

# Greece After the Referendum: Three Possible Scenarios for the Euro Area

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About ten days ago Alexis Tsipras, the Greek prime minister, announced that there was going to be a referendum, and thus terminated the negotiations on a new rescue package unilaterally. Since then the euro area has been plunged into a wholly unprecedented political crisis. Whether or not Greece can remain in the monetary union is more uncertain than ever, and decisions that can give a new twist to the political and financial situation are being made almost every day. The Greek banks have been closed for over a week. The economic data are deteriorating rapidly. And yet a solution is nowhere to be seen. The No vote in the Greek referendum has not exactly improved the chances of reaching an agreement. For the time being the positions seem to have become uncompromising. At the summit of the heads of state and government on 7 July the Greek government was given five days and a “final deadline” in order to

come up with viable proposals for reform. Thus the next few days are of crucial importance. At the weekend the heads of state and government of all 28 EU member states are going to meet in order to decide the future of Greece.

This flashlight europe provides an overview of the events of the last few days, outlines possible scenarios for what may happen in the near future, and identifies factors which may exert an influence in the short term. We are not trying to give an exact forecast or to formulate action recommendations. But we are trying to shed some light on a confusing situation by identifying important patterns and some of the salient factors.

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### What happened so far...

In the week that began on 22 June there were a number of meetings between Greece and its creditors – the European Commission, the European Central Bank (ECB) and the International Monetary Fund (IMF). There was now only a week in which to finalize the negotiations, which had been going on for five months, on the disbursement of the last tranche of the second rescue package for Greece, which was scheduled to end on 30 June. It is worth recalling the important dates and events of the last ten days:

**Wednesday, 24 June:** Meeting of the finance ministers of the euro area.

**Thursday, 25 June:** Meeting of the heads of state and government of the euro area. The creditors make an offer.

**Friday, 26 June:** The sherpas negotiate the final agreement that is to be signed the following day. In the evening Alexis Tsipras announces that he intends to hold a referendum on the offer made on Thursday, and to tell the Greek electorate to vote No.

**Saturday, 27 June:** Meeting of the finance ministers of the euro area, initially with Yanis Varoufakis, the Greek representative. After a break and a press conference given by Jeroen Dijsselbloem, the President of the Eurogroup, the finance ministers continue their meeting without their Greek colleague. In the evening the Greek Parliament meets and decides to adopt the prime minister's initiative.

**Sunday, 28 June:** The ECB Council decides not to increase the ELA loans (ELA stands for "emergency liquidity assistance") for the Greek National Bank, but to keep them at the same level. The Greek government announces that it will shut down the banks and the stock exchange for at least a week, and impose capital controls. The maximum sum for cash withdrawals is set at €60 per day.

**Monday, 29 June:** The European heads of state and government call on the Greeks to vote Yes and not to take the advice of the Greek government. Jean-Claude Juncker, the President of the European Commission, gives an emotional and pugnacious speech "to the Greeks".

**Tuesday, 30 June:** Post arrives from Athens. An application for a third rescue package is sent to Dijsselbloem, the President of the Eurogroup. The finance ministers hold a telephone conference. They tell Tsipras to have the referendum, and then to go on talking. At midnight the second rescue package officially comes to an end. Furthermore, Athens does not pay the instalment due to the IMF and is thus the first industrialized country in the history of the International Monetary Fund to fall "into arrears".

**Wednesday, 1 July:** Federal Chancellor Angela Merkel issues a government statement. The debate in the German Parliament is broadcast live and on Greek television with a simultaneous translation.

**Wednesday to Saturday, 1 to 4 July:** Election campaign in Greece. The Greek government continues to call for a No vote, the other euro countries for a Yes vote.

**Sunday, 5 July:** At the referendum in Greece 61% vote No, and 38% vote Yes.

**Monday, 6 July:** In Paris Merkel and French President François Hollande talk about the consequences of the referendum. Finance minister Yanis Varoufakis resigns. He is succeeded by Euklid Tsakalotos of the Syriza Party. The Greek banks stay shut, and the capital controls are kept in place.

