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The Anatomy of Populist Economics

PARIS – For at least the past year, populism has been wreaking havoc on Western democracies. Populist forces – parties, leaders, and ideas – underpinned the “Leave” campaign’s victory in the United Kingdom’s Brexit referendum and Donald Trump’s election as President of the United States. Now, populism lurks ominously in the background of the Netherlands’ general election in March and the French presidential election in April and May.

But, despite populism’s seeming ubiquity, it is a hard concept to pin down. Populists are often intolerant of outsiders and those who are different; and yet Geert Wilders, the far-right Dutch populist leader, is a firm believer in gay rights. In the US, Trump’s presidential campaign was described as an anti-elite movement; and yet his administration is already practically a subsidiary of Goldman Sachs.

While today's populist resurgence comes from the nationalist right, some of the leading populist exponents in recent decades – such as Venezuela's late president, Hugo Chávez – were firmly on the left. What they share is a zero-sum view of the world, which necessitates the creation of scapegoats who can be blamed for all problems. Moreover, because populist leaders claim to embody the uniform will of a mythical “people,” they consider democracy to be a means to power, rather than a desirable end in itself.

But populists have more in common than an obsession with cultural boundaries and political borders. They also share a recipe for economic governance, one that *Project Syndicate* commentators have been tracking since long before today's brand of populism began dominating the world's headlines. Guided by their insights, we can begin to understand the origins of today's populist resurgence, and what is in store for Western countries where its avatars come to power.

Diagnosing the Problem

Given populism's many faces, is it really possible to identify a root cause? For Warwick University's Robert Skidelsky, it is no coincidence that the two major political upheavals of 2016 – the Brexiteers' success in last June's referendum and Trump's election victory – occurred in “the two countries that most fervently embraced neoliberal economics.” The US and the UK's economic model over the past few decades, Skidelsky observes, has allowed for “obscenely lavish rewards for a few, high levels of unemployment and underemployment, and curtailment of the state's role in welfare provision.” And this widening inequality, he writes, “strips away the democratic veil that hides from the majority of citizens the true workings of power.”

But Gavekal Dragonomics Chief Economist Anatole Kaletsky sees another dynamic at work, and offers “several reasons to question the link between populist politics and economic distress.” For starters, he points out that “most populist voters are neither poor nor unemployed; they are not victims of globalization, immigration, and free trade.” Having analyzed Brexit exit polls

and voter-survey responses, Kaletsky concludes that “cultural and ethnic attitudes, not direct economic motivations, are the real distinguishing features of anti-globalization voting.”

At first blush, these arguments may seem incompatible; but their disagreement is really only between ultimate and proximate causes. For Skidelsky, “It is when the rewards of economic progress accrue mainly to the already wealthy that the disjunction between minority and majority cultural values becomes seriously destabilizing.” Likewise, for Kaletsky, “The main relevance of economics is that the 2008 financial crisis created conditions for a political backlash by older, more conservative voters, who have been losing the cultural battles over race, gender, and social identity.”

Harvard political philosopher Michael Sandel warns against focusing exclusively on “the bigotry in populist protest” or viewing it “only in economic terms.” The fundamental issue, he argues, is “that the upheavals of 2016 stemmed from the establishment’s inability to address – or even adequately recognize – genuine grievances.” And, because these grievances “are about social esteem, not only about wages and jobs,” they are difficult to disentangle “from the intolerant aspects of populist protest” – namely, anti-immigrant sentiments.

Nobel laureate economist Edmund Phelps also links populist voters’ anger to their loss of dignity in the larger political economy. As the share of US employment in manufacturing has steadily declined, blue-collar workers, Phelps notes, “have lost the opportunity to do meaningful work, and to feel a sense of agency.” In other words, “losing their ‘good jobs’” meant losing “the central source of meaning in their lives.” And while many of the lost manufacturing jobs were replaced with new jobs in new sectors, as Oxford University historian Margaret MacMillan cautions, nuanced economic arguments “cannot counter the unhappiness of people who feel marginalized, undervalued, and scorned.”

A Democratic Disease

Princeton University's Jan-Werner Mueller, who published a highly regarded book about populism last year, has identified such "feelings of dispossession and disenfranchisement" as "fertile ground" in which populist politicians can sow seeds of resentment. And, in an earlier commentary that long predated the current news cycle, Mueller explained that, "Populism cannot be understood at the level of policies; rather, it is a particular way of *imagining* politics." Above all, he observes, the populist imagination is inherently divisive: "It pits the innocent, always hard-working people against both a corrupt elite (who do not really work, other than to further their own interests) and those on the very bottom of society (who also do not work and live off others)."

