



# Populism and the economics of globalization

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**Abstract**

Populism may seem like it has come out of nowhere, but it has been on the rise for a while. I argue that economic history and economic theory both provide ample grounds for anticipating that advanced stages of economic globalization would produce a political backlash. While the backlash may have been predictable, the specific form it took was less so. I distinguish between left-wing and right-wing variants of populism, which differ with respect to the societal cleavages that populist politicians highlight. The first has been predominant in Latin America, and the second in Europe. I argue that these different reactions are related to the relative salience of different types of globalization shocks.

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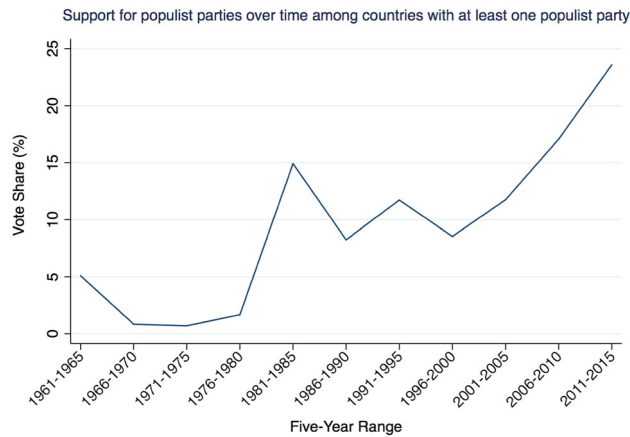
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## INTRODUCTION

“Populism” is a loose label that encompasses a diverse set of movements. The term originates from the late nineteenth century, when a coalition of farmers, workers, and miners in the US rallied against the Gold Standard and the Northeastern banking and finance establishment. Latin America has a long tradition of populism going back to the 1930s, and exemplified by Peronism. Today populism spans a wide gamut of political movements, including anti-euro and anti-immigrant parties in Europe, and Syriza and Podemos in Greece and Spain, respectively, Trump’s antitrade nativism in the US, the economic populism of Chavez in Latin America, and many others in between. What all these share is an antiestablishment orientation, a claim to speak for the people against the elites, opposition to liberal economics and globalization, and often (but not always) a penchant for authoritarian governance.<sup>1</sup>

I address two questions in this paper. First, what are the economic roots of populism? Second, what are the factors that affect the emergence of right- versus left-wing populism?

It may seem like populism has come out of nowhere. But the populist backlash has been on the rise for a while, for at least a decade or more (see Figure 1). More importantly, the backlash was perfectly predictable. I will focus in this paper on the economic



**Figure 1** The global rise of populism. *Notes:* see Appendix for sources and methods.

roots of populism, in particular the role of economic globalization. I do not claim that globalization was the only force at play – nor necessarily even the most important one. Changes in technology, rise of winner-take-all markets, erosion of labor-market protections, and decline of norms restricting pay differentials all have played their part. These developments are not entirely independent from globalization, insofar as they both fostered globalization and were reinforced by it. But neither can they be reduced to it. Nevertheless, economic history and economic theory both give us strong reasons to believe that advanced stages of globalization are prone to populist backlash. I will examine those reasons below.

The populist backlash may have been predictable, but the specific form it took was less so. Populism comes in different versions. Here I will distinguish between left-wing and right-wing variants of populism, which differ with respect to the societal cleavages that populist politicians highlight and render salient.<sup>2</sup> The US progressive movement and most Latin American populism took a left-wing form. Donald Trump and European populism today represent, with some instructive exceptions, the right-wing variant. A second question I address below is what accounts for the emergence of right-wing versus left-wing variants of opposition to globalization.

I will suggest that these different reactions are related to the forms in which globalization shocks make themselves felt in society. It is easier for populist politicians to mobilize along ethno-national/cultural cleavages when the globalization shock becomes salient in the form of immigration

and refugees. That is largely the story of advanced countries in Europe. On the other hand, it is easier to mobilize along income/social class lines when the globalization shock takes the form mainly of trade, finance, and foreign investment. That in turn is the case with southern Europe and Latin America. The US, where arguably both types of shocks have become highly salient recently, has produced populists of both stripes (Bernie Sanders and Donald Trump).

I argue that it is important to distinguish between the demand and supply sides of the rise in populism. The economic anxiety and distributional struggles exacerbated by globalization generate a base for populism, but do not necessarily determine its political orientation. The relative salience of available cleavages and the narratives provided by populist leaders is what provides direction and content to the grievances. Overlooking this distinction can obscure the respective roles of economic and cultural factors in driving populist politics.

The outline of the paper is as follows. I first discuss what economic theory and empirics have to say about the distributive consequences of trade liberalization ([Trade and Redistribution](#) section). In light of that discussion, I turn to the economics and politics of compensation ([Compensation and Safety Nets](#) section). In the next section, I examine questions of fairness and distributive justice, which economists have generally stayed away from, but are crucial to understand the populist backlash ([Trade, Redistribution, and Fairness](#) section). In [The Perils of Financial Globalization](#) section, I review the consequences of financial globalization. [The Political Economy of the Backlash](#) section brings the supply side of populism into the picture, discussing conditions under which right-wing and left-wing variants of populism are more likely to thrive. Finally, I provide some concluding comments in [Concluding Remarks](#) section.

## TRADE AND REDISTRIBUTION

Why does globalization, in its many forms, cause political conflict? How does the intensity of the conflict vary over time, depending on the stage of globalization, state of the business cycle, and other factors? In view of the contentious history of the first era of globalization, what enabled the later flowering after the Second World War? And how similar (or dissimilar) is the current populist backlash?



To anyone familiar with the basic economics of trade and financial integration, the politically contentious nature of globalization should not be a surprise. The workhorse models with which international economists work tend to have strong redistributive implications. In fact, the real puzzle is that the world economy could achieve such high levels of openness in recent decades and maintain it for so long – a question I will pick up later.

Start with trade theory. Models of trade and distribution are essentially exercises in tracing out the effects of price changes on the material well-being of identifiable economic groups. One of the most remarkable theorems in economics is the Stolper–Samuelson theorem (1941), which generates very sharp distributional implications from opening up to trade. Specifically, in a model with two goods and two factors of production, with full intersectoral mobility of the factors, owners of one of the two factors are made necessarily worse off with the opening to trade. The factor which is used intensively in the importable good *must* experience a decline in its real earnings. Note that the theorem establishes absolute losses, and not relative losses. Note also that the result holds regardless of consumption preferences: there are losses to one group even if they spend most or even all of their budget on the importable good (which gets cheaper in relative terms), although the magnitude of the losses is reduced. Applied with some amount of hand-waving to the US economy, the result predicts that low-skilled workers are *unambiguously* worse off as a result of trade liberalization.

The original Stolper–Samuelson theorem was derived under very specific conditions, and it is sometimes thought that more complicated, or more realistic, models soften the edges of this striking conclusion. This is true to some extent. But there is one Stolper–Samuelson-like result that is extremely general, and which can be stated as follows. Under competitive conditions, as long as the importable good(s) continue to be produced at home – that is, ruling out complete specialization – there is always at least one factor of production that is rendered worse off by the liberalization of trade. In other words, trade generically produces losers.

The proof of this result is simple enough to be stated quickly here. Let's express the unit cost of production for the importable sector that is being liberalized as  $c = \varphi(w_1, w_2, \dots, w_n)$ , with  $w_i$  denoting the return to the  $i$ th factor of production used in that sector. Since payments made to the factors must exhaust the cost of production, changes in

unit costs are a weighted average of changes in payments to each of the factors, where the weights (in perfect competition) are the cost shares of each factor.<sup>3</sup> In other words,  $\hat{c} = \sum \theta_i \hat{w}_i$ , where a “hat” denotes proportional changes,  $\theta_i$  is the cost share of factor  $i$ , and  $\sum \theta_i = 1$ .

Now consider what happens with trade liberalization. The effect of trade liberalization is to raise the domestic price of exportables relative to importables. Let the importable described above be the numeraire, with price fixed at unity. We are interested in what happens to the returns of factors used in the importable. Since this good is the numeraire, we have the equilibrium condition  $c = \varphi(w_1, w_2, \dots, w_n) = 1$ , stating equality between price and unit cost (the zero-profit condition). As long as the good continues to be produced, this condition holds both before and after the liberalization. Therefore,  $\sum \theta_i \hat{w}_i = 0$ . Since the weighted sum of factor price changes add up to zero, there must be at least one factor of production, call it the  $k$ th factor, such that  $\hat{w}_k \leq 0$ . (The inequality will be strict when goods differ in their factor intensities.) Meanwhile, exportable prices have increased ( $\hat{p} > 0$ ), thanks to the liberalization. Hence,  $\hat{w}_k \leq 0 < \hat{p}$ , and the return to the  $k$ th factor declines in terms of both the importable and exportables, producing an unambiguous fall in real returns, regardless of the budget shares of the two goods.

This is known as the magnification effect in trade theory and follows from the fact that factor price changes must bracket price changes in neoclassical equilibrium. Hence, its generality. The result that openness to trade creates losers is not a special case; it is the implication of a very large variety of models, including those where labor is not particularly mobile across industries and regions.

The particular configuration of gains and losses depend on the details of the model. In the  $2 \times 2$  case of the Stolper–Samuelson theorem,  $\hat{w}_l < 0 < \hat{p} < \hat{w}_h$ , where  $w_l$  and  $w_h$  denote the returns to low- and high-skill workers, respectively. Another benchmark model in trade is the specific-factors model, where each good has a factor that is used only in that sector. In that model, the factors that lose are those that are specific to the importable sector(s).

More recent work in trade theory has emphasized heterogeneity among firms and workers. These models have additional margins for redistribution, between firms and workers that otherwise look quite similar. Grossman, Helpman, & Kircher (2017), for example, enrich the Stolper–Samuelson



framework by considering heterogeneity within broad worker categories. “Managers” and “workers” must combine in teams, and their productivity depends on the quality of the match. Trade liberalization induces re-matching and generates distributional effects within occupations and industries, in addition to the standard effects across broad factors of production and industries.

