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Three essays in political economy on: populism, political survival, and informal economy

Yustyna Zanko

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THÈSE DE DOCTORAT



Trois essais d'économie politique sur : le populisme, la survie politique et l'économie informelle

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École doctorale n° 530, Organisations, Marchés, Institutions (OMI)
Discipline : Sciences Economiques et Gestion

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sous la direction de **Ferhat MIHOUBI**, Professeur des universités, Université Paris-Est Créteil,
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To my dear country Ukraine
To my babcya Dana, mama, and tato

Abstract

Today's world is facing multifaceted challenges in the political and economic realms. Russia's full-scale invasion of Ukraine has revealed the delicate nature of peace in Europe and the impunity of the aggressor. The West has witnessed a recent upswing in the prominence of populist leaders and parties, oftentimes enforced by the Kremlin regime and seeking to undermine the established liberal world order. These developments erode political institutions, destabilizing the economy, which might lead to the impoverishment of the people and, thus, compelling them towards informal employment as a survival strategy. Against this background, this thesis contributes to the literature on political economy through three chapters on independent but intricately entwined topics: populism, political survival, and informal economy.

The first chapter seeks to bring to light the nexus between specific contexts and drivers of the informal economy. The following four key macro-drivers of informality are distinguished: governance and institutions; taxes and labor-income incentives; macroeconomic instability, growth, and international trade; and social benefits and labor regulations. On the other hand, this study defines four main micro-drivers of informality: discrimination based on socio-demographic characteristics; job mismatch; lack of access to finance and land; and job quality and occupation. The novelty of this chapter lies in its attempt to analyze how specific contexts, such as war and violence, natural resources, poverty, and migration, enhance drivers of informality. The chapter differentiates rapid and more gradual informal economy growth contexts. The rapid context associated with war and violence creates an unstable economic environment where informal employment can serve as a survival strategy. In contrast, the more gradual contexts related to natural resource abundance, poverty, and migration act more progressively due to slower changes in the institutional framework. Hence, in the context of war, the informal economy expands primarily due to state and institutional failure. The natural resource abundance and significant migration flows predominantly affect the governance-and-institutions' driver, while poverty undermines social protections and labor regulations.

In light of the recent resurgence in populism worldwide, the second chapter endeavors to uncover the causal factors behind it. This investigation looks at the support for populism by developing a novel mechanism of political supply creating its own demand. In other words, the hypothesis is that it is populist political appeals that generate and influence electoral decision-

making. In contrast to prior studies usually focusing on one specific factor of populism, ours employs a multi-factorial approach seeking to provide a more comprehensive understanding of this complex phenomenon. Building upon the existing scholarly work and centering this chapter specifically on populism in the European Union, we proxy support for populism by distrust in the European Union, often portrayed by populists as a technocratic and bureaucratic organization opposing the interests of people. Employing cross-sectional data from the Eurobarometer surveys over the 2012–2023 period, we perform a probit analysis. This chapter finds evidence that populist actors foster electoral support through four main channels: leveraging economic insecurity, weaponizing and inducing the isolation of individuals, inciting political polarization, and exploiting social media tools. Another result of this study is the discovery that populists target a specific socio-demographic voter profile in their political campaigns based on who is more prone to vote for them, including men, those with lower levels of education, rural and suburban residents, unemployed, retired, and those belonging to the working class. The relationship between age and populist inclination is found to follow an inverted U-shaped pattern.

The third chapter investigates the cornerstones of political survival, for the first time, as far as we are aware, incorporating insights from the “resource curse” theory and diversionary theory of war. Moreover, in a pioneering manner, our study examines the impact of the interplay between oil wealth and military aggression on political durability. Focusing on the region of Eastern and Southern Europe and Central Asia, we conduct a survival analysis based on the panel dataset over the period of 1990–2021. This chapter finds that political leaders might exploit oil wealth and wage wars in the pursuit of maintaining a firm grip on power. The positive association between oil and political survival could be due to oil revenues equipping political leaders with a financial means to apply various strategies to remain in power, including redistribution and unsustainable spending, patronage and co-optation, and repression of dissidents, political rivals, or even political elites. On the other hand, the positive relationship between military conflict instigation and political durability could be explained through the diversionary theory of war, made manifest through two key mechanisms: the “rally around the flag” and “gambling for resurrection” effects. This chapter also suggests the interdependent nature of the influence of oil wealth and war instigation on political survival. Oil exerts a more significant effect on political durability in non-aggressor states compared to aggressor states, while the effect of conflict on political survival diminishes as the level of oil wealth increases.

Keywords: *Informality, governance, institutions, war, natural resources, poverty, migration, populism, Euroscepticism, political survival, resource curse, diversionary theory of war*

Résumé

Le monde d'aujourd'hui est confronté à des défis multiples dans les sphères politique et économique. L'invasion à grande échelle de l'Ukraine par la Russie a révélé la nature fragile de la paix en Europe et l'impunité de l'agresseur. L'Occident a récemment assisté à une montée en puissance des leaders et partis populistes, souvent soutenus par le régime du Kremlin et cherchant à saper l'ordre mondial libéral établi. Ces développements érodent les institutions politiques et déstabilisent l'économie, ce qui pourrait conduire à l'appauvrissement des populations et, par conséquent, les pousser vers un emploi informel comme stratégie de survie. Dans ce contexte, cette thèse contribue à la littérature sur l'économie politique à travers trois chapitres sur des sujets indépendants mais étroitement liés : le populisme, la survie politique et l'économie informelle.

Le premier chapitre vise à mettre en lumière le lien entre contextes spécifiques et moteurs de l'économie informelle. Quatre principaux macro-moteurs de l'informalité sont distingués : gouvernance et institutions ; impôts et incitations au revenu du travail ; instabilité macroéconomique, croissance et commerce international ; et avantages sociaux et réglementations du travail. D'autre part, cette étude définit quatre principaux micro-moteurs de l'informalité : discrimination basée sur les caractéristiques sociodémographiques ; inadéquation de l'emploi ; manque d'accès au financement et à la terre ; et qualité de l'emploi et profession. La nouveauté de ce chapitre réside dans sa tentative d'analyser comment des contextes spécifiques, tels que la guerre et la violence, les ressources naturelles, la pauvreté et la migration, renforcent les moteurs de l'informalité. Le chapitre différencie les contextes de croissance économique informelle rapide (non linéaire) et plus linéaire. Le contexte non linéaire, associé à la guerre et à la violence, crée un environnement économique instable où l'emploi informel peut servir de stratégie de survie. En revanche, les contextes plus linéaires liés à l'abondance de ressources naturelles, à la pauvreté et à la migration agissent plus progressivement en raison de changements plus lents dans le cadre institutionnel. Ainsi, dans le contexte de la guerre, l'économie informelle se développe principalement en raison de la défaillance de l'État et des institutions. L'abondance de ressources naturelles et les flux migratoires importants affectent principalement le moteur de la gouvernance et des institutions, tandis que la pauvreté sape les protections sociales et les réglementations du travail.

Face à la résurgence récente du populisme dans le monde, le deuxième chapitre s'efforce de découvrir les facteurs causaux derrière celui-ci. Cette enquête examine la montée du populisme en développant un nouveau mécanisme d'offre politique créant sa propre demande. En d'autres termes, l'hypothèse est que ce sont les appels politiques populistes qui génèrent et influencent la prise de décision électorale. Contrairement aux études précédentes se concentrant généralement sur un facteur spécifique du populisme, la nôtre emploie une approche multifactorielle visant à fournir une compréhension plus complète de ce phénomène complexe. S'appuyant sur les travaux universitaires existants et centrant ce chapitre spécifiquement sur le populisme dans l'Union européenne, nous mesurons le soutien au populisme par la méfiance envers l'Union européenne, souvent dépeinte par les populistes comme une organisation technocratique et bureaucratique s'opposant aux intérêts des peuples. En utilisant des données transversales issues des enquêtes Eurobaromètre sur la période 2012–2023, nous effectuons une analyse probit. Ce chapitre trouve des preuves que les acteurs populistes favorisent le soutien électoral à travers quatre principaux canaux : exploitation de l'insécurité économique, armement et induction de sentiments de solitude et d'isolement, incitation à la polarisation politique et exploitation des outils des médias sociaux. Un autre résultat de cette étude est la découverte que les populistes ciblent un profil d'électeur socio-démographique spécifique dans leurs campagnes politiques en fonction de ceux qui sont plus enclins à voter pour eux, y compris les hommes, ceux ayant un niveau d'éducation inférieur, les résidents ruraux et suburbains, les chômeurs, les retraités et ceux appartenant à la classe ouvrière. La relation entre l'âge et l'inclination populiste semble suivre un motif en forme de U inversé.

Le troisième chapitre étudie les fondements de la survie politique, pour la première fois, autant que nous le sachions, en intégrant des perspectives de la théorie de la « malédiction des ressources naturelles » et de la théorie de la guerre comme diversion. De plus, de manière pionnière, notre étude examine l'impact de l'interaction entre la richesse pétrolière et l'agression militaire sur la durabilité politique. Se concentrant sur la région de l'Europe de l'Est et du Sud et de l'Asie centrale, nous menons une analyse de survie basée sur le jeu de données en panel sur la période 1990–2021. Ce chapitre constate que les dirigeants politiques pourraient exploiter la richesse pétrolière et mener des guerres dans le but de maintenir une emprise ferme sur le pouvoir. L'association positive entre le pétrole et la survie politique pourrait être due au fait que les revenus pétroliers équipent les dirigeants politiques de moyens financiers pour appliquer diverses stratégies afin de rester au pouvoir, y compris la redistribution et les dépenses non durables, le clientélisme et la cooptation, et la répression des dissidents, rivaux

politiques ou même des élites politiques. D'autre part, la relation positive entre l'instigation du conflit militaire et la durabilité politique pourrait être expliquée par la théorie de la guerre comme diversion, manifeste à travers deux mécanismes clés : les effets « rassemblement autour du drapeau » et « pari pour la résurrection ». Ce chapitre suggère également la nature interdépendante de l'influence de la richesse pétrolière et de l'instigation de la guerre sur la survie politique. Le pétrole exerce un effet plus important sur la durabilité politique dans les États non agresseurs par rapport aux États agresseurs, tandis que l'effet du conflit sur la survie politique diminue à mesure que le niveau de richesse pétrolière augmente.

***Mots-clés :** Informalité, gouvernance, institutions, guerre, ressources naturelles, pauvreté, migration, populisme, euroscepticisme, survie politique, malédiction des ressources naturelles, la théorie de la guerre comme diversion*

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List of Acronyms

AfD	Alternative for Germany party
DPI	Database of Political Institutions
EAP	East Asia and Pacific
ECA	Europe and Central Asia
EMDEs	Emerging market and developing economies
EPZ	Export processing zone
EU	European Union
FI	Forza Italia party
FN	National Front party
GDP	Gross domestic product
GNP	Gross national product
GNI	Gross national income
HR	Hazard ratio
IE	Informal economy
IEA	International Energy Agency
ILO	International Labour Organization
IMF	International Monetary Fund
IPUs	Informal product units
LAC	Latin America and the Caribbean
LFI	La France Insoumise
LN	Lega Nord party
LNG	Liquefied natural gas
LSMS	Living Standards Measurement Study
LTTE	Liberation Tigers of Tamil Eelam
M5S	Five Star Movement party
MNA	Middle East and North Africa
N&E	North and East
NAFTA	North American Free Trade Agreement

NGO	Non-governmental organization
OCHA	United Nations Office for the Coordination of Humanitarian Affairs
OECD	Organization for Economic Co-operation and Development
OSH	Occupational safety and health
PiS	Law and Justice party
RN	National Rally party
SAR	South Asia
SD	Swedish Democrats party
SSA	Sub-Saharan Africa
UKIP	United Kingdom Independence Party
UNDP	United Nations Development Programme
VAR	Vector autoregression
VAT	Value-added tax

General Introduction

Background and motivation: political and economic instability

Today, more than ever over the last decades, we are witnessing alarming events worldwide, providing little solace beyond the gloomy outlook for the future. However, these events did not emerge in a vacuum but rather can be traced back to long-lasting underlying political and economic developments. The horrific large-scale Russia's invasion of Ukraine started on 24 February 2022; however, we would have to be oblivious to say that it took us by surprise, since the foundation was built in front of our eyes. Russia under Putin has had an indisputable and consistent history marked by bloodshed and carnage both at home and across its borders. The numberless acts of war crimes, such as the carpet bombing of Grozny, phosphorus bombs on Aleppo, and burning villages in South Ossetia, to name some, were not enough for the Kremlin regime to face any effective repercussions from the international community. The West's misreading of the reality can be to some extent attributed to what the Yale historian Timothy Snyder called "politics of inevitability" in his book "On tyranny: Twenty lessons from the twentieth century" (2017):

We allowed ourselves to accept the politics of inevitability, the sense that history could move only in one direction: toward liberal democracy. After communism in eastern Europe came to an end in 1989-91, we imbibed the myth of an "end of history." In doing so, we lowered our defenses, constrained our imagination, and opened the way for precisely the kinds of regimes we told ourselves could never return.

The dissidence kept being quelled, more blood kept flowing in new lands, fresh gas and oil deals kept blooming, Putin's popularity back home kept rising. We imagined that there were some red lines that the West would not let Russia cross with impunity. Yet, Russia's annexation of Crimea and invasion of the Donbas region of Ukraine starting in 2014 were followed by the construction of Nord Stream 2, amplifying the EU's energy dependence on Russia, and casting its energy security into disarray. Simultaneously, the Kremlin has been building close ties with and financing political leaders and parties in the US and the EU, seeking to undermine liberal democracies in the West.

Now, when Putin's vision of the world culminated with Russia launching the genocidal war against Ukraine, the international community found itself a hostage to Russia due to its

longstanding policy of appeasement and its deepening economic and political relations. The red lines from a day before evolved into today's new normal. As Timothy Snyder put, "anticipatory obedience means adapting instinctively, without reflecting, to a new situation." Instead of abruptly implementing severe sanctions, which could have potentially held back Russia's military aggression, the EU initiated a policy of gradual sanctions packages. With a one-year delay and tens of thousands of lives lost in the war, the G7 group imposed an oil price cap, and the EU implemented a ban on seaborne oil products from Russia. However, the EU has since increased its oil consumption by 2% compared to the beginning of the invasion, importing oil products from countries that purchased their oil from Russia, including India, China, and some African nations (Ghantous, 2023). Hence, Russia's oil, the key fuel of its war machine, is still flowing around the globe now following new routes. As a result, the real cost of energy resources is not reflected by the increased energy bills but by the lives of Ukrainians taken daily.

There have been wide debates on why the Kremlin started a war with Ukraine, leading to the further isolation and impoverishment of its own population. If we look at the historical trend of Putin's apparent popular support rate, we can notice one clear and appalling pattern. Each military conflict Russia has undertaken has resulted in a substantial increase in Putin's popularity and a further consolidation of power. Thus, Putin has been converting lives taken abroad into votes back home. By diverting attention from domestic issues through military campaigns, Putin has been rallying the Russian population behind Russia's flag and stirring nationalist sentiments. This "rally around the flag effect" finds its theoretical roots in social psychology's in-group/out-group hypothesis, which posits that a conflict with an external group fosters the cohesion of an internal group (Simmel, 1898; Coser, 1956). Being from Ukraine and, therefore, personally affected by Russia's war against Ukraine, I was compelled to direct attention to its essence in this thesis. Driven by the contextual backdrop and personal motivation, Chapter 3 delves into a comprehensive examination of the relationship between oil, armed conflicts, and political survival.

The dichotomy of "us" versus "them" as a tool of political actors to stay in power does not manifest necessarily only through its last and most extreme form of instigating war. The so-called "political magic" of us versus them (Edsall, 2019) has taken over the ballot boxes in different parts of the world, invigorating the unprecedented resurgence in populism, which compelled us to investigate this phenomenon in depth in Chapter 2. Thriving on the antagonism between "pure people" and "corrupt elites," populism has no core values and acts instead as a

“thin-centered ideology,” exhibiting a chameleon-like ability to attach almost any other, more comprehensive, ideology across the political spectrum (Taggart, 2000, 2004; Mudde, 2004; Stanley, 2008). Regardless of their ideological standing, populists expose a clear anti-elite and anti-expert sentiment. Their usual enemies and scapegoats include mainstream center-right and center-left political parties, national and supranational institutions, mainstream media, the corporate world, international organizations, and NGOs. Furthermore, populists oppose any forms of globalization, such as international trade, economic integration, immigration, and multiculturalism, perceiving them as cultural and economic threats. In Europe, populists depict the EU as the enemy, projecting all the problems onto it (Gros, 2014).

