

Olli Rehn: Living with populism - reflections on the economy and democracy in Europe

Speech by Mr Olli Rehn, Governor of the Bank of Finland, at "Waiting for Populism? Problems of Interpretation and Policy Issues: Four Lectures and a Conversation", Central Bank of Malta, Valletta, 9 May 2019.

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Accompanying [slides](#) of the speech.

Ladies and Gentlemen, Dear Friends,

Let me first wish you a very good Schuman Day – or Europe Day. It is a great pleasure and honour to meet and talk with you today.

It is indeed appropriate that precisely on the Schuman Day 2019 we discuss one of the major political developments in Europe of our time, the rise of political populism. All over Europe we are currently living with populism, which calls for broader reflections on the economy and democracy, and I will discuss these matters today in my talk.

These issues are also of paramount importance for central banking. That's why I want to warmly thank the Central Bank of Malta for organising this conference and Governor Mario Vella for taking the initiative to create an interdisciplinary European research network to look into the notion of populism in central bank communication. Populism has become a normal part of the democratic process in today's Europe, and as democratically-minded people we have to recognise the role it plays.

Why does this matter for central banking? Because the central banks, including the ECB and euro area central banks, do not live in a vacuum, but are reflections of the society at large – independent reflections and actors, I should add. In this context, let me refer to Joseph Schumpeter, one of the greatest economists of all time, who wrote: "The condition of the monetary system of a nation is a symptom of all its conditions."¹

SLIDE 2. Schumpeter's Triangle

What Schumpeter said about a nation, goes today as well for Europe as a whole, for our Economic and Monetary Union. What happens to our money, is a reflection of the state of our union and its economy, of the society and the democracy. So we have to take a broad view.

1. Let me start by pondering the root causes of populism. Pinpointing a single underlying reason for this development is impossible. However, there seems to be broad agreement that a combination of increased economic insecurity, perceived threats to identity i.e. identity politics, and failures of the political decision-makers to address citizens' concerns, all these have acted as a key trigger for populist surges in recent years.

Many countries have faced a host of challenges in the decade following the global financial crisis. The euro area was particularly hard hit following the sovereign debt crises in several member states. On top of all economic hardship, a refugee crisis exploded in Europe. Nowhere else were these impacts felt as strongly as here in the Southern Europe.

SLIDE 3. Economic recovery of the Eurozone from 2013 onwards

With the help of a strong policy response by member states and EU institutions, not least the European Central Bank, and by reforming the Eurozone economic governance and institutional set-up, Europe eventually managed to overcome the financial and economic crisis.

However, the institutional response has not yet been completed. More remains to be done to complete the job with the banking union, and the EU fiscal framework needs to be amended to better protect against the highs and lows of the economic cycle, and support economic reforms.

Apart from the economic and financial policies, it is particularly regrettable that the EU has been unable to decide on and implement sufficient measures to address the refugee crisis, which you know only too well here in Malta and more broadly in Southern Europe. This is a policy area where more consequential joint European efforts are critically needed.

2. Populism is a multidimensional phenomenon and difficult to define. There is no single definition of populism. That is probably because the roots of populist parties and their political agendas vary by country. Let's look at some varieties of definitions of political populism.

SLIDE 4. Timo Soini's Pro Gradu

On this, the views of the present Finnish foreign minister, Mr. Timo Soini, are particularly worth reading, as he has for long time combined both the theory and practice of populism: he wrote his master's thesis on populism some 30 years ago², and was a party leader for the True Finns for over 20 years, before leaving the party in 2017 – so he very much practiced what he preached, and indeed preached what he had studied!

Soini wrote in his 1988 thesis that “populism is an ideology of the people, but it requires almost always a charismatic leader and a group of intellectuals to lead it.” He regards the nationalist ideology as the basis of populism and as the common denominator of all populist parties in Europe.

The distinguished historian of the world economy, Professor Barry Eichengreen comes in fact very close to this definition, having written in his recent book *The Populist Temptation* as follows: “[populism] involves the reaction of voters against the political establishment, nationalist and racist sentiment directed against foreigners and minorities, and a yearning for forceful, charismatic leadership”.

In line with Eichengreen and Soini, populism typically focuses on a handful of ideas with anti-elite, authoritarian, and usually nationalist tendencies in appealing to their base of supporters. Both rightly point out that populist movements have been part and parcel of the democratic political landscape for a long time, from the United States to Finland.

3. What about the relationship of populism to economic hardship? Does economic crisis breed populism? One can make an interesting observation that the recent rise of populism is widespread, and not just contained in the countries experiencing the biggest economic difficulties.

