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Political Accountability During Crises: Evidence From 40 Years of Financial Policies

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ABSTRACT

We show that politicians facing a binding term limit are more likely to engage in financial deliberalization than those facing reelection, but only in the wake of a financial crisis. In particular, they implement policies that tend to favor incumbent financial institutions over the general population, such as increasing barriers to entry in the banking sector. We propose a conceptual framework and several mechanisms to rationalize this behavior and show that revolving doors between the government and the financial sector play a key role in encouraging bank-friendly policies after crises.

JEL Classification: D72, D78, G01, G28, P11, P16

> "*Never let a good crisis go to waste*."
>
> (Winston Churchill, 1940s)

1 | Introduction

Financial crises are an endemic feature of market economies. Banking, currency, and sovereign debt crises have occurred in almost all countries throughout history (Reinhart and Rogoff 2009). The negative effects of these crises on national economies are generally severe, leading to recessions, banking systems collapsing, and government debt increasing to dangerous levels. These dire repercussions often lead governments to intervene and reform the financial system. However, whether the new financial policies they introduce favor the general population or financial institutions remains an open question.

It is a priori unclear whether financial crises make politicians more likely to act in the interest of voters. On the one hand, financial crises put financial regulation in the spotlight. This increases the salience of financial reforms in the public eye and hence voters become more likely to hold politicians accountable for ill-designed policies. On the other hand, financial crises increase legislative activity and raise opportunities for interest groups to push reforms that favor the financial sector.[1] The effect of financial crises therefore depends crucially on whether politicians can be held accountable through the prospect of reelection.

Our contribution in this paper is threefold. First, we integrate two previously separate strands of the literature to provide the first systematic examination of how crises mediate the effect of term limits on electoral accountability. While the effect of term limits on political behavior has been thoroughly documented, the interaction between crises and term limits has received little attention. We show that, although term-limited and non-term-limited politicians do not tend to regulate the financial sector differently in normal times, they adopt markedly

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divergent financial policies when the legislative environment is disrupted by crises. Second, we introduce new data to study this question. We combine different data sets on financial policies to generate the first analysis of the determinants of financial policies in 88 democracies from 1973 to 2015, covering the periods before and after the global financial crisis. Third, we go beyond documenting differences in policymaking by also exploring the mechanisms behind these differences. In particular, we provide evidence that the differential postcrisis behavior of term-limited leaders is linked to quid pro quo relationships between banks and policymakers.

Theoretically, the effect of crises on electoral accountability is ambiguous. In the absence of crises, elections discipline the behavior of politicians: as long as the benefits from holding office are large enough, politicians would prefer to pass financial reforms beneficial to voters. Crises can have conflicting effects on electoral accountability. On the one hand, they can increase the salience of financial policies to voters, which increases their scrutiny and make politicians more likely to pass policies in their favor. They can also increase the pressure politicians exert on each other or heighten their sense of civic duty. On the other hand, crises can make information noisier, create windows of opportunity for legislators to push bad policies, and increase the rewards offered to politicians by the financial sector for passing policies aligned with its interests.

Empirically, we first show that democratically elected political leaders (such as presidents or prime ministers) facing binding term limits are more likely to engage in financial deliberalization in the wake of a financial crisis than those facing reelection.[2] We exploit within-country variation in the timing of *legally-binding* term limits to show that, while both term-limited and non-term-limited politicians reverse the process of financial liberalization in the wake of financial crises, term-limited politicians do so to a much greater degree. We show that it is financial crises themselves that significantly alter the differences in policy choices between term-limited politicians and those up for reelection, since the two types of politicians' financial policymaking does not differ systematically outside of crises.

Next, we investigate the interaction between crises and reelection prospects in different policy domains. Focusing on banking sector policies, we find that term-limited politicians enact relatively more policies that favor financial institutions over the general public in the wake of financial crises. Relative to politicians facing reelection, term-limited politicians are more likely to increase barriers to entry in the banking sector, bail out troubled banks and relax bank supervision (although that last effect is not statistically significant).[3]

Finally, we present evidence that the reforms enacted by term-limited politicians are linked to the prospect of receiving personal benefits from the financial industry. First, we show that the postcrisis effect of term limits on policies favoring the banking sector is stronger in countries where revolving doors are more common. Second, using a hand-collected data set on postgovernment careers of more than 500 individual policymakers (finance ministers and central bank governors) in 32 countries, we show that the political allies of term-limited leaders who served in the aftermath of a financial crisis are more likely to pursue a career in the private financial sector after leaving government. Finally, we confirm that the policies pushed by term-limited politicians do not bring any additional benefits to the general population. Using a global bank-level data set from Bankscope, we show that bank stability and performance do not meaningfully differ after crises when these politicians are in power.

The paper proceeds as follows. The next section surveys the existing literature and places our contribution. Section 3 describes the construction of the data set. Section 4 details our conceptual framework and methodology, while Section 5 presents the main results. In Section 6, we investigate possible mechanisms behind our results. Section 7 concludes the paper.

2 | Existing Literature

Term limits and political accountability. A large literature has explored the link between term limits and policymaking. In a seminal contribution, Besley and Case (1995) find that gubernatorial term limits have a negative impact on the tax-raising performance of US governors after natural disasters. Besley and Case (2003) then show that term-limited governors in the middle of the 20th century taxed and spent more than governors who were eligible for reelection but that this effect has disappeared over time. Alt et al. (2011) point out that economic growth is lower when term-limited governors are in office while Ferraz and Finan (2011) find both that term-limited mayors in Brazil are more corrupt and that the effects of term limits are stronger in places where incumbents face lower chances of being punished. Among cross-country studies like ours, Johnson and Crain (2004) document that the size of government has expanded more rapidly in countries with one-term limits than in countries with two-term limits while Conconi, Sahuguet, et al. (2014) provide evidence that international conflicts become more likely when political leaders in democracies face a binding term limit. More recently, Klašnja and Titiunik (2017) show that the use of term limits may lead to an incumbency curse when the politicians have weak attachments to their parties and their pursuit of private agendas damages the party reputation in the upcoming elections, while Lopes da Fonseca (2020) uses exogenous variations in mayoral term limits to conclude that term-limited politicians pursue more conservative fiscal policies in Portugal. We contribute to this literature by exploring the interaction between crises and term limits. Crises can have a number of effects on policymaking as politicians are forced to act quickly and decisively while being put under the spotlight. How these effects interact with term limits remains an open question which we seek to answer in this paper.[4]

Policymaking in times of crises. A large literature exists on the nexus between crises and structural reforms. Following the seminal paper of Drazen and Grilli (1993), this literature has argued that, in societies with conflicting interests, vested interest groups become more powerful over time, but that their influence is weakened by crises and emergencies. As a result, crises allow governments to undertake necessary reforms. This crisis-begets-reforms hypothesis has been tested empirically in a number of contributions (see, e.g., Nelson 1990; Krueger 1993; Williamson 1994). They have generally shown that crises trigger reforms that lead to liberalization and stronger influences of market forces.[5] Within this literature, a strand specifically explores the link between

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crises and financial liberalization. Abiad and Mody (2005) show that financial crises may drive policy changes, though not always in the same direction. While balance-of-payment crises are likely to induce more liberalization, banking crises act in the opposite way, encouraging reversals in the liberalization process. Pepinsky (2012) shows that developing countries deliberalize in response to currency crises by closing their capital accounts. Mian et al. (2014) argue that financial liberalization experiences a deadlock and tends to reverse in most postcrisis episodes. Gokmen et al. (2021) find that democracies neither open nor close their economy in the aftermath of financial crises. This literature has therefore provided mixed answers on whether crises lead to financial liberalization. Our contribution is to show that political institutions, and in particular the existence of term limits, matter for the relationship between crises and financial liberalization.

Politics and finance. Lastly, our work is related to the literature on the political economy of finance.[6] The most closely related strand in this literature examines how legislative processes can be influenced by corporate or constituent interests, mostly focusing on the US setting (Hall and Wayman 1990; Stratmann 1998, 2002; Mian et al. 2013; Igan and Mishra 2014). In particular, several papers investigate the relationship between private interest groups and financial deregulation (Kroszner and Strahan 1999; Rajan and Zingales 2003; Chari and Gupta 2008; Mian et al. 2010; Papadimitri et al. 2021). Closely related to our analysis, Mian et al. (2010) examine congressional voting on two key pieces of legislation in the immediate aftermath of the US mortgage crisis and illustrate how policymakers' behavior is linked to both their constituents' preferences and the pressure from special interest groups through campaign contributions. In this paper, we confirm that a lack of accountability can push policymakers to favor the interests of financial institutions over those of the general public and that the effect is stronger in contexts where interest groups can engage in quid pro quo such as revolving doors. We complement this literature by exploring how private interests may influence postcrisis financial policymaking when electoral accountability is impaired due to binding term limits.

3 | Data

In this section, we list the data sources and the key variables we use in our analysis.

