



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■



LSE 'Europe in Question' Discussion Paper Series

The Politics of Disinflation

Bob Hancké and Tim Vlandas

LEQS Paper No. 127/2017

December 2017





Editorial Board

Dr Bob Hancke
Dr Jonathan White
Dr Sonja Avlijas
Dr Auke Willems
Mr Hjalte Lokdam

All views expressed in this paper are those of the authors and do not necessarily represent the views of the editors or the LSE.

© Bob Hancké and Tim Vlandas



The Politics of Disinflation

Bob Hancké* and Tim Vlandas**

Abstract

What explains the shift from the moderate to high inflation rates of the Golden Age of post-war capitalism to the low inflation regime of monetarism in the 1970s and 1980s? Conventional views emphasise the rise of monetarism as a new economic paradigm that convinced policy makers to delegate monetary policy to conservative and independent central banks – a view that comes in many variants, from constructivist to orthodox economics. In contrast to these arguments, we introduce electoral and party politics into the debate. This paper models and examines the shifts in the inflationary preferences of the median voter and their translation into party politics and economic policies. As the median voter accumulates nominal assets against a background of de facto and de jure increasing job security and rising wages, her preferences on macro-economic policies shift from concerns about employment-friendly to inflation-averse policies. Social democratic parties, who are pivotal players in this regard because of their ‘natural’ preference for high employment over low inflation, are thus forced to adopt anti-inflation policies as well to remain electorally viable. We show that the employment situation of the average worker improved in every respect during the 1960s and 1970s, that most of the population became inflation averse during the 1970s and 1980s, and that social democratic parties were forced to adopt more economically orthodox party manifestos. We then analyse the shift to a low inflation regime in a series of country case studies.

Keywords: inflation, Western Europe, Monetarism, Keynesianism, electoral politics

* **London School of Economics and Political Science**

Email: r.hancke@lse.ac.uk

** **University of Reading**

Email: t.r.g.vlandas@reading.ac.uk

Table of Contents

Introduction	1
1. Explaining disinflation.....	3
2. Shifting macro-economic preferences of the median voter	9
3. From median voter to policies	17
4. The moving median voter and the shifting party system.....	21
5. Economic security, inflation aversion, party orthodoxy and inflation.....	27
6. Case studies: the UK, France, Germany and Sweden	33
United Kingdom: From Thatcher to Blair via low inflation.....	33
France: from socialism in one country to competitive disinflation.....	37
Germany: Social-democratic monetarism.....	42
Sweden: Holding the fort	44
7. Conclusion	49
References	52
Appendix	56

Acknowledgements

We thank Dustin Voss for excellent research assistance, and seminar participants at APSA 2017, University of Geneva, LSE, Sciences Po Paris, and in particular Lucio Baccaro, Matthias Matthijs, Jonas Pontusson, and Thomas Sattler for comments on those occasions. We are also very grateful to Peter Hall and Björn Bremer for detailed comments on previous versions of the paper.

The Politics of Disinflation

Introduction

Between the end of the Second World War and today, inflation rates varied dramatically across countries and over time in Europe. In the 1950s both inflation rates and variation across advanced capitalist countries were quite high by contemporary standards. In 1956, for instance, inflation was 11.6% in Finland, 4.9% in Sweden, almost 5% in the UK, 2.6% in Germany, 5.8% in Spain, and 3.8% in Norway (OECD 2016). Despite the relatively high levels in many countries, it was rarely identified as a problem, and attention went disproportionately to economic growth and the goal of full employment. In Austria and Germany, the average growth rate of GDP per capita during the 1950s was 5.6% (for Austria) and 7% (Germany) 2.2% in France 3.4% in Belgium (Maddison 2013 database). During the 1960s, inflation again fluctuated sharply, this time against a background of full employment and high economic growth – but was not seen as a serious policy problem either. This perception changed in the 1970s, when the simultaneous occurrence of high inflation, rising unemployment, and low growth was identified as a major economic policy problem, with inflation increasingly as the more serious one (see table 1).

The monetarist interventions of the first half of the 1980s by the Banque de France under Mitterrand, the Bank of England under Thatcher and Paul Volcker's Federal Reserve heralded a much more subdued inflation regime and by 1990, inflation appeared to be conquered, though against a background of relatively high equilibrium unemployment rates and low economic growth,

both usually understood as problems with their roots in rigid supply-side institutions.

Table 1.
Unemployment and inflation between the 1950s and 1980s in Western European countries

	Unemployment		Inflation (CPI)	
	1950-1973	1974-1983	1950-1973	1974-1983
Belgium	3%	8.2%	2.9%	8.1%
Finland	1.7%	4.7%	5.6%	10.5%
France	2%	5.7%	5%	11.2%
Germany	2.5%	4.1%	2.7%	4.9%
Italy	5.5%	7.2%	3.9%	17.6%
Netherlands	2.2%	7.3%	4.1%	6.5%
UK	2.8%	7%	4.6%	13.5%

Source: Maddison 2001: Table 3.8 page 134.

What explains this variation both in actual inflation rates and in the political interpretation of the problem? That is the central question of this paper. The dominant arguments in this debate concentrate on the ideational power of a paradigm shift in economic thought; instead, we emphasise the evolution of the median voter's inflationary preferences as a result of increasing economic security and the way these translated into party-political programmes and economic policies. In a nutshell, the argument goes as follows: as the median voter accumulates nominal assets against a background of *de facto* and *de jure* increasing job security and rising wages, her preferences on macro-economic policies shift from concerns about growth and employment to concerns about the asset-eroding effect of rising inflation. This shift in the median voter's preferences in turn has important implications for party dynamics: social democratic parties, who are pivotal players in this area because of their 'natural' preference for high employment over low inflation, are forced by this rightward shift of the median voter to prioritise anti-inflation policies to remain electorally viable.

The relevance of this question should be obvious. Understanding the political dynamics underlying inflation and disinflation is not only important in historical perspective; equally important is bringing politics back into the wider picture of big shifts in economic policy-making. It is possibly even of significance today because of the struggles of OECD economies to generate higher inflation in the wake of the Great Recession. For the past decade, most advanced capitalist economies have witnessed extremely low inflation, often verging on deflation, and with interest rates close to zero, have been forced to resort to quasi-fiscal monetary policies (known as ‘quantitative easing’) to avoid being stuck pushing on a string, in the words of Keynes. Understanding how exactly we got here could shed light on the policy options today.

The balance of this paper starts with a short review of the debates on the disinflation of the 1980s, moves on to a detailed exposition of our argument before delving into several empirical subsections on the mechanism that we propose. We end that empirical section with a set of short case studies – of the UK, France, Germany and Sweden – on the political dynamics surrounding disinflation. A short conclusion summarises the findings and raises some further questions.

1. Explaining disinflation

Arguably the single most important set of approaches to the question of low inflation and its institutional corollaries builds on an important ideational shift in macroeconomic theory. According to the economists’ narrative, as Iversen & Soskice (2006) call this, politicians suddenly realised in the 1970s that inflation was a bad thing because everyone in the economy anticipated it. Prices thus rose without real effects if governments tried to inflate the economy and governments, quite sensibly, created institutions, such as conservative,

The Politics of Disinflation

independent central banks, to enforce price stability (in two very different versions but with the same conclusion, see Barro & Gordon 1983; McNamara 1998). The 1970s were the era when the shortcomings of Keynesian macro-economic policies became clear to everyone; faced with stagnation, a new regime, foreshadowed by new macro-economic thinking, was installed. This ideational shift was, needless to say, supported by a dramatic rise in the perception of the dangers of inflation in the 1970s and 1980s by citizens, politicians and interest groups.

These ideational arguments, powerful as they may seem, face the simple problem that every approach based on ideas faces: the defeat of one way of understanding the economy and the victory of a competing vision cannot be explained, neither *ex ante* nor *ex post*, simply with reference to the substance of the ideas alone. The notion of sound money at the basis of monetarism has in some form or other been around since the formalization of classical economics in the 18th century and embodied in the gold standard regime, yet has been more or less politically attractive over the past 250 years depending on the politics of economic policy, not the functional requirements of economic problems. New ideas may be a necessary condition for such shifts, but they are far from sufficient.

Hall's (1989) interesting ancillary argument about the political conditions for policy learning does not really resolve the problem, since policy change, even in what may appear to be a highly technical matter such as macro-economic policy, requires more than the bureaucratic and elite politics that complement these ideational approaches. Put differently, since sustained anti-inflation policies have both short-term and long-term distributional effects, they eventually also require approval and support by electorates, and voters, especially those groups in the population that are disproportionately hurt by

such a shift in macro-economic policy making, may have different ideas about the priorities of economic policy.

In fact, it is not even obvious to what extent the complementary point of a growing problem load that focused attention on inflation is convincing. Take the countries with comparatively low (average) inflation rates in the 1970s, such as Germany (5%), Austria (6%), Belgium (7%) and the Netherlands (7%); in all of these, inflation was one of the two most important (economic) policy problems, according to opinion polls, usually collecting 65-70% of the votes. But in countries that faced comparatively much higher inflation rates over the decade – Italy (12%), Ireland (13%) and the UK (13%) – the population did not have a higher sense of inflation as a major problem. There is simply not a very strong relationship between the inflation rate and feelings about inflation across these countries.

Materialist political scientists, starting with Hibbs (1977), have developed a very different argument: Left governments, with a constituency of salaried workers depending on employment for their livelihood, cared more about unemployment than inflation; for governments of the Right, who represented more economically privileged groups in the population, the opposite was the case. For these interpretations, inflation is the outcome of domestic distributive conflict between Labour and Capital over the surplus generated by economic growth (Hirsch & Goldthorpe 1978; Carlin & Soskice 1990). Wage bargaining systems where workers can, for a variety of mainly political and institutional reasons, systematically claim wage rates that are higher than labour productivity rates (i.e. where the wage share in the economy rises), produce, all other things equal, higher inflation than those where nominal wages and productivity are more closely aligned. Conversely, the increasing weakness of Labour after 1980, expressed in declining union density (Visser 2013), fragmentation of collective bargaining systems (Katz 1993), and labour market

The Politics of Disinflation

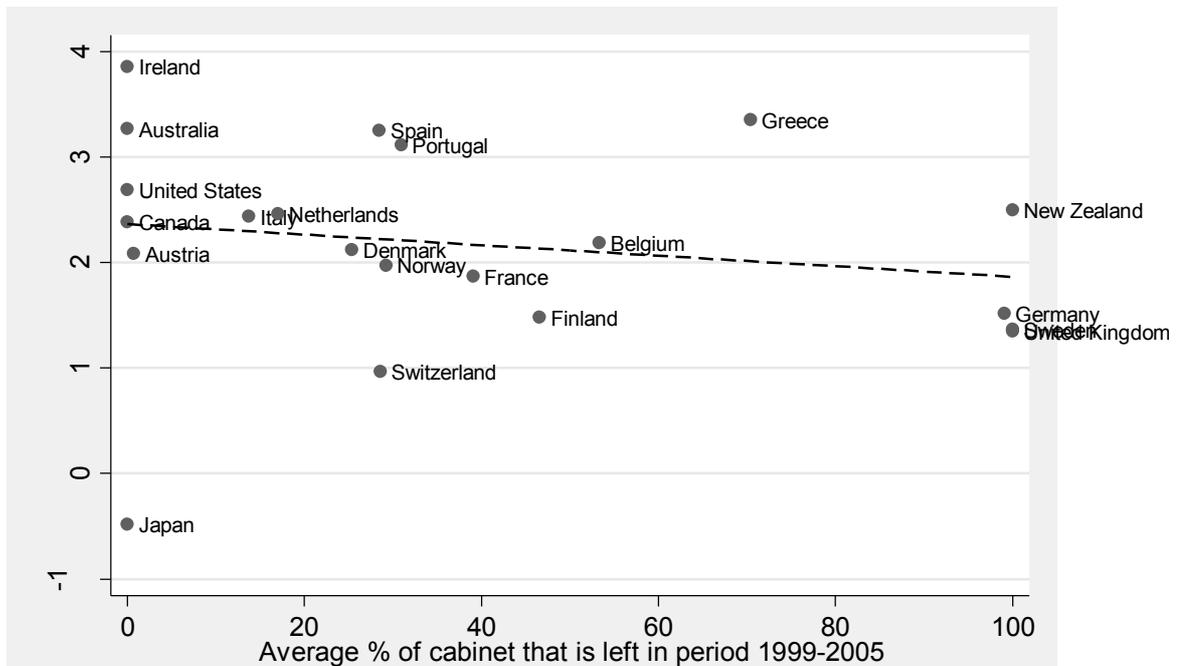
deregulation (Vlandas 2013; Avdagic 2013) allowed capital to capture a larger share of economic growth, and inflation rates fell, since businesses did not have to raise prices to compensate for losses associated with higher wages. This dynamic captures almost perfectly the adjustment from the high-inflation 1970s to the low-inflation 1990s.

But this argument also faces a few important problems. The partisan argument by Hibbs (1977) certainly sounded persuasive when it was published, but a look at party manifestos, government policies and inflation rates since the 1990s suggests that Left parties of a social-democratic bent have now also become inflation hawks, not to be outdone by their Right counterparts (see Notermans 2000: 160-221; Boix 2000). Simple correlations between inflation rates and Left control of cabinet, as reported in Figure 1, have been negative in the period 1999-2005 for much of the OECD. Since the argument about different policy preferences of Left and Right held for the 1960s (as in Hibbs 1977), something else must have changed after that period to undermine this previously robust relationship.

A more structural materialist argument emphasises the international political-economic constraints imposed by the sudden turn towards disinflation in the US under Fed Chairman Paul Volcker in the early 1980s (Brenner 2000). Because of the central role of the dollar in the international monetary system, all major convertible currencies were forced to follow the US when the Fed dramatically raised interest rates to force inflation down, and the effect was a generalised disinflationary bias in the OECD economies. While this international monetary framework certainly may have set the direction of change, it has a hard time explaining the variation in timing among the advanced capitalist economies. As late as 1990, right before the start of the Maastricht process leading to EMU, and which heralded a generalised disinflation regime across the EU, inflation rates varied from a low of 2.7% in

Germany Germany to a high of over 6% in Italy (and over 20% in Greece!) (OECD 2016). It was, in fact, not until the late 1990s that inflation rates across what was to become EMU converged on the low German inflation rate – more

Figure 1.
The power of the Left and inflation rates in the early 2000s



Note: both variables are averages for period 1999-2005. Source: Armingeon et al. 2015.

than 15 years after the Volcker crackdown. It is difficult to reconcile the sense of urgency implied by the structural power argument with the rather laconic and slow adjustment of some of the advanced economies in Europe, and all the more so because these seem to have had their hand forced by a European political development rather than a US dollar-led policy shift.

In sum, many of the arguments that have been put forward to explain the sharp drop in inflation in much of the OECD after 1980 offer necessary pieces of the jigsaw puzzle – but at the same time also fail in important respects. The key problem with them, we think, is that most of them underestimate the importance of politics in economic policy. Whatever the intellectual virtues of a particular position on the economy – and remember that many of these

The Politics of Disinflation

supposed virtues remain under discussion – the translation into actual policies requires a majority in legislative settings to pass. Put differently, even the most brilliant policy idea will not gain political traction if it systematically destroys the livelihood of its electorate.

