The Financial Crisis and the Collapse of Political Parties in the Advanced Countries: Theories and Evidence

Thomas Ferguson

October 27, 2018

Tenth Anniversary of Lehman Bankruptcy –

Authorities and former policy makers mostly congratulated themselves on avoiding a second Great Depression; reaffirmed the correctness of the policy measures they pursued in 2008 and later.

Many others wondered about a connection between the financial crisis and the fact that ten years after the collapse, virtually all the world's most developed countries were sliding into deep political crises

These crises share several features:

“Traditional” alignments in party systems in are collapsing

“Populist” parties attacking political establishments are ascending

It is mostly center-left parties that are collapsing

Stylized Facts on Center-Left parties

- **1. France: 2017, Socialist Party presidential candidate gets 6.4% of vote after party won presidency and controlled Senate and lower house and most regions in 2012.**
- **2. Germany: SPD vote share halved since 1998; in 2017 down 5.2% to barely 20% from previous election; sinking in polls since.**
- **3. Netherlands: Dutch Labor Party vote in 2017 down 19 points from previous election.**
- **4. Greece: Pasok vote in 2009 was 43.9; in 2015 6.3%.**
- **5. Spain: Socialist Party vote declines from 43.9% in 2008 to 22.6% in 2016.**
- **6. Italy: Democratic Party and allies won 37% in 2008; in 2018 23%.**
- **7. Sweden: Social Democrats in 1994 won 45.2%; in 2018, 28.4.**
- 8. **US Democratic Party riven by sharp conflicts**

One explanation that isn't:

Statistical Studies of Financial Crisis and Great Recession Assert

Fin crises advantage right wing parties

1. de Bromhead, Eichengreen, O'Rourke 2013 – Pre-WWII crises benefit right wing Parties, though extent varies with how long the slump continues, WWI, and pol traditions
2. Funke, Schularick, Trebesch 2016 -- 1870 to 2014, Confirm the benefit to only the Right

These conclusions need serious qualifications.

1. **The pre-war data are left censored.**

If the left vote started to grow, often the system was destroyed.

Goering at the famous fundraiser between Hitler, Schacht, and many leading German industrialists on Feb. 20, 1933:

"That the sacrifice asked for surely would be much easier for industry to bear if it realized that the election of March 5th will surely be the last one for the next ten years, probably even for the next hundred years."

2. Funke, Schularick, and Trebesch's post-WWII data are heavily dominated by countries hit by the 2008 crash. But they also conclude that "The graphs demonstrate that the political effects are temporary and diminish over time. 10 years after the crisis, almost all variables are back to their pre-crisis levels."

Hmmmm…..Sept, 2018, Foreign Affairs, They propose that learning by Populists could explain the discrepancy.

