

Financial Crisis, Creditor-Debtor Conflict, and Populism

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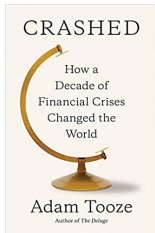
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Financial crises and populism

- Surge in support for **populist parties** in the past decade
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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

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- Can **debtor distress** boost support for **populism**?

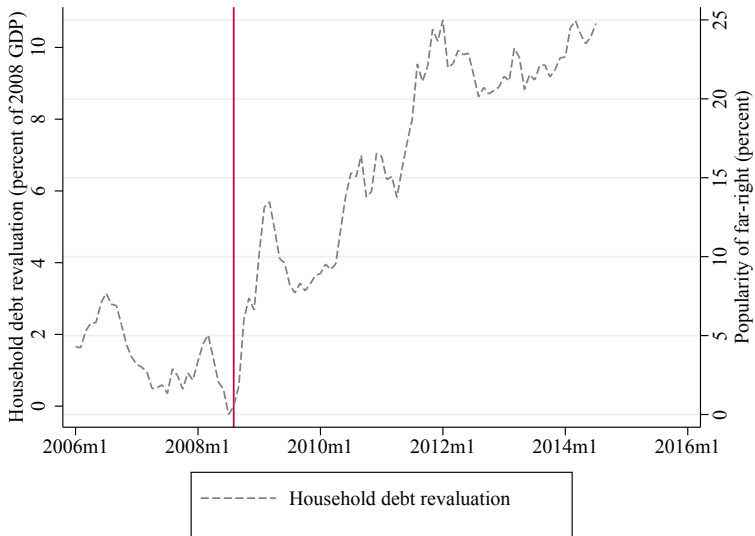
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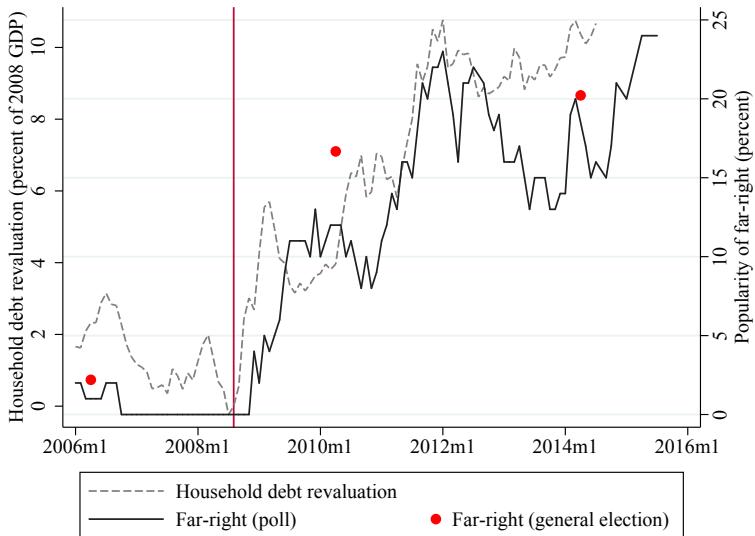
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- We focus on a **foreign currency debt crisis** in Hungary that coincided with a sudden rise of the populist far-right party
 - Became the “most successful [populist movement] in the EU” (Scheppele, 2014)
- Estimate impact of **unexpected household debt shock** on populist far right support using zip-code and individual-level variation

