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Following elections earlier this month, Greece’s political parties failed to form a government, and fresh elections are now set for June. Christopher Alessi of the European Council on Foreign relations interviews the LSE’s Iain Begg, who argues that while the political and economic uncertainty in Greece is likely to have a dampening effect on the global economy by aggravating uncertainty, we should not necessarily assume an automatic Greek exit from the Eurozone.

Greek political leaders failed to form a coalition government following the recent elections, and a fresh vote is now scheduled for mid-June. How will this affect Greece’s ability to implement the budget cuts required by the EU and IMF’s latest bailout package?

The package agreed to in March and endorsed by the Greek parliament in April is already in progress, but has been called into question by the support gained by parties opposed to the severity of the measures. Since further tranches of financing from the EU and the IMF depend on milestones being achieved, political paralysis in Athens could be debilitating. It is, however, important to emphasize that so-called ‘austerity’ is not merely about budget cuts and tax increases, but also encompasses profound supply-side changes [including the privatization of state-owned companies, reforming the public entitlement system, reforming the labor market, and relaxing regulations that limit foreign companies from operating in Greece]. The latter will involve taking on vested interests.

To some extent, it is a game of chicken in which Greek voters hope that by electing parties that will emphasize growth rather than austerity, they can persuade the creditors to be more accommodating. But before long, reality will have to be confronted, such that even if fresh elections tilt the balance further against the two traditional parties, whoever ends up in government will have to choose between doing enough to obtain the next tranche of funding and coming up with some alternative.

What circumstances or factors could trigger a Greek exit from the Eurozone?

If Greece does not do enough to convince its creditors to maintain the flow of funding, it will be in default. But default does not necessarily mean euro exit—an option that does not exist within the EU treaties.

That said, exit could be envisaged, but would almost certainly come only from the Greeks themselves if their political processes led to a majority prepared to take that route. So far, none of the parties that won the most seats in the recent election has advocated euro exit.

What would be the effect in the rest of the currency union if Greece left the euro? How would other at-risk sovereigns be affected, as well as the European financial sector?

The rest of the EU has steadily been building up its firewall against contagion spreading from Greece to other sovereigns, and the betting is increasingly that the storm could be weathered, were exit to happen. Many continental European banks are still fragile, and a Greek exit would probably intensify strains in the sector, including the specter of a further seizing-up of the interbank market. However, the European Central Bank showed with its two rounds of LTRO (long-term refinancing operation) that it was prepared to act; it would probably do so again if a credit crunch loomed.

What should be expected from a new round of Greek elections? Is the anti-austerity far left likely to be strengthened or weakened in a second vote?
As it looks today, Syriza (the left wing, anti-austerity party) seems to have struck a chord with the Greek electorate and would be expected to gain more seats in a fresh election, possibly enabling it to emerge as the largest party—albeit well short of a majority. Equally, Greeks will be made well aware that they cannot continue to procrastinate, and there will be enormous pressure on whatever mix of parties results to find a way to cooperate. It may be that the election of [President Francois] Hollande in France will lead to some minor concessions on the pace of public finance consolidation and more support for growth in Greece (and elsewhere), but the need for supply-side reforms will not go away.

What are the broader implications of the Greek situation—outside of Europe—for global financial markets and for the fragile global economy?

The problems in Greece and potential for turmoil in the rest of the Eurozone will have a dampening effect on the global economy by aggravating uncertainty. However, a possible positive spin is that the crisis is coming to a head and will have to be resolved soon. To revert to the metaphor of ‘kicking the can down the road’ in common use over the last two years, the wall at the end of the road is close.

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About the author

Iain Begg – LSE European Institute
Iain Begg is a Professorial Research Fellow at the LSE European Institute. His main research work is on the political economy of European integration and EU economic governance. He has directed and participated in a series of research projects on different facets of EU policy and his current projects include studies on the governance of EU economic and social policy, the EU's Lisbon strategy, the social impact of globalisation and reform of the EU budget. Other recent research projects include work on policy co-ordination under EMU and cohesion policy.

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