In its more virulent forms, populism can be thought of as being akin to an autoimmune disease, whereby democracy gives rise to forces that attack it. Andrés Velasco, a former finance minister of Chile, laments that the nature of representative democracy can create an impression that politicians are "distant and untrustworthy." The "rhetoric of modern democracy," he writes, "emphasizes closeness to voters and their concerns." But elected representatives cannot spend all of their time interacting with constituents when they have a duty to govern. When this dissonance between rhetoric and reality becomes "too glaring," Velasco notes, "political leaders' credibility suffers."

This loss of trust leads disaffected citizens to put a premium on perceived authenticity. So, "although populist policies reduce overall economic welfare," Velasco notes, "rational voters choose them because they are the price of distinguishing between different types of politicians." In fact, such a willingness to suffer further economic pain in order to avenge elite betrayals and strike back at scapegoats may be a defining element of today's populist resurgence.

Populist leaders in Hungary and Poland, who are currently advancing their own brand of "illiberal democracy," seem to have staked their governments' future on this presumption. As Central European University's Maciej

Kisilowski points out, it may not even matter that “the high economic costs of illiberal democracy are already apparent.” These countries’ electorates, Kisilowski surmises, “may regard economic stagnation as an acceptable price to pay for what they want most: a more familiar world where the state guarantees the dominant in-group’s sense of belonging and dignity, at the expense of ‘others.’”

Sławomir Sierakowski of the Institute for Advanced Study in Warsaw provides further support for this point. When Jarosław Kaczyński’s Law and Justice Party (PiS) returned to power in Poland a year ago, many assumed that it would quickly fail. Instead, it has succeeded, because Kaczyński mastered the politics of “two issues near and dear to voters: social transfers and immigration,” Sierakowski explains. “As long as he controls these two bastions of voter sentiment, he is safe.” Of course, given the PiS government’s politicization of the courts, the civil service, and the press, the same cannot be said for Poland’s democratic institutions.

A Populist Placebo

But how long can populist governments sustain generous transfers in the absence of strong economic growth? The answer will depend on how long their supporters remain convinced that they can have their cake and eat it – which is precisely what former Brexit leader and current British Foreign Minister Boris Johnson promised to Leave voters. Indeed, as Columbia University’s Jeffrey Sachs observed just after the Brexit vote, “Working-class ‘Leave’ voters reasoned that most or all of the income losses would in any event be borne by the rich, and especially the despised bankers of the City of London.”

Given the UK economy’s unexpected resilience last year, the populists probably feel vindicated. But, though most economists misjudged “the immediate impact that the United Kingdom’s [vote] would have on its economy,” writes Chatham House’s Paola Subacchi, “a gloomy long-term

prognosis is probably correct,” given British leaders’ desire for a complete break from the European Union’s single market and customs union.

Such delayed effects can create an alibi for unsustainable policies, which, according to Velasco, is precisely “how economic populism works.” For example, the approach that Trump seems likely to take – tax cuts, growth-stimulating measures, and protectionism, with little thought given to inflation or public debt – is untenable, and will ultimately fail. But, as Velasco puts it, “‘Ultimately’ can be a very long time.” And that can give populist governments more staying power than many observers assume. “Populist policies are called that because they are popular,” he notes. “And they are popular because they work – at least for a while.”

In the meantime, populist leaders can pursue policies favored not only by their base, but also by many of their opponents. In the whirlwind of his first days in office, for example, Trump fulfilled his campaign promise to abandon the 12-country Trans-Pacific Partnership (TPP). This, Princeton University’s Ashoka Mody believes, was actually a welcome move, given that “international trade agreements, propped up by powerful interests, have become increasingly intrusive.” Similarly, before Trump’s election, Harvard University economist Dani Rodrik called for a rebalancing “between national autonomy and globalization.” In Rodrik’s view, it should go without saying that “the requirements of liberal democracy” must come before “those of international trade and investment.”

Trump’s promise of corporate tax reform has also wide appeal beyond his electoral base. For Harvard’s Martin Feldstein, who chaired President Ronald Reagan’s Council of Economic Advisers, current legislative proposals to overhaul the US’s outdated tax system could “have a highly favorable impact on business investment, raising productivity and overall economic growth.” Assuming that Trump, working with congressional Republicans, can strike the right policy balance, he will have bought himself some time with the business community.

Princeton University economic historian Harold James makes a related point, arguing that “the economics of US populism will not necessarily fail, at least not immediately,” owing to the US’s “uniquely resilient” position in the global economy. “Because [the US] has historically been the global safe haven in times of economic uncertainty,” James notes, “it may be less affected than other countries by political unpredictability.”

A Turn for the Worse

But even if Trump can extend his honeymoon, James does not discount the possibility that “today’s contagious populism will create the conditions for its own destruction.” One way that could happen, argues Benjamin Cohen of the University of California, Santa Barbara, is if the US loses its “exorbitant privilege” as the issuer of the dominant international reserve currency. If Trump “pursues his protectionist promise to put ‘America first,’” Cohen writes, “investors and central banks could gradually be impelled to find alternative reserves for their spare billions.”

