

2. POPULISM AND ECONOMICS

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2.1. INTRODUCTION

One of the most important changes in the political landscape in Europe and elsewhere in recent decades is the rapid and marked increase in the support for populist policies and ideas.² This is illustrated by many events, most notably by the outcomes of a number of elections – including the electoral wins of Presidents Trump and Bolsonaro in the US and Brazil, the Fidesz party under Victor Orbán in Hungary and the Law and Justice party in Poland under Jarosław Kaczyński and his late twin brother Lech – and in Brexit.

Of course, economic populism has a long tradition in Latin America. But that was left-wing populism, which often had socialist overtones. As Dornbusch and Edwards (1991) note in their widely cited book, it had its roots in a deep popular dissatisfaction with economic performance, involved a rejection of the perceived constraints on government policies (such as deficit financing) emphasized by neoclassical economics, and focused on income redistribution and economic restructuring.

By contrast, much of the recent growth of populism is of the right-wing variety. Wolf (2018) characterizes it as denunciation of the liberal elite and its values of democracy, technocratic governance (“people in this country have had enough of experts” as Michael Gove put it), and of the globalization of economics and finance. It involves a deep disenchantment of corruption of the political process and desire to elect a political leader with authoritarian tendencies who will sweep it away by “draining the swamp.” It is often forgotten, as Eichengreen (2018a) emphasizes, that authoritarianism tends to amplify rather than reduce corruption by abolishing checks and balances in the political system.

The growth of populism raises a number of questions for economists. For instance, what role have macroeconomic conditions and policies played in fuelling populism? And, what impact might populism have on economic policies. These are some of the issues discussed in this article.

Before addressing these questions, it is necessary to define what is meant by populism. In the academic literature, there are plenty of broadly similar and long

¹ EFG Bank and CEPR.

² This article draws from remarks prepared for the SUERF/BAFFI CAREFIN Centre Conference on *Populism, Economic Policies and Central Banking*, held in Milan on 8 November 2020. The views expressed here are solely my own. I thank GianLuigi Mandruzzato and Rebecca Stuart for very helpful comments.

definitions. For instance, Albertazzi and McDonnell (2008, p. 3) define populism as “*an ideology which pits a virtuous and homogeneous people against a set of elites and dangerous ‘others’ who are together depicted as depriving (or attempting to deprive) the sovereign people of their rights, values, prosperity, identity and voice.*” Shorter and clearer definitions are available in dictionaries. Encyclopaedia Britannica defines it as a “*political program or movement that champions the common person, usually by favourable contrast with an elite.*”³

But, of course, there are many different political programs that can champion the common man. Eichengreen (2018b, p. 1) writes “*The awkward fact is that there is no agreed definition. Populism is a multidimensional phenomenon with multiple perspectives on each dimension. ... Here I define populism as a political movement with anti-elite, authoritarian, and nativist tendencies. Since populist movements combine these tendencies in different ways, there are different variants of the phenomenon. In particular, there are populist movements of the Left, which emphasize the anti-elite element, and of the Right, which emphasize hostility towards foreigners and minorities.*”

Without a single agreed definition, it is difficult to measure populism. Any statistical analysis of it must therefore be based on proxy variables – variables that are imperfectly correlated with populism but that can be measured. No such variable is likely to perfectly capture the phenomenon, but may nevertheless convey useful information. This is the approach taken here.

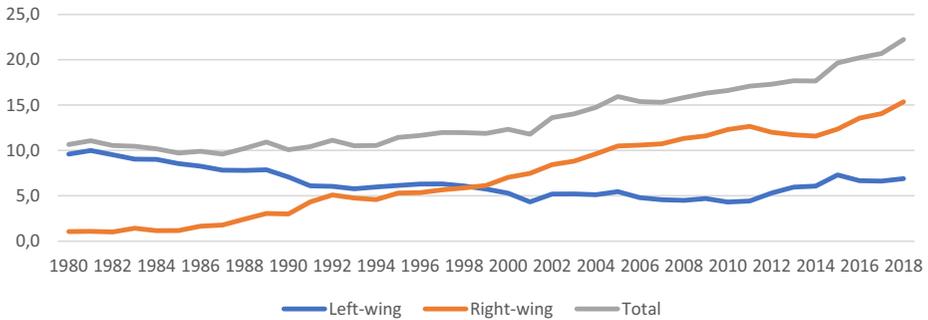
2.2. HOW HAS SUPPORT FOR POPULISM EVOLVED OVER TIME?

