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Article

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EconPol Forum

Provided in Cooperation with:

Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

Suggested Citation: Levi, Eugenio; Stillman, Steven (2024) : External shocks and populism, EconPol Forum, ISSN 2752-1184, CESifo GmbH, Munich, Vol. 25, Iss. 2, pp. 19-23

This Version is available at:

<https://hdl.handle.net/10419/289770>

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Eugenio Levi and Steven Stillman

External Shocks and Populism

Based on a minimal definition, populism is “an ideology that considers society to be ultimately separated into two homogeneous and antagonistic groups, ‘the pure people’ versus ‘the corrupt elite’, and which argues that politics should be an expression of the *volonté générale* (general will) of the people” (Mudde 2004, 543). While populism has been around since at least the end of the 19th century, its resurgence in Western countries is quite recent.¹ In the political debate of recent years, populism has become an uncomfortable guest, unrelated to political orientation and typically denied by those who invited it in. However, the negative consequences usually associated with populism – among others, illiberalism, bad economic policies, lack of competence – beg for a better understanding of the causes of its initial development and long-lasting success.

In a recent paper (Levi et al. 2024), we examine the impact that two large external shocks, one related to structural reform and another to immigration policy, had on the initial development and long-term success of New Zealand First (NZF), one of the oldest populist parties in the OECD. We use electoral survey data with very localized geographic identifiers to examine the impact that these shocks had: (i) on voting for NZF in the first years of its existence; (ii) on individual beliefs and political preferences; and (iii) on long-term persistence in voting for NZF, as well as long-term impacts on individual beliefs and political preferences. Importantly, we build instruments for these shocks and provide unbiased estimates. This policy report describes the research design and the main findings of the aforementioned article.

After introducing some background context about New Zealand (NZ) and presenting the main results of the paper, we conclude by drawing some policy implications that may help foster a debate on how to tackle the challenges posed by populist political parties.

NEW ZEALAND FIRST

Founded in 1993, NZF can clearly be categorized as a populist party because of an anti-elite stance fueled by disgruntlement toward traditional politics. However, unlike most European populist parties that clearly belong to either the left or the right, NZF promotes a mixture of (far-) right and (far-) left policies. It is against big business, unions, and big government, critical of the 1980s pro-market reforms discussed below and wants NZ to go back to a “golden age” where

¹ Most political scientists agree that the American People's Party and the Russian Narodniks were the first populist parties appearing in the late 1900s.

KEY MESSAGES

- **In this report, we examine the impact that two large external shocks, one related to structural reform and another to immigration policy, had on the initial development and long-term success of New Zealand First (NZF), one of the oldest populist parties in the OECD**
- **Using survey data together with localized geographic identifiers, we investigate a rich set of mechanisms underlying the impact of the shocks, namely political beliefs and preferences, individual and community characteristics**
- **We find that both shocks had an important role in the initial development of NZF**
- **Economic, cultural, and political explanations of the development of political populism in NZ are found to be highly intertwined. The shocks caused an increase in mistrust towards the mainstream parties and in feelings that a strong leader is needed, while “losers” of structural reforms and of immigration flows are not found to be more inclined to vote for NZF. Furthermore, the impact of these shocks was found to be concentrated in rural or less cosmopolitan geographical areas**
- **The impact of these shocks on populist voting persisted in the medium term and still had an influence after 20 years. It also led to a rightward shift in political preferences**

the country was more isolated from the rest of the world.

It exploded onto the scene in 1996, getting a remarkable 13 percent of the vote and entering government as a coalition partner with the mainstream center-right National Party. After 1996, NZF never reached the same percentage of votes, ranging from a high of 10.4 percent in 2002 to a low of 2.6 percent in 2020. It succeeded in becoming part of the government again in 2005 and 2017, both times in coalition with the center-left Labour Party, and in the most recent elections in 2023, this time in coalition with the National Party. Hence, even though it is in many ways a marginal party in NZ, it has played an important role in helping to set the policy agenda, in particular on immigration policy and on support for older individuals and rural interests.

NZF attracts very similar voters in terms of observable characteristics as current populist parties in Europe (Levi et al. 2024). Additionally, the Mixed-Member Proportional (MMP) electoral system

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in NZ is nearly identical to that in Germany and thus similar to that in other European countries with proportional representative parliaments. Hence, it presents an ideal case study for understanding the birth and development of a modern populist party, without confounding effects from the recent global emergence of populism, and to provide insights into the potential future development of populism, particularly in Europe.

