

Quick Take On The Latest Euro Crisis Developments

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What a day to wake up with a Halloween hangover.

Greek Prime Minister Papandreou announced the intention to hold a referendum on the latest Greek bail-out package, or rather the draconian austerity measures demanded by the EU to qualify for it. In addition, the government announced a 'Vote of Confidence' in Parliament this week to endorse the referendum plan. If the latter fails, Greece could face an election campaign amidst the worst economic crisis in the country in living memory. Financial markets reacted predictably negative as elections, or a referendum, will take time to organize and would paralyze decision-making in Athens. This is clearly a development that nobody seemed to have had on their list of predictions. Here are a few thoughts on what this could mean:

Don't be afraid of democracy.

First, I actually think a referendum is a good idea. In a democracy, it is extremely difficult to demand a government, even if elected by a majority, to implement as dramatic a set of changes to the lives of, in this case, the Greek people, as Prime Minister Papandreou's party is being asked to do. He didn't even get a majority in the most recent 2009 elections – 'PASOK'¹ got only 43.9% – which gave him a fragile 10 seat majority in Parliament. What Greece needs is a broad political consensus on the necessity of drastic spending cuts to restore competitiveness and avoid the disaster of a disorderly Euro exit. With a referendum or an election campaign, Papandreou essentially forces the conservative opposition to support his bail-out policy since there is no alternative. In the current debate, the opposition can always claim they would do a better negotiation

job; in a referendum, they have to choose between staying in the Euro zone or leaving the EU with all the associated consequences. I believe, if a referendum takes place, the government will win majority support for the current policy. The results of snap elections are far less clear, but the possibility of a pragmatic coalition between the two main parties, 'PASOK' and 'Nea Dimokratia',² would provide a more stable political basis to implement necessary reforms in Greece.

Sending out an S-O-S.

Second, the referendum plan sends a message to Brussels that Greece has reached the limit of what the country can endure in terms of fiscal austerity. It also emphasizes the point I have been making for months that the critical element missing in the bail-out debate is a credible growth plan that gives countries like Greece hope to ever get out of the current crisis. While a controlled devaluation in Greece could impose more losses on the private sector in the rest of Europe, which would have to be absorbed by the Euro zone governments, it could at least start to draw the outlines of a post-debt crisis perspective for Europe's periphery.

The devil is in the detail.

Third, the problem with the referendum plan, as with so many ideas, is the implementation. A positive result is by no means guaranteed and the opposition may well decide to go down the irrational, populist path and call for a unilateral withdrawal from the Euro zone. We could also see increasing violence in the streets as fringe parties vie for influence reminiscent of Germany during the 'Weimar Republic'. Given Greece's history, I think a military coup would be a distinct possibility, if the civilian government were to lose the

ability to maintain law and order. I have argued many times that it is 'stability' that Europe values over and above anything else and it is the specter of Yugoslavia and the uncontrolled break-up of that country that still haunts European politicians. I have no doubt Greece descending into a autocratic military dictatorship would be as much a sign that the European Project has failed as would be a break-up of the Euro zone.

Bottom line.

It's hard to predict what will happen next. I think we will see many reactions from EU politicians and attempts to change Papandreou's mind, but I doubt the EU will actively become more hostile towards Greece. My point that Greece is signaling it has reached the limit will be understood in Brussels. The key issue is the level of violence in the streets of Athens and the position of the main Greek opposition party. However, there are more reasons to be worried about Europe's impact on financial markets. Behind all the 'Greek Fire' is still a deteriorating European growth backdrop and the threat of a downgrade of France's credit rating, which would unravel the European Financial Stability Facility leverage idea and force the European Central Bank ("ECB") back into the bond buying role. Paradoxically, that would actually be a stabilizing move. Like so many decisions in this crisis, however, the ECB will only be willing to take on that role again if they are forced to acknowledge the current plan was never going to work in the first place. Until then, Macro Risk will remain extremely high. ■

¹ The Panhellenic Socialist Movement, known mostly by its acronym 'PASOK', is one of the two major political parties in Greece.

² Nea Dimokratia is the main center-right political party and one of the two major parties in Greece.



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