Presentation on Labor Market Developments and Policy Options in Greece

Bob Traa, IMF Resident Representative, 25 June, 2013

Thank you Raymond for this very interesting and thoughtful presentation. I would like to provide some further context to the presentation from the point of view of our own work and experience in the IMF local office here in Athens with labor market issues. I will take a macroeconomic point of view, while recognizing that good labor market policy also needs detailed and careful microeconomic analysis. I will speak for myself and not on behalf of the Troika.

As Raymond has already demonstrated, the recession has been deep, and **the labor market has been much affected by it**. The unemployment rate is too high and a significant number of persons have left employment and that is something that no-one wants to see continue; we must do everything we can to help the economy turn around and start sustainable growth and create new jobs.

From this angle then, allow me to give you a quick snapshot of the pictures that we look at on an ongoing basis to monitor developments in the labor market and see what policy recommendations we could draw from this.

The first chart shows the difficult situation in **employment** in Greece. At the same time, it is also becoming evident that employment developments have started to turn around recently**. Greece deserves credit for the significant policy work that has already been done in the labor market**, and consequently, **the economy is now gradually finding a path towards stability and new growth expected in 2014**. The labor market tends to react to growth in the economy with a delay, and we see that the rate of change in employment has now bottomed out, so we believe that the outlook is for a recovery in employment as well, as growth improves.

The next figures show the counterpart of employment, which is **unemployment**. We see here, too, that the increase in the number of persons is starting to decline and, we want, in fact, to see unemployment turn down in absolute terms as quickly as possible, helped by better prospects for job search, more flexibility in labor arrangements, and a more productive and competitive labor force. **Again, Greece has made progress in these areas**, and this has paid off in achieving the turnaround that we now see emerging, and we hope that this progress can continue further.

Raymond makes a very important point in his presentation on **investment dropping off significantly in Greece**. I fully agree and cannot emphasize enough how critical it is to correct this problem to achieve new jobs growth. We are of the view that in the first decade of the 2000s, Greece overshot in spending on consumption and did not pay enough attention to improve the conditions for investment. Investors tend to find it difficult to set up shop in

Greece and to employ Greece's ample potential (we also see this in the slow privatization process). This is the reason why we put considerable emphasis on **getting the investment climate right**, keep labor costs moderate, and improve productivity of capital and workers (the well know **structural reforms**).

Improving the investment climate requires that rigidities in the economy need to be further addressed, such as **further opening product and services markets, reducing bureaucracy, and fostering a stable overall macro picture**, otherwise the risks will inhibit investors. This requires promoting easier entry and exit out of the product and services markets for firms and also into and out of the labor market for workers, while wage and labor cost remain moderate for some time. All of this should be assisted with the public finances being moderate in spending and taxation, and with a stable banking system.

Today, total **consumption spending in Greece** is still more than 90 percent of GDP and investment spending is only in the low teens, so together with the recovery, this should gradually change in the direction of less consumption and more investment (and exports). In my personal view, Greece should build a policy framework for the investment/GDP ratio to reach well above 20 percent again, from the current 10-15 percent range.

This discussion brings me to the slides on the **competitiveness gap**. There is no doubt that **Greece is making good progress** in competitiveness as measured by unit labor costs. But we are **not convinced that the "competitiveness gap" in a broader and more fundamental sense has been fully closed**.
First, as noted, **unit labor costs** (ULCs) had overshot during the early decade by more than output prices; at the peak some 35 percent in ULCs relative to some 25 percent for output prices. As a result, unit labor costs also need to decline somewhat more than output prices. (As an aside, it is common to compare today's ULC's to 2000 levels, but these may not be the correct comparator as Greece entered the Euro zone with a slightly appreciated exchange rate.)
Second, output prices are now starting to decline and by some of our estimates they appear still to be above where they should be.
Third, the external current account is in a deficit of around 3 percent of GDP, despite the lengthy recession and a large negative output gap. If growth returns at current relative prices (i.e. competitiveness), then the external current account could again widen again, which is not good for Greece.
Fourth, one cannot assess competitiveness in isolation of **debt**. Greece is the most heavily indebted economy in Europe and in order to reduce debt, Greece needs to have cautious spending for some time, to help the debt ratio decline.

