvency framework was agreed to be a temporary crisis measure ending end-2018. However, the protection was unilaterally extended in December 2018 by two months, during which the authorities presented a new protection scheme that also offers a limited state subsidy component to the borrower. Based on a preliminary assessment, the proposal raises serious concerns regarding its impact on the payment culture and bank balance sheets and its overall design could enable strategic defaults. In particular: (i) the proposed eligibility perimeter would be significantly wider than under the current primary residence protection, including business loans; (ii) the proposal would create an additional protection scheme that would apply in parallel to the existing household insolvency law; (iii) the replacement scheme appears to require banks to accept mandatory pre-defined debt restructurings for a large group of eligible borrowers; (iv) the proposal is not sufficiently targeted to the most vulnerable and interacts directly with several other proceedings, such as bankruptcy/special administration, OCW, concluded NPL sales and securitisations; (v) the proposal risks creating further delays for debtors with pending applications under the existing protection scheme and who apply for the new scheme, as all pending proceedings would be suspended until the new restructuring procedure is completed; (vi) no impact assessment of the new proposal has been provided, for example on the potential impact on the capital base of banks; (vii) the wide scope puts the authorities' commitment to eliminate the backlog of all household insolvency applications by end 2021 at risk; (viii) new stays on enforcement introduced by the proposal would be expected to affect future auctioning and foreclosure proceedings; (ix) additional clarity on the fiscal aspects of the scheme is required. Discussions with the institutions are ongoing with a view to address the open issues. The authorities have also launched a formal consultation of the ECB on their legal proposal, while any new scheme will require State aid approval by the Commission.

**There has been progress with regard to the work of the Hellenic Financial Stability Fund**. More specifically and in line with the end-2018 specific commitment, the HFSF has developed its exit strategy for the sale of its shares in the four systemic banks. While the strategy will be implemented by the HFSF as an independent institution, the potential involvement of the authorities in the final stage of the divestment is still subject to consideration. The authorities have clarified that in their view the alignment of the mandate of the selection panel with that of the HFSF (end-2018 specific commitment) does not require a legislative amendment; this is subject to confirmation by the Legal Council of State. In line with the HFSF law, the Minister of Finance should complete the appointment of the Deputy CEO of the HFSF and the vacant General Council position on the basis of the shortlist produced by the Selection Panel. The setting up of the four systemic banks' operational framework following their restructuring plans and the exit strategy are closely intertwined, and the HFSF has been working on those two issues in parallel.

**The Greek authorities are exploring additional initiatives to support NPL reduction efforts, working with stakeholders including the HFSF and the Bank of Greece.** The authorities recently sent a draft proposal to the Commission services with a proposal for a type of asset protection scheme which aims at accelerating the ongoing NPL resolution efforts. The proposal will need to be assessed from a State aid perspective.

## Labour and product market reforms

**Reforms of labour market institutions and the wage bargaining framework in recent years have helped Greece regain cost competitiveness and are contributing to increasing employment rates and falling levels of unemployment.** The implementation of those reforms over the long run is critical to Greece achieving sustainable economic growth. The functioning of the labour market is being supported by the implementation of an action plan on undeclared work and ongoing efforts to strengthen active labour market policies.

**The government has increased the statutory minimum wage by 10.9%, effective as of 1 February 2019, and abolished the sub-minimum wage for persons aged under 25 (implying an increase of 27% for this group).** In making the revision, the authorities formally followed the procedure (an end-2018 specific commitment) laid down in Article 103 of Law 4172/2013 which consists in the gathering of analysis by different institutions, a consultation with the social partners, and the publication of a report with recommendations by a committee of independent experts specifically appointed for this purpose. The Commission nonetheless considers that important lessons should be drawn for the next revision of the minimum wage due in June 2020. The quality of dialogue with social partners could be improved, and the committee of experts would need to take on board the concerns of the institutions as regards significant analytical shortcomings on the estimate of the share of minimum wage workers. Moreover, the transparency and credibility of the process would be further improved if explanations were to be provided in case that the final increase decided by the government deviates from the recommendation issued by the committee of experts.