STRUCTURAL CHANGE

Until 1984, NZ had a highly regulated economy, with subsidies for agriculture, protection for industry, and a closed capital account. By that time, the country was facing unsustainable fiscal and current account deficits, runaway inflation, and a foreign exchange crisis. This led to widespread recognition that macroeconomic reforms were needed to

correct imbalances and reduce inflation, and microeconomic reforms were needed to improve productivity (McMillan 1998).

From 1984 to 1990, a Labour government increasingly deregulated the economy, opened the capital account, eliminated subsidies to agriculture, and privatized most publicly owned companies. After the 1990 election, a new government led by the National Party pushed through large reforms. Welfare was scaled back from universal provision to a tightly targeted system (Boston et al. 1999) while the labor market was deregulated (Evans et al. 1996).

As a consequence of these reforms, from 1986 and 1991, real per capita GDP growth averaged – 0.83 percent and unemployment rose from 5 percent in 1984 to almost 11 percent in 1992. Mean real household income dropped by 4.7 percent between 1986 and 1991.

NEW IMMIGRATION POLICY

NZ is historically a high-immigration country with most migrants settling in the larger cities of Auckland, Wellington, and Christchurch (Maré et al. 2007). In 1986, 15 percent of the population was already foreign-born, but immigrants were mostly of European descent (49 percent of them were British compared with 6 percent Asian). Independent of the economic reforms discussed above, the Immigration Act of 1987 removed the traditional source country preference for European and Anglo-Saxon countries. The Immigration Amendment Act of 1991 then replaced the

previous “occupational priority list” system with a point system.

Combined, these acts inverted a previous trend in net migration by increasing arrivals. While between 1980 and 1989, NZ lost a net 122,500 migrants out of a population of slightly more than 3 million, mainly because of unfavorable economic conditions, from 1990 net migration turned positive even though the economy was still struggling. In 1995, a peak net inflow of 28,500 was reached and by 1996, immigrants made up 21 percent of the total population. More importantly, these policy changes led to a large change in the composition of the immigrant population in terms of skills and country of birth; by 1996, 15 percent of the immigrant population was of Asian descent and 33 percent of the new migrants had a university degree.

DATA AND EMPIRICAL STRATEGY

We utilize the New Zealand Election Study (NZES), which is fielded after each election by the University of Auckland and offers detailed data on individual voters’ characteristics, political opinions, and behaviors, to examine the impact of structural reform and immigration shocks on voting for NZF. The “structural reform shock” is defined as the change in average income in a local market area (LMA) between 1986 and 1991, a period known for significant industry-specific economic changes. The “immigration shock” is measured by the inflow of new migrants into an LMA over the five years preceding an election. This period witnessed a substantial and ethnically diverse influx of migrants, making it a significant factor in the study.

We use a regression model to examine the impact of these two shocks on whether an individual voted for NZF, controlling for other variables such as gender, age, ethnicity, education, and location. We also control for contemporary local area characteristics such as population, unemployment rate, average income, and demographic details to account for indirect impacts of the shocks. Additionally, we control for several socio-economic local area characteristics measured in 1981, including variables closely related to our shock measure, which helps ensure that we are picking up purely exogenous variation in shock exposure at the local level. We also control for the electoral district in which a person resides to avoid any confounding factor due to localized political reactions.

To address endogeneity concerns, we use a shift-share instrumental variable strategy. This approach predicts the spatial distribution of new migrants based on earlier immigration patterns and the spatial distribution of structural reforms based on the geographical location of different industries. These predicted shocks should be purged of any endogenous relationship between actual economic shocks and populist opinions and voting behavior.

THE IMPACT OF SHOCKS ON THE DEVELOPMENT OF NZF

Using this instrumental variable approach, we find that in 1996, a 1 percentage-point increase in recent arrivals causes a 5.7 percentage-point increase in the NZF vote share while a one percentage-point greater income loss causes a 1.2 percentage-point increase in vote share relative to a mean vote share of 10.7 percent for NZF. In Figure 1, we illustrate the size of these impacts by predicting the vote share for NZF in 1996 across the quantile distribution of each shock variable, holding all other variables constant. In LMAs where recent arrivals are in the first quartile, NZF is predicted to get 2.4 percent of the votes, while if the arrivals are in the highest quartile, the votes share for NZF would instead be 28.5 percent. For the structural reform shock, the vote share for NZF increases from 6.9 percent in LMAs in the first quartile of the structural reform shock distribution to 18.2 percent in the highest quartile. These numbers suggest that the impact of the shocks on the initial development of NZF was sizeable.

