THE TIMES

# A euro break-up is nothing to be afraid of

Anatole Kaletsky

February 15 2012 12:01AM

## The departure of Greece could in turn bring a workable system of national currencies

The latest "strategy to save the euro" will again end in failure. That much is clear from the riots in Greece and from the warnings by some Greek politicians that they will not be bound by any deal imposed from Brussels and Berlin.

Even more important was the promise this week from François Hollande, the probable President of France this coming May, that if elected, he too would reopen the half-baked treaty on fiscal union signed with such fanfare last December by Angela Merkel and Nicolas Sarkozy. This treaty now looks unlikely to be fully ratified.

As financial markets, currently intoxicated by cheap money, come to recognise these political realities, they will doubtless tumble, triggering yet another financial crisis.

At present, the odds still favour the euro's survival over its break-up. But everything depends on the Germans, who have frequently failed to calculate their own best interests. It was no surprise therefore last weekend to hear the German finance minister, Wolfgang Schäuble, describe with undisguised relish the mechanism that could trigger a euro break-up.

Mr Schäuble suggested that Greece should be denied its next European bailout because democratic politicians could not be trusted to implement agreements signed by the present technocratic Government. The implication was that Greece might be denied its next EU bailout, despite the agreement it signed last week. This would force a Greek default, which, in turn, would force Greece to leave the euro. What Mr Schäuble did not seem to understand is that a Greek exit would probably start a chain reaction leading to the euro's disintegration.

Yet there is no necessary connection between a Greek default and a euro break-up. In theory, if Greece wrote off its debts this could help it to stay in the euro. If its Government's debts to foreign creditors were wiped out, it would become one of the best credit risks in Europe.

Why, then, would a Greek default break the single currency? Because Mr Schäuble has himself created this danger by making a euro exit synonymous with default. As a result, if a default looms, savers in Greece will instantly withdraw their money from the Greek economy. This capital flight will force the Greek Government to start printing a new currency to keep its banks open and its economy alive.

The question that politicians and businessmen across Europe should now be asking is: what would happen next? The official answer is: "Nothing much." In fact, German politicians mostly believe that expelling Greece would make the euro stronger. They are almost certainly wrong.

If Greece were expelled, the euro would cease to be an "irrevocable" single currency and instead become just another fixed exchange-rate arrangement of the kind that Europeans have repeatedly seen blown away. Once this became apparent, the same vicious circle of financial expectations that forced Greece out of the euro would start spinning in Portugal, Ireland, Spain and eventually Italy and France. As Mervyn King noted during the Northern Rock crisis: "Once a bank run has started, it is rational to join in."

The European and German authorities would doubtless offer reassurances after a Greek exit that devaluation was "unthinkable" anywhere else. But why would anyone believe them, if the same people's promises to "do whatever it takes to save the euro" turn out not to be true?

To make matters worse, there is a political Catch-22. If Greeks suffer horrendous losses after devaluation, fear of similar consequences will encourage capital flight from other vulnerable countries. If, on the other hand, Greece does surprisingly well after default and devaluation, as many countries have in the past, this will create a tempting precedent for other countries crushed by austerity.

In short, a break-up of the euro, while not yet inevitable, has become quite likely. It is therefore time to start making contingency plans to prevent the financial apocalypse predicted by European politicians to terrify their voters. Luckily an orderly break-up now looks more feasible than it did even a few months ago.

Finance and banking are being renationalised as the crisis intensifies. Cross-border bank lending has almost stopped, meaning that French companies now borrow almost exclusively from French banks, which rely on funding from French deposits or loans from the Bank of France. Governments are also borrowing largely from their own national banks and savers. And pan-European businesses are restructuring to match their assets and liabilities in different EU countries — if a Spanish company has 60 per cent of its assets in Spain, it tries to rely on Spanish banks for 60 per cent of its borrowing. As this process of renationalisation progresses, a break-up of the euro becomes less alarming.

The euro was created in 1999 out of a basket of national currencies, called the ecu. This process could be reversed. The euro could be turned back into a weighted average of national currencies, with all contracts inside national borders switched back into domestic currencies, while cross-border contracts remained in euros. As these liabilities shifted from private debtors to governments and central banks, the gains and losses from a currency break-up could be shared out through negotiations of the kind conducted many times after previous devaluations and defaults.

Europe's politicians will insist that any discussion of such a plan is nonsense, since an orderly break-up of the euro is completely impossible. But remember: these are the same people who said just a few months ago that it was completely impossible to imagine a euro government's default.

© Times Newspapers Limited 2012 | Version 1.30.0.5 (40552)
Registered in England No. 894646 Registered office:
*3 Thomas More Square, London, E98 1XY*
**My Account | RSS | Site Map | FAQ | Classified advertising | Display advertising**
**Privacy Policy | Syndication | Terms & Conditions | Contact us**