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Post-Summit Commentary – Greece on the brink

Fabian Zuleeg and Janis A. Emmanouilidis

The developments of recent days have been dramatic – the saga of the Greek crisis has probably opened its decisive chapter. Negotiations between Athens and its creditors failed after the Greek government decided to leave the negotiating table and hold a referendum on 5 July. The future of the country in the common currency and the potential consequences for the EU and the euro are uncertain. There are clear signs of fatigue, everywhere. But there is still time to avert the worst, if there is the political will on all sides to work on a new perspective for Greece and for the future of the Economic and Monetary Union (EMU).

While Greece seems to have one foot out of the Euro, the blame game is on its way. With one eye to electorates and another to posterity, both sides blame each other for the lack of compromise. But whoever carries more responsibility for reaching this impasse – and surely both sides have to accept their share – the highly negative consequences of Grexit for Greece, the Eurozone and for the European integration process should provide an impetus for all to find a last-minute solution.

The coming days and weeks will be the final opportunity to avoid an exit of Greece from Europe's common currency. On balance, the Eurozone, the ECB, the IMF, and other global partners have a strong interest in preventing a Grexit, although the risk that the situation might spiral out of control is now dangerously high.

A risky referendum

The developments in the coming days will show Greeks some of the consequences of a potential departure from the euro. The closing of banks and the imposition of capitals controls to stabilise the Greek banking system and the standstill of the economy in the midst of the tourist season could be a strong wake-up call ahead of the referendum.

If the electorate follows the recommendation of the Greek government to reject the deal offered by the country's creditors (which, in fact, will no longer be on the table on July 5), Greece will move into full default and then Grexit seems more likely than ever. All polls show that this is not what the majority of Greeks want. But in a highly polarised campaign they might be given the illusion that a better deal with creditors is still a possibility if they vote 'no'. In reality, however, this seems not likely.

But even a 'yes' in the referendum would not be a guarantee for Greece remaining in the Euro. The big questions would be: who would speak for the Greek people after such a vote? Who would negotiate and conclude a new programme with the country's creditors? Would there be a new government coalition, maybe a government of national unity, or will the country have to face new elections? The answers to these questions are not clear. But what seems certain is that time is running out and the continuing uncertainty and instability already have massive negative repercussions on the country and its citizens.

Avoiding the worst

In the end, everyone in Europe needs to keep their eyes on the bigger picture. While some claim that Grexit would be affordable for the Eurozone and, at the same time, in the interest of Greece, the reality is likely to be different, with high economic and political costs for both sides. One can argue as to whether Greece should ever have entered the common currency. But turning the clock back is impossible and wasting time speculating does not help to get out of the current impasse.

Debt default and Grexit would devastate Greece's economy, with banks and companies in need of access to international finance being instantly cut off. The government would no longer be able to pay its civil servants and pensions, and would most likely have to resort to the printing press, leading to devaluations and hyperinflation. Capital flight and shortage as well as mass emigration would become endemic problems, also affecting the rest of the EU. The low exchange rate of a new currency would be of little use, with few competitive export-oriented industries and tourism affected by political and social turmoil. Introducing and devaluing a new currency would not solve the underlying fundamental structural problems. Greece would have to continue painful reforms and suffer the negative effects of fiscal consolidation, but outside the EU's core and without the economically and politically stabilising framework of a strong currency.

From the perspective of Greece's partners, the country's departure from the common currency would also have incalculable economic, financial, political, and geopolitical effects, even if the euro area seems more resilient today than it was some years ago. It could challenge the notion that the euro is irreversible and spark a renewed bout of market speculation about which country might be next. The effect would go beyond the Eurozone: Greece would remain within the EU and it is highly questionable whether the Union has the mechanisms to deal with a potentially disillusioned and recalcitrant member state, especially in a period of multiple crises.

In economic terms, a Grexit would impose huge financial losses on its lenders, who have guaranteed billions to rescue the country within the Eurozone. More money might have to be injected into European banks to stabilise the financial system. Grexit could imply even higher long-term costs, as Athens' partners would most probably have to support the country for many years, even after it would have left the Eurozone.

In addition, there is the risk that Greece's potential political destabilisation, characterised by a deeply divided society, could have devastating geopolitical effects in an already unstable region. The geopolitical dangers have sharply increased since 2011/2012, when the Grexit option was first discussed, because of the escalation of conflicts in the Middle East and North Africa and as a result of the stand-off between the West and Putin's Russia following the Ukrainian crisis and the annexation of Crimea.

Finally, the longer-term consequences of Grexit would affect the European project as a whole. It would set a precedent and it would further undermine the *raison d'être* of the EU: after all, European integration was initiated to prevent this kind of development.

Grexit could lead to even more citizens starting to question the purpose of European integration, starting with the planned referendum in the UK, where progress of even a modest reform agenda in a post-Grexit EU is highly questionable. The European integration process would be irretrievably damaged, both within the EU and to the outside world, and populist anti-EU/euro forces would exploit the situation for their own cause.

No way out?

But even if there were a common understanding of the costs of Grexit, many believe that it has become inevitable, believing that it might be better to end it now than to keep this process going indefinitely, without a resolution in sight for Greece or for the creditor countries, and more and more money being committed without results.

There is some truth to this way of thinking. Certainly, the current crisis recipe has not produced the results that were needed to improve the situation in Greece and to make EMU more sustainable. But the answer is not to try and turn back the clock or surrendering to signs of fatigue – neither with respect to Greece nor the common currency.

In the case of Greece, the EU should in its own interest offer a new perspective. It should spell out what a future could look like if Greeks vote 'yes' to Europe and to the common currency. There is no doubt that staying within the euro will not be easy and further turmoil is likely, but the country needs some sort of hope to be able to manage and endure the difficult times ahead. Deep structural reforms in return for support, including a re-profiling of Greece's debt but also targeted funding aimed at generating growth and employment, remains the right formula, although the balance between both will have to be recalibrated.

At the same time, the partners of Greece also need to be persuaded that it will be worth the effort. This will not be easy either, especially after the experience of recent months and the immense loss of trust and confidence on all sides. But it will be worth it, given that the potential economic, financial, political, and geopolitical consequences of failure could be enormous.

With respect to the Economic and Monetary Union, we need to go back to the drawing board. The lessons of past years and recent developments regarding Greece have shown the need to further improve EMU governance. The 'Five Presidents Report' issued last week points in the right direction. It is a balanced document, realistic and ambitious enough to open up a credible path for the immediate and the more long-term future of EMU. It is certainly not perfect and it leaves a number of questions open, but it is a sound basis and deserves a strong endorsement by EU governments. Working out an EMU+ cannot be done overnight. But in the long run, it would provide the common currency a chance to survive and prosper rather than lurching from one existential crisis to the next.

Fabian Zuleeg is Chief Executive and Janis A. Emmanouilidis Director of Studies at the European Policy Centre (EPC).