

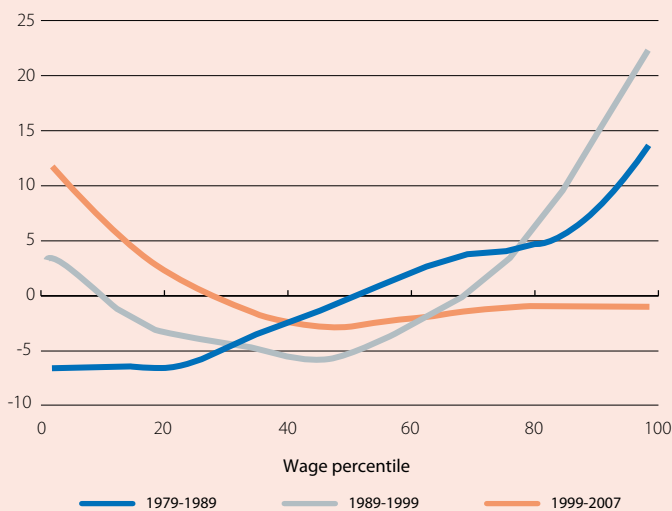
## Inequality and populism: myths and truths

In recent times, much ink has spilled over the relationship between economic inequality and the rise in populism in advanced countries. In many cases this relationship has been taken as read, as if it were an undeniable fact that economic inequality is the main reason for the emergence of populist parties. Nevertheless, it may be rather premature to assume such a relationship exists. This article looks at whether inequality is actually one of the factors behind the rise in populism and, if so, how much impact it really has.

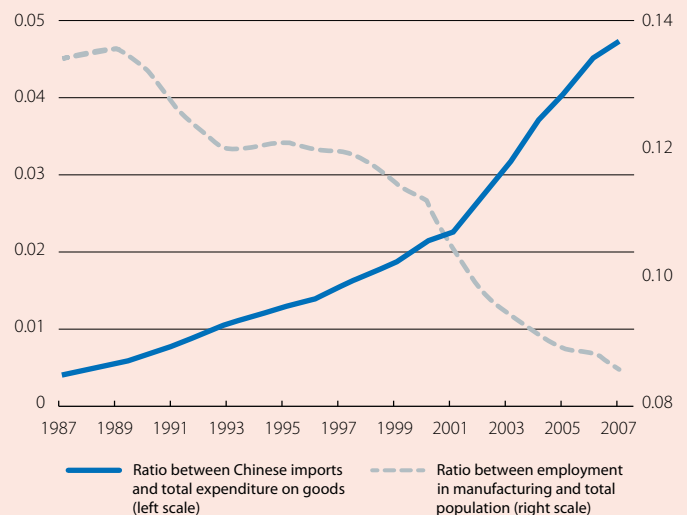
Focusing on the first question, it should be noted that there are hardly any academic articles in the field of economics that provide clear-cut evidence of a cause/effect relationship between inequality and populism. The exceptions are the articles that were written, in 2016, by the renowned economists David Autor, David Dorn, Gordon Hanson and Kaveh Majlesi, focusing on the US.<sup>1</sup> However, this contrasts with the absence of similar studies showing such a relationship in Europe. The aforementioned authors present a convincing case that it is precisely in those American districts with greater exposure to import competition from China that have elected congressional representatives with more extreme ideologies and where the Republican Party significantly increased its electoral support in 2016 compared with 2000.

### Labour polarisation in the US

Changes in employment per wage percentile in each period (%)



### Trade competition with China in the US



Source: CaixaBank Research, based on data from Autor, D. (2010) and Autor, D., Dorn, D. and Hanson, G. (2013).

In addition to this empirical evidence, studies that contribute to understand the impact of Chinese import competition in one of the key areas behind the trend in inequality, namely the labour market, are also particularly useful for an analysis of the causal relationship between inequality and populism. An important strand of the economics literature has shown that those areas most exposed to import competition with China have suffered more job losses and more industrial plants' foreclosures.<sup>2</sup> In fact, according to a recent article,<sup>3</sup> this commercial shock resulted in 1.98 million job losses between 1999 and 2011, of which 985,000 were in manufacturing. According to another article by Autor, Dorn and Hanson,<sup>4</sup> competition from Chinese imports lies behind one fourth of the jobs lost in the US manufacturing sector.

Having reached this point, it is important to note that, although these studies help show the relationship between inequality and populism, we should not infer that commercial integration is negative *per se* as there is also extensive literature documenting the positive impact of trade on an economy as a whole,<sup>5</sup> although there are very specific economic sectors that may be harmed by greater commercial integration, as has been the case in the US. Neither should we forget that manufacturing's progressive share loss in the economy is due mainly to changes in technology and in the production model (see the Dossier «Industry 4.0» in MR11/2016).

1. See Autor, D., Dorn, D., Hanson, G. and Majlesi, K. (2016), «Importing Political Polarization? The Electoral Consequences of Rising Trade Exposure» and «A Note on the Effect of Rising Trade Exposure on the 2016 Presidential Election», MIT Working Papers.

2. See, among others, Pierce, J. and Schott, P. (2016), «The Surprisingly Swift Decline of US Manufacturing Employment», American Economic Review.

3. See Acemoglu, D., Autor, D., Dorn, D., Hanson, G., and Price, B. (2016), «Import Competition and the Great US Employment Sag of the 2000s», Journal of Labor Economics, 34(S1).

