

Volume 40, Issue 4

Macroeconomic effects of populist radical right parties in a rational partisan model

Montserrat Ferre

Universitat Rovira i Virgili and ECO-SOS

Carolina Manzano

Universitat Rovira i Virgili and ECO-SOS

Abstract

European countries have witnessed a surge of populist radical right parties in the last decades, some of them entering government coalitions with right-wing parties in several democracies. In this article we will study the impact of such coalitions on macroeconomic variables like inflation and output. To this end, we will use a rational partisan theory model extended with fiscal policy and an independent central bank to reflect the European context.

We acknowledge financial support from Ministerio de Ciencia, Innovación y Universidades (PID2019-105982GB-I00/AEI/10.13039/501100011033), Universitat Rovira i Virgili and Generalitat de Catalunya (2019PFR-URV-B2-53 and 2017 SGR 770).

Citation: Montserrat Ferre and Carolina Manzano, (2020) "Macroeconomic effects of populist radical right parties in a rational partisan model", *Economics Bulletin*, Volume 40, Issue 4, pages 3211-3218

Contact: Montserrat Ferre - montserrat.ferre@urv.cat, Carolina Manzano - carolina.manzano@urv.cat.

Submitted: July 15, 2020. **Published:** December 14, 2020.

1. Introduction

The two-party policy that has shaped many democracies in Europe since 1945 has recently faced a fragmentation of voters' preferences with the surge of populist radical right parties (PRRP). Rodrik (2018) states that the rise of right-wing populism in Europe has been swift: from below 5% of the vote in the late 1980s to more than 20% by 2015. Many of these parties have managed to establish themselves as relevant actors, entering government coalitions with more traditional conservative right-wing parties in Austria, Denmark, Finland, Italy, Poland, Norway, Slovakia and Switzerland, among others (De Lange, 2012; Inglehart et al., 2016; Mudde, 2016). In this article we will develop a rational partisan theory model to study the expected effects on macroeconomic variables of such coalitions.

A major source of the support for PRRP is intrinsically related to the fear that immigration will erode welfare state benefits, particularly in countries that experienced austerity measures and recession (Hatton, 2016; Cavaille and Ferwerda, 2017). Linked to this, is the fact that working-class voters support for the PRRP has increased and in some cases they even constitute the most important group of support (Alfonso, 2015; Goodhart and Lastra, 2018).

Even though most of the PRRP do not present clear socio-economic agendas during electoral campaigns (Röth et al. 2018), several authors conclude that these parties attract more working class voters if they combine economically left-wing and culturally conservative attitudes (De Lange, 2007; Harteveld, 2016). For example, some of the PRRP have pledged to bring economic benefits to the less educated and poorer segments of the community (Goodhart and Lastra, 2018). Another illustrative example is the Danish People's Party, who is "alone among Denmark's right-wing parties in proposing a rise in public spending, drawing strong support from older people".¹

This economically left-wing tendency generates a potential source of tension for PRRP when they participate in coalitions with conservative or traditional right-wing parties. As pointed out by Häusermann et al. (2013), supporting the reduction of the generosity of the welfare state traditionally favoured by conservative parties might be a serious problem for PRRP, given that part of their electoral base has a strong interest in traditional social insurance programs. One way to deal with the trade-off between what their coalition partners and what their voters want, is to differentiate socio-economic policies of de-regulation from redistribution. Röth et al. (2018) find no difference in deregulation policies when PRRP participate in a centre-right coalition, but the reduction of the generosity of the welfare state is clearly restrained when a PRRP is a member of a centre-right coalition.

¹The Financial Times, June 16th, 2015.

