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The Greek economy is unlikely to benefit from further devaluation

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Martin Wolf offers an excellent analysis of how the Greek voter may feel about Sunday's referendum.[1] There is no good option: either be engulfed in the chaos following the rejection of the programme, exit and collapse of the economy or accept another programme.

On one account, however, Mr Wolf's gentle optimism may be disappointed. He suggests that the cost of exiting might be temporary and offset by the benefits of the ensuing devaluation in terms of increased competitiveness and exports. This is indeed what one would expect from a small open economy, where the export sector is important and benefits from lower domestic costs.

Unfortunately, Greece is a rare case of a small quasi-closed economy. Exports now account for about 30% of GDP, but a large part of this consists of oil and global maritime transportation services. Since Greece is not an oil producer, oil exports are in reality just re-exports with little domestic added value. Similarly global maritime services do not employ Greek sailors and also have no connection with the domestic economy. 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 experience of Argentina is often adduced as evidence that devaluation can work wonders. Indeed, Argentina experienced a sharp turnaround after its 'Argexit'. But this happened because commodity prices started to increase at exactly that same time. The huge increase in grain prices, and that of oil, over the next few years paid for an extended period of increasing living standards and unorthodox economic policies. But all of this was due to a global commodity boom driven by demand from China. The huge devaluation did not improve export performance; on the contrary. During the decade before the devaluation, real export growth had averaged 9%, whereas over the next decade it fell to only 3.3% although global trade growth remained close to 6%.

[1] "How I would vote on Sunday if I were Greek", *Financial Times*, 30 June 2015.

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Moreover, there was no diversification in the structure of exports, which remain concentrated in commodities. In principle the devaluation should have stimulated the export manufacturing goods. But the share of manufacturing good in total exports remained at 10% even after the devaluation and has fallen today to only over 6%.

Greece cannot hope for a similar lucky break as befell Argentina to help lift its economy out of the depths to which its financial system would plunge in the wake of an exit and breakdown. Many argue, however, that the tourism sector in Greece has been expanding even during the crisis and could be a key driver of future recovery.

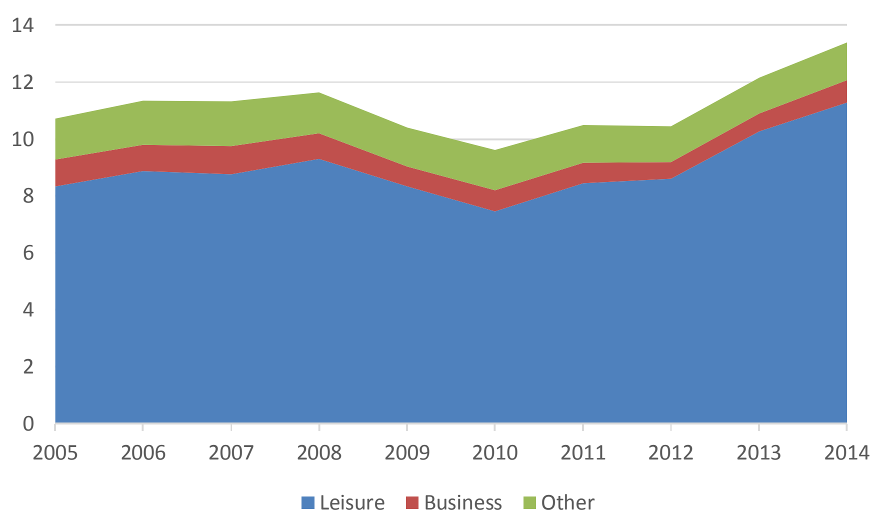
No doubt tourism is important for the Greek economy and when looking at certain indicators it appears that it has been expanding, but this may not be enough for salvation.

Tourism receipts, which are recorded under 'travel services' in the balance of payment of a country, are Greece's single largest export item, accounting for 22% of the total in 2014. Business travel is of only minor importance (representing less than 6% of total travel receipts in the last three years), whereas private leisure travel makes up to 85% (in 2014) of the total.

In judging tourism receipts as recorded in the balance of payments, one has to keep in mind that they are estimated on the basis of the product of two numbers: the number of inbound travellers in Greece, mainly at the Athens international airport, and the spending per tourist, which is estimated from surveys distributed to arriving passengers.

As the figure below shows, travel receipts in 2014 in nominal value were above the level of 2008 (about €2 billion), but the increase is not striking. This performance is quite at odds with the impression given in numerous press reports of a tourism boom in Greece.

