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Monetary union is reversible

Greece could revert to the Drachma if it wanted

It sounds categorical: according to the Treaty of Lisbon a country in the Euro zone could neither voluntarily resign from the monetary union nor be forced to do so by the other countries. "Euro participation is irrevocable", states Ollie Rehn, EU Monetary Commissioner. Nevertheless, Germany's finance Minister Schäuble is calculating what Greece's withdrawal and bankruptcy might cost. In Germany, Finland and the Netherlands calls for an amendment of Euro regulations are growing louder. Perhaps no addendum would actually be needed?

The entry of a country into the monetary union and conversion to the Euro currency does not have to be a conclusive and irreversible process. Senior Partner Dr. Urs Schenker from Baker & McKenzie Zürich and asset manager Rolf Schlegel came to this result after taking a closer look at this question.

A reversion should be possible: the EU could legally secure the return to the local currency by law. "By reversing from the Euro to a local currency, the affected country can win back its international competitiveness," argues Schenker. Although it would lead to losses for creditors. However, these would not be a consequence of the currency reversion but due to the fact that creditors had lent money without evaluating the risks. People speculated that the EU would step in with support.

If Greece would want to return to the Drachma, it must firstly introduce this by law as legal tender and convert all outstanding Euro debts owned by domestic debtors into Drachma at a rate of for example 1:10. Simultaneously the EU would declare the currency conversion as binding for all creditors in its member states.

The EU and Greece would allow the Drachma to float freely against the Euro. It would be assumed that the market would immediately devalue the Drachma by around 25 to 35% lower, about 13 Drachma to €1. All outstanding Euro debts existing today would have to be devalued to the same extent. This devaluation also involves the debts that Greek nationals have towards creditors abroad to avoid that Greek companies that still have to pay back debts in Euros can do so in Drachmas as their assets and income are been valued in Drachmas.

This would restore competitiveness. Greek products and services would be around 30% cheaper in Euro countries. The associated inflation effect (imports becoming more expensive) is in part balanced by the fact that Greece will make fewer imports and the domestic industry could cover the higher domestic demand locally. This would create jobs. According to Schenker and Schlegel it is significantly simpler to re-establish competitiveness through devaluation than through savings and emergency measure programmes as insisted by the EU and IMF.

With the currency reform the Drachma interest rate level would also rise to a few percentage points above the Euro level. Higher interest rates would be an expression of a risk-adjusted capital return and would neutralise speculative inflows.

This conversion decreed by law would also include the country's sovereign Euro debt. That would be necessary as the fiscal revenue of Greece would only be accrued in Drachma and insufficient Euros would be available for repayment of the debt. KR

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