Despite their diverse ideological connotations, populists craft, leverage, and pander to people’s intrinsic sentiments of fear of the new, different, and unknown. Populist actors exploit the feeling of fear to isolate and polarize the people, turning, as coined by Hannah Arendt, “atomized individuals” against each other. Populists read public sentiments and frame any socio-economic issues accordingly as outgroup threats (Mols & Jetten, 2020). Therefore, the actual context often matters less than its perceived, shaped by populists’ skillful framing. Strong and charismatic populist leaders often emerge out of the idea of defending people against outside threats, with the leaders eager to execute stringent enforcement and aggression toward those who are deemed a threat to the security of common people (Norris & Inglehart, 2019). With a simplistic communication style, they position themselves as one of the people ready to fight against any enemy, applying a war-like rhetoric. Nowadays, the new media's role has been conducive to the populists’ endeavors. Social media allows populist actors to communicate with their electorate directly, bypass traditional media gatekeepers, frame societal issues to their advantage, and lock people in “echo chambers,” making them further isolated while their views are further polarized.

Populism has been going strong in the EU for the last decade. In 2010, Victor Orban took office as Prime Minister in Hungary, sliding his country towards “illiberal democracy.” In 2014, populists saw success in the European Parliament elections, with the National Front (FN) and the United Kingdom Independence Party (UKIP) holding the leading positions in France and the United Kingdom. In 2015, a coalition between a radical left SYRIZA party and a nationalist far-right Independent Greeks party gained power in Greece, threatening to take the country out of the euro zone. In 2015, Poland witnessed a shift in political power as the right-wing populist Law and Justice (PiS) party took office, jeopardizing the judicial system and independent media. In 2016, the UK left the EU following the Brexit referendum, marked by an upsurge in

populism based on the criticism that the EU limited British sovereignty. In 2017, Marine Le Pen, the leader of the National Front (FN), advanced to the second round of the French presidential elections, while the far-right Alternative for Germany (AfD) secured seats in Germany's Bundestag for the first time. In 2018, the far-right Lega Nord (LN) political party and the anti-establishment Five Star Movement (M5S) party formed a coalition in Italy. During the latest 2019 European parliamentary election, populists experienced considerable electoral success, with French National Rally (RN) and Italian Lega Nord (LN) winning the most votes in France's and Italy's elections to the European Union, while German Alternative for Germany (AfD) also secured significant electorate support. The same year, Poland's Law and Justice (PiS) party won their parliamentary election, almost quadrupling their vote share since 2001. In 2022, Hungarian Prime Minister Viktor Orbán secured a fourth consecutive term in office after his right-wing Fidesz party won a supermajority with over half of the vote. In 2022, Giorgia Meloni's far-right Brothers of Italy party, with roots in the post-war neo-fascist Italian Social Movement, won the most votes in Italy's national election, forming a coalition government with Matteo Salvini's Lega Nord (LN) and Silvio Berlusconi's Forza Italia (FI). The same year, the far-right anti-immigration and anti-multiculturalism Sweden Democrats (SD) party with fascist roots came second in the last Swedish election. In the first round of the 2022 French presidential election, the successful performance of populists was telling, with far right and far left candidates garnering more than half of the votes collectively, as Marine Le Pen's far-right National Rally (RN) and Jean-Luc Mélenchon's far-left La France Insoumise (LFI) came in second and third respectively. In 2023, Robert Fico's populist left-wing Smer-SD party won the parliamentary elections in Slovakia and formed a coalition government with the far-right SNS party and Hlas-SD, a breakaway party from Smer. The Smer-SD party's nationalist agenda intertwined with pro-Russia narratives, and pledging to halt military aid to Ukraine was the driving force behind Fico's victory.

Following World War II, it has been a lengthy journey to build the current liberal order crucial for peace on the European continent. Yet, by eradicating pluralism, the multiplicity of opinions, and the protection of minorities, populism forms an existential threat to the very foundations of liberal democracy (Guriev & Papaioannou, 2022). Populism is only the initial step in the antagonistic worldview of "us" versus "them," paving first the way for authoritarianism, with the risk of no return due to weakened or eroded checks and balances, and then for wars as a final instance of this division. We have been witnessing how Russia has been building ties with,

enforcing, and financing populist forces in the West with a final goal of creating divisions within, bringing chaos to, and ultimately destroying the liberal world order.

Amidst conflicts, state institutions undergo destruction, resulting, in the breakdown of the formal economy and more. The state can no longer ensure access of people to basic livelihoods and provisions, while formal enterprises may cease to function or operate at significantly reduced capacities with limited prospects of investment. Consequently, the local population is faced with the pressing necessity to seek alternative means of economic survival. This is when the informal sector steps in, providing employment opportunities for laid-off workers. The informal sector serves as a “coping economy,” also offering households an avenue to supplement their formal sector incomes, which often become insufficient due to inflation brought on by a conflict and decreased availability of public services. Forcibly displaced populations in particular have to resort to engaging in informal jobs after they are stripped of their usual income-generating activities (Anastasia et al., 2022). However, the informal nature of such employment exposes the workers to vulnerabilities since it does not provide them with legal benefits or labor rights protections compared to formal employment. As a result of Russia’s full-scale invasion, Ukraine's informal economy's share is on the rise, serving as a survival strategy for the population (“Chastka tinovoi”, 2022). In protracted conflict contexts, informal employment may not only become a temporary coping mechanism, but a permanent means for survival (Canagarajah, 2023). Due to the long-lasting devastating humanitarian and economic effects of a military conflict, the reliance on informal employment persists in the post-war period as well.

Furthermore, the abundance of natural resources weakens local governance and institutional capacities due to corruption and conflict of interest. Since resource-rich countries’ budget revenues are derived mostly from natural resource rents rather than taxes, citizens are less concerned about the transparency and accountability of public institutions. Political elites tend to distribute taxes derived from resource revenues discretionarily, resulting in rent-seeking behavior (Tornell & Lane, 1999; Blanton & Peksen, 2023). Rent redistribution occurs partially through spending and cash inflow into the economy through informal activities (Najman et al., 2007). Moreover, resource-rich economies prioritize investments in the resource sector at the expense of other sectors, causing the so-called “Dutch disease.” Therefore, spending and investment related to natural resource revenues limit opportunities in the formal sector, thus driving labor and firms into the informal sector (Kpognon, 2022; Blanton & Peksen, 2023).

Motivated to examine how specific contexts enhance various drivers of informality, we explore it in detail in Chapter 1.

Outline of the thesis: informality, populism, and political survival

Against the provided background and in the complex mosaic of our global society, where the streams of economics and politics converge, we find the focal point of this dissertation. This scholarly endeavor embarks on the investigation of three distinct yet intricately entwined topics of research: populism, political survival, and informal economy. The examination of the complex net of interconnectedness offers a better and more holistic understanding of the multifaceted challenges the contemporary world is facing.

The outline of the rest of the thesis is provided below with the summary of the main motivation, research questions, empirical methodology, and outcomes of each of the three chapters. Each chapter in this thesis is self-contained and can be read independently.

Chapter 1: Informal economy: Main drivers and specific contexts

Chapter 1 is titled *Informal economy: main drivers and specific contexts*. The informal economy encompasses a wide range of economic activities that operate outside formal arrangements. Contrary to the economic activities in the formal sector, informal economic activities are usually unregulated, untaxed, and may involve cash transactions. This dynamic and complex sector plays a significant role around the globe, providing livelihoods for a substantial portion of the population. The informal economy accounted for around 32% of GDP and 31% of employment worldwide from 1990 to 2018 (World Bank, 2022). The informal economy is more prevalent in economically less developed countries (La Porta & Shleifer, 2014). Therefore, while the informal economy comprises one-fifth of GDP and 16% of employment in advanced economies, it constitutes around one-third of GDP and 70% of employment in emerging market and developing economies (EMDEs) (World Bank, 2022). Notably, throughout 1990–2018, we observed a decreasing trend in informality across the globe, especially in EMDES. However, the severe economic contractions in the formal sector due to the COVID-19 pandemic have resulted in an increase in the share of the informal sector (World Bank, 2020a, 2022).

Against this backdrop, in Chapter 1, our objective is to explore the main macro- and micro-drivers of informality and how the presence of specific contexts, such as war and violence, natural resources, poverty, and migration, amplifies their influence on the development and scale of the informal economy.

The key macro-drivers we define are (1) governance and institutions, (2) taxes and labor-income incentives, (3) macroeconomic instability, growth, and international trade, and (4) social benefits and labor regulations. High regulations, including environmental protection, consumer protection, quality control, labor protection, and financial capital availability, are typically associated with a sizable informal sector (Gershuny, 1979; De Soto, 1989; Johnson et al., 1998; Schneider & Enste, 2000; Mukherjee, 2016).

Moreover, while almost all the existing theoretical models suggest a positive relationship between taxes and the presence of the informal sector (Ihrig & Moe, 2004; Busato & Chiarini, 2004; Amaral & Quintin, 2006; Prado, 2011; D’Erasmus & Boedo, 2012; Mitra, 2017), empirically, there is less consensus. While taxes and informality have been found to be positively associated in developing economies, this is less of the case in developed economies due to more robust legal and enforcement systems, lower levels of corruption, and better public goods provision in the latter (Goel & Nelson, 2016; Dabla-Norris et al., 2008; Liu-Evans & Mitra, 2016; Friedman et al., 2000).

It is generally assumed that the informal economy is counter-cyclical, with it expanding during economic downturns and contracting during economic growth (Haghighi et al., 2012). Usually, informal survival activities and sub-contracted and outsourced activities expand during economic downturns (Horn, 2009, 2011). However, steady economic growth rates can also be linked to an increase in informal employment, in particular pertaining to small entrepreneurial firms and sub-contracted and outsourced activities associated with the global production system (Horn, 2009, 2011). Additionally, contrary to classical trade theories, globalization and trade reforms increase competition in the formal sector, which, at least in the short term, may lead to a decline in formal employment and an expansion of the informal sector (Sinha, 2011; Stallings & Peres, 2000; Sinha & Adam, 2000; Carr & Chen, 2002; Harriss-White, 2003; Sinha et al., 2003). Furthermore, since half of the population globally has no social security coverage, and only one-quarter has adequate coverage, the informal economy can often act as a social safety net (Van Ginneken, 2003; Bernabe, 2005). Also, employees and employers might agree to informal job arrangements to forego social security contributions in exchange for a higher take-home salary (Chen, 2012; Ospina & Saavedra-Caballero, 2013).

In this chapter, we distinguish four main micro-drivers of the informal economy: (1) discrimination based on socio-demographic characteristics, (2) job mismatch, (3) lack of access to finance and land, (4) and job quality and occupation. When the rule of law is weak, society's socially and economically disadvantaged groups are more prone to seek employment in the informal sector due to excessive discrimination (Mohapatra, 2012). Thus, minorities, rural-urban migrants, workers with immigrant backgrounds, residents of underdeveloped regions, women, and those with lower levels of education tend to be more likely to belong to the informal sector (Deininger et al., 2013; Walton, 2010; Kouadio & Gakpa, 2020; Başbaya et al., 2018; Malam, 2018; Aikaeli & Mkenda, 2014; Tansel & Acar, 2016; Adair & Bellache, 2012; Hazans, 2011). The relationship between age and informality is found to follow a U-shaped pattern (Başbaya et al., 2018; Hazans, 2011).

The informal economy may also be driven by a mismatch of skills caused by demographic changes and the educational system (Bartlett, 2013). Educated people facing difficulties finding formal employment may turn to informal employment due to the lower skill requirements in the latter. The brain drain can further exacerbate the mismatch.

Most of the informal economy consists of low-quality jobs without labor protection and is characterized by either a high number of hours worked without due financial compensation or very short hours of work and time-related underemployment. Incidence of informality is more common in sectors and across occupations associated with lower job quality. Informal firms are usually smaller, less productive, labor-intensive, and more widespread in the agricultural and service sectors (World Bank, 2022; Benjamin & Mbaye, 2012b).

Finally, lack of access to finance constrains firms to operate at a lower scale and often informally. In a similar vein, lack of access to land may force small farmers or agriculture workers to work in the informal economy (Bello, 2007).

Chapter 1 introduces the following four contexts that enhance the impact of drivers of informality: war and violence, natural resources, poverty, and international and internal migration. We define rapid and more gradual informal economy growth contexts. The rapid context, associated with war and violence, creates an unstable economic environment where engagement in the informal economy often serves as a survival strategy. The more gradual context, related to natural resource abundance, poverty, and migration, is more progressive due to slower changes in the institutional framework. First, we maintain that during conflicts the informal economy is booming mainly due to the state and institutional failure. Moreover,

conflicts undermine economic stability and weaken governance, with primary social benefits undergoing substantial cuts. The war amplifies all the micro-drivers, with discrimination being the most enhanced since conflicts sometimes target specific populations and render large groups vulnerable. Second, we posit that the natural resources context mainly affects the governance-and-institutions' driver through the channel of corruption and conflict of interest. Third, poverty leads, among others, to inadequate social protection and unenforced labor regulations. Fourth, the internal and international migration context mostly influences the governance-and-institutions' driver through the capacity of NGOs, citizens, or migrants' ability to be aware of and contest bad governance through their voices (Hirschmann, 1970). In addition, the context of migration may coincide with discrimination against migrants and reinforce the job mismatch.

Having reviewed the main points discussed in Chapter 1 on the main drivers and specific contexts of informality, we will now provide an overview of Chapter 2, which examines the driving forces behind the recent resurgence in populism.

Chapter 2: When political supply creates its own demand: Populism in the European Union

Chapter 2 is titled *When political supply creates its own demand: Populism in the European Union*. The resurgence of populism worldwide over the recent decades has come to the forefront. In the European Union, populist parties throughout the ideological spectrum have been steadily increasing in popularity. At the core of populism lies the antagonism between “pure people” and “corrupt elites” (Mudde, 2004). Populist politicians and governments strategically label the national and supranational formal institutions of liberal democracy, such as the EU, as corrupt creations of the “elites” (Grzymała-Busse et al., 2020). Against this background and amidst an extensive body of literature, we seek to investigate the causal factors behind the rise in this phenomenon, looking at it from the novel lenses of political supply creating its own demand employing a multi-factorial approach. We hypothesize that it is populist political appeals that generate and influence the electorate's decision-making. Focusing specifically on populism in the EU and building upon the prior scholarly work, we proxy support for populism by distrust in the EU, depicted by populists as a technocratic and bureaucratic organization opposing the interests of people (Fortunato & Pecoraro, 2022).

Based on the existing literature, we develop a theoretical framework and outline four hypotheses that direct our empirical analysis. We intend to study whether populists capitalize on the electorate's economic insecurity, the isolation of individuals, political polarization, and dependence on social media for receiving political news to enhance their political standing. In addition, we inquire as to whether there is a specific socio-demographic profile of a voter that populists are more prone to target. In our endeavor to uncover answers to these questions, we use cross-sectional data from the Eurobarometer surveys spanning from 2012 to 2023 and conduct a probit analysis.

We find that populist actors affect political demand through four key supply-side channels. First, populists leverage economic insecurity, represented in our study by the frequency of facing difficulties paying bills, to induce electoral support. Those who experience such difficulties from time to time and frequently are respectively around 8% and 17% more prone to vote for populists compared to those who almost never or never have them. This finding corroborates the economic insecurity thesis (Guiso et al., 2017, 2022).

Second, populists may exploit the isolation of individuals, proxied by the frequency of discussing European political matters, to foster electoral backing. Those who occasionally and frequently discuss these issues in their circle of friends and family are respectively about 6% and 4% less likely to distrust the EU than those who never do so. Drawing from these results and building on the political philosophy of Hannah Arendt (1951, 1953), we argue that populist leaders thrive on the isolation of the "atomized individuals," which makes individuals turn against each other and "the elites" and seek refuge in populist ideology.

Third, populist actors may leverage political polarization to serve their own agenda. Our econometric analysis indicates that having extreme political leaning increases an individual's likelihood of distrusting the EU by 3% when compared with having moderate views. Thus, based on the conceptual framework proposed by Mols and Jetten (2020), we maintain that populists move into or create electoral space at political fringes to position themselves strategically vis-à-vis their opponents, simultaneously capitalizing on the anti-establishment public sentiments.

Fourth, social media is seen as an essential asset for populists. We find those who rely on social media as the primary source for their news on European politics have around 6% higher likelihood to support populists compared to those who rely on other sources. This finding is in line with the existing literature, which argues that social media allows political leaders to

bypass traditional media gatekeepers and communicate directly with their voters, at times resorting to post-truth politics tools to read and shape public grievances to spur demand (Manucci, 2017; Engesser et al., 2017; Iosifidis & Wheeler, 2018; Flew & Iosifidis, 2020).

Finally, our empirical analysis shows that men, those with lower levels of education, rural and suburban residents, unemployed, retired, and those belonging to the working class are more likely to support populists. We find an inverted U-shaped pattern between age and populist voting.

This chapter brings several contributions to the literature on populism. To the best of our knowledge, this is the first attempt to empirically investigate the rise of populism through the mechanism of political supply creating its own demand. Moreover, in contrast to the prior studies that usually focus on one explanatory factor of populism, we apply a novel multi-factorial approach.

Having navigated through Chapter 2, which aimed to investigate how populist supply shapes political demand, we will proceed now with introducing Chapter 3, where we examine how political leaders can exploit oil wealth and wage wars for their political survival.

