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**Working Paper**

## Three Myths Behind the Case for Grexit: A Destructive Analysis

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CITYPERC Working Paper Series

Three Myths Behind the Case for Grexit:  
A Destructive Analysis

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# **Three Myths Behind the Case for Grexit: A Destructive Analysis**

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## **1.Introduction**

Greece faces a stark choice: either to compromise on the terms laid down by its international creditors and thereby remain in the eurozone or reject any compromise on the terms and exit the eurozone. The Syriza government was elected in January, 2015, on the double promise that it would tear up the deeply unpopular memorandum imposed by the Troika while at the same keeping the euro. It was a promise that it could not keep. After several months of tough negotiations it has become clear that Greece's creditors, led by the German government, have no intention of accepting a renegotiated deal that substantively lightens Greece's debt burden and thus the need for the type of harsh austerity measures contained in the memorandum.

The question, therefore, is what does the Syriza government now do? Given that it must make clear to the Greek people that it cannot fully carry out its election promise to have it both ways, does it

- (a) make further compromises with the Troika and thus keep Greece in the eurozone or
- (b) does it reject any further compromises and take Greece out of the eurozone?

While there is strong agreement within the Syriza party that both options are bad, there is an equally strong disagreement over which option is worse. The Left Plank of Syriza, which is supported by about 30% of the party membership, argues that (b) is by far the superior option. Three basic claims are advanced in support of exiting the eurozone and returning to the drachma:

- i. That it would enhance Greece's international trade competitiveness
- ii. That it would give Greece's government more scope for policy autonomy

- iii. That it would enhance Greece's international solidarity with other European countries that also exit the eurozone.

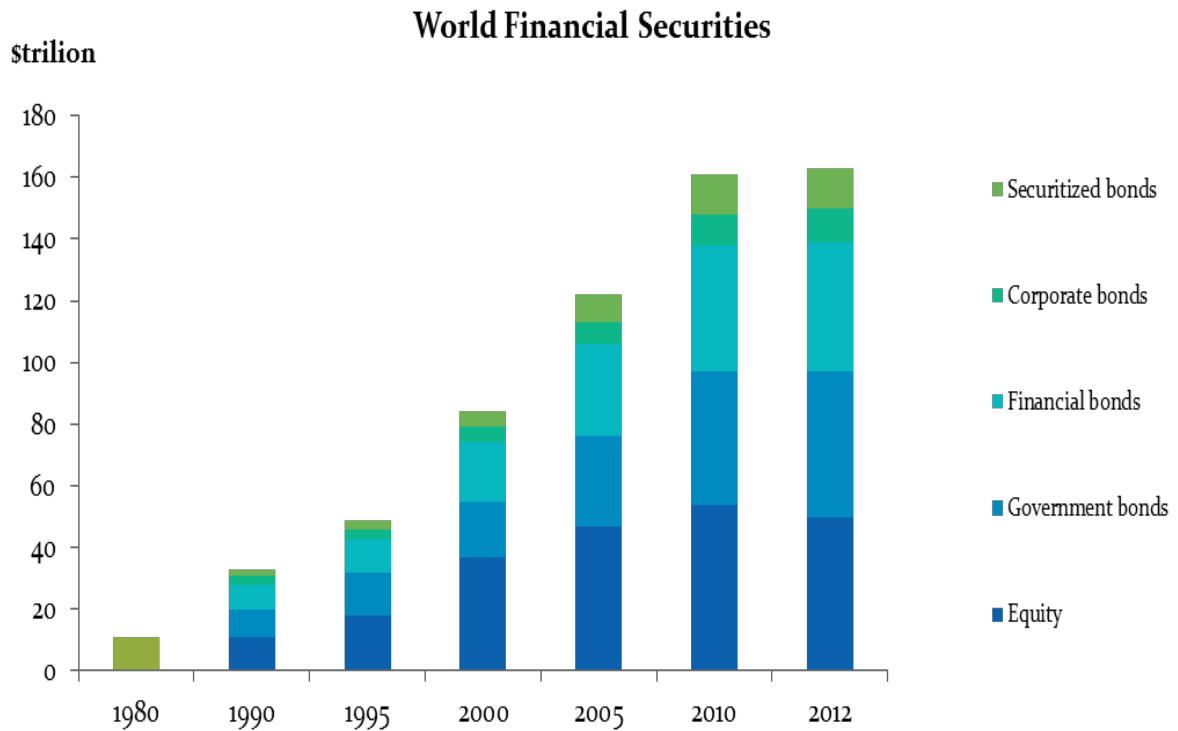
As is well known, the first two claims are not unique to the Left. They are essentially the same claims as put by the European Right, stretching from the Golden Dawn in Greece to the National Front in France. However, when vehemently opposing the euro, the European right wing parties only invoke national self-interests, never international solidarity considerations. It is precisely for this reason that in order to distinguish themselves from the European Right, the eurosceptic European Left invariably emphasises the 'solidarity' argument in making its case against the euro in addition to the 'sovereignty' and 'competitiveness' arguments.

In what follows it will be shown that when set in successive stages against the current global, European and Greek economic realities, each of the above three claims turn out to be myths: (i) from a global economic perspective, it becomes clear that Grexit would lead to less policy autonomy for Greece's government; (ii) from a regional, European perspective it becomes clear that Grexit would weaken any meaningful international solidarity between Greece's progressive forces and those of other European countries; (iii) from a local, Greek perspective it becomes clear that Grexit would seriously derail any real prospects of restoring Greece's economic competitiveness.

## **2. The Global Perspective**

The two most striking trends characterising the contemporary world economic landscape are globalisation and financialisation. The first trend essentially consists of the stretching of the commodity principle along the horizontal axis of geographical space: virtually all countries in the world today (North Korea being a notable exception) are now part of the global division of labour operating to the rules of market exchange. The second trend essentially consists of the stretching of the same commodity principle along the vertical axis of time (see table 1): with the vast and continuing accumulation of debt and equity securities, tradable claims against the future income streams generated by governments and corporations, the future is in effect being colonised, annexed as an extra space of economic activity.

