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WORKING PAPER

The Economic Analysis of Populism
A Selective Review of the Literature

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Summary:

Although the application of the conceptual and analytical framework of economics to the study of populism is still in its infancy, great advances have been made in recent years. This paper reviews some key contributions behind this progress. When analyzing populism, economists face two methodological hurdles: lack of consensus and clarity about its definition and reconciling the populist vote with voter rationality. The former has plagued sociologists and political scientists for decades. As to the latter, it raises a conundrum: if populist policies are detrimental to economic growth, as most economists agree, the vote for a populist candidate suggests some irrationality or inefficiency in the political markets. The works reviewed in this paper propose alternative approaches to address both issues. The most promising line of research in the economic analysis of populism draws concepts from other social sciences such political theory, sociology, history and social psychology.

Keywords: Populism, political economy, voter behavior, rationality, democracy.

JEL classification: B2, D72, D78, D83**,** H0, P47, P48.

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1. Introduction

Where the laws are not supreme, there demagogues spring up.

Aristotle, Politics, Book IV

Democracy is an abuse of statistics.

Jorge Luis Borges

Despite having been described by the ancient Greek philosophers, populism is essentially 20th century phenomenon (although many historians consider Napoleon III to be the first successful populist politician). In the 1930s right-wing populism sprang up in Germany and Austria and also in several Latin American countries, always adapted to the local culture and political situation (in Mexico it actually surfaced as left wing populism).[1] After Second World War, populism's fate diverged on both sides of the Atlantic. It disappeared in the Old World and it thrived in South America, where it became endemic in some countries such as Argentina. Since until recently, populism was confined almost exclusively to this region, it did not get much attention from economists, except with a special interest.[2] And among them it was more a subject of history than theory. Argentina's early and longstanding attachment to populism made it an object of particular interest within this sub-field of economics.

Things changed in 2016 when Brexit triumphed in the UK and Donald Trump won the presidency in the United States.[3] Since then, economists started paying increasing attention to populism, as evidenced by the number of recently published papers and articles on the subject (which still significantly lags those produced by political scientists and sociologists). Revealing this newfound interest, Nobel-prize winner Jean Tirole (2018) identified populism's reemergence as one of the most important challenges currently facing the world's advanced democracies:

[1] Hitler was the first successful populist politician of the 20th century. However, late stage Nazism was not right-wing populism but totalitarianism. See Paxton (2004), Finchelstein (2017) and Eatwell (207) for an analysis of the similarities and differences between populism and Nazi-fascism.

[2] The term "populism" is not included in any JEL Code.

[3] The populist experiences in the US and the UK are quite unique and probably compared to others in continental Europe (of both the left and right wing varieties). Trump did not get a majority of the popular vote and Brexit would not have happened without an unnecessary single majority referendum.

> Throughout the world, populist parties on both the right and left are gaining ground. Populism is hard to define because it takes many forms, but one common thread is the exacerbated eagerness to exploit the ignorance and prejudice of voters. Fanning widespread hostility to immigrants, distrusts of free trade, and xenophobia plays on people's fears. Rising populism clearly has specific causes in different countries, but anxieties about technological change and employment, the financial crises, the slowdown in economic growth, rising debt, and increasing inequality seem to be universal factors. On a purely economic level, the contempt the populist programs have for elementary economic mechanisms and even for simple public accounting is striking (pp.28-29).

Tirole believes economists have an important public role in explaining why "certain economic policies are at best useless, and at worst downright harmful." But to be effective they have to gain a deeper understanding of what populism is. It is pertinent to ask at this point in which way economic analysis can contribute to a better understanding of populism. Several questions come to mind: What are the limitations, if any, of the economic analysis of populism? Are the concepts and tools of economic theory useful to predict under what conditions populism will likely arise, what ideological bias it will take, what kind of policies it will adopt, and what consequences such policies will have? What are the determinants of the supply and demand of populism? Does populism represent an efficient outcome of political markets? Is it path-dependent?

The objective of this paper to review and summarize valuable contributions made by economists to such understanding. These contributions can be grouped into three major categories. The first comprises works written in the first half of the 20th century when the Western World first experienced a populist wave. The second group includes works that can be broadly defined as political economy, including the economic analysis of democracy, voting, social welfare, public choice and institutions. This literature –which includes seminal works of Arrow (1951), Downs (1957), Buchanan and Tullock (1962) and North (1990)– is vast and only a very small selection is included in this review. It is relevant to the study of populism because it analyzes the conditions that support a well functioning liberal democracy and those that lead to imperfections and inefficiencies in political markets. The third group

includes works that specifically analyze populism and populist policies, both at a theoretical and empirical level. This group constitutes the core of this review, which includes the most cited articles on the subject (according to RePEc's database) and several others that have received less attention but provide valuable insights.

The review is partial and reflects the author's limited knowledge and biases. In most cases, the works included were published, or are available, in English; in all cases they were written (or co-written) by economists, which by definition excludes a vast and valuable literature on populism from sociology and political science. The depth with which the works are analyzed is also entirely subjective.

The structure of the paper is as follows. Section 2, 3 and 4 review the works included in the three groups described above. Section 5 examines two key methodological issues that economists need to address to gain a better understanding of populism and develop useful theories to explain its rise and dynamics. The final section offers some conclusions.

2. First Encounters: Totalitarianism, Socialism and Democracy

The first direct encounter between the economics profession and modern populism took place in France in 1848. Frederic Bastiat not only was an economist but also a legislator in the National Assembly. In that capacity he unsuccessfully opposed the election of Napoleon III as the first president of France. Although in his writings he did not specifically analyze bonapartism or populism, Bastiat (1860) railed against redistributive politics and social orders predicated on the "outlandish" principle: "take from some to give to others" and predicted that such policies and orders would inevitably lead to "pauperism". Bastiat anticipated many important issues tackled by economists in the 20th century such as the consequences of voter ignorance and rent seeking behavior that are relevant to any analysis of populism (for a summary see Caplan and Stringham, 2005). Forty years later, the People's party (was born in the United States. Eichengreen et al (2017) have argued that although it didn't succeed in breaking up the two-party system, its emergence had lasting impact on American

politics. It also introduced the term "populism" in the Western World's political vocabulary.[4]

In the 1930s, economists again confronted populism when its right-wing variety emerged in Germany and other European countries.[5] It can be argued that Hitler was the first successful populist politician of the 20th century. In contrast to Mussolini, who rose to power thanks to an attempted *coup*, he rose to power mostly thanks to German voters.[6] In fact, the Nazi Party program of 1920 did not reject parliamentary institutions. As noted by a contemporary observer, like all demagogues, Hitler "was anxious to gain his power legally" (Neumann, 1938, p.492). However, most analyses from this period equated Nazism with Stalinism. Although it is true that in its advanced stage (which started shortly after it rose to power) the Nazi regime shared strong similarities with the latter, they were different in their origins. Nazism emerged in a democracy whereas Stalinism arose from a bloody revolution and murderous purges. What's missing from the economic analysis of Nazism from this period is how it used democracy to rise to power.[7]

Pareto's many important contributions to economic science are well known. Less so, at least among economists, are his theories of elites and social evolution (Pareto, 1916 and 1921). Including Pareto in this summary seems appropriate if only because he has been considered by many one of the ideologues of fascism, which in many ways inspired Nazism. Pareto sympathized with Mussolini because he believed he would end the corrupt plutocratic democracy that he despised (Cirillo, 1983). His theories might be considered more sociological than economic but nevertheless merit discussion.[8] In the aftermath of WWI, the social and political conditions in Italy and other European countries presaged the rise of right-wing populism. On one hand, politicians "eager to gain supporters and soothe opponents" were "all too willing to waste money by extending benefits, subsidizing prices, engaging in unnecessary public works, militarizing and tolerating disorder". On the other, citizens were "lazy

[4] Russia's Narodniks in the 1860s were the first to use the term populist to describe themselves but this was before the country had any semblance of democracy or parliamentarism.
[5] The only Nazi-fascist populist leaders in 1930s Europe were Hitler, Dolfuss (Austria) and Metaxas (Greece), who rose to power thanks to free elections. Mussolini, Franco and Salazar took power after a coup or military uprising.
[6] Although in the 1932 elections Hitler did not get a majority of the votes, the Nazi party held, by a wide margin, the largest number of seats in the Reichstag. It was Hindenburg who appointed him Chancellor.
[7] But was not missing from the analysis of sociologists and political scientists (see for example, Neumann, 1938 and Neumann, 1942).
[8] Pareto's sociological theory encompasses four volumes and more than a thousand pages which make it impossible to condense in a few paragraphs.

and insubordinate" and made "excessive requests that cannot be satisfied" (Pareto, 1921). He could have been describing the supply and demand of populism. In fact, Pareto anticipated it. "The popular classes are currently more powerful than the well to do. For this reason the bourgeois state is tottering… Plutocracy is weakening and demagogy is growing stronger".

With respect to human behavior, Pareto made two key assumptions. First, for the most part, it is non-rational and cannot be understood within the context of traditional economic models. Second, it is motivated by sentiments, which cannot be observed directly and change cyclically over time. What mattered, in his view, were aggregate and elite sentiments. Social order behaved cyclically reflecting the conflict of centripetal (concentration of power) and centrifugal forces (erosion of power), which in turn reflected the ebb and flow of such sentiments. Only elites could change the course of history. Two types of elites exist in Pareto's theory: governing and non-governing. The former was divided into two sub-types: one preferred to rule primarily through consensus (parliamentarism) and the other primarily through the use of force (militarism). Representative democracy inevitable gave way to a plutocracy dominated by one or the other elite in a cyclical manner (Pareto called this process the "Plutocratic Cycle"). Under a parliamentary system, wealthy speculators and wage earners (particularly factory workers) allied themselves to impose a "demagogic plutocracy" that ruled "through cunning or by making promises to the masses… those who do not pay taxes are allowed to impose taxes on others" (basically, populism). Pareto considered this system the most insidious form of government, as it was more concerned with appropriating and redistributing existing resources than with creating new wealth, and because it held power by manipulating "the sentiments of the masses". Over time, an inevitable economic stagnation and a social reaction would lead to an elite change and a military plutocracy would emerge. Parliamentarism would give way to force to impose social control. This is why Pareto is said to have forecast the rise of fascism. In reality, he predicted that democracy would oscillate cyclically between militarism and left wing populism.[9] In his view, democracy was an "illusion", nothing more than "an indeterminate and transitory" condition.

[9] Seems like a good approximation to Latin American political cycles in the second half of the 20th century

Schumpeter was as skeptical as Pareto about democracy and as convinced of the importance of elites. In *Capitalism, Socialism and Democracy* (1942), he introduced several ideas that are relevant to the analysis of populism. The main focus of the book, however, was to analyze whether socialism would inevitably replace capitalism and whether it was compatible with democracy. Schumpeter answered affirmatively to both questions. In his view, capitalism would be a victim of its own success. And the agents of its destruction were not the demagogues but the intellectuals such as Lenin who goaded the masses into revolt.

> The masses have not always felt themselves to be frustrated and exploited. But the intellectuals that formulated their views for them have always told them that they were, without necessarily meaning by it anything precise.

Schumpeter also proposed a theory of democracy that rested on two major assumptions. First, voters are irrational: the average voter "expends less disciplined effort on mastering a political problem than he expends on a game of bridge (p.261)." and tends "to yield to extra-rational or irrational prejudice and impulse (p.262)." To understand human nature in politics, Schumpeter recommended reading the works of Freud (1922) and Le Bon (1896). Second, the "will of the people" is a chimera that the will of the majority could never represent. It is the "product and not the motive power of the political process." In Schumpeter's view, democracy is simply an "institutional arrangement for arriving at political decisions in which individuals acquire the power to decide by means of a competitive struggle for the people's vote (p.269)". In other words, it is a mechanism to ensure competition for political leadership. Although Schumpeter never addressed populism or demagogy in his book, he emphasized that for an "active hostility" against a social order to exist, it was necessary "that there be groups to whose interest it is to work up and organize resentment, to nurse it, to voice it and to lead it (p.145)." So, in Schumpeter's theory it wasn't demagogues who played the key role in overturning capitalism, but intellectuals and special interest groups. Surprisingly, Schumpeter devoted very few words to Nazi-fascism. He must have believed it posed no real threat to capitalism despite the evidence to the contrary. Within his theory of democracy, fascism was a political method of monopolistic leadership (distinct from Stalinism which was a military autocracy). Schumpeter believed that if socialism prevailed in the United

States, it would likely present "fascist features". He also believed that exalting "national unity into a moral precept spells acceptance of one of the most important principles of fascism (p.352)." The same could be said about populism.

Almost forty years later, Paul Samuelson, who was his student at Harvard, argued that although Schumpeter was wrong in his belief that capitalism is economically stable but politically unstable, he was right in believing that populist democracy would alter the nature of the market economy. This is odd given that Schumpeter never used the term "populist democracy" or indirectly refer to populism in his book. Samuelson went on to propose his own theory of populism:

> The same gasoline that classical economists thought ran the laissez faire system, namely self-interest, will in the context of democracy lead to use of the state to achieve the interest of particular groups. It is a theorem of von Neumman's theory of games that this should be the case. Long before Marx, John Adams and Thomas Macaulay warned that giving votes to all would mean that the poorest 51 percent of the population would use their power to reduce the affluence of the richest 49 percent. Stagflation, upon which I could write a very long book, is one important manifestation of what is implied in this fundamental diagnosis (1981, p.43).

Even more interesting was the conclusion that Samuelson derived from Schumpeter's prediction about the demise of capitalism: "If you want to read the shape of things to come, perhaps your should turn your gaze from Scandinavia and toward Argentina (p.44)".

