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THE CONVERSATION

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Historically, governments that have chosen default have experienced a much higher risk of losing political office. AAP/Simela Pantzartzi

How would a unilateral Greek default affect politics and policy elsewhere in Europe? Governments in Ireland, Portugal and Spain have been conspicuously hard-line in negotiations with the Syriza-led government, partly out of concern that accepting Greek demands would strengthen anti-austerity parties at home.

Certainly, a Greek default may lead some voters in other countries to view default as an opportunity to shift resources from well-heeled foreign creditors to struggling public sector employees, pensioners, those on low incomes and the unemployed.

However, a Greek default is more likely to strengthen voter support across southern Europe for existing policies than to precipitate a new wave of defaults. This effect could in turn strengthen the Euro.

Historically, governments that have chosen default have experienced a much higher risk of losing political office – due largely to the unusually sharp economic downturns that typically follow default. Given this high risk, incumbent governments in democracies usually do their best to avoid it, which is why Greece's high stakes negotiating tactics have been so shocking to many of its interlocutors.

Since 1870, the average number of years between defaults among democracies that have defaulted at least once – even including negotiated debt restructurings – is 42 years. (Note: this has been calculated with the default measure from This Time is Different: Eight Centuries of Financial Folly by Carmen Reinhart, and Kenneth Rogoff (2009).)

Default is thus a once-in-a-lifetime experience for most voters; many will never experience it. Compare this with voter experience of standard economic recessions, which have occurred about every five years since 1870 in advanced economies.

The main reason why a Greek default is more likely to strengthen support elsewhere for current policies follows directly from voter inexperience with default. Psychologists have shown that people focus strongly on rare and vivid events. They are also more sensitive to the costs than to the potential benefits of policy change.

A Greek default and its immediate aftermath would be followed closely in all European countries. Voters elsewhere would be strongly inclined to view the accompanying chaos and economic disruption in Greece as highly relevant to their own national situation. Some voters would also view continued good behaviour by their own country as a useful and attractive counterpoint to economic misbehaviour in Greece.

Our research points to the empirical importance of this "network" effect. Since 1870, governments that opted for default against private foreign creditors were far more likely to lose elections when significant numbers of their trading partners had also defaulted. That is, voters punish their own governments much more severely when witnessing default by apparently similar countries.

Rather than break a social taboo, a Greek default is therefore likely to instead reinforce voter concerns in southern Europe that such policies are accompanied by unacceptably large costs.

Some historical examples illustrate this effect. When a number of other Latin American countries were defaulting in the early 1980s, Venezuela initially appeared as if it would be able to ride out the financial storm that hit the region and avoid the fate of its peers. After a series of bungled negotiations with its external bank creditors, the incumbent Christian Democratic government led by Luis Herrera Campins succumbed to an avoidable default. In 1983, it suffered a landslide election loss.

In the early 1930s, another peak period of default in the global economy, Australia also came close to default when prices for its commodity exports collapsed. A populist state Labor government led by Jack Lang in New South Wales unilaterally suspended interest payments on its large foreign debts in 1931 and demanded that the federal Labor government do the same. At the end of 1931, a newly formed United Australia Party government led by "Honest Joe" Lyons was elected on a platform of honourable repayment of all Australia's foreign debts and severe austerity at home. Lyons was strongly rewarded by voters, being re-elected twice before he died in office in 1939.

In a similar fashion, the British Conservative Party since 2010 used the Greek example as a counterpoint to reinforce political support for fiscal austerity at home. The comparison was of doubtful economic validity, but it was politically effective. There were also overtones in this case of one of Joe Lyons' most effective rhetorical devices – his claim that "British peoples", unlike those in less sturdy countries, always honoured their obligations.

Contrary to Lyons' claim, there is little evidence that cultural factors play a powerful role. Rather, voters become more cautious rather than more adventurous in the presence of extreme economic misbehaviour abroad. All of this suggests that a Greek default and possible "Grexit" would be more likely to lower rather than to raise the political incentives for other European governments to follow, contrary to the expectations of many commentators and political leaders.

This article is based on Networked Default: Public Debt, Trade Embeddedness, and Partisan Survival in Democracies Since 1870.

Greece
Debt default
Syriza