The Perils of Economic Populism

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Abstract: What is the relationship between economic crises and populism? Once almost exclusively the domain of Latin Americanists, the study of populism has emerged as a leading research agenda for scholars who study Europe and the US. However, researchers have hitherto failed to systematically account for the logic of economic populism and the fact that 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 provide a framework to make sense of this pattern and explain the systematic, mutually reinforcing association between crises and populism. We also adduce supporting evidence from very different places, Argentina, Chile, Spain, Greece, and Italy, and across disparate time periods. We argue that populism almost always threatens both liberal democracy and welfare state capitalism and 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. We also speculate about what might be in store for liberal democracy in light of the Covid-19 pandemic.

Argentina has cycled between populist democracies and military dictatorships over its modern history. This has catalyzed countless economic crises and catastrophes. The same is true of other Latin American countries. By contrast, Europe's liberal democracies and the US have largely avoided this predicament, at least since World War II. That is, until now: Their political-economic equilibrium seems to have unraveled since the 2008 Global Financial Crisis; with citizens increasingly questioning the legitimacy of incumbent institutions, including the media and higher education, researchers fear liberal democracy itself is under threat (e.g., Albertus and Menaldo 2018; Levitsky and Ziblatt 2018).

What is the relationship between crises and populism? What explains why some countries have avoided the economic perils associated with populism that have visited Spain, Argentina, Chile, Greece, and Italy? Why have contemporary politicians and publics flirted with populism in Great Britain, India, Poland, Hungary, and the United States despite its poor economic track record? Given the economic collapse engendered by the Covid-19 pandemic, what might be in store for populism and liberal democracy?

Populism is, roughly, the idea that the time-honored institutions that undergird liberal democracy and welfare state capitalism, and the experts who help them function, should be ignored in favor of the so-called will of the people, usually represented by a charismatic leader. The opposite is pluralism, which sees the opposing interests and opinions of the people as a strength, favors diversity, and espouses the view that politics is about compromise. Although for decades the study of populism was limited to Latin Americanists, given the recent rise of populist far right and far left parties, it has recently captured the attention of scholars who study Europe and the US.

While the institutions that populists rail against vary from place to place, populism almost always threatens both liberal democracy and welfare state capitalism. 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 destruction: the churn of ideas, firms, and industries that drive economic dynamism (North, Wallis and Weingast 2009). They also adopt policies that reduce risks associated with market exchange (Albertus and Menaldo 2018).

The checkered development history of populism should therefore give us pause. Whether they are governed by politicians on the left or the right, these political experiments share one thing in common: they usher in economic collapse. Populists spend too much too quickly, expropriate property from the wealthy, corporations and banks, and engage in trade protectionism and mercantilism. The upshot is economic volatility and stagnation induced by chronic balance of payments problems, sovereign debt defaults, financial crises, and hyperinflation. The ultimate result is a reactionary countermovement expressed in either a coup or internecine violence and rampant political instability. Today, Turkey and Venezuela tell a similar story.

Conversely, liberal democracy and welfare state capitalism have worked together, at least since the end of World War II, to promote political stability. Indeed, in Latin America populism has unfailingly led to economic and political crises. What is particularly troubling about today's populist reincarnation is that demagogues have exploited preexisting crises and rode waves of uncertainty, fear, and dissatisfaction with the status quo to office. They have then fomented further chaos once in power. Hungary's Viktor Orbán is a prime example, but there are others.

Besides evaluating this thesis, we seek to make a few additional contributions to the study of populism here. First, we submit that, 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 invariably characterized by "win-lose" situations. Moreover, populists are wont to stigmatize an outgroup: a convenient 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 from the left or the right, are equally tragic and 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.

In the rest of this paper, we explain the troubled economic and political history of populism. 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 provide a framework to make sense of this pattern and explain the systematic association between economic crises and populism. We proffer both historical and contemporary examples to adduce support for our view that include not only Argentina but also Chile, Spain, Greece, and Italy. We also play Cassandras, and forecast what the future might look like if populism continues its current ascendance.

WHAT IS POPULISM AND WHAT ARE ITS IMPLICATIONS?

There is some debate among scholars on how to define and understand populism. Let us start with the three main materialist conceptions, namely, economic, structural, and political-strategic, before turning to the dominant, ideational view. According to the economic definition, populism is associated with short-sighted redistributive policies. Daron Acemoglu and his colleagues define populism as “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). The structuralist definition of populism is a regime type controlled by a charismatic strongman who, motivated by an anti-status quo ideology, builds cross-class alliances and pursues import substituting industrialization. The political-strategic approach sees populism as a mass movement led by charismatic outsiders who exploit preexisting anti-elite discourse.

For the ideational approach, a few key ideas are the real, driving force behind the material features of disparate populist movements (Hawkins and Rovira Kaltwasser 2017). According to Hawkins et al. (2019), populism’s core feature is that it sees politics as a cosmic struggle between “the pure people” and the “corrupt elite”. Populism, however, is ultimately parasitic: it lives off a larger, host ideology, be it nationalism, socialism, or even liberalism. How it interacts with these “isms” depends on the historical, socioeconomic, and political context (Hawkins et al. 2019).

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. Populists may appeal to a wide array of groups, with differences over who constitutes the in-group versus the out-group. In its nativist variant, populists pit the interests of native-born citizens—the “pure people”—against those of immigrants. Left-wing populism envisages the nefarious elite as an alien force. In the case of the several episodes that have visited Latin America, US imperialism has been cast by populists as the perennial enemy. In the case of the aftermath of the 2009 sovereign debt crisis in Greece under Syriza, it was the European (creditor) Troika and the global economic system.

Studies of populism have also made a distinction between inclusionary and exclusionary populism (Mudde and Rovira Kaltwasser 2013). With respect to the material aspect, 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. Although a stark distinction is drawn between exclusionary and inclusionary populism by researchers, an overlooked feature of both types of populism is zero-sum thinking in the economic sphere. This pathology has grave consequences.

Populism and Economics

The interaction of populism and economics can be catastrophic. Populism is characterized by zero-sum thinking, an inability to admit to, and take tradeoffs, seriously, and the shrinking of time horizons to focus on the here and now with a disregard for future consequences, let alone long term planning.

Many of the economic policies proposed recently by aspiring populists both on the right and left subscribe to a zero-sum mentality: “your gain must be my loss.” Although populism should not necessarily be conflated with nativism (as exclusivist ethnic nationalism), the two often co-exist, especially in Western democracies. Central to both nativism and economic nationalism is a belief in zero-sum competition: any gains immigrants make must come at the expense of members of the host society. Similarly, the outsourcing of jobs to another country is subject to zero-sum-thinking: jobs gained in one country must mean a loss of jobs in another.

Zero-sum thinking complements other perverse policymaking patterns. Politicians who eschew admitting to and considering tradeoffs, including just simple opportunity costs. They may also ignore possible second- and third-order effects. Cost benefit analysis is for suckers; after all, it is conducted by sinister experts with ulterior, possibly globalist, motives. But this may be a moot point in any event, given that populists tend to indulge in short termism: the search for immediate payoffs at the expense of future costs and risks.

