POPULISM, INEQUALITY, AND ECONOMIC GROWTH

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Relevant Information

This document summarises the key points of one of the round tables held at the Fide Foundation 2nd International Congress at Oxford, on Nationalism, Populism and Identities: Contemporary Challenges. The key topic was **populism, inequality, and economic growth.**

The panel was comprised of **Charles Brendon,** Academic economist based at Queens' College and the Faculty of Economics, Cambridge, **Francisco de la Torre,** Tax Inspector, **Cecilia García-Peñalosa,** Professor of Economics at Aix-Marseille University and senior research fellow at the Centre Nationale de la Recherche Scientifique (CNRS) **Eva Gutiérrez,** Lead Financial Economist in the Latin American and Caribbean Region of the World Bank and **Joe Perkins,** Senior Vice President, and Head of Research at Compass Lexecon based in London. Fellow at Queens' College Cambridge *(Leader of the SG). As contributors:* **Jorge Padilla,** Senior Managing Director, and Head of Compass Lexecon EMEA. Member of Fide's International Academic Council, currently chair as of September 2022. *(Leader of the WG and constructive friend of this subgroup).* We would like to thank the following persons for their contributions during the preparatory sessions of the working group: **Hermenegildo Altozano,** Partner in charge of the energy and natural resources practise in the Madrid office of Bird&Bird. Academic Advisor to Fide, and **Julio Veloso Caro,** Partner of Broseta and Head of International.

About the Fide Foundation

The Fide Foundation is a legal-economic think-tank based in Spain, committed to involving the civil society in all major legal and economic developments in Spain, the EU and abroad.

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ABSTRACT

Economic inequality has increased in many western countries in the last few decades, though the timing and extent of the rise varies. Increasing inequality is linked to declining social mobility, as children born into poverty are more likely to remain in poverty in later life than their parents who were born in more equal societies. Rising inequality is one factor in the recent growth in support for populist political parties, who argue that there are simple solutions to economic problems - these are frequently attributed to external organisations or to disfavoured groups such as immigrants. The evidence to date suggests that populists in power tend to have some effect on inequality – right-wing populists raise inequality, left-wing populists lower it, but at the expense of reduced economic growth overall. We argue that there are alternative 'non-populist' ways of tackling increasing inequality, but that doing so effectively is likely to require a broad range of policies, rather than just changes to specific aspects of, for instance, taxes and benefits.

INTRODUCTION

In this paper, we assess how economic inequality has changed over time, and how this could be linked to the rising prominence of populist movements. We provide an overview of the economic effects of populism to date and consider alternative approaches to tackling economic inequality.

We do not include lengthy discussion of definitions, but have instead used the following working definitions of key concepts:

a. We define populism as encompassing those political movements which emphasise their anti-pluralism and anti-elitism, along with the moral right of leaders of those movements to represent 'the people'.[1]

b. We consider several different concepts of economic inequality, defined as differences in material well-being, or the possibility of achieving material well-being, between individuals and / or groups. Our principal focus is on inequalities in wealth and income, and on inequalities between all individuals in a society, rather than between different groups.[2]

The remainder of this document is divided into six sections, covering: the growth of inequality in western societies (Section 2); the links between inequality, social mobility and merit (Section 3); the growth of populists in unequal societies (Section 4); economic and social implications of populism (Section 5); the effects of the pandemic on inequality and populism (Section 6); and how to address inequality in a non-populist way (Section 7). In addition, the Appendix lists the members of the subgroup.

THE GROWTH OF INEQUALITY IN THE WEST

Global relative inequality has fallen significantly in recent decades, driven by the rapid growth of previously poor countries such as China and India.3 However, the picture looks quite different within many countries, particularly in the West. Income and wealth inequality in many western countries reached a historic low point in the late 1970s. Inflation and labour disputes had eroded the value of capital, and the growth of the meritocratic society had reinforced a sense of high levels of income and

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[1] See Müller (2016), "What is Populism?", **University of Pennsylvania Press**; Guriev and Papaioannou (2020), "The Political Economy of Populism", Journal of Economic Literature, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3542052

[2] United Nations (2015), "Development Issues No 1: Concepts of Inequality", available at:

https://www.un.org/en/development/desa/policy/wess/wess_dev_issues/dsp_policy_01.pdf

[3] Niño-Zarazúa, Roope and Tarp (2016), "Global Inequality: Relatively Lower, Absolutely Higher", Review of Income and Wealth, available at: https://onlinelibrary.wiley.com/doi/epdf/10.1111/roiw.12240 note though that absolute inequality, based on the absolute gap between rich and poor, has risen.

occupational mobility. Political leaders and other prominent figures were often from middle class or poorer backgrounds – 'poor kids made good' through the opportunities opened up by military service and the widening of education systems, or children of small business owners such as Margaret Thatcher and Jimmy Carter.

This began to change in the 1980s, beginning first in the UK and the US, before spreading to continental Europe from the 1990s. By the time the global financial crisis hit in 2008, several western societies were as unequal as they had been since reliable recording began. The financial crisis and its aftermath may have stabilised income inequality, but wealth inequality continued to rise, creating fears of a permanent capitalist elite. The richest people on earth began to challenge their Gilded Age counterparts such as John D. Rockefeller and JP Morgan in the amount of wealth they controlled.

As this basic narrative suggests, changes in inequality are driven by many factors, including long-term moves in the structure of economies (for instance, the shift towards high-tech and high-skill industries), crises and the responses to them, and institutional and political factors, such as changes in labour markets and in taxes and benefits.

FORMS OF INEQUALITY

We focus here on income and wealth inequality.[4] Each of these displays differing dynamics over time, and between countries, and each has several different measures that can tell somewhat different stories. The dynamics are also not necessarily the same at different points of the distribution. Nonetheless, some broad themes emerge.

Income inequality

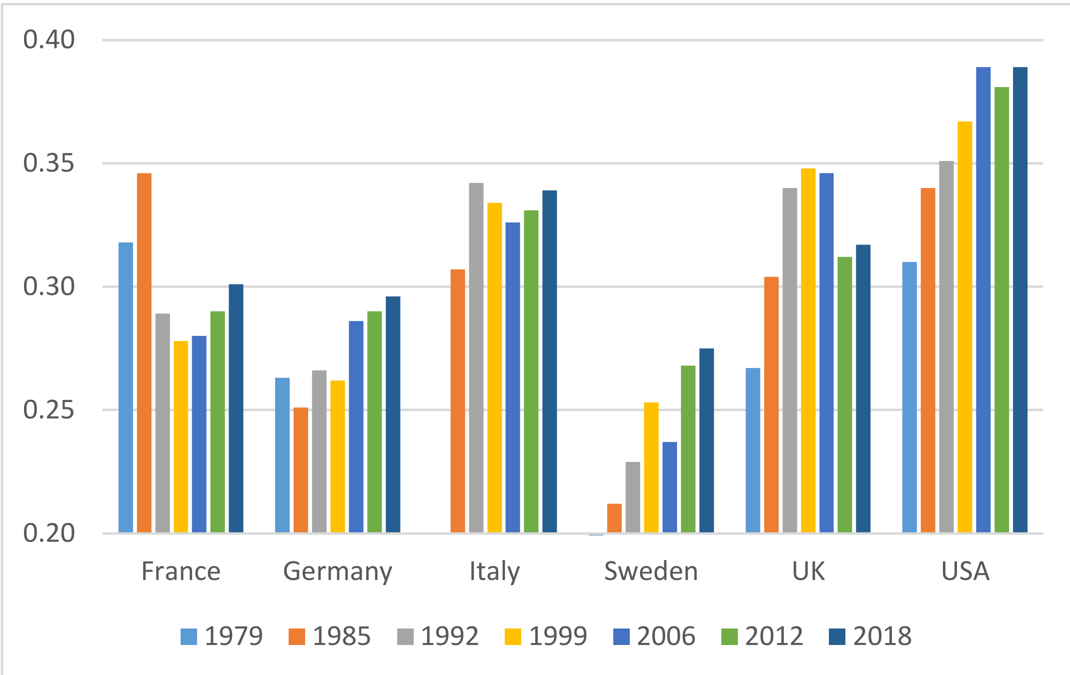
The most common way of measuring income inequality is via the Gini coefficient – a measure of income inequality between 0 and 1, where 0 indicates absolute equality, 1 indicates that the richest