**Tuesday, 7 July:** First there is a meeting of the Eurogroup, and in the evening a meeting in Brussels of the heads of state and government of the euro area. Greece does not submit a new written proposal. The European heads of state and government give the Greek government five days and a "final deadline" in order to present viable reform proposals.

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**Wednesday, 8 July:** Greece makes a formal application for assistance from the European rescue fund ESM (third rescue package). A detailed application is supposed to follow a few days later. Alexis Tsipras speaks to the European Parliament.

**Thursday, 9 July:** The Greek government has to submit a detailed application for a third rescue package by Thursday evening at the latest.

**Saturday, 11 July:** Planned meeting of the euro finance ministers.

**Sunday, 12 July:** Planned summit of all 28 European heads of state and government in order to decide the future of Greece.

At this point in time it is unclear what is going to happen to Greece and the euro area. There are three possible scenarios: "Gremain" (Greece remains), "Grimbo" (Greece in limbo) and "Grexit" (Greece exits).

### GREMAIN

**Negotiations are a complete success, and Greece remains a fully-fledged member of the European Monetary Union**

The negotiations begin rather sluggishly, but then quickly become constructive. Within a matter of days representatives of Greece and the Eurogroup reach agreement on a third rescue package. The agreement contains credible promises on the part of the Greek government to reform the Greek state and economy in a viable manner. As a quid pro quo the creditors agree to debt restructuring. This means that the debts are frozen in the long term and interest payments are suspended. A formal debt cut is held out as a distinct possibility if the reforms turn out to be a success. There is agreement on the need for an initial review after three years, and another after five years. In specific terms success means that public institutions are able to function, and that the Greek economy is growing. The parameters are defined jointly. The Greek government will have to decide

how it is going to reach these targets. As long as the debts are frozen, the Greek government will not be permitted to incur new debts. In this period its expenditures may not exceed its revenues. If, after five or ten years, the Greek government qualifies for a debt cut, the negotiations will not be about a complete waiver, but about reaching a debt burden that in realistic terms Athens can actually service. Estimates suggest that this would be about 50 percent of the present level.

There is not a great deal of time for a solution leading to Gremain. Even if they scale back their activities to a minimum (no counter service, ATMs do not pay out more than €60 a day per card), the Greek banks can only keep going for a few more days at the most. After that they will go out of business unless they are rescued with the help of the European Stability Mechanism (ESM). Since in formal terms such a measure is an assistance programme, it would enable the ECB to make further ELA payments or to come up with another kind of bridging loan. This would buy a little time in order to make it possible to attain a long-term, political and economically viable solution: Gremain, Greece's long-term membership of the euro area.

### GRIMBO

**There are protracted negotiations, but Greece does not leave the euro area, and a viable long-term solution fails to emerge**

A new set of negotiations begins, but it does not lead to a speedy agreement. The banks can no longer dispense cash, the capital controls remain in place, the situation of the banks deteriorates rapidly. The pressure on the Greek government increases. Syriza, which originally was no more than an alliance of various left-wing parties, breaks up, and so does the governing coalition. The country has to organize new elections, but in fact does not have the time to do so. There are already some spill-over effects on other euro countries, especially those on the periphery of the euro area. For this reason the Eurogroup, after consulting the European Commission and the

## flashlight europe

ECB, decides that the Greek banks will have to be stabilized, both in order to shore up the Greek economy, and in order to guarantee the financial stability of the euro area as a whole. A bank rescue package is put together with the transitional government in Athens. ESM resources are made available as in the case of Spain. This qualifies as an assistance programme, which means that the ECB can continue to support the Greek banks (with the help of ELA or some other instrument). The Greeks have an election, but it does not produce a clear mandate. The new government, which is a broadly-based coalition of various different parties, continues with the negotiations in Brussels. However, they are rather sluggish. The new government is weak in both domestic and foreign policy terms. It is unable to negotiate successfully with its euro partners, nor can it rely on the broad support of the Greek electorate. This is another reason why important reform projects do not make much headway and the economy continues to stagnate on a very low level. The Greeks are not convinced by all this, and the capital controls are felt to be an unwarranted attempt to strangle the economy. And the creditors are not satisfied either. It becomes more and more difficult to organize majorities in the euro area's national parliaments which are required to vote on these measures. The negotiating partners continue to be suspicious of each other. The EU approval ratings continue to sink both in Greece and in the other countries of the euro area. The euro area is stuck in a crisis mode. That is what Grimbo is all about. It is an inherently unstable scenario that sooner or later is bound to lead to a gradual kind of Grexit.

