Drachma diplomacy: What would life after the EU look like for Greece?

DAVID KENNEDY, FINANCIAL POST STAFF | February 13, 2015 | Last Updated: Feb 13 5:29 PM ET More from Financial Post Staff

A Greek exit may start not with boisterous rallies in Syntagma Square, but quietly, in the dead of an Athenian night. If Greece's ruling Syriza Party and its partners were to make that momentous decision, Greek banks would clandestinely get word the country is abandoning the eurozone and switching back to its own ancient currency. From there, the coordinated distribution of drachmas would begin, according to a worst case scenario painted by Alex Jurshevski, the managing partner and founder of Recovery Partners Ltd. "They'd have all the bills printed up," he said in an interview. "They'd be waiting in a bunch of dump trucks." The newly pressed drachmas would arrive at various locations of the Greek central bank, and after three or four days of closures to convert the euros, Greek banks would reopen for business. "It would happen, boom, like that," according to Mr. Jurshevski, who worked to restructure New Zealand's debt in the 1990s and consulted with Iceland during its 2010 crisis. It would be as if the whole 14 year euro misadventure never happened.

Few analysts, Mr. Jurshevski included, expect a Grexit to become an immediate reality. But all parties do acknowledge withdrawal would be calamitous for the small Mediterranean nation that makes up less than 2% of the US$13.15 trillion eurozone. What would life after EU look like? Capital flight is the most pressing threat to Greece, and it's already taking place. As Greek officials spouted uncompromising rhetoric at summits across Europe this week, Greek citizens quietly moved their savings from Greek banks to others in Europe, and packed hard currency under mattresses. Kathimerini, a Greek newspaper, reported Friday that over 14 billion euros were withdrawn from Greek banks in the runup to last month's election, and close to 3 billion euros have been taken out in the first two weeks of February alone.

They'd have all the bills printed up… They'd be waiting in a bunch of dump trucks This would in turn infect the EU. "When monetary unions die, it is always because of the banking system," Paul Donovan, a global economist at UBS AG, said in an interview. "People just pull their money out of the banks and you get a collapse in the banking system and that then spreads to different components of the monetary union." If Greece switches currency, any euros left in Greek bank accounts would be converted to drachmas – which would cost account holders dearly, as analysts estimate the drachma would depreciate by 50% to 60% in a matter of days. Steve Hanke, professor of applied economics at Johns Hopkins University and senior fellow at the Cato Institute, explains that, once cash flow evaporates, Greece's GDP collapses.

"You always have to have some kind of level for national income," he said in an interview. "The money supply, money and credit, determine that. If money and credit go down sharply, your economy is going to go down sharply." In such a scenario, Mr. Hanke, a currency specialist who has worked with various governments in Europe and South America, wouldn't rule out truckloads of bills and coins being carted out of Greece. The evaporation of Greek credit could lead to a debt spiral. Under the drachma, though, the Greek government would be able to pay government employees, something it won't do much longer if it can't secure more euro credit from the European Central Bank. According to Mr. Hanke, the Greek government now accounts for about 60% of the country's entire GDP, so keeping government workers on the job is paramount. The question is whether or not the bills would have any value. More money in circulation leads to inflation. "Whether it goes to hyperinflation depends on how many drachmas these people print up and the market's … reaction," Mr. Jurshevski said.

With the damage to its banking sector, Mr. Hanke thinks another recession would be imminent in Greece. Its economy has already lost 25% of its GDP since its peak in 2008, according to a UBS report. UBS predicts leaving the eurozone could cost the Greek economy up to 36% of its GDP over the next few years. After such devastation, it is unclear how Syriza could afford to keep any of its lofty campaign promises.

A Grexit has one saving grace for the Greek economy, however. The country would no longer be tied to a hard currency that makes it difficult to compete. A devalued currency would boost struggling exporters, draw deal-seeking tourists, and give the Greek economy room to recover. Otherwise, according to Mr. Jurshevski, Greece is doomed to struggle with slow growth and higher unemployment. "The economy is not completely flat," Mr. Jurshevski said. "They're not coming out of the war as a defeated loser… They still have the tourist industry. They still have the vibrant agricultural sector. They're still making and exporting wines, foodstuffs. The economy is still okay at a level. It's not at zero." In the long run, Mr. Jurshevski thinks Greece may actually do better by itself.

The calamitous immediate aftermath of its exit, though, means Greek leaders are playing a game of high stakes chicken, blindfolded. "If [the eurozone] does break down," Mr. Jurshevski said, "you've basically got a scenario where you've got a pool table with no bands or buffers and you're rolling a billiard ball on it hoping you don't scratch."