[4] There are many other valuable ways of thinking about economic inequalities, such as inequality of labour or capital earnings, or inequalities of different types of wealth, such as land holdings.

person receives all of the income. Figure 1 presents data for six selected countries.5 The data indicate that, amongst high-income economies, the Gini coefficient now varies between 0.29 and 0.39. Income inequality increased markedly in the UK and the US in the 1980s and early 1990s. Increases in inequality in other western economies typically came later, and from a lower base.

[5] See LIS data available at: https://www.lisdatacenter.org/ and OECD data, available at: https://data.oecd.org/inequality/income-inequality.htm. The data report household disposable income adjusted for the number of household members. While broad trends tend to be similar, precise figures differ depending on the definitions and data sources used.

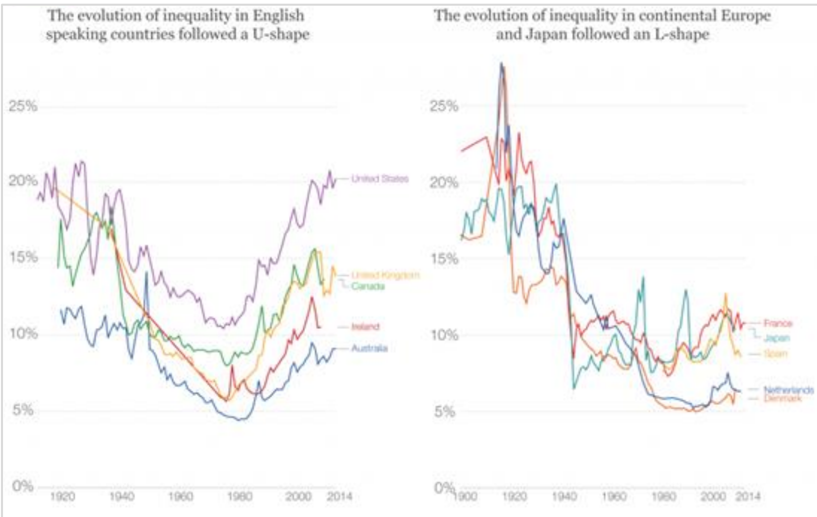
Figure 1: Gini coefficient, disposable income



Source: Luxembourg Income Study and OECD.

The Gini coefficient provides a useful overall measure of inequality in a country but can hide dynamics at different points in the income distribution – for instance, a country with a small wealthy elite and a lower-middle income majority could have the same coefficient as one with an equal spread of people across the income scale. Figure 2 shows that English-speaking countries have seen significant increases in the share of income going to the top 1%, but this has not been replicated more widely.

Figure 2: Share of Total Income to the Top 1% since 1900



Source: Our World in Data.

WEALTH INEQUALITY

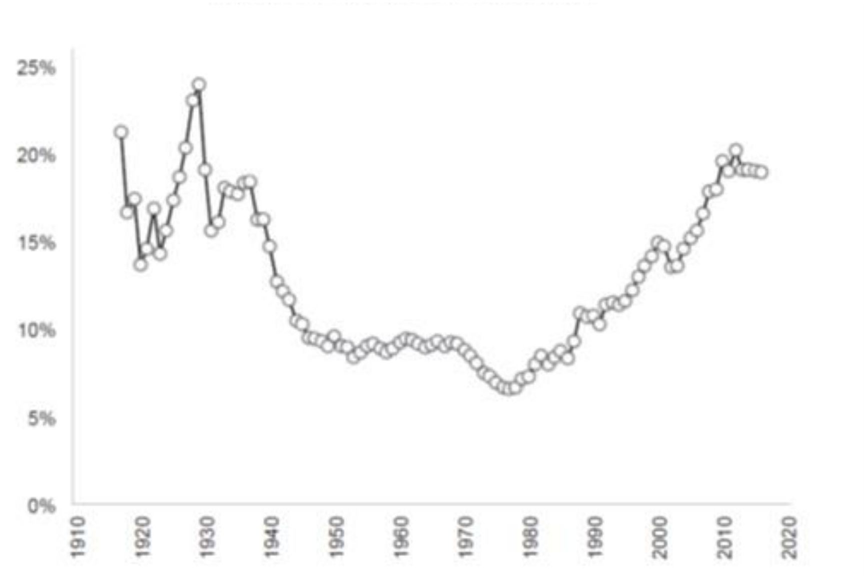
Wealth tends to be much less equally distributed than income; Alfani and Schifano (2021) estimate that in 2010 the Gini coefficient for wealth in G7 countries varied between 0.63 (Italy) and 0.88 (USA).[6] This reflects the inevitable dynamics of wealth accumulation (poor people tend to have lower saving rates than rich people), as well as limited taxation of wealth in most countries.

Wealth inequality has increased particularly significantly in the US, where the richest 0.1% of the population now controls about as great a proportion of the nation's wealth as they did a hundred

[6] Alfani and Schifano (2021), "Wealth inequality in the long run", available at: https://www.researchgate.net/publication/350384345_Wealth_inequality_in_the_long_run.

years earlier. The share of this top 0.1% has more than doubled since the 1970s (Figure 3).[7] Unlike with income inequality, several measures of wealth inequality continued to increase following the financial crisis, perhaps due to increasing asset prices in a time of low interest rates and quantitative easing.

Figure 3: Top 0.1% wealth share in the United States (capitalized incomes, equal-split adults)



Notes: This figure shows the share of total household wealth owned by the top 0.1% richest adults (individuals aged 20 and above) in the United States with wealth equally split between married spouses.

Source: Saez and Zucman (2016), updated.

[7] Zucman (2019), "Global Wealth Inequality", Annual Review of Economics, Vol. 11, available at: https://gabriel-zucman.eu/files/Zucman2019.pdf.

However, the picture in other countries is more mixed; Zucman (2019) finds only limited increases in the share of wealth going to the richest groups in France and the UK. There is some evidence of a shift in wealth towards highest-income households relative to those with middle incomes, related to an increase in the importance of financial and business wealth relative to property.[8]

CAUSES OF CHANGING INEQUALITY

A wide range of causes has been suggested for increasing inequality, and inevitably each of them has some validity. We provide an overview here of some of the leading proposed explanations.

