Exploring Economic Populism, a Neglected, but Growing, Phenomenon

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Abstract: The economic cost of populism is extremely high: after 15 years, GDP per capita is 10% lower compared to plausible non-populist counterfactuals. We seek to look under the hood and explain the mechanics behind these numbers: we provide a framework to make sense of this pattern and explain the systematic, mutually reinforcing association between populism and economic dysfunction and underperformance. Populists emanating from either the left or the right tend to converge on a similar political economic model: protectionism, crony capitalism, and inveterate rent seeking. We also adduce supporting evidence from very different places, Argentina, Chile, Greece, and Italy, and across disparate time periods. We argue that populism almost always ushers in economic collapse. We posit that a key reason for this is that, rather than seeing economic interactions as "win-win" situations, populists are obsessed with zero-sum thinking.

Keywords: Populism, economic crises, liberal democracy, welfare state capitalism, Latin America, Europe.

Populists tend to excoriate liberal democracy's time-honored institutions: independent courts, attorneys general, and antitrust authorities, for example. Populists also demonize the experts—e.g., public health czars, central bankers, and scientists—who help run these institutions, lionizing the so-called will of the people instead. They consider checks on their power as anathema and eschew pluralism and compromise.[1]

No one region or time period has a monopoly on populism. Argentina has cycled between populist democracies and military dictatorships over its modern history. The same is true of other Latin American countries. European countries have also flirted with populism since the end of World War II: France's National Front, beginning during the mid-1970s; Greece's Papandreou in the 1980s; Italy's Berlusconi, starting in 1994; and the Netherland's Fortuyn and Wilders during the 2000s, though they never won power outright. By contrast, the U.S. largely avoided this predicament—that is, until the presidency of Donald Trump (see Albertus and Menaldo 2018; Levitsky and Ziblatt 2018).[2]

There is widespread evidence that economies perform poorly under populist leaders (Funke, Schularick, Trebesch 2020). Populism's economic cost is extremely high: after 15 years, GDP per capita is 10% lower compared to plausible non-populist counterfactuals (Funke, Schularick, Trebesch 2020). Here, we explain the political-economic mechanics behind this economic underperformance. We provide quantitative and qualitative evidence from diverse case studies to show how catastrophic economic populism can be.

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[1] Of course, populists are not the only threat to liberal democracy in Europe or elsewhere. Thanks to fascism, Spain and Portugal, until circa 1975, were ruled by authoritarians. Even De Gaulle's coup d'état in 1958 installed a presidential system in France not unlike Putin's contemporary Russia.

[2] Interestingly, the movement that first launched the term "populism" in our global political lexicon—the American Populists of the late nineteenth-century—does not satisfy our conception of this term. These populists were opposed to tariffs, sought a reduction of the public debt, and sought to break the power of railroad and banking monopolies. Further ahead we offer a definition of populism and, most importantly, economic populism, which is the central focus of this paper.

While many scholars have studied what explains populism, fewer researchers have inquired into its economic logic and consequences.[3] To be sure, there was a spirited intellectual debate between monetarists and Keynesians regarding the consequences of import substitution industrialization policies during the 1970s and 1980s. It was propelled forward by high-profile economists such as Sachs (1989) and Dornsbusch and Edwards (1991). These authors stuck to macroeconomics narrowly defined and focused on balance of payments crises, sovereign debt crises, and currency crises, as well as inflation.

Our scope is broader—we identify the deeper, populist roots of these crises, including financial repression and trade protectionism, and the underlying logic behind economically populist policies.[4] We also explore the political logic of how populists dismantle and destroy liberal institutions on the road to employing populist policies.

Rather than seeing most economic interactions as "win-win" situations, which is the traditional economic perspective (namely, that there are always mutual gains from voluntary exchange), populists are obsessed with the idea that market exchanges are characterized by "win-lose" situations. Moreover, populists are wont to stigmatize an outgroup: a scapegoat blamed by them for the losses. Populists also eschew some of the other key tenets of economic thinking, such as weighing tradeoffs and future consequences. Finally, and ironically, the economic policies that populists pursue, whether they emanate

[3] In terms of its proximate causes, demagogues have exploited crises and rode waves of anxiety, uncertainty, fear, and dissatisfaction with the status quo to office. In terms of ultimate causes, researchers have put forth a host of explanations for populism: financial crises and recessions, waves of immigration and changes in demographics, and increases in crime and corruption. On the one hand, this has putatively created cultural wedges that have allowed rightwing parties to exploit xenophobia, ethno-nationalism, and support for authoritarianism. On the other hand, this has supposedly fueled leftwing politicians who rail against financial interests and the rich. Parties from both sides have also pushed back against globalization, whether for cultural or economic reasons. On all these points see Autor et al (2017) and Norris and Inglehart (2019).

[4] For similar accounts see Acemoglu, Egorov, and Sonin (2013), Eichengreen (2018), and Rodrik (2018).

from the left or the right, invariably end up harming the groups they claim to champion. For example, in Latin America these movements have claimed to help the poor and ended up doing the exact opposite. The story of Argentina is archetypical.

Whether they are governed by politicians on the left or the right, populist political experiments share one thing in common: they tend to usher in economic collapse. Populists spend too much too quickly, expropriate property from the wealthy, corporations, and banks, and engage in trade protectionism and sometimes outright mercantilism. The upshot is economic volatility and stagnation induced by chronic balance of payments problems, sovereign debt defaults, financial crises, and hyperinflation.

While the institutions populists condemn vary from place to place, populism's political-economic DNA threatens both liberal democracy and welfare state capitalism.[5] It also threatens the legitimacy and independence of the professional bureaucrats, scientists, economists, and diplomats who run and regulate the modern state and regulatory apparatus that make this system work. The protectionism and mercantilism that accompanies populism also weakens liberal democracy and welfare state capitalism in more subtle ways.

This has important normative and policy implications. The marriage of these two institutions explains why millions upon millions of people are more prosperous and secure than ever before (McCloskey 2016). Liberal democracies are more likely to foster industrial capitalism: to provide public goods that reduce transaction costs and promote arm's length exchange, deep and sophisticated capital markets, and Schumpeterian creative

[5] Liberal democracy is a Weberian ideal type. So is welfare state capitalism. No country embodies it perfectly. Take the United States, even before Donald Trump: until the Civil Rights Movement in the 1960s, Blacks were treated as second class citizens and restricted from voting (Jim Crow). They also endured institutional discrimination in the way of segregation and Redlining, the expropriation of their property, and state sponsored violence and intimidation.

destruction: the churn of ideas, firms, and industries that drive economic dynamism (North, Wallis and Weingast 2009; Olson 1993).[6] They also adopt policies that reduce risks associated with market exchange (Albertus and Menaldo 2018).

In the rest of this paper, we account for the logic of economic populism and the fact that populists representing either the left or the right tend to converge on a similar political economic model based on protectionism, crony capitalism, and inveterate rent seeking. We also explain the systematic association between economic crises and populism. We proffer case studies of Argentina, Chile, Greece, and Italy to advance our argument.

WHAT IS POPULISM?

Scholars have debated how to define and understand populism. According to the economic definition, which we draw from, populism is associated with short-sighted redistribution: "the implementation of policies receiving support from a significant fraction of the population, but ultimately hurting the economic interests of this majority" (Acemoglu, Egorov, and Sonin 2013: 2). A similar idea is that populism refers to a charismatic strongman who builds new cross-class alliances to punish incumbent oligarchs and pursue import substituting industrialization (see Albertus and Menaldo 2018).