Hence in all these models, redistribution is the flip side of the gains from trade. No pain, no gain. This is standard economic fare – familiar to all trade economists, even if not voiced too loudly in the public.

Economic theory has an additional implication, particularly germane to our discussion, which is less well recognized. In relative terms, the redistributive effects of liberalization get larger and tend to swamp the net gains as the trade barriers in question become smaller. In other words, the ratio of redistribution to net gains rises as trade liberalization tackles progressively lower barriers.<sup>4</sup>

The logic is simple. Consider the denominator of this ratio first. It is a standard result in public finance that the efficiency cost of a tax increases with the square of the tax rate. Since an import tariff is a tax on imports, the same convexity applies to tariffs as well. Small tariffs have very small distorting effects; large tariffs have very large negative effects. Correspondingly, the efficiency gains of trade liberalization become progressively smaller as the barriers get lower.

The redistributive effects, on the other hand, are roughly linear with respect to price changes and are invariant, at the margin, to the magnitude of the barriers. To a first order of approximation, a 10 percent reduction in import prices has twice the effect on factor prices of a 5 percent reduction. Putting these two facts together, we have the result just stated, namely that the losses incurred by adversely affected groups per dollar of efficiency gain are higher the lower the barrier that is removed.

Table 1 shows some quantitative simulations using a simple two-factor, two-goods trade model (of the Stolper–Samuelson type): the ratio of losses to net gains rises dramatically from a factor of 5 when tariffs are at 40 percent to more than 70 when tariffs are 3 percent!

Of course, the gains reaped by the winners, per dollar of efficiency gain, also increase correspondingly. But the main point is this: as globalization advances and policy makers go after the remaining, low barriers, trade agreements become more about

redistribution and less about expanding the overall economic pie. This is possibly one important reason why globalization becomes politically more contentious in its advanced stages.<sup>5</sup>

So much for theory. Does the evidence support these sharp distributional predictions? We now have some good empirical studies that have taken a detailed look at the consequences of NAFTA and of China’s entry to the WTO on labor markets in the US. They find that local labor-market effects in affected communities were indeed sizeable.

The most careful analysis of NAFTA to date has been carried out by Hakobyan & McLaren (2016). These authors use US Census data and focus on the 1990–2000 period. They measure the NAFTA “trade shock” by constructing an industry- and locality-specific variable that measures vulnerability to NAFTA. This indicator is a weighted average of initial tariffs on Mexican imports, where the weights are both local employment levels in each industry and Mexico’s revealed comparative advantage in those industries. To ensure they are capturing the effects of NAFTA proper, they also control for other trends that may be correlated with the NAFTA shock such as the general expansion of trade.

Hakobyan and McLaren find that NAFTA produced modest effects for most US workers, but an “important minority” suffered substantial income losses. They identify both a geographic and industry effect. Regions that were most affected by tariff reductions experienced significantly slower wage growth than regions that had no tariff protection against Mexico in the first place.<sup>6</sup> Not surprisingly, the effect was greatest for blue-collar workers: a high-school dropout in heavily NAFTA-impacted locales had eight percentage points slower wage growth over 1990–2000 compared with a similar worker not affected by NAFTA trade. The industry effect was even larger: wage growth in the most protected industries that lost their protection fell 17 percentage points relative to industries that were unprotected initially.

These are very large effects, especially when one bears in mind that the efficiency gains generated by NAFTA apparently have been tiny. Economists have struggled to find significant net gains for the US economy, largely because US tariffs vis-à-vis Mexico were quite low to begin with and Mexico is so small relative to the US (less than a tenth in size). The consensus of these studies is that there were large trade effects, but miniscule aggregate income effects. Romalis (2007) concludes that the overall



effect for the US was approximately zero. A recently published academic study by Caliendo & Parro (2015) uses all the bells-and-whistles of modern trade theory to produce the estimate that these overall gains amount to a “welfare” gain of 0.08% – 800th of 1 percent – for the US trade volume impacts were much larger: a doubling of US imports from Mexico.<sup>7</sup>

China is a much larger country, and its entry into the WTO was a bigger deal for the US. While US tariffs on imports from China did not change, the uncertainty about the annual renewal of most-favored nation status was removed and, as a result, there was a large increase in the volume of trade. In a well-known paper, Autor, Dorn, and Hanson have documented the labor-market disruption caused by the “China trade shock,” which was not only massive but also very persistent (Autor, Dorn, & Hanson, 2013; see also Autor, Dorn, & Hanson, 2016a; Autor, Dorn, Hanson, & Majlesi, 2016b).

These authors focus on the 1990–2007 period, which covers the years before and after China’s WTO entry. They identify the exogenous, supply-driven increase in Chinese imports by instrumenting these by the contemporaneous change in imports from China in eight other developed countries. Their unit of analysis is the commuting zone. Commuting zones have different compositions of economic activity, and some have more industries exposed to Chinese competition than others. This permits an examination of the labor-market effects of Chinese imports across different localities.

Autor et al.’s baseline result is that a commuting zone in the 75th percentile of exposure to Chinese import growth had a differential fall of 4.5 percent in the number of manufacturing employees and a 0.8 percentage point larger decline in mean log weekly earnings, compared with a commuting zone at the 25th percentile. They also find a significant impact on overall employment and labor force participation rates, indicating that this is an additional margin of adjustment to trade shocks. As the authors stress, this implies that the wage reductions are underestimated, both because of increase in nonparticipation and the fact that the unemployed are more likely to have lower ability and earnings. Beyond redistributive costs, Autor et al. (2013) point also to the adverse efficiency implications of these findings. Involuntary employment and transfers through the welfare system both induce non-negligible efficiency losses that eat into the standard gains from trade.

Moreover, these local labor-market effects appear to have been highly persistent. The wage, labor-force participation, and unemployment consequences had not dissipated after a full decade of the China trade shock (Autor et al., 2016a, b). The offsetting employment effects in export-oriented activities, which conventional trade models produce, had not taken place.

The studies I have just summarized look at the local labor-market effects of specific trade shocks, focusing on the variation across different geographical areas. There is also the question of trade’s effect on the overall levels of earnings and employment. There is an extensive literature on trade and wages going back to the 1980s that ascribes some – although not most – of the increase in wage inequality in the advanced economies to trade. Earlier studies tended to downplay the importance of trade, placing much more emphasis on skill-biased technological change as the dominant influence behind the increase in the skill premium. More recent studies have tended to give trade a more prominent role, in part because globalization has advanced and also because a sharp distinction between trade and technology has become harder to make (see Ebenstein, Harrison, McMillan, & Phillips, 2014 and the references therein). Recent evidence implicates import competition as the most important factor behind the decline in labor shares at the level of individual industries in the US since the late 1980s (Elsby, Hobijn, & Şahin, 2013).<sup>8</sup>

### COMPENSATION AND SAFETY NETS

In principle, the gains from trade can be redistributed to compensate the losers and ensure no identifiable group is left behind. Trade economists, aware of the distributive implications of their models, have long called for such compensation. If successive US administrations had done a better job at redistributing the gains from trade, could the protectionist backlash have been avoided?

The European experience is instructive here. Populism has certainly not spared Europe. But the opposition to globalization has taken a different political coloring, targeting Brussels and the EU’s perceived intrusion in domestic policy and regulations rather than trade agreements. European populism is not antitrade or directed at specific exporters such as China and Mexico. Some aspects of trade agreements, such as investor-state dispute settlement (ISDS) and regulatory harmonization, are highly controversial in Europe as well. But





neither right-wing nor left-wing populists have pushed for trade barriers. In fact, Brexit advocates in Britain presented free trade as an explicit objective. One of the advantages of leaving the EU, they argued, was that it would enable Britain to pursue policies closer to free trade!

One difference with the US that may account for this contrast is that Europe has long had strong social protections and a generous welfare state. Most countries of Europe, being smaller than the US, are much more open to trade. But openness to trade has been accompanied by much greater redistribution and social insurance. A number of empirical analyses have shown that there is a direct link between exposure to trade and expansion of public transfers (Cameron, 1978; Rodrik, 1998a, b). It is not an exaggeration to say that the European welfare state is the flip side of the open economy. (Interestingly, the European backlash against immigrants and refugees has some of its roots in the concern that the social benefits of the welfare state will be eroded or displaced.)

The US became a truly open economy relatively late. The share of imports in GDP more than doubled between the mid-1970s and the 2000s, going from 7% in 1975 to 17% on the eve of the financial crisis in 2008. Much of the increase in import penetration, especially during the 1990s, came from low-income countries (China in particular), which created special adjustment problems. In principle, US governments could have followed the European model. It could have complemented trade agreements – NAFTA, the WTO, and China’s WTO entry – with much more robust social insurance mechanisms and active labor-market programs and protections. Even though there was much talk about such supports during the Clinton administration, little was in fact done beyond tinkering with the existing trade adjustment assistance (TAA) mechanisms.

There are in fact two essential difficulties with compensation. The economic problem is that compensation can be very costly. Lump-sum taxes and transfers are not practical and they are rarely used. The taxes needed and the mechanisms used to dispense the assistance both create behavioral distortions – deadweight losses. These can be quite large. Using a 40% figure for the marginal excess burden of taxation, Autor et al. (2013) estimate that the increase in transfers resulting from the Chinese trade shock resulted in an annual deadweight loss of \$33 per capita. A more extensive welfare system,

along European lines, would likely produce bigger such numbers.