Hayek (1944) took a radically different point of view. First, he didn't believe socialism (including national-socialism) was compatible with liberal democracy. Second, he predicted socialism (loss of economic freedom) gradually but inevitably led to totalitarianism (loss of political freedom). In other words, the end of capitalism would mean the end of liberal democracy. As was common in that era, Hayek equated Nazi-fascism and Communism. Both conclusions were in great measure the consequence of an essential feature of totalitarian systems: the concentration of power in the hands of people who are the most likely to abuse it. This feature, in turn, resulted from the simultaneous action of three "negative selection factors". First, unanimity of values and beliefs can only be sustained by appealing to the lowest

common denominator. “The largest group of people whose values are very similar are the people with low standards,” explained Hayek. Secondly, sycophancy and loyalty to the leader are also more likely in this group of people: “those whose vague and imperfectly formed ideas are easily swayed and whose passions and emotions are readily aroused who will thus swell the ranks of the totalitarian party.” Third, and more importantly according to Hayek (and I would add particularly and directly relevant to the contemporary analysis of populism):

> It seems to be almost a law of human nature that it is easier for people to agree on a negative programme, on the hatred of an enemy, on the envy of those better off, than on any positive task. The contrast between the ‘we’ and the ‘they’, the common fight against those outside the group, seems to be an essential ingredient in any creed which will solidly knit together a group for common action. It is consequently always employed by those who seek, not merely support of a policy, but the unreserved allegiance of huge masses. From their point of view it has the great advantage of leaving them greater freedom of action than almost any positive programme. The enemy, whether he be internal like the ‘Jew’ or the ‘*Kulak’*, or external, seems to be an indispensable requisite in the armoury of a totalitarian leader (p.143).

This “we versus they”, “friend versus enemy”, “good versus bad” Manichean dichotomy is the essence of populist discourse (see Laclau, 2005). Also, the three negative selection factors described by Hayek also operate in populist regimes of any ideology. In fact, as Hayek pointed out, the last one resulted from “the deliberate effort of the skillful demagogue” seeking “to weld together a closely coherent and homogeneous body of supporters.” When the least principled and least ethical individuals rise to the highest echelons of government, the consequences are predictable: corruption, economic inefficiency, abuse of power and loss of individual freedom. The evidence shows that in populist regimes, there is comorbidity of kakistocracy (government of incompetent) and kleptocracy (government of the corrupt). Also and more importantly, as the Venezuelan experience shows, the road to serfdom (and poverty) can also be paved by populism.

3. Democracy and Institutions

The analysis of democracy has been a main focus of political economists since at least the beginning of the 20th century when it started to extend over most of the Western World. With a few exceptions most of the seminal works in this field were written after the Second World War. None of these works however even mentions populism. Probably because their authors never imagined that its emergence was a realistic possibility in advanced democracies. The works included in this section can be divided into four subgroups. The first analyzed the conditions under which liberal democracy worked. The second studied how the interaction of voters, politicians, bureaucrats and public officials in a democracy lead to collective decisions that lead to sub-optimal results from an economic standpoint (e.g., clientelism, pandering, rent-seeking behavior, corruption, crony capitalism, etc.). These inefficiencies or "pathologies" of government or democracy do not necessarily imply the existence of populism, but when combined with other features (such as an Manichean political discourse and institutional degradation) usually characterize it. The third subgroup explores under what circumstances income and wealth redistribution are most likely to arise in a democracy while the fourth examined what institutional setting is more favorable to sustained economic growth.

4.1 Economic Analysis of Democracy and Voting

The publication of Kenneth Arrow's seminal articles on social choice and individual values (1950 and 1951) marked a major turning point in the economic analysis of democracy. To put it succinctly, Arrow demonstrated that no voting system that can consistently convert ranked individual preferences into a ranked aggregate preference. As political scientist William Riker pointed out, the conclusions of Arrow's "impossibility theorem" are devastating for any justification of populism.[10] First, they consigned democratic outcomes and hence the democratic method to the world of "arbitrary nonsense" (Schumpeter would have agreed). Second, they undermined the logical foundations of populism: the view that in a democracy the vote of the majority expresses "the will of the people" (Riker, 1982).[11]

[10] Riker was not an economist but a political scientist but he applied both mathematics and game theory to the analysis of political problems.
[11] This conclusion remains valid irrespective of citizen preferences (Ingham, 2018).

Romer (1996) analyzed the political economy of entitlements and developed a model in which anger, punishment and revenge drove the decision to vote. Maskin and Tirole (2004) developed a model with rational voters that captured the advantages and disadvantages of making legislators, bureaucrats and government officials accountable through reelection. To model is used to predict when decision-making powers should be allocated to the public directly (direct democracy), to politicians (representative democracy) or to non-accountable judges (judicial power). The model has two periods and assumes voters are rational, have homogeneous preferences but limited information. Importantly however, they can learn. In each period they have to choose between two policies: A and B. They can do it directly (direct democracy) or delegating the decision to a politician that knows which policy is the best (representative democracy). Politicians are driven by two motivations. First, they want to leave a *legacy,* i.e., be remembered for having done great things. Second, they like power. When the first motivation dominates it denotes statesmanship, if the second dominates it denotes opportunism. Politicians' preferences can be congruent or incongruent with those of the representative voter. Although voters ignore if politicians are congruent they make them accountable with regular reelections. This can induce a non-congruent politician to act in the public interest and "weed out" non-congruent public officials. However, reelection may induce a politician may choose a policy, not because it is "right" for society, but because it is popular with voters (who ignore its consequences). In other words, she may pander to public opinion, which is exactly what populist politicians do (however, not all pandering denotes populism). Such behavior would conflict with the rationale for a representative democracy (i.e. representatives can make better decisions than ordinary citizens). Maskin and Tirole emphasize another important point relevant to populism: if minority rights are a concern, the ability to remove officials from office through reelections (even if they are congruent) may give the majority too much power. In theory, both concerns are mitigated by a republican constitution. Maskin and Tirole show that under certain conditions (such as no feedback to voters after period 1), pandering is the equilibrium solution in a representative democracy.[12] It is important to note however that pandering is a necessary but not sufficient condition for the existence of populism (see Section 6).

[12] In his recent book, Tirole doesn't seem to agree with this conclusion.

4.2 Public Choice and Democracy's Pathologies

Another important turning point in the economic analysis of democracy and public policy was the emergence of the school of Public Choice (Downs, 1957; Buchanan and Tullock, 1962; Olson, 1965). Influenced by Wicksell's work on public finance, economists enrolled in this school applied the assumptions of neoclassical microeconomics to the analysis of political decisions and collective action problems. An important conclusion of their analysis is that politicians and public officials are not loyal public servants only concerned with the public welfare and the satisfaction of people's will but rational individuals that seek to maximize their own utility and satisfice their own interests (1957b). A populist leader is an extreme case of an opportunistic politician intent on satisfying his or her own ambition at any cost.

Downs (1957a) proposed the hypothesis that voters are not irrational but rationally ignorant. As Schumpeter had already pointed out, the majority of citizens don't have the time or willingness to educate themselves about the details of the candidates' platforms. Instead they delegate that job to the experts. Insofar their vote is not decisive, their incentive to educate themselves politically or seek information about a politician's proposals will be minimal. In general, the position of Public Choice economists is that inefficient outcomes in the political market are the result of agency problems or asymmetric information and not due to voter irrationality.

Olson (1965) demonstrated the inappropriateness of extending predictions of individual rational behavior to the behavior of groups made of rational individuals. Smaller groups with homogeneous member interests tend to be more effective than larger heterogeneous groups. Concentrated benefits and highly distributed costs create strong incentives for groups to influence public policy. This has important implications in the political arena, not only with respect to lobbying activities but also to crony capitalism more generally, which is typical feature of populist regimes. Following the pioneering contributions of Tullock (1967) and Krueger (1974), the rent-seeking literature expanded rapidly. Murphy, Shleifer and Vishny (1993) posited the hypothesis that private and public rent-seeking behavior is highly detrimental to economic growth because it has increasing returns (making it more attractive than producing activities) and it stifles innovation. They also made two other important points: a) an economy can be stuck in a "bad" equilibrium in which rent seeking is

high and output is low and only a radical reform can move into a "good" equilibrium, and b) an economy in a good equilibrium can slide into a bad equilibrium as result of a war, a coup or social unrest that reduces productivity and undermines property rights. Acemoglu and Robinson (2006) developed a theory that posits that elites may oppose superior institutions and technologies because their adoption may reduce their political power, which could partly explain why underdeveloped countries can get stuck with populist regimes.

Barro (1973) developed a political agency model that showed that regular elections are an appropriate incentive device for disciplining self-interested politicians (i.e., would prevent populist from gaining power). Nordhaus (1975) contradicted this thesis with a model in which voters are shortsighted and ignorant and government officials driven only by their prospects for reelection. Basically, politicians played along the Philips Curve. In some respects, Nordhaus' model of political business cycle can be considered a precursor of modern theories of populist cycles. Maskin and Tirole (2014) developed a model of pork-barrel politics in which a politician tries to improve her re-election chances by directing public spending to targeted interest groups. Such targeting signals that she shares their concerns. Again, this is what populist politicians typically do. In this case, any rational voter motivated by his self-interest would reelect a politician who would benefit him through some kind of transfer. The underlying assumption is that the electorate doesn't know which are the politician's preferences with respect to pork barrel expenditures. Politicians thus have an incentive to send a signal to voters that they care about their interest. Maskin and Tirole conclude that pandering worsens the fiscal deficit if either the politician's overall spending propensity is known, or if it is unknown but the effect of spending on the deficit is opaque to voters. By contrast, if there is enough deficit transparency an unknown spending propensity may induce a politician to exhibit fiscal discipline.

4.3 Democracy and Income Redistribution

Income redistribution does not imply populism but populism always entails some form of income or wealth redistribution.[13] Focusing on voters rather than politicians, the so-called "Director's Law" enunciated by Stigler (1970) states that the rise of

[13] Even right wing populist movements resort to redistribution by confiscating the resources of ethnic or religious minorities considered to be the "enemies of the people".

public spending (which implies income redistribution) benefits mostly the middle class and is paid for by the rest of society. Starting from the fact that in most advanced democracies the middle class is the single largest voting block and dominant interest group, Stigler argued that it exerted its electoral influence to maximize the benefits it received from government at the lowest costs. Following Stigler's idea, Dixit and Londregan (1998) developed a model that explains how the ideological motive for redistribution mixes with the tactical and political motives to determine tax and transfer policies. Feld and Schnellenbach (2007) argued that Stigler's theoretical framework cannot explain the growth in public spending in the developed world. In other words, it is not entirely consistent with Director's Law. They argue that a more precise enunciation of this law would be that in modern democracies, in which taxes and spending can be directed to specific interest groups, middle and lower income voters sometimes coalesce to fiscally exploit high-income voters.

Romer (1975) and Meltzer and Richard (1981) posited the hypothesis that a widening gap between the income level of median and average voters (a measure of inequality), will lead to higher taxes and income redistribution, This would seem obvious: against an increase in inequality politicians will respond raising taxes paid by the rich (who are an electoral minority) and redistributing the proceeds to the majority. A corollary of this theory is that in a democracy inequality will tend to go down. This has not been the case of the US, at least since the 1980s. In fact, the opposite has actually happened and several theories have been proposed to explain why (Acemoglu, Naidu and Robinson, 2013). The evidence from OECD countries suggests that when the middle class feels it is farther away from the rich it forges an alliance with the poor to vote in favor of redistribution (Lupu and Pontusson, 2011).

Becker (1983) developed a theory of income redistribution that builds on the competition among pressure groups for political favors. In his model, political equilibrium depends on the efficiency of each group in generating pressure, the effect of additional pressure on their influence, the number of persons in different groups, and the deadweight cost of taxes and subsidies. An increase in the latter discourages pressure by subsidized groups and encourages pressure by taxpayers. In Becker's model governments correct market failures and favor the politically powerful.

Interestingly, in this paper Becker seemed to question the assumptions of rational choice model in politics when he stated that voter preference are not independent and can be manipulated "by interested pressure groups" (p.392).

Alesina and Rodrik (1994) hint at populism with a model that links political systems with distribution of income and wealth. Their model predicts that democracies with high levels of inequality should exhibit lower growth, technocratic dictatorships would show higher growth, independently of inequality whereas "populist" non-democratic governments would implement redistribution and experience lower growth. Despite this reference, the authors do not define what a populist government is but that they associate it with lack of democracy, which is inaccurate. McGuire and Olson (1996) argued that in a democratic setting a super-encompassing majority, even when it thinks only of itself and has no concern for the losses of minorities, will abstain from redistribution and will treat minorities as well as it treats itself. In essence their model suggests the impossibility of extreme forms of populism in advanced democracies. Reality suggests otherwise.

Alesina and Angeletos (2005) postulate that different beliefs about fairness and income inequality influence redistributive and tax policies. If a majority of voters believes that individual effort determines income, and that all have a right to enjoy the fruits of their effort, it will choose low redistribution and low taxes. In equilibrium, effort will be high and the role of luck will be limited, in which case market outcomes will be relatively fair and social beliefs will be self-fulfilled. On the other hand, a society in which a majority believes that luck, birth, connections, and/or corruption determine wealth, will levy high taxes, thus distorting allocations and making these beliefs self-sustained as well. The latter situation tends to be typical of countries in which populism is endemic, which suggests that culture has a strong influence.

These explanations of the dynamics of redistribution in a democracy are relevant to any analysis of populism. The evidence suggests that a persistent relative stagnation of middle class income (vis-à-vis high income voters) will almost likely lead to some form of populist redistribution. However, it is important to emphasize that income redistribution does not necessarily imply populism (although populism always implies some form of income or wealth redistribution).

4.4 Institutions and Economic Growth

As Aristotle, Polybius, Cicero and many others pointed out, populism always requires institutional degradation, i.e., it is a choice to deinstitutionalize. The relationship between institutional quality and economic growth postulated by NIE economists reinforces the notion that populism is antithetic with long-term sustainable growth. The institutional approach as articulated by North (1993, 1994 and 2010) provides valuable insights to the analysis of populism. North rejects the rationality assumption in political markets. In his framework, ideologies and institutions are created and provide closely shared perceptions and ordering of the environment. Ideas matter and the way by which they evolve and are communicated is key to understanding how societies are structured and evolve. Economic performance is a consequence of the institutional framework, which in turn is a function of the shared mental models and ideologies that prevail in society. The process of learning creates path-dependence in ideas, ideologies and consequently also in institutions (North and Denzau, 1994). This emphasis on values and beliefs ties in with the literature that emphasizes the link between culture (or social capital) and economic growth (for a summary see Guiso, Sapienza and Zingales, 2010).