For the ideational approach, core ideas drive disparate populist movements (Hawkins and Rovira Kaltwasser 2017). Hawkins et al (2019) aver that populists see politics as a cosmic struggle between "the pure people" and "corrupt elite". Populism, however, is parasitic upon host ideologies: nationalism, socialism, or even liberalism. It all depends on a country's history and the permissive conditions that drive populists to power.

[6] Of course, this is not a universal law. Italy has experienced two decades of uninterrupted wage stagnation and the growthless accretion of debt and not always under populism. We discuss this ahead.

While the struggle between the "evil elite" and the "pure people" is the warp and woof of populism, the "people" is unlikely to be a homogenous group across different populist movements. In its nativist variant, populists pit native-born citizens—the "pure people"—against immigrants. Left-wing populism demonizes foreign governments and organizations. Across Latin America, populists have cast U.S. imperialism as the perennial enemy. In the aftermath of the 2009 sovereign debt crisis in Greece under Syriza, the European (creditor) Troika and the global economic system took on this role.

Studies of populism have also made a distinction between inclusionary and exclusionary populism (Mudde and Rovira Kaltwasser 2013). The former espouses mass welfare programs that include the poor, while the latter prioritizes an internal security posture aimed at protecting established insiders who most benefit from the welfare state from immigrant outsiders. Both types, however, share a penchant for zero-sum economic thinking: promote policies aimed at helping the in-group at the expense of the out-group.

So, what is populism then? Is it an ideology, strategy, or set of political theatrics? In terms of *political* populism, we are ultimately agnostic and do not pretend to offer a dispositive definition. Inherently reductionist, such a definition would do violence against reality, since no two populists share the same ideas, tactics, or performative inclinations. Instead, we submit that "populism" is a hybrid, multidimensional phenomena: a thin ideology wedded to a loose set of mobilization strategies and bevy of related discourses. Conversely, what populist politicians share in common are a set of economic platitudes and policies centered on zero sum thinking, short-termism, mercantilism, and macroeconomic unsustainability.[7]

[7] Of course, this does not mean that liberal democracies ruled by conventional politicians do not exhibit mercantilist tendencies or erect and sustain tariffs and indulge in a modicum of financial repression.

THE POPULIST POLITICAL ECONOMIC DNA

Economic populism is characterized by zero-sum thinking, an inability to consider tradeoffs and consequences, and the shrinking of time horizons. Paradoxically, populists of all stripes invariably adopt economic policies that benefit a small elite at the expense of ordinary citizens. On the one hand, their political coalitions include cartels and monopolists that depend on politicized regulations to survive and thrive. On the other hand, they also include organized labor unions and other blue-collar pressure groups that only represent a minority of workers, most of whom remain unorganized and politically vulnerable.

Governments that practice economic populism often resort to trade protectionism. They do this primarily to shelter big manufacturing firms. This often involves adopting stiff import tariffs, imposing quotas on finished goods, or exempting inefficient domestic manufacturers from import taxes. Governments may grant these firms special permits to import capital and intermediate goods under the auspices of cascading tariffs structures.[8]

Populists governments indulge in other industrial policies that benefit key players in their coalition. They may impose high barriers to entry in key sectors and subsidize their allies' foreign exchange prices, raw materials, land, labor, and intermediate inputs. They may also exempt handpicked winners from regulations reserved for their rivals, including those intended to improve working conditions, health, safety, and the environment.

Regarding protectionism, take the European Community: it sustains import tariffs and even quotas on countries outside of its trade zone. Regarding mercantilism, take Germany: its penchant for subsidizing exports has arguably decimated industries across the continent, while at the same time securing a captive market for its products from Belgium to Ukraine.

[8] This is not to deny that some countries not ruled by populists have practiced direct government intervention as they industrialized to address the non-pecuniary externalities associated with technological acquisition from the core. Even beyond their attempts to reduce steep search and coordination costs, learning by doing dynamics inspired governments in South Korea and Taiwan to cultivate the domestic production of goods and therefore engage in selective intervention via tariffs/quotas, subsidies, directed credit, and 'rationalization' that involved engineering strategic mergers and restructuring.

Populists may go further still and hammer firms and business interests outside of their coalition with specious antitrust suits, irregular "windfall" taxes, fines, and requirements to obtain special licenses. The larger aim: subject them to a climate of fear and uncertainty.

Financial repression is almost always adopted by populists of all stripes (see Menaldo 2016). Their governments distort financial prices by administratively fixing nominal interest rates to depress real rates. To do so they impose (i) ceilings on the interest rates that banks levy on loans; (ii) ceilings on the interest rates that savers earn on their deposits; (iii) quantitative restrictions on the amount of credit allocated; (iv) high reserve requirements that force banks to place a large proportion of their deposits in the central bank, and are tantamount to zero percent interest rate loans; (v) restrictions on the entry of new competitors in the banking sector; (vi) directed credit: state directed loans, loan guarantees, and rediscounting that subsidizes politically favored borrowing.

States that indulge in financial repression deliberately ration capital. Rather than raise the real rate of return to savings, which deepens the financial sector and incentivizes capital accumulation and innovation, populists use banking regulations to make capital scarcer than it already is. When governments reduce the real rate of return on savings, the demand for real money declines; total deposits also drop—as asset holders looking for higher returns exit the financial system—as do loanable funds. And because the costs of capital for politically unconnected firms increase, the supply curve for credit also shifts in.

The result is rampant inefficiency. These policies engender deadweight losses and erode consumer surplus. They also incentivize moral hazard. Businesses that do have access to subsidized credit make less judicious decisions. Bank bondholders and depositors tend not to incur the costs of the risky loans that become non-performing, taxpayers do.

This way of doing business creates clear winners. Banks typically earn rents through the spread between the interest rates they pay on savings deposits and what they charge for business and consumer loans. Populists can engineer these rents by heavily restricting the number of bank charters it allocates and/or by circumscribing banks' branches. This restricts the supply of credit so that interest rates on ordinary loans exceed their marginal cost. Populists may also help politically connected bankers generate rents by allowing them to increase their leverage—e.g., by letting them reduce their reserves. Populists may greenlight some bankers to increase their lending portfolio's riskiness by allowing them to maintain a low rate of equity to deposits loaned out.

Moreover, politically connected firms may obtain rationed credit at negative real interest rates. For example, populists may impose high reserve requirements on the "ordinary lending" conducted by commercial banks, but not on lending directed to politically favored companies. Or, the central bank and state-run development banks may either use rediscounting or lend directly to sheltered manufacturers. This will not only inflate the profits of politically connected firms but may translate into higher salaries for electorally supportive managers and employees (Mueller, Ouimet, and Simintzi 2017).

Populist financial policies also create clear losers. Unorganized financial market players often have a relatively inelastic demand for credit and other banking services and are therefore held captive by the domestic financial sector—a situation that may be exacerbated by outbound capital restrictions.[9] Or, politically unfavored borrowers may turn to alternative, perhaps informal credit markets that are expensive and volatile. Unorganized

[9] According to Calomiris and Haber (2014: 46): "After all, firms have to maintain bank balances to cover payrolls and accounts receivable, and some households must maintain minimal bank balances in order to execute certain payments. The transaction costs and legal constraints of avoiding the deposit market are prohibitive for some purposes."

savers that earn negative real interest rates may be incentivized to put their money under the mattress, on the one hand, or engage in riskier investments to generate sufficient yield, on the other. Worse still, credit may be rendered unavailable in places where it is needed the most. For example, unorganized farmers in the countryside may be unable to finance their everyday business operations, let alone make new investments in irrigation and seeding (Menaldo 2016). Small and medium-sized firms that are starved for credit may exit the market, or be deterred from entering it in the first place.