Antràs, de Gortari, & Itskhoki (2017) have recently presented an interesting exercise to quantify the full costs of compensation in an economy where tax-transfer schemes are necessarily distortionary. They construct a model in which opening up to trade disproportionately benefits the most productive agents in the economy, exacerbating income inequality. To counter this, an increase in the progressivity of income taxation is needed, which in turn produces adverse efficiency effects through the labor-supply channel. They calibrate their model using IRS tax returns data from the US and back out the implied trade frictions from measures of trade exposure. The authors compute both the required adjustment to the gains from trade under a welfarist criterion (compared to a distribution-neutral standard) and the losses incurred due distortionary redistribution. Under their baseline parameterization, “trade-induced increases in disposable income inequality erode about 20% of the U.S. gains from trade, while gains from trade would have been about 15% larger if redistribution had been carried out via non-distortionary means.”

Note that Antràs et al. (2017) do not explicitly model trade policy; their trade friction variable takes the form of an “iceberg cost” and, unlike import tariffs or quantitative restrictions, does not create government revenue or rents. In the presence of such revenues, opening up to trade would generally entail lower efficiency gains and greater redistribution. The deadweight loss of compensatory distortionary taxation would be correspondingly larger.

But perhaps the more serious difficulty with compensation is the political one, and it relates to credibility and time consistency. As long as reversing trade agreements is costly, governments always have the incentive to promise compensation, but rarely to carry it out. The winners need the losers’ assent for the agreement. But once the agreement is passed, there is little reason for the winners to follow through. This is largely the story of TAA in the US. Practically every trade agreement that the US has signed has had a compensatory arrangement attached to it in some form or another. Yet there is widespread agreement that TAA and similar measures have not proved very effective.<sup>9</sup> It is not implausible to think that the reason is the lack of political incentives *ex post* to render them effective.



Furthermore, trade agreements themselves have played a part in the shifting bargaining power between business and workers. They reflect the decline in the political influence of organized labor. And they reinforce that decline by changing the rules and norms of competition in turn. Viewed from this perspective, it is not surprising that compensation has not featured prominently. A labor movement strong enough to receive real compensation would have been strong enough to resist trade agreements with sharp redistributive impacts – or at least to shape the agenda of negotiations in a more worker-friendly direction.

In view of such economic and political difficulties, genuine compensation rarely occurs. It tends to be an add-on to trade agreements or an afterthought. Actual compensation works best when it is embedded in the general social policies of a nation, and not specifically targeted at trade impacts. Where it has worked, as in Europe, it has been part of a constitutive bargain between capital and labor that couples the open economy with generous safety nets. In these countries, there is little need for compensatory policies targeted at trade directly: individuals who are displaced, lose their jobs, or need retraining can access those broader mechanisms. European employers have traditionally consented to the high costs of such safety nets. And they have cemented their consent by institutionalizing it in the form of the welfare state.

The bargain enabled European nations to achieve much higher levels of openness and exposure to international competition than the US. It underpinned the return to high levels of globalization in the decades following the end of the Second World War. But this bargain too would fray eventually, as we shall see, under the impact of capital mobility and financial globalization.

### TRADE, REDISTRIBUTION, AND FAIRNESS

Economists understand that trade causes job displacement and income losses for some groups. But they have a harder time making sense of why trade gets picked on so much by populists both on the right and the left. After all, imports are only one source of churn in labor markets, and typically not even the most important source. Demand shocks, technological changes, and the ordinary course of competition with other, domestic firms produce much greater labor displacement than increases in import penetration. While disentangling the effects

of automation and globalization is difficult, most existing studies attribute the bulk of the decline in US manufacturing employment to the former rather than the latter.<sup>10</sup> Yet we do not see populists campaign against technology or automation.<sup>11</sup> What is it that renders trade so much more salient politically?

The usual answer is that trade is a convenient scapegoat, since politicians can point to identifiable foreigners – Chinese, Mexicans, or Germans – as the source of the problem. This is no doubt true to some extent. But there is another, deeper issue that renders redistribution caused by trade more contentious than other forms of competition or technological change. Sometimes international trade involves types of competition that are ruled out at home because they violate widely held domestic norms or social understandings. When such “blocked exchanges” are enabled through trade they raise difficult questions of distributive justice.<sup>12</sup> What arouses popular opposition is not inequality per se, but perceived unfairness.

Three psychologists have recently provided interesting support for this idea (Starmans, Sheskin, & Bloom, 2017). They note that people tend to express preference for equality in small groups, but when asked about the ideal distribution for their country (or large groups), they support an unequal distribution of resources. The authors argue that there is no evidence “people are actually concerned with economic inequality at all.” What they worry about is “something that is often confounded with inequality: economic unfairness.” Fairness concerns are likely deeply embedded in our evolutionary history as a strategy for dealing with opportunistic behavior (i.e., to punish cheaters). At the same time, people understand that unequal abilities, effort, or moral deservingness imply that a fair distribution in society would also be unequal. As long as there is belief in social mobility, high levels of inequality will be tolerated.<sup>13</sup>

To relate these considerations to international trade, consider the following thought experiment. Suppose Harry and John own two firms that compete with each other. Ask yourself how you feel about each of the scenarios below. In each of them, Harry outcompetes John, resulting in John and his employees losing their jobs. Should they be blocked or allowed to run their course?

- (1) Harry works hard, saves and invests a lot, and comes up with new techniques and products, while John lags behind.



- (2) Harry finds a cheaper (or higher quality) supplier in Germany.
- (3) Harry outsources to a supplier in Bangladesh, which employs workers in 12-h-a-day shifts and under hazardous conditions.
- (4) Harry brings Bangladeshi workers to the US under temporary contracts, and puts them to work under conditions that violate domestic labor, environmental, and safety laws.

From the standpoint of our two competitors and from a purely economic perspective, these scenarios are isomorphic: each creates losers as well as gainers in the process of expanding the overall size of the economic pie for the national economy. In each case, Harry's gains are larger than John's losses.

But most audiences react very differently to them. The manner in which the gains and losses are generated matter. Few people have issues with scenarios (1) or (2), which are perceived as acceptable market outcomes even if there are losers. But scenarios (3) and (4) appear problematic insofar as they force John to compete with Harry under ground rules that have been prohibited at home, in domestic competition. Furthermore, scenario (4) is illegal, even though its practical consequences are identical to those of scenario (3). Many economists who have no difficulty with the outsourcing scenario (3) would regard scenario (4) as unconscionable. But if we treat (3) as acceptable, why should we not accept (4) as well? Alternatively, if we reject (4), why would we accept (3)?

The thought experiment clarifies why the general public can view certain kinds of international competition [represented by scenario (3) above] to be in conflict with domestic norms as regards what's an acceptable redistribution. I take this to be the essence of the "fair trade" argument. It's one thing to lose your job to someone who competes under the same rules as you do. It's a different thing when you lose your job to someone who takes advantage of lax labor, environmental, tax, or safety standards in other countries.<sup>14</sup> The fairness concern generalizes beyond the individuals who are directly affected. Members of the broader community are more likely to empathize with those who lose their jobs or incur earning losses when they believe that this is the result of "unfair" practices. In the words of Rosanvallon (2016), "inequality is felt most acutely when citizens believe that the rules apply differently to different people."<sup>15</sup>

The notion of fair trade is much derided by economists, but it is already enshrined in trade laws in the form of antidumping and countervailing duties (used against dumped and subsidized goods, respectively). These so-called trade remedies undercut the gains from trade – by blocking certain exchanges – but they also enable political buy-in for an open trading system. A greater appreciation for the importance of procedural fairness may have prepared economists for the brewing opposition to an analogous form of dumping, one that might be called "social" dumping.

Finally, it is worth noting that the nature of trade agreements has changed over time, rendering them more divisive in terms of value and fairness considerations. Trade deals increasingly reach behind the border to harmonize domestic regulations. This is a form of economic integration that is called deep integration, to distinguish it from the shallow integration associated with tariff or quota liberalization. Often, deep integration is pushed by specific lobbies and special interests. For example, pharma companies have played a major role in bringing intellectual property rights protection into trade agreements. Multinational companies have pushed for special tribunals in which they can sue host governments, so-called ISDS. Financial firms have inserted clauses that make it difficult or impossible for signatories to manage cross-border capital flows, even though the usefulness of capital controls is acknowledged today even by the International Monetary Fund (IMF). Such features move trade agreements away from efficiency enhancement. They exacerbate clashes within nations on the relative power of corporations or the desirability of safeguarding regulatory autonomy.

### THE PERILS OF FINANCIAL GLOBALIZATION

Economists remain on the whole in favor of free trade, even though they recognize the distributional impacts may be sometimes adverse. The presumption of the gains from trade – the aggregate efficiency gains from eliminating barriers on cross-border commerce – remains strong. In principle, financial globalization generates important economic benefits as well: it should channel savings to countries where returns are higher, enable intertemporal consumption for nations through international borrowing and lending, and allow global portfolio diversification. Nevertheless, economists' views on capital mobility have been more ambiguous and prone to cycles.





In the immediate aftermath of the Second World War, the near-consensus of the economics establishment was in favor of controls on cross-border capital flows, to avoid the currency volatility of the interwar period and leave room for domestic macroeconomic management. By the 1990s, the consensus was reversed. The IMF, OECD, and the EU began to push for full capital-account convertibility for the present and prospective member states. Following the global financial crisis of 2008–2009, views changed yet again. The benefits of financial globalization were downgraded, and capital controls became acceptable once more.

The economics profession's current views on financial globalization can be best described as ambivalent. Most of the skepticism is directed at short-term financial flows, which are associated with financial crises and other excesses. Long-term flows and direct foreign investment in particular are generally still viewed favorably. Direct foreign investment tends to be more stable and growth-promoting. But as I discuss below, there is evidence that it has produced shifts in taxation and bargaining power that are adverse to labor.

