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The Greek threat to Euro Zone

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The anti-austerity mood of the Greek voters in recent elections suggests that the only long-term solution for the country's economic crisis is an orderly exit from the Euro Zone.

Greek voters have severely chastised the two major parties that had participated in the financial rescue and austerity package with the European Union (EU), the International Monetary Fund and private creditors. The vote is a sharp reaction to months of suffering and austerity forced down the throats of the Greek population, which held the two largest parties — the centre-right New Democracy (ND) and the centre-left Pan Hellenic Social Movement (Pasok) — responsible.

Parties on the left and right scored gains, further fragmenting the Greek Parliament of 300 seats, and creating uncertainty over the formation of a new government at the time of writing, and the future of the financial rescue package and Greece's ability to adhere to it.

In a famous Greek legend, Prometheus was punished by the gods for stealing secret knowledge and passing them on to mortals. He was chained to a rock and every day his liver was eaten by a great eagle, to grow back the next day. For Greeks today, the repeated bouts of austerity, with pay cuts, job losses, higher taxes and pension cuts the suffering must seem like that of Prometheus.

The constant strikes and demonstrations, and violent anti-austerity incidents were signs of a revolt among the people. The recent elections have confirmed this.

Fragmented polity

The biggest gainers in the elections were the anti-austerity groups on the right and left, capitalising on the public anger. Pasok saw its base shattered, losing a massive 119 seats and being reduced to the third rank in the Parliament with only 41 seats.

The ND managed to increase its strength from 91 to 108, emerging as the biggest party, and the nucleus of the future government. It has three days to conclude talks on government formation and report to the President.

The Coalition of the Left (SRIZA), a group of some 13 left-oriented parties increased its strength from 13 to 52, emerging as the second biggest player, which would be called upon to try and form the government if the ND fails.

The extreme right, anti-immigrant Golden Dawn party also scored gains, entering the Parliament for the first time with 21 seats. Other significant players are the Independent Greeks (a new ND breakaway group opposed to austerity measures) with 33 seats, the Communist Party (KKE) (up from 21 to 26 seats), and the Democratic Left (a new party with 19 seats).

The new constellation of parties reflects the fragmentation of the Parliament.

Severe problems are likely in forming a new government, especially one that will have to deliver on the austerity measures which are opposed by most of the new parties in the Parliament. If no government can be formed after the Presidential consultation process, another election is inevitable.

The implications of the election results are being felt beyond Greece. It threatens the financial rescue package and raises the possibility of Greece defaulting on its debts. The European markets are reacting to this threat to the financial institutions and holders of Greek debt, and confidence in the Euro Zone has been impacted. The election results from France have further dampened the sentiment. An anti-austerity wind seems to be sweeping across the Euro Zone.

Warning for india

Greece has a large current account deficit of 10.5 per cent of GDP, a public debt of 160 per cent of GDP and a government deficit of 9 per cent of GDP.

These are far from the Maastricht criteria for Euro Zone membership for public debt (60 per cent of GDP) and government deficit (3 per cent of GDP). Japan, which has a larger public debt of over 200 per cent of GDP, however, has a healthy current account surplus of 3.6 per cent of GDP.

The current account deficit is an indicator of the long-term competitiveness of the economy. Normally, if this deficit goes high, the currency gets devalued, restoring the balance. But since Greece is locked into the Euro Zone, depreciation of the currency is not an option. Bailout packages will not be able to make the Greek economy competitive. This suggests that the only long-term solution for the Greek economic crisis is an orderly exit from the Euro Zone, together with a further write-down of Greek debt. This would enable Greece to adjust its currency and regain competitiveness. Some EU countries such as Poland have drawn lessons and would like to retain their own currency.

The Euro Zone member States will need to provide for the unpalatable but necessary option of an orderly exit from the Euro Zone of a country in severe economic crisis.

Otherwise, the system will become increasingly unsustainable, since monetary integration without strong unified economic and political governance will not work. The markets will react to what the Euro Zone members do to deal with the Greek situation.

There is a warning for India in this. India's current account deficit has increased to 2.7 per cent of GDP from 0.7 per cent in 2007. The government deficit is 5.1 per cent of GDP. Depreciation of the rupee provides some counter-effect, but unless this translates into gains in goods, services and capital flows, it will not be sustainable. Rating agencies are assessing these trends. Our economic managers need to watch Greece closely and avoid the dangers of populist policies and economic policy blunders.

(The author is a former Ambassador of India to Greece.)

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