PARTISANSHIP AND THE PATH TO FINANCIAL OPENNESS

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The effect of traditional left-right economic preferences on countries' international financial openness is more subtle than existing studies have recognized. The authors investigate the role that partisan politics played in the liberalization of international financial markets within 12 Western European democracies from 1960 to 1986. The authors find that right governments tended to be active liberalizers of the capital account. They were more likely than left governments to enact liberalizations, and liberalizations were especially likely when new right governments entered office. Left governments typically acquiesced to these changes. Although less likely to enact liberalizations, they were no more likely to impose new restrictions. The authors' findings are consistent with studies that show how financial integration does not undermine welfare states but is still subject to partisan contention.

Keywords: *partisanship; capital controls; financial liberalization; Western Europe; welfare state*

A**lthough capital-account liberalization** proceeded rapidly in the industrialized world beginning in the 1970s, ultimately resulting in a world of highly integrated financial markets and massive international flows of capital, the dynamics associated with this liberalizing trend are still not entirely understood. One issue that continues to be clouded by considerable uncertainty is the role traditional left-right economic preferences played in capital-account liberalization in the OECD countries—uncertainty that derives in part from the tension that exists between two apparently contradic-

tory findings. First, prior to the general opening of financial markets in the mid-1980s, a state's government ideology is a reasonably good predictor of its financial-market openness; advanced democracies with left-leaning governments consistently had more restrictions on international capital movements than advanced democracies with right-leaning governments (Oatley, 1999; Quinn & Inclán, 1997). Second, however, capital-market openness does not undermine key programs advocated by left-leaning governments; countries can maintain capital-market openness without sacrificing welfare states and redistribution (Garrett, 1998; Kite, 2002; Mosley, 2003). If capital-account openness does not threaten the core programs of left governments, why are they associated with more restrictions on international capital flows than right governments?

Does a partisan effect on capital-controls policy indicate that openness to international capital flows poses more of a threat to welfare states than recent studies have suggested? Our findings suggest that it does not. Rather, we find that the effect of partisanship on capital-controls policies is more subtle than existing studies have recognized. By examining the timing of specific changes in capital-controls policies (rather than static levels, as previous studies have done) in 12 Western European parliamentary democracies from 1960 to 1986, we find considerable evidence that the *intensity* of partisan preferences over capital controls is not symmetric: Capital-account liberalization is high on the agenda of right-leaning governments, but conflicting interests leave left governments ambivalent about capital-controls policy. We find strong evidence that right governments are more likely to enact liberalizations than are left governments and that liberalizations are most likely in the months after a right government replaces a left government in office. We find no evidence, however, that left governments are any more likely than right governments to impose new restrictions on the capital account or that they impose new restrictions after replacing right governments. Because previous studies on partisanship's effects focus on static levels of capital-account openness (e.g., asking whether right governments tend to be associated with more open capital accounts), they do not point to this basic asymmetry—that left governments are less likely to open their capital accounts but no more likely to close them once opened. This asymmetry confirms a partisan effect but is also consistent with findings that international financial integration does not pose a grave threat to social democracy: If it did, we would expect to find left governments more eager to reimpose restrictions on the capital account.

This article proceeds in three sections. First, we briefly review existing literature on the determinants of capital controls and develop our hypotheses

regarding the effects of partisanship. Then, we describe our data and report our findings. We conclude with a discussion of the broader implications.

CAPITAL-CONTROLS POLICIES
AND PARTISAN TRANSITIONS

Several empirical studies have shown a general partisan influence on capital-controls policies, with right-leaning governments more predisposed to capital mobility than left-leaning governments (Oatley, 1999; Quinn & Inclán, 1997). Although capital mobility may not be *primarily* a class issue,[1] simple class interests can at least partly account for the partisan regularity because greater mobility can allow owners of capital to diversify against country-specific risks, which can expose labor to a greater risk of shocks (Rodrik, 1997; Rodrik & van Ypersele, 2001), and mobility may shift the burden of taxation from capital to less-mobile labor (Alesina & Tabellini, 1989).[2]

Nonetheless, the importance of partisanship in determining states' capital-controls policies remains controversial. In part, this is because numerous other variables may swamp or interact with partisan effects.[3] More fundamentally, there are reasons to believe that basic partisan preferences over capital-controls policy are more complicated than right governments prefer-

1. Class is probably only one of several influences. Jeffry Frieden (1991) approaches societal interests from a sectoral rather than a class perspective and hypothesizes that the preferences of capital interests regarding mobility vary according to the type of capital held. Li and Smith (2002) show that left and right parties form preferences over capital mobility in ways that are conditional on the degree to which their constituents that benefit from openness (multinational corporations for right governments and skilled labor for left governments) are politically influential. See also O'Mahony (2003) on partisanship and Lukauskas (2002) on the role of social groups.