Chapter 3: Oil, bloodshed, and power

Chapter 3 is titled *Oil, bloodshed, and power*. According to the selectorate theory proposed by Bueno de Mesquita et al. (2005), the primary goal of political leaders is to remain in power. However, we observe a wide diversity in the tenure duration of political leaders worldwide. Thus, in this chapter, we seek to investigate the underlying factors leading to the heterogeneity in political durability. In our research, we focus on the countries in Eastern and Southern Europe and Central Asia, which are united by a shared historical legacy and transition toward market-based economies. The region of our focus is marked by varying political leadership duration, diverse levels of natural resource endowment, and a sufficient number of military conflicts over the last three decades.

Against this background, our study draws from two distinct bodies of literature, with one on the “resource curse” and another on the diversionary theory of war. Per the “rentier states” theory, natural resource rents provide both incentives and a means to stay in power (Jensen & Wantchekon, 2004). Prior scholarly work has found that oil has significant implications on political survival, more than other natural resources, due to its investment’s practicalities and strategic implications (Omgba, 2009). Oil revenues enable political leaders to finance and

adopt a range of strategies to secure their power, such as “petro-populistic” redistribution and spending policies directed towards the population (Parenti, 2005; Bueno de Mesquita & Smith, 2010; Arezki & Brückner, 2012; Matsen et al., 2016), co-optation and patronage to bribe political rivals and dissatisfied elites (Ross, 2001; Acemoglu et al., 2004; Robinson et al., 2006; Crespo Cuaresma et al., 2011; Bjorvatn & Naghavi, 2011; Wright et al., 2015), and bolstering repressive apparatuses to tame dissent and dissuade challengers (Wintrobe, 1998; Ross, 2001; Acemoglu et al., 2010; Cotet & Tsui, 2013; Wright et al., 2015; Ishak, 2019). Additionally, the geopolitics of global oil demand plays a significant role in the survival of political elites in oil-rich countries (Rajan, 2012; Bellin, 2004). Our chapter builds specifically on those empirical studies that analyze the relationship between natural resources, particularly oil, and political leadership survival (Ross, 2008; Omgba, 2009; Crespo Cuaresma et al., 2011; Andersen & Aslaksen, 2013; Wright et al., 2013).

The second strand of the literature that guides our research pertains to the diversionary theory of war, which posits that political leaders can launch external or internal armed conflicts to divert the public’s attention away from domestic issues and enhance their popularity (Levy, 1989; Tir & Jasinski, 2008). There are two main mechanisms through which a war can bolster political leadership’s standing: the “rally around the flag” and “gambling for resurrection” theses (Haynes, 2017). The “rally around the flag effect” is rooted in social psychology’s in-group/out-group hypothesis, which argues that a conflict with an external group increases the cohesion of an internal group (Simmel, 1898; Coser, 1956). On the other hand, the “gambling for resurrection” thesis holds that in the unfavorable domestic context political leaders may instigate military conflicts as a strategy of last resort to prove their competence to their constituents through the successful implementation of aggressive foreign policy (Richards et al., 1993; Downs & Rocke, 1994; Tarar, 2006; Goemans & Fey, 2009; Haynes, 2017).

Drawing upon these two strands of literature, we propose the theoretical setting with the embedded hypotheses that underpin our empirical analysis. We strive to assess whether a greater oil wealth and instigation of military conflict results in a higher probability of political survival. In addition, we aim to test if the effects of oil and military aggression on political durability are interdependent.

In this chapter, using macro-level data from Zárata’s Political Collections dataset, Database of Political Institutions, World Bank’s World Development Indicators’ database, UCDP/PRIO dataset, and Freedom House, we build a panel dataset covering 29 countries in Eastern and Southern Europe and Central Asia over the 1990–2021 period. The empirical methodology is

based on survival analysis. First, we employ the nonparametric Kaplan-Meier estimator to acquire a primary understanding of the relationship between oil, conflict, and political durability. To investigate this relationship more thoroughly, we apply the semi-parametric Cox proportional-hazards model.

This chapter finds that political leaders might exploit oil wealth and instigate an armed conflict in their pursuit to maintain a firm grip on power. Our survival analysis reveals that, on average, one percentage increase in oil rents in relation to a country's GDP decreases the hazard of political leadership experiencing failure by 47.63%, *ceteris paribus*, corroborating the findings of Ross (2008) and Omgba (2009). Moreover, holding other factors constant, the risk of political failure is, on average, 99.63% lower for leaders in states launching military aggression compared to those that do not, lending support to the diversionary theory of war (Levy, 1989). Additionally, our empirical results suggest that oil wealth has a more significant influence on political survival in non-aggressor states than in aggressor states and that the effect of conflict on political survival diminishes with greater levels of oil wealth. The possible explanation is that in a scenario without an armed conflict, political leaders can use oil wealth to fund various domestic strategies. However, when a state launches a military conflict, the latter eclipses all other factors. Furthermore, the ample oil revenues enable political leaders to carry out several strategies domestically that might be more likely to extend their tenure in the long term compared to diversionary policies, which might have only a short-term effect.

To sum up, this chapter contributes to the literature by integrating for the first time, as far as we are aware, the insights of the “resource curse” theory and diversionary theory of war in investigating political survival. Also, by analyzing how the interplay between oil wealth and military aggression affects political durability, we offer a more intricate understanding of the complex relationship between oil, conflict, and political survival.

After presenting the outlines of each chapter of the thesis, we will now reiterate its main contributions to the existing literature.

Contributions

In essence, this thesis makes contributions to the existing literature in the following ways. First, it examines how the presence of specific contexts, such as war and violence, natural resources, poverty, and migration, enhances the impact of macro- and micro-drivers of informality. Second, it contributes to the body of literature on the resurgence of populism by looking at it

through novel lenses of political supply creating its own demand, applying a multi-factorial approach. Third, this thesis furthers our understanding of political survival by investigating it through the synthesis of insights derived from the “resource curse” theory and diversionary theory of war.

With the aforesaid, the findings of this thesis provide deeper insights into understanding of the complex issues of today’s world, particularly by investigating populism, political survival, and informal economy.

Chapter 1

Informal economy: Main drivers and specific contexts

“In developing countries, informal firms account for up to half of economic activity. They provide livelihood for billions of people. Yet their role in economic development remains controversial.”

— La Porta & Shleifer (2014)

1.1 Introduction

The term “informal sector” was first coined by economic and social anthropologist Hart in his research on Ghana (Hart, 1973) and became widely accepted after the International Labour Organization used it to analyze economic activities in Kenya (ILO, 1972).

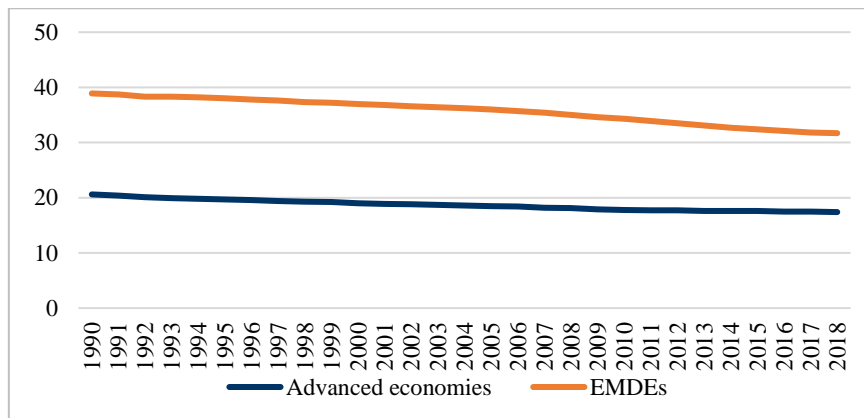
Nowadays, the term “informal economy” is preferred to “informal sector” because the workers and firms in question cross multiple economic sectors rather than being confined to just one. The ILO defines the term “informal economy” as all economic activities by workers and economic units that are legally or practically not covered or insufficiently covered by formal arrangements. Their activities fall outside the law, which means that they are operating beyond the formal scope of the law; or they are not covered in practice, as the law is not applied or not enforced; or the compliance may be deterred by legal provisions that are inappropriate, burdensome, or impose excessive costs (ILO, 2002).

The motivation behind informality stems from two complementary concepts: “exclusion” and “exit” (Perry et al., 2007). First, some workers and firms find themselves “excluded” from the formal economy due to burdensome entry regulations and a lack of human capital. This type of informality is often characterized by low productivity and poorly paid and low-skilled employment (La Porta & Shleifer, 2014; Loayza, 2018; World Bank, 2022). Conversely, other informal workers voluntarily “exit” the formal sector and opt for an informal activity for its

flexibility, independence, and reduced regulatory obligations (Blanchflower et al., 2001; Falco & Haywood, 2016; Günther & Launov, 2012; Maloney, 2004; World Bank, 2022).

According to the World Bank (2022), globally, the informal economy comprised around 32% of GDP and 31% of employment over the 1990–2018 period. A higher level of development, as indicated by per capita income, is linked to lower levels of informality (La Porta & Shleifer, 2014). Hence, while the informal economy constitutes one-fifth of GDP and 16% of employment in advanced economies, it represents an average of one-third of GDP and 70% of employment in emerging market and developing economies (EMDEs), of which self-employment accounts for over 50% (World Bank, 2022). The proportion of informal economy varies across the regions. When analyzing the situation in EMDEs, Sub-Saharan Africa (SSA), Europe and Central Asia (ECA), and Latin America and the Caribbean (LAC) experience the highest informal economy’s output share. On the other hand, SSA, South Asia (SAR), and East Asia and Pacific (EAP) have the highest share of self-employment. From 1990 to 2018, informality showed a decreasing trend across the globe, especially in EMDES, as highlighted in Figure 1.1 and Figure 1.2.

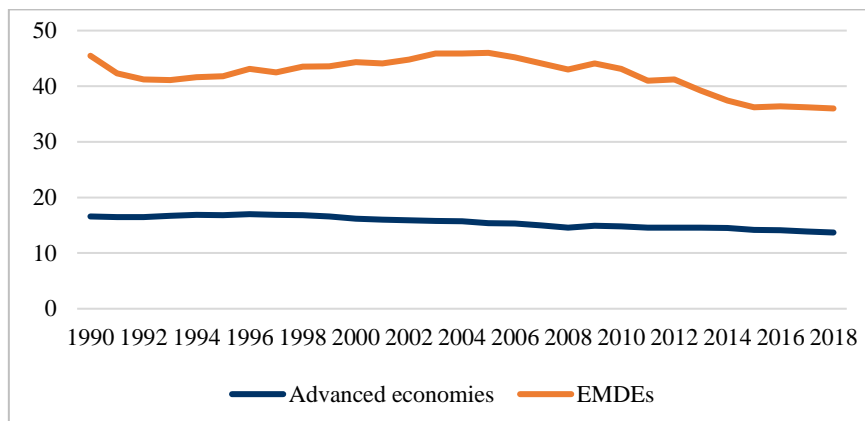
Figure 1.1: Informal share of output, 1990–2018 (% of GDP)



Source: Based on data from the World Bank (2022)

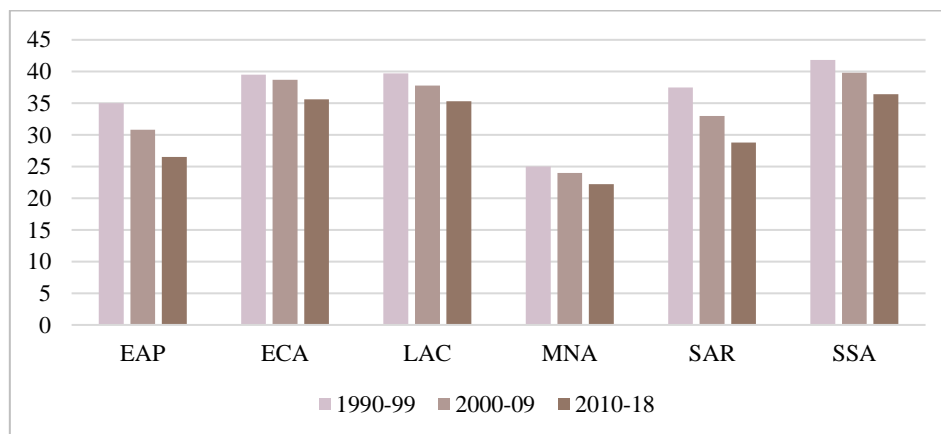
The most substantial reductions in output informality were observed in EAP and SAR (Figure 1.3). Conversely, the Middle East and North Africa (MNA) and SSA witnessed the most significant declines in employment informality (Figure 1.4). In ECA employment informality has remained essentially unchanged, while in LAC it has increased.

Figure 1.2: Informal share of employment, 1990–2018 (% of employment)



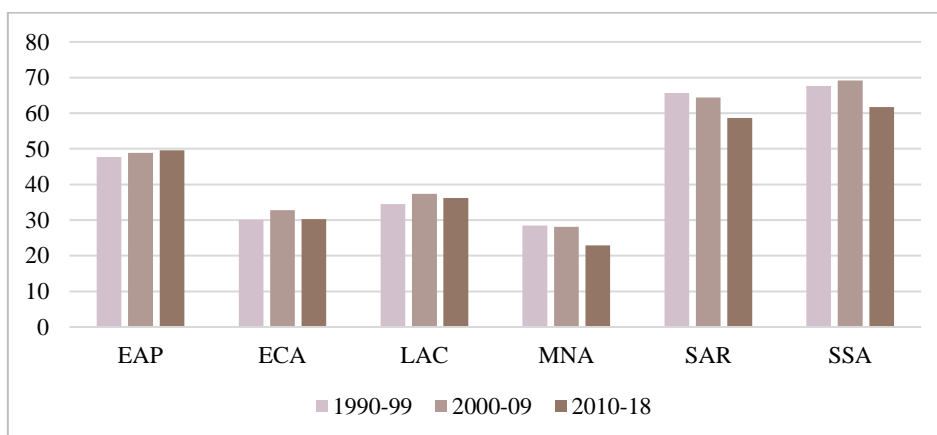
Source: Based on data from the World Bank (2022)

Figure 1.3: Output informality per region (% of GDP)



Source: World Bank (2022)

Figure 1.4: Employment informality per region (% of self-employment in total employment)



Source: World Bank (2022)

The COVID-19 pandemic hit the informal sector particularly hard (World Bank, 2020a). Since the service sector depends on in-person interactions more than the industrial or agricultural sectors, it witnessed a more negative impact by government-imposed mobility restrictions. Nearly three-quarters of firms in this sector are informal. Due to their low incomes, insufficient savings, significant exclusion from formal social safety nets and government assistance programs, and challenges adjusting to digital operations, informal workers were more likely to lose their jobs, suffer severe income losses, and put their health at risk (Balde et al., 2020; Yoshida et al., 2020; Schotte et al., 2021; World Bank, 2022). Severe economic contractions in the formal sector caused by the pandemic have led to an increase in the share of the informal economy.

Four dominant schools of thought related to the nature of the informal sector are usually listed (Thomas, 1992):

- The Dualist school, popularized by the ILO in the 1970s, considers the economy's informal sector separate from and unrelated to the formal sector. It merely serves as a source of income and a safety net for people experiencing poverty during periods of crisis (Hart, 1973; ILO, 1972; Sethuraman, 1976; Tokman, 1978).
- The Structuralist school sees the informal economy as economic units and workers subordinated to the formal sector. The informal economy helps large capitalist firms compete more effectively by lowering input and labor costs (Moser, 1978; Portes et al., 1989).
- The Legalist school sees the informal sector as comprised of micro-entrepreneurs who decide to operate informally to avoid the costs, time, and effort of formal registration and requiring property rights to convert their assets into legally recognized assets (De Soto 1989, 2000).
- The Voluntarist school sees the informal sector as comprised of micro-entrepreneurs who deliberately try to avoid regulations and taxation but, contrary to the legalist school, do not blame registration procedures.

These four fundamental background literature pillars continue to impact research. However, the most recent literature links informal and formal economies more systematically. At the same time, a number of papers acknowledge the need to analyze interactions between formal and informal firms, as well as formal and informal activities (La Porta & Shleifer, 2014; Böhme & Thiele, 2014; Ali & Najman, 2017, 2016).

This chapter attempts to contribute to a body of literature that seeks to understand the forces behind the development and magnitude of the informal economy. Our work's main contribution and novelty lie in its objective to examine the interplay between distinctive contexts and informality drivers. Our hypothesis posits that these specific contexts amplify the influence of these drivers, thereby rendering their effects stronger and more significant. Hence, we contend that the informal economy development trend, pace, and scale depend on the interaction between the informal economy drivers and the contexts.

This chapter is structured as follows. In Section 1.2, we present the literature review of the informal economy drivers, both macro and micro. In Section 1.3, we analyze and discuss the four specific contexts providing country examples of the interlinkage between these contexts and the informal economy drivers. In Section 1.4, we assess how particular contexts influence the relative importance of informality drivers. The last section concludes this chapter.

1.2 Literature review on main drivers of informality

In order to understand the main drivers of the informal economy's development, we present a careful study of research and policy literature. We divide the drivers into macro and micro according to the characteristics patterns by the individual, state, regional, and sector levels. In our study's first stage, we focus on how the drivers directly shape the informal economy. We start with presenting first the macro-drivers since they also affect the individual incentives.

