

Is Populism Necessarily Bad Economics?

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Economists dislike populism, and for good reason. The term evokes irresponsible, unsustainable policies that often end in disaster and hurt the most the ordinary people they purportedly aim to help. The emergence recently of populist movements in Europe and the United States has made these concerns more relevant. But populism is a term with many possible meanings and its political and economic ramifications are different. In this short paper, I will provide a limited defense of economic, but not political, populism under our present circumstances.

I. Defining populism and its political and economic variants

The distinctive trait of populism is that it claims to represent and speak for “the people,” which is assumed to be unified by a common interest. This common interest, the “popular will,” is in turn set against the “enemies of the people” -- minorities and foreigners (in the case of right-wing populists) or financial elites (in the case of left-wing populists).

Since they claim to represent “the people” at large, populists abhor restraints on the political

executive. They see limits on their exercise of power as necessarily undermining the popular will.

In politics this is a dangerous approach that allows a majority to ride roughshod over the rights of minorities. Without separation of powers, an independent judiciary, or free media – institutions which all populist autocrats detest – democracy degenerates into the tyranny of those who happen to be currently in power. Elections become a sham: in the absence of the rule of law and basic civil liberties, populist regimes can prolong their rule by manipulating the media and the judiciary at will.

Similarly in economics, populists reject restraints on the conduct of economic policy. Autonomous regulatory agencies, independent central banks, and external constraints (such as global trade rules) narrow their policy options and hence need to be overcome.

It is important not to conflate these two dimensions of populism – political and economic – as they need not always go hand in hand. Table 1 shows the possibilities.

Personalized regimes such as Vladimir Putin’s in Russia or Tayyip Erdogan’s in Turkey are characterized by the absence of restraints in both the political and economic

domains (box 1). But it is possible to conceive of autocratic regimes where important aspects of economic policy are placed on automatic pilot or delegated to technocrats (box 2). Pinochet’s regime in Chile provides an example.

TABLE 1— A TAXONOMY OF REGIMES

		Restrains on economic policy	
		no	yes
Political restraints	no	(1) personal autocracy (Erdogan)	(2) authoritarian technocracy (Pinochet)
	yes	(3) populist democracy (Sanders)	(4) liberal technocracy (EU)

Alternatively, a regime can be populist in the economic sense without rejecting liberal, pluralist norms in the political domain (box 3). Finally, a regime that is constrained in both politics and economics might be called a “liberal technocracy” (box 4). The European Union may be an example of the last type of regime: economic rules and regulations are designed at considerable distance from democratic deliberation at the national level, which accounts for the frequent complaint of a democratic deficit.

My focus here is on the respective advantages and disadvantages of regimes (3) versus (4). I ask: when is lifting restraints on

economic policy a good idea, or equivalently, when is liberal technocracy too constraining?

II. Economists’ soft spot for technocracy

Economists tend to prefer rules, or delegation to autonomous technocratic agencies, because of the tendency of short-term interests to dominate when economic policy is in the hands of politicians. In particular, policy is often subject to the problem of time-inconsistency, which undermines the pursuit of policies that are desirable for the long term.

One canonical example is discretionary monetary policy. Politicians who control the printing presses may have an incentive to generate “surprise inflation” so as to boost output in the short run. But this backfires, since firms and households adjust their expectations. In the end, discretion results only in higher inflation without any output or employment gains. One solution to the problem is the delegation of monetary policy to an independent central bank, insulated from politics, which is charged solely with the task of maintaining price stability.

More broadly, the costs of macroeconomic populism are quite familiar in Latin America. As Jeffrey Sachs, Sebastian Edwards, and Rudiger Dornbusch analyzed a while back, unsustainable monetary and fiscal policies were the bane of the region until economic

orthodoxy began to prevail in the 1990s. These policies produced periodic and very painful economic crises, which hurt the poor in particular. To break these cycles, the region turned to fiscal rules and technocratic finance ministers.

