# Partisan Financial Cycles

J. Lawrence Broz

This version: February 21, 2012

## 1. Introduction

Scholars give little attention to the partisan character of government as either a cause, or a consequence, of financial crises. While the subprime crisis that began in 2007 has been attributed to a surge in capital inflows from abroad in the context of lax regulation, neither the policies that contributed to the capital inflow nor the level of regulatory oversight have been linked to government partisanship in the run-up to the crisis. Similarly, few scholars have analyzed government partisanship in the aftermath of financial crises, or found evidence of consistent ideological shifts in the electorate in response to such crises (Bartels 2011).

I develop the endogenous argument that the partisan character of government is both a cause and a consequence of financial crises. My hypothesis is that a *partisan-policy financial cycle* exists in which right-wing governments preside over financial booms, funding credit expansions and asset-price appreciation with foreign borrowing and deregulating financial activities in line with their pro-market ideology. When the crash occurs, voters reassess their support for right-leaning governments, making it more likely that left-wing governments will be

elected after financial crashes. Once in power, left-wing governments pursue policies to unwind the financial excesses of their predecessors and oversee the broad re-regulation of financial activities. In short, the political orientation of the government is both a cause of pre-crisis policies and a consequence of financial crises.

I find some support for this argument in data from all bank-centered financial crises in developed countries since 1973—a total of 35 cases. Like Reinhart and Rogoff (2009), I give particular attention to the most severe banking crises. These include the "Big Five"—Spain (1977), Norway (1987), Finland (1991), Sweden (1991), and Japan (1992)—and the subprime crises of 2007 and 2008: Austria, Belgium, Denmark, Germany, Iceland, Ireland, Luxembourg, Netherlands, United Kingdom, and the United States. While partisan financial cycles are most likely to occur in systemic banking crises, I also consider lesser crisis, using Reinhart and Rogoff's (2009) sample of 13 "milder" banking crises prior to 2007, and Laeven and Valencia's (2010) sample of eight "borderline" crises from the subprime era.

The argument is context-specific and applies to economically developed (OECD) countries in the post-Bretton Woods period. It is limited to the OECD because political partisanship does not hew to the left-right dimension in many developing countries, which is to say that data on the political orientation of developing-country governments is limited. It is restricted to the post-Bretton Woods period because banking crises *always* occur in an environment of financial globalization, where free capital mobility fuels asset booms (Bordo and Landon-Lane 2010). While banking crises have been common since the early 1970s, they were nonexistent in industrialized economies during the Bretton Woods era (Jordà, Schularick, and Taylor 2010; Bordo and Landon-Lane 2010). This is no coincidence. Bretton Woods was characterized by widespread capital controls and extensive financial regulations, which insulated

countries from financial booms and busts. By contrast, the post-Bretton Woods period saw the removal of capital controls, the liberalization of domestic financial markets, and the return of banking crises. While crises were common during the gold standard era and the interwar period, my argument does not extend to these earlier epochs because political partisanship had not yet come to reflect the dominant left-right cleavage that it does today. Prior to the Great Depression, the role of the state in the economy was small and other issues—religion, constitutional reform, suffrage, imperialism—shaped partisan competition. Furthermore, it was only after 1973 that right-wing parties, led by the Republican Party in the U.S, moved away from their traditional policy of balanced budgets and fiscal rectitude to embrace the idea that "deficits do not matter" (Bartlett 2007). International capital mobility was the enabling condition behind this partisan policy shift because large fiscal deficits would have produced much sharper declines in private investment had foreign capital not been available to finance the dissaving.

While I evaluate the argument with evidence from all OECD countries that experienced financial crises in the recent era of large-scale cross-border capital flows, it is most suited to deficit nations that funded external deficits with capital *inflows*. I find that a right-to-left partisan financial cycle is most evident in countries that run large current account deficits and experience correspondingly large capital inflows. **Table 1** contains the crisis episodes employed in my comparisons.

In terms of research design, this paper is more exploratory than explanatory. By focusing on cases where banking crises occurred, I am selecting on the dependent variable which precludes drawing causal inferences about the relationship between partisanship and crises. Whenever possible, however, I include an "OECD baseline" to assess whether political trends observed in the crises cases are distinct from general trends among advanced countries. Even

still, this research design is not suited to causal inference. But it can help *rule out* partisanship as a cause of whether a country experiences a financial crisis. It can also help *rule out* whether government partisanship is a consequence of crises. This is because partisanship cannot "explain" crises—or post-crisis partisanship—if it varies widely over the crises cases.

With this research design, it is crucial to select observations without regard to values of the explanatory variables. That is, the sample should be as representative of the population as possible and should never be chosen to "fit" a particular hypothesis (King et al 1994). As mentioned above, I use the entire population of advanced-country banking crises as identified by Reinhart and Rogoff (2009) and Laeven and Valencia (2010). These authors, and the sources they reference, never mention "government partisanship" as a criterion for selecting crises observations.

Several themes set this paper apart from previous work. First, I treat financial crises as endogenous events originating in the policy choices of governments. While the triggering event may vary from crisis to crisis, the preconditions are rooted in the tendency of nations to combine large fiscal and current account deficits with lax bank regulation. Second, I associate these pre-crisis policies with partisanship: in deficit countries that experience a financial crisis, right-of-center parties are more likely to be in power during the boom, overseeing policies that precipitate crises. This suggests that partisanship is a source of pre-crisis booms by way of the macroeconomic and regulatory choices of governments. It also suggests that right parties, enabled by international capital mobility, run fiscal and current account deficits to reward their high-income constituents with asset booms. Third, I argue that crises also have consequences for partisan electoral competition. I show that after a financial crisis, the electorate tends to move to

the left and this leftward shift is associated with subsequent changes in government partisanship to the left. Thus, crises appear to affect the partisan orientation of electorates and governments.

In the next section, I present comparisons of partisanship across cases of financial crises. In Section 3, I overlay these partisan patterns on the policies that have been associated with financial crises. In Section 4, I explore two subprime cases in more detail: the United States and Germany. The cases differ in both partisanship and current account status. Before the subprime crisis, the right was in power in the U.S. while Germany was ruled by the left. Furthermore, the U.S. current account deficit exploded, inducing a "capital flow bonanza" in that country just as Germany's current account went into substantial surplus, indicating a large net capital outflow.[1] These cases support the argument that the effect of partisanship on crises is conditioned by the current account balance. In Section 5, I conclude.

## 2. Partisanship and Financial Crises

**Figure 1** compares the political orientation of government across the Big Five cases of financial crisis. Following the convention in Reinhart and Rogoff (2009), period *T* represents the year when the banking crisis began, period *t - 5* is five years prior to the onset of the crisis, and the graph continues to *t + 5*, the period five years after the crisis began. Political orientation data is from the *Database of Political Institutions* (DPI), which records the left-right orientation of the party heading the executive branch (Beck et al 2001). Governments headed by right parties are coded 0, governments headed by center parties are coded 1, and governments of the left are coded 2. As a baseline for these comparisons, the figure also includes the "OECD mean," which is the average political orientation of the chief executive for all OECD countries, minus the

[1] The term, "capital flow bonanza" is from Reinhart and Reinhart (2009) and signifies a period of abnormally large capital inflows (i.e., above-average foreign borrowing).

country in crisis, during equivalent time periods. I include the OECD baseline to assess whether partisan political patterns are specific to crisis countries or reflect more general trends.

**Figure 1** shows that governments moved rightward before the Big Five crises, shifting from center to right-of-center orientations by the *t-4* period. A turning point in political orientation begins with the onset of the crisis and this leftward shift continues, after a partial three-year retrenchment, with another large movement to the left. The change in government partisanship is most extreme between the *t-4* and *t+4* periods, during which governments moved from right to left by 0.9 points on average--a 33% shift from right to left. The plot of the OECD mean indicates that this partisan pattern was not part of larger trends in other advanced countries.

**Figure 2** displays partisan orientation in countries hit by the subprime crisis. Here, the data extend only to *t+2* since partisan outcomes in the DPI dataset have not been updated beyond 2010. In the systemic crisis cases, political orientation was substantially more right-wing on average than in OECD before the crisis. In the sample with borderline cases, executives were slightly more right-wing than average before the crisis. More striking is that government orientation moves sharply to the left after the crisis--an indication of a partisan turning point.

**Figure 2** may understate the relationship between partisanship and crises because it conjoins external surplus countries, like Germany, with external deficit countries like the United States. Unlike deficit countries that pursued macroeconomic policies that induced a capital inflow bonanza, the policy failings of surplus countries were primarily microeconomic: inadequate risk assessment on the part of the banks and their regulators leading to overinvestment in dangerous mortgage-backed securities from abroad.

If we disaggregate the subprime cases into those that were primarily home-grown with roots in macroeconomic policy from those that were primarily imported and regulatory, as in

**Figure 3,** we observe a stronger partisan pattern. The "CA deficit" countries ran current account deficits prior to their crises; the "CA surplus" countries were net capital exporters. The figure reveals that, in the run-up to the crisis, the deficit countries had more centrist governments than the surplus countries or the rest of the OECD on average. But after a crisis, deficit countries moved sharply to the left while surplus countries remained steadfastly right-wing. Put another way, governments in deficits nations appear to have been punished at the polls for presiding over a crisis while governments in surplus nations avoided electoral punishment. Indeed, deficit nations experienced far greater political change, with elections bringing the left to power in all but one case—Ireland—by 2010.

This suggests that crisis politics play out very differently in deficit and surplus countries. Part of the difference may be due to the fact that deficit countries experienced crises in both finance and housing while surplus countries avoided housing crises (Schwartz 2009). **Figure 4** supports this intuition. It plots the percentage change in real house prices over the five years prior to a systemic crisis against the current account balance average for that period. It shows that without foreign capital inflows to fuel house-price appreciations, surplus countries avoided housing booms (and busts) during their financial crises.

In the case studies to follow, I explore whether the electoral fallout of a crisis tends to be smaller where voters witness only financial sector bailouts but not collapsing house prices. I also explore the possibility that voters in surplus countries may refrain from exacting an electoral toll on the incumbent government if they viewed the crisis as originated elsewhere (i.e., in the U.S.) and spreading via financial linkages.

Before pursuing the deficit-surplus difference in more detail, I test to see if the partisan pattern found above is robust to an alternative measure of partisanship. In **Figure 5**, I calculate government partisanship as the share of cabinet portfolios held by left and center parties, weighted by the number of days the government was in office in a given year. These data are Armingeon et al. 2010. Left parties are defined as Labor parties, Social Democratic parties, and parties to the left of these mainstream left parties, while center parties include most Christian Democratic parties. The figure shows that the percentage of total cabinet posts held by left and center parties declined in the run-up to the crisis in each of the three crises samples and then increased as the crisis approached. Left and center parties continued to increase their share of cabinet portfolios in the year of the crisis and made gains through most of the post-crisis period. This is consistent with the patterns observed in Figures 1-3.

