

The economic causes of populism

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Populism is on the rise in many industrialized countries. The reasons are manifold, but recent research reveals common trends – which turn out to be fundamentally economic. Global economic developments fostered inequalities. In turn, this spurred support of populist parties and candidates from those on the losing side of economic change. To counter this development, it is not enough to just increase welfare state transfers.

Populist parties have been active throughout Western countries for many years. But only over the last decade, have we seen a general trend of increasing support of populist parties, mainly from the right fringe of the political spectrum. This is happening against the backdrop of longer-running economic trends: the labor share in income has gradually decreased, and the demand for lower-skilled labor has declined. The result has been a rise in inequality between skill and income groups, with a distinct regional profile. Those on the losing side of this development turn to supporting populist parties with protectionist and nationalist agendas, economic research shows (see Fetzer and Gold [2019] for a comprehensive overview). Driving forces behind this are the globalization of trade, which has led to an outsourcing of low-skilled jobs to low-wage countries, and austerity policies in the

aftermath of the financial crisis, which exacerbated the perception of distributional conflicts, e.g. stemming from immigration.

»Economic growth and structural change have distributional consequences.«

MACROECONOMIC TRENDS AND VOTING BEHAVIOR

The rise of populism is taking place against the background of broader macroeconomic developments. Over the past decades, the labor share in national income has continuously declined in developed economies. Thus, income inequalities between factor owners of labor and capital have increased. Increasing income inequalities were driven by the internationalization of trade, which shifted the production of labor-intensive goods to low-wage countries, and technological change, which mainly increased capital productivity. Simultaneously, inequalities increased within the labor income group. Demand for high-skilled labor increased, while less-skilled workers suffered from job and wage losses.

It is well known that economic growth and structural change have distributional consequences. Accordingly, developed

economies have established welfare state institutions to support individuals or regions negatively affected by these developments. The idea behind this is to support an overall positive development by compensating its losers with transfer payments. However, the compensation mechanism does not seem to work this way anymore. On the one hand, this may be due to the fact that the welfare state has withdrawn in many places. On the other hand, monetary transfers alone do not seem to be sufficient to counter economic uncertainties. In any case, research shows that inequalities resulting from macroeconomic developments have substantially contributed to the success of populist parties in developed economies.

IN FOCUS: GLOBALIZATION

The economic causes of populism are comparatively well researched for the case of international trade. With the integration of poorer countries into the global economy, labor-intensive production is relocated to low-income countries. Conversely, developed countries concentrate on the production of knowledge-intensive goods and services. As a result, consumer prices fall, which has a positive impact on the general standard of living. Specialization on knowledge-intensive production may lead to turbulences on the job markets though, but regional and sectoral mobility should help the individuals affected to adjust to the new market environment.

Against this background, a study by Autor, Dorn and Hanson (2013) has had a major impact, by revealing unexpectedly high regional inequalities in the labor market responses to international trade. The study assesses how increasing trade

with China affects local labor markets in the US – and finds that imports from low-wage countries have led to significant job losses in the manufacturing sector, without offsetting job losses through gains in other industries. Low-skilled workers are particularly negatively affected. Moreover, some regions are disproportionately hit by the adverse labor market effects of international trade, while other regions may even benefit. In a follow-up study, Autor et al. (2017) show that these inequalities have led to political polarization in congressional elections and helped Donald Trump win the US presidential race in 2016.

In comparison, Germany is a beneficiary of trade integration, as Dauth, Finden and Südekum (2014) show. They find that increasing trade with Eastern Europe and China has created additional jobs in Germany. However, they also point to regional differences. Dippel, Gold and Heblich (2015) study the political consequences of these differences in exposure to globalization, and find that the support of right-wing extremist and populist parties rises in regions exposed to increased import competition from low-wage countries, while it decreases in regions benefiting from new export opportunities.

These political consequences of international trade can be fully explained by trade's labor market effects, as a follow-up study by Dippel et al. (2018) shows. The populist response to international trade is driven by low-skilled voters working in manufacturing industries. Obviously, the "losers" from globalization support parties promoting a nationalist alternative to increasing internationalization, while the "winners" reject such policies at the ballot box.

Several studies on different European countries confirm that import competition from low wage countries causes populism (e.g. Malgouyres (2017); Colantone and Stanig (2018) for an overview). However, trade effects alone are not sufficient to explain the success of populist parties. In general, it is unlikely that the rise of populism can be explained by one single cause only. Still, it is evident that the regional and individual differences in exposure to globalization prepare the ground for the success of populist campaigning, as it addresses exactly such inequalities.