In the paper, we also have several extensions: (a) we find a large statistically significant impact of Asian immigration compared to non-Asian immigration, suggesting that the changing composition of migration to NZ was an important component leading to the development of NZF; (b) when we control for a wide range of political opinions and previous voting behavior, the estimated coefficients on the immigration shock decrease by 24 percent and that on the structural reform shock by 33 percent, so between one-quarter and one-third of the impact of shocks on voting for NZF occurs because of the impact of these shocks on political opinions, beliefs, and policy preferences; (c) we do not find any significant impact of the shocks on the other political parties or turnout, consistently with shocks pushing people towards populism as opposed to towards parties with particular policy platforms.

WHY DO THESE SHOCKS MATTER?

Employing the same econometric model, we now examine the impact of these shocks on a wide range of political beliefs in 1996. Figure 2 presents the results of this analysis: each label on the y-axis corresponds to a separate regression run for a different dependent variable. Experiencing a larger immigration shock causes individuals to report themselves as favoring reduced immigration and that defense and law and order should be more important policy areas. Experiencing a larger income loss from structural reforms causes individuals to report themselves as being more in favor of redistribution, and that unemployment should be a larger policy concern, economic growth a smaller one. Crucially, we find that experiencing a larger size of either shock causes people to think that

Figure 1
Predicted Impact of Shocks on Voting for New Zealand First in 1996

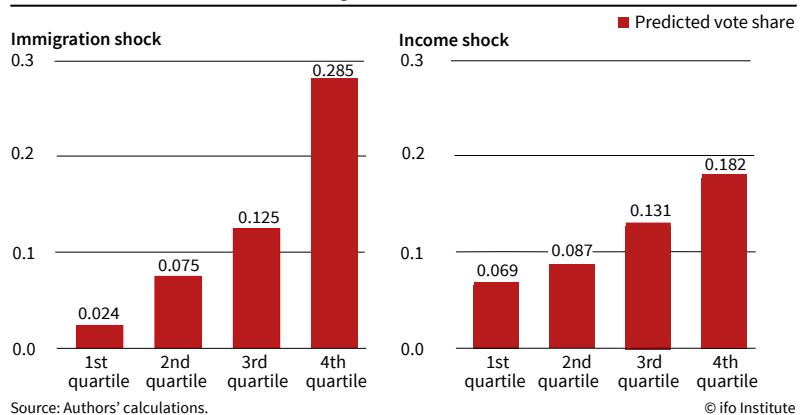
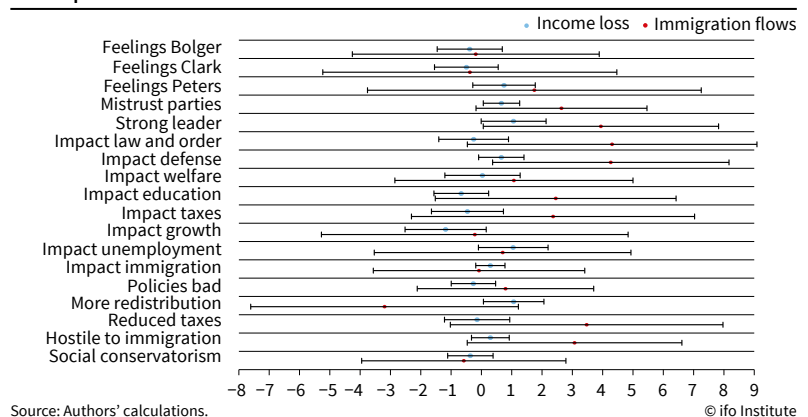


Figure 2
The Impact of the Shocks on Political Beliefs in 1996



a strong leader is needed and increases their mistrust of traditional parties. The magnitudes of the effects are similar in size to the impacts that the shocks have on voting for NZF. Overall, changing political beliefs are an important part of the story of how NZF initially developed.

We next examine how the impact of the shocks varies by individual and community characteristics. In general, we find little evidence of heterogeneous impacts of shocks across individual characteristics. The only exceptions are that we find that structural reform shocks have larger effects on voting for NZF for older individuals and individuals who are not employed. NZF has a strong focus on improving policies for older individuals, such as free use of health services and public transit, and keeping the retirement age from increasing, which may explain these results. Taken together, this evidence suggests that standard economic explanations for populism are not what drove the emergence of NZF.

We also examine the role of community characteristics. Specifically, we examine whether the shocks have differential impacts in urban versus rural areas and in areas with a longer history of immigration. Consistent with previous research (Dustmann et al. 2019; Levi et al. 2020), we find that in high density areas

neither immigration nor structural reform shocks impact voting for NZF. The impact of shocks is fully concentrated in lower density LMAs.