**Figure 6** plots the *change* in partisanship that occurred after each systemic crisis, with the cases grouped by the current account balance. "Change in Partisanship" indicates the difference in the average value of the DPI partisanship indicator between the post-crisis (*T* to *t+2*) and the pre-crisis (*t-3* to *t-1*) periods. Positive values indicate a shift to the left. The figure provides evidence of a right-to-left partisan financial cycle, but only among deficit nations. Among these cases, 7 of 12 cases (58%) underwent a partisan shift from right to left as of three years since the onset of crisis. Only one deficit country—Sweden (1991)—moved from left to right after a crisis. Sweden's current account deficit reached 2.5% of GDP the year before its crisis while the left was in office. By contrast, just one surplus country—Austria (2008)—moved to the left after its crisis, and six of nine surplus nations (67%) experienced no change in political orientation. Thus, surplus countries were both more likely to be headed by right-wing governments before a crisis and to remain under right-wing rule after a crisis. Overall, we

cannot rule out partisanship as a *cause* of major banking crises. That a majority of deficit countries had governments that were more left-of-center after a crisis also suggests that we cannot reject the hypothesis that partisanship is a *consequence* of crises.

We can explore this possibility further. If deficit countries have a tendency to move to the left after a crisis, then presumably changes in the electorate are driving this shift. While election outcomes are an indirect measure of this shift, **Figure 7** provides information on the shift in mass political attitudes that follows a financial crisis. The data are from the World Values Survey (WVS), which carried out representative national surveys of political attitudes since 1981. The series allows me to measure the change in individual attitudes that followed a banking crisis. However, no observations from the subprime era are possible since the most recent WVS wave was in 2007, and I can only calculate the change in mass political attitudes for 10 of the 18 crisis cases in the Rogoff and Reinhart (2009) sample of major and minor crises. In these cases, a financial crisis occurred between two waves of the WVS.

The change in “mass political orientation” is the change in the country average of individual responses to the WVS query: “In political matters, people talk of "the left" and "the right." How would you place your views on this scale, generally speaking?” Responses range from 1 = far left to 10 = far right. In **Figure 7**, crisis countries are indicated on the left axis, with the onset year of the crisis in parenthesis. An asterisk indicates a Big Five crisis. Next to the bars are the years of the two WVS surveys used to calculate the change (delta) in national attitudes. Negative values indicate a shift to the left.

The largest change in political attitudes occurred in the deficit nation of Finland. Before its Big Five meltdown, Finland ran current account deficits that reached - 5% of GDP; the massive capital inflow led to an uncontrolled credit expansion and rapidly rising real estate and

share prices (Honkapohja 2009). Political attitudes in Finland shifted to the left by over half a point between 1990 and 1996 (the crisis occurred in 1991 but took several years to unwind). In England, where the current account deficit surpassed - 4% of GDP in the early 1990s, two mild banking crises took place in the interval between WVS surveys. Political attitudes in England moved leftward by a third of a point during this interval. In Norway, another Big Five deficit case, attitudes shifted by almost a quarter of a point to the left. Norway's current account deficit ballooned to - 6.1% of GDP the year before its crisis—a clear example of a capital flow bonanza.

Among the deficit cases, Denmark is the main exception to the right-to-left pattern. Like Finland and Norway, Denmark experienced a surge in capital inflows prior to its minor crisis in 1987. But unlike the other Nordic debtors, Denmark's electorate turned slightly rightward after its crisis. Perhaps by consequence, Denmark's ruling coalition remained under the leadership of the Conservative People's Party.

Japan is the only surplus country in this sample but it appears to fit the surplus country partisan pattern. Even though Japan's financial crisis was arguably the most serious and long-lasting of the Big Five crises, the political fallout was quite minimal, with attitudes drifting only slightly to the right. Notably, Japan's crisis was financial crisis and not a housing crisis. While banks were heavily exposed to collapsing asset prices, the balance sheets of Japanese households were very conservative, and this meant Japan did not experience widespread household bankruptcies or foreclosures (Nakagawa and Yasui 2009).

Overall, **Figure 7** suggests that political attitudes shift to the left after crises in deficit countries. Furthermore, it suggests that it is not just swing voters choosing left parties over right parties after a crisis. After a crisis fewer people in deficit nations identify as right-wing and *more* identify as left-wing. Hence, we cannot rule out the possibility that mass political attitudes

are affected by crises, and that a post-crises shift to the left in the electorate may be the source of the leftward shift in government orientation in deficit nations.

## 3. Partisan Policies and Banking Crisis

In the previous section, I showed that financial crises appear to have political *consequences* in deficit nations. In this section, I develop the argument that government partisanship might also be a *cause* of financial crises. I assume that political parties represent different constituencies and make policy choices that reflect the interests of their core constituents. I focus on macroeconomic policies that make boom-bust financial cycles more likely: large current account deficits driven by fiscal deficits in the context of financial deregulation. I suggest that right-of-center governments in deficit nations run these policies in order to reward their high-income constituents with sharp increases in wealth.

### *3a. Current Account Deficits*

Reinhart and Rogoff (2009) establish policy similarities between the U.S. subprime crisis and previous banking crisis episodes. They pay particular attention to the massive U.S. current account deficit that preceded the crisis—and the foreign borrowing binge that it precipitated—and they show that such capital flow bonanzas are a common precursor of financial crises. Likewise, Chinn and Frieden (2011) argue that the subprime crisis is but the most recent example of a capital flow cycle in which foreign capital floods a country, stimulates an economic boom, encourages financial leveraging and risk taking, and eventually culminates in a crash.

The current account balance records the difference between a country's savings and its investment. If the current account balance is positive, it measures the portion of a country's savings invested abroad; if negative, it is the portion of domestic investment financed by foreign

savings. Since any excess of national spending over income must be financed by foreigners, the current account deficit is equivalent to the net inflow of capital from abroad.

**Figure 8** provides evidence of the association between the current account balance and financial crisis. In each sample, countries amassed current account deficits in advance of a crisis, reaching 2% of GDP on average for the subprime cases. But averaging masks important differences between the samples. While pre-crisis external deficits were very large for all Big Five cases save one—Japan ran a surplus—the subprime cases are more varied. **Figure 9** displays the sharp difference between these groups. In capital inflow countries that had systemic crises (Iceland, Ireland, U.K., U.S.), the external deficit averaged a huge 10% of GDP in the year of the crisis. The same holds for the deficit countries that experienced borderline subprime crises (Greece, Hungary, Portugal, Spain). In all nine deficit nations, foreign capital fueled credit booms and asset-price bubbles, especially in real estate (Claessens et. al. 2010, Aizenman and Jinjarak 2009). Inasmuch as macroeconomic factors determine the current account, it is fair to say that these crises were home-grown, with roots in macroeconomic policy.

Yet subprime crises also hit the surplus economies of Austria, Belgium, Denmark, France, Germany, Luxembourg, Netherlands, Sweden, and Switzerland. As export-oriented economies with high savings and low domestic demand, capital inflow bonanzas did not play a role in these nations. Rather, these surplus countries imported the subprime crisis via their banking sectors' accumulation of risky U.S. mortgage-backed securities. Their policy failures were thus microeconomic (regulatory) rather than macroeconomic—a topic I explore in the case studies..

The policy link between the current account and macroeconomic conditions is the fiscal deficit. When a government increases its fiscal deficit, domestic residents may use the additional

income to boost consumption, causing total national saving to decline. Unless domestic investment decreases to offset the saving shortfall, the country must borrow from abroad, i.e., it must run a current account deficit. This is known as the "twin deficits" relationship. Chinn and Ito (2007) show that the budget balance is an important determinant of the current account balance for industrial countries. In the next section, I examine the fiscal accounts of deficit governments that presided over financial crises and find evidence that suggests a twin deficits policy.

*3b. Fiscal Balances*

**Figure 10** plots the average structural budget balance for the subprime crises countries, grouped by the current account balance (the structural balance is cyclically adjusted, to better capture a government's fiscal policy stance). For the cases that fit the capital inflow bonanza profile (CA Deficit/Systemic and CA Deficit/Borderline), the budget balance turned sharply negative in the pre-crisis period. These governments were running a twin deficits policy of deficit spending financed by capital inflows. Typically, the fiscal balance worsens after a crisis, reflecting large stimulus spending during post-crisis recessions.

But are twin deficits preferred by the right? Connecting the fiscal component of the twin deficits relationship to the right runs counter to conventional wisdom since the right is supposed to favor balanced budgets and a low level of public consumption. However, this view finds little empirical support (Cusack 1999). In fact, a number of studies conclude that the partisan impact on fiscal policy is the opposite of the conventional wisdom. Cameron (1985) finds that left governments are usually *less* likely to incur large budget deficits than governments controlled by centrist, Christian Democratic or conservative parties. Similarly, Garrett and Lange (1991) find

that OECD countries with left governments and strong labor parties tend to run smaller budget deficits than do right parties.

These findings suggest a partisan fiscal pattern in which the left is more likely to adopt a conservative stance than the right. While unconventional, this is consistent with Persson and Svensson (1989) and Pettersson-Lidbom (2001), who theorize that right-wing governments strategically run fiscal deficits in order to force their left-wing successors to curtail public spending—a strategy known as "Starve the Beast" (Bartlett 2007). This echoes a similar argument by Alesina and Tabellini (1990) in the context of Reagan administration deficits. The strategy can be effective because, by lowering taxes and issuing debt, right-wing governments constrain future spending. In addition to strategically limiting the fiscal choices of successors, deficits have another attraction for the right: they favor high-income constituents by cutting taxes more than spending.

These arguments suggest an electoral mechanism for the partisan financial cycle in which right-wing governments preside over fiscal deficits. But are *current account deficits* that generate risky capital inflows a policy of the right? Begin with the assumption that right parties disproportionately represent homeowners and other asset-owners, as in Ansell (2007, 2009). Since external deficits fuel asset booms in housing and equities markets, right-wing parties may derive short-term electoral benefits from this policy, even if the wealth effect that asset-holders experience turns out to be transitory. Moreover, when capital inflows are available to finance budget deficits, right parties can generate asset price appreciations via large fiscal deficits without crowding-out private investment and thereby antagonizing their high-income business constituents. This is because capital inflows prevent domestic interest rates from rising above

the world interest rate, so that the crowding out of investment that usually takes place in a closed economy doesn't occur (Friedman 1992).