»It is unlikely that the rise of populism can be explained by one single cause only.«

MIGRATION AS A DOMINANT ISSUE

Inequality is a structural phenomenon that has evolved over decades. Populist parties have also been active in Europe for a long time. But only recently has populism become a European trend. A unifying element of populist parties – particularly from the right wing of the political spectrum – is their critical attitude toward migration. This became obvious in the context of the "refugee crisis". A number of studies (e.g. Dustmann et al. (2019), Dinas et al. (2018), Halla et al. (2017)) confirm that refugee in-

flow increases support for right-wing populist parties. At first glance, it seems this cannot be explained with economic reasons, given the very modest economic impacts of refugee immigration. Specifically, there are hardly any labor market effects of immigration in general – and of refugees in particular – that could explain why immigration fosters populism. Xenophobia and fear of "cultural alienation" seem to be more important for the populist response to the refugee crisis. The interrelations between economic and socio-cultural factors in explaining populism are not yet well understood, though.

Indeed, there are also economic rationales linking immigration to populism. Among other things, the incumbent population competes with immigrants for the provision of public goods. Economic models (e.g. Alesina, Baqir and Easterly (1999)) show that the greater the cultural distance between two societal groups, the less willing they are to share. And indeed, it turns out that support for redistribution measures decreases with the inflow of migrants – and that there is a connection between refugee inflow, the supply of public goods and the support for right-wing populist parties. Against this background, it is not surprising that populist parties managed to mobilize support on an anti-immigration platform throughout Europe. In the aftermath of the global financial crisis, many countries reduced the provision of public goods. Distributional conflicts between natives and immigrants were thus intensified.

BREXIT AS A CASE IN POINT

The campaign for the Brexit referendum is a textbook example of the success of pop-

ulist campaigning. With a mix of ideological arguments, selective interpretation of facts, and untruths, the protagonists of the Leave campaign were able to win support for a project that would clearly decrease welfare. Leave votes were very unequally distributed across regions. In cities and regions specialized in service industries, most voters supported staying in the EU, while Leave received the most support in agricultural regions and the old industrial centers. The latter are regions that have been particularly hard-hit by import competition and the resulting labor market frictions. Differences in the industry structures of the Leave and Remain regions are also reflected in the differences in skill structures of the local populations. In fact, there is a clear, statistically significant correlation between the regional share of low-skilled workers and voting for Brexit.

Against this background, Fetzer (2019) shows that the UK government's austerity policies increased the voting share for leaving the European Union by around 10 percentage points, on average. Welfare cuts disproportionately hit those individuals and regions that had experienced rapid structural transformation. Accordingly, supporting Leave clearly reflected a vote from the "left-behind".

Again, the economic context may explain this political backlash. Since the 1960s, the labor share in the UK's national income has continuously declined. Along that line, the inequality in income distribution between high- and low-skilled individuals has steadily increased. Rising income inequality has been accompanied by regional inequality, as high-skilled workers and earners of capital income – i.e. the main beneficiaries of globalization and

technological change – tend to cluster in urban regions. Thus, the reduction in public spending not only affected individual recipients of transfer payments, but the development prospects of entire regions. The Leave campaign successfully addressed the distributional conflicts resulting from these inequalities, e.g. by polemicizing against Eastern European immigrants – although the labor market perspectives of UK workers are hardly affected by Eastern European immigration, as Becker and Fetzer (2018) show.

»Monetary assistance must be accompanied by active labor market policies and qualification measures.«

DOES IT HAVE TO BE LIKE THIS?

The success of populist parties in Western economies is caused by several economic factors. Global economic developments have increased inequalities between income and skill groups. The “losers” of this development have been particularly hit by a series of adverse economic shocks. Instead of countering this development with welfare state measures, austerity policies

have further increased distributional conflicts. However, this does not necessarily explain the rise of populism. Economic factors can well explain why voters turn away from incumbent parties. But why do the “losers” of globalization select into the populist camp?

In fact, populist parties are very successful in their campaigning strategies. They mix facts with fiction to provide a – superficially – coherent picture of socio-economic developments that disadvantage their electorate, linking economic grievances to social and cultural developments. In this way, populists provide a justification for otherwise unspecified fears and anxieties, which makes them an attractive political alternative for the “losers” of globalization. Thus populist voting has economic causes, but is further boosted by socio-cultural developments.

From an economic point of view, the rise of populism is critical because the policies propagated by populists have protectionist tendencies – thus having all the potential to decrease aggregate welfare, if enacted. To counter this development, policy has to tackle the economic causes of populism. Merely increasing transfer payments will not be enough, however. Monetary assistance must be accompanied by active labor market policies and qualification measures. Regional policy must generate development perspectives for deprived regions. Above all, populist rhetoric must be countered by facts and figures in order to provide voters with reliable information about advantages and disadvantages of economic change. Well-informed voters will be less inclined to support policies that harm themselves in the long run. Bringing that message across in an

increasingly polarized political debate is the challenge for policy makers oriented toward increasing general welfare.

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¹ The original version of the article can be found under the following link: <https://makronom.de/die-oekonomischen-ursachen-des-populismus-33900>

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