Finally, the biggest losers are taxpayers. The losses created by nonperforming loans can be subsidized by them ex post through the government's relaxation of prudential regulation. Or, much more common in the aftermath of populist experiments: outright bank bailouts engineered by populists are financed with taxpayer money.

Economic populism in general has negative effects on economic efficiency beyond its impact on the financial system. Trade protectionism and subsidies generate deadweight losses and reduce incentives and opportunities for firms to reach economies of scale and become more competitive. Big, normally uncompetitive industrial firms are protected and subsidized and thus can command market power prices for their products. Worse yet, these monopolies and oligopolies do not reinvest their profits into the type of research and development that may foster innovation and better products at lower prices; they do not face incentives to reduce costs or produce new and improved products. Instead, the name of the game is to secure and maintain monopoly rights.[10]

[10] That is not to say that the search for monopoly rents does not sometimes incentivize innovation; under the right conditions, it is the key to Schumpeterian creative destruction. It is to say, however, that the erection of barriers to entry in perpetuity means that entrepreneurs are prevented from entering the market to displace incumbent firms, whether the latter are monopolists or not, through innovation.

Governments that sponsor economic populism may also turn to financial repression and seignorage to finance the big increases in public spending associated with their new, unfunded promises. This means they impose negative real interest rates upon savers and stoke inflation. “Development banks” therefore not only funnel money to populists’ friends but also subsidize mushrooming public debt. Or governments might sell banking charters to banks for a steep price in exchange for monopoly rights—as a quid pro quo they are obligated to finance the government’s budget deficit.

This approach to a nation’s political economy is not sustainable. Eventually, the government has to borrow ever greater amounts to prop up its favored industries and firms. Eventually, because the country becomes closed off from the world economy, it loses its competitive edge, prices spiral upward, domestic innovation grinds to a halt, and new ideas and technologies that would otherwise improve productivity and tame inflation are suppressed. As the economic winners selected by populists become ever more inefficient and corrupt, the losers who hunger to compete on an even playing field and who have the ability to, based on their education, skills and ingenuity, are left with fewer options—if they can, they emigrate to developed countries (see Albertus and Menaldo 2018).

RELEVANT EXAMPLES

Argentina

Since World War II, Argentina has oscillated between democratically elected, yet illiberal, governments and military juntas. Both civilian governments and generals alike have faced a nationalized and powerful labor union that has been quick to mobilize behind its economic and political interests. This has been coupled with heated demands by both nonunionized workers and the poor for social justice and increased government intervention in the economy. Rather than spurring the introduction of a mature and viable safety net, however, populists have unfailingly indulged in procyclical macroeconomic policies. The end result has been stagflation and widespread immiseration. What's worse: the captains of industry producing goods for the country's domestic market have never shied away from seeking protection from imports and generous rents at the expense of sound monetary, financial, and fiscal policy.

Before launching into the details, consider the fact that, at the turn of the 19th Century, Argentina was significantly wealthier than Canada, over 50 percent wealthier, in fact. However, over the 20th Century, the former's economy deteriorated significantly. By 2006, Argentina's per capita income was less than 50 percent of Canada's (see Figure 1).

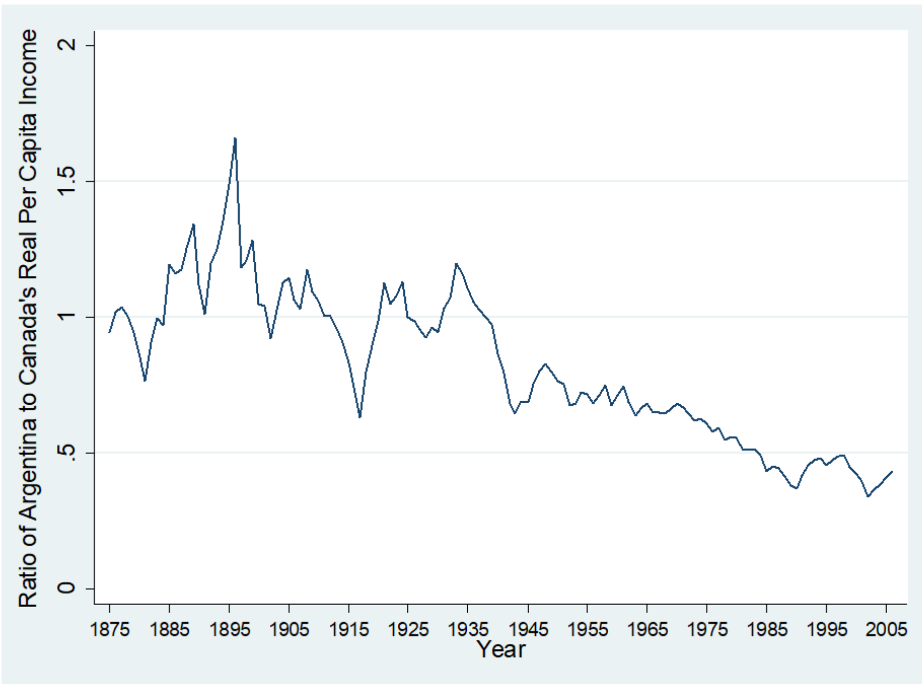
This is telling because, on paper, both countries are very similar. First, both were founded as federal systems that boasted strong provincial and local governments[11]. Second, they were populated by European colonists who encountered relatively small indigenous populations. Third, historically-speaking, their political economic model was characterized by settlers who farmed fertile land in the rural periphery well suited for grains, albeit each nation had a bustling, dense metropolis that was cosmopolitan and externally focused: Buenos Aires and Toronto, respectively.

Indeed, these countries' export-oriented economies were centered on trade with Great Britain; in the case of Canada, grains, fur, timber, and minerals; in the case of Argentina, grains and beef. Fourth, they industrialized (at least at first) quite gradually, on the back of the expansion of railroads into the interior and investments in infrastructure

[11] Canada gained independence from Great Britain in 1867 while Argentina became independent from Spain in 1816.

like ports. Fifth, they had very similar financial systems centered during long stretches of time on wildcat banking and a hands-off regulatory approach.

Figure 1. Ratio of Argentina's Real Per Capita Income to Canada's.



Notes: Real Per Capita Income for both countries in 2007 dollars.
Source: Haber and Menaldo (2011).

Economic populism was an important fork in the road that helps explain the divergence in their economic fortunes—albeit, as Figure 1 reveals, the onset of this divergence preceded its emergence. Juan Perón, a former general, first came to power in 1946 after a landslide electoral victory and reoriented the terms of political contestation in Argentina to pit agricultural capitalists and foreign investors against coddled manufacturing and labor.

Ruling for close to a decade, Perón had inherited a vibrant post-war economy with a substantial trade surplus. The country's limited participation in World War II meant that Argentina did not have to adopt policies of forced domestic austerity. This placid state of affairs was not to last, however. Perón and his populist successors ended up destroying the Argentine economy.

