



Populism and income redistribution[☆]

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ABSTRACT

Populist governments might attempt to favor workers in the short-run by encouraging nominal wage increases. But if the real wage can only be affected by productivity in the long-run, these redistributive attempts would lead to inflation and no real improvement. Based on this widely accepted argument, this paper proposes a simple method to disentangle productivity from, what is here called, populist shocks. In particular, a Bivariate Structural Vector Autoregressive analysis with nominal and real wages, and where long-run restrictions are imposed, can be used to identify these two structural innovations. The methodology is applied to Argentina using data from 1865 to 1974 to identify populist regimes.

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1. Introduction

The economic crises around the world gave place to opportunistic political candidates who exploit the voters' frustration with populist campaigns. Even though pundits and policy makers, as well as academics, frown upon the recent advancements of populism in the world, there is no consensus on what populism is.¹

We propose a methodology that allows us to identify and quantify populist shocks and refrains from exploring the electoral rhetoric or voters' sentiment. Thus, rather than studying the current affairs of the populist experience, we take a historical approach to the classification of populism, its costs and benefits. Following this procedure, we shed light on some ambiguous classifications of populism and we quantify the degree of populist policy making.

Focusing exclusively on the economic characteristics of populism, we make an agnostic simplification of policy makers and we pose that populist ones concentrate their redistributive efforts on wages. On the contrary, non-populist policy makers focus on productivity to affect wages. With this assumption, we employ a Bivariate Structural Vector Autoregressive analysis with nominal and real wages and use long-run restrictions to identify two structural innovations: productivity and populist shocks (à la Blanchard and Quah, 1989; Benati, 2012). In our identification, productivity increases can have permanent effects on the real wage whereas positive populist shocks can only have transitory real effects.

The main advantage of our identification scheme is that it relies on a widely accepted argument: only productivity shocks can have a long-run impact on real wages. Additionally, we show that the methodology is robust to controlling for potential demand shocks that could be confused with populist ones. We depart from the more standard classifications of populist regimes (based mostly on non-economic issues), and we show which regimes can be thought of as economic populism.

The current approach is related to Guiso et al. (2019), who highlight the keys to electoral success of populist candidates: anti-elite rhetoric, immediate protection and hiding future costs. Even though our definition is consistent with Acemoglu et al. (2013)'s definition of populism and Rodrik (2018)'s definition of left wing populism, in our analysis we refrain from studying the candidates' rhetoric but we quantify the short-lived potential benefits of populism for the case of Argentina.

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¹ Suter (1994) argued that "The diversity of populist phenomena together with the lack of comprehensive and systematic comparative research has contributed to the fragmentation and vagueness of the theoretical discussion" (page 183).

We use Argentina as our case study due to the available historical data (wages and inflation data since 1865) and its numerous presumed populist experiments. We differentiate between rises in wages that came from productivity improvements and those set under populist regimes and that were doomed to failure. Our methodology allows us to shed light on some regimes for which the historiography has no clear answer. For instance, we show that the presidencies of Yrigoyen (1916–1922) and Perón (1952–55) were not populist even though they are usually thought of as populist periods. Moreover, we find evidence that the populist threat is more severe after the end of World War II, when Argentina became a relatively closed economy. In that regard, openness could be interpreted as a protecting mechanism from populist experiences (in line with Brambilla et al. (2018) and Guiso et al. (2019)).

The Argentine case has caught the attention of international scholars. While one of the richest countries in the world at the end of the 19th century, Argentina entered the 21st century struggling with economic and political crises, unemployment and inflation (Glaeser et al., 2018; Taylor, 1992; Campante and Glaeser, 2018). We show that populism can be an additional factor explaining Argentinean trajectory from poster child to basket case, which has seen many culprits (Díaz-Alejandro, 1970; Della Paolera and Taylor, 2003; Escosura and Sanz-Villarroya, 2009; Taylor, 2018).

Lastly, this note contributes to a growing literature that bridges the gap between economics and political economy by merging standard macroeconomic tools with political economy insights. On these lines, Rauh (2017) and Di Tella and Rodrick (2019) are also two recent contributions.

2. The empirical approach

Estimation. The estimation is based on one assumption: productivity is the only driver of real wages in the long-run. Then, a simple way to identify populist shocks is to use a bivariate VAR with nominal and real wages in which productivity innovations have permanent effects on real wages while populist shocks have only transitory effects. Real and nominal wages at time t are denoted by w_t and W_t , respectively, and two structural shocks are identified: the productivity shock (ε_t^y) and the populist shock (ε_t^p).