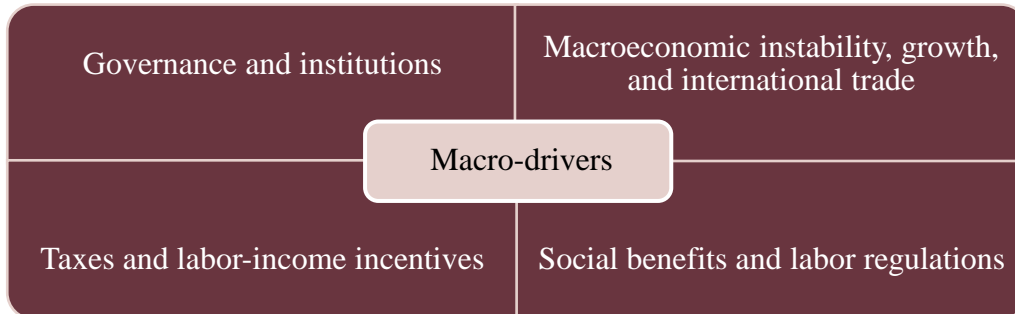
Main macro-drivers of informality

Figure 1.5 presents macro-drivers of informality, which may have national, regional, or international causes. The most crucial reforms affecting the informal economy, in either positive or negative ways, are institutional and policy ones. Furthermore, labor regulations and the legal framework are key factors for the informal economy's development (Singh et al., 2012; Rei & Bhattacharya, 2008; Chen, 2005).

Economists suggest that, in the short term, policies are even more important than institutions ("rule of the game"; North, 1990). Sound policies may enhance incomes generated by the informal economy and thus reduce poverty or ease the situation of some vulnerable groups. Hence, soft regulation on street sellers may help them develop their businesses and generate

more income for their families. It can also reduce street sellers’ operational costs and allow them to sell the goods they propose at a lower price.

Figure 1.5: Informal economy main macro-drivers



Source: Authors’ construction

On the other hand, weak institutions in the context of macroeconomic instability may enhance the informal economy, mainly as a survival strategy. When formal wages decrease, small informal activities flourish in developing countries (Fields, 1990). In the context of high inflation and macroeconomic instability, the formal sector may be unable to maintain purchasing power. Therefore, formal sector workers may need to carry out informal activities. The informal economy is significantly growing in an economic crisis context, such as in economic crises in Latin America in the mid-1980s or in East Asia in the mid-1990s (Chen, 2012; Tokman, 1992). Also, numerous examples of transition economies in the 1990s, like Ukraine, Romania, and Serbia, suggest that workers may have to move to the informal sector when formal earnings are declining.

In addition, below, we analyze taxes and labor-income incentives as crucial drivers of informality or formality. Finally, we address how social security benefits and the protection they provide shape the formalization.

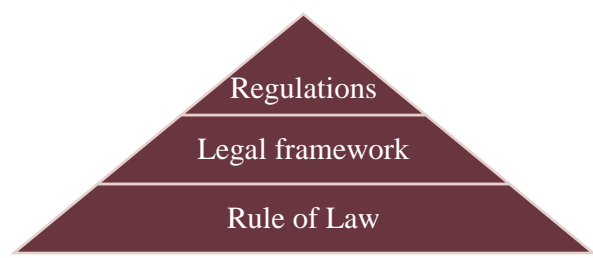
Further, we will describe in detail the informal economy macro-drivers: governance and institutions; taxes and labor-income incentives; macroeconomic instability, growth, and international trade; and social benefits and labor regulations.

Governance and institutions

Amongst the causes at a larger scale, institutions exercise a major influence on the development and the size of the informal economy: a weak rule of law, combined with complex and arbitrary

regulations, have a direct impact on the participation or not in informal activities, on the creation of informal jobs rather than formal ones or the informalization of formal jobs (Figure 1.6). Since the quality of the governance determines the effective functioning of the institutions, suspicions of public sector corruption and bureaucracy have a meaningful effect on the size of the informal economy.

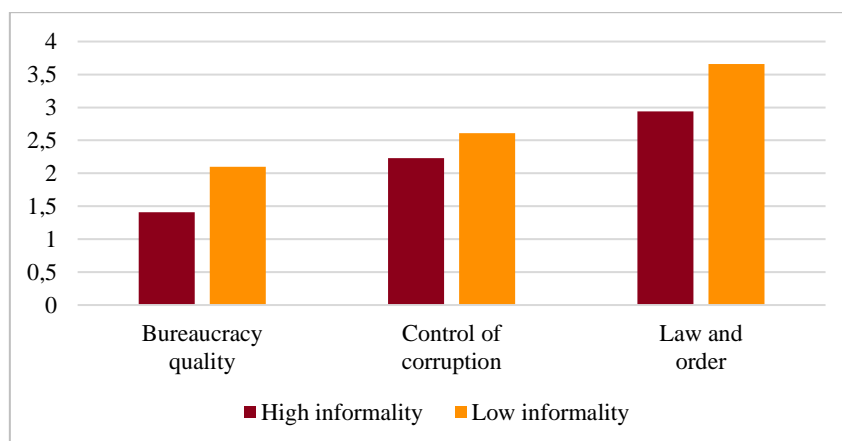
Figure 1.6: Informal economy, institutions, and regulations



Source: Authors' construction

Figure 1.7 shows that EMDEs with more pervasive informality have weaker governance. Furthermore, participation in informal activities is not necessarily chosen. It is often primarily imposed by the legislation and its implementation. In Table 1.1, we describe the main cases shortly.

Figure 1.7: Governance and informality¹



Source: World Bank (2022)

¹ Informality is approximated by dynamic general equilibrium (DGE)-based estimates of informal output in percent of GDP. Data for emerging market and developing economies (EMDEs). “High-informality” (“Low-informality”) are EMDEs with above-median (below-median) DGE-based informal output measures. Simple group averages are in bars over the period 1990–2018. “Bureaucracy quality,” “Control of corruption,” and “Law and order” are from International Country Risk Guide (ICRG), with higher values corresponding to better outcomes.

Table 1.1: Voluntary involvement in the informal economy?

Participation/Legislation	Voluntary	Partially voluntary	Forced
IE ² not covered by current labor and social security legislation (legally or in practice)			X
Inadequate laws and regulations in terms of costs and benefits and modalities to comply	X	X	
Lack or ineffective compliance mechanisms	X	X	
Little economic freedom (see Schneider, 2002)			X

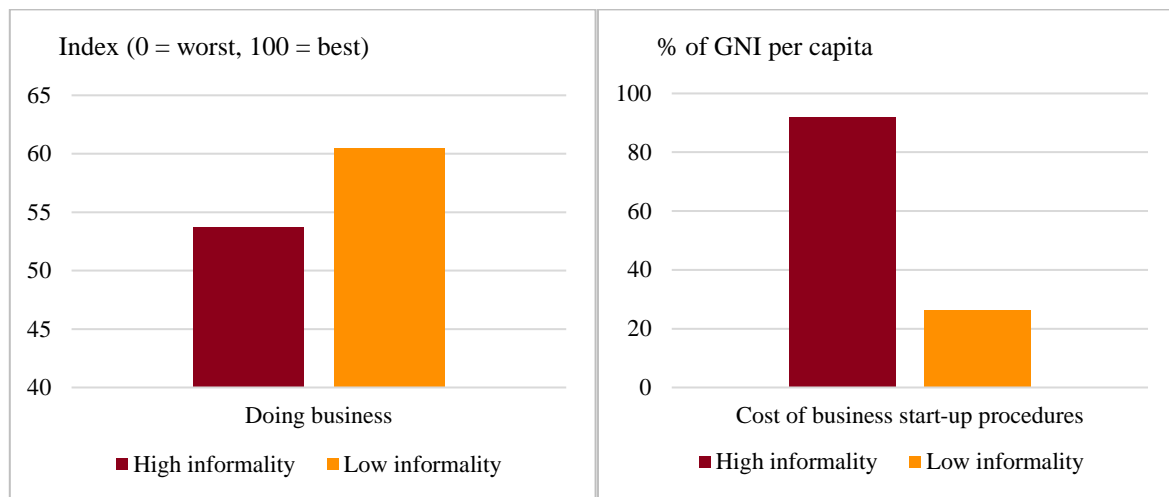
Source: Authors' construction

According to Gershuny (1979), De Soto (1989), Johnson et al. (1998), Schneider and Enste (2000), and Mukherjee (2016), a sizable informal sector exists in countries with high regulations, which include environmental protection, consumer protection, quality control, labor protection, and financial capital availability. Meanwhile, Rei and Bhattacharya (2008) find that a mix of good governance and regulation, as opposed to deregulation, favors promoting the official economy. A better regulatory environment, including better enforcement, an effective bureaucracy, economic freedom, less corruption, and non-discriminatory justice, reduces informality (Johnson et al., 1998; Friedman et al., 2000). One of the critical factors affecting the size of the informal economy is the effectiveness of government officials' discretion in the operation of the regulatory system (Johnson et al., 1998). Kus (2004) argues that the development of the informal economy is related to the nature of the state's regulatory intervention in the economy. The size of the informal economy is typically largest in countries with a high level of economic regulation and ineffective enforcement and lowest in countries with a low regulatory burden and effective enforcement (Figure 1.8).

Without effective enforcement, deregulatory policies will not contribute to the formalization of the economy (Kus, 2006). In a similar vein, Heinz and Pollin (2003) assert that while government regulations have decreased over the past two decades in many developing nations, informalization has increased.

² Economic units in the informal sector and workers in informal employment.

Figure 1.8: Regulatory burdens and informality³



Source: World Bank (2022)

Several scholars emphasize the significance of the distinction between de jure and de facto regulation, highlighting that it is not the written law itself that matters but rather how it is applied and enforced (Johnson et al., 1998; Ihrig & Moe, 2001; Loayza et al., 2005; Almeida & Carneiro, 2006). Almeida and Carneiro (2006) find that strengthening the enforcement mechanisms facilitates law-abiding conduct. In a number of different countries, informal economic units and workers in informal employment are not covered either de facto or de jure by labor and social security legislation. Participation in the informal economy is primarily voluntary or partially voluntary when insufficient laws and regulations or ineffective compliance mechanisms exist. Finally, we often observe forced involvement in the informal economy in countries or regions with weak economic freedom.

Loayza (1997) breaks down the costs of formality into costs of entry and costs to remain formal. De Soto (1989) and Tokman (1992) found that the business registration procedure faces bribes to government officials and is very time-consuming in Peru and other Latin American countries. Remaining in the informal sector allows firms to circumvent the burdensome costs.

The costs of staying formal can be divided into three main categories: taxes, regulations, and bureaucratic requirements (Loayza, 1997). According to De Soto (2000), individuals compete

³ Informality is proxied by dynamic general equilibrium (DGE)-based estimates of informal output in percent of GDP. Data for emerging market and developing economies (EMDEs). “High-informality” (“Low-informality”) are EMDEs with above-median (below-median) DGE-based informal output measures over the period 1990–2018. Simple group averages are in bars over the period 2003–2018 (2010–2018 for doing business scores). Doing Business scores range from 0 (lowest performance) to 100 (best performance).

in the informal economy because either formal laws (such as property rights protections) or institutional procedures (such as business registration requirements) increase costs and barriers for firms to enter and operate in the formal sector. Ouédraogo (2017), Shleifer and Vishny (1993), and Johnson et al. (1998) argue that a high level of corruption and poor institutional settings that encourage the extraction of bribes from registered firms are factors in the growth of the informal economy. If monitoring and compliance are imperfect, it may be advantageous for some individuals or firms to circumvent regulations and their associated costs and operate informally (Loayza et al., 2005). Furthermore, regulations on statutory minimum wages can lead to rigidity in labor costs in the formal economy by restricting how much can be passed on to employees by businesses, which serves as another reason to hire undocumented workers (Jütting & Laiglesia, 2009).

On the other hand, while there are costs associated with becoming legal, it is also costly to remain outside the law. For example, Godfrey (2011) finds that operating a business extra-legally may entail paying authorities bribes and commissions worth up to 10–15% of one's annual income. In addition to such payments, the costs of avoiding penalties, making transfers outside legal channels, and operating from dispersed locations and without credit are high. Thus, a better rule of law, more possibilities to trade, a better credit market, and improved government effectiveness and efficiency would favor the decision to stay in the formal economy (Rei & Bhattacharya, 2008; Krakowski, 2005). For instance, simplifying firm registration procedures leads to an increase in the firm registration rate (Bruhn, 2011; Kaplan et al., 2006).

A larger informal economy is specifically linked to stricter employment protection legislation (Almeida & Carneiro, 2006; Botero et al., 2004), with strong enforcement of labor laws moderating this relationship. Higher minimum wages are linked to lower formal economy employment and higher informal employment, especially in countries where the minimum wage is mandatory in the formal sector (Comola & De Mello, 2009; OECD, 2008).

To sum up, beyond economic development, good governance is a crucial determinant of the size and development of the informal economy. Examples of Slovenia, Croatia, and Serbia are very instructive. The governance quality and the informal economy trends evolved in a very different path in these countries. If Slovenia adopted the EU regulations (*acquis 24communautaire*) rather quickly, Croatia and even more Serbia were reluctant to reform their institutions, especially the judiciary system. Serbia and, to some extent, Croatia experienced a sizable informal economy increase in the 2000s, while Slovenia stabilized and reduced the

share of the informal economy in the GDP (Krstić & Sanfey, 2011). In addition, Schneider and Teobaldelli (2012) indicate that the degree of direct democracy is negatively associated with the size of the shadow economy.

Many workers and enterprises of the informal economy face unequal treatment from local/central authorities. In many countries, informal workers are under pressure and strict control. They are suffering from inefficient regulation and, at the same time, a lack of social protection. In other words, they are not considered equal in front of the law (*Rule of Law*). The necessary policies and practices must be implemented to regulate the informal economy for vulnerable groups. In addition, since it is often accompanied by significant discrimination towards vulnerable groups, the weakness of the judiciary system can be one of the core informal economy institutional drivers.

Continuing our analysis, we will examine taxes and labor-income incentives as classical macro-drivers of informality.

Taxes and labor-income incentives

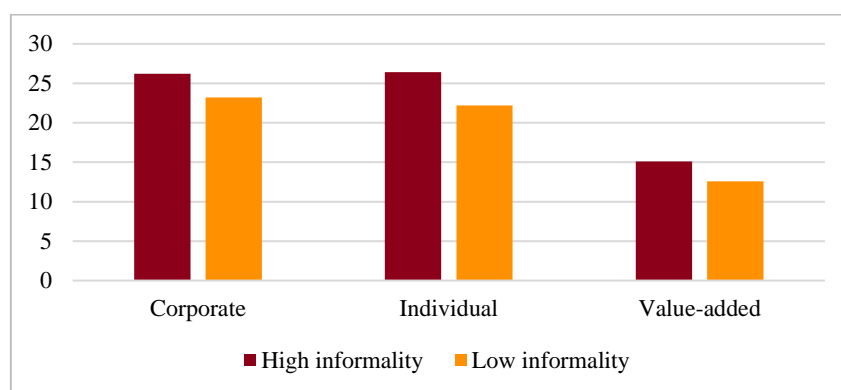
Although, to some extent, taxes and labor-income incentives can be considered as micro-drivers, we place them among macro-drivers of informality due to their largely country-specific effects and impact on the overall economy.

Nearly all the existing theoretical models presuppose a positive relationship between taxes and the presence of the informal sector (Ihrig & Moe, 2004; Busato & Chiarini, 2004; Amaral & Quintin, 2006; Prado, 2011; D’Erasmus & Boedo, 2012; Mitra, 2017). In more informal EMDEs, corporate, individual, and value-added tax rates are higher (World Bank, 2022; Figure 1.9). Still, empirically, there is less agreement regarding how taxes affect informality. While some empirical studies find a negative impact of taxes on informality, others see a positive one.

Prior scholarly work finds that there are numerous ways that taxation can boost the attractiveness of the informal sector and informal employment (Andrews et al., 2011; Schneider, 2005; La Porta & Shleifer, 2008). Djankov et al. (2010) and La Porta and Shleifer (2008) demonstrate that corporate income taxation discourages formal entrepreneurship, particularly in developing economies. According to Loayza (1996), based on a sample of countries in Latin America and the Caribbean from 1980 to 1992, an increase in the highest statutory corporate tax rate was followed by an increase in informality. High taxes on labor

income, including employee social security contributions (especially given a weak connection between contributions and benefits), diminish the benefits of providing labor in the formal economy (Davis & Henrekson, 2004; Jütting & Laiglesia, 2009). High labor income taxes may also deter self-employed workers from declaring their earned income (Jütting & Laiglesia, 2009; OECD, 2008). On the other hand, the introduction of value-added tax (VAT) may encourage firms to either register to obtain VAT refunds or to operate informally to offer lower prices excluding VAT (World Bank, 2022).

