Special Report on Greece

Cutting Through The Clutter In Greece

What Can The World Expect?

June 2012

Historically, modern Greeks have tended to think of themselves as being more important in world affairs than they've actually turned out to be. But the special election on June 17th could prove a notable—and frightening—exception to the rule.

This tiny country of barely 11 million people, perched on the rocky southeast fringe of Europe, accounts for less than 2% of the European Union's economic activity. However, the outcome of the June 17th vote could bring about the rapid unraveling of the European monetary union and the dismemberment of the euro as the world's second-most-widely accepted reserve currency after the dollar.

The implications of all this for businesses all around the world may be sweeping.

The Awful Choices

In recent days, an array of public opinion polls has begun to show a solid majority of the Greek people coalescing around the idea that as bad as things are now, everything would be worse—a lot worse—if they were to elect a government determined to renounce the country's foreign debts (mostly to Germany), abandon the euro, and revert to its historical currency, the drachma. The National Bank of Greece is now warning that doing so would lead to a 55% fall in per capita income, with bank lending rates soaring to 37%, while output would plunge by 22% and property values would fall by half.

Also, a return to the drachma would immediately precipitate a 65% fall in the new currency's nominal value. Unemployment would shoot up to 34% from the current 21% and inflation would initially explode to 30% and keep on rising.

Gasoline prices would soar overnight to perhaps $20 per gallon, and food for most people would become unaffordable. This doomsday scenario has now been dubbed "drachmageddon."

It is also the reason why none of the three main political parties in Greece want to sabotage their chances on the 17th by endorsing Greece's exit from the euro. The three parties are (1) the conservative-centrist Nea Demokratia (New Democracy) party, which was founded by the grand statesman of modern Greek politics, Constantine Karamanlis, after the collapse of a seven-year military junta in 1974, (2) its arch-rival socialist-center PASOK, and (3) the far-left fringe party, Syriza.

The State of Play

In fact, what is threatened by drachmageddon is happening in Greece already. Soup lines are a commonplace sight, and in one widely reported recent incident, an elderly pharmacist committed suicide at midday in front of the Greek Parliament building in central Athens. His reason? Professed shame and desperation over the fact that he could no longer feed his family.

There is some dispute over who said, "In a democracy the people get the government they deserve," though the author was probably the French 19th century political thinker Alexis de Tocqueville. In any case, Greece is proving the wisdom of those words, for in every respect the calamity now besetting it is a direct consequence of the corruption, cronyism and incompetence visited upon the accepting Greek people by their political leaders.

Now they are stuck with the results, and there is no heroic Leonidas of Sparta to rally them against the Persian hordes. Not after almost seventy years of corruption and venality as a way of life.

Meanwhile, the patience of the IMF and the EU has run out, and both say they will turn off the tap if political instability continues. The EU has ratcheted up the pressure by holding back €1 billion ($1.24 billion) of a €5.4 billion ($6.7 billion) tranche of help in May. With cash running out, the finance ministry will struggle to pay pensions and public-sector wages by the end of June.

Even so, it seems a long shot that a stable government will emerge from the special election. The reason the election is being held is that none of the competing parties was able to win a governing majority in the last election, in early May, or cobble together a ruling coalition.

At the moment, the largest party—the conservative New Democracy group—has support of only 24.5% in the polls, with the ultra-leftist Syriza group right behind them at 22.1%. The socialist-left PASOK party is trailing the field, with just 12%.

What is frightening about all this is that neither New Democracy nor Syriza can stand on its own, for the simple reason they are attracting support from the political spectrum's furthest frontiers. On the right this means the neo-Nazi Golden Dawn Party, which openly embraces the Nazi salute at rallies and blames all Greece's troubles on "immigrants and Jews." On the left, similar anti-immigration sentiments now echo from the Greek Communist Party.

With these unsavory ingredients, Greece must somehow forge a "stable" government in the special election. No one thinks it can be done, especially if no party wins an absolute majority and New Democracy and PASOK try to form a coalition to lock out Syriza. That party's young leader, Alexis Tsipras, a one-time member of the Greek Communist Party, is inexplicably being championed as the "hero of the hour" and Greece's last best hope for salvation– this in spite of the fact that he reportedly supports a strong military able to crush civil unrest in the mayhem he fears is coming.