Trump’s version of economic populism could also face a reckoning if it results in a new boom-bust cycle – one that could end in a period of stagflation around the 2018 US congressional elections. Just before the election, Feldstein warned that “overpriced assets are fostering an increasingly risky environment.” Given that the US economy is already at full employment, with an inflation rate near 2%, Trump’s planned fiscal stimulus could push it into overdrive, and force the Federal Reserve to raise the federal funds rate.

Such a scenario would certainly worsen the plight of Trump’s constituency of white working-class voters in America’s former manufacturing heartland. But so, too, would his trade proposals, which could easily precipitate trade wars with China, Mexico, and other trading partners. Trump has told displaced blue-collar workers to blame trade deals and competition from imports for the loss of their jobs. But, “with productivity gains exceeding demand growth” worldwide, Nobel laureate economist Joseph Stiglitz points out, America “would have faced deindustrialization even without freer trade.”

Given this, Trump's prescription of trade protectionism, Stiglitz says, will only "make all Americans poorer." One reason, explains former World Bank Chief Economist Anne Krueger, is that imports create and sustain jobs, too. The irony of Trump's proposed import tariffs is that they threaten American *exporters*. Many export-industry jobs, Krueger points out, exist because inexpensive imports enable American manufactures to compete domestically and abroad; and "exporting to the US gives foreigners more income with which to buy imports from the US and other countries."

Simon Johnson of MIT also fears such a lose-lose scenario. If Trump starts taxing imports, Johnson argues, "the cost per job will be high: all imports will become more expensive, and this increase in the price level will filter through to the cost of everything Americans buy."

Botching the Operation

Other *Project Syndicate* commentators have pinpointed a deeper flaw in populist economics, apart from any specific policy proposal: recklessness. Populists often overplay their hand by flouting legal, economic, or political conventions, or by exerting inappropriate influence in markets to try to funnel benefits to their supporters. In fact, according to a classic study of economic populism in Latin America by Sebastián Edwards of UCLA and the late Rüdiger Dornbusch of MIT, it is standard populist practice to show "no concern for the existence of fiscal and foreign exchange constraints" in the pursuit of faster growth and redistribution.

New York University's Nouriel Roubini suspects that Trump may be similarly tempted to interfere inappropriately in currency markets. As his stimulus measures push up the value of the dollar, Roubini says, "Trump could unilaterally intervene to weaken the dollar, or impose capital controls to limit dollar-strengthening capital inflows." But if Trump is too reckless with his "damage-control methods," already-wary markets will succumb to "full-blown panic."

Mody, for his part, sees serious risks in Trump's interference in corporations' practices and business decisions. By bullying companies over Twitter to keep jobs based in the US (or to punish them for dropping his daughter Ivanka's clothing line), Trump has already begun to undermine "the norms and institutions that govern markets." And in Phelps's view, Trump's Twitter interventions, combined with his deregulation agenda, risk entrenching corporatism at the expense of the innovation and competition necessary to sustain economic dynamism and income growth.

The Search for a Cure

With populist movements leaving political establishments reeling, could a positive counter-populist economic policy agenda soon emerge? The Nobel laureate economist Michael Spence sees an opportunity in disaffected voters' rejection of an insufficiently inclusive economic-growth model. "With previous presumptions, biases, and taboos having been erased," he writes, "it may be possible to create something better." Likewise, for Stiglitz, Trumpism's silver lining is that its opponents are experiencing "a new sense of solidarity over core values such as tolerance and equality, sustained by awareness of the bigotry and misogyny, whether hidden or open, that Trump and his team embody."

An implicit argument running through many *Project Syndicate* commentaries is that the only prophylactic against economist populism is more aggressive redistribution. As Rodrik puts it, populism – and poor governance generally – emerges when elites prove unwilling to "make adjustments to ensure that everyone does indeed benefit" from the existing economic model.

Behind recent, large-scale rejections of the "system" is a widely shared sense among certain groups of voters that the "establishment" has subordinated citizens' interests to cosmopolitan goals such as globalization, immigration, and cultural diversity. Most commentators agree that economic shocks such as the Great Recession or the eurozone sovereign-debt crisis are neither necessary nor sufficient to explain the rise of populism. Rather, populism is

more a response to prolonged economic malaise, deteriorating living standards, declining trust in established institutions, and a common perception that incumbent leaders have feathered their nests at the people's expense.

These are complex economic and political problems for which populism offers fancifully simple solutions. Efforts by the media to move the populist mind have proved counter-productive, and will likely continue to do so. Those opposed to the populist cure will have to come up with an equally powerful alternative, or look on helplessly as economic uncertainty and despair overwhelm the patient.

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