Indeed, we see that a large part of the recent improvement in the current account deficit has not come from a boom in exports, but from a decline in imports, and from assistance by Euro zone countries in reducing Greece's interest burden. Greece needs more improvement in investment and exports than is visible now. In short, while **competitiveness is moving in the right direction**, **and this is a hard-won achievement that Greece deserves ample credit for, the job is not yet finished**.

We can connect the previous thought to another slide, one that is worried that Greece is **liquidity and credit** constrained for growth and jobs to return. The good news is that the bank recap is almost complete and deposits are returning. It is true that credit has declined in Greece, following that the economy is over-indebted. But demand for credit is also weak; it is not just a supply side issue. Calculations by my colleagues in the IMF show that a recovery can be started without a large increase in credit. Further, debt is not the only way to support growth. **Greece primarily needs more equity based growth**. This is the notion of competitiveness in a more fundamental sense—**can Greece attract equity investors?**

Allow me to say a few words about **jobs programs, active labor market policies, support for young persons to get back into the job market, and fighting undeclared work**. We welcome all of these efforts and in the program for Greece we now have further assistance with EU funds for such purposes. We are very happy that the ILO is assisting Greece in these important areas, because youth unemployment in particular is a terrible thing that Greece needs help with. The effectiveness of such programs is important, so that they do not become just another spending program without focus and direction, and with money being wasted. Therefore, we encourage strong monitoring to make sure that Greece gets the full benefit from these important programs. ALMPs can lead to some displacement of existing labor if not well targeted, but I count on the expertise of the ILO and our colleagues in the European Commission to avoid these pitfalls. The fight against undeclared work is also important because informality introduces unfairness for workers in the formal labor market.

As another remark, I wonder if you would agree that there is a kind of **dual labor market** in Greece. This comprises the private sector labor market on the one hand, and the public sector labor market on the other hand. The unemployed people have come from the private sector, while the public sector labor market has been relatively unaffected. This suggests important distortions in the allocation of the good labor skills present in Greece, and we believe that the public sector still needs to show that it can reform too. To be sure, that is a difficult task.

I welcome warmly the ILOs call for **improved social dialogue**. Greece cannot solve the problems in the macro-economy alone—we in the international community need to offer our help and our bridge financing, which we are doing. But individual groups within Greece also cannot solve the problem on their own, whether they are labor organizations, employers organizations, or the government. A strong deliberate tri-partite consultative process is necessary. All need to make some concessions and all need to have their voice heard, so that the country can move forward with confidence and satisfaction that the difficulties are being addressed in a cooperative manner. There is a lack of trust in Greece and we hope that this can be improved in a process of dialogue.

Finally, I like to show you charts that I find encouraging; on **labor productivity and progress in the economic cycle**. These pictures show that real GDP is starting to recover from the depth of the recession, and that labor productivity growth is now positive again, and that the labor market is following this improvement with a lag—as it always does. The reason I find this encouraging is that it confirms the sense expressed by the Prime Minister and the Minister of Finance that Greece is turning the corner and that developments are now toward stability and new growth and jobs. Evidence is on their side, while still being realistic that there remains some way to go.

In closing, the key points are:

- Greece has undertaken far-reaching labor market reforms which have contributed to a significant closing of the competitiveness gap.