Financial regulation. The original cross-country data set on financial reforms was constructed by Abiad et al. (2010; henceforth, ADT).[7] ADT assesses seven dimensions of financial policy in 91 countries over the years 1973–2005. Specifically, it includes three indices directly related to the domestic banking sector (bank entry barriers, bank privatization, and bank supervision), two indices for the lending/borrowing relationships between financial and real sectors (credit controls and interest rate controls), one index on international capital account controls and one on the regulation of security markets. Each of these variables is constructed using discrete responses to a set of standardized questions which are then aggregated to capture the extent of liberalization in each reform area. They take values between 0 and 1, with higher values implying more liberalization.[8] Online Appendix Table A1 contains the specific questions used for each policy index in Abiad et al. (2010).

Since these indices are only available until 2005, we further use data compiled by Denk and Gomes (2017) (henceforth, DG) who have extended the original ADT data set until 2015 for a subset of the original countries and some additional ones. These authors follow the same methodological approach for the years 2006–2015 and keep the original coding rules when aggregating responses to individual questions.[9] Their data also extend back to the 2000–2005 period for which they can confirm that their scores are comparable to the ones obtained in the original ADT series.[10] Online Appendix Table A2 contains the specific questions used for each policy index in Denk and Gomes (2017). As a result, DG is composed of seven financial reform indices for the years 2000–2015 for 43 countries (38 of which were among the 91 countries from the ADT data set while five were added by DG).[11]

For our analysis, we first take the full panel created by DG and then merge it with the remaining country-time-series from ADT. Hence, we obtain an unbalanced panel consisting of 96 countries over the period from 1973 to 2015. To our knowledge, this is the first study analyzing this combined data set of financial policies.

Term limits and political controls. For the political variables, we use the Database of Political Institutions (DPI) which was originally created by Beck et al. (2001) and later updated by Cruz et al. (2020). We use the DPI index of electoral competitiveness for executive leader in order to focus on the country-year observations that can be categorized as "democratic."[12] As a result, we end up with 88 countries in the baseline sample.

The main variable we obtain from DPI is *TermLimit*, which captures whether a country's political leader in a specific year is facing a binding term limit or can be reelected at the end of their current term (the variable is called "REELECT" in the DPI data set). The variable $TermLimit_{it}$ takes the value 1 if the executive leader (either the president or the prime minister) of country i faces a binding term limit in year t, and 0 if not. It is important to note that the *TermLimit* dummy is time-varying. It is thus not perfectly correlated with other political characteristics of a country and not absorbed by country fixed effects. For instance, in a country with a two-term system, the politician can be reelected when serving her first term, but not in the second term. The variable would take a value of 1 if year t falls during the politician's second term, but a value of 0 if year t falls during the politician's first term. In countries with no limits on the number of terms, the variable is equal to 0 for all observations.[13]

We obtain additional variables from DPI to use as controls: *Right* and *Left* are dummies for the leader's ideological position (with *Center* as omitted category), *Presidential* and *Parliamentary* are indicator variables for the country's system of governance (with *Assembly-elected President* as omitted category), *OfficeYears* counts the number of years the leader has been in office, *YearsLeft* is the number of years left in the leader's current term, *HerfGov* is the Herfindahl index—the sum of the squared seat shares of all parties in the government, *GovFrac* is the probability that two deputies picked at random from among the government parties will be of different parties, *GovShare* is the fraction of seats held by the government, and finally *Checks* represents the number of distinct bodies that can act as a veto player in the country's democratic process. Summary statistics for these variables are reported in Table 1 and Appendix Table A3.

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TABLE 1 | Summary statistics for main variables.

Variables	Mean	Median	Std. Dev.	Min	Max	Obs.
Financial liberalisation (Average)	0.66	0.71	0.20	0.14	0.96	2209
Credit controls	0.67	0.75	0.36	0.00	1.00	2209
Interest rate controls	0.79	1.00	0.36	0.00	1.00	2242
Entry barriers	0.74	1.00	0.35	0.00	1.00	2242
International capital controls	0.65	0.70	0.35	0.00	1.00	2242
Privatization	0.54	0.67	0.39	0.00	1.00	2242
Banking supervision	0.57	0.67	0.37	0.00	1.00	2242
Security markets	0.68	0.67	0.35	0.00	1.00	2242
Financial crises (any crisis)	0.07	0.00	0.25	0.00	1.00	2242
Banking crises	0.03	0.00	0.18	0.00	1.00	2242
Sovereign debt crises	0.01	0.00	0.09	0.00	1.00	2242
Currency crises	0.04	0.00	0.19	0.00	1.00	2242
Term limit	0.19	0.00	0.39	0.00	1.00	2104
Postgovernment finance career	0.39	0.00	0.49	0.00	1.00	534

Note: The table outlines the summary statistics for variables related to financial policies and crises. The policy database is obtained by merging two subsets of observations from Abiad et al. (2010) and Denk and Gomes (2017). Data on financial crises are obtained from Laeven and Valencia (2018). Political variables are obtained from Cruz et al. (2020) and Wirsching (2018).

Financial crises. To date financial crises, we use a widely used data set from the IMF (Laeven and Valencia 2013) and its more recently updated version (Laeven and Valencia 2018). This data set includes the starting dates for three different types of financial crises: banking, currency, and sovereign debt crises. The coverage in this data set is larger compared to alternative data sets (such as Reinhart and Rogoff 2011) and contains 165 countries between the years 1970 and 2017. In the data, crises are represented by a dummy variable which takes a value of 1 in the initial year of the crisis and 0 for any other years. We are therefore unable to trace the duration of a crisis based on the IMF data set. As explained below, we instead use this data set to construct a time window for the periods immediately following the initial year of a crisis. After merging the financial crises data set with the reform data set, we end up with 73 banking, 81 currency, and 19 sovereign debt crises in the sample.

Revolving doors. To explore the revolving doors between government and financial industry, we use a data set constructed by Wirsching (2018) that includes information on 534 top government officials (i.e., finance ministers or central bank governors) in 32 democratic countries between 1973 and 2005. The dependent variable (*Postgovernment finance career*) measures whether or not the corresponding individual pursued a career as either president, chairman, member of the board, or adviser of a private financial institution in their country after leaving politics.

Financial stability. Finally, we employ a global bank-level data set from Bankscope that covers the years from 1999 to 2014 in up to 123 countries to measure bank stability and performance.[14] We construct measures of distance to default by computing the *z*-scores for each bank. This score captures how much equity and income buffer each bank has relative to the volatility of its past income flows.[15] We complement these measures with various measures of bank profitability and performance (such as return and provision ratios).

Table 1 presents the summary statistics for each financial policy domain as well as the overall financial liberalization variable, which is the simple average of the former.[16] The table shows that there has been at least one country that was not liberalized at all (0) and at least one that was fully liberalized (1) at some point within our sample period for each reform area. This confirms that the questions used to measure liberalization capture a realistic range of policies. Instead, the aggregate index of financial reform never hits 0 or 1, implying that there are no country in our sample that receives only 0s or only 1s simultaneously in each dimension. On average, liberalization seems to have been highest in interest rate controls, followed by entry barriers and security markets. Privatization is the least liberalized area on average with significant state presence in domestic banking sectors.

We plot the average values over time for each financial policy domain in Figure 1. All of these series show a slow move toward less government intervention over time, except in the area of banking supervision where the regulations have become more restrictive. Since the early 2000s, financial liberalization seems to have come to a halt and, after the Global Financial Crisis in 2007–2008, some of these areas (such as privatization) have even faced a more interventionist stance. In Figure 2, we plot the average financial liberalization index for selected countries from our sample covering three major regions (Americas, Europe, and Asia) and a mix of developed and developing countries. The figure shows that the overall increase in financial liberalization masks a range of heterogeneous country trends. The figure also shows that the index only captures reforms that are sufficiently important and can be constrained by upper or lower bounds.[17] These constraints limit the variation in the dependent variable

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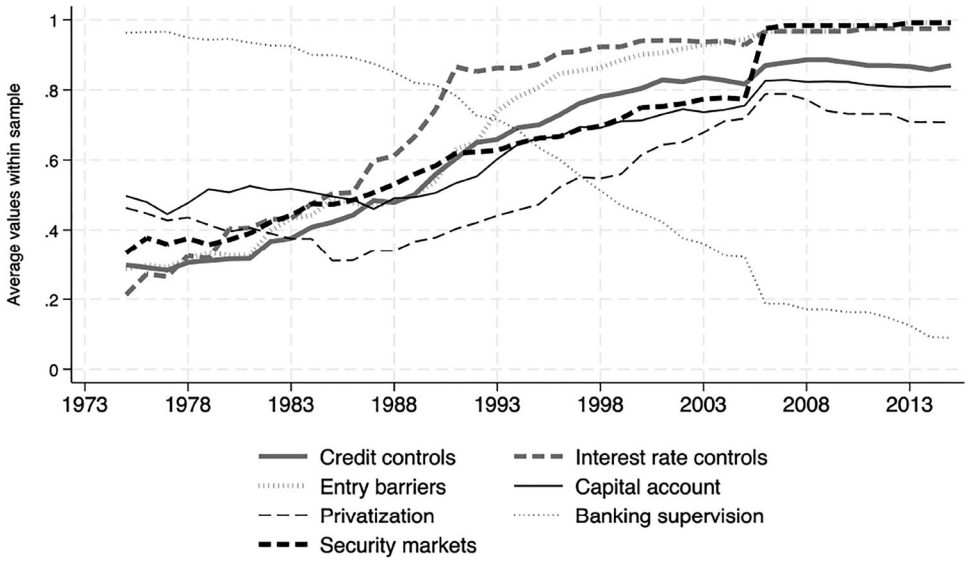

FIGURE 1 | The evolution of financial policy domains within our sample period. *Note*: The figure illustrates the average value for each financial policy domain across all countries within our sample in each year. The policy database is obtained by merging two subsets of observations from Abiad et al. (2010) and Denk and Gomes (2017).

thus making null results relatively more likely and our analysis more conservative.