There are several potential proxy variables that can be used. Timbro (2019) has proposed an *authoritarian populism index* which includes all European democracies: the 27 members of the European Union (EU) plus Iceland, Norway, Switzerland, Serbia and Montenegro and the United Kingdom.⁴ The index is available since 1980 and measures the fraction of votes that left-wing and right-wing populist parties have achieved in parliamentary elections in the period considered.

Figure 1 shows the electoral support of populist parties. Overall, their support rose gradually but consistently from 10.7% of the votes cast in the parliamentary elections in 1980 to 22.2% in the elections in 2018. This is a very major change of the political landscape in Europe.

³ See <https://www.britannica.com/topic/populism>.

⁴ The methodology and the inclusion criteria are discussed in Timbro (2019, pp. 13-14).

Figure 1: Average share of votes for populist parties, in %

Source: Timbro (2019).

The figure also shows that this rise in populism was associated with a decline in the support of left-wing populist parties from 9.6% in 1980 to 4.3% in 2010. Triggered by the financial crisis, it then started to rise, reaching 7.3% in 2015 and has since remained broadly stable just below 7%. Interestingly, left-wing populist parties are largely a southern European phenomenon.

The most striking aspect of the figure, however, is the increase in the support for right-wing populist parties. While 1.1% of voters supported them in parliamentary elections in 1980, by 2018 15.4% did so. The increase is particularly large at the end of the period: support rose from 11.6% in 2014 to 15.4% four years later.

Several factors may have played a role in this rise. First, the unspeakable crimes that were committed by right-wing regimes during World War 2 appear to have made right-wing populism unacceptable to large parts of the electorate. The level of support in 1980 might thus have been unusually low.⁵ As time passed and new generations became voters, support rose. Second, as countries formerly behind the Iron Curtain, where right-wing populism may have been boosted by 40 years of communist rule, became democratic from the late 1980s onward, they entered the index. The support for right-wing populist parties may thus be increased by the change in the composition of the countries included in the index. Third, the arrival of large numbers of refugees in Europe in 2015 appears to have strengthened right-wing populist sentiment.

Assuming that populism leads to a reduction of democratic rights, another plausible way to gauge the growing support for populist policies is to consider the EUI's *Democracy Index* (EUI 2020), which is available for 165 countries and 2 territories annually since 2006.⁶ The index is based on 60 indicators, grouped into five

⁵ Funke et al. (2016) provides a long-term perspective on populism.

⁶ The index is not available for 2007 and 2009; in the graphs below I use linear interpolation to create observations for the missing years.

categories: electoral process and pluralism; civil liberties; the functioning of government; political participation; and political culture. Each category has a rating on a 0 to 10 scale, and the overall Index is the simple average of the five category indexes.

Table 1 shows that the index fell the most in Eastern Europe followed by Western Europe, and smaller declines in Latin America and North America, between 2006 and 2020. For the world as whole the index was largely unchanged.

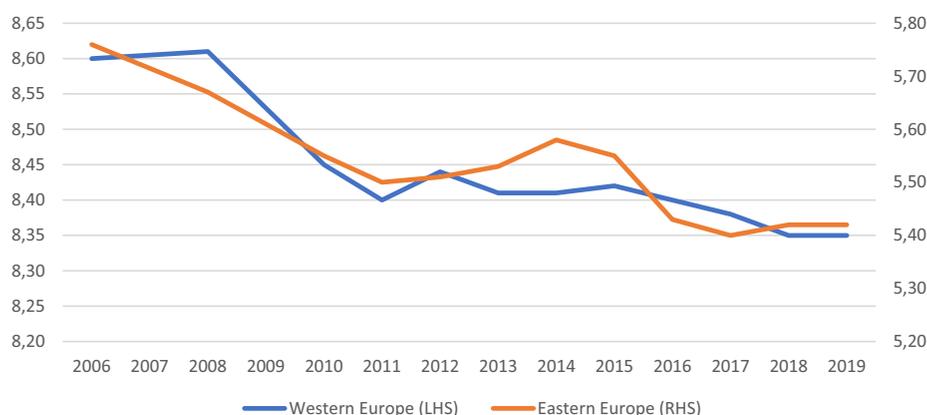
Table 1: Democracy Index 2006-2019 by region

