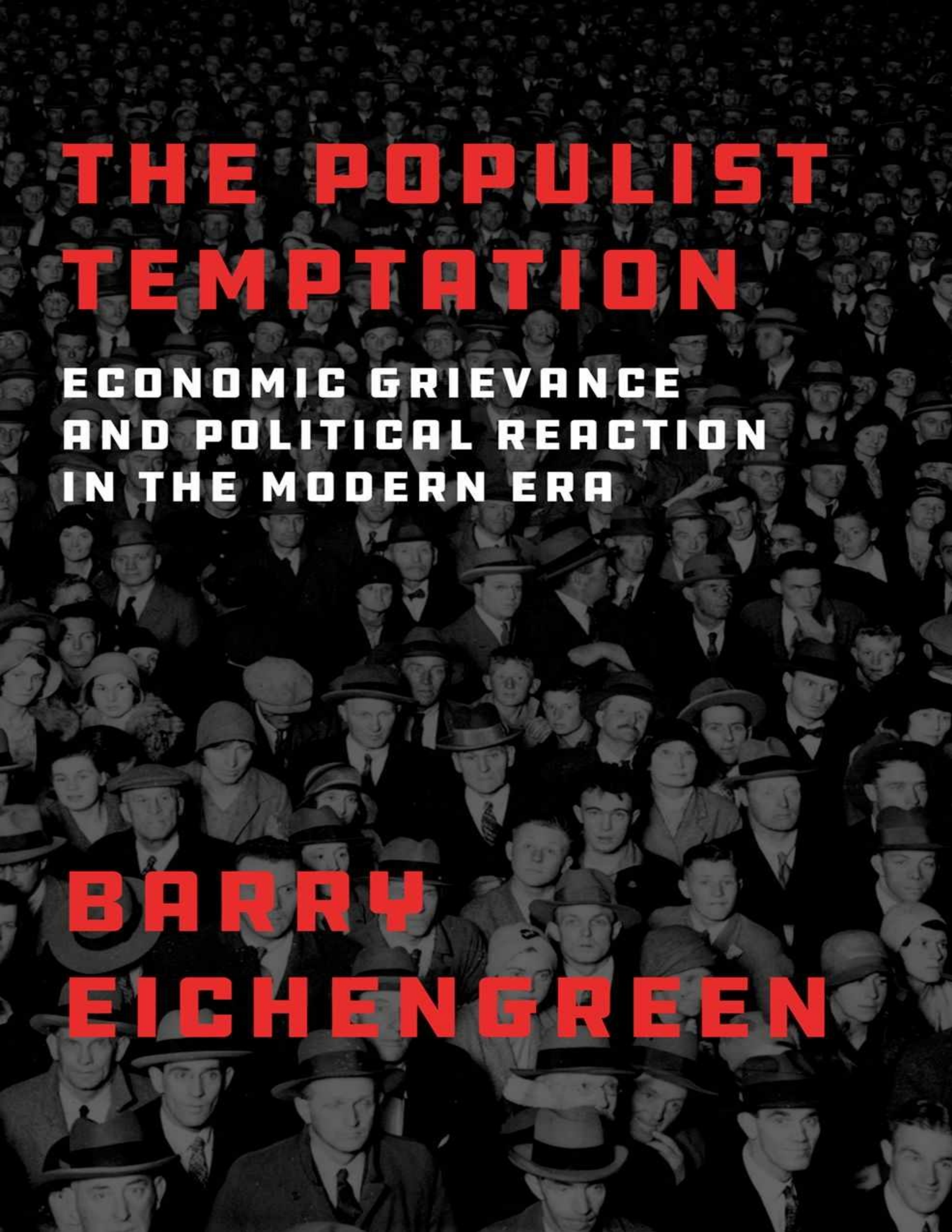
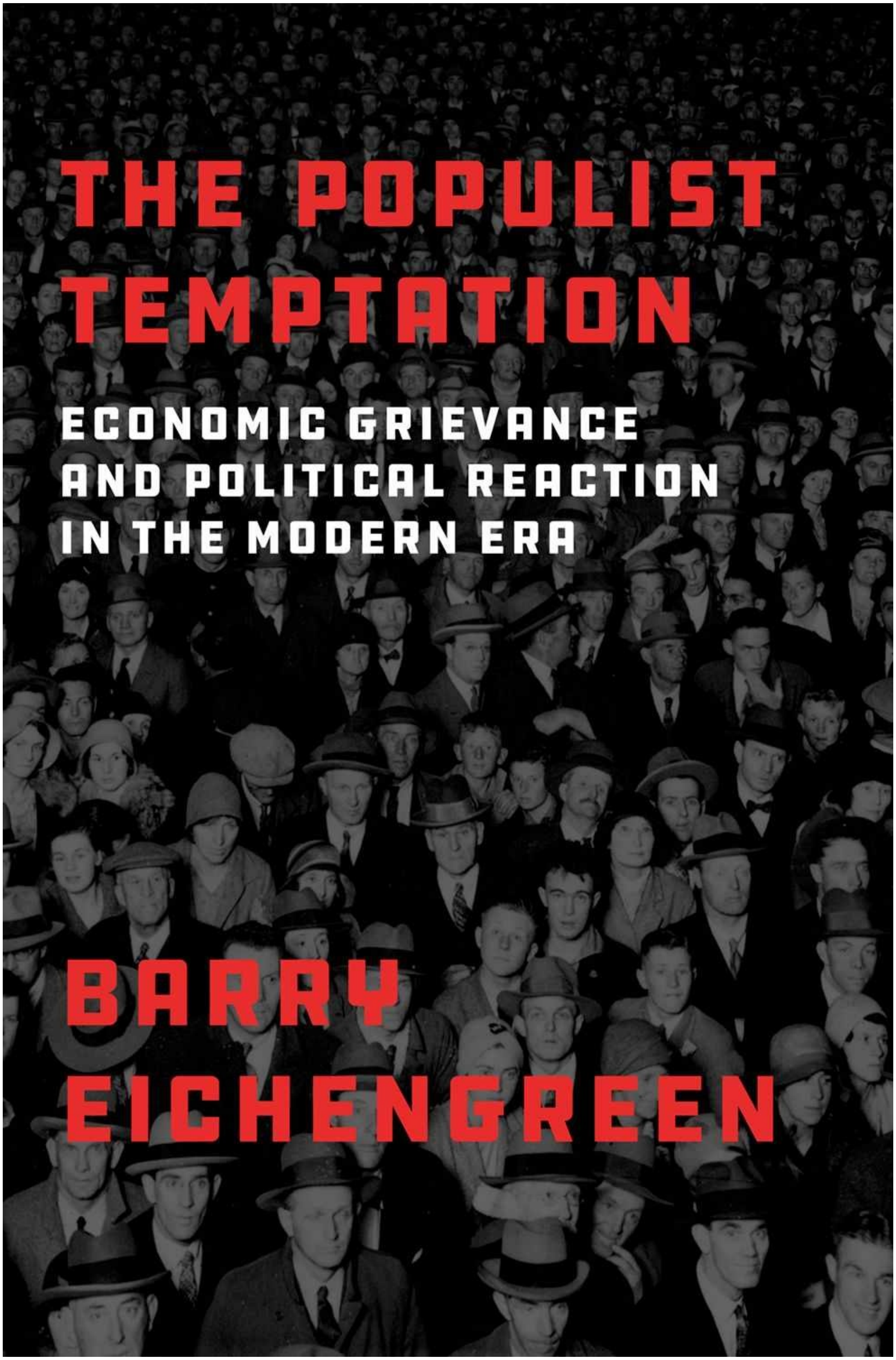
# THE POPULIST TEMPTATION

## ECONOMIC GRIEVANCE AND POLITICAL REACTION IN THE MODERN ERA

BARRY EICHENGREEN

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This book is dedicated, once more, to Michelle, for all her love and support.

# The Populist Temptation

## 1

## The Populist Archetype

efforts to define populism remind one of Justice Potter Stewart's definition of pornography: "I know it when I see it." The awkward fact is that there is no agreed definition. Populism is a multidimensional phenomenon, with multiple perspectives on each dimension. "To each his own definition … according to the academic axe he grinds," wrote the political economist Peter Wiles half a century ago.[1]

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 toward foreigners and minorities.[2]

At the most basic level, populists divide society into the elites and the people.[3] The elites control government, business, and banking, reproducing themselves through favored access to education, the executive suite, and higher echelons of the public sector. Superficial differences notwithstanding, they form a united front. There is little difference, for example, in the backgrounds and interests of the families and networks controlling the major political parties. It follows that there is little difference, in the populist conception, in the policies they espouse. Populists invoke these notions to advance the idea that mainstream politics is an elite conspiracy that produces results inimical to the interests of the people. "Politicians prospered but the jobs left and the factories closed. The establishment protected itself, but not the citizens of our country. Their victories have not been your victories. Their triumphs have not been your triumphs," was how President Donald Trump put it in his inaugural address.

The people may lack the education of the elite, but they possess a basic common sense, passed down through collective traditions, religion, and community, to which populist politicians can appeal. "Virtue resides in the simple people, who are the overwhelming majority, and in their collective traditions," to again quote Peter Wiles.[4] Populist politics is then the process by which the general will, informed by this common sense, is translated into policy.

But who, exactly, constitute the people is easier said in theory than in practice. In nineteenth-century America, members of the agrarian movement, comprising midwestern wheat farmers and southern cotton growers, faced the dilemma of whether to ally with disaffected factory workers, and vice versa.[5] In Donald Trump's America, the candidate sought to broaden his base by appealing not just to blue-collar workers left behind by technological change and globalization but also to a middle class concerned about the decline of traditional American values.

One way of resolving these ambiguities is by defining the people in opposition to the other. In nineteenth-century America, the other was identified as financiers, railroad barons, and industrialists who gained great wealth by exploiting honest, hardworking farm and factory workers. The unity and homogeneity of the people were further defined by the exclusion of visible minorities like indentured Chinese labor and so-called new immigrants from southern and eastern Europe. This same definition by opposition is prevalent in other populist movements. The hostility of populist politicians to not just concentrated economic power but also immigrants and racial and religious minorities thus is intrinsic to the movement.

Viewing society this way breeds an instinctual antagonism to technocrats and governmental agencies. Technocrats are members of the elite, by definition.[6] They use privileged information and preferential access to achieve their objectives. Agencies of government staffed by technocrats, by virtue of their statutory independence and the complexity of their procedures, are remote from the people. Populist politicians regularly impugn the integrity of central bankers, those most technocratic of technocrats, and question the independence of their institution. The Federal Reserve System, together with its early American progenitor, the Bank of the United States, has been a favorite target of politicians with populist leanings, from Andrew Jackson in the nineteenth century to Huey Long in the twentieth and Donald Trump in the twenty-first. In the run-up to the 2016 referendum on whether the United Kingdom should leave the European Union, UK Independence Party leaders like Nigel Farage similarly appealed to voters by criticizing the integrity and competence of EU technocrats and demanding that decision-making power be restored to the British people.

Populism thus favors direct over representative democracy insofar as elites are disproportionately influential in the selection of representatives. It favors referenda over delegating power to office holders who can't be counted on to respect the will of the people. The pioneering referendum processes adopted in Oregon, California, and other western states at the turn of the twentieth century, in which citizens could petition to place questions on the ballot and pass them by simple majority vote, were part of a populist revolt against corruption and a political establishment dominated by large corporations and other powerful interests. The Oregon referendum and initiative movement championed by William Simon U'Ren, for example, was immediately informed by these concerns. Referendum U'Ren, as he was known, mobilized the Farmers' Alliance and trade unions, the two principal sources of support for the Populist Party, of which he was Oregon state secretary, in support of the referendum law adopted in 1902 as a way of making an end run around what he and his followers saw as corrupt politicians, unresponsive elites, and self-aggrandizing railroad monopolies—classic populist tropes all.[7] This value imputed to the will of the people is also a way of understanding why Donald Trump attached such importance to the idea that he would have won the popular vote for the presidency in 2016 but for "pervasive and widespread" voter fraud.[8]

In the case of the Brexit referendum, supporters of Leave defended the outcome on analogous grounds: the result reflected the will of the people.[9] The Brexit campaign was visibly tinged by anti-elite, anti-expert rhetoric, with supporters seeking to discredit the view of professional economists and others that leaving the EU would have significant costs.[10] As Michael Gove, justice secretary in the soon-to-be-former Cameron government and leading supporter of Leave, put it in a television debate, “People have had enough of experts.”[11]

Populism is also a political style. Candidates portray themselves as no-nonsense leaders prepared to knock sense into establishment figures unwilling to address society’s urgent needs, an intention they communicate using harsh, unconventional words and tactics. Disregarding the niceties of political convention is a way of demonstrating independence and force of personality. Political incorrectness and off-color language are ways of signaling seriousness of purpose and speaking directly to the people. In the extreme, forcefulness is conveyed by the assertive dismissal of inconvenient facts and a menacing undercurrent of violence.[12]

Populist politicians regularly rely on new technologies to circumvent channels of communication controlled by mainstream parties and convey their views directly to their followers. As Michael Conniff wrote of Latin American populism two decades ago, “Skillful use of … new media [is] an important attribute of … populists.”[13] In Latin America in the 1920s and the United States in the 1930s, radio played an important role in disseminating populist views, bypassing the establishment press.[14] Decades earlier, in his 1896 campaign for the U.S. presidency, William Jennings Bryan, the candidate of the Democratic and Populist Parties, made unprecedented use of the railway, a revolutionary transportation and communications technology if there ever was one, delivering more than six hundred speeches directly to the people. Bryan raised few funds, made little use of pamphlets and other conventional political media, and leaned only lightly on the Democratic National Committee for campaign support. There was no little irony in Bryan’s reliance on the railway, since he consistently criticized it as exemplifying corporate abuse of monopoly power. But no matter. Bryan’s campaign similarly made unprecedented use of the telegraph to schedule and publicize his appearances. His “Cross of Gold” speech at the 1896

Democratic National Convention made such a splash partly because the telegraph was used to transmit his message nationally, rather than relying on reports by newspaper correspondents and their publishers, many of whom were hostile to his candidacy.[15]

Bryan's strategy was in contrast to that of William McKinley, the candidate of the Republican Party establishment, who remained firmly planted on his front porch. McKinley drew—successfully, in the event—on the ample financial and organizational resources of the National Republican Party and its chairman, "Dollar" Mark Hanna. The mainstream Republican newspapers were also firmly in McKinley's camp. For an outsider like Bryan, competing with a generously financed establishment candidate, new technology was the only option. If McKinley triumphed in the end, Bryan's approach exemplified populist tactics.

Later, in the mid-twentieth century, populists in Latin America and elsewhere used small planes to bring their message directly to the people, again circumventing established media channels. The twenty-first-century variant is of course Donald Trump's use of Twitter for bypassing traditional print media and communicating directly with voters. (In his reliance on Twitter, Trump was unwittingly following the precedent of another exemplar of the populist temperament, Venezuela's Hugo Chávez.) Meanwhile, cable television channels, satellite radio talk shows, and alt-right Internet websites undermined control by the political mainstream and party establishment of news flow and political narrative. Resort to these new technologies and outlets enabled Trump, like his populist predecessors, to disintermediate the establishment media and disable its interpretative influence.

A further dimension of populism is its characteristic economic policies. Rudiger Dornbusch and Sebastian Edwards, drawing on Latin American experience, define populism as an approach to economics that emphasizes distribution while deemphasizing the risks to economic stability from sharp increases in government spending, inflationary finance, and government interventions overriding the operation of the market.[16] While mainstream politicians have also been known to run on platforms promising faster growth with greater equity, populists differ in the ambition of their claims. They are distinctive in the directness with which they speak to popular concerns about growth and distribution, their denial of constraints, and their disregard of expert opinion about limits. Populist politicians dismiss objections that ambitious policies intended to spur growth will only fan inflation, create worries about indebtedness, and aggravate balance-of-payments deficits. They deny the existence of trade-offs between restricting immigration and redistributing income toward their working-class supporters, on the one hand, and doubling the rate of economic growth, on the other. The existence of such constraints, as they see it, is falsely promoted by forces hostile to their economic and political agenda.

But pro-growth is not the same as pro-market. Populists, whether of the Left or the Right, are more than willing to see government intervene in markets in order to advance their policy agenda and personal position. This helps to explain the association of populist rule with favoritism toward companies and individuals allied with the regime and its charismatic leader.

Here comparisons of the populist tradition in Latin America and President Trump speak for themselves. In both cases one sees the ambitious goal of significantly boosting economic growth. One sees a similar denial of constraints. If the feasibility of that goal is questioned, then in both cases the doubters are technocrats and entrenched members of the political establishment hostile to the leader and his followers. If its achievement is frustrated, then in both cases the villain is outside forces, the International Monetary Fund in one case and unfair competition from China and Mexico in the other. One sees similar readiness to forswear economic purity and intervene in markets, something that has been common to Latin American governments of the populist Left (Dilma Rousseff in Brazil) and Right (Cristina Fernández de Kirchner in Argentina) and equally in

Trump's use of the leverage attached to his office to criticize manufacturers moving jobs abroad and renegotiate the price of government-purchased aircraft.

Against this background, my goal in this volume is to understand the wellsprings of populist movements. Specifically, I seek to identify the economic and political circumstances under which populism takes hold, and the economic and political responses that most effectively combat it.

I do so by enlisting the history of populist and proto-populist movements and parties in the nineteenth and twentieth centuries. My focus is on populism in the advanced Western democracies, although no discussion of the question can be entirely uninfluenced by the large literature on Latin American populism. But whereas Latin American populism is of long standing, the upsurge of populist sentiment in the advanced countries, evident in the election of Donald Trump, the Brexit referendum, and support for populist parties across Europe, is more recent.[17] It is this phenomenon in the advanced countries that motivates what follows. For that reason I concentrate on the United States and Europe, starting with the Populist Revolt in the United States at the end of the nineteenth century, arguably the first populist movement of the modern era, before moving on to its twentieth-century successors.

I exclude another case sometimes cited as a pioneering populist movement: the Narodniks, who sought to organize a revolt of Russian farmers in the 1870s and 1880s. Google Translate, which, conveniently for present purposes, utilizes crowdsourcing, translates *narod* as "people" and *narodniki* as "populists," echoing the contemporary presumption that this abortive agrarian revolt had elements in common with its American counterpart.[18] But Narodnik leaders were in fact urban intellectuals without roots in the countryside. They rejected religion, which is dear to the people, and embraced modern science, of which populists are skeptical because it empowers technocrats and legitimizes experts. I therefore see the Narodniks as a fundamentally different phenomenon.[19]

More generally, there is the challenge of whom to classify as populist.

Disagreement about the definition of populism means, inevitably, that there is disagreement about any such classification. Even the definition here, of populism as a political movement with anti-elite, authoritarian, and nativist tendencies, implies uncertainty about specific cases, since politicians may display some of these tendencies but not others. Whether William Jennings Bryan is properly viewed as a populist is disputed, for example, since Bryan, while positioning himself as anti-elite, did not prominently exhibit the authoritarian and nativist tendencies of classic populism.[20]

As the above should make clear, not every political figure described in these pages is necessarily a populist. In some cases my concern is to understand why members of the political establishment responded effectively to popular grievances, preventing a more violent anti-establishment reaction. Franklin Delano Roosevelt is an example of such a figure. FDR and his political allies responded to popular discontent with economic and financial reforms visibly intended to get the economy moving again. He advanced unemployment insurance and Social Security to address popular concerns with economic insecurity. But FDR was nothing if not a member of the elite. He was the son of a wealthy country gentleman, graduated from Groton and Harvard, and had been the Democratic nominee for vice president in 1920 on a ticket with the media mogul and governor of Ohio, James Cox. FDR was neither authoritarian nor nativist.[21] But because he addressed popular concerns with economic hardship and insecurity, sometimes using harsh anti-business rhetoric, there is a tendency to think of him as a populist.[22] Nothing could be less accurate. Whether Donald Trump is a populist politician or simply a pro-business president is similarly open to question.[23]

Nor are populist and anti-system movements necessarily the same. Anti-system movements and leaders seek to subvert the operation of prevailing political institutions. They are opposed to pluralist democracy and the territorial unity of the state.[24] Examples include Nazi, fascist, authoritarian, and

Communist parties seeking to replace pluralist democracy with an authoritarian regime where power is concentrated in the hands of an entity or group not directly accountable to the people. Other examples include secessionist and irredentist parties that seek to replace the existing political system with one in which a subset of the people, defined by region, religion, or ethnicity, is represented separately or exclusively.

Conceived this way, populism is not anti-system. Populist politicians and their followers can work through prevailing political institutions to advance the interests of the people as they define them. They can voice their support for the courts, their regard for permanent civil servants, and their respect for freedom of the press. Like William Jennings Bryan, they can attempt to harness existing parties and processes to advance their political agenda. As Charles Postel wrote of Bryan and his followers, most "sought economic and political reform, not the overthrow of the existing systems."[25]

But while nothing prevents populists from working through the political system, populism in practice can be conducive to anti-system tendencies. Because populism as a social theory defines the people as unitary and their interests as homogeneous, populists are temperamentally impatient with the deliberations of pluralistic democracy, insofar as this gives voice to diverse viewpoints and seeks to balance the interests of different groups. Since the people are defined in opposition to racial, religious, and ethnic minorities, populists are intolerant of representative institutions that protect minority rights.[26] To the extent that populism as a political style emphasizes forceful leadership, it comes with a natural inclination toward autocratic, even authoritarian rule. And the longer popular grievances are allowed to fester, the more willing are followers to embrace leaders with this inclination.

Thus, even when there is no intent on the part of members of a populist movement to subvert the prevailing pluralistic system, there may be a tendency for its leaders to do so by weakening or circumventing checks on executive power. Seeing political institutions as captured and irredeemably corrupt, they will seek to advance the interests of their followers by weakening the system. Even when they take office through legitimate means, as a result of electoral support or by being asked to form a government, they may advance legislation or issue emergency decrees that abrogate the operation of representative institutions, as in the cases of Benito Mussolini in Italy or, more recently, Nicolás Maduro in Venezuela. They may use force and violence, or at least fail to reject them, while curtailing the rights of minorities and denying the legitimacy of rival politicians and governments.[27] When I describe in Chapter 6 how in Weimar Germany the popular reaction against economic instability and a succession of ineffectual governments set the stage for the rise of the Nazis, this is not because I see National Socialism as populist, but rather because I wish to show how populist grievances, if left unaddressed, can descend into something worse.

