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Greece Is to Europe as Puerto Rico Is to America

by James G Neuger

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Some economists don't fear a Greek exit from the euro because they can count the costs. Most political leaders are petrified because they can't.

No one quite knows how a Grexit would be engineered, but the case for it runs like this: with 11 million people, Greece represents 3.2 percent of the population and 1.8 percent of the output of the 19-nation euro zone's 10.1 trillion-euro ($11 trillion) economy.

By that score, the European economy is only a bit more exposed to Greece than the U.S. is to Puerto Rico, now wracked by a debt crisis that hasn't exactly rattled confidence in the dollar. Cut Greece loose, and the euro region would remain the world's second-largest economy, happily exporting Mercedes and BMW cars from Germany and Louis Vuitton handbags from France.

The euro's role as a symbol of European unity has always sat uneasily alongside its more mundane function as a unit of account. Greece's admission to the currency in 2001 was an act of statesmanship, as were its first two bailouts in 2010-12. The question now is whether the sheer weight of its economic afflictions blunts the political imperatives for keeping the euro zone intact.

“People might think if Greece leaves the euro why won’t it be another country that abandons it in the future,” Spanish Prime Minister Mariano Rajoy told Cadena Cope radio on Tuesday, underlining the currency’s status as the continent’s political glue. The risk of a domino effect, he went on, would be a “serious problem.”

‘Strategic Consequences’

Despite ever-louder murmurings from the back benches, that is still the prevalent view across the European Union, already juggling external threats from Russia and the sectarian flames of the Middle East and northern Africa, and by home-grown disturbances such as the rise of extremist parties and Britain’s potential secession.

“This is not only a financial issue for the European Union, but we should bear in mind the strategic consequences, and especially the EU’s ability to prove it can solve problems - - something the outside world is paying attention to,” German Foreign Minister Frank-Walter Steinmeier said Tuesday.

To be sure, creditor governments would likely bid adieu to what they’ve lent to Athens. Germany’s theoretical maximum loss of 84.5 billion euros, as estimated by Spiegel magazine, is about 3 percent of German gross domestic product. But Greece’s repayments are spread until the middle of the century, minimizing the annual hit.

ECB Safety Net

Since 2010, Europe has set up a permanent bailout fund, stiffened deficit- and debt-limitation rules, tightened surveillance of national economies to prevent asset bubbles, centralized bank regulation and -- perhaps most important -- allowed the European Central Bank to act as a safety net for unhinged economies.

As a result, a Greek departure or expulsion would cause "some disruption in the short term, but actually the euro zone is probably stronger without Greece than it would be with Greece," Richard Jeffrey, chief investment officer at Cazenove Capital Management in London, said Tuesday on Bloomberg Television.

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The opposing view is that once the euro's nimbus of permanence is punctured, it becomes just another fixed exchange-rate regime, like the wobbly matrix that tried to stabilize inner-European currency rates from the late 1970s until the euro's arrival in 1999.

'Weakest Link'

Bond and currency speculators feasted on that imperfect system, culminating in the mayhem of 1992 in which investor George Soros made $1 billion betting against the British pound. That event became a rallying cry for British euro-skeptics, proof for them of the wisdom of steering clear of the continent's monetary adventures. And London's sentiments drive European markets.

"It's not as if you get rid of Greece and then you have a really hard-core group of countries that are clearly an optimal

currency area," said Alessandro Leipold, a former International Monetary Fund official who is now chief economist at the Lisbon Council research group in Brussels. "The reversibility of the euro would have been clearly demonstrated, and people will look for the next weakest link. Perhaps not immediately, but when a shock hits, that will be the game in the markets."

The euro's founders had more than balance-sheet arithmetic in mind, with Germany's Helmut Kohl going so far as to call it an insurance policy against another European war. Some of that emotion resonates in the mantra "if the euro fails, Europe fails" of Germany's otherwise coolly scientific chancellor, Angela Merkel.

As Sunday's referendum nears, Merkel isn't threatening to let Greece go, a tactic she used in November 2011 when Greece considered, and then aborted, a popular vote on bailout policy. As the champion of austerity, and with undertones of German-Greek wartime history, Merkel is a hate figure in Greece. But the context has changed as well.

When the debt crisis broke out, democracy was flickering in the Arab world and Russian President Vladimir Putin had yet to pounce on Ukraine. The all-night EU summits of 2010, 2011 and 2012 were about fixing the economy. Now, the issues keeping Merkel et al. up late are the influx of migrants from the miscarried Arab uprisings and re-armament against Russia's emboldened military.

Greece is Europe's soft underbelly, on the frontlines of the migration crisis and its anti-capitalist Syriza government in Putin's sights as a convenient ally.

"Greece on the outside would be a failed state on the borders of Europe's currency union," said Miguel Otero Iglesias, a senior analyst at the

Madrid-based Elcano Royal Institute. The upshot would be “major instability in a region that is already highly unstable, with the likelihood that it might fall into the Russian orbit at a time when Russia is showing its teeth.”