4 | Conceptual Framework and Empirical Strategy

We can now turn to our main results. We begin by discussing possible reasons why crises could affect political accountability. We establish that crises can create both forces leading to more accountability and forces leading to less accountability. We then describe our empirical strategy to assess the effect of crises on electoral accountability.

4.1 | Conceptual Framework

Elections are one of the most important mechanisms to incentivize politicians to act in the public's interest. When elections are effective, politicians up for reelection need to satisfy the demands of voters to be reelected and are therefore more likely to act in their interests relative to politicians who face term limits. Politicians facing term limits cannot be reelected and are not constrained to act in the public's interest as their future prospects do not depend on voters' perceptions.[18] This logic suggests that we should observe systematic differences between the behavior of term-limited politicians and those up for reelection and underpins the large literature on the effect of term limits (Besley and Case 1995;2003; Alt et al. 2011; Ferraz and Finan 2011).

While the effect of reelection and term limits is well understood, the effect of crises on electoral accountability remains an open question. On the one hand, crises can create forces that reinforce elections' accountability mechanism. First, crises often create a stronger policy awareness among voters. For instance, Oppermann and Viehrig (2009) show that international political crises increase the salience of foreign policy issues, Paul and Fitzgerald (2021) and Folsz (2019) show that the large immigration influx and the refugee crisis increased the salience of immigration policies, while Dennison and Kriesi (2023) show that extreme events increase policy salience in the unemployment, immigration, and environmental domains. This salience effect can increase voter scrutiny and politicians' incentives to act in voters' interests. Second, crises can increase the importance of political capital (Gratton et al. 2022). As political survival becomes more uncertain, politicians need to rely more on the support of fellow legislators. This might make them more reluctant to expand political capital to pass laws that do not align with broader societal interests. Third, politicians' sense of duty toward voters might be heightened during crises, in line with evidence that opposition parties hold more positive views of the government's action in the early days of a crisis (Louwerse et al. 2021).

On the other hand, crises can reduce political accountability. First, if legislative activity increases in response to the crisis, legislators might have less attention to devote to scrutinizing policies (Doust and Hastings 2020; Bolleyer and Salát 2021). This lower scrutiny might create "windows of opportunity" for ill-intentioned political leaders to push through policies that benefit them at the expense of the public. Second, voters might themselves receive noisier information during crises and have less attention to devote to politics, counteracting the increased salience described above, and making these windows of opportunity more valuable. Finally, special interest groups tend to become more active in the wake of crises (Kastner 2018; Junk et al. 2022; Blau et al. 2022). This heightened activity can both increase the benefits of pushing policies aligned with these private interests—as interest groups might be more likely to reward favorable policies with lucrative jobs (Blanes i Vidal et al. 2012; Bertrand et al. 2014; LaPira and Thomas 2014)[19]—and decrease the cost of passing bad policies—as interest groups have higher incentives to provide "legislative subsidies" (Hall and Deardorff 2006; Ellis and Groll 2020) to support politicians pushing policies in their favor.[20]

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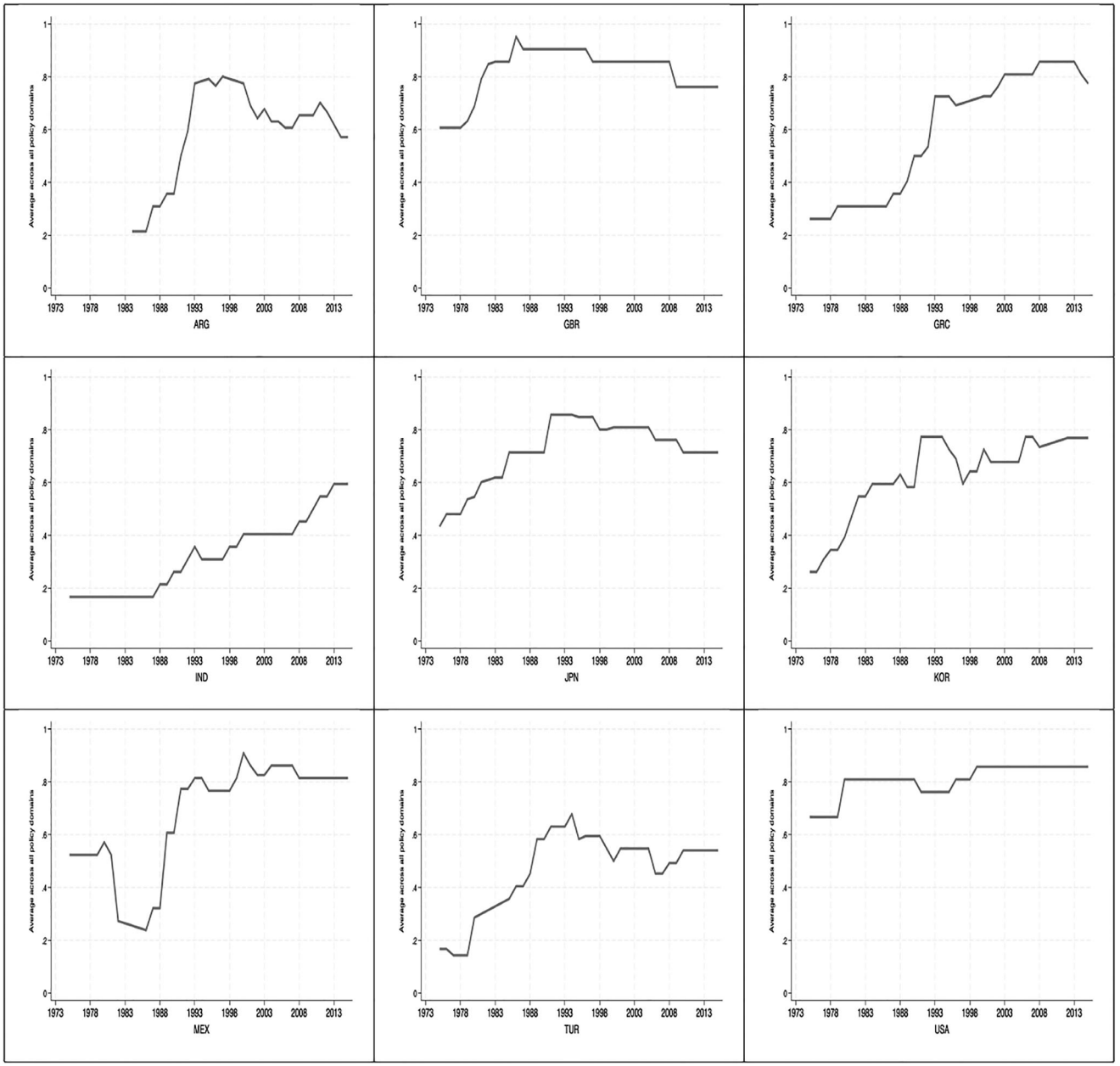

FIGURE 2 | Evolution of average financial policy index for selected countries. *Note*: The figure illustrates the average value of the index for selected countries within our sample in each year. The policy database is obtained by merging two subsets of observations from Abiad et al. (2010) and Denk and Gomes (2017).

Importantly, the relative strength of these different mechanisms determines whether differences in the behavior of term-limited politicians and those up for reelection are magnified or attenuated by crises. Mechanisms that affect voters' electoral behavior and strengthen accountability, such as an increase in salience, or those that increase politicians' accountability to other legislators, such as an increase in the importance of political capital, should increase the wedge between the two types of politicians by making politicians up for reelection act more in voters' interests following crises. Mechanisms that particularly affect the incentives of term-limited politicians, such as receiving more offers of lucrative jobs after crises, should also increase the differences between the two types of politicians, but, in this case, due to term-limited politicians acting less in the interest of voters following crises.[21]

Instead, mechanisms that affect voters' behavior but weaken accountability, such as crises making voters' information noisier, reduce the differences between term-limited politicians and those up for reelection by making politicians up for reelection relatively less likely to act in voters' interest.

Finally, mechanisms affecting both types of politicians could lead politicians to change their behavior after crises but may not have an effect on the difference between the two types. For example, an increase in politicians' sense of civic duty might lead both types of politicians to act more in the interest of voters following crises but may not necessarily change the difference between the two types of politicians. Similarly, a decrease in legislative scrutiny might lead both types to act less in the interest of voters but not

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necessarily increase or decrease the difference between the two types of politicians.

4.2 | Empirical Strategy

To evaluate how financial crises affect financial liberalization, and how this impact differs between term-limited politicians and those up for reelection, we regress the degree of financial liberalization in a given country and a given year on a variable which captures whether this country-year observation falls in the 5-year period following a financial crisis, a variable that captures whether the country's leader during that country-year observation faces a binding term limit, and the interaction of these two variables.