4. See Autor, D., Dorn, D. and Hanson, G. (2013), «The China Syndrome: Local Labor Market Effects of Import Competition in the US», American Economic Review 103(6).

5. See, among others, Grossman, G. and Helpman, E. (1991), «Trade, Knowledge Spillovers, and Growth», European Economic Review 35, 517-526.

As we look into why these changes in the labour market have increased economic inequality in the US we should remember that, in this country, inequality is a reflection of the polarised nature of labour. Between 1950 and 1980, the manufacturing sector allowed a large number of US workers without secondary education or a university degree to access the middle class. But nowadays, the labour market, with an increasing share of services in GDP, is providing more job opportunities for other types of employment in which high value activities coexist with lower value activities. As a result, the salaried class, which had been more homogeneous in wage terms, is now more polarised. This could help explain why populism has emerged recently. The key lies in the fact that the increasing polarisation of labour over the last few decades has led to the impoverishment of a part of the middle classes so that a large social group has seen how their living conditions and social status declined substantially. This phenomenon has resulted in social unrest, which is fertile ground for political proposals which claim that it is possible to go back to the good old times quickly and easily.

Summarising the analysis carried out thus far, the literature points to a certain causal relationship between inequality and populism in the US and, among the different mechanisms that may be playing a role, the studies have explored one specific channel: the one that goes from international competition to industrial job losses and from a decline in employment in the secondary sector to a rise in inequality, finally closing the circle and stating that, in these cases, political polarisation has increased.

Having confirmed the causal relationship between inequality and populism in the US, we should now examine its extent and determine whether inequality is the main source of the current political polarisation. This magnitude is not especially sizeable: in those electoral districts most exposed to commercial competition with China, electoral support for the Republican Party in 2016 was 2.2 pps higher than in those districts with little competition with China. Given this number, it would be audacious and even hasty to claim that inequality is the main factor fuelling populism, especially when we know there are other economic and financial variables that are also related to the success of populist movements. A case in point are financial crises: according to an influential article by the German economists Manuel Funke, Moritz Schularick and Christoph Trebesch, electoral support for far-right parties has increased by 30% after the financial crises occurring between 1870 and 2014 in the main developed countries, a considerable increase.<sup>6</sup>

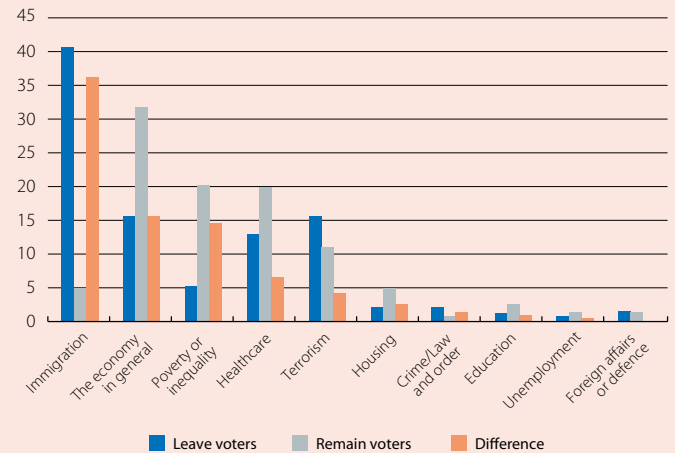
Another reason to be cautious is that there is a growing body of opinion among various economists and political scientists that claims cultural factors are at least as important as economic factors, or even more so, in explaining the rise in populism. Those defending this opinion believe that people vote for populist parties because some layers of society wish to preserve their cultural homogeneity and certain social attitudes. In this respect, the political scientists of Michigan and Harvard, Ronald Inglehart and Pippa Norris, have shown that, in the European Union, cultural values are a more accurate indicator of support for populist parties. In particular, electoral support for these parties is stronger among the elderly, men, people with less educational training and ethnic majorities. On the other hand, such conclusive findings do not hold for the economic variables. Similar analyses carried out after the Brexit vote suggest that cultural and social factors are crucial to explaining the outcome of the referendum, casting doubt on the view that inequality is the main cause of such populism. For example, a study by the Nesta think tank in the UK shows that being in favour of the death penalty is a far better predictor of voting in favour of leaving the European Union than income or social class, and a survey led by the Birkbeck College professor, Eric Kaufmann, indicates that those in favour of Brexit were much more concerned about immigration than inequality.

In short, economic inequality is a factor to bear in mind when analysing the origins of the rise in populism at a global level. In the case of the US, academic studies have appeared recently that use reliable econometric techniques and demonstrate a causal relationship. Nonetheless, this impact does not seem to be very large and there are reasonable doubts that inequality is the main driver. Whatever the case, it is evident that the rise in populism is a phenomenon of the utmost importance that warrants more in-depth study.

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### Brexit and the most important issue facing the UK today

(% of respondents who believe each issue is important)



Note: Sample of 1,677 people, of white race, interviewed on 17 August 2016.

Source: CaixaBank Research, based on data from the joint study between Birkbeck College, Policy Exchange and YouGov.

6. See Funke, M., Schularick, M. and Trebesch, C. (2015), «Going to Extremes: Politics after Financial Crises, 1870-2014», CEPR, Discussion Paper No. 10884.