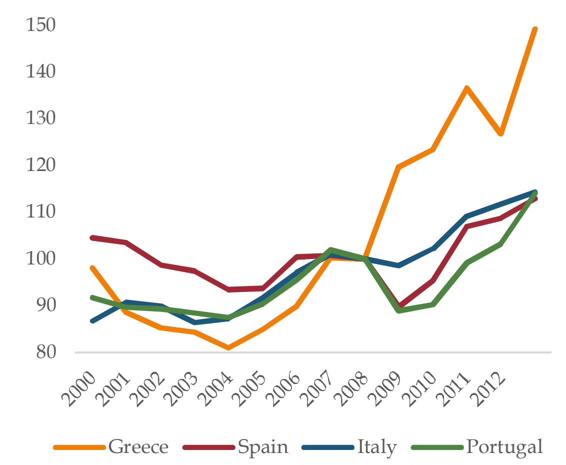
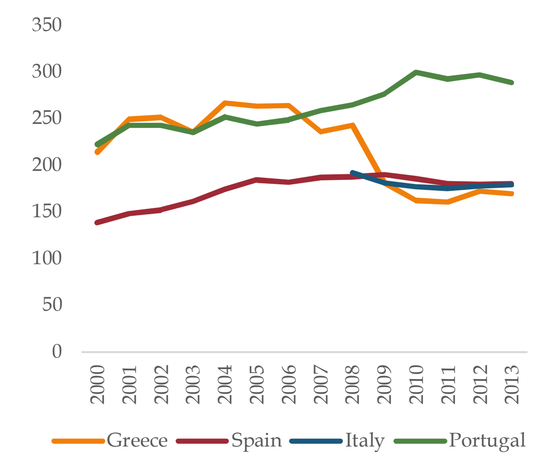
Receipts by purpose of travel in Greece (€ billion)



Source: Bank of Greece, Balance of Payment statistics.

On explanation of why Greece's (recorded) receipts have increased only moderately is that the (reported) spending of travellers per night has plummeted. As a tourist destination, Greece has not suffered from the crisis in the sense that the number of arrivals (and of overnight stays in hotels, hostels and other residences) has increased by about 50% since 2008 (see Panel a in the figure below). This is in stark contrast to the other peripheral countries where the number of overnight stays shrunk initially and then recovered relatively slowly. However, the spending per night has declined significantly, while in the other countries it has either increased or remained stable (Panel b)

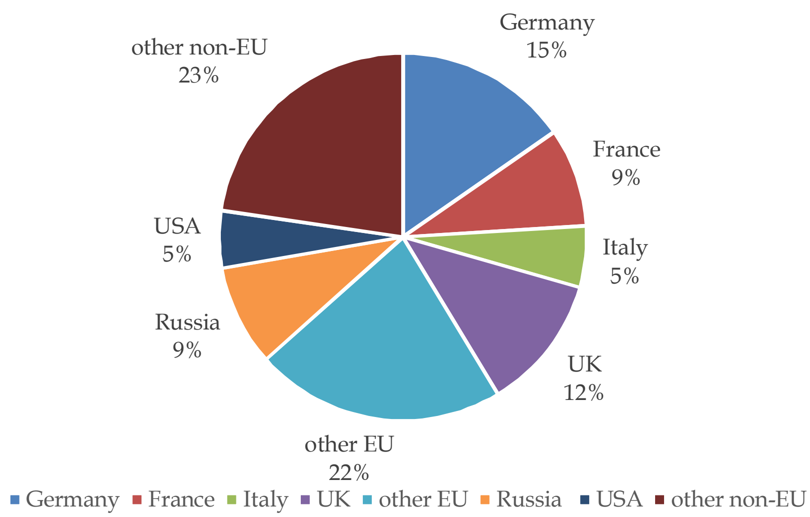
Length of stay and expenditure by tourists in Greece, Spain, Italy and Portugal, 2000-12

Panel a: Number of nights spent by non-residents (2008=100)	***Panel b: Travel spending per night (€)***
	

Source: Eurostat.

This is why overall the effect is smaller than one would have expected. In terms of their origins, tourists to Greece seems to be well diversified. Before 2011, nearly 50% of tourists were eurozone citizens for which exchange-rate movement are irrelevant. The share of eurozone citizens today has substantially shrunk to less than 40%, while the share of Russians has tripled from only 2.9% in 2009 to 9% in 2014. This implies that Greece has the ability to attract new tourists.

Receipts by tourist origin, percent shares (2014)



It remains to be seen whether tourism can really work as key driver of growth for the economy.