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European Populism

In our [2015 Geopolitical Outlook](#), one of the risks we discussed was the rise of populism. In this week's report, we will focus on European populism. The recent attack on the employees of *Charlie Hebdo* in France makes this a timely topic.

In this report, we will define populism, examine why populism has developed in the West, note the particular characteristics of European populism and identify the effects it could have on general geopolitics in the future. As always, we will conclude with potential market ramifications.

Populism

Populism is one of those words that everyone understands until they try to define it. A simple definition is a political doctrine that appeals to the interests and conceptions of the general people as opposed to the interests of the elites.¹ A more formal academic definition suggests it is an ideology that "pits a virtuous and homogeneous people against a set of elites and dangerous 'others' who were together depicted as depriving the sovereign people of their rights, values, prosperity, identity and voice."²

The media has tended to describe populism as a solely right wing movement, but that description is probably too narrow. Instead,

populism is based on the concept that the people are sovereign; populists support democracy, although they tend to narrow their definition of "the people" to those that mostly agree with their views and have similar backgrounds. In other words, their vision of the people is usually homogeneous. Populist leaders tend to argue that democracy has been "hijacked" by cosmopolitan elites and "others" (often, but not always, immigrants), and only with a return of democracy to its roots, where government represents the will of the people, narrowly defined, can the nation be saved.

This concept of the people usually includes ethnicity, race, religion and culture. There is an inherent distrust of elites and those outside of the favored group.

Populism is generally viewed as a pejorative term. Those groups and political parties that espouse such positions usually reject the label of populist. However, it appears that such movements do exist and have existed throughout history. In general, they seem to gain traction during periods of great change. After all, if a person finds groups within his country that compete with him for jobs, his culture, his religion, etc., some reaction against that situation shouldn't be surprising.

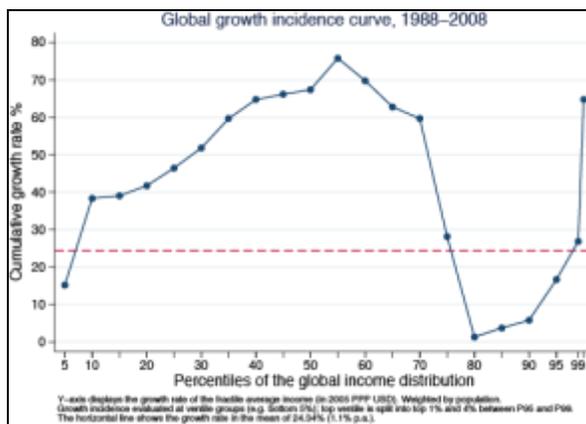
Populism in the West

In general, we believe the roots of populism rest with the Reagan/Thatcher Revolution. Although both politicians appealed to the "common man," their economic policies undermined the economic stability of the post-WWII world.

¹ Wikipedia

² Daniele, A., & McDonnell, D. (2008). *Twenty-First Century Populism* (p. 3). Palgrave Macmillan.

Deregulation, globalization and the sharp reduction in marginal tax rates created a boom of efficiency. New technologies were rapidly introduced; new job categories were created, many jobs were destroyed. Over the past 35 years, the labor markets have favored those with the skills and knowledge to compete in a globalized, highly technological environment. For workers in Western developed nations who lack those abilities, conditions have not been favorable.



(Source: Milanovic, Branko and Lakner, Christoph, *Vox*, May 27, 2014.)

This chart shows the cumulative global income growth by income deciles for the period from 1988 to 2008. This data shows the impact of globalization on incomes. Income growth was very strong up to the 50th decile. From the 70th to the 98th decile, growth was significantly weaker. Only for the top 2% was there a return to strong growth.

Essentially, as production shifted to the emerging economies, the middle classes in the developed world lost income to poorer workers in developing economies. In fact, it can be argued that in the developed world only the highest income brackets saw income growth. The above chart generally confirms data from individual developed countries; in the U.S., most of the income

gains have gone to the upper income brackets alone.

These income differences will have a political impact; for the most part, this impact is rising opposition to globalization and its corollary, immigration. For the elites, the globalization and deregulation started by Reagan and Thatcher have been a boon and so these groups have supported efforts to maintain these policies. However, for the middle classes who are under pressure from these policies, there has been growing opposition to these policies.

Populism in Europe

There are some interesting differences between the U.S. and Europe. Politically, for example, in the U.S. presidential system, the two-party system generally forces the establishment and populists to work out some sort of accommodation. In practice, this has mostly meant the establishment elites effectively co-op the populist opposition, usually by appealing to these groups by supporting social policies they favor.³ Economic policies, on the other hand, still tend to favor deregulation and globalization.⁴

In contrast, most European nations are parliamentary, which means that various parties create coalitions. Thus, different parties can effectively force their way into

³ Another way of observing this condition is in the lengths presidential candidates go to project an image of being a “regular guy.” In some presidential elections, this is described as whether or not a voter would “like to share a beer” with the candidate.

⁴ Although regulations change and are added all the time, one possible example which would show that the U.S. is reregulating would be when mobile phone developers need government permission to release an upgrade. Prior to deregulation, the government tended to regulate the introduction of new technology which reduced the “creative destruction” of capitalism.

power. Populist parties have existed in Europe for a long time but only on rare occasions have they gathered enough votes to warrant consideration in forming a government. In some nations, like Germany, there is a 5% vote threshold that eliminates small parties from participation in government.

In recent years, we are seeing the popularity of populist parties rise steadily in Europe.