These arguments suggest that political parties can derive electoral benefits from pursuing macroeconomic policies that may provoke a financial crisis. When capital is internationally mobile, right parties can generate wealth gains for their constituents via a twin deficits policy without crowding out private investment. My data suggest that right-wing governments are more likely to pursue this strategy in the context of large current account deficits. In surplus nations, by contrast, the right takes a more conservative fiscal stance, discouraging excessive consumption and pre-crises asset booms.

*3c. Financial Regulation*

In party manifestos, right parties champion free enterprise capitalism and the superiority of markets over government regulation and allocation (Budge et al. 2001). Did right-of-center government act on these prior beliefs and deregulate financial markets in the run-up to crises?

Financial supervision is more than the sum of the formal rules and regulations established by law because governments can use their executive powers to interpret and implement regulations, creating a gap between *de jure* regulation and *de facto* regulation. Since I am interested in the effect of partisanship on *de facto* regulation, I need a measure that captures the legal rules as well as the actual implementation and enforcement of the rules. My data come from Abiad et al. (2008) who rely on a mix of *de jure* and *de facto* criteria to code this dimension of government financial policy. Their index of bank regulation ranges from 0 to 3, with higher values representing more (or better) regulation. I use this index to explore the argument that the right tends to deregulate the financial sector prior to crises and that their left-wing successors tend to re-regulate after the crash occurs.

**Figure 11** plots the average value of the bank regulation index for the Big Five crises. These data do not extend beyond 2005 so comparisons of the subprime cases are not possible. The figure includes the OECD baseline and a separate plot for Japan—the only Big Five nation in external surplus before its crisis. The figure suggests that bank regulation was much weaker on average in the Big Five countries prior to a crisis. In Japan, bank regulation was even weaker. Regulation then increases sharply once a crisis has occurred. But bank regulation is improving across the OECD during the same time periods, indicating a more general trend. One reason for this upward trend is the coding of the Basle capital adequacy criterion: Abiad et al. (2008) assigned a value of 0 to all cases prior to 1993, before Basle regulations were in place. This ensures that regulation is increasing over time in all samples. Nevertheless, the Big Five countries had weaker regulation and supervision than the OECD average before their crises, which is consistent with the argument that these countries made a partisan policy choice to have less regulation.

The evidence in this section is not sufficient to rule out the possibility that financial cycles have origins in partisan policy choices. The evidence is strongest with respect to macroeconomic policy in deficit countries. Prior to the onset of a major financial crisis, deficit-country governments presided over rapidly deteriorating current account deficits (a.k.a., capital inflow bonanzas), and these external deficits were related to a policy of government dissaving (a.k.a., budget deficits). The data also suggest that regulation of the financial sector was weaker than average before crises in the countries that experienced a major financial crisis. However, this may reflect measurement error since Abiad et al. (2008) retrospectively code bank regulation and may have inferred that a crisis is evidence of lax regulation.

## 4. Case Studies of the United States and Germany

To provide leverage on the politics of financial cycles, this section reviews partisan patterns in the United States and Germany during the subprime episode. The cases differ in government partisanship and current account status. In the U.S., the Bush administration presided over record-setting current account deficits (and thus foreign borrowing) while encouraging homeownership, private debt accumulation, and the deregulation of financial markets. These policies led to deep crises in both banking and residential real estate. In Germany, a left-wing coalition of the Social Democratic Party (SPD) and the Greens was in government between 1998 and 2005. This government ran a conservative macroeconomic policy and introduced major cutbacks in welfare programs, which encouraged saving and led to massive current account surpluses. These conservative policies continued after the right-leaning Christian Democrats succeeded the SPD in 2005, with Angela Merkel as Chancellor. There was no housing bubble and German households were not highly leveraged with debt. This may explain why the subprime crisis had different partisan consequences in Germany.

*4a. Partisanship and Crisis in the United States*

The U.S. case provides partial support for the argument that right-of-center political parties are more likely to enact policies that help fuel housing booms while left-of-center parties are more likely to be elected as a consequence of financial and housing crises. Before the subprime crisis, a Republican administration was in office pursuing twin deficit policies, reducing the level of financial regulation, and actively promoting homeownership. However, deregulation began prior to Bush, under a Democratic administration, and both major parties actively promoted homeownership.

Before the crisis, the U.S. current account deficit ballooned to over 6% of GDP, an all-time record for the United States. Chinn and Frieden (2011) attribute the burgeoning current

account deficit to Bush administration fiscal policies; the emphasis after 2001 on cutting taxes while increasing spending on national security and Medicare produced a large federal budget deficit that had to be financed. The huge pool of foreign savings available from surplus countries like China, Japan, and Germany provided the Bush administration with a way to finance its fiscal deficits. The administration had promised its right-wing constituents that it would reduce taxes while increasing spending. The globalization of financial markets allowed it to finance the resulting fiscal imbalances without crowding out domestic private investment. However, the massive foreign borrowing was not invested to increase the productive capacity of the U.S. Rather, it was used to finance the rise in federal deficits and an explosion of private housing and consumer debt (Chinn and Frieden 2011, Schwartz 2009).

It may seem unconventional to argue that it is the right-wing party that lacks fiscal restraint, but this is easy to confirm in the U.S. case. Since 1973, Republican presidents have run budget deficits 2.5 times larger on average than Democratic presidents (3.2% vs. 1.3% of GDP). Republican administrations also ran current account deficits that were nearly twice as large as those of Democrats (-3.0% of GDP vs. -1.7% of GDP). With respect to financial regulation, however, partisan differences all but disappear.

While the Bush administration deregulated financial markets in the run-up to the subprime crisis, deregulation began in the late 1970s under a Democratic president. One of the principal deregulatory laws of the postwar era—the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA)—was passed under Jimmy Carter, albeit with support of the Republican majority in Congress. The DIDMCA phased out deposit interest rate ceilings, allowed S&Ls and credit unions to offer checkable deposits, and permitted banks to merge. However, the Reagan administration was squarely behind the Garn-St. Germain Depository

Institutions Act of 1982, which expanded the nonresidential lending powers of commercial banks and S&Ls, allowing them to move aggressively into commercial real estate lending.

The DIDMCA and Garn-St. Germain composed the "first wave" of financial deregulation (Schwartz 2009). By deregulating real estate finance, the spread between deposit rates and lending rates narrowed, encouraging banks and thrifts to sell their mortgage assets in the securities market and generate profits from fee and transaction income. By consequence, these laws expanded the supply of securitizable mortgages (Schwartz 2010). The second wave began during the Clinton administration and allowed investment banks to enter the mortgage market. The Financial Services Modernization Act of 1999 repealed the Glass-Steagall Act and reduced barriers between banks and securities firms. Investment banks were given direct access to mortgages and could securitize mortgages on their own, bypassing Fannie Mae and Freddie Mac--the government sponsored enterprises charged with expanding the secondary market for mortgages. But since investment banks and other "private-label" issuers lacked an implicit federal guarantee, they could not compete effectively with Fannie Mae and Freddie Mac for conforming mortgages. So they concentrated on nonconforming mortgages--loans not eligible for guarantees by Fannie Mae and Freddie Mac because they were too large (jumbo mortgages) or too risky (subprime mortgages).

While the basic features of the system were in place during the 1990s, George W. Bush accelerated the rise of subprime lending with a policy of regulatory forbearance. Among the most important changes was the 2004 decision by the Securities and Exchange Commission (SEC) to relax net capital requirements on investment banks and put these firms on a regime of self-regulation (Johnson and Kwak 2010). This ruling enabled investment banks to triple their leverage ratios, fueling the growth in MBS supporting subprime mortgages.

Both political parties also championed homeownership as part of their electoral strategies. Since the 1970s, each party sought to engineer permanent majorities by expanding homeownership to new, largely minority, constituencies (Schwartz 2010). The strategy reached its apogee under George W. Bush's "Ownership Society," which recalls Margaret Thatcher's promotion of homeownership in the 1970s. The Bush administration's goal was to replace traditional welfare programs with an asset-based system of welfare centered on homeownership. The political mechanism behind the strategy was to remake low income, minority voters--who traditionally aligned with the Democratic Party--into economic conservatives by removing financial barriers to homeownership. Like Thatcher, Bush strategists reasoned that rising home prices would bias the new homeowners against government welfare spending, and so motivate them to shift their allegiance to the Republican Party.

Financial deregulation and the promotion of homeownership occurred under both parties, leading some scholars to argue that the key explanation for the crisis is the excessive political influence of the financial and mortgage industries (Mian, Sufi, and Trebbi 2010a, 2010b; Johnson and Kwak 2010). But the right deregulated while simultaneously pursuing macroeconomic policies that invited a crisis: fiscal and current account deficits twice as large as those of Democrats. Destabilizing macroeconomic conditions brought on by such policies only tend to produce financial crises when the microeconomic rules of banking regulation are poorly designed and implemented (Calomiris 2009). It is thus fair to conclude that Republican administrations satisfied both the necessary (macroeconomic) and the sufficient (microeconomic) conditions for a home grown financial crisis.

*4b. Partisanship and Crisis in Germany*

The German case presents a mirror image of the United States in terms of partisanship, macroeconomic policy, external balance, and housing policy. Before the crisis, the left was in power pursuing restrictive fiscal policies and accumulating large external surpluses--policies that *reduced* the likelihood of a home grown crisis. The left also reformed the welfare system, which contributed to external surpluses by causing households to ramp up their precautionary saving. Nevertheless, heavy involvement by state-owned banks in U.S. subprime assets left Germany exposed to the crisis, which cost the left dearly in subsequent elections. The German surplus-country case thus presents the partisan financial cycle in reverse: the left was in office prior to the crisis pursuing restrictive macroeconomic policies and generating external surpluses, and the right succeeded the left after the crisis occurred.

The German case also demonstrates that lax bank regulation is sufficient to induce a crisis. There was no housing bubble in Germany and therefore no easy profit opportunities in domestic real estate. Perhaps by consequence, the state-owned *Landesbanks* sought more attractive returns in the U.S. subprime market, as well as in the sovereign debt of peripheral euro area nations like Greece. Like Fannie Mae and Freddie Mac, the German state banks operated with explicit and implicit public guarantees, and their excessive risk-taking went unchecked by regulators. With heavy exposures to off-balance sheet U.S. asset-backed securities, the Landesbanks were at the forefront of the German subprime crisis when derivatives tied to subprime mortgages in the United States were downgraded.