Another example is governments' treatment of foreign investors. Once a foreign firm makes its investment it essentially becomes captive to the host government's whims. Promises that were made to attract the firm are easily forgotten, replaced by policies that squeeze it to the benefit of the government treasury or locally owned firms. But investors are not stupid, and, fearing this outcome, they invest elsewhere. The local economy is deprived of capital and expertise. External constraints can help overcome this problem too. For example, many governments resort to trade or investment agreements with a so-called Investor-State Dispute Settlement (ISDS) clause. These allow foreign firm to bypass the local judicial system and sue the government in international tribunals.

Yet another illustration is the problem of legislative log-rolling, which produces inefficient outcomes as special interests trade off favors for each other. When trade tariffs were determined by Congress, the result was excessive protectionism. Delegation of trade policy authority to the President, and in turn to

international trade agreements, is often seen as a mechanism for achieving freer trade outcomes that are on balance beneficial to more groups.

These are examples of restraints on economic policy that take the form of delegation to autonomous agencies, technocrats, or external rules. As described, they serve the useful function of preventing those in power from shooting themselves in the foot by pursuing short-sighted policies. When power-holders represent the majority, or people at large, such restraints do not harm the "popular interest." In fact, they advance it by ruling out policies that would be broadly harmful.

III. Restraints that serve special interests

Such cases are to be distinguished from another possibility. Commitment to rules or delegation may also serve to advance the interests of narrower groups, and to cement their temporary advantage for the longer run.

Imagine, for example, that a democratic malfunction or random shock enables a minority to grab the holds of power. This allows them to pursue their favored policies, until they are replaced. In addition, they might be able to bind future majorities by undertaking commitment that restrain what subsequent governments can do.

These kinds of restraints will not be desirable as a rule. Unlike under time consistency, delegation to autonomous agencies or signing on to global rules will serve not society at large, but narrow interests. The results will be primarily redistributive rather than efficiency enhancing. Were a future government to find a way of relaxing restraints of this second kind, society would benefit.

Part of today's populist backlash is rooted in the belief, perhaps not entirely unjustified, that restraints imposed on economic policy in recent decades have been precisely of the second kind.

Take monetary policy, for example. Independent central banks have played a useful role in bringing inflation down in the 1980s and 1990s. But in a low inflation environment, their exclusive focus on price stability tends to impart a deflationary bias to economic policy. In principle, this can be fixed by adjusting the inflation target upwards, say from 2 percent to 4 percent, as many economists have argued. But the problem remains that central bankers motivated purely by inflation concerns will likely try to hit their target overwhelmingly from below. This may well create a tension with employment generation and growth.

When the conflict becomes severe, the independence of the central bank can be called in question. In such circumstances allowing a

certain degree of politicization of monetary policy may be the lesser evil.

Or consider global trade rules. One can make the argument that the agenda of international trade agreements has increasingly been shaped by special interests -- multinational corporations, financial institutions, pharmaceutical and high-tech companies. The result has been global disciplines that disproportionately benefit capital at the expense of labor.

For example, global and regional trade agreements now incorporate stringent patent and copyright rules the main purpose of which is to create and distribute rents for big pharma, Hollywood, and tech firms. So-called Trade-Related Intellectual Property Rights (TRIPs) clauses enable such firms to extend their domestic monopolies globally. It is difficult to make the case that TRIPs enhances global welfare, in the way that standard free trade does.

Similarly, while international investor tribunals (ISDS) can be in principle beneficial to both foreign firms and host governments, in practice they have increasingly turned into a redistributive vehicle. They allow foreign investors to effectively pressure governments not to adopt policies that affect their profits adversely, regardless of the public interest. As

a result, many developing country governments are now reconsidering the value of ISDS.

With respect to delegation to domestic regulatory agencies, the possibility that they might be captured by the industries they regulate has long been a concern. In recent decades, financial institutions have been particularly influential in that manner. The expertise and resources they have at their command have left public agencies necessarily at a disadvantage. The result has been the relaxing of regulations that had previously reined in excessive risk taking and the unleashing of practices that render financial crises more likely and costlier.

