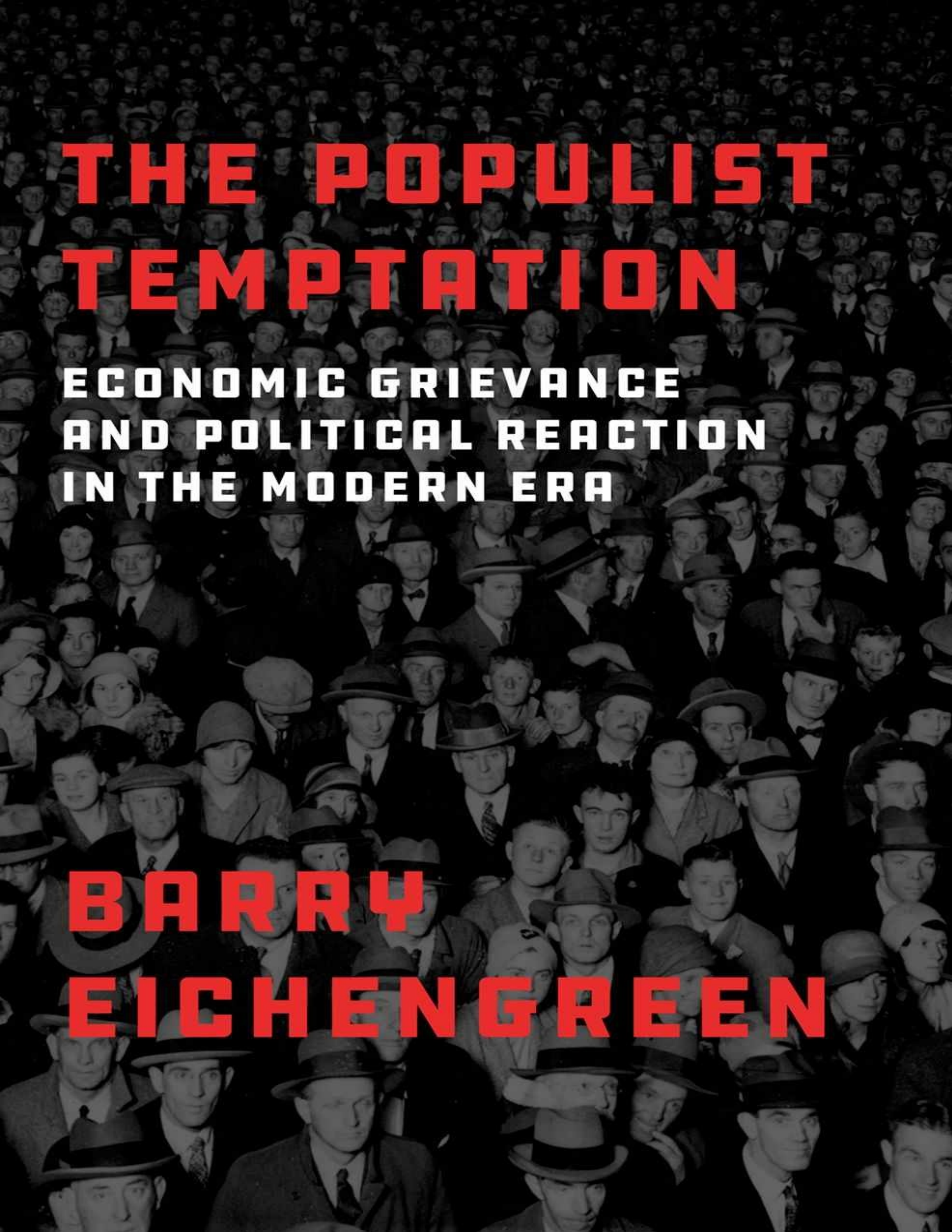

THE POPULIST TEMPTATION

ECONOMIC GRIEVANCE AND POLITICAL REACTION IN THE MODERN ERA

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7

The Age of Moderation

seen in the rearview mirror, the third quarter of the twentieth century looks like a golden age of political moderation. The period was not without its populist firebrands, from Pierre-Marie Poujade in France to Enoch Powell in Britain and George Wallace in the United States.[1] No doubt it felt less moderate to those who lived through it. The perception of an earlier era as a utopia of economic stability and political equanimity is something to be guarded against, especially by those whose untroubled childhoods coincide with the period.

