MORE THAN A GREXIT: THE IMPLICATIONS OF AN INCOMPLETE UNION

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INTRODUCTION

Since 2009, the question of a Greek exit from the Eurozone, or “Grexit”, has been looming over European politics and gaining the attention of political economists. Despite continuing tensions in the European Union (EU) regarding Greece, a Grexit has yet to occur. Should Greece ultimately leave the Eurozone or the Union altogether, the economic and political consequences would be long felt throughout the region. Whether or not Greece retains the Euro, this recent economic crisis has highlighted the unsustainability of the European Monetary Union (EMU) in its current form. Immediate measures such as bailouts or strengthening the European Central Bank (ECB) may prevent an impending Grexit but a large scale restructuring is necessary to prevent recurring crises and instability. A fiscal union among EMU members along with enforced fiscal discipline is needed to compliment the monetary union and prevent the regional trade and capital flow imbalances from threatening monetary stability.

IMPLICATIONS OF A “GREXIT”

Some have argued that the EU would benefit from Greece exiting the EMU saying the remaining states might be strengthened by cutting out their financially weakest member (Ruparel, 2015). However, there are three major implications of a Grexit that need to be considered.

Contagion

The idea of contagion is perhaps the most widely discussed consequence of a Grexit. While Greece has been an extreme case of financial instability and crisis, its situation is not unique in the region. Other EMU members such as Cyprus, Italy, Portugal, and Spain have all suffered from significant sovereign debt and threatened the stability of the Euro (Wodak & Angouri, 2014, p.417). In
addition, the UK continues to threaten its own exit (Pickard, 2015). Should Greece choose to exit, this action could prompt others to do the same in a future crisis if not sooner creating a great deal of economic uncertainty. Greece may not be a large economic player but Italy, Spain, and the UK are all significantly larger. Their absence would most certainly be felt.

*Trade Disruption*

Building off of the idea of contagion is a concern about trade disruption. Intraregional trade is the primary source of trade for most EU states including the largest economy in the region, Germany. In 2014, Greece was only the 38th largest export receiver and 47th largest importer for Germany. However, potential contagion countries such as the UK, Italy, and Spain ranked 2nd, 7th, and 11th respectively for Germany’s export and 7th, 5th, and 13th respectively for Germany’s imports (IMF, 2015). Should these states exit the EMU, transaction costs through currency exchange and instability would increase.

*Security*

Finally, even without a concern of contagion, a Grexit threatens both the internal and external security of the EU. Upon its exit of the EMU, Greece would likely suffer severe instability coupled with rapid inflation. If Greece maintained its status as an EU member, its economic instability and political frustration would likely cause Greece to stall EU votes based on consensus and weaken the organization’s ability to take action (Stavridis, 2015). Additionally, a dramatically weakened Greece still attached to the EU could create weakened border protection for the entire region.

Finally, a full exit from the EU would likely create external security concerns particularly between Greece and Turkey. “A Greece that is angry and increasingly untethered from the traditional European organizations could become more suspicious and difficult in its immediate locale. Without strong and enthusiastic membership in NATO, the relationship with Turkey looks very different from Athens, as do Greek perceptions of the Balkans. If Greece does not have the EU and NATO ‘at its back,’ it will be far less secure in how it approaches Turkey, an old enemy and the source of much conspiracy” (Stavridis, 2015).
AN INCOMPLETE UNION

While much of the Greek debt crisis can be contributed to poor domestic practices, many scholars have discussed the inherent flaw in a monetary union with no fiscal union. “There is no central fiscal authority charged with income redistribution and stabilization policies in response to asymmetric shocks, which highlights the flawed architecture of the EMU” (Watts et al, 2014, p.474) Unless this systemic flaw is corrected, monetary instability within the region cannot be prevented as states are unable to adjust their currency and the EMU is unable to adjust capital flows for them. This incomplete union has contributed to the Greek crisis (Visvizi, 2014).

Surprisingly, it has also created difficulties for stronger economies such as Germany by creating an artificially devalued currency and trade imbalances with the rest of Europe (Bernanke, 2015).

RECOMMENDATION

In order to minimize future monetary crises and an otherwise inevitable Grexit, the EMU must adopt a fiscal union and enforced fiscal discipline amongst its members. In their research on the EMU, Bargain et al (2013) found that EMU states would greatly benefit from a region wide tax and transfer as well as potentially from a fiscal equalization scheme. Monetary and fiscal policies are inherently linked and when states share a common central bank, it is in the central bank’s interest to promote fiscal uniformity (Hefeker & Neugart, 2015). In addition, despite their potential costs, fiscal transfers between states can increase support for European integration (Chalmers & Dellmuth, 2015). Finally, even with a fiscal union in place, Dr. Paola Conconi argues that “budgetary discipline alone is not sufficient for a European fiscal union to work…most EU countries (and certainly Germany) view budgetary rules as a necessary ingredient of a fiscal union. Without strengthening fiscal discipline, it seems unlikely that the more extreme reforms considered in this paper will ever be undertaken” (Bargain et al, 2013, p.412).

The implementation of a fiscal union is necessary for the stability of the EMU and would likely lower regional inequalities (Bargain et al, 2013). However, such potential economic benefits cannot occur until significant political challenges are overcome in adopting a European wide tax
and transfer system. The primary challenge is political will. According to Dr. John Ryan at the London School of Economics, “there isn't a willingness to do what is necessary to create a proper monetary union, with a fiscal union and especially a transfer union - transferring money from the rich countries to the poor - which has no support at all in Germany” (Robertson, 2015). Strong campaigning with an emphasis on the economic and political consequences of a Grexit discussed above, particularly in the richer Northern states would be absolutely necessary.

Perhaps such a step forward in the European integration process will not be possible until a Greek exit occurs as such an event might be necessary to create the political will currently missing. According to the former Greek finance minister, Stefanos Manos, a Grexit “might instead scare people in Europe and force them to do more than they were going to do to create more of a union. Beside a banking union, they need some sort of fiscal union. So a Grexit would be a good reason to accelerate the process…We would be an example to avoid” (Robertson, 2015).

CONCLUSION

A Grexit would create instability both politically and economically throughout the EU. While much of the solution must be found in the domestic policies of the Greeks, the crisis highlights a systemic flaw in the EMU. Smaller temporary fixes such as bailouts or strengthening the ECB do not go far enough. While some may argue that this calls for a complete dissolution of the EMU (Watts et al, 2014), I argue that the solution is to push for more dramatic reforms including a fiscal union along with enforced fiscal discipline in order to stabilize the Union in the long term and maintain important economic and political bonds within the region.
REFERENCES


