When Wolves Cry "Wolf":

Systemic Financial Crises and the Myth of the Danaid Jar

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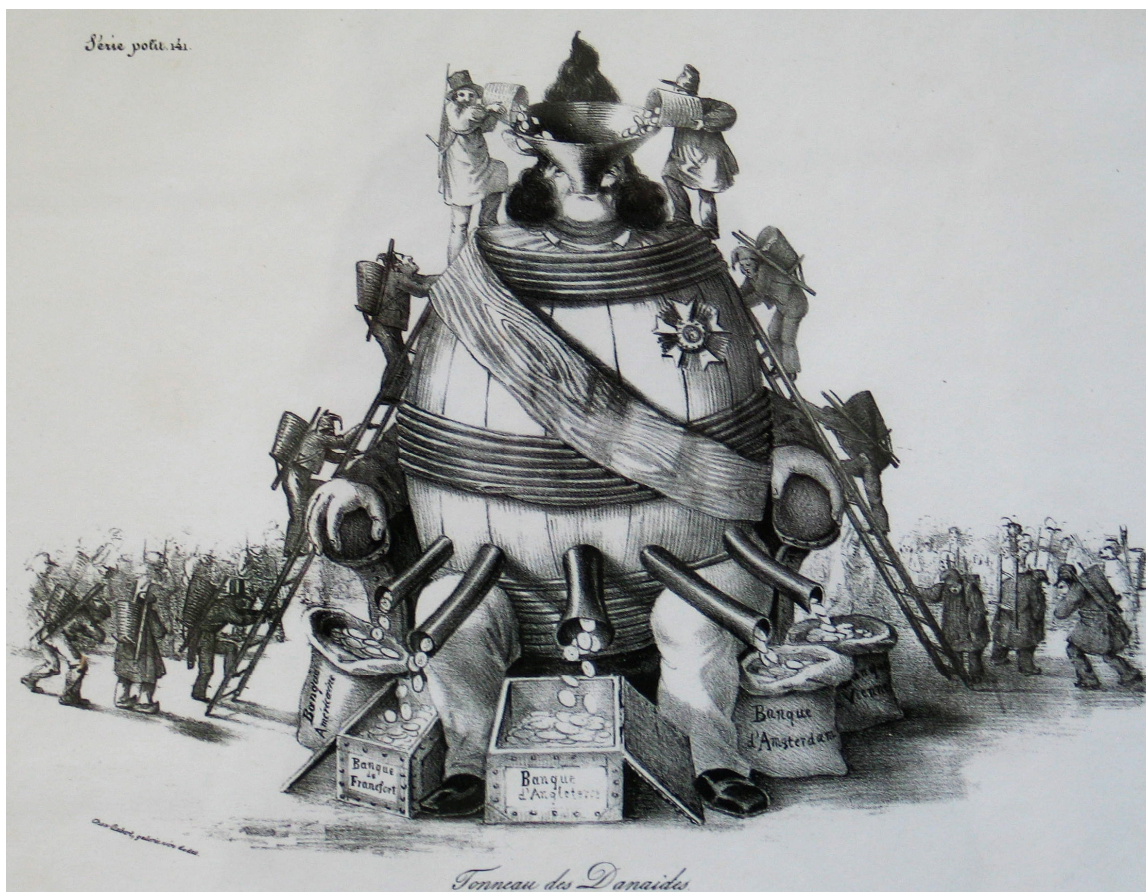

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Abstract

Financial crises are staggeringly costly. Only major wars rival them in the burdens they place on public finances. Taxpayers typically transfer enormous resources to banks, their stockholders, and creditors, while public debt explodes and the economy runs below full employment for years.

This paper compares how relatively large, developed countries have handled bailouts over time. It analyzes why some have done better than others at containing costs and protecting taxpayers. The paper argues that political variables – the nature of competition within party systems and voting turnout – help explain why some countries do more than others to limit the moral hazards of bailouts.

Ovid, Horace, and Baudelaire all wrote poems about it. Salieri based an opera on it. Rodin and many other artists found inspiration in it – as did Keynes, whose use of it as a metaphor in his *Treatise on Money* drew Hayek's ire. And in France, under the July Monarchy, it was brilliantly adapted by a gifted caricaturist to satirize how the government of Louis Philippe funneled the taxes of the French people to banks.[1] [See above.] The Myth of the Danaid Jar thus seems a perfect departure point for our reflections on comparative bank bailouts.

The myth recounts the sad story of the daughters of Danaus. Forced to marry against their will, all but one murdered their husbands on their wedding night. As punishment, they were sent to Hades and condemned forever to try to fill with water a jar that was really a sieve.

Systemic banking crises strikingly resemble the jar in the myth. The difference is that the sentence only seems to last forever – crises come to an end once the financial system is finally fixed. But that takes years. In the meantime, ordinary citizens pour tax

dollars into banks owned mostly by people far richer than they are, while enduring higher rates of unemployment and large output losses. Public deficits mushroom while government spending on everything else gets crimped. Parallel to the huge transfers taxpayers and bank customers make to financial houses are sweeping reallocations among firms within the financial sector and between finance and the rest of the economy. Just as in the *La Caricature*'s little gem, however, in the final analysis the broad flow of resources is upward, from the poor and middle classes to the rich.[2]

With so many countries running gigantic deficits to rescue the financial sector, we think the time is ripe for a brief, comparative examination of the historical record. Our hope is to understand why some countries do better than others at minimizing immediate bailout costs and limiting moral hazard (i.e., making bailouts painful enough that banks are not quickly tempted to start blithely running huge risks again). We are also curious about which countries have best held down long run output costs, though we can afford only to glance at that issue.

The answers to these questions are of great interest themselves, but, we argue, they also provide valuable insights into the conditions of effective financial regulation.

Before we begin, however, we need to call attention to one fact whose significance will become clear later: The "baseline" bank regulatory structures of all the countries we study emerged either in the inter-war period (e.g., the U.S. New Deal) or soon after World War II. In all, social movements involving political parties of the left, representing significant numbers of industrial workers and sometimes agrarian movements, were politically significant, even if they did not control the government.

Either by virtue of American occupation or Cold War transfers, the example of the U.S. New Deal sometimes also exercised modest influence.

What We Study and Why

Many recent papers have analyzed financial crises using large data bases filled with cases from all over the world.[3] Our interest here is different. We deliberately limit our concern to relatively large, developed countries that suffered systemic banking crisis involving the actual collapse (or near-collapse) of big financial houses.[4] We are clear that failures of many small banks certainly can create systemic risk, but a preliminary analysis convinced us that the politics and economics of such rescues are different – and, usually, easier, precisely because the institutions are small. They are also comparatively rare: e.g., U.S. Savings & Loans in the late 1980s, Swiss cantonal banks, etc.[5]

We therefore exclude from our sample small countries where outcomes are crucially determined from outside, for example, the IMF or dominant neighboring countries, or where other factors unique to smaller states are in play, for example, city states, (small) islands, and entrepot economies like Hong Kong.[6] We also gladly acknowledge that our criterion has an essentially historical nature – in the 1930s, for example, only Germany and the United States, and probably Italy, clearly qualify under it. We consider these earlier cases at the end, with an eye for how they might affect conclusions derived from recent experience where data is better.

One other comment, about sample "censoring." It is clear that adroit maneuvering by state authorities and the private sector sometimes restrains countries on the edge of a systemic crisis from tipping over into one. And once a crisis hits, authorities often promote mergers of weaker with stronger firms to head off additional state intervention.[7]

But chasing down “near misses” and crises that never occurred is beyond the scope of our discussion; this paper focuses on cases where large, developed states actually intervened.