**Table 1**



Strillions

	1980	1990	1995	2000	2005	2010	2012
World Deposits	9	23	26	35	42	57	62
World GDP	11	22	30	33	46	64	72

Source: Mckinsey (2013), IMF (2013)

The governments and corporations issuing securities never see them as commodities but only as financing instruments that help to facilitate the production of commodities. The contrary is now the case, however, for the large institutional investors that dominate the demand side of the world's securities markets. For the pension funds, mutual funds, insurance companies and the asset management arms of banks, securities are financial commodities whose use values are to serve as portable stores of value into which clients' monies can be poured and from which monies can be extracted to repay clients. Once it is observed that securities have become commodities in their own right, and once this observation is combined with the fact that

financial commodities now completely dominate the material commodity base (world GDP) on which they ultimately rest (compare the top and bottom halves of table 1), it becomes easy to understand the huge scale asymmetries that characterise the contemporary global currency markets.

From about \$1.5 trillion in 1998, daily turnover in the global foreign exchange (forex) markets had grown to \$5.5 trillion by 2013 and now probably exceeds \$6 trillion. Of this vast sum, only about 1% to 1.5% has any connection to cross border trades in goods and services or to foreign direct investments. While a substantial proportion of the remainder can be traced to purely speculative currency trades, the majority part is associated in one way or another with trading in financial securities. This latter fact explains why just four national currencies, led by the US dollar, account for over 155% (out of 200%) of daily forex trading as shown in table 2

**Table 2**

Currency distribution of global foreign exchange market turnover

Net-net basis,<sup>1</sup> percentage shares of average daily turnover in April<sup>2</sup> Table 2

Currency	1998		2001		2004		2007		2010		2013	
	Share	Rank	Share	Rank	Share	Rank	Share	Rank	Share	Rank	Share	Rank
USD	86.8	1	89.9	1	88.0	1	85.6	1	84.9	1	87.0	1
EUR	...	32	37.9	2	37.4	2	37.0	2	39.1	2	33.4	2
JPY	21.7	2	23.5	3	20.8	3	17.2	3	19.0	3	23.0	3
GBP	11.0	3	13.0	4	16.5	4	14.9	4	12.9	4	11.8	4
AUD	3.0	6	4.3	7	6.0	6	6.6	6	7.6	5	8.6	5
CHF	7.1	4	6.0	5	6.0	5	6.8	5	6.3	6	5.2	6
CAD	3.5	5	4.5	6	4.2	7	4.3	7	5.3	7	4.6	7
MXN <sup>3</sup>	0.5	9	0.8	14	1.1	12	1.3	12	1.3	14	2.5	8
CNY <sup>3</sup>	0.0	30	0.0	35	0.1	29	0.5	20	0.9	17	2.2	9
NZD <sup>3</sup>	0.2	17	0.6	16	1.1	13	1.9	11	1.6	10	2.0	10
SEK	0.3	11	2.5	8	2.2	8	2.7	9	2.2	9	1.8	11
RUB <sup>3</sup>	0.3	12	0.3	19	0.6	17	0.7	18	0.9	16	1.6	12

Source: BIS

The heart of the matter, as illustrated in figure 1, is that country size as measured in global commodity space and as denominated in currency terms is now primarily determined by a country's contribution to global securities stocks rather than by its contribution to global material output. Thus the continuing primacy of the US dollar as an international currency rests on the fact that the US continues to account for over 50% of the world's supplies of debt

and equity securities while the subordinate positions of the Chinese yuan (with only 2.2% out of 200% of forex trades) and of the Russian rouble (with only 1.6%) and of the hosts of other national currencies comes down to these countries' negligible contribution to securities stocks.

**Figure 1**

**Capital markets, 2012**



The huge size asymmetries in global financial commodity space have equally huge asymmetrical practical and policy implications for the countries occupying this space. Consider the implications of any sharp gyration in the exchange rate between, for example, the US dollar and the currency of a country that has a relatively small domestic capital market. In the case of the US, the dollar's gyration will have a differential economic impact on its exporting and importing firms, an impact that then sets in train investment shifts across US financial securities with monies flowing into the securities of firms that have benefitted from the dollar's gyration and out of the securities from firms that have been adversely affected. However, as these investment shifts occur within the same dollar-denominated mass of securities they do not aggravate the initial exchange rate gyration. In other words, the huge mass of financial securities behind the US dollar acts as a *currency shock-absorber* in the event of any exchange rate change triggered by developments in the underlying production and trade base. By contrast, in the case of a country with a small domestic capital market, any investment shifts across securities triggered by the impact of any exchange rate change on exporting and/or on importing firms will likely also take the form of cross-currency shifts that

will potentially further aggravate the initial exchange rate change and its effects on the underlying real economy. In other words, the very smallness of the capital markets of most countries occupying global commodity space potentially cause them to be *currency shock amplifiers*.

The asymmetric effects of exchange rate gyrations on countries with different currency masses translate into asymmetric policy implications. On the one hand, the monetary authorities of a country that has a large currency mass such as the US can conduct their monetary and interest rate policies without having to pay any regard to the effects of these policies on the US dollar's exchange rate against any other national currency or group of currencies because they know that any such exchange rate change will have little if any substantive aggregate effect on the domestic US economy. In other words, they can treat the dollar's exchange rate with "benign neglect": any upward or downward movement in the dollar's rate against another country's currency is always the other country's problem, never the US' problem. On the other hand, no such luxury can be enjoyed by the monetary authorities of a country that has a small currency mass: knowing that any sharp upward or downward movement in their currency's exchange rate against a leading currency such as the dollar will have potentially destructive effects on their domestic economy they have no choice but to conduct their monetary and interest policies in ways that always keep in mind the effects of these policies on their currency's international exchange rate.