Figure 1.9: Tax rates and informality⁴



Source: World Bank, 2022

High employer social security contributions may incite businesses to hire low-skilled labor informally (Andrews et al., 2011). Similarly, high effective tax rates on profits may encourage firms to conceal output and profits to pay less in taxes. Also, high consumption taxes may cause businesses and households to shift their spending toward informal, non-taxed goods and services.

Various studies claim there is a positive correlation between the level of marginal tax rates and the intensity of regulation on the one hand, and the relative size of the informal economy on the other (Loayza, 1997; Krakowski, 2005). The interaction of social benefit and tax systems can result in high effective marginal tax rates on declared labor income because benefits are reduced as earned income rises. This can serve as a deterrent to looking for employment in the formal economy since the net income is higher if benefit recipients receive these transfers while working informally. Thus, Lemieux et al. (1994) find that high effective marginal taxes create

⁴ Bars are group means for emerging market and developing economies (EMDEs) with above-median dynamic general equilibrium (DGE)-based estimates on informal output (“high informality”) or those with below-median dynamic general equilibrium (DGE) model-based estimates on informal output (“low informality”) over the period 2010–2018.

solid incentives for welfare recipients to work informally. Effective marginal tax rates may also have an impact on how much second-income earners and lone parents participate in the informal economy.

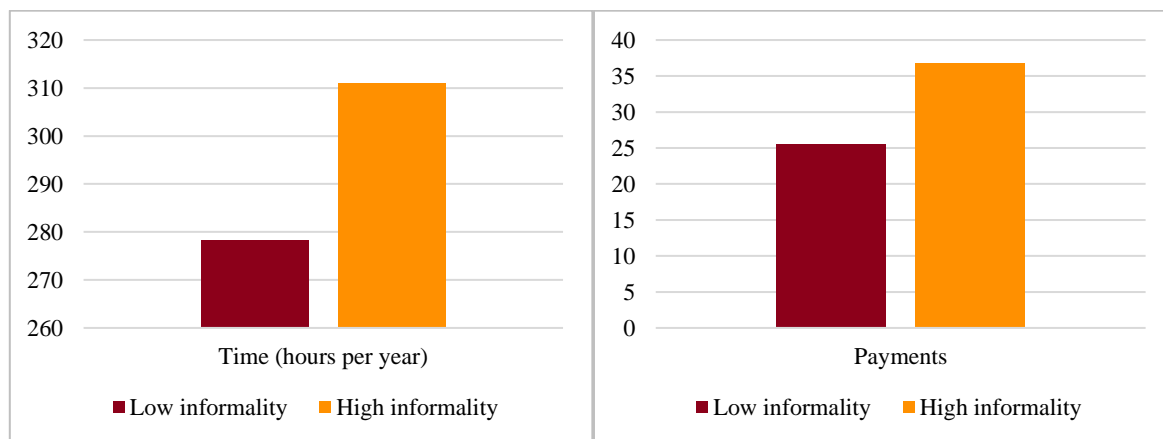
Goel & Nelson (2016) assert that how taxes affect informality varies between developing and developed economies, mainly due to the disparate nature of the institutional quality in these economies. The authors find that while an increase in tax rates stimulates the growth of the informal sector in developing economies, it slows it in developed countries.

The degree of tax system enforcement is a crucial factor in the tax-informality relationship. A higher likelihood of being audited and stricter penalties for non-compliance result in lower incentives to evade taxes and engage in informal activity (Andreoni et al., 1998). Thus, informality is more prevalent in countries with a lower expected penalty for failing to report earned income to tax or social security authorities. Dabla-Norris et al. (2008) report that taxes and informality are significantly positively correlated in developing economies, however, more robust legal and enforcement systems reduce the significance of taxes. Less strict tax enforcement implies a lower probability of being caught and punished. Liu-Evans and Mitra (2016), also focusing on developing countries, discover a significant positive correlation between informality and taxes and a significant negative correlation between informality and various enforcement proxies. Ihrig and Moe (2004) find that while reductions in the tax rate, coupled with increased enforcement, reduce the size of the informal sector, tax rate reductions and penalties for evasion are the most effective. According to Mitra (2017), as enforcement increases, the positive relationship between taxes and informality weakens until there is a high enough likelihood of detection. After this point, informality declines with taxes because it is too expensive to hide. On the other hand, Williams (2015) finds that higher taxes and greater state intervention reduce the degree and intensity of informalization because governments with efficient tax enforcement regimes are able to make social transfers, reducing the need for the population to rely on employment in the informal economy as a means of survival. Finally, more costly and time-consuming tax compliance disincentives firms from formal registration (World Bank, 2022). Hence, on average, firms need more time and more payments to comply with tax regulations in more informal EMDES than in less informal EMDEs (World Bank, 2022; Figure 1.10).

Authors who examine transition and OECD economies come to contrasting conclusions. Johnson et al. (1998) and Friedman et al. (2000) conclude that tax rates and the informal sector's size are inversely related. Friedman et al. (2000) argue that this is possible (at least in

the richer countries) where a higher tax burden is balanced out by better public goods provision. Therefore, the benefits of improved public services outweigh the costs of higher tax burdens, decreasing any incentive for taxpayers to enter the informal economy.

Figure 1.10: Firms' tax compliance burdens and informality



Source: World Bank, 2022

Additionally, some studies discover that the effect of taxes on informality varies with the level of corruption used as a proxy for governance quality. Torrini (2005) and Friedman et al. (2000) find that the level of corruption affects the relationship between taxation and informality: at low levels of corruption, higher taxes are typically associated with lower rates of informality. This reflects the idea that higher taxation results in a lower rate of self-employment in nations where there are fewer opportunities for tax evasion to the extent that self-employed workers' income is more sensitive to individual effort and, consequently, more responsive to tax rates than the income of wage workers (Torrini, 2005; Robson & Wren, 1999). However, when corruption levels are high, the probability of being caught and punished for tax evasion is lower, and tax increases tend to be associated with higher rates of self-employment and informality (Torrini, 2005).

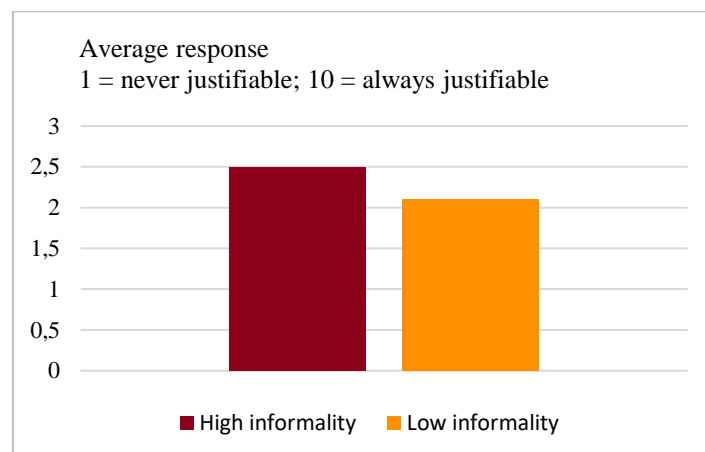
Furthermore, Elgin (2015), based on a dynamic political economy model, shows that countries with more stable governments may exhibit a negative relationship between taxation and informality, whereas those with less stable governments may have a positive relationship.

Johnson et al. (1998) argue that the way the tax system is administered is the crucial determinant of the tax burden. Better tax administration reduces the share of the unofficial economy. How the tax system is designed can also impact informality, with a more complicated

tax system increasing compliance costs and providing more incentives to evade taxes. (OECD, 2008).

In addition, tax morale is found to be weaker in EMDEs with higher informality, with citizens being more prone to deem underreporting income for tax purposes justifiable (World Bank, 2022; Figure 1.11). Among other reasons, a lack of trust in the government and dissatisfaction with the quality of public service delivery cause weaker tax morale.

Figure 1.11: Tax morale and informality



Source: World Bank (2022)

Moving forward, we will analyze macroeconomic instability, growth, and international trade as other macro-drivers of the informal economy.

Macroeconomic instability, growth, and international trade

In the 1960s and 1970s, it was generally understood that the informal sector would contract as the economy grew. Although there has been significant global growth along with a massive increase in international trade, the share of employment in the informal economy has stayed consistent in many developing countries and has even increased in some regions (Sinha, 2011).

Macroeconomic instability has detrimental effects on both public and private activities, particularly on investments that can be very volatile due to uncertainty. Generally, a combination of inflation, budget deficit, fluctuation of the real exchange rate, and change in terms of trade constitutes a serious barrier to a country's economic growth (Haghighi et al., 2012). It leads to substantial impacts on the formal labor market. A common assumption

considers that the informal economy is counter-cyclical: it expands during economic downturns and contracts during periods of economic growth. In many countries, the economic crisis and the macroeconomic instability may contribute to layoffs and formal wage drops. In the absence of social and unemployment benefits, the need for additional income pushes many workers to join the informal sector.

In addition, Chen (2012) argues that during periods of slow or no economic growth, not enough jobs are being created, making many frustrated formal job seekers turn to informal employment. Moreover, capital intensification causes a decrease in the labor force; as a result, workers who are unable to find desirable jobs in the formal sector are more likely to become unemployed or work informally. Finally, the author also mentions that high-tech growth tends to generate more high-skill service sector jobs than lower-skill manufacturing jobs, forcing those without the necessary skills to compete for high-tech formal jobs to find employment or remain in the informal economy.

Furthermore, according to Horn (2009 and 2011), recent data analysis from various developing countries paints a more complex and dynamic picture, with substantial variation in patterns of informality across countries. An increase in informal employment is correlated with sudden economic downturns. However, steady economic growth rates in some countries are also linked to an increase in informal employment. Some forms of informal employment expand during economic downturns, such as informal survival activities and sub-contracted and outsourced activities since formal firms try to cope with the recession. Other informal employment forms expand during economic upturns, including small entrepreneurial firms and sub-contracted and outsourced activities associated with the global production system.

In the mid-2000s, three important studies were published that examined the relationship between the rate of informality and the rate of growth at two points in time in various sets of countries: Heintz and Pollin (2008) in 20 developing countries; Galli and Kucera (2003) in 14 Latin American countries; and Loayza and Rigolini (2006) in 18 developing and 24 developed countries.

Heintz and Pollin (2008) find that informal employment outpaced formal employment even in countries with strong growth rates. The authors conclude that higher growth rates are typically associated with smaller increases in the informality rate and that informality may decrease at very high levels of growth. Galli and Kucera (2003) find that informality has counter-cyclical aspects (survival and subordinated activities) as well as pro-cyclical (independent and

subordinated activities) aspects. According to Loayza and Rigolini (2006), the informal economy acts as a buffer that expands during economic recessions and as an adjustment mechanism under temporarily high tax regimes. In the long run, the informal economy is larger in countries with lower GDP per capita, high formality costs (rigid business regulations), and less control over informality (weak policy and judicial systems).

Interestingly, informal employment is considered to be mainly unresponsive to business cycles in the formal economy (World Bank, 2022). This means that workers do not usually transition between formal and informal employment. Once informally employed, people are likely to either increase or decrease working hours in accordance with the business cycle. Hence, an increase in informal employment brought on by the COVID-19 pandemic may not be reversed during the economic recovery.

Assessment of recent trends in Turkey shows that informal activities increase as a result of higher unemployment rates in the context of the economic crisis: efforts are therefore made to offset the loss in household income by adjusting hours of work, with women typically shouldering the additional workload (Bahçe & Memiş, 2013, 2014). Following reforms in Turkish regulations, entrepreneurial activities were facilitated as the legal barriers decreased. By doing so, the regulatory barriers to informality were also reduced, leading to private sector growth and the expansion of informality (Kus, 2014).

With regard to the impact of trade and trade liberalization on the informal economy, studies conducted since the late 1990s show that, contrary to classical trade theories, trade liberalization does not always result in an increase in the welfare of unskilled labor (Sinha, 2011). A number of studies indicated that globalization and trade reforms increase competition in the formal sector, which, at least in the short term, may lead to a decline in formal employment and an expansion of the informal sector (Stallings & Peres, 2000; Sinha & Adam, 2000; Carr & Chen, 2002; Harriss-White, 2003; Sinha et al., 2003).

Harris and Todaro (1970) proposed the dual economy model, which divides the economy into rural and urban sectors. Most of the studies that adopt this model show that trade typically results in more employment in the informal sector of the economy (Marjit & Acharyya, 2003; Marjit & Beladi, 2005; Chandra & Khan, 1993).

Studies based on wage differentials, which show that wages in the formal and informal economies differ due to differences in skills, the availability of capital, credit, and information, as well as various barriers to spatial mobility, suggest that opening up trade may shift

production to the informal economy, where wages stagnate or even decline (Kar & Marjit, 2001; Marjit & Maiti, 2005; Goldberg & Pavcnik, 2003).

From a structuralist perspective, Cimoli and Porcile (2009) contend that as trade opens up, production units in the formal sector begin specializing in goods for export and that the production of goods and services not intended for export is transferred to the informal economy.

Even though the vast majority of theoretical models show that trade liberalization increases informal employment in developing countries and that extensive trade reforms implemented in developing countries frequently coincide with higher informality, the relationship between trade and informality is not conclusively established (Sinha, 2011). On the one hand, cheaper imports, which may also result from the appreciation of a trading partner's currency, may put pressure on domestic prices, drive local businesses out, lessen their incentives to fill new positions, or push them toward less expensive means of production in the informal economy. Conversely, lower tariffs might encourage the import of capital and technology from abroad, raising the demand for complementary skilled labor that, over time, tends to increase formality.

Furthermore, in order to examine a connection between trade and the informal economy, a number of econometric analyses have been conducted, particularly on the LAC countries where the reduction of trade barriers took place in the 1980s and 1990s. Goldberg and Pavcnik (2003) find that while in Brazil trade reforms had no effect on informality, in Colombia they had a minor effect. In particular, tariff declines were associated with an increase in informal employment in the industries with the largest tariff cuts, however, only in the period before the labor market reform. Bosch et al. (2007), reexamining the Brazilian case through the lens of gross labor flows, find a small but positive impact of trade liberalization on informality.

According to Mondino and Montoya (2000) and the World Bank (2008), Argentina's share of salaried informal workers increased significantly in the early 1980s. Reforms in the late 1970s drastically reduced tariffs and resulted in an appreciating exchange rate, even though the last round of trade liberalization did not start until 1990 (Sinha, 2011). On the contrary, in the study on the impact of NAFTA on informality in Mexico, Aleman-Castilla (2006), based on a dynamic industry model with firm heterogeneity, finds that eliminating import tariffs could lower the prevalence of informality by making it more profitable for some firms to enter the formal sector, driving out the least productive informal firms and encouraging the most productive formal firms to trade.

The studies discussed above look at specific developing countries and provide different insights into the impact of trade on the informal economy. In their turn, Fiess and Fugazza (2010) attempted to find relationships between trade and informality by analyzing statistical data at the macro-level and on a global scale. The results were contradictory: macro-founded data produced results supporting the view that the opening up of trade reduces informality, while micro-founded data suggested the opposite. Empirical results also indicate that informal employment decreases with deeper trade liberalization and informal output increases with deeper trade liberalization. The empirical findings might indicate that after trade liberalization productivity in the informal sector rises.

In the upcoming part, we will focus our analysis on the impact of social benefits and labor regulations on the informal sector.

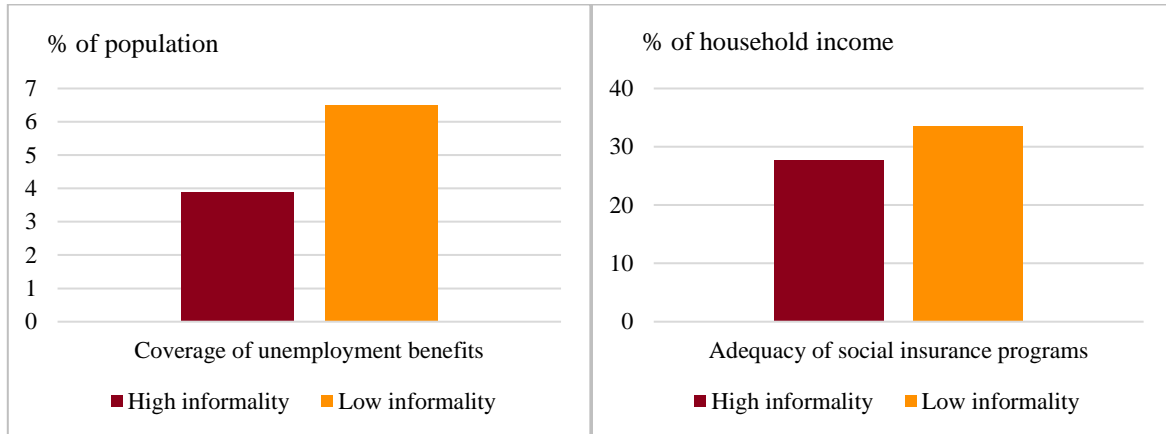
Social benefits and labor regulations

Affiliation to social security benefits gained through the employment relationship can be a way to define formal employment (Charmes, 2012). Lacking any form of social or legal protection, self-employed and informal wage workers are, by definition, not protected.