We also find that the impact of the immigration shocks on voting for NZF is much higher in areas that historically had less immigration and that there is no impact in areas that already had high levels of immigration in 1986. This may be because the distinction between rural areas and urban areas carries forward long-lasting political preferences and different ways of organizing political life (Cramer 2016) or because people in more densely populated regions are exposed to cosmopolitan beliefs. This is consistent with the cultural channel being particularly important for understanding how immigration shocks lead to populist voting.

DO THESE IMPACTS PERSIST?

We next examine if the impact of the shocks on political opinions and voting persists over time. During the period from 1999 to 2008, we find that having experienced a larger immigration shock led to a rightward shift in both political attitudes, specifically preferences for redistribution, and voting behaviors, specifically an increased likelihood to vote for NZF and National and a decreased likelihood to vote for Labour. On the other hand, having experienced a larger structural reform shock led to a persistent increase in voting for NZF. Interestingly, the short-term impact of having experienced a larger structural reform shock on increased preferences for redistribution disappears in the medium term. We also find no medium-term effect of having experienced shocks on populist attitudes or voting turnout.

Turning to the period from 2011 to 2020, where there was much more economic uncertainty due to the 2008 global economic crisis, we find less persistence in the impact of these shocks. There is some evidence that having experienced a larger immigration shock led to long-term hostility to immigration and a rightward shift in political attitudes. We do not find an impact of either shock on voting for NZF or on populist attitudes in the long run. We believe this is the case because of an increasing shift of the mainstream political parties in NZ towards more populist policy positions (Vowles and Curtin 2020).

POLICY CONCLUSIONS

In our paper, we find several important explanations for the initial development and persistence of an “old” OECD populist political party consistent with prior research. First of all, populist parties usually emerge in combination with large economic shocks such as structural reforms that lead to substantial income losses or immigration reforms that lead to increased migration from culturally distant countries. In NZ, both occurred. Second, populism configures itself

as a multi-faceted phenomenon: not fully driven by economic reasons, but also not fully driven by political or cultural motives. In our analysis, economic shocks triggered increased political populist attitudes within the population. Furthermore, the impact of these shocks was found to be concentrated in rural or less cosmopolitan geographical areas. Overall, then, economic, political, and cultural explanations are highly intertwined. Third, large economic shocks lead to persistent impacts on voting behavior and political opinions that last at least a decade. More specifically, the impact of these shocks on populist voting persisted over time, and it also led to a rightward shift in political preferences.

Policymakers may learn several lessons from our findings. The most important one is that economic and immigration shocks need to be openly addressed. Attempts by mainstream political parties to downplay the relevance of these shocks among the population is doomed to fail. People seem to take notice of the shocks and, without any leader addressing their concerns, turn to populist political parties who often offer the simplest solutions. This taps into the problem of which policies to propose to address citizens’ concerns so as to turn them away from the populist ones. There is no simple answer as it depends on the specific nature of the shock and on the specific country.

However, based on our results, we can argue that redistribution policies and more convincing migration policies may be a first step. Indeed, in NZ, individuals changed their preferences exactly in the direction of asking for more redistribution and having immigration flows reduced. In Europe, this could be translated to additional welfare state measures, more border controls, and integration policies. It is important to note that these grievances do not seem to be specific to the “losers” of globalization or of immigration flows, but to everyone who lived in areas affected by shocks, especially in rural and less cosmopolitan areas.

Policymakers (or better, politicians) also need to take seriously people’s blaming of mainstream political parties for the arrival of shocks. These parties need to become more conscientious about having an open public debate on how to address structural issues in our societies, such as low economic and productivity growth, worsening inequality, and low social mobility. And when individuals express dissatisfaction with the political response to economic or cultural shocks, politicians and policymakers need to address the consequences as much as the causes because the two cannot be easily distinguished once populist attitudes are unleashed. Therefore, they should also return to producing a political culture, participation, and a competent ruling class at all electoral levels, recovering a sense of purpose beyond winning elections and the survival of individual leaders.

To conclude, NZ is in many ways a forerunner to many of the current trends affecting OECD countries. The structural reform process that occurred in the

1980s increased competition for certain industries in a way similar to how China's joining the WTO impacted industries in the rest of the developed world in the 2000s. Similarly, NZ was one of the first countries to develop a skilled migration system that had no restrictions on country of origin. In this sense, it is unsurprising that populist parties are emerging in European countries that in recent years have featured increased competition in many economic sectors and a large inflow of ethnically diverse migrants.

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