	2006	2019	Change
Asia and Australasia	5.44	5.67	0.23
Latin America	6.37	6.13	-0.24
Middle East and North Africa	3.53	3.53	0.00
North America	8.64	8.59	-0.05
Sub-Saharan Africa	4.24	4.26	0.02
Eastern Europe	5.76	5.42	-0.34
Western Europe	8.60	8.35	-0.25
World Average	5.52	5.44	-0.08

Source: EUI, (2020, p. 24)

Figure 2 shows the evolution over time of the indices for Eastern and Western Europe. While there is a difference in levels (note the difference in scales), the two indices behave in strikingly similar ways. Thus, they fall sharply from 2006 to 2010, stay broadly constant, and fall sharply from 2015 to 2018.

Figure 2: Democracy index 2006-2019, in %



Source: EUI (2020).

2.3. WHAT MIGHT BE DRIVING THESE CHANGES?

By analogy to economic growth, it is useful to think of these developments as reflecting a combination of secular changes, cyclical factors and unpredictable shocks. Rodrik (2019) discusses one important secular change – the deepening rift in values between social conservatives and liberals. The argument is that as younger generations have become richer, more educated, and more secure than their parents, they have adopted liberalism, secularism and diversity at the expense of religiosity, traditional family structures and conformity. By contrast, older generations have become alienated, more politically active, and vote in greater numbers, supporting nationalist, authoritarian politicians. This has led to split between older and younger voters.

He goes on to argue that secular changes have also led to a split between those that live in large urban areas and the rest of society. Urbanization is a process of spatial sorting. It creates thriving, multicultural, high-density areas where socially liberal values are dominant and leaves behind rural areas and smaller cities that are socially conservative and averse to diversity.

Taken together, these developments have set the scene for a backlash from older voters and from voters outside of the major cities.

But it is easy to imagine that secular changes in the form of globalisation and digitalisation have also played a role. These factors tend to increase the demand for well-educated workers, and therefore impact on relative incomes and thus the income distribution. This appear to have caused an underlying, pre-existing discontent that manifested itself once the financial crisis hit and austerity was imposed. Thus, cyclical factors and adverse economic outcomes have also fuelled the growth of populist sentiment by causing economic anxiety and insecurity.

Funke et al. (2016) and Funke and Trebesch (2017) show that financial crises have historically boosted right-wing populism. Not only has the decade after the onset of the *Great Recession* in 2008 been associated with such populism, but so was the decade after the *Great Depression* in 1929.

One way in which a financial crisis can fuel a shift to populism is through austerity. Fetzer (2019) shows that the shift to fiscal consolidation in the UK in response to the budgetary consequences of the financial crisis gave a sharp boost to the support for Brexit in the communities most affected by cuts to welfare spending. In contrast, exposure to the EU in terms of immigration and trade appears to have been much less important (Becker et al., 2017).

Similarly, Dal Bó et al. (2018) show that a combination of policy changes in the form of tax cuts and social welfare reductions that the centre-right government in Sweden introduced in the early 2000s to “make work pay,” together with the

financial crisis that increased the risk of unemployment among vulnerable groups, explain the dramatic increase in the support for *Sverige Demokraterna* (the Sweden Democrats). This right-wing populist party won 1% of the votes in the 2002 parliamentary elections but, according to the SVT/Novus väljarbarometer survey, has grown to become the largest party with 24% popular support in December 2019.

But while economic factors have plainly played a role, poor economic growth is not the sole explanation for rising right-wing populism. Indeed, the US economy has grown strongly since the financial crisis, yet the election of President Trump represents a turn to populism. What seems to matter is the distribution of the benefit of economic growth, in particular the fortunes of workers with low skills who in many countries have provided populists with their main support.

Eichengreen (2018b) and Vlandas and Halikiopoulou (2016) argue that the size of boost that populist parties may benefit from after an adverse economic event is shaped by the social safety net and labour market institutions. In brief, populism receives less of a boost if safety nets are strong since the marginal income groups are then better protected. This interpretation is buttressed by the analysis of Schwander and Manov (2017), who show that economic deprivation does not predict the rapid growth of support for the *Alternative für Deutschland* (AfD), a German right-wing party which has attracted strong popular support, because of a well-functioning safety net. This is illustrated by the fact that the party has gained huge approval in both the poor Bundesländer of the former GDR and the wealthy states of Baden-Württemberg and Bavaria.