Household debt revaluation shock



Household debt revaluation and populist far right support



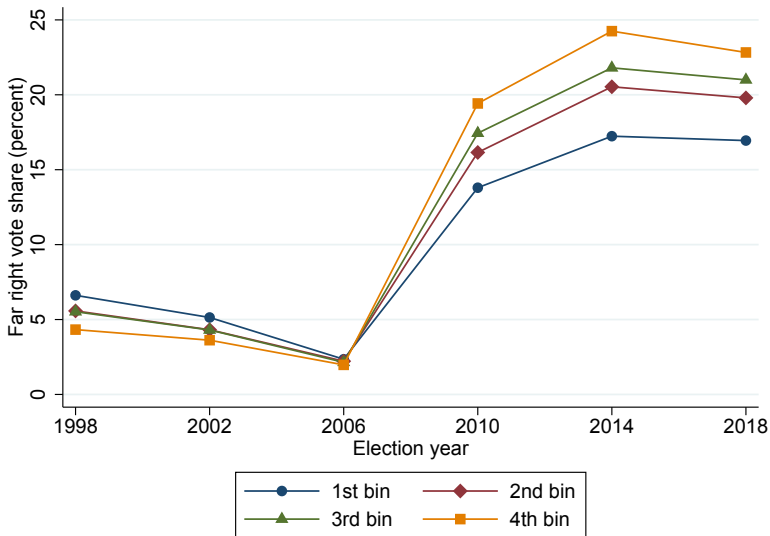
Key results

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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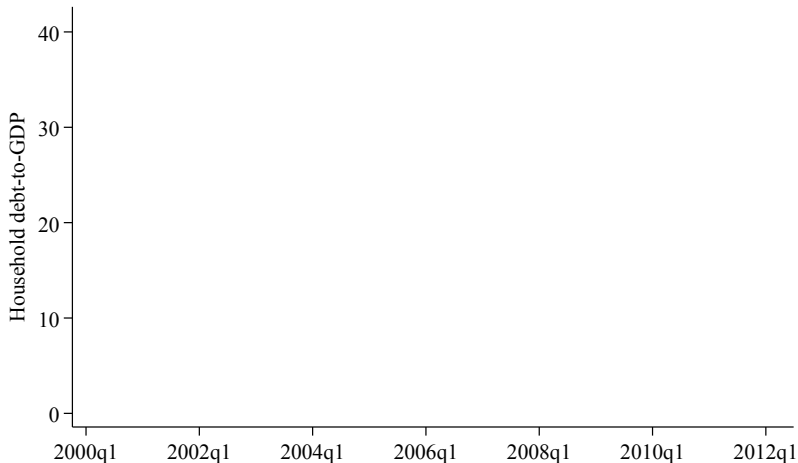
1. Following the depreciation, zip codes with higher exposure to FC debt see a persistent **increase in the far-right populist vote share**
 - Explains 20% of the increase between 2006 and 2010
2. Far-right party success is driven by **creditor-debtor conflict**
 - Debtor distress creates a niche for 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