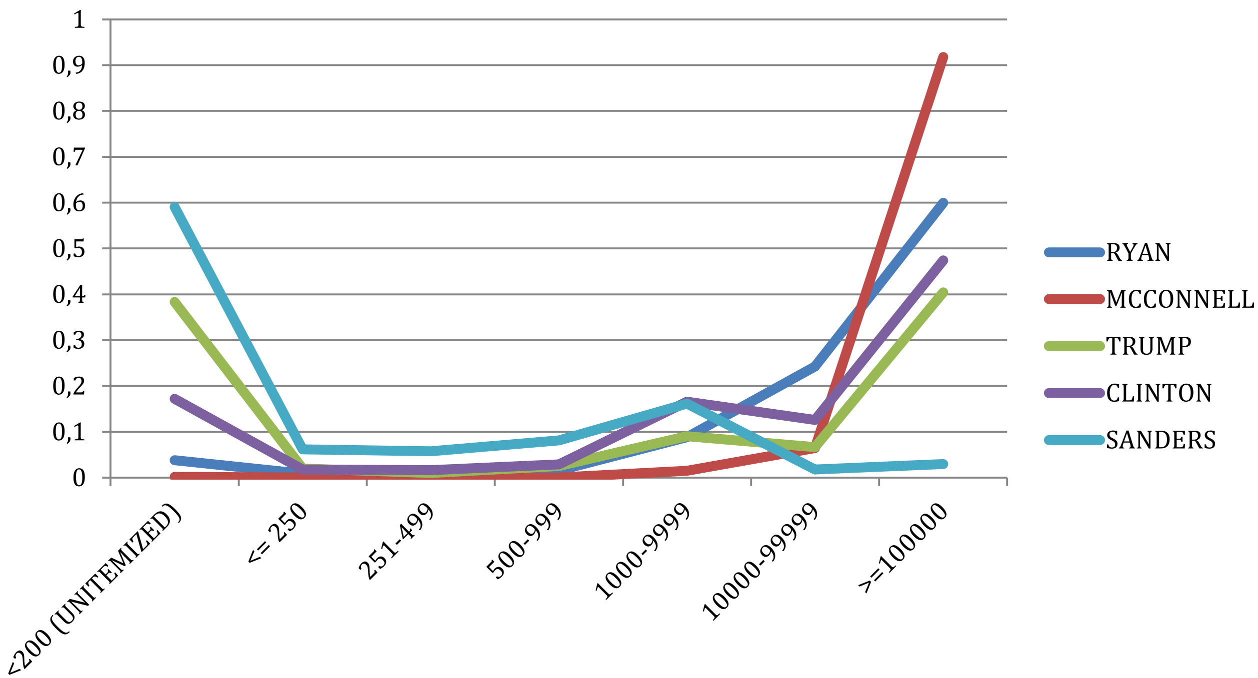
3. Conspicuous exceptions to the rule are also easy to find; some of are of towering historical significance: Consider the US New Deal, the Blum government in France, or even Obama’s two presidential victories in the United States after 2008.

A closer look at "Populism" helps to understand the role the financial crisis played in helping to generate it.

One picture shows the key point.

2016 and the Trump Era: Size Distribution of $ Contributions of US Political Leaders

Data from Ferguson, Jorgensen, Chen, 2018



Conclusion:

Two Different Forms of Populism Exist:

1. **Top Down**
2. **Bottom Up**

In the 2016 US Election Both Were on Display

So what can Top Down Populism mean?

- **Answer: Differences within investor blocs in parties: an investment approach to party competition -- (Ferguson, 1995), but also predecessors: Kehr, Rosenberg, Gershenkron, Kurth.**
- **Difference with Median Voter Theory: Only appeals that can be financed can be brought before public.**
- **Crucial consideration: Classical Liberal theories of democracy underestimate costs facing voters who want to control the state: Not only information, but all sorts of transactions costs, and sheer time. Plus, often, active concealment and repression. So parties become, first of all, bank accounts, directly or indirectly. This defines the investment approach to party competition.**

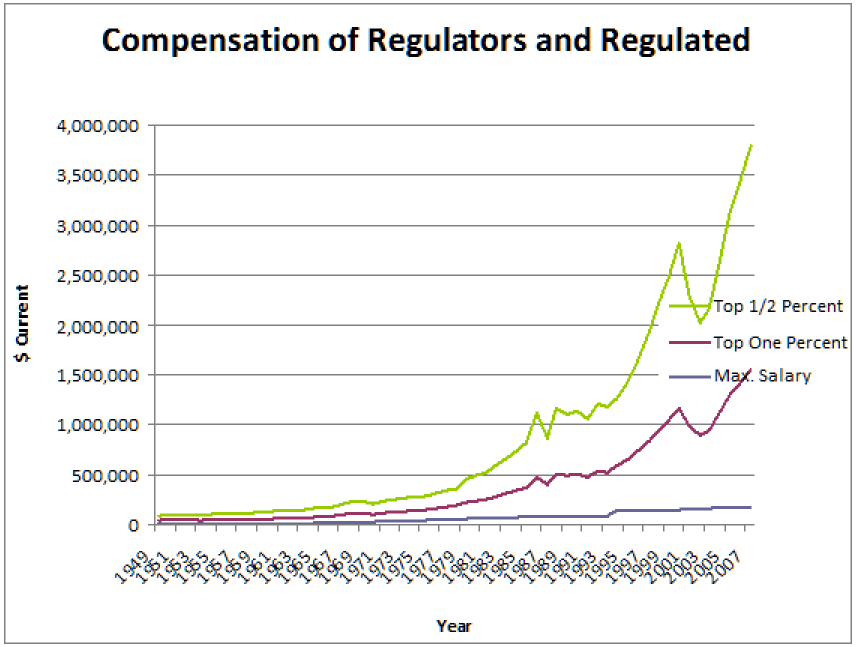
Formal Campaign Money is Only A Slice of the Spectrum of Political Money