These considerations are very relevant to the analysis of populism. First, populism implies a sub-optimal institutional choice, which basically suggests the existence of impediments in the collective learning process (or some kind of collective amnesia). The populist narrative proposes a cognitive model, by confusing cause and effect, impairs learning. If the populist narrative prevails, it leads to the adoption of not only of policies but also institutions that are detrimental to economic growth. Under certain circumstances, the resulting stagnation and/or crisis makes populism even more attractive, because in the populist model it is the consequence of other factors (for example, a conspiracy by Wall Street bankers or the IMF). This may explain why in certain societies like Argentina populism is endemic. For obvious reasons, populist politicians have a strong interest in promoting the "wrong" model (ideology) to interpret reality. This is one of the reasons why once in power they give so much importance to control of the media. If populism is an imperfection (or failure) of a society's "cultural" learning process, explaining its origin requires understanding: a) how certain values and beliefs that hamper that process became predominant in the

electorate, and b) in which way they filter the impact of social, demographic and/or economic the exogenous shocks that eventually generate frustration.

Acemoglu, Johnson and Robinson (2005) and Acemoglu and Robinson (2012) posit that the evolution of a society's institutional evolution results from the interaction of interest groups, critical junctures and drift. Inclusive institutions –both political and economic– lead to economic growth. According to their theory, political institutions dominate, i.e., democracy is a prerequisite for sustained long-term growth. This conclusion has been challenged on both theoretical and empirical grounds. Glaeser, La Porta, López-Silanes and Shleifer (2004) argued that growth and education actually lead to the establishment of democracy. The Argentine experience since the middle of the 20th century seems to refute both arguments: an educated society that chose to degrade its democracy and its economy by embracing populism. From a different perspective, Caplan's theory of voter's rational irrationality also challenges Acemoglu and Robinson's thesis as there is no guarantee that voting will lead to good economic policies.

Acemoglu, Robinson and Verdier (2004) developed a model to explain why many developing countries fall under regimes that expropriate private resources (or misappropriate public ones) and adopt policies that are highly inefficient in order to enrich themselves and remain in power. Kleptocracy has been an enduring characteristic of populist regimes in Latin America. Robinson, Torvik and Verdier (2006) studied the link between institutions and the natural resource curse. Their model predicts that at times of resource booms, incumbents will have an incentive to pursue populist policies to increase their chances of re-election. Whether they succeed or not is determined by the quality of the country's institutions. However, this model does not contemplate the hypothesis that populism a) essentially implies an institutional degradation, and b) seems to be an endogenous response to a boom in prices. Robinson and Verdier (2013) analyzed the political economy of clientelism. Their model provides an explanation for why much income redistribution takes an inefficient form, particularly employment in the public sector. A job is a credible way of redistributing when it provides rents (such as in situations with moral hazard), and employment is optimal *ex post*. Moreover, a job is selective and reversible, and thus ties the continuation utility of a voter to the political success of a particular politician.

Robinson and Verdier show that the need to make offers of employment incentive-compatible leads to inefficiencies in the supply of public goods. They also show that such redistribution becomes relatively attractive in situations with high inequality and low productivity (as it is the case in many developing countries). Inefficiency is increased when the stakes from politics are high, when inequality is high, and when money matters less than ideology in politics. Again, these are very relevant considerations to any analysis of populism, particularly the variety predominant in Latin America.

4. The Economic Analysis of Populism

This section reviews works by economists that specifically analyzed populism and populists policies. The section is divided into two broad subsections: a) generic theoretical analysis of populism and b) theoretical and empirical studies that focus on a specific country or region. The first subsection is divided into two subcategories: the first includes works that assume voters are rational (Neoclassical) and the second that they are not (Behavioral). The second subsection is in turn divided into three subcategories: a) Argentina, b) Latin America and other developing regions, c) Europe and the US.

4.1 Neoclassical

Following the approach taken by Romer (1996) and Rabin's model of reciprocal altruism (1993), Glaeser (2004) developed a model of supply and demand of hatred. In other words, he explained how opportunistic politicians promote hatred (or resentment) towards certain ethnic or religious minorities and why this narrative results convincing to a majority of the electorate. Glaeser used this conceptual framework to analyze the evolution of anti-black hatred in the United States South, episodes of anti-Semitism in Europe, and the recent surge of anti-Americanism in the Arab world. Glaeser points out that, at group level, most inter-personal hatred is based on personal experience, but inter-group hatred is generally based on narratives about the supposed crimes of the hated group. In Glaeser's model, false narratives prevail with rational voters when those voters have little incentive to learn the truth behind them. Basically, the politician acts as an entrepreneur that promotes a narrative of resentment and the voter as a consumer that can buy such narrative. When minorities

are very different along a politically relevant dimension (e.g., their income levels, ethnics or religion), an opportunistic politician has a strong incentive to propose a narrative that generates resentment against them. Voter predisposition to believe this narrative is a function of the costs and benefits of acquiring information (education). Costs then to be lower for educated people. The model predicts that, *caeteris paribus*, a narrative of hatred will be more convincing in the less educated segments of society. Another important conclusion is that hatred only affects the voting intentions of the middles class. High-income voters will always vote for a politician that opposes income redistribution and lower income voters will do the opposite. Middle-income voters will shift from one side to another depending on the minority that is made the target of the hatred narrative. It is likely that left wing candidates will promote hatred towards the rich minority while right wing candidates will do so against ethnic or religious minorities. Although some of these conclusions are obvious, Glaeser's model confirms them rigorously. Despite its usefulness, his approach seems reductionistic. Voter predisposition towards a narrative of hatred seems to be more a function of predominant cultural values than a cost benefit analysis. Since hatred (or resentment) is a critical ingredient of the populist politician's discourse that gets him or her a majority of the votes, Glaeser's theory of hatred is in essence also a theory of populism, although the word populism does not appear in his paper.

Drawing on earlier literature on lobbying, Campante and Ferreira (2007) built a model of lobbying with imperfect commitment that explains how lobbying leads to inefficient outcomes. The model confirms the intuition that lobbyists are those who find it most worthwhile to spend their resources in that activity, rather than in production. Their success in shifting government behavior away from the optimal is likely to benefit inefficient sectors. They also conclude that if lobbies representing "the poor" and "the rich" have identical organizational capacities, equilibrium is biased towards the former, who have a comparative advantage in politics in relation to productive activities. However, pressure groups differ in their organizational capacity, both pro-rich (oligarchic) and pro-poor (populist) equilibria may arise, all of which are inefficient with respect to the constrained optimum. In Campante and Ferreira's model, populism is very narrowly defined as redistribution of public resources to lower income groups.

Based on the model accountability built by Maskin and Tirole (2004), Binswanger and Prüfer (2009) developed a model of policy choices that shows under what conditions populism is an equilibrium solution. In this model, voters and politicians play a political game over two periods in which the adoption of populist policies is a function of the level of sophistication of voter beliefs. Voters are perfectly rational. Every voter is endowed with an opinion about which policy maximizes his expected utility. Although voters' opinions may be heterogeneous, the policy that maximizes voters' utility is identical for all voters. In addition, voters are also endowed with a belief about the strategic behavior of politicians, i.e. how they set a certain policy based on their information. Rationality depends on the level of voter sophistication, which is implied by the order *k* of what they call level-*k* beliefs (voter rationality goes from bounded to full depending on the level of *k*). There are two types of politicians: competent and incompetent. Both receive a signal indicating which policy is optimal: the competent type's *ex ante* perfectly reveals the optimal policy, whereas the incompetent type's is noisy. Based on these signals, the strategy that maximizes voters' utility is to elect a politician for period 2 who is perceived as competent. To get reelected, politicians have an incentive to pander to the median voter's opinion. However, a noisy signal before the election reduces such incentive. Voters use these signals to form a "posterior opinion" to evaluate an incumbent's competence using Bayes' rule. Being better informed, a competent politician is more successful at anticipating the median voter's posterior opinion and hence faces a higher probability of being reelected. According to the model, the level of k determines whether a politician will adopt populist policies. For a finite *k*, a separating equilibrium occurs in which competent and incompetent politicians implement different policies. This equilibrium is characterized by only partial populism in that both the politician's signal and the median voter's opinion have a positive weight in affecting the policy choice. Limited strategic sophistication of voters weakens politicians' incentive to pander to public opinion because politicians know that voters expect them to pander less than fully. Thus, pandering is limited even if politicians are exclusively office-motivated and do not care about voters' welfare. In contrast, for an infinite level of *k*, a pooling equilibrium results in which both types of politician implement populist policies. In this case the results are exclusively determined by the median voter's prior opinion about the optimal policy and do not depend on the incumbent politician's signal at all.

Also building on Maskin and Tirole (2004), Fernández (2015) developed a model of rational populism in which the decision to vote for an opportunistic politician is rational in a scenario of uncertainty and asymmetric information.[14] In this model a populist politician is prepared to propose any "popular" measure to be elected (or reelected), even when he or she knows that such measure will be detrimental to overall welfare. As in Maskin and Tirole's model, a politician's preferences can be congruent or incongruent with the electorate. A politician is "impenitent" if the electorate doesn't punish her and she gets reelected for a second period. A successful populist leader would be the typical opportunistic and impenitent politician. In Fernandez' model, voters are rational but have limited information. They don't punish populist politicians because they don't know enough at the time of the election. In contrast to Maskin and Tirole, Fernandez doesn't incorporate learning by voters. As mentioned earlier, failure to learn is a sign of irrationality, particularly if mistakes are costly and recurring evidence is available. This seems particularly relevant in the case of Argentina, where populism has dominated elections for the last seventy years. Based on his model, Fernández proposes several conclusions: 1) populist policies are not the result of politician's ignorance, 2) populism does not necessarily arise out of voter insatisfaction or their need for a hegemonic redemptive leader, 3) the preservation of populism requires the absence of a solid institutional system that facilitates the impunity of opportunist politicians (lack of accountability), 4) it is more reasonable to assume that opportunistic politicians will always exist and that their aspiration to become a "hegemonic leader" but simply an ambition to win reelection and remain in power, 5) an essential part of a better control of opportunistic politicians is term mandates and accountability *a la* Maskin and Tirole to dismiss incongruent politicians, 6) absence of a suitable informative regime (transparency), managerial audits, an independent judiciary, federalism and restraints on opportunistic behavior by politicians favor the rise of populism. Many of these deficiencies are, according to Fernández, not the result of the lack of institutional development, but instead result from the destruction of pre-existing institutions in the hands of populist politicians (as in the case of Argentina). Given Fernández' vast experience as a public official and interaction with populist politicians over several decades, these insights deserve serious consideration. However, his dismissal of the importance of culture

[14] This work was published in Spanish.

and beliefs and the "frustration gap" (see section 6 for a definition of this term) as factors that facilitate the rise of populism don't seem to square with the evidence.

Dovis, Golosov and Shourideh (2016) developed a neoclassical model to analyze the interaction between external borrowing and redistributive policies in an open economy without commitment. Using a tractable heterogeneous-agent overlapping generations framework where government's redistributive motives determine fiscal policies, they study a repeated game between the government, households, and foreign creditors. The key insight of this model is that the current and future governments disagree on the composition of inequality and external debt, and that this disagreement gives rise to cyclical dynamics. The current government prefers to finance any given level of current consumption with a higher level of debt and lower inequality than the future government does. The reason is that delivering a unit of consumption via borrowing is cheaper than via production, since it does not incur the disutility of effort (as well as inequality in consumption and leisure). The future government, however, prefers that consumption be financed with lower debt and higher inequality. This is because the future government does not incur the leisure cost of production and the cost of inequality of consumption and leisure. The authors conclude that populist cycles, as described by Dornbusch and Edwards (1991a, 1991b), can arise endogenously in such settings due to inequality and weak institutions. Their model is useful to understand the dynamics of such cycles in Latin America since the 1970s and Southern Europe since the 2008 global financial crisis. However, the definition of populism adopted by Dovis, Golosov and Shourideh is too narrow to extend their model's conclusions to other countries/regions or to understand other varieties of populism.

Prato and Wolton (2018) analyze how voters' demand for economic reforms influences the success of populist candidates. They describe a form of "rational populism" that is a function of politicians' electoral incentives. The model rests on two key assumptions. First, voters are rational but poorly informed and not able to distinguish "good" from "bad" policy reform, i.e. they are rationally ignorant. The electorate has a demand for reform proportional to the gain expected from a successfully implemented reform relative to the status quo. This demand can be due to variety of exogenous factors (for example an oil shock or a global financial crisis),

i.e. due to a widening frustration gap. Politicians can be defined along two dimensions: competence and attitude towards the status quo. Only competent politicians can carry out beneficial reforms; incompetent candidates always implement botched reforms, which produce worse outcomes than the status quo for the electorate. Voters pay close attention to the campaign to discover whether a candidate's platform proposes a reformist platform or favors the status. However, even if they learn that a candidate is reformist, they cannot tell whether she is competent. This prevents them from anticipating the probability that reforms, if enacted, will be successful. In this model, a populist candidate is simply an incompetent opportunistic politician that proposes reforms despite knowing that she will be unable to carry them out successfully. If demand for change is high the best scenario for voters is that only competent candidates run. Ironically, according to this model competent reformism is possible only if such demand is low. When demand is high, incompetent candidates will find it optimal to adopt a reformist platform to improve their chances of getting elected. Even in the best possible scenario, there is no reform without the risk of populism. Prato and Wolton argue that populism arises due to the existence of opportunistic politicians, not because of voters' demand for reform. They also suggest that the rise of populism may cause political disenchantment rather than the other way round. This conclusion seems counterintuitive. It basically implies that many common policy prescriptions to fight populism are self-defeating. For example, policies that facilitate the acquisition of political information would increase the electoral reward of proposing a reformist agenda and therefore increase incompetent politicians' incentives to engage in populism. There are several problems with this approach. First, it precludes (ignores) the impact of learning. Secondly, it ignores the relationship between the populist narrative and voters' values and beliefs. Third, populist candidates are successful because they can articulate an explanation for society's woes that is both convincing and emotionally appealing to a majority of voters. Fourth, the theory is contradictory. Prato and Wolton argue that populism generates voter disenchantment and not the other way around. But what they define as voter demand for reform reflects an underlying disenchantment (what I call the "frustration gap"). Finally, populist politicians are better defined by other characteristics besides incompetence to carry out reforms (in fact they are quite competent in getting votes).

4.2 Behavioral

The application of behavioral economics to politics is still in its infancy but growing rapidly (see Schnellenbach and Schubert, 2015, for a summary). The intersection of psychology and economics has led to many fruitful insights, some of which are relevant to the analysis of populism. Evidence from surveys confirms that voters suffer from several systematic biases. One is a tendency to assign a disproportionate importance to whatever happens immediately before or after an election. The former denotes short memory and is an obstacle to learning. Another is "hyperbolic discounting" which refers to a tendency by voters to choose smaller rewards sooner, over larger rewards later. This behavior offers a rational explanation for political shortsightedness.[15] Such bias obviously contributes to the success of populism, which proposes short-term gains at the expense of medium to long-term stagnation.