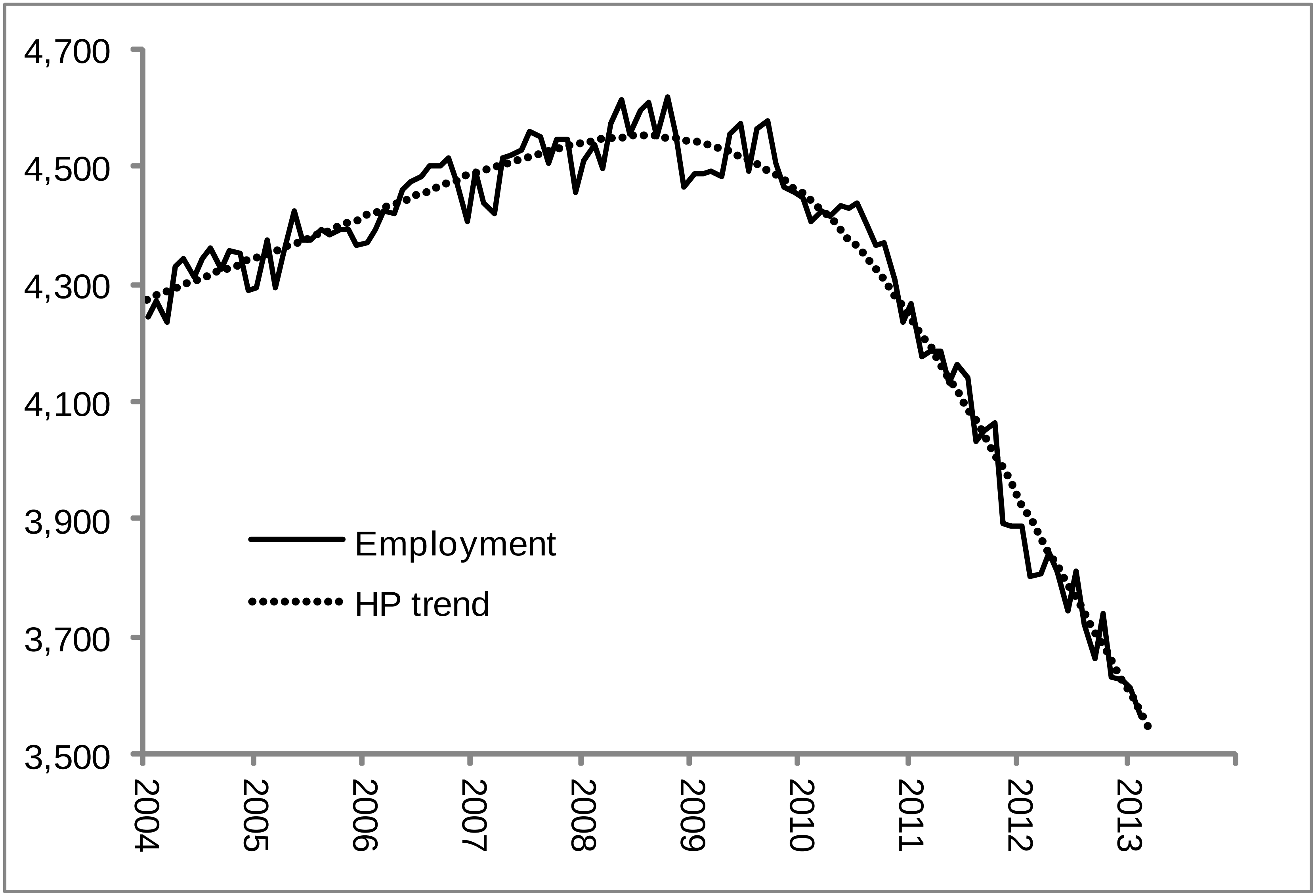
- While there is a need to review non-wage costs, further major changes in the labor market are not the first priority at this moment.

- What is needed, however, is to make further progress on product and services market reforms, and to cut red tape and bureaucracy, to make the economy truly more competitive from the output side and to attract more non-debt creating investments.