Liberal Democracy and Welfare State Capitalism vs. Populism

Contrast all of this with liberal democracies coupled with strong welfare state capitalism. North, Wallis and Weingast (2009) have argued that these things are complements and share a common DNA. We draw on their magnus opus to make the following points. Political rights nourish economic rights and vice-versa: both liberal democracy and capitalism depend on pluralism, competition, openness and taking calculated risks, whether at the ballot box, the front office, or the box office.

Liberal democracy and capitalism both rely on free speech, freedom of assembly, and the freedom to create a long-lived organization—corporations, unions, political parties, lobbying groups, and voluntary organizations. If you can register a political party, lobbying group, a union, or a rotary club, you can also start a business, open a bank, hire and fire workers, and expand your business into new markets. Both liberal democracy and the market rest on allowing individuals and organizations to enter new spaces, compete, and make their voice heard.

Liberal democracies are more legitimate and more effective than populist democracies and autocratic regimes. By participating in the political process in a host of different ways, citizens consent to it and tend to recognize the connection between public policies and their own lives. Liberal democracies tend to adopt policies that benefit the majority, not only a narrow elite. This is because of the voice and accountability bestowed by voting, checks and balances, and professional, depoliticized bureaucracies.

Now consider the lifeblood of capitalism: property rights, impartial contract enforcement, policies and regulations that reduce transaction costs, including the provision of public goods, and the rule of law. Taken together, these things nurture the allocative and productive efficiency of capital and other scarce resources, as well as their accumulation. They also foster the knowledge, education, and technology that fosters innovation.

Liberal democracy is therefore the key to economic development. It depends on the rule of law. It distributes political power relatively broadly and, if done right, reflects a society's diversity. It is a peaceful and legitimate way of processing political conflict. It also reduces the stakes of politics.

Vibrant markets require all of these things. More directly, politicians are punished for adopting bad economic policies and rewarded for good ones. This includes the encouragement of freer entry and exit and market competition, the promotion of larger and more sophisticated financial systems, and the promotion of innovation and adoption of advanced technologies.

Authors as diverse as Adam Przeworski, Barry Weingast, James Fearon, and Steven Levitsky and Dan Ziblatt have argued that, for a democracy to become a consolidated, liberal regime, and avoid populism or worse, it must be self-enforcing.[1] Formal institutions that define the rules of the game are ultimately enforced by informal institutions: shared values and beliefs. These norms, if enforced by citizens, incentivize politicians to stick to democratic rules.

Democratic norms must be underpinned by a broad consensus over basic rights and the rules of the game. Politicians must also share this consensus. In fact, both must police obedience to these norms: citizens and politicians must coordinate to punish those who defect from the consensus. If aspiring strongmen stop tolerating dissent, or stop exercising the forbearance needed to support the rule of law, then other branches of government must join the citizenry in calling out and sanctioning that behavior.

What this looks like in practice is that elections and governance are about peaceful competition with strong rules. Politicians and citizens with conflicting interests must respect the verdict of the polls and courts. While incumbents put control of government on the line by holding elections and respecting the results, losers wait for their chance to win office instead of using the threat of violence to take power. The majority on one issue does

[1] For the formal citations see the References section.

not attack the minority, or seek ultimate victory. Incumbents do not abuse the law to punish their enemies. By the same token, the minority does not act as a spoiler by trying to do an end run around political institutions: it accepts verdicts against it. This entails that the key norms that undergird liberal democracy are mutual tolerance, forbearance, and viewing those who disagree as the loyal opposition, not implacable enemies that must be vanquished (Levitsky and Ziblatt 2018).

There should therefore be strong incentives for governments to be responsive in a liberal democracy. And this further reinforces industrial capitalism and supports economic development. In liberal democracies, as Olson (1993) has argued, politicians have an encompassing interest as they represent the people and the people make their living from participating in the market. Therefore, the ruler will not care exclusively about maximizing state revenues or her personal fortune but seek to grow the pie and reciprocate taxes with public goods and social insurance. More to the point: in liberal democracies incumbents have strong incentives to promote prosperity, as failing to do so throws them out of office. Inveterate rent-creation and rent sharing is simply an inefficient political strategy; it either takes too long, or is simply too hard, for politicians to cobble together a large enough group to win office (Bueno de Mesquita et al. 2003).

The result is that clear and secure property rights and the rule of law in general will be written into the constitution and embodied in the legal system. Moreover, some political parties on the right will represent creditors and asset holders. Yet, just as important, some parties on the left and in the center will represent wage earners and the middle class and make sure their tax revenues are reciprocated with education, which raises their skills and wages, and public goods that reduce transaction costs or that are a key to innovation, such as basic scientific research (Albertus and Menaldo 2018). Therefore, although in a few areas you may see groups who can secure rents, such as agricultural lobbies that obtain tariffs or bankers that coopt banking regulations to erect barriers to entry or exploit excessive risk taking, eventually these rents will dissipate because pluralism ensures other groups will rise to enact countermeasures. In other words, in a true liberal democracy lobbying by one special interest is checked by lobbying by other special interests (North, Wallis, and Weingast 2009).

Finally, in a liberal democracy there are myriad incentives and opportunities for watchdogs to arise on the scene and monitor both governments and corporations. These include organized groups and political parties. These forces also empower consumers to identify corporations that cheat, steel, collude, harm consumers, and do bad things in general. This is yet another way in which liberal democracy reinforces capitalism and keeps it from devolving into crony capitalism (Albertus and Menaldo 2018).

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, as 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 and inform their decisions with the lessons of welfare economics. For example, the antitrust agencies of advanced industrial countries are staffed by economists who estimate econometric models to evaluate the consequences of their decisions and use clear objectives and metrics when making these choices, such as the impact that firm mergers have on prices and innovation.

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. The most developed countries on earth are also industrialized economies that have a high capital to labor ratio, advanced technology, and highly skilled and educated populations. The stakes could not be higher.

Constant process and product innovation since the First Industrial Revolution explains the above 2 percent levels of economic growth that culminated in thirty-fold or greater increases in living standards since 1820. We are much, much richer than our ancestors could ever have dreamt of being. Plus, there are many, many more of us alive today and most of us enjoy more and better food, higher quality clothing at a fraction of the price, cheaper and safer travel, medical devices that detect and treat almost every malady known to humans, and supercomputers in our pockets with more processing power than the machines who put men on the moon. While the fruits of the capitalist bounty are far from equally distributed, the path of improvement in absolute living standards is incontrovertible (e.g., McCloskey 2016; Gordon 2017).