He was able to consolidate power through a multipronged approach. Perón replaced Argentina's liberal constitution with one that codified the notion that the state was in charge of managing private property to advance the "general" needs of the national economy and promote social justice. He purged the Supreme Court and then packed it with his political lackeys. The Peronist party and its political allies came to hold large majorities in both the Argentine Chamber of Deputies and the Senate.[12] Perón also set upon a campaign to intimidate the opposition and curb free speech, which culminated with the expropriation of the well-respected newspaper "La Prensa". In 1947, his administration rescinded university autonomy and sacked over 70 percent of the professors across six of the nation's most important universities.

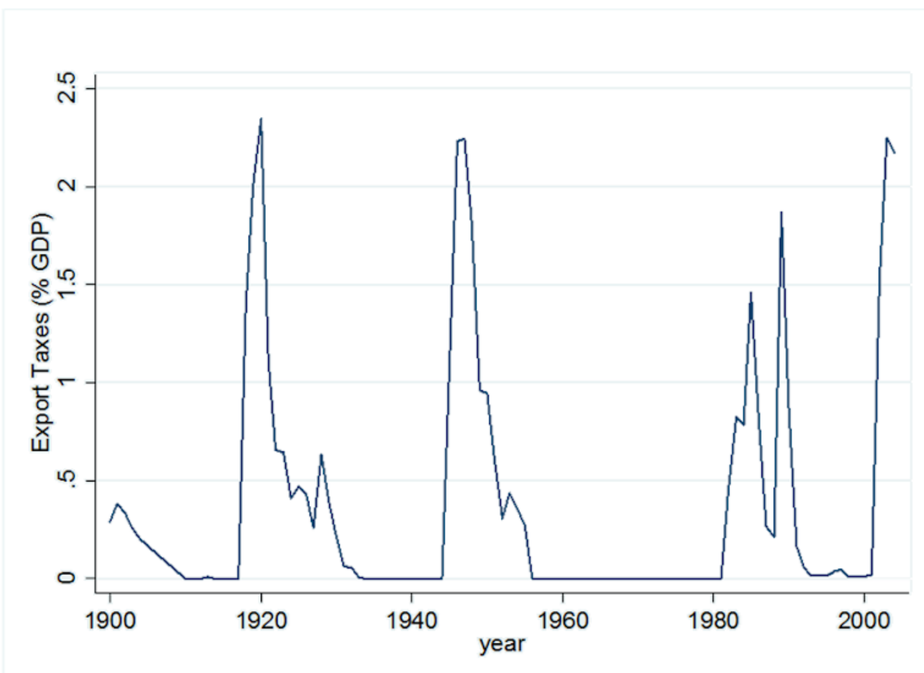
Consolidating political control over the three branches of government furnished Perón with the ability to engineer an economic revolution. He embarked on aggressive protectionism, industrialization, and redistribution based on distorting the market instead of slicing a growing pie more equitably. Economic policies under Perón were geared towards boosting the real wages of the unionized formal sector employees who supported him over his communist and socialist rivals. He imposed sizable wage increases for labor unions, annual year-end bonuses, vacation pay, sick pay, and severance pay. Perón's pro labor policies managed to boost real wages for both skilled and unskilled workers by about 35 percent in just a few years.

[12] This is not to deny that U.S. President Franklin D. Roosevelt did not attempt to pack the Supreme Court (he was denied by both Republicans and prominent Democrats), breached the norm against holding office for more than two presidential terms, and nationalized key industries. Admitting his populist tendencies does not gainsay our argument or the patterns we outline above.

But this came at a great cost. To help finance his ambitious plans, he raised taxes at confiscatory rates on the lifeblood of Argentina's economy, the outward oriented agricultural sector. This led to a plummeting of exports and, by extension, hard currency and, eventually, receipts from export taxes themselves. This was part of a recurring cycle of expropriatory taxation on Argentina's primary commodity exports, whether it be wheat or soy, repeated by populists throughout post World War II Argentine history, albeit it was a fiscal tactic that preceded Perón. Figure 2 illustrates that pattern.

Yet huge, unfunded increases in social spending, generous transfers to unions, and massive public sector investment required serious spending. Alas, as Figure 2 evinces, taxes imposed on agricultural exports were not a sustainable way to make up for the gap.

Figure 2. Populist Cycles of Argentina's Commodity Export Taxation

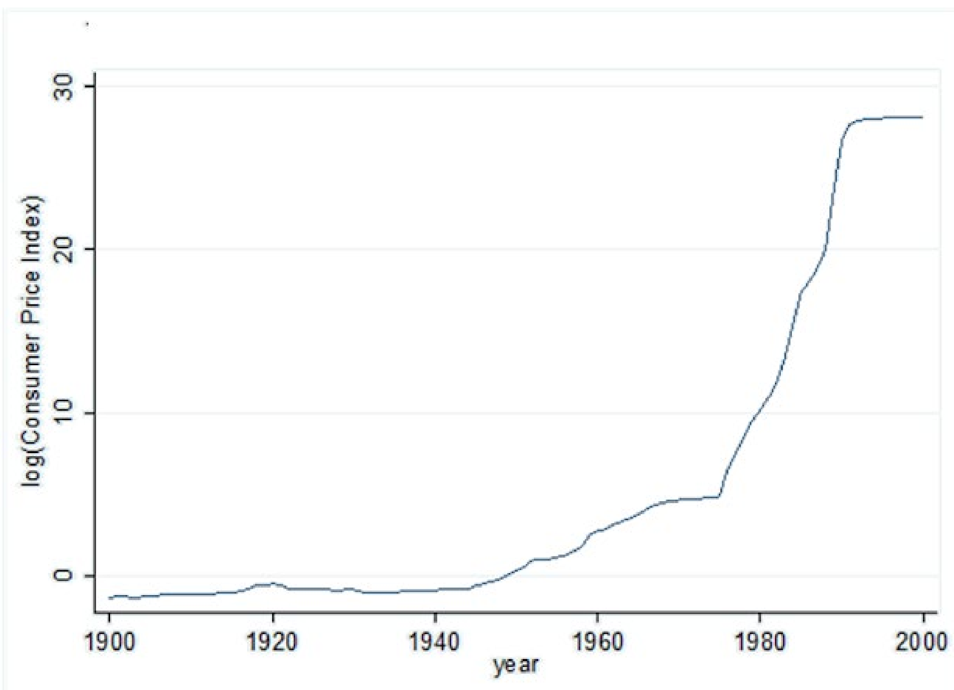


Notes: the vast majority of export taxes were levied by Argentine governments on primary commodities, with wheat and soy as the top two, but also cattle related exports.
Source: Menaldo 2009.

Thus, Perón turned to the printing presses to make up for a huge budget deficit, which fueled inflation: Argentina saw an increase of over 500 percent in consumer prices by 1955.

Ultimately, Perón's economy went into a tailspin, and he was ousted from power in a military coup. He returned as president in 1974, died in office the next year, and was replaced by his second wife, Isabel Perón. Under her leadership, Argentina saw a 50/50 income split between labor and capital for the first time in its history. Yet, like what had happened decades before under her husband's first bout in power, this also came at a significant cost: the inflation rate reached 400 percent by 1975, and she too was ousted by the military. Figure 3 depicts the inflationary legacy of Juan Perón's monetary populism.