It should be obvious that this research strategy comes with costs. We end up with but 15 cases and the small sample size is exacerbated by the necessity of using variables with distributions that are far from normal.[8] As will shortly be obvious, measurement is often cloudy, with many problems translating institutional realities into clear econometric coding schemes. Reasonable people may disagree with some of our choices. The Appendix lists the countries we analyzed.

Standards of Judgment

Assessing how countries fared requires some standard of judgment. Our’s is perhaps not without controversy, but nothing in this area is. We ask three sets of questions, which are heavily influenced by what are widely regarded as the gold standard among bank bailouts, the Norwegian and Swedish cases of the early nineties.

Firstly, did the authorities react quickly, or did they delay resolution with the hope of covering up need for action on impaired financial institutions? The latter option invariably sends the ultimate costs of the bailout to the moon.

Secondly, how did authorities deal with the immediate bailout costs? Here what is crucial is to end uncertainty about solvency and counterparty default by getting the bad assets quickly identified and out of the system. Then banks need to be recapitalized, so that they can lend again. By comparison with recapitalization, just selling bad assets to the state or a “bad bank” set up by the state is a wretched idea (as, for example, Treasury Secretary Paulson initially proposed in his now famous TARP program). New capital leverages far more loans for the same amount of money. In addition, states almost never

get the price right. Too low a price leaves banks without the resources to start lending again. That, however, is rarely the problem. Instead, what happens is that after a ritual dance of purity recalling the final scene of the *Firebird,* finance ministries overpay, bestowing huge gifts on financiers and their creditors and stockholders.

Recapitalization, however, is wildly unpopular with banks, because it dilutes existing shareholders, including management. In addition, to the extent the public obtains equity in the bank, it is guaranteed a piece of any upside from the rescue. As the dismal history of the Obama's administration's handling of the TARP program illustrates, however, bankers prefer to keep those gains for themselves.[9] They, accordingly, lobby for free or low cost money: the euphemism is the need to "get a new balance sheet into the game." That is, hand off the losers to the public.

Along with bank creditors, which in the U.S. include giant bond funds like Pimco and BlackRock, bankers also form a phalanx against making bank creditors share any costs of bailouts by converting debt into equity – which, of course, is exactly what states concerned about their taxpayers should do. Financiers also hate the idea – important for reasons of moral hazard – of losing their jobs, or limits on their salaries and bonuses. Not surprisingly, wolves are artful specialists in crying wolf: Moves by states to make banks pay the costs of cleaning up are greeted by what we like to call the "immaculate deception": that such steps amount to "socialism" and will choke off recovery and drive "talent" out of the banks.[10]

Where bad banks or other schemes for warehousing assets are set up, the price at which those assets are eventually resold often generates another mare's nest of problems. And finally, there is the issue, widely overlooked in the literature, of how impaired banks

treat customers. In the current U.S. case and, we suspect, many others, "zombie" banks gouge clients by raising fees and other charges. More generally, in a financial equivalent of the Night of the Living Dead, they try to raise margins everywhere they can. All too often, they can almost everywhere, thanks to the waves of consolidation that financial crises bring in their wake.[11] In the recent crisis, for example, U.S. regulators repeatedly waived anti-trust guidelines for mergers. By the middle of 2009, four large banks were responsible for almost half of all mortgages and two thirds of all credit cards.[12]

A peculiarly destructive twist is the way many banks take advantage of low rates of interest and regulatory forbearance to "play the yield curve" in bonds instead of making business loans. The swift revival of the dollar "carry trade" in 2009 is the international version of this. Fundamentally, it represents a gift from taxpayers (and their central banks) that has made even mediocre bankers look like financial geniuses again, while refilling depleted war chests for additional dizzying rounds of political contributions, lobbying, and bonuses.

Our third and final set of questions concerns recovery policies, especially the macroeconomic policies adopted during the crisis. Nowadays nearly all central banks cut interest rates sharply in full bore crises (the thirties were a different story), but some governments also practice countercyclical macroeconomic policies or devalue the currency.

Data and Other Problems

Data is much better for cases after 1980, so those claim most of our attention. But that data is still not nearly good enough to set very realistic values on the government aid flowing to financial institutions. For the current crisis, the BIS, IMF, and several central

banks have compiled statistics on announced capital injections and for amounts actually paid up (with a reporting lag). Data also is at hand for asset purchases by national treasuries, for state guarantees, and "liquidity provision" and other forms of central bank support. But there are no estimates of portfolio losses by central banks or finance ministries on assets they purchased; these are likely to be substantial, though no one wishes to admit it.[13] Neither are there any measures of regulatory forbearance or government tax concessions to financial houses, which in the U.S. and probably other countries are gigantic.[14]

Because guarantees are contingent claims, they are hard to value. Real values of capital injections are also very difficult to assess – compare, for example what Warren Buffett's $5 billion dollars bought him of Goldman Sachs vs. the relatively paltry (and fleeting) stake that U.S. taxpayers received in the same institution for their money. In many cases, of course, no private investors would dare invest in many of the institutions taxpayers rescued. Which makes the "fair market value" of the state assistance far higher than the publicly announced value of cash advanced.[15]

The Shock of Recognition

Our cases fall into three "waves." The biggest group consists of countries involved in the current imbroglio. Japan, Norway, and Sweden in the nineties are another, while the three inter-war cases mentioned earlier make up a final group.

Our first question, about delays, can be treated summarily. *Almost* everyone now admits that right until Lehman went down, virtually every national regulator among developed countries (perhaps outside of Japan, where disaster struck earlier) reposed excessive faith in the "magic of the marketplace." To all, the serial disasters of 2007 and

2008 came as bolts from the blue.[16] Treasury Secretary Paulson (seconded, of course by Federal Reserve Chair Bernanke and then New York Fed President Geithner), merits special mention in this respect. He and his colleagues have retired the trophy for the world's record in delaying recognition of the obvious. In what we have termed the "Paulson Put," they did their level best to postpone dealing with the financial crisis until after the 2008 election.[17] Their delay cost taxpayers in the U.S. and many other many countries billions.[18]

The unwillingness of Japanese authorities to deal with their earlier crisis is a close second to this strategic blindness and has become a legend in its own right.[19] By contrast, Sweden and Norway in the nineties are poster cases of early recognition. Someone sensitive to the timing of elections there might raise a few questions about this optimistic assessment, but, basically, we do not disagree with the consensus.[20] The "Bank Holiday" Franklin Roosevelt adopted to deal with his banking crisis is unique; it was a brilliant and rapid partial solution to the problem of identifying bad assets and getting them out of the system, though at the time there were complaints about its slowness. The way his administration reshaped the Reconstruction Finance Corporation, along with the slew of housing financing vehicles the New Deal spawned, ranks as a bravura performance in bank cleanups, one that actually made a bit of money for taxpayers. By contrast, it is clear that Italian authorities long ignored problems in their banking system, while in 1931 German authorities were nervous, but basically surprised when Chancellor Heinrich Brüning's sudden proclamation that Germany could not continue paying reparations triggered a currency crisis that led to a banking crisis of colossal proportions.[21]

Minimizing Bailout Costs and Moral Hazard

If we answered our second question strictly, this part of the paper could be very short. With the partial exception of the New Deal, only Sweden and Norway approach "best practice" standards in cleanups, first in the nineties, and then again in the recent crisis. Everyone else falls short, sometimes drastically. Virtually every other country did much less to protect its taxpayers, get bad assets out of the system, or recapitalize so financial life could get back to normal.