Still, figures don't lie. The vote shares of extreme left-wing and, especially, right-wing parties across twenty advanced economies (the United States, Canada, Australia, Japan, and sixteen European nations) were lower in the third quarter of the twentieth century than before 1939 and after 1975.[2] No anti-system party, defined as one actively seeking to subvert the established political system, formed a government. No charismatic leader flaunting the three key populist traits—anti-establishmentarianism, authoritarianism, and nativism—actually took office.

This is not to deny that governments sometimes lost votes of confidence. Parliaments could be fragmented into many party groupings, complicating efforts to form stable coalitions. Street protests indicated the frustration of those unable to make their voices heard through conventional channels. Recall the events of May 1968 in France and the demonstrations at the 1968 Republican National Convention against the Vietnam War. Not everyone was satisfied by the political status quo or prepared to work for change by conventional means. That said, the traction of anti-system parties and politicians, as judged by votes garnered and offices held, was unusually low.

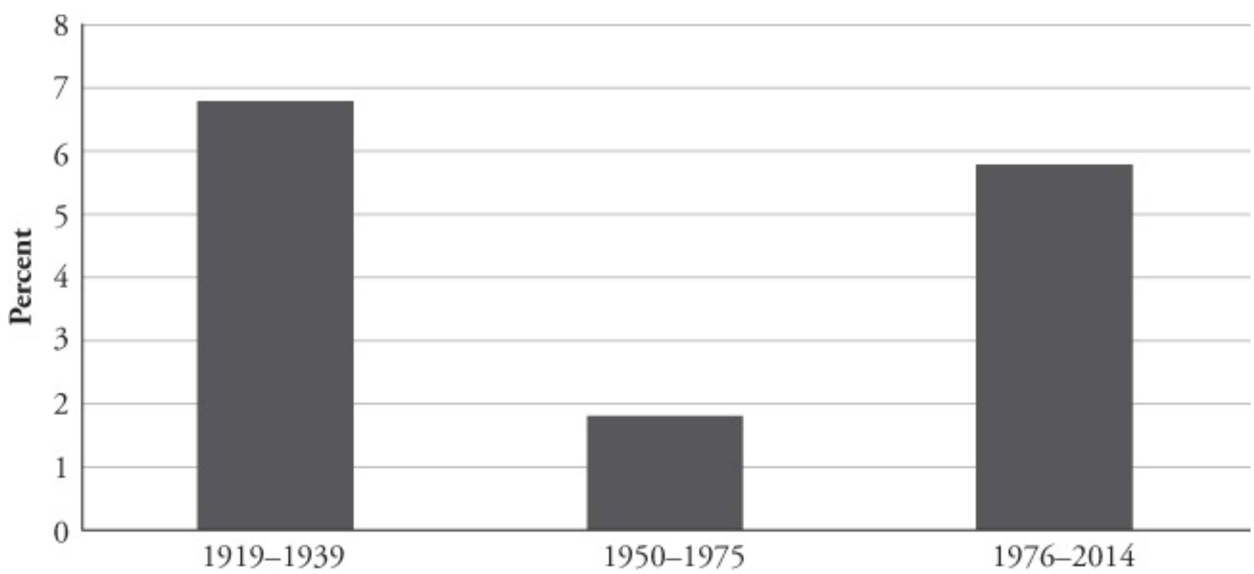

Figure 7.1 Average Vote Share for Far Right Parties in Twenty Democracies, Three Periods

Source: Author’s calculations, based on Manuel Funke, Moritz Schularick, and Christoph Trebesch, “Going to Extremes: Politics After Financial Crises 1870–2014,” *European Economic Review* 88 (2016): 227–260.