Technological causes

Skill-biased technological change was an important early explanation of rising inequality, based on the argument that technology changes have increased demand for (e.g.) college-educated workers relative to their less-skilled counterparts. There is some evidence that this has had an effect in the US and Germany, with rising wage premiums for more educated workers, though much more limited effects in other countries.[9] Capital-biased technological change (higher returns to capital rather than workers) could also be a factor, but it is only likely to be particularly significant in the US.[10]

Globalisation

Globalisation seems likely also to have had an impact – increasing competition from goods imported from developing countries, or from immigrants, could in principle reduce low-skilled wages in developed economies (while possibly increasing wages among a mobile globalised elite). There is

[8] Advani et al (2021), "The UK's wealth distribution and characteristics of high-wealth households", Fiscal Studies, Vol. 42(3-4), available at https://onlinelibrary.wiley.com/doi/full/10.1111/1475-5890.12286.

[9] Hoffman, Lee and Lemieux (2020), "Growing Income Inequality in the Unites States and Other Advanced Economies", Journal of Economic Perspectives, available at: https://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.34.4.52.

[10] See "Blogs review: Robots, capital-biased technological change and inequality", available at: https://www.bruegel.org/2012/12/blogs-review-robots-capital-biased-technological-change-and-inequality/.

some evidence of effects, particularly on changes in regional inequality due to the so-called China shock.11 However, impacts on overall inequality are difficult to disentangle. For example, increased trade and immigration could also have affected inequality indirectly, by reducing the bargaining power of labour, making it easier to push through institutional changes such as a reduced role of trade unions in wage setting. Lastly, globalisation is potentially a cause of high incomes at the very top of the distribution, as global competition has created an international market for super-stars.

Societal and institutional causes

Changes in labour markets are likely to have had significant impacts – though not all in one direction. For instance, high rates of unionisation can increase coordination of bargaining (tending to reduce inequality) while also increasing unemployment (raising inequality). The overall conclusion tends to be that changes in unionisation have been a significant driver – Checchi and García-Peñalosa estimate that the UK Gini coefficient would have been about 9 percentage points lower if it had Finnish labour market institutions.[12] Similarly, the Hartz reforms to German labour markets seem to have contributed to increased inequality from the early 2000s.[13] But note that changes in labour market institutions have gone in different directions (before the Great Recession) with some countries weakening them (US/UK) but others strengthening them (such as Spain).

Product market developments can also have an impact on inequality, for instance if increased competition were to lower prices and improve workers' real incomes. The evidence here is mixed; product market deregulation seems to be associated with lower prices and higher labour productivity,

[11] Autor et al. (2016), "The China Shock: Learning from Labor-Market Adjustment to Large Changes in Trade", Annual Review of Economics, Vol. 8, available at: https://economics.mit.edu/files/12751.

[12] Checci and García-Peñalosa (2008), "Labour market institutions and the personal distribution of income in the OECD", available at: https://air.unimi.it/retrieve/handle/2434/142829/122345/2.pdf.

[13] Immel (2021), The Impact of Labor Market Reforms on Income Inequality: Evidence from the German Hartz Reforms.

potentially reducing inequality.[14] But increased market power in several industries (associated with changing antitrust policy) could tend to increase inequality; Khan and Vaheesan (2017) argue that, in the US, "market power can be a powerful mechanism for transferring wealth from the many among the working and middle classes to the few belonging to the 1% and 0.1% at the top of the income and wealth distribution."[15] Some scholars have identified a trans-Atlantic divide, suggesting that increased market power may be a more important explanation of increased inequality in the US than in Europe.[16]

Tax and benefit changes

Changing progressivity of the tax and benefits system could reduce or increase inequality. In most western countries, taxes and benefits play an important redistributive role, reducing inequality substantially relative to market outcomes. 4 shows the significant differences in the progressivity of taxes and benefits between different European countries. In Slovenia and Finland, the tax and benefit system reduce inequality by more than 50%, while the impact is much smaller in countries such as Bulgaria and Cyprus.[17]

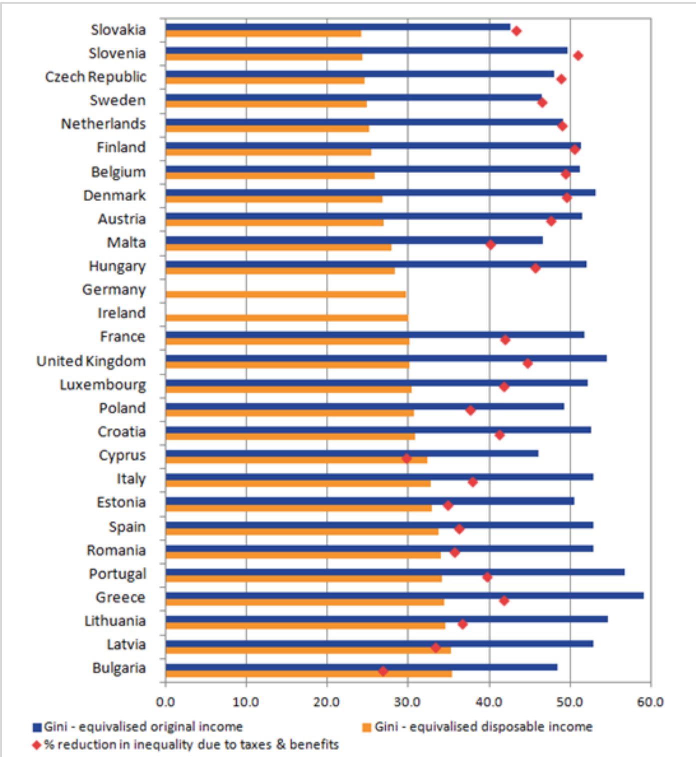
[14] Bouis et al (2016), Product Market Deregulation and Growth: New Country-Industry-Level Evidence. Conversely, MacKay and Mercadal (2021), Deregulation, Market Power, and Prices: Evidence from the Electricity Sector, find that deregulation increased efficiency but also increased market power, leading to higher consumer prices overall.

[15] Khan and Vaheesan (2017), Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents.

[16] Philippon (2019), The Great Reversal. See also Eggertsson et al (2021), Kaldor and Piketty's facts: The rise of monopoly power in the United States.

[17] ONS (2016), "The effects of taxes and benefits on income inequality: 1977 to financial year ending 2015", available at: https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/incomeandwealth/bulletins/theeffectsoftaxesandbenefitsonincomeinequality/1977tofinancialyearending2015.

Figure 4: The effects of taxes and benefits on income inequality: 1977 – 2015



Source: UK Office for National Statistics.

The key variables are:

a. the extent to which taxes and benefits are progressive (for instance, the extent of targeting of benefits on the poorest groups, and the balance between indirect taxes (which tend to be regressive) and direct taxes (which tend to be progressive); and

b. the size of benefits (or taxes) relative to incomes.

A detailed study of the tax and benefit system in the UK since 1977 suggests that the overall impact has not changed significantly over time – while the targeting of cash benefits has fallen, their absolute size has increased, meaning that the net change is small. However, some specific tax reforms do seem to have had significant impacts on inequality; for instance, reforms to capital gains taxation in Sweden are associated with large increases in top income shares.[18]

Crises and responses to them

Historically, crises, particularly major wars, have been a significant driver of changes in inequality. Progressive taxation was often developed to help pay for conflicts, and wars also affected the balance of power between capital and labour.[19] In most western countries, income inequality has largely stabilised since the financial crisis, perhaps reflecting changing political dynamics as well as reduced opportunities for high incomes as growth has stagnated. However, as noted above, wealth inequality in the US has increased.[20] The interaction between the Covid pandemic and inequality are discussed below.

[18] Roine and Waldenström (2011), "On the Role of Capital Gains in Swedish Income Inequality", Review of Income and Wealth, Vol.58(3) , available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2050893.