**The double-digit percentage increase raises concerns as regards the medium-term implications for growth and competitiveness.** Some increase in the statutory minimum wage was to be expected and is indeed welcome as its level had been frozen since 2012. In the near term, the increase may have positive effects in terms of increased disposable income and consumption. However, the employment prospects of specific groups may be negatively affected, and the medium term implications warranted very careful consideration for several reasons:

- Even prior to the large legislated increase, the level of the minimum wage in Greece was already at the levels seen in many euro area countries, both in absolute terms and as a proportion of the median wage. An increase of almost 11% is well above the projected rate of productivity growth for Greece in the coming years, and thus will entail a material loss in relative cost competitiveness compared to euro area and other peer countries.

- Although estimates differ across economic studies, the magnitude of the increase, combined with the fact that a relatively large share of workers earn the minimum wage in Greece, increases the risk of negative employment effects, especially on low-skilled and young workers. It is worth recalling that Greece has lower employment rates and much higher (youth) unemployment rates than other euro area countries, and that other former programme countries have adopted a more prudent and gradual approach to revising the level of their minimum wage shortly after programme exit.The increase in the minimum wage has the potential to raise the incidence of undeclared and under-declared work, which is still considered to be widespread in Greece.

- A critical issue is the extent to which the minimum wage hike has spill-over effects on the wider wage distribution, in particular through collective wage negotiations and the extension of sectoral collective agreements. It would be important for the government to assess the direct consequences of the minimum wage increase on the labour market, while also monitoring the broader evolution of collectively bargained wages. This includes both the signing of new sectoral agreements that could then be extended, as well as the outcomes of arbitration decisions.

**Product market reforms have progressed.** Under the investment licensing reform, the enabling legislation on installation and operation licensing procedures for environmental infrastructures has been adopted with the issuance of a joint ministerial decision, thus completing the end-2018 specific commitment. The authorities have proceeded with preparatory work for the commitments with deadlines in the outer years. Work is progressing well on the cadastre and the forest maps. However, the establishment of the new Hellenic Cadastre agency has seen some delay as regards managerial appointments and the integration of the mortgage offices. More efforts would need to be devoted to those actions (which are specific commitments for outer years). More broadly, there would also be scope for more ambition on wider product market reforms with a view to improve Greece’s standing in doing business and attract investment.

**The reform of the energy market has progressed, albeit at a slow pace and with some open issues remaining.** The divestment of the Public Power Corporation (specific commitment for end-2018) has been delayed as the tender process did not yield any successful bids. Steps to remedy this situation need to be agreed with the Commission, and the authorities have signalled their intention to submit a new proposal by early March 2019. The Commission invites the authorities to ensure that the new proposal is sufficiently detailed so as to enable an informed assessment to be made as to whether adequate progress is being made towards complying with the antitrust remedies and the end-2018 specific commitment. The government made important first steps towards the implementation of the Target Model for electricity (specific commitment mid-2019) with the publication of the spot (day-ahead and intraday) and balancing market rulebooks. While the project has experienced delays compared to original plans agreed in June 2018, the Target Model appears on track to go live by October 2019, with the full launch of the intra-day, day-ahead and balancing market. Further delays should be avoided. Electricity (NOME) auctions are proceeding in line with the adopted mechanism for the correction of quantities to be auctioned. Given the close link of the correction of auctioned quantities to the lignite divestment, the scheduled joint assessment will start later than planned, and the potential need for alternative policy or structural measures will be considered in that context.

### HCAP and privatisation

**The implementation of the strategic plan of the Hellenic Corporation of Assets and Participations' (HCAP) has proceeded as planned (continuous specific commitment).** HCAP proceeded in December 2018 to the preparation of its business plan for the period 2019-2021, implementing the strategic plan and setting quantitative and qualitative key performance indicators for its direct subsidiaries and the other non-listed subsidiaries. HCAP also continued making progress on its asset portfolios and the restructuring of its subsidiaries. The restructuring of the real-estate subsidiary (ETAD), which was a specific commitment for end-2018, has been completed according to plan.