A combination of factors accounts for this peculiar state of affairs. Most obviously there were memories of extremism gone wrong. In countries like Germany and Austria, those memories now delimited the politically acceptable. Nativism that spilled over into hate speech was unacceptable. Nationalism encouraging militarism was unacceptable. Government would be by a rules-based system that constrained elected and appointed officials. In Germany, these ideas coalesced into the doctrine of "ordoliberalism," a body of economic and social thought emphasizing rules as the basis for an orderly society, as barriers to intervention in the economy by grasping government, and as obstacles to arbitrary action by a charismatic leader. This is a doctrine that continues to shape German thought and policy down to the present day, as noted by critics of the country's cautious approach to the euro crisis.[3]

This postwar consensus on the limits of acceptable political thought and action was embedded in the constitution of the German Federal Republic (the Basic Law) and its Civil and Criminal Codes. Hate speech (*Volksverhetzung*, literally "instigation of the people") was punishable by imprisonment under Section 1 of the Criminal Code. Although Germany was no longer prevented after 1955 from raising an army, and restrictions on its military vanished with German reunification in 1990, self-imposed restraints on the foreign deployment of German forces remained in place, something that is still the case today.[4] These can be changed only by a two-thirds vote in the Bundestag (the legislative lower house) and a majority vote in the Bundesrat (the upper house). These self-imposed restraints merely formalize what was already understood about the limits of the permissible.

To be sure, even West Germany had its extremists. Reactionary nationalists began forming political groups in the American and British zones of occupation almost immediately following the cessation of hostilities.[5] By 1949 the Socialist Reich Party, or SRP, a radical nationalist splinter group with fascist tendencies, was prominent in northwest Germany. But the party's high-water mark came in 1951, when it polled 11 percent of the vote in Lower Saxony's state elections. Its vote share was highest where unemployment was worst. Ultimately, however, the SRP was unable to broaden its appeal, in part because the German economy was doing better. In 1952 the government then invoked Article 21 of the Basic Law, which banned political parties seeking to undermine the democratic order, dissolving the party and seizing its assets. The SRP had few hard-right successors of consequence.

At the other end of the spectrum, the German Communist Party never developed into a mass political movement because of its rigid allegiance to Marxism-Leninism and its association with Soviet authoritarianism. It was banned by the Constitutional Court in 1956. Its successor, the ideologically less hard-line League of Germans (BdD), fared little better. The German Peace Union (DFU), founded in 1960, attracted Communist front members but few others and rarely polled more than 2 percent of the vote.

With time, memories faded and the Third Reich's atrocities no longer discouraged support to the same extent for political parties and movements espousing nativist and nationalist sentiments. Memories of the brutality of the Soviet army no longer deterred militant far-left groups such as the Baader-Meinhof Group (subsequently the Red Army Faction) from bombings, kidnappings, and assassinations.[6] But so long as those wartime memories were still fresh, as they were in the 1950s and even the 1960s, they worked to suppress radical tendencies.

Political reform further limited the operating space of anti-system figures and parties. Countries with electoral systems of pure proportional representation that had previously experienced high levels of parliamentary fragmentation now imposed thresholds, typically 5 percent of the vote, to be exceeded before a party gained parliamentary representation. In Germany a party had to attract a minimum of 5 percent of the vote nationwide or else had to win at least three directly elected provincial seats. New parties with a significant following could still gain representation, but small splinter parties were excluded, making it easier to form a coalition.

Under the new German federal constitution, moreover, the chancellor could no longer be dismissed by a simple vote of no confidence, only by a "constructive vote" that included majority support for another candidate. This provision was designed to avoid the kind of revolving-door leadership that had bedeviled Weimar. So it did: there were no constructive no-confidence votes between the adoption of the new constitution in 1949 and when Helmut Schmidt was voted out in favor of Helmut Kohl in 1982. The same change was adopted by other countries that drew the same conclusion, for example Belgium.

