From Economic Miracle to Crisis: Accounting for output dynamics in PIGS economies

- Non-technical summary -

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The aim of this study was to investigate the dynamics of the so called Peripheral European economies (GIPS hereafter, i.e. Greece, Ireland, Portugal and Spain) in the period before and during the sovereign debt crisis.

The study employed two different models, a closed economy model with government, and an open economy model. These models were estimated for each of the GIPS economies and the so called wedges were derived using the Business Cycle Accounting methodology.

The most important results are the following:
1) The results based on the two models are similar.
2) Before and during the crisis, TFP and the labor wedge were the key drivers of output.
3) There is a limited role for the government spending, the bond wedge or the capital wedge.
4) A rise in the import prices can partly account for the drop in TFP during the crisis.
5) The labor wedge cannot be accounted for by taxes, as these did not change too much before or during the crisis.
6) The changes in the interest rates can account for the labor wedge during the crisis, and partly for the dynamics of the labor wedge before the crisis.
7) The Portuguese slump can be explained by the same two factors, the TFP and the labor wedge. A model with capital misallocations can account for the changes in TFP or the labor wedge.

Keywords: sovereign debt crisis, Peripheral European economies, business cycle accounting, TFP, labor wedge, capital flows.