Greece Should Not Quit the Euro Area, Part II

Anders Åslund explains that a Greek exit from the euro would produce chaos and bank runs throughout Europe and inevitably lead to a breakup of the euro area itself.


Steve Weisman: This is Steve Weisman with Anders Åslund at the Peterson Institute for the second part of our conversation about the potential for the euro zone and for Europe and indeed, for the world economy if Greece were to exit the euro zone in an orderly or disorderly way. If Greece were to exit the euro zone, which you have argued is a bad idea for Greece, what would happen in the rest of Europe?

Anders Åslund: What I think would happen is that because of these massive imbalances that are already in play, the uncleared imbalances between the northern countries and the southern countries in the European economic monetary union, means that if there were one country, regardless of which, moves out of the euro, there will be massive bank runs from the weak countries to the strong countries. The strong countries are essentially four: Germany, Finland, Holland, and Luxembourg. And as a consequence of this, the banks in the eight weak countries, most of them, will immediately close when one country declares that it will leave. And the banks in the north will also close because they don’t want more currency. They can’t do anything with the money. So, we will get currency controls on both sides and the payments mechanism will break down. And we have seen three currency zones with many countries breaking up in a disorderly fashion in the last century in Europe, and each ended with hyperinflation. Half of the countries that were involved did not come back to their GDP per capita before the crisis until 20-25 years later.

Steve Weisman: You studied these examples in your Policy Brief. What are they?

Anders Åslund: Yes. They are: the Austro-Hungarian Empire that broke up in the early ‘20s; Yugoslavia broke up from ‘91; and the ruble zone that broke up in ‘92, ‘93. Austria and Hungary had hyperinflation and really didn’t come back until the mid-1950s. Yugoslavia as a whole had hyperinflation in two rounds, and Serbia, Montenegro, Kosovo, and Bosnia-Herzegovina -- four out of seven have not come back to their economic level of 1970. In the former Soviet Union, 10 out of 15 countries had hyperinflation and five countries have not come back to the GDP level that they had in the 1970.

Steve Weisman: Your Policy Brief has stirred a debate. Some friendly criticism is that you can’t really analogize to, for instance, the Austro-Hungarian example because there was a war and a depression that were also factors in low growth.

Anders Åslund: War and social unrest are typical of the disorderly breakups of currency zones. The best example here is when Yugoslavia in ‘91 had a decent stabilization going at federal level. But then Serbia, under Slobodan Milosevic, issued much more currency in order to pay the richest countries, Slovenia and Croatia. As a result of this, in June ‘91, Slovenia declared independence from Yugoslavia and therefore, Milosevic sent in these troops in Slovenia and a minor war started. That was the first war that then became so bloody elsewhere in Yugoslavia. You can say that currency was the direct cause of the breakup of Yugoslavia and this was part and parcel also of hyperinflation.
Steve Weisman: A technical question. When you speak of hyperinflation, is it because one or the other of the parties just starts printing money after they break up?

Anders Åslund: Yes. Normally, what happens is that you have the kind of prisoners' dilemma. You have a common GDP to begin with, and the more currency one country that is part of currency union issues, the larger share of the common GDP does it get. The downside is that GDP falls everywhere so in the end, you lose. In Yugoslavia, it was Serbia that issued money; in the former Soviet Union it was particularly Ukraine that issued the most money and managed to get to a hyperinflation of 10,000 percent. In '92, Ukraine had a relatively small decline in GDP because it issued so much money. But all together, Ukraine had one of the biggest declines in GDP because of it. So, to issue money, it is to get away somewhat easier in the short term, but you suffer badly in the long term.

Steve Weisman: One final question, a dumb one perhaps: why should a bank run occur in a country whose fundamentals are strong, like Germany or the other northern European countries you mentioned?

Anders Åslund: No, the bank run would go to Germany.

Steve Weisman: Why?

Anders Åslund: Because you think that it's much more likely that Germany will survive because Germany has now big positive balances against the rest. The latest numbers we have is that Germany's positive balances in the EMU [European Monetary Union] clearing system are more than 1/3 of Germany's GDP. So the worry the German economists have is that this balance will become empty, meaningless, and that this will end up a cost to Germany. But Germany does not get paid for its deliveries to the southern countries.

Steve Weisman: So people take their money out of German banks?

Anders Åslund: No. People take their moneys out of southern accounts from Greece, Spain, Italy, Ireland, perhaps France, and put it in the German, or Finnish, Luxembourg, and the Dutch banks. But of course they will also take their money out of euro zone and such.

Steve Weisman: A disaster, no matter how you look at it.

Anders Åslund: Yes, because we have these huge imbalances already. If there had been no imbalances, then one could have a friendly breakup. This has happened when many colonies have become independent because then, normally, a colonial power has taken over the responsibility. I could imagine that the United States would put up a trillion euros or that China will do it or that the IMF [International Monetary Fund] will do so. But what would that mean for the sovereignty of the European Union? It would mean really that they become a protectorate of somebody and that was possible after the Second World War when the United States had won. But today, no way, and nor would anybody then be prepared to put up that amount of money.

Steve Weisman: Thank you very much for that gloomy but interesting review of the situation.

Anders Åslund: Thank you.