In this paper, therefore, we aim to bring politics, particularly distributive politics, back into the debate, and do so in two steps. The first step models and examines the shifts in the economic policy preferences of the median voter: as she accumulated nominal assets against a background of *de facto* and *de jure* rising job security and wages, her preferences on macro-economic policies shifted from concern about growth and employment-friendly policies to inflation-averse policies. The second is to introduce that development into a model of party competition, by examining at which point the median voter had shifted sufficiently to the Right (i.e. prefers inflation-averse policies) to carry all parties, but especially the pivotal Social-Democrats, along to the Right. Our hypothesis is that this shift in party platforms took place after a series of electoral defeats by Social-Democratic parties, who misunderstood the electoral implications of the improvement in the median voter's economic security (for which, ironically, their own policies and policy orientations in the post-war period were mainly responsible). Combined, these two points suggest that the turn towards inflation-averse policies in the late 1970s and the 1980s is the consequence of a shift in the underlying political sociology of the electorate and its translation into party platforms. The existence of new concepts of macro-economic policy-making that were transmitted through elite networks mattered because they provided a more or less coherent theoretical framework both to analyse the new world and to offer intellectual foundations for new policies – but the median voter dynamic drove the political process. This interaction between shifting policy preferences of the median voter and electoral success or failure also helps understand why previous periods of high

inflation went, in policy terms at least, almost unnoticed. However, once the median voter moved to the Right, low inflation became a pervasive policy goal across the entire political spectrum. Governments may have forced central banks to become conservative and independent to guard price stability, but they did so in response to very strong electoral pressures, thus our argument.

The balance of this paper presents this argument in four stages. We start by developing a model that explains shifts in median voter preferences with regard to inflation and then links that to the electoral competition to which social-democratic parties, the natural proponents of an employment-oriented economic policy, were exposed. We then offer descriptive evidence for our argument, followed by case studies of four countries – the UK, France, Germany and Sweden. The final section concludes by sketching some of the wider implications.

2. Shifting macro-economic preferences of the median voter

The first step in our argument deals with the relative preferences of the median voter for economic growth and inflation (we assume growth to cover both increases in real disposable income and security of employment) and we identify two key concepts in that regard.

The first is the subjective perception of job loss: since current income is entirely dependent on wages, and future income depends on the accumulation of human capital, a process impeded through unemployment, losing one's job is tantamount to a significant reduction in income, now and in the future, and more broadly to a deterioration of future life chances. A higher subjective perception of job loss implies that people are relatively speaking more concerned about unemployment than about inflation. In one of the few studies

The Politics of Disinflation

on this question, Scheve (2002) documents that greater exposure to unemployment risk leads to lower inflation aversion: respondents with more weeks of unemployment in the previous year are less inflation averse (Scheve 2002: 27). In addition, national unemployment rates and individual-level aversion to inflation are also negatively correlated (Scheve 2004: 15). Unemployed people are less inflation averse, while high-income individuals – with a lower risk of costly unemployment – are more so (Scheve 2004: 17). Our own analysis of Eurobarometer data from 1970 to 2000 suggests that Employment Protection Legislation, which reduces subjective unemployment risk, is positively associated with inflation aversion (see table A3 in appendix). Using the International Social Science Program (ISSP) data, we also find that insiders in permanent employment are more inflation averse than labour market outsiders in unemployment and precarious employment (see table A4 in appendix). Retired individuals, by definition not concerned about current and future unemployment risk, are also more inflation averse (Vlandas 2017).

The second variable starts from the income derived from the accumulation of nominal assets such as savings and other monetary income, pension funds and (in most places in the OECD) housing, with a relatively fixed (nominal) value – or at least until the deregulation of financial markets in the 1980s and 90s. Nominal assets have the particular characteristic that their value is eroded by inflation above zero; unless that is compensated by increases in value of the assets (through rising stock markets, for example, or real estate inflation), holders of such assets see their wealth disappear (or at least perceive it that way) when inflation is positive. Therefore, if people with assets are, everything else equal, more inflation averse, a rise in asset holdings throughout the population will lead to a higher degree of inflation aversion regardless of inflation actually having that effect of eroding the value of these assets. There is very convincing evidence that asset holders are more inflation averse:

Scheve's (2002: 26) analysis of the British Household Panel Survey, which asks respondents whether 'keeping inflation down' or 'keeping unemployment down' is the priority, finds 'clear evidence that ownership of nominal assets has a statistically and substantively significant positive effect on inflation aversion among citizens'. Similarly, relying on both Eurobarometer and ISSP data, Vlandas (2017) also finds that older retired individuals who rely on pensions and are more likely to hold assets are also more inflation averse.¹

These two relatively uncontroversial points about the subjective costs of job loss and of asset-eroding inflation allow us to build a simple model. Let us start by imagining a Taylor-rule type heuristic, which captures the utility function of an individual voter as a cost-minimisation problem with relation to the output gap (and therefore the negative effects of low growth on employment and wages) and inflation.

The positive externality associated with a small output gap (i.e. the benefit of a relatively small output gap that accrues to an individual, especially in terms of employment security and wage) is mediated by the subjective perception of the costs of job loss E . Similarly, the (perceived or real) costs of inflation are a function of nominal assets A . Higher inflation has (or is seen to have) a higher cost for those who have accumulated more nominal assets. The following stylised developments capture what we are looking for with this model. In 1955, E was large for a typical voter: full employment was still a distant dream, employment protection (EPL) was relatively weak and trade unions had at best only recently settled into their roles of guardians of the post-war settlement.

¹ There is some debate about the reasons for inflation aversion among households with mortgages: inflation is not necessarily a negative evolution for them, since rising general price levels can lead to asset inflation, including houses, while inflation erodes debt in mortgages. But rising inflation also produces a restrictive reaction by the central bank, which then (rapidly) increases debt service in a market with variable mortgages such as the UK and the USA and will have a negative effect on the employment rate.

The Politics of Disinflation

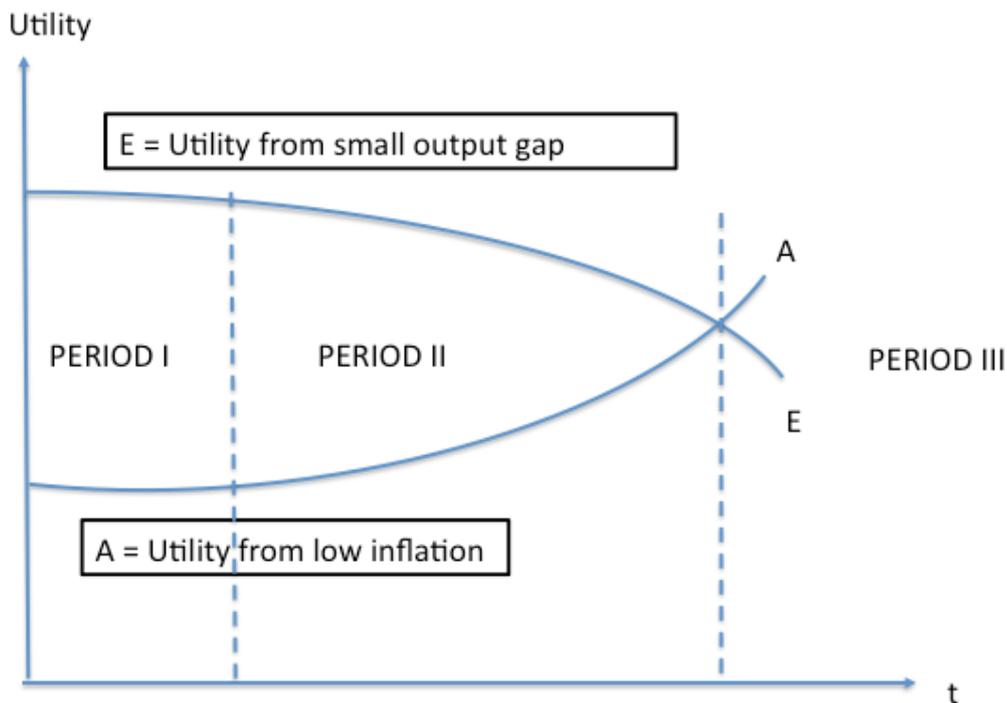
However, **A** was very small (she had accumulated few nominal assets, since both real wages and savings rates were low). A similar voter in 1975 (or the same one twenty years later; see below) may well have faced a very different situation, in which **E** was relatively small: full employment meant that the probability of job loss was very low, strong EPL was policed by strong trade unions, and the developed welfare states assured that even without employment, replacement incomes were relatively high. The term **A**, in contrast, would have grown considerably and may even have been relatively large, represented by more assets in the shape of, amongst others, savings, defined benefits pension schemes and mortgaged houses (in an era before speculative bubbles). Between 1955 and 1975, therefore, the perception of the relative impact of the output gap and inflation almost certainly converged and may even have reversed in some countries.

Figure 2 offers a graphic representation of the problem with notation that we will use in the rest of this paper. The vertical axis covers our two variables of interest, the subjective perception of job loss (**E**) and the accumulation of nominal assets (**A**) on an ordinal scale. When the subjective perception of job loss is high, the utility that the median voter derives from having a small output gap is high because a large output gap is seen as having a large negative effect on their employment security; conversely, the greater the accumulation of nominal assets, the higher the utility from having a low inflation. The horizontal axis covers time. Our argument is that these two variables move, in stylised fashion, along the curves **E** and **A**, starting out in the first period with **E** significantly above **A**, the two converging in period II, and **A** overtaking **E** in period III. Note that this mechanism could cover both individual life cycles – in the limiting case, pensioners do not care at all about their employment prospects (Vlandas 2017) – and the individual effects of ‘societal development’ life cycles, with a different person in the same occupation being considerably

more secure in their employment and considerably wealthier in 1975 than their counterpart in 1955.

This slow shift in (relative) preferences for E and A in the electorate over time has important political implications. As long as $E > A$ for the median voter, as in period I, policy preferences remain Left, i.e. growth (and employment) are ranked above low inflation. This is true for Left as well as Right parties, since both try to attract the median voter. But as full employment becomes entrenched, job security increases (supported by rising EPL), and real wages also rise, the subjective perception of job loss E slowly decreases. At the same time, nominal assets grow, probably in part as a result of the rise in real wages, and E and A converge.

Figure 2.
Graphic representation of the problem



In period III $E < A$: the median voter's concern about growth and employment has fallen. Full employment, seniority rules, growth in public sector employment, strong employment protection, higher skills and educational

The Politics of Disinflation

attainment, and increasing numbers of retirees who are retired for longer all have the effect that the median voter's subjective perception of job loss is very low and the importance attached to a small output gap is relatively low as a result. At the same time the accumulation of nominal assets such as savings, pensions and houses has reached a point where the concern about the erosion of their nominal value trumps (the meanwhile considerably smaller) concerns about growth and jobs. In period III, therefore, the median voter's preferences have been pulled to the Right, i.e. she has become more sensitive to high inflation (with an inflation rate of zero as optimal).

This dynamic captures quite well the evolution of the political sociology of advanced capitalist countries since WW II. After post-war reconstruction, salaried employment was crucial as a source of income for the vast majority of the population in most western European countries, even in those where agriculture was still an important sector, such as France and Italy. On average, wage earners made up the majority of the active population among western European nations. Households spent a considerable amount of their income on food and housing. In 1953-4, for instance, a household with two adults and two children in the middle of the income distribution would be spending 40% of its income on food in the UK and 42% in Germany (Kramper 2000: 53). At the same time, very few voters had accumulated significant assets. For instance, the US homeownership rate was only 43.6% in 1940 (Davis 2012) and most households in Europe rented their house in 1945 (Horsewood & Dol 2013: 4). The welfare state was also fairly limited, with social expenditures as a proportion of GDP below 15% in most European countries in the 1950s (Flora 1986): household income thus was primarily if not solely the result of salaried employment. Human capital was generally quite low: in 1950 less than 50% of the population between 25-64 years of age in OECD countries had completed upper secondary education or higher (OECD 2001: 84, Fig B6). This overall constellation

corresponds with period I in our model above, in which $E > A$ for the median voter.

During the *Wirtschaftswunder*, the *trente glorieuses* and generally the Golden Age of Capitalism in the late 1950s, the 1960s and the early 1970s, full employment policies, employment protection and growing real wages significantly reduced the threat of unemployment and poverty for the vast majority of the population.² Disposable real income rose fast during that period and doubled or more in the two decades between 1955 and 1975. In the 1951-55 and 1956-65 periods, for example, average annual real wage growth was consistently above 5% and above 7% in West Germany, above 5% and above 3% in France, above 3% and above 2% in the US and slightly less than 2% and above 3% in the UK (Brown & Darby 1985: 249). As a result, the share of income spent on food fell significantly, to 26% in the UK and 30% in Germany in 1973 (Kramper 2000: 53). Job security increased significantly as a result of tight labour markets and institutional safeguards such as increased employment protection, guarded by courts and trade unions, which also ensured wage increases in line with productivity growth. And, lest we forget the shifting composition of the workforce, a growing share was employed by government in public services, usually with stable life-time employment contracts: by the late 1970s the public sector accounted for more than 25% of employment in most of the OECD.

Higher real incomes also meant that savings could partly be channelled into assets such as pension funds and housing. Thus for instance, the US homeownership rate increased from 55% in 1950 to 62.1% in 1960, 64.2% in 1970, and 65.6% in 1980 (Davis 2012: 3). Between 1970 and 1980 the home ownership share as a percentage of the housing stock rose from 41% to 48% in

² The growth rate of per capita GDP for Western Europe was 4.08% in 1950-1973 – the highest growth rate in recorded history (Maddison 2001: 126).

The Politics of Disinflation

Austria, from 45% to 51% in France, from 49% to 56% in the UK, and from 50 to 59% in Italy (Horsewood & Dol 2013: 4). Social expenditures increased significantly reaching more than 25% by the late 1970s in most European countries (Flora 1986), thus providing substantial replacement income if citizens were unable to work. This generalized increase in employment security and accumulation of assets in the advanced capitalist world corresponds to the stylised period II in our model, in which E and A converge.

After the 1970s and in part supported by government policies, the accumulation of nominal assets started to spread quickly across the population. For instance in the UK, household total financial assets expanded massively from 1957 onwards, from 43 billion British Pound Sterling in 1957 to GBP 106 billion in 1970, and GBP 304 billion in 1980 (Sbano 2008: 47). At the same time, financial assets also grew in value. The index of the share price (with 1989 as 100) increased from 2.4 in 1950 to 19.8 in 1973 and to 100 in 1989 in France, from 3.6 to 33.5 to 100 in Germany, from 3.1 to 15.2 and to 100 in UK, and from 5.2 to 32.6 and to 100 in US (Maddison 2001: 141). Real disposable income rose to being twice as high, or more, than in the previous generation, which translated into higher savings. In addition, despite rising aggregate unemployment rates in the 1970s, job security and the chance of obtaining paid employment was actually de facto very high for the vast majority of the workforce, especially those with formal secondary and tertiary education.³ A large and rising share of the electorate grew older, eventually exiting the labour market and becoming increasingly reliant on pensions and income derived from nominal assets rather than work (Vlandas 2017).

³ In a context where education to upper secondary level or higher increased from under 50% to more than 60% in the 1970s in OECD countries (OECD 2001: 84).

These developments are captured by period III in our model, when $E < A$: for the vast majority of the working (and voting) population, the threat of long-term unemployment had become extremely low or inexistent, and households had become a lot wealthier as a result of disposable income growing beyond immediate needs. The fall in both market and post-tax income inequality between the 1950s and the 1990s also secured a relatively homogenous spread of income growth in most OECD economies, and especially the continental European and Nordic countries. At some point after the 1960s (or the 1970s in some countries), therefore, $E < A$. The possibility of unemployment and the cost associated with job loss had fallen dramatically for most of the (working) population, and the median voter's preference ordering shifted from Left (with employment concerns trumping inflation aversion) to Right.