[19] Besley and Persson (2009), "The origins of state capacity: property rights, taxation and politics", National Bureau of Economic Research, available at: https://www.nber.org/system/files/working_papers/w13028/w13028.pdf

[20] Kuhn et al (2018), "Asset prices and wealth inequality", available at: https://voxeu.org/article/asset-prices-and-wealth-inequality.

CONCLUSIONS

It is impossible to disentangle entirely the impacts of each differing factor on inequality. For instance, skill-biased technological change may have influenced deunionisation, which itself affects the political power of labour and the extent of redistribution via the tax and benefits system.[21] Similarly, globalisation is likely to have had an impact both directly and through indirect impacts on technological adoption, specialisation, and institutional change.

However, given the differing dynamics between the Anglophone sphere and other high-income economies, it seems likely that policy-related factors are important drivers of changes in inequality over time. Since inequality before taxes and benefits have increased as much or more than inequality after transfers, such policy causes may be deep-rooted – based in changes to the working of labour and product markets.

Even if inequality as measured by the Gini coefficient of disposable income stabilizes, perceptions of inequality may matter as much (or even more) to political and social dynamics than actual inequality. In particular, developments at the very top of the income and wealth distribution have become a focal point for protests and anti-elitist political movements, as discussed further below.

[21] Acemoglu et al. (2001), "Deunionisation, technical change and inequality", Carnegie-Rochester Conference Series on Public Policy, available at: https://www.sciencedirect.com/science/article/abs/pii/S0167223101000586.

INEQUALITY, MOBILITY, AND MERIT

Inequality in the aftermath of the Great Recession

European economies displayed a variety of inequality patterns over the second half of the 20th century. For Europe as a whole, inequality seems to have stabilised during the 21st century to date, but with significant differences between countries. Some countries have reversed their long-term trend, as is the case of Sweden where inequality started to increase around 1990, while in the UK, after almost three decades of rising inequality the trend was reversed during the Great Recession. While Europe has recently witnessed stable or decreasing inequality, inequality has typically continued to increase in the US.

The neoliberal rhetoric of the previous decades implied that by the time these changes in inequality became apparent two paradigms had been widely accepted. The first is the idea that market incomes are solely determined by technology and preferences, so that the pre-tax distribution is providing factors with the rewards they "deserve". The second is the concept of meritocracy which implies that achieving a position of influence or economic success is the result of demonstrated abilities or merit. As a result, the rhetoric of opportunity that characterized both the post-war decades and the neoliberal dogma turned, as inequality rose, into a rhetoric of failure. Those whose incomes did not grow were *responsible* for such outcomes.[22]

The 2007-08 Financial Crisis questioned this view of the world. The crisis was the result of inadequate decisions taken by individuals that were supposedly highly skilled, reportedly highly educated and undoubtedly highly paid. Such an outcome challenged the idea that market rewards were deserved, a perception that was exacerbated by government interventions to support the banking sector which, although justifiable in terms of macroeconomic stability, implied that those responsible for the crises

[22] See Sandel (2020), "The tyranny of merit: What's become of the common good?", on meritocracy, who argues that the defence of meritocracy is largely a way for elites to justify the intergenerational transmission of privilege.

did not suffer the corresponding losses. Not surprisingly, a widespread questioning of how income was distributed arose.

Mobility patterns

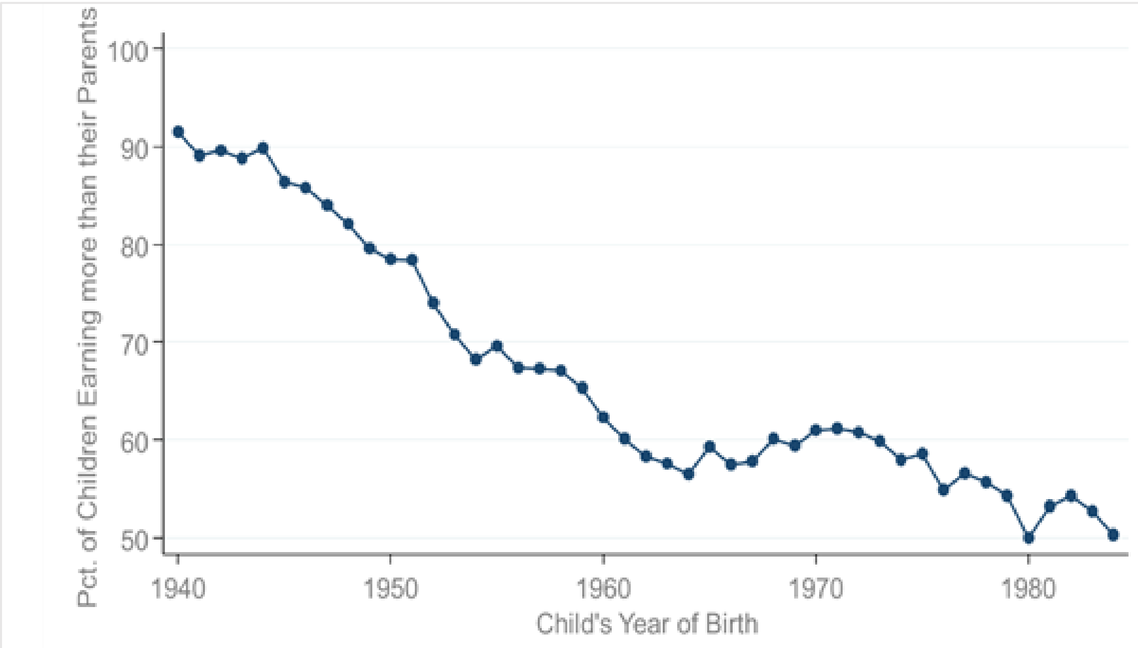
The debate on distributional outcomes has been reinforced by a marked decline in the extent of social mobility observed in high-income countries. After decades of extensive upwards social mobility driven by both economic growth and the expansion of higher education, this trend has been largely reversed.

To measure mobility, we can compute a simple statistic: the fraction of children who go on to earn more than their parents did, measuring both the children's incomes and their parents' incomes in their mid-30s. Figure 5 plots the statistic for the US separately by the year in which the child was born, including children born between the 1940s and the 1980s

The figure shows that for children born in the middle of the last century, it was a virtual guarantee that they would experience upwards mobility. Yet, over time there has been a dramatic reduction in this probability, which, for those born in the 1980s, is only about one in two. Similar declines have been observed in a number of countries.[23]

[23] Blanden, Gregg and Machin (2005), “Intergenerational mobility in Europe and North America. Report supported by the Sutton Trust”, Centre for Economic Performance, London School of Economics.