Figure After Ferguson, Jorgensen, and Chen, 2017

1. Payments to Lawyers for Services	**2. Payments to Political Figures**	**3. Foundations and Charitable Grants**	**4. Lobbying**	**5. Think Tanks**	**6. Formal Campaign Spending**	**7. Value of Stock Tips, IPOs To Political Figures**	**8. Public Relations Spending**
(After Stigler, See Text) Substantial, But Unknown	Many Hundreds of Millions of Dollars Includes Certain Directors Fees, Speaking Fees, Book Contracts; Some “Research” and Philanthropic “Advice” From Consultants	Many Not Political; Some That Do Go Through Think Tanks $296 Billion in Total Giving in 2006; Perhaps 3 to 5% Might Count as Broadly Political	Legal Definition Is Very Narrow 2010 On the Record Totals Approx. $3.5 Billion. $ Refers to Washington, D.C. Lobbying in States and Cities Also Large	Rapid Growth Especially Since 1970s In 2005 Major D.C. Based Think Tanks Spent Approx $411 Million Many More Now Outside Washington, D.C. Not Included in Estimate	Total Expenditures on Federal Campaigns Only $5.2 Billion in 2008; State and Local Spending Heavy, Too	“Event Analysis” Studies Suggest Very Large in Certain Periods See Text	Some Certainly Affects Politics

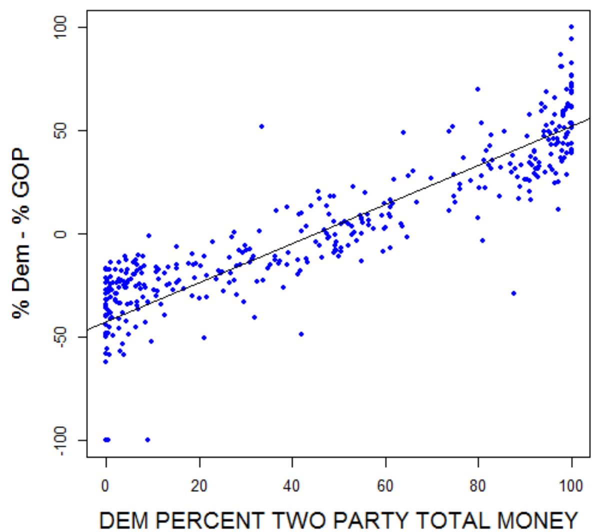
Problem of Money in Politics is Problem of Money in Society (Think Inequality)

