

Greek referendum: Papandreou's gamble could pay off

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Polls show that 70% of Greek voters are against leaving the euro but even in the event of a no vote, the EU and IMF could still step in

On the face of it, the decision by the Greek prime minister, George Papandreou, to hold a referendum on the latest bailout package looks like an act of political hari kari. Certainly that was the kneejerk response of the markets, which sold off heavily overnight and continued tumbling in Europe this morning. No question, the announcement of the plebiscite has put an end to last week's rally in response to the emergency measures announced at the Brussels summit. The next couple of months until the referendum is held will be a white-knuckle ride as investors contemplate what would happen if the Greeks say no. What worries the markets is that Papandreou's gamble backfires, the referendum is lost, the European Union and the IMF refuse to stump up any more money, Greece runs out of money, Greek banks go bust, the country defaults in a disorderly way and leaves the single currency, and a domino effect is triggered in other countries such as Spain and Italy.

But will this actually happen? Perhaps not. For a start, Papandreou may win the referendum. Polls in Greece have shown that 60% of the population are against the terms of the bailout but 70% are against leaving monetary union. If the vote is framed as "do you want to stay in the single currency or not" (which it will be if Papandreou has any sense) there is every chance the Greeks may agree to swallow another dose of austerity, however unlikely that looks at present. Voters tend to be quite conservative: they tend to prefer the status quo, which in this case would be remaining inside the single currency rather than taking the leap in the dark represented by default and exit.

The second thing in Papandreou's favour is that if Europe is a problem for Greece then Greece is actually an even bigger problem for Europe. If ever there was a case of "when you owe the bank €1000 you have a problem but when you owe €100bn the bank has a problem" then this is it. The question for Greece's partners in the single currency and for the International Monetary Fund is whether they want to push the Greeks so hard that they vote no to the deal, or whether they are prepared to soften the terms in order to safeguard against a disorderly default and all that implies.

My hunch is that even if the Greeks vote *no* then it will still get enough money to prevent it defaulting because the stakes for the rest of Europe are so high. Europe does not have a Plan B in the event of a Greek default. Let's be honest, it still doesn't have a fully worked out Plan A. It needs time to get its act together (assuming that it is actually possible) and will probably be prepared to buy time by making life easier for the Greeks. Papandreou is in a stronger position than people think.