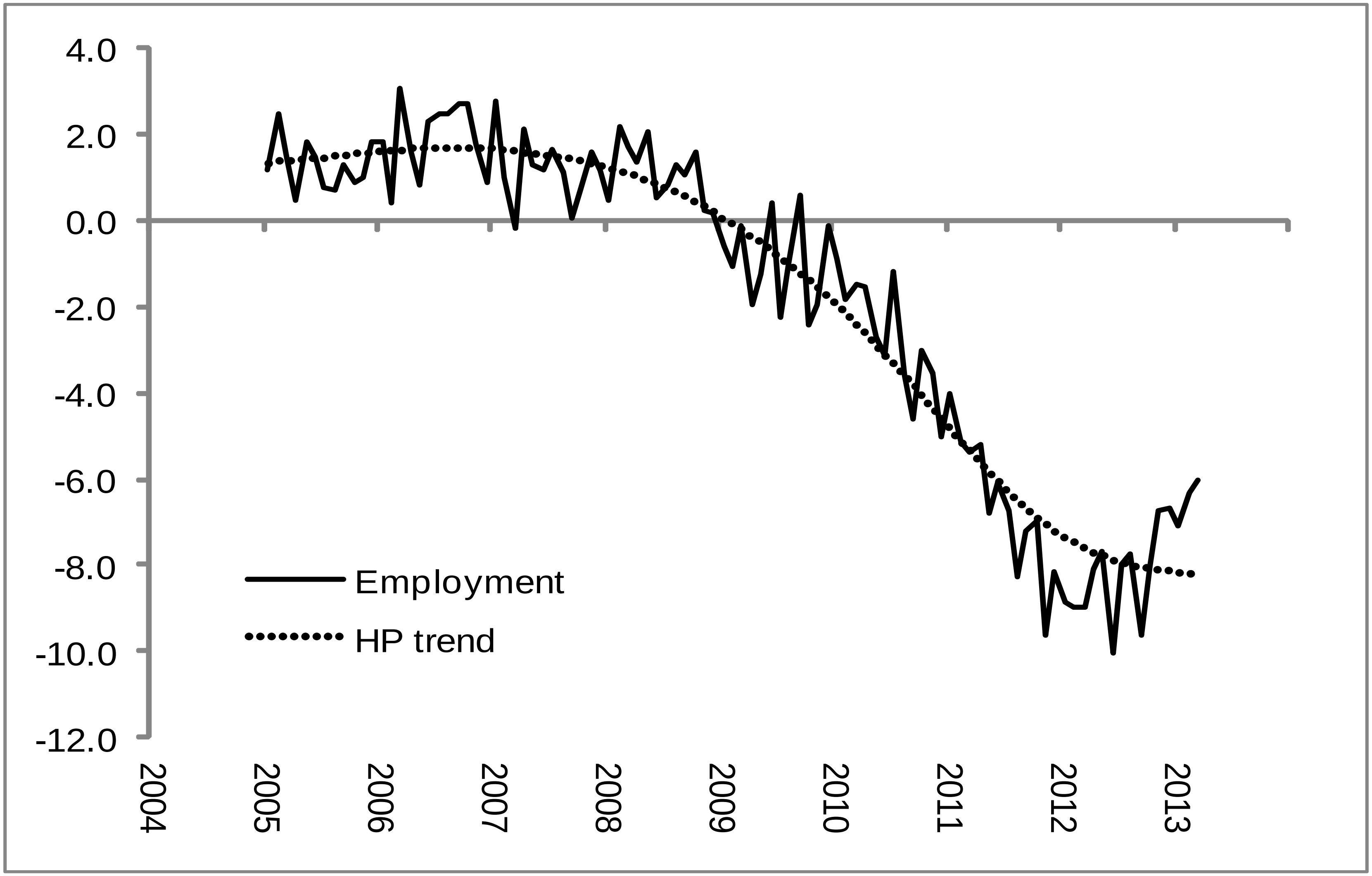
- This would also help to unburden labor a bit by easing output prices and protecting household incomes; and this would strengthen the social support for the government's adjustment program.

With these remarks, and a warm thank you to Raymond for his excellent presentation, I wish Greece a speedy recovery in growth and in jobs.