Obviously, the stylized picture painted here is exactly that: a stylized picture that needs to be refined by bringing in variations across the economies of the OECD. The type of capitalism in a country, its demographic evolution, the timing of different stages of industrialization and de-industrialization, and other exogenous factors can influence these developments. For now, the central message to take away from this analysis is that for the median voter after the Second World War, the relative weights of employment (and economic growth), symbolised by 'E' in our model, and accumulated nominal assets, 'A' in the model, reversed in her preference ordering. With it came, as we will document in the next sections, an increased fear of inflation – which translated into a shift to the Right in terms of preferences of economic policy-making

3. From median voter to policies

The second step in our argument tries to understand how the shifting preferences of the median voter found an expression in party platforms and

policy options. By making this process a problem rather than simply assuming it away as most median voters have done, we begin to address a point that is often ignored in studies relying on the median voter as a central driver of politics. We know that if the median voter's subjective perception of the loss associated with inflation trumps the loss associated with possible unemployment, she moves to the Right. But what then? Not only would a median voter model whereby her preferences are immediately mapped onto positions of parties strictly speaking only hold in pure majoritarian systems (of which there are actually very few in continental Europe: France and Italy, who come closest, effectively are diluted majoritarian systems); there is also the question of how, why and when positions adopted by the median voter find their way into party policy platforms. To take an example from another policy area: the median voter might well be in favour of reintroducing the death penalty for violent crimes that involve minors as victims, or in the USA the median voter is presumably not averse to (cheaper) universal health care. Yet neither of these policies has been adopted. There seems to be a missing step in the median voter–policy nexus. Assuming that median voter preferences steer the political agenda, the question is how changes in those preferences with regard to macro-economic outcomes – inflation versus growth and unemployment in our case – led to changes in policies?

We think that policy areas, and positions in policy areas, are 'owned' by political parties: Social democratic (SD) parties play a pivotal role in this particular economic policy. Think of SD parties (along the lines of what we did above) as the 'natural' expression of the preferences of the median voter in a world in which economic insecurity trumps (modest) wealth accumulation (E>A). Since all other parties are to the Right of the SD parties and therefore

always prefer relatively more restrictive macro-economic policies⁴, the critical shift happens when SD parties also adopt more restrictive monetary policies, since that pushes the entire policy area considerably to the Right. This changes the question from a rather general 'when did parties or policy-making move to the Right?' to a narrower and more specific 'how and when did SD parties move to the Right on macro-economic policy?'.

Our central hypothesis in this regard builds directly on the median voter model above: if the median voter has become more conservative in terms of macro-economic policy preferences when $E < A$, SD parties followed the median voter after defeats with an employment-oriented manifesto (where $E > A$), by also adopting inflation-averse policies as the priority. As a result, the economic policy spectrum moved dramatically to the Right, because all other parties to the Right of the SD parties had already attributed higher values to A than to E in the past, and only electoral competition anchored them on a growth-friendly path at that time. In effect the dynamics of the median voter's concern for her accumulated wealth against a background of negligible economic insecurity forced the SD parties to the Right in economic policy terms.

More formally, consider the dynamics between the median voter (MV) and SD parties in a one-dimensional space with three parties, Left (L), Centre (C) and Right (R), in which all three parties command (to keep things simple) one-third of the vote, and C can form coalitions with both L and R. In period I (when $E > A$ in the MV's preference ordering), L and C combined command more than 50% of the vote. Since the median voter's preference ordering is $E > A$, L reflects the plurality of the voters, L and C have a majority (with C tactically choosing to

⁴ We treat Communist parties as similar to SD on this dimension and ignore the – usually Right – populist parties that have a strong exclusionary, 'national' social dimension in their policies, but usually have very little of intelligence to offer on macro-economic policy. With very few exceptions these far Left and far Right parties have in fact played only a very small role in actual election outcomes.

The Politics of Disinflation

follow L's lead on macroeconomic policy to avoid electoral penalties in the next election) and economic policy remains more sensitive to employment than inflation. Again, to keep things simple, assume that the share of the vote does not change dramatically from one election to the next (but might obviously change significantly over longer periods of time).

In Period II, when $E=A$ for the MV, C can now effectively choose between L and R, without the risk of electoral penalties: the MV is, as it were, indifferent between E and A. Both a CL and a CR coalition yield a viable majority. C might want to stay in a coalition with L for reasons that are unrelated to this particular economic policy stance. Yet if C reads the move of the MV as a permanent shift to the Right, it will also consider and actively pursue a coalition with R (since that will allow C to reflect preference shifts more accurately and tactically reap electoral rewards by combining hawkish policies on inflation with more dovish positions on other policies outside macro-economics). That heralds period III: $E < A$ for the MV and the CR coalition is now entrenched.

Meanwhile L can hold on to expansive policies as long as that is part of the coalition with C. As the MV's preferences move to the Right, L can hold out as the employment and growth-friendly alternative but will ultimately be forced to adopt a policy that is closer to R than to the original L position lest it stumbles from one election defeat to another and sees its electoral basis decline. With that conversion on macro-economics by the social-democratic parties, inflation aversion has become the new centre in the political system, reflecting the MV's preferences for low inflation.

The next sections provide descriptive and analytical empirical evidence for these arguments – first of the shift rightwards in median voter preferences and then for the translation of this into social democratic party platforms as a result of electoral competition.

4. The moving median voter and the shifting party system

Figures 3-8 present a first systematic descriptive picture of how the preferences of the median voter in OECD countries have evolved since the early 1960s. These graphs suggest very strongly that the employment situation of the average voter (including their families) improved significantly in every respect during the 1960s and 1970s while the accumulation of nominal assets increased at the same time. The majority of the population became inflation averse in the 1970s and early 1980s, which in turn forced social democratic parties to become more economically orthodox.

In the 1960s, the average unemployment rate was extremely low in most OECD countries⁵, even by the full-employment standards of that period (see figure 3). At the same time, the institutional protection against job loss increased significantly as shown by the Employment Protection Legislation indicator developed by Allard (2005): the average across 19 OECD countries⁶ rose consistently throughout the 1960s and 1970s and levelled off in the early 1980s (figure 4). Both macro-economic policies and class politics thus combined to make employment more secure.⁷

To some extent this reflected the organized power of the working class: average union strength in 21 OECD countries, measured as the proportion of employees who are union members (density) increased throughout the 1960s and 70s, to level off in the early 1980s (Figure 5 also makes clear how precipitous and dramatic the decline has been since then). In addition, as women entered the labour market many households in the OECD were or became two-income

⁵ Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, United States.

⁶ Due to data availability the analysis excludes Portugal and Greece.

⁷ See data on unemployment risk in Rehm's latest book (2016).

The Politics of Disinflation

earner families in the 1970s and early 1980s. The data are not consistently available since 1960 to calculate a meaningful cross-country average but individual cases suggest that many countries had high female employment rates by 1970s and 1980s (see table 2). Even if unemployment rates among men increased, this means that in many countries possibly 60-65% of households could rely on two incomes.

Figure 3: Low unemployment in 1960s and 70s in OECD countries

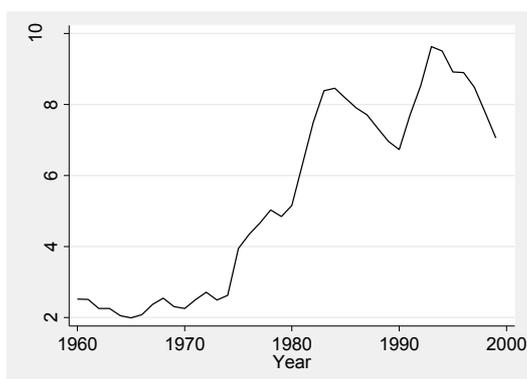


Figure 4: EPL rises from 60s to 80s in OECD countries

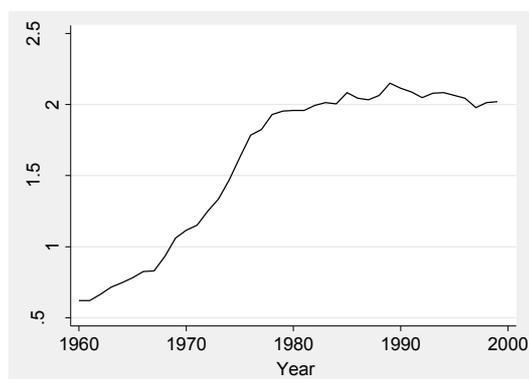


Figure 5: Union strength rises in 60s and 70s in OECD

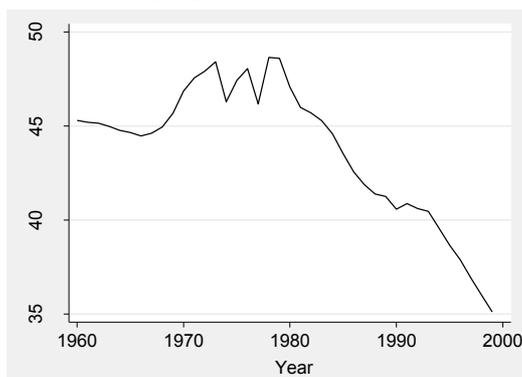
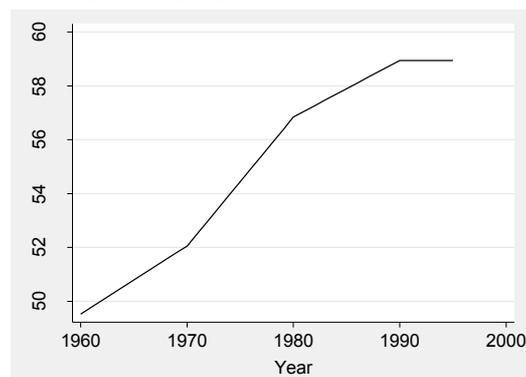


Figure 6: Housing ownership increases in OECD



If we take the owner occupancy rate in housing (housing/home ownership) as a proxy for assets, an interesting picture emerges. Against this background of increasing employment security (and broader social protection and economic security), average households slowly became wealthier. As Figure 6 shows,

home ownership rates in the OECD⁸ rose quickly from about half of the occupancies in 1960 to almost 58% in 1980, and leveled off by 1990 just below 60%.

Table 2.
Female employment rates passing 50% threshold in selected countries

Country	Earliest data	Year of earliest data	First available data point above 50%	
Country for which data < 50% exist				
Canada	47%	1976	51%	1979
Germany	46%	1970	51%	1989
Norway	48%	1972	59%	1975
US	39%	1960	51%	1977
First data point suggests these countries had already passed the 50% mark early on				
Finland	60%	1963	64%	1979
Sweden	53%	1963	70%	1978
Japan	53%	1968		
First available datapoint in 1980s				
Australia	52%	1986		
Denmark	64%	1983		
France	50%	1983		
New Zealand	60%	1986		
UK	1984			

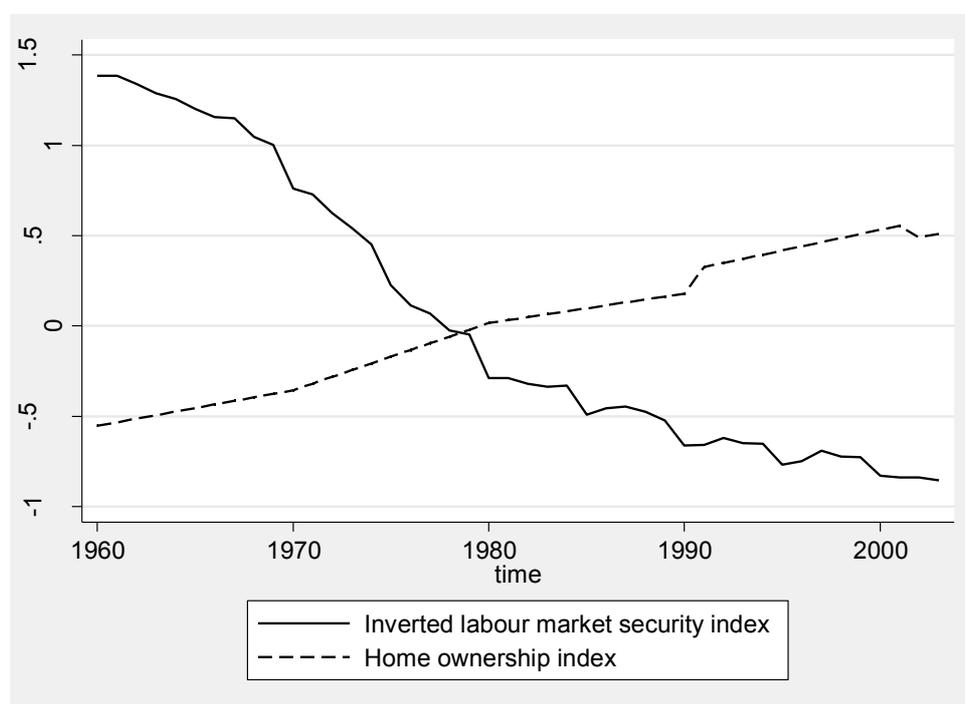
Source: The following examples are rounded and taken from the comparative politics dataset (Armingeon et al. 2015).

To compare our proxy for assets with what happened to subjective employment insecurity requires creating an index for the latter, which is more complicated. An obvious choice would be the unemployment rate but this may be related to inflation through a direct economic (short-term Phillips curve) mechanism rather than the political and policy channel that we explore here. Unemployment may also be a poor predictor of insecurity when income replacement rates are high and/or strong EPL means that insiders do not face a large risk of being unemployed in dualised economies (see Rueda 2007; Emmenegger et al. 2012). We therefore choose to rely on two main variables to create an index of labour market security: *Employment Protection Legislation*, which captures job security, and *educational attainment in years*, which captures

⁸ The cross-national average excludes Greece and Portugal due to a lack of data.

(the increased development of) human capital. EPL could be argued to have a positive impact on wages, but this then actually stacks the cards against our argument because if this effect were to dominate, the correlation between EPL and inflation would be positive (think of this as the conventional new Keynesian view, as in Carlin and Soskice (2006), or the Kaleckian view, both of which suggest that the inflation rate rises if job security increases).

Figure 7.
Labour market insecurity and asset ownership, cross-country average



In Figure 7, we plot the cross-country average of the inverse⁹ of our index of labour market security and our index of asset ownership. Both indices are standardised with a standard deviation of 1 and mean of 0, which allows us to evaluate in which period our cross-country average was under or above the average for the whole sample for each index. Before 1980, labour market insecurity was high (i.e. the inverse of security was high, meaning that labour

⁹ We calculate the inverse to facilitate the identification of the point at which the curve for the rise of home ownership crosses the curve capturing labour market security.

market security was low) while home ownership was low. Around 1980, labour market insecurity fell below the average for the period 1960-2003 while home ownership rose above the period average. This is an encouraging result, as it is almost exactly what we anticipated in our model and which was graphically represented in figure 2.

The results of this combination of (perceived) increased employment security and accumulation of assets was that the majority of the population – which obviously included the median voter – became considerably more inflation averse in the 1970s and early 1980s. Figure 8 shows the percentage of respondents in the integrated Eurobarometer trend survey that identify inflation as the first or second priority. Unfortunately, since the data only start in the mid-1970s we cannot investigate inflationary preferences in the 1950s. We can see that inflation aversion on the whole was very high in the 1970s and only started to fall after social democratic parties had also become more economically orthodox.

