75

International Monetary Fund

Remarks by Bob Traa, Senior IMF Resident Representative in Athens, Greece

Economist Conference
September 19, 2011

As prepared for delivery

The economic program launched by the Greek government in May 2010 has been subject to much criticism lately. And, indeed, there is no doubt that the program is at a critical juncture. The focus of my remarks today will therefore be on corrections and modifications needed to ensure further success.

But before doing so let me stress that we (in the IMF) strongly disagree with those who argue that the program has been unsuccessful to date. With the deficit having surged to a highly destabilizing level of 15½ percent of GDP, and having abruptly lost access to capital markets, Greece was standing at the abyss in May of 2010. Despite an unprecedented level of support from the international community—other Euro Zone countries, the ECB and the Fund—the Government had no other choice than focusing its immediate efforts on stabilizing the economy. And it did so: with the corrections to fiscal policy that are under discussion right now, Greece is aiming to achieve a reduction in the public sector deficit by some 7½ percent during 2010-11, despite a contraction in GDP of almost 10 percent during these two years. This is impressive progress that Greece deserves credit for. The efforts to restore sound public finances are difficult and socially painful, but they have already produced very impressive results.

But having made this impressive start in two years, Greece is now at a stage where further reduction in the still too-high deficit and, above all, a return to robust economic growth, will require a much stronger focus on structural reforms. This is what I want to talk about.

Structural Reforms

The program has entered a difficult phase. This is evident from the fact that the economy is trending lower than expected only a few months ago. We now expect GDP to contract by 5 ½ percent in 2011 and some 2 ½ percent in 2012.

The reason for the deeper-than-expected recession is fundamentally that investor and consumer confidence has not improved as hoped for when the program was launched. On the strength of such an improvement, we expected investments to begin recovering by now, setting the stage for an overall gradual recovery in GDP by the end of this year.

There are multiple reasons why the improvement in sentiments has not happened. Some are external to Greece, including the unexpected turmoil in other countries in the periphery and uncertainties among investors about the framework for a comprehensive policy response in the Euro Zone to the crisis.

However, other reasons are undoubtedly internal and Greek specific. Most important in this regard is the slowing of the pace of structural reforms this year. Reforms started strong, with comprehensive pension reforms and labor market reforms, but they have now become much more incremental. This means that Greece is still well away from the critical mass of reforms needed to transform the investment climate and to give a boost to the economy. We have been very concerned, and we have said this publicly on multiple occasions, since the beginning of the year that the recovery will not materialize without a re-invigoration of reforms, and the significant revision to the forecast that is now being made is unfortunately evidence that such downside risk, on the back of a lack of structural reform progress, are beginning to materialize.

Rather than being at an inflection point where the positive impact of productivity boosting reforms are beginning to outweigh the negative impact of large fiscal and financial tightening, the recession is continuing, and we are not yet seeing signs that it is definitely bottoming-out. Thus, the downward revision to the outlook highlights that a reinvigoration of structural reforms remains the overarching challenge facing the authorities.

Fiscal Policies

But the immediate challenge today facing the authorities is in the fiscal area. The notably weaker-than-expected economy and the attendant contraction in the revenue base is clearly one reason why the authorities are struggling to meet their fiscal targets—we need to take the so-called automatic stabilizers duly into account. But another reason is that further progress in reducing the deficit is going to be very hard without underlying structural fiscal reforms.

The medium-term fiscal program to which the Government committed this summer is a very important step forward in developing such structural fiscal reforms. Implementation is underway and the Government has assured us that it is committed to adopt the remaining legislation soon. Thus, the fiscal consolidation program is in the process of being set on a stronger foundation.

Still, additional measures will be needed as we go forward in order to reduce the deficit to a sustainable level. This points to an important issue. The so-called "Memorandum" is not something that is fixed once and for all. It is an organic thing that will change over time, in part because circumstances inevitable change, in part because some of the undertakings in the Memorandum are not much more than objectives that still need to be translated into concrete measures, reflecting the fact that technical preparations of complex reforms necessarily takes time. Thus, the call for "no new measures" is not realistic.

In calibrating the fiscal program as we go forward, the authorities clearly need to guard against this program becoming unbalanced. In particular, they must not resort to higher and higher taxes on a limited tax base. This would be neither economically nor politically sustainable. To avoid this, there is a need for refocusing of the fiscal program in two ways:

First, efforts to improve tax administration have clearly not produced the hoped-for results so far. We do not believe that Greece will be able to undertake—in a socially acceptable manner—the large fiscal consolidation that still lies ahead without a much stronger resolve to tackle the problem of tax evasion. While Greece cannot achieve this consolidation through spending cuts alone, the increase in revenues that is necessary to put the fiscal accounts on a sustainable footing must *primarily* come from improving tax collections rather than by increasing tax rates. Let's be frank: the well off need to pay their fair share of taxes. The good news is that with the technical assistance that has been provided during the last year Greece should be able to improve tax collections if there is a political resolve to do so.

Second, the public sector is very large and another essential element of a credible fiscal strategy must be to reduce the public sector's claim on resources: a credible strategy must primarily focus on sustainable expenditure cuts. This inevitably will require closure of inefficient state entities as well as reductions in the exceptionally large public sector work force and in generous public sector wage (which in several cases are above their private sector counterparts). As we go forward, it is essential not to be constrained by taboos regarding closure of inefficient enterprises and involuntary redundancies.

Allow me one note of caution. While we do agree that there is a case for reducing tax rates in some areas, the international experience strongly suggests that such reductions by themselves do not produce an increase in tax collections. Instead, they lead to higher deficits. One must avoid putting the cart in front of the horse: tax rates can only be reduced once Greece has managed to improve tax collections and reduced the public sector's claim on resources through reforms that cut spending on a sustainable basis.

To sum up, while Greece has made impressive progress, the country has now for some time been at a critical juncture where further progress will require a reinvigoration of structural reforms: fiscal structural reforms to prevent that the deficit gets entrenched at a still far too high level: and broader structural reforms to reach the critical mass needed to transform the investment climate and set the stage for strong economic growth and job creation.

Finally, let me leave you with two observations in this regard:

First, the reforms will undoubtedly be strongly challenged by vested interests. It is therefore a matter of considerable concern that the program has not had broader political support, as the lack of such support ultimately tends to embolden vested interests. The importance of getting broader political support as the reforms get more difficult cannot be emphasized enough.

Second, at their summit on July 21, European leaders took the bold step to agree to provide financing to Greece at terms enjoyed by triple-A rated countries, and to do so for as long as it takes to restore access to capital markets, provided that Greece continues to implement its adjustment strategy. This is extremely important. Even if headwinds prove stronger than expected, your European partners will stand by you "for as long as it takes", provided that Greece continues to pursue sound policies. The ball is in Greece's court.

IMF EXTERNAL RELATIONS DEPARTMENT

Public Affairs		Media Relations	
E-mail:	publicaffairs@imf.org	Phone:	202-623-7100
Fax:	202-623-6278	Fax:	202-623-6772