The following table shows information on the political parties and the average government spending for some European countries during the period 2011-2019:²

COUNTRY	Period	2011 - 2017	12/2017 - end 2019
Austria	Parties in office (political position)	SPÖ (CL); ÖVP (CR to RW)	ÖVP (CR to RW); FPÖ (PRRP)
	Average real public spending	€175 billion	€179 billion
	Period	10/2011-2/2014 and 2/2014-6/2015	6/2015 - 6/2019
Denmark	Parties in office (political position)	SD (CL); RV (C to CL); SF (CL to LW) and SD (CL); RV (C to CL).	V (CR); DPP (PRRP); LA (CR to RW); DKF (CR)
	Average real public spending	€1,049 billion	€1,052 billion
	Period	6/2011-6/2014 and 6/2014-5/2015	5/2015-6/2017 and 6/2017-6/2019
Finland	Parties in office (political position)	KOK (CR); SDP (CL); VAS (LW); SFP (C); VIHR (C to CL); KD (CR) and KOK (CR); SDP (CL); SFP (C); KD (CR); VIHR (C to CL)	KESK (C); PS (PRRP); KOK (CR) and KESK (C); KOK (CR); PS (PRRP); SIN (PRRP)
	Average real public spending	€106 billion	€108 billion
	Period	2011 - 10/2013	10/2013- end 2019
Norway	Parties in office (political position)	DNA (CL); SV (LW); SP (C)	H (CR); FRP (PRRP)
	Average public spending	1,306.7 m. NOK	1,630 m. NOK
	Period	2011 - 10/2015	11/2015 -end 2019
Poland	Parties in office (political position)	PO (C to CR); PSL (C to CR)	PiS (PRRP)
	Average real public spending	€675.4 billion	€772.3 billion
	Period	2011-4/2012 and 4/2012-4/2016	4/2016 - end 2019
Slovakia	Parties in office (political position)	SDKV (CL to CR); KDH (CR); Most (C to CR); SaS (CR); SD (CL to LW) and SD (CL to LW)	SD (CL to LW); SNS (PRRP); Most (C to CR); Network (C to CR)
	Average real public spending	€32.2 billion	€37.3 billion

Table 1: Political parties in office and average government spending for some European countries during the period 2011-2019. We use the following abbreviations: C: centre; CL: centre-left; CR: centre-right; LW: left wing; RW: right wing; PRRP: populist right.

²The period studied runs from 2011 until 2019, to avoid the data being distorted by the 2008 crisis and also to reflect the fact that this is the period in which populist parties gained more support. We have selected 6 countries among those mentioned in the introduction: Austria, Denmark, Finland, Norway, Poland and Slovakia. We have excluded Italy as a technocrat government was in place from the end of 2011 until 2013. Further, Switzerland and Hungary have also been excluded, as the populist parties SVP and Fidesz, respectively, were in power throughout the whole period studied. The data has been obtained from the Political Data Yearbook and from the IMF World Economic Outlook. Real values have been calculated using the GDP deflator.

This table shows that it is difficult to classify a government as left or right wing: there have been parties involved in government that range from left wing to right wing during the periods where no populist parties were in government. It could be argued that, on average, the governments that preceded a PRRP in office had a centrist ideology in Austria, Finland and Slovakia, and centrist to centre right in Poland. On the other hand, in Denmark and Norway, the governments preceding a PRRP were more centre to left wing. In all of these countries the average government expenditure is higher when a PRRP enters the government through a coalition.

Following on from this, we will introduce in our analysis a preference for higher government spending when a PRRP is in office in a right-wing coalition. The presence of a PRRP in a conservative government coalition, by exerting an upward pressure on government expenditure, could introduce an inflationary bias which could, in turn, affect growth in a negative way. In the next section we will present the rational partisan theory model. In Section 3 we will study the effects of a PRRP entering a coalition with a conservative party and finally, section 4 will present the conclusions.

2. The model

We will extend the rational partisan models of Alesina and Tabellini (1987) and Alesina and Gatti (1995) to consider two parties competing for office, party L (a left-wing party) and party R (a right-wing party), with an exogenous probability P that party L wins the elections and takes office. If party j is in office ($j = L, R$), output is given by:

$$x_j = \pi_j - \pi^e - \tau_j - w^* + \varepsilon, \tag{1}$$

where π_j and π^e are the actual and expected inflation rates, respectively. Further, τ_j represents taxes levied on output, w^* denotes the target real wage that workers seek to achieve, and ε is a productivity shock such that $E(\varepsilon) = 0$ and $var(\varepsilon) = \sigma_\varepsilon^2$.