How did this happen? Industrial capitalism unleashed specialization and innovation that allowed for an unprecedented escape from the Malthusian cycle of diminishing returns and immiseration experienced by our ancestors, in which growing populations outstripped their resource base. In per capita terms, we now produce and consume much, much more with fewer resources. In turn, industrial capitalism has thrived in liberal democracies, beginning in the Netherlands and Great Britain, continuing in Belgium, the United States, and Sweden, and then flourishing, after World War II, across Western Europe, Japan, and the Asian Tigers, which democratized while finetuning this system. Countries as diverse as Sweden, South Korea, Australia, Canada, Uruguay, and Botswana have also developed sophisticated and generous safety nets that protect workers against the risks and changes associated with the market.

THEORETICAL FRAMEWORK

Paradoxically, populists almost always 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 nonetheless only represent a minority of workers, most of whom who remain unorganized and politically vulnerable. Populist economic policies induce scarcity that generates monopoly profits in the non-tradable sectors. They benefit industrialists, managers, and laborers clustered in urban areas (Albertus and Menaldo 2018; Bates 1981; Haber, Razo, and Maurer 2003; Menaldo 2016a; 2016b).

For starters, 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. In the same vein, governments may grant these firms special permits to import capital and intermediate goods under the auspices of cascading tariffs structures.

Populists governments also exploit a welter of additional tools to stimulate industrial production that benefits politically favored insiders. They may impose high barriers to entry, including subsidizing credit (more on that below) and foreign exchange and restricting foreign ownership. Populists may also subsidize their friends’ 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. Populists may go further still and hammer firms and business interests outside of their coalition with specious antitrust suits, irregular "windfall" taxes, fines, requirements to obtain special licenses, sky-high borrowing costs, and a climate of fear, intimidation, and uncertainty.

Financial repression is always an ingredient in the tried-and-true economic recipe followed by populists of all stripes (see Menaldo 2016c). 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; quantitative restrictions on the amount of credit allocated; (iii) 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; (iv) restrictions on the entry of new competitors in the banking sector; (v) and mandatory investments that occur via loans directed by the state, loan guarantees, and strategic 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; so do total deposits—as asset holders looking for higher returns exit the financial system—and 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. The state can engineer these rents by heavily restricting the number of bank charters it allocates and/or circumscribe banks' branches. This restricts the supply of credit so that interest rates on ordinary loans exceed their marginal cost. Moreover, states may help bankers generate rents by allowing politically favored banks to increase their leverage—for example, by allowing them to reduce their reserves. The government may also allow some bankers to increase their lending portfolio's riskiness by allowing them to maintain a low rate of equity to deposits loaned out. And even if politically favored banks do face abnormally high reserve requirements in order to finance government budget deficits, profits that are just as abnormally high due to barriers to entry make up for these foregone lending opportunities.

Moreover, politically connected firms may obtain rationed credit at negative real interest rates. For example, governments 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.[2] Or, politically unfavored borrowers may turn to alternative, perhaps informal credit markets that are expensive and volatile. Unorganized 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 need 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 (Bates 1981). 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: the 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

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[2] 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."

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.[3]

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

[3] 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.

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).

To understand how populism threatens the prosperity and progress associated with liberal democracy and welfare state capitalism, we now turn to the history of populist experiments that visited several countries during the 20th Century.

SOME RELEVANT HISTORICAL EXAMPLES

Spain

Spain experienced economic populism during the better part of the 20th Century. This phenomenon began during the early 1920s when Miguel Primo de Rivera, a dictator who succeeded a republican interlude, ramped up protectionist policies and used the rhetoric of nationalism and self-sufficiency as a smokescreen to erect barriers to entry and actively pick winners and losers.[4] This was just the beginning. After another, short experiment in parliamentary government, Francisco Franco put economic populism on steroids during the 1940s. With the support of the so-called Falingists, he adopted a cascading tariff structure, quantitative import restrictions via licenses, and foreign exchange controls with multiple exchange rates. Franco also nationalized enterprises under the auspices of the *Institute of National Industry*, a state holding company.

What remained of the private economy was heavily regulated to achieve national investment and employment goals, as well as to boost the earnings of industrial sector wage

[4] To be sure, protectionism did not emerge out of nowhere. There were tariffs levied on imports in 1891, 1906, and 1922. Some researchers argue that these tariffs were not protectionist per se; that they instead served as revenue generating measures. See Berend and Ranki 1982: 106; Tortella 2000: 201. On the other hand, non-tariff laws that subsidized domestic industrialization efforts were passed in 1907, 1909, 1917, 1918, and 1922 (see Roses 2003: 999).

earners. There were two reasons for this. First, Franco included important industrialists and labor unions in his ruling coalition. Second, the regime feared instability associated with labor militancy and leaned on magnates who headed heavy industries for political support.

The details were straight out of a mercantilist playbook. Tax breaks and subsidies were doled out by the Spanish government to a host of manufacturing industries, including textiles, domestic appliances, and vehicles (Pons Brias 2002). The state also encouraged mergers to ostensibly “help firms reach economies of scale” (de la Torre and Garcia Zuniga 2014: 169), but Spanish firms rarely achieved this status during Franco’s regime. Under the umbrella of stringent local content requirements, Foreign Direct Investment played a limited economic role at this time: Franco’s government was bent on having Spanish firms manufacture the intermediate inputs at the heart of industrial supply chains (de la Torre and Garcia Zuniga 2014: 167; 169).

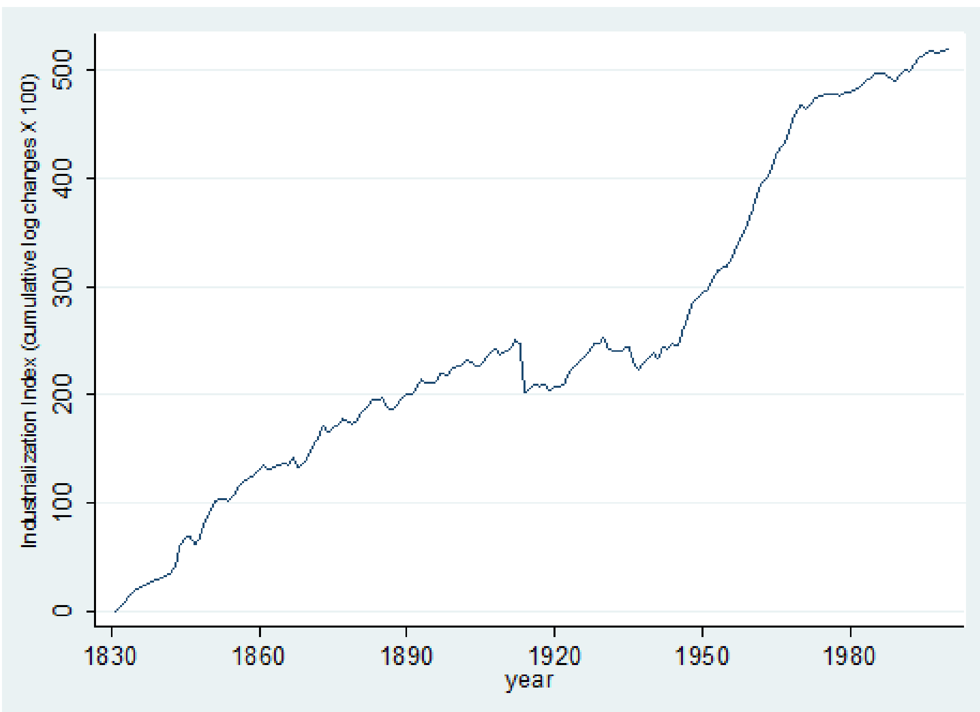
His economic populism also relied on financial repression. The Spanish government restricted entry into the banking system and capped interest rates, so credit was artificially rationed. The upshot was a highly concentrated, inefficient financial system centered on five big banks. In exchange for market power rents, these banks had ownership and controlling stakes in important industries, many of them state-run enterprises, to which they directed subsidized credit. These banks also held the government’s debt at below market rates: it was compulsorily invested in long-term government securities that could be automatically discounted with the Bank of Spain at no additional cost.

