FINANCIAL TIMES

May 23, 2012 7:02 pm

We must break up the failing euro

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By Martin Jacomb

As the struggle to preserve the euro goes on, two worrying trends are emerging. One is the migration of able and energetic young people away from the poorer eurozone countries. The other is the increasing belief that, since the euro is shaky, it is better to have your deposits in German banks than in those of the weaker countries.

Unless addressed at once, both these developments may become irreversible – but the second is the more urgent. The domestic banks of weaker eurozone members are losing deposits. The pontifications of European leaders have given the impression that Greece may revert to a new national currency. Depositors who envisage their euro deposits being converted into devalued new drachma are withdrawing them and keeping the money in euro notes (a liability of the European Central Bank) or in deposits with German banks. It amounts to a slow run on Greek banks.

This is greatly weakening the banks from which the money is withdrawn and lessens any chance of recovery in that economy. It may already be too late to alleviate the position in Greece, but this trend may develop in other weak eurozone countries.

Once a bank run starts to develop, it is already too late to take action. So now is the time to act, to ensure that a euro deposited with any sound bank will be worth the same as one with a bank domiciled in a strong country. Otherwise the banking sectors of the weaker countries may be seriously damaged.

Given Germany's understandable reluctance to underwrite the euro system without limit, it is difficult to do this. But unless a way is found, the situation may get a whole lot worse without much warning.

One way would be to accept that the opportunity to "save the euro" has been lost and for all 17 members to decide at once to revert to national currencies. The chance of differentiating between eurozone countries, weak and strong, has been lost. This is how it could be done.

There must be no advance warning. Experience shows that currency break-ups, like devaluations, have to be handled so as to avoid anticipatory speculative activity. The essential requirement is a single, unequivocal decision to revert to national currencies, reached confidentially by all 17 governments and announced without prior notice.

The decision would be that all obligations and rights denominated in euros would be converted legally into rights and obligations denominated in new national currencies, with each euro henceforth to be divided into the 17 national currencies in the proportions in which member states hold capital in the ECB. All 17 governments would undertake to legislate to confirm this.

The conversion would apply not only to notes, bank deposits and loans, but also to bonds, including sovereign bonds, and to commercial contractual rights. There would be no difference between the worth of a euro deposit with a German bank and one with a Greek bank. Legal disputes about commercial obligations would mostly be avoided.

In theory, the aggregated values of the fractions of each euro should be the same as the value of the euro itself, but in practice there would be a discount from the previously prevailing value because of the need to unwind the agglomeration of national currencies. The holders of what were euros would want to sell the fractions they did not want and in exchange buy the fractions sold by others, so that all would end up holding the currency they wanted.

There would be a five-day bank holiday to enable foreign exchange markets to prepare.

Euro notes would continue to circulate until the new national currency notes were available. It would not be possible to unwind the euro notes while they were in circulation. But where quantities of notes are held, they could be deposited with a bank to effect the exchanges desired.

The advantage of the plan outlined above is certainty, combined with only limited dislocation. Although the new Deutschmark would be in demand and the new drachma would no doubt attract a discount, there is no reason to suppose that buyers or sellers would behave irrationally. Sensible values would quickly emerge; these currency variations are what is needed anyway in order to achieve competitiveness. Confidence would soon start to reappear.

The writer is chairman of Share plc and former chancellor of the University of Buckingham