Why was there no agreement between the Greek government and the Institutions?

Briefing prepared by Euclid Tsakalotos,

Coordinator of the Greek Negotiation Team

Any breakdown in negotiations is unlikely ever to have one cause. This is especially true when, as in the case of the Greek government, we were negotiating with three institutions which did not always see eye to eye on the desired details of any agreement, let alone over the wider strategic issues such as the question of whether the Greek debt is sustainable and needs to be re-profiled. All sides have claimed that they showed the maximum amount of flexibility in order to ensure an agreement. Unfortunately this is a claim that is not easily supportable with respect to the negotiating stance of the institutions.

1) Fiscal Targets and Fiscal Measures

The Greek government agreed to quite recessionary targets for fiscal surpluses for the coming years, especially when one considers the income loss (25%) over the last five years and the huge unemployment rate we face. In this context one would have expected the institutions to be quite "flexible" – their favourite word – over how we reach those targets. Not at all:

- **They insisted** that for 2016, the fiscal package must include 1% of GDP from the VAT. We were told that increasing the VAT rate on restaurants/catering to 23% would constitute a "deal maker" – another favourite word. But on the last day of the negotiations, the institutions changed their stance. Even though the two sides at the technical level had previously agreed what such an increase could be expected to raise in tax revenue, they now said that the sums could only add up if both catering/restaurants **and** hotels were increased to the highest VAT rate. Given the effect of such changes on Greek tourism, it was a little strange to hear the institutions claiming that it was the Greek government that was proposing measures that would harm the competitiveness of the Greek economy.

- **They insisted,** also that for 2016, the fiscal package must include 1% GDP from the pension side. The Greek side had proposed a serious reform proposal on pensions, including cutting early retirement arrangements and raising the effective retirement age. We also proposed to set up a serious actuarial study which could have led to proposals for new reforms to be introduced once the economy turned around, and unemployment began to fall. But when you insist on 1% GDP from pensions for 2016, you are insisting on pension cuts not pension reform.

- **They insisted** that no administrative measures could be included in the fiscal package to close the fiscal gap. Now it is certainly the case that administrative measures, such as fighting corruption and tax evasion, take time to bear fruit. But it is another matter not to allow **any** revenues whatsoever from such measures to be included in the proposed fiscal package. And this is even more extraordinary in the case of this government that ran the election on an anti-corruption and anti-tax evasion programme.

- **They were reluctant** to accept measures that would have been paid by the elites and the richer sections of society, claiming that this was anti-developmental. Thus they did not accept the lump-sum levy on the profits of firms with over 500,000 profits, while at the same time they proposed that all businesses, small or large, prepay 100% of their taxes for the following year. For reasons best known to the institutions, the latter was presumably deemed developmental.

- **They insisted** that wage decompression in the public sector, not in itself necessarily a bad move, should be carried out in both directions. That is to say that the wages of the poorest public sector workers should be continued to be cut.

2) <u>Structural Reforms</u>

The institutions never accepted that in the spirit of the February 20 Eurogroup decision, the Greek government could propose, at least some, reforms based on a different logic. For they insisted that the privatization list be extended, and that workers should face real wage cuts as they would be required to increase their social and health contributions. Moreover:

- **They never accepted** that the Greek government could, in cooperation with the ILO, quickly introduce a system of collective bargaining, something that already exists in most of our partner economies. For us such a system can contribute to a new productive model in which firms succeed through innovation and searching for new markets, rather on the basis of poor wages and poor labour relations. Delaying this reform merely allows firms to continue sacking workers on, say, 700 euro a month, and replacing them with others on 500 a month. Hardly an approach to ensure a vibrant new economy.

- **They never accepted** that the Greek government, this time in cooperation with the OECD, could set out a new reform agenda for product markets, different from that of the previous governments. On the contrary they insisted that liberalizing pharmacies and bakers was somehow crucial to addressing the competitive deficit of the Greek economy. We, on the other hand, argued that we should go for the big fish first; that is to say start with important cartels in certain industries, public procurements, and anti-corruption measures. We further argued that the correct sequencing of supply side reforms was crucial to their success, and that the OECD agreed with us that, in the past, a failure of sequencing was in part responsible for the failings of the structural adjustment policies in Greece.

3) Financing

The financing of any extension of the programme was planned to continue on the old model: reform-disbursement-payment, with multiple reviews one after another. These financing arrangements would have relied on IMF disbursements, which could not be taken for granted. Moreover they would have not addressed the issue of arrears, delayed payments to our own citizens, and would have provided precious few buffers for unforeseen events. The above would hardly have provided the fiscal space for the government to have been able to concentrate its attention on its ambitious reform agenda.

Moreover with respect to problem of the debt, we were offered a slightly improved version of the November 2012 promise of the Eurogroup to reconsider the issue of debt after the summer. The modest proposal to shift bumpy ECB debt into less bumpy, and longer term, ESM debt, without providing any more money for the Greek government itself, was never seriously considered.

Conclusion

It is difficult to believe that the proposal of the institutions would have put aside, once and for all, the question of Grexit. It would have merely pushed it back till the moment that a new programme, and the debt, were negotiated. In this context it is difficult to believe that the pent up demand in Greece would have been released: that consumers would have increased their consumption; that citizens would have returned their money, from abroad or from under the mattress, back to the Greek banks; that investors would have invested. It is difficult to believe, in other words, that the economy would have turned around, that we would have been able to keep our promises on fiscal surpluses.

So what does the Greek government think of the proposed flexibility of the Institutions? It would be a great idea. We see the referendum as part of the negotiation process, not in lieu of it. So we look forward to greater flexibility in the days to come.