Figure After Ferguson and Johnson, 2013

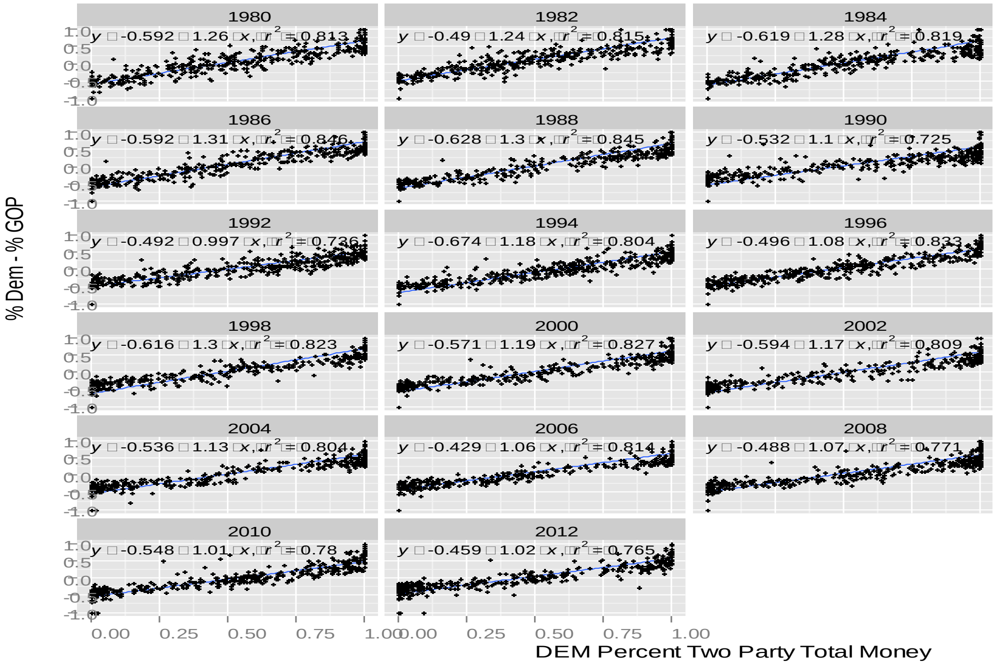


Linear Models of Legislative Elections: U.S. House 2012; All Such Elections For Which We Have Data, Including France (Cagé, 2018) Look Roughly Like This

2012: Pseudo-R Sq .779; Bayesian Latent Spatial Instrumental Regression, Ferguson, Jorgensen, Chen 2016



House 1980-2012



Testable Implication: Differences between investor blocs account for many partisan differences

Implied Contrast: Piketty, 2018, "Brahmin Left vs Merchant Right: Rising Inequality and the Changing Structure of Political Conflict"

"Since1970s-80s… high-education elites vote for left, while high-income/high-wealth elites for the right. I.e. intellectual elite (Brahmin left) vs business elite (merchant right)."

Problems With Piketty

- **Not true in general that Right parties represent the business elite, while left parties the highly educated: he recognizes that median voter accounts are way off, why then fixate on precise voting totals as the explanation? Cf. the Gilens and Page result for US, now also found in Germany.**
- **"Education" is systematically misunderstood in the Information Age and the triumph of fiscal austerity.**

Investment Approach:

Parties differ in their mass support bases, but also in the industrial structure of their elite supporters.

The two factors are closely related and in principle can be modelled as multi-dimensional graphs (Ferguson, 1984, 1995).

Sectoral Differences in Major Party Candidate Support 2012 BB only = Only Firms in Big Business in the Sector Just Above Romney % of Money is 100% - Obama % of $

Sector (N =)	Obama % of Firms	O % of $	Romney % of Firms
Mining (41)	20%	14%	68**
Coal Mining (227)	11%	3%	48%**
BB only (6)	33%	4%	83% (.18)
Paper (48)	42%	16%	73%**
Chemicals (140)	42%	37%	65%**
BB only (15)	69%	33%	88% (.08)
Oil (4057)	23%	24%	40%**
BB only (67)	48%	7%	85%**
Utilities (159)	48%	40%	58%* (.03)
BB only (31)	90%	29%	100%
Insurance (4072)	13%	24%	29%**
BB only (32)	75%	34%	88% (.10)
Private Equity (181)	38%	18%	61%**
BB only (47)	19%	19%	57%**
Inv Bk & Hdg Fds (5253)	26%	33%	48%**
BB only (53)	38%	48%	60% (.07)
Com Banking (2902)	16%	28%	35%**
BB only (20)	75%	27%	95% (.05)
Health (245)	55%	42%	65%**
BB only (20)	68%	89%	68%

Ferguson, Jorgensen, Chen, 2013

Table 4: ctd

Health Insr. (49)	88%	70%	84%
BB only (9)	100%	49%	100%
Pharma (574)	47%	46%	41% (.04)
BB only (15)	73%	55%	93% (.08)
Defense & AirCrft (54)	56%	50%	67% (.20)
BB only (9)	100%	49%	78%
Electronics (176)	64%	37%	61%
BB only (11)	91%	28%	91%
TeleCom (202)	60%	74%	59%
BB only (59)	59%	62%	56%
Software and Web (271)	69%	53%	58%**
BB only (28)	57%	51%	54%
Computers (76)	63%	68%	59%
BB only (20)	65%	28%	65%
Mfgr for Web (67)	64%	41%	60%.

