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The Great Slowdown and Political Populism

KEY MESSAGES

- **Populism embeds truth in a welter of lies**
- **Populism erodes trust in mainstream political parties, institutions, ideas, and ideologies**
- **Stagnating productivity, large trade imbalances, and waves of immigration have contributed to increased discontent in the West and eroded trust**
- **Inclusive growth would lift all boats and rebuild trust**
- **Populist policies are an impediment to such growth**

Populist parties are gaining ascendancy in many Western countries. Giorgia Meloni, the leader of the populist Brothers of Italy party, is the prime minister of Italy. In recent opinion polls, the populist AfD party in Germany has polled above 20 percent, much higher than the ruling SPD party of Chancellor Scholz. In France, a recent poll shows that Marine Le Pen could win the second round of the 2027 presidential election and places her party at an all-time high in public voting intentions. In 2023, the government of Mark Rutte in the Netherlands fell due to disagreements on immigration policies and the populist Party for Freedom led by Geert Wilders became the largest party.

Populism, as defined by Mudde (2007), poses a threat to our rules-based order and democratic institutions in its blindly following a leader, in defining a common enemy, and in defying the lessons coming from universities, the media, and international institutions, which we disown at our peril. For those of us who consider populism to be a threat to liberal democracies, it is important to think about the causes of this development and about how to deal with the challenge it poses.

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CAUSES OF POPULISM

There is a large literature on the causes of populism, surveyed by Guriev and Papaioannou (2022). These include the role of secular economic factors such as trade and automation; the Great Financial Crisis of 2008–2009 and the austerity policies that followed; the cultural backlash to identity politics; the effects of immigration and the recent refugee crisis; and, finally, the effect of the internet and social media.

Voters for populist parties share a distrust of mainstream political parties, the media, universities, and other established institutions as well as mainstream ideas and ideologies. The distrust is usually acquired through disappointment with current economic performance. In one study, Dustmann et al. (2017) found that both high unemployment and low GDP growth weakens support for European integration and also trust in both European and national parliaments.[1] Economic insecurities and opposition to immigration are often related.[2]

I start with the causes of the upsurge in populism before turning to the consequences of spreading populism and the possible policy responses.

The Great Economic Slowdown

There is a hidden development behind much of the turbulence in the modern world. The prelude to the emergence of populism in many Western countries can be found in the falling rates of productivity growth in the West in recent decades.[3] Falling productivity growth has affected societies in a myriad of ways and created disillusion with the economy and anxieties among workers. Wages have stagnated in many countries. Real interest rates have fallen. Lower interest rates have caused the price of stocks and homes to rise, making the distribution of wealth ever more unequal. In some countries, the share of profits in national income has risen due to higher markups of prices over the cost of production, this development being reinforced by the rising market power of the likes of Google and Apple. Non-democratic countries such as China have managed to catch up with the US, threatening the rules-based global order.

Figure 1 shows the growth of labor productivity and the growth of real GDP per capita in six developed economies. Note the upward-sloping relationships in each of the figures that show falling growth rates since the early 1950s. In France, Germany, and Italy there is rising growth of productivity in the early

[1] Algan et al. (2017) also found a strong relationship between increases in unemployment and voting for populist parties across European regions in the years following the Great Recession.

[2] Arnorsson and Zoega (2018) found that the less educated, the older generations, and those on low incomes were more likely to vote for Brexit; feared EU enlargement more; did not want to have immigrants as neighbors; and thought immigrants were taking jobs away from natives, underming cultural life, increasing crime, and being a burden on the welfare system.

[3] This is the topic of the recently published book *The Great Economic Slowdown* (Phelps et al. 2023), which describes the falling rate of productivity growth over the past four decades and its manifold macroeconomic consequences.

1950s but then both productivity growth as well as real GDP growth start to fall in the middle of the decade and continue to fall until 2022.