In explaining why populist movements gain traction in some cases but not others, an obvious starting point is economic factors. Poor economic performance, which manifests itself in slow or no growth, feeds dissatisfaction with the status quo. It fosters support for populist alternatives when that poor performance occurs on the watch of mainstream parties. Rising inequality augments the ranks of those left behind, fanning dissatisfaction with economic management. Declining social mobility and an absence of alternatives reinforce the sense of hopelessness and exclusion. Rapid economic change heightens insecurity—the sense that even if there is no lack of opportunity now, there will be a lack of opportunity in the future—when the political establishment fails to buffer the effects.[28]

Such economic grievances are not equally likely, however, to give rise to populist reactions in all circumstances. Rather, economic hardship, exclusion, and insecurity are most likely to do so when they result from, or at least are closely associated with, developments that highlight the divergent interests of the people and the elite. Banking and financial crises are an example, combining as they do the classic ingredients of a populist reaction. Not only are the financiers and plutocrats who are the precipitating agents of such crises indisputably members of the elite, but they are seen as profiting at the expense of taxpayers—that is to say, at the expense of the people. Hence financial crises and bailouts regularly induce political swings to the extremes and popular reactions against the political establishment.[29] The banking crises of the 1930s had this effect, as have banking crises in other times, including our own.

Populist politicians, moreover, are best able to capitalize on these economic circumstances in polarized, low-trust societies where unfavorable conditions are readily attributed to outside forces, either elites or immigrants and foreigners—the antipodes with reference to which the people are defined.[30] In such circumstances, populist leaders can more easily capitalize on anti-immigrant, anti-foreigner, and anti-elite sentiment to drain mainstream parties of popular support.

Non-economists will object that populism is about more than economics—it is also about identity. "It's no longer the economy, stupid: our identity politics are polarizing us" is how Fareed Zakaria put it in describing the Trump phenomenon.[31] Populism is about the challenge to the majority from immigrants and racial, religious, and ethnic minorities. It is a protest against the declining influence of the traditions, beliefs, and community of the once-dominant group. It is a reaction against the challenge posed by immigrants and minorities to the people as a homogeneous, well-defined entity. Populists seeking to capitalize on these feelings appeal to a glorious, mythologized past grounded in the collective traditions of that once-dominant majority. They invoke nationalism as intrinsic to that vision and criticize mainstream politicians who embrace diversity, open borders, and equal rights as out of touch with the people.

Those emphasizing identity politics have a point. But identity politics is most powerful against an unfavorable economic backdrop. Once-dominant groups can blame their economic plight on immigrants, foreigners, and minorities, and populists seeking to make hay from their economic dissatisfaction can play up those identity politics. In this way economic grievances and identity politics feed on each other.

The question ultimately is why the populist alternative is marginalized at some times but not others. It is why some campaigns, like Donald Trump's, succeed, while others, like William Jennings Bryan's, fail to loosen the grip of mainstream politicians on power. In answering this question, it is again tempting to start with economic factors. In the same way deteriorating economic conditions breed support for populist movements, improving conditions limit that support. Bryan campaigned against the gold standard, an arrangement dear to the political establishment, painting it as an engine of deflation injurious to the people. But by the time he rose to national prominence in 1896, deflation had given way to inflation. This change may have been fortuitous, or it may have been intrinsic to the operation of the monetary system. The discoveries of gold in the Klondike and Western Australia that ended the deflation of the 1870s and 1880s can be interpreted either way.[32] But whatever the interpretation, the end of deflation meant lower borrowing costs for farmers, more investment, and faster employment growth, which together took the wind out of the Populists' sails.[33]

Similarly, when Huey Long broke with Franklin Delano Roosevelt in 1934, preparing to launch a left-wing populist campaign for the presidency, the U.S. economy, after suffering through four years of depression, was firmly on the road to recovery. The low point was in March and April 1933, coincident with FDR's bank holiday and just preceding his decision to take the United States off the gold standard. In 1934, the first full year of recovery, U.S. GDP jumped by an impressive 10.9 percent. Unemployment was still painfully high, and the worst Dust Bowl year, 1935, was yet to come. But there was no question that the economy was improving dramatically, 10.9 percent growth being nothing if not dramatic. Whether this improvement was due to better policies or because even dead cats bounce is beside the point. The economic upturn is reason to think that the incipient populist movement of the 1930s would have failed to prevent the reelection of a sitting president even had its charismatic leader, Long, not fallen to an assassin's bullet in 1935.

Admittedly, Donald Trump's success rests uneasily against this backdrop. By the time of his election in 2016, the U.S. economy had been expanding for seven straight years. Real GDP was 15 percent higher than at the apex of the 2008 financial crisis. One can object that Barack Obama's achievement in raising GDP by 15 percent in seven years was less impressive than FDR's feat of raising it by 11 percent in one. It can be argued that income gains under FDR were more widely shared. Average per capita weekly earnings in manufacturing, deflated by the cost of living, rose by 4 percent between 1933 and 1934, while employment in manufacturing rose by 14 percent.[34] In 2016, in contrast, there was much discussion of how real hourly earnings had stagnated or even fallen for workers at all wage levels, not just since the financial crisis but for decades. There was anger over how economic gains accrued exclusively to those at the top of the income distribution. In 2015, real median household income as measured by the U.S. Census Bureau was still nearly 2 percent below its 2007 peak and nearly 3 percent below its level at the end of the twentieth century.

This is a reminder that the economic argument about the success or failure of populist insurgencies is as much an argument about distribution as about aggregates. It is less about past economic performance than it is about expectations of the future and the response—or lack thereof—of the political establishment. In the late nineteenth and early twentieth centuries, mainstream politicians and parties responded to the complaints of the Populists with railroad regulation, interest rate regulation, and, eventually, a federal income tax and monetary reforms culminating in the Federal Reserve Act, a crowning achievement that William Jennings Bryan, no less, described as "a triumph for the people."[35] All this gave disaffected voters grounds for hoping that the future would be better than the past. In the 1930s, Roosevelt and the Congress responded to popular discontent and working-class insecurity with legislation creating unemployment insurance and Social Security, as noted above. It wasn't called the Social *Security* Act for nothing, in other words.

The gridlock between President Obama and the Republicans in Congress in the wake of the 2008 financial crisis was not conducive to this kind of activist response. As a result, recovery from the crisis was underwhelming, regulatory reform more limited.[36] The ultimate irony is that the principal measures addressing economic insecurity under Obama, the Affordable Care Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act—the first of which was designed to address insecurity about health care access, the second intended to address the risk of future financial crises—were vigorously attacked by candidate Trump, an attack for which he was generously rewarded in November 2016.

Trump's attacks and the electorate's response point to a fundamental contradiction between the economics and politics of populism, most visible in the case of the United States but also seen more generally. Economic progress creates risks. This includes progress resulting from globalization and technical change. Progress that entails creative destruction poses the risk that some industries and individuals will be left behind. Such displaced people rely on government to provide them with social insurance, since they are poorly placed on their own to insure themselves against these contingencies.[37] Displaced workers lacking the resources to invest in new skills similarly rely on government to provide them with vocational training and adjustment assistance.

But the United States has long invested less in such programs than other advanced countries, while at the same time doing less to limit creative destruction. The result is an obvious tension. Populist hostility to the agencies and functions of government, rather than helping resolve this tension, militates against the public provision of social insurance and adjustment assistance. The identity politics aspect of populism makes it still harder for government to provide these public goods. Communities riven by ethnic divisions spend less on collective goods because each cash-strapped group resists paying taxes to finance programs that also benefit others.[38] This is specifically the case in communities where immigration is an issue and in countries with a history of racial and ethnic division, such as the United States.[39] Populist movements and politicians, for their part, only serve to further accentuate these intergroup differences.

Ironically, then, the populist turn in twenty-first-century American politics, by highlighting these divisions, moved the country further away from the kind of constructive policy responses to the problem of economic insecurity whose absence gave rise to that populist tendency in the first place. This leaves us with the troubling question of where disaffected voters, seeing no solution to their problems, will turn next in search of one.

# 2

# American Panorama

economic inequality and exclusion dominated electoral politics in 2016 and no doubt will do so again in the not too distant future. The context and country may change, from the Brexit referendum in the United Kingdom and Donald Trump's presidential campaign in the United States, to support for Geert Wilders's anti-immigrant Party for Freedom in the March 2017 Dutch elections, and Marine Le

# Voyage of the Bismarck

the german empire plays an iconic role in the literature on the social insurance state. Imperial Germany pioneered health insurance, accident insurance, and old-age insurance in the 1880s, earlier than Britain, which adopted its own limited form of social insurance at the turn of the twentieth century, and earlier than the United States, which took similar steps only in the 1930s. For those concerned with how states respond to economic insecurity and why some respond faster than others, it helps to understand what informed this precocious state-sponsored action. It helps, specifically, to understand what motivated the Reichstag, the German parliament established in 1871, and Otto von Bismarck, the towering figure who served as chancellor for two decades.

In answering these questions, some invoke the traditional obligations of Prussian landowners to their agricultural tenants, Prussia being the largest member of the German Confederation. Others point to time-honored associations of artisans that had long provided disability insurance to their members. Still others emphasize the rapidity of German industrialization, which outstripped the capacity of these traditional arrangements to provide protections against insecurity, and to the uncertainties of a rapidly changing work environment. They point to the active role of the state in German economic growth—to the role of the Reich in mobilizing resources for the expanding industrial sector, for example.[1] That the state should similarly play a role in providing protections that markets left to their own devices were unable to supply was part and parcel of this experience.

The alternative is to emphasize personalities, much as historians of the British welfare state emphasize David Lloyd George and American historians emphasize Franklin Roosevelt. The role of the state as problem solver was exalted by no less than Georg Wilhelm Friedrich Hegel, who by the 1820s had relocated to Berlin, the seat of Prussian government, and become something of an academic celebrity. Hegel's pupil Lorenz Stein, longtime professor at the University of Vienna, elaborated his mentor's vision of Prussia as a social kingdom whose benign monarch was responsible for the welfare of his subjects.[2] Stein's arguments were then taken on board by economists of the German historical school, starting with Gustav von Schmoller, who coined the term "social policy" and made it the focus of his research.[3]

Bismarck himself was no radical seeking to overturn the prevailing order. He was, to the contrary, a conservative seeking to strengthen the state precisely in order to secure the established state of affairs. Shepherding health, accident, and old-age insurance through a Reichstag dominated by conservative politicians was his strategy for convincing the working class that there were alternatives to the Socialist Party for advancing their interests, something that was imperative once imperial Germany adopted universal male suffrage in 1871.[4] It was a way of heading off more-radical political movements. It gave workers an interest in the stability of the state insofar as their pensions now depended on it. All this was important for a German Empire whose unity was still to be forged.

To be sure, Germany was not the only place where workers complained of insecure factory employment, farmers protested capricious market forces, and industrialists clamored against unfair foreign competition. It was not the only country with political, regional and religious divisions. The United Kingdom had its Welsh, its Scots, and, most nettlesome, its Irish. America's Populist Revolt set the agricultural South and West against the industrial East. But Germany was the one place where the response took the form of tariffs for agriculture and manufacturing together with state-mandated social insurance to protect workers against the insecurities of industrial life.[5]

Before the 1870s, German states relied on tradition and custom to aid their destitute and disabled subjects. Catholic and Protestant churches supported indigent believers. Craft guilds pooled the resources of their members and supported invalids and other unfortunates. Lords acknowledged their obligations to their serfs as well as the other way around until Prussia abolished serfdom in 1807, and even then many *Junkers,* the landowning nobles who dominated East Prussia, retained a sense of obligation to their tenants. Bismarck himself, not incidentally, was a sixth-generation *Junker*.

In addition, Prussia, whose policies set the pattern for other German states, had a poor law not unlike England's, under which the state delegated the administration of poor relief to localities. The Prussian poor law reform acts of 1842 gave those local measures a modicum of uniformity, similar to what happened in England with its 1834 reforms. As in England, the generosity of relief was limited by fears that excessive support would "impair the energy of self-help."[6] And as in England, there were worries that overly generous support would attract opportunistic migrants and heighten the burden on local ratepayers. Prussia's 1842 legislation therefore allowed towns to deny residence to destitute newcomers.[7] As a further brake on migration, a three-year waiting period was established, only after which was an individual entitled to relief.[8]

Compared to England, the Prussian system focused more on industrial workers.[9] Attention to their condition was heightened by riots by weavers in Silesia in 1844. Like the Luddites before them, the weavers of southeastern Prussia suffered wage cuts due to the substitution of machinery and less-skilled workers. The difference was that this substitution now occurred as much abroad —in Lancashire—as at home, and the vehicle was cheap imports, inciting unhappiness about foreign competition along with mechanization.

The weavers responded by destroying machinery, burning warehouses, and attacking the homes of local merchants, which were rather more accessible than the textile mills of Lancashire. Having adopted the same tactics as the Luddites, they met the same fate. The army was deployed. Eleven protesters were killed, and the leaders were arrested, flogged, and imprisoned. The weavers' tragic end was memorialized by the German poet Heinrich Heine in his "Song of the Silesian Weavers," published in Karl Marx's newspaper *Forward !*[10] Friedrich Engels may have succumbed to wishful thinking when he wrote how "the working classes … have been aroused from their lethargy by misery, oppression, and want of employment, as well as by the manufacturing riots in Silesia and Bohemia" and claimed that one could not "go on board a steamer, or into a railway-carriage, or mail-coach, without meeting somebody … who agrees with you, that something must be done to reorganize society."[11] But there is no question that something was in the air.

That something unsettled the conservative aristocracy. Baden, the Palatinate, the Rhineland, Bavaria, Saxony, and Prussia all saw political uprisings, inspired by protesting French workers, in 1848. The workers demanded better wages and working conditions. Middle-class elements inveighed against the clannish, poorly run autocratic governments of Germany's fragmented states and called for modernization of their archaic civil and criminal codes. The two groups met at the barricades.

Accommodating middle-class demands was straightforward. Baden broadened the franchise. Prussia's King Frederick William IV agreed to popular election of a national assembly to draft a constitution together with the Crown.[12] Calls to replace the many anachronistic principalities with a Greater Germany were met by expanding and deepening the customs union, setting the stage for eventual creation of the German Empire.

It was less clear how to placate the workers. Bismarck, having been elected to the first Prussian diet (the Landtag) in 1849, initially favored a reactionary response, namely restoring the guild system of mandatory membership and self-insurance.[13] But this conservative approach, in which artisans banded together on the basis of craft to support one another and limit unwelcome competition, was not well suited to an economy on the cusp of industrialization. Workers were moving into industrial employment, where there was less stability. Factory labor associated with an industry rather than a specific set of skills was not easily organized into guilds. Workers might have been encouraged to form industrial unions capable of providing health, disability, and old-age insurance to their members, but employers realized that members might also make other demands, including higher wages and shorter hours. If encouraged to organize, they might form a political movement that diverted popular support from established parties.

In 1849 the Prussian diet, still seeking to build on the traditional approach, authorized municipal authorities to order factory workers to join mutual welfare funds without at the same time recognizing their right to bargain. The result was some two hundred such funds. But membership was spotty, benefits were limited, and funds to which employers as well as workers contributed were the exception.[14] The weakness of these schemes was their local nature. Employers could object that mandating substantial contributions might render them unable to compete with firms in neighboring jurisdictions.

Discussion of these problems acquired urgency in the 1860s with more ferment in the ranks of industrial workers. The weavers were battered again, this time by cotton shortages caused by the American Civil War. The German labor movement created new associations, the most important of which, the German Workingmen's Union, sought to advance the interests of its working-class members in the electoral arena. It quickly acquired 125,000 members—an ominous number from the conservative standpoint—mainly urban and factory based. The Workingmen's Union then merged with a competitor, the Social Democratic Workers' Party, to create the Socialist Workers' Party, renamed the Social Democratic Party in 1890.[15]

Above all, there was the industrialization of Germany itself, powered by unification of its formerly independent polities into a federal state with an imperial chancellor in 1871. Employment in industry, unlike that in agriculture, did not follow predictable seasons. Protections from poverty and insecurity afforded rural workers by a local poor law authority and charitable bodies were not available to their urban counterparts, or at best were available only after an extended waiting period.

Bismarck, previously preoccupied by the territorial consolidation of Germany and war with France, now turned his attention to the internal unity of the empire. Unity required the allegiance of the working class, and social insurance was a means to this end. The chancellor, one author writes, “wanted the worker as a loyal and obedient ally, and to accomplish this the worker’s interest had to be closely tied to the state. The state, therefore, had to become the protector of the workingman.”[16] This was strategic statecraft, not altruism. It was a policy “born in fact not of love, but of fear” of a populist or revolutionary working-class reaction.[17]

The initial result was the Employer Liability Act of 1871, which anticipated similar British legislation by several decades.[18] It made the employer liable for a worker’s injury even when fault lay not with the employer directly but with other workers.

Although this was a significant step, there was as yet no equivalent of the modern Federal Ministry of Labor and Social Affairs to enforce standards and establish procedures for adjudicating claims. To obtain a judgment, a worker had to sue his employer, a challenging task for someone with limited financial resources. To collect, he had to convince the court that the fault lay with others and not himself. Thus, the 1871 act was important more for the precedent than for actual compensation.

But, having started down this road, German legislators were in a position to go further. When a financial crisis erupted in 1873, it strengthened the hand of those favoring a more interventionist state. The crash inaugurated a period of slow growth and falling prices referred to by contemporaries as the Great Depression (or Long Depression), not to be confused with the Great Depression of the 1930s. Workers experiencing wage cuts and unemployment rallied around the Social Democratic Party, which, alarming establishment politicians, polled 9 percent in Germany's 1877 election—almost the exact same share polled by the People's Party in the U.S. presidential election fifteen years later.

The insecurity associated with industrial change, slower growth, and heightened foreign competition also manifested itself in nationalist and nativist sentiment. It found expression as the convenient belief that someone other than hardworking Germans themselves was responsible for these unpredictable and not uniformly desirable changes in economic life. In the United States, it was expedient to blame immigrants and to pass the Chinese Exclusion Act. In Germany, a country of emigration, it was easier to target the Jewish minority. Jews were blamed for the 1873 stock market crash by the magazine publisher Otto Glagau, who took heavy financial losses and channeled his frustration in anti-Semitic directions, and whose inflammatory publications attracted a considerable audience.

Bismarck, meanwhile, had just launched the *Kulturkampf*, his culture war against the Roman Catholic Church, with the goal of weakening religious control of education and thereby strengthening the role of the federal state. By highlighting religious differences, the *Kulturkampf* cleared the field for anti-Semitism. Not least, it encouraged anti-Semitism among Catholics who sought to deflect blame for the perceived sufferings of the German people onto others.

More generally, the newly created empire was fertile ground for anti-Semitism because Bismarck and others, in an effort to further strengthen support for the state, also sought to foster the notion of a German *Volk*. Jews were impugned as not fully German, making it possible to single out what was now characterized as not just a religious minority but also a racial group.[19] Thus, the same resentments, fed by economic insecurity and nationalism, that would give rise to anti-immigrant sentiment in the twenty-first century fostered ant-Semitism in the nineteenth. And then as now, there was an effort by politicians and others to use that nationalistic, anti-other sentiment to advance their policy agendas and political careers.

Fortifying the imperial state required securing the allegiance of not just workers, of course, but also industrialists and landholders. In the United States, where the depression triggered by the Panic of 1873 led similarly to falling crop prices and to difficulties for capital-heavy industrial firms that made profits only when plants ran at capacity, the response took the form of the McKinley Tariff, which protected manufacturing from cheap foreign imports. In Britain too, tariff reform was fiercely debated, although in the end allegiance to free trade proved too strong. In Germany, building a winning coalition required forging an alliance between heavy industry, whose political influence, while growing, remained limited, and the country's still powerful Prussian agriculturalists. This was the so-called marriage of iron and rye. Agriculture and industry were both suffering from the post-panic slowdown in growth. Large landowners felt competition from foreign cereals as railways and steamships lowered the cost of importing grain from Russia, the Danube Basin, and the United States. These transport improvements similarly made it less costly to import iron and steel products from Belgium and France, where producers received government-financed export bounties.[20] And even where Germany remained the low-cost producer, tariffs were needed in order for firms to limit output and raise prices, cartel behavior being German industry's preferred way of limiting price cuts when demand weakened.[21]

Industrial interests therefore formed the League for the Protection of the Economic Interests of the Rhineland and Westphalia, also known, for self-evident reasons, as the "Long Name Society." They emphasized not just foreign bounties but also domestic security as justifying import duties.[22] Large landowners, for their part, established the more parsimoniously named League for Tax and Economic Reform to lobby against the grain invasion.

Bismarck's own conversion to protectionism occurred in the 1870s. He was responding to the complaints of industrialists and agriculturalists—four hundred Rhenish-Westphalian producers who met in 1877 to petition against unfair foreign competition, for example—and seeking their political support. He was searching for a source of federal revenue, since the Reich still depended on transfers from its constituent states. That this was a period of mounting tensions in the Balkans and between Germany and Russia made obtaining this dedicated fiscal and military capacity seem all the more urgent.

Bismarck was also maneuvering politically, having broken with the Liberal Party and its left wing. He saw the tariff as a way of attracting industrialists and agrarians affiliated with the *Junker*-dominated Conservative Party and the Catholic-based Center Party.[23] On July 12, 1879, his tariff bill was approved by a coalition of Center and Conservative Reichstag members together with fifteen rebellious members of the right-wing National Liberal Party. The chancellor thus achieved much of what he wanted, though not the full increase in federal revenues, being forced by the Center Party to cede a significant fraction of the increase in import duties to the states.