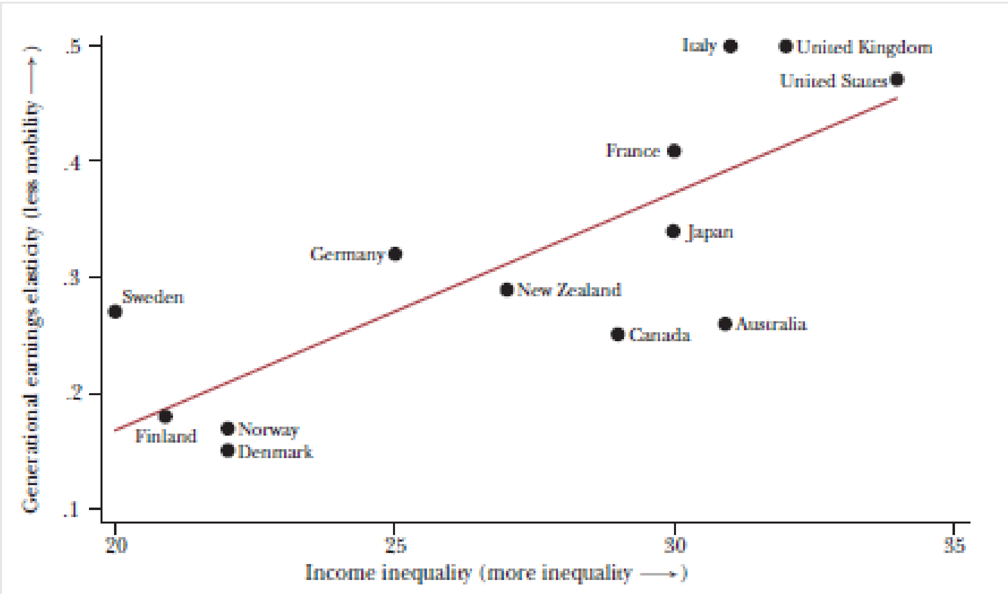
Figure 5: Percent of children earning more than their parents by year of birth



Source: Chetty et al. (2017).

Mobility and inequality are closely related, with less equal societies also displaying less social mobility. Consider Figure 6. The vertical axis shows the intergenerational earnings elasticities, the values lying between 0 and 1. A lower intergenerational elasticity means that there is higher income mobility in that country. The horizontal axis shows the Gini coefficient (Gini coefficient of disposable household income, measured in around 1985). The *Great Gatsby Curve*, as termed by Krueger (2012), indicates that overcoming one's parents' income level is easiest in countries with low Gini coefficients. This observation suggests that rising inequality may reduce upward mobility, which would compromise the fairness of a society.

Figure 6: Cross-sectional inequality vs. intergenerational mobility (the Great Gatsby curve)



Notes: Income inequality is measured as the Gini coefficient of disposable household income, measured at around 1985 (OECD data). Intergenerational income mobility is computed as the elasticity between fathers' and sons' earnings as adults (the latter measured in the mid to late 1990s) and compiled in Corak (2006).

Source: Corak (2013).

A meritocratic society?

The idea of identifying talent throughout an entire society in order to employ talented individuals in government,[24] although initially developed in China found its strongest defendants in the Western economies, where the combination of Protestantism with the Enlightenment led thinkers to formalise the importance of natural ability and education to identify those that should lead a society. The traditional elites (based on birth) forfeited their privileged access to education and Western universities acquired the crucial role of identifying talent, thus shaping future employment possibilities and earnings (see Woolridge, 2021).

Public funding and a reform of the institutions providing higher education delivered several decades in which educational attainment expanded and intergenerational income mobility was high. Yet, even at its best, the meritocratic ideal is problematic. As argued by Michael Young in his 1958 book *the rise of meritocracy*, meritocracy risks dividing a society. In his satire, when intelligence and hard work replace traditional divisions based on social class, society becomes stratified between a merited power-holding elite and a disenfranchised underclass. Two problems appear: the elite will seek to transmit privilege while the underclass, if they accept the meritocratic ideal, will need to accept that their outcome is deserved.[25]

Young's vision seems to have, to some extent, come true in the early twenty-first century, as Western societies have polarized, and elites have increased the extent of social reproduction. In his critique of the US higher education system (although many of his arguments apply elsewhere too), Michael Sandel (2020) shows how what were once merit-based entry exams have become a system in which the children of the elite have privileged access through networks, all-the-coaching-that-money-can-buy, or undisclosed payments in the form of donations.[26] The result has been a sharp decline in the

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[24] Well, men. Until the mid-20th century, the concept of talented individuals included exclusively males. A notable exception is Plato who, in The Republic, claimed that women were equally capable of being "guardians" of the ideal Republic.

[25] The first problem was a major concern for Plato, who argued that the price that the 'guardians' had to pay for being the ruling elite was not to have children.

[26] Sandel (2020), Tyranny of Merit: What's Become of the Common Good?

social mix in top institutions, a reduction in intergenerational mobility, and an increasing feeling of entitlement of those who get educational credentials.

Interestingly, this decline in equality of opportunity has, to a large extent, been driven by parental decisions rather than by policy choices.[27] But why are today's parents different from those in the 1950s and 1960s? Doepke and Zilibotti (2019) argue that this change is the result of growing inequality.[28] When income inequality is low, your child's expected income will be rather similar whatever her education. As a result, parents invest little time and monetary resources in trying to advantage to their child. In contrast, as the income gap associated with different educational paths increases, it becomes rational for parents to forgo leisure time and own consumption in order to increase the likelihood of their children getting into an elite institution. Since high income parents have more resources, they will best advantage their children, thus increasing the likelihood that the latter have access to the best education irrespective of the child's natural ability. As a result, social mobility declines and the Great Gatsby Curve appears.

[27] Although the reduction in public funding, and in particular the decline in the relative salaries of primary- and secondary-school teachers, in many high-income countries has not helped.

[28] Doepke and Zilibotti (2019), Love, Money and Parenting: How Economics Explains the Way we Raise our Kids.

FROM MERITOCRACY TO POPULISM

Starting in 2007, the Financial Crisis, the Sovereign Debt Crisis and the ensuing Great Recession constituted a major shock that questioned the economic dogmas that had been put forward since the late 1970s. The distribution of market incomes is under scrutiny, and an awareness of the role of socio-political relations in shaping inequality and mobility has emerged that rejects the idea that we live in a meritocratic society and that markets deliver all individuals their worth.[29] Several aspects have paved the road for a rejection of the meritocratic ideal. The first is the increased awareness that opportunities, and in particular educational opportunities, are not equally distributed. The second has been the way in which the Financial Crisis questioned whether the earnings of those at the very top of the distribution actually reflect their productivity, when their decisions lead to systemic risk and put in peril the entire financial system.

Lastly, a key element was the way in which the international community dealt with the twin crises of 2007-09 and 2011-13. The decision to bail out banks during the Financial Crisis was the right decision in terms of economic policy yet had massive political costs. The looming crisis was largely the result of excessive risk-taking in the financial sector, yet those responsible for the crisis were getting away with it. Shortly after, when Greece, Ireland and Portugal found themselves in a debt crisis because of inadequate financial decisions, the policy was not to bailout these countries but to argue that moral hazard problems required making them responsible for their decisions. The consequence was austerity, recession and a massive loss of income that hit hardest those with fewer resources and fewer skills.

Moreover, austerity in the wake of the crises was widespread in the EU, with major consequences for the wellbeing of certain groups of the population that felt left behind. A possible reading of those policy decisions was that punishment falls on the people but not on the elite.

[29] For example, Piketty (2020) presents a historical perspective of inequality dynamics, where distributional outcomes are not a deterministic outcome but rather result from the combination between fundamentals (preferences and technology) and ideological factors.