**HCAP continues its work on the governance of State-owned enterprises (SOEs), in particular regarding the review (and replacement, if needed) of the boards of the SOEs, and improving internal and external audit capabilities.** The implementation of the Coordination Mechanism setting out the procedures and deliverables for interaction between the State, HCAP and SOEs has been launched. The authorities have agreed to address the legislative cap on the remuneration of SOE board members that leads to obstacles in attracting applicants through the adoption of a legislative amendment in time for the third enhanced surveillance report. The transfer of the Olympic Centre, OAKA (an end-2018 specific commitment), however, will take significantly longer to complete than initially planned: this is partly due to the complexity of the project and partly to delays within the control of the government. The authorities have developed a roadmap for specific actions to be taken during 2019 to address the open technical issues, which appears appropriate in light of the complexity of the project.

**The authorities continued implementing the asset development plan (ADP), and there has been good progress with the transactions scheduled as specific commitments for completion by the end of 2018.** The ADP was updated in December 2018 as foreseen. The transaction of the Natural Gas Transmission System Operator (DESFA) and the concession of the Athens International Airport have been successfully concluded, generating combined privatisation proceeds of some EUR 1.4 billion. The authorities have continued their efforts to complete conditions precedent for the transfer of Hellinikon shares to the developer. Nonetheless, the project has encountered some delays due to factors beyond the control of the government, such as delays on the casino licencing process and on the approval of certain urban planning and environmental studies. As key intermediate steps, the request for proposals for the casino license has been launched and the urban planning and environmental studies by the investor have been submitted.

**Progress on some privatisation transactions that are due to be completed by the end of 2019 is welcome, but the overall picture is clouded by recurrent delays on other transactions.** Satisfactory progress has been made in the tender for the long-term concession of the marina of Alimos and further steps have been taken to prepare the joint sale (along with the other strategic shareholder, PanEuropean Oil and Industrial Holdings S.A.) of a majority stake in Hellenic Petroleum. In addition, obstacles to the privatisation of regional ports, that were reported in the first enhanced surveillance report, have been resolved. By contrast, the concession of the Egnatia motorway continues to face recurrent obstacles: in January 2019, the authorities agreed to a number of actions to be swiftly implemented by the authorities and Egnatia S.A. in order to deal with these obstacles.

However, to date only a limited number of these actions have been implemented, while a range of substantial actions to remove obstacles remains to be completed, notably with a view to providing adequate financial and staff resources to Egnatia S.A.

## Public administration and the justice system

**Progress with advancing public administration reforms has been uneven.** As regards the end-2018 specific commitment on the recruitment of senior managers in the public administration, the appointment cycle for 90 Directors-General has been completed. However, none of the expected 69 appointments of Administrative Secretaries has been made to date. In view of this very significant shortfall to target, the authorities have adopted a series of complementary measures which have the aim of ensuring that the core objectives of the reform remain on track. These measures include the adoption of a critically needed law to introduce more long-term recruitment planning and to closely link it with the medium-term financial strategy (MTFS). Further, the authorities have firmed up on the modalities of the independent assessment of the selection process that is planned to be completed by mid-2019 with recommendations to be followed up on by September 2019. The third cycle of the mobility scheme was launched in August 2018 with a view to be completed as a specific commitment by mid-2019, while the fourth mobility cycle is planned to be launched by the end of February 2019. While the use of the mobility scheme has been steadily increasing, the transfers related to the previous two cycles are still to be finalised. The authorities have continued their solid progress towards establishing an integrated Human Resource Management System which is a specific commitment for the end of 2019). Finally, the authorities are progressing with an important HR reform relating to the public revenue administration that initiated the implementation of linking grading to job descriptions. This will act as the first-stage implementation of a pilot for a wider public administration reform linking skills and tasks to a supplementary remuneration system.

