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Waiting for Export-led Growth: Why the Troika's Greek Strategy Is Failing

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Greece's unemployment rate just hit 27.6 percent. That wasn't supposed to happen. The European Commission (EC) and International Monetary Fund (IMF)—which, along with the European Central Bank (ECB), have dictated the policies that are supposed to rescue Greece from its version of the Great Depression—predicted back in December 2010 that Greek unemployment would be below 15 percent this year. In 2011, that was revised upward to around 20 percent. Their newest projections, released in June, tell us—once again—that if Greece continues to stick with the program, growth and employment gains are right around the corner.

Our research, based on a macroeconomic model specifically constructed for Greece, suggests that these latest predictions will turn out to be as (in)accurate as their predecessors. Moreover, the worst is yet to come: we should not be surprised if the unemployment rate hits 34 percent by the end of 2016, in contrast to the EC and IMF's "sunny" forecast of around 20 percent.

Why has the troika—the EC, IMF, and ECB—been so consistently wrong about the effects of its handpicked policies? The answer is that, despite some recent admissions of error along these lines by the IMF, the troika still relies on a theory of how the economy works that badly underestimates the negative effects of austerity.

The strategy being imposed on Greece by its international lenders depends in large part on the idea of "internal devaluation": that reducing wages will make its products more attractive, thus spurring a return to economic growth powered by rising exports.

How is this strategy faring? As it turns out, Greece has indeed registered an increase in the sort of "competitiveness" the strategy demands: its relative unit labor costs have fallen more than those of any other country in the eurozone, save Germany. So far, so good, though it should also be noted that, until recently, consumer prices continued to rise as wages were being forced down, pushing people deeper into poverty.

Greek exports have also expanded since austerity measures began in 2009–10. However, most of this growth (71 percent) stems, not from Greece's reduction of unit labor costs, but from an increase in the value of its trade in refined petroleum products, due to higher oil prices (a notoriously volatile factor) and increased demand as a result of the global recovery. Internal devaluation has also generated little growth in high-tech exports and may be driving a shift in production toward agricultural and medium-to-low-tech sectors. Finally, *net* exports have contributed to real GDP largely due to a drop in imports since the beginning of the recession.

Even more worrisome, however, is that the improvement in Greece's balance of trade has not come close to making up for the huge declines in the other components of aggregate demand. Contrary to the troika's theory that government spending cuts would have little effect—or even a positive effect—on the rest of the economy, the budget cuts it prescribed have been accompanied by an accelerating collapse in private consumption and investment, suggesting a fiscal "multiplier" higher than 2.5 (in other words, for every euro in spending cuts, Greece loses more than 2.5 euros of economic output). The net export gains Greece has enjoyed have not been sufficient to keep the economy from shrinking, let alone produce the kind of catch-up growth needed to bring GDP and employment back to precrisis levels.

The hope for the troika's strategy is that exports may increase at an even greater rate at some point in the future, but our analysis suggests that achieving significant growth in net exports through internal devaluation would, at best, take a very long time—and that a great deal of immiseration and social disintegration would take place while we waited for this theory to bear fruit. Nor is there much reason for optimism on the horizon: the most recent data suggest that Greek exports have been falling since the end of 2012.

There are alternatives to the troika's approach. A modest public spending stimulus of 30 billion euros (2 billion euros per quarter beginning in 2013Q3), using funds from the European Investment Bank or another European Union institution, could yield 200,000 more jobs by 2016 than if Greece stuck with the status quo. This "Marshall Plan" for the 21st century would only begin to touch on the problem, but compared to the path laid out by the troika it would mean the difference between a continuing descent into impoverishment and the beginnings of a modest recovery. We also suggest expanding a program that is already being successfully implemented in Greece: a direct job creation program that offers paid work providing public benefits. Announced in 2011, it was designed to support 55,000 positions for the unemployed—but ended up attracting 270,000 qualified applicants (and this was back when Greece had an unemployment rate of "only" 16 percent, or 810,000 jobless). Scaling up direct job creation would provide much-needed assistance to the still-growing ranks of the unemployed. Changing course at this point, however, would require the troika to acquiesce to economic reality and cast aside the theories driving its failing strategy.

A more detailed discussion of the issues can be found at www.levyinstitute.org/publications/?docid=1836.

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