Consider the U.S. case, for example. Paulson's TARP is now universally accounted a blunder; even the Treasury Secretary admitted that he did not believe in his proposal by the time it became law.[22] The AIG bailout was what everyone knows it is – a backdoor way to channel funds to giant private institutions. The FDIC insurance guarantees and other benefits cost the banks much less than they were worth in the emergency, while the terms of the "ring fences" for Citigroup and Bank of America were derisory considering the gigantic size of the packages (Citi's was said to be worth over $300 billion dollars; the assets protected were neither named nor priced).

The Obama administration did nothing to improve matters. Instead of forcing the banks to get rid of their bad assets, it shifted instead to a regime of regulatory forbearance all too reminiscent of Japan in the nineties. Prerequisite for this was a change from "mark to market" to "mark to myth" accounting standards by the Financial Accounting Standards Board, which is formally a private body. This was accomplished via means that were crude even by U.S. standards, including a memorable session of a subcommittee of the House Financial Services Committee.[23]

After talking tough on banker bonuses, the President and the Treasury allowed most of the major banks to raise private capital and buy their way out of controls slapped on less fortunate institutions. The administration also proposed, but, happily mostly failed to implement, the Public Private Partnership Investment Program. This was instantly recognized as a clumsily disguised effort to funnel taxpayers' money to participating financial institutions.[24] And Treasury allowed Citi to convert the government's preferred stock into common shares at about three times the market price. The price of all this forbearance was high: overstatement of capital, understatement of losses, and excessive bonus pools based on non-recognition of the real losses that allow revenues to fly out of banks into the pockets of managements instead of going to rebuild capital bases.

Many countries, including the U.S, have ended up owning small banks that they did not want. Several, including Belgium and Austria, were forced to swallow major institutions when the situation approached the Dantesque. Germany and France had to rescue banks they already owned, to general embarrassment and taxpayer discomfort, while the Belgian government collapsed over terms of another bailout. The Germans set up a special fund, the Sonderfonds Finanzmarktstabilisierung – "Special Fund for Market Stabilization" – worth some 480 billion Euros, which bailed out a series of banks, including many with large real estate holdings. More sensationally, the Special Fund also acquired 25% plus one share (giving it certain veto rights) in the giant Commerzbank for an investment that eventually grew to 18 billion Euros. Otherwise most countries, to the immense relief of their bankers, have tried to avoid taking shares in institutions they rescued, especially the large ones. The outstanding exception is the United Kingdom, which secured a share of the upside for taxpayers by acquiring major positions in several

banks, including the Royal Bank of Scotland. Alas, the UK did not force even the banks it owned to write down their bad assets or otherwise get the bad loans off their balance sheets.

In sum, in the current crisis, most countries have related to their banks like parents to teenagers: They mostly just sent money. Outside of Norway and Sweden, we are little impressed by what they have asked of their banks in return for all this assistance. But most have insisted on at least some concessions on banker bonuses and salaries, even if a close observer can be virtually certain that many governments are merely playing to the gallery.

Heroic Simplification

The heterogeneity of national responses – reluctant nationalization, guarantees, stock purchases, asset purchases by central banks and finance ministries – along with the absence of information about final losses on assets taken over makes summary assessment impossible. We, accordingly, give up any notion of trying to measure the subsidies embedded in all of them.

Instead, in the spirit of Sir Peter Medaware's injunction that science is the "art of the soluble," we focus on a smaller problem. If we cannot specify how well governments have done in protecting their taxpayers from direct costs, we focus on a closely related problem. We try to assess how they have responded to the problem of limiting moral hazard by putting into place policies that penalize managements, creditors, and stockholders to deter risky behavior in the future.

This is more tractable. We abstract completely from contingent guarantees, accounting forbearance, and backdoor aid from central banks. Then we thrust aside

details of the myriads of conditions countries have attached to the capital injections and asset purchases they have showered on their bankers and simplify all these into a single variable: the percentage of bailout funds that came with "serious" stipulations on banker bonuses, pay, or job tenure that remained in force a year or more after the aid flowed. Framing the issue this way catches cases, such as the U.S. and Switzerland, where authorities allowed large banks rapidly to buy their way out of compensation restrictions, even though the institutions remained fragile.[25]

We do not count purely voluntary limits, or temporary curtailments, such as those Japanese banks may have made at the behest of the Japanese Ministry of Finance.[26] We do recognize cases such as the Netherlands, where the government squeezed the peak financial organization to adopt a scheme setting limits on compensation that the government now proposes to enshrine in law. By contrast, the U.S. TARP case fails to measure up; indeed, as discussed below, the American government's posture in the recent crisis is in major respects without precedent. While TARP famously clamped down on auto companies (some top executives were even forced out), it quickly allowed most of the big private banks to buy back the government's preferred stock, thus releasing them from controls on bonuses.[27]

Our strategy is then to partition all these cases into two, in effect creating a binary variable, that can be interpreted as roughly distinguishing "serious" from "less serious" efforts to limit moral hazard. But while this step reduces the diversity of experience to manageable dimensions, it comes with a price. In small samples, tests on binary dependent variables become very difficult when one includes more than one independent variable, because the usual tool, logistic regression, requires a fairly large

number of cases for its algorithm to converge. Accordingly, the best we can do is run separate non-parametric tests on variables we suspect are important and then display a joint scatter plot. Sometimes, however, a picture really is worth a thousand words.

So What Explains Country Policies Toward Limiting Moral Hazard?

We are not surprised to discover that traditional economic variables offer little help. But two political variables do appear to matter. The first is the percentage of seats in the national legislature (lower house in most parliamentary systems) held by labor and socialist parties when the bailout packages were created.[28] The second is voting turnout, averaged across several elections prior to the crisis.[29]

Given the binary nature of the dependent variable, we started with Mann-Whitney tests, which are non-parametric. They suggest that both variables significantly influence the probability that states take a harder line toward banks. (See Appendix.) We concede that such tests are not dispositive, since they are conducted on each variable separately. Logistic Regressions testing both together along with other possible variables would be more compelling. But since the small sample size precludes that, we instead scatter plot the countries with respect to both variables. The result is striking: Figure 1 shows countries with relatively lax policies on moral hazard clustering together in the lower left corner of the figure, with low voter turnouts and few labor or socialist members of parliament. The reverse pattern is evident for the other countries with stronger policies on moral hazard.[30]

Figure 1 About Here

A word of caution about the political party variable is in order. We would not like to be understood as suggesting that demand for serious moral hazard protection is unique to labor or socialist parties. As discussed below, we emphasize instead how the strength of these parties opens spaces for wider political coalitions in systems that come closer to the ideal of "open societies." In other words, perhaps liberal (in the European sense) parties are less likely to turn into lobbies for bailouts when they face more qualitatively serious competition.[31]

The evidence about voter turnout also requires a comment. The cross-national evidence that levels of voting turnout are complexly related to the electorate's ability to affect policy over time is strong.[32] But assessing what turnout means from place to place or even within the same system over long stretches of time is difficult, though its variations are always important to understand.[33] The U.S. between 1896 and 1932 is a particularly instructive case. Burnham documented the sharp decline in voter turnout in that period and argued that outside the South, the decline was related to the spread of industrialization. In political science, though not history, Burnham's argument was widely derided, but rarely tested in a serious way. After almost a generation of sometimes curious discussion, Ferguson and Chen confirmed the claim, using spatial regressions.[34] Future studies of bank bailouts should consider this variable carefully and include it in data bases that purport to capture institutional features affecting bailout policies.