From 1998 to 2005, Germany was governed by a coalition of the Social Democrats and the Greens, with the SPD's Gerhard Schröder as Chancellor. During this period, Schröder's "red-green" coalition practiced fiscal restraint and embarked on a major effort to reform the German welfare state. Even though collective bargaining had encouraged wage moderation in agreements

between trade unions and employers' associations, German non-wage labor costs had risen steadily due increasing employer contributions for pensions and unemployment insurance (Streeck and Trampusch 2005). In the context of high unemployment and weak growth, the left initiated the "most ambitious German reform project in social insurance policy since World War II" (Kemmerling and Bruttel 2006). Known as "Agenda 2010," the reforms imposed large cuts in pension and unemployment benefits, causing an upheaval in the SPD and subsequent defeats in regional elections. The SPD losses were widely attributed to discontent with the reforms and Schröder admitted defeat and called an early election. The 2005 election produced a grand coalition between the SPD and the center-right Christian Democratic Union (CDU), with Angela Merkel heading the executive. The CDU had supported Schröder's reforms, making it easier for the SPD to join in coalition with the CDU than with traditional party allies on the left.

The welfare reforms coincided with a major shift in Germany's external balance. After a decade of external deficits in the 1990s, during which capital inflows helped finance the costs of reunification, Germany's external position moved sharply into surplus in the 2000s, reaching a record surplus of 7.5 percent of GDP in 2007. The increase in the surplus reflected several factors. Wage moderation, engendered by high unemployment, had positioned German exporters to take advantage of a cyclical surge in global demand. But low investment and high saving also contributed to the large increase in the current account surplus. While investment had slackened cyclically in the aftermath the reunification boom, household saving rose sharply as a result of SPD's welfare reforms, which reduced the generosity of pension and unemployment benefits. Falling house prices also contributed to the rise in saving.

Real house prices declined in Germany in mirror image to house price increases in the United States, with both trends reflecting the forces of global capital flows (**Figure 4**). In

Germany, capital exports led to declining home values which encouraged more saving as homeowners perceived themselves to be poorer. The antithesis occurred in the U.S. where capital inflows fueled house price increases, making homeowners feel wealthier and less inclined to save.

The crisis that hit Germany was thus a financial crisis but not a housing crisis. The cause was related weak regulation in the state-owned sector of the financial system. The Landesbanks account for about a fifth of all commercial lending in Germany, more than Deutsche Bank and the other big private banks combined (Hüfner 2010). Landesbanks had a prior history of losses and public bailouts and were known to be staffed by political appointees (Hau and Thum 2009). But the key distortion was that Landesbanks operated with government guarantees on their liabilities. The guarantees helped the Landesbanks to get high credit ratings, borrow cheaply, and take big risks in international finance. With profit opportunities within Germany limited, Landesbanks turned increasingly to risky asset-backed foreign securities, where the returns were higher (Sinn 1999).

Landesbank assets invested in complex foreign securities more than doubled between 2005 and 2008 (Hüfner 2010). When the high-yielding assets in their portfolios were downgraded, two Landesbanks were forced to merge immediately and three others had to be bailed out by various state governments. Four months before Lehman Brothers collapsed, the Landesbanks reported write-downs of $21 billion, which accounted for 43% of total losses incurred by German banks--almost double the Lanesbank's share of total banking assets. Merkel was forced to coordinate a bank bailout just five months before the 2009 elections.

In the election, the blame for the crisis fell squarely on the SPD, which saw its vote share drop 11.2% to a post-war low of 23%. The SPD had been in power during the crucial 2001-

2005 period when Landesbanks issued massive amounts of state-guaranteed debt and invested the proceeds in subprime securities from the U.S. Voters did not lay blame on the right as the CDU lost only 1.4% of its vote share. In fact, the right made substantial gains. The biggest winner was the libertarian Free Democratic Party (FDP) which increased its vote share by 4.8% to 14.6%, an all-time record. The FDP, which formed a right-wing coalition with the CDU, had raised strong objections to use of state aid for troubled Landesbanks.

The partisan-policy contrast between Germany and the United States is striking. In the U.S., the right encouraged net foreign borrowing with large public deficits and then channeled the capital inflows to the housing market by deregulating the financial and mortgage industries. In Germany, the left encouraged net foreign lending with policies of fiscal consolidation and welfare state retrenchment. As a consequence of its large external surpluses, Germany experienced fewer domestic housing-related problems than the U.S. But the left's structural reforms and macroeconomic conservatism helped generate large net capital outflows, which were invested unwisely in U.S. subprime securities by the under-regulated Landesbanks.

## 5. Conclusion

Were the financial crises that stuck OECD economies since 1973 related to "politics" by way of the ideological orientation of government? The evidence presented here is not sufficient to rule out the existence of a partisan-policy financial cycle. In countries that run large external deficits, governments in power prior to a financial crisis are more likely than average to be right-of-center in political orientation. As right-leaning governments are more likely to be in office prior to a crisis, they are therefore more likely than average to be associated with policies that predict crises: twin deficits, capital inflow bonanzas, and financial deregulation. However, once a financial crisis occurs, causing widespread macroeconomic distress, the causal arrow flips and

government partisanship becomes a *consequence* of crises. The evidence suggests that the electorate moves to the left in deficit countries after a financial crisis, and this leftward shift is associated with changes in government partisanship to the left.

In capital exporting countries, there is little evidence of a right-to-left partisan-policy financial cycle. In these surplus countries, the right is more likely to be in office prior to a financial crisis, and more likely to remain in office after a crisis occurs. Why financial crises exact a smaller electoral toll on surplus-country governments is not entirely clear, but one plausible explanation is the absence of a housing boom-and-bust cycle in these cases. As net capital exporters, surplus countries are far less likely to experience surges in pre-crisis asset prices than capital importers. In these cases, a financial crisis occurred because regulatory laxity permitted domestic banks to invest their nations' surplus saving in risky foreign securities. Voters in surplus countries may thus refrain from punishing incumbents if they view the crisis as originated elsewhere and spreading via financial linkages to their countries.

Case studies of the United States and Germany are generally consistent with these cross-country partisan patterns. In the 2000s, the Bush administration launched massive tax cuts without imposing discipline on the rate of growth of government spending. The result was record budget deficits and record current account deficits, which is to say that foreign capital financed the twin deficits and set the stage for a major run-up in asset prices. Deregulation and the promotion of homeownership channeled the foreign credit to the housing sector, where the boom continued unchecked until the crisis occurred.

From the perspective of the right's traditional association with fiscal discipline and balanced budgets, the Bush administration's macroeconomic accommodation of the boom is puzzling. This is where global capital markets enter the picture. Prior to the 1980s, fiscal

restraint made sense for the right since, in the absence of large-scale capital flows, budget deficits crowded-out domestic investment to the detriment of the party's business constituents. But with the free flow of international capital, the right obtained greater scope to run fiscal deficits without generating increases in domestic interest rates.

Fiscal deficits have another appeal for right parties when capital is internationally mobile: deficits financed by capital inflows tend to raise asset prices, and the gains of asset price appreciation go disproportionately to right-party constituents, namely homeowners and older asset-holders. In trying to convert lower income minority voters into home-owning Republicans, the Bush administration merely pushed this strategy to its logical end. By undermining the appeal of balanced budgets and providing a way to generate short-run wealth effects for asset-owning constituents, international capital mobility may have caused a fundamental shift in the right's electoral strategy. Unfortunately, this shift exposed other OECD countries, like Germany, to a higher risk of financial crisis.

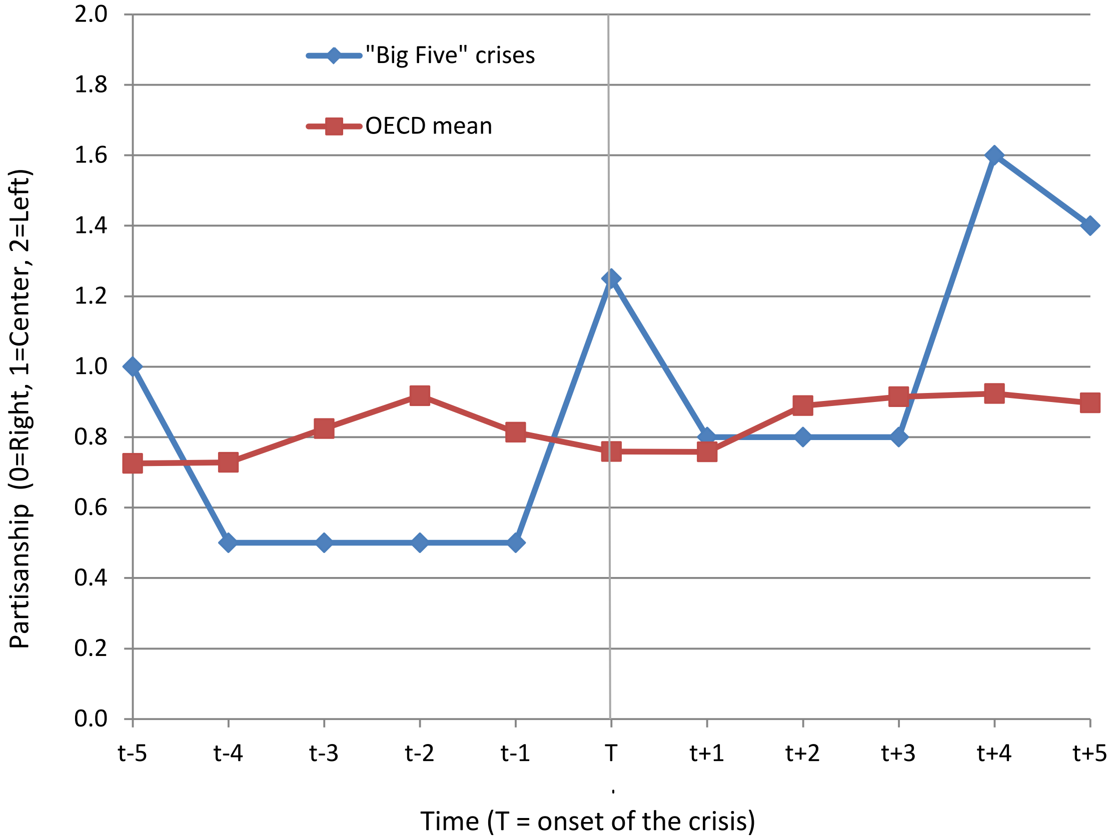
The German case is a mirror image of the U.S. case. Before the crisis, the left was in power pursuing restrictive fiscal policies and accumulating large external surpluses. These policies reduced domestic demand and the odds of home-grown financial crisis. But Germany was vulnerable to an imported financial crisis because the left did a poor job regulating how the nation's surplus savings was invested overseas. In the 2009 elections, the SPD was punished by the electorate and the biggest winner was the free-market party that had railed against state bailouts for the Landesbanks. As in the United States, voters in Germany appear to have held the party responsible for the crisis to account.