A recent paper by Broner & Ventura (2016) captures well the mainstream perspective on the anomalous consequences of financial globalization. The starting point is that opportunistic behavior by governments and low-quality domestic institutions make foreign finance subject to periodic debt crises. In their model, when debt is domestic, debt contracts are enforced and defaults are rare. The entry of foreign creditors increases government incentives to default. And when governments cannot perfectly discriminate between foreign and domestic creditors, foreign and domestic debt crises occur together. This gives an incentive for domestic residents to send their savings abroad. Financial globalization therefore may result in the apparent paradox that countries that should be normally importing capital become exporters of capital ("capital flight"). Countries with deep financial markets where governments are loath to default opportunistically become safe havens for foreigners' savings, and receive excessive financial inflows. The result of all of this is that the consequences of financial globalization for investment, growth, and financial stability are uncertain and cannot be presumed beneficial.

The essence of the Broner–Ventura story is that financial globalization accentuates the weakness of domestic institutions and debt-enforcement mechanisms. Capital mobility interacts with domestic

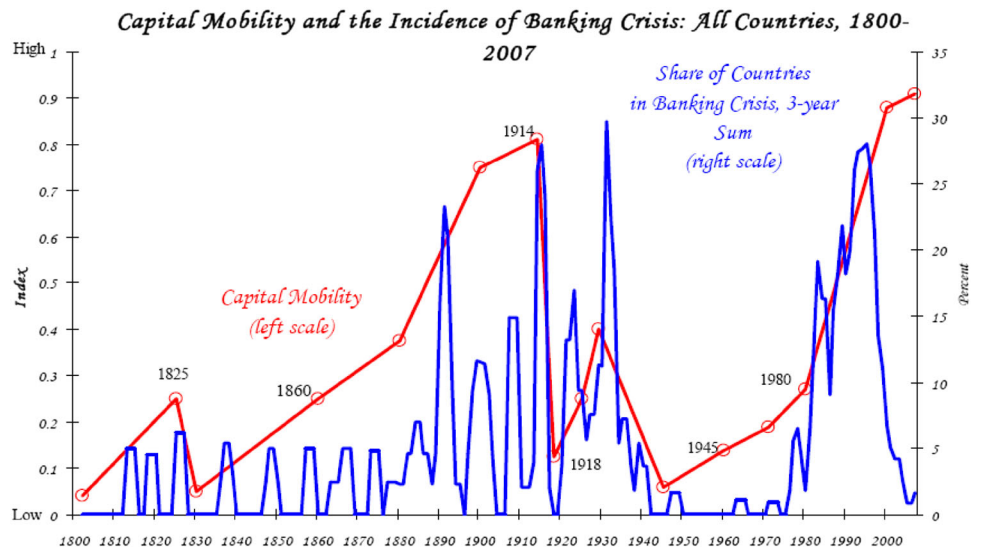
market failures to produce adverse effects that possibly offset its direct beneficial effect.<sup>16</sup> This type of the second-best reasoning is the reason why many prominent economists such as Jagdish Bhagwati and Joe Stiglitz do not favor free capital mobility, even though they are strong supporters of free trade.

Such accounts also rationalize two sets of empirical findings that pose problems for advocates of financial globalization. First, the association between capital-account convertibility and economic growth is weak at best (Rodrik, 1998a, b; Schularick & Steger, 2010; Kose et al., 2011; Ostry, Prati, & Spilimbergo, 2009). Typically, positive growth effects are found either for specific periods (e.g., during the late nineteenth century when capital flowed to the new world), specific subsamples of countries (e.g., those with strong institutions and macroeconomic management), or particular types of capital (foreign direct investment). Second, there is a strong empirical association between financial globalization and financial crises over time. The canonical chart on this comes from Reinhart & Rogoff (2009), who show that the time trends of financial globalization and the incidence of banking crises coincidence coincide almost perfectly. (Their chart is reproduced here in Figure 2.) Banking crises and financial globalization rise and fall together.

The boom-and-bust cycle associated with capital inflows has long been familiar to developing nations. Prior to the global financial crisis, there was a presumption that such problems were largely the province of poorer countries. Advanced economies, with their better institutions and regulation, would be insulated from financial crises induced by financial globalization. It did not quite turn out that way. In the US, the housing bubble, excessive risk-taking, and over-leveraging during the years leading up to the financial crisis were amplified by capital inflows from the rest of the world. European banks were major purchasers of US asset-backed securities and the appetite of emerging-market creditors for "low-risk" investments fueled the US credit boom. In the words of Lane, "financial globalization magnified the impact of underlying distortions, such as inadequate regulation of credit markets and banks, by allowing the scaling-up of financial activities that might have faced capacity limits in autarkic financial systems" (Lane, 2012: 9).

In the euro zone, financial integration, on a regional scale, played an even larger role. Monetary unification and the introduction of the euro in

**Figure 2** Capital mobility and financial crises. Source: Reinhart & Rogoff (2009).



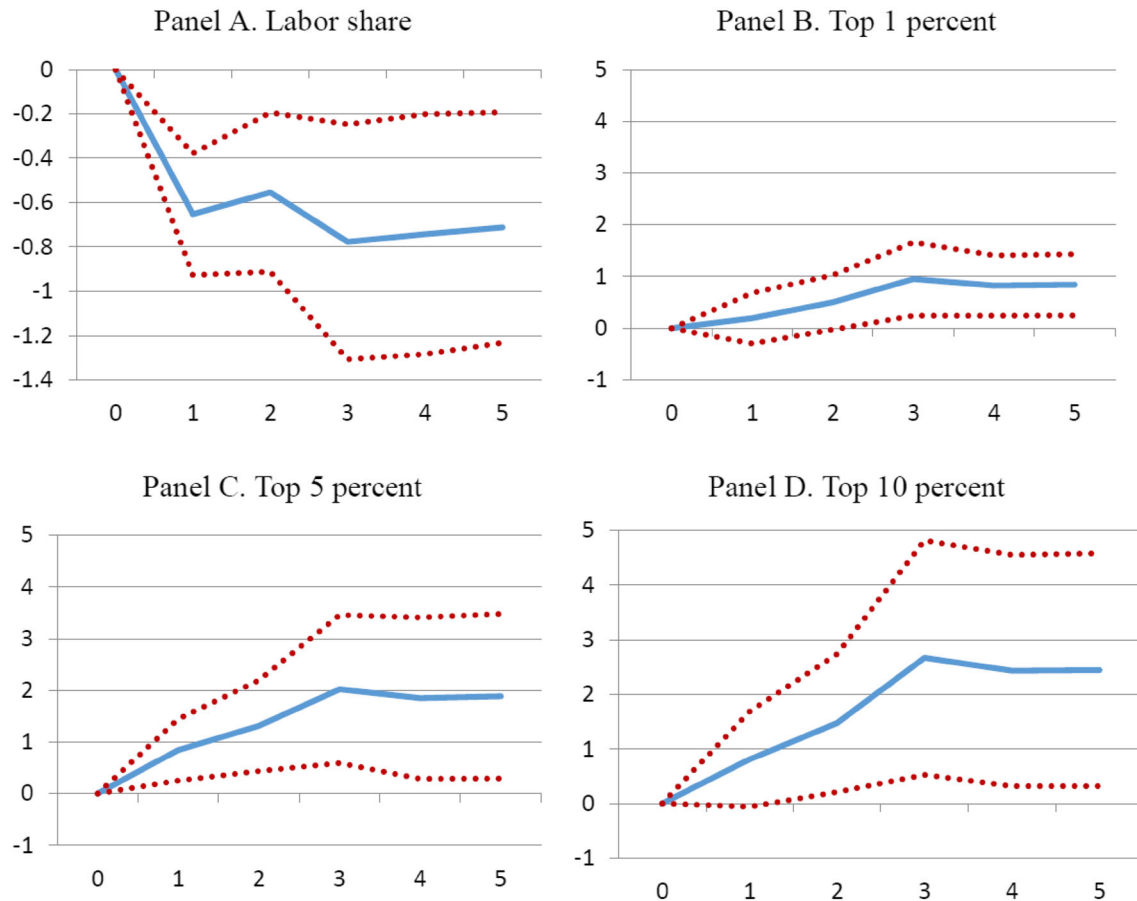
1999 drove down risk premia in countries such as Greece, Spain, and Portugal, and led to the convergence of borrowing costs across member states. This enabled borrowers to run large current account deficits and accumulate problematic amounts of external debt. Construction and other nontradable sectors were boosted in the receiving countries at the expense of tradable activities. Such credit booms would eventually turn into bust and sustained economic collapses in Greece, Spain, Portugal, and Ireland once credit dried up in the immediate aftermath of the crisis in the US.

Financial globalization appears to have produced adverse distributional impacts within countries as well, in part through its effect on incidence and severity of financial crises. In a remarkable series of papers, researchers at the IMF have documented these negative inequality impacts (Jaumotte, Lall, & Papageorgiou, 2013; Furceri & Loungani, 2015). Most noteworthy is the recent analysis by Furceri, Loungani, & Ostry (2017) that looks at 224 episodes of capital-account liberalization, most of them taking place during the last couple of decades. Liberalization episodes are identified by big changes in a standard measure of financial openness (the Chinn–Ito index) and large subsequent capital flows. They find that capital-account liberalization leads to statistically significant and long-lasting declines in the labor share of income and corresponding increases in the Gini coefficient of income inequality and in the shares of top 1, 5, and 10 percents of income (see Figure 3 for their key results).<sup>17</sup> Furthermore, these adverse effects on inequality are stronger in cases where de jure

liberalization was accompanied by large increase in capital flows.<sup>18</sup> Financial globalization appears to have complemented trade in exerting downward pressure on the labor share of income.