Fear of the destructive effects of exchange rate gyrations explains why at the present time some 66 countries peg their currencies to the US dollar in one form or other while a further 27 countries peg their currencies to the euro. While large exporting countries such as China can use their trade surpluses to build up substantial dollar reserves to protect their currency's informal dollar peg and thus be in a position to retain a certain degree of domestic policy autonomy, no such option is open to small countries that struggle to maintain an overall trade balance let alone generate trade surpluses. In their case, pegging their currency to a foreign currency such as the dollar or the euro means having to adapt their domestic monetary and interest rate policies in line with the corresponding policy actions of the US Federal Reserve or the European Central Bank. To put this point as a formal proposition:

*There cannot be any policy autonomy, or any meaningful economic sovereignty more generally, for a small exporting country that chooses to occupy global financial commodity*



*space but can only do so as a financial colony orbiting a huge currency mass such as the US dollar.*

This proposition about commodity mass and gravitational pull is exactly that which captures the political-economic rationale behind the euro by the time it was formally established on January 1<sup>st</sup>, 1999. In its report “*One Market, One Money*” published in 1990, the European Commission listed the following four major objectives behind European Monetary Union (EMU): as 1.reduce transaction costs; 2.reduce exchange rate risks; 3. Increase price transparency; and 4. Stimulate an EU wide capital market. From this list it is clear that the Commission’s original focus of attention in the initial stage of the EMU project was on GDP-related criteria, as the principle goal behind the first three of the four objectives of the project was to remove the currency-related obstacles to the creation of a genuinely integrated European market for material goods and services. Indeed, it was precisely because the original focus was on the material product markets that there was strict adherence to the central tenets of Optimum Currency Area (OCA) theory (namely, that only countries with broadly similar economic structures and production profiles should merge their currencies together) and it was because that there was such adherence that even as late as 1997 it was expected that only 5 or 6 of the then 15 EU member states would join the euro with the remaining members following at a much later stage.

However, the summer of 1997 marked a structural break in the thinking behind the euro project, the cause of that break being the Asian currency crisis. When the French and certain other European governments saw what happened across South East Asia that summer - when one Asian currency after another, from the Thai baht to the South Korean won, was subjected to massive speculative attack and forced off its dollar peg and into free-fall devaluation with catastrophic domestic economic effects – they realised the importance of currency mass in the new global financial reality. The last of the above four listed objectives behind EMU, the stimulation of an EU wide capital market, suddenly became the first and overriding priority objective, and it was because of this that the invitation to join the euro was thrown open in 1998 to 14 of the 15 EU member states (Greece alone was not invited). If the initial rationale behind the euro was to put the finishing touches to the Single European Market (SEM) programme first launched in 1987, after the Asian crisis of 1997 the central rationale behind the new currency was to give it sufficient weight and mass as to enable it to resist the gravitational pull of the US dollar and thus give Eurozone governments the same kind of latitude over monetary policy as enjoyed by the US government.

In light of the above observations, is it at all advantageous for the Left progressive forces in the eurozone countries to give up the euro in favour of a return to separate national currencies? The answer has to be an emphatic no. In the new global financial reality of asymmetric commodity masses, exiting from the euro would not mean the restoration of economic sovereignty for small countries such as Greece or Portugal so much as their exposure and subjugation to even harsher external financial pressures and constraints. Given that the very essence of the euro's existence is so that it can serve as a protective hub providing shelter against these external pressures, the point is to keep the euro but fight to turn it round so that it supports a very different European economic agenda. If the right wing governments and other forces of Europe can pool their sovereignty together to pursue a neo-liberal economic strategy, as manifested in the current rules and structures of the eurozone, so should left wing governments pool their sovereignty so as to be able to pursue a more progressive economic strategy.

Any attempt to change the rules of the eurozone to accommodate and help promote such an alternative strategy will not be easy. On the contrary, it will be extremely difficult as the Left eurosceptics constantly point out. Difficult as this task may be, however, it has to be pursued because the alternative is worse. If countries such as Greece or Portugal or Spain give up the euro and return to their separate national currencies, any hope of a radical change in the economic direction of Europe will be crushed because that change requires international solidarity and that solidarity in turn requires the euro. The next section takes up this issue.

### **3. The European Perspective**

One of the preconditions for an alternative European economic strategy is government financing to boost investments in infrastructure, welfare services and other growth and job generating projects. In the wake of the damage done to government's finances by the bank bailouts and other crisis-related emergency public spending measures, such a finance for growth agenda requires as one of the top priorities an EU wide harmonization in tax structures. At the present time, this does not exist in any significant degree in the EU, and least of all in the Eurozone where the trend fall in corporate taxes and the trend shift away from progressive (income) taxes towards regressive (VAT and excise) taxes have been as sharp as anywhere in the world. Table 3 illustrates the situation as regards corporate tax rates. Clearly, while the member states of the Euro zone have been prepared to pool their

sovereignty in monetary and interest rate matters, they have been far less willing to do so in taxation matters even while being subject to the strict debt and budget deficit ceilings as laid down in the Stability and Growth Pact

**Table 3**

EU Corporate Tax Rates

	1995	2007
EU 27	35.3%	25.5%
Greece	40%	25%
Ireland	40%	12.5%
Cyprus	25	10%

Part of the reason for this state of affairs is political: for eurozone countries to give up national control over their domestic tax structures would be tantamount to full political union. Another part of the reason is ideological: for every theoretical argument in favour of tax harmonization (a notable one being its redistributive effects as listed in table 4) there is a counter argument in favour of tax competition (the most notable of which for neo-liberal economist concerns fiscal discipline). While the EU commission has broadly remained neutral between these two opposing positions, it has on occasion come out strongly against “harmful” tax competition. Thus in 1996 it published a report on taxation in the EU in which warned against the most harmful effects of a tax competition race to the bottom which included the “erosion of the tax base” i.e. the “degradation of revenue due to the use of the “exit option” by certain taxpayer groups”. Specifically, it highlighted the “differential economic power of productive factors” i.e capital’s use of its “mobile” propensity to shift the tax burden on to “immobile” tax bases such as labour. As is well known, the Commission has more recently set up investigations into the tax affairs of Ireland, Luxembourg and other jurisdictions that appear to have arranged “sweetheart” tax deals with global corporations.