2. An additional possibility, subject to debate, is that capital mobility can eliminate a potential mechanism for redistribution by reducing monetary-policy flexibility (Epstein & Schor, 1992), in effect by changing the shape of the inflation-employment trade-off in a way that makes it more costly for left governments to inflate (Clark & Hallerberg, 2000; Walker, 2002). This finding is generally consistent with "rational partisan cycles" arguments (Alesina, Roubini, & Cohen, 1997; Franzese, 2002) as well as with virtually any argument that links partisanship to macroeconomic outcomes (Boix, 2000). Other evidence, however, demonstrates that political parties have largely converged in macroeconomic policy (Clark, 2003; Clark, Golder, & Golder, 2002). Note that even if left governments were not more willing to pursue inflationary policies than right governments, the two motives we identify in the text (exposure to shocks and allocation of taxes) may still operate. Our study can shed light on this debate because for the first time we show differences in how and when governments use the specific policy tool of capital controls, instead of measuring policies indirectly by observing outcomes. For a similar policy-focused contribution that centers on fiscal and monetary policy, see Boix (2000, p. 39).

ring openness and left governments preferring closure, all else being equal. Capital-account liberalization is by no means purely redistributive (whether by class or some other way), because openness to world capital markets is generally beneficial for economic efficiency and growth (Edison, Klein, Ricci, & Sloek, 2002; Eichengreen, 2001; Quinn, 1997; Quinn, Inclán, & Toyoda, 2001; Voth, 2003).

Because capital-account openness is probably conducive to overall economic efficiency, and all governments presumably favor economic growth ceteris paribus, partisan preferences in wealthy countries regarding capital-controls policies are likely to be asymmetric. That is, right governments in wealthy countries would prefer a low level of restrictions on cross-border capital flows because openness benefits both core constituents (capital holders) and overall economic conditions. The interests of left governments in capital-account openness, however, are more mixed. On one hand, left governments also stand to benefit from the efficiency effects of capital-account liberalization, and perhaps more important, they stand to suffer from the efficiency losses (including the loss of investor confidence) that would accompany a rollback of previous liberalizations. On the other hand, labor (a key constituency of most left governments) may be harmed by openness for the reasons described above.

In general, the international integration of economies starting in the 1960s created tension within left parties in advanced economies, as the goal of growth through market openness began to come into conflict with the goal of protection for specific constituencies. The story of how left parties have coped with this tension has become one of the most important—and intensively studied—topics in comparative political economy. As the world economy opened, social democratic parties in Europe began to form larger coalitions that went beyond their traditional roots in organized labor. The success in the 1990s of mass center-left parties in Britain, Germany, and elsewhere that established majority coalitions by identifying themselves as a centrist "third way" (Green-Pedersen & van Kersbergen, 2002; Kitschelt, 2003; Padgett, 2003) was only the most recent manifestation of this phenomenon. Katzenstein (1985) and Kitschelt (1994) show how social democratic parties were already embracing economic openness by the early 1970s at the latest

3. For example, government institutions mediate distributive conflicts, and several recent studies integrate the distributive effects of capital controls with institutional variables (e.g., Henning, 1994; Grilli & Milesi-Ferretti, 1995; Verdier, 1998; Oatley, 1999). Quinn and Inclán (1997) show that partisanship interacts with resource endowments to shape policy. Other studies have emphasized how systemic constraints may interact with partisanship in important ways (see especially Simmons, 2001; see also Andrews, 1994; Elkins & Simmons, 2003; Goodman & Pauly, 1993; Helleiner, 1994; Leblang, 1997; Sobel, 1994, 1998).

(Katzenstein's argument traces openness in corporatist states to adjustments that began as early as the 1950s).

Because key left constituencies can be harmed by capital-account liberalization, we expect that although left governments may have been willing to accept and adapt to financial integration because of the potentially high economic costs of reversing openness, they are not necessarily eager to actively facilitate deeper financial integration either. This partisan asymmetry in preferences—right government support for capital-account openness contrasted with more ambiguous and conflicted left-government preferences—has a number of implications regarding the probability that any one particular government may change capital-account regulations. Specifically, we expect that right governments will tend, all else being equal, to be active liberalizers of capital-controls policy, whereas left governments will be generally ambivalent about liberalization. As such, the underlying probability of a liberalization in the capital account should be higher under a right government than under a left government. But left-government ambivalence also means that neither right nor left governments actively favor the imposition of new capital-controls restrictions; we therefore expect the decision to impose new restrictions to be uncorrelated with partisanship.[4]

> *Hypothesis 1:* All else being equal, capital-controls liberalizations are more likely when right governments are in power than when left governments are in power.

> *Hypothesis 2:* All else being equal, capital-controls restrictions are not more likely when left governments are in power than when right governments are in power.

Hypotheses 1 and 2 do not say anything about the *timing* of specific capital-controls policy changes. However, the asymmetry in partisan preferences regarding capital-account openness has clear implications regarding a partisan cycle to capital-controls policy changes.