Joining the debate between Barro (1973) and Nordhaus (1975), Drometer (2006) developed a model to address the issue of voter shortsightedness and politicians' incentives. In his model the government offers two types of public goods, a short-term consumption good and a long-term investment good. Voters exhibit hyperbolic discounting. Hence, they value the former more than they should. This gives the incumbent politician an incentive to shift expenditures towards current consumption in order to be reelected. This in turn results in a suboptimal allocation of public funds. Drometer defines the distortion towards present consumption due to hyperbolic discounting as a "populist distortion". He argues that such distortion prevails even if the political process is perfectly transparent and politicians cannot appropriate any rents for themselves (the "imperfect agency" distortion).

Based on the theory of expressive voting, Jennings (2011) developed a principal-agent model of populism that also includes rational and rationally irrational voters. He defines populism as a set of "bad" policies from a macro point of view but electorally popular (for example, excessive fiscal deficits financed in an inflationary manner). According to Jennings, populism is an inefficiency that denotes a degree of irrationality that cannot be explained by principal-agent models with only rational voters. His model therefore includes two other types of voters: informed and

[15] It could be argued that such behavior is a rational response in a highly uncertain and volatile environment such as Argentina.

"expressive" and uninformed due to rational irrationality. Rational voters vote for the electoral results that they expect will benefit them the most (or the candidate associated with such result). Expressive voters are also informed but do not vote driven by their self-interest because they know that it is not decisive. For example, if they consider themselves protectionists, they would vote for a candidate that proposes protectionist policies even if such policies are harmful to their interests. The third group includes Caplan's rationally irrational voters. To what extent voters are rationally irrational or expressive (emotional) is key to Jennings' analysis. The model includes three types of politicians: good, bad and populist. Good politicians know which policies lead to good economic outcomes and want to implement them, bad politicians also know which policies are good but are corrupt, and populist politicians only care about getting a majority of the votes.[16] In Jennings' model populism is driven by an uninformed impulse (which could be corrected with the provision of information) and an expressive bias. Basically, Jennings provides a simple explanation for the rise of populism: voters chose policies that harm them economically because they are emotionally attached to them. Such emotionality can dominate in an electoral setting because voters know they are not decisive. Another conclusion of this model is that only when expressive voters take honesty into consideration, good politicians have an advantage over populist ones.

4.2 Country or Region Specific

This subsection includes works on populism that focus on specific countries or regions. Argentina deserves special consideration, as it is the only country in the world that over a period of seven decades systematically embraced populism. No other country (with the possible exception of Venezuela since the beginning of the 21st century) suffered so much and so visibly its negative economic consequences.[17] The earliest studies of Argentine populism were written in the early 1970s. Latin America also deserves special attention. It is the region where populism has been more prevalent in the last century. The earliest works on the subject date back to the late eighties. Economists focused on Latin America made two important contributions to the analysis of populism: b) suggested a positive relationship between inequality

[16] The evidence from Latin America suggests that the set of bad politicians and the set of populist politicians as defined by Jennings are identical.
[17] Interestingly, populism has been stronger in the two countries that at one point were the richest in Latin America and among the wealthiest in the world.

and left-wing redistributive policies, and b) confirmed the negative impact of such policies on economic growth. As to the literature on populism in Europe and the United States, it was mostly published since the beginning of the 21st century.

5.2.1 Argentina

Juan Peron (1895-1974) has been often described as the quintessential populist leader and was the inspiration for many politicians throughout Latin America (most notably Hugo Chavez). He ruled Argentina between 1946 and 1955 and between 1973 and 1974 and in both cases he reached power with a substantial majority of the votes. Since Argentine recovered democracy in 1983, the Peronist party has governed 70% of the time and has held, on average, a majority of Congress and controlled most provinces. Although in Argentina Peronism represents populism's most electorally successful format, populist policies were implemented by the Radical party and even by military governments. Peronism defies usual categorizations, as its ideological biases were completely opportunistic. It started as a neo-fascist movement but over time it incorporated revolutionary Marxist elements and rhetoric, always appealing to a strong nationalist sentiment. It has proven to be a well-oiled machinery to reach and conserve power.

Cuban-American economist Carlos Diaz-Alejandro (1970) wrote the pioneering study of the economic consequences of Peronism. Relying on extensive data, he explained how Peron's nationalistic and populist policies accelerated the country's decline in the aftermath of WWII. Diaz-Alejandro also highlighted how non-economic considerations –a prevalent paranoid mentality– impaired collective learning. Instead of analyzing objectively the sources of the country's decline and a growing frustration gap, the elites turned to conspiratorial explanations. The literature on the effects of populist economic policies in Argentina expanded considerably since then. Mallon and Sourrouille (1975) analyzed how social conflict influenced the economic policies implemented during 1930-1970, including those of the Peronist regime.

The first economist to develop a formal model to explain the dynamics of redistributive populist policies for Argentina in the postwar era was Canitrot (1975).[18] Anticipating the conclusions of Dornbusch and Edwards (1991a and 1991b), he noted

[18] This work was published in Spanish.

that these policies had promoted consumption at the expense of investments. Consequently, the inevitable result in the medium and long term was lower growth and rising inflation. Canitrot also incorporated a political economy perspective to his analysis. He argued that the confluence of interests that provides electoral support to populism breaks down, "conflicting interests replace complementary ones," the explosive inflationary context intensified conflicts and populism ended up "entangled in its own contradictions". Canitrot concluded that populist redistribution of income was "an experience destined to frustration".[19] This frustration in turn sets in motion a vicious cycle: thanks in great part to populism the frustration gap keeps growing, which in turn increases the demand for populism. This may explain its path dependency in Argentina. Other attempts to model economic policy and performance in Argentina since the 1930s that help explain the rise and persistence of populism can be found in Galiani and Somaini (2010) and Gerchunoff and Rapetti (2015).

Sturzenegger (1991) provided a descriptive analysis of the populist policies adopted by the Peronist regime between 1973 and 1976 with the objective of trying to evaluate and understand their possible motivations and long-run implications. He concluded that as an experiment in economic policy, it was a complete failure when measured in terms of stability, redistribution of income, growth, investment and increased standard of living. Sturzenegger proposed several reasons to explain why policymakers insisted with these policies (including, irrationality, bad luck, corruption, etc.) none of which he found fully satisfactory. After and documenting the failure of populist economic policies in Argentina during the eighties, Fernández (1991) asked himself whether populist politicians had learned anything from fighting high inflation. His answer: not much.

Following a methodology partly inspired by Becker (1992) and Glaeser (2004), Di Tella and Dubra (2010) analyzed the rise and continued electoral success of Peronism in Argentina despite having led the country into economic decline and political instability. According to a widely held explanation, Argentine voters behave irrationally. But, as Di Tella and Dubra point out, accepting such hypothesis would lead to the conclusion that "democracy is not a reasonable way to elect the country's leaders". Di Tella and Dubra also argue less convincingly, that rejecting rationality in

[19] This is an interesting conclusion coming from someone who actually favored populist policies.

political markets logically implies rejecting it in economic markets. Di Tella and Dubra offer an alternative explanation for the pervasiveness of populism in Argentina that incorporates several elements not typical in economic models: 1) transactions in the labor markets include more than just the exchange of work for wages, 2) the possibility that owners not only do not care about the welfare of their works but in some instances exploit them, 3) voters (particularly workers who make up a majority of the electorate) want to maximize something beyond their material welfare: some kind of emotional satisfaction, and 4) since voters believe that workers sometimes are exploited by businessmen (i.e., they embrace a Marxist ideology) they demand fairness from political candidates. Di Tella and Dubra hypothesize that Argentine businessmen are more likely to misbehave (i.e., be "unfair" to workers) than their counterparts in rich countries (maybe because of low competition or lower productivity). Therefore the government must intervene to ensure a "fair" outcome in labor markets. According to their model, even if voters understand that populist policies are bad from an economic standpoint, they may still demand them because they "correct" the alleged "unfairness" of capitalism. When they are not, they experience resentment, which decreases when government (i.e. Perón) punishes "bad" businessmen with taxes, expropriations or controls. As Di Tella and Dubra note, Perón systematically promoted the notion of worker exploitation in his speeches. They conclude that by introducing distortions in the economic system that led to stagnation, Peronism contributed to perpetuate the beliefs that originally brought it to power. This may explain its path dependency. Another important conclusion from this study is that the continued electoral success of Peronism suggests that the welfare loss that voters experienced in economic terms must have been more than compensated by the emotional satisfaction obtained by the punishment Peron imposed on "bad" businessmen. This model is one of the most enlightening applications of the tools of neoclassical economic theory to the understanding of populism. Although its assumptions and conclusions are specific to Argentina, the approach could be adapted to other countries.

Fernández and Monteserin (2014) applied the conceptual framework developed by Acemoglu and Robinson (2012) to the analysis of Argentine populism. Based on a historical perspective, they identified certain cultural patterns and institutional

practices since colonial times that help explain the country's institutional evolution.[20] This study also discusses the implications of "historical atavisms" in the articulation of the populist narrative to understand how populism operates in Argentina and how it impacts institutional quality.

Ávila (2015) applied the theory developed by Huntington (1968) to explain the evolution of the Argentine political system. In his typology of political regimes, Huntington did not specifically mention populism but included it within a broader concept that he defined as mass praetorianism. This political regime arises when a society's level of political participation exceeds its institutional development. According to Huntington, mass praetorianism is by nature unstable. Huntington considered the first Peronist regime as its classic example. Ávila hypothesizes that Argentina's political instability since 1945 results in a high country risk premium that penalized investment and reduced capital per worker, labor productivity and per capita income. Ávila shows that this premium reached its maximum levels when mass praetorianism prevailed. He also postulates the existence of a correlation between the nature and duration of a country's political order and the level of its fiscal deficit, with country risk being the variable that links both. Huntington's theory is useful to explain the rise of Peronism in the mid 1940s and the recurrence of military coups in Argentina in the second half of the 20th century. However, it is not as useful to analyze: a) the dominance of Peronism since 1984, and, b) the emergence of populism in Europe and the US (unless one admits that some kind of de-institutionalization took place).[21]

Following the approach of Acemoglu, Robinson and Verdier (2013), Ocampo (2015a and 2015b) verified the hypothesis that in Argentina populist cycles are explained by agricultural commodity price cycles. The typical narrative proposed by Peronism and populism in general provides the link between them: the landed oligarchy conspires to exploit the Argentine people with the help of foreign imperialists. Voters interpret booms in agricultural commodity prices as a signal that the farming sector –associated in that narrative with the landed oligarchy– will regain its former economic and

[20] This work was published in Spanish.
[21] Also, if this were the case, the theory cannot explain how a politically developed democracy "regressed" institutionally.

political power and therefore will seek to frustrate the aspirations of "the people".[22] This paper includes the first attempt to quantify with an index the populist bias of economic policy. The index of economic populism confirms two other important conclusions: a) since 1983 populist economic policies have been inversely related to institutional quality, and b) the only period in the last seventy years during which populist economic policies were not applied was during the 1990s.

Fernández (2016) proposed a novel approach to explain the rise and fall of populism in Argentina with a "predator-prey" (or friend-enemy) model of the price cycle of livestock, which he considers a proxy for the populist cycle. [23] In Fernandez' model, the "people" want to consume meat at affordable prices with the mediation of a "friendly" government that seeks to "articulate" that demand within a political discourse to increase its own power. Within this political discourse, the "enemy" is defined as cattle growers, meat packers and the meat marketing system. These sectors react by protecting the long-term sustainability of their business and defending their interests, which in this context are antagonistic to the "people". Using the government's policy towards the meat industry as a proxy for populism has two advantages. First, there is ample evidence with time series of the stock of live cattle for slaughter and consumption where the impact of several interventions by different governments can be evaluated. Second, historically in Argentina the meat-producing sector has been one of the targets of populist policies, banded together in the populist narrative with the "landed oligarchy" as the "enemies of the people".

Cachanosky (2018) analyzed the macroeconomic and institutional costs imposed by the Kirchner governments during the period 2003-2015. Ocampo (2018) explored the historical roots of four psychological traits, cultural values and beliefs prevalent in Argentine society since its origins that have been functional to the rise and persistence of populism: individual and group narcissism (the belief that Argentines and Argentina are superior to the rest of Latin America and that it is destined for greatness), *caudillismo* (the predisposition to obey a strongman), anomy (the inclination to ignore laws and cultural norms of conduct that govern social behavior) and entitled indolence (the belief that living well with no hard work or effort is a God

[22] Demand for redistribution also has a simpler explanation: in Argentina commodity price booms have a negative impact on real wages.
[23] This work was published in Spanish.

given right). The narrative proposed by Peron and his successors appealed to and promoted these traits, values and beliefs. Ocampo's hypothesized that their prevalence and persistence impaired society's learning process as described by North and Denzau (1994). Therefore they created a cultural humus favorable to the rise and continued electoral success of populism.[24]

5.2.2 Latin America and Other Developing Regions

During the 1980s a populist wave swept over the largest countries in Latin America sparking the interest of many economists that specialized in the region. Sachs (1989) proposed as a hypothesis that high-income inequality generated strong distributive pressures that led to the implementation of populist policies, which in turn led to stagnation and instability. In other words, in Latin America populism was the consequence of a simmering social conflict. A collective inability to resolve this conflict explained its electoral success. However, the hypothesis that in Latin America high income inequality was the main factor that explains populism is refuted by Argentina: the country in which the most pervasive and persistent form of populism emerged was also the one with the highest per capita income, the largest middle class and one of the lowest levels of inequality.

Desai, Olofsgard and Yousef (2005) used data for 120 countries over the period 1960–2000 to test the hypothesis that conflicts between the rich and poor generated "populist pressures" for inflationary financing. Their results confirm that there is relationship between inflation and inequality that is conditional on the prevailing political structure. In particular, inequality is positively correlated with inflation in more democratic political systems, whereas the opposite occurs under non-democratic regimes. Despite its empirical value, this study doesn't specifically define what populism or "populist pressures".

