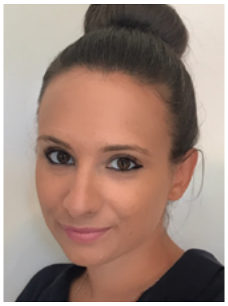
POPULISM: A Tale of Political and Economic Catastrophe

by Beatrice Magistro and Victor Menaldo



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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). In today's populist reincarnation, demagogues exploit preexisting crises and ride waves of uncertainty, fear, and dissatisfaction with the status quo; this has been the case in Hungary with Orbán, Greece with Tsipras, Italy with the Lega and Five Star Movement, and Turkey with Erdogan.

In this essay, we consider the following questions in turn: What is the economic playbook used by populists from both the left and the right, across time and place? Why does the populist playbook lead to economic crises? And how do economic crises themselves foster populism, in a vicious circle? Are Europe and the United States dangerously close to the path taken by Argentina under populist governments in the post-World War II era? To answer these questions, we use both historical and contemporary examples that include Argentina, Italy, Greece, and the US. Finally, given the economic collapse engendered by the Covid-19 pandemic, we forecast what might be in store for populism and liberal democracy.

Populism is 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, not absolute victory.

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 the fabric of 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 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.

The Populist Political-Economic Playbook

The troubled economic and political history of populism is rooted in 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. 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. Argentina and Venezuela are archetypical examples.

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 – consider today's Turkey, for example. Conversely, liberal democracy and welfare state capitalism have worked together, at least since the end of World War II, to promote political stability.

Populism and Crisis: A Vicious Circle

What is the relationship between crisis and populism? While in Latin America populism has unfailingly led to economic and political crises, in today's populist reincarnation the relationship is often reversed: political entrepreneurs take advantage of preexisting crises and dissatisfaction with the status quo to rise to power. Let us start with one of the most notorious cases, Argentina, and then move on to the new wave, including European cases and the US.

From populism to economic and political crises: The case of Argentina

Consider Peronism's disastrous track record in Argentina, which was one of the world's richest countries at the turn of the 20th century and is now a relatively poor one. President Juan Perón consolidated his power during the 1950s by gutting democratic institutions, replacing 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. Perón also vitiated the media and the universities.

Perón put together an urban coalition of domestic industrialists and unionized workers and indulged in policies with a considerable urban bias, hammering agricultural interests in the process. Perón's policies boosted real wages for skilled and unskilled workers by 35%. Yet his subsidies to coddled industries, transfers to labor unions, and public sector hiring spree proved very expensive. Because Perón discouraged Foreign Direct Investment while devastating the export-based cattle and wheat industry and also incentivized heavy industry to import expensive machinery, Argentina suffered a huge foreign exchange shortfall, culminating in a massive devaluation, sovereign debt default, and hyperinflation.

This triggered a coup that unseated Perón; and while he returned to power decades later, his interregnum was marked by a rash of short-lived elected governments succeeded by coups. And his second turn at the wheel was followed by a brutal military dictatorship and a return to democracy marred by new and equally devastating populist experiments. Since 1983 they have been marked by serial currency, sovereign debt, and banking crises, followed by stagflation, immiseration, inequality, and political instability.

The cases of Italy and Greece in the aftermath of the Eurozone crisis

The new wave of populism that has recently visited Europe is mainly a result of two crises: the Eurozone crisis starting in late 2009, and the refugee crisis starting in the summer of 2015. One example is Greece's populist experiment in the aftermath of the Eurozone crisis. In 2009, the newly elected Socialist Prime Minister George Papandreou revealed to the world that Greece had been distorting its government debt and budget deficit figures. 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.

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 experience with populism in the aftermath of the Eurozone crisis came much later than Greece's. After a technocratic government from 2011 to 2013, which kept Italy out of any formal agreements with the Troika but at the cost of harsh austerity measures, and after the Democratic Party's failure to deliver reforms that would put Italy on a more sustainable fiscal and economic path, Italy's economy remained stuck in neutral and it was hit by a refugee crisis of unprecedented proportions. This set the stage for the electoral success of populism.

Immigration and the economy were two of the key issues for voters during the 2018 election and the anti-establishment Five Star Movement (FSM) and Lega parties successfully fed off of citizens' increasing anger and disillusion. Both the FSM and Lega ran on a similar populist platform 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. 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 new elections, the FSM and Italy's Democratic Party managed to form a new coalition government, 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 is now polling at close to 30%, while Brothers of Italy, a far-right nativist and Eurosceptic party, polls at close to 15%, up from 4% in the 2018 elections.

The two faces of populism in our own backyard: The case of the US

To witness the recent ascendance of political and economic populism, we do not have to go further than the United States. For all of the hand wringing about President Trump's political populism and flirtation with authoritarianism between 2016 and 2020, it seems like pundits and academics voiced fewer concerns about his alarming economic populism. This may be because the following actions have—rightly perhaps—sucked up all the oxygen: his ham-fisted attempts to goad foreign governments to interfere in the 2020 election on Republicans' behalf; harassing the media; threatening the post office with drastic budget cuts in the middle of a pandemic in which voting by mail became an insurance policy against mass disenfranchisement; calls to supporters to vote twice; rampant interference with the Department of Justice; and his prevarications about respecting the results of the Presidential Election, as well as claims that it was despoiled by fraud.