Let the vectors of variables and structural residuals be defined, respectively, as:

$$Y_t = \begin{bmatrix} \Delta w_t \\ \Delta W_t \end{bmatrix} \quad \text{and} \quad e_t = \begin{bmatrix} \varepsilon_t^y \\ \varepsilon_t^p \end{bmatrix}$$

Also, let $B(L)$ be the coefficients' matrix of the structural VAR representation. Then, let us consider the following structural moving average (MA) representation:

$$B(L)Y_t = e_t \quad \text{with} \quad e_t \sim N(0, I_2) \quad (1)$$

The identification strategy is performed considering the long-run effects of the structural innovations, as in Blanchard and Quah (1989). The calculus of this effect (in the online appendix) leads to:

$$\underbrace{\begin{bmatrix} \Delta w_t \\ \Delta W_t \end{bmatrix}}_{Y_t} = \underbrace{\begin{bmatrix} \xi_{11} & \xi_{12} \\ \xi_{21} & \xi_{22} \end{bmatrix}}_{\Xi_\infty} \underbrace{\begin{bmatrix} \varepsilon_t^y \\ \varepsilon_t^p \end{bmatrix}}_{e_t} \quad (2)$$

where Ξ_∞ is the long-run matrix. Following Dornbusch and Edwards (1991), Sachs (1989) and Canitrot (1975), the long-run multiplier ξ_{12} is set to 0 to impose that there is no effect of populist shocks over real wages in the long-run, and only productivity shocks can have lasting effects over real wages.

Since it could be argued that some populist shocks might be confounded with positive demand disturbances, a conciliatory interpretation of our results would imply that we identify “non-populist regimes” and potential “populist regimes”. In addition, even if populist shocks were capturing positive demand disturbances, they can be interpreted as populist because the government did not act accordingly to curtail them. Furthermore, Keating (2013) shows that numerous models consider that demand innovations can have permanent real effects. Following Keating's point, the online appendix provides a robustness check where populist shocks are disentangled from demand disturbances, assuming that the latter can have permanent real effects but the former cannot. The results do not change significantly.

After the OLS estimation of the reduced-form coefficients and variance-covariance matrices, we obtain the structural impact matrix which is used to calculate the (accumulated) impulse response functions and the variance and historical decompositions. The uncertainty around the estimates is calculated using 2,000 bootstrapped iterations from estimated residuals.

It is important to stress that, although we focus only on positive populist shocks, the model could be used to identify negative ones. Due to the model's linearity, the latter would mirror the current results. In our framework a negative populist shock would imply reductions in nominal wages in the short-run, which would represent an anti-populist shock. Moreover, such events are not present in our data and are not observed very often in other contexts either, due to nominal downward rigidities. From now on, we refer to positive populist shocks as “populist shocks”, for simplicity.²

3. The evidence

Data. The main advantage of our strategy is that we only need data on wages and inflation. Thus, we exploit the availability of historic data in Argentina since mid-19th century. In particular, we take annual data from Ferreres (2005) for the period 1865–2004, and we focus our analysis in the period 1865–1974 as we explain in next subsection.

Brief historical background. Argentina's adopted universal vote in 1912 when the “Saenz Peña Law” was enacted. Yrigoyen (1916–1922) was the first elected President by “popular vote”, as before that, there were restrictions in voting and the vote was not secret (see Lupu and Stokes (2009)). Yrigoyen is allegedly the first populist leader in Argentina.

Since the end of Yrigoyen's second mandate (1928–1930), military regimes (fostered by coup d'états) and democratic presidents alternated until 1983. The alleged second populist leader was Domingo Perón, who was the “Secretary of Labor” during a military regime but was later elected president for three mandates (1946–1952, 1952–1955, 1973–1974). Since WWII, only Perón completed a full mandate. The other democratically elected presidents during those years were Frondizi (1958–62), Illia (1963–66) and Cámpora (1973–1973).

3.1. Argentina 1865–1974

Fig. 1 shows the variables used in the estimation: nominal wages variations and inflation. And the shaded area in the figure highlights the hyperinflation period (1974–91). Including these years in the fixed-coefficient estimation of the VAR model can deliver biased results due to potential structural breaks. Hence, the following results refer to the period from 1865 until 1974 only.³

² We are very grateful to an anonymous referee for pointing this out.