Partisan transitions, when control of the government changes from one party to another, are ideal times to observe differences in partisan preferences. Suppose that parties have distinct policy preferences and that, when in power, they seek to implement their preferred policies. Any policy that is enacted becomes the new status quo. The likelihood that a governing party will enact policy changes therefore depends upon the difference between the status quo policy and the party's ideally preferred policy. When a new government takes office and when this new government has the same partisan

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4. Governments of any kind may be expected to enact restrictions from time to time, for example, to stem speculative attacks on a country's currency (Eichengreen, 2001; Eichengreen & Leblang, 2003). We control for these other motives in our data analysis.

identity as the previous government (e.g., when both the old and new governments are made up of left parties), the new government will be no more motivated to change the policy than the old government was. A new government is most likely to make changes, conversely, when it and the old government differ in their preferences.

Consider policy liberalizations. If left governments were less inclined than right governments to favor open capital markets, then the overall level of capital-account openness following a period of governance by left-leaning parties is likely to be lower than a right government would ideally prefer, holding all else constant. Because new right governments are likely to place liberalization of the capital account relatively high on their agendas (they have no mixed motives, unlike left governments), we expect to find that capital-account liberalization is especially likely shortly after a new right government enters office following a period of left governance. This is an effect that goes beyond the increase we predict with Hypothesis 1, as right governments seek to quickly change the relatively restrictive status quos they inherit.

> *Hypothesis 3:* Capital-controls liberalizations are especially likely shortly after right governments enter office following periods of left governance.

On the other hand, we expect no increase in the probability of new capital-controls restrictions being imposed shortly after a left government enters office following a period of right governance, due to the conflicting pressures to which left governments are subject. Even left governments that favor less openness than they inherit are likely to put policy changes relatively low on their agendas.

> *Hypothesis 4:* New capital-controls policy restrictions are not especially likely shortly after left governments enter office following periods of right governance.

DATA AND RESULTS

To test our hypotheses, we examine liberalizing and restricting policy changes in 12 Western European parliamentary democracies from 1960 to

5. The sample countries are Austria, Belgium, Denmark, Finland, France, Germany, Iceland, Italy, the Netherlands, Norway, Sweden, and the United Kingdom. According to Müller and Strøm (2000), there were 14 Western European countries that can uncontroversially be classified as parliamentary democracies over the entire time from 1960 to 1986: the 12 considered here plus Luxemburg and Ireland. We do not include Luxemburg in our analyses, because the International

1986.[5] Limiting the analysis to a set of countries from the same region that share a common set of political institutions helps to control for potential competing explanations of policy change. Economic data used for our control variables are relatively sparse before 1960; the year also marks a natural starting point for the analysis because the states did not establish full currency convertibility until 1959. The year 1986 is a natural point at which to end the analysis because that is the year the Single European Act was signed, mandating eventual capital-account liberalization among its signatories. The salience of domestic factors for capital-controls policy changes likely declined after that date (Simmons, 2001); nonetheless, extending the analysis into the 1990s does not change our results, as we describe below.

Hypotheses 3 and 4 require an examination of the *timing* of capital-controls policy changes. Unfortunately, existing data on capital-controls policy are inadequate for such tests.[6] Yearly (or larger) aggregates of policy do not precisely specify the timing of policy changes, and it is often impossible to show whether a government made policy changes early or late in its term. In general, aggregating discrete event data over inappropriately large time units can lead to incorrect inference (Shellman, 2004).

We therefore use a dependent variable from a new data set (Kastner & Rector, 2003) that assigns a date to each capital-controls policy change within each country and notes whether the change was a liberalization or a restriction.[7] The data are based on written descriptions of policy changes in the International Monetary Fund's annual publication *Annual Report on Exchange Arrangements and Exchange Restrictions*, a yearly summary of each member state's financial regulations. The advantage of using these data is that policy changes can be attributed to particular governments, at particular points in their terms, with great precision.

We examine two separate dependent variables using logit analysis: whether a capital-controls policy liberalization occurred at Time T in Country J and whether a capital-controls policy restriction occurred at Time T in Country J. The Time T is a 2-week interval; we use this short period to reduce the likelihood that policy changes will be attributed to the wrong government and to allow us to examine policy changes shortly after a new government

Monetary Fund (IMF) merges Luxemburg with Belgium in its reports on capital-controls policy changes. We did not include Ireland because of incomplete macroeconomic data.

6. There are a number of existing measures of states' capital-controls policies. The most extensive direct measure is probably Quinn and Inclán's (1997), which uses a 14-point scale of total financial openness (Quinn, 1997, describes the data). The IMF also provides dummy variables indicating whether states had capital controls in a given year in its annual report on exchange restrictions. Eichengreen (2001) reviews measurement issues.

7. The raw data and a replication file for this article are available at http://home.gwu.edu/~rector/.

comes into office. Data on the precise dates of government changes come from Müller and Strøm (2000).[8]

CAPITAL-CONTROLS POLICY LIBERALIZATIONS

Our first model examines the correlates of capital-controls policy *liberalizations*; we use this model to test Hypotheses 1 and 3. Here, the dependent variable is coded 1 if a policy liberalization occurred at Time T in Country J and coded 0 otherwise. We control for temporal dependence in the data with a variable equal to the number of time periods since the previous liberalization in Country J, which we call *previous liberalization* (Beck, Katz, & Tucker, 1998).