** = Significant at .01 Level; Based on McNemar Test and Repeated Logistic Model

Trump Becomes Trump, Inc.: The Primaries: He mostly self finances

Total Amount	Trump
<200 (UNITEMIZED)	18.7
<= 250	1.3
251-499	.7
500-999	1
1000-9999	3.3
10000-99999	1
>=100000	74.1

As late as mid-May, Trump remained convinced that his success in using free media and his practice of going over the head of the establishment press directly to voters via Twitter would make it unnecessary for him to raise the “$1 billion to $2 billion that modern presidential campaigns were thought to require” (Green, 2017).

As the Convention Approaches, the Logic of The Investment Approach to Politics Becomes Overpowering: the Trump Campaign Looks For Money.

Short summary of Ferguson, Jorgensen, Chen, 2018:

Two waves of money for Trump:

Around Convention time, many firms seeking tariffs

In August, after another crisis, Mercers, Bannon, and Conway into campaign:

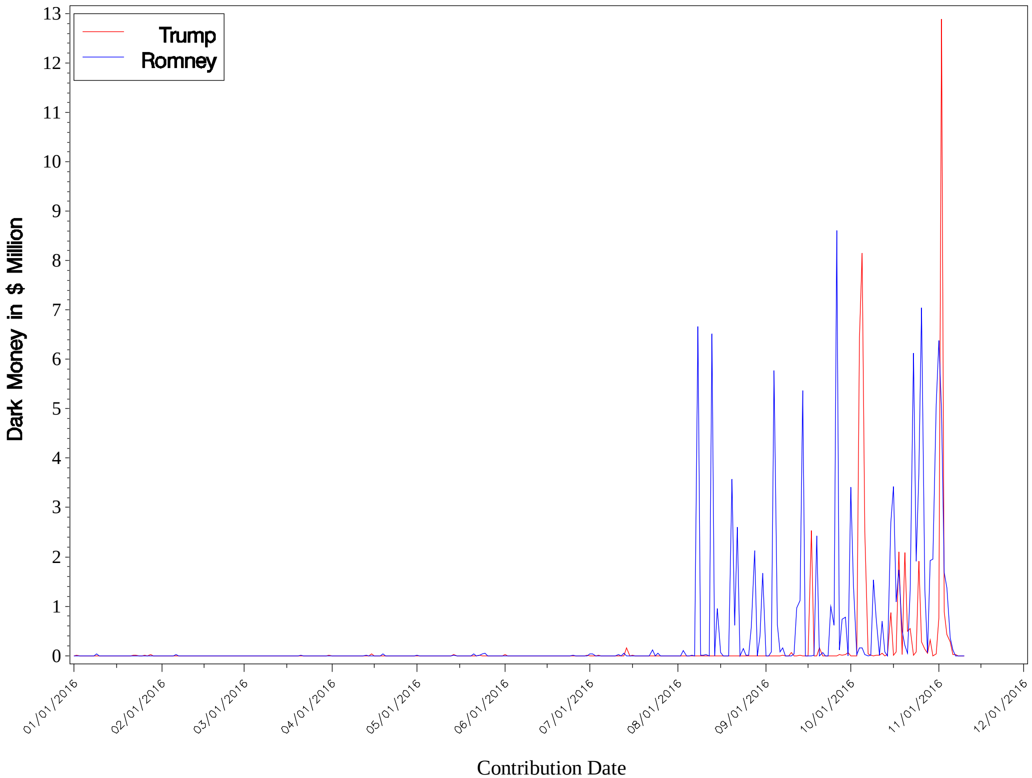
Wave of money from big private equity firms, casinos, other market fundamentalists opposed to Clinton.