The budget constraint for government j is

$$g_j = \tau_j + \pi_j, \tag{2}$$

where g_j denotes the ratio of public expenditures over output when party j is in office. Note that public spending will be financed by a distortionary tax (controlled by the fiscal authority) and/or by money creation (controlled by the authority responsible for monetary policy).

In this economy, the timing of events is as follows. First, agents will form expectations on π^e under electoral uncertainty, as they do not know what party will be in office. As party L has a probability P to win the elections, and party R a probability $(1 - P)$, $\pi^e = PE(\pi_L) +$

$(1 - P)E(\pi_R)$, where $E(\pi_j)$ represents expected inflation if party j is in office ($j = L, R$). Once elections take place, the party in office and the monetary authority will choose their policies simultaneously, in an attempt to stabilise the economy after the shock ε occurs. Then, the optimal values of inflation and output will be revealed.

Fiscal policy will be under the control of the government. Therefore, the party in office will use the instrument τ to minimise the following loss function, which is similar to Huang and Wei's (2006), among others:

$$V_{Gj} = \frac{1}{2} (\pi_j^2 + \delta_j(x_j - x^*)^2 + \gamma(g_j - g_j^*)^2), \quad (3)$$

where δ_j and γ represent the relative weights assigned to output and public spending stabilisation with respect to inflation, respectively, ($\delta_j, \gamma > 0$) and x^* and g_j^* denote the output and public spending targets, respectively. According to this objective function, the party in government aims to stabilise output and inflation, and tries to meet a spending target g_j^* , which could reflect demands from interest groups that influence the government. Following Hibbs' (1977) partisan hypothesis, we suppose that $\delta_L > \delta_R$. Further, to reflect the fact that left-wing parties tend to prefer a higher target for public expenditure than right-wing parties, we assume that $g_L^* > g_R^*$.

To represent the generalised presence of independent central banks in Europe, monetary policy will be undertaken by an independent monetary authority with the following loss function:³

$$V_{CB} = \frac{1}{2} (\pi_j^2 + \delta_{CB}(x_j - x^*)^2), \quad (4)$$

where $\delta_{CB} \geq 0$.

Proposition 1: *The policies chosen by the central bank and the party, if in office, are given by*

$$\pi_L = \frac{\delta_{CB} \left(\left(\frac{\delta_R}{\gamma} + 1 + \delta_{CB} \right) A_L + \delta_{CB} A^e \right)}{\Delta} - \frac{\delta_{CB}}{\frac{\delta_L}{\gamma} + 1 + 2\delta_{CB}} \varepsilon, \quad (5)$$

$$\pi_R = \frac{\delta_{CB} \left(\left(\frac{\delta_L}{\gamma} + 1 + \delta_{CB} \right) A_R + \delta_{CB} A^e \right)}{\Delta} - \frac{\delta_{CB}}{\frac{\delta_R}{\gamma} + 1 + 2\delta_{CB}} \varepsilon, \quad (6)$$

$$\tau_L = g_L^* - \frac{\left(\frac{\delta_L}{\gamma} + \delta_{CB} \right) \left(\left(\frac{\delta_R}{\gamma} + 1 + \delta_{CB} \right) A_L + \delta_{CB} A^e \right)}{\Delta} + \frac{\frac{\delta_L}{\gamma} + \delta_{CB}}{\frac{\delta_L}{\gamma} + 1 + 2\delta_{CB}} \varepsilon \text{ and} \quad (7)$$

$$\tau_R = g_R^* - \frac{\left(\frac{\delta_R}{\gamma} + \delta_{CB} \right) \left(\left(\frac{\delta_L}{\gamma} + 1 + \delta_{CB} \right) A_R + \delta_{CB} A^e \right)}{\Delta} + \frac{\frac{\delta_R}{\gamma} + \delta_{CB}}{\frac{\delta_R}{\gamma} + 1 + 2\delta_{CB}} \varepsilon, \quad (8)$$