Finally, it seems likely that occasional shocks also play a role in determining the support for populist parties. The wave of refugees from war-torn Syria and other countries that reached Europe in 2015 is a case in point. It seems to have provided a boost to right-wing populist parties.

2.4. WHAT DO POPULIST ECONOMIC POLICIES LOOK LIKE?

Given the surge in support for populist right-wing political parties, it is natural to ask what economic policies they might pursue if elected. As noted earlier, historically the focus has been on left-wing economic populism. Dornbusch and Edwards (1991, p. 9) define such populism as an “*approach to economics that emphasizes growth and income redistribution and deemphasizes the risks of inflation and deficit finance, external constraints and the reaction of economic agents to aggressive non-market policies.*” Such policies were often combined with some interpretation of socialism (Mudde 2015).

There are few examples of recent such left-wing populist regimes in Europe. The

most obvious example is Syriza which formed the Greek government in 2015-2019. However, the fact that Greece is a member of the euro area and was subject to the conditionality of an EU-ECB-IMF Troika programme which limited the policy options available to the Syriza government.

Thus, the new type of populism is novel in several dimensions (Guriev 2018). It is gaining ground in developed economies, typically with long records of democracy. The focus is not on redistribution and greater equality, but rather on “protecting” the public from a “cosmopolitan elite.” And while some of its policies, such as hostility to the EU, is supported by both left- and right-wing politicians, the new populism is generally right-wing and nationalist (Mudde 2015).

Nevertheless, it is difficult to form a view of what economic policies right-wing governments would pursue since right-wing populist parties firmly in power – as opposed to being, or having been, part of coalition government as in Austria or Switzerland – are also rare in Europe. The best examples are in Poland and Hungary, although also they are constrained by EU membership.⁷ Thus, in Poland the *Law and Justice Party* is the largest political party in the Polish parliament. The party was in the government coalition in 2005-2007, in opposition 2007-2015, but have formed a majority government since 2015. In Hungary the right-wing populist *Fidesz* party has formed the government under Viktor Orbán in 1998-2002 and since 2010.

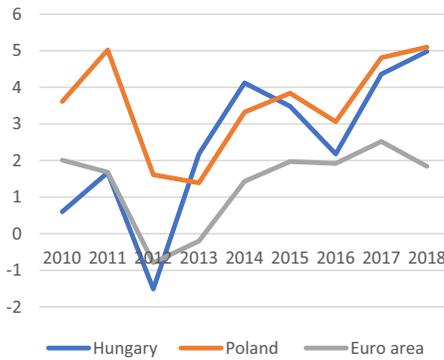
So how have the Hungarian and Polish economies fared in the last decade? Figure 3 shows that real GDP growth in Poland has been higher than in the euro area since 2010, and that growth in Hungary has exceed that in the euro area since 2013. Figure 4 shows that unemployment shows a similar pattern: while the Polish unemployment rate was always below that of the euro area in this period, the Hungarian unemployment rate fell below the euro area rate in 2012.

Figure 5 shows that public debt in Hungary was always a little below that in the euro area and that Polish public debt was much below that of the euro area. Finally, Figure 6 shows that workers’ compensation has been growing more rapidly in Hungary and Poland than in the euro area, in particular since 2015.

Of course, one interpretation of these figures is that they merely illustrate that the former communist economies in Eastern Europe are still catching up with the rest of Europe, starting from a situation with little public debt. Nevertheless, these graphs lend some support to the argument in Lubin (2019) that, with the exception of Trump, current right-wing populist leaders are not given to irresponsible macroeconomic policies.

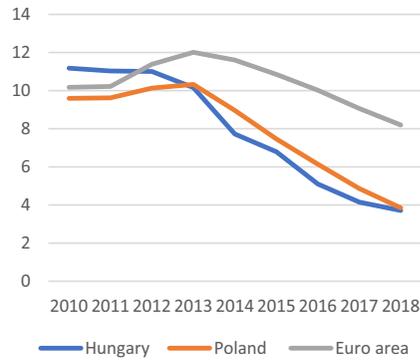
⁷ A right-wing populist government was also in power in Italy from June 2018 to August 2019. Its tenure was short and the policies pursued do not seem to have been beneficial for the Italian economy as they fuelled doubts about the membership of the euro and led to confrontations with the EU Commission over the 2019 budget.