Additional Evidence About the Importance of Parties

The idea that labor or socialist parties play a pivotal role in affecting how states deal with moral hazard in bank bailouts can be strengthened by a closer look at the current U.S. case. At least once upon a time, Social Democratic parties clearly

represented social movements.[35] But so did the Democratic Party of the New Deal. Indeed, it was that party, and its leader, Franklin D. Roosevelt, that put in place the period's landmark regulatory reforms. But this time, something *is* different: The experience of the United States in the current bailout is without precedent. It is not simply that, as Joseph Stiglitz and Simon Johnson have both documented, the Obama administration's policies toward financial reform are consistently favorable to finance.[36] It is that in no other country, ever, have bankers managed to pay themselves record, or near-record, bonuses only months after being bailed out by taxpayers. And kept right on doing it, in the full glare of publicity, even as the country slid into deep recession.[37]

What accounts for this transformation? Why, more precisely, do labor or socialist parties in other countries squeeze states to move more aggressively on moral hazard than the modern Democratic Party?

The usual story – about the triumph of the "idea" of deregulation in the last thirty years – is breathtakingly superficial. Whatever one might think about that five or ten years ago, no one outside of finance and policy circles finds anything attractive about vast state aid to banks. More precisely, the evidence is overwhelming that banker friendly policies are wildly unpopular with both the Democratic base and in the country at large. Indeed, the Obama administration's unwillingness to challenge the banks played a role in the Democrats' shocking loss in the special election recently held to fill the Senate seat formerly held by Ted Kennedy.[38] Yet the administration ploughs ahead with what is, by world standards, a set of financial "reform" proposals well to the right of most conservative parties outside the U.S. It also repeatedly intervenes in international forums to block or slow down reform of derivatives "markets," which are central to the whole

"too big to fail" debate, and trails well behind other countries in efforts to reform financial compensation.[39]

One can always try to explain this by adding epicycles to some theory about the miraculous leadership qualities of certain individuals, such as former Secretaries of the Treasury, the psychology of presidential leadership, or even political games in the White House. Our approach is very different. We think that the equivalent in political science of "efficient markets" in economics – that is: free market fundamentalism – is the theory of the median voter – that 51st voter in a group of 100 who guarantees victory to whichever party comes closest to her position.

A much better approach to understanding what is happening with financial reform and the Democrats is the "investment theory of party competition."[40] This frankly acknowledges that information does not flow costlessly from candidates and political parties to voters and that substantial transactions and information costs face electorates trying to control the state. As a consequence, such political systems become more or less money-driven, drastically altering the logic of partisan competition: Only positions that can be financed on a large scale are represented in the public sphere, even if everyone knows that a heavy majority of the population desperately desires a different policy.

This approach to party competition raises searching questions about what makes for a true "open society." It amounts to a flat denial that formal party competition by itself guarantees popular control of the state. Instead, it suggests that the right question to ask is whether ordinary people can afford to control any political party in the system. That is an empirical question to be settled by reference to actual patterns of political

finance; it is not to be deduced from some ideal Cartesian geometry of formal party competition.

The current situation in regard to financial reform in the United States impresses us as a kind of Michelson-Morely experiment between the two approaches to understanding party competition. As one of us warned many months before the presidential election in 2008, analysis of the early money in the primaries left no doubt that financial reform would not be a priority of the Democrats.[41] Neither, of course, was there any paying constituency for financial reform among Republicans. Never mind that an overwhelming numbers of voters detest the system that gave us Bear, Stearns, Lehman, and a raft of other disasters worthy of a modern day *Book of Job*. As a celebrated bank attorney publicly forecast as the new administration came to power, the system that destroyed the world in 2008 is likely to survive with only modest changes.[42]

Now let us link the discussion of parties back questions of mass political movements and effective bank supervision. Part of the answer to the question of what happened to the Democratic Party between the New Deal and today should now be obvious. Organized labor had a substantial position within the Party during the New Deal era. Indeed, that was the moment labor arrived on the American political scene in a serious sense. Labor groups were also central to the successes of socialist and labor parties in other countries. Over the last few decades, union density has tended to fall almost everywhere. But in the United States, the percentage of workers in unions has plunged from a high of just over 30% to about 12%, of which half are in the public sector. In addition, U.S. political parties do not have any kind of dues paying base among their “members.” People become Democrats or Republicans by deciding to style

themselves one. But campaigning is expensive; it costs heavily in time and money. This ineluctable fact opens space for industry groups to fill both parties' coffers. In the case of the Democrats, much of that money comes from parts of finance and a few other sectors.[43]

In most other countries in our sample, rates of unionization remain substantially higher. In addition, most labor and socialist parties still retain substantial numbers of dues paying members. Many parties also now receive various forms of public financing. A broader public – not necessarily the whole public, for we would not suggest that the whole population is always well represented in these systems[44] -- therefore figures in policy deliberations. A wider cross-section of voters can coalesce with other political groups – including some businesses and financiers, churches, community organizations, etc. – in favor of financial reform.

By contrast, in a system as thoroughly driven by money as the current U.S. system is, such coalitions do not happen. Instead, as even the briefest glace at the recent U.S. financial crisis shows, major donors repeatedly influenced policymakers and helped shape the responses of both major political parties.[45]

One obvious prerequisite of effective financial regulation is thus campaign finance reform. (We would note that U.S. style money politics tends to spread with globalization, so that while lobbying and even political money still function somewhat differently in other democratic countries, America surely shows these lands their future.[46])

By itself, however, election finance reform will not suffice. A Reagan era initiative deliberately removed Congressional staff from the federal pension program,

thus greatly adding to pressures on staff to exit at some point for more lucrative lobbying work – and hold the door open to that possibility by making friends with lobbyists and interest groups while at work on Capitol Hill. And if Congressman and women can instantly become multimillionaires by leaving their office for positions with lobbying firms or trade associations, then outcomes will be eminently predictable.[47]

Two less heralded developments also require notice and effective remediation. Firstly, careful empirical work on Congressional stock market portfolios shows that they exhibit some of the highest rates of return over market ever documented.[48] It is clear that a good stock tip is now more valuable to legislators than a campaign contribution – and is all too common, though not everyone in Congress plays the game to the hilt. Regulation and ethics laws need to be adjusted to reflect this new reality, which is all but undetectable by ordinary citizens and barely understood by Congressional scholars. Needless to say, the recent Supreme Court decision allowing the use of corporate funds in campaigns marks a giant step backward.

Secondly, U.S. policy discussions are now heavily dominated by think tanks, which provide much of the fodder for media commentary and discussion. None of these are profit making enterprises; all are subsidized. In addition, as is obvious from public disclosure forms required of presidential appointments and news reports of Federal Reserve consultants, many people quoted in the media as policy authorities derive substantial income from honoraria, speeches and consulting contracts from corporate and, especially, financial interests. Many of these fees are huge – tens of thousands of dollars; some run into six figures. It is ridiculous to think that fees of this size reflect "market" rates for policy opinions. They testify to the obsolescence of George Stigler's observation

years ago that the reason there are so many lawyers in politics is that it is easier to pay them off legally.

A Special Problem with Regulation

This brings us to a fundamental point that current discussions about improving regulation overlook. We have already alluded to the historical origins of contemporary financial regulatory systems and noticed the role labor and socialist parties played in the politics of those times. But these junctures were, almost without exception, also times in which income differentials narrowed sharply within the economy. By comparison with the rest of the population, executive compensation and incomes, for both purely economic, but also political reasons, were crimped. Indeed, historical statistics suggest both often hovered near historic lows. By contrast, after the late seventies, salaries and bonuses in the whole corporate sector, but especially finance, exploded.[49]

The implication for regulation is crucial. At some point after incomes in the financial sector took off, lifetime earnings of the regulated far outstripped what any regulator could ever hope to earn. *Rising economic inequality was translating into a crippling institutional weakness in regulatory structure.* Not surprisingly, as one former member of a U.S. regulatory agency expressed it to us, regulatory agencies turned into barely disguised employment agencies, as staff increasingly focused on making themselves attractive hires to the firms they were supposed to be regulating.

