Financial Crisis, Creditor-Debtor Conflict, and Populism

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Kiel IfW & NBH  MIT Sloan

NBER Summer Institute

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Financial crises and populism

- Surge in support for **populist parties** in the past decade
  - Populist: anti-establishment; claim to speak for “the people” against the elite or outsiders
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- Debate over role of the **financial crisis**

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**No, the Financial Crisis Didn’t Spawn Populism**

Election results and economic data suggest the two aren’t as closely connected as some commentators believe

*By Greg Ip*
Financial crises and populism

- Surge in support for **populist parties** in the past decade
  - Populist: anti-establishment; claim to speak for “the people” against the elite or outsiders

- Debate over role of the **financial crisis**

- Financial crises often followed by political polarization and increased support for populism (Mian et al., 2014; Funke et al., 2015)
  - Limited direct evidence
  - Underlying mechanisms are not well understood
This paper

- Financial crises are often **debt** crises, leading to divisions between debtors and creditors
  - Populist parties exploit divisions through pro-debtor position
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• Can debtor distress boost support for populism?
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- We focus on a foreign currency debt crisis in Hungary that coincided with a sudden rise of the populist far-right party
  - Became the “most successful [populist movement] in the EU” (Schepele, 2014)
This paper

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• Can debtor distress boost support for populism?

• We focus on a foreign currency debt crisis in Hungary that coincided with a sudden rise of the populist far-right party
  • Became the “most successful [populist movement] in the EU” (Scheppele, 2014)

• Estimate impact of unexpected household debt shock on populist far right support using zip-code and individual-level variation
Household debt revaluation shock

Household debt revaluation (percent of 2008 GDP)

Popularity of far-right (percent)

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Household debt revaluation
Household debt revaluation and populist far right support
Key results

1. Following the depreciation, zip codes with higher exposure to FC debt see a persistent increase in the far-right populist vote share
   - Explains 20% of the increase between 2006 and 2010
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1. Following the depreciation, zip codes with higher exposure to FC debt see a persistent increase in the far-right populist vote share
   • Explains 20% of the increase between 2006 and 2010

2. Far-right party success is driven by creditor-debtor conflict
   • Debtor distress creates a niche for the far right populist party to advocate for aggressive debtor friendly policies and “bash the banks”
Far right vote share increases most in high FC debt areas
Background
Household credit expansion in the 2000s

- Subsidized LC loans introduced
- LC subsidies removed
- Entry of FC loans
- Forint depreciates by over 30% against Swiss franc

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**Household debt-to-GDP**

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<th>Quarter</th>
<th>2000q1</th>
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<td>LC + FC at market exchange rate</td>
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Graph:
- Household debt-to-GDP
- Two lines:
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Household credit expansion in the 2000s

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Graph showing household debt-to-GDP ratio from 2000q1 to 2012q1.
Household credit expansion in the 2000s

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Household debt-to-GDP

Year:
- 2000q1
- 2002q1
- 2004q1
- 2006q1
- 2008q1
- 2010q1
- 2012q1

Lines:
- LC
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Legend:
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LC:

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- LC + FC at market exchange rate
Default rates rise significantly for FC loans
Main Result
Empirical framework

$$FarRightShare_{it} = \alpha_i + \delta_t + \mu_{ct} + \beta FCS_i \times Post_t + \gamma X_{it} + \varepsilon_{it}$$
Empirical framework

\[ FarRightShare_{it} = \alpha_i + \delta_t + \mu_{ct} + \beta FCS_i \times Post_t + \gamma X_{it} + \varepsilon_{it} \]

- \( FCS_i \) is the share of loans in FC in zip code \( i \) as of September 2008
  - Variation comes from \textit{timing} of borrowing
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- \( FCS_i \) is the share of loans in FC in zip code \( i \) as of September 2008
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- Controls: Pre-crisis demographics, household income, unemployment rate, education shares, number of loans, and debt-to-income
Foreign currency debt exposure and far-right vote share

\[ \text{FarRightShare}_{it} = \alpha_i + \delta_t + \mu_{ct} + \beta FCS_i \times \text{Post}_t + \gamma X_{it} + \varepsilon_{it} \]

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Zip and election FE  
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Baseline controls  
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Zip code linear trend  
\(R^2\)  
Observations

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Persistent impact on far right support

\[ \text{FarRightShare}_{it} = \alpha_i + \delta_t + \sum_{y \neq 2006} \beta_y \text{FCS}_i \times \mathbb{1}(t = y) + \Gamma X_{it} + \epsilon_{it} \]
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- **Magnitude**: Explains 20% of increase in aggregate far-right vote ⇒ 740k FC loans increased number of far right votes by 142k
Mechanisms
Creditor-debtor conflict

- Debt contracts impose the full burden of adjustment on borrowers
  - Debt relief introduces ex post state contingency that can increase welfare, which may be supported by majority voting (Bolton and Rosenthal 2002)

-But debt relief is often not a Pareto improvement?
- Divisions over who should bear the burden of adjustment

- Banks can easily organize themselves and influence policy (Olson, 1965)
- Creates niche for populist party to represent debtors’ interests

- Why populists?
  - Speaking for “the people” against (foreign) banks (Müller, 2016)
  - Outsider credibility and signaling (Acemoglu et al., 2013)

- Establishment parties have different constituencies and less of an incentive to experiment with radical policies (Rodrik 2014)
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Creditor-debtor conflict: Supply-side
Campaign promises

• Jobbik manifesto contains frequent mentions of FC debt and specific proposals:

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• Center left: “In the field of retail lending we need greater security, a mitigation of risks, and the introduction of new products.”

• Fidesz: no mention household FC debt, but critical of bank bailouts
  • Ultimately passed debt relief after pressure from far right
Creditor-debtor conflict: Supply-side
Textual analysis of 320,724 parliamentary speeches

Foreign currency loans

Eviction, foreclosure, and debt relief

Fraction of speeches


Far right
Fidesz & CR
Center left
Creditor-debtor conflict: Demand-side

- C-D conflict implies that it is FC debtors *themselves* who vote far right
- Voters *indirectly* affected by the crisis should not necessarily vote far right
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Results for center-right parties
Other potential mechanisms are less compelling

- Financial distress ⇒ Immigration concerns/xenophobia?
  - No relation between FC debt exposure and 2016 EU migrant referendum vote share
  - Immigration first became an important issue in 2015

- Declining trust?
- Limited effect on turnout or blank "protest" votes
- Increased preferences for redistribution?
- Far-right tax/transfer policies less pro-redistribution
- Debtors are middle class

To summarize: Creditor-debtor conflict most straightforward and compelling explanation

- Some far-right populist voters may be "single issue" voters
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Final Thoughts

- Debtor distress can help explain increased support for populism after financial crises. Other examples:
  - Ancient Mesopotamia (Goetzmann 2016)
  - 19th century populism in the US (Stock 1984; Eichengreen et al 2017)
  - Debtor countries in the 1930s (Frieden 2015)
  - Podemos in Spain, PiS in Poland (Ahlquist et al 2018)…

- Financial globalization, in addition to trade globalization, may matter for understanding the recent rise of populism (Rodrik 2020)

- Why right-wing and not left-wing populism?

- Hungary-specific: legacy of communism

- Anti-foreign creditor position dovetails with anti-outsider messaging
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Thank you!