NEGOTIATING WITH TROIKA: A STOP AND GO EXERCISE ON THE SLIPPERY SLOPE

The coalition government was formed last June on high hopes for a swift conclusion of discussions with troika based on the assumption that Greece at last will start implementing reforms and that our partners cum creditors will offer some token gifts or sweeteners so that the bitter pill is swallowed with the minimum of social and political turbulence.

As usual in this Greek contemporary drama hopes were soon dashed. Since early July we are witnessing unfolding in front of our eyes a parody of negotiations. As time goes by the Greek government is forced to abandon its reservations on major issues and Troika is pushing for more bloodletting.

First, the Greek side has adopted the usual lazy attitude on implementation regarding the previously (March 2012) agreed commitments most of them characterized as prior actions (to disbursement). Major reforms have been shelved due to the double elections and the mistaken belief that over time somehow the creditors will forget about them. The illusion of "renegotiation" played a key role in neglecting implementation at least over the summer. Political and ideological "baggage" of the coalition parties has prevented the elaboration of a realistic approach to the initial negotiation platform. The "untouchables" of the civil service remain to this day a source of friction with Troika and irritation with the general public. Eventually this grand coalition government became a "one issue" government like the ones before it: the one issue being negotiations with Troika on a full time basis. A lonely Minister of Finance was confronting the Triumvirate with little support from his colleagues and under constant fire by at least one of the leaders of the coalition parties.

Second, Troika has been burnt by consistently underestimating the impact of measures on the economy and thus on achieving targets. Growth estimates were revised downwards every quarter while debt sustainability exercises became irrelevant within months. The design of the first package (May 2010) was faulty as reforms were not frontloaded and poorly sequenced. As we all know career bureaucrats have to look first and foremost after their career. This time with the Greek side on the ropes waiting for the release of the huge tranche of 31.5 billion euro, they seized the opportunity to open all outstanding issues and cover all possible eventualities. Their demands came in waves one after the other and the new package will lead Greece into deeper recession in 2013. It seems that Troika's vision of Greece is increasingly closer to a new Bulgaria rather an Ireland of the south.

Third, the creditors (EU/ECB/IMF) have multiple problems to address at the political level and were unable to reach a consensus on how to react to a failing salvage operation. Successive rounds of austerity, the destruction of investment climate, capital flight and the ensuing liquidity constraints have taken their toll on the real economy. Even the best of reforms at a time of deep and prolonged recession will not lead to any automatic recovery. It is clear that the patient is not responding to the medicine. Something is missing from the policy mix. The European Union has probably to recover from the deep freeze some of Mr. Hollande's ideas on a growth dimension. The IMF is increasingly raising the issue of debt sustainability again as projections are indicating debt levels of 140% of GDP in 2020[1]. The question is whether Ms. Merkel will finally accept the need for a slight change of direction regarding austerity as the issue of a further debt reduction has been ruled out.

In this context it comes to no surprise that the two sides have failed to agree so far this week and the Greek prime-minister Mr. Samaras will go to the European Council on the 18th without having a full agreement in his hands. This is not a tragedy provided that this delay does not conceal more fundamental differences of opinion especially among the Troika members regarding the sustainability of Greek debt.

The main outstanding issues of negotiations involve two themes:

(a) Labor market reforms and in particular the level of redundancy compensation in the private sector and the abolition of automatic pay increases based on maturity (every 3 years), and
(b) Firing of civil servants with the government proposing a system of transferring civil servants to a reserve pool for a year before lay-offs.

[1] This is another point of friction between the Greek side and Troika. The Greek side insists that the desired debt to GDP ratio can be achieved by raising the denominator while some Europeans still believe that more emphasis should be given to the reduction of the numerator. A technical way of resolving the issue is to agree that the 120% debt/GDP ratio is achieved at a later date for instance 2025 instead of 2020.

Labor relations policies are important for the stability of the coalition government as the two junior partners (PASOK/DIMAR) rely heavily for their support on trade unions and they are reluctant to accept any further reduction in workers protection. A new round of discussions among the coalition partners is expected today but final decisions will be taken after the European Council when negotiations with Troika resume.

The fiscal package has largely been agreed with Troika insisting on 9 billion of measures for 2013 as opposed to the 7.8 billion included in the Draft budget. This estimate is based on the macroeconomic scenario for 2013 with Troika initially estimating a recession of -5% as opposed to the government estimate of -3.8%. There are indications that Troika is revising their estimate downwards to a figure of about -4% and that will leave some room for maneuver by the Greek side.

In conclusion, the long delays in negotiations has led Greece to the verge of collapse and todays dramatic statement in Parliament by the Minister of Economics Mr. Stournaras that **"either we take the next tranche or we die from suffocation"** is an indication of the gravity of the situation. He also added that "without the two year extension for the debt to become viable the primary surplus should have reached 4.5% of GDP in 2014 and that would have required measures of 18 billion euros over the next two years. Now, if the extension is granted measures will be of the order of 13.5 billion and if things develop as we expect, we should not take any new measures in the coming years".

However, the dramatic tone used by the Minister of Economics may also reflect the changing political tactics of the government as they come closer to the vote for the measures. It is a sensible way of putting pressure to MPs that they are engaged in loose talk all this time but they have soon to face the consequences of their decision.

A decision on the release of the tranche may be taken, following a positive Troika report, at an extraordinary Euro-group meeting towards the end of October or at the regular Euro-group meeting on the 12th of November. The latter is too close for confort to the point of asphyxiation.

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