# Greece: a new drachma unfolds

**The electoral triumph of Syriza in Greece has awakened the sleeping ogre of the eurozone crisis. No plausible outcome of the confrontation between Greece and its creditors will resolve the inconsistency of a monetary union unsupported by political union, says** David Rowe

At the risk of sounding grossly insensitive, I must say that for a financial commentator, the eurozone crisis is the gift that keeps on giving.

As the crisis has morphed from acute to chronic, some kind of populist reaction had to follow, and we should not be surprised this occurred where it all began, in Greece.

It is easy to make the case that Greece brought this crisis on itself through irresponsible fiscal policies and falsified accounting, but it must also be remembered that Greeks have suffered a contraction in GDP comparable to that experienced by the US during the Great Depression of the 1930s. Unemployment has risen to a level consistent with this decline in GDP – so the surprise, if there is one, is that a political reaction has taken this long.

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Now, we really do appear to be headed for a classic collision of the irresistible force and the immovable object. Virtually any plausible outcome of this collision bodes ill for the future of the euro.

Syriza cannot back down from its uncompromising campaign promises without its supporters feeling betrayed. An outright Greek default and exit from the euro would have dire consequences for the country. Assuming official sources are not forthcoming, it is hard to imagine where the new government could obtain external funding for its expansive fiscal ambitions. One alternative would be even more draconian cuts in benefits than would be required under an extension of the terms of the bailout. This is clearly incompatible with the philosophy and promises that brought Syriza its political victory.

A far more likely scenario following a Grexit is that the Syriza-led government will fund its programme by effectively unlimited printing of new drachmas. This, of course, would lead to internal inflation and a rapid erosion of the competitive benefits that devaluation initially provided to Greek industry.

The implications of a Grexit would also be harsh for the remaining members of the eurozone. Holdings of euro-denominated Greek debt would have to be written down and would be the subject of endless litigation and ill will for years to come. Perhaps more importantly, a Grexit would overturn the inviolability of the "irrevocable conversion rates" adopted by the European Union Council on December 31, 1998.[1] The prolonged doubt this would create about other countries' permanent place in the euro would be a perennial source of instability.

Of course, a compromise still might be possible. Some respected voices, including the editors of *The Economist*, have argued for a more expansionist fiscal and monetary policy stance in the eurozone. To be credible, however, it would have to be an EU-wide adjustment. Anything that smacked of a special concession to Syriza's demands would embolden similar insurgent parties in other countries.

Perhaps the most problematic of Syriza's promises is its intention to reverse the labour market reforms that have already been implemented. Renewed labour-force rigidity would create a serious obstacle to the adjustments required for economic recovery. As such, it would undermine, and possibly outweigh, the benefits of any potentially more expansionist fiscal and monetary policies.

Certainly the most worrying aspect of the current situation, and the one that could tip the balance into an outright Grexit, is a potential loss of faith in Greek banks. Fears of domestic deposits being forcibly converted into rapidly depreciating new drachmas might become pervasive. The resulting rush to move euro balances into other eurozone banks in Germany and elsewhere would be the moment of truth. The European Central Bank (ECB) has said it will not support Greece's banks if the country is not in an agreed bailout programme. If the ECB steps aside as the lender of last resort to these banks, it is hard to see how a major liquidity crisis and eventual Grexit can be avoided.

Another tempting strategy for dealing with this type of crisis is an Orwellian corruption of language. Some form of evasive formulation may be devised to mask concessions made by one or both sides. This fudge might even work for a while, leading the unwary into complacency. Unfortunately, just like people, a system of governance cannot be sustained on a steady diet of fudge. Eventually, internal contradictions become obvious and harsh reality cannot be avoided. **R**

[1] *www.ecb.europa.eu/press/pr/date/1998/html/pr981231_2.en.html*