THE GROWTH OF POPULISM IN UNEQUAL SOCIETIES

Populist movements may adopt some policies associated with traditional conservative or social democratic parties, such as immigration control or nationalisation of key services, meaning that there is no bright line between populist and mainstream programmes. Moreover, some mainstream parties have become closely associated with populist movements, such as the Republican Party and the Tea Party in the United States and the Conservative Party and the Brexit movement in the UK. Nonetheless, Timbro argues that “In general, it is not as difficult to categorize political parties as one might expect. Despite some disagreement on labels, there is a rather wide consensus among scholars on where parties fit in.”[30]

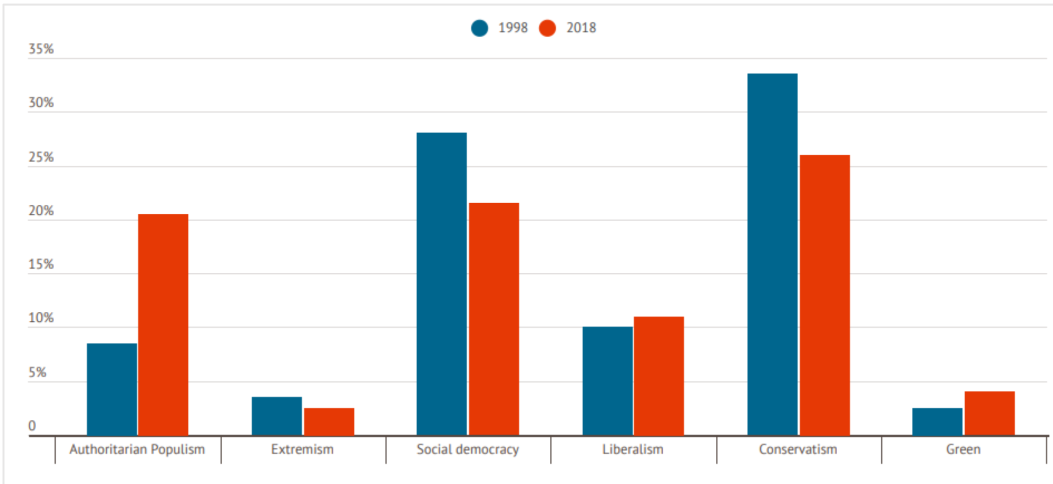
While precise definitions can be questioned, studies of populism have consistently identified increasing political prominence of populist parties over the last forty years. For instance, the Timbro Authoritarian Populism index finds that more than a quarter of European voters supported populist parties in 2018. The growth of populism has come at the expense of traditional social democratic and conservative parties (Figure 7).[31] Populist parties have entered power in several European countries (typically as part of coalitions), and populist movements have also had substantial influence on the platforms of traditional parties.

[30] Timbro Authoritarian Populism Index (2019), available at:

https://populismindex.com/wp-content/uploads/2019/02/TAP2019C.pdf.

[31]Ibid.

Figure 7: Percent of votes for different ideologies, 1988 and 2018.



Source: Timbro Authoritarian Populism Index (2019).

A potential link between political developments and economic inequality has long been recognised. Amartya Sen identifies a two-way link between rebellion and inequality, writing that: "The relation between inequality and rebellion is indeed a close one, and it runs both ways. That a perceived sense of inequity is a common ingredient of rebellion in societies is clear enough, but it is also important to recognize that the perception of inequity … depend[s] substantially on possibilities of actual rebellion."[32]

It is therefore tempting to associate together contemporary rises in economic inequality and support for populist parties. Inequality, it may be thought, induces greater resentment and distrust of elites, and a drive to find simple solutions that will overthrow their power on behalf of 'the people'. This could

[32] Sen (1973), "On Economic Inequality", Oxford: Clarendon Press.

particularly be the case if rising inequality is attributed to outsiders, such as increased globalisation or immigration.

Quantitative evidence supports the case for a link between inequality and populism. In their study of 14 OECD countries, Engler and Weiss tanner (2021) find that increased income inequality is associated with growing support for right-wing populist parties, with middle-income high-status voters particularly likely to be attracted to right-wing populism; they attribute this trend to fears of losing subjective social status.[33] The link between inequality and declining trust in elites, and increasing national identity, may also help to explain how inequality increases populism.[34]

Inequality therefore does seem to have encouraged the growth of populist movements, particularly on the right of the political spectrum. The relationship is, however, not one to one, and some countries have seen increasing populism without noticeable rises in inequality (such as France and Spain). This suggests that other factors are important too – and perhaps that perceptions of inequality may play at least as large a role as objective measures of it.

[33] Engler and Weisstanner (2021), "The threat of social decline: income inequality and radical right support", Journal of European Public Policy.

[34] Stoetzer et al (2021), "How does income inequality affect the support for populist parties?", Journal of European Public Policy, available at: https://www.tandfonline.com/doi/full/10.1080/13501763.2021.1981981.

ECONOMIC AND SOCIAL IMPLICATIONS OF POPULISM

Populism is a broad term, encompassing what can be thought of as right- and left-wing populism. Right-wing populists tend to emphasise national identities, and oppose the influence or status of outsider groups, such as immigrants or minorities. Left-wing populists tend to emphasise class identities and oppose the influence of a (perceived) corrupt self-sustaining domestic elite.

Nonetheless, populist economic programs of both left and right have some common 'anti-market' elements. Populist leaders present themselves as true representatives of "the people", promising to fight some "elite" who works on their own interest as opposed to "the people's" interest. Economic populism is therefore typically anti-market; a populist leader knows better than the outcome of individual choices.[35] Populist movements often support limitations on immigration and international trade, for a mix of cultural and economic reasons. Anti-elitism and anti-pluralism can also be manifested through opposition to international organisations and treaties; in the US, Donald Trump's presidency emphasised the need to renegotiate the NAFTA agreement, while in Europe, populists have reacted to fiscal discipline measures imposed by the European Union and "elite" bureaucrats. Since at least the 19th century, populism has also been associated with measures to counteract powerful companies, for instance through the 1890 Sherman Act in the US.[36]

Populist movements often downplay the costs of significant interventions in existing regimes, or of major changes to market outcomes; for instance, reductions in trade or immigration are often argued to have few or no downsides. Concerns about fiscal sustainability can also be dismissed, particularly if they are associated with outside actors such as the IMF or the European Union. This denial of trade-offs in policymaking, and of the need for compelling evidence for policy changes, is an important characteristic of many populist movements. In the UK, this view was summarised during the 2016 debate over Brexit by then-Lord Chancellor Michael Gove's statement that "the people in this country

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[35] See Bourne (2019), "Economic Populism on the Left and Right is Poisoning US Political Discourse", available at: https://www.cato.org/commentary/economic-populism-left-right-poisoning-us-political-discourse.

[36] Wright and Portuese (2019), "Antitrust Populism: Towards a Taxonomy", Stanford Journal of Law, Business and Finance, Vol. 21, available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3400274.

have had enough of experts from organisations with acronyms saying that they know what is best and getting it consistently wrong".

Empirical studies find negative economic impacts of populist governments both right and left wing. Funke et al (2020) is an important recent study of the economic consequences of populist governments since the early 1900s.[37] The authors find that over 15 years, GDP per capita and consumption decline by more than 10 percent compared to a plausible non-populist counterfactual for each individual populism episode. This economic stagnation is linked to economic nationalism and protectionist policies, unsustainable macroeconomic policies, and the erosion of institutions and legal protections, hampering long-term growth through negative effects on innovation, education, and capital accumulation.[38] Prior to 1990, the decline in GDP growth is driven by left-wing populists while in recent decades it is increasingly driven by right-wing populists. Several other studies focussed on populism in Latin America have also found negative economic impacts of populist governments.[39]

The bulk of evidence on the economic impacts of populism is negative, but Funke et al do find that left-wing populism is associated with reductions in inequality. They conclude that, compared to a plausible counterfactual, Gini coefficients fall by about 2 percentage points on average over 15 years after a left-wing populist leader comes to power, while rising by about 1 percentage point after a right-wing populist comes to power. Left-wing populism is also associated with workers receiving a higher share of total GDP, while the reverse is true of right-wing populism.