The pattern is somewhat more complicated in the UK and the US, although these countries also show falling rates of productivity growth over the past decades. In the UK, real GDP growth increased during the Thatcher years in the 1980s while labor productivity growth did not. The most noteworthy departure from falling productivity growth is found in the US in the 1990s, the period of the internet boom in the second half of the decade when productivity growth was increasing. The growth of real GDP per capita has also increased more in the US than in the other countries since the financial crisis of 2008.

Were productivity growth to rebound with new technologies, many of the developments we have seen in the past would be reversed. Real interest rates would rise, the stock market decline, house prices fall, and wages start to grow at a faster rate, most of these developments conducive to increased satisfaction among the population, making populism less attractive.

Trade Imbalances

Another long-term feature of the world economy is persistent and large current account imbalances. These separate the surplus savings countries, such as Germany and the Netherlands, from the chronic deficit countries, such as the United States. The current account balances of several countries in 2022 are shown in the table below. In the group of surplus countries we have Germany and the Netherlands, and three Nordic countries, Switzerland, Ireland, and then China and Japan. The US is by far the biggest deficit country, followed by the UK. The US, on its own, could spend the surplus savings of China, Germany, Norway, and Saudi Arabia, the UK the surplus savings of the Netherlands and so forth. This pattern has persisted over a long period.

There are two main reasons why this pattern matters. First, the persistent US trade deficit has made the US lose manufacturing jobs to lower-cost producers such as China, pushing workers into lower-wage service-sector jobs. Nations seldom complain about having trade surpluses: the desirability of a persistent trade surplus for Germany is not being debated in that country; this is not the case in chronic deficit countries such as the US.

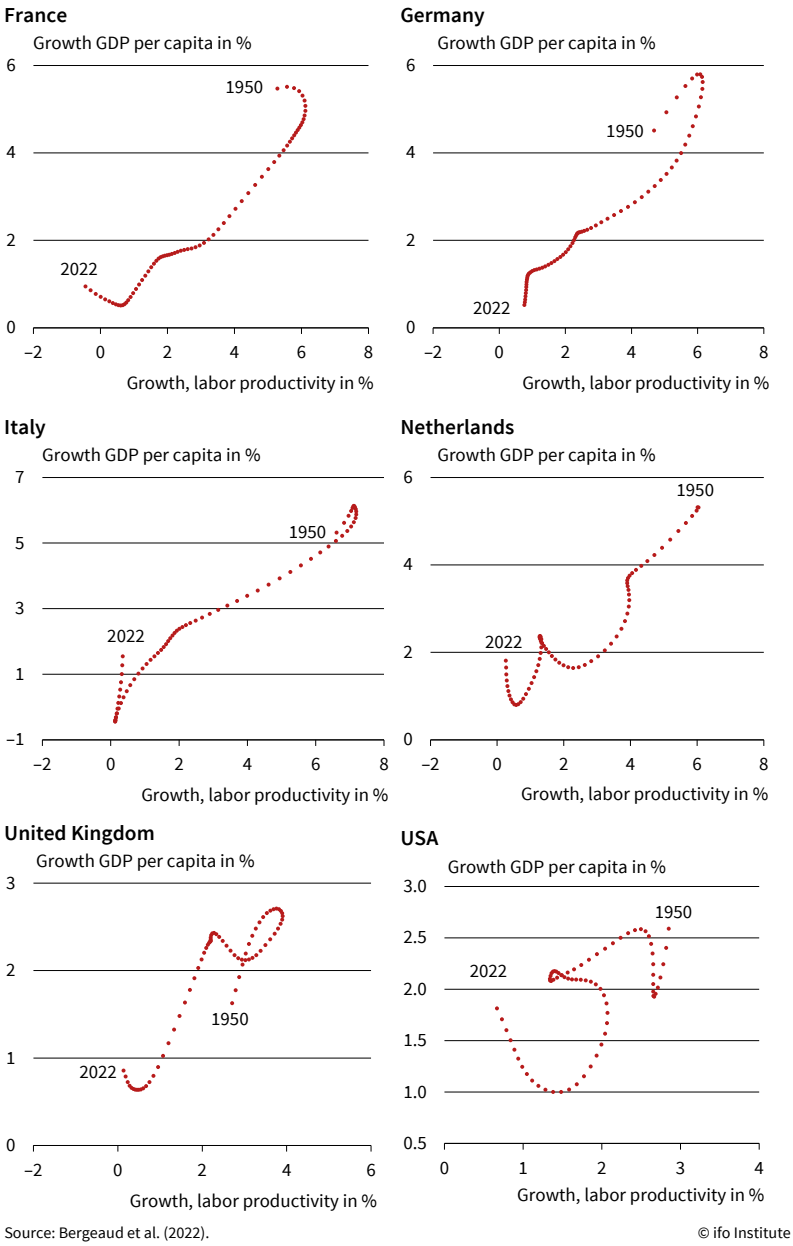
Surpluses on the current account measure, by definition, the excess of the sum of private and public saving over domestic investment. If a surplus country, such as Germany, saw its savings invested in the US because of government deficits in the US or a lack of private saving or attractive and profitable investment opportunities in that country, one would expect complaints coming from the Germans. The fact that they do not complain suggests that it is the surplus German (or Dutch or Norwegian and so forth) savings that contribute to the US current account deficit by raising the value of the dollar and making imports cheaper.