Mercantilist intellectual property rights were also instrumental to the state’s self-styled industrialization policies.[5] In 1929, Spain’s patent system was reformed under the

[5] The following section draws on Saiz (1995: 152-162; 2014).

auspices of a new law governing industrial property; the goal was to significantly strengthen introduction patents—monopolies on inventions coopted from abroad but manufactured in Spain for the first time. Their duration was extended from 5 to 10 years, and patent holders now had only 1 year to put them into practice, which, along with companion tariffs, incentivized import substitution. The law also pioneered "exploitation patents": monopoly rights granted to Spaniards who sought to introduce a whole new industry to the country, rather than a particular invention; these were granted for 10 years.[6]

Figure 1. Spanish Industrialization (1830 to 2000).



Notes: natural log of industrialization index subtracted from 1830 log value and multiplied by 100.
Source: Taylor (2016).

[6] Exploitation patents were abrogated in 1930, however. We should also note that there were other, less important, changes made to the patent system under the 1929 law; for example, a host of regulations governing who could seek "addition patents," as well as how many could be sought and for what purpose (see Saiz 1995: 165).

The upshot was short term gains for longer term pain. To be sure, Spain's industrial output increased to an exponential degree during Franco's regime (see Figure 1). This growth path was unsustainable, however. It relied on an inefficient allocation of resources, including an overreliance on labor. Spain's big banks accumulated high levels of risky loans that culminated in a financial crisis (see de la Torre and Garcia-Zuniga 2014). Inflation skyrocketed on the back of chronically high budget deficits. A balance of payments crisis enveloped the country in 1958. This led to a fiscal crisis, which mushroomed into an economic debacle.

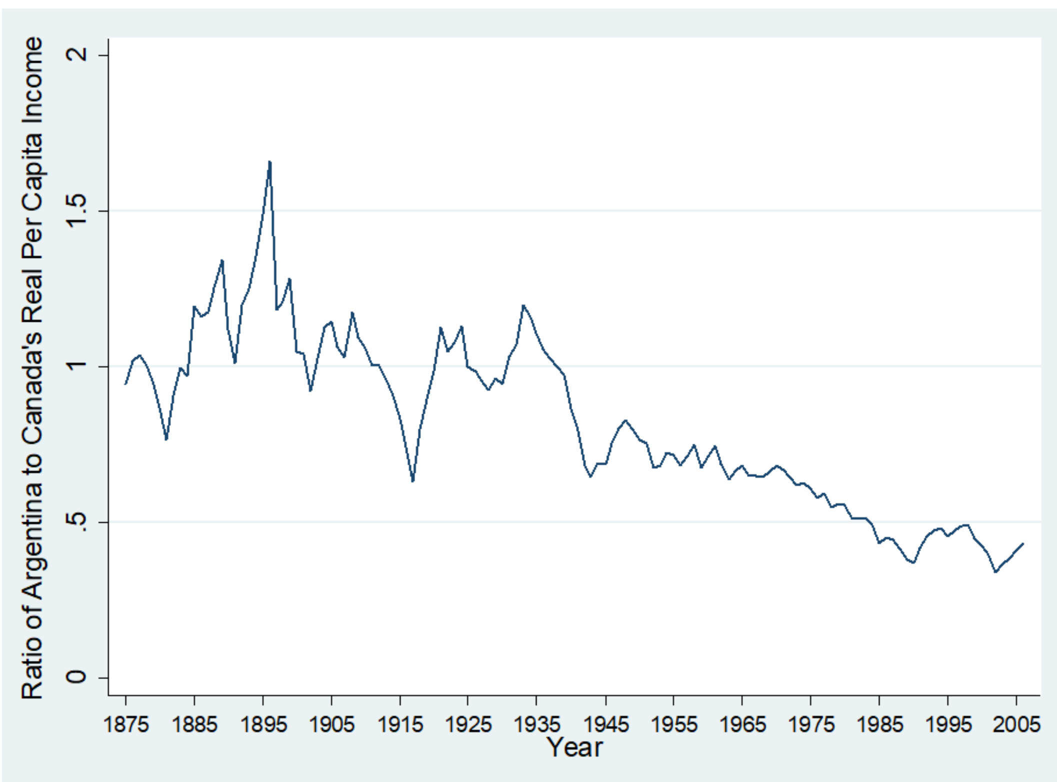
Argentina

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, this has unfailingly led governments to indulge in procyclical macroeconomic policies. The end result has been stagflation and widespread immiseration. What's worse: the captains of industry producing 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 2).

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. Second, they were populated by European colonists who encountered relatively small indigenous inhabitants. 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.

Figure 2. 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).

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

Economic populism was an important fork in the road that helps explain the divergence in their economic fortunes – albeit, as Figure 2 reveals, the onset of this divergence preceded its emergence. Juan Peron, 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, Peron 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. Peron and his populist successors ended up destroying the Argentine economy.