The number of employed persons has declined to around 3.6 million

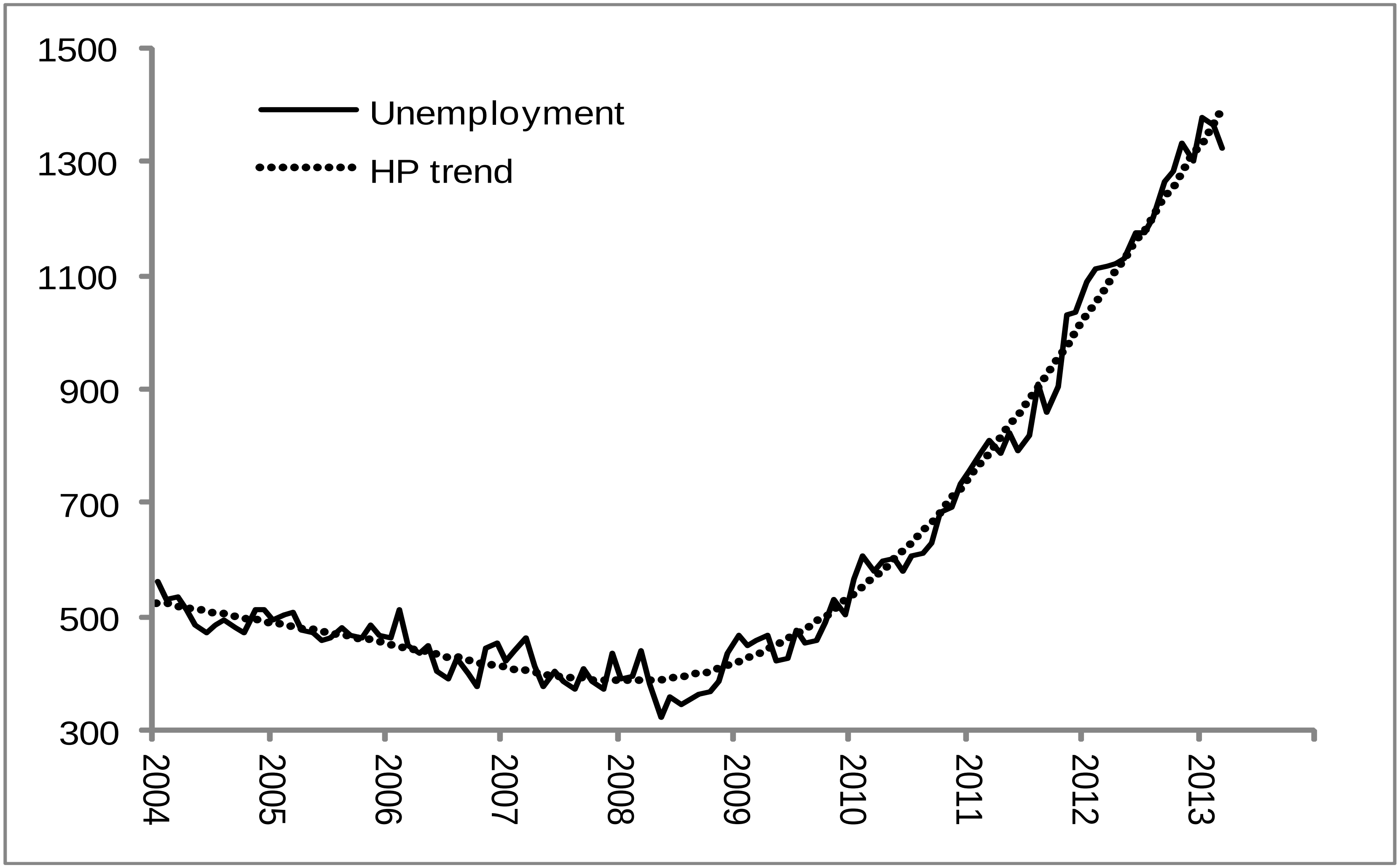


The y/y percentage change is starting to recover.