Half of the world's population has no social security coverage, and only one-quarter has adequate coverage (Van Ginneken, 2003). While around 90% of the population in most OECD countries has social security coverage, less than 10% of the population in most sub-Saharan and South Asian countries is covered by social security since most of the workforce is employed informally (Sigg, 2005). Therefore, the informal economy is often considered to be a social safety net (Bernabe, 2005). In EMDEs with above-median output informality, only 3.9% of the population is covered by social security programs such as unemployment insurance, while in EMDEs with below-median informality – 6.5% (World Bank, 2022; Figure 1.12). The adequacy of social security programs for informal workers is limited as well. Lacking access to social safety nets and having limited savings, informal workers are susceptible to negative shocks that can push them into poverty. Thus, informal workers were mainly unable to afford to follow COVID-19 social distancing requirements, with lockdowns of early 2020 having a significant effect on an estimated three-quarters of the world's informal workers (ILO, 2020). In some EMDEs, the measures in response to COVID-19 involved the provision of benefits to informal workers, often through digital platforms, however, the effectiveness and extent of these benefits to informal workers remained insufficient (World

Bank, 2022). Consequently, extending social protection to the informal sector is already a priority in many developing countries.

Figure 1.12: Access to social benefits and informality



Source: World Bank (2022)

The relationship between informality and social protection can be explained through the “exit” and “exclusion” perspectives since they take into account the various interactions between the state and economic agents (Ospina & Saavedra-Caballero, 2013). Labor market segmentation, burdensome entry regulations for small firms, and excessive tax and regulatory burdens for large firms contribute to the “exclusion” of workers from government benefits, which is referred to as involuntary informality (De Soto, 1989; Perry et al., 2007). In contrast, the “exit” perspective contends that workers decide whether to engage in informality based on implicit cost-benefit calculations considering the effectiveness of the state’s service delivery and enforcement capacity (Hirschman, 1970).

As Levy (2008) notes, social protection is a factor of informality, and it contributes to informality through the following channels: non-salaried workers are excluded from social security; social security works like a tax on salaried labor; social protection functions like a subsidy to non-salaried labor; and employers and employees engage in illegal behavior by generating informal salaried labor.

In some instances, the employer and employee may agree to forego social security contributions in exchange for higher take-home pay or “under the table” bonuses, primarily when social security systems are inadequately run (Chen, 2012; Ospina & Saavedra-Caballero, 2013). Since social protection is not free, there is an incentive to forgo participating in the formal institution if there is a lower-cost alternative. For instance, in Mexico, when any one

family member works in the formal sector, medical benefits are frequently provided to the entire family, so there is no benefit to the second formal sector worker from paying labor taxes (Maloney, 2004). Likewise, high employer social security contributions might encourage firms to hire low-skilled labor informally (Andrews et al., 2011). In developing countries, mandatory contributions to benefit programs are sometimes seen as a drawback of formal salaried work since many formal services are often of poor quality and have high administrative overhead costs (Maloney, 2004). In their work on Chile, Barr and Packard (2000) find that participation in the government's voluntary pension program is extraordinarily low, at just 4%.

When comparing the wage distribution for several countries for informal and formal salaried workers, Maloney (2004) finds that minimum wage is most binding among informal salaried workers, suggesting that employers in the informal sector adhere to standards for salary level even if they do not register their employees with social security administrations. In addition, according to Gonzalez de la Rocha and Kotwal (1997), the informal sector provides many older workers a safety net by offering "insecure occupations (such as the services) in which their age is not a limitation after they have been kicked out of the formal manufacturing or formal services." Finally, during economic adjustment or transition, employment in the informal economy frequently increases since the workers who are laid off and unable to find alternative formal jobs often enter the informal sector, especially in countries without unemployment benefits (Chen, 2012).

As compliance with labor and social security legislation might prove costly in terms of social security contribution or additional recruitment due to a limitation in working hours, most informal employment or activities appear to not benefit from the formalization. Therefore, the costs of becoming formal (time, costs of registration) and of being formal (taxes and contributions, accounting costs, paperwork) will be balanced against the potential benefits of being formal (income security ensured by social security benefits, access to credit, fewer risks of fines) before deciding whether to enter the informal or the formal sector (Bruhn & McKenzie, 2014).

On the other hand, the lack of labor regulations implementation has significant negative incentives on formalization: the informal economy is considered to be the norm. For example, in Cameroon, labor regulations are not fully implemented, and as a result, the working conditions in the formal and informal sectors deteriorate (Tsafack Nanfosso, 2007).

The lack of labor regulations and social benefits mainly affects sectors employing low-skilled workers, such as construction, intermediary professions, or those with general competencies (characterized by high job turnover, low tenure, and no capital-specific competencies). The complexity of formalization can also increase informality as business regulations appear to be barriers to firms becoming formal, hence remaining informal (for India, see Bhattacharjea, 2006).

Employment protection legislation may increase firms' uncertainty about their ability to adjust their workforce in response to economic fluctuations and increase their incentives to hire workers on the informal market (OECD, 2008; Andrews et al., 2011). Stricter employment protection legislation is linked to a larger informal economy (Abrás et al., 2018; Loayza et al., 2006; Botero et al., 2004; Andrews et al., 2011). Regulations on statutory minimum wages can also result in rigidity in labor costs in the formal economy because they restrict how much of these costs can be passed on to employees, which creates yet another incentive to hire informal workers (OECD, 2004). In developing countries, higher minimum wages are linked to lower formal-economy employment and higher informal employment, at least in those countries where the minimum wage is mandatory (Comola & De Mello, 2009; OECD, 2008; Andrews et al., 2011).

The interaction of social benefit and tax systems may result in high effective marginal tax rates on declared labor income, which might discourage people from seeking employment in the formal sector because their net income will be higher if they continue to receive benefits while working informally (Andrews et al., 2011; Lemieux et al., 1994). A weak link between benefits and contributions to welfare systems is likely to increase incentives to work informally (Andrews et al., 2011).

Several studies analyze the influence of social protection on informality. For Mexico, Levy (2008) suggests that non-targeted social assistance programs may increase informality. Azuara and Marinescu (2013), also for Mexico, analyze the impact of "Seguro Popular" (subsidized health services for informal workers), finding no meaningful evidence of increased informality due to the social assistance program. On the contrary, Bosch and Campos-Vazquez (2014) and Frölich (2014) find a positive impact of "Seguro Popular" on informal employment in Mexico, as informal workers in Mexico now have access to healthcare regardless of the contributions they make. In addition, Galiani and Gertler (2009) find that "70 y más," a non-contributory Mexican pension program, increases informal employment among older workers.

For Argentina, Gasparini et al. (2009) find that the “Jefes de Hogar” program (cash transfers to unemployed household heads) implies a labor informality bias when the value of the cash transfer is relatively high compared to wages in the formal labor market.

For Colombia, Camacho et al. (2014) evaluate the government’s expansion of social programs in the early 1990s, particularly publicly provided health insurance, and find robust and consistent estimates of an increase in informal employment after the expansion. Ospina and Saavedra-Caballero (2013) find that a Conditional Cash Transfer program (Familias en Acción), a social safety net for Colombia’s poorest people following the economic crisis of the 1990s, may create perverse incentives that push people toward informality through a substitution effect since workers might leave the labor market or make risky decisions of starting an informal business with the program’s money as the initial investment.

Analyzing the case of Uruguay, Bérigolo and Cruces (2011) find that extending health coverage to private sector salaried workers’ dependents increases the incentive to become a formal worker and contribute to the social security system.

Ultimately, Angel-Urdinola et al. (2009) evaluate the “Green Card” program (a non-contributory health system for the informal sector) in Turkey and do not find an impact of the program on informality due to a substantial differential in wages between formal and informal workers explained by differences in workers’ productivity.

The four drivers’ dimensions present a strong degree of interaction: taxes are related to institutional quality since weak institutions and governance create an environment hindering the proper collection of taxes. The lack of tax recovery directly affects social benefits and can, in addition, create a large budget deficit and macroeconomic instability. In return, macroeconomic instability can weaken institutions through budget instability and defiance of public policies. Most of the time, these four macro-drivers enhance the informal economy. However, each of them reflects a different informal economy’s development rhythm. Severe economic crises, together with job destruction and wage drops, create large informal economy incentives and opportunities. Macro-level drivers also present a strong degree of interaction with individuals’ features (micro-level determinants).

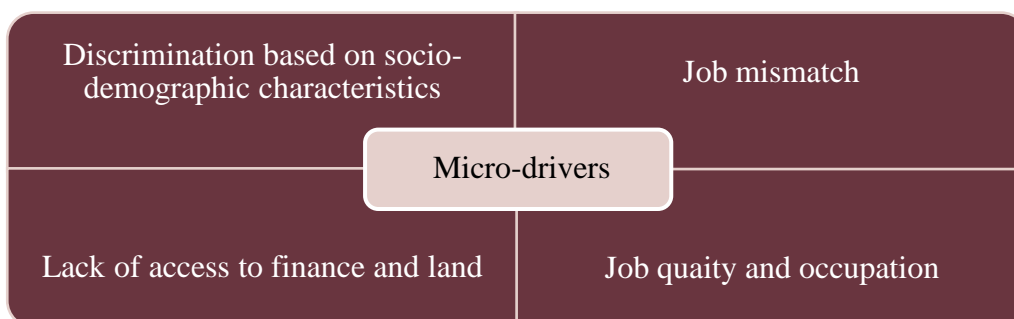
The subsequent sub-section will delve into a comprehensive analysis of the main micro- drivers of the informal economy, such as discrimination based on socio-demographic characteristics, job mismatch, job quality and occupation, and lack of access to finance and land.

Main micro-drivers of informality

Numerous interesting papers make use of individual surveys, such as labor force, household budget, LSMS, enterprise surveys, to find out why and who is working in the informal economy.

Empirical studies using individual surveys help us distinguish four different micro-drivers of the informal economy: discrimination based on socio-demographic characteristics, job mismatch, lack of access to finance and land, and job quality and occupation (Figure 1.13). They all affect the productivity of informal activities.

Figure 1.13: Informal economy main micro-drivers



Source: Authors' construction

Expanding upon this, we will examine in detail the main four micro-drivers of the informal economy, as seen in Figure 1.13.

Discrimination based on socio-demographic characteristics

Discrimination can be defined as a systematic gap in factors of production incomes. Expected income from labor (both the probability of having a job and the average income are impacted) is lower for discriminated categories. Such a phenomenon is due to easily identifiable group characteristics, such as skin color, origin, or gender (Deininger et al., 2013). The informal economy accounts for a significant portion of society's socially and economically disadvantaged groups (Mohapatra, 2012). When the rule of law is weak and citizens are not treated equally, these groups are more likely to turn to informal activities due to excessive discrimination. Discrimination affects low and medium-skilled jobs and professions more.

Discrimination is especially relevant for the poorest part of the population choosing to migrate from rural to urban areas and bound to rely on informal labor markets to survive (Deininger et al., 2013; Walton, 2010). Rural-urban migrants also face wage discrimination based more on gender rather than productivity gaps or selectivity bias, and in the case of India, even more than caste.

A set of studies claim that being a woman increases the probability of working in the informal sector (Kouadio & Gakpa, 2020; Başbaya et al., 2018; Malam, 2018; Aikaeli & Mkenda, 2014; Tansel & Acar, 2016; Adair & Bellache, 2012), as a result of women in developing countries being often housewives and practicing income-generating activities to meet their extra-familial expenses (Kouadio & Gakpa, 2020). The absence of resources such as capital and education, household responsibilities (single mothers) coupled with the difficulties in getting a maternity leave or childcare, and the dilemma with the formal work and family life balance induce women to enter the informal market, usually in the lowest segments of the informal economy, often working very short hours for paid or profit. For instance, Hassan and Farooq (2015) find that women in Pakistan are bound to work within their homes as sociocultural norms do not allow them to engage in economic activities outside of the home. In their study on Indonesia, Gallaway and Bernasek (2002) observe that women are marginalized in the informal sector due to their responsibilities for unpaid work at home, particularly for the care of young children. Meanwhile, Angel-Urdinola and Tanabe (2012) find that while being a woman is associated with higher levels of informality in countries where agricultural employment accounts for a significant portion of total employment since women are frequently engaged in unpaid/subsistence agriculture, being a woman is linked to lower levels of informality in countries where public employment makes up a sizable portion of total employment.

Conversely, other studies find that men are more engaged in the informal sector than women (Williams & Horodnic, 2015; McInnis-Dittrich, 1995; Williams & Round, 2008; Williams, 2011). Such findings are confirmed by the ILO estimates (2018), according to which, globally, the informal sector is a greater source of employment for men than for women, for both emerging and developing countries and developed countries, and for agricultural and non-agricultural informal employment. However, women in the informal economy face limited access to certain activities (construction, transport, mechanical field, etc.) compared to their male counterparts. They are more often found in the most vulnerable situations and the informal economy's poorest segment, such as domestic work, home-based work, or providing for the family (Chen, 2001; ILO, 2016).

Large families with a high ratio of dependents over breadwinners may also be a characteristic of the informal economy and *moonlighting* households (Williams & Horodnic, 2016; see examples of Bamako, Dakar, Niamey, Lomé, Cotonou in Herrera et al. 2012).

With age, a person's likelihood of being informal decreases (Kouadio & Gakpa, 2020; Angel-Urdinola & Tanabe, 2012; Williams & Horodnic, 2016). Başbaya et al. (2018) and Hazans (2011) observe a U-shaped relationship between age and informality. Both the young and the elderly are likely to be among the least demanding job seekers due to their below-average productivity and their interest in flexible working hours, which are more typical for the informal sector. Flexibility emerged as informality's most appealing argument. Retirees work in unregistered jobs to get full pensions from the state. Given their lack of experience and employment, the young who are less likely to get a standard job formally are more inclined to adopt informal practices (Shehu & Nilsson, 2014). Networking may help to get a more formal job, but young and isolated people do not always have this asset. Thus, informal employment could be viewed as a transitional job before finding a formal one (Tsafack et al., 2019). Also, young workers are likely to be less concerned with social security and more willing to exchange it for higher cash payments.

Individuals who are single (or customarily married as well as divorced/separated) are more likely to belong to the informal group than those who are married or widowed (Kouadio & Gakpa, 2020; Başbaya et al., 2018; Angel-Urdinola & Tanabe, 2012; Williams & Horodnic, 2016). In addition, while some studies find a positive relationship between living in urban areas and employment in the informal sector (Kouadio & Gakpa, 2020), others do not find this link (Williams & Horodnic, 2015).

Literature's findings indicate that with an increase in education level, the likelihood of being in the informal sector declines (Kouadio & Gakpa, 2020; Aikaeli & Mkenda, 2014; Malam, 2018; Başbaya et al., 2018). Furthermore, the more educated a father is, the less likely his child is to work informally (Başbaya et al., 2018). According to Losby et al. (2002), in urban areas, higher-educated individuals are more likely to work in the formal sector, while those with lower levels of education are more likely to work in the informal sector. However, in rural areas, the authors observe no correlation between education level and employment in the informal sector. Furthermore, according to Hazans (2011), minorities, workers with immigrant backgrounds, and residents of underdeveloped regions are more likely to work informally due to their significant informal social capital that may also interact with their lack of trust in institutions

and with productivity issues brought on by language barriers. Lastly, the author discovers that compared to formal employees and informal self-employed, a significantly higher proportion of informal employees in most studied countries identify as a group that experiences discrimination due to age, gender, sexual orientation, and disability.

Also, Başbaya et al. (2018) find that individual preferences for an economically strong, interventionist, and egalitarian state, as well as confidence in state and political institutions, are positively and significantly correlated with employment in the informal sector, while factors related to support for competition and confidence in free market institutions are negatively and significantly correlated with employment in this sector. The authors also show that people who engage in peaceful and lawful political processes are significantly less likely to work in the informal sector. Finally, individual norms, such as religiosity and tax morale, are negatively associated with employment in the informal sector.

In the following segment, we will address the role played by job mismatch in informality.

Job mismatch

Compared to the formal economy, the informal economy usually requires rather low-skilled workers and mobilizes learning by doing competencies. The concentration of workers with low levels of education in the informal economy may affect durably their productivity and capacity to access their labor rights. Moreover, the opportunities for learning and upgrading skills are usually significantly reduced in the informal sector compared to the formal one (Losby et al., 2002). The informal economy may be driven by a mismatch of skills caused by demographic changes and sometimes by the educational system. This is the case in Egypt, where insufficient formal jobs are being created for a large number of young, educated workers entering the labor market where industrial and technological levels are lagging behind (Bartlett, 2013).

As skill requirements in the informal economy tend to be much lower than in the formal economy, some educated people having difficulties entering the formal market turn to informal employment to find a job, even in low-skilled professions. Consequently, educated people, henceforth, turned overeducated, would have to compete with unskilled workers for the same jobs in the informal sector where their skills are largely unrelated to the actual skill requirement, which might result in a mismatch situation. Accordingly, Handel et al. (2016) find that employment in the informal sector is negatively correlated with under-education since

informality is usually a response to a lack of formal job opportunities. Meanwhile, employment in the formal sector is one of the few factors that consistently explain under-education. While employment in the formal and informal private sectors and self-employment are linked to over-education, employment in the public sector, typically associated with formality, is strongly associated with jobs more in line with worker education. Given that the strongest indicator of over-education is employment in informal jobs, skill underutilization constitutes a severe issue in developing contexts. Similarly, the ILO's analysis (2019) show that overqualification is positively related to the level of informality. Herrera and Merceron (2013) claim that informality and mismatch by education level constitute forms of underemployment in countries without unemployment insurance and where incomes are too low to allow job seekers to remain unemployed until employment more consistent with their educational attainment becomes available.

