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Financial Crises and the Populist Right[1]

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INTRODUCTION

Almost ten years have passed since the start of the most severe financial crisis of recent decades. The 2008 crash, which was followed by the Eurozone debt crisis in 2011/2012, resulted in a severe decline in GDP and a spike in unemployment. Besides these economic costs, the crisis also triggered major political disruptions. Two-party systems that had been stable for decades were swept away, long-ruling parties saw their vote share drop to single digits and populist parties gained new political space. Right-wing populist parties in particular thrived, as they entered parliaments and, in some cases, government. The election of Donald Trump in the US and the Brexit vote in the UK are the most recent culminations of the rise of populism in the Western world.

In a recent paper (Funke et al. 2016) we asked how the political aftermath of the 2008 crisis compares to previous experiences. Can we identify systematic shifts in the political landscape after financial crises and if so, what do these shifts look like? To answer these questions, we conducted a comprehensive historical analysis of the political fall-out of financial crises. We traced the political history of 20 advanced democracies back to the 1870s and constructed a dataset of over 800 elections from 1870 to 2014. We then complemented this dataset with existing data on over 100 financial crises from Jordà et al. (2017).

The results in Funke et al. (2016) show that financial crises put a strain on democracies: government majorities shrink, parliamentary fractionalization rises, the number of parties in parliament increases, and the far-right parties see strong political gains. In a counterfactual analysis, we find that financial crises have much stronger political effects than other type of economic downturns, such as recessions or output collapses that do not involve financial turmoil. We therefore conclude that political fragmentation, polarization and radicalization are a hallmark of major financial crises.

Here, in this short piece, we build on our long-run work to drill deeper into the political developments of the past decades, with a focus on right-wing populism. To define right-wing populist parties, we follow recent work by Mudde (2015), Pausch (2015), Bauer (2016) and particularly Rodrik (2017), according to whom right-wing populist parties "emphasize a cultural cleavage, the national, ethnic, religious, or cultural identity of the "people" against outside groups who allegedly pose a threat to the popular will." (p. 22/23).

To set the stage, it helps to review the recent literature on the determinants of populist voting, which has mainly focused on the impact of (i) globalization, (ii) cultural and institutional dissatisfaction, and (iii) immigration. Autor et al. (2013), Dippel et al. (2015) and Colantone and Stanig (2017) suggest that populist voting is largely driven by a backlash against economic globalization, particularly in regions with a declining manufacturing sector that have suffered from increasing competition from China and Eastern Europe. Dustmann et al. (2017) show that trust in the political system is eroding, and especially trust in the European Union. Inglehart and Norris (2016) find evidence in favour of a "cultural backlash" hypothesis, as many voters are opposed to the rapid change in Western value systems and increasingly progressive politics. Moreover, Steinmayr (2016) and Halla et al. (2017) study the link between populism and immigration, particularly after the rapid increase in the number of refugees entering Europe after 2015 (with conflicting findings).

Here, we complement these and other studies by focusing on financial crises as an additional, and possibly reinforcing driver of populist voting. More specifically, we study the link between crises and right-wing populism in two main crisis clusters of recent decades: First, we explore the political aftermath of the financial crises in Scandinavia, Switzerland and Italy during the 1990s, and secon, the period after 2008, again with an emphasis on Europe.

BORN IN THE 1990s: POST-CRISIS POPULISM IN SCANDINAVIA, ITALY AND SWITZERLAND

In the late 1980s and early 1990s, Denmark, Norway, Italy and Switzerland were hit by financial crises.[2] How did right-wing populist parties fare back then? Figure 1 shows the voting shares in national parliamentary elections of the main right-wing populist parties in these four countries. We consider the last election before the outbreak of the crisis and the three elections thereafter. The main takeaway from this figure is that right-wing populist parties gained traction from the financial crises in their countries.

In Norway, the vote share of the right-wing populist Progress Party stalled at 5% or lower for ten years. However, in the wake of the 1988 crisis, its vote share tripled from 3.7% in 1985 to 13.0% in the first post-crisis election of 1989. Subsequently, the party temporarily suffered losses in the 1993 election, but bounced back to 15.3% in 1997, remaining well above the pre-crisis level at all times. Today, the party has become a domi-

[1] This work is part of a larger project kindly supported by a research grant from the Bundesministerium für Bildung und Forschung (BMBF).

[2] Dates of financial crises are based on Jordà et al. (2017). Financial crises are defined as events during which a country's banking sector experiences bank runs, sharp increases in default rates accompanied by large losses of capital that result in public intervention, bankruptcy, or the forced mergers of financial institutions.

nant force in Norwegian politics and made it into the government in 2013.

The Danish Progress Party also benefitted from the Nordic financial crisis. After a stretch of stagnant and decreasing voter support in the late 1970s and 1980s, the party more than doubled its vote share from 3.6% in 1984 to 9% in the 1988 post-crisis election. In the following two elections, the vote share remained above the pre-crisis level, but the party essentially collapsed in the late 1990s. However, a new party, the Danish People's Party was founded by former leaders of the Progress Party in 1995. The People's Party can be interpreted as the de facto successor of the Progress Party and now plays a crucial role in Danish politics. Indeed, the center-right minority governments of the past ten years all relied on the People Party's parliamentary support.