However, the case of the US, where Gallup surveys have been carried out further back in time suggests that inflation was identified as the nation's most important problem by less than 30% of the public in the 1950s and 1960s (and at times by considerably fewer people) but by more than 50% and at times more than 70% of the respondents in the 1970s (Fischer and Huizinga 1980: Figure 1, page 5)¹⁰. Hibbs (1982: 224) also found that 'popular support for the President

¹⁰ Smith (1980: 169-170) similarly finds that: 'Figure 4 shows what proportion of all economic responses mentioned inflation. Low points occurred in 1949, 1954, 1958, and 1961, during postwar recessions, and similar drops appeared during the 1970-71 slowdown and the 1975 recession. Peaks appeared in 1966 and 1974. The 1966 point in part reflects the beginning of the 1966-1975 inflationary spiral, but in part appears to reflect the relative absence of unemployment and other economic problems at that time. The 1974 crest, on the other hand, probably reflects the double-digit inflation that crested that year rather than the absence of other economic concerns. The secular trend, once the large cyclical swings are set aside, was for inflation to decline as the prime economic problem from the late 1940s to 1961 (note that each trough hits bottom at a lower level) and for it to rise as an economic concern from 1961 to the mid-1970s.'

The Politics of Disinflation

was relatively more sensitive to nominal, inflation economic performance than to real economic performance in the 1970s than in the previous decade. In the 1960s the mean of the real elasticities was about twice the mean of the inflation elasticities (0.3 versus 0.14); in the 1970s the average real and nominal elasticities were both in the vicinity of one-half. By the second quarter of 1980 the relative impact of inflation on political support had increased enormously.'

Figure 8: Inflation aversion peaked in 1970s and early 1980s

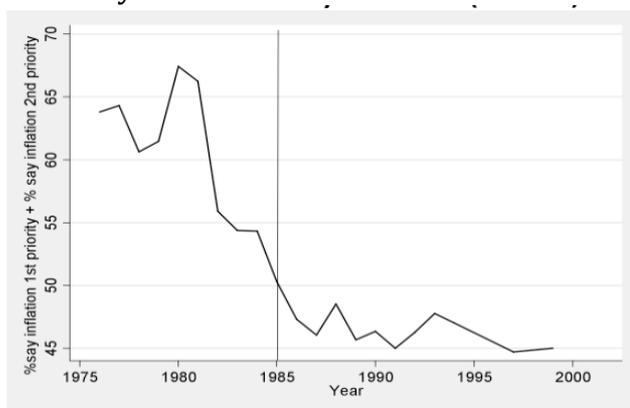
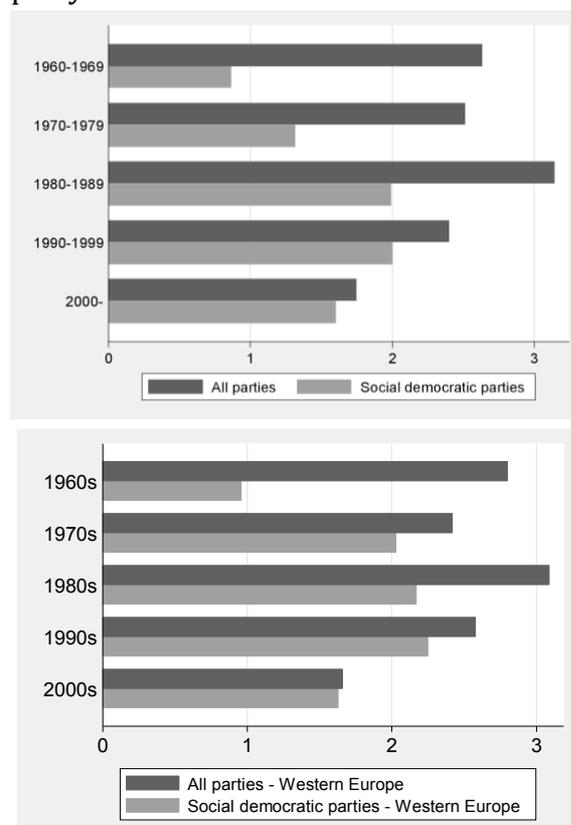


Figure 9: Average 'economic orthodoxy' of party manifesto



The top panel of Figure 9 maps the degree of 'economic orthodoxy' in every decade covered by the party manifesto database (Volkens et al. 2014) and shows very clearly that social democratic parties became more economically orthodox in the 1970s, reached a peak in the 1980s, which remained stable in the 1990s and only started to fall in the 2000s – when inflation was no longer a matter of concern, even among Right parties and extremely orthodox

economists (although it never ceased to be one for central bankers, as we saw during the onset of the financial crisis). If we focus only on western European countries¹¹, shown in the bottom panel of Figure 9, social democratic parties became more orthodox in the 1970s and continued to become more orthodox in the 1980s and 1990s. Following a decade of low inflation the manifestos of both the social democratic parties and their right-wing counterparts had become very similar in terms of adherence to economic orthodoxy.

In general terms, therefore, these aggregate figures suggest that the three phenomena more or less follow our logic: with the increase of employment security, and the accumulation of nominal wealth, the move to the Right of the median voter in turn brings about a shift to the Right of SD parties in their economic policy platforms.

5. Economic security, inflation aversion, party orthodoxy and inflation

In figures 10-12, we present several combinations of relevant variables that allow us to explore, at least descriptively, the key causal relationships in our argument. We systematically plotted shifts in one of our independent variables in the argument in a decade against shifts in the following decade – for economic security, inflation aversion, party manifestos, and actual effects on inflation rates.

Figure 10 plots the relation between our index of economic security (which combines the two indices of labour market security – not the previously constructed inverted version – and assets presented in Figure 7) and the mean

¹¹ The following countries are included in the analysis: Austria, Belgium, Denmark, Finland, France, Germany, Great Britain, Greece, Iceland, Ireland, Italy, Netherlands, Norway, Portugal, Spain, Sweden, and Switzerland.

The Politics of Disinflation

inflation aversion in the 1980s. That association is positive, although the spread of cases across the two-dimensional space is large, with Belgium and Denmark,

Figure 10.
Security and party manifesto economic orthodoxy in the 1980s

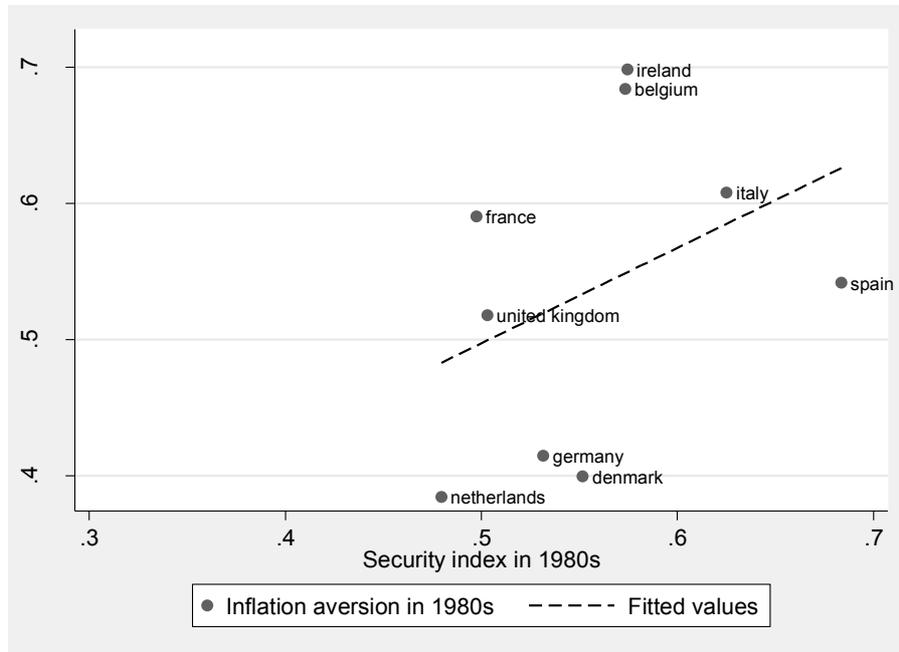
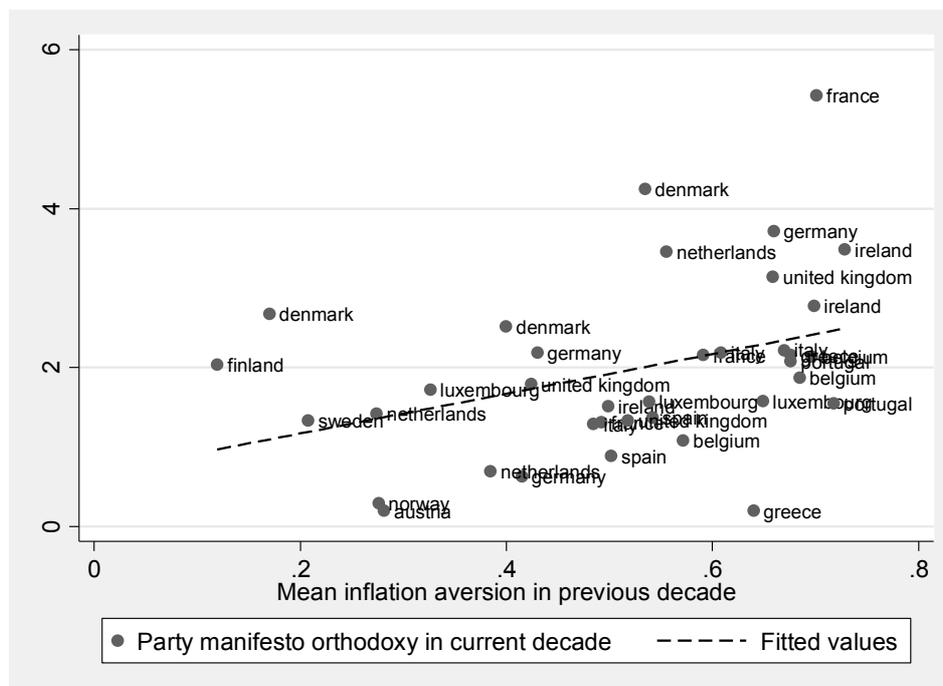


Figure 11.
Inflation aversion and party manifesto economic orthodoxy

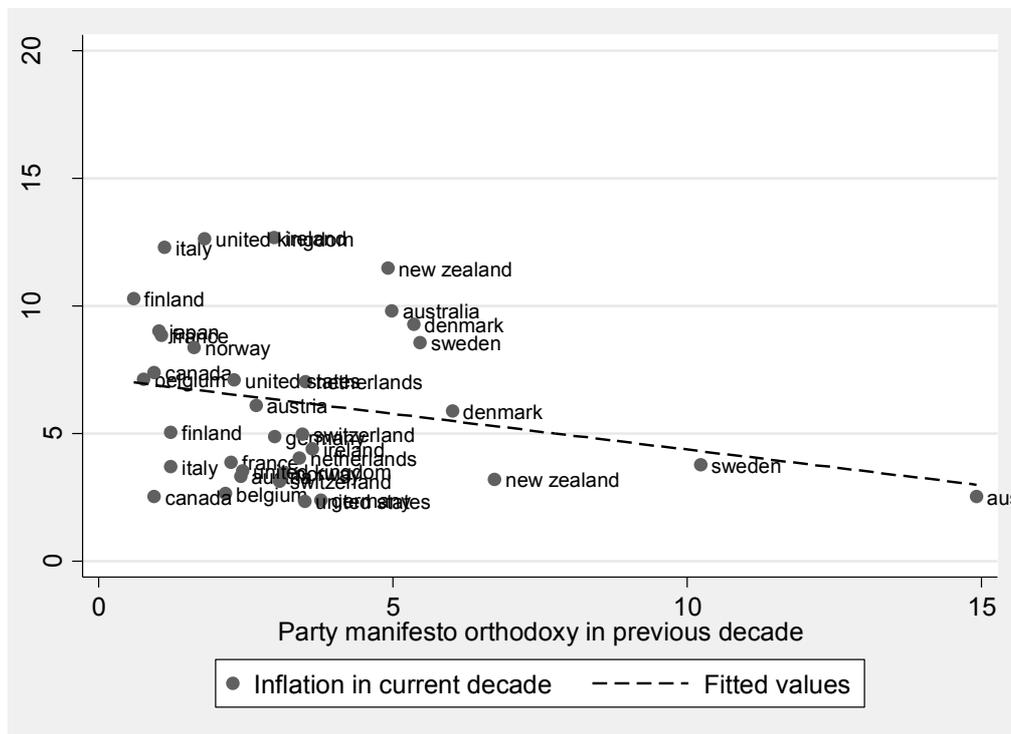


for example, scoring roughly equally high on the economic security index but found on opposite sides of the party orthodoxy score. The bivariate correlation coefficient associated with the data in Figure 10 is 0.39 (with a p-value of 0.30).

Inflation aversion, in turn, is positively correlated with higher economic orthodoxy of parties in the decade that follows, as figure 11 demonstrates. The

Figure 12.

Party manifesto economic orthodoxy in a decade and inflation in the next decade



bivariate correlation coefficient between inflation aversion in the decade before and the average score of party manifestoes over a decade is 0.37 (and a p-value: 0.025). The spread of cases is also slightly narrower than in the case of figure 10. In addition to the scatter plot in Figure 11, we also performed a simple regression analysis, which consisted of 34 observations. We used average orthodoxy in economic policy platforms in a country over a decade as our dependent variable, whilst inflation as well as mean inflation aversion in the preceding decade were our independent variables. This regression analysis suggests that inflation aversion has a (significant) positive relationship with

economic orthodoxy (the coefficient was equal to 2.59 with a p-value equal to 0.087), while the within-R² is 0.57; these two variables alone thus explain 57% of the variation in economic orthodoxy in a country in a given decade. Finally, figure 12 shows – tentatively - that the economic orthodoxy of party manifestos is, in turn, associated with lower inflation in the next decade.

Table 3.
Security and inflation

Column	(1)	(2)	(3)	(4)
Dependent variable	Inflation rate	Inflation rate	Inflation rate	Inflation rate
Index of security (<i>standard normal</i>)	-3.50** (1.047)	-1.43* (0.635)		
Index of labour market security (<i>standard normal</i>)			-1.52* (0.554)	
Index of security 2 (<i>standard normal</i> , with share of elderly)				-2.37*** (0.502)
GDP growth rate (<i>standard normal</i>)	-1.39 (1.454)	-0.18 (0.977)	-0.15 (0.783)	-1.03 (0.642)
Unemployment rate (<i>standard normal</i>)	-0.60 (0.498)	-0.65* (0.259)	-0.51t (0.281)	-0.57* (0.229)
Left control of cabinet (<i>standard normal</i>)		-0.12 (0.501)	-0.24 (0.468)	-0.11 (0.465)
Union density (<i>standard normal</i>)		1.42 (0.842)	1.28* (0.518)	1.41t (0.686)
Trade openness (<i>standard normal</i>)		-0.51 (0.556)	0.01 (0.658)	-0.43 (0.559)
Capital openness (<i>standard normal</i>)		-2.42*** (0.439)	-2.71*** (0.385)	-2.06*** (0.436)
CBI (<i>standard normal</i>)		-0.10 (0.325)	-0.32 (0.367)	0.01 (0.358)
Constant	6.38*** (0.314)	6.28*** (0.256)	6.26*** (0.169)	6.65*** (0.191)
Observations	79	73	78	73
Number of countries	19	19	20	19
Country fixed effects	Yes	Yes	Yes	Yes
R-squared within model	0.40	0.87	0.89	0.90
R-squared overall model	0.03	0.62	0.74	0.61
R-squared between model	0.40	0.04	0.41	0.00

Note: robust standard errors clustered by country in parentheses; *** p<0.001, ** p<0.01, * p<0.05; t p<0.1. The sample is composed of 10 years period average: 1950s, 1960s, 1970s, 1980s, 1990s, and 2000s.