Dornbusch and Edwards (1991c) edited a much-cited collection of analytical and descriptive studies of populism in Latin America by economists and political scientists. Included among these works, is their own analysis of the macroeconomics of populism. Dornbusch and Edwards (1991a) defined *economic* populism as an

[24] Although it is not by definition an economic theory of populism the psychological-cultural explanation can be helpful to build such theory.

"approach to economics that emphasizes growth and income distribution and deemphasizes the risks of inflation, external constraints and the reaction of economic agents to aggressive nonmarket policies." As noted by the authors, populist regimes attempted to reduce income inequality via overly expansive macroeconomic policies that relied on deficit financing, wage and price controls and a complete disregard for basic economic concepts. This set of policies almost unavoidably resulted in major macroeconomic crises that ended up hurting those voters they were meant to help. "How can we explain Latin America's proclivity toward macroeconomic mismanagement?" asked Dornbusch and Edwards. Explaining the self-destructive and cyclical nature of populism in Latin America was one of the biggest challenges facing any economist or political scientist. Dornbusch and Edwards considered three potential explanations for this phenomenon: "Is it deeply rooted ignorance on the mechanics of deficit financing, or is it the deliberate consequence of Machiavellian politics or, is it, perhaps, the unavoidable outcome of distributional struggles? (1991b, p.1)". Left out of their analysis was why voters wouldn't learn and keep voting for populist politicians.

After a second left-wing populist wave hit Latin America in the early 21st century, Edwards (2010) took another look at the forces behind it. In his view, Latin America's move to the left was the result of a "deep disillusionment" with a number of market-oriented reforms implemented during the 1990s that failed to deliver sustainable growth and efficiency. According to Edwards, the failure of these reforms was the result of misguided and inconsistent exchange rate and fiscal policies. He reiterated his view that under populism economic performance and social conditions could only deteriorate. In Edwards' view Latin American countries would split into three major groups: the first includes those in which populism is endemic, the second those that are "stuck in the middle" and the third those who embrace reform. The first group will sink into poverty and instability, the second will experience mediocre growth and the third will converge with advanced countries in Europe, Asia and North America.

Using data for Brazil, Argentina, Peru and Bolivia from 1970 to 2007, Bittencourt (2010) tested the hypothesis of what he defined as "the populist view of inflation". This hypothesis predicts that in countries with high economic inequality that re-

democratize, the coalition that comes into power will favor redistributive policies. Since this is usually done through high and unfunded public deficits, or nominal wage and salary increases, it eventually leads to inflation and macroeconomic instability which in turn ends up hurting the supposed beneficiaries of these policies. The results of this study suggest that the implementation of democracy requires an institutional framework (e.g., constraints on the executive, independent central bank) that raises the costs of pursuing populist policies.

Acemoglu, Egorov and Sonin (2013) argued that the electoral success of left wing populism in Latin America –defined as in Dornbusch and Edwards– was the result of weak institutions that lead voters to believe that politicians, no matter their rhetoric, are vulnerable to being "bought" by the establishment. In their model, an extreme rhetoric and the support of redistributive policies are a signal that an honest politician sends to the voters to convince them of his or her honesty. Its main prediction is that honest politicians that haven't been bought by the establishment will propose policies that are to the left of the median voter. The model predicts that the leftist bias will be larger, when the value of remaining in power grows, the wider the divergence between the policy preferences of the establishment and the median voter, and the stronger the perception among voters that all politicians are corrupt. On the other hand, if voters fear that there is a secret leftwing agenda, the emerging populism will have an opposite ideological bias. Acemoglu, Egorov and Sonin provide an original explanation for the rise of leftwing populism in Latin America but it is one that doesn't square with the facts. The evidence of the last century shows that populist politicians tend to be the most corrupt. An implicit assumption of their model would seem to be that voters are irrationally ignorant (i.e., do not learn from experience). Also, weak institutions don't explain the populist vote in Europe and the US.

Using data for 33 countries Rode and Revuelta (2015) assessed the effect of populist governments on a country's economic institutional quality. The former was measured with an index of populism compiled by Hawkins (2009), while the latter by the Economic Freedom of the World (EF) Index. Their analysis confirms that a strong negative relationship exists between both variables, i.e., populism degrades institutions. There are two major issues with this study. First, Hawkins' measure of populism –based on a subjective analysis of the political discourse of political leaders

who are in power– in some cases leads to the strange conclusions that don't square with reality.[25] Second, although there is a negative relationship between populism once in power and institutional quality, there is no relationship between the rise of populism (i.e., its electoral success) and institutional quality. Contrary to the hypothesis advanced by Acemoglu, Egorov and Sonin (2013), populism can emerge in countries with strong institutions, such as the US, Germany, France or the UK. However, institutions cannot survive intact under a populist regime. In essence, populism is, by definition, institutional change.

Grier and Maynard (2016) estimated the costs of populism in Venezuela under Hugo Chávez using a synthetic control group. Since that control group does not exist, they synthetically created one using macro variables of countries similar to Venezuela. Grier and Maynard found that, relative to this group, per capita income fell dramatically. While poverty, health, and inequality outcomes improved, they also improved in each of the corresponding control cases and thus they could not be attributed to Chávez' policies. Grier and Maynard conclude that these policies inflicted significant costs on the Venezuelan economy.

Matsen, Natvik and Torvik (2016) analyzed the rise of petro-populism –the excessive use of oil revenues to buy political support– in Russia, Venezuela and Iran. In their model, politicians exhibit rent-seeking behavior, therefore to reap the full gains of natural resource income, they need to remain in office for a long period. Even a rent-seeking incumbent who prioritizes his own welfare will want to provide voters with goods and services if that promotes his probability of remaining in office. While this incentive benefits citizens under the rule of rent-seekers, it adversely motivates benevolent policymakers to short-term overprovision of goods and services. The model predicts that in equilibrium, politicians of all types indulge in excessive resource extraction, while voters reward policies they realize cannot be sustained over time. Moreover, such over extraction might even be reinforced as voters become better informed.

Cachanosky and Padilla (2018) analyzed the impact that leftwing populist policies on GDP per capita and the HDI index for Argentina (2003-2015), Bolivia (since 2006),

[25] For Argentina it suggests that Cristina Kirchner was not a populist politician.

Ecuador (since 2007), Nicaragua (since 2007) and Venezuela (since 1999). The choice of periods and countries is based on their subjective assessment. Cachanosky and Padilla conclude that populism exacts a heavy economic cost on society. In some cases this cost was as high as the one generated by an economic crisis (the experience of Venezuela shows that it can be higher than that resulting from a major war). Cachanosky and Padilla (2019) built an index of populism for 12 countries in Latin America that combines both economic and institutional aspects to test the impact of commodity prices and economic crises on the existence and intensity of populist regimes. The evidence suggests a positive correlation.

5.2.3 United States and Europe

In a lengthy analysis of crony capitalism in the US, Zingales (2012) made several interesting points about populism. First, he argued that populism had manifested itself in two equally bad extreme formats (p.116). One is reactionary populism, which stokes "primitive feelings" such as racism, resentment and religious intolerance. Zingales mentions Peronism and Nazi-fascism as typical examples of this format. The other format is left-wing populism, which "plays on envy and class warfare, pitting have-nots against haves in an effort to destroy meritocracy and introduce a new, political allocation, of resources" (ibid.). This type of populism inevitably leads to economic stagnation (Mao is proposed as a typical example of this format). Second, Zingales identified certain key factors that predict the rise of a populist movement: growing inequality, a struggling middle class and distrust of the elites. Since all of these factors were present in the United States in the aftermath of the 2008 crisis, he correctly predicted that some form of populism was "inevitable" (p.28). Third, Zingales argued that crony capitalism is one of the reasons that lead people to believe that the status quo is unfair. In other words, it facilitates the rise of populism. Finally, he claimed that there is version of populism that can be pro-markets. However, he recognized that in any other country other than the US such format "would be an oxymoron (p.109)". Zingales proposed to channel "populist anger into fighting crony capitalism and corrupt elites instead of destroying the free market system". Otherwise, the US would follow the road to decline under the European or South American formats of crony capitalism. Some of these observations are more valuable than others. With respect to the first distinction, it would be wrong to place Peronism as an

extreme form of reactionary populism. In fact, it was a hybrid. Secondly, Mao could have never been a populist because no democracy existed in China. Third, free market populism has so far proven a chimera. The issue is semantic: what Zingales describes is popular capitalism, not pro-market populism, which is an oxymoron.[26] Fourth, although Zingales rightly points out that left-wing populism is destructive, he remained mute about the consequences of reactionary populism. Fifth, although crony capitalism can certainly exist without populism, it is one of its most distinguishing features. Aligica and Tarko (2014) explored the strong links between crony capitalism, rent-seeking behavior, institutions and ideology. Borrowing a term from Buchanan, they defined populism as "an attitude of nihilism towards economic organization", a flexible and polymorphic ideology "that manages to circumvent the standard ideological expectations of basing one's arguments in a coherent and unitary system of thought" (p.170). This is why crony capitalists and rent-seeking oligarchies find in populism "a wonderfully malleable and effective instrument" to advance and strengthen their interests.

Glaeser (2012) examined the political risks, related to corruption and populism, of differing approaches to the problems of monopoly, externalities and market breakdowns in mortgage insurance by government sponsored enterprises (GSEs) such as Fannie Mae. In this narrow context, he defined populism as a form of political favoritism (serving the interest of those citizens who do not pay taxes but received benefits from the GSEs) and a populist leader as a politician who favors the poor (although he admits the more realistic alternative that they favor groups that are strong politically). According to Glaeser, if the political risks of corruption and populism are sufficiently high (some factors such as ethnic or cultural fragmentation seem to favor the emergence of both), then laissez-faire may produce higher levels of public welfare than interventions. Glaeser's model could potentially be expanded beyond the narrow issues that are its main focus.

With respect to the recent populist experience in the United States, Di Tella and Rotemberg (2016) developed a simple model of "paranoid voters" that explains populism as the rejection of "disloyal" leaders. By adding the assumption that people

[26] One could argue that Menem in Argentina is evidence that pro-market capitalism can exist. The problem is that it is not an equilibrium solution. At least it wasn't in Argentina. Corruption and crony capitalism eventually lead to institutional degradation and true face of populism emerges.

are worse off when they experience low income as a result of leader betrayal (than when it is the result of bad luck) to a simple voter choice model their model predicts a preference for incompetent leaders. These deliver worse material outcomes in general, but they reduce the feelings of betrayal during bad times. Di Tella and Rotemberg's hypothesis is that the vote for Trump was an insurance policy taken by a large portion of the electorate to avoid being betrayed by the elites even knowing that his economic policies could end up hurting them. They cite evidence that suggests that voters with low levels of education are more concerned about not being betrayed by a politician than but his or her level of competence. In other words, they exhibit a paranoid bias. Although populist narratives always exhibits a "paranoid style" Di Tella and Rotemberg don't explore how it arises and becomes so important to voters (understandably as it is a topic beyond the frontiers of traditional economics).

In a much-cited recent work, using regional survey data Algan, Guriev, Papaioannou and Passari (2017) analyzed the impact of the Global Financial Crisis on the vote for anti-establishment parties in Europe. Their study found a strong relationship between increases in the unemployment rate and voting for non-mainstream political candidates. Their main conclusion is that crisis-driven economic insecurity was a substantial driver of populism and political distrust. The authors recommend that national governments and the EU focus not only on structural reforms, but also at preserving the trust of their citizens and mitigating economic insecurity.

Rodrik (2017) not only tries to identify its economic roots but also explain why in some countries it is articulated from the right and in others from the left. On the first question the answer is easy: the dislocations caused by globalization explain much of the electoral appeal of populist policies in Europe and the United States. But other causes also act as feedback to globalization such as technological progress, a tendency towards oligopoly and labor liberalization (with the consequent loss of power of the unions). Regarding the second question, as Rodrik explains, "the economic anguish and distributive struggle exacerbated by globalization generate a basis for populism, but not necessarily determine its political orientation ... The relative relevance of existing divisions [in society] and the narratives provided by populist leaders are what gives direction and content to their demands." That is, these claims can be articulated from either end of the ideological arc. For this reason, Rodrik says, in Europe right-

wing populism dominates whereas in Latin America we see the opposite. This way of predicting the ideological bias of populism seems useful. Another important point highlighted by Rodrik is that even when the dislocation that affects society has economic origin, its political manifestation may have an ethnic or nativist dimension.

Eichengreen (2017) argued that the election of Trump, Brexit and the recent populist backlash in Continental Europe all have the same root: economic inequality and social exclusion. The common denominator is the sense among a growing segment of society of being left behind. People see their wages stagnating and jobs becoming less secure. They channel their anger by voting against establishment candidates. The author puts the current backlash in historical context by presenting an historical account of the rise of populism in the US in the late 19th century.

Guiso, Herrera, Morelli and Sonno (2017) wrote one of the most ambitious and comprehensive economic analyses of populism to date. Their objective was to: a) develop analytical tools useful to study populism, and, b) to identify the key factors that explain the recent populist wave in Europe and the US. Using individual data on elections and platforms of political parties in Europe, they analyzed the determinants of voting for populist candidates or parties (the demand for populism) as well as the emergence of populist politicians and parties (the supply of populism). They start by identifying three key elements of any populist politician's rhetoric that reinforce each other: 1) pretending to defend the interest of the common citizen against the power of the elites, 2) fomenting feelings of resentment and chauvinism among voters, and 3) promoting policies without considering their long-term harmful consequences. When a non-populist politician criticizes a populist policy proposal by emphasizing its long-term costs, the populist politician replies that this concern is actually driven by the elite that seeks to defend their interests. This explanation is convincing to the public when a conspiratorial mentality prevails.

To identify the factors behind the populist vote in Europe, Guiso and his colleagues analyzed individual data from multiple opinion polls. Their conclusion is that, at the individual level, voting preferences are fundamentally influenced by economic insecurity and decreased trust in traditional parties. For the empirical verification of this hypothesis, economic insecurity is measured by three variables. First, an indicator of whether the voter has been unemployed in the last five years and was forced to

look for a new job. Second, an indicator of whether it has been difficult for the voter to live with his or her current income based on an indicator of voter exposure to globalization according to employment, industry and workforce skills. Finally, they measured loss of confidence in the political system by the results of the ESS Survey.