Given that both the crisis variable and the term limit variable are time-varying and can influence each other, we cannot take a causal interpretation of the parameters of interest. To reduce endogeneity concerns, and increase our confidence that the effects we identify are driven by the combination of crises and term limits, rather than by country-specific or time-specific characteristics, we use both country and year fixed effects. Finally, to reduce these concerns even further, we introduce a range of additional fixed effects and controls.

First, we control nonparametrically for the pace of the liberalization process specific to each country by including country-specific time trends in our estimations. This is crucial as the comparison of crisis experiences across countries with different reform speeds may lead to a bias in our estimates, especially if crises are not randomly distributed across varying levels of liberalization. As shown in Figure 2, the liberalization trends over time can vary by country and be driven by country-specific characteristics over time. If we did not control for country-specific time trends, our estimates could therefore capture these idiosyncrasies rather than the effect of term limits and crises.[22] Second, following Giuliano et al. (2013), we include interacted fixed effects between reform domains and countries/years to absorb any implicit bias that may exist due to the combination of two data sets produced by different researchers.[23]

We start by estimating the following baseline model:

$$FL_{i,t,r} = \beta_1 \times Crisis_{i,t} \times TLimit_{i,t} + \beta_2 \times Crisis_{i,t} + \beta_3 \times TLimit_{i,t} + \sum_i \delta_i \times d_t + \mu_{i,r} + \lambda_{r,t} + \varepsilon_{i,t,r}, \quad (1)$$

where the outcome variable ($FL_{i,t,r}$) measures the *level* of financial liberalization for country i, year t, and specific reform (i.e., policy) index r, and varies between 0 and 1. δ_i is a dummy for each country and d_t is a linear time trend. In the baseline estimation, we include the basic set of fixed effects at the country, year, and reform levels and saturate the specification in subsequent estimations with country × reform ($\mu_{i,r}$) and reform × time ($\lambda_{r,t}$) fixed effects. *Crisis* is a binary dummy variable taking a value of 1 in the first 5 years after any crisis including the starting year itself, and 0 otherwise. Importantly, we abstain from controlling for any country-level economic or financial variables in our estimations as these variables themselves might be strongly influenced by financial crises and thus be "bad controls."[24]

In addition, we interact our *Crisis* dummy with the *TLimit* variable, which is a dummy taking a value of 1 for the country-year observations where the political leader is in the midst of their last legally allowed term of office and thus cannot run for the next election. We also include the variable *TLimit* without the interaction in order to see if financial liberalization is different between policymakers with and without binding term limits outside crisis periods.

The effect of a crisis on financial policymaking when policymakers face no binding term limits is captured by β_2, whereas the effect of a crisis (relative to no crisis) on a political leader facing a binding term limit is measured by: $(\beta_1 + \beta_2 + \beta_3) - (\beta_3) = \beta_1 + \beta_2$. The *differential* effect of crises on term-limited politicians relative to those up for reelection is therefore the difference between these two cases: $\beta_1 + \beta_2 - \beta_2 = \beta_1$. Finally, β_3 captures the effect of term limits in normal times (outside crises).

5 | Main Results

We now present the answer to our main question and show that political leaders in their final term engage in more financial deliberalization in the wake of crises, relative to those up for reelection. We first present our results on the overall financial liberalization index and then those specific to banking policies.

5.1 | Effect of Term Limits and Crises on Overall Financial Liberalization

We begin by showing our results including all seven policy domains of financial liberalization in the same estimation. Table 2 estimates Equation (1). The coefficient on the interaction $Crisis \times TLimit$ estimates β_1 in Equation (1) and captures the differential change in behavior following a crisis for policymakers who face a term limit relative to those up for reelection. Each subsequent column in Table 2 saturates the model with additional fixed effects.

The main takeaway from Table 2 is that deliberalization after financial crises is approximately three times larger when a term-limited policymaker is in power than when a policymaker is up for reelection. While financial crises make both term-limited policymakers and those up for reelection more likely to engage in financial deliberalization, term-limited policymakers are much more likely to do so. Given an average value of the index of liberalization of 0.66 (Table 1), this implies that one crisis reduces liberalization by about 3% for a politician up for reelection, but by over 9% for a politician facing term limits, or about half of the standard deviation of the index over time and across countries.

The table also shows that the coefficient estimates on *TLimit* is positive and not statistically significant. This implies that, outside of crises, term-limited policymakers are not generally more prone to deliberalize the financial sector than those up for reelection. Instead, the differential behavior occurs specifically *after* financial crises.

Timeline of policy interventions. The pace of financial deliberalization following financial crises is of interest in its own right.

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TABLE 2 | Baseline results.

	(1)	(2)	(3)	(4)
Dep. variable		**Financial liberalization index**		
TLimit × *Crisis*	−0.042**	−0.042**	−0.042**	−0.042**
	[0.018]	[0.018]	[0.018]	[0.018]
Crisis	−0.019*	−0.019*	−0.019*	−0.019*
	[0.010]	[0.010]	[0.010]	[0.010]
TLimit	0.017	0.017	0.016	0.016
	[0.013]	[0.013]	[0.013]	[0.013]
Observations	15,661	15,661	15,661	15,661
Adjusted R^2	0.297	0.509	0.596	0.780
Country FE	Yes	Yes		
Reform FE	Yes			
Year FE	Yes		Yes	
CountryTime trend	Yes	Yes	Yes	Yes
Reform × Year FE		Yes		Yes
Country × Reform FE			Yes	Yes

Note: Sample includes only democratic countries with an executive index of electoral competitiveness equal to or higher than six. Dependent variable, *Financial Liberalization Index*, varies over countries, years, and policy domains. *TLimit* is a dummy variable equal to one for the country-year observations where the political leader is in the midst of their last legally allowed term of office and thus cannot run for the next election. *Crisis* is a dummy variable equal to one in the first 5 years after a financial crisis including the starting year itself. Robust standard errors are clustered at the country level and reported in brackets. $^{*}p < 0.1$, $^{**}p < 0.05$, $^{***}p < 0.01$.

To analyze it, we adjust our specification and zoom into the 9-year period surrounding a crisis to estimate the following regression:

$$FL_{i,t,r} = \beta_\tau \times Crisis_{i,t+\tau} \times TLimit_{i,t} + \gamma_\tau \times Crisis_{i,t+\tau} + \eta \times TLimit_{i,t} + \sum_i \delta_i \times d_t + \mu_{i,r} + \lambda_{r,t} + \varepsilon_{i,t,r}, \quad (2)$$

where the crisis dummy captures the effect of being τ years away from the start of the crisis ($Crisis_{i,t+\tau}$) conditional on a set of controls as in Equation (1). We employ a rolling definition of this variable for which τ corresponds to the years before and after a crisis.

In Figure 3, we plot the estimated coefficients β_τ from Equation (2) for values of τ ranging from −4 to +4, which capture the differential behavior over time of term-limited leaders relative to those up for reelection.[25] The plot highlights that the differential effect of a crisis on term-limited politicians' policy choices only appears *after* a financial crisis and not before. Moreover, leaders in their final term of office are not actively changing financial policies at the outset of crises, but significantly reduce financial liberalization up to 3 to 4 years after the start of the crisis.

Do political characteristics matter? The characteristics of politicians facing binding term limits and serving after crises and the characteristics of countries in which binding term limits are possible and crises occur can both correlate with the choice of policies. To reduce omitted variable concerns, we control for all relevant aspects of political heterogeneity both as baseline parameters (Online Appendix Table A5) and in interaction with the crisis variable (Online Appendix Table A6).

First, there may be a concern that leaders facing binding term limits in the aftermath of a crisis are different than leaders who do not face these circumstances. The effect we observe might therefore be driven by these individual differences rather than by term limits and crises. Specifically, term-limited politicians could be more experienced than those up for reelection since they are likely to have already survived a reelection in the past (Ferraz and Finan 2011). To address this, we control for the number of years that the executive has been in the office. The results in Online Appendix Tables A5 and A6 are very similar in these alternative specifications. Similarly, elections are likely to select more capable leaders since leaders facing term limits have in most cases survived a previous reelection and might therefore have a higher intrinsic ability. Hence, the difference between the policy choices of term-limited politicians and those up for reelection could be due to the difference in skills at handling the crisis rather than to political accountability. To check this, we use the vote share of the government's party as a proxy for the leader's ability to handle the financial crisis.[26] We control for this variable both in the baseline and interacted with our crisis dummy in Online Appendix Tables A5 and A6 and confirm that our findings remain unaffected.

