Elections in Greece, Part II: Will Greeks Also Say 'No' to the Euro Area?

Jacob Funk Kirkegaard says that if Greeks confront the consequences of leaving the euro area, they will very likely balk and accept their bailout terms.

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Steve Weisman: This Steve Weisman at the Peterson Institute for International Economics with Jacob Kirkegaard of the Institute discussing the aftermath of the confusing and chaotic Greek election results. In our last interview, Jacob said that Greece is now confronting the reality that if it doesn't come to terms with the IMF bailout, it could face an even greater economic disaster than the one it is now in the middle of.

Now Jacob, explain why Greece faces an even graver disaster if it should leave the euro zone.

Jacob Kirkegaard: If a country leaves the euro zone, it has to change its units of account, which means that it is going to go back, in this case, from the euro to a much, much weaker currency, the new drachma, which certainly will lead to massive inflation in Greece, which is certain to hit the middle classes and the lower income groups. Everybody who has any savings in the Greek banking system will have them wiped out. Anybody who has to spend most of their income on basic necessities such as food is going to be suffering from inflation disproportionally.

Steve Weisman: Why should the cost of food rise unless they're importing their food?

Jacob Kirkegaard: Well, they are; that's the problem. Greece is a sizeable food importer. They may not import olive oil, but they import a lot of other food. And the cost of energy is going to go up a lot as well because Greece imports most of its energy, which it is going to pay in what now will all of a sudden be hard foreign currency.

And then there is the other element to this which is that -- unlike a country like Argentina, which obviously is a major commodities exporter -- Greece doesn't really export very much. It has the lowest export ratio of any country in the euro area, of only about 10 percent of GDP of its total goods exports.

The idea that Greece is going to get a lot economic growth by an increase in its competitiveness from this lower exchange rate, I just think that's a complete fallacy. And I think that the one thing that you could point to, which is that Greece may have a significant boost to its tourism from a reintroduction of the drachma -- that's quite unrealistic because we do know that tourism in-flows tend to be relatively sensitive to cost competitiveness and exchange rates, but tourism is even more sensitive to threats of social unrest.

You're fundamentally not going to go to a country, even if it's a little cheaper than the neighboring country, if you risk being stuck at the airport and can't get a taxi or any kind of other transportation because of a strike or other things. So these are the issues that Greece is going to struggle with. I'm quite confident in saying that if Greece decides to leave the euro area, which they may -- I still don't think that it is the likely outcome but I think the risk of this happening has gone up -- no, it'll be an absolute disaster for Greece.

Steve Weisman: It would be tempting for Greece to say, "Well, why don't we default, why don't we leave the euro zone?" But in effect, they've already defaulted because through their agreement with their creditors and the IMF gave them about as much debt relief as they could get. Or am I overstating it?

Jacob Kirkegaard: No, I think that they got well over a hundred billion euros in debt relief, which is a non-trivial sum.

Steve Weisman: And is that agreement out the window?

Jacob Kirkegaard: No, no, no. That agreement is sort of water under the bridge. Those losses have already been realized. That debt is gone. That's why that debt disappeared into thin air, if you like. During the debt swap.

But if Greece decides to go down this route, they will be defaulting overwhelmingly. By defaulting, I mean imposing significant financial losses on not necessarily market participants or banks, they'll be imposing them directly on the taxpayers of other euro area countries and potentially, although I think very unlikely, also on all the members of the IMF. But I think that's the least likely. But certainly, the taxpayers in all of the other euro area countries are going to be potentially hurt by this.

And unsurprisingly, as a result of that, the euro area countries are probably not going to look too favorably on Greece after such a decision. So the reality is that this is going to be about much more than just leaving the euro area. Ultimately, I think if Greece decides to leave the euro area, they also have to leave the European Union. Because they won't be able to function within a group that has such close collaboration at the same time as they are imposing significant financial losses on all their partners.

Steve Weisman: So under your scenario, a failure to form a government is going to force a new election. Under your scenario, in that election, whether to stay in the Euro zone is basically the issue before the voters, and you think they may look over the abyss and swallow their medicine.

Jacob Kirkegaard: Yes. I think that the real key issue as we look forward to a likely new Greek election is really what is going to be the driving narrative during this election campaign. There is no doubt that in the run up to this current election, everybody is fed up with the incumbent parties. They're fed up with austerity and Greece has been obviously in economic recession for a very long time.

And when that is the narrative, it's not surprising that the incumbent parties are losing out to various varieties of populist parties and parties that, however as I see it, are peddling snake oil, in the sense that they're saying that—many of them, not all of them – that we want to stay in the euro area, but we also want a new deal from the IMF. Once it becomes clear, which I think it is in the process of becoming, that there is no other IMF deal on the table, and the alternative to taking what is on offer is an exit from the euro area, then the narrative of the next election can be very different from the current one.

It really becomes about, “Do you want to stay in the Euro area or not?” Not about, “Do I like austerity or not?” And if we believe the polls in Greece, somewhere between 60 and 70 percent of the Greeks are very much in favor of staying in the euro area. Therefore I think that in an upcoming election in Greece, there is a significant chance that the established parties -- New Democracy and PASOK, who are obviously the parties in favor of the IMF bailout as well as staying in the euro area – they might do significantly better.

Steve Weisman: And gain a majority between them.

Jacob Kirkegaard: And gain a majority. It won’t mean that they would regain the sort of crushing majorities that they had in the previous parliament, but I think it may mean that they may regain a governing majority and therefore be able to implement the IMF program as was agreed with the previous government.

Because at the end of the day, I don’t think that the majority of the Greek population is going to really elect a parliament that will see Greece exit the euro area.

Steve Weisman: Thank you, Jacob.

Jacob Kirkegaard: Pleasure.