Greece Blinks on Euro Threat
Papandreou, Future Uncertain, Kills Referendum

By MARCUS WALKER And ALKMAN GRANITSAS

ATHENS—Greece's leadership struggled to restore political stability to the country and safeguard its membership in the euro zone, as global powers gathered in France looked for ways to halt the spiraling European debt crisis.

Greek Prime Minister George Papandreou on Thursday agreed to shelve a controversial plan for a referendum on Athens's latest financial bailout. The turnabout followed a tumultuous few days that thrust Greece to the brink of political chaos, forcing euro-zone leaders to contemplate the possibility that Greece would exit from the single currency.

Leaders of the Group of 20 industrial and developing nations, meeting in Cannes, France, debated how to shore up the wider euro currency zone—a major part of the global economy—against the financial chaos unleashed by the Greek turmoil.

U.S.-led international pressure is on the euro zone and the European Central Bank to take bolder action to resolve the crisis, which
struggle to ward off financial collapse. During her report, the opposition party stormed out of the room. Photo: Louisa Gouliamaki/AFP/Getty Images

is threatening to undermine global economic confidence. But euro-zone governments were unable to give a commitment that their most powerful financial instrument—the ECB—would intervene more heavily in bond markets to reduce the borrowing costs of beleaguered members of the single currency, such as Italy.

The ECB surprised markets by cutting its key interest rate to 1.25% from 1.5% on Thursday, a move aimed at helping Europe’s economy cope with impending recession. But its new president, Mario Draghi, rejected calls for the bank, which is politically independent, to act as a lender of last resort to euro-zone governments and insisted that ECB bond purchases would remain limited.

Greece's referendum controversy left survival of Mr. Papandreou's government in doubt ahead of a planned confidence vote on Friday. Yet the poll's cancellation quelled fears of an imminent Greek exit from the euro exit from the euro zone, a move that some feared risked triggering the collapse of the currency itself.

Battered financial markets rallied after the referendum—whose uncertain outcome could have pushed Greece into the biggest sovereign debt default in history and tipped Europe into an economic slump—was taken off the table. Investors also cheered the rate-cut news, though Europe's economic prospects remain subdued.

The stress in European sovereign bond markets relented, albeit slightly. Prices for Italian, Spanish and French debt rose after the ECB delivered the rate cut, pushing yields—which move in the opposite direction of prices—lower.

The euro, which initially sank after the rate move, later climbed as it became clear a referendum in Greece was unlikely. In the U.S., the Dow Jones Industrial Average closed up 208.43 points, or 1.76%, at 12044.47. Asian markets opened higher Friday morning, with Japan gaining 1.2% and Australia gaining 2.3% in early trading.

Still, headlines from Greece and Cannes dominated the U.S. Thursday afternoon and yields on Greek debt remained elevated—a sign that investors are skeptical about a resolution to the crisis.

Mr. Papandreou, faced with rebellion in his own party over the referendum, backed away from the plan Thursday, saying he would instead seek a bipartisan alliance with Greece’s conservative opposition to form a national consensus on the bailout.

Mr. Papandreou had floated the referendum this week as a democratic necessity for sustaining his drastic austerity policies aimed at curbing Greece’s debts. But on
Thursday the Greek leader caved in to pressure from his own Socialist party as well as European governments, who began for the first time openly questioning whether Greece would have to leave the euro.

Amid mounting panic in Greece that the country could be thrown out of the European currency and into bankruptcy, conservative opposition leader Antonis Samaras offered the embattled Mr. Papandreou a way to climb down.

Mr. Samaras—an old friend of the premier’s from their student days together at Amherst College in Massachusetts—said he would support Europe’s latest bailout deal with Greece, under which the country must deepen its austerity measures in return for €130 billion ($179 billion) in international loans and a restructuring of its bond debts.

Mr. Samaras told parliament that he conveyed that demand to the premier in an afternoon phone call. "If he thinks I want to govern together with him, he understood wrong," Mr. Samaras said: "I told him clearly to resign and that we go to elections." Mr. Papandreou rebuffed the call to step down quickly. He repeated his position, also expressed earlier this year, that he might step aside to make a bipartisan government happen.

The Greek prime minister said at an emergency cabinet meeting earlier on Thursday that building a bipartisan consensus for the bailout plan is now his priority, according to comments released by his office.
"If the opposition comes to the table and accepts the [bailout] agreement, then there is no need for a referendum," Mr. Papandreou said. Other government officials said the referendum idea was effectively dead. The premier in any case lacked the votes in parliament to authorize a referendum, political analysts said.

The increasingly open debate in Europe's capitals about whether Greece should be kicked out of the euro has mortified the Mediterranean nation. Only a minority of Greeks want to see the old national currency, the drachma, return.

Economists say reintroducing a weak national currency would probably destroy Greece's banking system and cause widespread financial ruin in its society. Being cast out of the euro, centerpiece of 60 years of European unification, would also be a huge blow to the morale and identity of a nation that sees itself as the cradle of European civilization.

Even many Socialist voters are furious with Mr. Papandreou for putting Greece's place in Europe in doubt. "He brought Greece to its knees, brought misery to the people and ridiculed the country abroad," said Georgia Apostolopoulou, a 41-year-old insurance company worker from Athens. "I can't believe that Papandreou still doesn't get it and insists on staying on," she said.

Despite his U-turn on the referendum, Mr. Papandreou was still fighting to survive a parliamentary vote of confidence due late Friday. Most analysts in Greece doubt Mr. Papandreou will cling on to power for long, despite his track record of tenacity. Whether he wins or loses the confidence vote, early elections are increasingly likely.

Mr. Samaras has long insisted that Mr. Papandreou would have to step down as prime minister before any government of national unity can be formed. When the two men held talks in June this year about forming a "government of national salvation," Mr. Papandreou said he would step aside if a successor vowed to continue his overhauls of the country. Those earlier talks failed when conservatives leaked them to media and Socialists balked at giving up power.

Another day of Greek drama began before dawn, when Mr. Papandreou's finance minister, Evangelos Venizelos, attacked his boss's proposed referendum in a statement. "Greece's place in the euro is a historical conquest by the Greek people that cannot be placed in question," Mr. Venizelos said. Defending this achievement, he said, "cannot depend on a referendum."

The two men, longtime political rivals within the ruling Socialist party, had just landed in Athens after visiting the G-20 summit in Cannes, where Mr. Papandreou got a dressing-down from European leaders. German
Chancellor Angela Merkel and French President Nicolas Sarkozy piled pressure on the Greek premier to stick to the bailout plan and hold any referendum as soon as possible.

By Thursday morning, Mr. Papandreou's narrow Socialist majority of two seats in parliament had evaporated when two more lawmakers came out against him, joining earlier rebels against his leadership. Mr. Papandreou was widely expected to resign in the afternoon after a cabinet meeting—but instead came out fighting.

—Costas Paris and Matt Phillips contributed to this article.

Write to Marcus Walker at marcus.walker@wsj.com and Alkman Granitsas at alkman.granitsas@dowjones.com