Number 79

2 June 2016

Economic Bulletin

NO END TO THE GREEK TRAGEDY

- Greece's latest round of fiscal consolidation will hamper economic growth. 90% of proposals involve raising tax rates while just 10% is from cutting wasteful spending.
- No agreement on debt relief means IMF fails to participate in bailout deal. IMF also concerned about unsustainable pensions and tax collection rates falling.
- Greek Government's compliance with demands for structural reforms stands at just 15%. Market reforms and competition proposals are not being observed.
- Unless a package of targeted reforms that is aimed at improving competitiveness comes forward, the Greek economy will be destroyed.

1. OVERVIEW

The Greek pension system will continue to drag down on the Greek economy. Greece's worker to pensioner ratio is just 1.38 compared to the UK's 2.75, meaning that are just 138 Greek workers for every 100 Greek pensioners. Furthermore, the Greek pension system has received 216 Billion Euros in subsidy since 2000, and more than 80% of Greek debt corresponds to deficits created by the pension system (for more analysis, see *Greek Pensions Crisis: The Last Act of the Greek Tragedy?,* CPS, 2016).

The Greek Government has recently embarked on a further 5.4 Billion Euros of fiscal consolidation, leading to Eurozone finance ministers announcing that an additional 10.3 Billion Euros of bailout money will be released to the Greek Government – although most of these funds will be recycled to repay some imminent debts. After late night talks, the French Finance Minister declared that "the crisis between Greece and the Eurozone is over and behind us". The evidence would, however, suggest that this pronouncement is ludicrously over-optimistic.

2. GREEK GOVERNMENT'S RESPONSE TO THE TROIKA'S DEMANDS

As part of the Memorandum of Understanding (MoU), the Greek Government was required to make an additional 5.4 Billion Euros of fiscal consolidation last month. The Greek Government has implemented new tax-raising measures to help raise these funds. Under the new 7,000 page Parliamentary Bill, the sales tax rate on food products will rise by 1 percentage point, and increased taxes will be levied on petrol, diesel, electricity, internet, mobile communications, cigarettes and alcohol. There have also been significant increases in dues – those taxes that relate to Greece's healthcare and pension system.

In comparison to these new taxes, minimal action has been taken to improve the competitiveness of the Greek economy. 90% of proposals have been linked to new taxes compared to just 10% from a reduction in wasteful government spending, according to Institute for Regulatory Policy Research (IRPR). This leads to concerns about whether the measures are recessionary in nature and will contribute to a further decline in Greek GDP, which has fallen by 33% since the financial crisis, according to Trading Economics. Domestic data sources show that the number of business closures in Greece is up 46% this year, and this situation could be exacerbated by the latest measures.

There are concerns about the impact on the self-employed, in particular, some of which – given the new conditions – will face marginal tax rates of between 70% and 80% (or 200 to 300 Euros for every 1,000 Euros earned).

Figure 1: Case study of taxation impact for Greece's self-employed

CASE STUDY

A typical Greek lawyer will now face:

- VAT rates of 24%.
- Average pension and health dues of 38.5%.
- General taxation rates of 33%
- An annual solidarity due of 650 Euros.

This leaves many self-employed Greeks with marginal tax rates of 70-80%.

Source: Greek Liberties Monitor

New measures linked to the pension system will, for example, lead to:

- A doctor with income of 15,000 Euros seeing his dues (taxes related to pensions and healthcare) go up from 3,837.6 Euros to 4,624 Euros, while if his income is 30,000 Euros they will go from 3,837.6 Euros to 9,285 Euros (with a 'discount' offered until 2020, so until then they would be paying 2,414.30 Euros and 6,220.95 Euros respectively).

- An engineer with income of 15,000 Euros will see his dues go up from 4,514 Euros to 5,692.50 Euros, while if his income is 30,000 Euros they will go from 4,514 Euros to 11,385 Euros (with a 'discount' offered until 2020, so until then they would be paying 2,960.10 Euros and 7,627.95 Euros respectively).

It appears that the Greek Government is also ducking the major structural reforms demanded under the MoU. The compliance rate is estimated to be just 15%, and areas such as public procurement transparency, market reforms and fair competition proposals are not currently being observed, according to IRPR's analysis.

3. KICKING THE CAN DOWN THE ROAD – IMF REFUSES TO SIGN UP TO AGREEMENT

The IMF's rules on conditionality mean that it can only provide loans to countries that are capable of repaying. As the IMF now views Greek debt – which stands at 176% of GDP – as "highly unsustainable", it has concluded that Greece cannot repay any further loans. As a result, it cannot currently lend finance to Greece and has refused to add its resources to the bailout package agreed by the Eurozone finance ministers. In a press conference, the IMF made it clear that they will only contribute to a bailout package when concrete proposals for debt relief are agreed. The Eurozone's current commitment is to deliver debt relief only "if needed".

The IMF is also more pessimistic about the growth prospects of Greece than the Eurogroup finance ministers. It projects that Greece's long run primary balance will be 1.5% of GDP by 2018, which is far lower than the expectations of 3% by the Eurogroup. The IMF has also highlighted a number of issues with the implementation of reforms to the Greek economy. The IMF's debt sustainability analysis suggests that Greece's pension system remains unaffordable and unsustainable, and that collection rates of taxation have been steadily declining despite efforts to strengthen tax administration. It also only expects 5 Billion Euros from Greece's privatisation fund by 2030 – compared to the MoU requiring 50 Billion Euros to be realised from the fund.

4. CONCLUSION

The measures implemented by the Greek Government, which overwhelmingly rely on increased taxation, are merely aimed at short term stability and not the long-term viability of the Greek economy. The measures passed will almost certainly be recessionary, fail to boost Greece's competitiveness and will, in any case, not be implemented.

Short-term politics has once again trumped economics – thereby delaying any sensible resolution of the Greek crisis, and deepening and extending its effects. In particular, the 2017 elections in Austria and Germany mean that there is now little appetite for major concessions on debt relief.

Yet the economic facts cannot be ignored for ever. Greece's debt position remains unsustainable in the long term. And the recessionary measures being implemented by Greece's Government will undoubtedly lead to poorer business performance and will hit the self-employed particularly hard. That in turn will make the worker to pensioner ratio even less sustainable. Unless a package of targeted reforms aimed at improving Greek competitiveness becomes a priority, instead of more tax and recessionary measures, the Greek pension system and the Greek economy will be destroyed.

Michael Iakovidis, Daniel Mahoney and Tim Knox
Centre for Policy Studies

DISCLAIMER: The views set out in the 'Economic Bulletin' are those of the individual authors only and should not be taken to represent a corporate view of the Centre for Policy Studies

Follow us on:

Twitter **Facebook**

Forward to a friend

AUTHORS

Michael Iakovidis combined a background in Civil Engineering (Business Studies. In December 2014 he founded the Greek Liberties Monitor platform (www.liberties.gr), which is implementing a number of projects related to personal and fiscal freedoms within Greece. He co-organised the acclaimed Emergency Economic Summit for Greece, and has authored a number of acclaimed papers on the details of the Greek economic crisis.

Daniel Mahoney is Head of Economic Research at the Centre for Policy Studies.

Tim Knox is Director of the Centre for Policy Studies.

Special thanks to Melina Daskalaki for research support in relation to this bulletin.