**Table 4**

**Tax Harmonisation versus Tax Competition**

- ▶ Pro Tax Harmonization
  - Reduction of compliance costs
  - Transparency for taxpayer
  - Tax neutrality
  - Redistributive effects of taxation
- ▶ Pro Tax Competition
  - Downward pressure on tax burden
  - Fiscal discipline
  - Proper balance of tax level and public goods corporations.

While the EU commission has shown some important initiatives in redressing harmful tax competition, much more needs to be done if national governments are not to be forced into making further deep cuts in welfare and social spending and if the tax burden is again to be shifted back on to the richest sections of societies. It is here that we come back to the question of the euro in relation to international solidarity, which, in concrete economic terms comes down to such specific issues as tax harmonisation. Does the existence of the euro place those countries that are members of the currency union in a better position to coordinate their tax structures to prevent tax competition to the bottom? Or does the removal of the euro and a return to separate national currencies place countries in a better position to attain this objective? To answer this question let us briefly look at 2 case studies, those of the Republic of Ireland and Cyprus.

The Greek Syriza government is not the only Eurozone country that has drawn up its 'red lines' which it cannot cross in its negotiations with the troika. When the Irish government was similarly forced into seeking financial help from the Troika following the massive bailout of its collapsed banks, it too drew up a 'red line' that it would not cross when receiving financial aid, namely, an outright refusal to increase its corporate tax rate from 12.5% to the EU average of 25%. Ireland's creditors never officially pressed for such a policy, but it is interesting to note that when the French government raised this prospect it was met with howls of protest from Dublin. At the time of writing every major political party in Ireland supports this corporate taxation policy and this includes Sinn Fein . Of all the Irish parties, this has the most radical, anti-austerity economic programme, and yet it too not only

refuses to oppose the 12.5 corporate tax rate as set in Dublin but also pushes for its introduction into Northern Ireland. When it is pointed out that Ireland's tax structure has a negative externality effect on working people not only in other parts of the UK but also in other parts of Europe, Sinn Fein's official reaction is the conventional one: we are a small island economy and we need a favourable corporate tax rate to attract foreign investment on the scale needed to survive as a small economy. "Our first and foremost responsibility is to our own people".

A similar situation characterises Cyprus. Up to the 1980s, Cyprus's main export industries were tourism and agriculture. From then to the present time, however, there has been a dramatic structural shift in its export profile towards financial services as evidenced in the fact that by 2010 some 75% of the working population were employed in finance related sectors ranging from the accounting and legal professions on the one hand to banking and insurance professions on the other. Key to this recent structural transformation of the Cyprus economy has been the implementation by successive Cypriot governments of corporate tax policies aimed at making Cyprus one of the most foreign investor friendly, off shore tax havens in the European region. The reduction of the corporate tax rate from 25% in 1998 to 10% by the early 2000s, combined with other foreign investment friendly measures such as no capital controls and double tax treaties with other countries have caused Cyprus to become a favourite destination for Russian and other overseas investors. From the late 1990s through to the outbreak of the Cypriot financial crisis in 2011-1013, Russian monies by the billions flowed through Cyprus, with a substantial proportion of these billions remaining in Cyprus to take advantage of the relatively high returns offered by the Cypriot private banks and another substantial proportion returning to Russia as 'foreign capital' that would thus be exempt from domestic Russian taxes. When the AKEL government took office in 2008 there was absolutely no change in these foreign (ie Russian) investor friendly policies. When asked whether it bothered their conscience as a left wing government that the Russian billions flowing through Cyprus were benefitting Cypriot law, accounting and insurance companies at the expense of investments in services for the Russian working people, the answer was invariably the same: we are a small island economy and we have to do everything possible to survive. "If we do not offer Russian investors the type of offshore financial services they need, some other country will do so and therefore why not us?"

The cardinal lesson that one has to take from the above two cases is that if progressive parties in Ireland and Cyprus can forego any sign of international class solidarity in the area of tax policy harmonisation when their countries are in the eurozone thus enjoying a strong measure of protection from global financial pressures they are hardly any more likely to show such solidarity if their countries exit the eurozone and thus lose this protective shell. If anything, the contrary will be the case. To put this argument as a second formal proposition:

*Small exporting countries that struggle to survive in the contemporary global economy while retaining their own currency will adopt whatever economic policy measures that are required to secure this survival even at the cost of prioritising self- national interests over the national interests of other countries.*

Will this proposition apply to Greece if it exits the eurozone? Those on the Greek left who loudly call for a return to the drachma will just as loudly deny this possibility. However, the hard facts that show with remorseless and unforgiving clarity the parlous state to which the Greek economy has been reduced in recent decades point to a very different answer.

#### **4. The Greek Perspective**

In addressing the question as to whether the Greek economy and thus the Greek people will be better off outside the eurozone than inside, let us first dispense with a gross misconception. It is the idea that Greece can stage an ‘orderly’ or ‘disciplined’ exit from the euro through the imposition of capital controls on the one hand and the resurrection of an Exchange Rate Mechanism on the other as the two principle means of protecting the drachma. Apart from the difficulties in implementing capital controls in Greece (comparisons with the Cyprus case are not really helpful) there are other implications that will be taken up below. As for the proposal to tie the drachma to the euro in an ERM system, its delusional nature becomes clear as soon as we look closely at its basic idea of symmetrical burden adjustment (i.e. that the protection of the drachma’s new exchange rate against the euro is as much the responsibility of the European Central Bank as it is that of the Central Bank of Greece) and ask the question as to why the ECB should give financial assistance to Greece without strict conditions when it is outside of the euro when it is not willing to show such ‘goodwill’ to Greece when it is inside the euro.

