

ECONOMICS OF POPULISM

Takeaways

Populism and economic policy

“The growth of populist power may have the positive effect of forcing governments to address economic issues they have failed to take into account so far” p. 51

“The populist economic agenda is characterised by short termism, the denial of intertemporal budget constraints, and a failure to evaluate the pros and cons of different policy options or the trade-offs between them” p. 53

“The populist economic agenda rejects compromise as well as checks and balances and favours simplistic solutions” p. 53

“The populist policy prescription is a mix of debt financed expansionary policies, higher wages, and foreign exchange, as well as domestic price controls to prevent inflation” p. 54

“The winners from freer trade have not compensated the losers” p. 56

“Mainstream parties could crowd back populism by offering a larger spectrum of political programmes and views, which includes real alternatives to existing economic policies” p. 63

“Many populist parties do raise important questions and issues [...] However, the answers provided by the populist economic agenda are overly simplistic and partly based on false information” p. 65

Brexit: special deal versus damaging divorce

“The prospect of Brexit [...] poses an existential challenge to the European integration process” p. 67

“The economic test of what Brexit precisely means is still to come, and the politics are fuzzy” p. 68

“A reform (of the EU) should be based on significantly lowering the importance of agricultural transfers” p. 70

“In the future Europe would be likely to react with scepticism and hostility to a UK attempt to build a very lightly regulated (and thus potentially risky) offshore financial centre to work with and in Europe)” p. 71

“The critical question is [...] how far EU market access, and integration in a labour market that allows or encourages the free mobility of labour, affects Britain’s economic performance” p. 73

“How the rest of the EU reacts to Brexit is crucial to its future development. Accepting UK participation in the single market without personal mobility would dilute the project. A bitter divorce could consolidate the remainder of the EU. But a push towards further political integration [...] may not be credible or politically feasible” p. 77

“As a fear of domino effects tilts EU negotiating strategies towards intransigent attitudes, and British popular sentiment rejects sensible flexibility [...], the UK and Europe head towards a bitter and contested divorce: a Brexit that will be hard for Europe too” p. 78

“Could Brexit offer the EU an opportunity to streamline itself and become more effective?” p. 78



“Europe needs to deliver. It certainly needs a vision, and needs to communicate that vision effectively. But equally importantly it needs evidence that the vision produces results” p. 81

“EU constraints, previously invoked as a reason to reform, are now often presented as something to be removed, possibly by exiting the EU” p. 81

“A Europe that is being pushed conceptually back to a narrower core might find it hard to respond effectively to global problems” p. 81

Immigration and the refugee crisis – can Europe rise to the challenge?

“At a global level the number of displaced persons in the past decade has been around 40 million per year, or about 6 percent of the world population, but recent conflicts have caused an increase” p. 83

“Refugee policies are a prime example of a policy area calling for international harmonization and cooperation, not least within the EU. [...] Paradoxically, the EU adopted a Temporary Protection Directive back in 2001 [...] However, the Directive has never been implemented” p. 91-92

“The tension from immigration arises from the fact that it tends to reinforce the skill-bias problem by increasing the supply of low/less skilled labour” p. 94

“The German government estimates that each refugee will cost the state around 12,000 euros per year” p. 97

“A speedy resolution of asylum claims and early integration of refugees into the labour market would both reduce costs and help diffuse the building-up of social pressure” p. 97

“After Angela Merkel’s “Wir schaffen das” (“We can do this”) statement, expectations started to form that there would be virtually no limits to Germany’s (and by extension, to Europe’s) absorption capacity for refugees. [...] It is important that European leaders clearly manage such expectations and burst the bubble. This requires clear and transparent rules for when asylum is granted, and common criteria for safe countries where people are not under imminent threat” p. 99



Policy advice

Populism

- Delegating clearly defined tasks to independent and supra-national institutions can play a valuable role in restraining populism
- EU institutions should act strictly within their mandate; EU policies should adhere to the principle of subsidiarity. The EU Commission should focus on its role as a guardian of EU treaties, rather than attempting to play a more political role.
- Referenda should be used sparingly, and their role needs to be clearly defined in the constitution

Brexit

- The United Kingdom and the EU27 should lay out the basis for negotiating Brexit with the utmost clarity to avoid an informational deficit that enhances the public perception of a democratic deficit.
- The terms of Brexit need to comply with a norm of constitutional adequacy, which would also reflect the extent to which it is acceptable to regional units, including Scotland and Northern Ireland.
- Brexit – and other international developments – offers Europe the opportunity to sustainably remodel itself to more accurately reflect its citizens' aspirations. Such a remodelling is unlikely to occur via intergovernmental bargains, but they may nevertheless prove the only way to consider the trade-offs of costs and benefits in different policy areas.

Immigration

- EU member states should act preventatively to help vulnerable countries develop their economies, thus reducing incentives for their inhabitants to emigrate.
- New policies are called for to manage the expectations of potential refugees and prick the refugee bubble while protecting both European borders and individuals in real humanitarian need.
- The European Union should forge closer partnerships with countries that may potentially be willing to host asylum application centres.



The Quick Read

Populist economic policy and how to respond to it

Populism is sweeping across Europe, from the Front National and Geert Wilders' Freedom Party to Italy's M5S and the AfD in Germany. Populist support is driven by economic issues and by values like low tolerance of foreigners and other religions. It is crucial to explain to voters what the populist agenda is, why it is misleading and how national governments and the EU can respond.

What is populist economic policy?