When it comes to modeling the supply of populism, the authors note that in 2000 less than 70% of the European countries had a populist party, whereas in 2009 they all had at least one. Following the political science literature, they defined a politician as populist if he or she: a) promotes the view that "the people" are virtuous and essentially homogeneous; b) advocates popular sovereignty in opposition to the elitist government; c) defines him or herself against the establishment or status quo, which supposedly is contrary to the interest of the people. Guiso at al. find that populist parties are more likely to emerge when factors that drive the demand for populism accumulate (supply is somewhat endogenous). Populist parties are more likely to emerge in countries facing a systemic crisis that generates economic insecurity among voters, particularly if their institutional framework is weak and exhibits high political fragmentation. On the other hand, economic crises also discourage the participation of voters in elections, which somewhat mitigates the demand for populism. As for the ideology of the populist parties, Guiso et al. argue that it is determined by the availability of "political space". Once this is determined, the reaction of the non-populist parties is to reduce the distance of their platform with that of populist "new entrants", therefore expanding the aggregate supply of populist policies.

Rodrik (2018) moved from the positive to the normative plane and argued. In his view, the distinctive trait of populism is that it claims to represent and speak for "the people," which is assumed to be unified by a common interest –the "popular will"– that is opposed by the "enemies of the people". For right wing populists the latter are minorities and foreigners whereas for leftwing populists the financial elites. Rodrik argued that there is good populism (economic, which seeks a redistribution of income) and bad populism (political, which degrades institutions and seeks to perpetuate itself in power) which "need not always go hand in hand." He proposed FDR's New Deal an example of the first. Two objections can be made against this hypothesis. First, income redistribution doesn't necessarily imply the existence of populism. Second, the evidence shows that in order to survive, economic populism

requires some positive and significant level of political populism (institutional degradation). Recall that Roosevelt tried to "pack" the Supreme Court because it had ruled against some of his policies. He failed due to the strong opposition of the press, public opinion and the Senate itself. In the end, a compromised was reached. It is interesting to contrast this experience with the one in Argentina during the first Peronist regime. A year after being elected Peron fired the Supreme Court justices that opposed him. Both cases show the natural tendency of populism to undermine the institutions of liberal democracy. Whether it succeeds depends on how strong are the institutional and cultural antibodies. The "frustration gap" that creates conditions favorable to the emergence of populism does not simply end with protectionism and redistribution of income as proposed by Rodrik but by finding a solution to the structural problems that originated it, i.e. with structural reforms. This is the real challenge, because such reforms take time and are costly, and therefore, electorally unpopular. Even if it achieves Rodrik's goal of a more equitable income distribution, economic populism cannot survive for long without political populism, which has a natural tendency to authoritarianism or totalitarianism. The same criticism that Hayek (1944) leveled against socialism can be applied to Rodrik's thesis. Also, even if "good" populism were viable without "bad" populism, it always has a self-destructive character (particularly in its left wing variety).

Pástor and Veronesi (2018) developed a model in which a populist reaction emerges endogenously. In their model, voters do not like inequality, especially high and conspicuous levels consumption by the "elites." Economic growth exacerbates inequality due to heterogeneity in risk aversion. As a reaction, voters in rich countries optimistically vote for a populist candidate who promises to end globalization. Redistribution has limited value in containing the reaction against globalization, which is identified as the culprit. According to Pástor and Veronesi, countries with more inequality, greater financial development and current account deficits are more vulnerable to populism. These authors claim that evidence on who voted for Brexit and Trump in the 2016 election strongly supports their conclusion.

Using post-electoral surveys from France, Britain and the US, Piketty (2018) explained how the long-run evolution in the structure of political cleavages gave rise to populism in Europe. In the 1950s, the vote for left-wing parties was associated with

lower education and lower income voters while more recently it become associated with higher education voters. This gave rise to a "multiple-elite" party system in which high-education elites vote for the "left", while high-income/high-wealth elites still vote for the "right". According to Piketty, this contributed to a lack of democratic response to the growing multidimensional inequality caused by globalization and set the stage for the rise of populism. The problem is that nowhere in this paper he explains what is populism. He vaguely associates it with right wing xenophobia and identity-based politics. With respect to Brexit, Fetzer (2018) provided evidence that the austerity-induced withdrawal of the welfare state since 2010 is a key driver to understand how pressures to hold a referendum built up in the UK and why the Leave side won. In this case, the author identifies the causes of populism without ever defining it. Voss (2018) argued populism is a problem of political alienation stemming from the incapacity of social democratic parties to comprehensively represent the working class in the context of increased labor market segmentation. If underrepresented workers are not sufficiently numerous to be electorally relevant, right-wing populist protest parties can make use of the representational vacuum by reframing class-distributional issues along cultural conflict lines. Voss proposes an inverted hyperbolic causal relationship between labor market segmentation and demand for populism. He tested this hypothesis by analyzing the electoral effects of labor market reforms in Germany and Spain.

Eichengreen's *The Populist Temptation* (2018) is the first book written by a highly respected mainstream economic historian that is specifically focused on populism. Its length and breadth deserve a more detailed review than the one provided here. Eichengreen places populism's recent global resurgence in an historical context, identifies the economic and political circumstances under which it emerges and proposes some ways to neutralize it. In the first paragraph he defines populism as "a reaction of voters against the political establishment, nationalist and racialist sentiment directed against foreigners and minorities, and a yearning for forceful, charismatic leadership". He emphasizes that is a new phenomenon but also an very old one. Eichengreen's main thesis is that populists tend to thrive most in the aftermath of economic downturns, when it is easy to convince the masses of elite malfeasance. But populists' solutions tend to be simplistic and economically counterproductive. Moreover, by arguing that the ordinary people are at the mercy of

extra-national forces beyond their control –international capital, immigrants, cosmopolitan globalists– populist leaders often degenerate into demagoguery and xenophobia. Eichengreen's proposed antidote requires shoring up and improving the welfare state so that it can act as a buffer for those who suffer most during economic slumps.

5. The Challenge: Addressing Key Methodological Issues

Having reviewed the relevant body of literature, this section seeks to address two methodological issues that can hinder further progress in the economic analysis of populism. The first is definitional and the second related to assumptions about voting behavior.

2.1 Definitional Vagueness

Although much has been written about populism, as the preceding review shos confusion remains about how to define it precisely. For decades, sociologists and political scientists have dealt unsuccessfully with this problem (see Mudde and Kaltwasser, 2017). Consensus has also eluded economists who, as this review shows, have adopted definitions that in some cases are incomplete and in others outright misleading. This definitional vagueness is a hindrance to further progress both on the theoretical and empirical front. As noted by Rode and Revuelta (2015), while there are no clear definitions and reliable measures of populism, there is a growing need to study its political, economic, or social consequences empirically.[27]

The confusion about what is populism was eloquently demonstrated during a press conference at a NAFTA summit in mid-2016. Mexico's President Enrique Peña Nieto criticized populist politicians who wanted "to eliminate and destroy everything that has been built, what has taken decades to build… by using populism and demagoguery, they choose the easiest way to solve the challenges of today's world. And things are not that simplistic." His comment was aimed at the yet to be nominated Republican presidential candidate whose poisonous rhetoric had Mexico and its citizens as a favorite target. To the surprise of Peña Nieto, President Obama publicly rebuked him. "I'm not prepared to concede the notion that some of the

[27] For an political science perspective on the methodological issues that hamper the study of populism see Pappas (2017).

rhetoric that's been popping up is populist," said Obama. A populist politician is one who cares about "social justice issues or making sure that poor kids are getting a decent shot at life or have healthcare." Obama implied Trump was a chauvinist and a xenophobe but not a "true populist." He claimed this label for himself and Bernie Sanders.[28]

Peña Nieto was much closer to the truth. Populism by definition is always popular (at least once at the voting booth) but not all popular politicians or policies are populist. What distinguishes populism from what's popular is its contempt for the established order, the antagonistic relationship it proposes between "the people" and "others" (who are the enemy of the people) and the institutional and cultural degradation that it imposes on society. There is left-wing populism (Chavism), right-wing populism (Nazi-fascism) and chameleonic populism (Peronism). The first promotes class conflict, the second, xenophobia and/or racism, and the third, an opportunistic combination of both. In all cases they foster chauvinism, fanaticism and resentment. The object of the latter usually determines its ideological bias.

The way the ancient Greek philosophers defined populism has stood the test of time. Aristotle defined as "demagogy" and considered it a degeneration of democracy: "Most of the ancient tyrants were originally demagogues," wrote the Stagirite sage. This institutional degeneration occurs because the rule of law is overturned. "The demagogues make the decrees of the people override the laws." Following the Aristotelian approach, Polybius instead proposed the term "ochlocracy" to describe the government of the masses. According to Scottish philosopher James Mackintosh, this was simply a "degenerate democracy" (1791, p.225).

Although sometimes used as synonyms, today these terms have different meanings. Demagogy describes political activities or practices "that seek support by appealing to the desires and prejudices of ordinary people rather than by using rational argument." An ochlocracy would theoretically result from successful demagoguery. In reality the government of the people does not exist. As Arrow (1950) demonstrated, no voting system can faithfully convert ranked individual preferences into ranked aggregate preferences. No elected demagogue or self-appointed tyrant can actually represent

[28] "Read the Remarks From the 'Three *Amigos'* Summit Press Conference", *Time*, June 29, 2016.

"will of the people" (what Rousseau called the "*volonté générale*"). Populism is therefore an electoral scam.

Ocampo (2018) defined populism as the painless, simplistic and arbitrary "solution" to structural problems that a charismatic and opportunistic politician promotes using an antagonistic narrative that appeals to chauvinism and certain predominant beliefs, prejudices and anxieties, and that a majority of voters, a) finds convincing and emotionally appealing, and, b) imposes with its vote when those structural problems lead to widening divergence between its expectations and reality.[29] This divergence is what I call the "frustration gap".[30]

This definition allows us to distinguish between populist politicians, populist policies and populist regimes. A populist politician is one that proposes the populist solution to win elections. Populist policies are the effective implementation of such solution. Although in most cases this solution requires some form of redistribution of wealth or income, not all redistribution is necessarily populist. The election of a populist politician doesn't necessarily make his government a populist regime.[31] A populist regime is one that effectively applies populist policies (which could also arise out of the election of a non-populist politician). If the host-democracy in which it grows does not have strong antibodies, populism eventually destroys it, and, in its last phase, if ever reached, mutates into a dictatorship or autocracy. As Hamilton (1787) warned in *The Federalist Papers*, the "men who have overturned the liberties of republics" commenced as demagogues and ended up as tyrants (p.29). Hamilton's point is well-worth emphasizing: history shows that a populist regime, if successful in eroding institutions, always ends up as authoritarianism (Venezuela under Maduro) or totalitarianism (Germany under Hitler). An unelected dictator can also try the populist solution. But this does not mean that his or her regime is populist. Populism can only rise to power with –and needs to be validated by– free elections.[32]

A few other clarifications and amplifications are in order. First, the majority is usually not a homogenous group of low-income voters but a fragile coalition that cuts across

[29] Majority is defined as the minimum number of votes required in a specific electoral setting to secure the power of the executive.
[30] This work was published in Spanish.
[31] Trump is the perfect example. Even though he won the presidency with a populist rhetoric, the US remains a republic.
[32] Neither Mao nor Castro were populist leaders but dictators. Maduro is the leader of an authoritarian regime.

all income levels.[33] In fact, in most democracies, the middle class is key for the electoral success of a populist candidate. With the passage of time, this coalition can become a threat to its survival. Populist regimes are by nature politically unstable. Second, the frustration gap is a necessary but not sufficient condition for the emergence of populism. This gap has an objective and a subjective component. The former can be the consequence of a crisis, a war, an immigration wave, technological progress, a radical change in the international economic order (e.g., protectionism in the 1930s or deindustrialization in the last few decades due to globalization). Basically, the gap is generated by the sudden appearance of structural barriers that prevent the economy (or society) from functioning as in the past. It can generate a reaction against a cultural, ethnical or religious threat to the established (or idealized) order or as a demand for a redistribution of the resources generated by such order. The gap tends to be wider in societies that impoverished themselves after periods of prosperity (Argentina and Venezuela), in those in which median incomes have stagnated for a long time (the US), or in which a majority of the electorate feels that its cultural or religious values, or ethnic composition, are threatened by "outsiders" (the US, Western and Eastern Europe). The wider the frustration gap, the more likely an opportunistic politician will take advantage of it. Since by its failure to implement structural reforms, populism tends to widen the gap, in certain cases, it triggers a vicious cycle that makes it endemic.

The frustration gap also has a subjective component. It can result from unfulfilled expectations about the present, pessimism about the future or an unfavorable comparison between the present and an idealized vision of the past. Leftwing populists tend to emphasize the former whereas rightwing populists underscore the latter (i.e., they are more conservative). These comparisons are obviously entirely subjective. To the extent they are unrealistic, they generate an "unsatisfied" demand or what psychologist describe as a feeling of "relative privation". Arendt (1974) observed that Nazism and Communism started with "contempt for what you have"

[33] Even in the case of Peron, who is usually associated with the "shirtless" poor peasants, won his first election in February 1946 with a significant urban middle class and even some high-income voters that adhered to catholic nationalism.

and then tried to convince the masses that "everything must change".[34] Something similar can be said about populism.

The frustration gap is half the story. The other half is the populist leader, who plays a critical role in the rise of populism. His or her success depends on fostering (or reinforcing) a feeling of dissatisfaction with the status quo in a significantly large number of voters. This requires convincing them that they don't have the standard of living, respect or recognition, that easily identifiable smaller groups have (which, *ipso facto,* become the "enemy of the people"). This is where the populist narrative enters the story. This narrative explains the origin of frustration gap and how to close it (i.e., the populist solution). Generally the populist leader embodies (sometimes in an exaggerated way) certain psychological and cultural traits that area typical of the median voter. This facilitates the process of identification that Freud (1921) explained so well. These characteristics do not have a positive connotation. Both left-wing and right-wing populism reflect malignant group narcissism, a feeling of superiority that manifests itself as racism or xenophobia (Fromm, 1964). This was as true for Hitler, Perón and Chávez, as it is for Trump, Erdogan and Orban.[35] Recent studies have confirmed the link between the rise of populism and collective narcissism (Federico and Golec de Zavala, 2018).

