The Deal on Greek Debt: Political Gamechanger for Europe, Tactical Retreat (not Surrender) by Tsipras

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The conventional wisdom, delivered before anyone could really ponder the fine print of the Greek debt deal, is that Tsipras surrendered to the creditors in a humiliating defeat. His referendum and prior tenacity in negotiations proved futile,according to the predominant account that has emerged in the media and the twitter and blog worlds.

Wrong on all counts. And here's why.

It is well-understood that Greece's debt is un-repayable under any plausible economic scenario. But this is the reality that many European politicians cannot admit candidly in public, above all, Germany's politicians. With the imminent expiry of the last bailout program, Greece was faced with the predicament that, on the one hand, without more assistance, its banking system would collapse, yet a further bailout would do nothing meaningful to address the sustainability of its debt burden. At the same time, to distract their voters/taxpayers from the reality of the un-repayability of the debt the politicians, again above all Germany's, had to punish Greece, blaming its bad behavior for the crisis and imposing ever more onerous if irrational conditions. For the German political leaders, the calculation was that the people's satisfaction from seeing Greece punished and humiliated would be an effective *Ersatz* for the satisfaction of being repaid. (I will make no comment as to whether the politicians here rightly gauged the national character). Varoufakis and his colleagues were correct to see that at some point for the Germans, this exercise would only remain politically effective if Greece were given the ultimate punishment – removal from Europe. For Schäuble, the German Finance Minister, nothing was more appealing than the cleansing or purifying Europe of Greeks. The Greek Government knew that, once there was no longer a European community of fate fully including Greece, a profound geopolitical reorientation would be needed for Greece's economic and social survival.

Given Germany's leadership position in Europe, and effective veto on any positive solution, the Tsipras Government was faced with an almost impossible situation as the second bailout drew to a close. The only at all hopeful strategy was to try to change the longer term political dynamics so that debt unsustainability could finally be faced and directly addressed, and German influence somehow marginalized – but how to do so without courting short-term disaster?

Tsipras and company employed a number of tactics to implement this strategy, which are widely known but wrongly thought to have been ineffective. In fact the results have been impressive:

1) Germany, the major obstacle to ever facing the reality of debt unsustainabilty, has been isolated and disgraced; François Hollande has emerged as the new leader of Europe, someone much more prepared to open serious discussions about sustainability.

2) The United States, including the Treasury, as well as the IMF itself, have moved to the position that some some form of serious debt relief is crucial. Merkel and other European leaders are far from immune from US pressure; getting Obama's attention (the phone call to Merkel) is an achievement in itself, especially at a crucial juncture in other negotiations (Iran).

3) Given Schäuble was maneuvering in the Eurogroup to bring about Grexit, Tsipras needed a commitment of political leaders to Europe as a community of fate, where cleansing of any of its nations is an unthinkable betrayal of European values and of the lessons of history. To get such a commitment required raising the Greek crisis to the level of an ontological and moral crisis for Europe, which would concentrate minds at the top political levels as well as those of European and global opinion-makers. This morning Tsipras got the commitment. Grexit as an option, even in the confused "temporary" version that was part of the deceptive rhetoric of Schäuble, is unmentioned in today's agreement; it has become unmentionable. The EU has made a significant moral and

political re-investment in Greece, and through its resolution of the ontological crisis, made the salvation of Greece into a test of the viability and justification of the European project. This is being the case, the costs to Europe of a further failure or breakdown going forward with Greece have been upped considerably, especially at a time when European unity is being tried on *many* fronts.

4) Through the referendum and the subsequent negotiations with other political parties, Tsipras has largely foreclosed the tactic of inducing some kind of effective coup d'etat in Greece that would destroy the democratic fabric of the country.

5) While obtaining conditional commitments to the required short term support, Tsipras has also achieved agreement with the entire Eurozone, including Germany, that all forms of debt relief are negotiable except for "nominal haircuts." Since, as will be explained below, there are many ways to reduce a debt burden other than an reduction in the nominal amount of principal owed, this is an important advance, although heavily disguised in the agreement, obviously for the sake of German sensibilities.