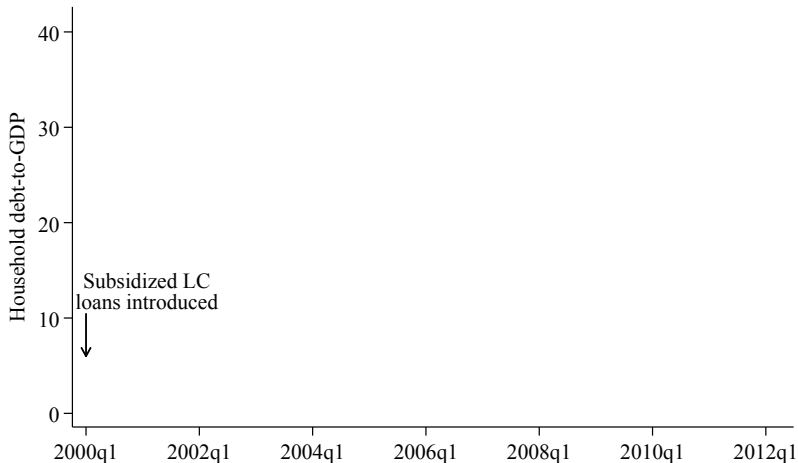


LC

LC + FC at 2008Q3 exchange rate

LC + FC at market exchange rate

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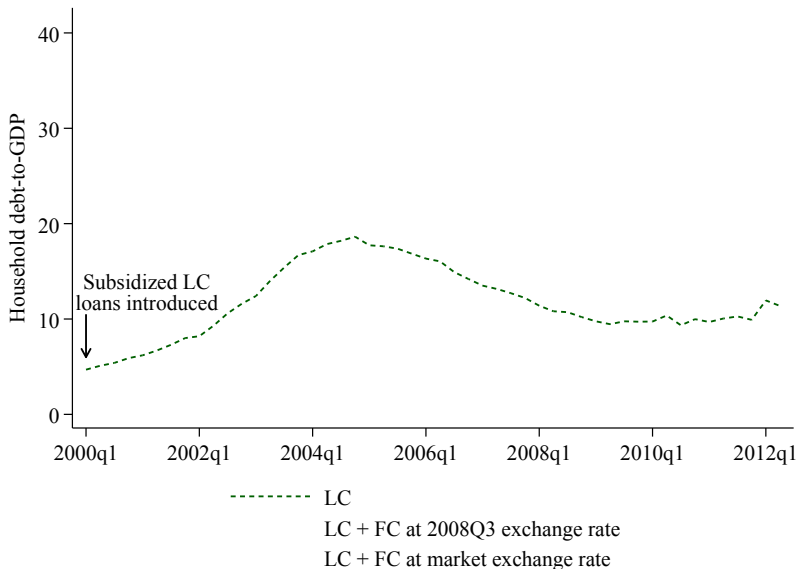