Although industrialists and landowners had now received the olive branch of protection, something still had to be done to pacify labor, more so insofar as taxes on imported grain made for higher bread prices. Expert opinion acknowledged the linkage. Adolph Wagner, the Berlin-based professor of economics and fiscal policy expert who helped to found the Social Policy Association (Verein für Sozialpolitik), a group of academics and parliamentarians seeking state-sponsored solutions to social problems, advanced import tariffs as a way of raising revenues to fund social programs, thereby strengthening the state. Von Schmoller, the preeminent economist of the time and leader of the German historical school, similarly supported tariffs on the grounds that these could be used to raise revenues for social programs.[24]

Bismarck's preferred design for health, accident, and old-age support was compulsory insurance for industrial workers, with contributions from employers and workers together with state subsidies, all administered by an imperial insurance office. He described these as ideas for heading off international socialism in an audience with King Ludwig II of Bavaria in 1880 and again in an interview with sympathetic journalists in 1881. Creating an imperial insurance administration could highlight the social role of government and foster worker allegiance. Public subsidies would give workers a financial stake in the stability of the state.[25]

This was a bitter pill for conservative social groups to swallow. Right-wing Liberals criticized Bismarck's administrative centralization for undermining self-reliance and private charity. Members of the Conservative Party opposed it for intruding on the organic relations between workers and employers. The Center Party, dominated by Catholics from Bavaria jealous of their regional autonomy, opposed anything that smacked of a strengthened role for the federal government and, by implication, the Protestant north.

Progress required compromise, even by an iron chancellor now firmly ensconced in office. The eventual compromise delegated the administration of health insurance to associations of workers and employers, dominated in practice by the latter, which reported to regional insurance offices.[26] One is reminded how regional opposition to New Deal programs in the United States was similarly overcome by delegating their administration to the states.

The way was thus paved for health insurance in 1883, the further extension of accident insurance in 1884, and old-age and disability insurance in 1889. While this was an impressive array of initiatives, in each case benefits were far from generous. Health-related payments, for example, were targeted at those with temporary ailments. Benefits, including sick pay and access to specialized medical attention, were provided for no more than thirteen weeks and capped at half the average wages of the insured.[27] With its limit of thirteen weeks, the program promised to create only temporary ties between the worker and the state, which rendered it one of Bismarck's lower priorities. The chancellor therefore acquiesced to suggestions that health legislation should build on the foundation of existing guild, factory, and union sickness funds. New funds were created for trades that lacked them, and local funds were established for workers who did not fit into existing categories. Regional offices administered these new insurance funds for workers not served by factory, industry, or union insurance. The federal role was limited to mandating the creation of additional funds and standardizing contributions, which averaged about 1.5 percent of the wage and came two-thirds from workers and one-third from their employers. All this represented a considerable scaling down of Bismarck's ambitions, but it was at least something.

In contrast to health benefits, payments to permanently disabled workers were provided for an extended period, promising to more firmly attach the individual to the state. Bismarck therefore pushed harder for subsidies to top up the contributions of workers and firms. The new accident insurance law covered all industrial accidents. It was administered by associations of employers. But there remained opposition to federal subsidies from Liberals who saw the idea as creeping socialism, and from Center Party members jealous of states' rights. In the final compromise, the financial role of the state was limited to providing a backstop in the event that private contributions proved inadequate.

Old-age insurance was administered by local pension boards controlled by civil servants and overseen by a state government ministry, giving government (albeit state rather than federal government) a more prominent role. In this case, moreover, Bismarck's proposal for state subsidies was retained. Subsidy supporters in the Reichstag heralded the role of pensions in "support[ing] … the total economic and social order."[28]

The insurance laws of the 1880s focused on industrial workers, who felt economic insecurity most strongly and were especially prone, in the prevailing view, to radical socialism. Insurance was finally extended to white-collar workers earning less than 2,000 marks a year in 1900 in the case of pensions, and in 1903 in the case of health insurance. The same year, 1911, in which Great Britain put in place its own social policy legislation then saw passage of the Reich Insurance Law, which provided health insurance to all employees, including agricultural workers, and benefits for dependents of the elderly and disabled.[29]

Germany's early start in adopting social insurance thus reflected long-standing awareness of the role of the state in governing the economy and of the need for public intervention as the country industrialized. Urbanization and the shift from agriculture to industry occurred even faster than the comparable transitions in Britain and the United States, heightening insecurity and limiting the effectiveness of traditional institutions for addressing it. Worries that those industrial workers might unite in an anti-market, anti-establishment movement were thus more immediate than in other countries.

These concerns fused with Bismarck's desire to tie the working class to the new federal state. They combined with the reaction against globalization by still-influential German agriculturalists and with the complaints of powerful industrialists about lack of market access and unfair foreign competition. These dissatisfactions too, like those of the workers, had to be harnessed. It was necessary to tie these additional interest groups to the state and to Bismarck's base in the Conservative and Center Parties.

This confluence was what made possible Germany's distinctive response to the pressures of globalization and industrial change, which included precocious development of the social insurance state combined with tariff protection for both agriculture and industry, a response that effectively suppressed anxiety about economic change on both the Left and the Right. It was not a confluence that was equally evident in America, where both revolutionary ferment and confidence in the administrative capacity of government were less. It was not as evident in Britain, where parliamentary institutions were well established, calming fears of revolution, and where agriculture had declined to the point where it no longer figured importantly in political calculus.

Politicians in other countries observed the German recipe of tariff protection for agriculture and industry together with health, accident, and old-age insurance for workers facing the uncertainties of industrial life. The German precedent influenced design of the McKinley Tariff and the health and pension benefits provided to Union Army veterans and their spouses in the United States. It informed the views of Beatrice and Sidney Webb and Britain's National Insurance Act. It led Denmark, Sweden, Norway, and other countries to create commissions to investigate the social question. In all these instances, legislators made reference to Germany's earlier measures and drew on them for inspiration and support.


Figure 4.1 German Tariff Rates, 1870–1913

Source: B.R. Mitchell, ed. *European Historical Statistics*, *1750–1970* (Springer, 1975).

But agreement on those German measures required compromise. As a result, Globalization had not yet eroded the demand for semi-skilled workers. Labor's sacrifices during World War II legitimized its demand for a fair share of the pie, which was met through trade union recognition and institutions such as industrial codetermination. The welfare state helped those who couldn't help themselves. Strikes and street demonstrations did occur throughout the period, but the dominant impression was that social and political institutions were responding adequately to the needs of the majority.

But if special circumstances contributed heavily to this happy outcome, there was already reason to think that those special circumstances wouldn't last.

# 8

# Things Come Apart

after 1973, everything ran in reverse. The growth of GDP per head in the United States slowed to 1.2 percent between 1973 and 1992, down from 2.4 percent in the period 1950–1973.[1] Growth similarly fell by half in Western Europe, from 3.8 to 1.8 percent. In Japan, where growth in the golden age had run fastest, the deceleration from 8.0 to 3.0 percent was even more dramatic.

Slow growth made everything harder. It was harder for governments to find the resources to help displaced workers. It was harder to credibly maintain that the benefits trickled down. Governments deriving support from their success in delivering growth saw their popularity wane. Jimmy Carter may have lost the 1980 presidential election because of Iran's failure to release the fifty-two

American hostages it was holding (a release that happened shortly after Ronald Reagan finished giving his inaugural address), but he also lost because of his less than stellar management of the economy. An econometric model by the Yale economist Ray Fair pinned Carter's loss on a handful of economic indicators, notably inflation and unemployment.[2] As the economist Sidney Weintraub put it, Carter succeeded "where all Democrats—and Republicans—have failed—namely, in making his own name a synonym for economic mismanagement and expunging memories of Herbert Hoover dawdling at the onset of the Great Depression."[3]

Disaffected voters in the United States and elsewhere turned initially to other mainstream parties and leaders. But the grasp on power of those leaders hinged on their ability to deliver the economic goods. In some cases, such as those of Reagan and Margaret Thatcher, they could claim some success. But Reagan's policies pushed up the dollar, which accelerated the deindustrialization of the heartland. Thatcher's policies of disinflation were accompanied by a sharp rise in unemployment. In no case were governments able to restore growth to the heights of *les trente glorieuses*, the thirty glorious years after World War II.

Blaming political incompetence was tempting insofar as there was no other convincing explanation for the slowdown. The slump in the advanced economies was necessarily a slump in productivity, since productivity accounts for the majority of GDP growth. Popular accounts emphasize the OPEC oil shocks of 1973 and 1979, queues at the pump being visible signs of economic distress. But energy is too small a part of GDP to explain more than a fraction of what happened to the economy as a whole. If higher energy prices depressed productivity by causing the obsolescence of energy-using capital equipment, moreover, then we would expect to see a sharp fall in the secondary-market price of such equipment, where no such fall in fact occurred.[4]

Some analysts blamed business-cycle volatility for discouraging investment and innovation.[5] This argument had appeal insofar as not just energy-price shocks but also other factors, from the resignation of Richard Nixon to rising inflation, could have contributed to that volatility. But there was no agreement on the sources of business-cycle fluctuations and, in particular, on whether one such source was the inept and destabilizing policy response of central banks and governments (the Jimmy Carter effect)—something that again pointed the finger of blame at establishment politicians.

Maybe the post-1973 slowdown was just the inevitable by-product of success. In the 1950s and 1960s growth had flowed from improvements in the quality of labor. With higher incomes it then became possible to invest still more in education. The 1940s had seen the fastest increase in U.S. high school and college graduation rates of any decade, as noted in Chapter 7, an upward trend that continued for an additional twenty years. But now high school graduation rates plateaued at 75 percent. It was hard to boost graduation rates still further with such a large share of capable students already completing school. The share of American men with university degrees plateaued at about the same time, at roughly 25 percent.

But the same was not true outside the United States. The high school movement of the 1910–1940 period was a distinctively American phenomenon.[6] The rise and broadening of educational attainment began later and proceeded more gradually in other countries. Average years of education of people between ages fifteen and sixty-four therefore continued to rise in Europe and Japan in the 1980s and after, continuing well after the growth of productivity slowed.[7]

Or maybe the growth slowdown just reflected the end of catch-up. Europe and Japan could grow rapidly so long as there existed a backlog of technology to be acquired from the United States, and so long as there was still underemployed agricultural labor to be shifted to more productive uses in manufacturing. By the 1970s, however, the technology gap vis-à-vis the United States had been closed, and the pool of underemployed agricultural labor was drained.

But this perspective suggests a gradual deceleration, when in fact productivity fell off a cliff. The pool of underemployed rural labor did not evaporate on a single day. The United States offered a range of technologies, some more advanced than others. European producers could start with the most attractive, but there was no reason to stop there, on a single day or in a single year like 1973. Similarly, the fact that the United States, which had no one to catch up to, suffered an equally pronounced slowdown underscores the limits of this interpretation.

By process of elimination, we are left with the possibility that the scope for productivity-enhancing technological progress had diminished. Robert Gordon has famously argued that productivity growth in the United States and more widely was supported by one great wave of innovation—the railway, the internal combustion engine, synthetic chemicals, electricity, radio, jet propulsion, and antibiotics. But after 1970 boosting output through the application of these products of nineteenth- and early twentieth-century science became harder. Nothing since has had comparable productivity-enhancing potential.[8]

This begs the question of why there was only one great wave of scientific advance. Maybe post-1970s governments invested too little in basic research to maintain the momentum. Maybe they provided inadequate incentives for private-sector R&D.[9] Maybe by raising hiring and firing costs as a low-cost response to labor market insecurity they discouraged start-ups and entrepreneurship. This was the view of critics of European policy who, from the early 1980s, spoke of "Eurosclerosis." But to the extent that all this was true, the finger of blame pointed, once again, at inept governments.

Working-class living standards stagnated not just because income growth slowed but also because the income growth that did occur accrued disproportionately to the wealthy. While the growing gap between the incomes of more and less skilled workers was widely noted in the wake of the 2008–2009 financial crisis, the increase in inequality in the United States in fact dates back to the 1970s.[10] This is how the median earnings of prime-age working men, adjusted for inflation, could fall by 4 percent between 1970 and 2010, despite the fact that the economy as a whole was continuing to expand.[11] While this trend toward greater inequality was most prominent in the United States and United Kingdom, it was similarly evident in a range of other advanced economies in the 1980s and 1990s, especially when one focuses on full-time male wage earners.[12]

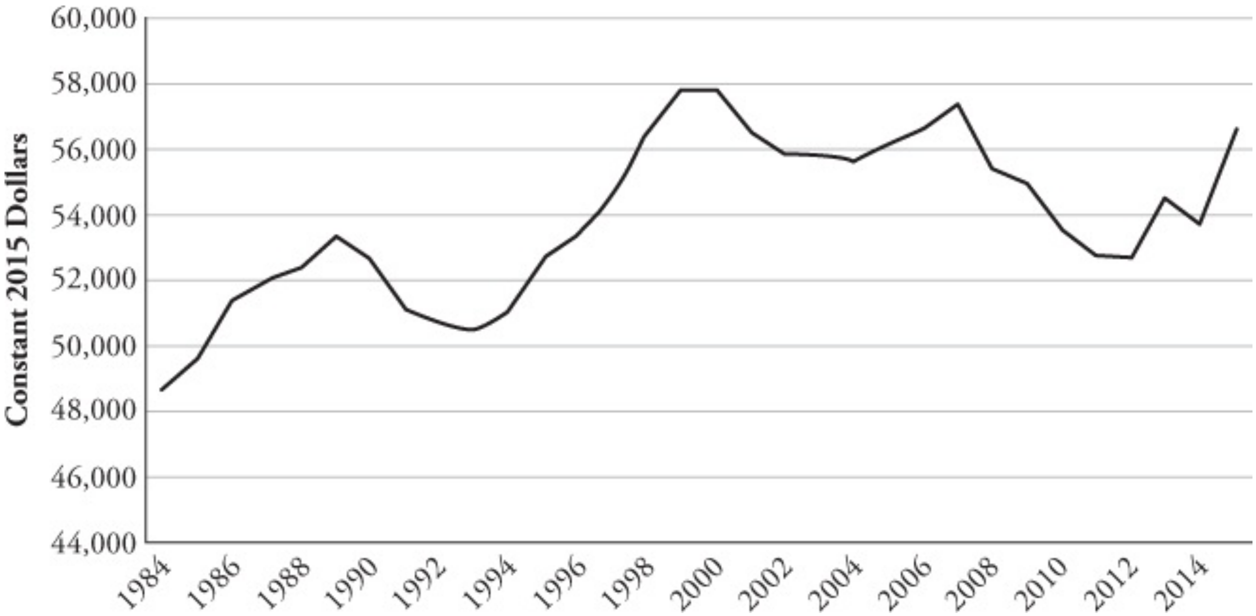


Figure 8.1 Real Median Household Income in the United States, 1984–2015

Source: U.S. Bureau of the Census, [MEHOINUSA672N], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/MEHOINUSA672N, February 23, 2017.

If there is a shortage of convincing explanations for the productivity slowdown, then the problem for inequality is the opposite, namely, an embarrassment of riches. These start with changes in technology, which for decades, if not centuries, had favored unskilled workers but now favored the skilled. The mechanization of weaving in nineteenth-century Britain had undermined the demand for skilled handloom weavers, allowing them to be replaced by women and children tending automatic looms.[13] The Luddites were skilled workers who lost out to technical change, in other words. More generally, the transition from the workshop to the factory and assembly line allowed artisans, who spent years in apprenticeship, to be replaced by workers responsible for only a narrow set of tasks who could be trained up in a short period of time. Henry Ford famously observed that assembly line workers could be trained up to their peak productivity in a matter of days.[14]

In the language of production theory, new technology and unskilled labor now complemented one another. In other words, the introduction of assembly-line technology and the creation of additional good jobs for unskilled and semi-skilled workers went hand in hand. Because this situation persisted through the third quarter of the twentieth century, American, European, and Japanese factories, fitted out now with machinery and assembly lines, offered an abundance of good manufacturing jobs.

But then the direction of technical progress shifted. New kinds of machinery replaced assembly-line workers undertaking routine tasks. General Motors installed the first industrial robot, UNIMATE, in its New Jersey assembly plant in 1962. Robots were first used in significant numbers on assembly lines in the 1970s and 1980s, when they replaced less skilled workers engaged in routine tasks. Maintaining this machinery required relatively high levels of literacy and numeracy; it required education and skill. Capital and unskilled labor were now substitutes (the more machines, the fewer jobs for unskilled and semi-skilled workers), while capital and skilled labor were complements (the more machines, the more need for skilled operatives to maintain them).

This change visibly affected the demand for more- and less-skilled workers and therefore their compensation. Whereas in 1965 American workers with college degrees earned just 24 percent more than high-school graduates, that gap widened to 47 percent in the mid-1980s and 57 percent in the mid-1990s.[15] The situation in Europe and Japan differed in extent but not in kind.[16]

This change in technological trajectory is best understood as a response by employers to rising educational attainment. So long as skilled workers were few, it didn’t pay to design jobs for them, or to install machines that required tending by skilled operatives. Instead firms hired less-skilled workers, trained them on the job, and gave them positions where they worked with limited amounts of complex machinery. But as the supply of high school and college graduates rose, it paid to design jobs expressly for them and to invest in advanced machinery for them to oversee. The result was higher productivity for skilled workers and fewer well-paying jobs for the less skilled.[17]

But this was not just a matter of machinery; it was also a matter of organization. Firms with ample supplies of skilled labor had an incentive to group workers into teams whose members were responsible for solving problems and developing ideas about how to better organize production. This was the essence of the Toyota Production System, pioneered by that company in the 1950s but adopted more widely in the 1970s and 1980s as workers with the requisite skills became more widely available.

This is an appealing story because it explains not just why technical change took the form it did—it was a response to increased educational attainment after World War II—but also how it was that the earnings premium for college graduates rose despite the fact that the supply of graduates was rising as well.[18] And there is evidence of its operation in a wide range of countries.[19]

The unskilled-labor-saving bias of technical change is not the entire explanation for the post-1970 increase in inequality, to be sure.[20] In a 2003 study, the economists David Autor, Frank Levy, and Richard Murnane concluded that computer-enabled technology, of which industrial robots are perhaps the most visible manifestation, accounted for no more than 30 to 40 percent of the shift in earnings toward college graduates in the preceding three decades.[21] Subsequent studies put the share attributable to technology a bit higher, perhaps because the full impact of computers and robotics was not yet evident at the turn of the century. But those subsequent analyses don’t change the basic conclusion that more than robots matters.

Import competition and immigration are the other usual suspects for the shift in income toward skilled labor. One of the most robust propositions in international economics is that foreign trade doesn't raise all boats. Some groups benefit disproportionately, while others lose in relative and absolute terms.[22] In the case of the advanced countries, skilled labor benefits, since it is the abundant factor used in the production of exports, while unskilled labor is left worse off. Because skilled workers already have high incomes, the result in this case is additional inequality.

This is not a controversial proposition, although there is less than full agreement on the magnitude of the effects. Most investigators agree, however, that those effects were "appreciable," in the judiciously chosen terminology of one recent study.[23] Their impact on the skilled-unskilled wage differential was roughly equivalent to that of technology.

Moreover, the negative effect on some workers and communities is strikingly persistent. Studying the impact of import competition from China on the United States, David Autor, David Dorn, and Gordon Hanson found substantial and persistent distributional consequences and adjustment costs. Wages and employment in local markets that were home to industries suddenly exposed to Chinese competition remained depressed for more than a decade. Workers formerly employed in the affected industries found it hard to secure stable employment in other sectors. They experienced income losses not just in the short run but over the balance of their working lifetimes.[24]

The mystery is why these impacts were neglected by economists and downplayed by politicians—and, equivalently, why globalization was embraced so wholeheartedly by the intellectual and political elites. The populist answer is that the elites knew on which side their bread was buttered. As skilled workers themselves and as investors in high-tech companies and multinationals, they were self-interested promoters of globalization. A less cynical response is that it took time for the full negative effects to materialize. Prior to the 1970s, when growth was rapid, it was still possible to argue that foreign trade raised all boats. As late as 1990, most trade flows were among advanced countries with similar factor endowments and average incomes, limiting the distributional consequences.[25] The trade-to-GDP ratio worldwide remained more or less flat through the 1980s; there was no massive globalization shock. All this changed with the rapid growth of exports from emerging markets in the 1990s and China's accession to the World Trade Organization. The decline in U.S. manufacturing employment accelerated, and the inequality trend grew more pronounced.[26]

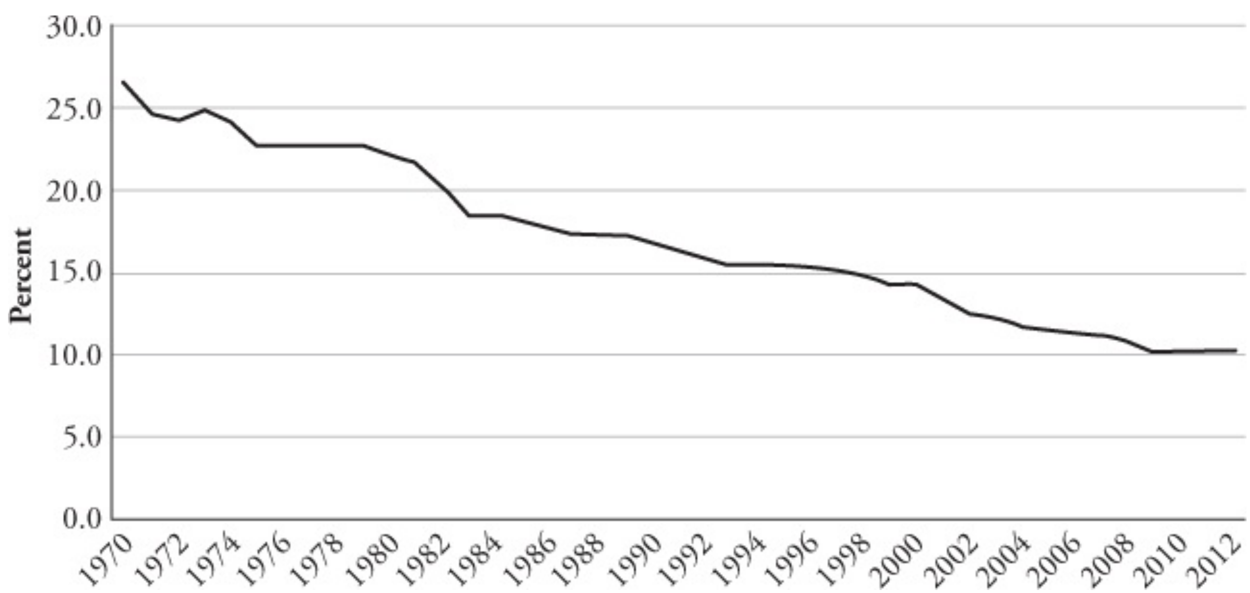


Figure 8.2 Percent of Employment in Manufacturing in All Nonfarm Employment in the United States Since 1970

Source: Retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/USAPEFANA.