In the finally analysis, the issue put bluntly comes down to this: can Greece exit the euro and remain sufficiently competitive as to be to able stand on its own feet? Put another way, the question is: if Greece returns to the drachma at a competitive rate of, say, 500 to the euro, can it maintain this rate over time and thus avoid a continual depreciation/inflation spiral? There are those who concede that there may initially be difficulties in protecting the drachma but remain absolutely confident that these difficulties will be overcome in the medium term when the drachma will begin to enjoy a period of tranquil stability. Greece's recent historical experience provides little basis for any such optimism. As can be seen in table 5, over the 23 year period between 1978 and 2001, the eve of Greece's entry into the euro, the Greek drachma's rate against the European Currency Unit (the euro's predecessor) fell from 46.8 to 340; in other words, the drachma's value against the ECU in 2001 was about one eighth of its value in 1978. Furthermore, as can be seen in figure 2, the consequence of the drachma's precipitous decline in the two decades before being substituted by the euro was an equally precipitous increase in Greece's differential inflation rate as compared with the EU average. It is noteworthy that even after euro entry in 2002, Greece still managed to have a domestic inflation rate of between 1.5%-2% higher than the EU average. Given that this differential could not, by definition, have been caused by currency depreciation and given that the percentage increase in nominal hourly wage rates in Greece was actually lower than the increase in most other EU countries, it becomes clear that the cause lay in deeper structural problems in the domestic Greek economy.

**Table 5**

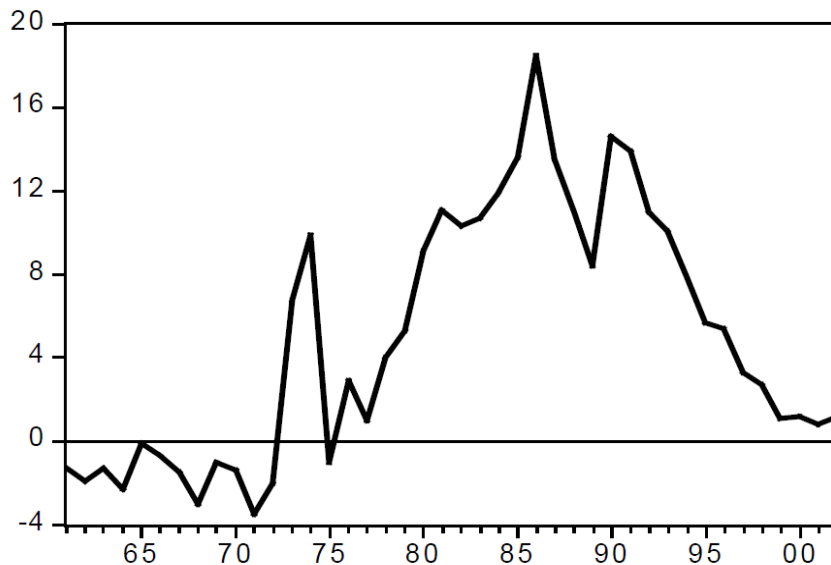
Drachma-ECU Exchange Rate, 1978-2001

Year	1978	1983	1988	1993	1998	2001
Rate	46.8	78	167.6	268.6	330.7	340.8

Source: Bank of Greece

**Figure 2**

Inflation Differential between Greece and the EU average, 1961-2002



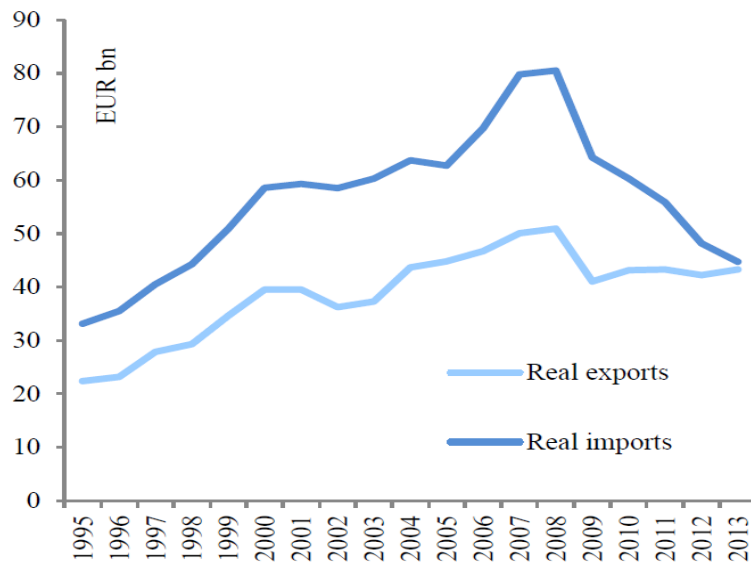
Source: Bank of Greece

These structural problems find immediate reflection in Greece's trade balance. As can be seen in figure 3, Greece's imports consistently outpaced its exports right through to end 2013 and early 2014 at which point an overall trade balance was reached. Now as this balance did not result from any discernible increase in exports but from a collapse in import volumes caused by the severe economic recession and huge rise in unemployment in Greece, the question arises as to whether Greece can maintain this external trade balance as and when its domestic economy recovers. In other words, can Greece expand its export volumes or, at the very least, can it expand its domestic import substitution production so as to make it less dependent on imports? Moreover, can it do all of this in a short enough time so as to maintain its 500Dr/Euro exchange rate? The omens do not look good.