Figure 3. Argentina's 20th Century's Inflation History

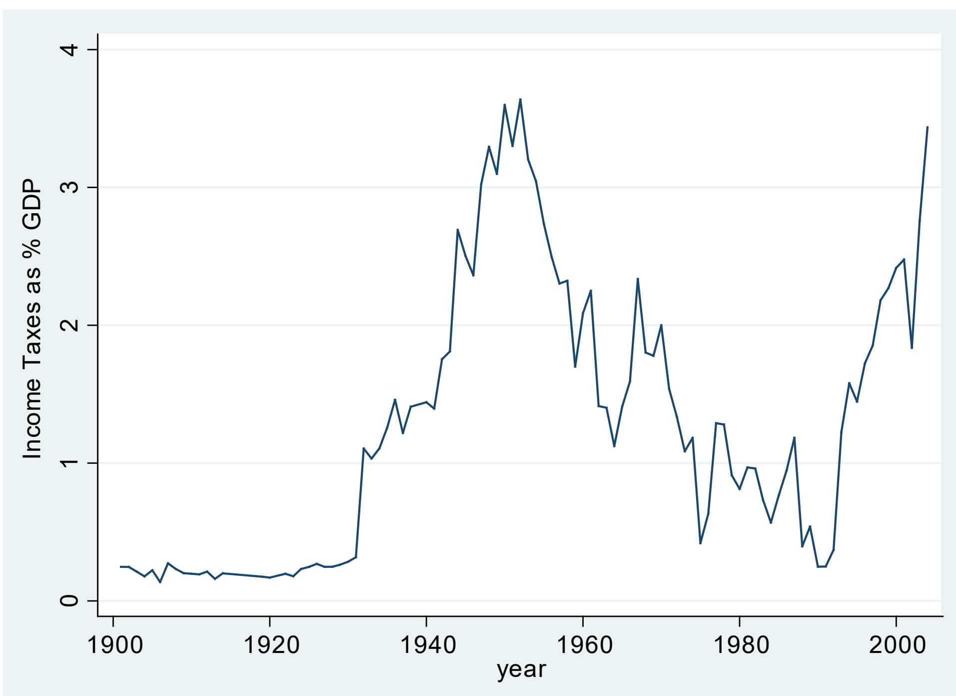


Notes: Index = 100 in 1970
Source: Astorga et al. 2003.

The military then ruled incompetently for almost a decade. Argentina suffered two currency crises and a sovereign debt crisis during this time. The first currency crisis occurred in 1975, followed by a second in 1981. A sovereign debt crisis hit in 1982. As had been the case under Perónism, a decline in the availability of international financing led the government to rely on monetary policy and restrictive bank regulations. This spurred several bouts of capital flight, precipitating two currency crises. While the government eventually eased up on financial repression, the real exchange rate appreciated, and the current account deficit increased. This led to both high inflation and a serious output shock. In turn, this ushered in a collapse in tax revenues (see Figure 4).[13]

These types of crises and their associated fallouts continued after the return of democracy in the 1980s—and the return of electoral populism. Argentina suffered its ninth and largest sovereign debt default in May of 2020 under the rule of the Perónist Party.

Figure 4. History of Argentina's Income Taxation



[13] This was for two reasons. First, bracket creep: increasing marginal rates were not adjusted by the tax authorities to reflect rising prices; thus, real tax obligations rose due purely to nominal increases in wages, encouraging income tax evasion. Second, taxpayers were incentivized to delay paying their taxes as inflation ballooned to allow the passage of time to erode the real value of their fiscal bill.

Notes: Income Taxes includes taxes on income, profits and capital gains.
Source: Menaldo 2009.

Chile

After several episodes of autocracy, Chile had become a full-fledged liberal democracy by the 1960s; populism would eventually trigger a reactionary coup that ended the experiment. It began with Jorge Alessandri's Administration (1958–1963). Alessandri indulged in monetary and fiscal stimulus, coupled with financial repression and price controls. This stoked Chilean inflation to alarming levels. Coupled with very high levels of external debt, the economic situation became unsustainable.[14]

To fight inflation, Alessandri adopted several stabilization and austerity measures aimed at constraining monetary policy and reducing fiscal deficits. At first, this included a partial wage freeze, restrictions on directed credit, a transition to uniform exchange rates, budget cuts, and tax increases. Alessandri's anti-inflationary policies were met with significant opposition. Organized labor mounted several nationwide strikes in response.

These protests had considerable success in arresting Alessandri's austerity measures. For example, although Alessandri tried repeatedly to rescind the automatic wage adjustment mechanisms that had been in place since the era of the Radical Party's hegemony (1938–1951), he ultimately failed. Moreover, his administration faced a severe balance of payments crisis in the early 1960s that culminated in a massive currency devaluation in 1962–further stoking inflation. Toward the end of his term, Alessandri revived price controls and import restrictions and rescinded credit restrictions.

Salvador Allende, Alessandri's successor, took things further. In 1970, he won the presidency on his fourth try with a small plurality (he garnered only 37 percent of the vote)

[14] This section draws on Albertus and Menaldo (2018).

at the head of a so-called Popular Unity coalition composed of communists and socialists. After running on an explicitly socialist platform and a pledge to "eliminate the hacienda," Allende immediately nationalized the copper industry through a constitutional amendment, expropriating the Anaconda and Kennecott mines without compensating their North American owners. He also expropriated more than five million hectares of land. Between Frei and Allende, 43 percent of Chile's agricultural land was expropriated or purchased from private landowners. Allende also nationalized the country's banks, as well as more than 150 firms, including more than 50 percent of Chile's largest companies.

The serial violation of property rights represented by these nationalizations was then complemented by subtler ones. Wage laborers and peasants took over several privately-owned factories and farms, triggering social unrest. Indeed, Allende leveraged the farm occupations to apply Article 171 of the 1967 labor law, which allowed the government to acquire private lands in the event of labor disputes. On the macroeconomic front, Allende unleashed the printing presses like no Chilean president before him. He did this to boost wages and salaries. Price controls were also instituted. Thus, the average inflation rate during his tenure was 152 percent; it reached a high of 362 percent in 1973.

The result was disastrous. Although in the short run these policies boosted demand and therefore economic growth, eventually they triggered an economic implosion. Real wages fell precipitously due to inflation, and economic growth collapsed. Chile's economic catastrophe galvanized domestic support for a coup by Chile's upper and middle classes, the military, and the Nixon administration. With the help of the CIA, Allende was overthrown by the military on September 11, 1973. That same day, a military junta composed of the heads of the armed forces, air force, navy, and national police force took over, with General Augusto Pinochet at the helm.

EUROPEAN POPULISM

The early 21st Century has witnessed the rise of Eurosceptic populists and the electoral successes of radical-left and far-right parties across the continent and English Channel. Across the political spectrum, these populists have voiced skepticism about, if not outright hostility to, the European Union. They have exploited several stereotypes held by citizens ranging from Britain to Poland about the EU: that it lacks democratic accountability, is remote from the people, and advances elite centric values eschewed by regular Europeans (Dustmann et al. 2017).

Why have we seen a rise in populism in Europe in the last decade? The financial and economic crises that began in 2009, and the refugee crisis beginning in 2015, played a crucial role. Therefore, unlike the Latin American cases outlined above, in the case of countries such as Greece and Italy, which we will evaluate in greater detail below, the sequence of events has run mainly from an economic crisis to populism to a worse crisis.

Yet, the way in which the Eurozone Crisis affected European nations did not occur in a vacuum; in the southern countries populist-like policies centered on debt and unsustainable spending had paved the way for an economic reckoning after 2008. Moreover, we show ahead that populism has only served to exacerbate the economic problems that fueled it across the EU. This illustrates that fact that while populism might thrive when the economy is in turmoil, populists inevitably turn to a playbook that makes things worse and, paradoxically, may make their electorates even more receptive to economy killing policies.