This process can be tracked empirically. In the Securities and Exchange Commission, the Commodity Futures Trading Commission, and several other agencies responsible for regulating the financial sectors, the highest positions below the political appointees are normally reserved for qualified members of the Federal Senior Executive

Service (SES). (The Federal Reserve has its own compensation ladders, but they surely track at least broadly the Senior Executive Service's.) A plot over time of top level SES salaries against high level, but not the highest level, financial sector salaries (which we proxy using the data for the income levels of the top 1% and top .5% of the American income distribution) shows what might be termed the "opportunity cost of doing good."[50] (Figure 2)

Figure 2 About Here

Once that gulf reaches a certain point, talk about improving regulation by drafting better, more specific laws, new supervisory agencies, or even campaign finance reform is largely idle. The interest of the regulators in going for gold through the "revolving door" will overwhelm every other consideration. Some way has to be found to prevent regulators from being swept up by a golden equivalent of the whirlwind that carried the prophet Elijah up to heaven. If a new social movement does not emerge to narrow the income gap, then agencies need a substantial redesign to professionalize their inspectorates.

Final Reflections: The Great Depression and Later Cases

How are these conclusions affected if we widen our gaze to include the three great Depression era cases mentioned earlier?

Each is enlightening in different ways. The example of the New Deal points up the importance of labor or socialist parties in championing limits on moral hazard while also warning against the idea that such parties monopolize that cause. In the thirties, the

U.S. Chamber of Commerce regarded Roosevelt as a Socialist (rather like the same body does the current U.S. President – some things never change). So did many other investors and much of the leadership of the Republican Party. But two generations afterward, everyone can see what nonsense that was. Roosevelt's coalition fused labor with (mostly capital intensive) businesses and financiers. In sharp contrast to the way most business groups have closed ranks today, the New Deal was supported by a veritable Milky Way of investment banking stars, including Averell Harriman, James Forrestal, and Sidney Weinberg (who sat on the Democratic National Committee's Finance Committee and is said to have raised more money than anyone else in the pivotal 1936 election for the President).[51] Jesse Jones, the Texas banker who headed the Reconstruction Finance Corporation, often requested letters of resignation from the top three officials of the banks he rescued, though he kept many in his pocket. The RFC also bought preferred stock in enterprises it aided, thus ensuring that the public shared in some of the returns from its money. It seems clear that the "terms of trade" between labor and business in that era's Democratic Party, which were fundamentally affected by labor meteoric rise in the political system, resulted in substantially better policies for the market system as a whole.

The German and Italian cases are different. There is little doubt that German bankers did not enjoy the takeovers (some were partial) that their government reluctantly engineered to save them in 1931.[52] While the government generally played its new hand lightly, it appears to have played a role in the subsequent reorganizations of these institutions, before they were reprivitized under the Nazis.

In Italy, there is no doubt that a group of bankers who included important original sponsors of Mussolini had developed the practice of hiving off losses on the Italian state into a fine art, before their institutions finally went bankrupt in 1931.[53] But when the Duce did take them over, he fired several, including the Finance Minister who was key to their plans. He also put the shares of the three big rescued banks into a state holding company, the famous Istituto per la Ricostruzione Industriale (IRI), along with the shares of the industrial companies previously owned by the banks. The new Italian banking law, passed in 1936, went far beyond anything contemplated today, such as the "Volcker Rule": it restricted banks to granting short term credit.[54]

For all the vast differences between them, Hitler, Mussolini, and Roosevelt all can be said to have presided over genuine mass movements, though each also had significant business support.[55] The lesson from these cases may, accordingly, be that to stop the banks, it takes a village – i.e., a mass movement, from either the left or the right.

Where the inter-war cases are most helpful, though, is in filling out the evidence about recovery from systemic financial collapses. The current Great Recession will one day produce a raft of new cases to study, but right now is too soon to say anything. That leaves only the early nineties cases of Norway, Sweden, and Japan among contemporary examples.

It seems plain that the Nordic countries' long commitment to avoiding deflationary policies served them in good stead as they battled to overcome their nineties financial crises. But their recoveries certainly owed much to currency devaluations undertaken at times when the world economy was growing. Their value as examples for the current crisis are thus limited, since the whole world cannot devalue against itself,

however inspiring the Nordic examples may be object lessons in how to fix banks without saddling taxpayers with enormous costs.

Japan in the nineties offers a clearer lesson. We agree with Koo that the commanding lesson of that crisis is that official forbearance combined with steady deleveraging by the private sector implies a need for sustained public spending, or the country stagnates.[56] As Koo also argues, the New Deal points to precisely the same conclusion, though its record is marred by the disastrous decisions Roosevelt made after the 1936 election to bow to conservative critics and raise interest rates and cut public spending. (The rate rise was part of an election understanding with the outgoing head of the American Bankers Association and other financiers.[57]) This immediately plunged the U.S. back into the depths of depression, finally forcing it to embrace consciously Keynesian expansionary policies.[58] .

In Germany, by contrast, Hitler allowed Schacht, working with a bloc of legendary German industrialists, to organize reflation extensively outside the banking system (but using state credit), via the famous Metallurgische Forschungsgesellschaft, m.b.H. (MEFO) scheme.[59] Along with the dismal cases of Herbert Hoover and the futile trio of German chancellors – Brüning, von Papen, and Schleicher – who proceeded Hitler, we think the German case points up the most important of all the similarities between financial crises and the Myth of Danaid Jar: A policy of cutting state expenditures under conditions of high unemployment is virtually guaranteed to run deficits up, not down, as tax revenues decline while national income plummets.

In his famous essay on the Myth of Sisyphus, Camus insisted that it was necessary to regard Sisyphus as happy while he went about his own impossible, never

ending task. That suggestion is utterly implausible for either the daughters of Daunas or policymakers who try to use recessions to curb deficits. The Myth of the Danaid Jar is a timeless warning against trying to fill up a sieve; both bank bailouts and the Depression cases show all too clearly what happens in the real world when policymakers are foolish enough to try.

Appendix

Our cases are Austria, Belgium, France, Germany, Italy, Japan, The Netherlands, Norway, Sweden, Switzerland, United Kingdom, and the United States in the current crisis; Japan, Norway, and Sweden in the nineteen nineties, and Germany, Italy, and the United States in the Great Depression. As explained in the text, the statistics and Figure 1 include only the cases from the nineties to the present. Also as discussed there, we partition the bailouts into a single binary variable coded as either Serious (=1) or Not Serious (=0), depending on restrictions each county put on banker compensation and tenure as conditions for bailout.

We ran Mann-Whitney tests to see if voting turnout and labor or socialist party strength (expressed as a percentage of all the seats in the relevant house in parliament – see our main text) differs significantly across countries that have bailed out their banks. In other words, whether either of these variables is associated with states that try to restrain moral hazard by curbing banker compensation or tenure in a serious fashion. The Mann-Whitney test is non-parametric, an advantage given the binary nature of the variable characterizing moral hazard in bailouts. The tests indicate that both labor or socialist party strength and voter turnout are associated with more serious moral hazard restraints. The former is significant at a .002 level; the latter at .036.