Second, there may be a concern that these leaders encounter a different political environment than leaders not facing binding term limits or crises. To address this concern, we control for various time-varying characteristics of the political environment, ranging from the political ideology of the executive to the fractionalization of their government.[27] None of these additional controls, shown in Online Appendix Tables A5 and A6, lead to a noticeable change in our main findings. The coefficients on right-wing ideology are the only consistently significant ones. The effect of

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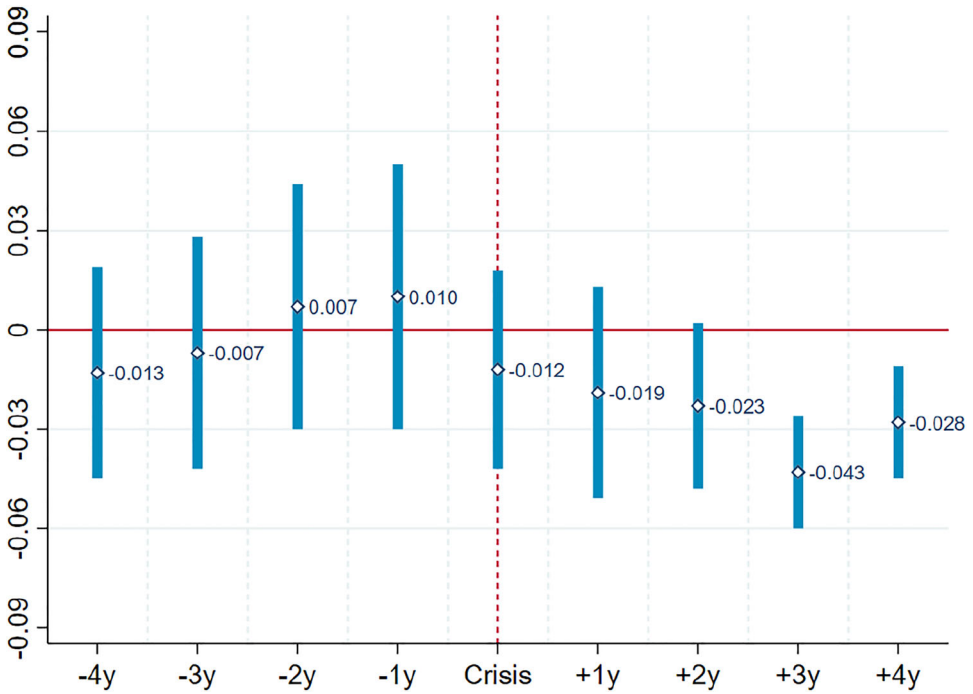

FIGURE 3 | Timeline for the interaction coefficient between crisis and term limits before and after a financial crisis. *Note*: The figure plots the estimates for β_τ from the rolling specification in Equation (2). The policy database is obtained by merging two subsets of observations from Abiad et al. (2010) and Denk and Gomes (2017). Data on financial crises are obtained from Laeven and Valencia (2018). Political variables are obtained from Cruz et al. (2020). Robust standard errors are clustered at the country level and confidence intervals are at 90% significance level.

having a right-wing government on financial liberalization ranges from 0.026 to 0.027 (variable "Right" in Online Appendix Table A5), indicating that right-wing governments are more likely to introduce financial liberalization. This allows us to benchmark our main coefficient of interest: the "additional" effect of a term limit on postcrisis policymaking is 30% larger in magnitude than the baseline effect of a political leader having right-wing (compared to a centrist) ideology. Instead, the coefficient on left-wing parties (variable "Left" in Online Appendix Table A5) ranges from 0.010 to 0.011 and is not statistically significant (the omitted category is centrist party).

Finally, and most importantly, we control for whether the country has a parliamentary or presidential system.[28] Since countries with presidential systems are more likely to impose a term limit on their presidents, our estimates of β_1 in Equation (1) might be confounded in the absence of political controls if presidential democracies are more effective in reacting to a crisis.[29] Online Appendix Tables A5 and A6 show that, although the coefficient on presidential systems is negative and significant, our main results remain robust to controlling for political systems. To further attenuate concerns that countries with term limits are structurally different from countries without term limits, we drop countries whose leaders have never experienced term limits during our sample period and reestimate Equation (1) for this subsample. Online Appendix Tables A8 and A9 report the results on this subsample without and with additional controls. Even with a smaller set of countries,[30] the effect of the interaction between term limits and crises becomes stronger, suggesting that the countries which never had any binding term limits tend to bias our baseline results downward.

Can extreme ideological shifts after crises play a role? Recent literature has emphasized the rise in extreme politics in the aftermath of financial crises (Funke et al. 2016; Doerr et al. 2022; Gyöngyösi and Verner 2022). If the public discontent with crises leads ideologically more extreme parties to come to power, this may explain the interventionist policy stance we report in this paper. Although our previous analysis controls for the right- and left-wing ideology of the executive leader, these variables fail to take into account the *intensity* of the ideology. To mitigate this concern, we extracted the names of all 250 political parties corresponding to each country-year observation and added separate dummies in our main specifications for country-year observations when a particular party was in executive power. This within-party specification ensures that the effect of an extreme party coming to power in the aftermath of a crisis is automatically absorbed by the party dummies. Tables A10 and A11 reestimate Table 2 and Online Appendix Table A6 by including these party fixed effects. Tables A12 and A13 do the same but only for the subsample of countries which experienced term limits during our sample period. Our findings remain qualitatively the same and thus are unlikely to be explained by the rise in extreme politics after crises.

5.2 | Effect of Term Limits and Crises on Banking Policies

We now turn to estimating the effect of term limits on three key policies in the banking domain: bank entry barriers, privatization, and supervision. We show that, in these domains, term-limited politicians are more likely to intervene in favor of financial

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TABLE 3 | Baseline results for three separate policy domains.

Dep. var.	(1) Entry barriers	(2) Privatization	(3) Supervision
TLimit × *Crisis*	−0.093**	−0.084*	0.025
	[0.044]	[0.050]	[0.025]
Crisis	0.004	−0.037	−0.003
	[0.017]	[0.027]	[0.017]
TLimit	0.024	0.040	0.019
	[0.027]	[0.037]	[0.021]
Observations	2104	2104	2104
Adjusted R^2	0.860	0.835	0.873
Country FE	Yes	Yes	Yes
Reform FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
CountryTime trend	Yes	Yes	Yes
All baseline controls	Yes	Yes	Yes

Note: Sample includes only democratic countries with an executive index of electoral competitiveness equal to or higher than six. Dependent variable is a financial policy domain varying over countries and years. *TLimit* is a dummy variable equal to one for the country-year observations where the political leader is in the midst of their last legally allowed term of office and thus cannot run for the next election. *Crisis* is a dummy variable equal to one in the first 5 years after a financial crisis including the starting year itself. Robust standard errors are clustered at the country level and reported in brackets. $^{*}p < 0.1$, $^{**}p < 0.05$, $^{***}p < 0.01$.

institutions than those up for reelection in the aftermath of crises.

The results from Section 5.1 revealed that term limits have important effects on financial deliberalization, but only in the wake of financial crises. This suggests that financial crises affect the electoral accountability mechanism of elections or the incentives of term-limited politicians. However, financial liberalization is a broad umbrella covering a range of policies with different winners and losers. Therefore, it is important to zoom into the specific domains of financial liberalization to understand what drives the interaction between crises and electoral accountability.

We focus on three policy domains where it is relatively easier to differentiate between the direction preferred by the general public and that preferred by financial institutions. Specifically, we restrict attention to bank entry barriers, bank supervision, and bank privatization.[31] Higher entry barriers are favored by incumbent banks who stand to lose from the entry of competitors. Instead, since higher entry barriers reduce market competition, they can lead to higher prices and lower service quality at the detriment of the broader population.[32] Bank supervision is generally unwelcome by banks but is viewed favorably by consumers since lack of supervision can increase systemic risk in the financial system and reduce the level of consumer protection.[33] Finally, while nationalization might not be welcomed by the banking industry under normal circumstances, it translates into government bailouts (in the form of equity injections) for troubled banks after financial crises. This implies that interventions in this domain is likely to be supported by the financial industry in our context.[34]

Table 3 estimates a specification similar to Equation (1) but with policies in each domain as a separate independent variable instead of a combined index. As for Table 2, the main coefficient of interest is the coefficient on the interaction between *Crisis* and *TLimit* (β_1 in Equation 1), which is significantly negative for entry barriers and privatization (columns (1) and (2)), indicating that, in these domains, crises increase the difference in behavior between politicians up for reelection and those facing term limits.[35] As discussed in Section 4.1, this difference could, in principle, be the result of increased voter awareness after crises (which makes politicians up for reelection relatively less likely to pass policies in favor of the financial industry), increased rewards from the financial sector (which make term-limited politicians relatively more likely to pass policies in favor of the financial industry), or both.

The coefficient on *Crisis* in Table 3 indicates that the difference is more likely to come from the effect of crises on term-limited politicians than on those up for reelection. This coefficient gives the estimate of β_2 in Equation (1) and captures the effect of crises on politicians up for reelection. The coefficient is not significantly different than zero for any of the policies, indicating that politicians up for reelection do not behave systematically differently in the aftermath of crises than during normal times. This suggests that factors that could increase political accountability during crises, such as an increased salience of financial policies to voters, do not seem to play an important role, or could be outweighed by other factors such as better opportunities for pushing bad policies through the legislative process.

Finally, the coefficient on *TLimit* in Table 3 estimates β_3 in Equation (1). This captures the effect of term limits during normal times (outside crises). While this effect is positive across policy domains, it is relatively small and never statistically significant. This suggests that term-limited leaders do not tend to behave systematically differently than those up for reelection in these

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three financial policy domains, and that systematic differences only arise in the aftermath of crises.