With respect to the nature of the populist "solution" some clarifications are also necessary.[36] First, it is supposedly painless (or costless) for the majority that votes for it. Second, it is simplistic because it appeals and promotes prejudices, anxieties, fears and beliefs (overt or latent) that are widely held by the population. Therefore, no intellectual effort is needed to understand it. This makes it particularly attractive for voters with low educational levels. In the mind of those who vote for a populist candidate, the populist solution cannot fail to achieve its declared objectives. In fact, its effectiveness seems assured by its simplicity, which rests on the twin pillars of manichaeism and paranoia: the populist politician's narrative only admits the existence of good (the "people" or those that vote for him) and bad ("the enemy of the

[34] Although Nazism in its later stage resembled Stalinism, its origin was essentially different. Bolshevism arose out of a violent revolution and Stalin rose to power through cunning, murder and repression. Hitler instead obtained the largest representation of any party in the Reichstag through free elections.

[35] As a well-known US political consultant explained, Trump is "an avatar" for the "worst instincts" and "deepest desires" of the American people (Wilson, 2018). A great number of voters channeled their resentment through him.

[36] Defining populism as a "solution" allows for the inclusion of populist manifestations such as Brexit into the analysis. No populist candidate won an election in England but a populist solution received a majority of the vote.

people" or those who oppose him), the latter always conspiring to exploit the former. The inevitable consequence, or undeclared objective, of this narrative is to generate resentment, which is the psychological and emotional nutrient of populism.

Finally, the populist solution is arbitrary because it requires trampling on established institutions (formal and informal). The populist leader's will, which supposedly represents the "will of the people", is above any law or established tradition or norm of conduct. This arbitrariness undermines key building blocks of liberal democracy: limits on the executive, protection of property rights, freedom of expression and safeguarding minorities' rights. Populism's arbitrariness also manifests itself in another important way. The populist solution requires that "others" (within or outside the country's borders) bear the cost of closing the frustration gap (real or imagined). This in turn requires identifying them as "the enemy of the people" and making them pay. Almost by definition, the domestic enemies of the "people" are a minority and the populist "solution" requires undermining or violating their rights (Lukacs, 2005). For example, if the enemy is the landed oligarchy or the bankers, a populist regime can extract resources via direct taxes, expropriation or outright confiscation. If the enemies of the "people" are immigrants (legal or otherwise) or an ethnic minority it is possible to deport them, expropriate their assets, prevents their entry into the country or confine them in concentration camps. When the enemy is external (i.e., a foreign country or its nationals) it is possible to apply tariffs or nationalize companies owned by its citizens. War and invasion are the last resort of populism, particularly of the right-wing variety.

To the extent it convinces an electoral majority, the antagonistic narrative that divides society between good and evil allows the populist leader to justify any arbitrariness in the treatment of a minority identified as the "enemy of the people" (i.e., responsible for the existence of a frustration gap).[37] As an historian of fascism explained, each culture "specifies" its own national enemy (Paxton, 2004, p.37). To a great extent, this specification determines the ideological bias of populism. As one of its most influential intellectual promoters emphasized, populism is not an ideology but a way of doing politics (Laclau, 2005). If the enemy of the people can be identified (or

[37] Populist politicians conceive politics as described by Carl Schmitt: the only distinction which is valid in politics is antagonistic (Schmitt, 1927, 26). Although Schmitt was the ideologue of Nazism, his political ideas were revived by modern ideologues of left-wing populism such as Laclau (2005).

defined) along ethnic, religious or cultural dimensions, it tends to be of the right-wing variety. When defined by an economic dimension –such as income or wealth levels– with a class-struggle connotation, it tends to be left-wing. The right wing variety of populism defends an ideal or imagined cultural and racial status quo, while the leftist attempts to extract resources from those who support, and benefit from, that status quo.

The experience in the US primary and presidential elections in 2016 eloquently proves this point. Populism was embraced by leading candidates of both parties. These candidates agreed on the diagnosis but articulated different explanations of the origin of the frustration gap and specified who was responsible for it (i.e., the "enemy of the people"). According to Trump, the American dream was over because of unfair competition from Mexico and China, which squared well with the beliefs of many voters.[38] Sanders on the other hand blamed income inequality and Wall Street bankers, an explanation that is also shared by a significant portion of the electorate. Given this diagnosis and identification, their respective "solution" was radically different: one proposed protectionism ("make foreigners pay"), while the other a massive redistribution of income and wealth ("make the rich pay").

As anticipated by the Classic thinkers, populism's life-cycle has three phases: demagogy, ochlocracy (implementation of the populist solution) and degeneration into autocracy or tyranny. In the first phase it is a contender for power and, in the last two, an incumbent. The dynamics of each phase are different and their overall length varies due to economic, cultural and institutional factors. Not all populist regimes complete the full cycle (it all depends on society's antibodies). The first phase always requires legitimization by the popular vote (even Hitler did it). In the second phase, the regime seems to achieve the goal of "closing" the frustration gap. But this is a mirage disguised by favorable exogenous factors or a redistribution of resources at the expense of minorities that are electorally irrelevant (the "enemies of the people"). With the passage of time, these groups manage to evade exactions via capital flight and/or emigration or simply run out of resources (e.g., commodity prices crash). Meanwhile, the institutional degradation imposed by the populist regime and the absence of structural reforms ensures that the frustration gap remains open or even

[38] Although the evidence shows that automation was a much more important factor. See Acemoglu and Restrepo (2017).

widens. This is when populism's third phase starts. With free elections, the broad and growing discontent threatens the survival of the populist regime. The populist leader and the clique that supports him react to this threat by doubling down: they promote a conspiratorial narrative (the crisis is due to the perverse action of the enemies of the people) through state controlled media and systematically abuse executive power (by violating property rights and restricting press freedom). Taken to the extreme, the populist "solution" essentially self-destructs. In its last mutation, the regime kills democracy, ceases to be populist and mutates into an autocracy (Venezuela under Maduro) or a totalitarian state (Germany under Hitler). Understanding populism requires distinguishing between these different phases and their internal dynamics.

Measuring the occurrence and/or intensity of populism is not easy (for a discussion see Rode and Revuelta, 2015, Ocampo, 2015a, and Cachanosky and Padilla, 2019). One approach focuses on the textual analysis of the political discourse of political leaders, which was pioneered by political scientist Kirk Hawkins (2009). Hawkins produced a dataset of elite-level populist discourse in over 40 current and past leaders from a variety of countries across the world, with special focus on Latin America. According to Hawkins, this measure of populism has high reliability comparable to standard human-coded content analysis, compares well to common understandings of actual cases of populism, and is a reasonably efficient technique even in small samples. However, as the author himself recognized, the methodology leads to strange results. For example, with respect to Lula, Brazil's president during 2003-2010, Hawkins did not find any speech that was strongly populist, and with Cristina Kirchner, who was president of Argentina during 2007-2015, he found no evidence of populism in her speeches.

The alternative is measure the conditions that give rise to populism or the impact of populist policies. The former would require measuring the frustration gap. However, there are two problems with this approach. First, the frustration gap is a necessary but not sufficient condition for the rise of populism. Second, it may reflect considerations that are not strictly economic (although implicitly or explicitly it generally underlies them). There are several methods to measure the frustration gap. The first is using public opinion polls and surveys, such as those regularly published by Pew, Gallup, World Values Survey, European Social Survey (ESS) or Latinobarómetro. These

surveys generally include metrics of voter dissatisfaction and distrust of the political system. However, they impose a temporal limit on any study (which maybe appropriate in the case of Europe or the United States but not for Latin America). A second approach is to measure the difference between a country's GDP per capita and that of a comparable neighbor (or a country historically viewed as a rival). The disadvantage of this method is that it is less realistic (the general public rarely makes such comparisons). Another measure of the frustration gap is given by the ratio of the average to median income, or the percentage of total income that accrues to the top 1% or 10%. In general any indicator that measures the relative deterioration of the standard of living of the middle class (largest single bloc of voters in most democracies) is a good proxy. Finally an alternative measure is the output gap or the gap between actual GDP per capita growth its trend from recent decades. Some of these measures lead to similar conclusions.

The second approach involves measuring the impact of policies that are typical of populist regimes. However, it can also lead to misidentification: non-populist regimes (e.g., military dictatorships) occasionally resort to populist policies. This method was used by Ocampo (2015a) to build an index of economic populism for Argentina for the period 1916-2015. The index averages the following variables: a) the gap between official and market exchange rates, which measures both a specific measure (foreign exchange controls) and a policy outcome (overvaluation of the currency) as well indicating the regime's willingness to "correct" market outcomes, b) the level public spending as a percentage of GDP, which measures both clientelism through subsidies and other social transfers, c) fiscal deficit as a % of GDP, which measures the degree of fiscal profligacy, d) the participation of wages and salaries as a % of GDP, which is a proxy for income redistribution, e) an index of real wages, f) the number of public sector employees at the national level, as a measure of clientelism, and g) the rate of government extraction of resources from the agricultural sector. More recently, Cachanosky and Padilla (2019) built an index of populism for 12 Latin American countries for the period between 1996 and 2016. The index is made up of two sub-indices that capture the difference between governments that may be institutionally populist but economically not populists and vice-versa. The institutional sub-index has four components: corruption, rule of law, value and accountability and freedom of the press. The economic sub-index has three components: government size, revenue,

and taxes on exports. According to Cachanosky and Padilla these three variables capture distinctive economic aspects of populist regimes. The advantage of this approach is that, in contrast to Ocampo (2015a), it captures populism's inherent institutional degradation. The main issue is to decide which variables should be included in each sub-index. For example, taxes on exports are a typical, if not exclusive, measure taken by populist regimes in Argentina but it is not common in other countries. Also, the index has obvious limitations when analyzing right-wing populist regimes (which could be partially solved by adding measures of protectionism and control of immigration). However, the underlying idea behind these three approaches could be improved and expanded to make them more useful in cross-country studies.

2.2 The Rationality Conundrum

The second methodological issue economists need to address when analyzing populism is what assumption about voter behavior is more appropriate to explain its rise. In recent decades psychologists and behavioral economists have challenged the rationality assumption in economics (see Simon, 1955, Tversky and Kahneman, 1974, Kahneman and Tversky, 1979, Thaler, 1985). However, mainstream economic theory assumes that when making economic choices, individuals are essentially rational maximizers of their material well-being. It would thus seem inconsistent to assume they are irrational when making political choices. If that were the case, rationality would be "a bit like the Cheshire cat of Alice in Wonderland: now you see it, now you don't" (Di Tella and Dubra, 2010). Moreover, if individuals are rational and maximize their utility, then, in the aggregate, their decisions should lead to an optimal social outcome. Both economic theory and the empirical evidence confirm that populist policies have long-term negative economic consequences, which seems to suggest populism is a suboptimal outcome of the political market.

Conceptually, there are five possible explanations for the populist vote: a) ignorance, b) irrationality (or stupidity), c) the consideration of non-economic dimensions such as feelings and emotions, d) the use of alternative models to interpret reality, and, e) the expectation of personal gain via some kind of direct transfer. Some of these reasons are not mutually exclusive and could reinforce each other.

The first reason seems plausible since acquiring information is costly. Tirole (2018) argues that politicians "exploit the ignorance and prejudice of voters". Since Downs (1957), rational ignorance has been the underlying assumption of the economic theory of democracy. However, it doesn't seem to explain the vote for populism over repeated instances, as has been in many countries in Latin America. Making mistakes is costly. Given the high costs of populism, over time it would be rational for voters to learn (i.e., acquire information). Which leads us to the second reason: irrationality. There is strong evidence from psychology and behavioral economics that supports the view that systematically irrational behavior exists in many spheres of human activity.

Irrationality in this context implies that individuals may vote for political candidates or policies that will hurt their material well-being. By doing so they would not be maximizing their utility. This seems self-contradictory but psychologists have amply proved that contradiction is a typical characteristic of *Homo sapiens*. In fact, cognitive dissonance is a mental discomfort that arises when individuals have inconsistent thoughts, beliefs, or attitudes. Akerlof and Dickens (1982) incorporated this idea into a model that explains how workers in hazardous environments react to the dangers they face and why these reactions cannot be incorporated into Bayesian decision theory. The model is based on three propositions. First, individuals have preferences over states of the world and over their beliefs about those states. Second, they can exercise some choice over beliefs given available information and they also can manipulate their "desired" beliefs by selecting sources of information likely to confirm them ("confirmation bias"). Third, once chosen, beliefs persist over time. The cognitive dissonance model not only predicts systematic differences in interpretation of given information but also systematic differences in receptivity to new information according to preferences. Basically, if individuals believe something other than the truth, "they do so by their own choice". If they made a mistake, they tend to discard information that would suggest that because "the cognition that the decision might be in error is in conflict with the cognition that ego is a smart person". In other, words it is mechanism to eliminate dissonance. Akerlof and Dickens recognize that in most economic transactions "cognitive dissonance plays no role" but in many situations – such as advertising and crime– it does. Rabin (1994) argues that cognitive dissonance plays a role in social change and incorporates this factor into a rational choice model to analyze moral behavior. In an empirical study of US presidential elections,

Mullainathan and Washington (2006) found support for the relevance of a narrow definition of cognitive dissonance to voting behavior, whereas Elinder (2007) rejected the hypothesis after analyzing US and Swedish data.

The third reason behind the populist vote is the influence of non-economic considerations (such as resentment, fear, notions of fairness and justice, etc.). It seems like a plausible explanation. The populist vote is not just a vote for a specific set of policies but, as the evidence shows, it is also emotionally –one could even say viscerally– charged. It implies a punishment of some form to certain minorities or foreign countries. There is undoubtedly a significant non-rational component present in populism (both of the left and right wing varieties). Incorporating non-economic considerations to the explanation of the populist vote raises a very important question: at what cost? Understanding the nature of such trade-off would then be the key to understanding populism. Also, it would be necessary to explain the nature of those non-economic considerations and how they arise and become prevalent in certain societies at certain times. This in turn would require the help of history, psychology, sociology, cognitive science and anthropology.

