

## Economic Drivers of Populism<sup>†</sup>

By SERGEI GURIEV\*

Populism is not a new phenomenon and has been studied reasonably well by economists and political scientists. In modern economics, the most conventional definition of populism refers to its 1980s Latin American reincarnation. Dornbusch and Edwards (1991, p. 9) define such populism as an “approach to economics that emphasizes growth and income redistribution and deemphasizes the risks of inflation and deficit finance, external constraints and the reaction of economic agents to aggressive non-market policies.” An essentially similar version of populism emerged in post-communist countries in the 1990s and 2000s where the gains from painful market reforms were not broadly shared. This helped anti-reform populists take over. The populists then used the public anger with the social cost of the reforms and built crony capitalism systems (EBRD 2013, 2016).

The newly emerging type of populism is qualitatively different. First, this populism has gained ground in developed countries with consolidated democracies—rather than in the emerging markets. Second, the populists no longer pursue a traditional redistribution agenda. Instead, today’s populists are positioning themselves as “nativists” protecting the “ordinary people” against the “cosmopolitan elites.” There is a growing realization in political science (De Vries 2017) that the conventional left-right dimension is no longer relevant. The extreme left and extreme right politicians now join forces to defend a parochial agenda against the mainstream center that represents markets and globalization. For example, in Europe both the extreme left and the extreme right oppose the EU (the former blaming it for being too liberal

and pro-market, and the latter for being too interventionist and pro-welfare state).

This transformation of the political agenda has led many scholars to redefine the very notion of populism<sup>1</sup> and to look for non-economic explanations of the recent rise in populism, such as cultural preferences and identity politics. For example, Inglehart and Norris (2016) analyze the European Social Survey data and conclude that populism is driven mostly by cultural rather than economic factors.

While there is still no consensus on the origins of the recent rise of populism, in this paper I discuss several pieces of evidence which support the view that economic, rather than cultural, factors still matter.

First, in Algan et al. (2017) we show that the increase in unemployment during the Great Recession has had a causal impact on the rise of populism in Europe. Second, in line with conventional trade theory, Aksoy, Guriev, and Treisman (2018) finds that skilled and unskilled workers respond to globalization in a differential way—depending on the skill composition of exports and imports. Finally, Guriev (2017) shows that corruption and inequality (in particular, inequality of opportunity) matter for the support of market reforms.

### I. European Crisis and the Rise of Populism

In Algan et al. (2017) we track the change in unemployment and the vote for populist parties before and after the Great Recession in 240

\*European Bank for Reconstruction and Development, Sciences Po, and CEPR (email: [sergei.guriev@sciencespo.fr](mailto:sergei.guriev@sciencespo.fr)).

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<sup>1</sup>Mudde and Rovira Kaltwasser (2017, p. 6) define populism exactly as a “thin-centered ideology” that considers society to be ultimately separated into two homogeneous and antagonistic groups: the pure people and the corrupt elite. Most economists link the term’s negative connotation to the non-sustainability of populists’ policy proposals. Rodrik (2018) however argues that modern populism does not have to involve unsustainable economic promises. Whether modern populists can or cannot deliver on their campaign manifestos is not important for this paper as we discuss determinants rather than implications of populism.

subnational regions in 26 European countries in 2000–2017. Unlike other studies (Inglehart and Norris 2016; Guiso, Herrera, and Morelli 2017; and Dustmann et al. 2017) that study self-reported voting from the individual-level survey data, we look at the actual region-level voting outcomes. We find that controlling for regional fixed effects, an increase in unemployment is associated with the rise in populist vote. The effect's magnitude is large: a 1 percentage point change in unemployment implies 1 percentage point change in the populist vote.

In order to identify the causal effects, we instrument the increase in unemployment by the precrisis composition of the regional economy. We find that instrumental variable results imply even a larger magnitude of the effect: 1 percentage point increase in unemployment leads to 2 percentage points increase in populist vote.

The effects that we find are larger than those found in other studies. This is likely to be driven by the fact that the other studies measure the relationship between individual-level employment status and his/her vote. We study the region-level relationships and thus can better identify the impact of economic insecurity. Indeed, an increase in regional unemployment raises economic insecurity and undermines the confidence in the system even for those voters who are currently employed. Indeed, even those who have a job are concerned with higher unemployment—as they face higher risks of losing their jobs and are less likely to see significant wage increases.

To identify the mechanism, we study the relationship between the change in unemployment and change in political trust. We find that the increase in unemployment causes the decline in trust in European and national political institutions and alienation from existing parties. At the same time there is no, or almost no, impact on the generalized social trust, on the trust in police, or on the trust in church—or on the trust in the United Nations.

In order to understand the role of identity politics, we also study the change in attitudes to immigration. We find that an increase in unemployment results in a more negative attitude to immigrants for economic reasons—but there is no impact on the attitude to migrants for cultural reasons. It may well be that the survey respondents are ashamed to admit their adherence to identity politics and ascribe cultural aversion

to immigration to an economic one. However, Barrera et al. (2017) show that even if this bias exists, it is very small.