Why would financial globalization increase inequality and the capital share in particular? There is no analogue to trade theory’s Stolper–Samuelson theorem in international macroeconomics. So to some extent these distributional consequences of financial globalization are a genuine surprise. But there may be an obvious, bargaining-related explanation (as argued in Rodrik, 1997, Chap. 2). As long as wages are determined in part by bargaining between employees and employers, the outside options of each party play an important role. Capital mobility gives employers a credible threat: accept lower wages, or else we move abroad. Indeed, Furceri et al. (2017) provide some evidence that the decline in the labor share is related to the threat of relocating production abroad. As a proxy for the potential threat, they use layoff propensities of different industries. They find the effect of capital-account liberalization on labor shares is particularly strong in those sectors with a higher natural layoff rate. The bargaining explanation is also consistent with the finding in Jaumotte et al. (2013) that it is foreign direct investment in particular that is associated with the rise in inequality.<sup>19</sup>

Differential mobility has other implications that bear on distributional questions. Another argument I made in Rodrik (1997) was that capital mobility would increase volatility of labor earnings and, in particular, shift the burden of economic shocks to labor. This too follows from the differential



**Figure 3** The effects of capital-account liberalization on labor and top income shares (percent). *Source:* Furceri et al. (2017).

mobility of labor and capital across borders. The factor that is stuck within borders has to absorb the costs of idiosyncratic shocks. Subsequent evidence on the volatility of labor-market outcomes has been largely consistent with this conjecture (Scheve & Slaughter, 2002; OECD, 2007; Buch & Pierdzioc, 2014). Workers with the lowest skills and qualification, those least able to move across borders, are typically the most affected by this risk shifting.

Another type of shift relates to taxation. As capital becomes globally mobile, it becomes harder to tax. Governments increasingly have to fund themselves by taxing things that are less footloose – consumption or labor. Indeed, corporate tax rates have come down sharply in virtually all advanced economies since the late 1980s, sometimes by half or more. Meanwhile, the tax burden on wages (social security charges, etc.) has remained roughly constant, and value added tax (VAT) rates have generally increased.<sup>20</sup> It is not implausible to think that these global trends are related to globalization and its effects on tax competition.

There is some systematic empirical evidence that provides support for this hypothesis. In a panel study of fourteen OECD countries for 1967–1996, Bretschger & Hettich (2002) find that proxies for openness of capital and trade accounts are related negatively to effective corporate tax rates and positively to labor taxes. Similar results are reported in a more recent study with data through 2007 (Onaran & Boesch, 2014). In a study covering the 1981–2001 period, Garretsen & Peeters (2007) find that foreign direct investment levels (instrumented by an index of capital-account restrictions) exert downward pressure on effective tax rates on capital, but that there is considerable heterogeneity depending on country characteristics (e.g., size, neighborhood, density). Devereux, Lockwood, & Redoano (2008) explicitly model governments' selection of both the corporate tax rate and the corporate tax base in a game theoretic framework. They find that strategic, downward pressures operate only in countries with open capital accounts, and conclude “the reductions in equilibrium tax

rates can be explained almost entirely by more intense competition generated by the relaxation of capital controls.”<sup>21</sup>

In view of this ambiguous record of financial globalization with respect to efficiency and equity, to put it mildly, it is curious that economists did not take a stronger stand against the cumulative removal of restrictions on capital flows. Many prominent economists supported financial globalization, believing that the promise would eventually outweigh the risks.<sup>22</sup> That in turn strengthened the hand of policy makers in the US, Europe, emerging markets, and multilateral institutions like the IMF and the OECD who pushed for financial openness.<sup>23</sup> In his 2015 presidential address to the American Finance Association, Zingales (2015) would complain that economists had not distinguished themselves in the years leading to the global financial crisis. “We should acknowledge that our view of the benefits of finance is inflated,” he wrote. Economists’ attitudes toward financial globalization exemplified this attitude.

### THE POLITICAL ECONOMY OF THE BACKLASH

Globalization had a big upside. It greatly expanded opportunities for exporters, multinational companies, investors, and international banks, as well the managerial and professional classes who could take advantage of larger markets. It helped some poor countries – China in particular – rapidly transform farmers into workers in manufacturing operations for export markets, thereby spurring growth and reducing poverty. But the decline in global inequality was accompanied by an increase in domestic inequality and cleavages. Globalization drove multiple, partially overlapping wedges in society: between capital and labor, skilled and unskilled workers, employers and employees, globally mobile professionals and local producers, industries/regions with comparative advantage and those without, cities and the countryside, cosmopolitans versus communitarians, elites and ordinary people. It left many countries ravaged by financial crises and their aftermath of austerity.

Globalization was hardly the only shock which gutted established social contracts. By all accounts, automation and new digital technologies played a quantitatively greater role in de-industrialization and in spatial and income inequalities. But globalization became tainted with a stigma of unfairness that technology evaded. People thought they were losing ground not because they had taken an

unkind draw from the lottery of market competition, but because the rules were unfair and others – financiers, large corporations, foreigners – were taking advantage of a rigged playing field.

Many of these consequences were predictable and are not a surprise. The same can be said about the political backlash as well. A number of empirical papers have linked the rise of populist movements – Trump and the right-wing Republicans in the US, Brexit in Britain, far-right groups in Europe – to forces associated with globalization, such as the China trade shock, rising import penetration levels, de-industrialization, and immigration.

Analyzing electoral results across US congressional districts, Autor et al. (2016a, b) have shown that the China trade shock aggravated political polarization: districts affected by the shock moved further to the right or the left, depending which way they were leaning in the first place. Elected Republicans became more conservative, while elected Democrats became more liberal. For Britain, Becker et al. (2016) find that austerity and immigration impacts both played a role in increasing the Brexit vote, in addition to demographic variables and industrial composition. Also analyzing Brexit, Colantone & Stanig (2016) find a much more direct role for globalization. Using an Autor et al. (2013)-type China trade shock variable, they show regions with larger import penetration from China had a higher Leave vote share. They also corroborate this finding with individual-level data from the British Election Survey that shows individuals in regions more affected by the import shock were more likely to vote for Leave, conditional on education and other characteristics.

A second paper by Colantone & Stanig (2017) undertakes a similar analysis for 15 European countries over the 1988–2007 period. It finds that the China trade shock played a statistically (and quantitatively) significant role across regions and at the individual level. A larger import shock is associated with support for nationalist parties and a shift toward radical right-wing parties. Finally Guiso, Herrera, Morelli, & Sonno (2017) look at European survey data on individual voting behavior and find an important role for economic insecurity – including exposure to competition from imports and immigrants – in driving populist parties’ growth. The same variables also affect voter turnout: individuals who experience greater economic insecurity are also less likely to show up at the polls. As Guiso et al. (2017) indicate, the latter result suggests that studies that focus on vote shares





alone underestimate the importance of these economic drivers, including globalization shocks.

A question that has attracted little interest to date is why the backlash has taken the particular form it has in different countries. Most (but not all) populist movements in the current wave are of the right-wing variety. These 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. In the US, Donald Trump has demonized at various times the Mexicans, Chinese, and Muslims. In Europe, right-wing populists portray Muslim immigrants, minority groups (gypsies or Jews), and the faceless bureaucrats of Brussels as the “other.”

An alternative variety of populism revolves around a largely economic cleavage, the wealthy groups who control the economy and define its rules versus the lower income groups without access to power. The original American populism of the late nineteenth century was of this variety, focusing its opposition on the railroad barons and the Northeastern financial elite. Bernie Sanders’ presidential campaign in 2016 took a similar form. In Europe, there are a few left-wing populist movements, of which Greece’s Syriza and Spain’s Podemos are the best known. In Latin America, by contrast, populism has long taken mostly a left-wing form.

In Figure 4, I provide some systematic evidence on the dynamics of support for populist parties around the world since the 1960s. The figure shows the aggregate vote shares of populist parties in countries with at least one populist party. I distinguish between left-wing and right-wing populists and between Europe and Latin America. (The US presidential election of 2016 is not included.) The Appendix discusses data sources and parties/countries covered.

What jumps out of Figure 4 is the sharp contrast between the patterns of populism in Europe and Latin America. In Europe, the rise of populism is very recent and swift – from below 5 percent of the vote in the late 1980s to more than 20 percent by 2011–2015. Moreover, this increase is driven exclusively by right-wing parties. The left-wing populist vote share remains throughout well below 5 percent of the aggregate electorate in the countries included. By contrast, left-wing populism has always been strong in Latin America, with vote totals between 15 and 30 percent. It also has experienced a recent, if less marked, rise. Right-

wing populism has remained at very low levels in Latin America.