6) The tougher new conditions, while in some sense a tactical retreat by Tsipras, are couched in language that on many points, such as privatization and review of collective bargaining, leaves ample room to execute them in a manner consonant with progressive social and economic values – the means chosen to implement reforms is very much left open, and presumptively in Greek hands (provided the results are "ambitious", "comprehensive" etc). To my mind, calling the conditions tougher than the last offer in the previous negotiations is a bit misleading in the sense that these earlier proposed conditions were tinkering with very specific aspects of policies, leaving little room to maneuver on the design of reforms in some cases. That Tsipras is being "forced" to act quickly and get some reforms passed immediately as a precondition to negotiation of a definitive deal is not a concession but is likely to work to his benefit, consolidating his political legitimacy in Greece and solidifying his de facto move to a unity government that will have a stronger hand in future bargaining with the creditors. Because as already noted, the stakes have been further raised for Europe by its moral and political reinvestment in Greece, in interpreting whether, for instance, pension reform has been "ambitious" or VAT has been "streamlined", the Eurogroup will favor readings that are generous and don't threaten further impasses. If Germany does otherwise it will increase its disgrace and come under suspicion of trying to undermine a positive way forward.

That's the big picture. But the devil is in the details. So let's quickly look at some of the most important ones. (Parts of these have to be passed this week, other in longer times frames (such as full pension reform))

VAT: what is required is "streamlining" and "broadening of the tax base". That's considerably more respectful of policy space than what was at play in the previous negotiation (very particular changes to the VAT structure), and allows the Greek government to strengthen tax revenue while ensuring that the tax burden is more, not less progressive.

Pension reform: requirements are that reform be "ambitious", "comprehensive", implement the "zero deficit" clause or "mutually agreeable alternative measures" and improve "long-term sustainability" of the pension system. Note that virtually nothing is said here about *the specific measures* that have to be adopted to change the pension scheme, leaving the Greek government the policy space to ensure that pension reform does not make worse off, but ideally better off, the most vulnerable.

Privatization: Probably the most misrepresented part of the deal. The independent fund, managed by Greek authorities, will be given the primary responsibility, to determine the method of privatization. Privatization is not the only means permissible to monetize assets, under the agreement. Moreover, Greece enjoys protection against pressure to offer these assets at fire sale prices, by reference to international practices regarding "adequate asset sale pricing." Only 25% of revenues from these sales will have to go toward paying down Greece's existing debt. The rest will be for recapitalization of Greece's banks and for investments (the latter seemingly at the discretion of the independent fund).

Haircuts: as noted the only form of debt relief explicitly excluded is "nominal haircuts", reducing the face value of principal to be repaid. The only forms explicitly mentioned are longer grace and payment periods, which of course can be designed in such a way as to provide relief on interest (anyone who has refinanced a mortgage will know that lower interest can be a very significant reduction in debt burden). Neither mentioned nor excluded but entirely possible consistent with the commitment not to reduce the nominal amount of principal to be repaid, would be innovative changes to the debt obligations, for instance GDP-indexed bonds.

Collective bargaining: contrary to many reports Greece is not being asked to abandon workers' rights. The benchmarks are EU directives and best practices and international international ones (presumably reflected in the Conventions of the International Labor Organization). Labor market reforms can be a race to the top, not the bottom.

Odious debt: the agreement states: "the Greek authorities reiterate their unequivocal commitment to honour their financial obligations to all their creditors fully and in a timely manner." Of course if parts of Greece's debt were to be found to be odious or illegal (and a final report of the Parliament's Truth Committee is still awaited on this matter), then by virtue of legal doctrine, that part of the debt would no longer *be* a "financial obligation"; its odiousness would vitiate its obligatoriness. In sum, Greece has not in any way waived possible future claims concerning odious or illegal debt.

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