**Recent hiring announcements by the authorities raise concerns regarding the achievement of the authorities' staffing and wage bill targets.** The hiring ceilings for permanent staff set by the 1:3 attrition rule in 2018 were slightly exceeded by around 1,000 staff. While the small deviation reflected unforeseen developments (mainly fewer-than-expected retirements) and could be absorbed over time, announcements by the authorities on the hiring of permanent staff in 2019, if fully implemented, would lead to a further breach of the attrition rule by close to 1,800 staff. The increase in temporary staff has been more significant, with the ceiling for 2018 exceeded by 1,500 posts, while other categories not accounted as part of the ceiling, most notably public entities of private law, have seen a considerable increase of staff since 2016. It will therefore be key for the authorities to continue paying close attention to the evolution of the public sector headcount, keeping within the replacement rule (1:1 from 2019 onwards) for permanent hiring but also reining in the trend of increasing temporary staff, so as to avoid a return to the pre-crisis excessive number of public servants and corresponding pressure on fiscal targets.

**There has been mixed progress in the efforts to increase the efficiency of the judicial system.** The first phase of the Integrated Judicial Case Management System (OSDDY/PP), an end-2018 specific commitment, was completed on time and the second phase will follow. However, setbacks to the operation of the new framework of out-of-court mediation, an important reform adopted under the ESM stability support programme, need to be remedied as soon as possible. It is also critical to ensure that efforts are deployed towards the speedy and thorough implementation of all actions of the project, and more broadly, of the ongoing three-year strategic plan for Justice.

**The authorities have continued their efforts to fight corruption on a number of areas included in the National Anti-corruption Action Plan for 2018-2021.** The authorities are finalising legislative proposals, to be submitted to Parliament over the next three months, related to (i) establishing a legal framework to protect whistle-blowers in the public and private sectors; (ii) internal auditing across the public administration; and (iii) an update of the mandate of the General Secretariat of Anti-Corruption. The setting up of a coordination mechanism for corruption cases will warrant particular attention in the coming months.

**The Commission has continued monitoring developments in relation to the legal proceedings against the members of the Committee of Experts (CoEx) of TAIPED and the former President and senior staff of the Hellenic Statistical Authority, ELSTAT, in line with the request of the Eurogroup of 22 June 2018.** Regarding the CoEx, the Supreme Court Council admitted the appeal against a ruling referring the case to a public trial, and referred it back to the council of the Court of Appeal. In January 2019, the latter's prosecutor submitted his proposal to the council, concluding in favour of a dismissal of the charges against the defendants. The case is currently pending before the Court of Appeal. In the case against former ELSTAT President Georgiou related to the publication of fiscal statistics, there have been no further developments in comparison to those described in the previous enhanced surveillance report. The case continues to raise serious concerns, and underscores the importance of providing adequate protection for officials in charge of statistical reports to underpin confidence in the integrity of statistical data. The Commission will continue to closely monitor developments in both procedures and to report back in the context of enhanced surveillance.

### Overall assessment on progress with reform commitments

**Greece has made considerable progress in completing the implementation of the specific reform commitments annexed to the Eurogroup statement of 22 June 2018 which were to be completed by end-2018.** More specifically:

