

Grexit Looks Inevitable. But Greece Will Need Moscow's Help

As Prospects of a Grexit Grow, Greece May be Obligated to Defy the Europeans and Turn to Moscow for the Vital Economic Help it will Need

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The Greek bailout negotiations are stuck. So are the parallel negotiations Greece has been having with Gazprom.

Why is this and what are the implications?

The big news last week is that (1) Greece failed to reach an interim deal with the Eurogroup finance ministers at the summit in Riga on Friday 24th April 2015, with Greek finance minister Yarrowfakis getting a severe dressing down and the meeting breaking up after a short interval; and (2) that Greece did not sign the deal with Gazprom last week that had been heavily trailed since Tsipras's visit to Moscow.

A few days ago I wrote a piece for Russia Insider in which I said that the reason the EU Commission had rushed out an announcement of its anti-trust claim against Gazprom was concern about the possible Greek deal with Gazprom.

I have since had a lengthy discussion with a source in Athens. He confirmed to me that the Greek government in the end balked at the Gazprom offer (which was ready for signature on 23rd April 2015) following warnings from the EU Commission that its terms were contrary to European law - i.e., to the Third Energy Package.

I was told by my source that the Greek government could not in the end bring itself to defy the EU Commission on this issue because of its fears that this would jeopardise its negotiations with the EU finance ministers at the Eurogroup meeting on the following day.

In fact the negotiations at the Eurogroup got precisely nowhere. Far from Greece's refusal to sign a deal with Gazprom having bought for Greece goodwill, the failure to do so left Greek finance minister Yarrowfakis playing at the meeting from a desperately weak hand. Without the \$5 billion he might have had from Gazprom, he was left begging for money, which predictably he failed to get.

Greece's negotiating strategy actually makes little sense and points to a divided and inexperienced government. There was no point in making overtures to Moscow if Greece was not prepared to follow them through. It was totally predictable that the EU authorities would object to whatever deal Greece made with Russia or with Gazprom. If Greece was not prepared to defy the EU authorities on this question, it should not have proceeded at all. As it is the Russians must be annoyed at being led up the garden path, while the European

leaders have been antagonised and persuaded that Greece's anti-austerity posture is ultimately a bluff.

They are probably right to think so. The very latest opinion poll shows that 72% of Greeks still want to keep the euro and still want Greece to come to a deal with the EU. Only 23% don't.

Taken in combination with Greece's failure to sign a deal with Gazprom, this will have told the EU leaders that Greece will in the end come round, so no concessions to Greece are necessary.

Syriza is now paying the price for the way it won its election victory. Syriza promised the Greek people that they could have both an end to austerity and keep the euro. That was a promise Syriza could not keep because it was outside its power to do so. The promise always looked a reckless bluff that would leave both Greece and Syriza desperately exposed if it were ever called.

The Syriza government's options are now very stark. Since a deal with Gazprom has been ruled out, Greece has to choose between either backing down and accepting an indefinite extension of austerity — possibly with a few minor cosmetic concessions — or being forced out of the euro.

As things stand I think it is more likely Greece will try to back down. The political cost of doing so will be very high and I am not sure that in that case the present Greek government will survive, at least in its present form. However the cost of a Grexit in political terms is probably even greater and I suspect that the Greek government will do everything it can to avoid it.

There remains however a high probability that Greece will be forced out of the euro whatever happens.

Ultimately Greece's debt burden is unsustainable and it is simply not realistic to think that Greece can maintain present levels of austerity indefinitely. Unless there is a fundamental shift in European policy to allow an easing of austerity — of which there is no sign — a Grexit looks ultimately inevitable. In the end what is not economically sustainable is not politically sustainable either.

Recent comments from Germany suggest that some German politicians are now belatedly coming round to that view. It is an open secret that German finance minister Wolfgang Schauble wants a Grexit, which he sees as the only way to bring this saga to an end.

Here it is important to dispose of an argument that has recently been gaining currency including in Greece itself.

Several people including Wolfgang Munchau of the Financial Times are now saying that there is legally no reason why Greece cannot retain the euro even if it defaults and that this is what it should do.

Legally speaking these people are absolutely right. Indeed that is precisely what should have been done in 2010. Greece should have been allowed to restructure its debts (which means in effect default on them) so as to put them on a sustainable basis, while remaining

in the Eurozone and keeping the euro.

The Eurozone is a currency union, not a transfer union, and there was no logical or legal reason why other Eurozone states or institutions should have assumed responsibility for Greece's debts by bailing Greece out. Certainly Greece should not have been given a bailout it could never hope to repay. That incidentally was actually illegal on any objective reading of the treaties.

It is now too late for this. The EU cannot allow Greece to default on the huge sums it owes the EU's institutions and keep the euro. It would set a completely unacceptable precedent that other deeply indebted Eurozone states that have received bailouts might be tempted to follow. For that reason the other Eurozone states and the European authorities will not entertain it.

What is most likely to happen is that if, or rather, when Greece defaults, after a short interval and probably during a weekend, the ECB will withdraw support from Greece's banks. The Bank of Greece will in that case have no option but to print drachmas to support the banks. At that point Greece's membership of the Eurozone will be over.

The immediate effect of a Grexit would be catastrophic for Greece. There will be little confidence in the new currency, there would be a run on the banks, most of which would crash, and inflation would spiral.

At that point Greece might have little choice but to turn to the one country that is its largest bilateral trading partner and which is the only country that would be in a position to provide it with the food and energy it would need to get through.

That country is Russia – Europe's biggest energy and food producer.

However if the Russians help Greece it will be on their terms.

Setting aside speculation about Mediterranean naval bases (which Russia doesn't want and doesn't need) that would almost certainly involve some resurrection of the Gazprom deal.

Once Greece is outside the euro, EU leverage over Greece ends.

Southern and eastern European states unhappy with the EU's anti-sanctions and anti-Gazprom policy have nonetheless felt obliged to go along with it because they do not want to risk loss of their EU structural or bailout funds or their hopes of joining the euro.

If Greece is ejected the Eurozone it is no longer in that position.

Structural and bailout funding will have been forever lost. It is not being provided now and will certainly not be provided in future if Greece leaves the euro and defaults.

Having been thrown out of the euro, there will be little or no prospect of Greece ever rejoining any time soon, certainly not while it remains in default on its liabilities to the EU's institutions, so the hope of one day joining the euro will not be there.

There is no mechanism to expel a country from the EU. In the event of a Grexit, Greece would remain a member of the EU and would still share in the benefits of the common European market.

Greece would however be free to make whatever deals with Gazprom it saw fit, regardless of whether the EU Commission said they were legal or not. The EU Commission could bring legal action against Greece, but in the absence of central EU funding it is difficult to see what practical effect that would have.

Greece would also be free to veto sanctions against Russia if it disagreed with them without having to fear retaliation if it did so.

I do not say that this is what will happen if there is a Grexit. Ultimately it will depend on how the political situation within Greece evolves in response to a Grexit. However the option to act independently would finally be there. Whether the Greeks make use of it once they have it is another matter.

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