At the time, these changes did not entirely preclude the formation of parties and movements with views far out of the mainstream. Nor have they prevented the rise of new extremist parties in recent decades. But the practical appeal of such parties was less, insofar as supporting them was tantamount to throwing away one's vote unless one was convinced that others would vote likewise. The ability of their representatives, even when elected, to disrupt the government by supporting a no-confidence vote was less, insofar as they were unlikely to agree on a constructive alternative.

The Cold War further suppressed support for radical anti-system parties. The Soviet threat raised the value of national solidarity and undercut support for hard-left Communist parties taking instructions from Moscow. The United States had troops stationed in Germany, and its financial support was needed for postwar reconstruction. The United States conditioned its assistance to France and Italy on the expulsion of Communist parties from their governments. Voters in these and other countries drew the obvious conclusion: U.S. aid was predicated on their own electoral support for centrist politics.

Then there was the favorable economic performance of the advanced economies after World War II. Not for nothing was the 1950–1973 period known as a golden age of economic growth.[7] In Western Europe, real GDP per capita rose by 3.8 percent per annum, nearly four times as fast as in 1913–1950 and at more than twice the rate of 1973–1993. Living standards in the United States grew more slowly, by 2.5 percent a year, but even this was a significant acceleration.[8] Japanese growth, approaching double digits, was the most miraculous of all. In all these places, there was less reason to attack the economic status quo when that status quo was delivering the goods.

In a sense, the postwar growth miracle was not all that miraculous; it was just a matter of making up lost time. Investment had been depressed in the 1920s and 1930s. War did not favor the consumer goods industries that were the drivers of demand in the second half of the twentieth century. Avoiding a repetition of earlier disasters allowed countries to exploit the resulting backlog of investment opportunities. Investment rates after World War II were half again as high as they had been between 1913 and 1950.[9] The United States had leapt ahead in developing mass production methods, with Henry Ford's moving assembly line, the reorganization of production to take advantage of electric power, and wartime mobilization of industry. By investing in these same technologies and methods, Europe and Japan could now follow its lead.

The roots of modern mass production in the United States stretch back further to the country's pioneering development of the large corporation in the second half of the nineteenth century.[10] As a result, by the end of World War II a very considerable gap had opened up between Europe and America that could now be closed by straightforward investment in technology and organization.[11] Europe had a literate and numerate labor force. It had apprenticeship and vocational training to equip workers with the skills needed to implement American technologies. It had labor to draw out of underemployment in agriculture and be put to work in manufacturing, the movement of smallholders from southern Italy to the Fiat factories of Turin being a classic case in point.[12] Germany had refugees from the East to work in its expanding industrial sector. Between 1947 and 1950, nearly a million people of German and Polish descent, many with prior industrial experience and in their prime working years, moved from

Eastern to Western Europe.[13] And the countries of the Continent now had stable political institutions to reassure investors.

Producers, for their part, had access to American know-how, from the multidivisional corporate form to modern personnel management practices and numerical inventory control, all aspects of the scientific management revolution associated with the efficiency expert Frederick Winslow Taylor. Multinationals like the Ford Motor Company, which invested heavily in Europe, provided a vehicle, as it were, for transferring this knowledge. European labor and management gained exposure to American techniques on productivity missions sponsored by the Marshall Plan. What they encountered in the United States they brought back and adapted to local conditions.[14] American business and trade union representatives traveled to Europe to spread their "gospel of productivity."[15] Under other circumstances the Americans might have attempted to husband their technical and organizational secrets. But they understood that extraordinary steps to boost European productivity and security were warranted by the circumstances of the Cold War.