**Table 1: Bank-Centered Financial Crises in the OECD**

| Country | Onset of crisis |
|---|---|
| **The Big Five** | |
| Spain | 1977 |
| Norway | 1987 |
| Finland | 1991 |
| Sweden | 1991 |
| Japan | 1992 |
| **Subprime Systemic Crises** | |
| United Kingdom | 2007 |
| United States | 2007 |
| Austria | 2008 |
| Belgium | 2008 |
| Denmark | 2008 |
| Germany | 2008 |
| Iceland | 2008 |
| Ireland | 2008 |
| Luxembourg | 2008 |
| Netherlands | 2008 |
| **Milder/Borderline Crises** | |
| United Kingdom | 1974 |
| Germany | 1977 |
| Canada | 1983 |
| United States (S & L) | 1984 |
| Iceland | 1985 |
| Denmark | 1987 |
| New Zealand | 1987 |
| Australia | 1989 |
| Italy | 1990 |
| Greece | 1991 |
| United Kingdom | 1991 |
| United Kingdom | 1995 |
| France | 1994 |
| France | 2008 |
| Greece | 2008 |
| Hungary | 2008 |
| Portugal | 2008 |
| Spain | 2008 |
| Sweden | 2008 |
| Switzerland | 2008 |

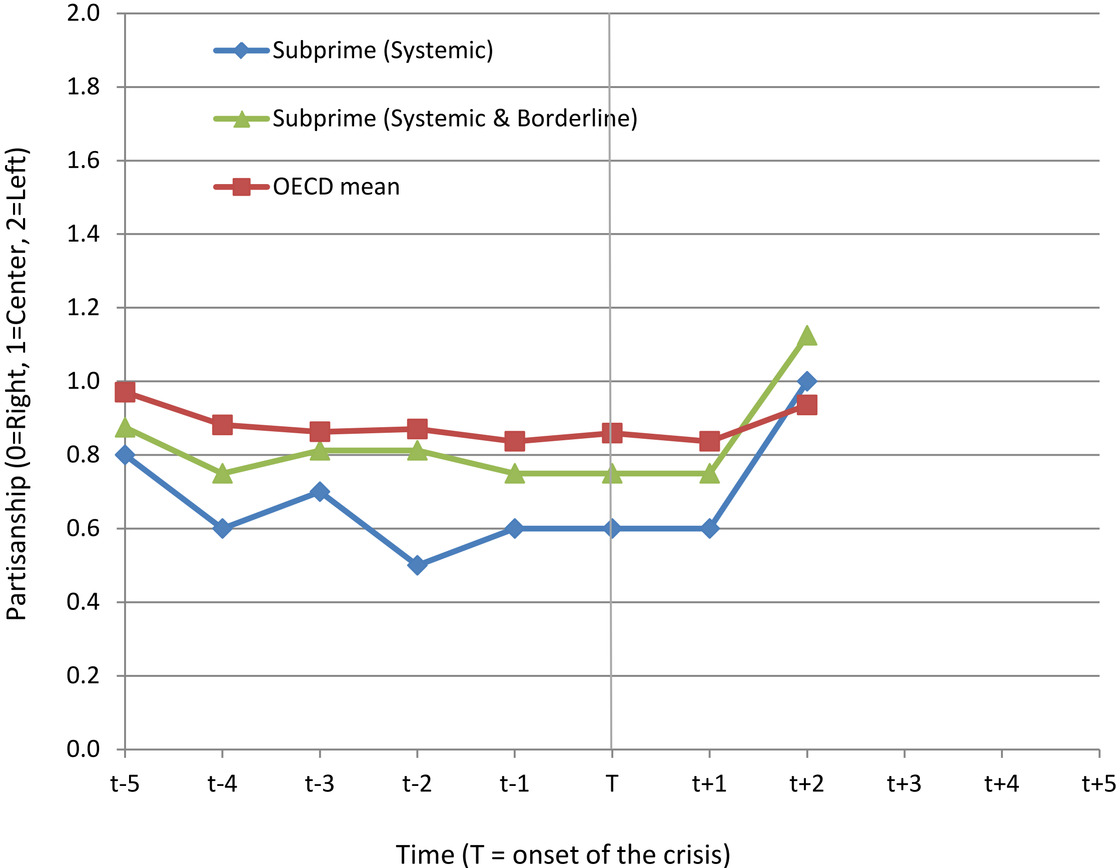
*Notes*: Crisis cases prior to 2007 are from Reinhart and Rogoff (2009). Subprime cases are from Laeven and Valencia (2010).

**Figure 1: Government Partisanship before and after a Big Five Crises**



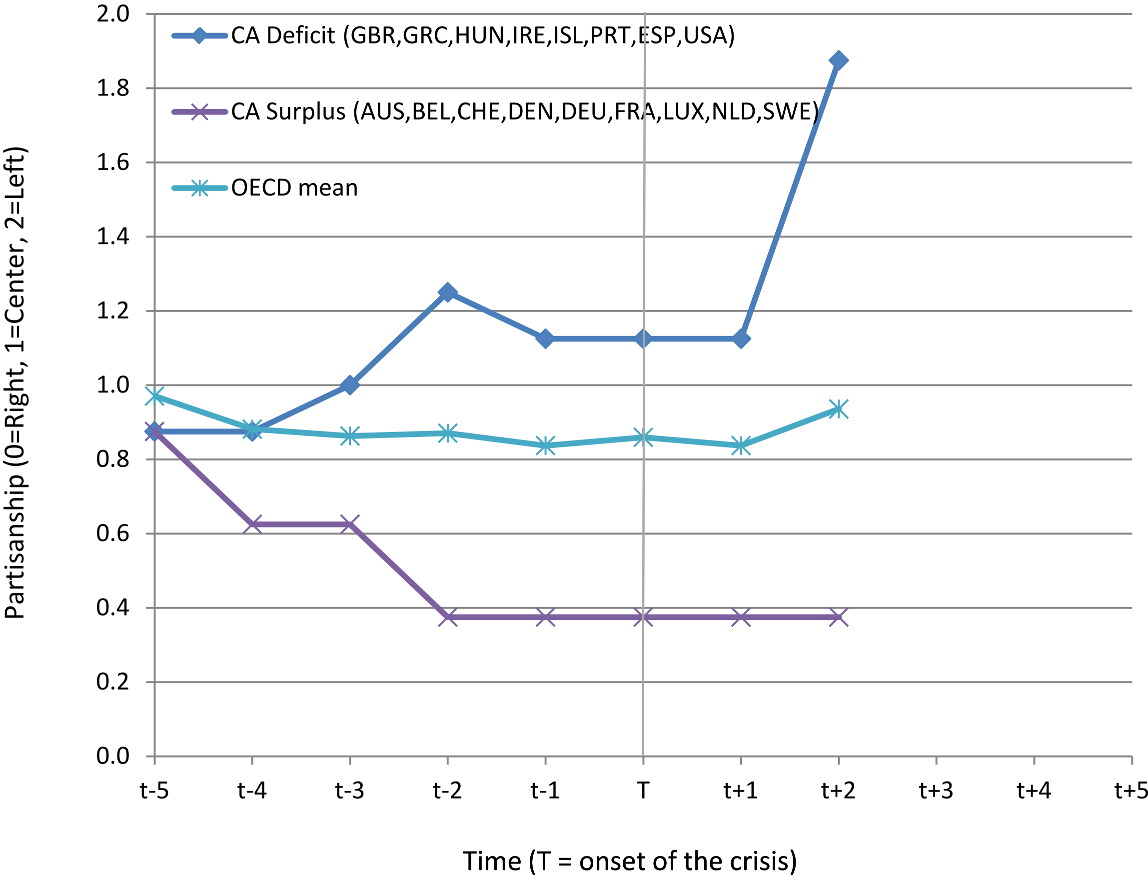

*Notes*: Missing data: Spain 1977 (*t-5* to *T*).