Economic control variables include the change in the domestic inflation rate (which we call *change inflation*), the change in reserves (*change reserves*), and the change in the discount rate (*change discount rate*) because economic turbulence can make reforms less likely. We also include the absolute value of the percentage change in the exchange rate (*change exrate*) because exchange-rate volatility may lead states to enact policy changes in the capital account. These economic variables are monthly observations; as such, the economic controls always remain unchanged for the two time periods within any month in Country J (International Monetary Fund, 2002). We also include a dummy variable equal to 0 if the exchange rate is fixed and equal to 1 if otherwise (*fixed exchange rate*).[9]

The likelihood of states enacting liberalizations in the capital account may also be partly contingent on existing levels of controls—states that have already removed most of their controls may be less likely to liberalize, all else being equal. We therefore include Quinn and Inclán's (1997) 4-point scale of capital-account openness for the year in question (*existing controls*). Although yearly data are not a perfect fit, all existing measures of overall levels of capital-account openness are yearly (or longer) aggregates, so their index is the best measure available to control for existing levels of restrictions at any given time.

States' capital-controls policies should likewise be partly contingent on the behavior of other states in the international system, so a liberalization may be more likely when other industrialized countries are also liberalizing.

8. Government data (such as partisanship) are coded missing during transition periods between governments.

9. The relationship between capital-controls and exchange-rate regimes is almost certainly more complex than we are capturing here (Walker, 2002). However, because our research design examines particular changes in capital-controls policies, we in effect hold exchange-rate policy changes constant.

We use a control equal to the total number of liberalizations within 19 OECD parliamentary democracies during the year in question (*systemic liberalizations*). This variable also acts as a control for other, unobserved systemic factors that may cause states to liberalize. Our expectation is that more liberalizations in the system generally will be related to a higher likelihood of a liberalization in any particular country.

Finally, we control for the number of veto-player parties in government (Kastner & Rector, 2003; Woldendorp, Keman, & Budge, 1993) because more veto players should make it more difficult for a government to agree on policy change, ceteris paribus.[10]

Hypothesis 1 predicts that policy liberalizations should be more likely under right governments than under left governments. Hypothesis 3 predicts that liberalizing policy changes should be more likely to occur when a change of partisanship occurs away from a leftist government; this effect should be most evident shortly after a new, more-conservative government assumes office. We thus include four additional variables that allow us to test these hypotheses.

To measure partisan preferences, we use a left-right ideological scale (Woldendorp et al., 1993), which we convert into a dummy variable (to avoid scaling problems) equal to 1 if the government is center, center-right, or right and equal to 0 if the government is left or center-left.[11] We call this variable *center/right government*.

To capture partisanship change in a rightward direction, we include a dummy variable equal to 1 if both the present government is center, center-

10. The number of veto-player parties is the number of parties that can stop a policy from being implemented. We code this variable to equal 1 in single-party majority governments, the number of government parties in minimal winning coalition governments, the minimum number of parties required to obtain a majority in surplus majority coalition governments, and the number of government parties plus the minimum number of parties outside the government necessary to obtain a majority within minority governments (Kastner & Rector, 2003). On veto players, see Tsebelis (1999).

11. In our empirical tests, we place center governments in the same category as right or center-right governments because center governments' preferences over capital controls are much more likely to mirror right-government preferences than left-government preferences. Like all governments, center governments stand to gain from the broader economic benefits of liberalization. If center governments seek to court support from both capital and labor, then liberalizations offer the prospect of immediate political payoff from capital interests, whereas restrictions in and of themselves offer no such payoff from labor (they only make other, prolabor policies more feasible). We thus expect that a shift to a center government following a period of left governance should lead to a spike in the probability of a capital-controls liberalization. Below, we also report sensitivity tests that show our results to be robust to removing center governments from the center/right government variable.

right, or right and the previous government was left or center-left, *and* equal to 0 if otherwise; we call this variable *government shift right*. Next, we include a dummy variable that equals 1 if the observation occurs within 4 months of the start of a new government and 0 if otherwise; we call this variable *4 months*.[12] Finally, we include a variable that interacts *4 months* with *government shift right*.

We expect to find *center/right government* and *government shift right* to be positively correlated with the probability of liberalization in a given time period. Furthermore, we expect that governments are more likely to liberalize early in their terms, so *4 months* should also be positively correlated with the dependent variable. But we especially expect to find the interactive variable to be positively correlated with liberalizing changes; moreover, the inclusion of the interactive term is likely to eliminate any independent effect of a change in partisanship or the *4 months* variable. That is, the bulk of the effect of a change in partisanship should be seen shortly after the new government comes into office; conversely, the "newness" of a government should be correlated only with policy liberalizations in cases where there has been a shift to a government that prefers liberal policies from a government that did not.