Though the technological and organizational backlog was least in the United States, American economic growth accelerated as well, as we have seen. The 1940s were the decade with the most rapid increase in four-year college graduation rates, courtesy of a GI Bill enabling veterans to attend college at federal expense.[16] More education meant more literacy and numeracy, enhanced analytical skills, and greater facility in operating complex machinery in factory and office.[17]

On the capital side, there was continuing investment in electricity and the assembly line. Electrically generated horsepower in American factories rose by 70 percent between 1940 and 1950. These investments constituted a significant increase in the quality of the capital stock, commensurate with the increased quality of labor. And not only was there higher-quality investment, there was more investment, not just in general but in industry in particular. Investment in producers’ durable equipment as a share of GDP was half again as high in 1948–1957 as in the 1930s (6.2 percent of GDP as opposed to the earlier 4.1 percent).

Finally there was government, which had invested in machine tools and other equipment used by American industry as part of the war production push. Now it invested in the Interstate Highway System, allowing manufacturing to cluster in advantageous locations and its output to be distributed nationwide. This allowed full realization of the efficiency advantages of mass production, the internal combustion engine, and trucking.

Growth, besides being faster, was also more stable. The European economy expanded steadily in the 1950s and the first half of the 1960s, the only interruptions of note being mild recessions in France in 1957–1958 and Italy in 1964–1965.[18] GDP growth was only half as variable as it would become in the 1970s and 1980s.[19] Although the United States experienced mild recessions in 1954 and 1958, U.S. growth was steady as well.[20] Together, stability and growth meant that only a small fraction of the workforce was exposed to extended spells of unemployment, attenuating the insecurity associated with economic change.

An obvious contributor to this stability was better policy: it wasn’t hard, after all, to improve on the policy disasters of the 1920s and 1930s. While active countercyclical monetary and fiscal policy was still more in the realm of theory than action, the spread of Keynesian ideas at least prevented governments and central banks from repeating their worst mistakes. On top of that, there was the simple fact that public spending was more stable than private spending. When the economy slowed, the growth of tax receipts slowed with it, and budgets moved into deficit. Because these mechanisms worked automatically, they were known as automatic stabilizers. And because the public sector had grown, the induced change in tax receipts was now larger as a share of GDP. Automatic stabilizers thus worked even more powerfully than before to dampen the business cycle.

Moreover, there was no high inflation like that of the 1920s, aside from a brief period immediately following World War II. There was no reparations tangle to blow a hole in government budgets. To the contrary, U.S. insistence that demands for German reparations be subordinated to other goals, namely, social stability and the resumption of growth, was what led to the final break with the Soviet Union, the one power committed to extracting reparations by force.

A further stabilizing factor was the Bretton Woods international monetary agreement. Under the Bretton Woods System agreed to in 1944, other countries committed to keeping their currencies stable against the dollar. So long as the United States kept inflation low, as it did successfully in the 1950s and much of the 1960s, it conferred comparable stability on other countries.[21]

The stability of the Bretton Woods System was reinforced by the stability of the international economic environment generally. The latter was partly a matter of good luck: there was no serious interruption to Middle East oil supplies when the Six-Day War between Israel and the Arabs erupted in 1967, and there was no OPEC oil shock before 1973.[22] But there was also good judgment. International trade was liberalized cautiously. Tariff barriers were lowered gradually through not one but a succession of periodic GATT negotiating rounds.[23] Domestic markets were not thrown open to foreign competition before they were ready. There was no shock to the global trading system as large as China's accession to the World Trade Organization in 2001.[24]

Controls on international financial flows were relaxed even more cautiously, governments having learned from the 1930s that unrestrained capital movements could be destabilizing. Removing capital controls was not an obligation of signatories of the Bretton Woods Agreement. Even as they dismantled barriers to merchandise trade, Japan and Europe retained their restrictions on capital movements, in some cases only finally removing them in the 1980s as part of the broader push for financial liberalization and deregulation. Memories of the destabilizing effects of capital flows, much like memories of political excesses, faded with time, and eventually did less to shape decision-making. For the moment, however, the lessons of the 1930s ruled.