Results from a preliminary regression analysis on a sample of 21 OECD countries in the period 1950s-2000s seem to confirm our hypothesis (see table 3). Our regression analysis reports robust standard errors clustered by country, includes country fixed effects and is carried out on 10-years period average to capture the fact that we are looking at slow moving shifts in variables rather than year-on-year variation. Column 1 suggests that our index of security combining both labour market security and home ownership (shown in Figure 7) is negatively correlated with inflation when controlling for GDP growth and unemployment. Adding Left control of cabinet, union density, central bank independence, and trade as well as capital openness does not change the results (column 2). In column 3, we show that focusing just on labour market security while excluding assets does not change the results. Adding the share of elderly in our index to capture the fact that the elderly are more inflation averse and unaffected by labour market insecurity (see Vlandas 2017) does not change the results (column 4).

If we use yearly data the results do not change (table A2 in appendix). One could argue that this correlation is coincidental and driven by the high inflation and low security of the 1970s. In column 3 of table A2, we therefore restrict the sample to the moderately low-inflation post-1978 period: our index of economic security is still statistically significant. In column 4, we investigate whether the results are robust to the exclusion of country fixed effects: union density is no longer significant but our index of economic security remains significant with the correct sign. In columns (5) and (6), we take the first and second lags, respectively, of our key independent variables (except for GDP growth). In column 7 we present the results when we run the regression on 5-years period averages and in columns 8 to 10 we try alternative specifications of our index of security. The main results are unchanged. Finally in column 11,

we add union density to this index of economic security (which as a result becomes composed of EPL, educational attainment, housing ownership, the share of elderly and union density): the coefficient is still negative and significant at the 10% level. Finally, we have also rerun the yearly analysis using an error correction model (ECM)¹² which suggest our index of security has a significant negative long run effect on inflation but no short term effect (not included in this paper but available from authors).

An important caveat at this stage is that there are potentially important methodological problems with such a regression analysis because of the nature of our dependent variable and argument. Our aim is to explain a regime shift – from Keynesianism to monetarism (captured in the transition from moderate/high to low inflation), which happens at *a single point in time in all developed countries* (though not necessarily at the same time), and **not** the *cross-national variation in inflation across countries and time*. In addition, we argue that this shift was driven by a *combination of changes* in the economic conditions of the electorate, which fed into their inflation preferences and in turn into political parties' economic orthodoxy. Economic insecurity might also be endogenous to inflation, at least partly. As a result the correlational logic underpinning regression analysis might not provide a good test of our argument, which is why we pay more heed to the careful historical analysis of how these shifts have occurred in Western Europe in the next section.¹³

¹² Panel data unit root tests on the yearly sample reject the null hypothesis that all panels contain a unit root for inflation but not for our index of security so the latter may be non-stationary. ECMs are designed to handle non-stationarity. The error correction coefficient is statistically significant suggesting both series are co-integrated (i.e. the error term is stationary) and hence the inference from the ECM is valid.

¹³ Focusing on the impact of ageing is more promising from a statistical perspective because the share of ageing is exogenous to inflation. Ageing on its own is unlikely to lead to a shift in the inflation regime, but if we are right we should observe that countries where the share of people above 65 is larger also have lower inflation. This is precisely what Vlandas (2017) finds using a wide range of methods and samples. He provides robust statistical evidence for the part of our argument that is exogenous to inflation and can be expected to have a cross-national effect.

That said, we have thus far found highly suggestive aggregate historical, descriptive cross-national, and statistical-analytical evidence for our argument. But the analysis was carried at a level of aggregation that makes it hard to trace the process through which changing economic conditions feed, through the electorate, into shifts in party positions. This is what we do in the next section.

6. Case studies: the UK, France, Germany and Sweden

The dynamics between the median voter and social-democratic parties are the subject of four short case studies of the UK, France, Germany and Sweden, more or less going back to the mid-1960s. The four countries embody the main broad political-economic models found in Western Europe, thus maximising the differences between these systems: this suggests that the causal mechanism operates regardless of broader historical-institutional background conditions (see also Hall 2007 on these four). In addition, they also teach us something more immediate with regard to the argument that links median voters and social-democratic parties. Across these four cases, we will go from a pure majoritarian electoral system, where median voter preferences directly influence the electoral fortunes of social-democratic parties, to a pure proportional system in Germany and Sweden – but with the latter having a hegemonic social-democratic party that can, to some extent at least, shield itself from direct electoral competition on macroeconomic policies. That means that we have both cases of high median voter influence (the UK and, to a lesser extent, France), cases of party competition beyond a simple dyad and, in the latter, even one with low levels of multi-party competition.

United Kingdom: From Thatcher to Blair via low inflation

We start with the *United Kingdom*, the country in Europe with a straight majoritarian electoral system. Here the logic implied by our argument unfolds

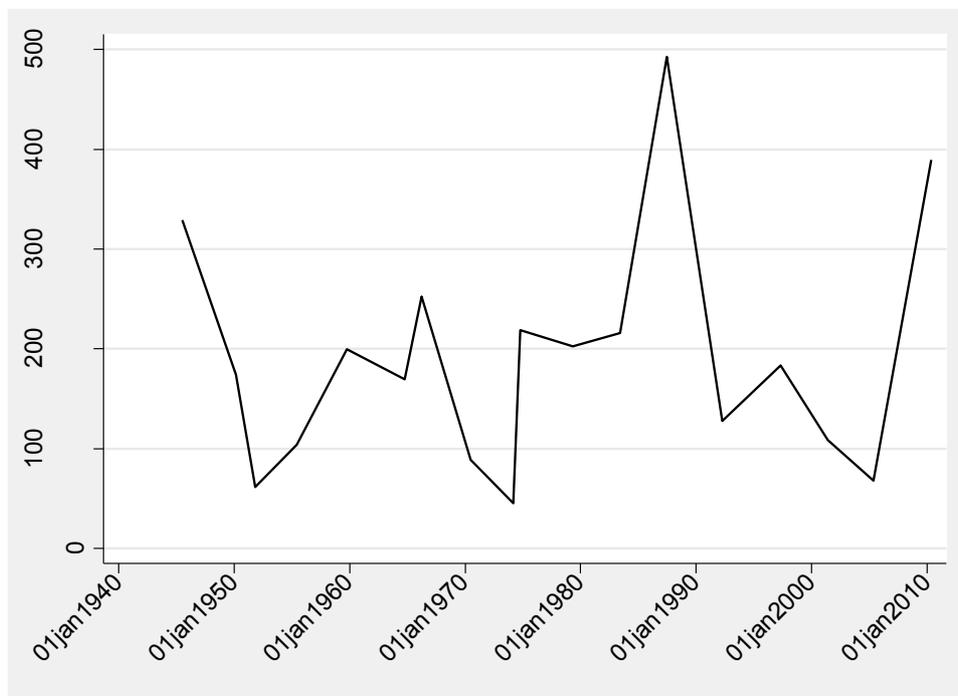
The Politics of Disinflation

quite nicely. In essence the story starts, not unsurprisingly, with Margaret Thatcher's election victory in 1979. The policies the Conservative Prime Minister adopted afterwards grafted themselves onto slow shifts in the economic situation of the median voter, with the effect that Thatcher de facto changed the profile of the latter. While her government initially was not off to an auspicious start, once unemployment fell in the mid-1980s, the fear of job loss also fell significantly as a result of a previously large increase in education, possibly the single best predictor of increased life chances and especially low unemployment in the late 1980s and 1990s. This came on the back of a significant reduction in working hours during the post-war boom years (Sutcliffe 1996: 147). In addition, the combination of lower taxes and financial deregulation induced a 'wealth effect' among voters (Crouch 2009).

For figure 13 (and figures 14-16) we calculated an index of support for economic orthodoxy. For every party in every election since the Second World War, we multiplied the manifesto 'orthodoxy score' and the percentage of the vote that party received. We then added, for every election, these scores to obtain an overall score of support for orthodox policies in the electorate during that election, and plotted those for every election. A high score on this measure indicates that many people voted for a party with a high score on economic orthodoxy. The graph in Figure 13 shows quite clearly the spike in the index of support for economic orthodoxy. The level of support, highly subdued during most of the 1970s (despite high inflation rates of 20% or more), actually falls for most of the decade. Estimates of changes in political support in response to economic outcomes for the period 1959-1978 suggests that the fall in support was almost twice as high for an increase of two points in unemployment than for an increase of two points in inflation (Hibbs 1985: 184). In the late 1970s, it started to rise sharply, never to fall until inflation was below 4% in the early 1990s.

In terms of our median voter E-A model developed in Section 2, the subjective perception of costs associated with unemployment (E) fell for large segments of the population, while the nominal value of assets (associated with A) rose rapidly. This undermined the classical social-democratic electoral strategy of Labour, based on $E > A$, and locked in the median voter on the Right of the economic spectrum, more concerned about inflation than about employment and growth.

Figure 13.
The evolution of support for economic orthodoxy in UK



Source: Orthodoxy support is the sum of [vote share for party i ($=1, \dots, n$)] times economic orthodoxy of party i ($=1, \dots, n$), for all political parties in an election (see detailed explanation in the text).

Labour responded to Thatcher's victory by moving considerably to the Left, writing what was, in effect, a socialist electoral programme for the 1983 elections. Voters in 1983 viewed Labour as prioritising unemployment much more than inflation while the reverse was true for the Tories (Clarke 1986: 128). An analysis of popularity in the period 1979 to 1983 reveals that one percentage point in inflation cost the Labour party roughly one third of a point in support (ibid: 132). The headwinds for Labour associated with the split in the party and

The Politics of Disinflation

the ultra-patriotic mood in the country after the Falklands war, both of which have been invoked as reasons for Labour's defeat that year, certainly made things worse for the party, but they should not divert attention from the long-term development in the British electorate towards explicit inflation aversion. In response, the Kinnock years saw a gradual move to the centre-Left, symbolized in the struggles against the socialist factions that had organized within the Labour party. On macroeconomics, the party adopted a considerably more orthodox platform for the 1987 election than it had done even in the late 1970s (when inflation was, in fact, rampant and thus arguably required a vigorous policy response): the score for orthodoxy as recorded in the Party Manifestos Project shot up from close to zero in 1983 to 2.5 out of 5 in 1987. The Labour party gained ground in the election that year, but remained nonetheless over 10 percentage points behind the Tories. By 1992, the Tories and Labour were neck-and-neck in the election, which Labour lost narrowly, but in the 1997 election, Labour won a massive majority with an election manifesto that scored 4.5 on economic orthodoxy – effectively moving to the Right of the Conservatives. Keen to brandish their new credentials, once in office, Tony Blair and Gordon Brown handed operational independence to the Bank of England, thus sealing the fight against inflation *AND* against growth-oriented Keynesianism in their own party – at least until the financial crisis of 2008.

In sum, once the median voter's preferences had moved from concern over growth and employment to fear of inflation, Labour slowly followed suit, and ended up being more orthodox than the Conservative Party. In a dramatic and highly symbolic move a few days after Labour's election victory in 1997, the Blair government handed the Bank of England political independence: in that new inflation-targeting regime the government set the target and appointed

governors, but the latter, in the Monetary Policy Committee of the Bank, were given the autonomy to decide how to meet the target.

France: from socialism in one country to competitive disinflation

A very similar process took place in *France*, our second case. Under the Fifth Republic the Left took a long time getting to power, and was elected in 1981 on what would today be considered a far-Left programme, while at the same time, the electorate was slowly moving to the Right on economic policy issues. The conversion to a soft version of monetarism and inflation targeting followed a series of defeats against the centre-Right and, very importantly, a series of struggles within the Socialist Party – but ultimately the French Left ended up in a very similar position to Labour (pushed there, to some extent, by European economic policy constraints), after a very similar conversion.

The place to start the French case study is the post-war boom. Between the end of post-war reconstruction (around 1950) and the second oil shock in 1979, the French lived through what became known as the *'Trente Glorieuses'* (or *'Glorious Thirty'*, in the words of Fourastié 1979). The country modernised its economy and industry, becoming the best pupil of Taylorism and Fordism on the continent (Hancké 2002), while standards of living for the average family almost doubled during the first twenty years of that period: spending on food and clothing took up roughly 65% of household's consumption in 1950, fell to 54% in 1959, and to 44.5 % in 1968 (Sutcliffe 1996: 145), while average annual working hours fell by more than 250 hours between 1950 and 1973 (Sutcliffe 1996: 147). Wealth was slowly accumulated, while job security increased dramatically for the majority of workers. Private savings as a fraction of national income had increased significantly during the 1950s and 1960s and

The Politics of Disinflation

remained high in the 1970s.¹⁴ From its lowest point in the 20th century after the Second World War, the wealth to disposable income ratio increased from under 300% to over 400% by the late 1970s and early 1980s.¹⁵ Temporary work was regulated in the 1970s (Vlandas 2013) while the EPL index (developed by Allard 2005) shot up from 0.1 in 1960 to 2.3 in 1980, 2.8 in 1985 and 3 in 1990. Educational attainment also increased sharply in the 1980s, on the back of government policies to have over 75% of a cohort pass their certificate of secondary studies, the *Baccalauréat*, by 1994 (up from 25% in 1984), and go on to higher studies, in technical or academic colleges and universities. In effect, by the mid-1980s, inflation looked like a far more important problem for the vast majority of the French than unemployment – despite the jump in the unemployment rate in the previous years. More than 70% of respondents to the standard Eurobarometer survey put inflation as the first or second biggest problem in the early 1980s. This contrasts markedly with the political importance of inflation prior to that. Though the Eurobarometer does not have data on inflation aversion, in an analysis of presidential approval ratings and economic indicators in the period 1969 to 1978, Hibbs and Vasilatos (1981: 52-3) find that inflation did not have a statistically significant impact whereas the growth of real income did.

Most of French post-war economic history can be understood as a combination of rapid, centralized supply side modernization, and a fight against resulting inflation, either through wage repression (Ross 1982) or through ultimately self-defeating devaluations (which make exports cheaper while making imports, in what is a very open economy, more expensive and thus fuel inflation). This tension came to a head in the social explosion of May 1968

¹⁴ See figure 11, <http://piketty.pse.ens.fr/files/EU%20Wealth%2023-11-2010.pdf>

¹⁵ See figure 5, <http://piketty.pse.ens.fr/files/EU%20Wealth%2023-11-2010.pdf>

(Howell 1989), which partly modernized the wage-setting system, but also led to a devaluation of the Franc by more than 10%. The attempt by President De Gaulle to have his social policies ratified through a referendum backfired and after the General's resignation, the 1969 presidential election turned into a massive defeat for the candidate of the Left, Gaston Defferre, with only 5% of the vote and shut out of the second round. François Mitterrand took advantage of this defeat to agglomerate all the Left parties (one of them was called, somewhat anachronistically in an era of predominantly national politics, the 'French Section of the Workers' International' or SFIO) and founded the Parti Socialiste (PS), a Left-leaning centre-Left party in 1971.