The fourth reason why individuals may vote for populist candidates is that they rely on models with causal relationships that are different from reality (or from the models used by economists). This is what we loosely define as priors, ideology or beliefs. Ideologies can be defined as the shared mental models that groups of individuals possess that provide both an interpretation of the environment and a prescription as to how that environment should be structured. These shared mental models are the product of "cultural learning" (Denzau and North, 1994). Certain voters may believe populist policies do not inevitably lead to stagnation, inflation or financial instability and that such outcomes are due to other factors. For example, as farfetched as it may sound, some people fervently believe that the Venezuelan crisis is due to a US embargo or that Argentina's economic decline is due to a conspiracy of the landed oligarchy allied with US imperialism.[39] A key element of populism is what is known as the "paranoid style" of politics (Hofstadter, 1996). One could argue that, to some extent, this fourth explanation is also related to ignorance. However, there is an

[39] In countries in which populism is endemic such as Argentina, the average voter can hardly be blamed for not associating dismal economic performance to populist policies, as non-populist governments also failed to deliver sustainable growth.

important distinction. Ignorance can be cured with education. Ideology on the other hand, like religion, has proven impervious to facts or logical reasoning and is shaped by culture and other non-rational factors. As with the previous explanation, one would need to understand how ideologies are formed and evolve, which again requires crossing the boundaries of other social sciences such as political science, sociology, etc. (Denzau and North, 1994; Chai 1998, 2001; Bénabou and Tirole, 2006). Also, it would be necessary to understand what kind of trade-off exists between erroneous beliefs and material welfare (Rabin, 1994).

The last reason behind the vote for populism –material self-interest– is obvious. Corruption, patronage, clientelism and crony capitalism play a big role in most populist regimes. However, by definition, material self-interest cannot explain a majority vote for populism except when income/wealth inequality is very high at the outset. With the passage of time, however, populism will impair the material well being of the majority, even if inequality is reduced. Under such scenario –reflective of what has happened in Argentina and Venezuela– how do we explain the persistence of the populist vote? The answer would bring us back to ignorance, irrationality or non-economic considerations.[40]

When explaining the populist vote, economists have relied on one or more of these five reasons. Those who favor the rational choice model tend to rely on reason 1 and/or 3, whereas those who question it are more inclined to emphasize reasons 2 and 4. An overview of their positions follows.

The application of the rational choice model to politics recognizes that in political markets individuals operate under different rules and constraints than in economic markets but that the rational choice model remains applicable and makes useful predictions. As Becker (1976) forcefully argued: "I find it difficult to believe that most voters are systematically fooled about the effects of policies… voters perceive correctly the gains and losses from all policies." In fact, some Chicago school economists have argued that democratic markets work as well as economic markets and that the existence of principal-agent and informational problems is greatly exaggerated (Wittman, 1989). According to this view, any inefficiency is "optimal".

[40] In countries such as Argentina where over 40% of the population depends from some kind of transfer from government this explanation carries more weight.

Such methodological stance would imply rejecting the notion that voting for a populist candidate is irrational. Instead, it could be caused by a variety of other factors. Some are exogenous (such as institutional frictions, principal-agent problems, asymmetric information, externalities, etc.) and others inherent to voters. The latter category would include ignorance and strong non-economic preferences. The first can be explained as a rational decision (information is costly). As mentioned, rational ignorance is one possible way out of the rationality conundrum. However it doesn't answer an important question: why do voters even vote? Voters might be ignorant about the effect of the policies proposed by candidates in an election but they surely know that their vote will not change its outcome. If voters are perfectly rational, voter turnout should be 0%.[41]

Within the rational choice tradition, another solution to the conundrum proposes expanding the definition of rationality: individuals maximize their welfare (utility) as "they conceive it, whether they be selfish, altruistic, loyal, spiteful, or masochistic". In other words, rationality doesn't necessarily imply narrow materialism (Becker, 1992; Rabin, 1994). It is simple a question of adding non-economic preferences to an individual's utility function (reason #3 above). This approach offers some promise but also raises questions about how fairness, altruism, spite, etc. get incorporated into an individual's utility function and why this is more important at certain times and certain places. To the extent these values and beliefs are relevant to explain the populist vote we would first need an answer to these questions for the model to yield useful predictions. There is another problem with this approach. Incorporating non-economic considerations into an individual's utility function not only can justify any observed behavior as rational (it almost eliminates the possibility of irrationality) but also leads to circular reasoning.

Rabin (1994) modeled an individuals' difficulty of maintaining "false" beliefs with a cost function such that his utility-maximizing will trade-off his preference for feeling good about himself with the cost of maintaining his false beliefs. Glaeser (2003) argued that solving the irrationality conundrum in political decisions entails bringing economics into psychology and not the other way around. In his view, errors will be more common when the costs of making mistakes to the individual are low.

[41] These considerations are obviously less relevant in countries where voting is mandatory and failure to vote is punished by law like Argentina.

Therefore, we should expect more errors in political markets (because individual votes don't matter) than in economic markets (because making foolish purchases is at least somewhat costly).

Even within the Chicago School, there is a long tradition of questioning voter rationality. Knight believed voters were ignorant, emotional and usually irrational (Stigler, 1982). Coase put it more bluntly: "I find it difficult to ignore the role of stupidity in human affairs". He couldn't understand why economists had so easily adopted the view that men acted rationally: "history has shown that a politician who wastes his country's resources on a grand scale may have a successful career" (Coase, 1998). Even Buchanan acknowledged that with the strict version of *homo economicus* it is difficult "to explain the actual behavior of individuals, be it in the market or in politics" (Kirchgässner, 2014).

North (1993, 1994, 2010) also questioned the applicability and usefulness of *homo economicus* in the analysis of institutional choices. The rationality assumption may be appropriate for individuals making choices in highly developed and competitive markets but not when making decisions under the conditions of uncertainty that have characterized the political and economic choices that shape historical change (North, 1994). Measuring and enforcing agreements in political markets is difficult because citizens and politicians exchange votes for promises. An individual has little incentive to become informed because his vote is not decisive. In addition, the complexity of political issues increases uncertainty. Competition is also far less effective than in economic markets. For a variety of simple, easy-to-measure, and important-to-constituent-well-being policies, voters may be well informed, argued North, but in most other settings ideological stereotyping prevails. There is also a fundamental agency problem in political markets. As principals, voters have difficulty evaluating what degree of coincidence exists between their objectives and those of the politician that seeks to represent them. In North's view, when it comes to most public policy issues voters rely on very imperfect, and sometime contradictory, models to evaluate policy choices. His proposed solution to the conundrum is to retain neoclassical micro-economic theory under the assumption of "bounded rationality" (Simon, 1955). In North's view, ideas, ideologies, myths, dogmas, and prejudices have a significant influence in political and institutional choices (Denzau and North, 1994). Therefore

an understanding of the way they evolve is necessary to develop a useful framework to understand societal change.

Caplan's theory of rational irrationality (1999, 2001 and 2007) offers an alternative paradigm for voting behavior. His starting point is empirical: when it comes to politics people hold beliefs that are systematically mistaken even though it would be inexpensive to correct them. Consistent with the view of Bastiat and the work of Kahneman and Tversky (1974), Caplan argues that individuals exhibit systematic cognitive biases that affect their voting decisions. These surveys suggest that American voters exhibit four main biases: 1) they do not grasp the "invisible hand" of the market, with its ability to harmonize private greed and the public interest (anti-market bias), 2) they underestimate the benefits of interaction with foreigners (anti-foreign bias), 3) they equate prosperity with employment and not with production (make-work bias), and, 4) they are overly prone to think that economic conditions are bad and will get worse (pessimistic bias).[42]

In Caplan's view, economics can handle irrationality the same way it handles everything: with prices and preferences. Irrational behavior is like any other normal good: when its price is low, its demand tends to be high. Holding erroneous beliefs, such as racism, are rational as long as the cost of keeping them are low. In fact, holding certain beliefs may generate a certain psychological satisfaction. Caplan argues that is entirely rational for people to vote according to beliefs that are erroneous but make them feel good. Basically, voters have "two arguments in their utility function: personal wealth and loyalty to their political ideology (2007, p.17)."[43] According to Caplan, voters are worse than ignorant: they are irrational, vote irrationally, and, more importantly, they have no interest or incentive to correct their beliefs. "Like the adherents of traditional religion many people find comfort in their political worldview, and greet critical questions with pious hostility (Caplan, 2007 p.16)." Since they know their vote is not decisive in an election they vote for whichever political candidate shows "greater affinity" with their beliefs. If a significant number (or a majority of voters) behave in this way, representative democracy cannot be expected to systematically deliver good economic outcomes.

[42] Surveys results from World Values Survey and Latinobarómetro suggest that these biases are strong and prevalent in many countries in Latin America.
[43] Although Caplan doesn't explicitly recognizes it, this statement implies an agreement with Becker's approach to broadening the definition of utility (Becker, 1992).

Democracy fails "because it does what voters want. In economic jargon, democracy has a built-in externality. An irrational voter does not hurt only himself. He also hurts everyone who is, as a result of his irrationality, more likely to live under misguided policies (2007, p.3)."[44]

Even though Caplan doesn't analyze or consider populism, the possibility of its rise underlies his whole line of reasoning. According to his theory, voting for a populist candidate would be a rationally irrational even if the individual knew that over the long term populist policies would be harmful to himself and the economy. However, his theory should predict a lot more populism (or bad policies) than what advanced democracies have experienced (until recently)

An alternative (or complement) to the rational ignorant voter of Downs and the rationally irrational voter of Caplan is the theory of the expressive voter (Brennan and Lomasky, 1993; Brennan and Hamlin, 1998; Hamlin and Jennings, 2011). According to this theory, voters are motivated by considerations that are independent of the result of an election (and the policies that could derive from it) and more directly and immediately linked to the act of voting for a particular candidate or platform. The basic idea is that voting, or voting in a particular way, may "express" some aspect of a voter's beliefs, values, ideology, identity or personality which is independent of the impact that such vote could have on the outcome of the election. Such "expression" may be valuable to the individual and provide sufficient motivation to vote. However, accepting that expressive motivation plays a key role in voting doesn't tell us much about how individuals vote. Brennan and Hamlin (1998) concluded that expressively motivated voters are moderates and instrumental voters tend to be extremists. Drinkwater and Jennings (2007) found the opposite.

The publication of Daniel Kahneman's *Thinking fast and slow* (2011) was hailed as a "major intellectual event" that would have "enormous impact" on applied economics and policy making (Shleifer, 2012). Building on earlier work in cognitive psychology, Kahneman posited that when making decisions humans rely on two modes of thinking: 1) System 1 (or fast thinking) is intuitive, operates automatically, tends to require little effort, and relies on shortcuts and heuristics to make judgments, 2)

[44] Caplan's definition of irrational equates with the definition of stupidity proposed by Cipolla (1976).

System 2 (or slow thinking) allocates attention to the effortful mental activities that demand it, including complex computations, and serves as a mental check on System 1. According to Kahneman, System 1 generally dominates. In politics, this dominance is more prevalent among uninformed voters "who watch a lot of television". Intuition is automatic and reactive, not optimizing. This implies that decisions made under its influence don't even fit Simon's model of bounded rationality. This has great implications for the study of populism. Economists have yet to introduce Kahneman's dichotomy to their analysis of voting. Not so political scientists. A recent study involving focus groups in the UK suggests that predominance of the intuitive mode may be having a "long-term corrosive effect on citizens' attitudes to politics and their faith in the political system" (Stoker, Hay and Barr, 2016). Political marketing strategies and social media reinforce this trend. Although it is never mentioned in this study, the intuitive mode is also the one most favored by (and most favorable to) populist politicians. This is certainly one area that deserves attention by economists.

In summary, a methodological asymmetry between economic and political decisions can be justified not only by the different nature of the choices faced by individuals in economic and political markets but also by the significant structural differences that exist between those markets. Assumptions about voter rationality may provide the most fundamental criteria to classify the contributions made by economists to our understanding of democracy and populism. It is important to note, however, that such assumptions do not have normative implications. Someone can act rationally and still do harm (as Becker argued, criminals follow perfectly rational behavior). On the other hand, assuming that voters sometimes act or behave irrationally does not imply questioning the legitimacy or advantages of democracy.

6. Conclusion

Although it has been a marginal field of study, as this review shows, economists have made a valuable contribution to the analysis of the rise, dynamics and consequences of populism. The populist wave that hit much of the developed world in recent years sparked the profession's interest in the subject, leading to greater depth and breadth in their theoretical and empirical analysis. To make further advances, economists need to address two methodological issues. One is definitional and the other related to assumptions of voting behavior.

As some of the works reviewed here show, an agreement over the definition of populism remains elusive (and in some cases the definitions used are inaccurate or misleading). To some extent, the same has been true among sociologists and political scientists. It would be unrealistic to expect economists to do better in this regard. However, certain clarifications are in order. The first is obvious, but worth repeating: popular policies do not necessarily imply populism (although populism must be popular to win elections).[45] Second, a political candidate cannot be defined as populist simply, or only, by his incompetence to carry out reforms, his opportunism, his popularity, his xenophobia or his charisma. Third, populism is more than a set of macroeconomic policies: it is a sub-optimal "solution" to structural problems that sooner or later requires some form of institutional degradation and leads to stagnation. Fourth, the evidence shows that the distinction between political and economic populism (or good or bad populism as Rodrik proposes) is not sustainable over time. Fifth, populism is not an ideology but a way of doing politics. Its ideological bias is culturally and temporally idiosyncratic

The second issue is how to solve the rationality conundrum. If populist policies are detrimental to economic growth (a conclusion with which most economists seem to agree), populism can be considered an inefficient outcome of political markets. If individuals act irrationally when it comes to making economic choices, economists must provide a convincing explanation of why they don't act rationally when voting (or vice versa). Several schools of thought have explained why the asymmetry is valid both logically and empirically. Assuming voters are rational leads to different conclusions about the fundamental cause behind the rise of populism.

Narrow rationality remains a powerful assumption. Some economists argue it should not be abandoned but expanded. When it comes to individual behavior in political settings many of the papers reviewed here recognize the existence of different classes of voters (e.g., rationally rational and expressive). Others incorporate emotions and beliefs in voters' utility functions. This approach offers a lot more promise than the traditional rational choice model (see Di Tella and Dubra, 2010). However, these models also have limitations because they don't explain why certain beliefs and emotions are critically important to voters at certain times and in certain countries.

[45] Popularity in this sense means the minimum number of votes required in a specific electoral system to gain executive power.

Last but not least, rationality doesn't seem to square with the visceral reaction that populism generates among voters.

The concepts and tools of economic theory have proved useful to predict under what conditions populism will likely arise, what ideological bias it will take, what kind of policies it will adopt and what will be the consequences such policies. They are also helpful to identify and model the supply and demand of populism. However, if defined narrowly, the economic analysis of populism faces certain limitations. The most valuable theoretical and empirical contributions made by economists to the understanding of this complex have incorporated concepts and tools from other social sciences such history, political theory, sociology and social psychology.

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