In Switzerland, the right-wing populist People's Party secured roughly 10% of the vote throughout the 1970s and 1980s, including in the 1987 election. However, after the Swiss financial crisis of 1991, the People's Party gained a further 4 percentage points of the vote in the first election after the crisis (1995), and moved towards 30% in the following two elections (1999 and 2003). Since then, the party has continuously experienced these high levels of voter support and has been the largest faction in the Swiss National Council since 1999.

The roots of Italy's Lega Nord party go back to the 1980s. In 1987, the movement (back then named the Lombard League) gained a mere 0.5% of the vote and two mandates in parliament. In the first post-crisis elections (1992), however, it gained 8.7% and 55 deputy seats. The party achieved a similar result in the 1994 elections and formed a short-lived coalition government with the right-wing nationalist Alleanza Nazionale and Silvio Berlusconi's conservative Forza Italia. Lega Nord gained further ground in the 1996 elections and eventually returned to government in 2001-2005 and again in 2008-2011, both times as part of Berlusconi's coalition. The party faced losses in 2013 with votes absorbed by the new protest party Five Star Movement, but is doing far better in recent polls. Its role is likely to be crucial in the next Italian election. In short, the Lega Nord is an important example of how a political force moved from political obscurity to political significance in the wake of a financial crisis.

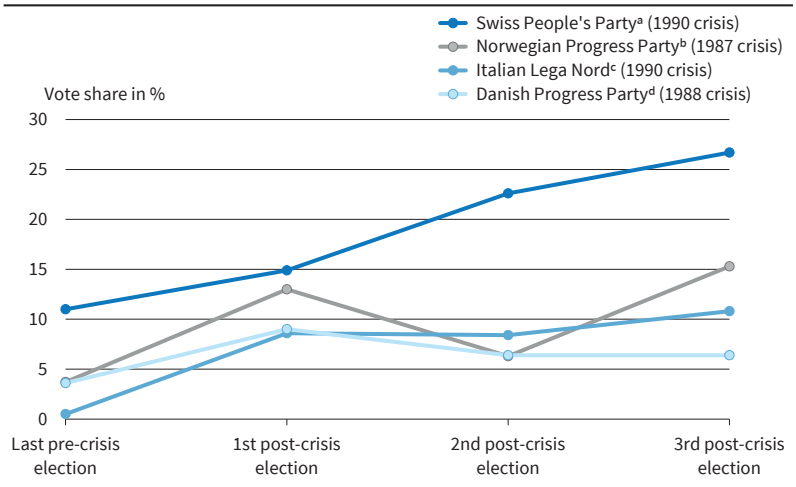
EUROPE SINCE 2008: RIGHT-WING POPULISM ENTERS THE CORE

In terms of right-wing populism, the European experience after the crash of 2008 has been strikingly similar to that of the more idiosyncratic, country-specific crises of the 1990s. Figure 2 shows the vote shares of right-wing populists in three consecutive general elections after the Lehman collapse of September 15, 2008 (focusing on lower house results in bicameral systems). It is evident that right-wing populist parties found themselves in a considerably better position after 2008 than before. On average, the vote share of right-wing populists was about 5% prior to the crisis. Two elections later, however, their average vote share had climbed to double-digit levels (between 10% and 20%), resulting in significantly higher levels of parliamentary representation. Thus, similar to the evidence from the 1990s right-wing populist parties advanced from the political fringe to the centre of the political arena.

Established right-wing populist parties also capitalized on the crisis. The Freedom Party of Austria improved its vote share from 11.0% in 2006 to 20.5% in 2013 and now has hopes of entering government after the upcoming election in late 2017. Similarly, the Norwegian Progress Party reached an all-time high in 2009 (22.9%) and in 2013 became part of the government coali-

Figure 1

Right-wing Populist Vote Shares after the Financial Crises of the Late 1980s/Early 1990s



[a] Nationalrat elections 1987, 1995, 1999 and 2003 (financial crisis in 1991).
[b] Storting elections 1985, 1989, 1993 and 1997 (financial crisis in 1988).
[c] Camera dei deputati elections 1987, 1992, 1994 and 1996 (financial crisis in 1990).
[d] Folketing elections 1984, 1988, 1990 and 1994 (financial crisis in 1987).

Note that Denmark and Switzerland held elections in the crisis outbreak year: the Danish Progress Party reached 4.8% in 1987 and the Swiss People's Party 11.9% in 1991. We exclude these elections because in contrast to the 2008 Lehman collapse it is more difficult to identify the exact month in which the crisis culminated and, thus, whether elections were held before or after that date. However, including the results (either as last pre-crisis or first post-crisis results) does not change the general picture that right-wing populists were successful post-crisis.