### GREXIT

#### The negotiations founder, and Greece leaves the euro area

Alexis Tsipras – strengthened by the referendum and the joint declaration of all of the parties represented in the Greek Parliament – goes to Brussels. However, he gets off to a difficult start. His negotiating partners emphasize again and again that they intend to respect the result of the Greek

referendum, but this does not lead to a significant change in their positions. In political terms the two sides are even more intransigent in the wake of the referendum. The Greek prime minister continues to press for a debt cut, which he thinks is the only solution. He feels even more honour bound to adhere to this idea as a result of the referendum. However, the other euro states are not in the mood for concessions. They have also adopted a clear-cut position. Assistance without unambiguous conditionality is not an option. A bevy of meetings within a short space of time fails to resolve these conflicting goals. The ECB's hands are tied. Without an assistance programme it cannot make any more ELA payments. At the same time the economic situation of the country keeps getting worse and worse. The banks stay shut. For a few days the euro cash in the country leads a life of its own. Its value detaches itself from that of the euro elsewhere. For a short time this has the effect of an increase in the amount of cash available, which helps with day-to-day payments, but does not resolve any of the fundamental problems of the Greek economy. Imports and exports are virtually impossible in view of the fact that invoices cannot be paid. Important goods such as medicines and foodstuffs are increasingly in short supply. The EU and its member states begin to provide humanitarian assistance. The political pressure grows. The Greek banks finally go out of business. No economic system can function without a payments system. The Greek government feels compelled to introduce a parallel payments system with the help of IOUs. The value of the new de facto currency declines dramatically, and the size of Greek debts in euros multiplies. They can definitely no longer be serviced. Either a debt cut is negotiated, or the Greek government declares unilaterally that it cannot repay its debts. It would be a case of sovereign default. In formal terms Greece remains a member of the euro area, but in practical terms it is cut off from the euro. This is how Grexit would happen.

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### Keep an eye on this

Recent weeks have shown that forecasts about the outcome of the Greek debt crisis are virtually impossible. Unexpected political or economic events can quickly turn the situation on its head. Under these circumstances it would be presumptuous to assume that the process can be kept under control or that Grexit can proceed in an “orderly” fashion. However, a number of factors are worth keeping an eye on in the days ahead.

**Stability of the Financial Services Sector:** For how long can the Greek banking system keep its head above water, and when are its last reserves used up? And to what extent will the ECB shore up the Greek banking system with the help of emergency loans?

**Cohesion of the euro countries:** Will the other member states of the euro area and the creditor institutions succeed in adhering to a single negotiating position? Or will the north-south conflict continue to worsen, i.e. Germany, the Netherlands, Finland and some Eastern European countries are advocates of a hard line towards Greece on the one hand, and France and Italy are proponents of more flexibility on the other?

The fact is that without the political cohesion of the euro countries the whole euro area is in danger. Finding a solution for Greece is a challenge. But it is also a challenge to protect the other euro countries from catching the disease.

**The domestic situation in Greece:** Will the governing coalition manage to survive? Or will the failure of the negotiations in Brussels to come up with a speedy resolution of the issue lead to the downfall of the government and new elections?

**Willingness to compromise:** Will both of the negotiating parties be prepared to make concessions that may well run counter to the statements they have made in the past? In the case of Greece this will mean far-reaching and credible reforms, whereas the euro countries will have to give an undertaking to restructure Greek debt. This will be a sensitive issue particularly for euro countries that have undergone painful reforms themselves (Portugal, Spain, and Ireland) or that have lower levels of income and social protection than Greece (Slovak Republic). Or will the suspicions on both sides become more pronounced, and will the two sides become even more intransigent at the negotiating table?

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