

Parallel currency - the only cure for Greece

Surprising severance of Friday's discussions between Greece and its creditors brought the country to the edge of disaster. What else can happen in the coming days or months? Is the idea of a parallel Greek currency reasonable? - analysis by Marcin Lipka, Cinkciarz.pl currency analyst.

For almost six months the Greek government, the European Commission (EC), the International Monetary Fund (IMF), and the European Central Bank (ECC) have negotiated the conditions on when the last installment of the aid program should be paid. The difficulty of these discussions was based on the fact that at the end of January Syriza begun its reign in Greece. The party promised an end to the savings policy forced by the creditors by raising salaries and pensions and hiring back dismissed office workers.

Troika (EC, IMF, EBC) agreed to pay billions of euros in aid, but only if Athens would present a credible program of economic reforms. Last week, the discussions clearly accelerated, because the arguments of both sides got closer.

Only on Friday the consensus appeared to be within reach. It was confirmed by some information reaching the media, including copies of particular reform plans and the concept of extending the aid program by six months.

However, at a certain point the negotiations collapsed. Prime Minister Tsipras returned to Athens and announced a referendum to be conducted regarding the acceptance of the creditors' offer on Sunday. This movement strongly complicates the discussions. It puts the Greek membership in the eurozone at stake, and the whole eurozone in danger of economic perturbation.

Too late for a referendum

Expressing the opinion of the society regarding the reforms is theoretically a good solution. It was mentioned already in May by the German minister of finance Wolfgang Schauble, who since the beginning has been a supporter of a rigid approach towards Greece. However, this concept was rejected by the Greek side. They argued that the elections recently occurred and it is the government who has the mandate to conduct negotiations with the creditors.

The problem is that the current aid program for Greece ends on 30 June. On this day the IMF needs be paid an installment of 1.6 billion euro. This means that the country can already go bankrupt at the beginning of July as the national vault is empty. Also, if there is no agreement between Athens and the creditors, the last installment of aid worth over 7 billion euro will not be paid.

Another serious matter is also the fact that Greek banks are truly on the edge of bankruptcy. They could normally only work thanks to the liquidity supplied by the EBC. When the Eu-

European monetary authorities announced on Sunday that they are withholding “the drip”, the government was forced to introduce the control of capital flow after just a few hours.

As a result, Greece will be paralysed for at least a week. It’s not just about the citizens, who are able to withdraw only 60 euro per day, but mostly about the enterprises. It will be impossible for them to work during the coming days. The branch which will be damaged to the biggest extend is the tourism industry, which is now entering the season’s peak. Thus, the effects of Tsipras’ decision are already catastrophic.

What will happen to Greece?

What will happen with Greece in the coming days and weeks? The finance ministers of the eurozone countries did not want to speculate about it. During the extraordinary summit of the Eurogroup held on Saturday evening, many of them expressed the opinion that the risk of Grexit increased significantly. They also said that they do not understand Prime Minister Tsipras’ decision to conduct the referendum in such a decisive moment at all.

Theoretically, a return to the discussions is plausible if the majority of the Greek society supports the reforms. It would probably cause the fall of Tsipras’ government and lead to the new election. It is possibly the only way to rescue Greece from falling into deep recession, and eventually a financial collapse with its paralysed banking system, huge debt and an empty vault. Additionally, converting to its own currency would mean high inflation.

However, the scenario of Grexit is getting more and more likely. The whole operation would occur under time pressure and during economic collapse. Because of this, the Athens’ effort regarding the reform in the last few years would quickly go to waste.

Parallel currency

Speculations regarding Grexit have lasted for many years. Thus, there are analyses projecting this process. It was well presented by Jeremie Cohen-Setton in the Bruegel think tank. Athens can issue a so called IOU („I owe you”). It would be a type of national obligation towards the citizens and a promise to perform it in the future.

For example, if an employee hired in the public sector earns one thousand euro and the country does not have any money,, it could pay him one thousand IOU’s with a promise to exchange them to the European currency in 1:1 relation, within the next 3 years. With the IOU the citizen can pay e.g. for taxes, or other settlements for the country.

There is a problem when it comes to paying for goods and services from the private sector. However, there is a possibility for exchanging the IOU to the euro or other currencies. Those citizens not willing to wait three years, or not trusting the country to keep its promise, can exchange the IOU to the euro on the market. Of course, the rate will be much worse, for example, 1 IOU per 0.5 euro.

This way the real earnings of the Greeks will decrease by half. It will improve their competitiveness without the necessity of decreasing nominal wages, which is often met with the resistance of citizens. After a while the IOU might become a new currency, and a formal Grexit occurs.

The other possibility is that the IOU is terminated, but not at the rate promised by the government and by the one established by the market.

Is it possible? At first sight, not necessarily. A better solution for Greece would be to build an agreement with the creditors. However, this opinion should be quickly verified after reading what the current Greek minister of finance wrote about the IOU one and a half years ago. Yanis Varoufakis claimed on his blog that this concept “has many advantages, because it creates a source of liquidity for the government outside the debt instruments market, does not require banks’ involvement (in creating the money – author’s note), and lies beyond the restrictions of the European institutions”. Thus, it is possible that the current events are a part of this plan.

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