- **The following specific commitments for end-2018 can be considered as having been achieved**: (i) the adoption of a budget for 2019 which should reach a primary surplus target of 3.5% of GDP; (ii) the non-accumulation of net arrears, though additional efforts are still needed to clear the backlog and avoid the build-up of new arrears; (iii) the opening of a critical mass of primary health care centres (TOMYs); (iv) the completion of important steps to ensure centralised health care procurement; (v) the relaxation of capital controls in line with the agreed roadmap; (vi) the definition and adoption of the HFSF divestment strategy, with the potential involvement of the authorities in the final stage of the divestments still under consideration; (vii) the adoption of enabling legislation for investment licensing; (viii) the revision of the minimum wage formally in line with the legislated procedure, although the magnitude of the increase raises risks for employment and competitiveness; (ix) the completion of phase I of the e-justice project; (x) the implementation of the HCAP strategic plan; (xi) the restructuring of ETAD and launch of the implementation of the coordination mechanism for SOEs falling under HCAP in light of delays in the transfer of the Olympic Centre (OAKA); (xii), the updating of the Asset Development Plan of the privatisation agency (TAIPED), the completion of key privatisation tenders including the gas transmission network (DESFA) and the extension of the concession for Athens International Airport, as well as the completion of key steps related to the Hellinikon project; and (xiii) the authorities have agreed with the Commission on the modalities to carry out an independent assessment of the appointment process for the Administrative Secretaries and Director Generals by mid-2019, and have adopted key legislation to improve recruitment planning in the public sector and linking the multi-annual hiring plan with the MTFS.

- **There is a broad understanding on the actions required to complete the following specific commitments for end-2018: however, these reforms will only be considered as fully completed once all of the agreed measures are enacted:** (i) the adoption of legislation related to the corporate restructuring of DEPA; (ii) the completion of all agreed measures to keep the Egnatia transaction on track for completion in 2019 in line with the updated Asset Development Plan of TAIPED, and (iii) the appointment of the Deputy CEO and vacant General Council position at the HFSF and confirmation on the mandate of the Selection Panel by the Legal Council of State.

**Intensive discussions are still underway between the Greek authorities and the European institutions on the following end-2018 specific reform commitments and it is urgent to reach an agreement in the near future**. More specifically:

- The commitment to implement reforms aimed at restoring the health of the banking system is currently not met. Discussions are still ongoing regarding a proposal of the Greek for a **new system of protection of primary residences** to replace current protections under the Household Insolvency (Katseli) law (expiring at the end of February 2019). The European institutions have shared their observations and concerns. There are a large number of design and technical details which need to be settled so as to ensure that the scheme is genuinely temporary, properly targeted to protect the most vulnerable households and does not encourage strategic defaults. Further analysis is required to fully understand the potential impact on the banks' balance sheet and to quantify the fiscal impact. The authorities sent a request for a legal opinion to the ECB on 19 February 2019, and any new scheme will require State aid approval by the Commission. The European institutions are committed to work with the Greek authorities to find an agreement on a scheme that does not give rise to serious concerns, which requires significant changes on several key parameters. Secondly, shortcomings in legal frameworks relevant to NPL resolution should be addressed. The action plan to reduce the number of pending case under the household insolvency law would need to sufficiently specify how the target of the elimination of the backlog of cases by 2021 could be reached, and how the newly proposed scheme for protecting primary residences will affect progress. Impediments to the successful conduct of e-auctions should be addressed. Also the current action plan on State guaranteed-loans needs to be updated and made sufficiently ambitious.

- Further steps are needed to complete the complementary measures to address the shortfall on staffing levels of the **Independent Agency for Public Revenue**. In particular, the authorities need to adopt a legislative amendment to IAPR's enabling legislation. This would also contribute to the wider public administration reform agenda, where the commitment to appoint Administrative Secretaries is significantly delayed.

- The commitment related to the **divestiture of lignite plants** has not been completed, following a failed auction process. Discussions between the Greek authorities, PPC and the Commission are still underway to find an acceptable remedy to the antitrust case in line with the requirements of EU law. This is an important setback to the achievement of a critical structural reform, which aims to introduce competition, attract investment, raise competitiveness and thus support potential growth.