Inevitably, academic work to date has not produced definitive results on the economic impacts of very recent populist movements in the US or Europe, though there have been analyses of some specific

[37] Funke et al. (2020), "Populist leaders and the economy", Kiel Working Papers 2169, available at: https://www.ifw-kiel.de/publications/kiel-working-papers/populist-leaders-and-the-economy-15277/..

[38] See also Acemoglu, D., S. Johnson, J.A. Robinson (2005), "Institutions as the Fundamental Cause of Long-Run Growth", Handbook of Economic Growth, available at: https://economics.mit.edu/files/4469.

[39] See e.g., Grier, Kevin, and Norman Maynard (2016), "The economic consequences of Hugo Chavez: A synthetic control analysis." Journal of Economic Behavior & Organization.

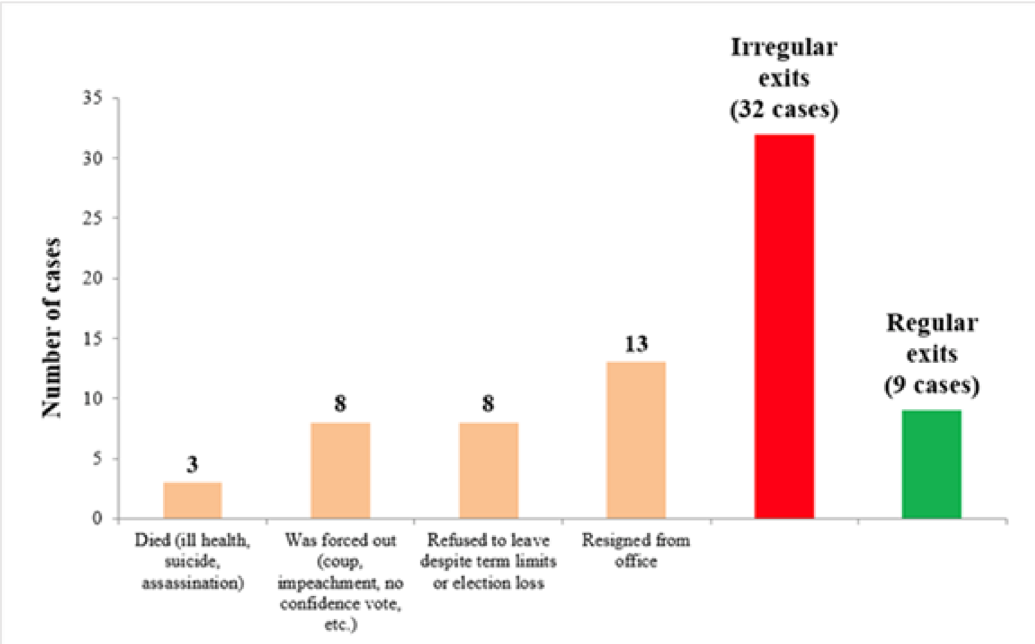
aspects, such as trade policy.[40] Before the arrival of Covid, discussed below, recent populist governments seem to have broadly acted in line with the longer-run evidence on populism, including fiscal expansions, restrictions on international trade and / or immigration and conflicts with international institutions. Some populist governments have provided significant income support to lower-income households, either through social work programmes (Hungary) or minimum income schemes (Italy, Spain).

Beyond such economic effects, Funke et al (2021) provide important evidence on wider social and political consequences of populist governments, finding that populist leaders are associated with reductions in judicial independence and constitutional integrity, and that populist leaders often leave office 'irregularly' (for instance, through resignation, after refusing to leave following an election defeat, or being forced out by a coup or impeachment) – see Figure 8.[41]

[40] Amiti et al (2019), "The impact of the 2018 trade war on US prices and welfare", National Bureau of Economic Research, available at: https://www.nber.org/papers/w25672.

[41] Funke et al (2021), "The cost of populism: Evidence from history", available at: https://voxeu.org/article/cost-populism-evidence-history.

Figure 8: Exit patterns of populist leaders (since 1970)



Source: Funke et al. (2021).

COVID, INEQUALITY AND POPULISM

Covid and inequality

The scale of the Covid pandemic has had correspondingly large economic effects, including on inequalities. Initial assessments suggest that poorer workers have been disproportionately likely to suffer employment impacts; Chetty et al estimate that, in the US, employment rates fell 37% for workers in the bottom quartile of the wage distribution, compared to 14% for workers in the top quartile.[42] In France, richer households were more likely to increase their savings during the pandemic, while poorer ones borrowed more.[43] Recent dramatic rises in energy prices are also likely to have disproportionate impacts on poorer households, who spend a higher proportion of their incomes on heating and electricity.[44]

However, these effects have typically been counteracted, at least in the short term, by the extent of public support packages, which caused a significant drop in poverty levels in the US, and reduced income inequality in several European countries.[45] Of course, this is not good news overall – merely a sign that, due to government interventions, poorer households seem to have suffered proportionately less economically than richer ones.

[42] Chetty, Friedman, Hendren, Stepner and The Opportunity Insights Team. (2020), "How did COVID-19 and stabilization policies affect spending and employment? A new real-time economic tracker based on private sector data", Cambridge: National Bureau of Economic Research, available at: https://www.nber.org/papers/w27431.

[43] Bounie, Camara, Galbraith (2020), "Consumers' Mobility, Expenditure and Online-Offline Substitution Response to COVID-19: Evidence from French Transaction Data", available at:

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3588373.

[44] House of Lords Library (2021), "Rising energy costs: the impact on households, pensioners and those on low incomes", available at: https://lordslibrary.parliament.uk/rising-energy-costs-the-impact-on-households-pensioners-and-those-on-low-incomes/.

[45] Matthews (2021), "The big drop in American poverty during the pandemic, explained", available at: https://www.vox.com/22600143/poverty-us-covid-19-pandemic-stimulus-checks; Clark, Ambrosio, Lepinteur (2021), "The Fall in Income Inequality during COVID-19 in Five European Countries", available at https://halshs.archives-ouvertes.fr/halshs-03185534/document.

The longer-term effects of the Covid pandemic are still highly uncertain, but there are several ways in which it could affect economic inequality, including:

1. People whose connection to the labour market is less stable, such as older workers and those with caring responsibilities, may have chosen to drop out of the labour force, with effects on their human capital and future earnings.[46] Those just about to enter the labour market may also suffer long-term negative effects.[47]

2. Already lower-achieving children seem to have particularly suffered from educational disruptions, with potentially serious impacts on their long-term life chances.[48]

3. The substantial increases in public debts may contribute towards governments' decisions to cut future public services, with disproportionate impacts on poorer citizens. Conversely, inequality could fall if governments decide to raise taxes.

Covid and populism

As with Covid and inequality, Covid and populism can interact in both directions – populist governments may adopt different strategies to tackling the virus from mainstream political parties, and the political and social effects of the pandemic could affect the demand for populist rulers.

While there is little comprehensive evidence to date, some researchers have identified differences in the approaches to Covid taken by populist and non-populist governments – with the former less likely to impose restrictions on social interactions. This has consequent impacts on death rates during the pandemic. For instance, Bayerlein et al (2022) conclude that Covid mortality rates in countries with

[46] House of Commons Library (2022), "Coronavirus: Impact on the Labour Market", available at https://researchbriefings.files.parliament.uk/documents/CBP-8898/CBP-8898.pdf.

