



**Halle Institute
for Economic Research**
Member of the Leibniz Association

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Rejection of Reforms as a Chance for Reforms

The President of the Halle Institute for Economic Research (IWH) – Member of the Leibniz Association continues to see a chance for an agreement between the European Union (EU) and Greece. On the surface, Grexit looks now more likely than ever. But the resignation of Yanis Varoufakis, Minister of Finance, and the outcome of the referendum may also provide a chance for the Greek government to agree on reforms and save face. But the window of opportunity is closing very fast.

The Greek population rejected reforms with an overwhelming majority on Sunday. Everything set then for a Greek exit from the Euro? One could think so: Unless the EU wants to risk the entire success of the common currency, it has to stand firm and deny credit to a country that refuses to undertake reforms that would restore its medium term sustainability. The European Central Bank (ECB) may now be forced to raise haircuts on Greek collateral, forcing a collapse of the Greek financial system. Under those circumstances, an (relatively orderly) introduction of a new currency should be the preferred option relative to formally sticking to the Euro. Sticking to the Euro would force the government to allow a parallel currency based on IOUs, simply in order to pay wages and pensions, with huge adverse distributional effects for the private sector. One of the main problems a parallel currency would entail is that corporate debt would remain in Euro, forcing these firms into bankruptcy. If a new currency was introduced and the Euro abandoned, corporate debt could be converted to the new currency, permitting more firms to survive.

But perhaps the referendum combined with the surprising resignation of Varoufakis is the chance to finally agree on something substantial. The past week may have finally gotten the point across to even the most steadfast ideologue in the Greek government that not agreeing with the EU is suicide. Combined with Varoufakis' departure, the referendum may give the Greek authorities the chance to save face and agree to a half-way reasonable program. From the outcome of the referendum one can get the impression that the Greek population is less interested in substance and more in preserving what is perceived to be some "pride". Hence, what was on the table last week with some minor modification may now have chances in the negotiations.

There may still be a small window of opportunity to avoid the worst. The EU and Greece should seize it.

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