Populist macroeconomic policy is expansionary and short termist. It advocates higher public spending, promises tax cuts, and plays down the adverse consequences of growing public debt or inflation. Populists offer simplistic solutions to complex problems. The benefits of excessively expansionary fiscal and monetary policy tend to be felt fast, while the adverse consequences of growing debt burdens, or even financial destabilization, take longer to emerge. But they inevitably will.

Populists oppose immigration, claiming that immigrants compete with natives in the labour market, take away their jobs, depress wages, and bleed the welfare state. Rejecting the notion that migrants are refugees fleeing war and prosecution, populists claim that they are economically motivated and often enter host countries illegally. Populists ignore that immigration can also have very positive effects, bringing new ideas and dynamism to host countries.

Globalisation and international trade are vilified by populists, who accuse foreign companies or governments of dumping and unfair competition. Globalisation, they say, harms most of the domestic population and only benefits an elite that disseminates false information through biased 'experts'. Most populist parties oppose European integration as a loss of sovereignty for EU member states, decry the euro and challenge the freedom of movement for EU citizens. They also claim that supra-national institutions evade democratic control.

Who supports populist parties and why?

Populist supporters see themselves as the victims of globalisation, international trade, capital mobility and notably migration. Economic crises also fuel populism due to the widespread perception that their costs are not borne by the "elites" deemed responsible, but by the "ordinary people." But populist support can also have non-economic roots in views and values like a low tolerance level of foreign cultures and different religions. In the Brexit referendum Leave supporters tended to be older, less educated, low earners and people outside the workforce.

How can moderate politicians erode populist support?

One way of dealing with populists is to isolate and ignore them. Another, arguably more successful, strategy is to integrate populist parties and let them be part of coalitions, provided they respect the basic rules of democratic decision-making. If populism marks a reaction to a growing political convergence between the left and right wing, mainstream parties could crowd back populism by offering a larger spectrum of political programmes and views.

To some extent, governments may sap populist support and reconnect with voters by changing their economic policies. More redistributive taxes and higher minimum wages may boost the income of low-earners, albeit at the risk of raising unemployment. Investing more in education and vocational training would also benefit low-skilled workers, and may enable them to find better paying jobs, although the potential of professional training is limited. Populist politicians simply ignore these tradeoffs.

One way to combat manipulative, post-truth political campaigning would be to ask a neutral institution to analyse the economic policy agendas of all parties standing for election. This would force them to submit an agenda complete and consistent enough to stand up to evaluation and serious public debate.



Such analyses are performed regularly in the Netherlands. They have not stopped Geert Wilders, but he may have been even more successful without them. Referenda play an important role in the constitutions of many countries, but governments should not be allowed to use them as a strategic instrument.

Delegating clearly defined tasks and responsibilities to supranational institutions like the EU may also help to rein in populism. Joining the EU marks a long-term commitment to adhere to fundamental principles of democracy, openness and the rule of law. To protect the EU's image, however, mainstream politicians should stop using it as a scapegoat for their internal economic and political problems.

EU policies should be transparent and comply with the principle of subsidiarity, while EU institutions, including the ECB, need to adhere more closely to their mandate. As for the European Commission, it should focus on its role as a guardian of the European treaties, and withstand pressures to play a more political role.

Brexit – special deal versus damaging divorce

The UK referendum outcome partly derives from a vision of the European Union that differs from that of other members. Traditionally it is less regulated, hostile to the idea of Europe-wide fiscal centralisation, less concerned with the fortunes of the agricultural sector, and more dependent on financial services. But Brexit partly represents an extreme instance of a more general scepticism over European integration.

The longer uncertainty prevails over the UK's access to markets and the nature of future migration policy (including the position of current EU nationals working in the United Kingdom), the higher the costs of Brexit will be. There is a powerful bargaining logic that points in the direction of a bitter and damaging divorce, which may end up leaving both sides worse off. That would be catastrophic.

Should integration fail to yield positive results in the remaining EU27, ordinary Europeans will start to question Europe's *raison d'être* and their own identity. The European Union could turn this situation around and undermine populist support by monitoring its policies more closely and deliver on promises to deliver a brighter future that is worth a few short-term sacrifices.

Immigration and the refugee crisis – can Europe rise to the challenge?

In 2015 the number of refugees applying for asylum in the European Union reached 1.3 million, with the majority of applicants coming from Syria, Afghanistan and Iraq. Although various measures slightly reduced refugee flows into the EU in 2016, the underlying problems remain and the pressure of humanitarian-driven migration on Europe persists. The current flow of refugees, while comparable with that observed in the 1990s at the peak of the Balkan conflict, also involves much broader and more populated areas of the world, raising the issue of absorption-capacity.

Across Europe, and not merely at the far-right end of the political spectrum, the massive immigration of culturally (and, often, visually) very different people is fuelling fears related to the preservation of European national identities and ways of life. Many traditional European political parties were slow to react at the onset of the refugee crisis, allowing populists to shape the debate.

The refugee wave is a humanitarian challenge calling for cooperative solutions across countries, and certainly for a coordinated response from EU members. A “More Europe” approach to the crisis could involve all EU countries contributing to a joint “refugee fund” (calculated based on relative GDP, for example). An incentive-compatible allocation scheme would maintain the right of member countries to determine inflows of asylum seekers, while ensuring that they do not free ride on the common policy.

The “Less Europe” approach, more frequently seen to date, is that of European countries attempting to defend their own national borders, often disregarding the welfare of others (this is partially already happening). This solution is costly, and will probably lead to the eventual break-up of the Schengen Treaty, one of the EU's key achievements to-date. Countries that opt for an opportunistic approach by pursuing narrowly defined short term national interests will make things tougher for everyone in the long run.