The main take-away from this table is that the deliberalization policies chosen by term-limited politicians in the aftermath of crises tend to favor financial institutions over voters. The contrast in policy stance between the two types of policymakers is starkest for entry barriers. The actions of politicians in this domain allow incumbent banks to extract rents by discouraging new entry into the financial industry. Term-limited leaders are also more likely to nationalize banks than those up for reelection in the wake of financial crises. While both types of politicians nationalize banks at higher rates after financial crises, term-limited leaders do so significantly more, suggesting their policies might go beyond the optimal bailout strategies that would normally be favored by the median voter.

6 | Mechanism

The results from Table 3 suggest that factors influencing the behavior of politicians up for reelection, such as increased policy salience, are unlikely to drive the difference between term-limited politicians and those up for reelection after crises. Instead, factors more likely to influence the behavior of term-limited politicians, such as rent opportunities from the financial industry, seem to become more important during financial crises. In this section, we carry out some additional analyses to further explore this mechanism.

We show three pieces of evidence in support of this interpretation. First, we show that the effects of term limits and financial crises that we measured in Section 5.2 are stronger in countries where revolving doors are more frequent. Second, we show that policymakers who serve under a term-limited leader in the aftermath of a crisis are more likely to pursue a career in the financial sector than those who served under a leader up for reelection. Finally, we show that the policies chosen by term-limited leaders are not more likely to promote financial stability and be in the public's interest.

6.1 | Heterogeneity by Frequency of Revolving Doors

A large literature has shown that the prospect of future career opportunities in the private sector incentivizes policymakers to pass policies in favor of the firms that can hire them (see, e.g., Blanes i Vidal et al. (2012), Bertrand et al. (2014), LaPira and Thomas (2014), McCrain (2018), or Shepherd and You (2020)). We should therefore expect the effects we measure in Table 3 to be stronger when this type of quid pro quo behavior is more likely.

To assess the heterogeneity of our effects with respect to the frequency of revolving doors, we use a data set compiled by Braun and Raddatz (2010). The authors rank a large cross section of countries based on the frequency of the directors in their banks who used to be high-ranking politicians in the past. Figure A1 in the Online Appendix maps the intensity of this revolving door phenomenon across the globe. The measure is only available for the year 2006, so we use it to classify countries into low and high frequency of revolving doors based on whether the frequency is above or below the median in the sample (see Figure A2 in the Online Appendix).[36]

Assuming that the availability of revolving doors in a given country captures the general propensity of the financial industry to reward politicians, this measure can be considered a proxy for policymakers' incentives to act in the interest of the financial industry. It is important to note, however, that formal employment of the term-limited leaders is not necessarily the only way to reward them. It is also possible that they are influenced by the career incentives of members of their cabinets or bureaucrats (which we test in the next section) and possibly by less visible means such as corruption or illegal family enrichment including bribery, improper loans, or other personal gains derived from the financial sector. A comprehensive search into 106 term-limited leaders who were in power during our sample period revealed that more than half of them had at least one of these links with the financial industry in their country (see Figure A3 in the Online Appendix).[37]

We should therefore expect that the difference in behavior between term-limited policymakers and those up for reelection in the aftermath of crises is amplified in countries where revolving doors are more common. Table 4 presents the results from reestimating Equation (1) after dividing our sample into two equal subsamples of countries depending on the frequency of revolving doors. We restrict attention to the three policy domains with clear conflicts of interest which we analyzed in Section 5.2. In line with our expectations, the coefficient on the interaction between term limits and financial crisis for entry barriers and privatization is larger in countries with high revolving doors. Term-limited leaders liberalize bank supervision in countries with high revolving doors but not in those with low revolving doors (though both estimates are statistically insignificant). In the final columns of both panels in Table 4, we estimate the same specification as in Table 2 by pooling all three policy domains.[38] Term-limited political leaders in countries where revolving doors are common are almost three times more likely to pass reforms that favor financial institutions in the aftermath of financial crises than those in countries with fewer revolving doors.[39]

These results are therefore consistent with our interpretation that the difference in behavior between term-limited leaders and those up for reelection is driven by a desire to act in the interest of financial institutions.

6.2 | Policymakers' Financial Careers

While we cannot trace the careers of each individual political leader in our sample, we show that high-ranking decision makers in financial policymaking (such as finance ministers and central bank governors) serving at the same time as term-limited leaders are more likely to pursue careers in the financial sector upon leaving politics. Importantly, this relationship holds only when the relevant decision maker served under a term-limited leader *after a financial crisis*.

We use a novel data set constructed by Wirsching (2018) that includes information on 534 top government officials decisive in financial policymaking in 32 democratic countries between the

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TABLE 4 | Heterogeneity of baseline results by intensity of revolving door.

Panel A: High revolving door countries				
	(1)	**(2)**	**(3)**	**(4)**
Dep. var.	**Entry barriers**	**Privatization**	**Supervision**	**Combined**
$TLimit \times Crisis$	−0.113	−0.157*	0.072	−0.114**
	[0.072]	[0.084]	[0.045]	[0.047]
$Crisis$	5.070	3.241	3.376	1.645
	[4.672]	[7.929]	[7.178]	[4.198]
$TLimit$	0.061	0.105	−0.006	0.057
	[0.045]	[0.069]	[0.032]	[0.035]
Observations	1058	1058	1058	3174
Adjusted R^2	0.864	0.848	0.869	0.882
Country FE	Yes	Yes	Yes	Yes
Reform FE				Yes
Year FE	Yes	Yes	Yes	Yes
CountryTime trend	Yes	Yes	Yes	Yes
All baseline + interacted controls	Yes	Yes	Yes	Yes
Panel B: Low revolving door countries				
	(1)	**(2)**	**(3)**	**(4)**
Dep. var.	**Entry barriers**	**Privatization**	**Supervision**	**Combined**
$TLimit \times Crisis$	−0.049	−0.069	0.003	−0.040
	[0.057]	[0.048]	[0.043]	[0.026]
$Crisis$	−6.685	0.375	0.111	−2.141
	[5.062]	[5.827]	[3.860]	[2.390]
$TLimit$	−0.017	0.050	0.015	0.006
	[0.041]	[0.031]	[0.030]	[0.025]
Observations	1029	1029	1029	3087
Adjusted R^2	0.863	0.840	0.886	0.881
Country FE	Yes	Yes	Yes	Yes
Reform FE				Yes
Year FE	Yes	Yes	Yes	Yes
CountryTime trend	Yes	Yes	Yes	Yes
All baseline + interacted controls	Yes	Yes	Yes	Yes

Note: Sample includes only democratic countries with an executive index of electoral competitiveness equal to or higher than six. Dependent variable is a financial policy domain varying over countries and years. *TLimit* is a dummy variable equal to one for the country-year observations where the political leader is in the midst of their last legally allowed term of office and thus cannot run for the next election. *Crisis* is a dummy variable equal to one in the first 5 years after a financial crisis including the starting year itself. Robust standard errors are clustered at the country level and reported in brackets. $^{*}p < 0.1$, $^{**}p < 0.05$, $^{***}p < 0.01$.

years 1973 and 2005. The data contain the name of each government official, their past position in the government (finance minister or central bank governor), the time period during which they served and whether or not they were employed by the *private* financial industry (as president, member of the board of directors, or advisor) after they left their government posts. This definition excludes careers pursued in state-run financial institutions and hence mitigates the concern that the transition from government to financial industry might be mechanically driven by the nationalization of the banking sector after crises. We estimate the following model of financial careers at the individual government official level:

$$PostGov'tFinanceCareer_j = \beta_1 \times TLimit_j \times Crisis_j + \beta_2 \times Crisis_j + \beta_3 \times TLimit_j + \mu_i + \gamma_p + \kappa_e + \omega_x + \psi_n + \varepsilon_j, \quad (3)$$

where j represents the individual, i their country of service, p their position (finance minister or central banker), e the

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TABLE 5 | Term limits, crises, and postgovernment finance career.

	(1)	(2)	(3)	(4)	(5)	(6)
Dependent variable	Postgovernment finance career					
TLimit × *Crisis*	0.368***	0.318**	0.312**	0.303*	0.328**	0.328**
	[0.140]	[0.143]	[0.147]	[0.158]	[0.157]	[0.164]
TLimit	0.117	0.061	0.059	0.068	0.072	0.093
	[0.096]	[0.129]	[0.128]	[0.132]	[0.134]	[0.138]
Crisis	0.007	0.070	0.051	−0.019	−0.031	−0.025
	[0.049]	[0.055]	[0.055]	[0.058]	[0.058]	[0.060]
Observations	534	534	534	534	534	531
Adjusted R^2	0.023	0.145	0.160	0.174	0.176	0.169
Country FE		Yes	Yes	Yes	Yes	Yes
Position FE			Yes	Yes	Yes	Yes
Entry decade FE				Yes	Yes	Yes
Exit decade FE					Yes	Yes
Tenure FE						Yes

Note: The table summarizes the estimation results of a linear probability model. Sample includes a cross section of top government officials who served across 32 democratic countries between the years 1973 and 2005. The dependent dummy variable measures whether or not the corresponding individual pursued a career as president, chairman, or member of the board of a private financial institution in their country after leaving politics. *TLimit* and *Crisis* are dummy variables equal to one if the individual served under a term-limited political leader and if they served in the first 5 years after a crisis, respectively. Robust standard errors are reported in brackets. $^{*}p < 0.1$, $^{**}p < 0.05$, $^{***}p < 0.01$.

decade in which they entered the governmental position, x the decade in which they exited the governmental position and n the number of years they served in government. The dependent variable, *PostGov'tFinanceCareer*, is a dummy measuring whether or not the corresponding individual pursued a career as either a president, member of the board or advisor of a private financial institution in their country after leaving politics. *TLimit* and *Crisis* are dummy variables turning on if the individual served under a term-limited political leader, and if they served in the first 5 years after a crisis, respectively.[40]

While the coefficients capture conditional correlations, rather than the causal effect of serving under a term-limited leader, we mitigate obvious omitted variable concerns by saturating the model with a range of fixed effects. We include country fixed effects (μ_i) as finance careers might be more common in some countries than others, position fixed effects (γ_p), as finance ministers or central bankers in general might be more or less likely to end up in finance, fixed effects for the decade of entry (κ_e) and exit (ω_x) of the official in order to take into account generational effects, and tenure length fixed effects (ψ_n), in order to control for previous government expertise.