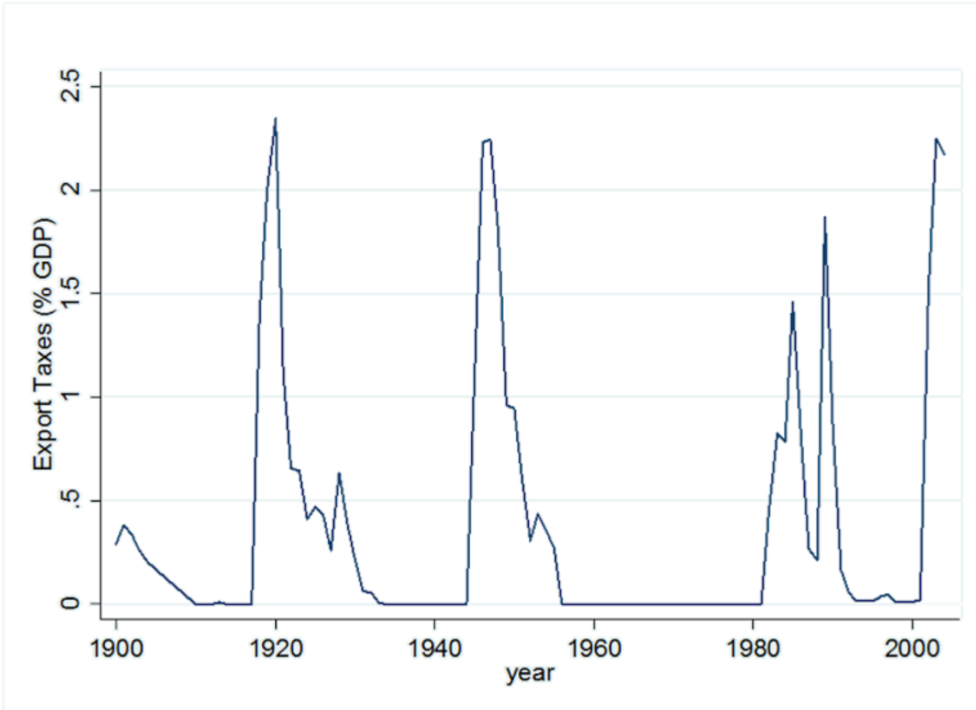
He was able to consolidate power through a multipronged approach. Peron replaced Argentina's liberal constitution with one that codified the notion that the state was in charge of managing private property to advance the "general" needs of the national economy and promote social justice. He purged the 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. Peron 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, university autonomy was rescinded and his administration sacked over 70 percent of the professors of six of the nation’s most important universities.

Consolidating political control over the three branches of government furnished Peron with the ability to engineer an economic revolution. Peron embarked on aggressive protectionism, industrialization, and redistribution based on distorting the market instead of slicing a growing pie more equitably. Economic policies under Peron 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. Peron’s pro labor policies managed to boost real wages for both skilled and unskilled workers by about 35 percent in just a few years.

But this came at a great cost. To help finance his ambitious plans, Peron 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 Peron. Figure 3 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 3 evinces, taxes imposed on agricultural exports were not a sustainable way to make up for the gap.

Figure 3. Populist Cycles of Argentina's Commodity Export Taxation

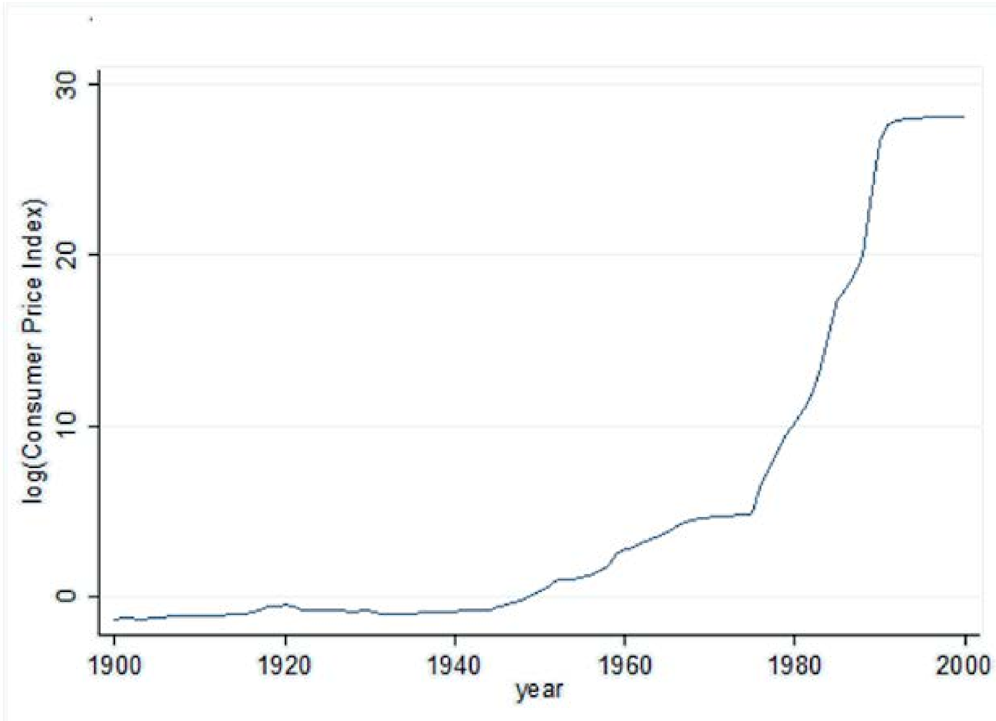


Notes: the vast majority of export taxes were levied by Argentine governments on primary commodities, with wheat and soy as the top two, but also cattle related exports.
Source: Menaldo 2009.

Peron 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, Peron'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 Peron. 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 4 depicts the inflationary legacy of Juan Peron's monetary populism.

Figure 4. Argentina's 20th Century's Inflation History



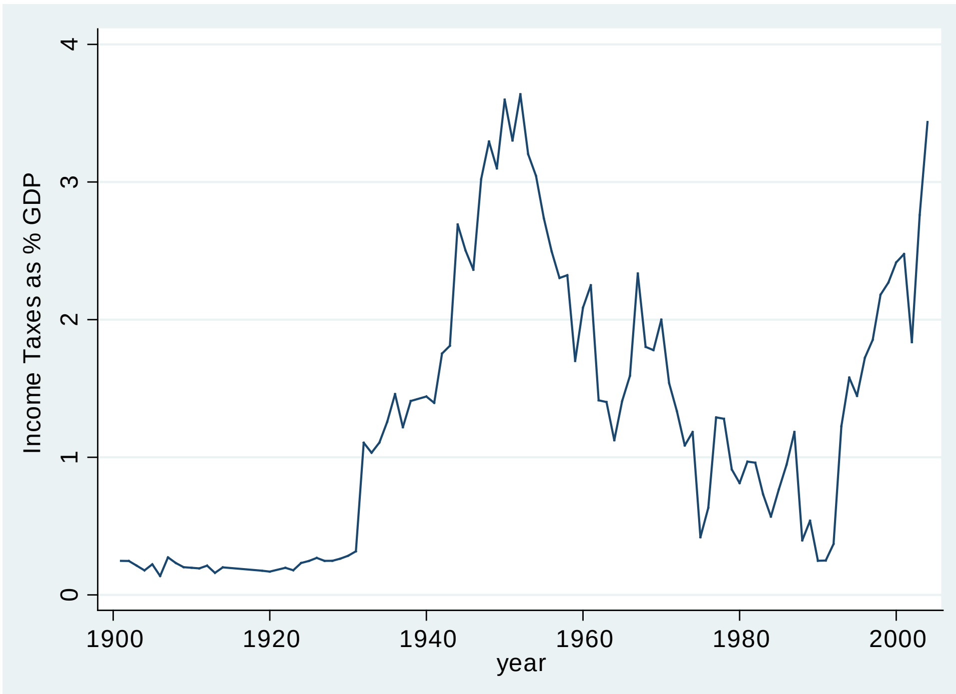
Notes: Index = 100 in 1970
Source: Astorga et al. 2003.

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 Peronism, 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 5).[7]

[7] 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

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 Peronist Party.