None of this challenges the presumption that trade can be beneficial for advanced countries as well as emerging markets. But if trade has distributional consequences and adjustment costs, then these must be addressed by income transfers, training schemes, and regional policies if there is to be a political consensus in its favor. These observations are straightforward, but they run headlong into free market ideology, skepticism about the problem-solving capacity of government, and budgetary constraints. They were paid lip service but little more in the countries now experiencing an anti-trade backlash.

The impact of immigration is even more contentious, given that there is no agreement on its overall effects. Its impact on native-born workers depends, moreover, on whether immigrants are skilled or unskilled. It depends on how directly immigrants compete with natives—whether their skills and experience are different, and whether they choose similar occupations. It depends on the size and suddenness of the immigrant inflow, since larger flows mean higher adjustment costs.

In the United States, the immigration issue is fraught because the distributional impact is the same as that of trade. Most immigrants are less-skilled workers.[27] Their impact has thus been to depress the living standards of natives who are not high school graduates while raising those of U.S.-born workers with at least a high school diploma. Workers in fast food outlets and poultry processing plants earn less, but skilled workers consuming McChicken sandwiches see their earnings go further. Most studies conclude that the positive effects on the wages of native-born workers dominate on balance.[28] But the fact that the losers from immigration are the same folks who have lost from trade makes the issue socially and politically problematic.

Studies of other advanced economies reach similar conclusions. Research on the United Kingdom suggests that "immigration has a small impact on average wages of existing workers but more significant effects along the wage distribution: low-wage workers lose while medium- and high-paid workers gain."[29] But if the direction of the effect is the same as in the United States, the operative word here is "small." Half of all immigrants in the United Kingdom are from other EU countries.[30] They are more likely than natives to have some post-high-school education. Hence they do not have a pronounced effect on the wage distribution or disproportionately impact workers at its lower end. Even

U.K. regions with a large influx of immigrants from Eastern Europe after 2004 did not see larger-than-average falls in the wages of native-born workers or a larger rise in inequality.[31] More generally, most immigrants to European countries possess at least some post-secondary education, the opposite of what is the case in the United States. It follows that those immigrants have done little to raise inequality in the recipient countries and may have even reduced it. Recent inflows of undocumented immigrants and refugees from Africa and elsewhere, many of whom lack the same education and skills, are a different matter—which is one reason why their presence and the inability of governments to control the influx are so contentious.

Even after taking all these factors into account, recent changes in income distribution vary across countries. It's not all about technology, trade, and immigration, in other words—it's also about institutions. We saw in Chapter 7 how the increased strength and legitimacy of unions after World War II enabled their members to share in the rents accruing to employers.[32] This was true of not just union members but also nonunion workers, whose pay was similarly influenced by union wage norms. It was true even in the United States, never a hotbed of unionism, following the Treaty of Detroit in 1950. We also saw how the existence in Germany of strong trade unions with a seat in the boardroom helps to explain why that country didn't share in the more general decline in full-time male real wages experienced in other countries in the final decades of the twentieth century.

It follows that declining unionization has been a factor in rising inequality. The share of American workers covered by unions fell from 27 percent in 1973 to barely 17 percent in 1993 and 11 percent in 2016. Some authors ascribe as much as a third of rising inequality over the period to this decline in union coverage.[33] Since unions also help to restrain CEO pay, their decline may have also facilitated the explosion of compensation at the top. It is revealing that the rise in inequality was greatest in the United States and United Kingdom, where the fall in union coverage was most pronounced.

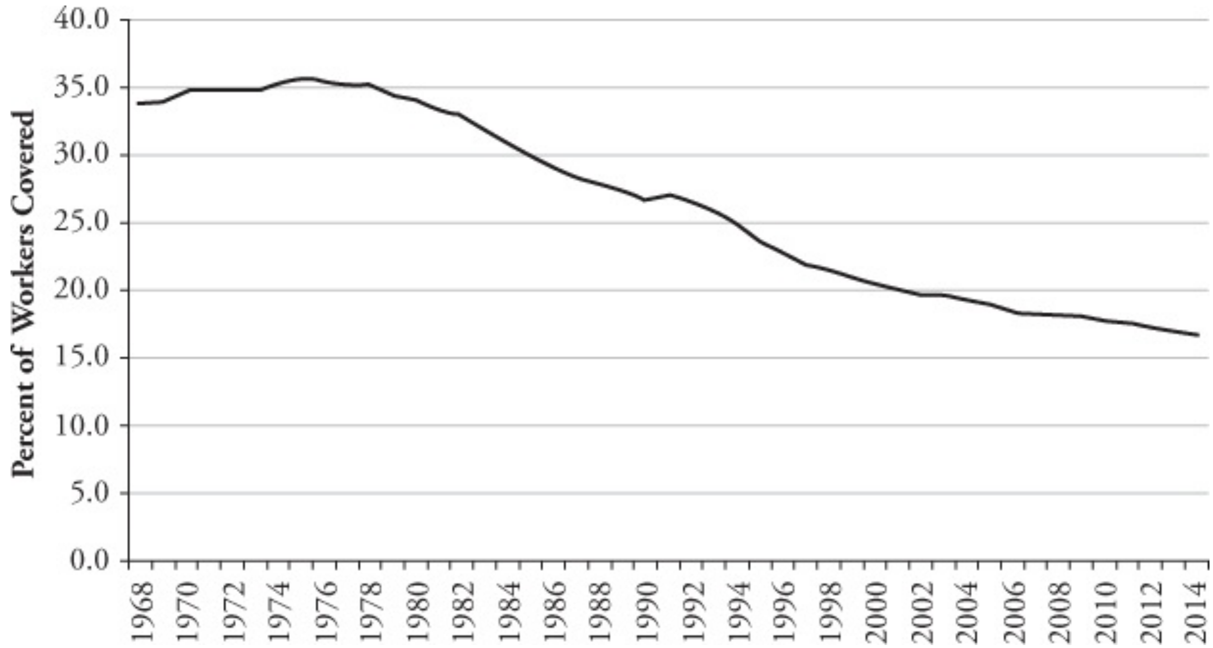


Figure 8.3 Trade Union Density in OECD Countries, 1968–2014

Source: OECD.Stat, https://stats.oecd.org/Index.aspx?DataSetCode=UN_DEN#.

An extended analysis of why unionization declined would take us far afield. One factor was the falling share of the workforce in manufacturing, where unions traditionally organize. That fall resulted from automation, globalization, and simple economic maturation, as we have seen. But it had negative implications for the union movement, given the greater difficulty of organizing workers in the service sector.[34] Another factor was the same skill-biased technical change described above. Changes in technology and organization favoring skilled workers, by creating new high-paying opportunities, weakened their support for union policies of wage compression, from which those skilled workers stood to lose. Those changes thereby undermined the coalition of skilled and unskilled workers traditionally supporting unions.[35]

The result was a vicious spiral of deunionization and inequality. As jobs were reorganized, improving opportunities and pay for skilled workers, those same skilled workers withdrew their support for union organizing efforts. Weaker unions were less able to enforce norms of wage compression—they were less able to raise wages for less-skilled workers. Inequality rose further, advantaging skilled workers more. This in turn undermined the skilled-unskilled worker coalition still further, weakening the union movement even more and reinforcing the wage-inequality trend.

In addition, there was the changed political climate. By the 1980s, the role of union members in having helped win the war was a distant memory. A postwar settlement that spoke of social partners and shared wage norms was valued only so long as it successfully delivered fast growth. Hence as growth slowed, those norms were increasingly questioned by skilled workers who now saw themselves as sacrificial lambs. They voted in growing numbers for Reagan and Thatcher, who defined their political reputations in opposition to the air controllers and coal miners unions. In this changed political climate, employers were empowered to intensify their opposition to unionization efforts and free to relocate to regions like the U.S. South, where union tradition was weak.

Elected officials were also less inclined to embrace labor's legislative agenda. Organized labor was less effective in countering those who argued for lower top tax rates. Minimum wages were allowed to lag inflation where unions were in decline. A substantial body of evidence suggests that that increases in the minimum wage reduce inequality, and that reductions in the real value of the minimum wage have the opposite effect.[36] Modest increases in the minimum wage push up the earnings of those at the bottom of the income ladder at the cost of few if any jobs. They reduce turnover in firms employing low-wage workers, enhancing efficiency and encouraging hiring. The debate about the minimum wage may be ideologically charged, but the facts are reasonably clear. Similarly, that a more progressive tax system reduces inequality is self-evident.[37] But these inequality-reducing policy interventions became harder when organized labor was in decline.

Finally there was welfare state retrenchment. Slower growth meant tighter budgets, making some welfare state cuts unavoidable. This was especially true in Scandinavia and the Netherlands, where the provision of social benefits overshot sustainable levels.[38] Unemployment benefits, pension payments, public employment, the public share of health care spending, and sick pay were all ratcheted up in response to the economic volatility of the 1970s.[39] Norms adapted to enable workers to exploit permissive aspects of the social-welfare system. By 1980, for example, fully 10 percent of Dutch workers were claiming sickness and disability benefits.[40] This situation, clearly, was unsustainable, a realization that led the Dutch to overhaul their system in 1987.

Welfare state retrenchment was as much political as economic, of course. Inequality meant greater social distance between more and less skilled workers and less inclination to contribute to collective goods.[41] Where unions were in decline, they were less able to support political candidates favoring an extensive welfare state.[42] Pension payments were cut back in the 1980s as aging populations put pressure on pay-as-you-go systems.[43] Unemployment replacement rates were cut in six OECD countries, with the largest cuts in the United Kingdom.[44] Sick pay was cut in another half dozen OECD countries besides the Netherlands. And even where welfare programs were not cut, their growth slowed or stopped. Replacement rates were lower in absolute terms at the turn of the century than they had been in 1975 in eight of seventeen countries in the case of sick pay, and in ten of eighteen in the case of unemployment insurance.[45]

Popular support for welfare-state institutions meant that these changes were incremental, not radical.[46] Pay-as-you-go pension systems, for example, were formidably difficult to reform. But the era when the welfare state grew faster than the economy was now over, and significant cuts were no longer the exception.

Indeed, the same pattern of cuts occurred both where the welfare state was most extensive, in Northern Europe, and where it was least, in the United States.

It was evident in countries with left-of-center and right-of-center governments. Retrenchment was undertaken in response to slower growth, aging populations, and fiscal strains. It reflected changes in technology and workplace organization that made for greater inequality and social distance between those up and down the economic ladder. It was influenced by ideology and by changed perceptions of the welfare state, ideology and perceptions that themselves flowed from underlying economic conditions. And the same factors operated, with broadly similar effects, across the advanced economies.

The bottom line is that there was now a more limited safety net protecting unfortunates who fell from the economic trapeze. The hopeful response to this was that the economy was now more stable, so fewer participants were at risk of losing their grip. This, recall, was the era of the "Great Moderation," from the second half of the 1980s through the first half of the 2000s.[47] Business cycle volatility declined not just in the United States but across the advanced countries. Economists credited a combination of improved policy (the stable monetary policies of inflation-targeting central banks) and good luck (the absence of commodity-price shocks and then improved productivity performance, especially in 1995–2005, when the boost from new information and communications technologies was greatest). Some observers credited financial deregulation and innovation for making it easier for households to borrow and smooth their spending over the cycle.[48]

Subsequent events, in the form of the global financial crisis, showed the Great Moderation to have been an illusion. The same factors credited with having reduced business cycle volatility—low and stable inflation, financial deregulation, and the absence of shocks as an inducement to risk taking—set the stage for an exceptional episode of volatility and economic loss. And that episode, it turned out, was one with which Western societies were singularly ill prepared to cope.

# 9

# Trumped Up

america was thus ripe for a populist insurrection. Growth had slowed. Inequality had risen. Globalization and automation heightened insecurity for workers lacking vocational training, trade union funds, or an extensive insurance state on which to fall back. A financial crisis undermined faith in the competence and integrity of decision makers. These are the classic preconditions for a populist reaction. Or so 20/20 hindsight suggests.

The obvious objection to this readout of the 2016 election is that the results were driven by more than just economic insecurity. They reflected fears about national security, more specifically security from terrorism. They reflected insecurity around national identity, the feeling that the identity of the United States as a country of Judeo-Christian values, in which Anglo-Saxon males held the power, was under threat from ethnic and racial minorities, from women's rights advocates and LGBT activists, and from acceptance at the elite level of the very concept of diversity.

The best response to this objection, as in Chapter 1, is that these national, social, and personal security concerns are most compelling against a backdrop of economic insecurity. In the United States, worries about national security fused with economic insecurity to feed opposition to immigration. Donald Trump's signature speech on immigration, in Phoenix, Arizona, in August 2016, referred to the concerns of "working people" that immigrants were negatively affecting "their jobs, wages, housing, schools, tax bills, and general living conditions," while also highlighting "the issue of security," asserting that "countless innocent

American lives have been stolen because our politicians have failed in their duty to secure our borders and enforce our laws." The threat to economic security and threat to national security were thus ascribed to a common source, illegal immigration. If mass shootings in San Bernardino and Orlando were not the work of illegal immigrants, or if Mexican immigrants took jobs that natives were unwilling to accept, then these facts could be conveniently ignored. This immigrant-centered diagnosis of mutually reinforcing economic security and national security concerns was simply too compelling as a way of mobilizing "the [working] people" against the other. Moving on, Trump spoke to the identity concerns of the once-dominant white working class in passages warning that "not everyone who seeks to join our country will be able to successfully assimilate" and asserting the right of America as a sovereign nation "to choose immigrants that we think are the likeliest to thrive and flourish here."[1]

This narrative makes Trump's electoral victory look preordained, which of course it wasn't. The outcome might have been different without FBI director James Comey's decision to discuss the issue of Hillary Clinton's use of a private email server in a July 2016 press briefing and then his announcement, just eleven days before the election, that he might reopen the case. It might have been different in the absence of Vladimir Putin and Russian hacking into Democratic National Committee servers. It could have been different had the opposition fielded a candidate who spoke more effectively to working-class concerns and hadn't given $250,000 speeches to Goldman Sachs.

But if populism is a theory of society, a political style, and an economic approach that rejects convention and constraints, then Trump effectively embodied each of these populist traits. He embraced the theory that divides society into the virtuous people and the corrupt elite. His campaign was first and foremost anti-establishment. "The establishment," he argued in a final television ad a few days before the election, "has trillions of dollars at stake. … For those who control the levers of power in Washington and for the global special interests, they partner with these people that don't have your good in mind. … The only people brave enough to vote out this corrupt establishment," he concluded, "is you, the American people."[2]

Reinforcing this message, Trump positioned himself as an enemy of Republican Party orthodoxy. He showed scant regard for the party's stands on social policy, foreign policy, and trade policy and even less for its other candidates. He refused to make common cause with his rivals for the nomination. He had little use for the Republican National Committee and shunned its operatives in the general election campaign.

Instead, Trump spoke directly to voters in rallies at which he flamboyantly arrived via personal jet, echoing William Jennings Bryan's dramatic arrival by railway. He appealed to the people and their common sense in classic populist fashion. As CNN wrote in its election postmortem, "Donald Trump and his political advisers decided early on that two words would drive the billionaire's campaign for president: Common sense."[3] The people, Trump asserted, understood what ailed the country. If the problem was simple, say a decline in manufacturing jobs, then so was the solution: common sense suggested using threats and inducements to prevent companies from building factories abroad. If the problem was illegal immigration, which the people understood was occurring in larger numbers than the official statistics allowed, then common sense dictated building a wall. The wall became a symbol of U.S. national security and a commitment by the candidate to secure the nation's borders. Conceived in opposition to Hispanic immigration, it symbolized the Anglo-Saxon desire to regain control of the country's cultural boundaries. The wall also symbolized the divide between the people and the elites on which Trump sought to capitalize. So too did the idea of a 35 percent tariff on imports, which promised to do for trade what the wall would do for immigration and set Trump apart from expert opinion in his own party. And no sooner did Hillary Clinton denounce Trump's supporters as "deplorables" than they and the candidate embraced the label precisely to distance themselves from the elite and so-called respectable opinion.

Trump’s political style was fundamentally populist in its use of colorful and off-color language. It was populist in its disregard of political and personal niceties and its reliance on blunt talk to communicate strength of personality. It was populist in its undercurrent of violence against opponents. It was populist in its denigration of the establishment press and use of alternative media like Twitter to speak directly to the people.

Trump’s campaign was also populist in its approach to economics, which emphasized growth and distribution while denying constraints. A Trump administration would double the rate of economic growth, the candidate asserted, without specifying how. Trump’s emphasis on infrastructure spending echoed earlier populists who commissioned monumental projects in which the public could take pride and with which the leader would be forever identified, from Mussolini’s Monumento Nazionale to Gamal Abdel Nasser’s Aswan Dam. Here Trump’s background as a builder stood him in good stead. The wall along the Mexican border was only the most symbol-laden such project.

Trump’s resort to tariffs was another characteristic populist move. Populist leaders can deny the existence of constraints on their ability to cut taxes and raise growth, but it is beyond even their power to abolish the balance-of-payments constraint. The additional spending stimulated by their policies will include additional spending on imports, like it or not. Populist politicians generally don’t like it and therefore impose trade restrictions to limit imports and protect industry from foreign competition. One thinks of the import-substitution policies of Latin American populists such as Juan Perón and Getúlio Vargas or, perhaps stretching the point, the even more draconian trade restrictions of Mussolini and Hitler.

Tariffs appeal to the populist temperament as an assertion of national autonomy. For Bismarck they were a way of uniting industry and agriculture against economic competition from abroad. For Joseph Chamberlain they were a way of uniting the British Isles and White Dominions against foreign nationalities and races. Tariffs are especially appealing when they are used to protect industry, which is associated with economic self-sufficiency and military might. They protect the good manufacturing jobs promised by the leader. Whether these policies in fact create jobs and stimulate growth is another matter. But that other matter is beside the point for a charismatic leader for whom taxing foreign goods is a visible assertion of national authority.

For Trump, running as a Republican, tariffs were also a way of breaking with party establishment. The Republican Party had not always been the party of free trade, it is worth recalling. Nineteenth-century Republican presidents from Abraham Lincoln to William McKinley had supported tariffs to protect industry from foreign competition. The Fordney-McCumber Tariff was adopted in 1922 during the Republican presidency of Warren Harding, the Smoot-Hawley Tariff during the Republican administration of Herbert Hoover. Before World War II, tariffs were thus very much in the party mainstream. This changed with the Cold War, when congressional Republicans reluctantly embraced foreign trade and aid to support the Western alliance. Comforted by the unassailable position of American manufacturing, Republican members of Congress agreed to grant foreign producers unfettered access to U.S. markets while allowing Japan to pursue restrictive industrial policies and European countries to create a preferential trade area.[4] Exposing a robust manufacturing sector to limp foreign competition was a small price to pay for cementing Western unity, getting the Allies back on their feet, and repelling the Soviet threat. There was still the possibility that the Republicans would revert to their traditional protectionist stance when they regained the White House in 1952. But Dwight D. Eisenhower, a general first and a student of economics second, was swayed by the geopolitical argument.

While this rationale for an open U.S. economy dissolved with the collapse of the Soviet Union, Republican support for free trade did not dissolve with it.

Opposition to protection became part and parcel of the post-Reagan Republican Party's ideological objection to government intervention in the economy. It was hard to argue for deregulation in other spheres but stricter regulation of trade. By the 1990s, in addition, a large number of Fortune 500 companies had factories overseas and sourced inputs abroad. In return for supporting other elements of the Republican agenda, they expected fidelity to free and open trade. Moreover, there was growing recognition by corporate strategists and politicians alike that America benefited from the existence of a rules-based multilateral trading system that obliged other countries to open their markets to U.S. exports.

None of these rationales was particularly compelling to Trump, an interventionist by temperament who was less beholden to free-market ideology than a run-of-the-mill Republican. Alliances with other countries were not his priority. Using commerce to cultivate harmonious security relations was not high on his list. Nor did Trump obviously appreciate the importance of multinational production and global supply chains for U.S. manufacturers. He was more inclined to deploy threats and sanctions in bilateral negotiations than to put his faith in international organizations. He regarded the reciprocity rules of the World Trade Organization (WTO) as undesirable restraints on unilateral decision-making and infringements on U.S. autonomy. If some of his more extreme proposals threatened to violate WTO rules, then this was a feature, not a bug. And if the party elite was antagonized by this stance, all the better, given the candidate's position as an outsider.

Trump's criticism of the Federal Reserve was also straight from the populist playbook. Inveighing against concentrated financial power had been a constant of American politics ever since Andrew Jackson went to war with the Bank of the United States and vetoed the congressional bill renewing its charter in 1832. Jackson's background was not unlike Trump's in that he had engaged in property speculation and suffered a series of financial setbacks, notably in the Panic of 1819. Where a less headstrong individual might have ascribed those reversals to his own flawed judgment, Jackson blamed them on the Bank of the United States. The bank had manipulated monetary conditions, Jackson complained, inflating and then depressing land prices, and in so doing had bankrupted Jackson's counterparties in a series of land deals.[5] For his part, Trump in his first week chose a portrait of Jackson to adorn the Oval Office.