³The subscript j means that party j is in office.

where $A_j = g_j^* + w^* + x^*$, $j = L, R$, $A^e = PA_L + (1 - P)A_R$ and

$$\Delta = \left(\frac{\delta_L}{\gamma} + 1 + 2\delta_{CB} \right) \left(\frac{\delta_R}{\gamma} + 1 + \delta_{CB} \right) + P\delta_{CB} \left(\frac{\delta_L - \delta_R}{\gamma} \right). \quad (9)$$

Moreover,

$$x_j = x^* - \frac{1}{\delta_{CB}}\pi_j \text{ and} \quad (10)$$

$$g_j = g_j^* - \frac{\delta_j}{\delta_{CB}\gamma}\pi_j, \quad j = L, R. \quad (11)$$

We will now study the effect on these macroeconomic variables when the traditional right-wing party, party R , enters into a coalition with a PRRP.

3. The impact of a populist radical right party

Given that government spending will tend to be higher under a right-wing coalition with a PRRP than under a traditional right-wing party alone, we will study the effect of an increase in the government expenditure target g_R^* :⁴

Proposition 2: *An increase in g_R^* leads to higher inflation and lower output, regardless of what party is in government. An increase in g_R^* also leads to lower government spending if party L is in office, while the opposite occurs if the right-wing coalition is in office. Additionally, inflation, output and government spending are less stable.*

Apart from a higher public spending (higher g_R), the presence of a PRRP in a coalition with party R would increase inflation and lower output. If the coalition is in office, it will have an incentive to increase taxes in order to have more resources for government spending, even though this will have a negative impact on output (lower x_R). This, in turn, will affect the behaviour of the central bank, as it will set a higher inflation (higher π_R). Interestingly, the presence of the PRRP in the coalition will also affect the macroeconomic variables if party L is in office. This is due to the fact that agents, when forming their expectations, take into account the possible participation of the PRRP in the coalition, leading to a higher overall expected inflation π^e . The increase in π^e negatively affects output if party L is in office (see Equation 1) and, hence, party L will prefer a tax reduction, while the central bank has more incentives to inflate in this case (higher π_L). These effects will lead to a lower public spending for party L (lower g_L).

⁴Our model looks at the effect of an increase in government spending when a PRRP enters in a coalition with a conservative party, but it does not state whether the government spending in this case should be higher or lower than what it would be with a left wing party.

In relation to the stabilisation of inflation, note that

$$E(\pi^2) = PE(\pi_L^2) + (1 - P)E(\pi_R^2). \quad (12)$$

Using the expression $E(\pi_j^2) = (E(\pi_j))^2 + var(\pi_j)$, $j = L, R$, we can see from Proposition 1 that $(E(\pi_j))^2$ will be increasing in g_R^* . Further, from expressions (5) and (6) we find that $var(\pi_L)$ and $var(\pi_R)$ will be independent of g_R^* . Consequently, both $E(\pi_L^2)$ and $E(\pi_R^2)$ increase in g_R^* . Equation (12) implies that a rise in g_R^* leads to a more unstable inflation.

Concerning the stabilisation of output, from Equation (10), it follows that $x^* - x_j = \frac{\pi_j}{\delta_{CB}}$, $j = L, R$. Hence, $E((x - x^*)^2) = \frac{E(\pi^2)}{\delta_{CB}^2}$, which implies that the lower stabilisation of inflation due to an increase in g_R^* also gives rise to a lower stabilisation of output.