**Figure 3**

Exports and Imports, Greece

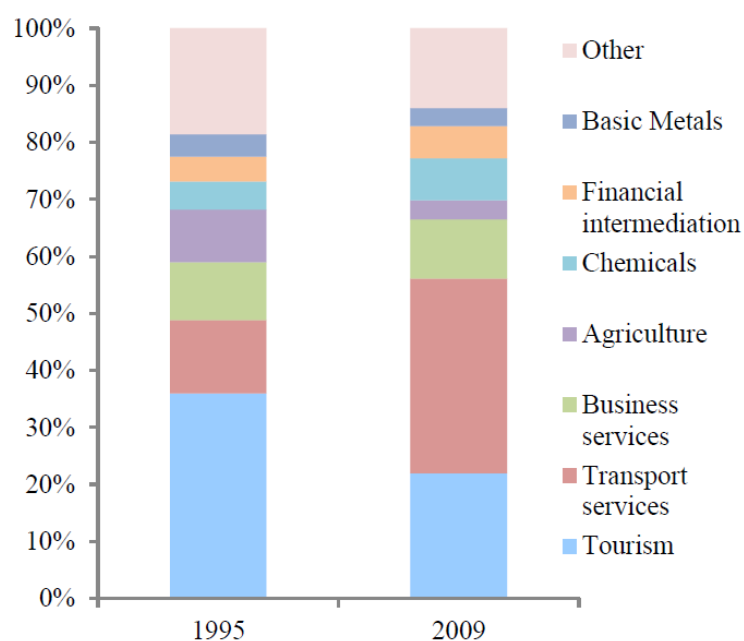


Source: European Commission

From figure 4 it is clear that during the years of eurozone membership, Greece experienced a degree of deindustrialisation: the share of services in exports (shipping and tourism) expanded while the shares of manufacturing (listed in the ‘other’ category) and agriculture shrank. Table 6 makes clear that the shrinkage of Greece’s manufacturing base is not confined to any particular industrial sub-sector but actually spans the entire set. Thus of the twenty industrial categories listed on the left hand side of table 6, there is not a single one, as can be seen on the far right side of the table, where domestic production is greater than domestic absorption. Indeed, in some sub-sectors including office machinery and computers, motor vehicles and medicines and medical equipment, Greece is almost totally import dependent.

**Figure 4**

Greece: export value added by sector



Source: OECD/WTO

**Table 6**

Greece: Trade in manufacturing, 2008 (in %)

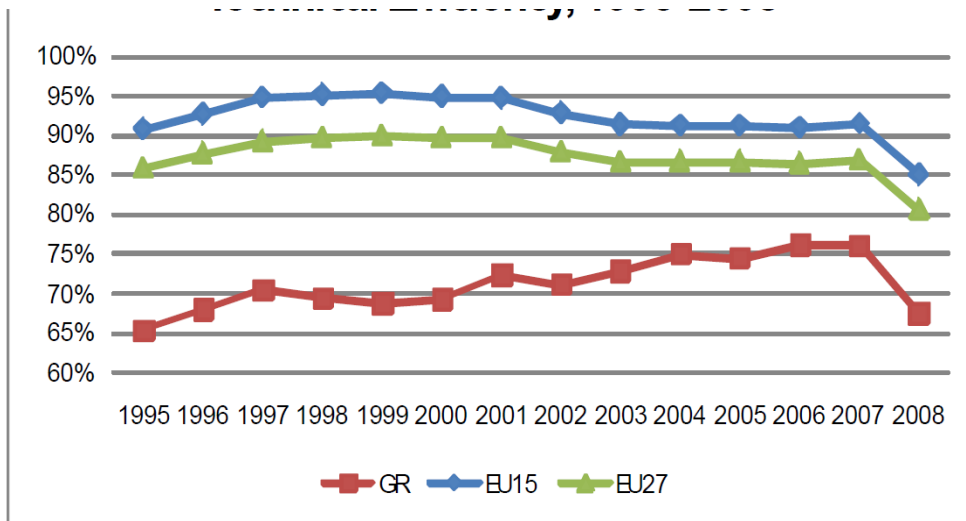
	Exports as a share of total manufacturing exports	Exports as a share of industry production	Domestic production as a share of absorption (1)
15 Food products and beverages	14.42	12.10	86.74
16 Tobacco products	1.06	28.19	91.01
17 Textiles	4.80	67.68	61.79
18 Wearing apparel, dressing and dyeing of fur	5.78	51.01	61.93
19 Leather, leather products and footwear	0.61	21.98	34.48
20 Wood and products of wood and cork	0.45	7.37	66.66
21 Pulp, paper and paper products	0.84	11.25	53.53
22 Printing and publishing	0.84	5.17	91.96
23 Coke, refined petroleum products and nucl.fuel	12.59	14.75	93.35
24 Chemicals and chemical products	13.93	49.24	40.63
25 Rubber and plastics products	3.77	30.42	73.96
26 Other non-metallic mineral products	2.87	11.74	89.00
27 Basic metals	15.76	43.95	82.47
28 Fabr. metal products, except machinery and equip.	3.26	10.81	86.56
29 Machinery and equipment, n.e.c.	5.12	39.22	35.41
30 Office, accounting and computing machinery	0.78	1451.10	0.78
31 Electrical machinery and apparatus, n.e.c.	3.67	25.19	73.30
32 Radio, television and communication equipment	2.17	56.35	25.38
33 Medical, precision and optical instruments	1.17	51.68	19.52
34 Motor vehicles, trailers and semi-trailers	1.35	55.37	7.78
35 Other transport equipment	3.45	31.37	37.28

Source: OECD

This situation is not likely to change over the short to medium term simply by switching to the drachma because price competitiveness is not a sufficient condition for executing the urgently needed radical change in Greece's production profile. Other, more crucial conditions (because more material in nature) include technological and skill factors on the one hand and institutional and business environment factors on the other. In both of these cases Greece lags well behind other EU and OECD countries, as shown in figures 5 and 6.