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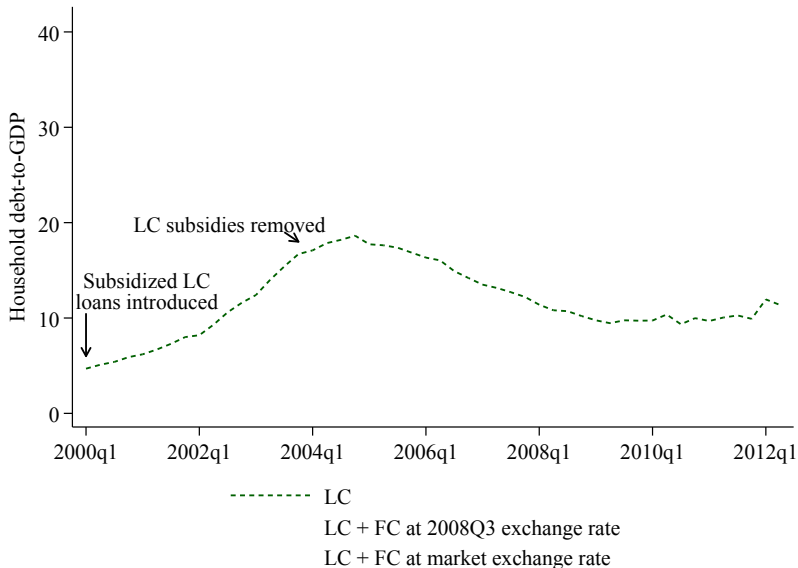
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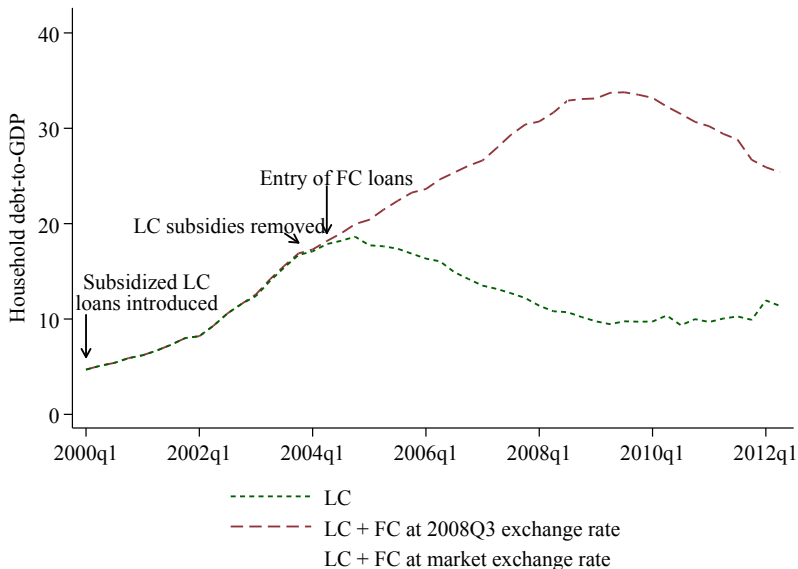
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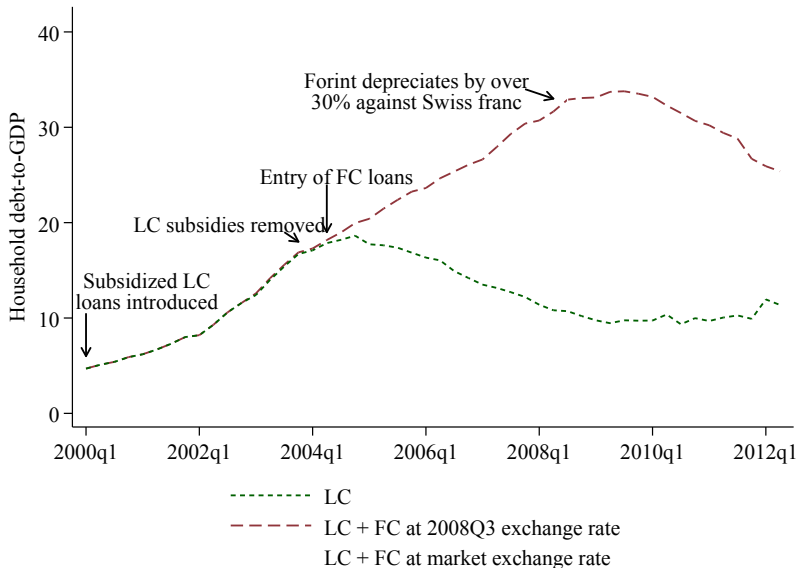
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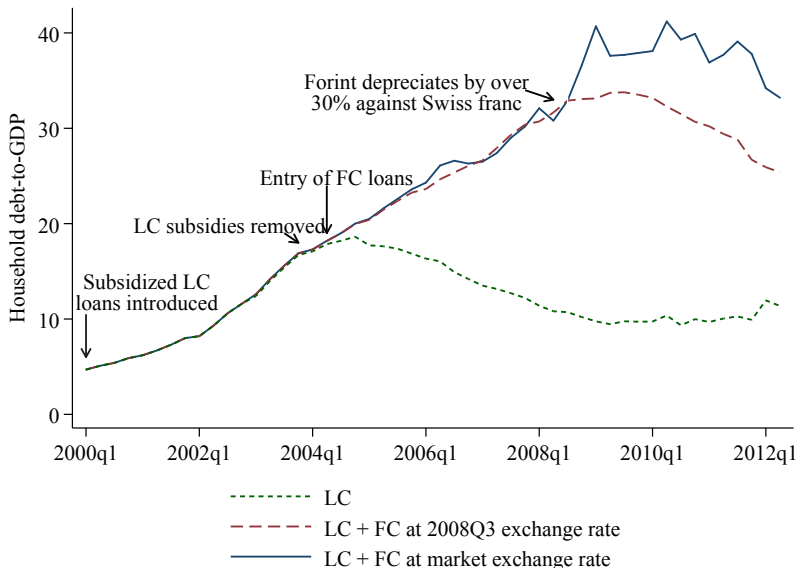