Finally, from Equation (11), $g_j^* - g_j = \frac{\delta_j}{\gamma\delta_{CB}}\pi_j$, $j = L, R$. Thus,

$$E((g - g^*)^2) = P\left(\frac{\delta_L}{\gamma\delta_{CB}}\right)^2 E(\pi_L^2) + (1 - P)\left(\frac{\delta_R}{\gamma\delta_{CB}}\right)^2 E(\pi_R^2). \quad (13)$$

As an increase in g_R^* leads to an increase in both $E(\pi_L^2)$ and $E(\pi_R^2)$, Equation (13) implies that public spending is also less stable with the presence of the PRRP in the coalition.

4. Conclusions

Populist radical right parties have participated in government coalitions in Europe in the last years. This article has used a rational partisan model with an independent central bank and fiscal policy carried out by the party in office to study the effects of such coalitions on macroeconomic variables. The analysis presented here shows that when a PRRP might be in office in coalition with a traditional right-wing party, inflation in election times increases, while output decreases. Further, the probability of such populist parties entering government can lead to less stable inflation, output and public spending.

Appendix

Proof of Proposition 1: Suppose that party j is in office. The central bank chooses π_j in order to minimise (4). The first order condition (FOC) of this optimisation problem is given by $\frac{\partial}{\partial \pi_j} V_{CB} = \pi_j + \delta_{CB}(x_j - x^*) = 0$, which implies (10).

The party in office chooses τ_j in order to minimise (3). The FOC is given by $\frac{\partial}{\partial \tau_j} V_{G_j} = -\delta_j(x_j - x^*) + \gamma(g_j - g_j^*) = 0$, which implies (11) because of (10). Using (1) and (2) in the FOCs of the authorities' problems, we get

$$\pi_j = \frac{\gamma\delta_{CB}}{\delta_j + \gamma + 2\gamma\delta_{CB}} (\pi^e + A_j - \varepsilon), \text{ and} \quad (14)$$

$$\tau_j = g_j^* - \frac{(\delta_j + \gamma\delta_{CB})(\pi^e + A_j - \varepsilon)}{\delta_j + \gamma + 2\gamma\delta_{CB}}, j = L, R. \quad (15)$$

Using (14) in the expression for π^e and solving for π^e , we obtain

$$\pi^e = \frac{\delta_{CB} \left(P \left(\frac{\delta_R}{\gamma} + 1 + 2\delta_{CB} \right) A_L + (1 - P) \left(\frac{\delta_L}{\gamma} + 1 + 2\delta_{CB} \right) A_R \right)}{\Delta},$$

where the expression of Δ is given in (9). Substituting it into (14) and (15), (5), (6), (7) and (8) are derived. ■

Proof of Proposition 2: Using Proposition 1, it follows that

$$\frac{\partial}{\partial g_R^*} \pi_j > 0, \quad \frac{\partial}{\partial g_R^*} x_j < 0, \quad j = L, R, \quad \frac{\partial}{\partial g_R^*} g_L < 0 \quad \text{and} \quad \frac{\partial}{\partial g_R^*} g_R > 0.$$

Operating:

$$\begin{aligned} E(\pi^2) &= \frac{\delta_{CB}^2 \left(P \left(\left(\frac{\delta_R}{\gamma} + 1 + \delta_{CB} \right) A_L + \delta_{CB} A^e \right)^2 + (1 - P) \left(\left(\frac{\delta_L}{\gamma} + 1 + \delta_{CB} \right) A_R + \delta_{CB} A^e \right)^2 \right)}{\Delta^2} + \\ &\quad \left(P \left(\frac{\delta_{CB}}{\frac{\delta_L}{\gamma} + 1 + 2\delta_{CB}} \right)^2 + (1 - P) \left(\frac{\delta_{CB}}{\frac{\delta_R}{\gamma} + 1 + 2\delta_{CB}} \right)^2 \right) \sigma_\varepsilon^2, \\ E((x - x^*)^2) &= \frac{E(\pi^2)}{\delta_{CB}^2}, \quad \text{and} \\ E((g - g^*)^2) &= \frac{P \left(\frac{\delta_L}{\gamma} \left(\left(\frac{\delta_R}{\gamma} + 1 + \delta_{CB} \right) A_L + \delta_{CB} A^e \right) \right)^2 + (1 - P) \left(\frac{\delta_R}{\gamma} \left(\left(\frac{\delta_L}{\gamma} + 1 + \delta_{CB} \right) A_R + \delta_{CB} A^e \right) \right)^2}{\Delta^2} + \\ &\quad \left(P \left(\frac{\frac{\delta_L}{\gamma}}{\frac{\delta_L}{\gamma} + 1 + 2\delta_{CB}} \right)^2 + (1 - P) \left(\frac{\frac{\delta_R}{\gamma}}{\frac{\delta_R}{\gamma} + 1 + 2\delta_{CB}} \right)^2 \right) \sigma_\varepsilon^2. \end{aligned}$$