Table 5 shows a positive relationship between serving under a term-limited leader in the aftermath of a crisis and pursuing a financial career after leaving the government across all specifications. The effects do not change significantly as the model is saturated with varying fixed effects indicating that the relationship is not driven by country or policymaker-specific characteristics. Focusing on the most conservative estimate in Column (4), we conclude that there is at least a 30% higher chance of pursuing a financial career after leaving government if the official served under a term-limited leader than one up for reelection in the aftermath of a crisis. This effect is large in magnitude and equal to more than 75% of the unconditional mean of the dependent variable (see Table 1).[41]

These findings further support the view that term-limited leaders choose policies that favor financial institutions because they, or policymakers close to them, get rewarded for these choices. In line with our theoretical conjecture, this occurs exclusively for allies of the term-limited leaders who were in power in the aftermath of a financial crisis.

6.3 | Effect of Term-Limited Politicians on Financial Stability

While our results so far suggest that term-limited politicians tend to pass policies in favor of financial institutions after crises, they do so more in countries where revolving doors are common, and their allies obtain positions in private banks after leaving their government posts, one could argue that the interests of financial institutions and those of the public are not necessarily misaligned. Moreover, it is also possible that the policies chosen by term-limited leaders in the aftermath of crises are actually needed to address the crisis and restore financial stability. If this were the case, one would expect a better postcrisis performance in the banking sector of countries which had a term-limited leader at the helm when they faced a financial crisis. Contrary to this logic, we show that these additional policies pursued by the term-limited leaders do not translate into higher financial stability or better bank performance after crises.

Table 6 reports the results of estimating a specification similar to Equation (1) over a balanced panel of banks with a range

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TABLE 6 | Term limits, crises, and bank stability/performance.

Dep. Var.	(1) log Z-score 3-year	(2) log Z-score 4-year	(3) log Z-score 5-year	(4) Return on asset	(5) Return on equity	(6) Non performing loans	(7) Provision Op. income ratio	(8) Provision asset ratio
TLimit × *Crisis*	−0.179	−0.044	0.134	0.013	−0.003	0.003	−0.100	0.002
	[0.145]	[0.112]	[0.098]	[0.016]	[0.031]	[0.007]	[0.072]	[0.001]
Crisis	−0.417***	−0.385***	−0.338***	−0.004***	−0.073***	0.010***	0.167***	0.002**
	[0.114]	[0.097]	[0.074]	[0.001]	[0.014]	[0.004]	[0.042]	[0.001]
TLimit	0.114	0.108	0.068	−0.024	−0.006	−0.002	0.021	−0.002**
	[0.074]	[0.091]	[0.091]	[0.029]	[0.013]	[0.004]	[0.059]	[0.001]
Observations	12,366	11,500	10,618	14,434	14,425	14,488	14,195	14,488
Adjusted R^2	0.391	0.468	0.532	−0.001	0.079	0.509	0.024	0.130
Bank FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Note: Sample includes only democratic countries with an executive index of electoral competitiveness equal to or higher than six and only those banks that have observations in each year from 1999 to 2014. *TLimit* is a dummy variable equal to one for the country-year observations where the political leader is in the midst of their last legally allowed term of office and thus cannot run for the next election. *Crisis* is a dummy variable equal to one in the first 5 years after a financial crisis including the starting year itself. Robust standard errors are clustered at the country level and reported in brackets. $^{*}p < 0.1$, $^{**}p < 0.05$, $^{***}p < 0.01$.

of dependent variables measuring riskiness and performance of the domestic banking sector. The first three columns show the effect of crises and term limits on the financial stability of banks. Financial stability is measured using different version of the *z*-score, which essentially measures the distance of a bank to bankruptcy.[42] Columns (4) and (5) show the effects on profitability as measured by returns on assets and equity. The last three columns show the effects on bank loan performance.

The main take-away from this table is that, while crises predictably reduce financial stability and bank performance across all metrics, as captured by the large and significant coefficients on the crisis variable, term-limited leaders do not significantly improve financial stability. None of the coefficients on the term limit and crisis interaction are significant.

We can therefore conclude that the policies chosen by term-limited leaders are not chosen to improve financial stability or to create a better-performing banking sector.

7 | Conclusion

In this paper, we study the determinants of financial policies and shed light on the interaction between financial crises and electoral accountability. Based on a novel panel data set of 88 countries over the period 1973–2015, we first present evidence that financial crises tend to encourage reregulation in financial markets and that this effect is particularly strong for term-limited policymakers. However, the reregulation carried out by these policymakers tends to favor financial institutions over the general population. Term-limited policymakers are more likely to raise barriers to entry or bail banks out.

We consider several possible mechanisms to rationalize the facts that both term-limited policymakers and those up for reelection engage in more deliberalization, but that the term-limited ones push these policies further. We present some suggestive evidence that the motivations of term-limited leaders could be driven by the prospect of pursuing careers in the financial sector and show that the policies chosen by term-limited leaders following crises do not improve financial stability or bank performance compared to those chosen by politicians up for reelection. This is consistent with the idea that these politicians are not motivated by the interests of the general public.

Our findings reveal that the context in which policies are chosen can have important implications for the role of institutions designed to keep politicians accountable.

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Data Availability Statement

The data that support the findings of this study are openly available on the Open IPCSR repository at http://doi.org/10.3886/E251054V2.

Endnotes

[1] The idea that regulatory policymaking could be captured by private interest groups goes back to the seminal pieces by Stigler (1971), Krueger (1974), or Peltzman (1976) and has been shown to be important in the case of the financial sector by Mian et al. (2010) and Igan and Mishra (2014).

[2] There are usually several key players involved in financial policymaking in democratic countries, including political leaders but also cabinet members such as finance ministers and nonelected officials such as central bank governors. Their tenure is not directly determined by the term limit of the political leader under whom they work. Therefore, to the extent that these other players are influential in financial policies, we would likely underestimate the true effect of term limits in our setting.

[3] Entry barriers are associated with rent extraction (Friedman 1970; Goddard et al. 2011) and thus benefit banks at the expense of consumers. Similarly, bailouts benefit banks while the general public has mixed views on them. Though Chwieroth and Walter (2019) argue that some level of bank bailouts is demanded by voters during times of crises, Faccio et al. (2006) show that private incentives could lead to excessive bailouts that can exacerbate the moral hazard problem in the banking sector (Dam and Koetter 2012), consistent with surveys indicating opposition to taxpayer-funded bailouts (Pew Research Center 2010; Reuters / Ipsos 2023). We discuss additional evidence to support our classification of policies favored by the banking sector at the expense of voters in Section 5.2.

[4] There is also an adjacent literature that studies the role of term length (or electoral proximity) in shaping policymakers' preferences and effort (see, among many others, Amacher and Boyes 1978; Thomas 1985; Rothenberg and Sanders 2000; Bernhard and Sala 2006; Dal Bó and Rossi 2011; Conconi,Facchini, et al. 2014). While these papers argue that larger electoral incentives (due to shorter term lengths or elections taking place closer in time) may encourage politicians to behave in line with their constituents' preferences, we argue that the *lack* of electoral incentives (due to binding term limits) encourages politicians to serve the "private interests" of the banking industry. In both cases, electoral incentives (or lack thereof) matter in swinging policies from one direction to another.

[5] These include crises such as high inflation, fiscal stress, and growth crises, see Bruno and Easterly (1996), Lora (1998), Perotti (1999), Drazen and Easterly (2001), Pitlik and Wirth (2003), and Alesina et al. (2006).

[6] See reviews by Pagano and Volpin (2001) and Lambert and Volpin (2018).

[7] These authors in turn build on the earlier and smaller set of observations compiled by Abiad and Mody (2005). Some of the recent studies employing this data set include Mendoza et al. (2009), Prati et al. (2013), and Giuliano et al. (2013).

[8] In the original data set, a positive increase in banking supervision implies more government intervention, and thus less liberalization. For this reason, we use the banking supervision index in the reversed form $(1 - x)$ in our estimations to make sure that our sign interpretations are consistent across different indices.

[9] The two data sets differ in some dimensions: the index on capital account restrictions in DG is based on the index built by Chinn and Ito (2006) and one sub-question in the credit controls section is dropped. In the next section, we describe how we control for possible biases that may arise due to these differences.