**Figure 2: Government Partisanship before and after a Subprime Crisis**



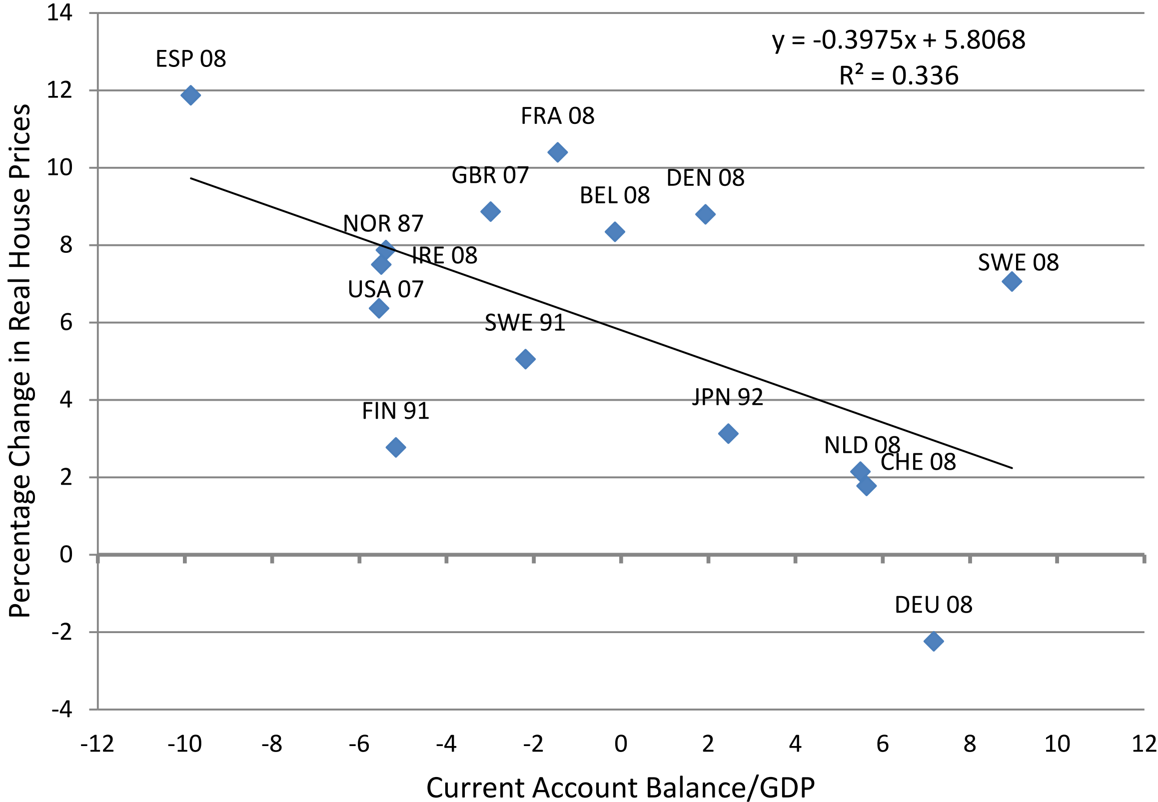

***Notes***: Missing data: Switzerland (*t-5* to *t+2*).

**Figure 3: Partisanship before and after a Subprime Crisis (Grouped by Current Account Balance)**



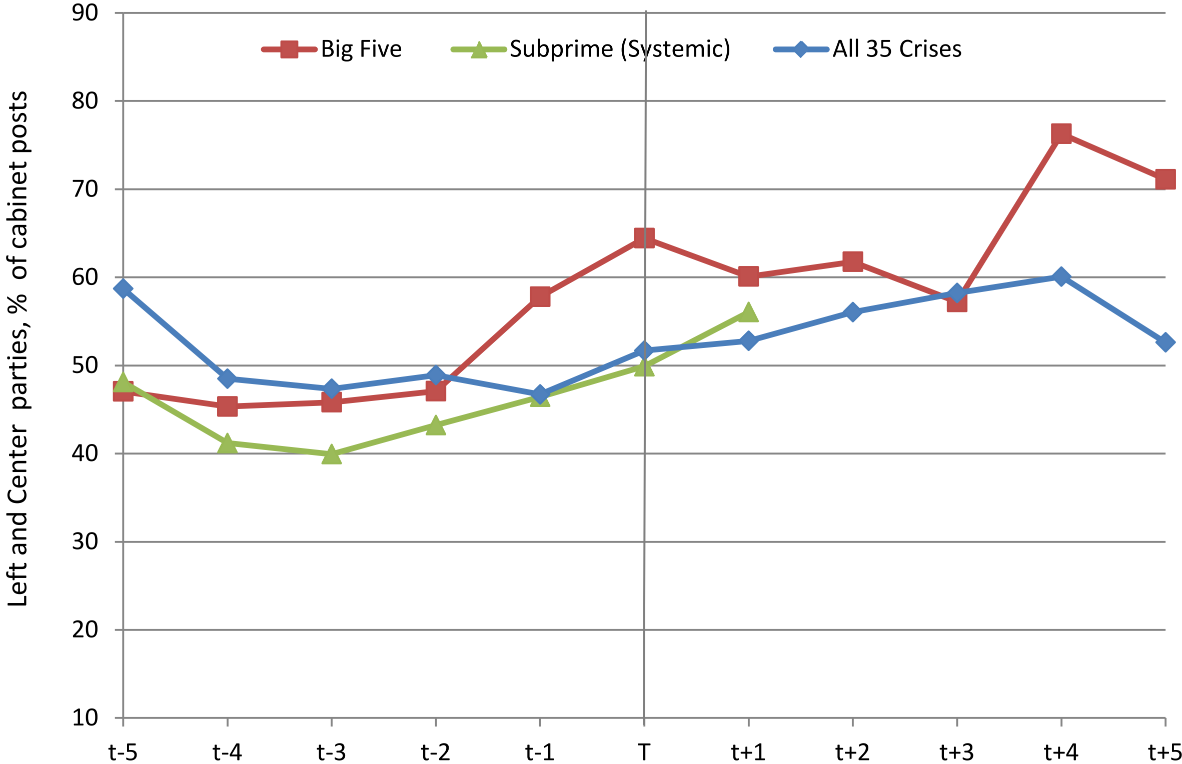

*Notes*: Missing data: Switzerland (*t-5* to *t+2*).

**Figure 4: Real House Prices and the Current Account Balance, Big Five and Subprime Cases**




**Notes:** Data are averages over the period *t-5* to *T* (crisis onset). Current account/GDP is from the IMF's *World Economic Outlook*. The Real house price index is from the BIS Property Price Statistics.

**Figure 5: Partisan Composition of the Cabinet before and after a Banking Crisis**




*Notes*: Missing data: Spain 1977 (*t-5* to *T*).

**Figure 6: Change in Partisanship after a Crisis (Big Five and Subprime)**

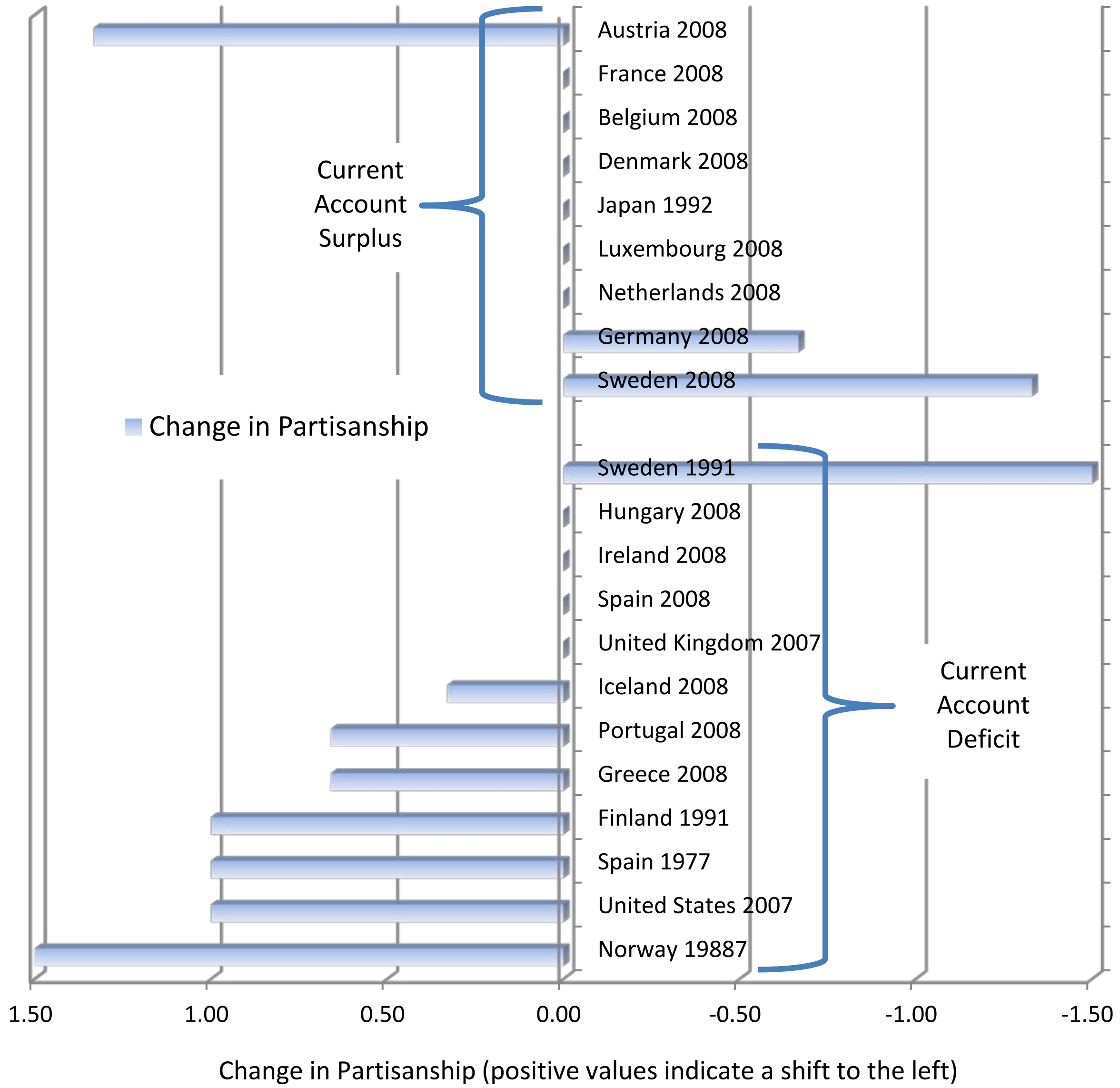
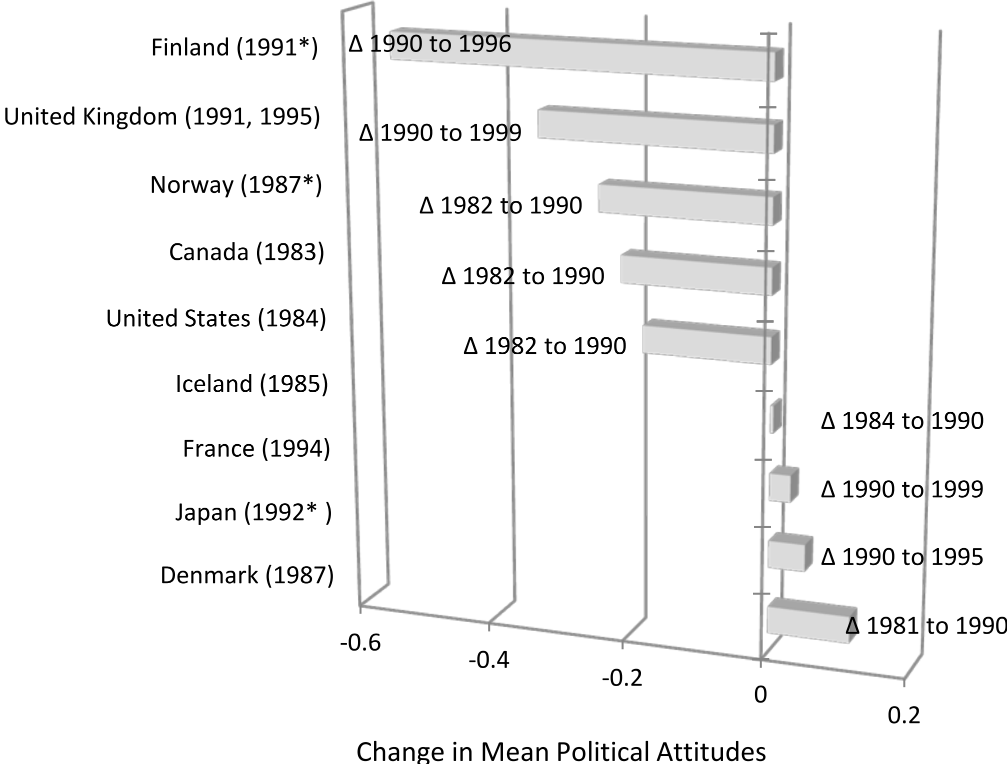
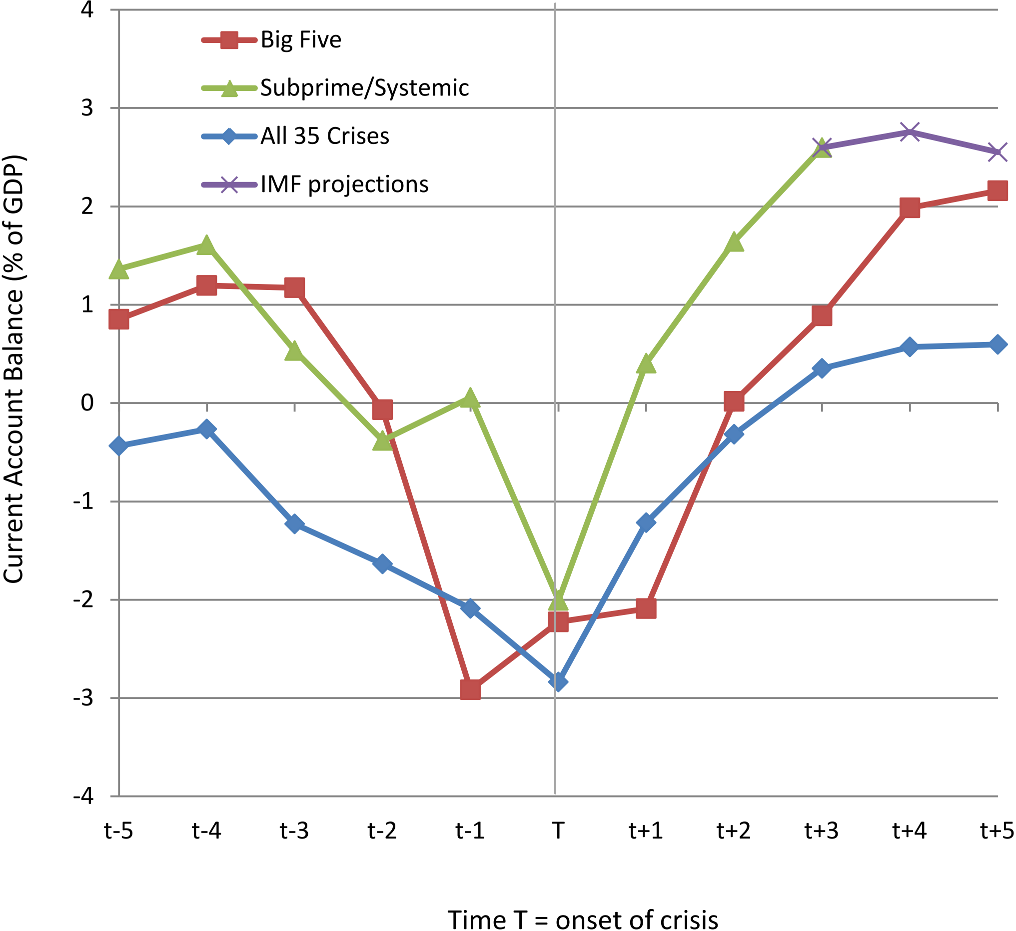


