Avoiding Apocalypse

Larry Summers has written a scary column warning that Greece may be on the verge of becoming a "failed state". It's a useful corrective to the extraordinary complacency I'm hearing from too many European officials. But I do think it's worth pointing out that this need not happen, even if there is no deal.

What Summers seems to portray is a scenario in which Greek banks collapse and take down the economy with them. But what if Greece abandons the euro and issues its own currency to keep cash flowing?

For sure there would be a sharp devaluation, which would lead to a spike in inflation. But would hyperinflation follow? Remember that Greece is running a large cyclically adjusted primary surplus — that is, given even a modest economic recovery it would not need to roll the printing presses to pay its bills. And a a devaluation would, other things equal, promote recovery.

I know that many people are telling stories about immediate collapse due to inability to buy raw materials, complete failure of exports to respond, and so on. They could be right. But I actually can't think of any historical examples that fit this story — in particular, all the hyperinflations I know about involved governments too weak to collect taxes, and believe it or not, that's not true of Greece despite all you've heard.

So even if Greece goes over the edge in the next few days, there may be another off-ramp from the road to hell. And at that point the European problem would turn on its axis, as Wolfgang Munchau says, and become one of coping with the euro's evident reversibility.