The European debt crisis started in late 2009 in the wake of the Great Recession. This sovereign debt crisis was the result of a mix of complex factors: a credit-fueled housing bubble, competitiveness differences across countries, and fiscal misbehavior. Examples of populist parties that arose after the Eurozone crisis are Syriza in Greece, Podemos in Spain, Italy's Five Star Movement, and Germany's AfD.

Countries in the Eurozone periphery (Greece, Ireland, Italy, Portugal, Cyprus, and Spain) were hit especially hard by a classic debt fueled balance-of-payments crisis (Frieden and Walters 2017). When peripheral countries joined the Eurozone, their economies suddenly looked more promising to investors: their borrowing costs plummeted and even matched Germany's, Europe's economic powerhouse. This bolstered investors' confidence in new member countries that had previously tarnished their reputation due to economic mismanagement. Countries in the so-called South borrowed heavily, largely to finance current consumption, and took advantage of the fact that financial institutions in Europe's slow-growing northern countries sought higher-yielding opportunities in the more rapidly growing periphery (Frieden and Walters 2017).

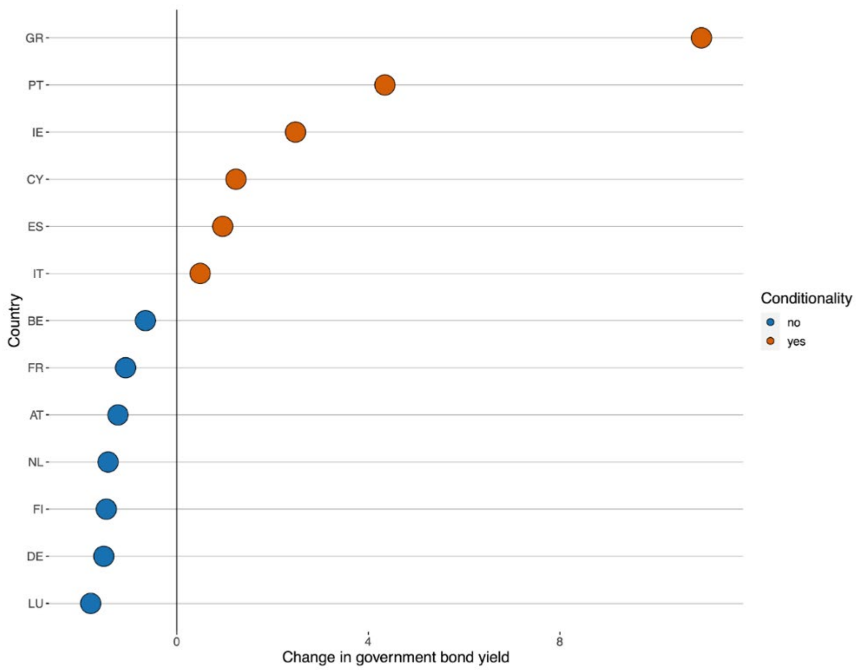
This heavy borrowing led to an economic expansion, which quickly turned from a boom into a modern-day bank run. Lehman Brothers' unexpected collapse in 2008 pricked the enthusiasm bubble: Once northern investors and southern depositors got nervous and started pulling their money out of the EU's periphery, it became clear to everyone that the economic expansion in Greece, Portugal, Italy, Spain, and even Ireland was the result of a credit boom and in some cases creative accounting, not a change in economic fundamentals. The most indebted countries found themselves unable to service their debts, unable to make up for the collapse of domestic demand by exporting, and unable to borrow additional funds due to skyrocketing yields on their governments' bonds.

Although Greece (and to some extent Italy) represented a genuine sovereign debt crisis, for the rest of the peripheral countries the crisis was mainly a private debt crisis, which then became a public debt crisis when governments had to step in to save failing private financial institutions (Blyth 2013). Also, apart from Italy, the other peripheral countries were highly indebted to the countries in the North. This opened a divide between northern Euro members (mainly including Germany, Austria, the Netherlands, and Finland) and southern ones (plus Ireland)—between debtors and creditors. The creditors were ultimately successful in shifting most of the burden of their balance of payments and fiscal adjustment onto the debtor states.

In 2010, Greece, Ireland, and Portugal became unable to access the sovereign bond market and eventually agreed to enter a bailout from the Troika – the EU, the International Monetary Fund (IMF) and the European Central Bank (ECB) (Bosco and Verney 2012). The situation for Italy and Spain was slightly different: Greece, Portugal, Ireland, and Cyprus entered into official agreements with the Troika in order to have access to financial aid, while Spain and Italy were subject to a more subtle "implicit conditionality" (Sacchi 2015), whereby the ECB dictated their policy response to the crisis behind the scenes.

Figure 5 illustrates changes in government bond yields from before (2007-2009) to after (2010-2012) the onset of the Eurozone crisis by EU country and conditionality status, whether the country was under an explicit or implicit adjustment program (Sacchi 2015). This graph reveals the stark division between the northern bloc (Austria, Belgium, Finland, France, Germany, Luxembourg, the Netherlands) and southern bloc (Cyprus, Greece, Ireland, Italy, Spain, and Portugal). In the latter, international investors began to demand higher premiums to buy their debt. As a consequence of these implicit or explicit fiscal adjustment programs, the southern countries and Ireland implemented stringent fiscal austerity packages and structural reforms.

Figure 5: Percentage change in Euro member government bond yields

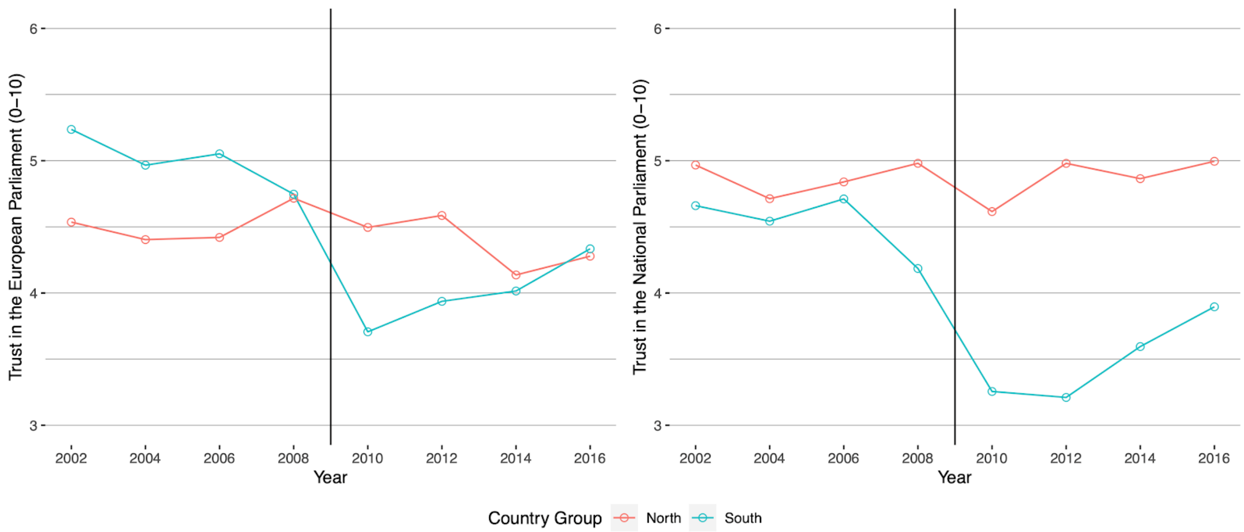


Notes: We exclude Estonia, Latvia, Lithuania, Malta, Slovenia and Slovakia, which joined the EU during or after the crisis. The data on government bonds is from the Economy and Finance theme, Interest rate subtheme, EMU convergence criterion series-annual data, of the Eurostat database.
Source: Eurostat.