We report two versions of the liberalization model in Table 1: The first (Model 1A) includes all variables except the interactive term, and the second (Model 1B) also includes the interactive variable. In Model 1A, the variable *center/right government* is significant in the expected direction, suggesting that center and right governments are more likely to liberalize than other governments. The variables *4 months* and *government shift right* are not independently correlated with the dependent variable, and as expected, a greater number of veto players is correlated with a smaller likelihood of policy change. *Previous liberalization* is negatively correlated with the probability of a new liberalization, suggesting, as expected, that change becomes less likely the longer it has been since the previous change. *Systemic liberalizations* is strongly correlated with the dependent variable, though *existing controls* is not. Of the other economic control variables, only changes in the exchange rate are correlated with liberalizing policy changes.

Model 1B includes the interactive variable. Here, the interactive variable exerts a large and significant effect on the probability of a liberalizing policy change. This suggests that a shift away from a left or center-left government has a strong effect on the likelihood of liberalization within the first 4 months of the new government but little effect thereafter (apart from the independent

12. The period of 4 months is chosen arbitrarily. Below we report sensitivity analyses that show the results are robust with 3 months or 5 months as the cut-off point.

Table 1
Logistic Analysis: Liberalizing Capital-Controls Policy Changes

Independent Variable	Model 1A (z)		Model 1B (z)	
Control variables				
Previous liberalization	–0.229**	(–3.88)	–0.229**	(–3.89)
Change inflation	–0.086	(–1.03)	–0.100	(–1.20)
Change exrate	5.898*	(1.81)	5.838*	(1.79)
Change reserves	–0.218	(–0.25)	–0.176	(–0.20)
Change discount rate	–0.066	(–0.47)	–0.079	(–0.56)
Veto players	–0.293**	(–4.10)	–0.302**	(–4.21)
Systemic liberalizations	0.025**	(6.64)	0.025**	(6.77)
Fixed exchange rate	0.060	(.33)	0.109	(0.60)
Existing controls	0.077	(.95)	0.061	(0.75)
Center/right government	0.416**	(2.91)	0.435**	(3.04)
Government shift right	0.031	(0.16)	–.278	(–1.23)
4 months	0.063	(0.43)	–0.103	(–0.65)
Government Shift Right × 4 Months			1.314**	(3.28)
Constant	–3.403**	(–11.08)	–3.344**	(–10.91)
N	6,130		6,130	
Pseudo-R^2	0.043		0.047	

Note: z-stats in parentheses.
* Significantly different from 0 with at least 95% confidence in a one-tailed test.
** Significantly different from 0 with at least 99% confidence in a one-tailed test.

effect of partisanship itself, because center, center-right, and right govern-ments continue to be more likely to liberalize, all else being equal). For a sub-stantive interpretation of Model 1B's results, consider Table 2. The table reports predicted probabilities that a liberalizing policy change will occur under three different circumstances (King, Tomz, & Wittenberg, 2000). Set-ting all control variables at their means, *fixed exchange rate* equal to 1 and *veto players* equal to 1, the probability of a liberalization occurring within any 2-week period under a left or center-left government that is not in its first 4 months is .055. When a new center or right-of-center government enters office, however, this probability jumps to .196; the difference between the two probabilities is significant at 99%. So, within the first 4 months of enter-ing office, new center or right-of-center governments are *much* more likely to enact capital-controls policy liberalizations than the preceding left or center-left governments. This result is shown in the top half of Table 2.

The bottom half of Table 2 reports the independent effect of partisanship on the probability of policy liberalization. Here, the probability of a capital-

Table 2
Predicted Probabilities Based on Model 1B

	Probability of Liberalization	*SE*
Left/center-left government[a]	.055	.011
Difference	+.140*	.053
New center/right government[b]	.196	.056
Left/center-left government[c]	.056	.011
Difference	+.028*	.010
Continuing center/right government[d]	.084	.015

Note: All control variables set to their means; *veto players* and *fixed exchange rate* set to 1.
a. Center/right government = 0; 4 months = 0.
b. Center/right government = 1; 4 months = 1; government shift right = 1.
c. Center/right government = 0; 4 months = 0.
d. Center/right government = 1; 4 months = 0; government shift right = 0.
* Significantly different from 0 with at least 95% confidence in a one-tailed test.

controls policy liberalization within any 2-week period under a left or center-left government (not in its first 4 months) is compared with the probability under a continuing center or right-of-center government that is not in its first 4 months. The independent effect of partisanship is significant but substantively small: The probability of change under the center or right-of-center government is .084, only .028 greater than the probability under the left-of-center government.

In sum, the effect of partisanship on the probability of capital-controls policy liberalizations is most felt shortly after a new center or right-of-center government enters into office; center or right-of-center governments that are not new in office are only slightly more likely to enact capital-controls policy liberalizations than their left-of-center counterparts.

SENSITIVITY ANALYSIS

To determine how sensitive our results are to the particular model used, we ran a number of different versions of Model 1B. We found our results to be highly robust to changes in the sample, changes in the control variables, and changes in specification regarding the variables of interest and the addition of country fixed-effects. Table 3 summarizes how each change described below affected the coefficient and the significance of the interactive variable of interest (*4 Months × Government Shift Right*).