## II. Globalization and the Rise of Populism

While the Great Recession was a one-off event, the midterm economic trends that are usually linked to the recent rise of populism are globalization and technological progress (see Autor et al. 2017 for the evidence on the United States). It is hard to disentangle the two. Technological progress reduces transportation and information costs—thus promoting globalization. On the other hand, globalization intensifies economies of scale that strengthen the incentives for innovation and introduction of new technologies.

Both globalization and technological progress result in job polarization (Goos, Manning, and Salomons 2014). In recent decades, advanced economies have seen job creation at the top and at the bottom of the skill pyramid. The high-skilled workers benefit from globalization as they sell their services to bigger markets and their employers' inputs get cheaper. Economic growth also results in creating the low-skilled jobs that are too cheap and too manual to get automated or outsourced. These are the middle-skilled jobs that are outsourced and automated. The prior holders of these jobs either have to get new skills (which is hard), or quit the labor force or downgrade and look for low-skilled jobs (which further depresses the wages in the low-skilled segment).

This analysis directly implies the need for breaking down the evolution of the anti-establishment sentiment by the level of skills. This is what we do in Aksoy, Guriev, and Treisman (2018). Using the Gallup World Poll, the annual nationally representative surveys run in more than a hundred countries in 2006–2016, we study how approval of country's leadership and confidence in government differs between skilled and unskilled individuals depending on the structure of trade.

For each country and year we measure the skill intensity of imports and exports. We find that controlling for country and year fixed effects, the gap in political approval between skilled and unskilled increases with the proportion of skilled exports in GDP and decreases with the share of skilled imports in GDP. The magnitudes are substantial: each additional

10 percentage points increase in skilled exports to GDP results in a 2 percentage points increase of political approval by the skilled (relative to unskilled). The impact of imports is even stronger: a 10 percentage points change in skilled imports to GDP results in a 3 percentage points decrease in political approval by the skilled relative to unskilled.

In order to identify the causal effects, we use the conventional instrumentation strategy based on the air/sea distance differential and the assumption that air transportation costs are declining faster than those of the sea transportation. We use the air/sea distance differential as an instrument for skilled trade (the skilled-intensive products are more likely to be transported by air rather than by sea).

The instrumental variable results are similar to those in the panel regressions but are larger in magnitude. Each additional 10 percent increase in skilled exports to GDP results in a 3 percentage points increase of political approval by the skilled (relative to unskilled). The impact of imports is again stronger: a 10 percent change in skilled imports to GDP results in a 7 percentage points decrease in political approval by the skilled relative to unskilled.

### III. Fairness and Populism

The traditional view of populism links it to inequality and redistribution. In recent decades, there has emerged a distinction between “fair” and “unfair inequality” (Starmans, Sheskin, and Bloom 2017). If inequality is driven by effort and skill, it is “fair” and contributes to efficiency and growth. If inequality is predetermined by exogenous circumstances of birth such as parental background, gender, place of birth, ethnicity and race, it is unfair. If unfair inequality (inequality of opportunity) is high, the whole system is perceived as unfair and corrupt so there is a stronger disillusionment and rejection of the establishment.

In EBRD (2016) we use the conventional methodology of measuring inequality of opportunity and decompose inequality in 34 countries (based on the data from the Life in Transition Survey) into the component of inequality driven by the exogenous circumstances of birth (“unfair inequality”) and the residual inequality (the latter assumed to be driven by effort, or “fair inequality”). Guriev (2017) shows the higher

unfair inequality is associated with lower support of market reforms. The fair inequality actually increases the support for reforms; this is not surprising given that the pretransition command economy imposed too much *unfair equality*.

Guriev (2017) also reports the relationship between the attitudes toward corruption and political approval. Controlling for the municipality fixed effects and for respondents’ own income and employment status, we find residents who believe that corruption has been on the rise are more likely to reduce their confidence in government.

### IV. Policy Implications

Taken together, the results above suggest that economic factors have played an important role in the recent rise of populism. This implies the need for policies addressing the economic causes of populism, in particular, for structural reforms of labor markets and social support policies. Policymakers should use the window of opportunity during the cyclical recovery that is reversing the popularity of populists. Missing this opportunity would result in a vicious circle. In order to overcome unemployment, we need structural reforms. Reforms cannot be carried out without political trust: by definition, difficult reforms incur pain in the short run and deliver benefits in longer run. So the voters only support reforms if they believe that the reformers have their long-run interest at heart. The problem is that if unemployment is high, the trust in politicians is low.

Luckily, in 2017–2018, global and European economies are likely to experience relatively robust growth so that their policymakers will have the resources to fix the supranational institutions, increase flexibility of the labor markets, enhance targeted social policy, and most importantly, invest in skills. The latter are crucial for addressing the key challenges of globalization.

Another important criticism of the “economic view of populism” is that in the post-truth era the quantitative arguments and even straightforward economic facts do not matter anyway. Interestingly, Barrera et al. (2017) shows that this point of view may be correct. The experiments in Barrera et al. (2017) demonstrate that when French voters see quotes from Marine Le Pen that are then “fact-checked” by independent experts, they learn the true facts but are still

likelier to vote for Marine Le Pen. In this sense, populists can indeed win against facts, experts, pundits, and journalists. In today's post-truth era, evidence-based arguments are necessary but not sufficient. However, as the 2017 French election ultimately showed, if a populist is confronted by an honest and charismatic politician, the combination of evidence and charisma does help to overcome the populists.

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