Prudent management of globalization thus accentuated its positive impact. Countries were allowed to specialize along lines of comparative advantage and do more of what they did best while avoiding trade and financial shocks.

Another dimension was banking and financial stability. There were no systemic banking and financial crises in the advanced countries in the period through 1973. Banks still failed, but in no case did their failure imperil the banking and financial system.[25] More countries adopted deposit insurance, in the manner of the United States, limiting the danger of depositor panic. They more tightly regulated their financial institutions, discouraging risk taking so as to avoid banking crises like those that riddled the 1930s. Banking crises regularly breed populist reactions against the financiers and plutocrats who are seen as profiting at taxpayer expense, as noted in Chapter 1, and induce political swings to the extreme left and right.[26] Between 1945 and 1973, quite remarkably, there were no banking crises of consequence in the advanced countries to provoke this reaction.

Besides being rapid and stable, growth was widely shared. Real wages rose strongly in the third quarter of the twentieth century, in contrast to their subsequent stagnation. Low unemployment meant that the gains were distributed widely. Labor's share of national income was stable or rising. The share of national income accruing to the top 1 percent of high earners fell in continental Europe, Japan, the United Kingdom, and even the United States.[27] High growth and low inequality went hand in hand: as Robert Gordon writes of the United States, the remarkable fact "is not just that incomes grew at roughly the same rate for the bottom 90 percent, the top 10 percent, and the average, but that the real incomes for each group grew so rapidly."[28]

Wartime had seen higher taxes on the rich, both more progressive individual rates that hit those with high incomes, and higher corporate profit taxes. During the war, top marginal individual income tax rates peaked at 95 percent in the

United Kingdom, 92 percent in the United States, and 90 percent in Germany. The political scientists Kenneth Scheve and David Stasavage argue that mass warfare is a key catalyst for taxes on the rich.[29] Taxes on high incomes are ratcheted up because mobilization makes extraordinary demands on the working class and thus creates an argument for taxing the rich on grounds of equal sacrifice. The argument is general, but World War II is a case in point.

Those high top tax rates persisted. In Britain, the top tax rate in the 1960s was still 83 percent, and the wealthiest few paid an additional 15 percent on investment income. In the United States, the highest marginal tax rate was still 91 percent in the early 1960s. Deductions and loopholes there were, but these high top tax rates reduced the income share of the top 0.1 percent of the distribution by as much as half.[30]

Higher tax rates persisted because the hardships of mass mobilization didn't vanish with the end of the war. Higher taxes on the wealthy can thus be seen as part of the same social bargain prompting adoption of the GI Bill's education and home-loan provisions in the United States and analogous measures in other countries.[31] Taxing high incomes more heavily, moreover, changed norms about acceptable rates of taxation. It created a new status quo. The fact that higher rates on top incomes didn't destroy economic growth, as their critics had warned, changed assessments of the equity/efficiency trade-off.[32]

Technological progress also leveled incomes. The diffusion of machine tools and the spread of assembly-line methods to additional sectors stimulated the demand for semi-skilled workers. It created employment opportunities for people who lacked technical training but who could solder and weld. Workers learned these skills at Henry Kaiser's shipyards in Richmond, California, where the Pacific Fleet was built, and then applied them in enterprises supplying consumer durables, such as one in San Francisco that made fireplace screens and tool sets for sale by catalog retailers including Sears and Montgomery Ward.[33]