The country I know best, Finland, is a case in point. Finland was recently named – for what is worth, I don't know how much – in the World Happiness Report the “happiest country in the world”, for the second year in a row. In this ranking, all Nordic countries have fared well over the years. I should add that, instead of happiness, we should in my view really speak about life satisfaction in this context. The Report's results suggest that it is not just high national income, but supportive social systems and institutions that play a big role in creating ‘happy’ societies.

The good performance of Finland and its Scandinavian neighbours in these rankings is largely explained by the so-called Nordic model. This is a system that combines a market economy with highly inclusive social policies – strong safety nets, universal health care and free education.

SLIDE 5. Vote for populist parties over time in advanced democracies

The average share of vote for the populist parties in advanced democracies has substantially

grown over the past decades, as seen from this slide: from below 5% in the 1980s to 10–15 % in this millennium, and it has been growing in recent years, as we know.

You may find it then a bit surprising that populist political forces have fared so well in Finland and the other Nordic countries. In the Nordic countries, support for populist parties has ranged between 15–20 percent in recent years. In Finland, the (True) Finns Party has scored between 17–19 percent of the vote in the last three national elections in 2011–19.

So why is it so that even the “happiest people in the world” are so prone to populist temptations? As mentioned, the combination of economic insecurity and threats to national identity appear to trigger populist surges. This is amplified if the political system fails to address citizens’ concerns.

In fact, the economic argument about populism seems to be as much about distribution as aggregate growth – a favourable macro-economic development may mask big differences across different groups.

The distributional impacts of a key driver of today’s changes – especially technological development, such phenomena as artificial intelligence, automatization, digitalisation, robotics – have been widely recognised for some time. Initially, technological development mainly crowded out low-skilled labour. But more recently, with the latest advances in artificial intelligence, it is many medium-skilled jobs that are being threatened, thus placing an even bigger premium on high-skilled jobs and education.

One very relevant and realistic recent book that relate to populism is by Torben Iversen and David Soskice called *Democracy and Prosperity – Reinventing Capitalism through a Turbulent Century*. They refute the crisis of democracy, and rather call the present state of affairs as a challenge for democracy. As comparative or international political economists, their point of departure is the ongoing economic transformation into a fully-fledged knowledge economy, which is very skill-intensive.

For them, the question is how the majority of the people – or voters – can feel that they have a place, stake and future for their children in the society. The key intervening variable is education. Not primarily as a civilizational project, but rather as a way of maintaining one’ position in the reasonable prosperous middle class, or at least keeping up the aspiration for one’s children. They underline the ‘aspirational vote’ of the middle class.

Iversen and Soskice also counter the argument that states are powerless in the face of international capitalism. For them, location matters, and it is the clusters of industries that drive the economy and the thriving cities that attract people. Again, education and training are critical to keep the people on board. And the democratically elected governments can decide on the policies for competitiveness and on the nature of the welfare state. As political economists Iversen and Soskice coin their argument as follows:

“We suggest that the essence of democracy is not redistribution or equality, as so commonly assumed, but the advancement of middle class interests, and we capture this idea as the “fundamental equality of democracy” (to distinguish it clearly from Piketty’s (2014) “fundamental inequality of capitalism”).³

Likewise, in two recent books, Paul Collier and Raghuram Rajan highlight the role played by the widening geographic divide and the loss of shared identity between the thriving metropolis and the declining provinces.⁴ This is related to technological development. In particular, the rapid evolution of the knowledge economy has significantly boosted specialisation to harness productivity gains. Thus, specialists need to work near other specialists with complementary skills to maximise their productivity – and cities provide an opportune environment for close connections.

For the firms eager to harness economies of scale, cities offer large pools of both workers and customers. As the economies of scale have become more important, many provincial towns find it hard to keep up with the competition. At the same time, increased global competition has led to the demise of traditional manufacturing industries in the advanced economies, many of which have been situated in these provincial towns.

4. The geographic redistribution of growth is also associated with the diminished role of local communities and the decline in different forms of belonging to society. This case is particularly strongly made in Raghuraj Rajan's recent book "The Third Pillar": the three key pillars of society – the state, the market, and the community – need to be in balance for strong, sustainable and inclusive growth and development. If any of the pillars weakens too much relative to the others, the society suffers. According to Rajan, this is exactly what has happened to the community pillar due to the centrifugal pull of global markets and new technologies.

In the populist agenda, localism matters and any actual or perceived transfer of power to a more distant elite is viewed with suspicion. This was clearly a key factor behind the Brexit vote, and many others. The regional reaction to rapid urbanisation has been called "the revenge of the regions".