Damage to the people from concentrated financial power is, of course, a constant of American history. It was a central complaint of the Farmers' Alliance and the People's Party in the final decades of the nineteenth century. Those complaints resulted in the creation of a peculiarly atomized central bank, structured to avoid the centralization of financial power. Similar objections cropped up whenever times were tough and politicians sought to appeal to working-class voters. Huey Long attacked financial interests when gathering himself to run for the presidency in 1934–1935, tarring both the Fed and banks controlled by the Morgans and Rockefellers. FDR, hardly a political outsider, sought to position himself as a critic of the banks when seeking reelection in 1936 in the face of a 17 percent unemployment rate.[6]

One suspects that Trump, like FDR before him, was mainly seeking to portray himself as a friend of the people rather than really preparing to break up the banks. In the run-up to the election, he took the position, unusual for a populist and a property developer both, of criticizing the Fed for keeping interest rates low. He argued that Fed policies were supporting a "very false economy," artificially inflating asset prices and favoring his Democratic opponent. But on other occasions he described himself as a "low-interest-rate person."[7] Be that as it may, the Fed typified the kind of elite institution that always has and continues today to be a target of populist ire. Trump showed no compunction during the campaign about weighing in on Federal Reserve policy, something mainstream politicians including his opponent Hillary Clinton warned was irresponsible. Not that he was deterred. That final campaign ad where Trump inveighed against "those who control the levers of power" and "don't have your good in mind" left no doubt about whom he had in mind, overlaying the candidate's voice on an image of Fed chair Janet Yellen.[8]

Other elements of Trump's policy agenda are more difficult to cast in populist terms. Nineteenth-century American populists were uncompromising critics of monopoly power. Huey Long campaigned against Standard Oil, denounced FDR as too cozy with big business, and condemned the New Deal as regulated monopoly. This anti-big-business, anti-monopoly stance is also typical of Latin American populism: in the 1970s, in Salvador Allende's Chile, large domestic business firms with international ties were tarred as "the monopolies."[9] Trump, with a background in business, appeared to want it both ways: to use business as a whipping boy when companies moved facilities abroad, but to enlist it in bringing manufacturing jobs back home. This personal background plausibly explains why Trump turned to businessmen such as Wilber Ross to fill cabinet posts and advisory positions. It explains why the anti-monopoly stance typical of populist movements did not feature prominently in his campaign, aside from some critical remarks about the pharmaceutical industry, and why Trump ceded the issue of market power to Elizabeth Warren, Bernie Sanders, and populists of the Left.

The same tension with standard populist positions also characterized Trump's fiscal plans. The more typical populist stance, typified by Long's "Share Our Wealth" campaign, is to raise taxes on the wealthy and large corporations to finance increases in social spending and guaranteed incomes. In 1934 Long would have assessed a graduated capital levy on all individuals with a net worth of more than $1 million. He would have used taxation to cap annual incomes at $1 million and inheritances at $5.1 million. He would have used the revenues to finance a basic income of $2,500 (roughly one-third of average annual family income), provide pensions for people over sixty years of age, extend universal health care to veterans, and guarantee free education and training to college and vocational-school students.

Trump’s fiscal plans cut in the opposite direction. They envisaged lowering marginal tax rates for high earners and abolishing the inheritance tax. They proposed cutting corporate tax rates, where corporate profits that translate into dividends and capital gains accrue disproportionately to the wealthy. Trump proposed a 10 percent reduction in government spending while ramping up outlays on defense and security, thereby putting social programs squarely in the crosshairs. The new president’s pledge to abolish the Affordable Care Act (Obamacare) with its subsidies for low-income households was a move away from universal social insurance. Applying the federal hiring freeze ordered in his first week in office to the Veterans Administration and its hospitals was the opposite of the posture adopted by Huey Long. Proposing to give the states fixed blocks of federal funds for Medicare, Medicaid, and food stamps, rather than increasing federal funding as use of these programs increased, similarly augured less, not more, support for low-income households.

This approach to fiscal issues may have reflected the fact that Trump was, in reality, more pro-business than pro–working people. It may have been an attempt to appeal to mainstream Republican skepticism about government intervention in the economy and to the party’s opposition to legislatively mandated redistribution. If so, it indicated that Trump understood the need to broaden his appeal from disaffected voters to the Republican mainstream.

An alternative in a more traditional populist vein is that Trump was attempting to ground his opposition to social spending in identity politics. Welfare benefits, he explained to his supporters, were exploited by illegal immigrants and minorities. “The Center for Immigration Studies,” he noted in his Phoenix immigration speech, “estimates that 62 percent of households headed by illegal immigrants used some form of cash or non-cash welfare programs, like food stamps or housing assistance. Tremendous costs, by the way, to our country. Tremendous costs.”[10] We saw above that the more heterogeneous a society and the greater the distance between social groups, the more reluctant are its members to fund public programs that benefit not just themselves but also others. In advocating reductions in social spending, Trump was tapping into the belief of his white, working-class, small-town supporters that these programs were being exploited by racial minorities, immigrants, and aliens.

Other aspects of the Trump phenomenon fit the Populist mold more closely. There was an almost perfect inverse relationship between the size of a metropolitan area and voters' proximity to it, on one hand, and the share of the vote going to Trump, on the other.[11] Andrew Jackson's bank war, the Farmers' Alliance, and the People's Party were all rural revolts by individuals sensing that they were no longer in control of their economic destinies as a result of urbanization, commercialization, and other changes to the economy. The swing in the Republican share of the vote between 2012 and 2016, between Romney and Trump, was largest in small cities and towns, especially those geographically remote from major metropolitan centers. These smaller towns and rural areas were disproportionately white. Their residents were older and less mobile geographically and socioeconomically. While they were not disproportionately poor, they had a disproportionate fear of poverty, reflecting the lack of alternatives that comes with remoteness. They were less likely to have college degrees, where college education enhances mobility.[12] Their homes and families were physically removed from the global cities where new employment opportunities in high tech and finance were concentrated. They were therefore likely to regard elites in Washington, New York, and Silicon Valley as out of touch with their reality.[13]

Metropolitan areas predictably swung in the other direction. The election of 2016 was the first time Orange County, California, went for a Democratic presidential candidate since FDR in 1936. Among metropolitan districts and counties, those with the largest increase in import competition from China in the decade prior to the election had the greatest likelihood of opting for Trump. More generally, such districts had a greater tendency to vote for candidates at one or the other end of the political spectrum.[14]

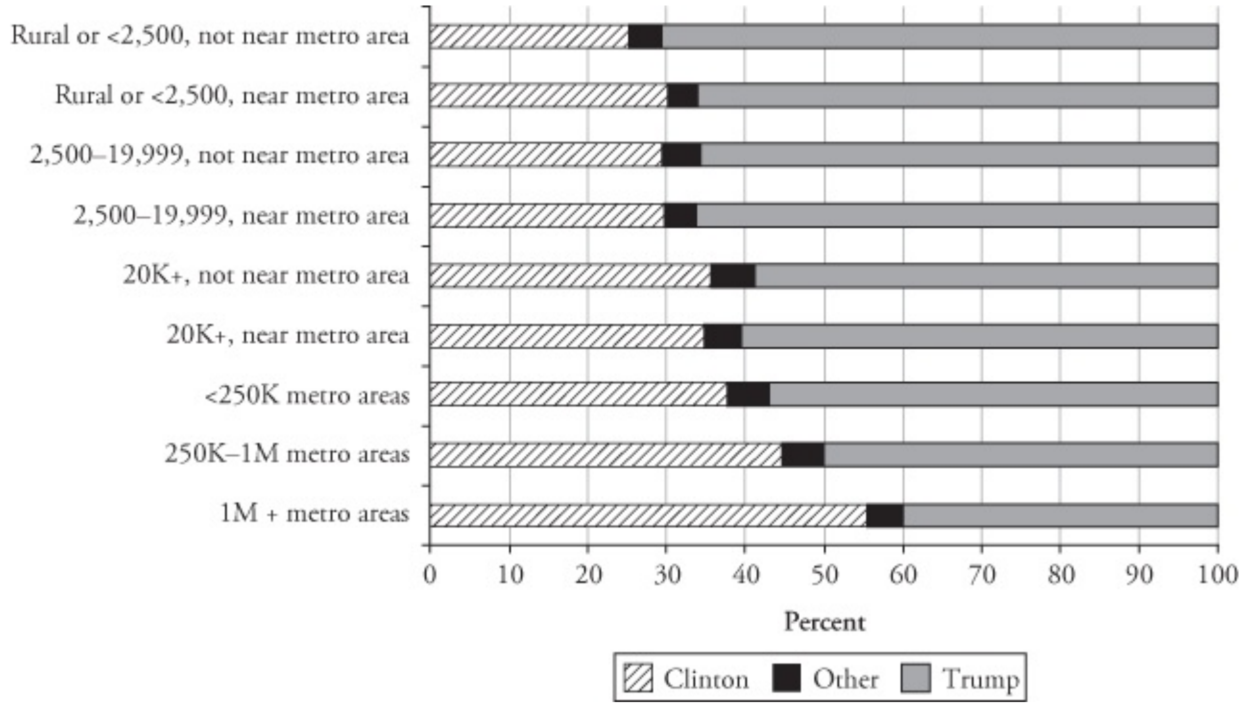


Figure 9.1 U.S. Presidential Votes, Urban Versus Rural Areas, 2016

Source: Danielle Kurzleben, “Rural Voters Played a Big Part in Helping Trump Defeat Clinton,” *NPR* (14 November 2016), http://www.npr.org/2016/11/14/501737150/rural-voters-played-a-big-part-in-helping-trump-defeat-clinton.

Moreover, counties where the swing from Romney to Trump was 15 percentage points or more were virtually all in the Midwest. The Midwest is a diverse and complicated place, but scholars of the region generally characterize it as more traditional than the country as a whole when it comes to issues such as women’s and LGBT rights.[15] Midwesterners were less likely to feel that they were benefiting from economic growth. The region had a lower concentration of immigrants and therefore a greater fear of the unknown than the West Coast, the Southwest, the Northeast, and Florida. It may be coincidental that the People’s Party held its 1892 convention in Omaha and that its 1892 presidential candidate, James Weaver, was from Iowa. It may be coincidental that William

Jennings Bryan was from Nebraska. Or it may be that midwesterners are, subconsciously at least, aware of their populist tradition.

Finally, Trump did especially well in states that enjoyed a temporary fracking boom but suffered subsequently from depressed energy prices. There is an obvious analogy with crop prices in the 1870s and 1920s: a temporary boom that created expectations of good times, followed by a slump.

What, in terms of economic policy, could mainstream politicians have done to head off this populist reaction? Answering this question requires one to take a stance on whether the decline in manufacturing employment in the United States was due mainly to trade or to technology. The argument that it was due mainly to automation and the declining labor intensity of industrial production starts with the observation that the fall in the manufacturing employment share predates the rise of competition from low-wage countries, and from China specifically. It goes back half a century, to when manufacturing firms learned to do more with less and employment shifted toward the service sector. Consider the coal industry, which, though the subject of much impassioned rhetoric in the 2016 campaign, was not directly exposed to Chinese competition. The amount of coal mined in the United States rose by more than 150 percent in the half century ending in 2011, but employee hours fell by more than 20 percent as the industry adopted open-pit mining, self-advancing longwall mining machines, and other mechanized processes.[16]

This diagnosis suggests that a more restrictive trade regime won’t be good for American workers. It will be good mainly for American robots insofar as it shifts spending back toward the products of domestic manufacturing firms. Eliminating regulatory restrictions on coal will benefit mainly the skilled-labor- and capital-using producers of longwall mining machines, not the long-suffering residents of Appalachia. Similarly, this diagnosis suggests that had Presidents Bill Clinton and George W. Bush been slower to embrace NAFTA or to agree to Chinese membership in the WTO, this would have done little to arrest the decline in manufacturing employment.

To be sure, import competition negatively affected specific local markets that were home to labor-intensive industries facing Chinese competition. If you had the bad luck to live in a county that was home to firms producing luggage, furniture, textiles, apparel, or electrical appliances, the impact could be devastating, just as in the English Midlands towns producing boots, shoes, gloves, and silks and facing foreign competition in the 1870s.[17]

Because displaced workers lack the resources to move, there is an argument for attempting to bring jobs to them. The Tennessee Valley Authority, begun in 1933 in an effort to bring manufacturing to the region by investing in hydroelectric power, is a case in point. But evidence on the effectiveness of the TVA and its modern equivalent, Empowerment Zones that subsidize the provision of infrastructure, training, and other forms of business assistance in depressed regions, is mixed at best. Moreover, studies suggest that to the extent that the TVA succeeded in attracting new industries, it did so mainly at the expense of other regions.[18]

This is not an argument against trying if the goal is to aid regions and workers displaced by imports. Moreover, the experience of countries like Germany, where manufacturing employment remains more important than in the United States, points to still other measures politicians might try: investing in apprenticeship and vocational training and keeping the national currency at competitive levels, for example. These are not new observations. President Obama proposed a $2 billion apprenticeship training fund in his fiscal year 2016 budget, and economists who believe that manufacturing matters have long criticized the country's strong dollar policy.[19]

These changes are more easily imagined than implemented, however. Germany's apprenticeship system is historically rooted. It is the product of a culture that values what Germans proudly call "blue-collar work." It requires patient employers prepared to invest in their workers, and strong trade unions to help coordinate the operation of the system.[20] Most un-American of all, it requires government, working with employers and unions, to establish standardized occupational profiles, define training curricula, and help pay the bills.

On the competitive-currency side, it's hard to imagine other countries welcoming U.S. efforts to push down the dollar. When smaller countries engage in this behavior, they can be safely ignored. But since the United States is a global heavyweight, other countries would almost certainly respond by pushing down their own currencies along with the greenback. Germany has the advantage, moreover, that it no longer possesses its own currency, giving it plausible deniability. If its exchange rate is low, then this can be conveniently dismissed as reflecting the circumstances of its euro-area partners, not self-interested manipulation by German policymakers.[21] And if Germany is running a trade surplus, any discomfort in the rest of the world is partially offset by the deficits of other less competitive euro-area countries.

But the single most devastating retort is that the share of manufacturing jobs in relation to total employment has been falling in Germany for half a century, just like in the United States. Having reached 40 percent in 1970, that share is now less than 20 percent. (Compare Figure 9.2 here with Figure 8.2 in Chapter 8, and try to detect a significant difference.) Whatever its other merits, even the German system offers only limited protection from the decline of manufacturing employment.

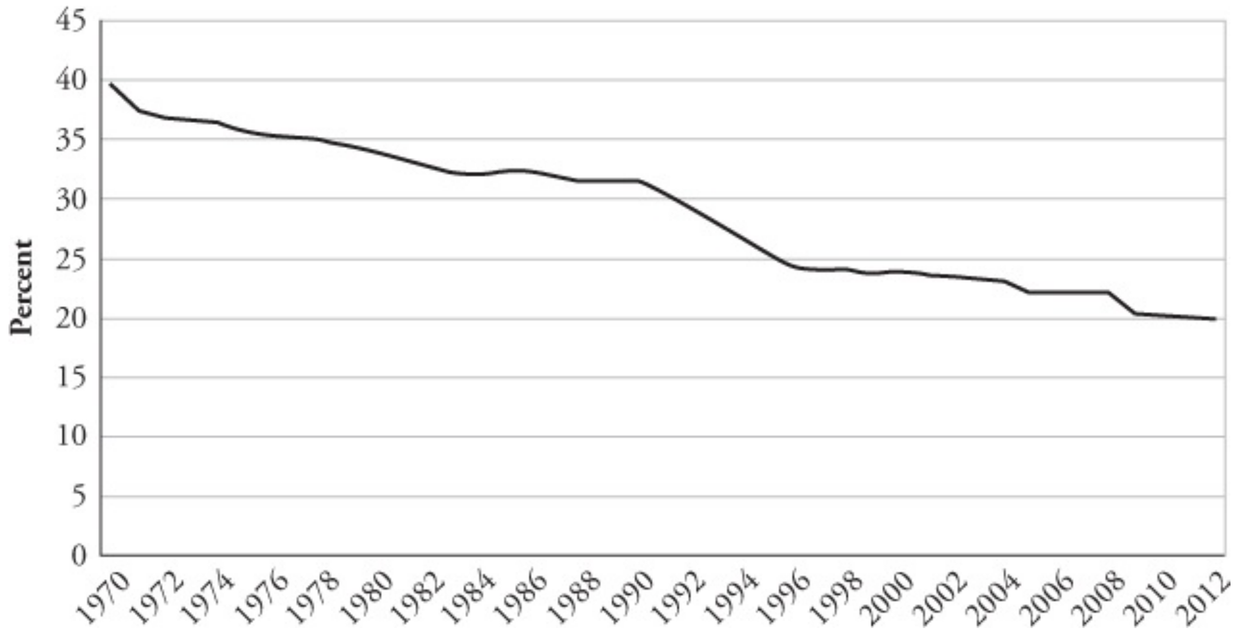


Figure 9.2 Percent of Employment in Manufacturing in Germany Since 1970

Source: U.S. Bureau of Labor Statistics, Percent of Employment in Manufacturing in Germany, retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DEUPEFANA.

If the problem is secular rather than cyclical, the result of technology rather than trade, and specifically due to the automation of routine tasks in manufacturing, then the solution is to better equip workers to undertake non-routine tasks, not just in manufacturing but also in the service sector. Restaurant chefs, home health care workers, security guards, and spiritual advisors require situational adaptability, interpersonal skills, and oral communication ability, but not always higher education. The importance of adaptability, collegiality, and communication make these jobs relatively safe from automation.[22] To be sure, a San Francisco start-up called Momentum Machines has developed a robot that not only flips hamburgers but makes them from scratch. But the mass production of burgers is the epitome of a routine task; it's hard to imagine the high-end Napa Valley restaurant French Laundry mechanizing the production of its tasting menu. In Japan, where a declining birth rate and a rapidly aging population make the problem of home health care especially acute, Honda has developed an autonomous humanoid robot, Asimo, to get food for the elderly and turn lights off and on. But in an age when robots still can't turn doorknobs or fold napkins, whether robotics can help with more complicated needs, provide emotional succor, and cope with the ethical dilemmas of elder care is uncertain. Another Silicon Valley company, Knightscope, is developing wheeled automatons equipped with sensors, microphones, and lasers to act as security guards. Its K5 model, however, is known mainly for knocking over a child and running over one of his feet at the Stanford Shopping Center. The company's website revealingly touts robots as appropriate for "boring and monotonous" patrols and acknowledges that "decision-making is best left to real people."[23]

Educators argue that the situational adaptability, ease of interpersonal interaction, and communication skills needed for non-routine tasks are heavily influenced by education, starting in early childhood. Interpersonal, collaborative, and communication skills are shaped when children are young, pointing to a high-return area in which to invest.[24] But it will take time, even in the best-case scenario, for such investments to pay off, the time from when a child receives early education to when she enters the labor force. That the problem of declining manufacturing employment due to the automation of routine tasks developed over a period of decades means, unavoidably, that it will similarly take decades to address.

Be this as it may, these were not directions in which the United States, following its startling 2016 election, was prepared to go. The new Congress and administration, critical of federal bureaucracy and mandates, were more inclined to cut early childhood education than to expand it. Skeptical of the ability of the federal government to solve problems, they had little appetite for place-based policies. The very notion of the federal government negotiating occupational profiles and dictating training curricula was anathema to the politicians brought to power in 2016.

And if the promise of bringing back good manufacturing jobs through

# 11

# Containment

the populist temptation is greatest when economic concerns fuse with identity politics and when the two are inadequately addressed by mainstream parties. In some cases the political establishment has responded with policies that address voters' concerns about living standards, equity, economic security, and the sense that their voice is not being heard. The Populist Revolt in nineteenth-century America was defused by freight rate regulation, interest rate regulation, and changes to the gold standard, limited reforms that went some way toward addressing the complaints of farmers and others, together with political reforms such as the referendum processes and direct election of senators advocated by the Populist Party. These steps took the wind out of the populists' sails. Mainstream politicians also appropriated certain less savory elements of the populist agenda, restricting immigration from Asia and taxing imported manufactures, for example. But these and other questionable tactics were more limited than they would have been in the absence of constructive responses.

Those constructive responses and their positive reception were favored by good luck and good institutions. Growth accelerated in the 1890s, creating new opportunities and diminishing the sense that change was a zero-sum game. Not just more favorable U.S. monetary conditions but also a more benign global environment helped to banish deflation. This was good luck at the best possible time. But the decentralized nature of the country's political institutions also helped in this period of limited federal powers. Rather than having to organize a successful national movement, as the Populists ultimately failed to do, reformers in Oregon and California organized locally, using referenda to enhance the voice of the people and address the concern that legislators were beholden to moneyed interests. Oregon and Nebraska could push ahead with the direct election of senators, again bypassing suspect state legislators, until the requisite three-quarters of states finally agreed to amend the Constitution in 1913.

Time will tell whether we are as lucky this time and whether the political establishment is as capable of mounting a constructive response. The ultimate good luck would be a better economy. Productivity growth fell sharply across the advanced countries in the 1970s, as we saw in Chapter 8. It then recovered during the 1995–2005 period before declining again. One can imagine that the years after 2005 were the anomaly and that growth is now poised to accelerate. Just as it took time to figure out how to apply new information technologies to retail trade, wholesale trade, and financial services, the sectors that led the recovery of productivity growth in 1995–2005, it may simply be taking time to figure out how to apply the cloud, quantum computing, artificial intelligence, and other recent IT advances outside the IT sector. Firms throughout the economy must first reorganize how they interact with their customers and how they recruit and deploy their workers.[1] If we're lucky, the results will materialize quickly.[2] Growth will accelerate, obviating the need for hard choices and blunting political extremism. Or not.

For those willing to be patient, there is a plain-vanilla recipe for fostering faster growth. It starts with investing in basic literacy and numeracy but also in vocational training, university education, and lifelong learning. It includes relaxing excessive regulation, but also retaining regulations that correct market failures. It requires sound and stable economic policies making for a favorable investment climate. This means not boosting demand in unsustainable ways, as before 2007, but also avoiding policies that actively depress spending, as in Europe after 2010.

But one thing these policies have in common is that they take time to work their effects. It takes time to train a more skilled and productive labor force. It takes time to renew the capital stock. It takes time to translate principles into policies and to develop a consensus around their implementation. The plain-vanilla recipe for fostering growth is like the dietician's advice to "eat healthy." Enhancing the environment for growth, like changing one's diet, takes discipline, attention to detail, and time to see the effects. And time doesn't favor those seeking to head off a populist reaction.