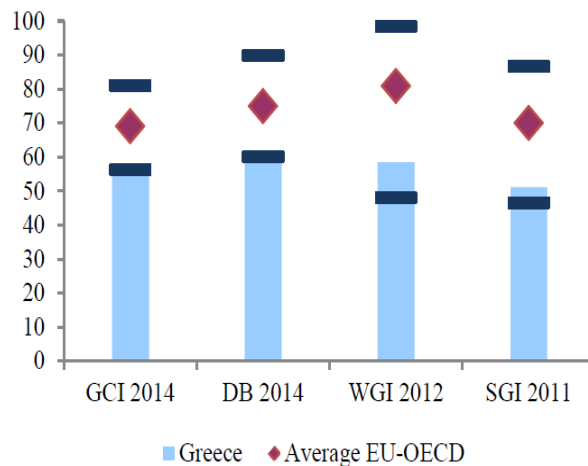
**Figure 5**

Technical Efficiency, 1995-2008



**Figure 6**

Institutional Quality Indicators, Greece and EU-OECD



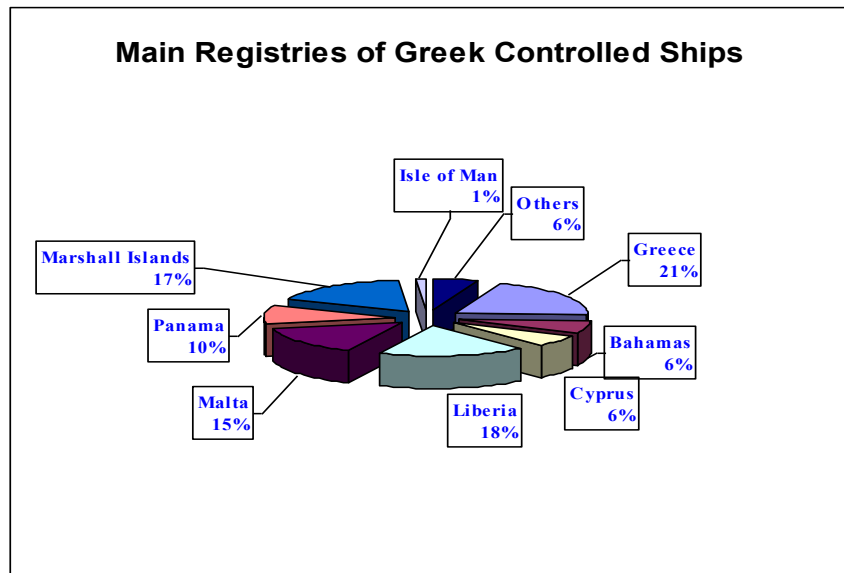
The closure of the technological and institutional gaps will require not only time but also a stable economic and social environment which can facilitate the various policy initiatives and investment expenditures aimed at strengthening Greece's manufacturing and export base. As a stable economic environment in the event of Grexit presupposes a stable drachma/euro exchange rate the question that logically arises here is whether Greece can rely on shipping and tourism receipts to secure such a stable exchange rate in the interim period. To answer this question let us start with shipping.

The Greek merchant fleet is one of the largest in the world and accounts for about 16% of the world merchant shipping trade. The problem is that while this statistic means that Greek shipping can continue to make a significant contribution to Greece's export earnings, there are other counteracting statistics that explain why its contribution is not likely to be a reliable one in the event of a return to the drachma. In the first place, the fact that the overwhelming majority of the 4000 ships or so under Greek control comprise of ore and bulk carriers, oil tankers and cargo ships explains why aggregate Greek shipping earnings can fluctuate wildly, rising in periods of global economic growth (as in the 2002-2007 period) and falling sharply in periods of global economic recession (as in the post financial crisis era from 2008-9 to the present).

However, what is even more problematic than the exposure of Greek shipping to the vicissitudes of the global economy is the exposure of Greek politicians to the whims and dictates of Greek ship owners. As can be seen in figure 7 only about 21% of Greek controlled ships (or some 800 in all) are registered under the Greek flag with the remainder registered under numerous other flags of convenience including those of Liberia, Malta, Panama and even Cyprus. This 21% figure is totally dependent on a host of generous concessions given to the Greek shipping companies, the most notable of which are the exemption (as enshrined in Article 89 of the Greek Constitution) of any taxation other than the tonnage tax (one of the most generous in the world); the guarantee of no capital controls on Greek shipping profits; and the minimal bars placed on the number of personnel that must be employed in the shipping offices based in Greece (just 4 persons) and on the amount of euro deposits held in Greece (just 100,000 euros). Given the global nature of the Greek shipping industry and the consequent ease with which Greek ship owners can relocate their offices and their operations anywhere in the world, it follows that any attempt to amend or remove any one or more of the above concessions will likely lead to just such a relocation. On a further note, we should point out that if it was the case that Greek nationals employed on Greek ships always insisted

on being paid in a hard currency such as the US dollar before Greece's entry into the euro in 2002 – with these dollar earnings only being remitted back to Greece in a step-like manner as and when necessary – then it is hardly likely for the situation to be any different if Greece returns to the drachma.

**Figure 7**



Source: Greek Shipping Cooperation Committee

In the end, it all comes down to tourism. If Greece exits the euro can its tourist industry generate sufficient export earnings as to help keep the Greek economy and the Greek drachma on an even keel? At first sight it might seem so as Greece's most valuable tourist resource - one of the most beautiful landscapes on the planet - is a fixed resource and thus can be relied upon to make a continuing contribution to the Greek economy. Just how important a contribution it can make is shown in table 7.