[10] For the few cases in which there is little divergence, they keep their own scores for consistency.

[11] These new countries are Iceland, Luxembourg, Saudi Arabia, Slovakia, and Slovenia and are observed only for the years from 2000 to 2015.

[12] The DPI defines a country as a democracy if its executive has a score equal to or higher than six in a given year (Cruz et al. 2020).

[13] Countries with no term limits at all may be systematically different than those with term limits. We show below that our results are robust to dropping countries with no term limits.

[14] See Silva (2019) for the construction of the baseline bank-year panel from the raw Bankscope data set.

[15] See, for example, Laeven and Levine (2009). More formally, we compute the following for each bank and year: $\frac{(Income_t + Equity_t)}{Assets_t}$ divided by the standard deviation of return on assets over the previous 4 years. As we have a relatively short time span in our sample, we use the previous 4 years as the window over which to compute the volatility. We present alternative windows of 3 and 5 years to show that our results are not sensitive to window size, despite the fact that longer durations reduce our sample size.

[16] Table 1 is constructed only with the observations that remain after merging the reform database with information on financial crises. Less than 25% of the full reform data set is dropped after the merging process. See Online Appendix Table A3 for the summary statistics of additional variables.

[17] For instance, the lack of variation in the United States of America following the 2008 crisis reflects both the fact that bailouts (through TARP) were not large enough to push the proportion of state-owned asset above 10%, which is necessary to push the index below 1, while the supervision index was already at its maximum and therefore not affected by additional supervisory measures.

[18] One mechanism that can counteract this force is the fact that, if politicians are term limited because they have reached the second term of a two-term limit (as is the case in many countries), then term-limited politicians have survived an election and are therefore more likely to have preferences aligned with those of voters. This mechanism could, in principle, make term-limited politicians more likely to act in the interest of voters. The evidence from the term limit literature suggests that this mechanism is generally not strong enough to offset the effect of lower incentives.

[19] This is likely to be the case as the returns to lobbying can be more important in times of crises, see, for example, Blau et al. (2013).

[20] If term-limited politicians are more likely to have preferences aligned with those of voters because they have survived a previous election (as noted above), then the rewards offered by private interests need to be sufficiently high for these politicians to choose policies against the public's interest. This would reinforce the effect of crises on the difference between term-limited politicians and those up for reelection.

[21] Promises of lucrative roles in the financial sector could, in principle, affect both types of politicians but are more likely to affect those facing term-limited who have no immediate employment prospects once their term ends.

[22] In Online Appendix Table A4, we show that the results are very similar in magnitude and significance if we use nonlinear trends instead of linear ones.

[23] For example, the interacted fixed effects between reform domains and years can capture any divergence in the outcome variable generated by the different criteria used in these two data sets as long as the resulting bias applies similarly to all country observations within a specific reform-year pair.

[24] Our empirical specification follows the previous literature testing the effect of crises on various policy indices (Mian et al. 2014; Gokmen et al. 2021). We also ran alternative specifications with a lagged dependent variable as explanatory variable and with the first-differenced financial liberalization index as outcome variable. Such robustness exercises

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(available upon request) do not qualitatively change our results. We do not use these specifications for our main results due to known estimation problems associated with including the lagged dependent variable as a control in fixed-effect panel-data models (Nickell 1981; Anderson and Hsiao 1982) or first-differencing outcome variables that contain measurement error (Wooldridge 2010).

[25] By including τ up to 4 years, we are able to fully dissect the *Crisis* variable in Equation (1) which is specified over the 5-year postcrisis period including the start year itself.

[26] Vote share is a good proxy for ability whenever leaders' ability and election performance are correlated. Since the underlying concern is that more capable leaders might be more likely to be reelected (and thus become term-limited) these two variables should indeed be correlated. If our control variable, government vote share, was not a good proxy for leaders' skills, then the identification concern itself would be irrelevant.

[27] See Section 3 for the definitions of these variables.

[28] More than 91% of the observations for term-limited leaders in our sample correspond to presidential regimes. The remaining observations are equally shared between assembly elected presidential systems and parliamentary systems. Hence, only a small portion of the variation (around 4%) in our term limit variable comes from parliamentary regimes. For our baseline estimations, we focus on the full sample not only to ensure external validity and transparency but also to use clean counterfactuals and overcome the "negative-weights problem" highlighted by the recent literature on two-way fixed effect models (De Chaisemartin and d'Haultfoeuille 2020). However, we conduct a robustness check in Online Appendix Table A7 where we restrict our estimations only to presidential systems. Our conclusions become stronger in this subsample.

[29] The presidential dummy is different from the *TLimit* variable. Although most presidential systems have term limits, the latter only applies to the second (or possibly third) term and almost never to the first term.

[30] These countries are Argentina, Azerbaijan, Belarus, Bolivia, Brazil, Colombia, Costa Rica, Algeria, Ecuador, Estonia, Georgia, Ghana, Guatemala, Indonesia, Kenya, Kyrgyz Republic, Korea, Sri Lanka, Mexico, Philippines, Poland, Portugal, Paraguay, Russia, Senegal, El Salvador, Tunisia, Tanzania, Uruguay, the United States, and South Africa.

[31] The other policy domains in our data have less clear conflicts of interest between voters and the financial industry. Credit and interest rate controls can be used to favor one industry over another and are therefore not necessarily supported consistently by lobby groups. Security markets reforms are likely to benefit both voters and the financial industry. For completeness, we present the results for these domains in Online Appendix Table A14.

[32] For example, the UK bank RBS indicated in written evidence submitted to the UK Parliament that "The number of players may have decreased since the period before the financial crisis, and therefore arguably competition, but [...] We believe that post crisis there remains an adequate level of competition and choice in the banking sector." (House of Commons Treasury Committee 2011). Instead, the consumer association *Which?* noted that "Consumers have seen a real impact from changes to the competitive landscape, with worsening product terms whilst banks themselves have seen increasing margins. [...] Significant entry barriers [...] remain which seriously fetter the prospects for effective competition." (House of Commons Treasury Committee 2011).

[33] The Consumer Financial Protection Bureau (CFPB) introduced in the United States by the Dodd–Frank Act has faced regular opposition from the financial industry (Wilmarth 2011; Block-Lieb 2012) but surveys show that voters are supportive of financial supervision with 82% of American voters favoring the CFPB (Center for Responsible Lending 2023), and 76% of UK voters "agree[ing] that the Government should regulate the sales, advertising and marketing activities of financial services firms" (Devlin 2006).

[34] See, for example, https://www.mlive.com/news/kalamazoo/2009/01/next_head_of_american_bankers.html. Evidence also shows that bailouts are used strategically by politicians in order to generate private rents (see Brown and Dinc 2005; Faccio et al. 2006; Duchin and Sosyura 2012). Voters' support for bailouts is less clear. On the one hand, voters are unlikely to welcome bailouts as they put taxpayers' money at risk and fail to punish bankers for overly risky behavior. On the other, voters seem to support government intervention while a crisis unfolds. Surveys conducted in September 2008 showed that 57% of voters were in favor of bailouts (Pew Research Center 2008). However, 2 years later, 46% of American voters reported that they would be less likely to vote for a candidate who supported major loans for banks during the crisis against only 13 percent who stated this would make them more likely to support a candidate (Pew Research Center 2010).

[35] The results for bank supervision (Column (3)), suggest that term-limited politicians tend to lower bank supervision in the aftermath of crises, which would also be aligned with the interests of incumbent banks, but that reduction is not statistically significant. Note that a positive change in bank supervision in our setting indicates more liberalization, thus less bank supervision.

[36] The measure is more precise for countries whose bank coverage is more widespread in the Bankscope data set, which makes it a noisy measure for the country-level frequency of revolving doors.

[37] To generate Figure A3, we manually searched publicly available sources such as Wikipedia, newspaper articles, official websites, and archival records. "Paid roles after leaving office" refers to instances where heads of state pursue employment in the financial sector after their term ends-through board memberships, consulting or advisory roles, executive positions, or high-fee speaking engagements. "High-ranking officials with employment links to banks" refers to cases where cabinet members or bureaucrats who served under a term-limited leader also had an employment relationship with a bank in the same country. "Corruption or family enrichment through banks" includes bribery, improper loans, and other personal gains linked to the financial sector, covering cases where family members benefit from owning shares in banks, holding executive positions, receiving contracts, or getting special treatment.

[38] For this estimation, we multiply the supervision domain by minus one to make it in line with our expected direction of private interests.

[39] The difference between the estimates reported in the final columns across two subsamples is statistically significant at conventional levels.

[40] Note that the *TLimit* variable captures whether the political leader under which individual *j* serves is term-limited, not whether individual *j* herself is term-limited. Unlike the *TLimit* and *Crisis* variable in specification 1, the variables here are not time-varying and take value 1 if the individual *ever* served under a term-limited leader or during a crisis.

[41] Due to the small number of countries in the sample (32), we abstain from clustering at the country-level. However in Appendix, we show that our results are robust to clustering: Online Appendix Table A15 provides the version with country-level clustering and Online Table A16 with country × position level clustering (64 clusters).

[42] Our results without log transformation are qualitatively similar but we use the log transformation of the *z*-score in our baseline as it takes into account the nonlinearity between crises and financial stability.

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