If faster growth fails to materialize, then it is all the more pressing to address distributional concerns. This will require new thinking, since the forces that made for greater equality in the third quarter of the twentieth century are unlikely to return. Trade unions, which advocate for factory workers, will find it more difficult to organize people working remotely from home. They will be less able to extract rents in a world of internationally integrated markets, where emerging economies with lower wages welcome employers with open arms. Capital mobility makes it harder for governments to use tax policy to level the income distribution as they did after World War II, since the wealthy and the corporations in which they invest can now shift their assets to lower-tax jurisdictions. The ethnic, racial, and religious diversity of Western societies, reflecting the cumulative effects of immigration, limits political support for governmental transfers. And the bias of technological change no longer favors blue-collar workers; it is the routine jobs of less skilled workers that are being disproportionately automated, while more-skilled workers oversee the automatons.

Insofar as offshoring of the labor-intensive component of manufacturing supply chains in the advanced countries has raised capital's share of GDP, one way of addressing inequality is by ensuring that capital is held more widely.[3] Anthony Atkinson suggested strengthened inheritance taxes to prevent concentrated claims on capital from passing down to the fortunate few and using the revenues to provide every citizen with a capital grant at the age of majority.[4]

But if the dead are in no position to lobby or flee to lower tax jurisdictions, wealthy parents can do both. Moreover, Atkinson's proposal centers on redistribution, which is politically fraught. It implies transfers from more to less fortunate ethnic, religious, and racial groups, which clashes with identity politics.

Subtler approaches would start with giving firms tax incentives to adopt employee stock option plans. Workers can be given tax incentives to invest in them. Individuals can be required to opt out of retirement and other payroll-linked savings plans instead of being given the choice to opt in. These policies won't redistribute capital ownership at a stroke. But they can give capital-poor individuals hope that the distribution of holdings will evolve in more equitable directions. And hope is what it's all about.[5]

Insofar as inequality reflects the very different labor incomes of top earners and others, societies again have the choice of whether to address this directly. In 2013 Switzerland voted on a referendum that would have limited executive pay to twelve times that of a company's lowest-paid employees. Voters rejected the proposal as too radical and too easily circumvented by non-salary compensation and perks. In the United States such regulation would likely be regarded as beyond the pale. Still, absent other measures to curb excesses, one can imagine more such proposals from left-wing populists in a variety of countries, including even the United States, where the average ratio of the pay of CEOs of big firms to that of their workers is a staggering 200 to 1.

Curbing those excesses should start with making corporate boards and compensation committees subject to stronger legal and administrative sanctions if they too readily acquiesce to CEO requests for higher pay, neglecting their fiduciary responsibility to other stakeholders. Regulators should require companies to disclose the existence of executive stock option plans. Only independent directors should be allowed to sit on compensation committees. Shareholders should be entitled to vote on—and veto—pay packages for top executives, as U.S. investors were empowered to do by the Dodd-Frank Wall Street Reform and Consumer Protection Act, put in place in 2010 in response to the financial crisis.[6] The fact that the increase in the share of labor income accruing to the top 1 percent has been heavily concentrated among employees in the financial sector, not just top executives but also others, suggests that restraining the growth of the financial industry, another intended effect of Dodd-Frank, can help to limit pay inequality in addition to limiting stability risks.[7] Whether Dodd-Frank will survive the backlash against post-crisis regulatory reform is uncertain. These are arguments for why it, or at least something like it, should.

In the United States, high rates of social mobility are traditionally cited as a reason not to be fixated on inequality. Even those at the bottom, the argument goes, have a chance of rising to the top. It follows that declining social mobility is part of the explanation for why inequality has become more of a concern. The economists Michael Carr and Emily Wiemers found evidence of a significant decline in lifetime earnings mobility in the United States since the early 1980s. The probability of an individual remaining in the same decile of the earnings distribution over his or her working lifetime went up for every decile of the distribution in the post-1980s period. Meanwhile, the chance that someone who starts in the bottom 10 percent of the earnings distribution will move above the 40th percentile dropped by 16 percent. The likelihood of workers who started their careers in the middle of the earnings distribution moving to the top deciles similarly declined by 20 percent.[8]

And what is true over an individual's working lifetime is true across generations as well. Fully 50 percent of a parent's earnings advantage, recent studies suggest, is passed on to the next generation. The intergenerational elasticity of earnings, the technical name for this form of persistence, is as much as two-thirds for those in the top half of the distribution.[9] Current estimates of intergenerational persistence are noticeably higher than those in the second half of the twentieth century.

Raj Chetty and his coauthors have shown further that the probability of a child from a family in the bottom fifth of the income distribution reaching the top fifth varies greatly across the United States. Areas with high earnings mobility have better primary and secondary schools; they better prepare children to succeed economically. Those areas have less residential segregation, enabling children from poor families to interact with people from different economic backgrounds and to acquire the social skills needed for getting ahead in the labor market. They have fewer single parents, a larger middle class, and more civic and religious organizations. Some of these variables are easier to influence with public policy than others, but these findings are at least suggestive that investing in primary and secondary education and legislating against residential segregation, using anti-discrimination and appropriate zoning laws, can enhance economic mobility and thereby ameliorate inequality concerns.[10]

When comparing regions, Chetty and colleagues do not find that people in places with better access to higher education, in the sense of sheer physical proximity, display higher earnings mobility. Physical access is less of an issue today than after World War II, given the proliferation of public, private, and for-profit institutions.[11] The University of California, to pick an example not entirely at random, added four general campuses in the 1950s, five in the 1960s, and a further one in the twenty-first century. Those campuses were situated where they were precisely in order to serve neglected communities.

Access to elite education still matters, however. The higher education that most affects the probability of an individual moving from the lower or middle part of the income distribution to the top 1 percent is attending an Ivy League–type school. This is a problem for those concerned with inequality of income and opportunity, since, as another Chetty-coauthored study shows, children from families in the top 1 percent of the income distribution are seventy-seven times more likely to attend an Ivy League–type school than children of families in the bottom fifth of the income distribution.[12]

This suggests eliminating favorable treatment by admissions committees of children of alumni, so-called legacy admissions.[13] It points to limiting the tax advantages of private universities with large endowments that cater to the children of the wealthy. It is an argument for providing additional funding to middle-tier public institutions like the City University of New York and California's system of state and community colleges (as opposed to the university) that enroll disproportionate numbers of lower-income students who, after graduation, have high rates of earnings mobility.[14]

All this can better equip young people preparing to enter the workforce, but there remains the question of what to do for those well into their working years. In a variety of times and places, from Bismarckian Germany and Edwardian Britain to the United States in the 1930s, a populist reaction against economic change has been contained by public programs that compensate the displaced and comfort others who fear the same fate. Unemployment insurance, health insurance, and old-age insurance address this need, as does assistance with retraining, job search, and relocation. These programs help workers cope with circumstances that they are less than fully capable of handling themselves, thereby addressing the anxieties of creative destruction. In some countries administration of these programs is top-down, while in others, like the United States, it is heavily decentralized—essentially for historical reasons, as we have seen. In Canada, the United Kingdom, and many European countries, health care provision and insurance are directly administered by the government, while in the United States, again for historical reasons, the direct role of government is limited to those with special needs—namely, the elderly (Medicare), the poor (Medicaid), and the military (the Veterans Administration)—to providing subsidies for people for whom health coverage is prohibitively costly, and to providing tax deductions for large medical expenses.[15]

It is not coincidental that the United States, where for historical and ideological reasons the role of government in providing social insurance is most limited, is also where the backlash against free trade and concern with the decline of manufacturing employment have been especially intense. Americans understand that they will not receive much help from publicly provided unemployment insurance, health insurance, and old-age insurance and little assistance with retraining and relocation if they lose their jobs to globalization and automation. Ethnic, racial, and religious heterogeneity has worked against the extensive provision of social assistance, with each group resisting calls to fund programs they believe benefit mainly others.

What is true of racial divides is true equally of socioeconomic divides. Insurance is not provided under a veil of ignorance. Skilled workers whose jobs are secure understand that they are being asked to finance insurance and income maintenance for less skilled workers whose livelihoods are at risk from globalization and technology. But this very observation suggests a bargain. Whereas less skilled workers are disproportionately on the receiving end of social insurance benefits, more skilled workers in the advanced economies benefit disproportionately from globalization, since their countries export mainly skill-intensive goods. Skilled workers also benefit disproportionately from new technologies that complement their skills. The high-wage workers in question may be funding transfers to others, but in return they are getting a social consensus favoring economic openness and technical change.

In other words, globalization and technological progress may be good things, as economists argue, but even good things are rarely free. Otto von Bismarck understood this when he advanced health, disability, and old-age insurance to reassure Silesian weavers displaced by technical change and imports that the German Empire had their backs. David Lloyd George and the New Liberals understood this when they adopted unemployment insurance to fend off pressure for tariff reform from workers in the shipbuilding, engineering, and iron-founding trades. Franklin Delano Roosevelt understood this when, at the same time as he sought to walk back the import restrictions of the 1920s and 1930s under authority granted him in 1934 by the Reciprocal Trade Agreements Act, he spearheaded a historic expansion of the welfare state.[16] John F. Kennedy understood this when he signed the Trade Expansion Act of 1962, which authorized the president to cut tariffs by 50 percent but also created programs to provide job training, job search assistance, and exceptional income support to workers displaced by foreign trade, enlisting the support of union leaders for the trade expansion bill.[17] The failure of twenty-first-century politicians, specifically in the United States, to make this connection is either a failure of courage, to the extent they are intimidated by hardcore ideological opponents of government action, or a simple failure of logic.

There are also more ambitious ideas. If jobs for unskilled workers are gone for good and not everyone can acquire the necessary skills, then there is a solidarity argument for a basic income for all. This was another idea the Swiss considered in a referendum, this one in June 2016. Although the ballot measure didn’t specify the amount, campaigners suggested that it would be some 2,500 Swiss francs per month per adult, or roughly $2,500—almost exactly the same in 2016 dollars, as fate would have it, as the allowance proposed under the Townsend Plan, described in Chapter 5, or under Huey Long’s “Share Our Wealth” plan, as described in Chapter 9.[18] The Swiss proposal was defeated, with 77 percent voting against, on grounds of cost (the measure would have cost 4 to 5 percent of GDP) and also for fear that an unconditional scheme would encourage indolence. It’s not hard to anticipate the same reaction elsewhere.[19]

Better would be to question the presumption that there is a large class of citizens unable to acquire the skills to make them employable and to reject the proposition that jobs for humans are gone for good.[20] Also better would be to redesign education and training to prepare workers for non-routine jobs that are difficult to automate—to impart the adaptability, interpersonal skills, and oral communication ability required for twenty-first-century work. This suggests focusing from an early age not just on literacy and numeracy but also on cultivating empathy, compassion, and other human instincts that machines find it difficult to emulate (so far) but which the elderly, ill, infants, and others value in interactions.

But if there are limits on the ability of society, through education and training, to raise the productivity of workers to the point where employers who have the option of using robots are willing to pay those workers a socially acceptable wage, then the solution is subsidizing wages and work. This would be cheaper and more socially acceptable than an unconditional basic income. It would enable workers to learn on the job. It would give people the satisfaction of having work. Wage subsidies could be extended to the worker or employer through the tax code. Even countries traditionally as suspicious of social engineering as the United States have experience with such programs. The U.S. federal government provides an Earned Income Tax Credit, for example, which reduces the taxes of low-income families so long as they work and which may even give them a refund (a negative tax liability). This tax credit scheme is in fact the country's third-largest social welfare program after Medicaid and food stamps. The United States similarly provides a Work Opportunity Tax Credit to firms that hire certain types of low-skilled workers, thereby making it more economical for employers to take them on.[21]

Also fashionable, since it has been suggested by no less than Bill Gates, is taxing robots to level the playing field.[22] Why should people pay taxes while robots get off scot-free? The resulting revenues could then be used to fund socially worthwhile programs.

But where, one might ask, do we draw the line between robots and ordinary machines? Is an ATM a robotic bank teller, and if so, should ATMs be taxed? Should all machines be taxed?

Definitional problems aside, a moment's reflection reveals that the owners of robots don't, in fact, get off scot-free. If robots are a source of profits, then their corporate owners pay tax. To the extent that those profits end up as dividends and capital gains, the recipients of these forms of income pay tax as well. And if they don't, then the fix is to reform corporate profits and personal income taxation.

Consumers, meanwhile, benefit from the cheaper goods and services provided by the new technology embodied in robots. From this vantage point, taxing robots is ultimately no different from taxing technological progress. It is also no different from taxing international trade. Taxing international trade limits the ability of a country to transform the goods it can produce most cheaply and efficiently into goods that can be produced more cheaply abroad. Taxing trade therefore reduces the purchasing power and living standards of residents overall. A tax on robots is no different.[23]

Not just these ambitious schemes but also more traditional interventions such as unemployment insurance and job training must confront the erosion of social solidarity in ethnically, religiously, racially, and economically diverse societies. The mechanical ties of kinship and the shared values emphasized by Emile Durkheim as sources of social solidarity no longer bind as tightly in countries whose residents lack the hegemonic belief system, the basis in community, the equality of incomes, and the access to opportunity of a fabled past. The organic ties of economic interdependence—the solidarity rooted in mutual economic interest also emphasized by Durkheim—no longer bind now that high- and low-tech industries are located in different places, out of sight of one another, and now that people of different political persuasions cluster in red and blue states.[24] This problem is, in a sense, even worse in the European Union, insofar as the majority of residents stubbornly self-identify as Spanish or Italian rather than European, notwithstanding the fact that "solidarity" is one of the six pillars of the European Union's Charter of Fundamental Rights.

In this setting, inequality and lack of social cohesion feed on one another. If income disparities result less from individual merit than from inheritance, family connections, and access to elite education, then those disparities will rightly be seen as unfair. This perception will in turn undermine trust in fellow citizens and in society generally.[25] As a result, government will not be trusted to undertake programs that reduce inequality, in turn making disparities worse and eroding trust and solidarity still further.

What's a heterogeneous society to do? One answer is federalism. Americans with a high level of trust in government and in one another can congregate in blue states, while the less trusting congregate in red states, and both can pursue their preferred policies. Blue states can offer higher minimum wages and more public support for education, training, and relocation, while red states do the opposite. If Californians want to organize a single-payer health plan and finance it with a wealth tax on residents with assets of more than, say, $20 million, and with a tax on the global profits of companies levied on the basis of the share of their sales occurring in California, then the U.S. Constitution allows them to proceed.[26] This would be not unlike the response to economic change and inadequate political voice that motivated reformers in Oregon and California to push for direct democracy at the state level in the early twentieth century. No less an authority than Mick Mulvaney, Donald Trump's budget director, said as much when Congress was debating repeal of the Affordable Health Care Act in 2017: "If you live in a state that wants to mandate maternity coverage for everybody, including 60-year-old women, that's fine." And if you don't, "then you can figure out a way to change the state that you live in … Change … state legislatures and state laws. Why do we look to the federal government to try and fix our local problems?"[27]

But the federal solution has limits. Some things, like providing a strong national defense, securing the nation's borders, and regulating immigration, can be done only at the national level, and in Europe's case at the European level. This is true of trade policy, so long as a country has free interstate commerce (in European terms, as long as the EU is a single market). Different trade policies are feasible only with restrictions on interstate commerce, since otherwise goods will enter through the state with the most liberal policy, which will then become the de facto standard. Decentralization therefore doesn’t solve the problem of displacement of labor by import competition. And it doesn’t reconcile different attitudes toward immigration.

Different states can still pursue different approaches to displacement, providing more or less ambitious retraining programs. But there are limits, since workers receiving retraining in one state can seek employment in another that doesn’t share the cost of imparting the new skills. The same is true of environmental policy. California can follow its own ambitious environmental policy, since it’s a big state and the wind blows off the ocean. But smaller states that are downwind will find adopting a stringent environmental policy more costly.

Clustering by taste will also limit interaction between individuals with different attitudes, thereby eroding trust and solidarity still further. This will make it even harder to agree on the provision of collective goods and services at the federal level. Familiarity breeds trust, not contempt, as James Coleman famously put it.[28] Communities with high levels of ethnolinguistic diversity spend less on collective goods like health, education, and infrastructure, as we saw in Chapter 1. But the more those different groups mix—the greater the extent to which they are co-located geographically—the more those effects are attenuated.[29] Also consistent with this view is the observation in Chapters 9 and 10 that natives of regions that are home to the fewest foreign-born residents display the least trust of immigrants.

This brings us finally to the vexed question of immigration. The narrowly economic case for more immigration in the advanced countries is impeccable. The immigrants themselves benefit enormously: both unskilled and skilled workers in developing countries see the purchasing power of their earnings rise by a factor of ten when they move to an advanced country where better infrastructure, technology, and contract enforcement render them more productive.[30] It's hard to point to another way that income gains of this magnitude can be conjured up overnight. The advanced countries on the receiving end benefit as well. They are capital abundant and labor scarce. Their dependency ratios are high. The labor force is growing slowly or, in some cases like those of Japan and Italy, not at all.[31]

The narrowly economic objections and alternatives to more immigration are not compelling. Although immigrants consume public services, they also pay taxes, on balance contributing more than they take.[32] Foreign aid might seem like an alternative to immigration: aid that fosters economic development can reduce the incentive to move and, not incidentally, make the donors feel less guilty about closing their borders. Both motives were apparent in the so-called Marshall Plan for Africa unveiled by the German Development Ministry in 2017. But even the most optimistic assessments do not suggest that development assistance can raise living standards tenfold overnight.[33] Additional trade preferences can be extended to poor countries, but access to export markets is not enough to bring incomes up to advanced-country levels when local institutions are the problem and, for historical reasons, remain difficult to change.

It can be objected that immigrants bring with them not just their manpower but also the culture and experience that lie behind the low productivity of their native country.[34] But the literature warning of such adverse effects is entirely evidence free.[35] It runs counter to historical experience with successful assimilation, and specifically to the historical experience of the United States, which has successfully assimilated successive waves of immigrants, raising their productivity to the level of natives rather than the other way around. It runs counter to the observation that immigrants are not randomly selected, it being the industrious and hardworking who have the get-up-and-go to migrate.

Maybe assimilation is harder now because the religion, race, or ethnicity of the current wave of immigrants is so different from that of natives. But every generation argues that assimilation is harder now. In the United States, the same argument was made about Irish and Italian immigrants in the nineteenth century, and then about Eastern Europeans and Asians. It could be that assimilation is harder when immigration reaches high levels. Immigrants then cluster in their own communities, reinforcing traditional values, and have less contact with natives. But this argument, if valid, is an argument against unlimited immigration, not against current levels of immigration, which have not obviously disrupted assimilation in this economic sense.[36] And insofar as residential and economic segregation make it difficult for immigrants to adapt to host country practices, it is in the interest of the host country to pursue housing policies that allow immigrants to interact more with natives, job training and nondiscriminatory employment policies that give immigrants more contact with other workers, and education policies that allow the children of immigrants to mix with the children of natives and be exposed to host country mores.

And apart from these economic arguments, there is also a humanitarian argument for admitting more refugees from impoverished, strife-torn countries.

These economic and humanitarian arguments of course run headlong into distributional and identity concerns—they run headlong, in other words, into populist politics. Where immigrants are unskilled, their arrival in large numbers is likely to have some impact, or at least to create fears of some impact, on the wages of less skilled natives.[37] This effect is especially problematic in advanced countries where import competition from low-wage countries and skill-biased technical change similarly disadvantage the less skilled and widen inequality.[38] And it is easier to point the finger of blame at immigrants and shut the door on new arrivals than it is to blame inventors and investors and turn back the clock on technology.

More education and training is an obvious policy response to pressure on the wages of less skilled natives. This is the same formula economists regularly recommend for addressing the negative impact on unskilled labor of skill-biased technical change and globalization. This observation is a reminder that simply shutting the door on immigration will not relieve the pressure on working-class living standards or reverse the rise in inequality that has fanned nativist sentiment, since shutting the door to foreign labor will not eliminate the unequalizing effects of technology and trade. It is a reminder that additional immigration creates a dilemma for those seeking to increase funding for education and training, insofar as ethnically, religiously, and racially heterogeneous societies find it harder to cultivate the trust in government and in others needed to maintain popular support for such programs. Again, this suggests that policies countering residential and economic segregation should be a priority, since they facilitate interaction between groups, building trust and thereby neutralizing the negative impact of increased diversity on society's willingness to provide education, training, and other services collectively.[39]

Some have suggested reforming the immigration system to deal with economic and identity concerns. U.S. immigration policy could move away from family unification and toward a Canadian-style point system that rewards education and training, as Donald Trump proposed in 2017. Since immigrants will be more skilled, they will not drive down wages for unskilled work. But this change, which downgrades humanitarian motives, would not be universally embraced. It would not be helping the poorest but rather favoring the relatively advantaged possessing advanced degrees. Alternatively, countries could move to a fixed-term guest worker system, like the Bracero Program implemented by the United States and Mexico in 1942 to alleviate wartime labor shortages and the German *Gastarbeiter* system of the 1950s and 1960s.[40] Since temporary workers won't set down roots, they won't be perceived as posing a threat to identity. Since they will be in the country for a limited period, they won't be inclined to bring their families, establish their own houses of worship, and found their own civic organizations. Since there is a large pool of farmworkers and software engineers in the developing world, the advanced countries can easily meet their labor force needs through a system of rotating fixed-term contracts.

But there are good reasons to doubt the feasibility of such schemes. The *Gastarbeiter* system broke down because German employers objected to the costs of training new workers every two years and pressured the authorities to let the incumbents stay. The Bracero Program was abolished in 1964 because of complaints that farmers were providing substandard wages and housing, problems that neither the Department of Labor nor the Department of Agriculture saw as priorities to solve, while Mexican farmworkers for their part lacked the civic and economic organizations, starting with unions, through which they could insist that these deficiencies be corrected.[41] Such systems can be made to work, it is said, if the authorities are sufficiently vigorous about enforcing fixed-term contracts and holding employers to the same wage and safety standards that apply to other workers. But the fact that guest workers lack a path to citizenship and are wards of the state for only a limited period suggests that their treatment will not be seen as a priority and that they would have few advocates and channels through which to press their case.