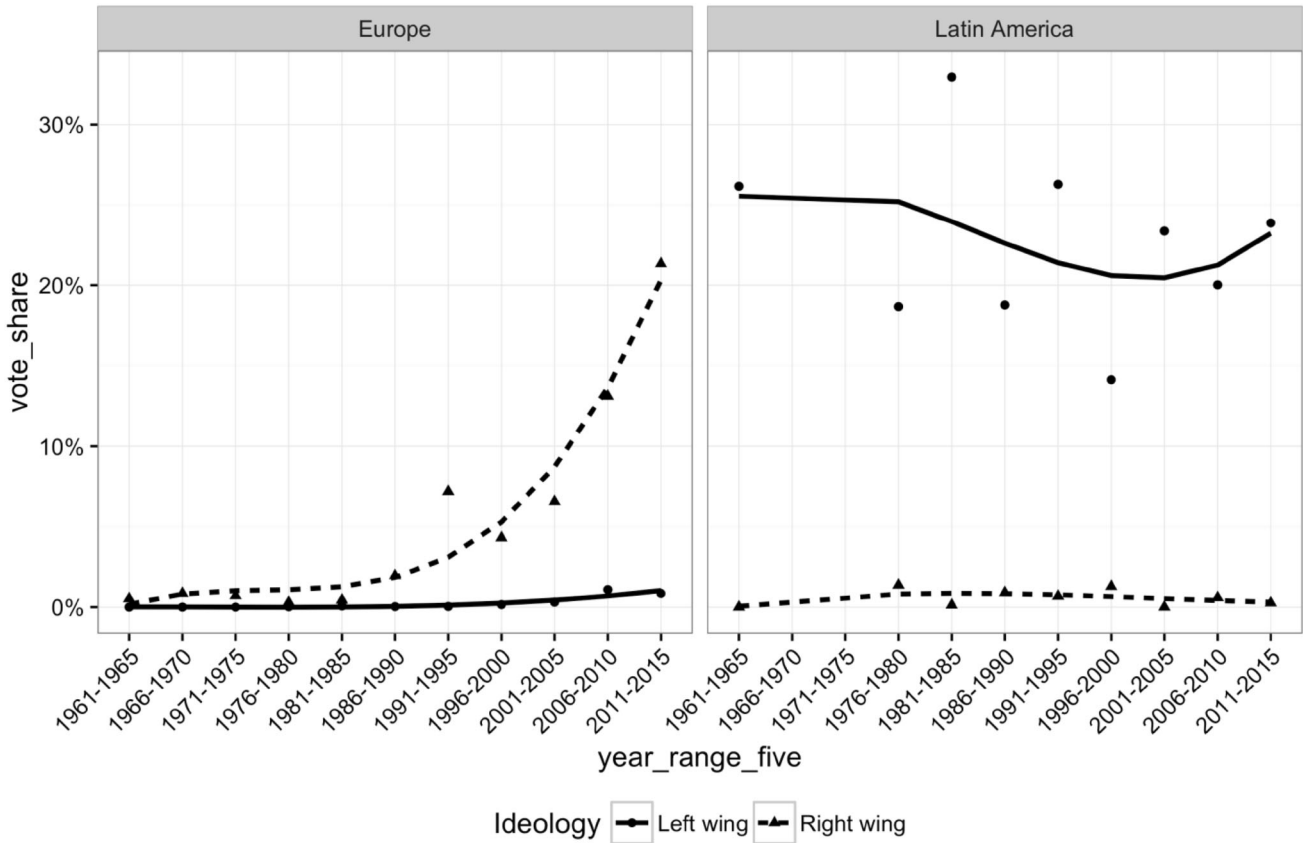
What explains the predominance of right-wing populism in Europe today, compared to the predominance of its left-wing variant in Latin America? To shed some light on this question, it helps to think of the rise of populism as the product of both demand- and supply-side factors at work.<sup>24</sup>

On the demand side, the distributional and other economic fault lines created or deepened by globalization generate potential public support for movements that position themselves outside the political mainstream and oppose established rules of the game. But the economic anxiety, discontent, loss of legitimacy, fairness concerns that are generated as a byproduct of globalization rarely come with obvious solutions or policy perspectives. They tend to be inchoate and need to be channeled in a particular programmatic direction through narratives that provide meaning and explanation to the groups in question. That is where the supply side of politics comes in. Populist movements supply the narratives required for political mobilization around common concerns. They present a story that is meant to resonate with their base, the demand side: here is what is happening, this is why, and these are the people who are doing it to you.

In Mukand & Rodrik (2017), we provide a model where political conflict can revolve around different axes. There are three different groups in society: the elite, the majority, and the minority. The elite are separated from the rest of society by their wealth. The minority is separated by particular identity markers (ethnicity, religion, immigrant status). Hence there are two cleavages: an ethno-national/cultural cleavage and an income/social class cleavage. These cleavages can be orthogonal or overlapping, producing different patterns of alliances and political outcomes.

With some simplification, we can say that populist politicians mobilize support by exploiting one or the other of these two cleavages. The “enemies of the people” are different in each case. Populist who emphasize the identity cleavage target foreigners or minorities, and this produces right-wing populism. Those who emphasize the income cleavage target the wealthy and large corporations, producing left-wing populism.

It is reasonable to suppose that the relative ease with which one or the other of these cleavages can be targeted depends on their salience in the everyday experience of voters. In particular, it may be



**Figure 4** Contrasting patterns of populism in Europe and Latin America. *Notes:* See Appendix for sources and methods.

easier to mobilize along the ethno-national/cultural cleavage when society is experiencing an influx of immigrants and refugees with dissimilar cultural and religious identities. Then economic anxiety can be channeled into opposition to these groups. Immigrants and refugees can be presented as competing for jobs, making demands on public services, and reducing public resources available for natives. Indeed, a major source of support for far-right parties in Europe has been the fear that immigration will erode welfare state benefits, a fear that is heightened in countries experiencing austerity and recession (see for example Hatton, 2016). Cavaille & Ferwerda (2017) find that support for right-wing populist parties is very responsive to perceived competition with immigrants for in-kind benefits, in their case public housing.

An important implication of this reasoning is that even when the underlying shock is fundamentally economic the political manifestations can be cultural and nativist. What may look like a racist or xenophobic backlash may have its roots in economic anxieties and dislocations.<sup>25</sup> The supply side of politics – the narrative on offer – matters a great

deal. This is a point that is often overlooked in current diagnoses. For example, it is not easy to know whether Trump’s victory represents an economic or cultural phenomenon without disentangling the demand and supply sides – the underlying grievances, on the one hand, and his narrative, on the other.<sup>26</sup>

What about Latin America? The reason that populism took a divergent path in Latin America may be related to the fact that the salient shocks associated with globalization took different forms there. Latin Americans who were affected negatively by globalization experienced it not as immigration or rule by Brussels/Frankfurt, but as rapid trade opening, financial crises, IMF programs, and entry by foreign corporations in sensitive domestic sectors such as mining or public utilities. The anger to be mobilized was against these forces and the domestic groups that supported them. This lent itself to left-wing (economic) populism rather than right-wing (cultural) populism.<sup>27</sup>

The European exceptions to right-wing populism provide further support to this argument. The two European countries that grew substantial left-wing

**Table 1** Distributive and efficiency consequences of trade liberalization: illustrative calculations

Initial tariff being removed (%)	Change in low-skill wages (A, %)	Increase in real income of economy (B, %)	Absolute value of ratio (A)/(B)
40	-19.44	4.00	4.9
30	-15.22	2.25	6.8
20	-10.61	1.00	10.6
10	-5.56	0.25	22.2
5	-2.85	0.06	45.5
3	-1.72	0.02	76.6

Notes: Column (B) is computed using the standard formula for the gains from trade (e.g., Feenstra, 2016: 220), assuming an import-GDP ratio of 25% and an import demand elasticity of  $-2$ . Column (A) is generated using a model with two factors (low- and high-skilled labor) and two goods with mobile factors, assuming the import-competing sector is low-skill-intensive. The cost shares of low- and high-skill labor in the import-competing sector are taken to be 0.80 (denoted  $\theta_l^I$ ) and 0.20 ( $\theta_h^I$ ), respectively. The factor cost shares in the exportable sector are symmetric  $-0.20$  ( $\theta_l^E$ ) and 0.80 ( $\theta_h^E$ ). To compute the change in real wages ( $\hat{\omega}_l$ ), I assume low-skilled workers spend 75 percent of their budget on the importable and 25 percent on the exportable. The corresponding derivation yields  $\hat{\omega}_l = \left\{ \left[ \theta_l^I - \theta_h^I \frac{\theta_l^E}{\theta_h^E} \right]^{-1} - 0.75 \right\} \hat{p}$ , where  $\hat{p}$  is the percent change in the relative price of the importable implied by the tariff reduction.

**Table 2** Differences in immigrations source countries: France versus Spain

Source country (only top 25 source countries included)	Host country			
	France		Spain	
	Share of migrant stock (%)	Share of home population (%)	Share of migrant stock (%)	Share of home population (%)
Predominantly Moslem	41	5	13	2
Sub-Saharan Africa	8	1	0	0
Other developing	4	0	3	0
Eastern Europe (incl. Russia)	3	0	18	3
Latin America	2	0	33	5
Developed Europe	24	3	17	2
Total of included countries	82	9	83	12

Source: World Bank bilateral migration matrix, 2013.

populist movements – Greece and Spain – bear a certain similarity to Latin America. They were major recipients of capital inflows under the European model of financial globalization, the euro. Once the sudden stop took place, their economies went into a tailspin and unemployment skyrocketed. The shock was then intensified by the presence of a common currency and austerity policies imposed from the outside – a troika made up of the IMF, the European Central Bank, and the European Commission. Although all countries in Europe were affected by the euro crisis, Greece and Spain were among the most adversely hit. Greece has yet to recover, and unemployment remains very high in both countries. All this is reminiscent of Latin American boom-and-bust cycles, going back at least to the 1970s. So it is not surprising that the financial crisis and its aftermath in Spain and Greece provided fertile ground for left-wing populists, for similar reasons.<sup>28</sup>

The relative weakness of cultural/religious cleavages to be exploited may also play a part in favoring left-wing over right-wing populist movements. In Latin America, the bulk of immigration has been from other Latin American countries or from culturally similar European countries. Within Europe, Spain and Greece once again provide instructive counter-examples. Compare the immigration experience of Spain with that of France, for example (Table 2). Even though Spain has a somewhat larger migrant stock in relation to its population, the majority of Spain's immigrants come from either Latin America or from advanced European countries.<sup>29</sup> In France, by contrast, the largest share (more than 40 percent) of migrants are from Moslem countries (Algeria, Morocco, Tunisia, Turkey) and an additional 10 percent come from Sub-Saharan Africa. A right-wing populist party (i.e., the National Front) has much more fertile ground in France than in Spain.



The US presents a mixed case, combining characteristics of both of these paths. Unlike Europe which had opened up to trade and reached a political settlement supporting it long ago – extensive safety nets in exchange for trade openness – the US experienced increased exposure to imports comparatively recently. And it did so without systematic compensation. Therefore, imports (especially from China) and trade agreements (with Mexico, Asian countries) were politically salient issues, around which large number of voters could be mobilized. The financial crisis and the differing fates of large banks versus low-income homeowners – one bailed out, the other not – engendered anger at the financial elites. At the same time, immigration from Mexico, the threat of radical Muslim terrorism, and lingering racial divides were ripe for political manipulation. In other words, the US presented ample ground for both types of cleavage. Correspondingly, the 2016 presidential elections were contested by major populist movements on both the left and the right, led by Bernie Sanders and Donald Trump, respectively.

