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Commentary

Eurozone exits no longer taboo

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The crisis has entered yet another phase, with Greece's membership of the euro zone being openly contested by commentators and even EU leaders. Provoked by Greek Prime Minister George Papandreou's unilateral decision to hold a referendum, German Chancellor Angela Merkel and French President Nicolas Sarkozy – supported by other EU leaders – asked the Greek government to quickly provide a clear answer as to whether the country is ready to stick to its commitments in order to remain within the euro area on the basis of the agreement reached at last week's Euro Summit. In addition, the sixth tranche of aid from partner countries and the IMF, which was scheduled for November, was put on ice.

Political developments in Greece are still fluid. The referendum is off the table and Papandreou's premiership seems to be reaching an end as his party's biggest players have further distanced themselves from the prime minister following the national and international turmoil provoked by the referendum idea. To overcome the political impasse, it now seems that Greece is moving towards a provisional government of unity supported by the two main parties (Pasok and Nea Demokratia). A potential 'government of national rescue' composed of (mainly) 'technocrats' would have to fulfil three main tasks: avoiding an immediate 'hard default' by first and foremost securing the transfer of the sixth tranche; implementing the decisions taken consensually by the Euro-17 on 26-27 October; and preparing the country for elections, probably in the early months of 2012. The main parties in the Greek parliament still have to agree on the new government's concrete mandate, timeframe, competences and composition.

The transitional government and every other future Greek government will face a tremendous task. With respect to its partners, Greece will in a very short period of time have to do everything to regain trust by providing evidence of the country's firm commitment and ability to fulfil its obligations. Efforts to attain a primary surplus and to reduce the country's debt to a sustainable level by 2020, in-depth reform of the public sector and the resurrection of the Greek economy will be a long and painful marathon – and it is by no means certain whether the country will in the end reach the finish line.

However, the chances of success have at least increased over the last couple of days, as the danger of being forced to leave the euro zone has become a realistic possibility. Although the proposal to hold a referendum is off the table, the genie has left the bottle: a potential 'voluntary' exit from the euro is no longer a taboo subject. The danger of a disorderly default has grown larger than ever and a growing number of politicians and commentators outside Greece argue that the country is a special case. The stability of the euro would – according to them – profit if Athens were to decide to exit the common currency.

In this situation, EU leaders and governments are sending different signals to Athens. On the one hand, they have further increased political and financial pressure on Greece by putting the disbursement of additional rescue funds on hold. Leading EU figures including the president of the Eurogroup, Jean-Claude Juncker, have declared that the euro zone must prepare itself for a potential Greek exit in order to avoid the negative effects of such a move for other EU countries and to boost the overall stability of the common currency. At the same time, eurozone leaders are reiterating their readiness to support Athens and expressing their desire to keep the country in the euro area – provided that it satisfies the agreed conditions.

But will Greece be able to live up to these expectations? No-one can really answer that question. However, one factor might help change the tide: the threat of being compelled to abandon the euro is fostering a more honest debate about the economic, social and political consequences of Greece returning to the drachma. Almost two years into the crisis, ordinary Greeks are suffering from the negative socio-economic effects of the crisis (high unemployment, cuts in wages and pensions, strikes etc.). Despair, frustration and anger are widespread. But the Sword of Damocles of a hard default and the threat of a 'voluntary' exit from the euro zone (or even the EU?) is increasing public and political awareness of what needs to be done in order to prevent much worse – unprecedented mass impoverishment, fundamental political instability and conflict, and increasing social tensions.

The gravity of the moment signals that the time for muddling through and political manoeuvring is clearly over. The potential establishment of a unity government with a well-defined mandate would be an important signal and a decisive first step in the right direction. But the spirit of cooperation among major political parties will have to continue, especially if the next elections do not provide a platform for one-party government, as current polls seem to indicate.

The realisation that exiting the euro zone is no longer taboo does not 'only' affect Greece: it is also a significant step for the entire euro area, in both positive and negative terms. On the one hand, fear of being forced to leave the common currency increases the ability of governments and the EU institutions to exert influence on those countries that are not playing by the rules – although the potential leverage is admittedly smaller with respect to some of the bigger and more economically powerful countries. On the other hand, breaking the exit taboo undermines the overall credibility of the euro zone and risks even more negative market reactions, especially if investors fear that other countries might eventually also end up like Greece.

It would be naïve, irresponsible and even dangerous to underestimate the potential financial, economic and political costs of allowing Greece or any other country to step out into the abyss. It is more than ever in the self-interest of everyone in the EU and especially in the euro zone for Greece to turn the wheel around and remain in the safe haven of the euro. But the level of uncertainty and risk has once again increased, putting the future of the euro on a knife edge.

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