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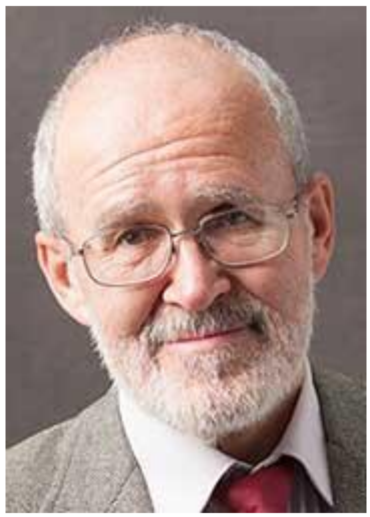
OPINION

# ‘Populist’ Macroeconomic Policy

By Vladimir Popov and Jomo Kwame Sundaram

**BERLIN and KUALA LUMPUR, Sep 22 2020 (IPS) -** ‘Ethno-populism’ has emerged and spread in recent decades in response to the mixed consequences of neoliberal globalization. It appropriates nationalist rhetoric for narrow ethnic, religious, cultural or other communal ends, typically with a chauvinist, jingoist rejection of selected Others as politically expedient.



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**Politics of macroeconomic policy**
Most elected governments in the world typically rely on the political support of coalitions among different interest groups, including classes. Hence, unsurprisingly, most political platforms involve what are essentially populist coalitions, within a political party or among several such groupings, seeking popular electoral support.

Mancur Olson’s notion of ‘distributional coalitions’ — i.e., political alliances cooperating to secure shared, complementary, not conflicting demands — presumed that such populist regimes typically have to raise enough tax revenue for redistribution in response to demands and pressures from interest groups.

Thus, fiscal mechanisms became central for such redistribution by determining not only the sources of state revenue, especially taxation, but also the beneficiaries and consequences of government expenditure.

Alleged ‘macroeconomic populism’ in Latin America has been used to explain its 1980s’ ‘lost decade’ as due to irresponsible fiscal policy. Other factors, such as abuse of the ‘non-system’ after US President Nixon ended the Bretton Woods system, are ignored in this narrative.

Thus, macroeconomic mismanagement, especially fiscal indiscipline, was blamed for the developing country debt dilemmas of the 1980s and the transitional economies' problems of the 1990s.

Retrospectively, the problems of communist party-run states were misleadingly blamed on both enterprise and national level 'soft budget constraints' (SBCs) when, in fact, these were much more pervasive during the problematic 1990s' transitions of 'post-socialist' economies.

**Coping with fiscal deficits**

Constrained by the unwillingness and inability to raise enough tax revenue, and the desire to redistribute in favour of particular interest groups to remain in power, governments are left with four options to indirectly finance subsidies.

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The first is to maintain control over particular prices, i.e., selective price controls. But controls over the prices of non-resource goods still require budgetary subsidies to companies producing the goods and services.

By contrast, price controls for fuel, energy and other resource commodities can redistribute resource rents to consumers. This option, only available to resource rich countries, thus contributes to the popular 'resource curse' story.

A second mode of subsidization, when funds are not available, is inflationary government budget financing. The government is said to cause inflation by spending beyond its (revenue) means, i.e., the tax revenue shortfall supposedly causes inflation, i.e., ostensibly 'imposing an inflation tax' on everyone.

A third option is debt financing, using either domestic or external borrowings. Debt financing buys some time to maintain subsidies, but debt servicing imposes an additional burden on the government budget to service the debt with payments for both the principal and interest.

A fourth option has been to maintain an overvalued exchange rate, effectively favouring consumers over producers, importers against exporters, and consumption at the expense of savings. Rising consumption, associated with increased imports financed by external borrowings or foreign exchange reserves, can only temporarily 'kick the can down the road', before balance of payments problems come home to roost.

There has long been a near consensus that persistent exchange rate overvaluation is detrimental for economic growth and transformation in developing countries. Needless to say, exchange rate overvaluation is favoured by governments collecting taxes in domestic currency having to service external debt in foreign currencies, and import lobbies, i.e., those earning at home and spending abroad.

## Macroeconomic populism and deficit budgets

There seem to be two ways to deal with demands for populist redistribution and to ensure macroeconomic stability. First, by eliminating demands for redistribution by reducing inequalities, especially to maintain political support for the ruling distributional coalition.

Second, those leading the ruling distributional coalition in power can redistribute income explicitly via direct subsidies, rather than indirectly. They can also try to reduce the costs of preserving political support by other means.

Research on Latin American and other countries suggests that 'transitional democracies' are less effective than either authoritarian regimes or well-established democratic regimes in resisting macroeconomic populism. Hence, some populist distributional coalitions have proved more politically stable and less wasteful than others.

Contrary to prevailing economic mythology, fiscal constraints in socialist economies were harder than in developing countries and no less hard than in most developed countries. SBCs in socialist economies were not pervasive, as widely presumed, but selective, i.e., involving subsidization of some enterprises or industries at the expense of others.

Such selective subsidization is typically part of industrial policy, whether successful or otherwise, but is neither an intrinsic feature of centrally planned socialist economies, nor of fiscal constraints. In many countries, especially in East Asia, such selective subsidies, not pervasive SBCs, have been successfully used to promote export oriented and high technology industries.

With democratization, small and well-organized lobbies, e.g., for resource and military interests, have been able to influence public policies far more successfully than the far more numerous, but typically poorly organized consumers, producers and others amorphously constituting the public interest.

The generally weak post-socialist states were generally unable to resist pressures from influential interest groups. Thus, subsidies and other policies supporting such industries and enterprises increasingly undermined the strict national fiscal constraints under socialism.

## Fiscal indiscipline myth

Thus, increasingly widespread enterprise-level SBCs engendered deficit financing, which became associated with permanent government budget deficits, debt accumulation and other macroeconomic imbalances, resulting in high inflation, in turn worsening macroeconomic instability during such transitions.

The combination of weak states and competing powerful interest groups thus caused governments to 'kick the can down the road' by accumulating deficits and debt, 'printing money' (inflationary financing), keeping domestic fuel and energy prices below world levels and maintaining an overvalued exchange rate.

Deficit spending is just one possible 'populist' macroeconomic policy. This was actually rare in socialist countries, but widespread in transition economies, especially the former Soviet republics, and also common to many developing countries, especially in Latin America and Sub-Saharan Africa.

The recent and ongoing rise and consolidation of ethno-populist regimes underscore the need for more rigorous understanding of the socio-economic bases for new distributional coalitions, the conditions enabling their emergence and sustenance, as well as their likely implications.