It follows that the US trade deficits are more likely to stem from excess savings in other countries than from fiscal deficits in the US. Thus, in the late 1990s the US had fiscal surpluses but there were trade deficits (Aliber 2023).

The second reason current account imbalances matter is that they have historically caused financial turbulence. As pointed out by the American economist Robert Aliber, the period after the collapse of the Bretton Woods system was characterized by multiple financial crises, from Mexico and Latin America in the early 1980s, to Japan and Southeast Asia in the 1990s, to the US and Europe in 2008 (Aliber 2011).

Figure 1

The Growth of Real GDP per Capita and Labor Productivity (Waves)



Source: Bergeaud et al. (2022).

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Table 1

Current Account, 2022 in Millions of Dollars

Surplus countries		Deficit countries	
China	401,855	United States	– 971,594
Germany	183,622	United Kingdom	– 95,175
Norway	180,054	India	– 79,520
Saudi Arabia	153,431	France	– 52,519
Netherlands	91,291	Turkey	– 48,411
Japan	79,101	Italy	– 31,370
Switzerland	77,248	Greece	– 22,359
Ireland	54,775	New Zealand	– 20,605
Denmark	54,287	Poland	– 16,601
Sweden	34,548		

Source: OECD.

Each of these episodes was preceded by capital flows from surplus countries to deficit countries ending with a sudden stop and a financial crisis. This has implications for populist politics because far-right populist parties have historically increased their vote share in the aftermath of financial crises (Funke et al. 2016).

The Pull of Liberal Democracies in Moderate Climates

The rules-based Western democracies attract migrants. Some are escaping political persecution while others are seeking to improve their standard of living. In the US, the populists want to build a wall from the Pacific to the Atlantic to prevent illegal immigration across the border with Mexico; Europe faces a constant influx of migrants from North Africa and the Middle East. This presents both an economic and a social challenge. While working-age immigrants can be looked at as "adopted children" in societies with low fertility rates, their skill levels may pose a more direct threat – real or apparent – to the employment opportunities of the less skilled native population. Moreover, it is difficult or impossible to maintain a welfare state with open borders, which may convince many to rein in the pace of immigration.

At a more social level, rapid immigration from countries whose culture – values and attitudes – differ from that of the destination country may make it more difficult to maintain social cohesion.

A warming climate and political instability can only increase the pressure of migrants coming from hotter climates to Europe. Declining birth rates and increased pressure from immigration will in the future force Western nations to formulate policies where the interests of employers, who need workers, and the local population, who fear the arrival of too many immigrants, are reconciled.

Stagnating living standards, disappearing jobs in manufacturing, and an influx of immigrants create worries and insecurities about the future that populist politicians can harness to their benefit.

THE CONSEQUENCES OF SPREADING POPULISM

What makes populist politicians dangerous is their ability to combine truth with fiction. Listening to them, one can only conclude that they are on to something and that is exactly what makes them dangerous.