Figure 1

Figure I: Moral Hazard Controls by Voter Turnout and Labor or Socialist Party Parliamentary Strength

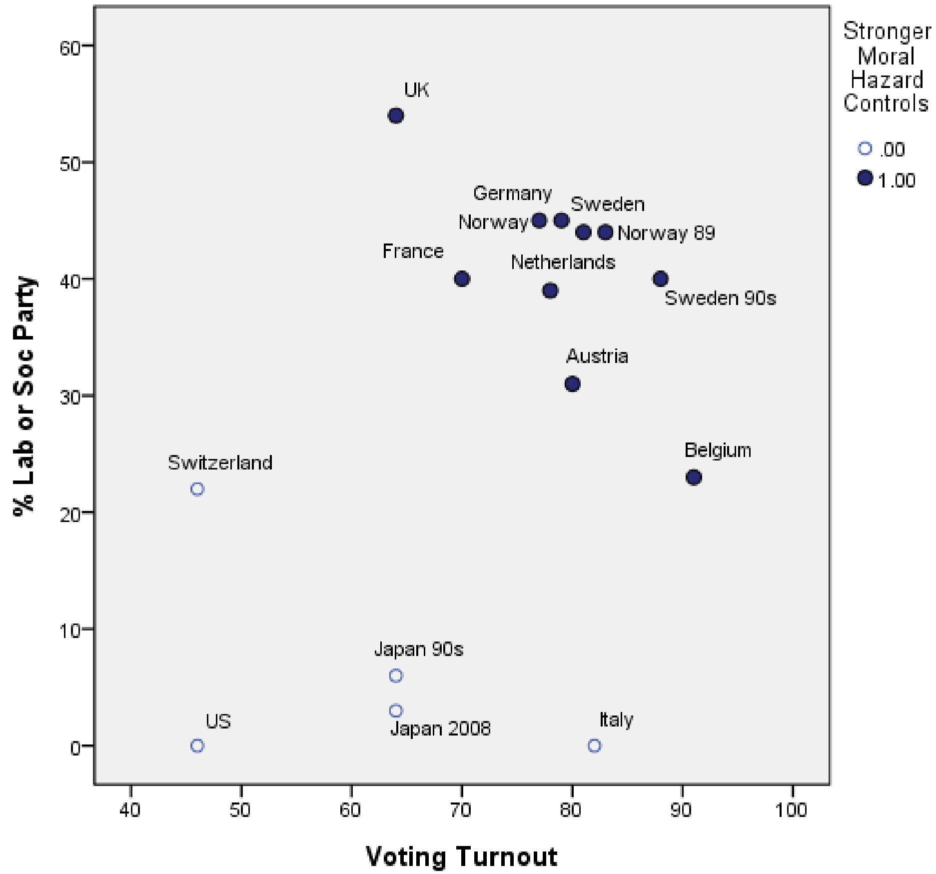
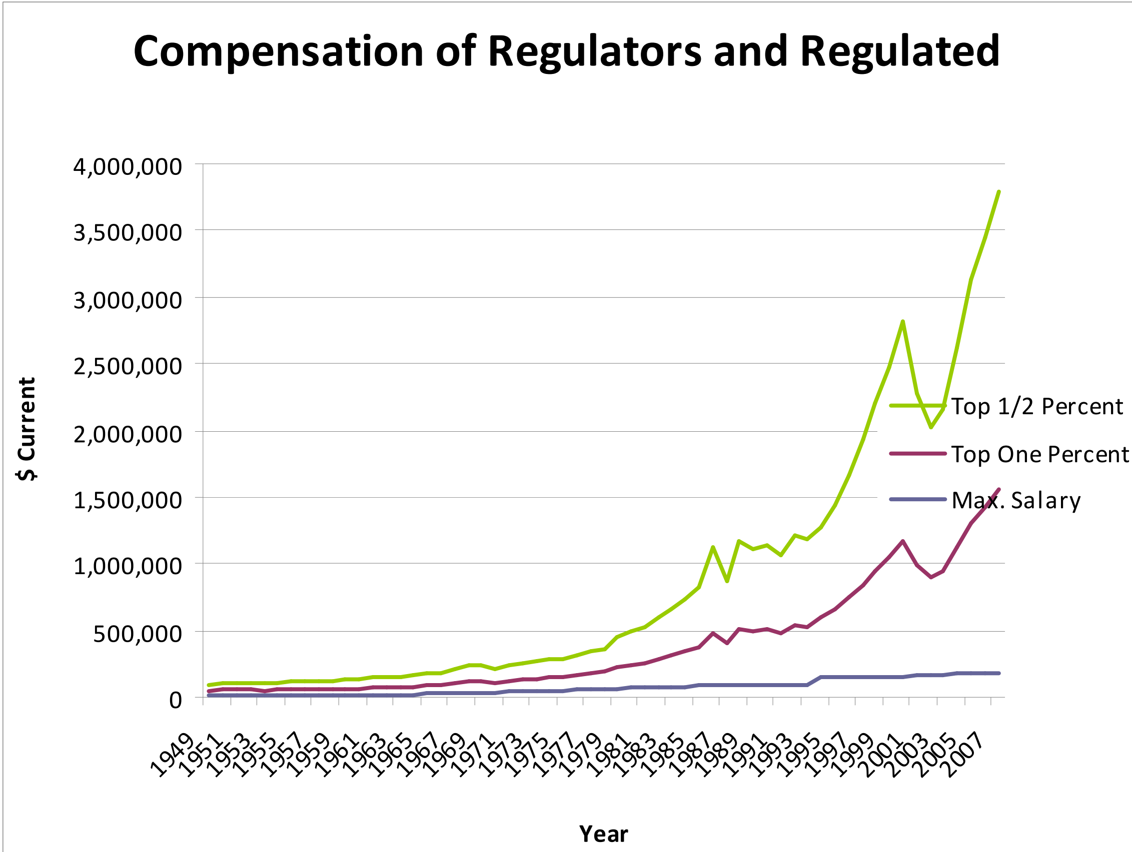


Figure 2

The Opportunity Cost of Doing Good:

Salaries of Regulators Compared with Incomes of the Regulated Over Time



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Notes

We are very grateful to Jie Chen and Marcello de Cecco for assistance and comments.

Unless otherwise indicated, references to newspapers and magazines are cited according to the dates specified in the electronic versions of their text on their websites; note that those are often published there in the evening before the hard copy comes out.

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[1] Cartoonists in the July Monarchy normally depicted King Louis Philippe as a pear. The portrayal of the King here adapts that convention to the myth. Eventually, state censorship shut down publication of such drawings and caricature evolved away from politics. In French, a "tonneau"is a cask or a barrel, not a jar, but we stick with customary usage in English classical studies.

[2] Marina Halac and Sergio Schmukler, "Distributional Effects of Crises: The Financial Channel," (Washington, D.C.: World Bank, 2004) for the distributional effects.. See also Carmen M Rinehart and Kenneth Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* (Princeton: Princeton University Press, 2009).

[3] The literature is too enormous to inventory here. Besides Rinehart and Rogoff, *This*, see, e.g., Enrica Detragiache and Giang Ho, "Responding to Banking Crisis: Lessons from Cross-Country Evidence," in Working Paper (Washington, D.C.: International Monetary Fund, 2010); Stijn Claessens, Daniela Klinggebiel, and Luc Laeven, "Resolving Systemtic Financial Crisis: Policies and Institutions," in *World Bank Policy Research Paper* (Washington, D.C.: World Bank, 2004); Luc Laeven and Fabian Valencia, "Systemic Banking Crises: A New Database," (Washington, D.C.: International Monetary Fund, 2008) and the works they cite.

[4] The concentration on "relatively large" countries is a short hand for "relatively autonomous," in the sense that outcomes are less likely to be driven extensively by outside political forces. See below.

[5] Early waves of bank failures in the United States in the Great Depression involved smaller institutions; by the time Roosevelt came on the scene, banks of every size were threatened.