Figure 5. History of Argentina's Income Taxation



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 Allesandri's Administration (1958–1963). Allesandri indulged in monetary and fiscal stimulus, coupled with financial repression and price

purely to nominal increases in wages, encouraging income tax evasion. Second, the so-called Tanzi effect: 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.

controls. This stoked Chilean inflation to alarming levels. Coupled with very high levels of external debt, the economic situation became unsustainable.[8]

To fight inflation, Allesandri 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, Allesandri'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) 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

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

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.

THE NEW WAVE OF 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 Spanish and 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 crisis to populism.

Yet, the way in which the Eurozone Financial 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 2018 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

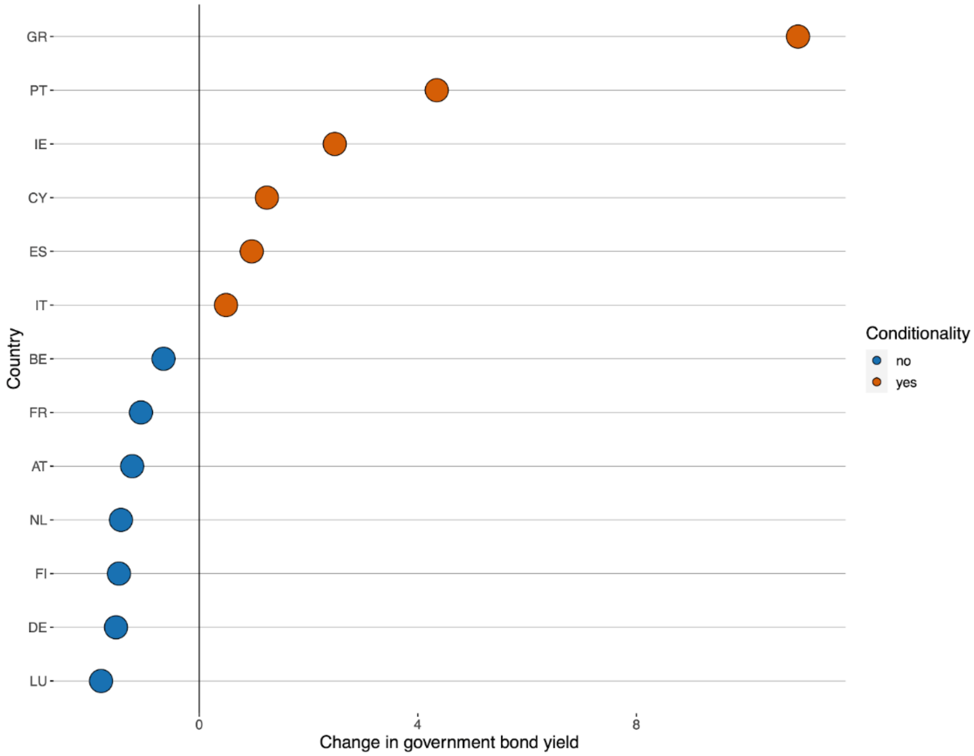
Finland) and southern ones (plus Ireland)—between debtors and creditors. The creditors were ultimately successful in shifting most of the burden of their balance of payments and fiscal adjustment onto the debtor states.

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 6 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. In turn, the costs of resolving the crisis have been borne almost exclusively by the debtor countries and Eurozone taxpayers, further reinforcing the divide between creditor member states in the north of Europe, on one side, and debtor states in southern Europe (plus Ireland), on the other.

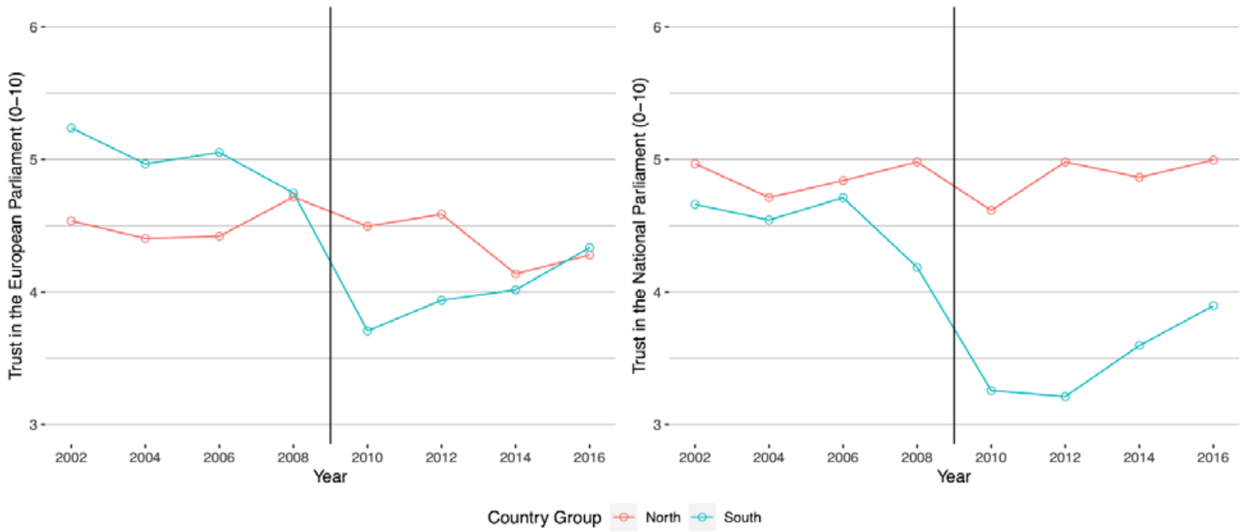
Figure 6: Percentage change in Euro member government bond yields



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 Ceka 2014; 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 Ceka 2014; Armingeon and Guthman 2014; Dotti Sani and Magistro 2016; Torcal 2014). Figure 7 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 quite steep and substantial.

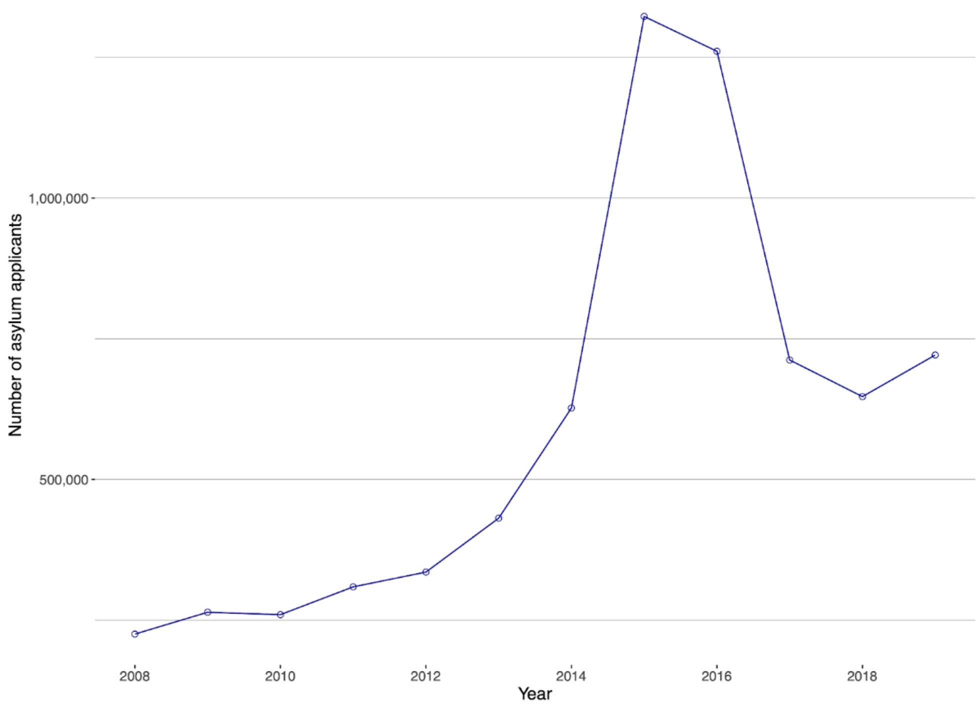
Figure 7: Trust in European and national parliaments.