Serial violations of the rule of law on behalf of neo-mercantilism intended to help Trump's friends and hurt his perceived enemies are deeply concerning as well though. Yes, pundits voiced outrage over the conspicuous corruption implied by the American President's attempts to steer business towards his properties—including The Trump International, Mar-a-Lago, and Doonbeg Resort—by holding official state functions there (Graham 2020). But other actions, many of which he undertook right after winning office, loom large too. In 2017 he jawboned Carrier, an HVAC maker, to keep an inefficient plant open in Indianapolis, ostensibly in order to save jobs. Or take his steel and aluminum tariffs: they might have benefitted a smattering of American steel and aluminum manufactures that don't also import some of these metals themselves, but they hammered the aerospace industry, automobile makers, appliance makers, canned goods manufacturers, and the construction industry. These industries inevitably passed on their higher costs to consumers. Or take his browbeating of Harley Davidson over their foreign plants.

Furthermore, Trump's fixation with Jeff Bezos has been particularly disconcerting. Against all logic and evidence, he repeatedly contemplated bringing antitrust measures against Amazon, as well as directed the Post Office to investigate whether it's being taken to the cleaners when delivering Amazon packages, even though Amazon related business has been a godsend that has helped it staunch its losses. This defies common sense, since the purpose of antitrust is to stop firms from using market power to hurt competition and discourage innovation. However, prices on Amazon goods and services keep falling like a stone as its costs keep declining. Plus, the company keeps plowing its profits into research and development, which has allowed it to innovate across its various divisions, including e-commerce, cloud computing, entertainment, and retail. This promises even better products and services and lower prices in the future. One can add to this a dubious case brought by the Department of Justice against the merger of Time Warner and AT&T that the government lost in federal court and that may have reflected President Trump's resentment against CNN more than any legal or economic merits (Morris 2019).

Finally, President Trump treated some of America's most productive farmers as his dependents: handing out aid to them to redress their losses from Chinese retaliation for tariffs he slapped on Chinese imports. This means Americans have paid for these tariffs twice, in the form of both higher prices and higher debt and taxes. Even before the COVID-19 pandemic hit, triggering sweeping stimulus spending, the United States was registering record budget deficits as a share of the economy under Trump (CRFB 2020)—thus reflecting one of the most commonly called plays in the populist playbook: spending way beyond your country's means.

The COVID-19 Pandemic: A Crossroads For Populism?

The COVID-19 pandemic represents a crossroads for populism. As economic activity plummeted everywhere in the wake of the spread—and attempted containment by governments—of the Covid-19 pandemic, unemployment skyrocketed. The length and depth of the current economic decline remains a source of great uncertainty; it 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). The same was true in November 2020 as well.

If these current trends continue and the virus crests as a "second wave", 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).

The biggest sources of future damage are likely to be human made, however. 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.

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 debated for months over how to allocate the recovery package. The Commission's proposal included 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 Commission's plan was 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).

After four days of negotiation, EU leaders finally reached a deal on July 21st 2020. These talks pushed the bloc's ability to overcome internal political divisions to the limits. However, this is a historical agreement, possibly the bloc's Hamiltonian moment, that should bring the EU closer to a fiscal union, since it would give the bloc the unprecedented power to borrow funds on the markets and allocate it to member states (Norman 2020). In the final version, the frugal four succeeded in reducing the overall amount of grants (from €500bn to €390bn) and increasing the amount of loans (from €250bn to €360bn); furthermore, they managed to secure rebates against their normal budget contributions. In terms of conditionality, member states will need to prepare national recovery plans, where in exchange for their allocated share of funding, which they will receive between 2021 and 2023, they commit to reform their economies (Brunsden, Fleming and Khan 2020).

As a result of the fierce battle between Italy and the Netherlands, they decided to introduce a governance mechanism that would allow a member state to ask for referral to the Council if they consider that there are serious deviations from the fulfilment of a country's promises in return from the EU funds. This kind of "emergency break" would allow any member state to temporarily block the EU's transfers while the EU investigates whether commitments are being respected. This however can only slow down the disbursement process, but cannot halt it, since the Commission retains the final say (Brunsden, Fleming and Khan 2020).

This historical agreement seems to ward off more exits like Britain's; yet, the burden of the latest crisis will once again fall heaviest on the peripheral countries. To be sure, this may help deepen European integration—but it may also fuel the ongoing backlash against the distributional consequences of a stronger political and fiscal union. While the jury is still out, 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 one of the European countries 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 before 2020, 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. It also remains unclear whether the GOP will decide to change political direction, away from its current nationalist, nativist, and populist drift. Maybe there is no going back to liberal internationalism, globalization, and free markets, however; the American electorate has changed, both demographically and ideologically, perhaps circumscribing its ability to maneuver politically (see 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 this year 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?

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.

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