### CONCLUDING REMARKS

One conclusion from the preceding discussion is that the simple economics of globalization is not particularly auspicious with respect to its political sustainability. This is especially true of the advanced phases of globalization – what I have called elsewhere “hyperglobalization” (Rodrik, 2011) – in which the ratio of political/distributive costs to net economic gains is particularly unfavorable. Historically, the unification of national markets has required an unequivocal political project led by a strong central executive. Nothing comparable exists globally, and the European experience provides ample reason to be skeptical that something like that can be achieved even regionally. In a world divided politically, markets face strong centrifugal forces as well.

The global economic arrangements of the immediate postwar era were built around John Maynard Keynes’ insight that sustaining a world economy reasonably hospitable to international trade and investment would require carving up space for domestic macroeconomic management. For Keynes, this meant capital controls in particular, which he viewed not as a temporary expedient but as a permanent feature of the international economic order. The same principle was followed in other domains as well. The GATT regime entailed a thin

model of trade integration, not reaching beyond direct border barriers or trade in manufactured goods among advanced economies. It left plenty of room for countries to design their own regulations and industrial policies – and indeed protect “sensitive” sectors (such as agriculture or garments).

The resulting system – variably called the Bretton Woods compromise or embedded liberalism<sup>30</sup> – was a great success. It fostered a large increase in global trade and investment and saw rapid economic development in both the advanced and developing economies. Perhaps it was too successful for its own good. By the late 1980s, policy makers and economists thought they could make it work even better by pushing for deeper economic integration. Trade agreements became more ambitious and reached beyond the border into domestic regulations. The removal of restrictions on capital mobility became the norm rather than the exception. In the process, the “embedding” or “compromise” that had made the earlier regime such a success was overlooked.

The rise of populism forces a necessary reality check. Today the big challenge facing policy makers is to rebalance globalization so as to maintain a reasonably open world economy while curbing its excesses. We need a rebalancing in three areas in particular: from capital and business to labor and the rest of society, from global governance to national governance, and from areas where overall economic gains are small to where they are large.

The benefits of globalization are distributed unevenly because our current model of globalization is built on a fundamental and corrosive asymmetry. Our trade agreements and global regulations are designed largely with the needs of capital in mind. Trade agreements are driven overwhelmingly by a business-led agenda. The implicit economic model is one of trickle-down: make investors happy and the benefits will eventually flow down to the rest of society. The interests of labor – good pay, high labor standards, employment security, voice in the workplace, bargaining rights – get little lip service. To move forward, labor must be given an equal say in setting the rules of globalization. In practical terms, this requires reconsidering which multilateral institutions set the agenda of the global conversation and who sits at the bargaining table when trade agreements are negotiated.

With respect to rebalancing governance, we should understand that the world economy does not really need global governance to be managed





appropriately. Most failures in the world economy are rooted in failures of domestic governance. In particular, restrictive trade policies are due either to complications that override the standard Ricardian argument for the gains from trade, or to domestic policy foul-ups (such as the neglect to redistribute the gains appropriately).

Society may value environmental amenities or distributional outcomes that would be undermined by free trade and it may not be possible to address those objectives through other policy instruments. A developing country may benefit from sheltering infant industries from foreign competition before they have developed some technological capabilities. In such instances, the rejection of free trade policies is not a problem, from either domestic or international perspectives. Global institutions have no business telling these countries to open up.

When the domestic policy process fails, there is a genuine problem. But the problem then lies in domestic politics – the excessive political influence perhaps of certain rent-seeking groups – and not in the absence of proper global rules. Empowering global governance in such circumstances may or may not work. Global rules sometimes can act as counterweight to protectionist interests. But it is a fortiori equally likely that the global rules will be written and administered by the very special interests that dominate domestic policy making as well. Think of the role of big banks in setting global capital standards or pharmaceutical companies in writing global patent rules.

None of this implies that there is no role at all for global governance. But in rebalancing globalization toward national governance, we must understand that the best contribution global arrangements can make is to make the nation state work better, not to weaken or constrain it. Correspondingly, the appropriate role for global institutions is to enhance key democratic norms of representation, participation, deliberation, rule of law, and transparency – without prejudging policy outcomes or requiring harmonization.

Finally, our approach to globalization must focus on areas where the net gains are large. Today the world economy is as open as it has ever been, and the most important challenge it faces is not lack of openness but lack of legitimacy. The traditional approach to trade deal-making that concentrates on exchanging market access is no longer appropriate. The rules that need to be developed are those that emphasize fairness, address concerns of

social dumping, and enhance policy space in both developed and developing nations.<sup>31</sup>

## ACKNOWLEDGEMENTS

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## NOTES

<sup>1</sup>Useful accounts, with varying definitions of populism, are provided in Kazin (1998), Judis (2016), Müller (2016), Mudde & Kaltwasser (2017).

<sup>2</sup>Judis (2016) also develops this distinction in his recent book.

<sup>3</sup>This framework can accommodate decreasing returns readily, by introducing fictional factors of production that soak up any surplus left over – effectively converting the technology to constant returns. Increasing returns are more problematic, as they would not be compatible with perfect competition.

<sup>4</sup>In earlier work, I have called this the political cost-benefit ratio (PCBR) of liberalization and presented some illustrative calculations (see Rodrik, 1994).

<sup>5</sup>It is possible for the net efficiency gains of trade to be magnified if globalization generates dynamic (or growth) effects, in addition to the static effects that conventional trade theory emphasizes. Such growth effects are often thought to make the redistributive consequences less significant. But this is not quite right since models of endogenous growth typically have ambiguous implications for the growth effects of trade liberalization. For example, the growth effects can easily turn negative when a country has (static) comparative disadvantage in the dynamic industries. In other words, dynamic effects do not as a rule magnify the gains from trade. They simply allow for larger effects in absolute terms – negative as well as positive.

<sup>6</sup>The finding that wage effects differed across localities and industries is of course inconsistent with the Stolper–Samuelson assumption that labor is fully mobile. It suggests additional margins of redistribution that Stolper–Samuelson overlooks. Hakobyan &



McLaren (2016) do document some outmigration from most affected communities, but apparently the magnitudes were not large enough to eliminate wage effects.

<sup>7</sup>Moreover, fully half of the miniscule 0.08% gain for US is not an efficiency gain, but actually a benefit due to terms-of-trade improvement. That is, Caliendo and Parro estimate that the world prices of what the US imports fell relative to what it exports. These are not efficiency gains, but income transfers from other countries (here principally Mexico and Canada). These are gains that came at the expense of other countries.

<sup>8</sup>Labor-market institutions may play an important intermediating role in the way trade shocks affect wages. Using French firm-level data, Carluccio, Fougère, & Gautier (2015) find that offshoring has adverse effects on blue-collar wages only in firms without collective bargaining agreements. In firms with frequent collective bargaining, offshoring does not seem to affect low-skill wages negatively.

<sup>9</sup>A 2012 study found the net effects of participation in TAA was actually negative for affected workers: unemployment and other benefits did not compensate for lower earnings overall, compared with non-participants (D'Amico & Schochet, 2012).

<sup>10</sup>Hicks & Devaraj (2015, 2017) estimate that 13% of the jobs lost in manufacturing during 2000–2010 were lost due to imports and import-substitution, with the rest due to domestic productivity growth. Acemoglu, Autor, Dorn, Hanson, & Price (2016) attribute 10 percent of the job losses over 2000–2007 to the China import shock.

<sup>11</sup>The use of machines to replace labor was equally controversial in an earlier era, during the early part of the nineteenth century, when the Luddite movement attacked and destroyed textile machinery. Since then, the introduction of new technology has become a regular aspect of industrial societies and does not appear to raise the kind of fairness concerns I discuss in the following paragraphs.

<sup>12</sup>The term “blocked exchange” comes from Walzer (1983) and refers to things that cannot be bought or sold because of moral stigma or legal strictures. See discussion and application to international trade in Rodrik (1997: 35–36).

<sup>13</sup>See Clark & D'Ambrosio (2015) for a survey of the literature on attitudes to income inequality, including fairness concerns.

<sup>14</sup>The previous thought experiment makes clear distinction between trade flows that suffer from this problem [scenario (3)] and those that don't [scenario (2)]. Similarly, low wages that are due to low productivity in a trade partner is different from low wages due

to the abuse of worker rights (the absence of collective bargaining, freedom of association, etc.). Both may generate distributional implications at home – but there is a problem of unfair trade only in the second case.

<sup>15</sup>Survey evidence shows that the fairness concern that motivates people is distinct from the self-interested “protectionist” aim that economists worry about. There is widespread support for safeguarding environmental and labor standards in trade, and the supporters of “fair trade” overlap, but not are identical to those who militate against job losses (Ehrlich, 2010).

<sup>16</sup>There are many other stories of how financial globalization interacts, adversely, with domestic market imperfections. In Rodrik & Subramanian (2009), for example, we explain the poor growth experience of capital-receiving countries by arguing that capital inflows aggravates appropriability problems in tradable sectors by appreciating the real exchange rate and reducing profitability of investment in tradables.

<sup>17</sup>Two earlier papers that document a negative relationship between measures of capital-account liberalization and the labor share of income are Harrison (2005) and Jadayev (2007).

<sup>18</sup>Using a “kitchen-sink” regression that includes a large number of potential determinants, Furceri et al. (2017) also find that financial openness has an effect on inequality that is commensurate with the effects of trade openness and technology.

<sup>19</sup>As Carluccio, Fougère, & Gautier (2016) argue, the wage bargaining regime itself may be endogenous to globalization shocks. Using administrative firm-level data for French firms, those authors find that positive exogenous export shocks increase the incidence of collective wage agreements, while offshoring shocks have no significant effects. The authors argue the latter finding may be due to two conflicting effects: offshoring increases firm-level productivity and profits, providing greater incentive for rent-sharing with unions, but it also reduced workers' bargaining power.