- Syriza, the anti-establishment party in Greece that is campaigning on debt renegotiation (or perhaps repudiation), has seen its poll numbers rise from 5% in 2010 to 27% at present. In upcoming elections, it is quite possible it will gather the most votes of any Greek party. The Golden Dawn party, a neo-Nazi group, remains a force on the right.
- Podemos, a left-wing anti-establishment party in Spain, has gone from zero in 2010 to 22% now, and has the second largest membership of any political party in Spain.
- The right-wing U.K. Independence Party had poll numbers of 3% in 2010; it now represents 16% of U.K. voters.
- The Five-Star Movement in Italy was polling at 2% in 2010; it now has numbers around 19%.
- A German anti-Islamic group, called the Patriotic Europeans against the Islamization of the West, or “Pediga,” has been holding marches in German cities for the past few months and is gaining significant participation. Reports suggest that up to 18k participants recently marched in Dresden in support of Pediga. In addition, the

AfD party has been pressing for Germany to exit the Eurozone.

- In Sweden, the Sweden Democrats, an anti-immigration party, nearly forced a snap election by rejecting the minority government’s budget. The party, which placed third in the last elections with 13% of the electorate, was likely poised to increase its seats in parliament; however, a power-sharing deal among the establishment parties allowed a new government to be formed without new elections.
- The National Front in France, a right-wing populist party run by Marine Le Pen, is probably the most popular party in France; Le Pen could win the 2017 presidential elections.
- The True Finns Party in Finland is a right-wing nationalist party that won 4.1% of the vote, giving it five seats in 2007; in 2011, it gained 19.1% of the vote and 39 seats.

This list, though long, is not exhaustive. There are populist movements in virtually all of Europe. These noted have all become increasingly popular since the 2008 financial crisis.

In general, political analysts and the media tend to differentiate between left- and right-wing populists. The left tend to be anti-globalization, secular, oppose capitalism, and support government intervention in the economy. The right wing are also anti-globalization, religious, support capitalism but only on a national (as opposed to a global) scale, and are less open to government intervention although will support government action on issues they favor.

At first glance, it appears that there are significant differences between right- and left-wing populists. However, the differences are probably not as wide as they first appear. The right and left tend to disagree on immigration and religion, for example. Nearly all of the right-wing populist parties oppose immigration on cultural and religious grounds, while the left is not overtly nativist. However, the left seems to expect immigrants to assimilate seamlessly so that, in practice, they end up opposing immigrants as well. For example, the left often supports restrictions on religious practice, which includes bans on religious dress in public. This directly restricts the freedom of immigrants who engage in such practices. In reality, both wings of populism end up opposing immigration, they just do so by different means.⁵

Ramifications

In the media, there is much written that draws distinctions between right- and left-wing populism in Europe. From the financial markets perspective, however, the differences are immaterial.

Western establishment elites have supported globalization and deregulation which have enhanced the economic situation of those who can compete in a globalized and technology driven world. For those who lack the skills to compete in this world, incomes have declined and jobs have become less plentiful. The latter group is obviously not happy with these trends and wants to reverse them to improve its lot.

⁵ Ralph Nader argued that there are enough similarities between right- and left-wing populists that a unified political movement could develop in the U.S.

Nader, R. (2014). *Unstoppable*. New York: Nation Books.

Globalization does increase economic efficiency and immigration allows people to find the optimal venue for their skills and talents. However, as the above income growth chart shows, developed country middle classes have not benefited from globalization on a relative basis since roughly the fall of the Berlin Wall. And so, it makes sense that they would oppose further measures to expand globalization.

So far, in the U.S., populist movements have been successfully managed by the establishment. Because elections have become quite expensive to fund in the U.S., potential populist candidates usually find they cannot raise enough funding to successfully compete.⁶ We note that Speaker Boehner easily overcame threats to his leadership recently and, in many cases, populist candidates failed to generate much traction in elections.

In Europe, on the other hand, parliamentary systems can allow populist parties to exist on a small scale for years and flourish if conditions are favorable. If these populist parties in Europe gain power, it will likely lead to a reversal of globalization. The Transatlantic Trade and Investment Partnership (TTIP) would likely fail to be implemented. Nearly all the populist parties oppose the euro; the single currency could be in danger if these movements gain power.

Globalization has probably made the world more peaceful and has improved global

⁶ Kenneth Vogel of *Politico* recently noted that the 100 biggest campaign donors in the U.S. supplied \$323 mm in 2014 to candidates, about as much as the 4.75 mm people who donated in amounts of \$200 or less. And these numbers don't include funding provided by non-profit groups that are not required to reveal their donor identities.

<http://www.politico.com/story/2014/12/top-political-donors-113833.html#ixzz3NJaCrKIH>.

economic efficiency. This could be lost if populist parties gain power and enforce measures to restrict trade and immigration. If the European populists succeed in undermining the euro, it is quite possible that the gains Europe has made in security since WWII, fostered in part by steady integration, will be lost. Although we would not anticipate an immediate breakdown of the European Union, a decline in Eurozone membership would likely signal that European integration, which began in the 1950s, has reached its zenith. European integration is a factor that has ensured the continent hasn't been the venue of another major war as it was twice before in the 20th century.

If populist parties become powerful enough to control governments, we would expect the euro to depreciate; if governments threaten to exit the Eurozone and reintroduce legacy currencies, their bond yields would likely rise. The turmoil would probably prompt flight to safety buying of U.S. assets. Thus, a rising European populist threat suggests investors should be very cautious about European investments.

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