First, recall that we chose the end year of our sample to be 1986, which we believe a logical end date because of the signing of the Single European Act in that year. However, we also found that our results do not change substan-

Table 3
Sensitivity Analysis: Variations on Model 1B

Change in Specification From Original Model 1B	Coefficient	z
1. Sample extends into mid-1990s.	1.26**	3.44
2. Systemic changes control is twice monthly instead of yearly.	1.20**	3.01
3. Center parties are not included with right-of-center parties; government shift right occurs only when a left-of-center government is replaced by a right-of-center government.	1.09**	2.66
4. Partisanship is made continuous. Government shift right is also made continuous, ranging from –4 (*major shift left*) to 4 (*major shift right*). This continuous variable is now interacted with 4 months.	0.209**	2.42
5. The period defining a new government is changed from 4 months to 5 months after entering office.	1.34**	3.41
6. The period defining a new government is reduced from 4 months to 3 months after entering office.	1.00*	2.04
7. Country dummy variables are added.	1.20**	2.95

Note: This table reports the coefficient and the standard error on the interactive variable for a number of different specifications of Model 1B. For each specification, the sample and variables used are identical to those of the original except for the change indicated.
* Significant at greater than 95% confidence in a one-tailed test.
** Significant at greater than 99% confidence in a one-tailed test.

tially if we extend our sample into the mid-1990s (to include the last government to leave office before 1997 in each country). The coefficient on the interactive term drops slightly to 1.26 but remains highly significant (see row 1 of Table 3). The independent effects of center or right-of-center governments continue to be significant as well. Similarly, we found the results to be robust to an alternative operationalization of systemic liberalization: If we include a variable equal to the number of changes in other Western European countries within the half-month period captured in each observation, the coefficient on the interactive term is 1.20 and remains highly significant (see row 2 of Table 3). The independent effects of center or right-of-center governments remain significant at the 95% level of confidence.[13]

Our results also hold when center governments are no longer clustered with right-of-center governments. If *center/right government* is coded 1 only if the government is right of center (i.e., 1 or 2 in Waldendorp et al.'s 1993 index), and if *government shift right* is coded 1 only when a left-of-center

13. Using the yearly aggregate of systemic changes yields a higher pseudo-R^2; the variable is still significant. Removing this variable entirely does not change our results.

government is proceeded by a right-of-center government, and 0 otherwise, the substantive effect of the interactive term declines by a small degree (the coefficient falls to 1.09), but it remains significant at the 99% level of confidence (see row 3 of Table 3). Right-of-center governments (again, now excluding center governments) continue to be significantly more likely to liberalize than other governments.

As an additional check, we allowed the partisanship variable to remain continuous, ranging from 1 (*farthest right*) to 5 (*farthest left),* rather than converting it into a dummy variable. *Government shift right* was also allowed to be continuous, ranging from –4 *(major shift to the left)* to 4 (*major shift to the right*). The interaction between this continuous version of *government shift right* and *4 months* continues to be significant at the 99% level of confidence (as shown in row 4 of Table 3). The continuous-partisanship variable also continues to exert a significant independent effect, such that left governments are less likely to liberalize than right.

We also found our results to hold when the variable *4 months* was changed to 5 months or 3 months. These results are reported in rows 5 and 6 of Table 3. Note, however, that the coefficient on the interactive term drops to 1.00 when 3 months is used, and it is only significant at the 95% level of confidence.

Finally, we were concerned that pooling our data from 12 countries may have introduced bias into our results. Recall that following Beck, Katz, and Tucker (1998), we included a control for temporal dependence in the data. However, the possibility remains that other country-specific factors may influence the dependent variable in ways that we did not control for in our model, thereby giving rise to omitted-variable bias. As such, we ran a separate version of the model where we included dummy variables for each country (leaving the United Kingdom as the excluded category); such fixed effects capture any country-specific correlations with the dependent variable that are not captured by the other variables. (On the importance of including fixed effects in a pooled data set, though in the context of dyads as the units of analysis, see Green, Kim, & Yoon, 2001. For counterarguments, see Beck & Katz, 2001). We find that the coefficient on the interactive term changes little after including the country dummies, and it remains significant at the 99% level of confidence (see row 7 of Table 3); *center/right government* likewise continues to be significant at the 95% level of confidence in the expected direction when the country dummies are included.

CAPITAL-CONTROLS POLICY RESTRICTIONS

We now turn to the correlates of capital-controls policy restrictions. The dependent variable is coded 1 if a new capital-controls policy restriction

occurred at Time T in Country J, and 0 otherwise. *Previous restriction* is the number of time periods since the previous restriction; the economic control variables and the veto-player variable are the same as before. The systemic control variable is now the number of restrictions enacted by other OECD parliamentary democracies in the year of the observation (*systemic restrictions*).

Here, we test Hypotheses 2 and 4, which predict no relationship between government ideology, change in ideology, and new capital-account restrictions. We generate a variable equal to 1 if the government at Time T is left or center-left and equal to 0 if otherwise (*left government*). *Government shift left* equals 1 if the government in power at Time T is left or center-left but the previous government in power was not and equals 0 if otherwise. We again use the variable *4 months* and now generate an interactive variable equal to *4 Months × Government Shift Left*. The interactive term thus takes on a value of 1 only when the present government is a new left-of-center government that recently took office.