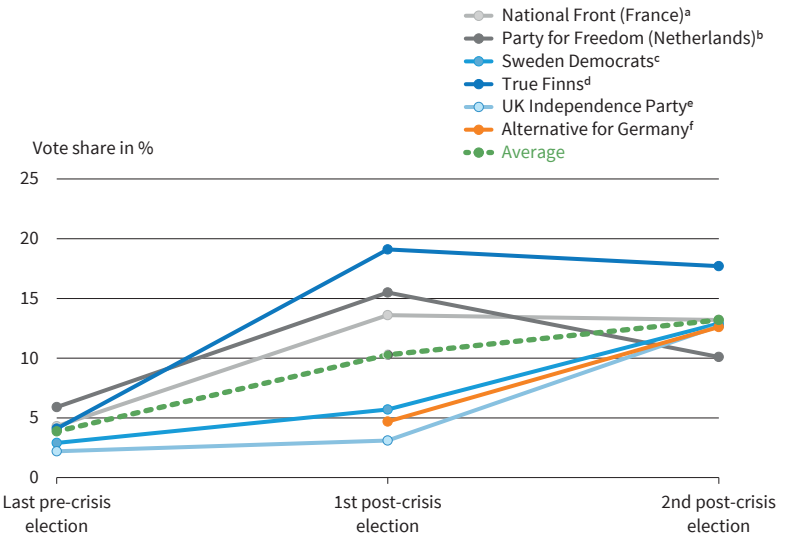
Source: Election results from Döring and Manow (2016); financial dates from Jordà et al. (2017). © ifo Institute

tion, while the Danish People's Party went from 13.8% in 2007 to 21.1% in 2015. Mature right-wing populist parties in Eastern Europe exhibit similar patterns. For example, the Hungarian Fidesz re-entered government in 2010, after the vote share had increased to a record 53.7% in 2007. Likewise, the Polish Law and Justice grew from 32.1% in 2007 to 37.6% in 2015, when it formed a majority government.

Last but not least, we observe the emergence of new right-wing parties. Since 2008, several European countries have witnessed the creation of entirely new right-wing populist parties; and some of these newcomers managed to enter national parliaments in record time. Notable examples of newly founded right-wing entrants include the People's Party in Belgium (after the 2010 election), the Independent Greeks (2012 election), Brothers of Italy (2013 election), Dawn in the Czech Republic (2013 election), Team Stronach in Austria (2013 election), Kukiz'15 in Poland (2015 election) and more recently, the Alternative for Germany (2017 election), whose latest electoral success is also shown in Figure 2.

Figure 2

Right-wing Populist Vote Shares in European National Elections since the Lehman Collapse (Sep 15, 2008)



[a] Assemblé national elections 2007, 2012, 2017 (first round results).
[b] Tweede Kamer elections 2006, 2010, 2012.
[c] Riksdag elections 2006, 2010, 2014.
[d] Eduskunta elections 2007, 2011, 2015.
[e] House of Commons elections 2005, 2010, 2015.
[f] Bundestag elections 2013 and 2017 (we include the two post-crisis elections that the party has contested so far).

Source: Döring and Manow (2016); official election statistics. © ifo Institute

The aftermath of the 2008 financial crisis can thus be characterized by a "rise of the right" in several dimensions. Parties that were inexistent or largely unknown prior to 2008 were propelled into the political mainstream. This is also true for a subset of countries like Germany, Finland and Britain that had been largely immune to populist politics for decades. Moreover, in those countries where right-wing populism was already strong to start with, the vote shares of populist forces increased further, thus facilitating their entry into government.

SUMMARY AND CONCLUDING REMARKS

The main insight from this short piece is that financial crises of the past 30 years have been a catalyst of right-wing populist politics. Many of the now-prominent right-wing populist parties in Europe, such as the Lega Nord in Italy, the Alternative for Germany, the Norwegian Progress Party or the Finn's Party are "children of financial crises", having made their breakthrough in national politics in the years following a financial crash. We also find that the 2008 crisis triggered a wave of governments in which right-wing populists gained power, often as a coalition partner.

As discussed, the crisis is just one of many potential factors explaining the recent successes of right-wing populism in Europe and beyond. Other drivers such as "cultural backlash", the impact of globalization, rising inequality, and the refugee crisis of 2015 surely played a critical role too. However, "the rise of the right" in Europe since 2008 cannot be fully understood without considering the impact of the 2008 and 2011/2012 financial crises.

To conclude, one can ask what makes financial crises so politically disruptive? Why do financial crises lead to the birth and success of extremist politics, whereas other types of economic downturns do not? A first potential explanation is that financial crises are perceived as inexcusable events that result from a failure of policies and regulation, rather than from an external shock. This leads to distrust in government and mainstream politics. Secondly, financial crises typically trigger creditor-debtor conflicts (Mian et al. 2014) and a rise in income and wealth inequality (Atkinson and Morelli 2010, 2011) to levels not observed in normal recessions. Thirdly, we know that financial crashes often involve large-scale bank bailouts and these are highly controversial and unpopular (e.g., Broz 2005). Such bail-out initiatives give traction to extremist ideas at the political fringe. In this environment of distrust, uncertainty and dissatisfaction, right-wing populists have learned to gain votes by offering seemingly simple solutions to complex problems, and by attributing blame to minorities or foreigners.

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