So, the very real possibility of even worse political instability looms ahead, no matter what the result of the election. Since March, Greece has received only half of the €145 billion ($185 billion) earmarked for it in the European Financial Stability Facility (EFSF), the eurozone's temporary rescue fund. Paying the rest can be dragged out by the EU to the end of 2014 if it wants, even if Greece agrees to its conditions. Ditto for the total of €28 billion ($34.6 billion) promised from the IMF; to date only €1.6 billion ($2 billion) has been handed over, and if the IMF wishes, it could drag out paying the rest until 2016. One can only imagine what shape the Greek economy will be in four years from now.

Most economists agree that the austerity measures foisted on Greece as part of the bailout are impossible to deliver because they would drive the country deeper into recession and make debt even harder to cut. Peter Bofinger, one of the five "wise men" who formally advise the German government on the economy, suggested that Europe should renegotiate the terms of Greece's bailout because they were originally based on overly optimistic assumptions of growth.

Meanwhile, there have been large withdrawals from Greek banks since the May 6th elections. Somewhere between €3 billion and €7 billion ($3.7 billion and $8.6 billion) has been taken out, according to the National Bank of Greece. This is just another route to drachmageddon, since the Greek banks could soon end up with no euros and would have to begin paying off depositors with drachmas, since only the European Central Bank can print euros.

If this happens, capital controls would be necessary because the drachma would immediately fall against the euro and Greece would be forced to renege on most of its debt to foreign creditors.

Didier Reynders, who is both Belgium's foreign and deputy prime minister, says, "There is no organized discussion at the European level along the lines of: What do we do (if Greece leaves). Now, if central banks and companies are not preparing for the scenario, that would be a grave professional error."

Consequences of an Exit

One reason there are no contingency plans is that the prospect for a Greek departure from the EU is so awful. If a "Grexit" does happen, European governments would have to bear heavy losses on the various bail-out loans they have made to Greece already.

Last year the ECB bought Greek bonds worth about €40 billion ($49.5 billion) to calm financial markets. Moreover, the Bank of Greece owes the ECB an additional €130 billion ($160.8 billion), which is internal banking debt but in the event of an exit would turn into real debt as well.

According to economists at Barclay's Capital, the Greek government owes the governments and institutions of the eurozone a total of over €290 billion, ($358.7 billion) about 3% of the eurozone's GDP—and none of this is likely to be repaid after an exit.

On top of that there is private debt, which at the end of 2011 was calculated at about €56 billion ($69 billion) owed to various international banks by Greek companies and households.

Add it all up: A total of more than €500 billion that Greece owes the rest of Europe, most of which would almost certainly not be repaid if Grexit were to become a reality.

Is There Life after a Grexit?

The only precedent that economists can point to is Argentina's default in 2001 and its subsequent economic resurrection. But it was the global boom in commodities that saved Argentina, leading to its GDP growth of 9% from 2003 to 2007. Alas, Greece's exports of cotton, rice, tobacco, steel, bauxite, petroleum, aluminium, and textiles are modest at best and not nearly enough to refloat the economy.

Meanwhile, there is more bad news on the trade front—this time involving imports. Two of the world's three largest underwriters for trade insurance to Greece announced that they are pulling out because it is such a bad credit risk.

A Possible Way Out

Considering all the foregoing, a "Plan B" is now imperative. Greece should begin to look to its Balkan neighbors and build a series of bilateral trade deals.

Greece could begin to secure grain and coal from the Ukraine, oil from Russia or Georgia and arrange direct exchanges of manufactured goods with Romania and Bulgaria, using its own exports (see above) as bargaining chips. Greece has historic ties to the region, with its industrialists and shipping connections enabling a strong presence in the Balkans and Black Sea countries.

Sad to say, however, there is not a single politician in Greece now talking about any of this.

Conclusion

Greece is in trouble, and because of that, so is all of Europe, and perhaps the world. The special election of June 17th is unlikely to make anything better.

As Bette Davis said in All About Eve, "Fasten your seatbelts, it's going to be a bumpy night."