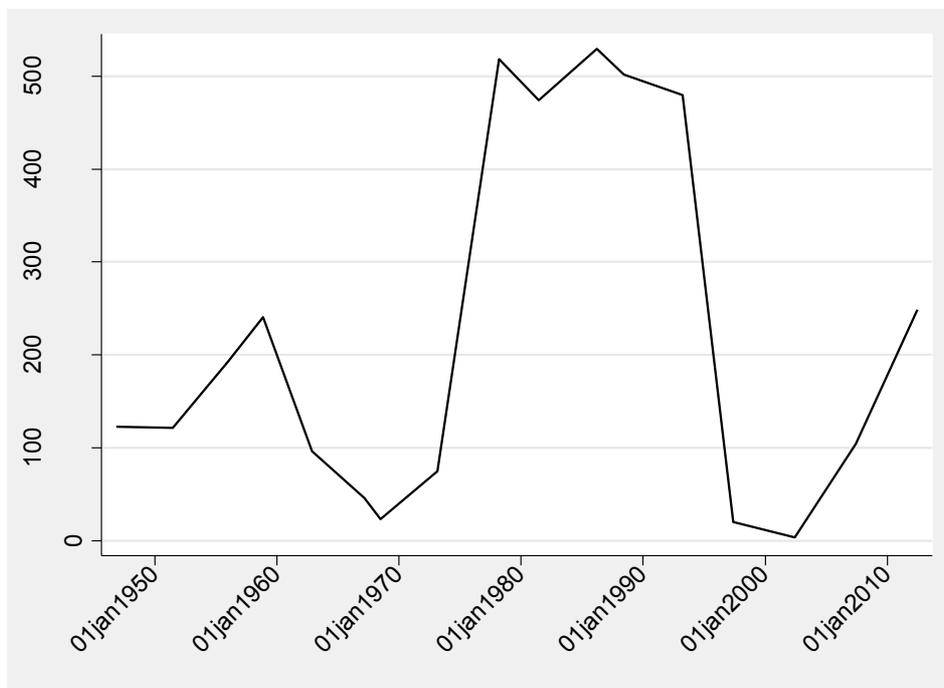
After president Pompidou's death in 1974, Mitterrand almost beat the centrist Giscard d'Estaing in the follow-up election (49% against 51%), and as a result the Left expected to win a majority in the 1978 parliamentary elections, which would *de facto* turn the president into a lame duck. This did not happen, and the lesson the Left drew was that the election programme required a bit more of an edge: it accused French capitalism of not being dynamic enough, producing both uncompetitive industries and high unemployment and inflation; the answer lay, according to this analysis, in the nationalisation of key industries and banks, as this was the only way to modernize and prepare them for increased competition in the Single European Market. Mitterrand, the candidate of the Left in 1981, won the presidential elections that year, and immediately embarked on an expansionary programme led by the Parisian centre, while also introducing decentralized buffering institutions designed to emulate the German economy (including, importantly, its low-inflation effects). Labour relations, regional policies and finance were reorganized to increase innovation, productivity and allocative efficiency and thus reduce the need for periodic devaluations. These policies failed in many respects (Levy 1999; Hancké 2002: 37-56): neither unions nor employers were able to handle

The Politics of Disinflation

the new governance responsibilities handed to them by law, banks were uneasy leaving the cosy financial shelter offered by the state, and regions became vacuous extensions of the centre without any of the local dynamism that decentralisation was supposed to spawn. French capitalism was, so it seemed, simply not transformable. The government responded to the emerging crisis by devaluing the Franc in 1982. At the occasion, Finance minister Jacques Delors pointed out that currency depreciations of this sort needed strong accompanying measures to assure others, and especially Germany, that France was serious about containing inflation (Favieu & Martin-Roland 1990: 489). As things got increasingly worse – both inflation and unemployment rose in 1982 – the Left lost local and regional elections that year. Using data that covers both Giscard d'Estaing's presidency from October 1974 to May 1981, and the period under Mitterrand's first two years of presidency until 1983, Lafay (1984: 345) shows that inflation seems to have a stable, negative effect on the popularity of the president. The year 1983 was the year of the second 'rupture', with socialism in one country this time. For a while, the Left of the PS stood its ground: the Cabinet was, in fact, totally divided between those who wished to pursue a consistent Keynesian policy of reflation and thus willing to risk French membership of the European Monetary System (the EMS, the immediate ancestor of EMU) as a result, and those who considered austerity and disinflation to be the basis for a sound economic policy that would allow the Franc to stabilize. By deciding to stay in the EMS, Mitterrand not only tied the currency to the Deutschmark (thus sacrificing all macroeconomic adjustment tools), but also imposed a drastic centrally led disinflation programme (Lordon 1998). Delors relied on the subservience of the Banque de France to quell sources of inflation in the system (leaving little doubt among the unions about an appropriate, i.e. disinflationary, wage rate). By the mid-1980s, as a result, a disinflationary regime had taken root in France, and the inflation rate fell from 9.5% in 1983 to 3.3 in 1987).

By the mid-1980s, these different processes led to a very different landscape of economic policy-making. The average household had seen its disposable income rise dramatically in two decades, while the state remained for many an employer of last resort or the purveyor of income support in the case of job loss. That shifted the economic policy preferences of the electorate to the Right, as figure 14, which reports electoral support for orthodox policies, shows. At the same time, the Left lost elections at an alarming rate – only a few years after finally having conquered the Elysée! Turning the electoral tide required the Left to adopt a more orthodox economic policy platform, based on inflation fighting instead of full employment – and it used the (politically highly dependent) Banque de France as its key instrument for that. As a result, inflation rates fell rapidly in the second half of the 1980s, and have stayed very low since. Despite the decentralising fervour with which the Left had started in office, it ended by introducing monetarist modernisation from above.

Figure 14.
The evolution of support for economic orthodoxy in France



Source: Orthodoxy support is the sum of [vote share for party i ($=1, \dots, n$) times economic orthodoxy of party i ($=1, \dots, n$)], for all political parties in an election (see detailed explanation in text near Figure 13).

Germany: Social-democratic monetarism

Our third case is *Germany*, the home base of monetarism in Europe. In many ways, low inflation in Germany may seem impossible to explain – because it is overdetermined. The policy mix in the larger sense is impressive indeed: entrenched inflation fears harking back to the twenties, the independent Bundesbank, the German mark as the symbol of the post-war economic revival, and the strong interest organizations at the basis of German competitiveness. Add to that the fact that the social-democratic party, the SPD, had its damascene conversion as early as 1959 in the Bad Godesberg conference, where it accepted capitalism as the key organizing economic principle of the country, the absence of a serious threat on the Left for most of the post-war years, and that the trade unions are of the ‘responsible’ kind, aware of the macro-economic effects of their actions, and it would be hard to even begin to imagine high inflation. Yet the history of disinflation as pursued by the SPD in Germany maps, somewhat surprisingly perhaps, quite well onto our model.

Despite everything that points in the opposite direction (not least the absence of a solid Keynesian tradition in German academia; see Allen 1989), the SPD remained a left-wing, Keynesian-inspired party for most of the 1960s: during the years in office after 1965 (in the Grand Coalition) and as a senior partner with the FDP from 1969 to 1982, the party pursued expansive policies where possible. Left voters in the 1970s attached more importance to unemployment relative to inflation than conservative voters (Kirchgässner 1991). The Bundesbank switched to monetary targeting in 1974, but once the trade unions understood that the central bank would retaliate against inflationary wage settlements, they moderated wage claims and the Bundesbank relaxed its stance. In the 1970s, as a result of electoral pressures, the SPD did not move to the Right (as could have been anticipated), but actually to the Left. After the 1976 election, when the SPD lost almost 10% of its seats, Chancellor Helmut

Schmidt agreed to a fiscal stimulus package to combat rising unemployment (Notermans 2000: 177), and at the Bonn summit one year later, Germany even agreed to be the economic 'locomotive' of the world economy in a concerted fiscal expansion. For most of the 1960s and 1970s, therefore, the SPD remained a relatively traditional social-democratic party with a Keynesian macroeconomic orientation – with massive electoral success as a result (gaining 40% or more of the popular vote and for many years between 40 and 47 per cent of the seats in the lower house).

The fall of the Schmidt government in 1982 heralded a fundamental shift in the SPD's approach to macroeconomic policy-making. The 1987 election was fought on traditional Left-Right terrain, with a large part of the SPD election programme based on standard wage increases and Keynesian policies for full employment. The SPD lost the election and in response shed its Keynesian cloak, emphasizing labour market flexibility and other supply-side measures (Notermans 2000: 228). This sealed the conversion of the social democrats to monetarism.

These political developments took place against a background of wide-ranging yet slow-moving shifts in the economic fortunes of the electorate. Throughout the 1960s and early 1970s, unemployment remained solidly below 2%, and while it increased moderately during the remaining part of the 1970s, it was under 5% – very low by European standards at the time. More importantly, those in jobs saw their economic security increase significantly: measured as the OECD employment protection legislation (EPL) index, job security increased from 1.2 in 1960 to 1.4 in 1970 and 2.9 in 1975 and stayed at that level until the mid-1980s; union density increased from 32% in 1970 to nearly 35% in 1980; and wages increased significantly: between 1962 and 1969, for instance, hourly wages in manufacturing increased by more than 50% (Sutcliffe 1996: 145). Average annual working hours, in turn, fell almost 25% by 500 hours between

The Politics of Disinflation

1950 and 1973 (Sutcliffe 1996: 147). While job security increased, savings shot up as a result of increased disposable income, and the rate of home ownership increased significantly from 29% in 1960 to 40% in 1980.

By the early 1980s, the median voter in Germany was, as these figures reflect, relatively wealthy, relatively secure in his job and could rely on a generous welfare system if income were to fall as a result of unemployment, health or retirement. For him, the economic insecurity associated with the end of the war, reconstruction and the early 1950s was a distant memory by then. Erosion of the value of their assets through inflation was a far more important problem, and political parties, even on the Left, rapidly reflected that shift. By the mid-1980s, with the conversion of the SPD, all parties had become proponents of sound money policies.

Sweden: Holding the fort

Sweden offers our final case study. The country is interesting for the argument we are developing here for several reasons. One, it is a standard electoral system of proportional representation – but one in which one party, the social-democratic SAP, dominated the political scene for almost all of the post-war era, often with large pluralities or even absolute parliamentary majorities. And secondly, despite the general affluence of the population and the political and institutional orientation towards full employment for most of the post-war period (levels and growth rates of GDP/cap in PPP terms are among the highest in the world and unemployment among the lowest), the SAP stubbornly resisted calls for a more restrictive policy regime until well into the 1980s and even the early 1990s (Notermans 1993). In other words, while the median voter's concrete preoccupations objectively must have shifted to the Right, the hegemony of the social-democratic party was such that it could trump this and maintain a growth and full employment oriented regime, at least until the early

1990s. The case study thus also offers a mirror to our argument about party competition: when the dual threat of defection by the electorate (and by centrist parties) to the Right is absent or very weak, social-democratic parties retain important degrees of autonomy from the shifting preferences of the median voter.

Let us start the analysis with the evolution of employment security and wealth of the median voter. Sweden since the Second World War offers an almost unique combination of several policies and institutions that increased and stabilised employment security for the bulk of the population at a high level: the relentless pursuit of full employment, the generalised rise in educational attainment, the very high union density rates and the strong position of trade unions in the domestic political economy more generally, the combination of relatively strong EPL and active retraining policies for the unemployed, coupled with generous unemployment benefits, and a large public sector as employer. For any voter who was employed, the potential cost of unemployment was low: it combined a low risk of unemployment with high actual income or replacement income. In our E-A model, E was therefore on a rapid downward trajectory.

Yet despite the dramatic increase in the standard of living during the post-war boom years – real GDP/cap increased from \$6739 (1990 dollars) in 1950 to over 14000 dollars in 1975 (Maddison 2013 database) – few families were able to build up significant assets because of the high tax rates. Net household savings rates remained low as a result, at 4.5% of GDP in the 1950s and 2.1% in the 1970s (Henrekson et al. 1996: 258), and both levels of and growth in home ownership was and remains low as well (it only increased from about 40% in the 1970s to about 45% in the 2000s – Nickell 2006). The high tax rate and the redistribution that followed implied, of course, that the economic security of citizens remained

The Politics of Disinflation

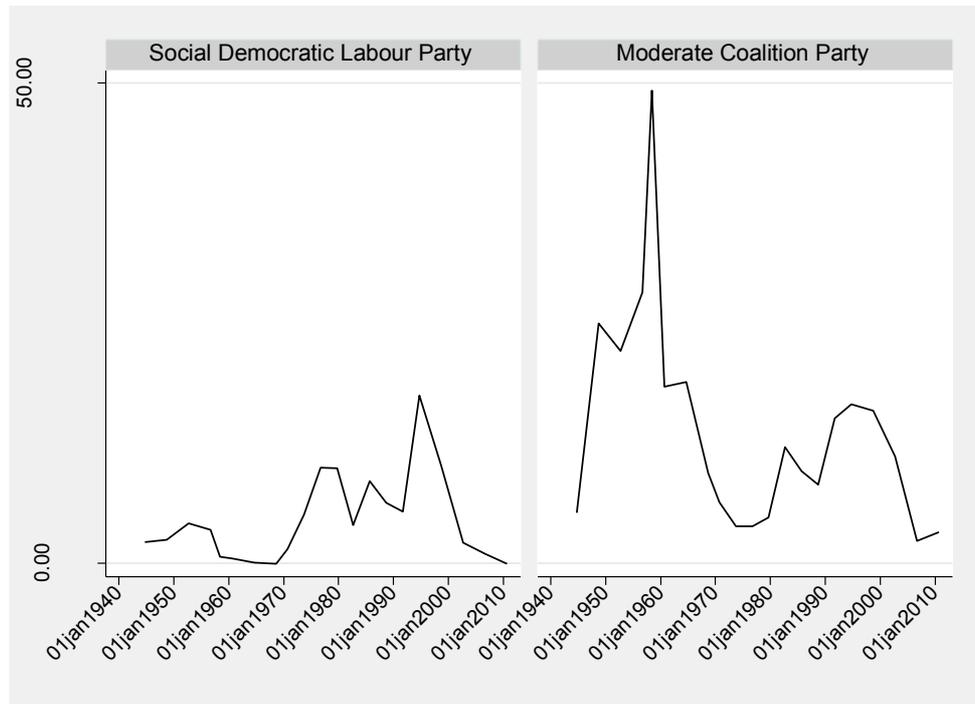
high: the universal welfare state, excellent educational system and government-sponsored housing schemes took the place of private wealth in other countries.

The social-democratic party in Sweden, the SAP, therefore did not come under pressure from the median voter the way centre-Left parties elsewhere in Europe did. Despite a low fear of unemployment and of the costs associated with job loss, the asset base of most Swedish households remained too narrow. Hibbs (1981: 40) found that inflation had no significant impact on electoral performance in the late 1960s and 1970s, and that the fall in electoral support for political leaders in response to higher unemployment was larger in Sweden than in the UK, France or Germany, while the fall in support in response to inflation was the lowest (Hibbs 1985: 184). While parties on the right adopted more orthodox economic policy platforms, the SAP did not do so before the 1990s – and only to a modest degree afterwards (see figure 15). However, since the SAP remained the dominant party, in large measure because of the combination of vote-winning redistributive policies and increased job and income security, the direct effect of this electoral competition on party policy remained quite small. In fact, we can perhaps best understand the policies by ‘bourgeois’ governments since the 1990s to liberalise the economy and privatise large parts of the state, including the welfare state, are in this context perhaps best understood as attempts to produce a more Right-wing median voter, with the aim of undermining the SAP’s electoral base.

Figure 15 shows clearly that the economic orthodoxy of the SAP manifesto only peaked in the late 1990s – not only very late in comparative perspective but also, compared to the centre-Right party’s peak earlier in the post-war period, a very modest rise. This surprising finding makes more sense when considering the timing of the increase in security and access to home ownership alongside shifts in party programmes. Using the EPL index as an indicator, the former only started rising in the 1970s and continued to do so well into the 1990. Similarly,

home ownership remained low during that period, under 40% well into the 1970s and only reached 45% in 2000.