Many studies have identified the recent financial and economic crises as major factors contributing to falling trust in various European and national institutions (Armingeon and Guthman 2014; Dustmann et al. 2017). Recent findings suggest that the negative effects of the economic crisis, the EU/IMF conditionality programs, and a widespread feeling by citizens that their choices were ignored at the polls affected their support for democracy, both at the national and at the European levels (Armingeon and Guthman 2014; Dotti Sani and Magistro 2016). Figure 6 illustrates how, while trust in

European and national parliaments remained relatively constant in the northern bloc, in southern countries the fall in trust after the 2009 Eurozone crisis was steep and substantial.

Figure 6: Trust in European and national parliaments.



Notes: We used waves 1 through 8 of the European Social Survey from 2002 to 2016, biannually. We exclude Estonia, Latvia, Lithuania, Malta, Slovenia and Slovakia (which joined the EU respectively in 2011, 2014, 2015, 2008, 2007 and 2009), and Luxembourg (which is only available in 2002 and 2004).
Source: European Social Survey waves 1-8.

We aver that this decline in trust is the direct result of the Eurozone debt crisis and fueled the rise of populist parties. The crisis not only caused economic hardship, but also placed considerable fiscal constraints upon a number of national governments, especially Greece. Many voters reacted to this development by turning their back on traditional parties and opted instead for new, or reinvigorated, challenger parties that reject austerity and European integration (Hobolt and Tilley 2016). Indeed, Dustmann, et al. (2017) find that there is a strong correlation between the probability of voting for a populist party and attitudes towards European integration and trust in political institutions. Specifically, low probabilities of voting for right-wing or left-wing populist parties are associated with a positive view towards European integration and high levels of trust in political institutions – both the European Parliament and national parliaments.

With the effects of the Eurozone crisis still lingering for some countries, the European migrant crisis (or refugee crisis) began in early 2015. This unleashed a rapid flow of millions of people from Syria and other Middle Eastern countries. Political and economic refugees entered the EU from across the Mediterranean Sea or overland through southern Europe. Eventually, on the heels of several failed attempts to reach an EU reallocation scheme some bilateral, ad-hoc agreements were made between EU countries; however, these are political agreements signed to cope with emergency situations outside of formal mechanisms and rules.

The refugee crisis had profound effects on European societies and increased the political strength of the far right (Dustmann, Vasiljeva, and Piil Damm 2019). The refugee crisis provided a powerful narrative for right-leaning populist parties to capitalize on in both the west (e.g., AfD in Germany, Lega in Italy, Front National in France) and the east (e.g., Fidesz in Hungary, Law and Justice in Poland). As a matter of fact, after the 2015 refugee crisis, although attitudes towards immigration did not change, the salience of immigration increased in most EU countries, often contributing to explain the rise of anti-immigration parties (Mader and Shoen 2019; Magistro and Wittstock 2020).

Greece

In the aftermath of the Eurozone crisis, the first experiment with populism in the EU occurred in Greece. When in October 2009 Socialist Prime Minister George Papandreou's government took office, he revealed to the world that, due to undisclosed debt, at over 12 percent of GDP, the budget deficit was double what the previous government had estimated. The budget deficit eventually reached 15.6 percent of GDP, more than five times the EU limit of 3 percent. Soon after that, Fitch downgraded Greece's credit rating. This was the first of a sequence of downgrades by all ratings agencies and precipitated the decline of Greece's debt into junk status.

First, in 2010, and then, in 2012, Greece negotiated two bailouts with the Troika that were conditional on adopting austerity measures and structural reforms. The fiscal and economic adjustments that Greece undertook after 2010 under the auspices of these bailouts were historically unprecedented. This, and the fact that many of the structural reforms advised by the Troika were not implemented, exacerbated the economic crisis.

Disillusioned and angry about the economic situation, Greeks catapulted Alexis Tsipras, from the fledgling Syriza Party, to the prime ministership in 2015 on an anti-austerity platform, which included plans to nationalize banks, expand the public sector further, stop all forms of privatization, extend unemployment benefits, and raise the minimum wage, all while cutting taxes. Syriza, a relatively minor far left party founded in 2004, had suddenly gained outsize electoral success. Although the party's platform was not explicitly populist during its founding, populism became its most prominent feature after the Eurozone crisis and the subsequent bailouts (Font, Graziano and Tsakatika 2019).

While things got off to a relatively good start under Syriza's rule, it was not to last. When Tsipras came to power, Greece had attained an unexpected primary budget surplus between January and September 2014; but, after the elections, as the Syriza-led government declared that they would not respect the terms of the current bailout agreement, the situation drastically changed. Tax compliance sharply deteriorated.

This heralded the start of an epic Game of Chicken. The Eurogroup granted Greece a four-month extension of its bailout program, which would have to be renegotiated by the end of April 2015. However, Tsipras rejected the existing bailout terms, hence the Troika suspended all of the remaining aid, expecting to renegotiate the terms soon after. This was not to be. The government broke off negotiations in June and announced a referendum, eroding whatever trust the rest of Europe still had in Greece.

Once the referendum was announced, capital flight worsened as investors and depositors feared that capital controls would soon be introduced. Eventually, in June 2015, their worst fears were realized: capital controls were adopted by the government and Greece was forced to close banks for about three weeks and put limits on cash withdrawals.

While the Game of Chicken did not end there, it did not end well for Greece. While the worst outcome for both contestants, Grexit, was avoided, Greece swerved and the rest of the EU drove straight ahead, leaving Greece to fall into a ditch on the side of the road. Opinion polls revealed that, as much as Greeks did not want any more austerity, they also did not want to leave the Eurozone. With the fiscal surplus long spent, and the country spurned by international financial markets, Tsipras would have been forced to implement austerity even if he abandoned the Euro. Greece had to accept a new deal, which was even worse than the one over which his government had called a referendum. In this final version of the bailout, there was no mention of debt relief and Greece conceded more to creditors than the previous one.[15]

[15] However, while there was no specific mention of debt relief, as it would have been against EU rules to concede on this front, Greece did secure indirect debt relief in the form of low interest rates with very long maturities.

When Tsipras won his first term at the start of 2015, he did so by pledging that he would keep Greece in the Eurozone while making its partners concede much better terms for a new bailout plan. Instead, not only did he not keep his promise, he exacerbated the crisis by forcing Greek citizens and businesses to live with punishing capital controls that further harmed the economy. Tsipras was forced to sign an agreement where Greece hardly won any concessions. By calling a referendum impulsively, he protracted the economic crisis for years. Tsipras was eventually voted out of office in July 2019, marking the end of Greece's populist experiment.

Italy

Italy's first encounter with populism happened much earlier than Greece's and is reminiscent of what has happened in the United States since 2015. Well before President Donald Trump entered American politics, Silvio Berlusconi came into the Italian political scene as a bombastic outsider, presenting himself as a self-made billionaire who would eradicate the existing corrupt political class and run the nation like he ran his businesses. He also claimed to be the true and authentic voice of ordinary Italians fighting with high taxes and bureaucracy, while dismissing his critics (including judges) as communists.

