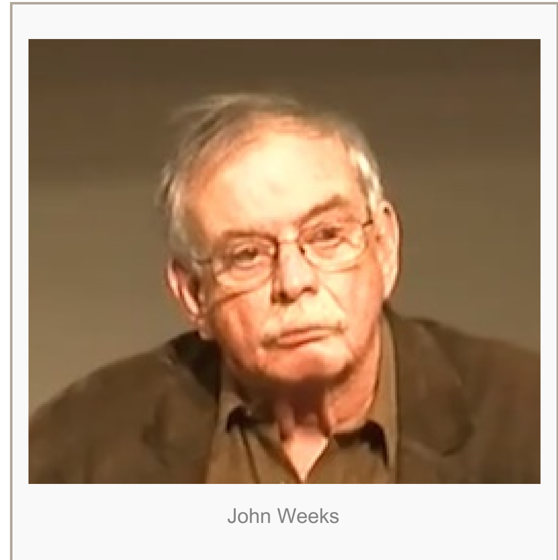
Grexit: When Not If

SE socialeurope.eu/2015/06/grexit-when-not-if/

John Weeks


John Weeks

The mainstream English language media consistently misinformed the public about the conflict between the Greek government and the Troika (aka "the Institutions", the IMF, European Central Bank and the European Commission, with the first two creditors and the third the performance monitor). For five months the media has maintained that the conflict involved negotiations between debtor and creditor to reach an agreement over the conditions under which the Troika would continue to provide financial support to the Greek government.

However, from the outset the Troika intended to accept only one of two outcomes: 1) the new Greek government would renounce its electoral pledges and capitulate to the policy package accepted by the Samaras government; or 2) the Greek government would leave the euro zone (see my article in *Open Democracy* or my radio interview with a member of the Debt Truth Committee of the Greek Parliament).

If these stark alternatives were not obvious to the Greek government previously they became crystal clear after the extraordinary decision of the Troika to hold a secret meeting *without Greek representatives* on 1 June "to thrash out differences between [Greece's] bailout monitors" (quote from the *FT* 1 June 2015).

From the Troika side the purpose of the five months of negotiations was two-fold: 1) to stretch out the sham process until the Greek public sector's cash reserves drained away, leaving the government's bargaining position hopeless; and 2) to create the illusion that "Grexit" was the choice of the Syriza government, thus absolving itself (the Troika) from culpability.

Exit, Planned Or Chaotic?

Given that the hand writing has been on the wall for months, it is surprising and a singular failure of the main stream media that we find so little analysis of the transition, planned or chaotic, for the replacement of the euro with a new, national currency. In February in the *Financial Times* Wolfgang Manchau offered a prescient exploration of the transition, and more recently Matthew Klein (also of the *FT*) analyzed the impact of exiting the euro on the Greek corporate sector.

Such serious treatments of the conflict between the Greek government and the Troika have been few and far between. To consider seriously so-called Grexit we must begin with a few obvious facts: 1) the Greek debt is unsustainable, requiring a major rescheduling exercise which the Troika ruled out; 2) the Troika is committed to a neoliberal European Union of deregulated labour markets, privatization, and constitutionally locked-in fiscal austerity; and 3) the Syriza government is pledged to a social democratic economic framework (dubbed as "radical" and sometimes "far left" in the English language media).

These three facts make it inevitable that the Greek government will leave the euro zone. Whether the Syriza government would have been wiser to "Grexit" immediately after its election to power is a topic

for another day. It is my interpretation that the Greek government's formal postponement of its June payment to the IMF represents a conscious hoarding of euros, necessary as part of the transition to a national currency when the euro will become foreign exchange.

