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# How to Save Greece?

## A Menu for Rebuilding the Greek Economy through Industrial Policy

Working Paper

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Underlying Greece's public debt crisis is a fundamental economic problem: its lack of international competitiveness. While in the short term the debt crisis must be solved, in the long term the economic perspective of the country will depend on whether it will succeed in developing competitive industries. Reducing costs by lowering wages in case Greece stays in the eurozone or by devaluing its currency if it does not is only a short-term answer. Increasing Greek competitiveness will depend on a farsighted industrial policy targeted on upgrading the economy.

The dramatic developments in Greece since the outbreak of its debt crisis make spectators wonder whether there is any global solution to the host of problems the country encounters. While there is no panacea to cure all structural ills of the Greek economy, proposing solutions presupposes structuring the “Greek crisis” into three separate ones that should be treated separately:

1. The Greek public-debt crisis: This is the most obvious structural problem the Greek economy faces. In theory, this problem would be the easiest to solve if it occurred alone and if there were no interdependencies: it would then suffice to reduce public expenditures and to increase public revenue. This would be a matter of few years.
2. The Greek government crisis: Greece's public sector is lacking efficiency. This makes it very difficult to solve the debt crisis. For example, increasing taxes will not augment public revenues if there is no effective tax administration capable of collecting higher taxes. Widespread corruption is another structural problem. To this problem there is no generalized solution. Rather, for each area of government activity customized solutions have to be

elaborated. This is a matter of at least five to ten years.

3. The Greek competitiveness crisis: Greece is lacking competitiveness. Apart from tourism, there are virtually no industries able to successfully compete in global markets. Greece's trade deficit is a signal of this fact. Quite shockingly, Greece's industrial structure resembles more that of a developing country than that of other EU member states. This problem is the most long-term one. Solving it will take several decades (Brenke 2012).

Complicating the situation is the fact that there are considerable interdependencies between approaches to solve the three problems mentioned. For example, lowering wages might be a way to improve Greek competitiveness in the short term. This would not provide durable competitive advantages for Greek industries but it could pave the way for a long-term upgrading process by enabling Greek producers to enter international markets by taking use of their newly attained cost advantage.<sup>1</sup> However, it would immediately put additional pressure on purchasing power and thus reduce Greek government revenue. Consequently, it would complicate efforts to solve the debt crisis.

As this is the most imminent problem, however, the debt crisis must be solved. In case of Greece exiting the euro zone, a similar argument holds. Introducing a new currency would certainly lead to devaluation. Greek industry would enjoy a cost advantage but the public debt crisis would become even more difficult to solve because the government would find it almost impossible to pay back euro-denominated debt. A default would become very likely and cut off Greece from international capital markets for a considerable time. Government functions might become even more difficult to perform and the second problem, the government crisis, would take even more time and effort to resolve. Unforseeable social consequences, including possible social unrest, are even more dire perspectives in this scenario.

Both situations would strain prospects to upgrade Greek industries' competitiveness. Fiscal stability is a necessary, although not a sufficient condition for economic growth. It does not create growth,

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<sup>1</sup> It should be noted that an increasing competitiveness will show in higher exports in competitive industries, but does not have to lead to durable trade surpluses. In view of the dangers durable trade imbalances engender and of the fact that some countries' surplus must be some other's deficit (Stiglitz 2007: 264), demanding a durable trade surplus for Greece would be imprudent. Increasing exports, however, is important as a proxy for increasing competitiveness. It would signal that Greece participated in the efficiency-enhancing and thus wealth-creating process of specialization in international trade by concentrating on its newly developing absolute and comparative advantages. Increasing imports in other goods where other nations hold absolute or comparative advantages would be the complementary aspect of this development that would ensure an equilibrium in foreign trade (Benner 2011a).

but it is necessary because fiscal instabilities can hamper growth if and when it emerges. Thus, all three problems must be solved at once. This requires approaches that eliminate the trade-off between solutions to the debt and the competitiveness crisis. As cost advantages through wage reductions and devaluation complicate solutions to the debt crisis, structural solutions to upgrade the economic structure of Greece are required. This holds true both if Greece stays in the eurozone and if it exits it. Thus, a modern industrial policy aimed at upgrading the Greek economy with very limited public money it needed.

### **Industrial policy: what is it?<sup>2</sup>**

Definitions of industrial policy in the literature vary widely (e.g. Conrad 1987: 4-5 and 20; von Einem 1991: 13; Krumbein 1991: 41; Eichhorn and Greiling 1995: 18; Brösse 1999: 1 and 12-15; Bruch-Krumbein und Hochmuth 2000: 59-60; Seitz 2000: 32-34; Aiginger 2007: 300-302 and 319-320; Meyer-Stamer 2009: 10-12). One open question is whether the term industrial policy refers only to manufacturing, to the industrial sector, or to the whole economy. Following the strand proposed in the U.S. literature (e.g. Rodrik 2004: 2), in the sense used in this article, industrial policy refers to the whole economy.