³ Alternatively, a time-varying coefficients estimation can be performed to deal with possible structural changes. However, it is not clear how to perform

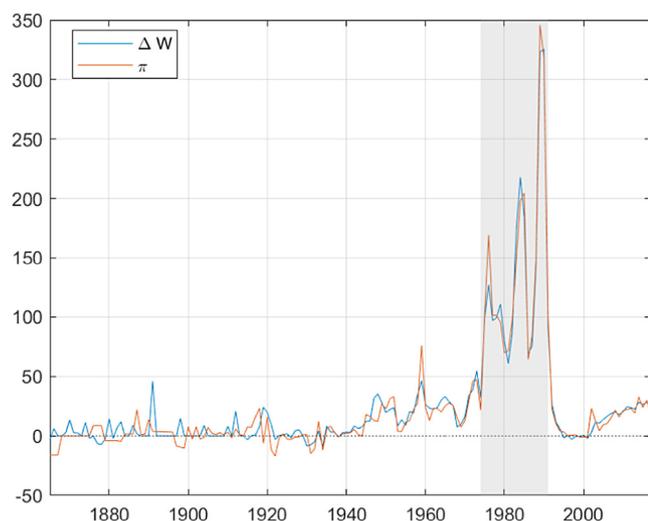


Fig. 1. Nominal wages and inflation, Argentina 1865–2017. This figure presents yearly variations in the nominal wage and CPI prices (both in logs). The gray area indicates the hyperinflationary period from 1974 to 1991.

Impulse responses. The estimation of the accumulated responses shows that the econometric strategy is a sensible one: Fig. 2 indicates that productivity shocks have permanent effects on real wages, whereas populist shocks have only transitory effects. In particular, the median estimates indicate that productivity shocks increase the nominal wage by 4% percent on impact (lower left plot) and have a permanent effect above 10% over the real wage (upper left plot). As for the populist shock, although the median

historical decompositions with time-varying coefficients estimations, as mentioned by Kilian and Lutkepohl (2017). Moreover, as the historical decomposition analysis is crucial in the present study, it is convenient to rely on the fixed coefficient estimation and to discard the periods with potential structural breaks.

estimates show that it increases the nominal wage by 10% on impact (lower right plot), that change has no statistically significant effect on real wages at any time horizon (upper right plot). This negligible small effect of populist shocks even in the short-run, may be consistent with the policy maker relying on workers' monetary illusion.

Variance decomposition. The variance decomposition confirms the previous results: Fig. 3 shows that real wages were mainly driven by productivity innovations, while nominal wages were mostly explained by populist shocks. In fact, the point estimates indicate that innovations in productivity explain around 97% of the real wage variation at all time horizons (upper left plot), while they explain around 12% of nominal wage variation from the first year on (lower left plot). At the same time, populist shocks only account for 3% of real wage variation at all time horizons (upper right plot), but around 87% of nominal wage variation from the second year onward (lower right plot).

Historical decomposition. The previous results allow us to consider a historical decomposition of nominal wages with confidence in our methodology. In particular, we select periods when nominal wage rises surpassed 20% and calculate how much of those increases responded to either productivity improvements or populist shocks. We match these periods with their corresponding presidential terms, and we present the results in Fig. 4.

Notably, seven out of nine episodes took place after the introduction of secret voting (1912), and six out of nine were after WWII. Up until the war, Argentina had an open economy. But after it, tariffs and other regulations led it to be a relatively closed one. These observations are in line with Guiso et al. (2019), who discuss the electoral incentives of populist candidates and openness as a remedy for populism.

Fig. 4 reveals that some administrations that were defined *a priori* as populist, were not. The first bar corresponds to Carlos Pellegrini's presidency in 1890, while the second one refers to the period in which the electoral law was changed by R. Sáenz Peña. Both episodes had large increases in productivity. More interestingly, the third bar corresponds to the first elected president

