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Last Act of Greek Crisis Negotiations?

Article By:

Sebastian F.A. Vos

Stuart Eizenstat

Jean De Ruyt

The latest chapter of the ***Greek*** crisis, which started with the electoral victory of the left wing Syriza party in January 2015, is reaching its close. The final deadline for reaching an agreement in principle to negotiate a new bailout has been set for Sunday, 12 July by the European Council.

This last chance given to ***Tsipras*** by his European colleagues, despite the resounding “no” in last Sunday’s referendum, does not raise much optimism in Brussels. One, and possibly the only, positive outcome of the referendum may be that the other mainstream Greek political parties have formally decided to support his negotiations. The Greek Prime Minister is now less dependent on the extremist wing of his party and he will have more flexibility in obtaining approval for difficult reforms at home. Tsipras even promised to have some measures on pensions and taxes approved as early as next week.

For the first time, the European institutions and the major Member States are seriously considering the option of Greece exiting the euro. This could happen soon after Sunday’s deadline, if the Eurozone Member States and the European institutions refuse to give Greece the aid it badly needs. In contrast to the crisis in 2010, the financial stability of the euro area as a whole is not in question. The financial markets remain quiet, with the spread between the German and Italian/Spanish 10 year bonds growing only modestly in the last few days. So far the Greek case has not spilled over to other Member States. Additionally, on 16 June 2015, the European Court of Justice upheld the European Central Bank’s Outright Monetary Transactions program (‘OMT’), allowing the bank to fully implement the program if needed.

It is unlikely that EU Member States will agree to address the fundamental issue of debt relief. Most economists, and even the IMF, consider the Greek debt to be unsustainable. Nonetheless, some EU countries are not yet prepared to address it. This includes not only Germany but also the new Member States, most of them poorer than Greece, and also countries like Ireland and Portugal, which had to implement painful austerity programs. However, this is mainly a political issue rather than a substantive financial problem, because no significant reimbursement is due to the other Member States before 2023 under the EFSM and the ESM arrangements.

Most experts consider that an orderly Grexit will be very difficult to implement. There is no legal basis in the EU Treaties to expel Greece from the euro, and Greece will probably not accept a formal decision to do so. Instead, it is more likely that a Grexit will be triggered by the collapse of the Greek banking system if the ECB ends the emergency lending to Greek banks. Moreover, it is difficult to plan for a Grexit while negotiations are still ongoing because any Grexit preparations will risk creating a self-fulfilling prophecy.

The wider implications for Europe of a potential Grexit will be far reaching in several respects:

- A Grexit will damage the image of the EU in the world. And the credibility of the Eurozone will suffer when it is realised that membership is not irreversible.
- Politically it will be a mark on the political legacy of German Chancellor Angela Merkel who, since the beginning of the Eurozone crisis in 2010, has favoured respect for the treaty commitments including implementation of the rules. A break up of the Eurozone is a great failure politically as Germany is the biggest supporter European integration.
- The Eurozone countries have contributed in a massive way and in particular Germany, to financially support Eurozone countries in need, in particular Greece. Eurozone countries will need to write off huge amount of loans which will create a heated public debate in Member States and will feed the negative sentiment towards the euro in Member States.
- At an institutional level, a Grexit will bolster calls for further fiscal and monetary integration of the Eurozone to prevent a new crisis.
- It will also accelerate the establishment of a two-speed Europe, with the members of the Eurozone at its core and other Member States on the periphery.
- A Grexit will also put Greece at risk of a severe humanitarian crisis, with an enormous brain drain of young people as it struggles to cope with an influx of immigrants from the Middle East and North Africa. A Grexit may also destabilise the Balkan region.

If a Grexit leads to a Greek departure from the European Union (which is still mainly a theoretical possibility), the geopolitical impact could be dramatic.

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