Eventually, programmable machine tools, computers, and robots allowed capital equipment to be substituted for semi-skilled labor, reducing the number of workers needed to run a forge or man an assembly line. Automatic teller machines (ATMs) were substituted for bank tellers, and barcode scanners were substituted for supermarket clerks. But this came later. The first ATM debuted in North London only in 1967, its first U.S. equivalent in Rockville Centre, New York, in 1969. The first supermarket scanner entered service in Troy, Ohio, only in 1974.[34] The development of numerically controlled, programmable machine tools had started during World War II, when the U.S. Air Force and Sikorsky Aircraft experimented with their use in the production of helicopters, but their practical application was limited until the advent of minicomputers in the late 1960s. Numerical control was so slow to catch on that the U.S. Army, to popularize its use, built 120 numerical control machines and leased them to manufacturers.[35]

And if technology favored the employment of semi-skilled labor, the international environment was especially conducive to its employment in the advanced economies. Tariffs, though falling, were not yet insubstantial. Transport costs were still to be reckoned with, especially before the logistics and containerization revolution reduced them significantly in the fourth quarter of the twentieth century.[36] Until then, however, it still made sense to produce close to final demand, which meant in the advanced countries, and first and foremost the United States.

And even where low labor costs were a decisive advantage, as in textiles, apparel, and footwear, the advanced economies could still compete. South Korea, Hong Kong, Taiwan, and Singapore, the first wave of "newly industrializing economies," only began industrializing in the 1960s. Not until the 1970s did they start moving up the technology ladder from textiles, apparel, and footwear into shipbuilding and machinery. China, at this point, was not even a blip on the radar screen of the most acutely sighted observer. Competition from developing countries in manufactured goods may have begun to materialize, but it remained significantly less intense than it would be subsequently.

A growing demand for blue-collar workers makes for rising blue-collar wages, the textbooks tell us. But, in addition, when firms have market power, they enjoy above-market returns that they can share with, or withhold from, their workers.[37] Those workers, if well organized, can secure a portion of those above-market returns, or rents, by threatening to disrupt production. Such disruptions were frequent in the 1920s and 1930s, leading U.S. manufacturers to now worry that the same could happen again. During World War II, government-designated business and labor leaders had cooperated in setting wage standards and maintaining industrial peace. Unions then emerged from the war with newfound respect.[38] Walter Reuther's United Auto Workers, for example, famously supported the war effort with a no-strike pledge. In return, an appreciative President Harry Truman convened a presidential summit in Detroit in 1945 bringing together representatives of management and labor. The president campaigned, albeit unsuccessfully, against the Taft-Hartley Act, which prohibited shops where only union members could work and limited certain kinds of strikes. He made a point of delivering a strongly pro-union Labor Day speech in Detroit's Cadillac Square in 1948.

This political support from a sitting president was not without effect. There was also the fact that automakers had invested heavily in new capacity, so they stood to lose financially if production was idled by lockouts and strikes, whereas pent-up demand left over from wartime rationing promised strong sales if labor disputes were avoided.

The result was a series of long-term contracts with the Big Three automakers. The template was the contract signed by the United Auto Workers and General Motors in 1950. In return for five years of labor peace, GM offered a $125 monthly pension, medical coverage, a schedule of annual wage increases, and a cost-of-living escalator. This, then, was finally the welfare capitalism envisaged by Herbert Hoover in 1929.

Ford and Chrysler quickly emulated the "Treaty of Detroit," as this agreement came to be known. Their contracts set the tone for labor-management relations in the 1950s and 1960s in Big Steel and other manufacturing sectors.[39]

In Europe, resistance members who had led the fight against the Nazis were now prominent in labor organizations, which acquired new legitimacy and respect as a result of their leaders' wartime actions. Labor was in a stronger position in European countries, where it did not have to contend with anything resembling Taft-Hartley. The share of the workforce that was unionized was also higher in Europe, reflecting the earlier development of union movements there. An example of the consequences was the German Coal and Steel Codetermination Act of 1951, which gave workers representation on the supervisory boards of directors of companies in those sectors.[40] Board approval was required for all major business decisions, not excluding wage settlements. There had been experiments along these lines under the Allied occupation and even earlier, during Weimar.[41] Bismarck himself had advocated the creation of a *Wirtschaftrat* (economic council) to bring together representatives of capital and labor.[42] But where these precursors had met with mixed success, they were now durably codified into law.