When the Eurozone crisis hit Italy, Berlusconi had put his country in a precarious economic position. The reform inertia that plagued his years in government made the Italian economy and welfare state much more vulnerable to external shocks (Sacchi 2018). Low interest rates on Italian government bonds after the country joined the Eurozone meant relief vis-à-vis servicing its huge public debt. In turn, this reduced pressure for structural reforms, including welfare reforms, when Italy could least afford to delay. Demographic changes, technological change, and globalization created new risks and challenges, but

Italy eschewed making the adjustments needed to adapt to this new reality. As a result, its economy hit the skids as its birthrate plummeted and immigration created conflict between native born Italians and newcomers.

Then the 2008 financial crisis hit. A sharp decline in investors' belief that Italy could continue to service its ballooning debt load began in the summer of 2011. This brought the country to the verge of a financial collapse and heralded devastating consequences for the EU as well. Italy was faced with the prospect of refinancing, on average, one billion Euros a day of its public debt, which now stood at over 130 per cent of GDP. Suddenly, investors started either turning their backs on Italian sovereign debt auctions or demanding very high interest rates. The spread between Italian 10-year bonds and their German counterparts rose to over 550 basis points in November 2011. Italy was at risk of becoming the new Greece.

Although Italy never entered an official conditional aid program with the Troika, it did yield to international pressure and committed to introduce wide-ranging reforms (especially pension and labor market reforms); this promise proved only paper thin, however. While this commitment was strongly advised by the ECB in a letter dated August 5th 2011, the Berlusconi government became paralyzed by internal conflict and inertia. After losing the support of its own coalition members, it resigned on November 12th in a cloud of political chaos. Italy's President then appointed Professor Mario Monti, a former member of the EU commission, as head of a "technocratic" government composed of experts drawn from civil society who lacked formal political affiliations.

The reforms passed by the technocratic Monti government saved Italy from having to join formal conditional aid programs administered by the Troika; yet they were insufficient nonetheless. A pension reform bill was passed 20 days after Monti took office in the midst of financial collapse. It was approved by the entire Italian parliament. Yet a labor market reform package was substantially watered down by the legislature once the collective sense of urgency had subsided. Furthermore, Monti failed to introduce much needed structural reforms, including one slated to liberalize the service sector.

Surprisingly, even on the heels of a grave economic crisis and a rather feckless technocratic government, Italy did not overwhelmingly vote for populism, but went back to mainstream parties and appointed a grand coalition government in 2013. This grand coalition was the result of the unlikely union between the center-left led by the Democratic Party, and the center-right led by Silvio Berlusconi. The government was headed by the Democratic party with first Enrico Letta at the helm, then Matteo Renzi between 2014 and 2016, and finally Paolo Gentiloni through the next election in 2018. However, a populist party, the Five Star Movement (FSM), founded by Beppe Grillo, a former comedian, gained a significant number of votes during the elections and gained politically pivotal seats in parliament. In a blog post, the main channel of communication for the FSM, Grillo explicitly stated that: “the FSM is not a rightist nor a leftist phenomenon, it’s on the side of the citizens. Proudly populist” (Font, Graziano and Tsakatika 2019).

While Renzi’s main accomplishment as PM was passing the bold “Jobs Act Reform,” which coupled labor market deregulation with increased welfare protection, by early 2016 his centrist approach was flagging. Sluggish growth did little to placate the majority of citizens who opposed what they saw as divisive reforms (Sacchi 2018). As a result, Renzi took a more accommodative stance towards Italy’s powerful labor unions and he indulged in clientilistic politics. He softened the Fornero pension reforms and once again allowed workers to retire earlier than they had after the changes made in 2011 and 2012.

The timing of Renzi's backsliding could not have been worse. As his government failed to deliver reforms that might put Italy on a more sustainable fiscal—and, eventually, economic, path—and as the economy remained stuck in neutral, a refugee crisis of unprecedented proportions hit Italy in early 2015. Arrivals of immigrants by sea increased from about 13,000 in 2012, to 170,100 in 2014, 153,842 in 2015 and 181,436 in 2016. The country found itself incapable of dealing with so many newcomers.

This set the stage for the return of populism. On the eve of the 2018 national elections, Italians were dissatisfied by the Democratic party's performance in government, and angered by continued economic hardship and the rising influx of immigrants. Immigration and the economy were two of the key issues during the 2018 election and the anti-establishment FSM and Lega parties successfully fed off of citizens' increasing anger and disillusion. While both the FSM and the Lega have expressed openly anti-EU and nationalist positions, historically the Lega has been Italy's main anti-immigrant party. After the 2015 refugee crisis, it graduated from a regional (northern) party to a national one.

Both the FSM and Lega ran on very different but similarly populist platforms during the 2018 elections. The FSM's agenda was centered on promises to introduce a guaranteed minimum income, increase public investment and employment, abolish illegal immigration, slash the costs of politics, and reintroduce early retirement, while the Lega were centered on similar promises to reintroduce early retirement, deport migrants, while at the same time introducing a flat tax that would cut taxes. The two parties then formed an unlikely coalition government in May of 2018.

The FSM-Lega populist government was true to its constituent parties' electoral campaigns. It introduced a guaranteed minimum income—which led Di Maio, the current FSM leader, to brag that they had "abolished poverty"—and further relaxed Italy's hard-won pension reforms. These policies are forecast by some analysts to cost upwards of 45 billion euros over a 10-year period.

In September 2019, as the Lega was riding high in the polls and its coalition partner, the FSM, was collapsing, Matteo Salvini (the leader of the Lega) pulled the plug on Italy's government. However, rather than calling elections, the President of the Republic, Sergio Mattarella, entered into deliberations with the FSM and Italy's Democratic Party to see if they could form a new coalition government, which they did, leaving the Lega on the political sidelines. Populism is far from dead, however, as the Lega continues to be beholden to a constituency that opposes economic reforms and is hostile to immigration, and as of October 2021, is polling at close to 20%, while Brothers of Italy, a far-right nativist and Eurosceptic party, polls at close to 20%, up from 4% in the 2018 elections.

CONCLUSIONS

In this paper, we provide a framework to make sense of economic populism and explain the systematic association between economic crises and populism. We argue that populists representing either the left or the right tend to converge on a similar political economic model based on zero-sum thinking, which complements other perverse policymaking patterns, including protectionism, crony capitalism, and inveterate rent seeking. We provided examples to adduce support for our view: Argentina, Chile, Greece, and Italy.

Contrast all of this with liberal democracies coupled with strong welfare state capitalism. This type of political economic system is conducive to "win-win" situations:

the sum of gains and losses is positive and the gainers gain more than the losers lose. Acknowledging tradeoffs is valued. Pluralism means empowering those who stand to both win and lose from economic reforms. Cost benefit analysis is baked into bureaucratic protocols. Experts can collect and analyze data. They inform their decisions with welfare economics: minimizing distortions, reducing inefficiency, and growing the pie.

It is therefore unsurprising that the most economically developed countries on earth, with the exception of Singapore, Brunei, and some of the Persian Gulf emirates, are liberal democracies. These countries are also industrialized economies that have a high capital to labor ratio, advanced technology, and highly skilled and educated populations. In the battle between liberal democracy and populism, the stakes could not be higher.

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