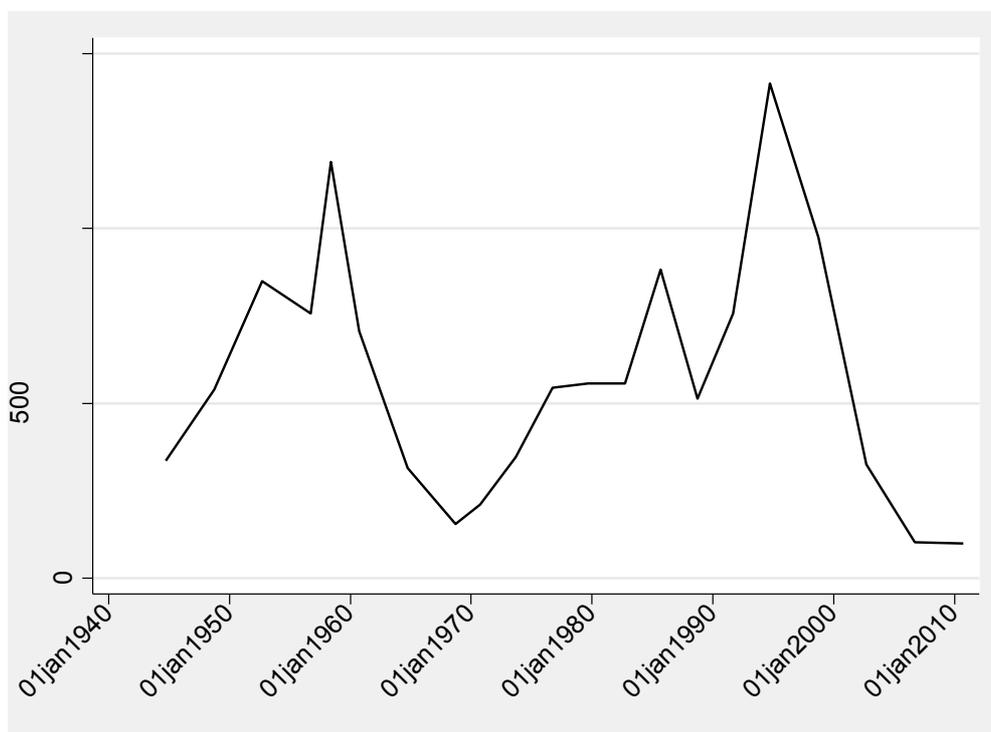
Figure 15.
Economic orthodoxy in the SAP and the
Right party's manifesto in Sweden, post-war period



Source: Orthodoxy support is the sum of [vote share for party i ($=1, \dots, n$) times economic orthodoxy of party i ($=1, \dots, n$)], for all political parties in an election (see detailed explanation in text near Figure 13).

This interaction between the relative economic security of the median voter in Sweden throughout the post-war period and the relative insulation of the social-democratic party from direct competition on the Right meant that the support for economic orthodoxy remained subdued in the country. After the inflationary scramble of the 1950s, which actually gave birth to the disinflationary centralized wage bargaining model that made Sweden famous in the literature on corporatism that emerged in the 1980s (Martin 1984), our index of support for economic orthodoxy only started to rise again in the 1990s, when inflation had become a wider problem as a result of an overheated economy. The financial and economic crisis of 1992 killed off inflation quickly, and public support for austerity waned as a result.

Figure 16.
The evolution of support for economic orthodoxy in Sweden



Source: Orthodoxy support is the sum of [vote share for party i ($=1, \dots, n$) times economic orthodoxy of party i ($=1, \dots, n$)], for all political parties in an election (see detailed explanation in text near Figure 13).

This case study of Sweden teaches us two important lessons. One is that the basic argument that links disinflation to relative shifts in aversion to unemployment and to inflation helps understand how inflation can remain a distant electoral and policy problem if the asset base of the median voter remains low and the accumulation of wealth is collective rather than individual. Despite the very low actual threat to living standards and life chances that unemployment posed in post-war Sweden, the narrow asset base of the average household meant that A in our model was never able to replace E as the dominant concern for the electorate until late in the 1990s, i.e. 15 to 20 years later than it did in the other three countries examined here. The second is that social-democratic parties could use a sustained and coherent strategy toward full employment and producing collective instead of individual wealth as a way of reaping electoral rewards that constituted a buffer against competition from the Right on economic policy. The dominant position of the SAP for almost the

entire post-war period is undoubtedly also in part the result of the success of its economic policies geared toward full employment and generalised welfare, which allowed the party to fend off attacks by the Right. Conversely, it is probably no surprise that support for SAP began to wane in the late 1990s and 2000s when it adopted a programme that was indistinguishable in orientation from its competitors on the Right. As Table 4 shows, between 1994 and 2006, the party's share of the vote collapsed from 45% to 35% (Volkens et al. 2014), exactly at the time that its economic orthodoxy score rose significantly.

Table 4.
Election results Swedish Social Democratic Party (SAP), 1994-2006

Election year	Percentage vote
1994	45.3
1998	36.4
2002	39.9
2006	35.0

Source: Volkens et al. 2014.

7. Conclusion

The decades after the end of the Second World War witnessed an unprecedented increase in living standards for the vast majority of the population in all OECD countries (and beyond). Real incomes shot up, while the fear of unemployment – still a massive threat to average families as late as the 1930s – dwindled as a result of full employment policies, employment protection legislation, the policing role of trade unions, and the vast expansion of the welfare state. At the same time, disposable income increased everywhere, as did household savings, which were converted into wealth. As the asset base of average families grew and fear of unemployment subsided – two processes that took place simultaneously – the electorate changed profoundly. Painted with broad brush strokes, if an average citizen – the median voter – was deeply concerned about (un)employment in the early 1950s, by the late 1970s she was

The Politics of Disinflation

at least as much and possibly more concerned with rising inflation, which was eroding the value of the assets she had accumulated.

That rightward shift of the median voter was reflected in the economic policies adopted by the main parties. While both the centre-Left and the centre-Right were full-employment oriented in the early 1960s, by the mid-1970s, the centre-Left was usually alone in that position. Electoral competition – elections are won in the centre, wherever that may move – forced social-democratic parties to the Right, and by the late 1980s most centre-Left parties had adopted more orthodox economic policy platforms, revolving around ‘sound money’ policies (cf. Przeworski & Sprague 1988). As a result of this shift, disinflation became entrenched across the political spectrum, control of inflation had become the primary policy goal, institutionalised in independent, conservative central banks, and inflation rates fell sharply everywhere and remained low since the early 1990s.

Our findings imply, therefore, that it is not because other parties had adopted the correct macro-economic policies in the past, as the combination of ideational and new-classically orthodox arguments suggests, that social-democratic parties moved to follow them (the effects of these policies remain a topic for debate, not least since economic growth rates have been lower since the generalised introduction of more restrictive macro-economic policies – cf. Glyn 2006), but because of party competition against the background of a changing electorate in terms of economic security. In sum, this argument allows us to understand the general adoption of monetarist policies throughout the OECD, as we set out to do.

Finally, two points for further research beyond the few remarks on that earlier in this paper. One, our argument turns much of the conventional wisdom in this area on its head. Both Keynesian and Kaleckian approaches in political

economy, as well as models derived from those, assume or imply a Phillips-curve inspired inverse relationship between full employment and inflation. Put simply, if unemployment falls to very low levels, the bargaining power of workers increases and wages rise; employers pass on these cost increases to consumers as price hikes. These then feed back into wage negotiations as cost-of-living adjustment and inflation begins to rise without an institutional check (see Carlin & Soskice 2006: 27-202 for the clearest version of the argument as a whole). We think that the relation between unemployment and inflation is more dynamic: the bargaining power of workers may have this effect, but only up to the point where the average worker, who we assume also to be (close to) the median voter, has accumulated assets that forces him to fear inflation more than threats to his employment status. What we need to specify here are the extra conditions that our model introduces and which have the effect of turning the Phillips curve-inspired theories on their head.

Secondly, governments are exposed to many different pressures when they make decisions about policies to pursue. Among those are international contexts that might, and often do, limit their autonomy, new ideas about policies, and domestic partisan politics. Our paper does not claim that the latter is all that mattered; but it does point out that ignoring it leaves a big hole in our understanding of the Great Moderation and especially in our understanding of the political origins of the Great Moderation. The quasi-monopolisation of the debate on the causes of disinflation by economists (and by political scientists who only pay attention to economic variables) has made political scientists and political economists shy of wading into that debate. Our paper, so we hope, is a way to reopen this discussion on the politics of economic policies, including their slow-moving, long-term effects. The economy is, after all, far too serious to be left to economists.

References

- Allard, Gayle (2005). "Measuring Job Security Over Time: In Search of a Historical Indicator", *Instituto de Empresa Working Paper WP05-17*. URL: http://latienda.ie.edu/working_papers_economia/WP05-17.pdf.
- Allen, Christopher S. (1989). "The Underdevelopment of Keynesianism in the Federal Republic of Germany", pp. 263-289 in Peter Hall (ed.) *The Political Power of Economic Ideas: Keynesianism across Nations*. Princeton, NJ: Princeton University Press.
- Armingeon, Klaus, Christian Isler, Laura Knöpfel, David Weisstanner and Sarah Engler (2015). *Comparative Political Data Set 1960-2013*. Bern: Institute of Political Science, University of Bern.
- Avdagic, Sabina (2013). "Partisanship, political constraints and employment protection reforms in an era of austerity", *European Political Science Review* 5(3): 431-55.
- Barro, Roberto J. and David B. Gordon (1983). "A positive theory of monetary policy in a natural rate model", *The Journal of Political Economy* 91(4): 589-610.
- Boix, Charles (2000). "Partisan Governments, the International Economy and Macroeconomic Policies in OECD Countries, 1964-93", *World Politics* 53: 38-73.
- Brenner, Robert (2000). "The boob and the bubble", *The New Left Review* 6: 4-44.
- Brown, Arthur J. and Jane Darby (1985). *World Inflation Since 1950: An International Comparative Study*. Cambridge: Cambridge University Press.
- Carlin, Wendy and David Soskice (1990). *Macroeconomics and the Wage Bargain: A modern approach to unemployment, inflation and the exchange rate*. Oxford: Oxford University press.
- Carlin, Wendy and David Soskice (2006). *Macroeconomics: Imperfections, Institutions and Policies*. Oxford: Oxford University Press.
- Clarke, Harold D. (1986). "Politics, economics and party popularity in Britain, 1979-83", *Electoral Studies* 5(2): 123-141.
- Crouch, Colin (2009). "Privatised Keynesianism: An unacknowledged policy regime." *British Journal of Politics and International Relations* 11(3): 382-99.
- Cukierman, Alex, Steven B. Webb and Bilin Neyapti (1992). "Measuring the independence of central banks and its effect on policy outcomes", *The World Bank Economic Review* 6(3): 353-398.
- Davis, Morris A. (2012). "Questioning Homeownership as a Public Policy Goal", *Cato Institute Policy Analysis No. 696*. URL: <http://object.cato.org/sites/cato.org/files/pubs/pdf/PA696.pdf>.
- De Neve, Jan-Emmanuel (2009). *The Median Voter Data Set: Voter Preferences across 50 Democracies from 1945*. Available at SSRN: <http://ssrn.com/abstract=1348323> or <http://dx.doi.org/10.2139/ssrn.1348323>
- Emmenegger, Patrick, Silja Hausermann, Bruno Palier and Martin Seeleib-Kaiser (2012). *The Age of Dualization. The Changing Face of Inequality in Deindustrializing Societies*. Oxford: OUP.
- Eurobarometer (2005). *The Mannheim Eurobarometer Trend File 1970 – 2002*. Data Set Edition v2.0.1. Codebook and Unweighted Frequency Distributions updated by Iris Leim and Meinhard Moschner, ZA, Cologne. January 20, 2005. (codebook update as of June 17, 2009). By Hermann Schmitt, MZES Mannheim, Evi Scholz ZUMA Mannheim.

- Favieu, Pierre and Michel Martin-Roland (1990). *La décennie Mitterrand: Les ruptures 1981-1984*. Paris: Seuil.
- Fischer, Stanley and John Huizinga (1980). "Inflation, unemployment and public opinion polls", *MIT Working Paper No. 256*, April 1980.
- Flora, Peter (1986). *Growth to Limits: The Western European Welfare States since World War II*. Berlin; New York: De Gruyter.
- Fourastié, Jean (1979). *Les trente glorieuses: ou La Révolution invisible de 1946 à 1975*. Paris: Fayard.
- Glyn, Andrew (2006). *Capitalism Unleashed*. Oxford: Oxford University Press.
- Hirsch, Fred and John H. Goldthorpe (1978). *The political economy of inflation*. London: Martin Robertson.
- Hall, Peter (1989). *The Economic Power of Political Ideas*. Princeton University Press.
- Hall, Peter (2007). "The Evolution of Varieties of Capitalism in Europe", pp.39-88 in Bob Hancké, Martin Rhodes & Mark Thatcher (eds.), *Beyond Varieties of Capitalism: Conflict, Contradictions and Complementarities in the European Economy*. Oxford University Press.
- Hancké, Bob (2002). *Large Firms and Institutional Change: Industrial Renewal and Economic Restructuring in France*. Oxford: Oxford University Press.
- Henrekson, Magnus, Lars Jonung and Joakim Stymne (1996). "Economic Growth and the Swedish Model", pp. 240-89 in Nicholas Crafts and Gianni Toniolo (2002). *Economic Growth in Europe Since 1945*. Cambridge University Press.
- Hibbs, Douglas (1977). "Political Parties and Macroeconomic Policy," *The American Political Science Review* 71(4): 1467-1487.
- Hibbs, Douglas (1981). "The Impact of Economic Performance on Electoral Support in Sweden, 1967-1978". *Scandinavian Political Studies* 4(1): 33-50.
- Hibbs, Douglas (1982). "Public Concern about Inflation and Unemployment in the United States: Trends, Correlates, and Political Implications", *National Bureau of Economic Research*. URL: <http://www.nber.org/chapters/c11460>.
- Hibbs, Douglas (1985). "Inflation, Political Support, and Macroeconomic Policy", pp. 175-195 in Leon N. Lindberg and Charles S. Maier (eds.) *The Politics of Inflation and Economic Stagnation*. Washington, D.C.: The Brookings Institution.
- Hibbs, Douglas and Nicholas Vasilatos (1981). "Performance économique et fonction de popularité des présidents Pompidou et Giscard D'estaing", *Revue d'économie politique* 93(1): 44-61.
- Horsewood, Nicholas and Kees Dol (2013). "Home ownership, mobility and unemployment: a re-evaluation of the Oswald thesis", *Neujobs Working Paper No.14.3a*. URL: <http://www.neujobs.eu/sites/default/files/NEUJOBS%2014%203a%20Home%20ownership%20and%20Unemployment%20final.pdf>
- Howell, Chris (1989). *Regulating Labour: The State and Industrial Relations Reform in Postwar France*. Princeton NJ: Princeton University Press.
- Iversen, Torben and David Soskice (2006). "New Macroeconomics and Political Science", *Annual Review of Political Science* 9: 425-53.

