Will the Eurozone Break Apart?

Our Opinion

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1) Break-up is not a simple process. Break-up could mean complete fragmentation, or it could mean secession by one or more states. Secession in turn could mean a strong state leaving, or it could mean a weak state leaving. The process could be sudden (a unilateral action) or it could be the result of negotiation.

2) The only way for a country to leave the European Monetary Union (EMU) in a legal manner is to negotiate an amendment of the treaty that creates an opt-out clause. Having negotiated the right to exit, the Member State could then, and only then, exercise its newly granted right. Negotiating an exit is likely to take an extended period of time. Bear in mind the exiting country is not negotiating with the Euro area (17 countries), but with the entire European Union (27 countries).

3) The Euro is made up of sovereign states. As such, these states could choose to repudiate the Treaties that they have signed, and unilaterally declare independence from the Euro and the European Union.

4) The cost of a weak country (Greece, Portugal, Ireland, Spain, Italy, France…) leaving the Euro is significant. Consequences include sovereign default, corporate default, collapse of the banking system and collapse of international trade. There is little prospect of devaluation offering much assistance. Also, it seems highly unlikely that a government could leave the Euro and expect to remain a fully functioning member of the European Union itself.

5) The cost of a strong country (Germany, Holland, Finland, Austria, Luxembourg) leaving the Euro is the rapid appreciation of its currency, on the assumption that the strong new national currency would be desired (at least by other Euro area inhabitants) as a reserve currency. Certainly if a strong country leaves, we would assume an appreciation of the new national currency relative to the rump Euro. The strong seceding country would effectively have to write off its export industry. Also, it seems highly unlikely that a government could leave the Euro and expect to remain a fully functioning member of the European Union itself.

6) Fragmentation of the Euro would incur geo-political costs. Europe's "soft power" influence internationally would cease (as the concept of "Europe" as an integrated polity becomes meaningless). It is also worth observing that almost no modern fiat currency monetary unions have broken up without some form of authoritarian or military government, or civil war.

Conclusion

An overwhelming probability is that the Euro area moves slowly (and painfully) towards some kind of fiscal integration (Eurobonds). The risk case, of break-up, is considerably more costly and close to zero probability.

In essence, like in the Hotel California song, *"you can check out … but you can never leave…"*