Table 4 reports the results of two versions of the restrictions model: Model 2A does not include the interactive variable, and Model 2B does. The most striking thing about both models is that many of the economic variables are strongly significant, whereas all political variables of interest are insignificant. The veto-players variable is again significant in the expected direction, as is the control for systemic restrictions. The level of existing controls is positively correlated with the dependent variable, suggesting that prior controls make the imposition of new controls *more* likely. In short, the models suggest that the economic control variables are much better predictors of policy restrictions than any partisan changes.[14] We submitted the results reported in Table 4 to a similar battery of robustness tests reported above for the liberalization model. In none of these robustness tests was the interactive effect between *government shift left* and *4 months* close to being significant.

Taken together, the results of the liberalization and restriction models suggest that right and centrist governments generally prefer capital markets that are more open than those they inherit when they take over from left governments. For left governments, however, reversing these policy changes does not seem to be a priority (as predicted by Hypothesis 4). But perhaps more

14. Strangely, the variable measuring change in reserves is significant but in the opposite direction from what we expected. This suggests that an increase in reserves is positively correlated with a decision to impose new restrictions on capital movement. We speculate that reserves, like capital controls but unlike the other economic variables, are partly endogenously determined by governments. This merits further study. Other economic variables are significant in the expected directions: Exchange-rate volatility, a rising inflation rate, and a rising discount rate are all correlated with new restrictions.

Table 4
Logistic Analysis: Restricting Capital-Controls Policy Changes

Independent Variable	Model 1A (z)		Model 1B (z)	
Control variables				
Previous restriction	–0.119**	(–3.54)	–0.118**	(–3.53)
Change inflation	0.088	(0.89)	0.088	(0.89)
Change exrate	3.912	(0.95)	4.100	(0.99)
Change reserves	1.996*	(2.19)	2.009*	(2.20)
Change discount rate	0.395**	(3.09)	0.390**	(3.05)
Veto players	–0.136*	(–1.66)	–0.138*	(–1.67)
Systemic restrictions	0.038**	(10.77)	0.038**	(10.75)
Fixed exchange rate	–0.072	(–0.34)	–0.071	(–0.33)
Existing controls	0.233*	(2.29)	0.226*	(2.21)
Left government	0.061	(0.35)	0.060	(0.34)
Government shift left	0.046	(0.28)	0.090	(0.51)
4 months	0.008	(–0.03)	0.066	(0.26)
Government Shift Left × 4 Months			–0.383	(–0.70)
Constant	–4.529**	(-11.20)	–4.514**	(–11.17)
N	6,130		6,130	
Pseudo-R^2	0.127		0.127	

Note: z-stats in parentheses.
* Significantly different from 0 with at least 95% confidence in a one-tailed test.
** Significantly different from 0 with at least 99% confidence in a one-tailed test.

fundamentally, the results offer little evidence that left governments are more likely than other governments to impose capital-controls policy restrictions at any time, once economic conditions are controlled for (Hypothesis 2). That is, although the models suggest that partisanship plays a large role in the decision to liberalize capital controls, it appears to play very little role in the decision to impose new restrictions.

A CLOSER LOOK AT THE DATA:
TRENDS IN FOUR COUNTRIES (1960-1986)

A brief survey of trends within two large countries in our sample, the United Kingdom and France, and two small countries, Denmark and the Netherlands, further confirms our findings. A qualitative examination also allows us to search for any empirical anomalies within these cases.

Broadly speaking, these four cases provide further evidence that partisanship plays a stronger role in liberalization decisions than it does in decisions

to impose restrictions on the capital account. Within these four countries, the rate of new restrictions under left governments was 2.44 every 100 weeks, not much different from the incidence under nonleft governments (2.23 every 100 weeks); nonetheless, there was substantial variation across countries. In the United Kingdom, 29 of the country's 42 restrictions occurred under left governments, despite that left governments were in office less frequently than right governments. Meanwhile, in France, 47 of the country's 48 policy restrictions occurred under right or center-right governments. But, in both countries, the large majority of restrictions (67% in the United Kingdom; 90% in France) occurred during the turbulent period from 1968 to 1978, when capital-controls policies were most unstable throughout Western Europe. During this time, France was governed entirely by right-of-center governments, whereas the United Kingdom was governed primarily by left governments (66% of the time). This suggests that new restrictions in capital-controls policies were more a function of economic than partisan conditions.