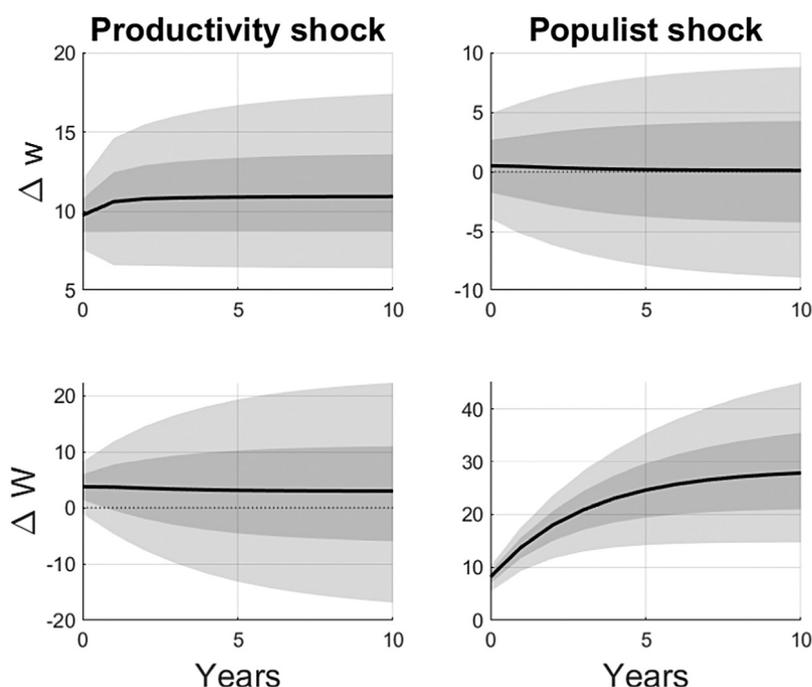


Fig. 2. Accumulated responses, Argentina 1865–1974. This figure presents the accumulated responses of real and nominal wage variations based on 2,000 bootstrap replications of the estimated VAR model. The solid line depicts the median, while the shaded areas show the 68% and 95% confidence intervals. The coefficients of interest, i.e. the productivity shock on real wages and the populist shock on nominal wages, are significant at the 95% confidence level.



Fig. 3. Variance decomposition, Argentina 1865–1974. This figure presents the variance decomposition of real and nominal wage variations based on 2,000 bootstrap replications of the estimated VAR model. The solid line depicts the median, while the shaded areas show the 68% and 95% confidence intervals.

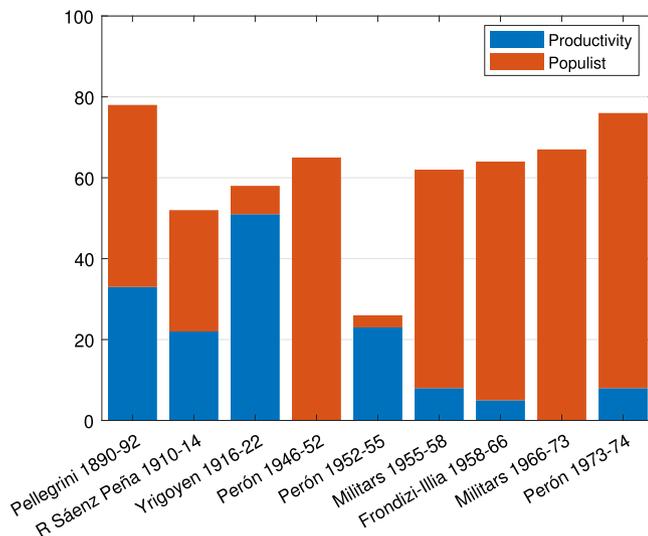


Fig. 4. Historical decomposition of nominal wages (in percentage). The bars in this figure describe how much of total nominal wage variation in selected periods can be attributed to each shock.

with the new law of universal and secret voting, Yrigoyen (1916–22). Although there is no consensus,⁴ he is mostly thought of as the first populist in Argentina (Horowitz, 2008). On the contrary, our analysis shows that, in economic terms, most of the nominal wage increase during his term was caused by productivity.

Was Perón a populist? Our estimates shed light on his administrations: while his first government (1946–1952) was dominated by populist shocks, his second one (1952–55) was not. This result is consistent with the analysis made by Gerchunoff and

Llach (2018), who highlights deep differences between Perón's first and second mandate. Particularly, the wage policy, which favored labor in his first government, became much more cautious in his second administration. In line with Sturzenegger (1991), Perón's last government (1973–74) was mainly affected by populist shocks, although some productivity innovations were also present. These results highlight the advantage of our methodology, as we can state that Yrigoyen and Perón's second term were clearly non populist. Only during Perón's first term, the populist shocks explain solely the increase in nominal wages.

Lastly, populist shocks are not an exclusive characteristic of democratic governments, at least for the case of Argentina. In fact, Fig. 4 shows that from 1955 until 1973, populist shocks were the main drivers of nominal wages. And this long period includes not only the democratic administrations of Frondizi (1958–62) and Illia (1963–66), but also two Military rules: the *Revolución Libertadora* (1955–58) and the *Revolución Argentina* (1966–73).

4. Conclusions

In this paper, we refrain from analyzing the institutional causes and consequences of populism in spite of their importance. Instead, we use a methodology to separate populist shocks from rises in productivity that can be applied universally to level the discussion of populism. Defining the object of study is the necessary step to embark on the institutional conversation.

The first contribution of this study is that our methodology can agnostically identify and quantify populist shocks without a demanding strategy (neither in terms of data nor computationally). The second contribution is obtained applying the model to Argentina: while most economic historians would agree that Perón was a populist, many claim that Yrigoyen (1916–1922) was one as well. Our analysis provides a nuanced qualification for Perón and rejects Yrigoyen's classification.

Appendix A. Supplementary data

Supplementary material related to this article can be found online at <https://doi.org/10.1016/j.econlet.2019.108773>.

⁴ Johnson (2018) discusses the literature on Yrigoyen during the 1916–1922 period in Argentina and shows that historians are divided in terms of the classification of his presidency.

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