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.

Figure 8: Asylum applicants (non-EU-28 citizens) in the EU-28 from 2008 to 2019.



Source: Eurostat - online data code: migr_asyappctza.

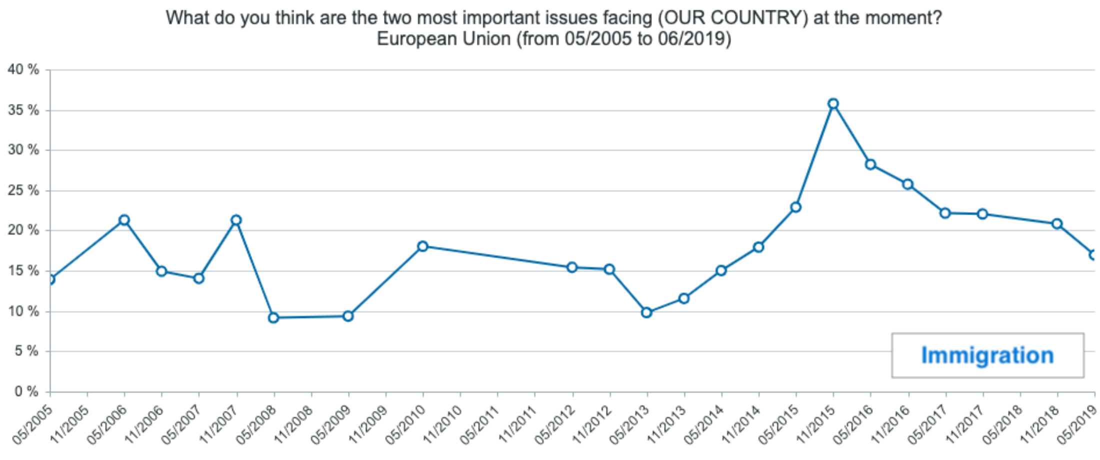
With the effects of the Eurozone crisis still lingering for some countries, the European migrant crisis (or refugee crisis) began in early 2015. This unleashed a rapid flow of millions of people from Syria and other Middle Eastern countries. Political and economic refugees entered the EU from across the Mediterranean Sea or overland through southern Europe (see Figure 8).

Since Italy and Greece were struggling mightily to handle the influx of migrants, in 2015 the EU proposed a new quota system to relocate asylum seekers among member states on the basis of quotas that consider the size of economy and population of each state, as well as the average number of asylum applications. However, rifts emerged between countries, especially between the eastern and the western blocs. Eventually, the scheme fell short of expectations, as only 27,000 refugees were relocated and some countries (Hungary and Poland in particular, but also Romania) refused to participate. On the heels of this failed 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).

Figure 9 illustrates how the percentage of people arguing that immigration is their country's number one or number two problem went up significantly after 2015. While far-right populist parties have gained ground all over the EU, there is a key difference between eastern and western Europe. In the west, far-right and anti-establishment groups have capitalized on these anti-immigrant sentiments, but in eastern Europe this rhetoric comes from the center of the political space: mainstream parties make political capital out of anti-immigrant sentiment and attempt to legitimize xenophobia (Hunyadi and Molnar 2016).

Figure 9: Percentage of people who think immigration is among important issues.



Source: Eurobarometer 2005 to 2019.

Greece's populist experiment

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 E.U. 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 antiausterity 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 populist 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 E.U. 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.[9]

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's long experience with populism

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

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

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 E.U. 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 make the labor market more flexible.

Surprisingly, even on the heels of a grave economic crisis and a rather feckless technocratic government, Italy did not elect a populist government, but went back to mainstream parties and elected a center-left majority government in 2013 headed by the Democratic Party, first with Enrico Letta at the helm and then Matteo Renzi. 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. The FSM is an explicitly populist party. 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 43,000 in 2013, 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 Renzi’s performance as prime minister, and angered by continued economic hardship and the rising influx of immigrants. Immigration and the economy were two of the key issues for voters 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. In the wake of the 2015 refugee crisis it graduated from a regional (northern) party to a national one. Both the FSM and Lega ran on a similar populist platforms during the 2018 elections. These were centered on promises to reintroduce early retirement, deport migrants, institute a guaranteed minimum income, and cut taxes. The two parties then formed an unlikely coalition government in May of 2018.

The FSM-Lega populist government was true its constituent parties' electoral campaigns. It introduce 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 (Galasso 2019).

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 FSM continues to be beholden to a constituency that opposes economic reforms and is hostile to immigration.

PREDICTIONS AND CONCLUSIONS

We would be remiss if we did not speak a bit about current events in light of the Covid-19 pandemic, which spread with astounding speed and ferocity around the globe in 2020. This occurred sometimes despite aggressive efforts by governments to contain it—

Australia and Singapore come to mind. It also wreaked havoc on the world economy, including pounding countries, such as New Zealand and Thailand, which escaped high levels of contagion and death.

Economic activity has plummeted everywhere in the wake of the Covid-19 pandemic and unemployment has skyrocketed. The length and depth of this economic decline will remain a source of great uncertainty and may ultimately depend on whether Covid-19 will continue to represent a public health threat (OECD 2020). According to the IMF World Economic Outlook 2020, the EU's economy is expected to shrink by 7.5 percent in 2020, with Greece and Italy expected to be the worst affected countries (seeing respective declines in GDP of 10 and 9.1 percent). That source also projects that the US economy will shrink by 5.9 percent.

In the most optimistic scenario, in which the pandemic's threat to public health recedes in the second half of 2020 and governments gradually lift restrictions, the US and EU economies are projected to grow by 4.7 percent in 2021, in a V-shaped fashion. However, there is great uncertainty over whether the most optimistic scenario will indeed materialize and during July of 2020 Covid-19 outbreaks significantly worsened in many US states, including in California, Texas, and Florida (Partlow and Miroff 2020).