On the other hand, based on household data from 15 countries in Latin America and Africa, Aleksynska and Kolev (2021) find that in most low- and middle-income developing countries, workers in informal jobs are more likely to be undereducated than those in formal jobs, while employees in formal jobs are more likely to be overeducated.

Skills mismatch in contexts of high informality and under-education is observed in Sub-Saharan Africa and South Asia. In contrast, skills mismatch in contexts of moderate informality and over-education is seen in Northern Africa, the Arab States, and Central and Western Asia (Losby et al., 2002).

The brain drain can reinforce the mismatch situation: the most dynamic and skilled part of the population may move out of their country of origin, typically leading to shortages of highly skilled people. If the more creative, educated part of the population migrates, the incentives and capacities to establish large formal firms will be affected. As a result, informal underemployment will flourish in the context of a significant outflow of educated people. Low and medium-skilled, or blue-collar, professions and those requiring general competencies are significantly affected by low productivity and job mismatch.

Finally, examining the Colombian labor market, Herrera-Idárraga et al. (2015) find that informal workers face not only lower returns to their education, but suffer a second penalty associated with educational mismatches, which puts them at a greater disadvantage than their formal counterparts.

As we progress, we will now turn our attention to job quality and occupation as a micro-driver of informality.

Job quality and occupation

According to Vanek et al. (2014), all employment in informal enterprises, including own account workers, employers, employees, and contributing family workers, as well as employment in informal producers' cooperatives, is part of the informal sector. Employees and contributing family members in formal enterprises (for the public sector, public enterprises, private enterprises, and non-profit institutions) who are not eligible for social protection or certain other employment benefits, as well as informal employees in households (paid domestic workers), constitute informal employment outside the informal sector. In EMDEs, informal employment consists predominantly of self-employed workers (World Bank, 2022).

Most of the informal economy is composed of low-quality jobs without labor protection and either a high number of hours worked without due financial compensation or very short hours of work and time-related underemployment. Hence, labor productivity in the informal economy is low, even in the services sector.

However, in some professions, informal economy hourly incomes are not necessarily lower compared to formal ones, while the number of hours worked in the informal economy is often limited. Therefore, informal economy monthly incomes are usually lower. Workers tend to combine formal jobs with informal activities (moonlighting) when possible. Box 1.1 illustrates the proportion of informal workers in short work hours worldwide.

Box 1.1: Workers in informal employment and working time

Informality and working time

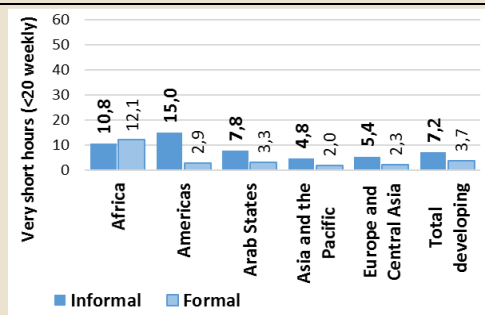
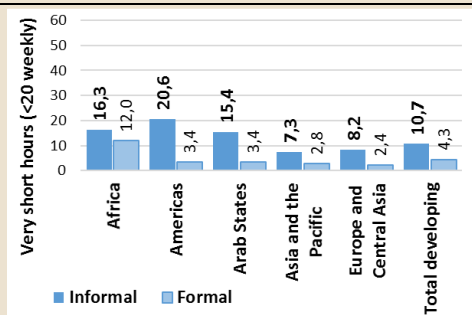
Workers in informal employment, not covered by labor laws, tend to be over-represented outside regular work hours. The proportion of workers in short hours of work (less than 35 hours) or very short hours (less than 20 hours a week) is systematically higher among workers in informal employment and among the poor compared to those in formal employment and the non-poor. The same happens when excessive work hours are considered in most regions, particularly Asia (International Labour Organization, 2016b).

Very short hours of work and informal employment (share of workers working less than 20 hours a week for pay or profit and formal and informal nature of employment)

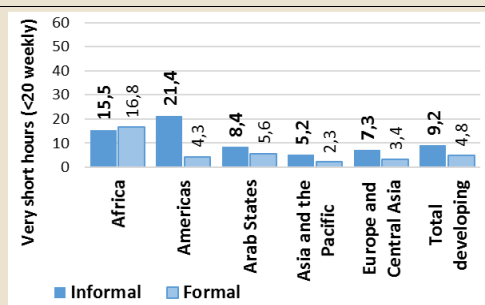
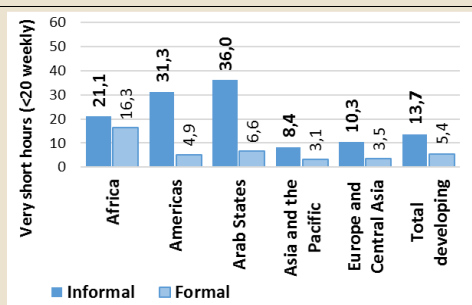
Total employment

Employees

Total



Women



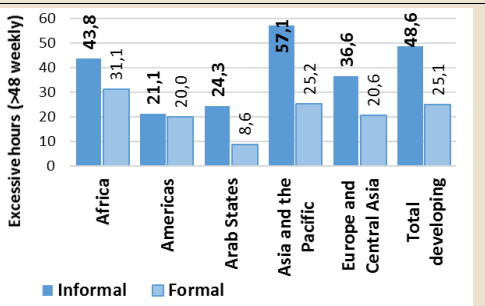
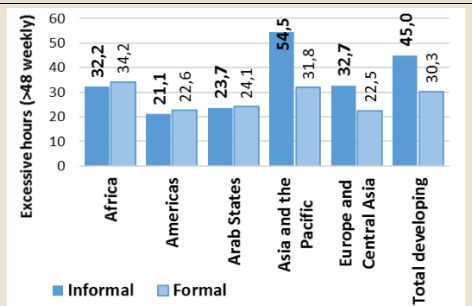
Note: based on 66 developing countries and Chile, the latest available year. Harmonized definition of informal employment (no registration or no complete set of accounts to define the informal sector and informal employment among own-account workers and employers; no social security gained through employment or, in case of missing, neither annual paid leave, nor paid sick leave to define informal employment among employees; all contributing family members are in informal employment).

Excessive hours of work and informal employment (share of workers working more than 48 hours a week for pay or profit and formal and informal nature of employment)

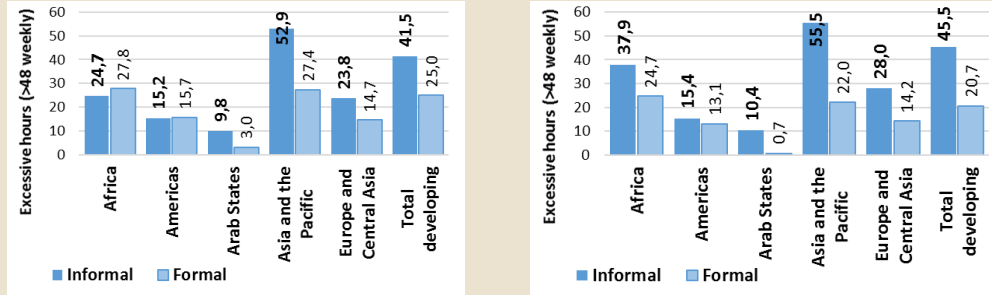
Total employment

Employees

Total



Women



Note: based on 66 developing countries and Chile, the latest available year. Harmonized definition of informal employment (no registration or no complete set of accounts to define the informal sector and informal employment among own-account workers and employers; no social security gained through employment or, in case of missing, neither annual paid leave, nor paid sick leave to define informal employment among employees; all contributing family members are in informal employment).

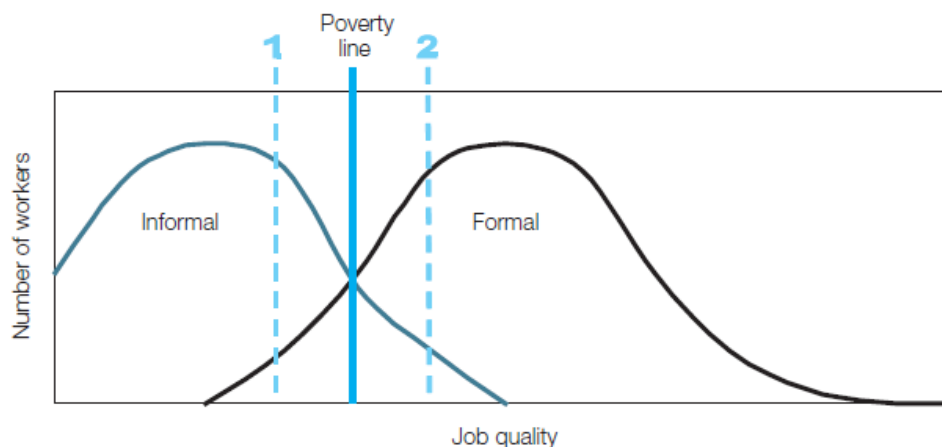
Source: ILO calculations based on national household surveys

On the one hand, the informal sector is clearly characterized by lower job quality than the formal sector and traps a significant share of workers (Kucera & Roncolato, 2008; OECD, 2015). On the other hand, as seen in Figure 1.14, when job quality in the informal sector decreases and the quality gap between the formal and informal sectors converges, workers have fewer incentives to continue working formally and may be attracted to the benefits of working informally instead. Hence, we consider low job quality in the formal sector to be one of the micro-drivers pushing people to work informally. For instance, this happened in the 1990s in Ukraine when occupational safety and health (OSH) standards were not respected in the formal mining sector, making people leave the hazardous formal work to find safer employment options frequently informally. In the same vein, it has been documented that the Chinese fast-fashion company Shein exploits its employees and severely violates their labor rights (De Pear et al., 2022). Such dire working conditions might compel the workers to seek a job elsewhere, often in the informal sector, since even the formal sector does not provide decent work.

Incidence of informality is more prevalent in sectors and across occupations associated with lower job quality. Peculiar characteristics of both firms and professions are often closely intertwined with decent work deficits, making them more prone to operate and work informally. Informal firms are typically smaller, less productive, labor-intensive, and more prevalent in the agricultural and service sectors (World Bank, 2022; Benjamin & Mbaye, 2012b). According to the World Bank (2022), in EMDEs, 90% of agricultural employment is informal. 72% of firms in the service sector operate informally, contrasted with 33% in the manufacturing sector. In

their turn, Vanek et al. (2014) claim trade to be the most important branch of informal economic activity, accounting for 25% (Eastern Europe and Central Asia) to 43% (Sub-Saharan Africa) of all non-agricultural informal employment across the regions. Furthermore, manufacturing and construction are significant branches of activity, representing from 14% (Latin America and Eastern Europe and Central Asia) to 29% (South Asia) and from 7% (Sub-Saharan Africa) to 28% (Eastern Europe and Central Asia) of non-agricultural informal employment, respectively.

Figure 1.14: Job quality distribution for formal and informal workers



Source: Kucera & Roncolato (2008)

The labor market is heterogeneous and segmented. In developing countries, the professions are considered informal, where labor regulations are often not implemented. The professions in the informal economy are the ones facing tough labor conditions. Most low/medium-skilled professions with general competencies are dominant in the informal economy.

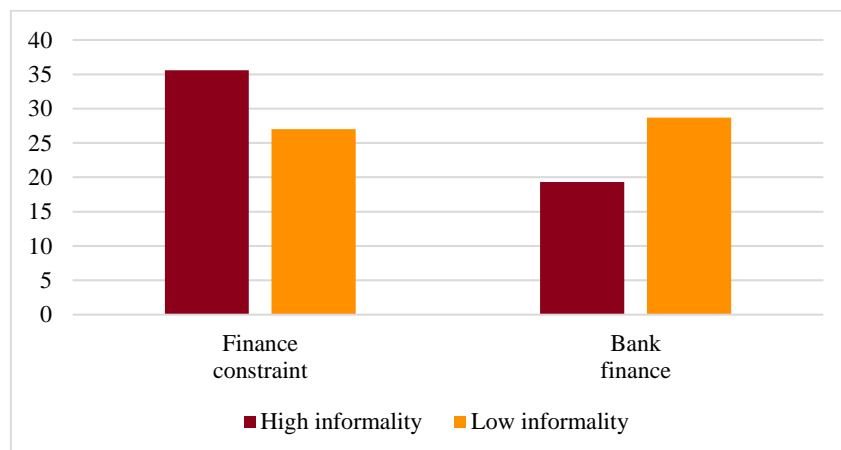
All over the world, some professions, such as street vending or subcontracted outwork (also called home-based work), are closely associated with both lower job quality and the informal market. For instance, homework is predominant in industries such as textiles, garments, leather, footwear, carpentry, electronics, and services (Chen, 2001). These professions sometimes produce input for formal firms. Many professions in the construction building industry, transportation, trade, home services, and even in education, health, and some new technologies/communication sectors are also part of the informal economy.

Concluding our examination of the micro-drivers of informality, we will now concentrate on the last one: the lack of access to finance and land.

Lack of access to finance and land

In many developing countries, less than half of the population has an account with a financial institution, and in some countries, less than one in five households do (World Bank, 2012). Figure 1.15 shows that countries with more pervasive informality experience lower financial development. Such a lack of access to finance hinders growth by trapping firms in small and low-productivity operations and perpetuates informality, inequality, and poverty. On the one hand, lack of access to finance confines firms to operate at a lower scale and often informally. On the other hand, already-set-up informal businesses have less access to credit from the banking sector and capital markets due to a lack of property rights, a lack of documentation for assets, and inadequate financial statements, which limits their capacity to invest (World Bank, 2022).

Figure 1.15: Access to finance and informality



Source: World Bank (2022)

Lack of access to finance is considered the most significant challenge that informal businesses face (World Bank, 2012; Singh et al., 2012). Studying the case of India, Sharma et al. (2019) assert that the informality of jobs constitutes the biggest challenge for financial institutions to provide financial services to a large section of society. In addition, Amin (2009) finds that opportunity entrepreneurs (i.e., voluntary and dynamic entrepreneurs) have better access to financing and banking than necessity entrepreneurs (i.e., forced or quasi-forced) do. However, this distinction between opportunity and necessity entrepreneurs is confined mainly to manufacturing firms.

Instead, a sizable portion of informal businesses obtains funding for their ongoing operations and investments from sources other than financial institutions, such as internal funds,

moneylenders, family, and friends (Garcia-Bolivar, 2006). Meanwhile, most businesses state that the most significant advantage of registering would be relatively easier access to finance (Farazi, 2014). Beck and Hoseini (2014) argue that access to finance is vital in reducing informality, particularly that financial outreach and depth are positively associated with a higher share of formal enterprises. Lack of access to finance traps firms in the informal sector. Furthermore, firms in the informal sector lack access to new technologies and greater business visibility through publicity (Farazi, 2014). Finally, access to land is particularly crucial in rural areas where most of the informal economy is related to agriculture. Many very small farmers or agriculture workers may be forced to work in the informal economy because they do not have access to land. For instance, in Nigeria, to receive funds and credit facilities from government and financial institutions, workers in the informal sector need landed property as collateral security (Bello, 2007), which traps them in the perpetual cycle of informality and poverty.

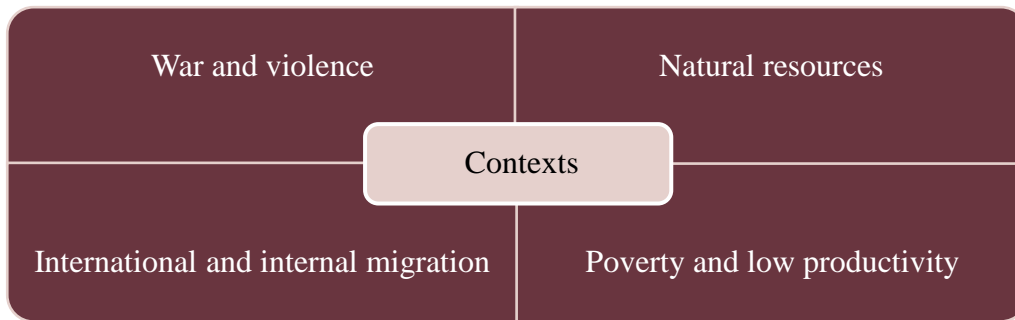
Having examined the main macro- and micro-drivers of informality, in the subsequent section, we will explore four specific contexts and analyze how their presence amplifies these drivers' influence on the informal economy's development and scale.

1.3 Building context-specific analysis

Countries and regions worldwide face different contexts, which are sometimes difficult to distinguish from the drivers of informality. The informal economy is increasingly large and extended when the context is favorable, and the incentives to work in the informal economy are greater due to local circumstances.