Lastly, there is the question of what kind of political system is best placed to respond to the populist threat. The traditional answer is a presidential system like that in the United States, where winner takes all. In this system, populist movements find it hard to make political headway against the established parties. Nominees appealing to the median voter have an incentive to move to the political center in the general election and to shun divisive, us-against-them policies.

But however sensible these rules of the road, recent experience suggests that the U.S. system is also dangerously accident prone. Against a backdrop of economic insecurity and contested identity and with his rivals at one another’s throats, it is not impossible for an unconventional politician to capitalize on anti-elite, nativist sentiment and capture a major party nomination. Faced with a weak opponent and benefiting from a bit of foreign meddling, it is not impossible for that nominee to win an election without moving to the political center.

In the American winner-takes-all system, the 49 percent of the electorate that voted for the other party may then be left with no political voice. Indeed, under the U.S. Electoral College system, which apportions electors mostly on a state-level winner-take-all basis, it is possible for an absolute majority of voters to be left without voice in the executive branch, as happened in 2016. Because the Electoral College was designed to enhance the representation of sparsely populated rural states—the number of electors equals the size of each state's congressional delegation, one for each member in the House of Representatives plus two senators for each and every state—the system aggravates the urban-rural divide that is regularly a feature of populist politics and was a feature of the 2016 U.S. campaign. It may be fun to imagine Electoral College reform, but it's hard to envisage three-fourths of state legislatures, necessarily including a number of smaller rural states, agreeing to amend this provision of the Constitution.[42]

Then there's the problem of buyer's remorse. Even if mainstream Republicans develop deep reservations about the actions of President Trump, they will hesitate to impeach him, because doing so would call into question the process through which he secured his party's nomination and therefore the integrity of the party itself. In the U.S. system, populist leaders are hard to remove once in office. A robust political system, like a driverless car, must be capable of course correction. In the United States, midterm elections that regularly produce divided government are the main course-correction mechanism. But because the president is able to appoint Federal Reserve Board members for fourteen years and Supreme Court justices for life, the course set previously may be impossible to correct.

Recent experience suggests that systems of proportional representation, as in the Netherlands, and two-stage general elections, as in France, are more robust when it comes to coping with populist insurgencies. In the Dutch system, parties are represented in parliament roughly in proportion to their share of the popular vote, ensuring a hearing for different religious and regional voices. Government is by coalition, and other parties can refuse to ally with an extremist party. The knowledge that this party will not be part of the policy-making coalition will discourage some voters from throwing away their ballots by supporting what will almost certainly be the opposition. These were the incentives that limited electoral support for Geert Wilders, his Freedom Party, and their racist, anti-Muslim message in 2017. In the French system, a large number of candidates compete in the first round, but only the two leading vote-getters proceed to the second. Even if an extremist wins a plurality in the first round, supporters of the other mainstream candidates have an incentive to unify around her rival in the second, allowing the center to hold. This was the system that hobbled Marine Le Pen in 2017.[43]

The French system isn't perfect. If the non-populist survivor is too far to the left or the right, voters from the other end of the political spectrum, whose preferred candidate doesn't make it to the second round, may fail to unite behind the non-populist alternative. Proportional representation systems similarly have drawbacks. Coalitions are fragile. Governmental turnover is high, and if elections are frequent, officials may devote more energy to campaigning than to governing. Government instability and the difficulty of making progress on policy when parliament includes many splinter groups can breed dissatisfaction with mainstream parties and leaders, and this frustration may feed support for more extreme alternatives, as in Italy in the 1920s. Minimum thresholds for parliamentary representation and hurdles to no-confidence votes, as in Germany, while helpful, do not eliminate these problems entirely.

In the end, all political systems are imperfect. But some are more imperfect than others.

# 12

# Au Revoir Europe?

that the european Union is a regular target of populist ire will hardly come as a surprise. The EU lacks what political theorists refer to as “output legitimacy.”[1] It was unable to deliver the economic goods following the global financial crisis and thus failed to amass support on the basis of results. Growth was anemic, and the deregulation and austerity endorsed by the technocrats of the European Commission, the EU’s executive branch, only worsened the problem. Its commitment to light-touch regulation and construction of an integrated financial market helped set the stage for the financial crisis. Budget cuts in countries like Greece, insisted on by the Commission and European Central Bank (ECB) as a condition for their assistance, visibly aggravated inequality. The EU’s failure to secure its external borders and then to enforce its rules requiring member states to share the refugee resettlement burden made the EU seem complicit in the immigration problem.

Thus, if economic hard times, inequality, and immigration are key triggers of populist reaction, then the EU is implicated in all three. Populists of the Right, like Hungarian prime minister Viktor Orbán, seeking to capitalize on authoritarian and nativist tendencies, could accuse the Commission and the governments of member states like Germany of weakness in the face of immigration. Orbán could inflame his followers by attacking “elite European politicians” for “deliberately bring[ing] millions of migrants to Europe,” in a not very veiled attack on German chancellor Angela Merkel, among others.[2] Populists of the Left, such as Alexis Tsipras in Greece, could accuse the institutions of Europe, meaning the Commission, the ECB, and other member states, again prominently including Germany, of insisting on policies that destroy growth while placing the adjustment burden squarely on the shoulders of the working class. The result has been that "social inequalities … soared—Greece places first on the social inequality index in Europe—unemployment tripled, wages s[a]nk, pensions suffered dramatic cuts and the welfare state literally collapsed. The only ones who did not sustain damage during this five-year period were the wealthy Greeks."[3] All this, Tsipras could allege, was the fault of the Commission, the ECB, the International Monetary Fund, and the memorandum of understanding that set out their conditions for financial assistance to Greece.

It is no coincidence, then, that these organizations, officials, and governments became the subjects of populist wrath. The ECB and the Commission are technocratic institutions staffed by experts with advanced degrees from elite institutions. The German Federal Republic has championed the European Union's fundamental values of liberal democracy, pluralism, and rule of law, making it a target for politicians with authoritarian, nativist, and nationalist tendencies. Berlin is also an advocate, for reasons rooted in German history, of conservative monetary and budget policies, rendering German officials temperamentally critical of budget-busting populist leaders—and vice versa.

The EU is equally lacking in "input legitimacy," that is, in legitimacy rooted in the process by which decisions are reached. The ECB is the least politically accountable central bank in the world. Its president regularly refuses to appear before national parliaments, whether on principle or because he would have to attend hearings of all nineteen.[4] Decisions on bailouts and debt restructuring are made through intergovernmental negotiations in which the big countries caucus beforehand and present the others with a fait accompli. Decisions by the European Commission are ratified by the European Council, the assembly of heads of state, by a two-thirds majority, where votes are weighted by country size, leaving small countries feeling that they have no voice. An example was the decision in 2016 on posted workers, which tightened rules allowing a company to send (or "post") its employees to work in other EU countries while continuing to make social security contributions in the country of origin. The parliaments of twelve smaller member states objected, but the Commission, with the support of big countries possessing two-thirds of the votes in the Council, barreled ahead.

It doesn't help that European integration has always been an elite project designed by technocrats and only then ratified by national parliaments and occasionally publics. The Single Market was an elite project. The euro was an elite project. There was broad public support, to be sure, for economic integration as a way of fostering political cooperation, with the goal of ultimately making another war unthinkable. Members of the former Soviet bloc displayed a strong desire to join the EU as a way of becoming normal European countries. That said, none of the specific economic projects of the EU bubbled up from below. None was the product of spontaneous public support. There was no mass movement to create a Single Market with free internal mobility of labor. There was no popular groundswell for replacing national currencies with the euro. In only a few cases were there referenda once leaders decided to take the plunge. When it turned out that not all Europeans benefited equally, and when some drew the conclusion that they benefited not at all, these initiatives were vulnerable to populist criticism as elite projects foisted on the people.

The elite in question, moreover, was foreign, necessarily so since it was made up of technocrats drawn from more than two dozen countries. The regulations of the Commission, promulgated in the name of Europe, could thus be attacked as ill-suited to domestic conditions. If the monetary policies of the ECB produced too little stringency for German taste but too much for that of Italians, this, it could be claimed, was because those policies were dictated by the national self-interest of officials from the other country. If their policies failed to deliver positive results, then they were construed as trampling on the will of the people.

In practice, the will of the people meant the will of the nation. Most Europeans continue to identify as French, German, or Italian nationals first and Europeans second if at all. A Eurobarometer survey in the spring of 2015 showed that 52 percent of EU residents defined themselves primarily by their nationality. Just 6 percent defined themselves first as European and second by their nationality, and just 2 percent defined themselves as European only.[5] The remaining 40 percent identified themselves exclusively by their nationality.

Common European culture, history, and economic interests are the most frequently cited factors making for a feeling of community or shared identity across EU countries. Awareness of these common cultural, economic, and historical factors is most prevalent among the well-educated and the middle and upper classes. Not only does education impart knowledge of that common history and culture, but more educated, prosperous individuals are best able to capitalize on the opportunities afforded by European integration (hence their belief in the existence of shared economic interests). The well-educated are in the best position to move in response to opportunities in other countries. They disproportionately benefit from free intra-European trade for the same reasons they disproportionately benefit from globalization. At the same time, those with less education and lower incomes are disproportionately hurt by the welfare-state cuts and austerity with which the EU is associated.

Inevitably, then, the solidarity required for effective EU policies runs up against the fact that Europeans continue to identify by nationality—they feel solidarity mainly or exclusively with their fellow countrymen. Recent events, the euro crisis and the refugee crisis in particular, only made the consequences worse. They sharpened antagonisms between member states, deepening international divisions and resuscitating old stereotypes. Greeks were irresponsible children, Germans heartless paymasters. Dutch finance minister Jeroen Dijsselbloem, in an unusual fit of candor, accused spendthrift Southern

Europeans of frittering away their money on women and drink.[6]

At the same time, Europe’s crises heightened divisions within countries, given the different attitudes the cosmopolitan elite and the working class hold toward the euro and toward refugees, and given the uneven impact of crisis policies. Recall Tsipras’s remarks about how the response to the Greek crisis prescribed by “the institutions” (meaning the Commission, the ECB, and the IMF) hurt the average citizen of his country while sparing the wealthy.

Faced with these tensions within and between countries, European leaders have been unable to decide whether to go forward, go back, or stand still. Going forward would mean deeper integration. It would entail common economic and foreign policies implemented by officials elected at the European level and held accountable by a European Parliament with teeth. Going back, on the other hand, would entail abandoning the European dream and renationalizing politics and policies. It would mean following Britain’s path. Standing still would mean gritting one’s teeth and hoping for the best, a strategy that history suggests doesn’t have high odds of success. In the spring of 2017, Jean-Claude Juncker, wearing his hat as Commission president, offered up all these scenarios and more, but, indicative of the pervasive confusion of the political class, refused to hang that hat on any one.

If there is a solution, it lies in rejecting the argument favored by populist politicians like Orbán that “more Europe” and “less Europe” are in fact the alternatives. In some cases, for example securing the EU’s external borders, actions taken—or not taken—by one country can have powerful repercussions for others. Here the choice is not between more Europe and less Europe but between more Europe and no Europe. If Greece can’t secure its borders, then Hungary will build a razor-wire fence and other countries will reinstate passport controls. Trucks will be delayed at border crossings. Trains will be stopped for passport checks. There will be no Schengen Agreement, no Single Market, and, ultimately, no Europe.

This argument, that European policy needs to be centralized or at least very strongly coordinated, can be made not just for border security but also for bank regulation, where the spillovers of one country's policies to its neighbors are powerful. It can be made for foreign and security policy, where individual European countries are too small to go it alone. Most Europeans, with the exception of the British, see the EU not so much as an engine of economic growth as a vehicle for maintaining Europe's geopolitical relevance in a twenty-first-century world where individual European countries are too small to matter.[7]

But this is another area where the EU lacks "output legitimacy," since it has failed to reassert Europe's geopolitical relevance or guarantee the security of its citizens. This last failure is especially galling to populist politicians for whom the forceful assertion of power and protection from foreign threats are the essence of politics. It thus provides an especially effective talking point for the EU's populist detractors.

In other areas, however, it is not at all clear that more Europe is needed. There's no reason why, for example, all EU member states should be required to adopt the euro. The cross-border spillovers of national monetary policies, especially those of small countries, are simply not that large. A Danish central bank that allows the krone to depreciate against the euro can make life slightly more difficult for German and French companies that compete with Danish exporters, but only slightly. We don't hear loud complaints from Berlin and Paris about Danish monetary policy, in other words. Similarly, each and every EU member state doesn't have to join the Schengen Area for the passport-free zone to function. Countries can opt in or out.

None of these points is controversial. Where there is controversy is on fiscal and refugee policies. The EU in its wisdom has decreed that there should be strong central oversight of the fiscal policies of its member states, those of euro-area states in particular. It has adopted a Stability and Growth Pact and a raft of ancillary procedures to give that surveillance teeth. Governments must submit their draft budgets to the Commission before presenting them to their national parliaments. They are subject to fines and sanctions for missing agreed fiscal targets. This approach is all but guaranteed to incite a populist reaction. Nothing is socially and politically more sensitive than whom to tax, how to tax, and how much to tax, unless it's the corresponding decisions of on whom and what to spend the money. These are national prerogatives, since it is only at the national level that the solidarity exists to raise taxes for collective purposes. EU oversight of national budgets by technocrats in Brussels is thus a chronic sore point.

This insistence on centralized oversight of budgets was adopted at German behest. It was Germany's condition for abandoning the deutschmark for the euro. Germans believe in their bones that fiscal profligacy leads to inflation. Infringing on the national fiscal sovereignty of euro countries is therefore necessary to ensure the stability of the euro and protect the ECB from pressure to inflate.

This argument, while straightforward, is shot through with holes. The ECB is governed by independent central bankers appointed to long terms in office and chosen precisely because they are more economically conservative than the average politician. For nearly two decades now, the ECB, under the guidance of these conservative central bankers, has demonstrated its price-stability bona fides, national budget deficits notwithstanding. Moreover, the aftermath of the global financial crisis was a reminder, if one was needed, that there is no one-to-one relationship between budget deficits and inflation. To the contrary, when deficits went up, inflation came down. And there was no sign of inflation exploding subsequently.

Moreover, the evidence for large cross-border spillovers of national fiscal policies is weak. The logic is straightforward. Excessive deficits in, say, France will raise spending and suck in more imports from Germany, stimulating the German economy and stoking inflation there. At the same time, however, deficits in France will drive up interest rates both at home and abroad, since the euro zone is an integrated monetary and financial area; those higher interest rates will tend to moderate German spending and inflation. Since these two offsetting effects on Germany work in opposite directions, their net effect on growth and inflation is no more than marginal. Indeed, German officials have made precisely this point when resisting calls for more expansionary fiscal policies in Germany, arguing that any positive spillovers to other euro-area countries—that is, any stimulus to spending and economic growth elsewhere—would be vanishingly small. None other than the European Central Bank has acknowledged as much.[8]

When cross-country spillovers are small but national preferences differ, the best approach is to leave decision-making at the country level. For fiscal policy, then, the appropriate reform is less Europe, not more. National parliaments and their constituents should be allowed to choose their preferred fiscal policies. Arguments from which populist politicians make hay—that the EU is the agent of austerity, that it is preventing the government from compensating the losers from technological change and globalization, and that it is violating society's inalienable right to tax and spend as it wishes—will then be off the table.

The objection to this argument is that when things go wrong, as they can when governments mismanage their finances, the results are catastrophic. Trusting each European government with its own budgetary policy is like trusting it with its own nuclear bomb. Countries like Greece and Italy have heavy debts already, leaving them little margin for error. Their banks hold government bonds, so when governments default on their debt obligations, the banking system comes crashing down. And because banks do cross-border business, what happens in Greece or Italy doesn't stay in Greece or Italy. We saw the power of this contagion and the depth of the its damage in the global financial crisis in 2008, and again when debt and banking problems erupted in Greece in 2010.[9]

But this only means that there are preconditions for repatriating fiscal policy. If the danger is that fiscal irresponsibility that culminates in debt default will topple the banking system, then banks should be bulletproofed. Specifically, they should be prevented from holding dangerous numbers of government bonds. For years, European policymakers did precisely the opposite. They maintained the fiction that government bonds were risk free. Those bonds were given zero risk weights, freeing the banks from the requirement of holding capital against them. Astonishingly, Greek government bonds received this preferential treatment even after the 2012 restructuring, when private investors were stripped of more than half the value of their holdings.[10] Banks resisted changing this rule because they would have had to hold more capital. Governments resisted because if they lost this captive market, they would have to pay more to finance and service their deficits.

But those governments would be getting something in return, namely, more control over their fiscal affairs, since this key objection to repatriating fiscal policy would be no more. Greece would no longer be subject to oppressive fiscal oversight from Brussels. Populist politicians, for their part, would no longer be able to blame foreigners for the country's dire straits.

This change should appeal to Germany as well, since surveillance by the European Commission creates an obligation to help if that surveillance goes wrong, help that ends up being footed, more often than not, by the German government and the long-suffering German taxpayer.[11] If Europe disconnects its banks from its sovereign debt market, it will finally be able to enforce its "no-bailout rule," the clause in the European Treaty specifying that member states should not be liable for the debts of other member states.[12] With banks no longer holding significant numbers of government bonds, applying this rule—which will require a government with an unsustainable debt to restructure it, instead of that government receiving an emergency bailout from other EU member states—will no longer endanger the financial system, neither the Greek financial system nor the German financial system. And then the likes of Alternative für Deutschland will no longer be able to attack the EU as a "transfer union" that exploits hardworking German taxpayers.

If responsibility for fiscal policy belongs at the national level, then a solution to the refugee problem, in strong contrast, can only be found at the EU level. Securing the EU’s external borders can only work if that border security encompasses Europe’s entire perimeter, and only if countries with exposed coastlines, including Greece and Italy, receive adequate financial and logistical support. The Dublin Regulation (so called because it was signed in Dublin in 1990) requires that applications for asylum be processed in the country in which a refugee first lands, making this a national responsibility and a national financial burden. Such a system may have been workable when refugee numbers were small, but this is no longer true. And the resettlement of large numbers of refugees will not be feasible, politically or economically, so long as only Germany and Sweden take them.

These are arguments for a coordinated response. But the reality and the constraint are that different European countries, with their different histories and identities, perceive the refugee problem differently. In the middle of the twentieth century Germany and Austria absorbed roughly 14 million refugees, mainly ethnic Germans (so-called *Volksdeutsche*) who fled or were expelled from the countries of Central and Eastern Europe in the late stages of World War II and after. This is an episode of which Germans of a certain age have firsthand recollection and about which young people learn at school. The result is a different attitude toward the refugee crisis than in countries on the other side of the postwar divide, such as Hungary, whose president has asserted, “We want no more people to come. Those who are here, go home!” and “We do not want to see among us significant minorities that possess different cultural characteristics and background to us. We would like to preserve Hungary as Hungary.”[13]

This is not to claim that there is no resistance in Germany to refugee resettlement. Nor does it imply that resettling refugees from the Middle East and North Africa will be as easy as resettling native German-speakers. But it is a reminder of how differences in history, culture, and policy preferences complicate efforts to mount a coordinated response.

The European Commission's initial attempt to organize that response, the European Agenda on Migration in September 2015, was not well received. It created a mandatory distribution formula based on the population of member states (with a weight of 40 percent), their GDP (40 percent), their unemployment rate (10 percent), and their number of past asylum applications (10 percent). Members were promised lump-sum transfers of €6,000 from the EU budget for each refugee taken. Only under exceptional circumstances like natural disaster could a country opt out, in which case it was required to make a contribution to the EU budget of 0.002 percent of its GDP.[14] Orbán, it is fair to say, was not pleased. It's comforting to imagine, as the Commission apparently does, that all European countries will adopt the same welcoming posture toward refugees. But the reality is that attitudes rooted in national histories will continue to differ.

Rather than abandoning the effort to mount a European response to a European problem, better would be to strengthen incentives. If countries want to limit resettlement, they should be required to pay generously. If other countries absorb a larger share of the refugee population, then they should receive significantly more than the measly €6,000 of the Commission's action agenda.

Agreeing on a formula won't be easy. But in a Europe of member states whose preferences differ, there has to be a formula that is superior for all concerned to the Commission's one-size-fits-all policy. Critics may regard bargaining over refugee resettlement as unsavory and insist that countries should display the solidarity to accept refugees according to their capacity purely on humanitarian grounds. That, unfortunately, isn't the actual, existing Europe.

Viewing the issues this way leads, then, neither to more Europe nor to less Europe but to a different Europe. On some issues, such as the Single Market and securing Europe's external borders, all member states will have to work together to achieve acceptable results, and their efforts must be coordinated. On other issues, including the euro and the passport-free Schengen zone, some countries will be in while others can remain out, both to their mutual satisfaction. And on still other issues, like fiscal policy, the relevant competency can reside entirely with the nation-state.

Note that this is not the two-tier Europe advocated by Eurofederalists like now former German finance minister Wolfgang Schäuble, in which an inner core of committed countries speeds ahead to deep economic, financial, and political integration while an outer ring of more cautious countries, still jealous of their national prerogatives, initially remains behind. Once upon a time there may have been a logic for this two-speed Europe. When Schäuble originally advanced this idea in a white paper written for Germany's Christian Democratic Union in 1994, it was possible to imagine that Europe would consist of a deeply integrated inner core centered on France and Germany, surrounded by the rest.[15] But today Schäuble's vision lacks a functional logic. Degrees of integration overlap: they do not break down into an inner core and outer ring. Not everything must be deeply integrated: the logic for a single fiscal policy run from Brussels is no more compelling than the logic for a single European language. This vision of a two-tier Europe also elicits strong opposition from Eastern European countries and other reluctant integrationists, which fear becoming second-class members.