**Figure 7: Change in Mass Political Attitudes after a Banking Crisis**



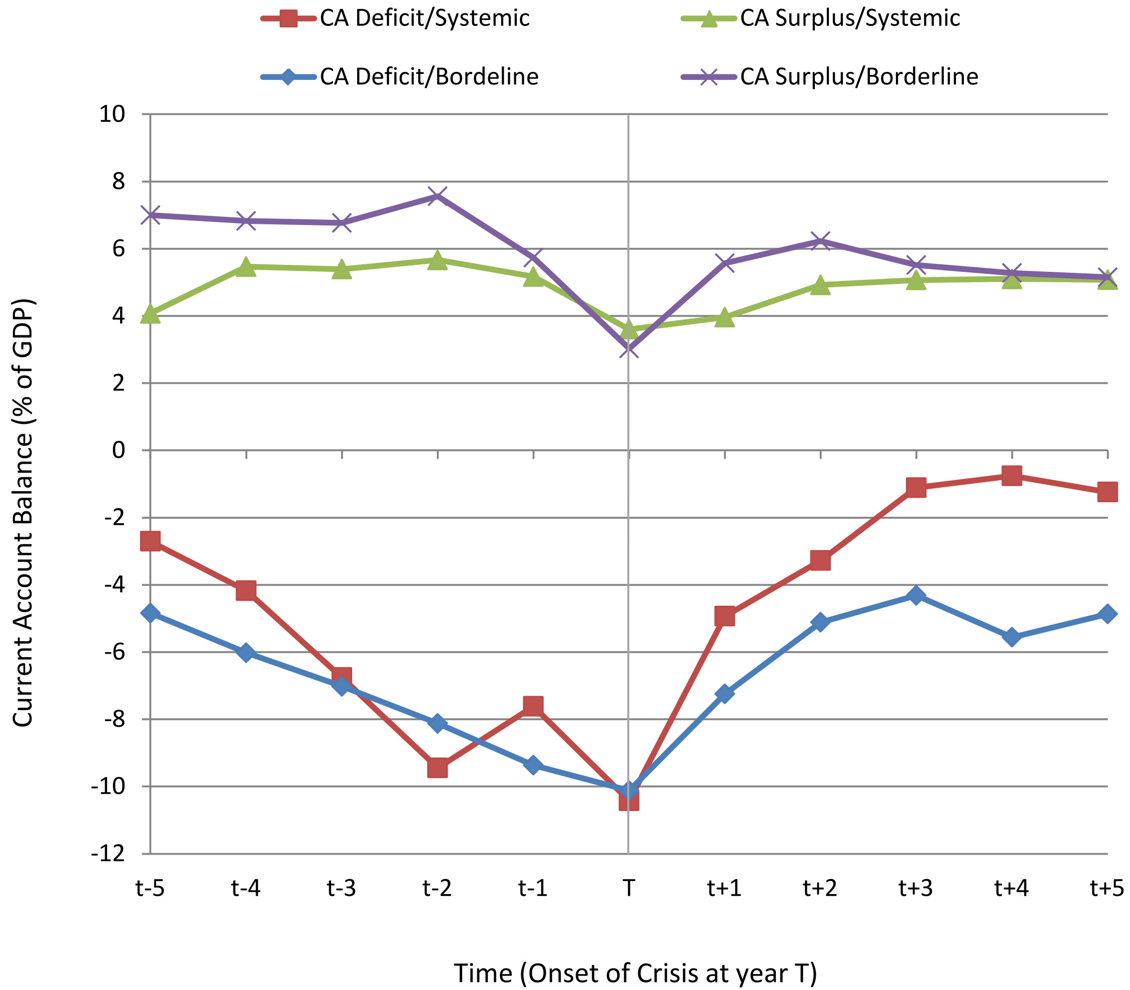

*Note:* Negative values indicate a shift to the left.

**Figure 8: Current Account Balance before and after a Systemic Crisis**



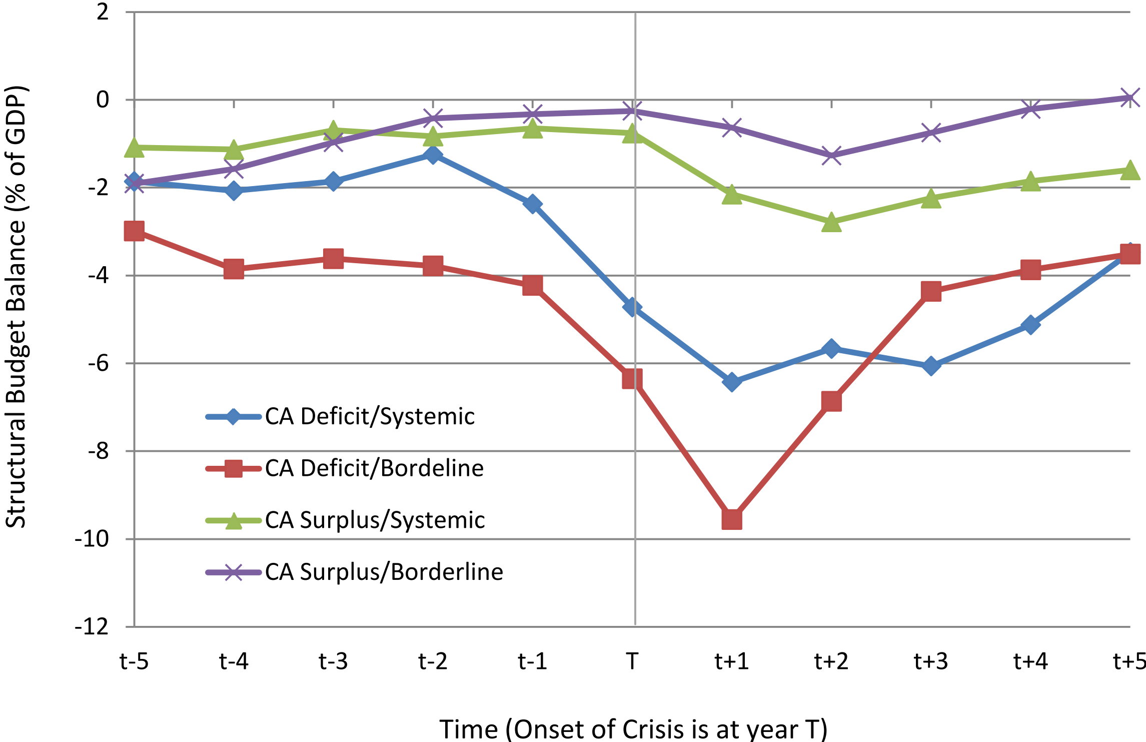

*Notes:* Data are from the *World Economic Outlook*. Missing data: Canada 1983 (*t-5* to *t-4*), Germany 1977 (*t-5* to *t*+2), Hungary 2008 (*t+4 to t*+*5*)United Kingdom 1974 (*t-5* to *t*+*5*).