Figure 3: Real GDP growth, in %



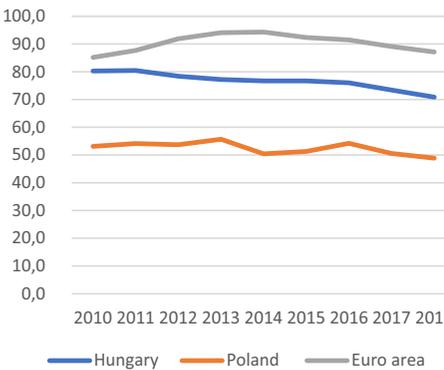
Source: OECD.

Figure 4: Unemployment rate, in %



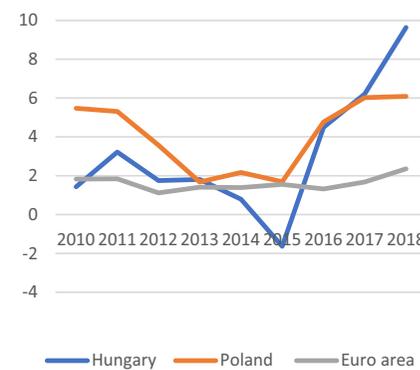
Source: OECD.

Figure 5: Debt-to-GDP ratio, in %



Source: OECD.

Figure 6: Workers' compensation, growth in %



Source: OECD.

2.5. TACKLING RIGHT-WING POPULISM

The surge in right-wing populism raises the question of how best to counteract it. Not surprisingly, how to do so, and how much success can be expected, depends on its sources. The analysis of Rodrik (2019) puts much of the blame on a deepening split in values between social conservatives and liberals, with younger generations becoming increasingly liberal and older generations becoming alienated and supporting right-wing authoritarian politicians. In this case, it would seem difficult to mitigate it.

But economic insecurity has also played a role in boosting right-wing populism. As noted above, the austerity following the financial crisis and governments'

failure to compensate the relatively few losers from globalisation must have been important. Indeed, it seems likely that these factors have reinforced each other.

If so, it suggests that right-wing populism can be tackled by economic policy geared at protecting those most vulnerable in society. Eichengreen (2018b) notes that there are plenty of historical examples of the latter, including Bismarck's social policies in Germany in the late 19th century and President Roosevelt's New Deal in the 1930s. Rodrik (2019) emphasises that the economic remedies to inequality and insecurity are paramount.

But while social safety nets can help those affected for some time, social welfare payments are not a permanent solution. Instead, retraining and other active labour market programs are necessary to return those that have become unemployed as a consequence of economic change to well-paying jobs.

2.6. CONCLUSIONS

The last quarter century has seen a surge in the support for populist parties in Europe. With that development has come a change in the composition of populism: while left-wing parties have lost some importance, there has been a surge in the support for right-wing parties. These changes reflect a mixture of secular social trends (in particular the fact that the horrors of right-wing regimes in the 1930s and 1940s are now more distant in time and the collapse of communism in eastern Europe), economic downturns following the onset in 2008 of the financial crisis, and idiosyncratic developments, in particular rising numbers of asylum seekers triggered by the Syrian civil war.

Changes in the distribution of income appear crucially important. Digitalisation and globalisation seem to have been important in that they have led to a rise in the demand for well-educated workers relative to other workers, which has skewed the income distribution. Such changes have also often been a consequence of austerity following the financial crisis, as suggested by the UK experience, although they also sometimes reflect policy changes, such as in Sweden. As a consequence, it seems clear that effective social safety nets that compensate those that lose from economic change, coupled with active labour market programs that return those that have become unemployed to well-paying jobs, are critical in stemming the tide of rising right-wing populism.

While the economic programs of left-wing populist governments share important characteristics, it is difficult to know what economic policies right-wing populist government may pursue. The main reason for this is simply that there is too little experience of right-wing populist governments in Europe. That said, the experi-

ences of Hungary and Poland suggest that their economic policies are not obviously imprudent.⁸

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⁸ The experiences of the short-lived Italian populist right-wing regime in 2018-19 are very different.

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