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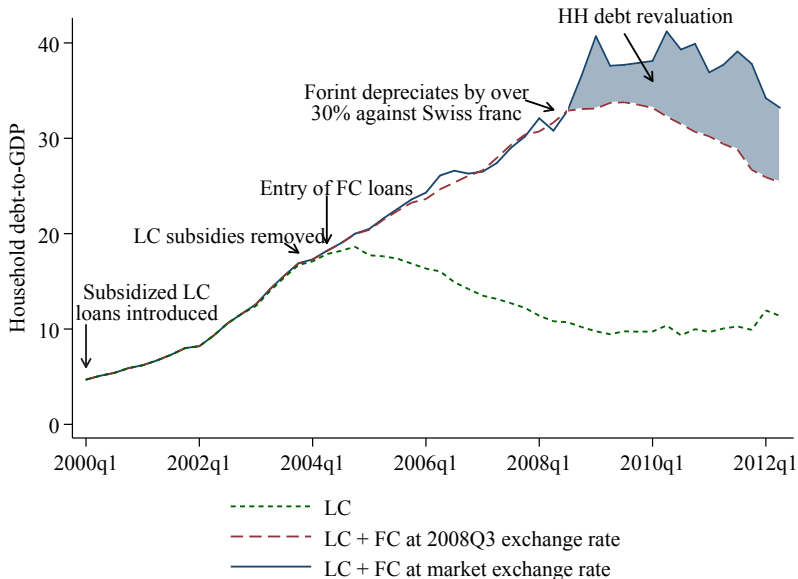
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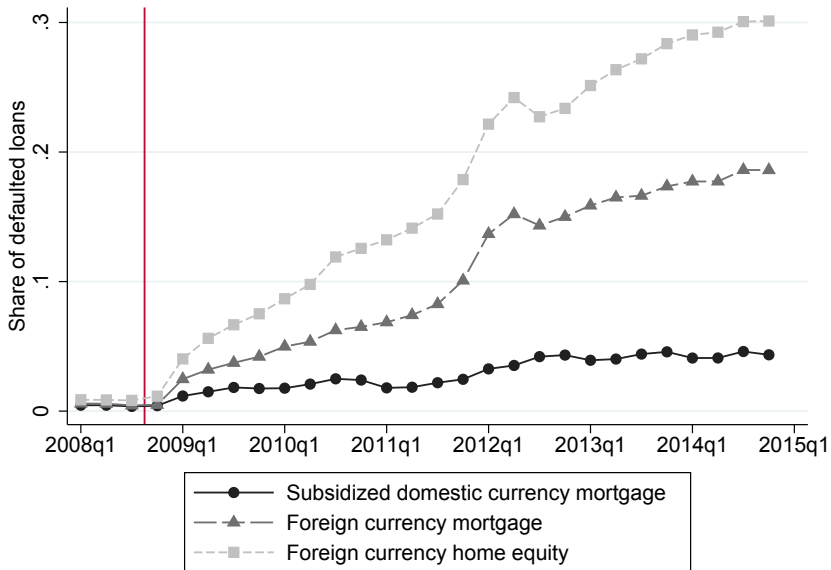
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Default rates rise significantly for FC loans