Trends in these four cases also correspond reasonably well to our findings in the quantitative tests concerning the timing of specific changes. During the 1970s, the United Kingdom experienced a partisan turnover in government three times. The two new Conservative governments (1970 and 1979) enacted liberalizing changes shortly after assuming office. In 1970, the United Kingdom announced a capital-controls liberalization that increased limits on institutional investment in offshore funds (although most controls remained in place even after the United Kingdom shifted to a floating exchange rate in 1972; see Artis & Taylor, 1990, p. 134). When the Conservatives under Margaret Thatcher came into office in 1979, the government removed all the United Kingdom's capital controls within a few months. In June, the government abolished requirements for cover maintained for overseas portfolios financed by foreign borrowing and made official exchange freely available for outward direct investment (up to £5 million per year). Then, in July, it removed remaining restrictions on outward direct investment and exempted the purchase of securities in the European Community from all restrictions. It lifted all remaining exchange controls in October (Artis & Taylor, 1990, p. 134). By comparison, new restrictions imposed by Harold Wilson's Labor government in the months after entering office in 1974 were limited, though the government did eliminate certain preferential treatments given to European Economic Community (EEC) countries regarding direct and portfolio investments.

In France, partisan shifts occurred in 1981, when the Socialist Party came to power following a long period of right dominance, and in 1986, when Chirac's conservative coalition entered office (Thiébault, 2000). No new policy restrictions were announced in the months after the 1981 shift; a minor

liberalization concerning the reporting requirements for foreign direct investment was announced shortly after Chirac's government entered office.

In Denmark, center-right or right governments replaced left-leaning governments three times during the period we study: in February 1968 (the Baunsgaard center-right coalition), in December 1973 (the Hartling Liberal minority government), and in September 1982 (the Schlüter center-right coalition). New left governments entered office in 1971 and 1975 (Damgaard, 2000). New right-of-center governments in Denmark liberalized capital-controls policies on several occasions. Shortly after the Baunsgaard government entered office, Denmark raised the amount resident businesses in several sectors could borrow abroad without National Bank approval. In the months after Hartling's government came to power, Denmark relaxed the restrictions governing investments in Danish bonds by investment institutions in the EEC and enacted a new law that enabled foreign banks to establish branch offices in Denmark (though the government also reversed earlier liberalizations on borrowing abroad for Danish businesses). And, after the Schlüter government entered office, Denmark announced a minor liberalization on the ability of foreigners to hold Krone in Danish banks. New capital-controls restrictions went into effect just once in the months after a new left government entered office, in 1971, when Denmark announced new restrictions on the net foreign position of foreign exchange dealers.

Although no left governments were in power during the period covered by our study in the Netherlands, there were transitions between left-leaning center governments and right-of-center governments, and we can point to a similar dynamic here. The center-right coalitions that entered power at the end of 1966 were the first move to the right (in the conventional sense) of the postwar era (Bax, 1990; Middendorp, 1991), and these center-right parties held the government except for two periods of left-leaning (but still centrist) coalitions: from 1973 to 1977 and from 1981 to 1982 (Timmermans & Andeweg, 2000). The de Jong cabinet from 1967 to 1971 was the first real center-right coalition of the modern (secular) party system, and during its first 7 months in office, the government enacted more liberalizations than the previous four governments had enacted in the 5 years prior; by the end of the first year, banks had unlimited access to foreign money markets. The new government aimed to completely overhaul the Exchange Control Decree (*Devienzenbesluit*) of 1945 and replace it with a single law that gave governments only limited powers to impose controls, but economic uncertainties stalled the reform effort (Bakker, 1996, pp. 36, 83, 131). The bill eventually was passed in 1980 by the center-right van Agt government. Although the labor-led den Uyl cabinet (1973-1977) did not follow through on the de Jong

government's proposed changes, it did not reverse the early de Jong reforms of 1967 either (de Greef, Hilbers, & Hoogduin, 1998).

CONCLUSIONS

Partisanship is an important predictor of capital-controls policy liberalizations: The probability of policy liberalization increases dramatically shortly after the partisan composition of the governing parties shifts to the right. This implies not just that right governments prefer lower levels of capital controls than do left governments but that liberalizations tend to be high on the agendas of right governments. Partisanship was far less important as a predictor of new capital-controls policy restrictions; here, economic factors appear to have played a much more central role. The probability that a state will impose new restrictions increases when inflation or interest rates are rising or when the exchange rate is unstable, but evidence that left governments are any more willing to impose new restrictions than are right governments is weak.

Our findings are interesting in light of current theorizing about partisan preferences and market integration in developed countries. Although there is a partisan effect on capital-account openness—right governments are more likely to be liberalizers—the effect is not symmetric. If our findings had been that left governments did rush to enact restrictions soon after taking office, then they would have challenged arguments that right and left governments had converged (Clark, 2003; Clark, Golder, & Golder, 2002) and that financial openness is not a threat to the Left (Mosley, 2000, 2003).[15] Our actual results that restrictions are more related to economic shocks (rather than political ones) suggest that left governments do not make moves to restrict their markets a priority.

We do, however, find that during the period following currency convertibility, right governments in the OECD seemed to be in a better position to take advantage of the opportunities presented by the world economy than their counterparts on the Left. A contributing factor to the opening of the world financial market that took place in the 1960s, 1970s, and 1980s was therefore the preferences of right and center-right parties that placed liberal reforms high on their agendas.

15. Other studies have concluded that capital mobility may be more of a threat to social redistribution in the developing world (Rudra, 2002). Brooks (2002, p. 498), for example, shows that pension privatization in Latin America may be a signal to international financial markets of a commitment to market reform.

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