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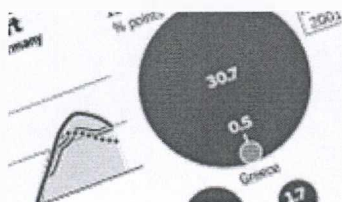
Greece: a hard puzzle to solve

By Joshua Chaffin

Christos Chanos sits in a conference room at his family's sun umbrella business in Athens and ponders one of the most pressing questions confronting his crisis-hit nation: should Greece leave the euro?

The head of a company founded by his grandfather in the ancient market stalls of the Monastiraki neighbourhood, he has first-hand experience weathering the destabilising effects of a debt crisis that has held Greece in its grip for nearly two years.



He understands the argument that reintroducing the drachma – which Greece swapped for the euro in 2001 – would enable the country to lower its costs and regain competitiveness. But, like many others, he is reluctant to go down that road. "If you ask me if we never should

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have entered, I could have a long discussion," says Mr Chanos. "But at this point, I think it would be a huge distraction. What would happen the day after?"

More than a decade after the birth of the single currency, that question is being asked with increased frequency across Europe, and at the highest levels. In what may one day be seen as a pivotal moment for the euro, the leaders of France and Germany openly speculated last week about the possibility of a Greek departure, shattering a longstanding taboo.

The trigger was a surprise call by George Papandreou, the Greek prime minister who is to step down on Friday, for a national referendum on a €130bn ($177bn) rescue package for his country that had been agreed just three days earlier at an all-night meeting of European Union leaders in Brussels. Without the money, Greece is almost certain to default on its debts – an event that could force it out of the euro.

The spasms in the Italian bond markets this week have only amplified the discussion, with José Manuel Barroso, the European Commission president, warning in a speech on Thursday of 1m job losses in Germany alone if the 17-nation eurozone were to shrink to a few core countries. "That is the threat hanging over us," Mr Barroso said.

Speed read

- **Unthinkable no more** The escalating crisis in the eurozone has raised a question that once was taboo: should ailing members be able to exit in order to restore their economies?
- **Easier said than done** As well as there being no legal means for quitting the euro, the necessary practical steps – from preventing bank runs to rejigging payment systems – are highly complex
- **No easy fix** Exit may not deliver the expected benefits. Exports may get a boost, but import costs would rise, pushing up prices – and wages

Such language would have been unimaginable to the single currency's architects. When they were assembling the euro, they were so confident in their creation that they opted not to include one practical design feature: an escape hatch. There are no legal means spelt out for a country to leave. In fact, the EU treaties mandate that all members – with the notable exception of the UK and Denmark and an implied opt-out for Sweden – eventually join as part of an ever deepening integration.

But the omission may have also reflected a darker premonition: that just imagining a means to leave the euro – let alone establishing one – would invite the reality of countries one day making use of it, and thus casting doubt on the entire venture. "If the notion becomes established in investors' and market participants' minds that eurozone membership can be a temporary arrangement, it would seriously undermine confidence in the lasting value of the currency," says Thomas Klau of the European Council on Foreign Relations and author of a book on the creation of the euro.

Even though Mr Papandreou binned the referendum idea before agreeing to leave office, Mr Klau fears that uncorking such a dangerous public discussion could plague

the eurozone for years to come. “There may be a steep price to pay for this,” he says. “It has added further question marks to the cohesion of the currency.”

At the Brussels headquarters of the Commission, the EU’s executive arm, officials are torn between the need to ready contingency plans for Greece and the fear that this would fan speculation about whether Italy or Spain – now the front line of the crisis – might also be heading for the exit. Just the perception of such a possibility could make euros in these countries less valuable than those in a stronger member such as Germany, economists warn, potentially triggering bank runs across the continent. “It becomes a very fickle zone if people can easily go in or out, and that’s the last thing we need right now,” observes one Commission official.

In spite of the dangers, many European officials had begun to speculate about Greece’s departure well before last week – albeit in private. In July, the UK Foreign Office launched a planning exercise to study what consequences might result from such a move, particularly for British citizens stranded in Greece.

In a prescient piece of scholarship, Phoebus Athanassiou, a lawyer at the European Central Bank, published in December 2009 a little-noticed discussion paper called “Withdrawal and Expulsion from the EU and EMU: Some Reflections” – six months before EU nations and the International Monetary Fund were summoned to Greece’s rescue. In it, Mr Athanassiou notes the headaches any government would encounter – from creating a new currency to repatriating its reserves from the ECB – and concludes that “a member state’s expulsion from the EU or [European Monetary Union] would be legally next to impossible”.

Yet while there is no built-in escape hatch from the eurozone, one was added to the broader EU with the Lisbon Treaty, which came into force two years ago. A special article 50 was drawn up that allows for a member state to leave, provided that its departure is approved by a weighted majority of the remaining members. The idea was to alleviate concerns – particularly among eurosceptic voters in the Czech Republic and the UK – that EU membership was akin to donning a permanent straitjacket.

Ultimately, EU officials acknowledge that legalities would not prevent any country from leaving the eurozone or the EU, if it was determined to do so. But leaving would be fraught with complications. Greece would have to renegotiate billions of euros in payments from Brussels. It still claims some €15bn in unspent development funds under the bloc’s current seven-year budget, for example. Its farmers also harvest a bumper crop of agricultural subsidies.

