Greece’s poor growth prospects

Mikkel Barslund
and
Thomas Barnebeck Andersen

21 August 2015

Four years ago – almost to the day – when the question of Greece’s debt sustainability was the subject of intense debate, we argued that Greece would face strong headwinds in its effort to ‘grow solvent’ (Gros, Barnebeck & Barslund, 2011). With the third rescue package dealing with the immediate liquidity issues in the works, and concerns being voiced by the IMF as well as other actors, the issue is once again pertinent (FT, 2015).

In 2011, we emphasised the ‘perfect storm’ character of the crisis hitting Greece’s economy concurrently with adverse demographic developments beginning to act as a drag on rather than a force for growth, as it had been in the 30 years up to 2011 (Figure 1). From 1970 to 2004, increases in the labour force contributed three-quarters of a percentage point to growth (van Ark et al., 2007). At the time we pointed out that this trend would be reversed in the coming 30 years. The latest Eurostat population projection (EUROPOP, 2013) suggests an even starker picture: over the next 25 years: until 2040, the working-age population will decrease with more than 1% annually.

The demographic growth differential is thus a staggering 1.75%. Even accounting for the uncertainty surrounding the population projections, this will be a steep mountain to climb. In fact, demographics are likely to further deteriorate, as people of working-age population leave Greece for better prospects elsewhere (Barslund & Busse, 2014).

It is possible to mitigate the effect of the negative trend in the working-age population if labour-market participation increases for persons aged 20 to 64. This is what labour market and pension reforms are supposed to facilitate. There is some scope for Greece to do just that for some groups of the population, particularly women. In the long term, an increase in labour-market participation for women will add to economic growth; in the short term, the effect on growth of adding individuals who may have been absent from the workforce for years will be limited. Thus, even if Greece were to experience a minor effect on the level of GDP – as a consequence of adding unskilled workers to the labour force – this will be dwarfed by the shortage of workers available in the coming years.

Similarly, immigration can alleviate the demographic pressure in the medium and long term if integration is well managed. Here Greece has traditionally done a successful job. Prior to the crisis (2007), non-EU foreigners in Greece had the highest employment rate of non-EU foreigners in EU countries; and even a higher employment rate than Greek nationals. This employment differential between non-EU foreigners and nationals has been eliminated during the crisis. A key indicator of the potential of immigration to contribute to future economic growth will be the extent to which employment rates of third-country nationals increase in line with nationals when employment starts to grow. While...
immigration – not least in light of the current situation – is bound to be of some importance in reversing the demographic decline, it remains an open question how large a contribution it can deliver.

Figure 1. Projection of working age population in Greece (20-64 years), 1960-2040

In addition to adverse demographics, we reiterated the point of a ‘small closed economy’ (Alcidi & Gros, 2011; Gros, 2011) and how the structure of the Greek economy with a small tradeable sector is likely to be a weak catalyst for growth in the near future. In particular, we noted that even though tradeables constitute a relatively small part of the Greek economy, growth had come almost entirely from the non-tradeable sector in the decade leading up to the crisis. In fact, since the beginning of the crisis tradeables have contracted more than non-tradeables (Table 1).

Table 1. Growth of Greek economy by main private sectors, 2000-09

<table>
<thead>
<tr>
<th></th>
<th>Gross value added, 2000 (€ billion)</th>
<th>Real growth, index (year 2000 = 100)</th>
<th>Contraction 2009-13 (% points)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-tradeables</td>
<td>90</td>
<td>100</td>
<td>130</td>
</tr>
<tr>
<td>- Services, Construction</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tradeables</td>
<td>23</td>
<td>100</td>
<td>103</td>
</tr>
<tr>
<td>- Agriculture, Manufacturing - Raw materials</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Eurostat.

Furthermore, the tradeable sector has a large component of raw materials (mainly oil) and global maritime transportation services, which add little value to the domestic economy. An noted by Alcidi & Gros (2015):

This means that the part of exports that is really sensitive to domestic prices and wages is rather small. This particular composition of Greek trade explains why the two adjustment programmes failed to deliver. It was not because wages and prices did not adjust. Wages have already fallen by more than 20%, but exports have barely moved. The Greek economy is thus unlikely to benefit much from a further devaluation.

The lack of export’s sensitivity to wage devaluation may also partly be grounded in the structural workings of product markets, effectively limiting entrants and/or price competition (Gros et al., 2014).

Thus, developments so far cause us to be even less optimistic about Greece’s medium-term growth prospects. Moreover, other important determinants of long-run prosperity, such as quality of institutions and human capital, are not particularly favourable to Greece either.
Institutional quality is notoriously poor in Greece. Despite a number of reforms in recent years, Greece is ranked 26th out of the 28 EU member states in the World Bank’s 2015 Doing Business report (only Croatia and Cyprus were ranked lower). This is no different than the ranking in 2009. Similarly, in another frequently-used measure of institutional quality, the World Bank’s Worldwide Governance Indicators (WGI), Greece is ranked at the very bottom among EU countries on all six sub-indicators.

The situation is no less different for human capital. Raw indicators of human capital in the form of educational attainment levels are only slightly below EU28 average for 25-54 year olds, although with a somewhat higher share of low-skilled. PISA results from 2012, however, reveal Greece (together with Bulgaria, Romania and Cyprus) to be at the bottom end of a performance ranking of the EU’s OECD members (OECD, 2014). Although Greece has seen progress in PISA scores since 2003, it is painfully slow.

These observations point to the fact that even with substantial debt relief Greece is likely to face difficult times for the foreseeable future.

References


1 Results for the Survey of Adult Skills – the Programme for the International Assessment of Adult Competencies (PIAAC) – will only be available for Greece in 2016.