Following Benner's (2012: 76) definition that is based on von Einem (1991: 13) which centers on industrial policy's motivation to affect the structural change of the economy by altering pure market results, industrial policy is defined for the purposes followed here

“as the focused use of measures of different partial policies. It consciently aims at influencing the change of the sectoral structure of the economy in the long term, either explicitly or implicitly, directly or indirectly. It pursues the goal of achieving results that cannot be expected at all, not in the same form, not to the same degree, or not at the same time exclusively under market influences” (Benner forthcoming).

Industrial policy can focus either on conserving old economic structures. This can be termed “traditional” industrial policy. Alternatively, it can aim at upgrading industries' competitiveness and thus constitute a “newer” form along the lines that Eichhorn and Greiling (1995: 18) describe. Then, it is not longer about holding back structural change but about promoting and maybe even accelerating it, as several East Asian newly industrializing economies did (e.g. Chang 2001; Hirono 2001; Kang 2001; Wong and Ng 2001). Such a policy resembles those described by Porter (1990),

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2 The section draws on the reasoning developed in Benner (2012) and Benner (forthcoming).

in contrast to the more traditional “industrial policy” Porter (1998: 248-249) criticizes. It suits a market system much better and has the potential to enhance the efficiency of the economy as a whole (which is at least very doubtful for traditional approaches of industrial policy). A modern industrial policy aimed at upgrading also presupposes an optimistic “positive sum underlying view of competition, in which productivity improvements and trade expand the market and many locations prosper if they can become more productive and innovative” (Porter 1998: 249). Consequently, when using industrial policy to enhance the Greek economy's competitiveness, “newer” industrial policy is the method of choice.

### **Economic growth: how to create it?**

Before using instruments of industrial policy, one has to develop a clear understanding of how it can influence economic growth. In the European political arena there seems to be the view that economic policy can “create” growth, e.g. through project funding by the EU's structural policy funds. However, it is important not to overestimate the possible impact of policy. Impulses for economic growth do not originate from government policy, but from entrepreneurial initiative. Government's role is to let businesses grow. For this, there has to be a market framework that gives them enough freedom to develop and a regulatory environment that exhibits adequate bureaucratic and fiscal rules instead of unduly burdensome and excessive ones. Structural reforms aimed at liberalization to free growth dynamics may be worth considering in a number of European economies. This can include liberalization in the labour market or in specifically regulated and protected markets, a cutback of protectionism in international trade, or the deletion of subsidies that distort competition. Functioning and effective governmental structures are another prerequisite for economic growth to occur. This is a matter of market policy (or in the German tradition, “Ordnungspolitik”).

In addition, however, government can play a role in empowering entrepreneurship.<sup>3</sup> It can create impulses for competitiveness in the long term in certain industries. This is what modern industrial policy is all about and where, for example, the focus of EU structural policy should lie. Thus, the question in industrial policy should not be how government can create growth but rather how it can promote it by fostering entrepreneurial initiative.

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3 The notion of economic policy empowering businesses follows an idea of Johannes Glückler for which I am grateful.

## **Upgrading: how to promote it?**

Under the caveat that (industrial) policy can not be expected to create but rather (at most) to promote growth and that the central role of entrepreneurial initiative should always be considered, there are numerous instruments of a modern, “newer” industrial policy that could be used to rebuild the Greek economy by helping it gain competitiveness.

The first competitiveness-enhancing measure that comes to mind is the possibility to lower costs mentioned above. Lowering wages is one way to do this, devaluation in the case Greece would exit the euro area is another. The problems associated with these approaches have already been discussed. In the context of promoting competitiveness it needs to be emphasized that such cost advantages are generally only effective in the short term. They can be very ephemeral if some other economy entering global markets has even lower costs. In addition, desired effects of devaluation can be threatened by the Dutch disease. Upgrading competitiveness requires moving to stronger competitive positions such as those gained and sustained by superior quality. Cost advantages can be helpful to initiate an upgrading process, especially for developing countries with structurally lower costs (e.g. due to abundant labor) and lower productivity. For Greece as a EU member country which aims at competing with other EU economies and whose major challenge is to keep its people's living standard in the long term, upgrading product quality appears as a more sustainable way. Still, this is a very long-term process (Porter 1990).

Even for Greece's most significant tourism industry, lowering costs is not a panacea. Concerning the low-cost strategy of neighboring Turkey and its widespread investments in modern large-scale tourist infrastructure during recent years, Greece should concentrate on other market segments. Competing on a cost basis against Turkey that has a similar landscape and that also comes up with coasts on the Mediterranean sea but has strong cost advantages does therefore not appear as a wise option for Greek tourism. Instead, putting a stronger emphasis on premium segments of tourism, as well as developing ecological, cultural, urban, or health tourism are possible approaches. This might also contribute to overcome the strong seasonality in Greek tourism (Brenke 2012: 11).

In order to stimulate high-quality production and services, enhancing competition is an important issue. This requires deregulation and privatization in protected industries (which is a matter of market policy) but there are also other, industrial policy instruments to promote competition within industries, such as awards or sophisticated public demand (Porter 1990; Benner 2012).

