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THE CONVERSATION

Academic rigour, journalistic flair

Greece's path out of the euro

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Greece: the mouse that roared? EPA/Simela Pantzartzi

Author



Michael Ben-Gad

Professor of Economics, City, University of London

Ever since Greece elected its new Syriza government, there has been growing talk of Greece defaulting on its debt and leaving the eurozone. I've been arguing that once Greece achieved a primary budget surplus it would default on its debt since late 2010, when Greece was negotiating its second bailout. This might not be such a bad thing.

Back in 2010 it was EU panjandrum Herman Van Rompuy who threatened that if Greece defaulted it would lead to no less than the collapse of the EU itself. It requires extraordinary faith in the power of semantics to believe that the apocalypse was only averted because the evaporation of 75% of the value of Greek debt held by European banks in March 2012 was termed a renegotiation.

Now Greece's new finance minister, Yanis Varoufakis, is the one issuing the threats, arguing that somehow a Grexit will usher in a European-wide calamity. Can a country that accounts for only 1.8% of the eurozone's economy have such an outsized effect?

The mouse that roared

This year marks the sixty years since the publication of Leonard Wibberley's novel *The Mouse That Roared* and Greece's strategy in negotiating with its creditors is strangely reminiscent of the book's plot. In it, the prime minister of a tiny alpine duchy, the cunning Count Mountjoy, sends a twenty-man force led by a hapless game warden-turned-field marshal to conquer New York. Mountjoy's hope

is that, as was the case for West Germany and Japan after World War II, the ever-magnanimous Americans will agree to rebuild the economy of its defeated foe.

Much like the newly minted field marshal, Greece's finance minister was dispatched on his tour of European capitals not to win the war but to lose it. The ultimate goal of Greece's prime minister, Alexis Tsipras, is not to compromise, but to facilitate an exit from the eurozone and regain control of both his country's fiscal and monetary policies.

Because relinquishing the euro is likely to be unpopular, resuscitating the drachma must be framed as a patriotic response to the economic aggression of Greece's foreign enemies. The villainised Troika of its international lenders and, better still, German chancellor Angela Merkel and her finance minister Wolfgang Schäuble serve this purpose. The **loan extension** that has emerged from negotiations in Brussels this week merely buys time for the Greek government to plan a more orderly return to its own currency.

Returning to the drachma

There is nothing particularly new or earth shattering about establishing a new currency. It generally happens when countries gain their independence or split up. The first step would be to freeze bank deposits, and make sure the plans do not leak so that people cannot withdraw their money in advance.

Everything, including contracts, would be redenominated from euros to drachma. The existing stock of euro notes would quickly disappear from circulation as people initially hoard them as hedges against the inevitable period of high inflation, and new currency notes would need to be printed.

The key to success would be measured in how substantial yet rapid a loss could be imposed on the buying power of those who own paper assets like bank accounts and government bonds the moment they are converted into drachma. This is why it would be most convenient to have a foreign country or institution to blame – Germany and the IMF will do nicely here.



Soon to be a relic of history? EPA/Ralph Hirschberger

Life after the euro

Once that is in place, and as long as the government then maintains fiscal discipline, avoids issuing too much new debt, or resorts to raising revenue by printing money, the value of the Drachma would soon stabilise. After all, the government would pay for the goods and services it buys as well as wages in the new currency, and individuals and businesses would need to get hold of it to pay their taxes.

Having repudiated all but the domestic component of its massive sovereign debt, lots of the pressure would be off the government's finances. At the same time, Greek industry would gain competitiveness and – provided the government resists the temptation to impose capital controls (alas, not likely given Syriza's governing ideology) – foreign investment will likely start flowing to take advantage of the favourable cost structure afforded by the weakened currency. Most important of all, employment would begin to recover, and the long nightmare that began for most Greeks in 2008 would slowly end.

The eurozone will survive with or without Greece as long as Germany, France and Italy remain committed to its existence. For Greece there is life after the euro, perhaps even an eventual return to pre-crisis prosperity, this time sustained by real economic activity rather than fraudulent accounting and unsustainable borrowing. Provided the Syriza government is prepared to institute many of the very reforms the Troika have demanded, perhaps framed this time as patriotic sacrifices necessitated by a national emergency imposed from abroad, leaving behind the euro as well as its debt burden may ultimately be Greece's best option.


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