The world witnessed four years of the economic management of President Trump. He embraced a populist policy to protect jobs in declining industries, emphasized the identity of workers who differ along ethnic lines, and followed nativist policies against the interests of immigrants. His economic management resembled that of Mussolini in Italy almost a century ago, who thought nothing of the individual, a free mind, and ability to innovative and replaced this with the interests of "the people" as defined by himself. The MAGA doctrine is thus about America as a unit led by a leader, not about fostering the creativity of individuals in a market economy.

There is a problem with the US having large and persistent trade deficits, as described above, if jobs in manufacturing are more valuable than service-sector jobs. But the former president Trump is on record claiming that German car exports pose a national threat to the US, which is clearly not the case since production takes place in the US. This brings us to economics.

Were tariffs to be imposed on German car imports, US consumers would simply buy Japanese cars instead. If a tariff were imposed on all imports, the dollar would simply appreciate, making imported goods, including cars, cheaper.

The populist politician is often oblivious to the fact that the structure of the economy is changing, that productivity improvements will occur in services in the future, in high-tech sectors and in health care, and that the future is uncertain and impossible for a dictator to predict or to control.

Populists see the economy as a zero-sum game and as rivalries between nations instead of seeing the mutual benefit of trade and collaboration. This brings out some of their worst instincts, such as a preference for unilateralism based on transactions

and dealmaking instead of establishing rules that all countries abide by. The populist thrives best in a world of dictators where national interests clash and the stronger countries prevail over the weaker.

POLICY CONCLUSION: GROWTH TO THE RESCUE

What can mainstream parties and politicians do in response to the response to the populist temptation?

A large piece of the answer would be "inclusive growth." The growth part of the phrase makes living standards improve over time and the inclusive part makes all or most workers benefit from the growth. Inclusive also applies to workers having a sense of belonging in the economy, feeling that they have a role and are valued and given opportunities.

The economics profession should go back to the Stolper Samuelson theorem and acknowledge that globalization and trade create both winners and losers, and although the former could compensate the latter, this rarely occurs without the intervention of a government. This can take the form of education and training of workers who lose their livelihoods due to a rapidly advancing technology or by granting relocation allowances. A more radical solution is for a government to instate a system of wage subsidies to lift the disposable income of low-income workers in order to encourage them to participate in the labor market instead of living off benefits (Phelps 1997).

A higher rate of productivity growth provides a large piece of the solution to the populist challenge. It will make real wages grow, alleviating the cost-of-living crisis as well as generating a more satisfied society in the long run. Wealth distribution would become more equal and homes more affordable.

The advent of AI technologies has already created hopes of higher labor productivity growth in the future. AI enables workers to perform tasks they could not do in the past, raising their wages (Brynjolfsson 2017). However, the full effect of the new technologies will take time to materialize. There is the implementation lag from the time the new technologies are invented until the necessary investments have been made and institutional changes have taken place (Eggertsson 2005), and technological innovations take a long time to be fully implemented through a series of microinventions (Mokyr 1993). While AI is a macroinvention, using the terminology of Joel Mokyr, it will generate many microinventions that will raise workers' productivity.

But what can countries do to promote productivity growth? The begining of the answer is a simple one, which is to avoid the populist temptation. Nothing is as deterimental to producitivity growth than a ruler who thinks he knows where the economy should go, who sets one ethnic group up against another, who thinks that one country's gain is another county's loss, and who deliberately ignores the lessons of science and economic policy making.

What is most important for the long-term growth of the economy is an economy where people have expanding opportunities to learn, to participate in the economy, and to find new ways of solving tasks. Ned Phelps describes such an economy in his 2013 book *Mass Flourishing* (see also Hoon et al. 2023). Here, jobs are rewarding and a source of life satisfaction. Such an innovative capitalist system requires investors, a stock market, company law, and good corporate governance in addition to the protection of property rights, a noncorrupt public sector, and the rule of law.

Populist politicians have no appreciation for such an economy. Their politics do not provide a solution to current economic problems. Instead, they are an impediment to growth.

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