Promoting new business formation is another long-term approach to stimulate competition and innovativeness and to help (re-) build competitive industries. Depending on the industry and technology in question, venture capital, incubators, a legal framework for university researchers to commercialize their inventions in spin-offs, coaching and consulting for entrepreneurs are applicable instruments (Benner 2012). Maybe even microloans might play a role, especially in rural regions where bank coverage might be weaker than in urban ones. In the long term, introducing and strengthening forms of entrepreneurship education could be considered as an additional measure.

Promoting the economy's openness is an essential aspect in fostering industrial upgrading. Competing in international markets means comparing with state-of-the-art competitors. This does not only refer to exporting companies but also to those exclusively competing domestically. They should not be protected from imports (Porter 1990).

An open trade policy that disregards the short-term political appeal of protectionism is a first step to enable businesses to measure up with sophisticated foreign competitors. Promoting their exports with consulting services, with trade-fair participation programs or delegation visits abroad are further steps (Benner 2012). Programs tailored after the model of the “German Silicon Valley Accelerator” that enable entrepreneurs to spend some time in the global hotbed(s) of their respective industry can also be used where appropriate (German Silicon Valley Accelerator Inc. n.d.).

Still, exporting and competing with high-quality imports is only one aspect of international openness. Being able to tap into international knowledge stocks and flows is another highly relevant issue. Participating in global knowledge “pipelines” can enable companies to upgrade their own knowledge and develop new one at the global technological frontier (Bathelt, Malmberg and Maskell 2004). Interestingly, many instruments that promote exports can enable businesses to enter these pipelines, too. Thus, participating in global processes of knowledge creation can be seen as a by-product (albeit a very important one) of export promotion. In addition, however, knowledge pipelines might also be constructed by taking use of nationals studying or working abroad. Promoting migration for the purposes of education, training, and gaining professional experience, and later return could be worth considering, especially in view of Greece's currently high youth unemployment. However, this requires strong language skills. Adequate education measures might be needed to convey them.

Approaches that combine industrial and regional structural policy such as cluster policy (Porter 1998; Benner 2012) can also provide starting points to promote growth. Initiatives to strengthen regional resilience could also be considered (e.g. Bristow 2010; Dawley, Pike and Tomaney 2010; Simmie and Martin 2010; Martin 2012). Where industries are localized, such concepts can provide an anchor for targeted measures to stimulate their growth. In addition, they (as well as other concepts of regional structural policy such as business improvement districts, city management, regional management and the elaboration and implementation of regional development concepts) can mobilize bottom-up dynamics of economic development which are very important for a sustainable upgrading process in the long term. They may also lead to the discovery of new potentials and starting points of focused industrial policy intervention. The national level could foster these bottom-up dynamics by tying the handout of regional development funds to certain networking or cooperation criteria in regional or local development strategy formulation and implementation. Cluster competitions are a popular example for this (Dohse 2000; 2003; 2007). EU structural funds could be used in this direction, too, and thus unfold a possibly strong and sustainable systemic effect in the respective regions. Such an approach might be complemented by capacity building in regional and local organizations critical to strategy formulation and implementation, e.g. local government departments for economic promotion, trade or business associations, or chambers of commerce (Benner 2011b; 2012).

Legal frameworks specifically tailored to the needs of several industries (e.g. renewable energies) might enable them to develop in the first place. However, opening up possibilities for private investment is something different from public flagship projects. This should be kept in mind. In general, it is important that industries to be promoted by industrial policy should not be arbitrarily selected, and their choice should particularly not be guided by political considerations. They don't need to be “representative” either. What counts is the growth impact industrial policy can have in affecting them.

While some thrusts of industrial policy can and often should be devised horizontally (e.g. promoting new business formation) or regionally, some others will need to be targeted to specific industries. Their selection should pass what Porter (1998) calls a “market test”. While in practice it may be difficult to confirm a case of market failure, industrial policy should not neglect this criterion. If some kind of market failure exists, industries might be barred from unfolding their full growth potential. If and when industrial policy can help overcome this flaw with instruments whose costs are justified by their benefits to the whole economy and that do not unduly distort market processes,



there is a case to deploy them in the respective industries. In industries in which this is not the case, instruments of industrial policy should be abandoned or not used in the first place. Of course this requires a thorough and continuous analysis of the sectoral economic structure (Benner 2012).

### **Saving Greece: can it be done?**

Several caveats must be placed here. Using instruments of industrial policy does not guarantee success. If the desired effects occur at all, they should be expected only in the (very) long term. Notwithstanding the Greek public-debt crisis which must be solved in the short term, the fundamental problem of the lacking competitiveness of Greek industry must be addressed with a very long-term perspective. This can be politically difficult because the results will take time to show (if they do so at all). In addition, some measures (e.g. deregulation or privatization) are likely to encounter political resistance.

Instruments of industrial policy will only unfold their full potential in stimulating growth if and when the Greek government crisis is resolved. Instruments of (industrial) policy require functioning and effective structures of government. Thus, promoting growth through industrial policy is neither a substitute to fiscal consolidation, nor to building effective government structures. Greece's three crises require a three-fold solution. Only then rebuilding Greece's economy becomes a realistic perspective.

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