Differentiating with respect to g_R^* , we get

$$\frac{\partial}{\partial g_R^*} E(\pi^2) > 0, \quad \frac{\partial}{\partial g_R^*} E((x - x^*)^2) > 0 \quad \text{and} \quad \frac{\partial}{\partial g_R^*} E((g - g^*)^2) > 0. \quad \blacksquare$$

References

- Alesina, A. and R. Gatti (1995) "Independent Central Banks: Low Inflation at No Cost?" *American Economic Review* **85**, 196-200.
- Alesina, A. and G. Tabellini (1987) "Rules and Discretion with Noncoordinated Monetary and Fiscal policies" *Economic Inquiry* **25**, 619-630.
- Alfonso, A. (2015) "Choosing Whom to Betray: Populist Right-Wing parties, Welfare State Reforms and the Trade-off Between Office and Votes" *European Political Science Review* **7**, 271-292.
- Cavaille, C. and J. Ferwerda (2017) "How Distributional Conflict Over Public Spending Drives Support for Anti-immigrant Parties" Unpublished paper, Georgetown University.

- De Lange, S. (2007) "A New Winning Formula?: The Programmatic Appeal of the Radical Right" *Party Politics* **13**, 411-435.
- De Lange, S. (2012) "New Alliances: Why Mainstream Parties Govern With Radical Right-Wing Populist Parties" *Political Studies* **60**, 899-918.
- Goodhart, C. and R. Lastra (2018) "Populism and Central Bank Independence" *Open Economies Review* **29**, 49-68.
- Harteveld, E. (2016) "Winning the 'Losers' But Losing the 'Winners'? The Electoral Consequences of the Radical Right Moving to the Economic Left" *Electoral Studies* **44**, 225-234.
- Hatton, T. (2016) "Immigration, Public Opinion and the Recession in Europe" *Economic Policy* **31**, 205-246.
- Häusermann, S., Picot, G. and D. Geering (2013) "Rethinking Party Politics and the Welfare State. Recent Advances in the Literature" *British Journal of Political Science* **43**, 221-240.
- Hibbs, D. (1977) "Political Parties and Macroeconomic Policy" *European Political Science Review* **71**, 1467-87.
- Huang, H. and S.J. Wei (2006) "Monetary Policies for Developing Countries: The role of institutional quality" *Journal of International Economics* **70**, 239-252.
- International Monetary Fund World Economic Outlook , October 2020 Database.
- Inglehart, R.F. and P. Norris (2016) "Trump, Brexit and the Rise of Populism: Economic Have-Nots and Cultural Backlash" Harvard Kennedy School Faculty Research Working Paper Series RWP16-026.
- Mudde, C. (2016) "Populist Radical Right Parties in Europe Today" in *Transformations of populism in Europe and the Americas: History and Recent Tendencies* Bloomsbury Academic: London, 295-307.
- Political Data Yearbook. <https://www.politicaldatayearbook.com>.
- Rodrik, D. (2018) "Populism and the Economics of Globalisation" *J. Int. Bus. Policy*. DOI: 10.1057/s42214-018-0001-4.
- Röth, L., Afonso, A. and D.C. Spies (2018) "The Impact of Populist Radical Right Parties on Socio-Economic Policies" *European Political Science Review* **10**, 325-350.