In Europe, the emphasis on economic integration – removing transaction costs to cross-border transactions – has encouraged rule-making that takes place at considerable distance from democratic deliberation at the national level. EU-wide regulations, fiscal rules, and a common monetary policy imply policy is increasingly made in Brussels and Frankfurt while politics remains in the national capitals (to use political scientist Vivien Schmidt’s evocative distinction). The system serves skilled professionals and internationally oriented companies well, but many others feel excluded. Complaints about the region’s democratic deficit, and the recent populist

backlash, are rooted in this style of technocratic policy making, insulated from politics.

IV. When economic populism works

In many of these instances, relaxing the constraints on economic policy and returning policy autonomy to elected governments may well be desirable. This is especially true in times such as these, when much conventional wisdom has been upended by political development and political populism in particular is on the rise. Exceptional times require the freedom to experiment in economic policy.

An apt historical example is provided by Franklin D. Roosevelt and his New Deal. FDR famously called for “bold, persistent experimentation” in 1932, arguing that correcting the faults of the prevailing economic system required enthusiasm, imagination, and courage to tamper with established arrangements. But to experiment he needed to do away with many of the shackles on economic policy.

FDR came to office during the worst economic downturn in U.S. economic history. The challenge he faced was to both tame and redirect the populist passions the Great Depression had inflamed. Huey Long, a demagogue and the authoritarian governor of Louisiana, was one vocal nemesis, calling for a

radical redistribution of wealth in the country. Another was the fascistic Father Charles Coughlin, with tens of millions of followers on the radio.

Roosevelt initially supported traditional policies such as a balanced budget. But he soon changed tack. Many of FDR's signal economic initiatives were dressed in explicitly populist garb. The 1935 Revenue Act which introduced a tax on wealth was known as the "soak the rich" tax. The Social Security Act, providing for financial support to the elderly and the unemployed, was in part a response to the popularity of a plan advanced by a physician named Francis Townsend to provide all elderly Americans with a stipend.

FDR's reforms required that he remove the economic fetters imposed by pre-existing arrangements. When they collided with his economic objectives external and domestic restraints were both done away with. In 1933, he took the U.S. off the Gold Standard, which had been a major (external) constraint on monetary policy. This allowed the dollar to depreciate and U.S. interest rates to come down. Output received an immediate boost.

In the domestic arena, it was the conservative courts that posed a major obstacle to Roosevelt's New Deal initiatives. For example, they rejected minimum wage laws as an unwarranted intervention in the bargaining

relationship between employer and employees. In what was perhaps his most daring gambit, FDR tried to increase the size of the Supreme Court so he could obtain a majority by appointing judges more sympathetic to his agenda. This so-called court packing plan ultimately failed. But the threat was effective. The Supreme Court eventually gave its approval to minimum wage laws and other interventions in labor markets.

In a 1936 address to the Democratic convention, FDR riled against what he called the "economic royalists" – the corporations, financiers, and industrialists who he said had monopolized the economy at the expense of ordinary peoples. He had been under constant criticism for his interventions in the market and for extending the power of the executive over the economy. "These economic royalists complain that we seek to overthrow the institutions of America," he said. "What they really complain of is that we seek to take away their power." His economic reforms, he explained, were needed not only to serve people better, but also for the "survival of democracy."

V. Concluding remarks

With the benefit of hindsight, we can say that Roosevelt was right. Saving the market economy and democracy during the Great

Depression required a significant overhaul of established economic practices that no longer served the interests of the vast majority of the nation. It was impossible to do so without significantly eroding the prevailing restraints on economic policy.

More broadly, I have argued that delegation to independent agencies (domestic or foreign) occurs in two different contexts: (a) in order to prevent the majority from harming itself in the future; and (b) in order to cement a redistribution arising from a temporary political advantage for the longer-term. Economic policy restraints that arise in the first case are desirable; those that arise in the second case are much less so.

Populism that undercuts liberal, pluralist democratic norms – what I have called the political variant of populism here – is almost always dangerous. But economic populism is different. There are times when some economic populism may in fact be the only way to forestall its much more dangerous cousin, political populism.