Euro-denominated domestic contracts – from property leases to salaries – would have to be redrafted. There would also be a wave of litigation from foreign creditors, who would fight any efforts to repay cross-border obligations in a new currency.

European leaders appeared to have some inkling of this risk when they wrung a key concession from Greece during last month’s negotiations over the rescue package. The

legal jurisdiction for the country's outstanding bonds was switched from Greece to the UK, making it in effect impossible for Athens to redenominate them.

Arguably the most sensitive task would be to avoid inciting a panicked run on the nation's banks. Since the new currency would be worth just a fraction of the euro, citizens would scramble to pull their savings before they could be converted. "If it were to happen, it would have to be a sort of five-to-midnight sort of thing," says one European diplomat. "The moment you announced it, people would start emptying their bank accounts and you would have suitcases of money flying out of the country."

In the midst of its own debt crisis in 2001, Argentina imposed capital controls, preventing citizens from withdrawing more than $250 at a time, and only $1,000 for foreign trips. But such measures would violate EU rules on the free movement of capital.

Printing and distributing new notes would also be no easy feat. In 2003, the US-led coalition managed after invading Iraq to roll out a new currency to replace Saddam Hussein-era cash there in less than three months. The coalition drew on the efforts of De La Rue, the British speciality printer, a squadron of 27 Boeing 747s and 500 armed Fijian guards.

Even without bullets flying, Greek authorities would face enormous legwork to reconfigure everything from bank machines to launderettes. "Computers will have to be reprogrammed. Vending machines will have to be modified. Payment machines will have to be serviced to prevent motorists from being trapped in subterranean parking garages. Notes and coins will have to be positioned around the country," wrote Barry Eichengreen, an economist at the University of California at Berkeley, in "The Breakup of the Euro Area", a 2007 paper. "One need only recall the extensive planning that preceded the introduction of the physical euro."

As the crisis drags on, a growing chorus of Greeks insist that the risks surrounding a drachma restoration are still better than enduring years of the austerity that has already plunged their economy into deep recession. Yet many – like Mr Chanos – are reluctant to abandon the euro. Its introduction sealed Greece's ties with the rest of Europe, adding a layer of security in light of its long rivalry with neighbouring Turkey.

Even those who would seem to benefit financially from an exit have their doubts. Tourism is held up as one of the areas of the Greek economy that would gain the most from a restored drachma, because lower prices would attract more free-spending foreigners. "This is one side of the coin," says Themos Tsokas, whose family owns a hotel on the island of Mykonos. "The other side is that the supplies we need for the hotel – everything – is imported." Those items would become more expensive overnight. He also reckons that interest rates on the hotel's bank loans would shoot up as a result of higher inflation.

Outside Greece, others are also coming to the conclusion that the country's departure from the eurozone might not provide the hoped-for benefits. Mr Eichengreen argues that wage inflation would eventually wipe out any gains in external competitiveness.

Nor is there any guarantee that a Greek exit would release the remaining euro members from the burden of supporting Athens. In addition to protecting their own banks from the shockwaves, Mr Klau says they might also have to prop up a destitute Greece for as long as a decade.

"The notion that the rest of the EU would sit by and let Greek citizens scavenge for food in rubbish heaps – I don't think European citizens would stand for this," he says. "It's often lost in the current crisis, but the founding principle of the EU is one of solidarity."

Middle-class anguish

If the radical option of leaving the eurozone is beginning to gain traction in Greece, it may be because the austerity measures taken to ward off the country's debt crisis are steadily laying waste to its middle class.

Consider the case of Leonidas Antonopoulos, a 49-year-old director-general at the tourism ministry with a graduate degree in public administration. Over the past two years, Mr Antonopoulos and his wife, an engineer, have seen their household income fall 60 per cent.

They have already taken their nine-year-old daughter out of private school and expect to withdraw her 15-year-old sister at the end of the year.

"Every cut was the last one – or so they told us. After the second or third one, no one believed them any more," Mr Antonopoulos recalls. "When we think about it, we become crazy."

Still, he counts himself among the lucky ones. In poorer neighbourhoods, the crisis is transforming life from difficult to desperate, he says – an observation supported by shuttered stores and reports of growing demand at Athens soup kitchens.

"Painful Adjustment" is the title of the Greece chapter of the quarterly economic forecast released on Thursday by the European Commission. In it, the EU executive arm predicts that Greece's economy will contract 5.5 per cent this year, with a further decline next year, and unemployment passing 18 per cent.

Given the extent of the damage, white-collar workers such as Constantinos Makris, a stockbroker in Athens, are also feeling the sting. Managers "gave me a call one morning and said, 'Would you come downstairs?'" he explains. "Then they said, 'Sign this paper and accept a 25 per cent reduction in your salary'." After threatening to quit, Mr Makris eventually settled for a smaller cut.

Meanwhile, lawyers complain about being hit with thousands of euros in special taxes levied by the government in a desperate attempt to restore its finances. "I would go out of business if I had to pay the proper tax," says one.

While there is cacophonous debate about how Greece should proceed – and who is to blame for its ills – there does seem to be a depressing consensus that, for all the suffering, the worst is yet to come.

"We used to think that there was a bottom to this. But now the general impression is that there isn't," says Mr Antonopoulos. "We don't know how low we can go."

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