Fortunately, there is no need to divide Europe into "ins" and "outs." Groupings for different areas may overlap, but they need not coincide. In fact, this is already the case: Denmark is in the Schengen Area but outside the euro zone, while Ireland is in the euro area but outside of Schengen. All countries that have adopted the euro participate in the EU's banking union, since monetary union without banking union will not work, but not all countries that are party to the banking union have adopted the euro or will necessarily do so. This may not be the forced march to economic, financial, and political union envisaged by dyed-in-the-wool Eurofederalists, but it is a way of preserving the fruits of European integration while acknowledging that national identities exist and preferences continue to differ.

Once upon a time, this model of overlapping groupings was sufficiently fashionable to have a name: it was called “flexible integration.” That phrase, curiously, seems to have fallen from fashion: Google’s Ngram Viewer, which tracks mentions in books, shows that references to the term peaked in 2000, around the time of the euro’s creation, but declined subsequently.[16]

That the concept fell by the wayside is not coincidental. Its champions couldn’t figure out how to structure a political system to hold those responsible for formulating these different policies accountable for their actions. They couldn’t figure out how to ensure the legitimacy of the policymaking process and satisfy citizens in different countries that their voices were being heard. If, for example, residents of the Schengen Area were unhappy with the operation of their passport-free zone, because some participating members were not adequately securing their borders, then it was not clear to whom exactly they should complain and how to get satisfaction. And the more overlapping clubs the EU created, the more opaque and complicated this process became, and the less satisfactory the results.

One conceivable mechanism for accountability is the European Parliament, and there have been many calls over the years for strengthening its powers. The Parliament could be given the power to initiate legislation, an agenda-setting prerogative that currently resides with the Commission. The range of Commission proposals and directives requiring approval by the European Parliament could be expanded; presently, most EU legislation is adopted via a procedure under which the Commission must only consult with the Parliament, and the latter has only the power of delay.[17] In the limit, all directives issued by the Commission could be required to receive the support of two-thirds of members of Parliament, or of the members of the relevant subcommittee, as opposed to just the support of the heads of state and government of countries holding two-thirds of the votes in the Council.[18] All Europeans would then have a voice in EU decision-making, insofar as all significant parties have members in the European Parliament—as opposed to the current situation, where only voters who supported the national head of state, or the coalition standing behind her, have a voice.

But strengthening the Parliament is harder when the policy domain is made up of a crazy quilt of countries that have agreed to pool their national prerogatives in some areas but not others. Why should the representatives of countries that have not adopted the euro vote on the appointment of the president of the ECB, for example? Why should countries that are not party to the Schengen Agreement have the right to approve decisions on how much additional intelligence and security information is shared by its members?

Thomas Piketty has suggested creating a second parliament—call it an assembly—made up of the representatives of countries adopting the euro.[19] That euro-area assembly would vote whether to restructure Greece's debt, extend a bailout loan, or attach specific conditions to financial assistance, decisions currently taken behind closed doors by the finance ministers and heads of state of the principal European countries. Members could be drawn from the European Parliament, directly from national parliaments, or, as Piketty suggests, from a combination of the two.

This is at best a partial solution, since it harks back to the antiquated vision of a two-tier Europe with a deeply integrated inner core, whose members are represented in the assembly and Parliament both, and the rest, whose representatives sit only in the Parliament. It equates deep integration with the euro, when in fact deep integration means different things to different people in different countries. To many Europeans, it means a common security and foreign policy, not a common monetary and fiscal policy.[20] And this approach assumes that national parliamentarians, who are generally preoccupied by other things, have the bandwidth to participate in this euro-area assembly. It imagines that national parliaments will reorganize their deliberations to enable their delegated members to attend.

In fact, the EU tried this before, in its first quarter century of existence, and the shortcomings of an assembly of national parliamentarians were what led to the creation of a separately elected parliament in 1979.[21] Going back to a European Parliament of appointed or nominated national representatives would ignore this history. It would be like the United States going back to the system of state legislative appointments under which the U.S. Senate was constituted before 1913. Returning the power to select members to national parliamentarians rather than giving this right to the voters is the opposite of what is needed.

Better would be to work within the framework of the already existing European Parliament. The Parliament could be given enhanced powers over, say, euro-related matters, but only parliamentarians from euro-zone countries would have the right to deliberate and vote on that subset of questions. A different subset of members, again from the participating countries, would have the power to vote on Schengen-related matters, and so forth. The Parliament would channel the voice of the people, rendering the technocrats of the Commission, the ECB, and other EU institutions democratically accountable, but only the voice of the relevant people—citizens of those countries that agreed to cede national prerogatives on the issue in question.

Critics of the European Parliament will object that it isn't capable of providing the democratic accountability for which Europeans hanker. Voters don't pay attention to the Parliament; turnout in European elections is rarely above 50 percent. Members do their business far removed from their constituents and are known mainly for their lavish expenses and for shuttling between their legislative homes in Brussels and Strasbourg. But if the Parliament had more power to initiate legislation and approve or reject directives and other decisions directly affecting the people, voters would have more reason to pay attention. They would have an incentive to elect members who more effectively represent their interests.[22]

A more radical step would be direct popular election of the head of the Commission. Under the provisions of the Lisbon Treaty, adopted in 2009, a candidate for president of the Commission is selected by heads of state from a slate of candidates put forward by the major political groupings, after which he is confirmed by the European Parliament.[23] This process puts two layers of separation between the people and their president. The distance between the Commission and the people would be less if its president was chosen by the voting public. If border security, national defense, and foreign policy become important EU competencies, these being the areas where European citizens, when polled, think the EU can make a difference, then the Commission will necessarily acquire additional decision-making power, since defense and security decisions have to be made quickly by an executive. With increased powers, it will then be important for that executive to be directly accountable to the voting public.

Skeptics will contend that no candidate can campaign in twenty-seven member states (although candidates for the American presidency campaign in most or all of the fifty U.S. states). They will object that linguistic obstacles make it difficult for such candidates to effectively communicate with their constituents (although translators both human and mechanical exist).[24] But the fact that Europeans expect the EU to deliver on border security, defense, and foreign policy means that in order to recapture and maintain widespread public support, the EU is going to have to create the more powerful executive that will be needed to effectively carry out these policies and act decisively when needed. And with power must come accountability. If EU members are serious about narrowing the gulf between their executive and the people, they will have to move to direct election of that executive.

Will this political reengineering be enough to beat back the populist insurgency threatening Europe? In politics there are no certainties. But an important prerequisite is to reject the vision of a one-size-fits-all Europe and, equally, the idea that two sizes fit all. Countries that are especially jealous of specific national prerogatives will be reassured by their ability to opt out of European policies in those delicate issue areas. Voters in those countries will then be less inclined to lend their support to a party or leader critical of the European project. It can only help to give the European Parliament strengthened powers to hold the EU's technocrats democratically accountable. Those who complain that the elites take key policy decisions behind closed doors, without due regard for the wishes of the people, should be assuaged.

Will this be enough? Maybe not. But it's a start.

# 13

# Prospects

this comparison of populism in the United States and Europe leads inevitably to the question of which countries are most immediately at risk. At one level the answer is clear: the United States. The United States glorifies income disparities. With a culture that celebrates the entrepreneur and decries government intervention, it does little to restrain market forces. But at the same time as it encourages creative destruction, it provides little assistance to the casualties of what is destroyed. It insists that workers displaced by globalization and technical change should fend for themselves and leave government out of it. When times are tough, this mix of policies and attitudes is all but guaranteed to produce high anxiety about income security, discomfort about prevailing levels of inequality, and anger at the political class.

In part these attitudes are a product of the distinctive American ideology of individualism and market fundamentalism. As the *New York Times* observed midway through the first year of the Trump administration, candidate Trump cited Ayn Rand, the objectivist avatar of individualism and market fundamentalism, as his favorite author, and her 1943 book, *The Fountainhead*, as his favorite novel.[1] Howard Roark, Rand's protagonist in *The Fountainhead*, is a determined individualist, one of the "exceptional men, the innovators, the intellectual giants … not held down by the majority."[2] The last six words are key. As Rand once put it, "Man exists for his own sake" and "must not sacrifice himself to others, nor sacrifice others to himself." So much, one might say, for helping one's brother. So much for collective goods. So much for trade adjustment assistance and social insurance.

Ideology doesn't exist in a vacuum, of course. This distinctively American antipathy to government and championing of individualism have material roots. The hostility of early Americans toward government was a reaction against the Navigation Acts and other economic impositions by the English on their North American colonies. Their exaltation of individualism stemmed from an abundance of natural resources and the safety valve of the frontier, which made it possible, in actual fact, for many Americans to lift themselves up by their bootstraps. Doubts about the efficacy of public programs reflected the limited bureaucratic capacity of a federal government that, after the War of 1812, never faced an existential threat from abroad and was never confronted with a national-defense imperative to develop its administrative competency. They reflected the corruption and patronage that grew up in the absence of that bureaucratic capacity, against which late nineteenth- and early twentieth-century Progressives inveighed and which fed popular skepticism about the ability of public policy initiatives, however well intentioned, to solve social problems.

Resistance to federal government intervention also reflected the country's historic division between black and white and between North and South. From Reconstruction through the civil rights movement, southern businessmen and farmers opposed federal government involvement in the economy for fear that it would compromise control of their black labor force. In the 1930s they opposed New Deal programs out of concern that these would interfere with their established way of doing business and the prevailing social order. White southerners were not opposed to the decentralization of social programs or to receiving federal matching funds so long as the design or at least the administration of those programs devolved to the states. Such devolution was consequently a legacy of the New Deal, one that endures even today, for example in the power of states to decide whether to expand Medicaid to cover low-income households under the Affordable Care Act, or Obamacare.

In practice, those individual states, acting on their own, can go some way toward addressing their residents' concerns over economic insecurity and inequality, but only some way. Smaller states, especially, find it hard to independently organize and fund retraining and relocation schemes for displaced workers or to impose additional taxes on high earners with the goal of leveling the income distribution, since such states constitute only a small part of a larger national market. Meanwhile, suspicion of and therefore opposition to federal social programs remain intense. For an America with this inheritance, the challenge of organizing adjustment assistance and compensating the casualties of globalization and technical change is daunting.

This same history of division works in still other ways to limit the willingness of Americans to fund collective goods, including social and economic insurance, as emphasized in Chapter 1 and elsewhere in this book. As the sociologist William Julius Wilson put it, "Many white Americans have turned against a strategy that emphasizes programs they perceive as benefiting only racial minorities. … [W]hite taxpayers saw themselves as being forced, through taxes, to pay for medical and legal services that many of them could not afford."[3] And what is true of racial diversity is true also of the ethnic and religious diversity that, in other respects, is a strength of the United States but which makes it more difficult to contemplate income redistribution, to provide public goods, and specifically to organize social insurance against economic insecurity, given lack of solidarity and the belief that the benefits of such programs accrue to others.

From this perspective, the contradictory nature of populism in the United States is no anomaly. People displaced by globalization and technical change are distressed about not sharing in the benefits of an expanding economy and by their government's failure to do more about it, leaving them susceptible to the siren song of populism. But their views are also informed by an ideology that tells them government is the problem, not the solution. One can't help but think of the constituent who allegedly warned Representative Robert Inglis of South Carolina, at a town hall meeting, to "keep your government hands off my Medicare," not realizing that Medicare was a government program. Herein lies the appeal of Donald Trump, who gives voice to the anger of the masses over their economic condition and the failure of government to address their problems, all in the manner of a populist, but who also opposes more spending on social insurance, more trade adjustment assistance, and higher taxes on the rich, all in the manner of a committed Randian. This is not a combination that bodes a happy ending.

Viewed through this lens, Europe has a number of advantages in seeking to beat back the populist threat. From Jean-Baptiste Colbert to Otto von Bismarck, Europeans have more freely acknowledged the role of the state in managing the economy. Industrial policy (*planisme* in French) is not a dirty word. Public policies to address issues of distribution have always been regarded as legitimate instruments of the state. Hostility to government intervention in the economy is not intrinsic to the European psyche. For all these reasons, Western Europe went further than the United States in the direction of the mixed or managed economy after World War II. To be sure, Europe is far from immune to neoliberalism. It has deregulated its markets. It has opened its economy to trade with the rest of the world. It has encouraged technical change and, in some cases at least, has allowed leading domestic firms to go under. But it has always gone further than the United States in acknowledging the role of government in managing economic change. As a result, most Europeans do not share the instinctual aversion of Americans to public programs offering trade adjustment assistance to displaced workers and training to the technologically unemployed.

Again, these are attitudes in which ideology plays a role. Social democracy as an economic, social, and political philosophy stretches back to the foundation of the German Workingmen's Union and the Social Democratic Workers' Party in the 1860s, as described in Chapter 4. While social democracy means different things to different people, one definition is an ideology that supports economic and social policy interventions intended to promote equality and social justice, including active labor market policies and redistribution, to be implemented by the state within a framework of market economy and representative democracy.[4] This idea that the fundamental goal of policy is to regulate the economy in order to correct its visible defects and alter the distribution of income in ways that make for solidarity and social justice is not something that is spoken out loud by the leaders of either U.S. political party, much less by their more Randian followers. It developed in Europe as an alternative to more radical working-class movements hostile to the market economy and to representative democracy, notably revolutionary Marxism—movements that never gained the same foothold in the United States. It was an effort to get European societies to pull together in order to avoid splintering apart.

Christian Democracy, also with origins in the mid-nineteenth century, is more fiscally and socially conservative and less enamored of an expansive economic role for the state.[5] But it also rejects individualism—again, contrast the United States—while privileging social consensus and, consistent with Catholic theology, solidarity with the weak. It thus supports state intervention to advance economic justice.[6] Again, this is not exactly a core philosophy of either U.S. political party.

In Europe too, these ideologies have material roots. The European continent is made up of a patchwork of small and medium-sized economies, not even the largest of which, Germany, approaches the continental reach of the United States. Small countries exposed to world markets are by their nature vulnerable to economic (and other) shocks from outside. They need government to buffer the effects, which is why they typically have large and active public sectors.[7] They face the imperative of having to adjust quickly—they need different social groups to pull together—which is why they have a history of national solidarity pacts, some stretching back to the 1930s, as described in Chapter 7.[8] In parts of Europe, like the Nordic countries, they have the advantage of relatively high levels of ethnic and religious homogeneity, limiting us-versus-them politics and easing agreement on the provision of social insurance and adjustment assistance. In other cases they have developed institutions and understandings, like the so-called Polder Model of political decision-making in the Netherlands, that acknowledge ethnic and religious differences but emphasize the importance of compromise and consensus.[9]

Finally it can be argued, as in Chapter 11, that European political systems are less susceptible to capture by populists and other dangerously out-of-the-mainstream politicians. This having happened in the 1920s and 1930s, electoral systems were restructured to prevent it from happening again. The United States avoided the shock of extremist capture, which was good, but it also avoided the subsequent process of political and electoral reform, a consequence that is not so happy.

To all these generalizations there are, of course, exceptions. Eastern European countries are in many respects exceptions. Collectivism and certain forms of government intervention have a serious taint in the region as a result of its half-century-long experience with Communism. The exposure of these countries to democratic political systems and their checks and balances is relatively recent. Their parliaments and courts, being young, and their media, being new, do not always restrain leaders with autocratic and authoritarian tendencies. Respect for individual rights, for different ethnicities, and for religious minorities is not always strongly informed by the lessons of the 1930s, insofar as successive post–World War II generations enjoyed an intellectual holiday from that history in the years of communist rule. Nor do dim recollections of that history delegitimize aggressive nationalism and hostility toward foreigners and minorities when these are used as rallying points by populist leaders, at least not to the same extent as in, say, Germany. Here we have Viktor Orbán's Hungary and Jaroslaw Kaczyński's Poland in a nutshell.

The United Kingdom is another exception. Britain never developed social democracy in the classic European mold.[10] To be sure, like other European countries it moved a long way in the direction of the welfare state and the managed economy after World War II. But starting in the 1980s, in response to a long period of singularly poor economic performance widely blamed on those same governance arrangements, it moved sharply back the other way. Under the leadership of Margaret Thatcher, it moved faster and further in the direction of deregulation, privatization, and welfare state retrenchment than other European countries. It responded similarly, with exceptional public spending cuts, to the financial crisis of 2008–2009, to the point where it now has one of the lowest levels of general government expenditure as a proportion of GDP of any advanced economy, limiting the scope for funding social insurance programs. It has a history of adversarial labor relations and is a kingdom of English, Welsh, Scots, and Irish, facts that complicate efforts to reach a consensus on social issues.

Finally, the United Kingdom, it can be said without threat of contradiction, displays more than the usual level of ambivalence toward the European Union. This reflects its position as an island, its historical status as a global power, and its supposed special relationship with the United States. This ambivalence means that when anti-elite, anti-immigrant, and nativist sentiment—that is to say, populism—rears its head, the resulting rancor is likely to be directed at the EU. But while Brexit satisfies these base instincts, it doesn't obviously provide a way to simultaneously control immigration, maintain the country's privileged access to European markets, achieve a faster rate of growth, and attack problems of economic insecurity (by, for example, magically increasing funding for the National Health Service, as the Brexiteers promised). Again, this is not a combination of circumstances that looks to end well.

More generally, Brexit points to Europe's gravest populist vulnerability, namely, lack of trust in the European Union. When asked by the European Social Survey in 2014 to rate their trust in the European Parliament on a scale of 0 to 10 (where 0 meant no trust at all and 10 meant complete trust), 12 percent of European respondents answered 0, and more than two-thirds returned a rating of 5 or below, which does not exactly indicate a favorable reaction. There is a strong correlation between lack of trust in the European Parliament and negative views of European integration, on the one hand, and support for populist parties in national elections, on the other.[11] The EU is, inevitably, a rich populist target. European integration has always been an elite project. The EU's most consequential institutions, the European Commission and the European Central Bank, are directed by technocrats. As a union of many countries, it is necessarily dominated by foreigners. It champions political freedom, transparency, and human and minority rights. Having started life as a customs union, it is inextricably linked to free trade and foreign competition. Because of the Single Market, it is associated with the right to immigrate in order to work, and therefore with all the economic and cultural concerns posed by immigrants. It is seen as subjecting national economies to a vast array of regulations not well suited to local circumstances, regulations that typify the loss of control felt by residents of once but no longer powerful nations.

In all these respects, then, the EU is readily portrayed as riding roughshod over national values, and over the national sovereignty needed for those values to be upheld. It is seen as a champion of globalization and cosmopolitanism and the enemy of national control. Here we have the platform of Marine Le Pen, steely leader of France's National Front, in short compass. "The EU world is ultra-liberalism, savage globalization, artificially created across nations," as she put it a BBC interview in February 2017, concluding, "I believe this world is dead."[12] Her party's 144-point election manifesto centered on a vow to restore "monetary, legislative, territorial and economic sovereignty," code for beating back interference by the EU and limiting the presence and influence of foreigners.[13] Le Pen vowed to pull out of the Schengen Agreement and create a 6,000-person-strong border control unit, and proposed in addition a phalanx of new rules affecting immigrants, foreigners, and followers of Islam, all at odds with EU norms. These would have limited legal immigration to ten thousand people a year and insisted on the immediate and obligatory deportation of illegals. They would have prohibited companies in other EU countries from sending their employees to work in France while paying social charges at home. They would have eliminated automatic naturalization for spouses and required French citizenship to be either inherited or "merited," a thinly disguised purity test if there ever was one. Le Pen vowed to end free education for the children of undocumented immigrants. "Playtime is over" was how she winningly described the idea. Her National Front's election manifesto would have restricted the use of foreign languages in schools. It would have banned radical Islamic groups and closed extremist mosques. It would have prohibited all wearing of veils in public.

While Le Pen did everything she could to distance herself from her father, Jean-Marie Le Pen, the founder of the National Front, and from his history of racist, anti-Semitic remarks, it was not hard to see the true targets of her proposed directives. These were the "external menaces" that had featured so prominently over the years in National Front rhetoric. They were immigrants from other continents, specifically immigrants of different races and religions who could be portrayed as not suitably French. They were the nationals of other EU countries, primarily the nationals of Eastern European countries, where wages and social charges were low. And they were the fundamental values of the European Union.

Le Pen's other economic proposals attacked the EU and its integrationist project directly. She promised to repudiate EU laws banning national preference in public procurement, while prohibiting foreign investment in strategic industries and protecting French companies damaged by "unfair foreign competition." She proposed replacing the EU's Common Agricultural Policy with a new French agricultural policy and "supplementing" the euro, whatever that meant, with a new French currency. She advocated adding to the French constitution a formal "national preference" for French citizens in hiring, housing, and social benefits, thereby institutionalizing discrimination against foreign nationals, including those of other EU member states. As the capstone, she proposed a referendum on EU membership within six months of taking office, raising the question of France's continued participation in the European project.

In the end, Le Pen failed to carry the day in France's 2017 presidential campaign. The opponents of her extreme brand of populism rallied around the other finalist, the pro-EU Emmanuel Macron, who rode to victory in the second round of the election. Reassured, many so-called experts declared that the wave of anti-EU populism in Europe had crested. One may ask whether their happy conclusion was premature. In a Europe where national histories differ and continue to shape national attitudes—and politics—in distinct ways, and where the majority of citizens identify first by their nationality and only secondarily, if at all, as European, tension between these mixed allegiances is unavoidable. While the EU is not going away, neither are populist attacks on its policies and its legitimacy.

Where, then, is vulnerability to a populist reaction most acute, in Europe or in the United States? The answer, unavoidably, is both. In both places, that vulnerability has deep historical roots. The individualism and the antipathy toward government that complicate efforts on the part of Americans to formulate public policy responses to problems of insecurity and inequality, giving populists fodder, have origins in the nineteenth century and earlier. In Europe, three wars in a century have made the EU and some pooling of sovereign functions an established fact, one that, Brexit notwithstanding, is not going to be undone. But that fact coexists uneasily with durable national identities and therefore with the desire for a significant degree of national policy autonomy, something that in turn will continue to empower anti-establishment, anti-EU politicians, including those of an extreme, Islamophobic, Marine Le Pen–like bent.

In neither case do the resulting problems admit of easy solutions. But understanding the problem is at least a start.

# Notes

## Preface

1. Max Weber, "Die drei reinen Typen der legitimen Herrschaft," *Preussische Jahrbücher* 187 (1922): 1–12. Republished as "The Three