

TW Notes on  
Nolan McCarty, Keith Poole, and Howard  
Rosenthal Political Bubble  
Princeton 2013

They argue that it wasn't just Wall Street ~~expansion~~ capture of Washington that caused the crisis.

They "stress the Three I's: ideology, institutions, and interests" p 7

There were "not only pressures from organizational interests but also personal beliefs about the proper role of government in regulating the financial sector... these ideological beliefs are rigid and are largely unresponsive to new information" p 7

"The fragmented and supermajoritarian structure of U.S. political institutions make it difficult for policy makers to keep up with financial innovation and to reform the financial sector in the past" p 8

They point to 'three pillars of the financial crisis' the increase in subprime mortgages, their securitization, and CDS.

"These three pillars, along with the easy money policies of the Federal Reserve

and the huge influx of foreign capital promoted a housing market bubble" p9

The same types of policy failures occurred in the Great Depression and the S+L crisis

"... behind every financial bubble there is a corresponding political bubble" [p 13] defined as "a set of policy biases that foster and amplify the market behavior that generate financial crisis" p 14

"... beyond the beliefs that underpin a particular bubble, basic ideological beliefs about the nature of government and the role of government also fuel bubbles" p 15

They use the terms "free market conservatism" and "fundamentalist free market capitalism"

They cite the OED's definition of ideology as a "systematic scheme of ideas ... especially one that is ... maintained regardless of the course of events" p 15

They cite Kindleberger and Aliber  
 "the supply of corruption increases in  
 a procyclical way much like the  
 supply of credit" p19

They blame "redistributive  
 egalitarianism" from the left as  
 well as market fundamentalism  
 from the right

They note that economists don't  
 agree among themselves and note  
 that Stiglitz wrote in a ~~ref~~ position  
 paper in 2001 that there was only a  
 1 in 500,000 chance that Fannie Mae would  
 They cite Willem Buiter for first <sup>90</sup> ~~best~~  
 using the term "regulatory capture"  
 'cognitive capture'

They define ideology as "a set of  
 basic beliefs about how the world  
 works and what is right and wrong" p 38

They distinguish between  
 "ideology and expectations primarily  
 in terms of the rigidity of the beliefs" p 38

They work with a behavioral  
 definition of ideology that stresses  
 consistency and give a discussion

of methods of measurement, they find that the explanatory power of the ideological model to predict Congressional votes has "increased dramatically" over the last 30 years p 50

They have found that one dimension explains a high proportion of voting and that the most important aspect of that left-right dimension is "economic issues and debates about the role and scope of the federal government" p 54

While the ideological positions of particular politicians are "quite stable" over time (with a few prominent exceptions) "the behavior of legislators deviates in large and systematic ways from the preferences of their average or median ~~constituent~~ constituent" p 55

"The primary ideological dimension of American politics is the role of the state in regulating the economy" p 57

The American public have had much less increase in polarization than the politicians

"Ideology is a powerful predictor of legislative action in financial and economic crisis" p 65

Interest groups have three main channels of influence

- mobilizing constituents
- political contributions
- provision of information through lobbying

"Legislators are not likely to feel much cross-pressure from other constituents on matters related to finance" p 79  
except during and after crisis

Information asymmetry and complexity

Members of Congress rely more on lobbyists and interest groups for information than their staffs p 85

The importance of negative agenda control, lack of party discipline and ~~may~~ absence of proportional representation, filibustering, veto ~~power~~ ~~power~~

They calculate deadlock ~~between~~ ~~interest~~

Strategic disagreements, Courts

With gridlock policy making is channeled toward executive and regulatory arenas. They describe the process of reversion of Glass-Steagall before its formal repeal

Low regulatory capacity undermines the informational rationale for delegation and makes it harder to hold agencies accountable  
bureaucratic reform to cope with  
gaps between low capacity and expertise

They note there were bubbles elsewhere but argue "the institutional impediments to financial regulation are relatively more severe in the United States than elsewhere" p 115

[I'm not sure this is true compared with the EU]

The housing markets off-budget subsidy

In the aftermath of the 2008 crisis, ideology, interests, and institutions all moved in the wrong direction

American history suggests common ~~res~~  
government response to paper

1 "Legislative responses" have generally  
been limited and delayed"

2 "The response often awaits a transition  
in political power"

3 Future changes in political power often  
reverse the initial response

4 "Short-term reelection concerns undermine  
the search for longer-term solutions" p154  
all are direct byproducts of the three I's

They suggest "delay appears to be  
inherent in democracy" and "ideology  
is an important impediment to a response" 154

"...The magnitude of these negative  
~~responses~~ consequences are directly  
related to the extent of party ~~polarization~~  
polarization" p154

They give many historical examples

After the 08 crisis the political shift  
in power was "far more important than  
any shift in ideology..." p190

A bare majority of the public supported  
the large fiscal stimulus under Obama  
and a strong majority favored tax  
cuts over spending increases

In July 09 65% opposed a new  
stimulus program

As unemployment failed to fall many independent voters began to accept the Republican narrative that the stimulus had hurt the economy

Bob Hall has estimated that the stimulus reduced the fall in GDP from 10.2 to 8.2%.

They conclude "ideology largely reduced to one dimension... The influence of interest groups on roll call voting ... does not generate a ~~second~~ systematic second dimension" ~~227~~ 227

A puzzle is why public outrage was "very restrained and short lived" 229

In the US anti business populism runs third to cultural and anti-statist versions

distrust of cultural elites

"Americans don't trust their government" 251

The strongest type of populist reaction was not from the left but the Tea Party

Lack of public engagement was due to a combination of skepticism that government could be effective and uncertainty about what should be done



Polls indicate that the public did blame the ~~public~~ financial sector and deregulation. They weren't opposed to government intervention and favored financial reform but worried about ~~capture~~ capture.

The opposition to TARP was driven by vocal minorities from both the left and right.

"political risks grow proportionately (if not exponentially) with the size of financial firms" 20?

Thus financial rules need to not only be simple but also account for political risks.