The Politics of Disinflation

- Katz, Harry C., Sarosh Kuruvilla and Lowell Turner (1993). "Trade Unions and Collective Bargaining", *Working Paper Series 1099*. The World Bank, Education and Social Policy Department.
- Kirchgässner, Gebhard (1991). "On the Relation Between Voting Intention and the Perception of the General Economic Situation: An Empirical Analysis for the Federal Republic of Germany, 1972 -1986." *European Journal of Political Economy* 7(4): 497-526.
- Kramper, Peter (2000). *From Economic Convergence to Convergence in Affluence? Income Growth, Household Expenditure and the Rise of Mass Consumption in Britain and West Germany, 1950-1974*. London: Department of Economic History, London School of Economics. URL: <http://eprints.lse.ac.uk/22382/1/wp56.pdf>
- Lafay, Jean-Dominique (1984). "Political Change and Stability of the Popularity Function: The French General Election of 1981", *Political Behavior* 6(4): 333-352.
- Levy, Jonah (1999). *Tocqueville's Revenge*. Cambridge, MA: Harvard University Press.
- Lordon, Frédéric (1998). "The Logic and Limits of *Désinflation Compétitive*", *Oxford Review of Economic Policy* 14(1): 96-113.
- Maddison, Angus (2001). *The World Economy. A Millennial Perspective*. Paris: OECD, Development Centre Studies.
- Maddison, Angus (2013). *The Maddison-Project*. URL: <http://www.ggd.net/maddison/maddison-project/home.htm>, 2013 version.
- Martin, Andrew (1984). "Trade Unions in Sweden. Strategic Responses to Change and Crisis." pp. 190-359 in Peter Gourevitch, Andrew Martin, George Ross, Stephen Bornstein, Andrei Markovits and Christopher Allen (eds.), *Unions and Economic Crisis. Britain, West Germany, and Sweden*. London: George Allen & Unwin.
- McNamara, Kathleen (1998). *The Currency of Ideas*. Ithaca NY: Cornell University Press.
- Nickell, William (2006). "The CEP-OECD institutions data set (1960-2004)", *CEPDP 759*. London: Centre for Economic Performance, London School of Economics and Political Science, ISBN 0753020653.
- Notermans, Ton (1993). "The Abdication from National Policy Autonomy: Why the macroeconomic regime has become so Unfavourable to Labor", *Politics and Society* 21(2): 133-67.
- Notermans, Ton (2000). *Money, Markets and the State*. Cambridge: Cambridge University Press.
- OECD (2001). *The Well-being of Nations: The Role of Human and Social Capital. Education and Skills*. Centre for Educational Research and Innovation. URL: <http://www.oecd.org/site/worldforum/33703702.pdf>
- OECD (2016). *Inflation (CPI)*. OECD Data. URL: <https://data.oecd.org/price/inflation-cpi.htm>.
- Przeworski, Adam and John Sprague (1988). *Paper Stones: A History of Electoral Socialism*. Chicago: University of Chicago Press
- Rehm, Philip (2016). *Risk Inequality and Welfare States. Social Policy Preferences, Development, and Dynamics*. Cambridge: Cambridge University Press.
- Ross, George (1982). "The Perils of Politics: French Unions and the Crisis of the 1970s." pp. 13-94 in Peter Lange, George Ross and Maurizio Vannicelli (eds.), *Unions, Change and Crisis: French and Italian Union Strategy and the Political Economy, 1945-1980*. London: George Allen & Unwin.

- Rueda, David (2007). *Social Democracy Inside Out: Partisanship and Labor Market Policy in Industrialized Democracies*. Oxford; New York: OUP.
- Sbano, Teresa (2008). "New historical data for assets and liabilities in the UK", *Economic & Labour Market Review* (2)4: 40-6.
- Scheve, Kenneth (2002). "Public Demand for Low Inflation", *Bank of England and Yale University Working Paper No. 172*. New Haven, CT: Yale University.
- Scheve, Kenneth (2004). "Public Inflation Aversion and the Political Economy of Macroeconomic Policymaking", *International Organisation* 58(1): 1-34.
- Smith, Tom (1980). "America's Most Important Problem. A Trend Analysis, 1946-1976", *Public Opinion Quarterly* 44(2): 164-80.
- Sutcliffe, Anthony (1996). *An Economic and Social History of Western Europe Since 1945*. London and New York: Longman.
- Visser, Jelle (2013). "Wage Bargaining Institutions. From Crisis to Crisis", European Economy *Economic Papers* 488. Brussels: European Commission. URL: http://ec.europa.eu/economy_finance/publications/economic_paper/2013/pdf/ecp_488_en.pdf.
- Vlandas, Tim (2013). "The politics of temporary work deregulation in Europe: solving the French puzzle", *Politics and Society* 41(3): 425-460.
- Vlandas, Tim (2017). "Grey Power and the Economy: Ageing and Inflation across Advanced Economies", *Comparative Political Studies*. Forthcoming.
- Volgens, Andrea, Pola Lehmann, Nicolas Merz, Sven Regel, Annika Werner, Laceywell Onawa Promise and Henrike Schultze (2014). *The Manifesto Data Collection. Manifesto Project (MRG / CMP / MARPOR)*. Version 2014b. Berlin: Wissenschaftszentrum Berlin für Sozialforschung (WZB).

Appendix

Table A1.
Descriptive statistics, description and sources for OECD sample

Variables	N	Mean	Std. Dev.	Min.	Max.	Descriptions	Sources
<i>Inflation</i>	1,110	5.098	4.761	- 4.480	31.02	Growth of Consumer Price Index (all items).Percentage change from previous year.	Armingeon et al. 2015:14.
<i>Share of elderly</i>	1,113	13.249	3.024	5.727	24.15	Population over 65 as a percentage of the whole population.	Armingeon et al. 2015:27.
<i>Real GDP growth</i>	1,092	3.048	2.796	- 8.539	13.20	Percent change from previous year.	Armingeon et al. 2015:13.
<i>Unemployment rate</i>	1,113	5.743	4.044	0	25.13	Unemployment rate as a percentage of the civilian labour force.	Armingeon et al. 2015:18.
<i>Openness</i>	1,091	60.075	30.789	9.354	187.8	Measured as total trade (sum of import and export) as a percentage of GDP, in current prices.	Armingeon et al. 2015:12.
<i>Central Bank Independence</i>	849	.408	.189	0.0900	0.920	The Cukierman-Webb-Neyapti Index for Central Bank Independence	Cukierman et al. 1992. Updated using Simone Polillo and Mauro F. Guillén, "Globalization Pressures and the State: The Global Spread of Central Bank Independence." American

Variables	N	Mean	Std. Dev.	Min.	Max.	Descriptions	Sources
							Journal of Sociology 110(6) (May 2005):1764-1802.
<i>Wage coordination</i>	1,056	3.168	1.358	1	5	Degrees of Coordination among different Institutions for Wage Setting.	Visser 2013:9-10.
<i>Left control of cabinet</i>	1,072	33.014	38.129	0	100	Cabinet posts of social-democratic and other left parties in percentage of total cabinet posts.	Armingeon et al. 2015:3.
<i>Union density</i>	1,032	41.151	19.86	7.600	100	Net union membership as a proportion of wage and salary earners in employment.	Armingeon et al. 2015:20.
<i>Adjusted bargaining coverage</i>	407	55.155	27.253	13	99	Bargaining Coverage, adjusted. Expressed in percentage.	Armingeon et al. 2015 (but originally created by Jelle Visser)
<i>Union authority</i>	941	0.440	0.210	0.1	0.9	Summary measure of formal authority of unions regarding wage setting at peak and sectoral level.	ICTWSS - http://www.uva-aiaas.net/
<i>Union concentration</i>	923	0.311	0.114	0.113	0.587	Summary measure of concentration of unions at peak and sectoral level.	ICTWSS - http://www.uva-aiaas.net/
<i>Capital openness</i>	871	1.440	1.267	-1.875	2.421	Index for the degree of openness in capital account transactions.	The Chinn- Ito Index. Armingeon et al. 2015
<i>Structural unemployment</i>	1073	1.987	2.017	0	7	Structural unemployment.	OECD
<i>Home ownership</i>	678	54.966	12.922	28	78	Housing owner occupation rate .	Data created by Andrew Oswald
<i>EPL (allard index)</i>	814	1.622	1.101	0	4.1	This series uses the OECD methodology generating an	Allard, G. (2005), "Measuring Job Security

The Politics of Disinflation

Variables	N	Mean	Std. Dev.	Min.	Max.	Descriptions	Sources
						index increasing on the range {0,5}.	Over Time: In Search of a Historical Indicator”, Instituto de Empresa Working Paper WP-05. (Available from http://www.ie.edu/eng/claustro/claustro_working_papers.asp)
<i>Inflation aversion</i>						<p>This variable is a sum of the answers to two questions asking respondents whether inflation is their first priority (variable name: valpri1) and their second priority (second choice variable name: valpri2). The formulation of the question is as follows.</p> <p>“There is a lot of talk these days about what the aims of <country> should be for the next ten years. <int.: show card ** - one answer only></p> <p>On this card are listed some of the goals to which different people would give top priority. Would you please say which of them you yourself consider the most important? and the next most important <goal>?</p>	<p>Eurobarometer (2005) The Mannheim Eurobarometer Trend File 1970 – 2002. Data Set Edition v2.0.1. Codebook and Unweighted Frequency Distributions updated by Iris Leim and Meinhard Moschner, ZA, Cologne. January 20, 2005. (codebook update as of June 17, 2009). By Hermann Schmitt, MZES Mannheim, Evi Scholz ZUMA Mannheim.</p>

Variables	N	Mean	Std. Dev.	Min.	Max.	Descriptions	Sources
						1. maintenance of law and order 2. giving the people more say in government decisions 3. fighting rising prices 4. protecting freedom of expression 103 8. dk, na 9. inap104	
<i>Economic orthodoxy</i>						Economic Orthodoxy Need for economically healthy government policy making. May include calls for: <ul style="list-style-type: none"> • Reduction of budget deficits; • Retrenchment in crisis; • Thrift and savings in the face of economic hardship; • Support for traditional economic institutions such as stock market and banking system; • Support for strong currency. 	Volkens, Andrea / Lehmann, Pola / Merz, Nicolas / Regel, Sven / Werner, Annika with Lacewell Onawa Promise / Schultze, Henrike (2014): The Manifesto Data Collection. Manifesto Project (MRG / CMP / MARPOR). Version 2014b. Berlin: Wissenschaftszentrum Berlin für Sozialforschung (WZB).

Table A2.
Determinants of inflation rate

Column	(1)	(2)	(3)	(4)	(6)	(7)
Note:	Parsimonious model	Adding more controls	Post-1978	Without fixed effects	All IVs lagged once	All IVs lagged twice
Index of security <i>(standard normal)</i>	-0.48* (0.194)	-0.44** (0.143)	-0.64** (0.207)	-0.27t (0.148)	-0.44** (0.138)	-0.48** (0.128)
GDP growth <i>(standard normal)</i>	-0.37*** (0.061)	-0.34*** (0.033)	-0.27*** (0.045)	-0.27*** (0.042)	-0.06 (0.046)	0.09* (0.041)
Unemployment rate <i>(standard normal)</i>	-0.46*** (0.106)	-0.54*** (0.073)	-0.59*** (0.113)	-0.28*** (0.071)	-0.59*** (0.071)	-0.53*** (0.089)
Left control of government <i>(standard normal)</i>		0.05 (0.037)	0.01 (0.044)	0.01 (0.051)	0.05 (0.044)	0.01 (0.043)
Union density <i>(standard normal)</i>		0.68*** (0.142)	0.78*** (0.191)	0.12 (0.112)	0.62*** (0.143)	0.52** (0.132)
Trade openness <i>(standard normal)</i>		0.48* (0.216)	0.26 (0.204)	-0.03 (0.102)	0.22 (0.223)	-0.07 (0.129)
Capital openness <i>(standard normal)</i>		-0.32** (0.110)	-0.38* (0.135)	-0.55*** (0.098)	-0.35** (0.100)	-0.42*** (0.076)
CBI <i>(standard normal)</i>		-0.16* (0.063)	-0.06 (0.058)	-0.09t (0.048)	-0.08 (0.063)	0.02 (0.050)
Constant	0.35*** (0.045)	0.46*** (0.055)	0.68*** (0.159)	0.39** (0.135)	0.45*** (0.043)	0.44*** (0.034)
Observations	643	528	394	528	529	530
Number of countries	19	18	18	18	18	18
Fixed effects	Yes	Yes	Yes	No	No	No
Time effects	No	No	No	No	No	No
R-squared within model	0.32	0.63	0.67	0.57	0.63	0.69
R-squared between model	0.38	0.01	0.05	0.04	0.01	0.00
R-squared overall model	0.05	0.16	0.10	0.42	0.21	0.34

Recent LEQS papers

White, Jonathan "Between Rules and Discretion: Thoughts on Ordo-liberalism" LEQS Paper No. 126, November 2017

Costa Font, Joan & **Zigante**, Valentina "Building 'Implicit Partnerships'? Financial Long Term Care Entitlements in Europe" LEQS Paper No. 125, October 2017

Bohle, Dorothee "Mortgaging Europe's periphery" LEQS Paper No. 124, September 2017

Iordanoglou, Chrysafis & **Matsaganis**, Manos "Why Grexit cannot save Greece (but staying in the Euro area might)" LEQS Paper No. 123, August 2017

Saka, Orkun "Domestic banks as lightning rods? Home bias during the Eurozone crisis" LEQS Paper No. 122, February 2017

Coulter, Steve "Signalling Moderation: UK Trade Unions, 'New Labour' and the Single Currency" LEQS Paper No. 121, December 2016

Di Cataldo, Marco "Gaining and losing EU Objective 1 funds: Regional development in Britain and the prospect of Brexit" LEQS Paper No. 120, November 2016

Avlijas, Sonja "Vicious and virtuous cycles of female labour force participation in post-socialist Eastern Europe" LEQS Paper No. 119, November 2016

Crescenzi, Riccardo & **Iammarino**, Simona. "Global Investments and Regional Development Trajectories: the Missing Links" LEQS Paper No. 118, October 2016

Teasdale, Anthony. "The Fouchet Plan: De Gaulle's Intergovernmental Design for Europe" LEQS Paper No. 117, October 2016

Campos, Nauro F. & **Macchiarelli**, Corrado. "Core and Periphery in the European Monetary Union: Bayoumi and Eichengreen 25 Years Later" LEQS Paper No. 116, September 2016

Foresti, Pasquale & **Napolitano**, Oreste. "On the Stock Markets' Reactions to Taxation and Public Expenditure" LEQS Paper No. 115, September 2016

Gelepithis, Margarita. "Rethinking the paradox of redistribution: how private insurance and means testing can lead to universalizing reform" LEQS Paper No. 114, July 2016

Costa-Font, Joan & **Turati**, Gilberto. "Regional Health Care Decentralization in Unitary States: Equal Spending, Equal Satisfaction?" LEQS Paper No. 113, June 2016

Bilgel, Firat & **Can Karahasan**, Burhan. "Thirty Years of Conflict and Economic Growth in Turkey: A Synthetic Control Approach" LEQS Paper No. 112, June 2016

Kochenov, Dimitry. "EU Citizenship and Withdrawals from the Union. How Inevitable Is the Radical Downgrading of Rights?" LEQS Paper No. 111, June 2016

Marzinotto, Benedicta. "Income Inequality and Macroeconomic Imbalances under EMU" Paper No. 110, May 2016

Luca, Davide. "Do bureaucracies enhance or constrain policy effectiveness? Evidence from Turkey's central management of public investment" Paper No. 109, April 2016



THE LONDON SCHOOL
OF ECONOMICS AND
POLITICAL SCIENCE ■



LSE Europe in Question
Discussion Paper Series

LEQS

European Institute
London School of Economics
Houghton Street
WC2A 2AE London
Email: euoinst.LEQS@lse.ac.uk

<http://www2.lse.ac.uk/europeanInstitute/LEOS/Home.aspx>