[6] We arrived at our list of countries by taking every country on the World Bank's list of richest countries per capita for 2008 and then excluding the classes of countries listed in the text. We doubt most of these exclusions are controversial, but one may be: Ireland. We think our conclusions would be unaffected by including it, but the point would take us far afield.

[7] Such shotgun marriages happened in many of the cases we discuss. German economic history, for example, instances several such cases, while everyone has heard of Bank of America and Merrill Lynch in the current crisis.

[8] Three cases – Japan, Norway, and Sweden – occur twice. Worries about whether they thus qualify as independent cases are perfectly reasonable, but in an effort of this size, there is no point in trying a more complex panel design.

[9] Joseph Stiglitz, *Free Fall* (New York: Norton, 2010).

[10] Regimes can of course destroy recoveries through bad policy. But this "property rights" specter is simply a ghost. Roosevelt's New Deal was widely viewed as threatening by many business groups. Recovery nonetheless proceeded, as long as the administration held to an expansionary course. We also note that "socialization" as a term of opprobrium applies only to efforts to retain gains for the public; socialization of losses triggers few protests within finance itself.

[11] The European Commission at least makes a show of examining the anti-competitive impact of financial mergers; the U.S. Treasury does not even make a gesture. Indeed, it turned out that Treasury was encouraging larger American banks to snap up their smaller competitors. See Thomas Ferguson and Robert Johnson, "Too Big to Bail: The "Paulson Put," Presidential Politics, and the Global Financial Meltdown Part II: Fatal Reversal– Single Payer and Back," *International Journal of Political Economy* 38, No. 2 (2009).

[12] David Cho, "Banks "Too Big to Fail" Have Grown Even Bigger," *Washington Post*, August 28, 2009.

[13] In the U.S. case, at least, they are likely to be unheralded, since they will "appear" as reduced contributions from Fed portfolio earnings to the Treasury.

[14] IMF Fiscal Affairs Department, "The State of Public Finance: Cross Country Fiscal Monitor: November 2009," (Washington, D.C.: International Monetary Fund, 2009) and earlier studies cited there.
[15] Eugene Fama, "Government Equity Capital for Financial Firms," *Fama/French Forum*, no. January 5, 2009 (2009), Pietro Veronesi and Luigi Zingales, "Paulson's Gift," (2009), http://faculty.chicagobooth.edu/brian.barry/igm/P_gift.pdf.
[16] Thomas Ferguson and Robert Johnson, "Another God That Failed: Free Market Fundamentalism and the Lehman Bankruptcy," *The Economists' Voice* 7, No. 1 (2010).
[17] Ferguson and Johnson, "Too Big to Bail: The 'Paulson Put,' Presidential Politics, and the Global Financial Meltdown, Part I: From Shadow Banking System to Shadow Bailout," *International Journal of Political Economy* 38, No. 1 (2009) and Ferguson and Johnson, "'Paulson Put,' Part II."
[18] The less than constructive role of the Federal Reserve in all this should not have come as a surprise, though it plainly did. We would tax the vast literature on central banks and previous crises severely for ignoring the problem of regulatory capture. Almost a quarter of a century ago, Epstein and Ferguson analyzed the Federal Reserve's conduct in the early thirties in detail; cf. Gerald Epstein and Thomas Ferguson, "Monetary Policy, Loan Liquidation, and Industrial Conflict: The Federal Reserve and the Open Market Operations of 1932," *Journal of Economic History* 44, no. Dec. (1984), ———, "Answers to Stock Questions: Fed Targets, Stock Prices, and the Gold Standard in the Great Depression," *Journal of Economic History* 51, No. 1 (1991). But most subsequent work on the Fed tip toed around this question, until the issue (and that earlier paper's account) resurfaced dramatically only days before the U.S. government was forced to take over Fannie Mae and Freddie Mac. See Willem Buiter, "Central Banks and Financial Crises," in *Federal Reserve Bank of Kansas City Symposium on "Maintaining Stability in A Changing Financial System"* (Jackson Hole, Wyoming: 2008), p. 102 and the discussion in Ferguson and Johnson, "'Paulson Put,' Part II, " p. 23.
[19] The Japanese crisis ran for years and through several cycles of official mistakes. The literature on it, like all the other cases we discuss, is huge. But see Takeo Hoshi and Anil Kashyap, "Will the U.S. Bank Recapitalization Succeed? Eight Lessons from Japan," (Cambridge: National Bureau of Economic Research, 2008). Working Paper 14401 and Richard Koo, *The Holy Grail of Macroeconomics: Lessons from Japan's Great Recession*, Revised ed. (Singapore: Wiley 2009). A fine study of the politics is Masami Imai, "Political Influence and Declarations of Bank Insolvency in Japan," (Middletown: Wesleyan University 2008).
[20] It is perhaps unwise to run the two cases tightly together; in Norway, the Swedish bailout was criticized for concession to Neoliberalism. But we lack space for discussions of individual cases, nor of the large literatures they generated.
[21] This is not the usual story, which begins with the bankruptcy of the Austrian Creditanstalt. But see the detailed discussion in Thomas Ferguson and Peter Temin, "Made in Germany: The Germany Currency Crisis of July 1931," in *Research in Economic History 21*, ed. Alexander J. Field (Oxford: Elsevier Science, 2003). And Ferguson and Temin, "Comment on 'the German Twin Crises of 1931," *Journal of Economic History* 64, no. 3 (2004).
[22] Ferguson and Johnson, "'Paulson Put,' Part II."
[23] Sarah Lynch, "FASB Pledges Mark to Market Guidance Soon," *Wall Street Journal*, March 12, 2009.
[24] Stiglitz, *Free*. The politics were somewhat less readily ascertained: Hedge funds and other entities that were not commercial banks would have shared in the booty.
[25] Cf. Info Swiss, "Bonus Policies Create Tension in UBS Ranks," Swiss Broadcasting Company, *Swiss Info.ch*, March 5, 2010. "The Swiss Financial Market Supervisory Authority (Finma), that regulates the industry, had forced UBS to slash bonuses by some 80 per cent in 2008. But the body has had no legal authority to directly intervene in the bank's bonus policy since UBS paid back emergency government funds last summer." It is interesting that Switzerland and the U.S. usually stand near the very bottom in voter turnout among advanced economies.
[26] Earlier we noted the separate waves of intervention by the Japanese government. Toward the end, the government got tougher; but we are not impressed when governments wait so long they finally have to take some banks over. The main thrust of Japanese policy seems very clear.
[27] Two giant government corporations, Fannie Mae and Freddie Mac, were of course taken into "conservation," i.e., effectively nationalized, while the government also took over many small banks and AIG. See Ferguson and Johnson, "'Paulson Put,' Part II." Policy toward the majority of big private institutions is our touchstone, however. See below for more discussion.