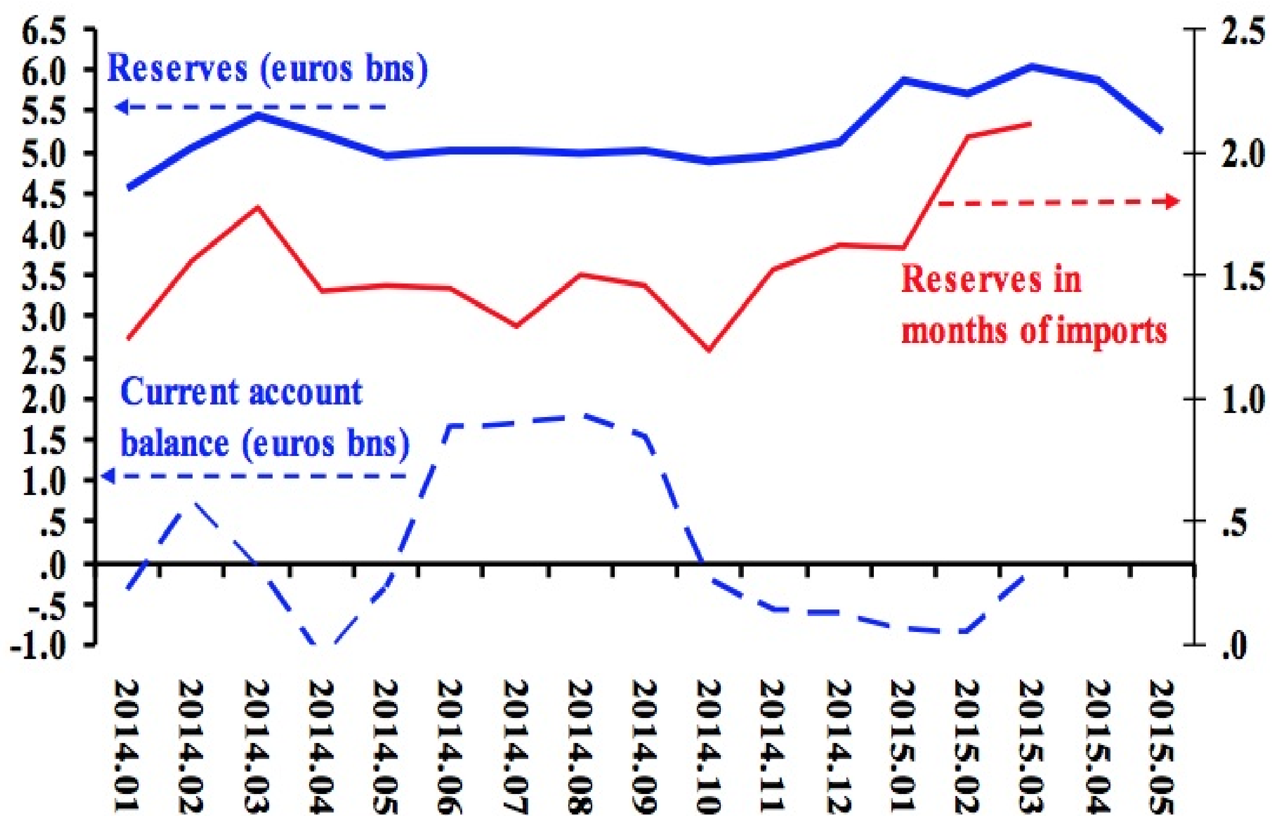
The first step in assessing the costs of the transition is to inspect the extent to which the economy can withstand the shock of currency conversion. The major economic danger during the transition would be the possibility of hyperinflation generated by an uncontrolled depreciation of the new currency (which for convenience I call the Drachma).

The defences against spiralling depreciation are a strong foreign reserve position and a surplus in the current account. The chart below reports these key policy statistics. In May 2015 total reserve assets of the Bank of Greece stood at €5.2 billion, below the level of the previous two months, but above a year before when they were €4.9 billion.

If we assume that imports in April and May did not increase substantially above the March level, this €5.2 billion was about twice the month's import bill. In the absence of heavy currency speculation this would be a manageable level of reserves. However, the Greek government can expect a heavy run on the new Drachma immediately it becomes obvious that transition to a national currency has begun.

The current account position improved from the end of 2014 to March 2015, moving close to balance – negative €83 million. As the months of imports line suggests, the problem of the current account is not imports but the level of exports. Since the Troika programs began over four years ago exports have stagnated despite the belief that wage depression would foster competitiveness.

Greece: Central Bank Reserve Assets and Current Account Balance (plus capital transfers), January 2014 to May 2015



Source: Bank of Greece. Import and current account balance through March.

Reserve holdings and the current account indicate that managing the coming transition to a national currency will be a knife-edge process for the Syriza government. As Matthew Klein points out (see reference above), should the Troika take a benevolent view of the Greek exit – "wayward sister go in

peace" – the currency transition could prove orderly though not smooth. If the creditors and monitors in Berlin, Brussels and Washington decide that "Greece must be taught a lesson", then the Greek people face a very difficult perhaps even a disastrous short and medium term.

Grexit In Real Time

The measures that the Greek government must implement very quickly are obvious to anyone familiar with currency crises: 1) strict capital controls, perhaps buttressed by temporary public administration of the banking system; 2) use of the Bank of Greece to provide temporary finance for the public budget; and 3) suspension of servicing of the public debt.

While characteristic of extraordinary conditions, none of the three is unusual. Indeed, only a few days ago the IMF announced that it would continue its program with Ukraine should the Kiev government suspend external debt servicing. Had Christine Lagarde decided to do the same for the government in Athens, told creditors "that the Fund was prepared to continue its own financing of [Greece] even if it stopped servicing its debts" (Ukraine in the original text), my article would never have been written.

Have something to add to this story? Share it in the comments below.