**Beyond the completion of specific reform commitments due for the end of 2018, and taking into account the general commitment to continue and complete reforms, developments in some areas raise concerns about reform delivery and continuity, including with a view to risks to the medium-term outlook.** This relates to several of the end-2018 specific commitments as well as the general commitment to safeguard key reforms enacted under the programme. Concerns arise in particular on:

- *The level of ambition in tackling remaining structural fiscal challenges and avoiding the creation of new fiscal risks including on recruitments in the public sector:* While no new arrears have been accumulated in net terms, progress with bringing arrears closer to zero has slowed down, and structural obstacles impeding a solution to arrears creation remain to be tackled with a higher level of ambition. With a view to avoiding fiscal risks, possible proposals on instalment schemes need to be considered with great caution; if poorly designed, such schemes could undermine public revenue collection and the payment culture. The level of permanent staff in the public sector at the end 2018 was somewhat above the authorities' one-to-three replacement rule, and the numbers of some categories of temporary staff are also on the rise. Whilst the authorities have indicated their general intention to make the necessary adjustment to the recruitments of permanent staff in 2019 so as to keep the public sector headcount stable, this does not appear to be consistent with other announcements of planned recruitments: it would be important from both a fiscal and a structural perspective to respect existing commitments on the size of the public sector. Finally, the authorities have sent mixed signals on their intentions to proceed with major growth-friendly tax reforms in 2020 involving the widening of tax bases and the lowering of tax rates on corporates and labour.

- *The pace of progress and degree of priority attached to measures needed to restore the banking sector to robust health.* The authorities have indicated that they recognise the importance of addressing the challenges in areas such as e-auctions, out-of-court workout, household insolvency backlogs and State guarantees. Work on systemic instruments to achieve a faster pace of NPL reduction is welcome, though its pace has so far been relatively slow and lacking a clear orientation to markets. Coordination across government departments and vis-à-vis relevant stakeholders, such as the Bank of Greece and HFSF, should be improved so as to ensure the design and implementation of coherent polies commensurate with the challenges and risks facing the Greek banking sector. More generally, it will be key for the authorities to resist pressures to address problems of indebtedness through across-the board solutions which, by protecting strategic defaulters, exacerbate risks of moral hazard and further undermine payment culture.

- *The commitment to safeguard wage competitiveness over the medium term and to establish an environment which is genuinely business and investment-friendly*. A possible short-term positive impact on economic activity from the legislated significant increase in the minimum wage risks coming at the potential costs of lower employment growth and a sustained loss of competitiveness. Higher wages can be justified if supported by underlying productivity growth. More generally, while the authorities have made welcome progress in the completion of some privatisation tenders and some structural reforms (e.g. cadastre) that are important for the business/investment climate, Greece continues to lag behind in international competitiveness indicators and investment activity remains subpar. Delays in certain key privatisations (e.g. Egnatia) and the persistent failure to achieve material structural change in energy markets linked to the dominant position of PPC are not conducive to a compelling reform strategy that supports investment and potential growth, which is a key priority for the Greek economy going forward.

## Sovereign financing and debt sustainability analysis

**Greece raised EUR 2.5 billion by issuing a 5-year government bond at the end of January 2019, the first bond issuance since February 2018, i.e. also since the end of the ESM programme.** The transaction attracted demand over four times in excess of the issued amount. This allowed the yield to be 3.6%, lower than the originally planned range of 3.75-3.85%. While this has been a positive development, it also shows that Greece's yield spreads remain elevated and sensitive not only to external market conditions but importantly also to domestic factors.

**Greece' sovereign financing profile remains favourable in the medium term.** There have been no significant changes in the roll-over risks of Greece's public debt since the enhanced surveillance report published in November. Greece still benefits from a debt structure with extremely long maturities and favourable interest rates. Medium and long-term amortisations remain moderate. Greece also benefits from a large amount of State deposits, which stood at EUR 26.8 billion at the end of 2018 and which, driven by amortisation and without new issuances, is projected to reach EUR 16.1 billion by the end of 2019.

**A technical update of the debt sustainability analysis (DSA) shows that the assessment of the sustainability of Greece's debt has remained broadly unchanged from the last DSA update published in November 2018.** Under the baseline assumptions, Greece's gross financing needs (GFN) will hover around 10% of GDP until 2032. Later, GFN starts to increase slowly, but is projected to remain sustainable at around 18% of GDP by 2060.