The combination of money and populist themes was powerful; Bannon explicitly focuses on white working class voters

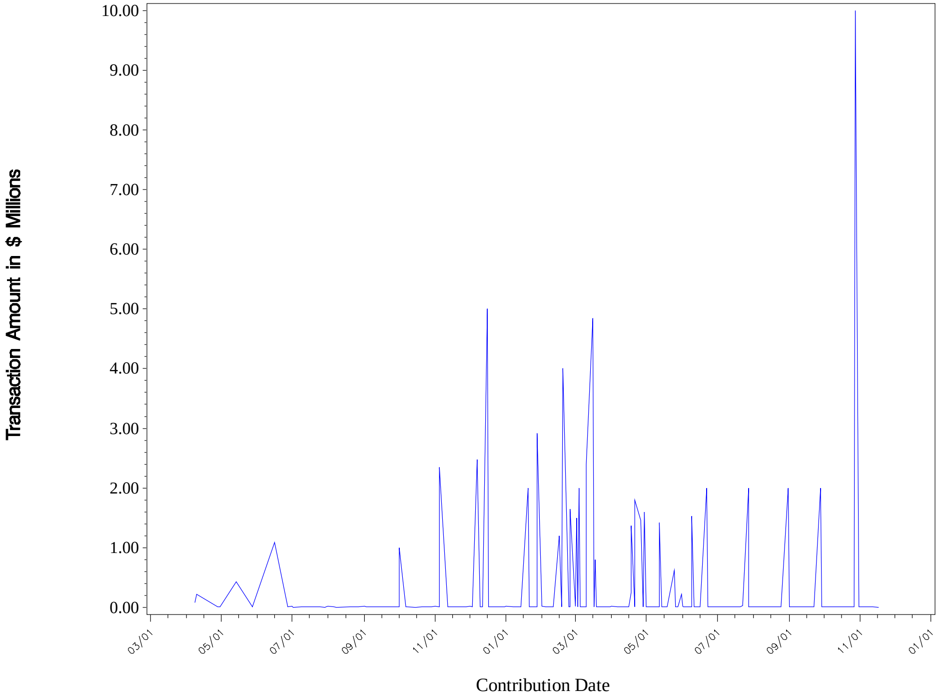
Racial resentment and gender were important, but so were the economic issues, including imports.

Ferguson, Page, Rothschild, Chang, and Chen, 2018

The October Surge of Dark Money for Trump Far Exceeded That for Romney in 2012 Ferguson, Jorgensen, Chen, 2018



Trump Total Loans and Contributions to Campaign Source: Calculated From FEC and IRS Data



Globalization steadily creates a dual economy in developed countries.

Long predates the Financial Crisis

In context of austerity, immigration and race become hot buttons.

1. Increases in income inequality; Wealth inequality

2. Pressures to lower tax rates, Esp. on high incomes

3. Restructuring of jobs, careers, consequent on financialization of firms.

4. Permanent fiscal squeezes over long periods of time

5. Laissez faire for most citizens, but state guarantees and support for finance and major firms

(Temin, Storm, Lazonick, Ferguson, Jorgensen, Chen – All INET Working Papers; David Weil on Job Fissuring

Now revisit the fine structure of the major episodes analyzed in the statistical papers: You see another pattern entirely

Call it the “in, out”; “out, in” rule: this can be repeated once or twice, but with a straightforward conclusion: Any left party that comes in and does little gets punished; right parties find it easier to ride out the storm. Important parts of their constituencies often really don’t want anything done; and most have little resistance to changing the story line onto immigrants, race, etc.

The reason the current crisis falls so heavily on center-left parties is that virtually all of these bought heavily into the "Neo-liberal," "New Labor," orthodoxy reflecting the ascent of fiscal austerity and a retreat from active intervention in the economy to secure jobs and aid workers. So they failed the Great Recession test and had already compromised themselves in the run up to it.

So the Issue is Top Down Led or Bottom Up Led Movements for “Change”:

Crucial Question is Alignments Within Business Community:

US, UK, distinctive in that they both have very large Free Market Fundamentalist Blocs;

Contrast Macron, German Situation; Also Parliamentary Coalitions Harder to Organize

Movements Against “Globalization” Have Succeeded With Strong Support From

Free Market Fundamentalists; Stance of the Rest of Business Becomes Crucial As These Movements Assume Power

The European Union Enters the Danger Zone; When Businesses Bail

European Union, Social Democrats, American Democrats –

Weaker Econ Appeals, Identity Politics

Market capitalization of listed domestic companies (current US$)

World Federation of Exchanges database.