[28] We do not count "Green" parties in these categories, except in France, where the tiny number of deputies makes inclusion moot. Some previous studies have suggested that "presidential" systems behave differently from parliamentary systems. We included this among other variables we examined and rejected, though the small sample is hardly a fair test of the broader hypothesis.
[29] For the 2008 cases, we averaged turnout in elections since 1997. Systems differ in the regularity of elections; we tried always to reckon over roughly a decade.
[30] One outliner, Italy, is interesting. It perhaps should be removed from the diagram altogether, since the government has intervened only slightly, according to the statistics in International Monetary Fund, Fiscal Affairs Department, "State of Public Finances Cross-Country Fiscal Monitor – November 2009," Annex Table 4, p. 39. What brings it close to the U.S. and other countries in the lower left corner is the absence of deputies from labor or socialist parties in parliament. That, however, is most unusual for Italy. Since World War II, the Italian left has usually had a strong position within parliament. In 2005, however, election laws changed. In the midst of dramatic political changes, The Left – The Rainbow ticket was shut out of parliament in April 2008.
[31] This point has an interesting implication: A fair number of Neoclassical critics of bailouts have promoted various ideas about "saving capitalism from itself" via policies that are protective of markets. Our result suggests this effort is fatally paradoxical: In practice, party systems without social democratic parties turn into systems of business lobbies and will not protect markets when it counts. See below on the investment theory of political parties.
[32] Walter Dean Burnham, *Critical Elections and the Mainsprings of American Politics* (New York: Norton, 1970), ———, "The Appearance and Disappearance of the American Voter," in *The Political Economy*, ed. Thomas Ferguson and Joel Rogers (Armonk, New York: M.E. Sharpe, 1984), ———, *Voting in American Elections: The Shaping of the American Political Universe since 1788* (Palo Alto: Academica Press, 2010). See also Peter Lindert, *Growing Public: Social Spending and Economic Growth since the Eighteenth Century* (Cambridge: Cambridge University Press, 2004) and Stanley Engerman and Raymond Sokoloff, "The Evolution of Suffrage Institutions in the New World," *Journal of Economic History* 45 (2005).
[33] Much of the complexity probably arises from the "manipulative" function of political rhetoric; cf. the discussion in George Soros, *The Soros Lectures at the Central European University* (New York: PublicAffairs Press, 2010), Lecture 3.
[34] Burnham, *Critical*, Thomas Ferguson and Jie Chen, "Investor Blocs and Party Realignments in American History," *Journal of the Historical Society* 5, No. 4 (2005).
[35] We would emphasize our qualification about "once upon a time." The European socialist parties have evolved substantially. In truth, many are beginning to look recognizably like the U.S. Democratic Party case discussed below. See for example, Richard Katz and Peter Mair, "Changing Models of Party Organization and Party Democracy: The Emergence of the Cartel Party," *Party Politics* 1, no. 1 (1995). Or David Osler, *Labor Party Plc* (London: Mainstream Press, 2002).
[36] Stiglitz, *Free*. Simon Johnson's contributions appear frequently in the blog The *Baseline Scenario*.
[37] The U.S. example has echoed weakly among international banks in other countries. As mentioned above, for example, Switzerland, have also allowed UBS to exit from its bailout arrangements before pay restraints bit hard. Others have witnessed some large payouts, but the scale and systematic way in which U.S. banks have proceeded is unique.
[38] Thomas Ferguson and Jie Chen, "1, 2, 3, Many Tea Parties? A Closer Look at the 2010 Massachusetts Senate Race," Working Paper (New York: Roosevelt Institute, 2010), available on line through the website of the Roosevelt Institute, New Deal 2.0: http://www.newdeal20.org/
[39] For derivatives, see, e.g., Financial Services, *Testimony of Robert A. Johnson before the U.S. House of Representatives Committe on Financial Services Hearing on Reform of the over-the-Counter Derivative Market: Limiting Risk and Ensuring Fairness*, October 7, 2010 and Stevenson Jacobs, "Financial Reform Efforts Pit Us against Europe," *Associated Press*, March 15, 2010. On financial compensation, see AP, "Geithner: World Leaders Agree to Limit Bonuses for Bankers," *FoxNews.com*, September 24, 2009.
[40] Thomas Ferguson, *Golden Rule: The Investment Theory of Party Competition and the Logic of Money-Driven Political Systems* (Chicago: University of Chicago Press, 1995). See also Soros*, Soros Lectures*, Lecture 4.
[41] Ferguson, "Financial Regulation? Don't Get Your Hopes Up," *TPM Café Book Club,* April 17, 2008; TPM*http://tpmcafe.talkingpointsmemo.com/2008/04/17/financial_regulation_dont_get/*

[42] Michael Moore and Jamie McGee, "Wall Street Firms Will Revert to Pre-Crisis Model, Cohen Says," *Bloomberg*, May 5, 2009.
[43] Ferguson, *Golden Rule*.
[44] This seems plain from the macroeconomic policies pursued in Europe. See, e.g., Jean-Gabriel Bliek and Alain Parguez, *Le Plein Emploi ou le Chaos* (Paris: Economica, 2006).
[45] Ferguson and Johnson, "'Paulson Put' Part I.", ———, "'Paulson Put,' Part II."
[46] Karsten Ronit and Volker Schneider, "The Strange Case of Regulating Lobbying in Germany," *Parliamentary Affairs* 51, no. 4 (1998), is instructive on some differences, even if one is led to conclude that the differences across systems are shrinking fast. Cf. also Hans Herbert von Arnim, *Die Partei, Der Abgeordnete Und Das Geld: Parteifinanzierung in Deutschland* (Munich: Knaur, 1996).
[47] Robert Kaiser, *So Damn Much Money: The Triumph of Lobbying and the Corrosion of American Government* (New York: Vintage, 2010).
[48] Alan J. Ziobrowski et al., "Abnormal Returns from the Common Stock Investments of the United States Senate," *Journal of Financial and Quantitative Analysis* 39 (2004), ———, "Committee Assignments and the Abnormal Returns Earned by U.S. Senators on Common Stock Investments," (2008).
[49] Thomas Piketty and Emmanuel Saez, "Income Inequality in the United States 1913-1998," *Quarterly Journal of Economics* 118, no. 1 (1998).
[50] The data come from the extended data sets on the websites of Thomas Piketty and Emanuel Saez for Piketty and Saez, "Income." We are grateful for a rapid response to a query on their data we received from Professor Saez. The salary schedules for the SES do not reflect any special payments for geographic location or other special purposes. Neither do they reflect bonuses which are sometimes awarded. These are all modest and would not touch our point. Note that the graph compares a top salary with total incomes and that a fair number of people not on Wall Street are included in the income levels we depict. But that is irrelevant: the graph accurately represents what upper tier members of Wall Street have earned, which is what is relevant to our point. A Wall Street "average wage" is not at issue.
[51] Thomas Ferguson, "From 'Normalcy' to New Deal: Industrial Structure, Party Competition and American Public Policy in the Great Depression," in *Golden Rule: The Investment Theory of Party Competition and the Logic of Money-Driven Political Systems*, ed. Thomas Ferguson (Chicago: University of Chicago Press, 1995).
[52] Karl Erich Born, *Die Deutsche Bankenkrise 1931 Finanzen Und Politik* (Munich: R. Piper, 1967), Ursula Buettner, *Weimar: Die Űberforderte Republik* (Stuttgart: Klett Cotta, 2008).
[53] Ernesto Rossi, "Nationalization in Italy," in *Nationalization in France and Italy*, ed. Mario Einaudi, Maurice Bye, and Ernesto Rossi (Ithaca: Cornell University Press, 1955) and Marcello de Cecco, private communication.
[54] We are grateful to Marcello de Cecco for invaluable advice on the Italian case.
[55] For Roosevelt and Mussolini, see the discussion and references above. Since the mid-1980s, the trend in both Germany and the United States has been to deny that Hitler had significant business support. But see Thomas Ferguson and Joachim Voth, "Betting on Hitler -- the Value of Political Connections in Nazi Germany," *Quarterly Journal of Economics* 123 (2008).
[56] Koo, *Grail*.
[57] Ferguson, "Normalcy."
[58] Robert Collins, *Business Response to Keynes* (New York: Columbia University Press, 1981).
[59] The question of Nazi economic policy is complicated and the literature is large. But for MEFO, see, e.g., Raymond L. Cohn, "Fiscal Policy in Germany During the Great Depression," *Explorations in Entrepreneurial History* 29, no. 3 (1992). In Italy, economic revival appears to have begun with the Abyssinian War.