

Did the Troika get it right?

Martin Myant of the European Trade Union Institute (ETUI) examines the forecasting record of the European Commission and finds it wanting

The European Commission has been consistently optimistic in its forecasts, always giving reassurances that recovery is under way, that progress is being made or, when reality clearly failed to match up with previous forecasts, that the EU economy 'has reached a turning point' (as EU Commissioner Olli Rehn claimed on 13 September 2013). It has appeared optimistic with the EU as a whole and, more specifically, with the programme countries (Greece, Ireland, Portugal, Cyprus) that have had to endure detailed policy prescriptions. At the same time, we frequently hear of apparent success with one indicator or another. We are reassured that even if not everything going right, then nor is everything going wrong.



Olli Rehn has claimed the EU economy has reached a 'turning point'

To put this into context, the ETUC/ETUI's latest version of its annual *Benchmarking Working Europe* publication presents a simple test of the effects of the Troika policies on three programme countries, Greece, Ireland and Portugal, setting results against predictions. It takes four indicators; GDP growth, export growth, budget deficits as a percentage of GDP and the unemployment rate. The forecasts made by the European Commission shortly after the packages were negotiated are then compared with results as near as possible to two years later.

The test is inevitably crude, partly because conditions were not all set in stone from the start – they were subject to further clarification and negotiation – and partly because the period is not exactly two years in every case. Nevertheless, the results are very clear, showing some forecasts running quite close to reality while others diverge markedly. That said, there are very few cases where results were better than forecast. A 'good' result, when set against the general level of performance of these predictions, is one that is not too far below the forecast.

Budget deficits were a major target and results fall into the 'not too bad' category, with Ireland even doing better than predicted. Budget deficits fell after 2009 across almost all EU members so, if the aim was to impose austerity, then it was broadly fulfilled. The obvious question then is whether imposing austerity can be seen as having achieved anything more positive.

Debt as a percent of GDP levels appears to have been another area of success, albeit with Portugal doing considerably worse than predicted. However, public debt levels were rising in all of these countries and to levels way above those of the pre-crisis years. Thus, remarkably, the policy target seems to have been to raise debt to beyond any level that could reasonably be repaid.

This outcome was easily predictable and the reasons for it absolutely clear. It was partly that austerity leads to rising debt by cutting GDP and reducing tax revenues and partly that the conditions imposed included substantial additional government spending to help out private banks. Nevertheless, it is remarkable that rising debt, allegedly the cause of the problems in the first place and the pretext for such severe policies, was comfortably incorporated into forecasts of the



results of programmes that were to restore countries to full financial viability within a few years. Public debt, it seems, was not really that much to worry about.

GDP growth was over-estimated in all cases, most dramatically in Greece. Estimates for **unemployment** were also too optimistic, largely because they were based on expectations of GDP growth which materialised only on a minuscule scale in Ireland. That, we were told, was a cause for regret, but evidently not enough regret to justify much change in policy. The error in the forecasts was the failure to predict the effects of austerity on GDP plus the failure to predict the development of exports.

The most interesting results were for **exports**. These were highly varied, both in reality and when set against forecasts. Exports fell in Greece, rose very slightly in Ireland and grew almost in line with the forecast in Portugal. Also across the EU as a whole there are wide variations in export performances that are difficult to link to short-term policy choices.

A major plank in the European Commission's policy agenda has been the argument that unit labour costs are too high in the worst-performing countries, leading to poor export performance. The solution is then to cut labour costs by cutting wages after which export prices should fall and exports would again become competitive. This is an extraordinarily naïve view of how competition takes place among advanced economies. It is much more about the nature and quality of products than their prices and this depends on structures that have developed over quite long periods of time and that are themselves undergoing continual transformation.

For Ireland, in which exports grew a little but not as much as the Commission forecast, the high-growth area was computer services which increased to take more than a 20% share in exports by 2012 (albeit with doubts about how this should be interpreted as a significant part may be from activities undertaken elsewhere but recorded in Ireland so as to benefit from the low rate of business tax). This is a relatively high-wage sector (pay increased from 28% above the average in 2008 to 39% above the average in 2013) employing 3.6% of the labour force in 2013. It was therefore not a beneficiary of policies for reducing pay levels – they only hit the public sector – and those activities that might depend on low wages, notably computer assembly, continued to migrate from Ireland in search of lower wages elsewhere.

For Portugal the extent of export recovery that was achieved came from existing sectors with an increase in prices 2008 to 2013 of 14%. For Greece, past economic development left a weak export sector. Exports were exceptionally low at the equivalent of 27% of GDP in 2012, and with problems of interpreting a high share of fuels that were clearly being re-exported. Moreover, a very low share in exports came from modern manufacturing. Cutting prices could never make much difference. In fact, again, average export prices actually increased by 20% from 2009 to 2013, the highest increase in any Eurozone member for which the average was 8.6%.

Thus, when set against European Commission forecasts, the Troika did not do very well. It got some things right, notably predicting big increases in debt levels, some things wrong, notably GDP and unemployment levels, and some things sometimes right and sometimes wrong. Exports fall into this category. These have been the driving force for what recovery and growth there has been in a number of EU member states, but they depend on having products of high enough quality to export and on having growing markets to export to.

The message from the results of Troika policies and from an analysis of export performance (*Benchmarking Working Europe*, Chapter 1) is that achieving export growth depends on overall modernisation of economies and that depends on investment in skills, education, research and infrastructure, all of which have been made more difficult by policies of austerity.

Martin Myant is the ETUI's chief economist



☺

