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Ireland can show Greece a way out of the crisis

By Ricardo Hausmann

The generosity of the world is again being wasted on Greece. As officials meet in Athens to thrash out the details of the latest bail-out, we must urgently recognise that our approach to understanding the crisis is flawed.

Greece has so far been analysed through either a fiscal or a Keynesian lens. The fiscal view argues Greece can only be fixed by raising taxes, cutting spending and restructuring debt. The Keynesian one says these measures hurt growth and tax revenues and so undermine the very purpose of the policies.

Both approaches neglect that Greece must export its way out of the crisis or face ruin. Greece has a large external deficit, reaching 8.6 per cent of gross domestic product in 2011. This gap is funded by an unsustainable level of external debt that markets are no longer willing to fund. At present it is being paid by official sources, who expect this to be temporary. Greece will have to bring its current account deficit down to zero at some point.

This can happen in two ways: either Greece exports more or spends less. Adjusting the current account by spending less would require an additional fall in GDP of 25 per cent, given that in Greece only one in four US dollars of spending cuts goes abroad. This is clearly not a pretty picture. But adjusting by raising exports would require they increase by 50 per cent, not an easy feat. Achieving it through tourism alone would require the industry to triple in size – an unlikely prospect.

It is less painful to raise exports than to cut spending. But two problems conspire against this more humane solution. First, while in the eurozone, Greece cannot devalue to make its exports more competitive.

Second, Greece does not have what it takes to be as rich as it is. In our book *The Atlas of Economic Complexity* , my co-authors and I calculated the amount of "productive knowledge" across various countries. A country with a high level of productive knowledge is one that exports many different goods and where these goods are complicated to make. Productive knowledge predicts how rich a country will be and hence how fast it will grow.

Here's the bad news for Greece: in our sample of 128 countries, it had the biggest gap between its current recorded level of income and the knowledge content of its exports. Greece owes its income to borrowed foreign spending it cannot pay back. It produces no machines, no electronics and no chemicals. Of every 10 US dollars of worldwide trade in information technology, it accounts for one cent.

This problem cannot be addressed by fiscal Keynesian stimulus, by bland trade facilitation or by paying lip-service to structural adjustment as the November International Monetary Fund agreement implicitly assumes.

The problem in Greece is uncommon in Europe. Ireland, for example, is also struggling with a fiscal burden caused by the bursting of its housing bubble, but has been able to move quickly to a current-account surplus, thanks to the knowledge base of its competitive export sector. In other words, Ireland does have what it takes to be as rich as it is now.

Greece should use its international support to reduce rather than postpone the pain of adjustment. It needs to expand its export base, not delay pension and public wage cuts. It needs to be able to fund Irish-style institutions that lure potential new exporters by guaranteeing specific investments in infrastructure, labour training and research and development. This should be funded by the EU but, if not, it is better to make cuts elsewhere.

Greece is a good place to try to replicate this aspect of the Irish model. We have calculated how easy it would be for countries to move to exporting more complex goods. Greece ranks second only to India in this dimension, a heartening finding. It needs to identify the missing knowledge and infrastructural inputs required by new industries and assure their provision, the way the Irish Industrial Development Agency does. Putting resources into creating the productive base for a more prosperous future is more important and less painful than wasting them in protecting an unsustainable past. Unfortunately, this lesson is not being heeded and Greece is ever closer to the brink.

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