Main Result

Empirical framework

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

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 - Variation comes from *timing* of borrowing
- 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

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

	(1)	(2)	(3)	(4)
FC share×Post	5.171** (1.279)	4.397** (1.174)	4.187** (1.079)	4.567** (1.372)
Vocational share×Post	24.48** (6.160)	16.78** (6.177)	19.72** (5.217)	13.59* (6.612)
High school share×Post	4.003 (4.693)	-15.10** (5.273)	-1.702 (3.141)	-12.86* (5.814)
College share×Post	-23.08** (6.122)	-28.30** (6.023)	-19.80** (2.412)	-21.99** (5.925)
Zip and election FE	✓	✓	✓	✓
County-election FE	✓	✓		✓
Baseline controls		✓	✓	✓
Subregion-election FE			✓	
Zip code linear trend				✓
R ²	0.910	0.913	0.933	0.969
Observations	13900	13900	13900	13900

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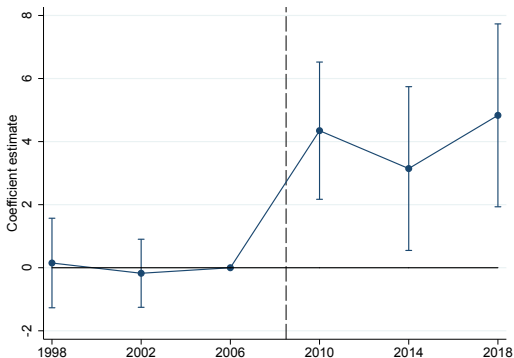
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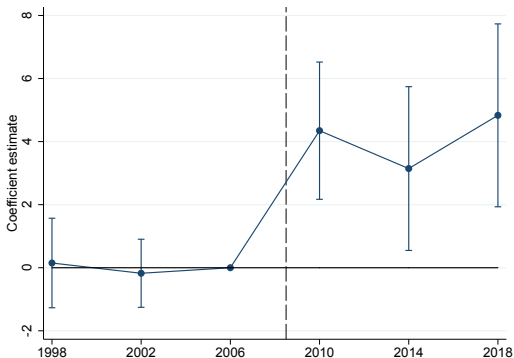
Persistent impact on far right support

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- **Magnitude:** Explains 20% of increase in aggregate far-right vote \Rightarrow 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)

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- 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)

Creditor-debtor conflict: Supply-side

Campaign promises

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

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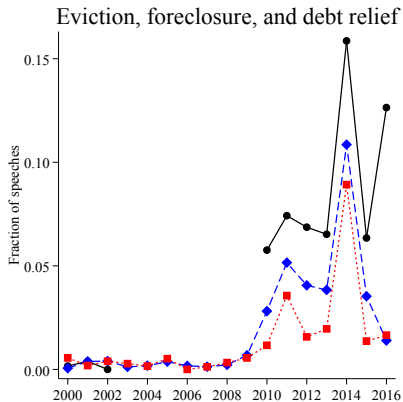
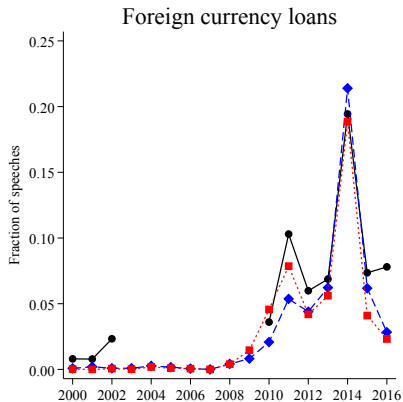
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- Center left: “In the field of retail lending we need greater security, a mitigation of risks, and the introduction of new products.”
- Fidesz: no mention household FC debt, but critical of bank bailouts
 - Ultimately passed debt relief after pressure from far right

Creditor-debtor conflict: Supply-side

Textual analysis of 320,724 parliamentary speeches



—●— 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
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	Δ_{06-10} Far right vote share				
	(1)	(2)	(3)	(4)	(5)
Δ_{08-10} Default	12.17** (3.892)	11.94** (3.943)			
Δ_{08-10} Unemp. rate		3.443 (8.902)	3.583 (8.914)	4.109 (8.880)	3.510 (8.904)
Δ_{08-10} Default, FC			8.917** (3.039)		8.773** (3.034)
Δ_{08-10} Default, LC				3.013 (2.955)	2.327 (2.958)
Controls	✓	✓	✓	✓	✓
County FE	✓	✓	✓	✓	✓
R^2	0.686	0.686	0.686	0.685	0.686
Observations	3473	3468	3468	3468	3468

Other potential mechanisms are less compelling

- Financial distress \Rightarrow **Immigration** concerns/xenophobia?
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- **To summarize:** Creditor-debtor conflict most straightforward and compelling explanation
 - Some far-right populist voters may be “single issue” voters

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)...

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 - Podemos in Spain, PiS in Poland (Ahlquist et al 2018)...
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- Why right-wing and not left-wing populism?
 - Hungary-specific: legacy of communism
 - Anti-*foreign* creditor position dovetails with anti-outsider messaging

Thank you!