<sup>20</sup>The information on tax rates here comes from the OECD tax database (see <http://www.oecd.org/tax/tax-policy/tax-database.htm#taxBurden>).

<sup>21</sup>A number of other studies have found insignificant or contradictory results to those reported here. A meta-study that reviews two decades of empirical analysis concludes that “study characteristics related to [different] globalization measures give rise to totally different findings concerning the relationship between globalization and capital tax rates. More precisely, studies employing: (i) international trade as percent of GDP and (ii) the globalization index developed by



Quinn (1997) are more likely to report a negative impact of international market integration on capital taxation, whereas studies employing the KOF index of globalization developed by Dreher (2006) are more likely to report a positive effect of globalization on capital tax rates" (Adam, Kammas, & Lagou, 2013).

<sup>22</sup>Stanley Fischer advanced the case in favor of financial globalization in the late 1990s and advocated an amendment to the IMF's articles the purpose of which "would be to enable the Fund to promote the orderly liberalization of capital movements" (Fischer, 1997). Despite the risks of opening up to capital flows, which he enumerated, he argued that these were more than offset by the potential benefits. On the paucity of evidence on beneficial effects, he argued that the evidence in favor of capital account would cumulate over time, just as with the evidence on the benefits of trade liberalization (Fischer, 2003: 14). Rudiger Dornbusch declared capital controls "an idea whose time is past" (Dornbusch, 1998), having previously advocated financial transactions taxes a short time back (Dornbusch, 1996). Frederic Mishkin's (2006) book *The Next Great Globalization* presented a strong argument in favor of financial globalization, making a case that the benefits would materialize as long as countries undertook the requisite complementary reforms.

<sup>23</sup>See Abdelal (2007) for a fascinating account of the politics of capital-account deregulation during the 1990s.

<sup>24</sup>A similar question is posed by Aytaç & Öniş (2014), who compare the Kirchners' left-wing populism in Argentina to Erdogan's right-wing populism in Turkey. The authors link the contrasting forms of populist politics to the perceived causes of previous economic crises, varying levels of dependence on capital inflows, and the strength of organized labor.

<sup>25</sup>The empirical case for cultural determinants of populism is made by Inglehart & Norris (2016). Gidron & Hall (2017) focus on perceived social status,

and changes therein, as a determinant of right-wing populism.

<sup>26</sup>Another instance in which the supply side of politics may override the demand-side is presented in the theoretical paper by Karakas & Mitra (2017). In that paper, the outsider status of populist candidates gives them an edge over establishment candidates from either the right or the left, because the former are perceived as more likely to disrupt the status quo. Voters with left-wing preferences (e.g., traditionally Democratic voters) may then vote for a right-wing populist candidate (e.g., Donald Trump).

<sup>27</sup>The classic book on Latin American economic populism remains Dornbusch & Edwards (1991). Sachs (1990) provides a parallel account of Latin America's populist economic policy cycle.

<sup>28</sup>See also Fernández-Villaverde & Santos (2017) for an interesting argument on how the Euro realigned traditional political cleavages in Europe.

<sup>29</sup>The top Latin American source countries in Spain are Ecuador, Colombia, Peru, Bolivia, and Venezuela.

<sup>30</sup>The term "embedded liberalism" was coined by Ruggie (1982), who remains the best exponent of the regime it describes.

<sup>31</sup>For a fuller discussion of the policy implications of the approach taken in this paper, see Rodrik (2017).

<sup>32</sup>These notes are prepared with the research assistance of Michael-David Mangini. Further details on the construction of dataset and how anomalous cases were dealt with are available on request.

<sup>33</sup>Dawn Brancati, "Global Elections Database," Technical report, New York: Global Elections Database. URL <http://www.globalelectionsdatabase.com> and Ken Kollman, Allen Hicken, Daniele Caramani, David Backer, and David Lublin, *Constituency-Level Elections Archive*, technical report, Produced and distributed by Ann Arbor, MI: Center for Political Studies, University of Michigan, 2016.

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## APPENDIX: SOURCES AND METHODS ON MEASURING POPULIST PARTY STRENGTH<sup>32</sup>

**Table 3** Countries, parties, and years in the dataset

Country name	Party name	Ideology	Source	min_year	max_year
Argentina	Partido Justicialista (Peronists)	Left wing	Kaufman and Stallings	1983	2013
Argentina	Radical Civic Union (UCR)	Left wing	Cardoso and Helwege	1983	2013
Austria	Austrian Freedom Party (FPÖ)	Right wing	Swank and Betz	1962	2013
Belgium	FnB	Right wing	Swank and Betz	1978	2010
Belgium	Vlaams Bloc	Right wing	Swank and Betz	1978	2014
Bolivia	Movimiento al Socialismo	Left wing	Mudde and Kaltwasser	2002	2014
Brazil	Brazilian Labor Party	Left wing	Roberts	1945	2014
Brazil	Brazilian Labor Party	Left wing	Kaufman and Stallings	1982	2014
Ecuador	Alianza PAIS	Left wing	Panizza and Miorelli	2013	2013
Ecuador	Concentration of Popular Forces	Left wing	De la Torre	1979	2006
Ecuador	Ecuadorian Roldosist Party	Right wing	De la Torre	1984	2013
Ecuador	Institutional Renewal Party of National Action (PRIAN)	Right wing	Miscellaneous	2006	2013
Ecuador	Partido Conservador of Ecuador	Right wing	Kaufman and Stallings	1979	1998
Finland	True Finns	Right wing	Kriesi and Pappas	1983	2015
France	Front National	Right wing	Swank and Betz	1988	2012
Germany	Republicans	Right wing	Swank and Betz	1990	2013
Greece	Golden Dawn	Right wing	NYT	1961	2015
Greece	SYRIZA	Left wing	Swank and Betz	1961	2015
Hungary	Fidesz	Right wing	NYT	1990	2010
Italy	Forza Italia	Right wing	Verbeek and Roslove	1963	2006
Italy	Forza Italia/Lega Nord	Right wing	Verbeek and Roslove	1963	2006
Italy	Lega Nord	Right wing	Swank and Betz	1963	2013
Italy	Movimento Cinque Stelle	Right wing	Kriesi and Pappas	2013	2013
Netherlands	Party for Freedom (PVV)	Right wing	Akkerman et al	1963	2012
Netherlands	Socialist Party	Left wing	Akkerman et al	1963	2012
Nicaragua	Sandinistas	Left wing	Dornbush and Edwards	1990	2011
Norway	Progress Party	Right wing	Swank and Betz	1977	2013



Table 3 (Continued)

Country name	Party name	Ideology	Source	min_year	max_year
Peru	American Popular Revolutionary Alliance (ARPA)	Left wing	Kaufman and Stallings	1963	2011
Poland	Law and Justice	Right wing	NYT	1991	2015
Sweden	New Democracy	Right wing	Swank and Betz	1960	2006
Sweden	Sweden Democrats	Right wing	NYT	2010	2014
Switzerland	Freedom Party of Switzerland (Automobile)	Right wing	Swank and Betz	1963	2007
Switzerland	League of Ticinco	Right wing	Swank and Betz	1963	2015

The populism database used to construct the figures in this paper is based on the Global Elections Database (GED) and the Constituency-Level Elections Archive (CLEA).<sup>33</sup> We define populist parties loosely as those which pursue an electoral strategy of emphasizing cleavages between an in-group and an out-group. Parties are coded as populist in the dataset if they are labeled as such in the academic or journalistic literature at some point in their history and fit this definition. The full list of populist parties included in the dataset is shown in Table 3 with sources.

The data are unique by state, year, district, and ideology. For each state, year, and district, there are three ideologies possible: left-wing populist, right-wing populist, and not populist. The vote totals represent the votes received by populist parties of that ideological representation in that district. Therefore, the total number of valid votes cast in a district for one election is the sum of the votes for right-wing populist parties, the votes for left-wing populist parties, and the votes for nonpopulist parties.

In general, populist parties fell cleanly into either the left-wing or right-wing categories. Only two parties were difficult to place. The Movimento Cinque Stelle in Italy was identified as a right-wing party because of its Euroskepticism and the Civic Radical Union in Argentina was identified as left wing.

When the data provide multiple rounds of voting per election only results from the first round are used. The reasoning here is that many of the small populist parties have the most visibility early in the election cycle. Furthermore, small populist groups are often eliminated from subsequent rounds of voting so voters do not even have them as a choice in later rounds. Only lower house and presidential (where applicable) elections are included in the dataset. CLEA only maintains information on lower house elections, so to ensure comparability between the datasets the upper house elections in GED are not included. Presidential elections are included because of their prominence in Latin America.

For reasons of continuity, the GED dataset is supplemented with the CLEA dataset as infrequently as possible. Thus, if the GED and CLEA have election data for the same election, the GED data are always prioritized.

The figures in the paper show only the countries with at least one populist party in their history. The populist share in countries which have never recorded a populist party is always zero. The vote shares for these charts are calculated as the sum of the number of votes for populist parties divided by the total number of votes.

The dataset only identifies parties, not individual politicians, as populist. This could be an important limitation in Latin America, where populism is more often associated with an individual leader (usually a presidential candidate) rather than a party. We identify Latin American populist leaders with their party. Furthermore, a party is treated as populist if it has been populist at any point in its history. This creates a particular anomaly in the case of Chile. Allende, considered a populist candidate, won the presidency as the candidate of the Socialist Party of Chile. Allende was later deposed by Pinochet: twenty-seven years after Allende's candidacy Ricardo Lagos also won the presidency as the Socialist Party's candidate. Despite having represented the same party as Allende, Ricardo Lagos is not often considered a populist. We adjusted the particular case of Chile by coding the Socialist Party of Chile as populist only before Pinochet's coup.

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