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{Translation of German original}

No one in Europe can want Grexit

*by Michael Heise*

The chorus is growing louder calling for the reform-shy Greeks to leave the eurozone. Grexit proponents argue that leaving the euro will not only return responsibility for economic and monetary policy to the Greeks themselves but, in the medium term, could also make the eurozone more stable: other countries would be compelled to show greater discipline to avoid the Greek fate. Such arguments often overlook the costs a Grexit would entail, above all for Greece, but also for the eurozone as a whole. In view of these risks, the political costs of a compromise that both the Athens government and the creditors would have to bear are manageable.

For four months now Greece has been wrestling with its international creditors over an agreement in the debt row. To date the Greek government has shown little willingness to accept the creditors' demands for further reforms affecting VAT, pensions and the labor market. In addition, the government keeps announcing additional spending that would result in new budget deficits. Under these premises there is little chance of further aid to the tune of EUR 7.2bn being released from the current bailout package. But Athens urgently needs this financial injection as in June alone it has to pay back EUR 1.6bn to the IMF. Unless something gives soon, default looms. Given Greek politicians' unwillingness to reform, an agreement on a debt haircut is highly unlikely. But without massive support from the European partners and the ECB, default would almost inevitably lead to an exit from the eurozone.

Default and the departure of Greece from the eurozone would entail considerable burdens and risks for the remaining members of EMU, but a break-up of the eurozone is not on the cards. Countries prone to contagion have implemented reforms and greatly reduced dangerous imbalances such as current account deficits. Ireland and Portugal have successfully ended their bailout programs, the Spanish banking sector has recovered, and in 2014 all peripheral countries returned to growth. In addition, European crisis mechanisms have been strengthened and institutional reforms undertaken such as the launch of the ESM, the decision on banking union and the extension of rules on economic policy cooperation. The willingness of the ECB to buy up bonds via its government bond purchasing program (PSPP and/or OMT) also helps to limit the risk of contagion for other peripheral countries.

Even if the existence of the euro is not at risk, a Grexit would nonetheless send shockwaves through the financial markets and exert a temporary drag on the real economy in the eurozone. And taxpayers in the creditor countries would face a hefty bill. Following the likely devaluation of the new Greek currency, there is no way that Greece could pay back the bailout loans totaling EUR 240bn in full. In addition, the ECB would have to absorb substantial losses on the Greek government bonds on its books and on the liabilities the Greek central bank has stacked up within the Eurosystem. For Germany we are looking at claims worth around EUR 90bn in total, not including private sector loans. So there is a lot at stake for Germany, too, even if only part of the claims would lapse.

A Grexit would have far more dramatic repercussions for Greece itself. It would be the proverbial tragedy if the country was to leave now after the painful reforms and the population's austerity efforts were starting to bear fruit.

In 2014 Greece successfully returned to the capital market, sentiment improved, the labor market stabilized and the economy recorded the first growth in six years. Default and exit from the euro would require further enormous sacrifices from the Greek population. Greek government bonds and the new currency would tumble, without additional capitalization banks would crash. The Greeks' purchasing power would be eroded, their savings devalued. As this risk dawns on savers they would rush to withdraw their money from the banks and transfer it abroad; sweeping capital controls would be needed. Certainly, with a weak currency the Greek economy could at some point get back on its feet, but the long-term success of the Greek economy hinges not on the currency, but on the unavoidable reform and modernization of the economic system. This much should be clear by now.

What should we conclude from this analysis? An exit from the euro is not in the interest of the European partners, and certainly not in Greece's own interest. Presumably the Greek government recognizes, at least in principle, the costs of a default and a Grexit and at the end of the day will shy away from this scenario. For this reason there is no need for rotten compromises on the part of the creditor countries and the IMF. The Greek government needs to set out how it intends to finance its desire for higher welfare spending without pushing up the deficit and expecting others to fund it. Whether this is an increase in VAT, the overdue collection of taxes on the wealthy or spending restraint elsewhere is up to Greece itself. The only thing that is important is that decisions are taken and implemented. Tackling tax evasion and corruption and improving the legal and political system were key pledges of the governing Syriza party and they chime with the international creditors' reform proposals. On this basis it must be possible to reach agreement. The costs of failure are simply too great.