**Table 7**

## Tourism Industry in Greece - Main Indicators (Year 2013)

Indicators	Year 2013
International Tourist Arrivals	16.4 millions
International Tourism Receipts	11.23 billion €
Contribution to GDP	16.2%
Contribution to employment	18.2%
Average per Capita Tourism Expenditure	646 €
European Market Share	2.9%
World Market Share	1.5%

Source: Sotiriadis and Varvaressos (2015)

A closer examination of the facts surrounding the Greek tourist industry begins to reveal a more complicated picture. To begin with, the sheer numbers of annual tourist arrivals – 16.4 million in 2013 i.e about one and half times the size of the Greek population – indicates a substantive need for a range commodity imports ranging from medicines to certain foodstuffs and beverages simply to accommodate the needs of the tourists. A much deeper problem, however, concerns the ‘quality’ as distinct from the ‘price’ dimension of Greece’s tourist service provision. As shown in table 8, Germany, the UK and France are the origin countries of some 32% of tourist arrivals but these tourists account for a much larger fraction of tourism receipts as those from other origin countries such as FRYOM, Serbia/Montenegro and Turkey tend to be poorer on average. These upper-end income tourist groups from Western Europe, precisely because they are on average wealthier than are the groups from other parts of the world, tend to pay as much if not more regard to quality- related factors as to price-related ones and on this issue Greece’s current record is not particularly good. On the contrary, it has deteriorated appreciably just in the past few years, as shown by the fact where its Travel and Tourism Competiveness Index (TTCI) was ranked 22nd in the world in 2008, its ranking had fallen to 32nd by 2013 (see table 9). From table 10, it is clear that Greece’s overall TTCI ranking compares very unfavourably with that of Spain, is roughly on a par with that of Croatia and compares favourably with that of Turkey.

**Table 8**

The top 10 origin markets (Year, 2012)

Country	2012	
	Arrivals	Share (%)
Germany	2,108,787	13.6
United Kingdom	1,920,794	12.4
FYROM	1,300,000	8.4
France	977,376	6.3
Russia	874,787	5.6
Italy	848,073	5.5
Serbia / Montenegro	620,450	4.0
Turkey	602,306	3.9
Bulgaria	599,110	3.9
Netherlands	478,483	3.1
Total of 10 markets		66.7%

**Table 9**

TTCI for Greece (Years 2008-2013)

Year	TTTCI Greece	
	Rank (out of 140)	Score (1-7)
2008	22	4.9
2009	24	4.9
2011	29	4.8
2013	32	4.8

**Table 10**

TTCI Comparisons, 2013

Country	Greece		Spain		Turkey		Croatia	
	Rank (out of 140)	Score (1-7)	Rank (out of 140)	Score (1-7)	Rank (out of 140)	Score (1-7)	Rank (out of 140)	Score (1-7)
<b>Index – Main elements</b>								
T&T Competitiveness Index	32	4.8	4	5.4	46	4.4	35	4.6
T&T Regulatory framework	39	5.0	14	5.5	64	4.6	42	5.0
Business environment & infrastructure	33	4.7	5	5.3	52	4.1	39	4.4
T&T human, cultural & natural resources	30	4.6	6	5.4	27	4.6	42	4.4

Source of tables 8-10: Sotiriadis and Varvaressos (2015)

Turkey is not in the euro and this fact, combined with the fact that it has a long Aegean Sea coastline, means that its tourist industry can price-compete with that of Greece for as long as and as far down as is necessary. Does Greece really want to get into this price-competitive war with Turkey? Does it really want the business model of mass, cheap, packaged tourism, currently confined to certain parts of Greece, to become the dominant model over the whole of Greece? Does it really want to risk the potentially huge environmental damage that would be done to its beautiful islands and coastline? I do not think so.

As if all the above concerns were not enough, an additional source of concern is the political and social stability factor. Those who suggest that restoring the drachma would enhance Greece's international competitiveness in tourism argue as if the two variables were independent. The truth of the matter is that they are not: if the drachma's exchange rate depends crucially on the numbers of tourist arrivals and on the ensuing volumes of tourism receipts, those tourist numbers in turn depend just as crucially on Greece's internal stability. For proof, we need only look at what happened in 2011 when there was a strike staged by the petrol tanker owners at the height of the summer season and in 2012 when there were two general elections, again at the height of the summer season: in both cases, there was a sizeable drop in tourist arrivals. If this could happen then, think what would happen if the drachma's exchange rate were to fall to such an extent as to trigger even more domestic economic and social unrest, including strikes and demonstrations: there would be a significant fall in tourist arrivals, particularly those from Western Europe, that would in turn further undermine the drachma and thus also further aggravate the conditions causing unrest.

The upshot of the above discussion is that if Greece takes the high-risk gamble of exiting the euro and returning to the drachma, the results could be potentially catastrophic on every front, economic, political and social. To put this point as our third and final formal proposition:

*If Greece returns to the drachma, there is a high risk of a return to a vicious depreciation/inflation spiral that could eventually trigger a political and humanitarian crisis in Greece whose scale would dwarf anything that we are currently witnessing.*



## **5. Conclusion**

To listen to those in the Left Plank section of Syriza who are urging for a “rupture” with the eurozone one would think that Syriza made only major promise in the run up to the general election of January 2015: to reject the terms of the memorandum. This is not the case. As stated at the outset of this talk, two promises were made: to reject the terms and to keep Greece in the eurozone. As also stated at the outset, if the Syriza government cannot keep both promises – despite every effort to do so – it faces the difficult and unpleasant task of having to choose the one that it must honour. Syriza’s Left Plank urges Grexit so as to avoid any compromise with Greece’s creditors. The majority of the Syriza party, along with the majority of the Greek people as would appear from recent opinion polls, urge continuing Greek membership of the eurozone. Instinct, combined with past experience, tells them that a return to the drachma would spell economic disaster for Greece. The central purpose of this talk has been to provide theoretical and factual backing to this instinct.

This conclusion raises one last question which is this: if the Syriza government must implement essentially many of the same austerity measures as demanded by the Troika that were implemented by the previous New Democracy government then what was the point of bringing Syriza to power? The answer rests on distinguishing what happens today and what happens tomorrow.

Today, there may be little difference in government policy. What is ultimately more important, however, is what happens tomorrow. The need to restructure and modernise Greece’s institutions is not open to question. What is open to question is how and at whose expense this restructuring is conducted. If Syriza loses power and is replaced by a right wing government then it is certain that such restructuring as takes place will be at the expense of the poorer sections of the Greek population. If, on the contrary, the restructuring is to take place on a fairer and more equitable basis then it is imperative that Syriza holds on to power. There will not be another opportunity.