Over time, codetermination was extended to the public sector and then to all companies with at least two thousand employees. Similar laws were adopted in Austria, the Netherlands, Sweden, and elsewhere. It is hard to think of a more direct mechanism for ensuring a fair division of rents between capital and labor. This is a reminder that more than rapid productivity growth contributed to rising working-class living standards. In addition, a supportive institutional framework on the shop floor, in the courtroom, and in parliament enabled labor to secure its share of the spoils.

Other countries developed their own variants of these arrangements, reflecting their distinctive national circumstances and histories. Europe's small countries, which were most directly exposed to external shocks, had previously reached framework agreements—the Basic Agreement in Norway in 1935, the Peace Agreement in Switzerland in 1937, the Main Agreement in Sweden in 1938—designed to enhance domestic stability. In each case the participants sought to identify wage and employment levels consistent with economic and social peace. Labor was recognized as a social partner, providing a basis for industry- and economy-wide negotiations in which the parties sought to agree on the division of profits and rents. In the Netherlands these arrangements grew into product and company boards (*publiekrechtelijke bedrijfsorganisatie*, or PBOs) made up of employers' representatives and union leaders, who jointly negotiated employment and investment decisions. In Sweden they developed into the Cooperative Body for Increasing Exports and Production, under whose auspices industry, labor, and government officials met to set wages at levels consistent with both rising living standards and continued export competitiveness. Under the so-called Scandinavian model, large engineering companies, including Volvo, ASEA, Alfa-Laval, and SKF, first reached rent-sharing agreements with their workers, after which similar agreements were extended by firms in other sectors.[43]

These arrangements were easiest to reach in small countries, open economies, and ethnically homogeneous societies.[44] They were most durable in West Germany, where they were buttressed by a historical legacy that discouraged labor strife. They worked least well in the United Kingdom, which inherited a fragmented craft-based union movement from its early industrialization. Labor-management relations there were contentious, creating disputes over staffing levels, discouraging investment, and causing productivity growth and incomes to lag. It is not a coincidence that a politician like Enoch Powell, who gained notoriety in 1968 with an explosive speech blaming immigrants for the nation's economic woes, found support among disaffected working-class voters facing chronic unemployment, stagnant living standards, and deteriorating neighborhoods.[45]

Finally, a more expansive welfare state provided insurance against economic displacement. Scholars dispute how best to measure the extent of the welfare state, but there is no question that it expanded considerably in this period.[46] By the 1970s, more than 90 percent of the Western European labor force was covered by state-sponsored insurance against income loss in old age and due to disability and sickness. More than 80 percent possessed accident insurance; 60 percent had coverage against unemployment. Whereas some 10 to 20 percent of GDP had been devoted to social expenditure in the 1960s, this share rose to between a quarter and a third of national income, depending on country, in the mid-1970s. Economic growth helped to fuel this expansion of state social expenditures, but the expansion of social expenditures also laid the basis for economic growth.[47]

By the end of the period, the contradictions of the welfare state were becoming apparent. Overly generous unemployment and disability insurance was discouraging recipients from actively seeking work and encouraging some to drop out of the labor force. Poorly designed old-age and health insurance was promoting early retirement and inflating health care costs. There was much to criticize about these government programs, as there is about all government programs. But without them it is hard to imagine that there would have been a durable consensus for policies that delivered rapid economic growth and tolerance of structural change.

Altogether, then, the third quarter of the twentieth century was exceptional for a constellation of forces that strengthened the political mainstream and limited support for populist leaders and anti-system parties. Fascism and the Cold War discredited extremism. Stronger political institutions improved governance and stability. Catch-up growth after three decades of depression and war promised to raise all boats.

Moreover, this growth was shared. The technical change associated with the adoption of mass production methods generated good blue-collar jobs.

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.