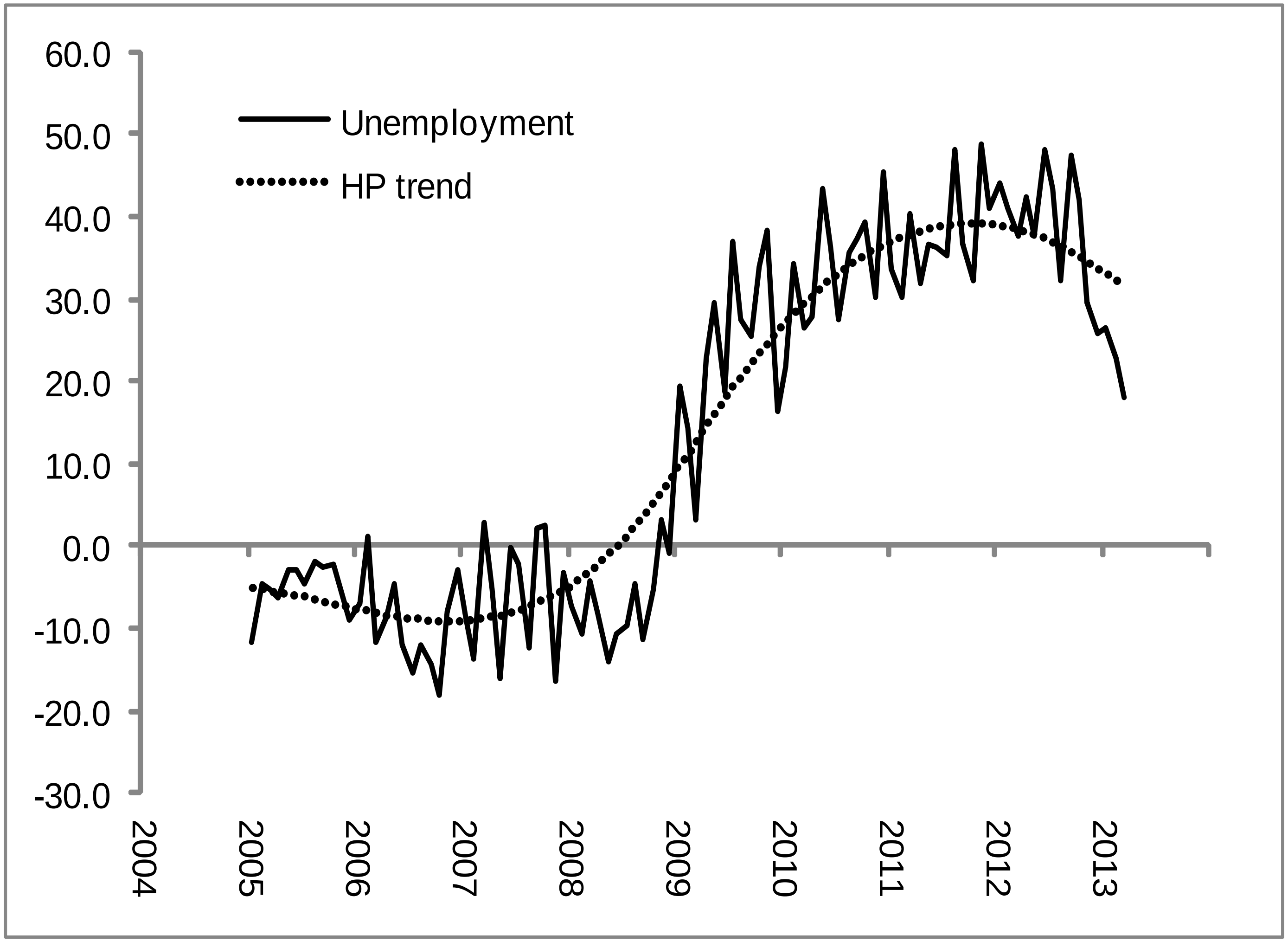


Source: ELSTAT, Labor Force Survey.

The number of unemployed persons has increased to over 1.3 million.