Finally, two significant shocks coincided with the rapid changes driven by globalisation and technological development. First, the 2008 global financial crisis, followed by the economic recession; second, the European refugee crisis. These amplified citizens' fears and frustrations towards the elites and the immigrants, thus further feeding to populist tendencies.

Overall, I see three stages in the development of populism. The first stage is recognition of protest or issues. In the second stage, there are increasing demands for policy change. And in the third stage, there are actions for a regime change – for more illiberal and authoritarian. In many advanced liberal democracies, we are normally in stage two.

5. Since economic policies of populist parties seldom provide real solutions, and the impact of populists on political institutions can be erosive, the liberal democracies need to find ways to contain the rise of populism. Otherwise, we face both fragmentation and un-governability.

SLIDE 6. Vote for the broad political centre in Finland

To illustrate this, in Finland the combined share of votes for the three main centre-left and centre-right parties has declined from a steady 65–70% up until the global financial and economic crisis to below 50 per cent in the most recent elections. At the same time, the share of votes for the largest party has declined from roughly 25 percent to less than 20 percent.

More generally in the advanced liberal democracies, the rise of populism has led to an increased fragmentation of the political system. It has made governing effectively harder, and also made it more difficult to form functioning coalition governments and to carry out structural reforms.

Another notable consequence of the rise in populism is its impact on the policies pursued by the mainstream parties. In some/many cases, the mainstream parties have shifted their policies towards the populists' agenda in fear of losing many more of their voters.

So what can the liberal democracies do to curb or accommodate populist pressures? In theory, the required policies are simple, but modern societies have shown little capacity to be able to respond in the correct way.

SLIDE 7. Agenda for reform in Europe

First step, reinvigorate economic growth. Second, and equally important, ensure that fruits of growth are widely shared. This includes not only that individuals displaced by technological progress and international competition are assured sufficient social support but also assistance

to seek alternative ways to fulfil a meaningful role in society.

As underlined e.g. by the IMF, the big changes affecting our economies and labour markets may require a new social contract to provide citizens with a greater sense of security and confidence in the face of imminent changes. This also involves making choices about the division of responsibilities between the community, the market, and the state.

In economic policy, it needs to be asked whether a more even balance between monetary and fiscal policy stances would be desirable in order to sustain the growth momentum. In our view it is important to underline that, in order to reap the full benefits from the ECB's monetary policy measures, other policy areas should contribute more decisively to raising the growth potential and reducing vulnerabilities. For the longer term, implementation of structural reforms is key for boosting euro area productivity and growth potential. In this way, one would enable a more balanced macroeconomic policy mix. Monetary policy should not be the only active player in town.

FT's Martin Wolf recently presented a list of issues to be tackled in order to contain a new wave of populism. These include leadership, citizenship, inclusion, economic reform, local communities, public services, and better management of globalisation. It is a long and challenging list and needs to be adapted to country-specific circumstances.

There are fundamental value judgements to be made in this process and it is up to the democratic political system to come up with them. On some controversial issues, we need to be able to take a pragmatic approach. Immigration is a case in point – a balance needs to be found between addressing the demographic headwinds by work-based immigration, while avoiding populist backlashes in the advanced economies.

Ladies and Gentlemen,

6. As we have seen, populism is here to stay and pose a challenge to liberal democracies and the rules-based international system, which has been pivotal in the global economic development and helped to lift a vast number of people from poverty over the last century. Nowhere else are the benefits felt more strongly than in small, open economies like Malta and Finland. The gains of commerce and free trade have been immensely important for both countries' catching-up process and prosperity.

The values that underpin our economic and political models in advanced liberal democracies are being challenged both politically and socially, from inside and outside. It is a common challenge for all of us to defend the values of liberty and democracy and the rules-based world order. I do hope that we realise the urgency of this effort, especially now as the role of Europe as the standard-bearer for liberal democracy is even more crucial.

In my view, the best and most effective way to defend liberal democracy is simply by finding and enacting such policies that solve practical problems of our citizens – be they related to employment, environment, immigration, climate change, or other things. We certainly need bolder joint efforts to steer our societies towards a more sustainable future.

Many thanks for your attention.

¹ "Der Zustand des Geldwesens eines Volkes ist ein Symptom aller seiner Zustände."

² Timo Soini, Populismi – Poliittikkaa ja poltinmerkki. Yleisen valtio-opin pro gradu -tutkielma. Helsingin yliopisto, Valtiotieteellinen tiedekunta, huhtikuu 1988. The University of Helsinki.

³ Iversen – Soskice, Democracy and Prosperity Reinventing Capitalism through a Turbulent Century, Princeton University Press 2019, p. 20.

⁴ Paul Collier, "[The Future of Capitalism](#)" and Raghuraj Rajan "[The Third Pillar](#)".