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GLOBAL INSIGHT

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Greek ship might set sail for other ports

By Tony Barber in London

Euro exit would encourage geopolitical realignment

Like ships that cross paths in a storm, Greece speeds from the heart of Europe to its furthest shore while a handful of Balkan states steer in the opposite direction.

Greece's departure from the eurozone is not yet a certainty, but across the European Union, businesses, bank regulators and bureaucrats are preparing for the possibility.

If it occurred in the next six to 18 months, it would coincide with the EU's admission of Croatia as its 28th member-state and the bloc's gradual embrace of Serbia and Montenegro.

Moreover, the political and economic upheaval of a Greek exit might stimulate the wider geopolitical realignment that is unfolding in the eastern Mediterranean. This involves Greece, Turkey, Cyprus, Israel and Russia.

For the EU, these consequences may be just as unsettling as the destabilising influence on western Europe of the eurozone's sovereign debt and bank crisis.

It is hard to exaggerate the national humiliation – not to mention the economic hardship – likely to be felt by ordinary Greeks in the event of a eurozone exit.

After the collapse of its 1967-74 military junta, Greece invested its hopes in shedding its Balkan skin and acquiring a modern European identity. Up to the outbreak of the national debt emergency in 2009, these hopes were to a certain extent rewarded.

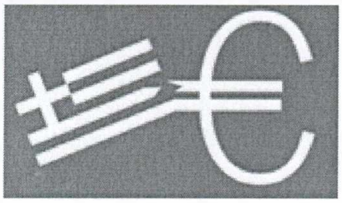
But Greece's progress concealed the pathology of a clientelistic culture in which politicians fed voters with favours and piled mountains of unpayable debts on the state.

Much attention now centres on how Greece might arrange its departure from the eurozone, and the introduction of a new currency, with minimal disruption to banks and businesses.

But such a discussion misses two points. For one thing, it is questionable whether Greece has the administrative capacity to replace the euro speedily.

FT series

If Greece goes...



Greece is back on a knife edge. In a timely and far-reaching series, the FT looks at the potential consequences of it leaving the eurozone

For another, as Greece's formal eurozone membership melted down, with the European Central Bank cutting credit to Greek banks, euros would be in tremendously high demand among Greek citizens.

The authorities would be under pressure to retain the euro as legal tender, permitting its use in domestic transactions alongside some separate, less valuable unit printed to pay wages and pensions.

In itself, retention of the euro would neither preserve living standards for most Greeks nor help Greece's banks. After taking extensive losses this year on their holdings of Greek sovereign debt, they need tens of billions of euros in recapitalisation.

But if Greece lost its eurozone status, the banks would have no access to the necessary funds. Nationalisation or foreign control would probably follow.

In other respects, however, retention of the euro would give Greece the flavour of daily life in Montenegro and Kosovo, its Balkan neighbours. These two states have used the euro (and, before that, the Deutschmark) since the launch of Europe's monetary union in 1999.

They have no representation on the ECB, which has tolerated rather than encouraged their use of the euro, and so have no say over its interest rate policies. Yet, at least in Montenegro, the euro has proved a success story.

The euro has tamed inflation and stabilised the monetary system so effectively that Montenegro began in 2010 to issue euro-denominated debt. It is a measure of the euro's influence in Montenegrin life that the nation's entry at the Eurovision song contest final on May 26 will be a tune called "Euro Neuro".

More serious are the regional implications of a Greek exit from the eurozone. The damage to Cyprus's financial system, heavily exposed to Greek debt, would be devastating.

Cyprus last year received a cheap €2.5bn loan from Russia in a gesture that reflected the Kremlin's interest in protecting wealthy Russian depositors with billions parked in Cypriot banks. It may soon need more aid.

At the same time, the discovery of gas in Cypriot and Israeli waters combined with Turkey's strained relations with Israel to produce closer co-operation among Greece, Cyprus and Israel.

Should their eurozone membership lapse or collapse, it is not difficult to imagine that Greece and Cyprus would be tempted to seek more comfort in the arms of Israel and Russia.

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