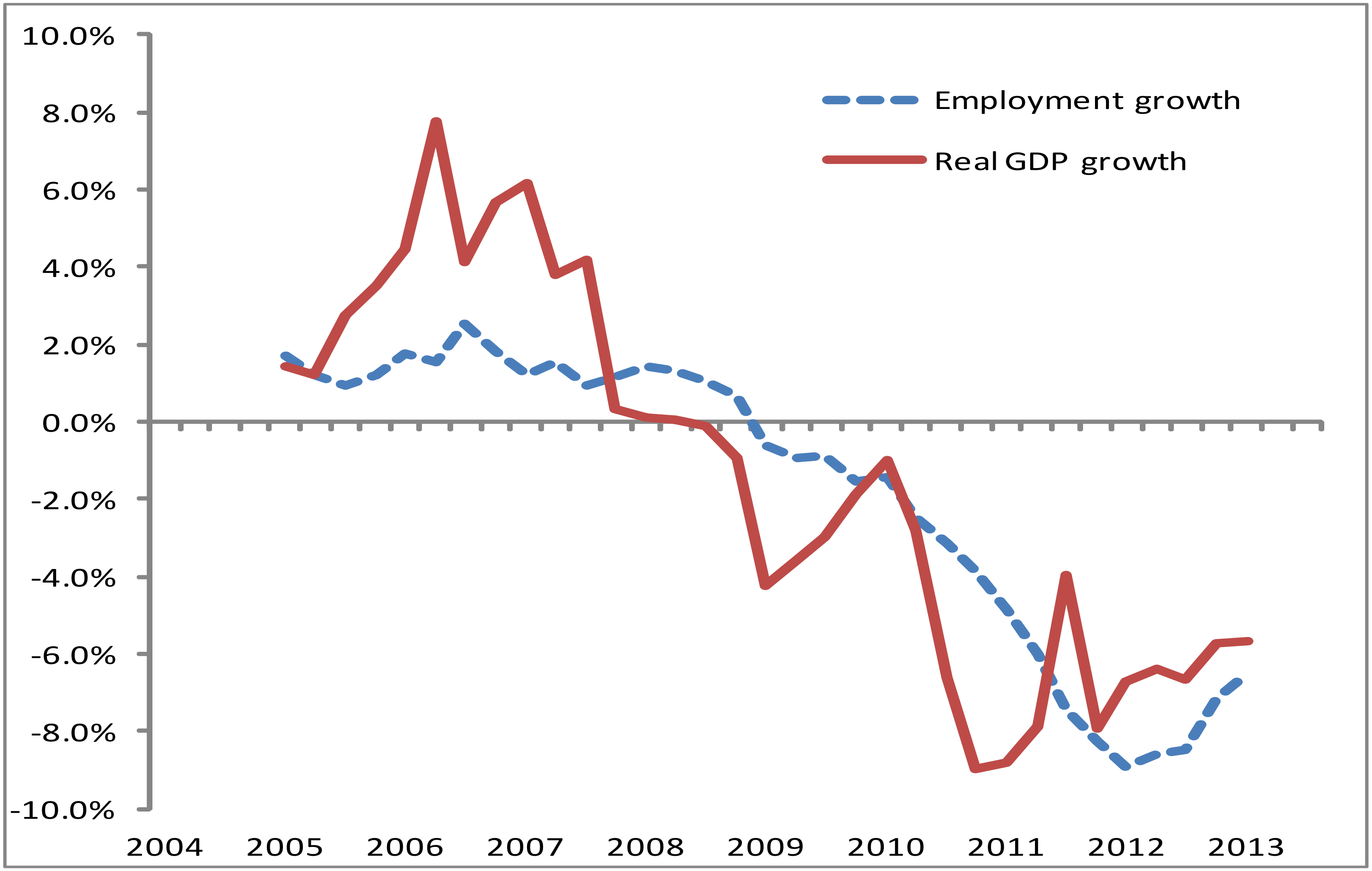


The y/y percentage change is declining.



Source: ELSTAT, Labor Force Survey.

The labor market always turns with a lag



Improving productivity means the cycle is advancing