If these current trends continue and the virus crests as a "second wave" in the fall, the likely economic fallout is projected to be much worse: the recovery will look more like a U or an L (Derby 2020). The upshot could be another huge increase in joblessness as lockdowns and quarantines follow new Covid-19 surges (OECD 2020). Indeed, early signs are that a nascent economic recovery in the US is under threat in the wake of an economic pullback induced by increasing Covid-19 infections (Tankersley and Casselman 2020).

The biggest sources of future damage are likely to be human made, however. We fear that, in the wake of the pandemic, populism and its attendant crises may become self-reinforcing: the ongoing economic crisis associated with Covid-19 might fuel more populism and populism, in turn, may make the economic situation worse, as well as stoke political crises. Let us examine the prospects for populism and continued crisis in the EU and the US, respectively.

When Covid-19 hit, the EU had just emerged from the worst economic crisis in the bloc's history, as well as a refugee crisis of epic proportions, and the United Kingdom's secession. Unexpectedly, 400 million people were forced into lockdowns and almost 180,000 people died. The result? European politicians began to attack each other with ferocity and turned inward, rather than cooperating (the Economist 2020). To speed up the EU recovery, a group of countries led by Spain suggested a grant of about euros 1.5trn, which would be funded by debt backed collectively by the EU as a whole. However, this plan was opposed by small northern countries from the get go since this recovery fund would mostly help collapsing southern European economies (the Economist 2020). On May 27th 2020, the European Commission issued its proposal for a recovery fund of about 750 billion Euros, mostly made up of grants, rather than loans, and a revised long-term EU budget of €1.100 billion for 2021-2027.

The recovery fund ("Next Generation EU") involves raising funds through bonds guaranteed by the EU budget and distributing them as grants and loans, conditional on whether expenditures are aligned with EU priorities (Leigh 2020). The EU and its member states have been debating over how to allocate the recovery package, which currently includes both an insurance feature, where countries hit harder get more EU funds, and a redistributive feature, where countries with lower per capita incomes receive more EU funds (Darvas 2020). The current plan is supported by Europe's four biggest economies, Germany, France, Italy and Spain, but not by the "frugal four": The Netherlands, Austria, Sweden and Denmark (Leigh 2020).

This raises the question of whether the EU will survive Covid-19 or if, instead, more exits like Britain's will be triggered by the pandemic's continuing economic and political fallout. The burden of this latest crisis will once again fall heaviest on the peripheral countries. While this may provide more impetus for a fiscal union and deeper integration, it may also fuel the ongoing backlash against the distributional consequences of a stronger political and fiscal union. The jury is still out on this question. However, recent history suggests that Europe will continue to be ripped asunder by the basic economic and political imbalances between northern and southern countries; these divides may, in turn, be magnified by populists and used to fuel campaigns of resentment, revanchism, and scapegoating in both blocs.

Italy is in perhaps the most precarious position. It was not only the European country that was hardest hit by the pandemic in terms of deaths from the virus, but its economy suffered a devastating blow. Although growth had just started to pick up slightly when Covid-19 hit, Italy's GDP is slated to experience a 9.5 percent contraction in 2020 according to EU forecasts. This may put further strain on Italian government debt as budget balances will likely deteriorate further in light of the pandemic induced downturn, leading to lower tax revenues and higher unemployment benefit payments. In order to afford its generous safety net and produce enough jobs for Italy's youth the country needs growth, a difficult task in light of the fact that its productivity effectively flatlined twenty years ago. Where this growth will come from is unclear.

What is not in doubt, however, is that the EU, rooted in the tenets of liberal democracy and welfare state capitalism, has delivered more than half a century of peace, stability and prosperity, raising living standards for over 300 million people. The Eurozone and refugee crises, and the economic and cultural struggles that ensued, fueled a populist upsurge in Europe; the ultimate scope of the Covid-19 crisis, and the individual response of member states, whether cooperative or unilateral, will determine the future of the EU, with consequences for prosperity, liberty, and stability.

The situation in the United States is unlikely to be much different. In a context where deglobalization, inequality, and populism were already on the rise, the ongoing economic crisis and spike in unemployment that has accompanied it may make the situation much worse. Anti-globalization feelings may increase further as restrictions on travel and cross-border investment continue apace. Populists are likely to take advantage of rising fears over legitimate national security concerns. They make seek to renationalize and on-shore industries that produce “essential goods” such as antibiotics, masks, and ventilators—and are unlikely to stop just there.

Whether Donald Trump wins or loses the US Presidential Election in November 2020 is also likely to affect the direction that the US will take. It is unclear if, were he to lose, the GOP will suffer an existential crisis and decide to change direction, away from its current nationalist, nativist, and populist drift. Maybe there is no going back to liberal internationalism, globalization, and free markets; the American electorate has changed, both demographically and ideologically, perhaps circumscribing its ability to maneuver politically. The road the Republicans take will likely also depend on what Joe Biden does if he is elected president; specifically, whether his policies will be centrist or more left-leaning (Brownstein 2020).

Furthermore, in addition to all the uncertainty surrounding the pandemic and its political consequences, another financial crash might be around the corner. The reforms passed in the aftermath of the 2008 financial crisis, although well intentioned, have not kept banks from falling back into old habits: while cheap mortgages fueled economic growth in the 2000s, easy and risky corporate debt issued at high levels of leverage has been juicing the US economy over the past ten years. Loan defaults are already on the rise in the wake of the Covid-19 crisis — and it may only get worse in the next few months.

But if banks were to find themselves on the edge of the precipice once again, facing the possibility of going insolvent and taking the global economy down with them, this time around the political response may be much different than in 2008. Both populists on the left and right have been highly critical of handouts to big banks and bailouts in general. It is also unclear if the US Federal Reserve can continue to keep its foot on the liquidity and stimulus gas pedal, which it has done since March of 2020 in response to Covid-19, without triggering an adverse reaction in the sovereign bond markets and stoking high levels of inflation. This would in turn fuel higher interest rates, making it more difficult for an economic recovery to take hold.

Finally, there is the effect of potential future populism in Europe and the US on the world. If deglobalization accelerates beyond essential medical supplies to include ordinary industries and the nationalization and vertical integration of supply chains, this is likely to have devastating consequences on the standard of living in developing countries. It basically risks putting hundreds of millions of people back into poverty (Rogoff 2020).

Are Europe and the United States dangerously close to the path taken by Argentina under populist governments in the post-World War II era? Is rampant crony capitalism and protectionism masquerading as industrial policy around the corner? What about serial balance of payments crises, sovereign debt defaults, and stagflation?

Nobody knows the future, least of all us. But if we were to read the tea leaves, there is much room for pessimism. Populism preceded the Covid-19 nightmare and polarization; inequality, and a breakdown in the norms of liberal democracy in the context of an economic depression and unemployment crisis may accelerate the march to dysfunctional and less accountable governments across the west. Plus, the payoffs to demagoguery are higher when the tradeoffs are costly and the solutions to problems complicated. It goes without saying that Covid-19 has increased those costs and complications to the nth degree. We wish we had better news.

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