**Figure 9: Current Account Balance in Deficit and Surplus Countries, Subprime Crises**



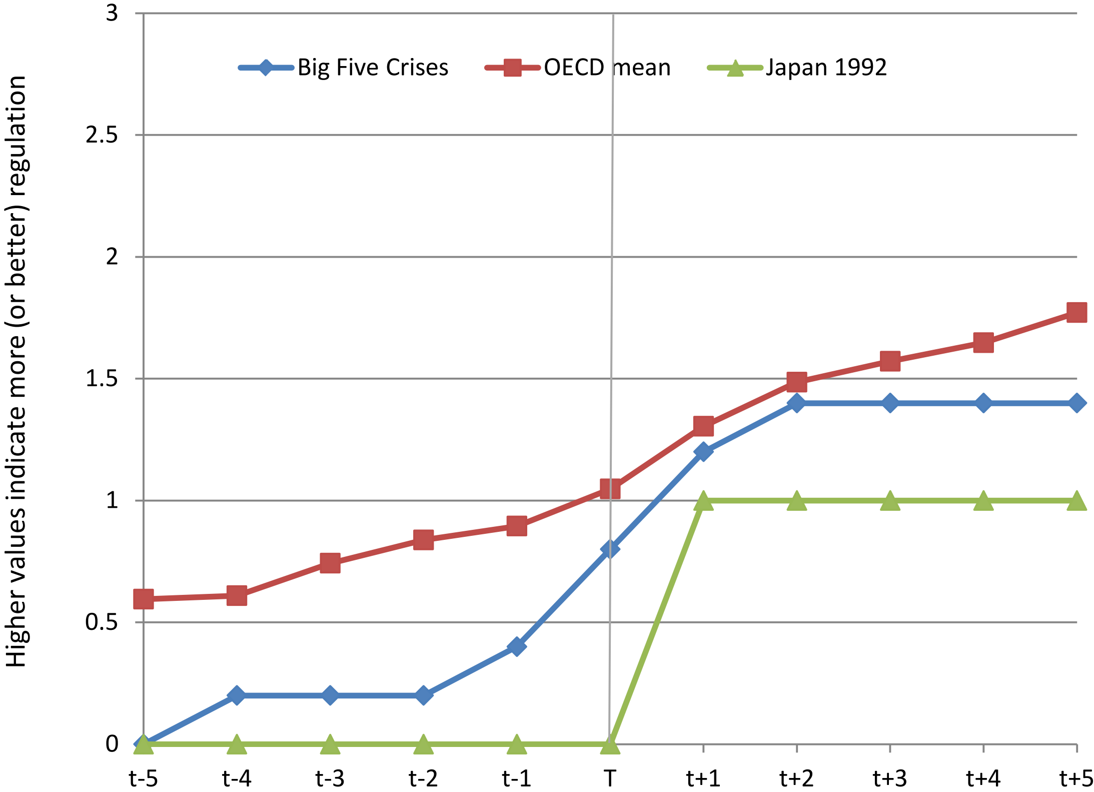

*Notes:* CA Deficit/Systemic: Iceland, Ireland, U.K., and U.S. CA Deficit/Borderline: Greece, Hungary, Portugal, and Spain. CA Surplus/Systemic: Austria, Belgium, Denmark, Germany, Luxembourg, and Netherlands. CA Surplus/Borderline: France and Sweden (Missing data: Switzerland). Source: *World Economic Outlook*. Projections *t+3* to *t+5* are IMF estimates.

**Figure 10: Central Government Structural Budget Balance before and after Banking Crises**




*Notes*: Missing data: Hungary 2008 (*t-5* to *t+5)*, Luxembourg 2008 (*t-5* to *t+5*). Source: *World Economic Outlook*. Projections *t+3* to *t+5* are IMF estimates

**Figure 11: Bank Regulation and Supervision before and after the Big Five Crises**



**References**

Abiad, Abdul G., Tressel, Thierry, and Detragiache, Enrica. 2009. “A New Database of Financial Reforms.” *IMF Staff Papers* advance online publication (6 October): 1-28.

Aizenman, Joshua and Yothin Jinjarak. 2009. “Current Account Patterns and National Real Estate Markets.” *Journal of Urban Economics*. 66, 2 (September): 75-89.

Alesina, Alberto, and Guido Tabellini. 1990 “A Positive Theory of Fiscal Deficits and Government Debt.” *Review of Economic Studies* 57 (3): 403-414.

Ansell, Ben W. 2007. “Bubbling Under: Political Preferences during Asset Bubbles.” Prepared for the 2007 Midwest Political Science Association Annual Conference.

Ansell, Ben W. 2009. “The ‘Nest Egg’ Effect: Housing, the Welfare State, and Political Incentives.” Prepared for the 2009 Midwest Political Science Association Annual Conference.

Armingeon, Klaus, Sarah Engler, Panajotis Potolidis, Marlène Gerber, Philipp Leimgruber. 2010. *Comparative Political Data Set 1960-2008*. Institute of Political Science, University of Berne.

Bartels, Larry M. 2011. “Ideology and Retrospection in Electoral Responses to the Great Recession.” Prepared for the conference on “Popular Reactions to the Great Recession,” Nuffield College, Oxford, 24-26 June 2011.

Bartlett, Bruce. 2007. “Starve the Beast” - Origins and Development of a Budgetary Metaphor.” *The Independent Review* 12, 1 (July): 5-26.

Beck, Thorsten, George Clarke, Alberto Groff, Philip Keefer, and Patrick Walsh. 2001. "New Tools in Comparative Political Economy: The Database of Political Institutions." *World Bank Economic Review* 15 (1): 165-176.

Bordo, Michael D., and John S. Landon-Lane. 2010. “The Global Financial Crisis of 2007-08: Is it Unprecedented?” NBER Working Paper No. 16589 (December).

Budge, Ian, Hans-Dieter Klingemann, Andrea Volkens, Judith Bara, and Eric Tanenbaum. 2001. *Mapping Preferences: Parties, Electors, and Governments, 1945-1998.* London: Oxford University Press.

Calomiris, Charles. 2009. "Banking Crises and the Rules of the Game." NBER Working Paper No. 15403.

Cameron, David. 1985. “Does Government Cause Inflation? Taxes, Spending, and Deficits.” In *The Politics of Inflation and Economic Stagnation*. Edited by Leon N. Lindberg and Charles S. Maier, pp. 224-295.Washington, DC: Brookings Institution

Chinn, Menzie D. and Jeffry A. Frieden. 2011. *Lost Decades: The Making of America's Debt Crisis and the Long Recovery*. New York, NY: W.W. Norton and Co.

Chinn, Menzie D. and Hiro Ito. 2007. "Current Account Balances, Financial Development and Institutions: Assaying the World "Saving Glut"." *Journal of International Money and Finance* 26, 4 (June): 546-569.

Claessens, Stijn, Giovanni Dell'Ariccia, Deniz Igan and Luc Laeven. 2010. "Cross-Country Experiences and Policy Implications from the Global Financial Crisis." *Economic Policy* 25 (62): 267-293.

Cusack, Thomas R. 1999. "Partisan Politics and Fiscal Policy." *Comparative Political Studies* 32, 4 (June): 464-486.

Friedman, Benjamin M. 1992. "Learning from the Reagan Deficits." *The American Economic Review* 82, 2 (May): 299-304.

Garrett, Geoffrey, and Peter Lange. 1991. "Political Responses to Interdependence: What's "Left" for the Left?" *International Organization* 45, 4 (Autumn): 539-564.

Honkapohja, Seppo. 2009. "The 1990's Financial Crises in Nordic Countries." Bank of Finland Research Discussion Paper No. 5/2009.

Jordà, Òscar, Moritz Schularick, and Alan M. Taylor. 2010. "Financial Crises, Credit Booms, and External Imbalances: 140 Years of Lessons." NBER Working Paper No. 16567 (December).

Johnson, Simon and James Kwak. 2010. *13 Bankers: The Wall Street Takeover and the Next Financial Meltdown*. New York, NY: Pantheon.

Kaminsky, Graciela L. and Carmen M. Reinhart. 1999. "The Twin Crises: The Causes of Banking and Balance of Payments Problems." *American Economic Review* 89 (June): 473-500.

Kemmerling, Achim and Oliver Bruttel. 2006. "New Politics in German Labour Market Policy? Implications of the Recent Hartz Reforms for the German Welfare State." *West European Politics* 29 (1): 90-112

King, Gary, Robert O. Keohane, and Sidney Verba. 1994. *Designing Social Inquiry: Scientific Inference in Qualitative Research*. Princeton, NJ: Princeton University Press.

Laeven, Luc and Fabian Valencia. 2010. "Resolution of Banking Crises: The Good, the Bad, and the Ugly." IMF Working Paper 10/146 (June):1-35.

Mian, Atif, Amir Sufi, and Francesco Trebbi. 2010a. "The Political Economy of the U.S. Mortgage Default Crisis." *American Economic Review* 100, 5 (December): 1967-98.

Mian, Atif, Amir Sufi, and Francesco Trebbi. 2010b. "The Political Economy of the Subprime Mortgage Credit Expansion." NBER Working Paper No. 16107.

Nakagawa, Shinobu and Yosuke Yasui. 2009. "A Note on Japanese Household Debt: International Comparison and Implications for Financial Stability." Bank for International Settlements (BIS) Paper No. 46.

Persson, Torsten, and Lars E. O. Svensson. 1989. "Why a Stubborn Conservative would Run a Deficit: Policy with Time-Inconsistent Preferences." *The Quarterly Review of Economics* 104, 2 (May): 324-345.

Pettersson-Lidbom, Per. 2001. "An Empirical Investigation of the Strategic Use of Debt." *Journal of Political Economy* 109, 3 (June): 570–83.

Reinhart, Carmen M., and Vincent R. Reinhart. 2009. "Capital Flow Bonanzas: An Encompassing View of the Past and Present." In Jeffrey Frankel and Francesco Giavazzi (eds.) *NBER International Seminar in Macroeconomics 2008*, pp. 1-54. Chicago: Chicago University Press.

Reinhart, Carmen M., and Kenneth S. Rogoff. 2009. *This Time is Different: Eight Centuries of Financial Folly*. Princeton, NJ: Princeton University Press.

Schwartz, Herman. 2010. "Finance and the State in the Housing Bubble." In Manuel Aalbers, ed., *Subprime Cities: The Political Economy of Mortgage Markets*, pp. 53-73. New York: Wiley/Blackwell.

Schwartz, Herman. 2009. *Subprime Nation*: *American Power, Global Finance and the Housing Bubble*. Ithaca, NY: Cornell University Press.

Sinn, Hans-Werner. 1999. *The German State Banks: Global Players in the International Financial Markets*. Cheltenham, UK: Edward Elgar.

Streeck, Wolfgang and Christine Trampusch. 2005. "Economic Reform and the Political Economy of the German Welfare State." *German Politics* 14 (2): 174-195.