[47] Cribb et al (2017), "Entering the labour market in a weak economy: scarring and insurance", IFS Working Paper, available at https://ifs.org.uk/publications/10180.

[48] Grewenig et al (2020), "Covid-19 and Educational Inequality: How School Closures Affect Low- and High-Achieving Students", CESifo Working Paper No. 8648, available at: https://www.cesifo.org/en/publikationen/2020/working-paper/covid-19-and-educational-inequality-how-school-closures-affect-low.

populist governments have been almost twice as high as those in countries with non-populist governments.[49] Historical links between populism and vaccine scepticism might also be expected to increase mortality rates in countries with populist leaders, though there is no direct evidence on this to date.[50]

It might be concluded that perceived failures of populist governments to handle the pandemic effectively could reduce the demand for populism among voters. Immediately after the 2020 US Presidential election, Lacatus and Meibauer (2020) argued that Trump's populist appeals failed to increase his vote share, while his "obvious lack of a competent COVID-19 management strategy may well have doomed him electorally."[51] Similarly, the popularity of the Bolsonaro government in Brazil collapsed during 2020 and 2021, as it was associated with high death rates and perceived mishandling of the pandemic.

However, this might be too comforting a conclusion for those who dislike populist approaches. To the extent that the long-term effect of the pandemic is to heighten distrust in politicians and to increase political polarisation, it might be expected to increase the appeal of populism over time.

[49] Bayerlein et al. (2022), "Populism and COVID-19: How Populist Governments (Mis)Handle the Pandemic", available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3849284. Note though that Spilimbergo (2021), "Populism and Covid-19" concludes that "I find no clear evidence to suggest that populists in power systematically mismanaged the response to Covid-19…"

[50] Kennedy (2019), "Populist politics and vaccine hesitancy in Western Europe: an analysis of national-level data" European Journal of Public Health, Vol. 29, available at; https://academic.oup.com/eurpub/article/29/3/512/5364298?login=true.

[51] Lacatus and Meibauer (2020), "Donald Trump's populist appeals failed to win over an electorate which wanted and needed a competent COVID-19 response".

ADDRESSING INEQUALITY IN A NON-POPULIST WAY

Increasing economic inequality is one of the central features of developments in many western societies over the past few decades. It can have significant impacts on political and social developments too, including by encouraging the growth of populist movements. Evidence suggests that populist parties once they attain power can have highly negative economic and social impacts. This therefore provides added impetus for a fight to reduce unjustified inequalities of economic outcomes. The need for a compelling approach to tackling inequality is further heightened by the many major challenges western societies are facing, including combatting global warming and responding to expansionist autocracies.

Here, we discuss first some principles that a non-populist approach to tackling inequality could follow, and then some potential policy changes that could be considered. Our role is not to provide definitive solutions – different members of the subgroup inevitably have different views on the desirability of otherwise of each of these policies. Moreover, there is no one size fits all solution – different approaches will be relevant in different countries. Rather, we aim to suggest issues and areas that may merit deeper consideration.

PRINCIPLES

First, **policies to reduce inequality should consider both ‘predistribution’ and redistribution**. Redesigning taxes and benefits can have a significant impact on inequality, but a narrow focus only on fiscal measures could overlook the main drivers of changing inequality. Market outcomes are not a fait accompli, and there is scope for well-designed policy measures to influence them significantly. Influencing market dynamics by, for instance, increasing carbon taxation could potentially benefit both environmental outcomes and social welfare. Conversely, redistribution via the tax system can be both politically and economically costly – both the givers and the recipients of perceived ‘charity’ may end up resenting it.

Second, **a non-populist approach needs to win hearts and minds**, positively making the case for a good society. Experience suggests that, without a positive case for actions to reduce inequality, any changes are unlikely to be robust to changing political dynamics. The framing of policy interventions is therefore important – the subtleties of utilitarian cost-benefit analysis may be harder to communicate than clearer rights-based formulations. A minimum wage is easier to understand than the outcome of a tax credit application, for instance. An effective non-populist approach may also require a different approach to policy design at the regional or community level, to ensure wider involvement of people across society, rather than just a perceived narrow elite based in the capital city. This could help to reduce geographical inequalities too, combatting the sense of regional decline that has set in in many post-industrial towns.

Third, **the process of policymaking should encourage long-term actions** and discourage a populist drive for immediate wins. Investments in, for instance, education and pre-school children may have significant positive effects, both overall and in reducing inequalities, but their impacts may not be seen for decades. The World Bank's move to place inequality at the centre of its policy process could be a model for national authorities to follow. Better reporting of the long-term effects of policies could help to embed a longer-term vision in political decision making. This also interacts with wider questions of how to support robust media scrutiny and political engagement in an age of social media – the experience of the pandemic shows how effective policymaking can become impossible where trust in any authority figures is lacking.

RECOMMENDATIONS AND PROPOSALS TO CONSIDER

Labour markets and industrial strategy

Approaches to improve the outcomes from labour markets include:

- 'Levelling up' labour market standards to reduce imbalances between the gig economy and the more permanent sector, which have become marked in many countries.
- Assess links between precarious employment (consumer risk-bearing) and (a) stress and health outcomes for employees, and (b) aggregate macroeconomic outcomes - including incentives to invest in an employment relationship, and propensity to consume.
- Target investments to achieve net zero to help tackle regional inequalities in particular. There are often strong opportunities for net zero investments in former industrial areas.
- Increase the role of employees in industrial management, for instance by expanding employee representation in boards.

Taxation and public spending

The rises in wealth inequality since the financial crisis create a strong case for increased use of wealth taxation. There may be scope for rebalancing taxation to increase the progressivity of tax systems for a given total tax take, for instance substituting direct taxation of wealth for indirect taxation of consumption.

A guarantee of universal basic services, potentially expanded outside traditional core roles of the state in health and education, could help to reduce both direct inequality and inequality of opportunity. For instance, this might include guaranteeing availability, cost, and standards of services in local transport or housing.[52]

Competition policy

The focus of competition authorities on promoting consumer welfare, and protecting competition rather than competitor firms, remains crucial to achieving good societal outcomes. However, there could be changes in focus to recognise the wider impacts of agreements and mergers, such as where labour markets may be harmed by agreements between firms or where mergers reduce workers' bargaining power.

Better understanding of the reasons for the growth in mark-ups and profitability is also important. Is this an inevitable consequence of technological trends towards concentration? Is it best combated by competition policy, or dealt with ex-post by seeking wider ownership of capital?

Macroeconomic stabilization

Low interest rates, and more recently QE, are commonly held responsible for fast relative growth in asset prices post-2000. An alternative potential tool for macroeconomic stabilisation is VAT (and/or other final sales taxes), which could be varied at relatively high frequency. As well as implying fewer wealth effects, this has the possible advantage of affecting budget constraints more evenly across the economy. It is also of particular use in the euro area, where it can be targeted to the particular conditions of individual countries.

[52] See Unesco (2021), "Move the debate from Universal Basic Income to Universal Basic Services", available at: https://en.unesco.org/inclusivepolicylab/analytics/move-debate-universal-basic-income-universal-basic-services.

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NATIONALISM, POPULISM, AND IDENTITIES:

CONTEMPORARY CHALLENGES

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