In our study, we analyze the interaction between the context and the drivers of informality in order to clarify the causal relations. Here, we present the four main contexts in a summarized manner: war and violence, natural resources, poverty, and international and internal migration (Figure 1.16). We can define rapid and more gradual informal economy growth contexts. The first assumes breaks and shocks, creating an unstable economic environment where engagement in the informal economy is often a survival strategy (in the case of the wars and violence context). The latter is more progressive due to slower changes in the institutional framework (in the case of migrations, poverty, and natural resources contexts).

Figure 1.16: Specific contexts



Source: Authors' construction

Further, we will analyze each of the four contexts and their interaction with informality. To enhance understanding, we will illustrate the dynamics of drivers within each context by focusing on a particular country. We will commence with the context of war and violence.

War and violence

The most visible and quick economic outcome of conflicts is the development of the informal economy. Unfortunately, a context of war and the destruction of state institutions is creating the most favorable environment for the rapid growth of the informal economy. Conflicts, depending on their intensity (see UCDP/PRIO dataset⁵), are usually a momentum of large wealth redistribution and formal job destruction. In this context, unregulated activities are flourishing, and informal street markets are expanding.

As conflicts create an unpredictable economic environment, most enterprises are no longer investing and are postponing all their medium-term projects. Over the last fifty years, many African countries have experienced conflicts (Human Security Research Group, 2014), significantly and abruptly impacting their official GDP. Looney (2005, 2006) finds that the informal economy tends to grow during periods of economic crisis, including periods of violence, since wars, sanctions, and insurgency can take a heavy toll on formal activities. As a result of conflict, private firms and public enterprises are reduced in size or shut down, pushing retrenched workers to enter the informal sector for survival motives as a means to generate income and maintain relative economic security. In addition, households frequently need to

⁵ The dataset is prepared by the Uppsala Conflict Data Program (UCDP) at the Department of Peace and Conflict Research, Uppsala University and the Centre for the Study of Civil War at the International Peace Research Institute in Oslo (PRIO). It is accessible at: <https://ucdp.uu.se/downloads/>

supplement formal sector incomes with informal earnings due to inflation brought on by conflict or reductions in the availability of public services. When there is a severe crisis, the breakdown of law and order may increase criminal activity, some of which occurs in the shadow economy, such as street vendors selling stolen goods.

Against this background, in conflict-affected situations, urban households often participate in informal markets to sustain their livelihoods (Mackie et al., 2017). Pantuliano et al. (2011), Iyenda (2005), and Cain (2004) find that access to petty trade and daily labor constituted the first survival strategy of urban workers in post-conflict Sudanese cities, Kinshasa, and Luanda, respectively. Mackie et al. (2017) observe that informal employment replaced absent services immediately after the conflict in Somaliland, mainly in the food, water, electricity, and transport sectors.

For instance, in Iraq, coalition officials intended to establish a free market economy (Looney, 2003). They anticipated domestic and foreign private businesses would take the lead in reviving the economy. However, violence, crime, and lack of certainty about the future have reduced investor confidence, which has prevented market-driven mechanisms from functioning as expected. The country's informal economy is the only sector of the economy that has not only endured both Saddam Hussein and the post-2003 period of unrest and instability but has significantly grown due to the uncertainty created by the insurgency together with ongoing corruption compounded by the country's population bulge, which has expanded the size of the labor force. Moreover, in countries with poor governance, the incidence of conflict and political instability is much higher and associated with a significant level of informality, as portrayed by several Sub-Saharan African countries.

Nordstrom (2000) describes shadow economies in war zones as existing outside of and alongside formal economic activity and as being just as centrally enmeshed in economic, political, and sociocultural forces. According to Nordstrom (2010), violence disrupts governmental support systems, infrastructure, and trade routes, making people increasingly reliant on informal jobs. The author argues that the informal economy becomes central to international trade in raw materials and human labor (from war zones) for commodities (from industrial centers). Similarly, Lamb (2011) concludes that in war-oriented contexts, informal economic activities are more pronounced than during peace and are considered a vital component of a war economy.

Wennmann (2005) explains this tendency by the fact that the increased insecurity and exploitive behavior of security forces and insurgent groups in a wartime environment usually results in ordinary people gearing their economic activities towards low-level subsistence in the informal economy. Additionally, significant job losses in the public and private sectors force civilians to resort to informal means of livelihood support (Collier, 2006). Furthermore, Lamb (2011) states that while formal sector employment opportunities in post-conflict countries tend to be infinitesimal, there is a significant increase in the number of small informal businesses due to the stabilization of the economy, the demand for essential goods and services, and labor flexibility in this sector.

Considering the case of the 1996–2006 civil war in Nepal, anger against the elite in place and dissatisfaction against the government fired the conflict. As a result of the war, recruitment by armed groups, forced migration, and the death of family members contributed to the rapid development of the informal economy and the need for an additional source of household income can be underscored (Menon et al., 2015).

Sarvananthan (2016) notes that lack of government administration, law enforcement and judicial services, and economic sanctions are the main factors contributing to the informal economy in the conflict region in Sri Lanka. Business registration in Sri Lanka is centralized in Colombo, and since during the war, in order to travel to Colombo from the North and East (N&E) Province, people had to obtain travel passes from the security forces and the LTTE (Liberation Tigers of Tamil Eelam) and go through rigorous security checks, businesses in the N&E have remained unregistered during the conflict. In addition, the LTTE directly or indirectly owns virtually every significant business in the LTTE-controlled areas, making them all informal by definition. Furthermore, since the LTTE imposed its own taxes and businesses in the N&E are unable to evade LTTE taxes even if they do evade government taxes due to the often-fatal penalties for non-payment of LTTE taxes, they decide not to register in order to avoid paying taxes to two authorities. Finally, due to the economic embargo on the LTTE-controlled areas imposed by the government in 1990 and restrictions on the supply of goods to some government-controlled areas, a shortage of goods occurred, resulting in the emergence of black markets for the restricted goods. Despite the unilateral lifting of the economic embargo in 2002, new restrictions have been placed on the movement of some goods following the increased violence since 2006. The author argues that the informal economy in conflict-affected countries/regions is transnational by nature and, therefore, policies to combat the informal economy require international cooperation.

As a result of Russia's full-scale invasion, the share of the informal economy in Ukraine is on the rise ("Chastka tinovoi," 2022), serving as a safety cushion and helping the population to survive (Michkovska, 2022). This is in line with the predictions of Anastasia et al. (2022), who argue that Ukraine's informal economy might expand in result of Russia's invasion due to the following reasons: (i) the incentive to avoid reporting incomes will increase as poverty and economic hardships rise; (ii) internal forced migration may increase an informal employment rate, based on the work of Bosch and Farré (2014) who find a positive relationship between immigration and the size of informal labor market; (iii) a more favorable environment for the informal economy may result from the weakening of institutions responsible for combating it as well as changes in the government's policy priorities following the war.

Furthermore, Ivlevs and Veliziotis (2018) study the impact of internal displacement caused by armed conflict within the former Soviet Union and Yugoslavia and find, among others, that the forcibly displaced people who fled conflict 10–15 years ago are more likely to work informally than people not affected by conflict.

Sekrafi et al. (2020) examine African countries and find that terrorism also positively affects the informal economy. Kohnert (2022) explains it through African countries' poorly diversified development economies and the class-specific impact of terrorism on welfare. According to UNDP (2019), increasing levels of terrorism can cause economic activity to shift from formal to informal by pushing trade and cross-border trading underground either because of terrorist activity directly or a state's response to terrorism, in particular tightening up security and regulations, which can have detrimental effects on a state's capacity to collect taxes, provide security and other public goods, and monitor the movement of goods and services. For instance, the analysis of the Boko Haram-related conflict's economic impact in northeastern Nigeria has identified three transmission channels: the conflict leads to the disruption of production as businesses and farms shut down; there is the physical destruction of capital such as roads and buildings; and there is the dislocation of workforce caused by migration or mortality. On the other hand, high levels of terrorist activity also impede informal economic activity, resulting in losses in livelihood opportunities and overall economic output.

Finally, according to Mackie et al. (2017), the informal economy creates employment for the youth, especially young men and ex-combatants, who, if unemployed, may participate in ongoing violence. Moreover, by providing the host communities with knowledge, technology, remittances, and other sources of income, displaced communities build social resilience that

can inspire creative conflict resolution strategies. In this regard, the informal economy may contribute to peace and recovery efforts (Chen & Harvey, 2017).

To provide a concrete illustration of how informality drivers intersect with the post-war context, we examine the case of Bosnia and Herzegovina following the war of 1992–1995 in the box below. We chose to study this country since the consequences of the Bosnian War, with its high intensity, have been drastically arduous, and the population continues to bear its enduring effects to this day. The war and its aftermath are reflected, among others, in the scale and dynamics of the country's informal sector.

Box 1.2: The post-war context in Bosnia and Herzegovina

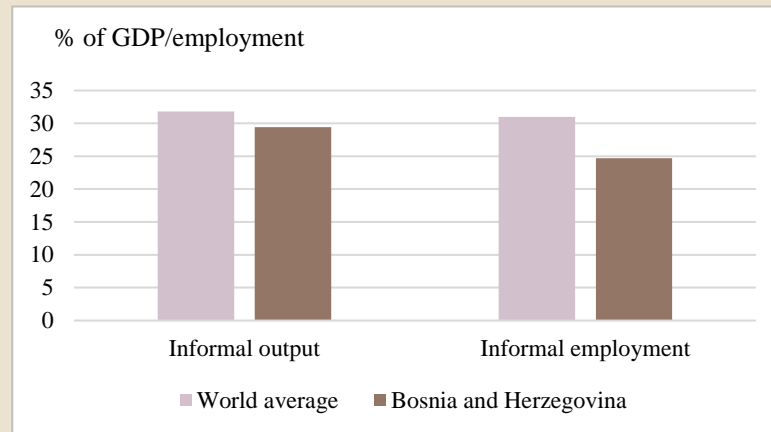
The Bosnian War of 1992–1995 brought a humanitarian disaster and completely devastated the country's economy. The war uprooted 1,3 million people from their original residence, resulting in their greatest socio-economic vulnerability (Kondylis, 2010). The post-war lagged transition and the complex institutional environment led to an increase in informal economic activities (A. Efendic & Hadziahmetovic, 2015; A. Efendic & Pugh, 2015). Albeit the informal economy of Bosnia and Herzegovina has followed a modest downward trend over time (Pasovic & A. Efendic, 2018), it remains at a high level, estimated at around 30% of GDP (Nastav & Bojnec, 2007; Schneider et al., 2010; Medina & Schneider, 2018; Pasovic & A. Efendic, 2018; N. Efendic et al., 2018; Gordy & A. Efendic, 2019; World Bank, 2022; Figure 1.17). The share of self-employment in total employment is 24.7% (World Bank, 2022; Figure 1.17). N. Efendic et al. (2018) contend that the informal economy in Bosnia is used as a survival strategy for households but also as a tool to supplement formal incomes, lower the costs of formal business, and overcome formal institutional rigidities. However, the authors find the growth of informal businesses to converge with formalization since informality at some point of business development hinders higher entrepreneurial growth aspirations.

Governance and institutions

The post-war reconstruction and transition period saw Bosnia's former formal institutions and regulations become obsolete or dysfunctional (Halilovich & N. Efendic, 2019). N. Efendic et al. (2018) used “trust in government” as a proxy of institutional quality and found that more than 60% of respondents have no trust in different levels of government. The low trust in institutions is expected to lead to the development of the informal sector (Schneider, 2010;

Williams & Horodnic, 2016). Moreover, people resorted to informal practices and networks as a substitute for formal institutions (A. Efendic et al. 2011; A. Efendic et al., 2018). The higher divergence between formal and informal institutions is argued to lead to higher participation in the informal economy (Williams & Vorley, 2014; A. Efendic & Pugh, 2015).

Figure 1.17: Informal output and employment in Bosnia and Herzegovina⁶



Source: World Bank (2022)

A. Efendic et al. (2018) assert that tax morality, to some extent, identifies asymmetry between formal and informal institutions since it reveals to what extent individuals believe what is legal aligns with what is socially legitimate. Thus, the greater the tax morality, the greater the alignment between formal and informal institutions. 40% of respondents from the household and entrepreneurial sectors in Bosnia justify tax evasion to some extent, indicating a relatively low level of tax morality (Pasovic & A. Efendic, 2018; N. Efendic et al., 2018).

Social benefits and labor regulations

Nastav and Bojnec (2007) argue that extremely restrictive employment protection legislation put in place before 2000 led to an increase in the share of informal employment. Moreover, a binding minimum wage imposed barriers to moving from the informal sector to the formal sector, especially for the young, unskilled, and women (World Bank, 2002).

Taxes and labor-income incentives

The World Bank (2002) indicates that high levels of taxes and high social security contributions push large numbers of workers into the informal sector. Furthermore, Pasovic

⁶ Informal output is based on the dynamic general equilibrium (DGE) model, in percent of official GDP. Informal employment is the share of self-employment in total employment. Data are for 2010-18.

and A. Efendic (2018) find that the value-added tax (VAT) reform introduced in 2006 led to a decrease in the informal economy.

Macroeconomic instability, growth, and international trade

The findings of Pasovic and Efendic (2018) reveal that the global economic crisis in 2009, as expected, resulted in an increase in the informal sector in Bosnia and Herzegovina.

Discrimination based on socio-demographic characteristics

The World Bank (2002) finds a high share of Bosnian informal employment among the young and the unskilled due to high barriers to entry into the formal sector. Regarding the age profile in the informal sector, a weakly inverted U-shaped pattern is observed (World Bank, 2005). N. Efendic et al. (2018) find that people belonging to vulnerable groups, such as unemployed, less educated, post-war returnees, and those from rural areas, turn to informality to overcome their socioeconomic difficulties. The author also finds that men participate in the informal sector more than women.

Job quality and occupation

According to the World Bank (2002), most informal employment in Bosnia and Herzegovina is present in agriculture (47%), construction (17%), and manufacturing (9%). Private employers employ most informal workers, 28% are self-employed, and about one-fifth are contributing family members.

The information provided in the box above highlights how the post-war context in Bosnia and Herzegovina enhances the effect of institutions and regulations, employment protection legislation, taxes, the global economic crisis of 2009, specific socio-demographic features, and job quality and occupation on the informal economy.

Taking a step further, we will now move on to discuss the context of natural resources and its interplay with the drivers of informality.

Natural resources

In countries characterized by weak governance, natural resources⁷ create large incentives for small undeclared activities, especially when oil prices are high. For example, in oil industries, jobs are relatively limited, and most of the rents are not channeled to the state budget and even less to social protection expenditures. The redistribution of oil rents, when it occurs, is going to the informal economy (Najman et al., 2007). Natural resource economies rarely create formal jobs or institutional capacities; in contrast, they tend to weaken local governance or even create incentives for conflicts (Nordstrom, 2010).

Countries where natural resources such as hydrocarbons are the main source of revenues are more likely to face growing informality, especially in the absence of political stability and when coupled with inferior institutional arrangements. This has been identified as the resource curse by Auty and Warhurst (1993), resulting in poor economic performances and thus creating favorable conditions for informality to expand.

Blanton and Peksen (2021), based on data from over 120 countries for the 1985–2012 period, argue that resource wealth growth directly fuels the growth of the informal economy because the patterns of investment and spending that go along with these revenues restrict opportunities in the formal sector, driving more labor and businesses towards rent-seeking in the informal sector.

According to the political economy perspective, resource revenues result in the misallocation of productive capital among economic sectors, with revenue windfalls being able to change the incentives faced by businesses, in particular, the costs and benefits of focusing on “grabbing versus production” (Ebeke et al., 2015; Mehlum et al., 2006). In this case, the potential productivity losses of resource wealth would be caused instead by its misallocation since otherwise productive workers can be motivated to concentrate on more profitable, although less productive, rent-seeking opportunities. Along these lines, resource revenues incentivize a narrow economic base that excludes many workers, pushing them into the informal labor markets. For instance, labor markets in oil-rich Arab countries are characterized by an oversized public sector since ruling elites attempt to avert revolt by using labor markets as a mechanism to transfer a fraction of the oil rent to politically influential groups through public

⁷ Can be measured using total natural resource rents (World Development Indicators), or the share of natural resource exports divided by total exports. The estimates of natural resources rents are calculated as the difference between the price of a commodity and the average cost of producing it.
<https://data.worldbank.org/indicator/NY.GDP.TOTL.RT.ZS?view=chart>

sector employment (Ali & Elbadawi, 2012). This results in a small formal private sector and, thus, the growth of informality (Adom & Williams, 2014; Malik & Awadallah, 2013; Gatti et al., 2013; ESCWA, 2012). Human rights organizations condemn the practice of many resource-rich nations, most notably Qatar, of using sizable informal labor pools for infrastructure and construction projects, frequently in unsafe and unregulated conditions (Human Rights Watch, 2017).

Likewise, according to Leary (2007), in Venezuela, oil exports make imported goods cheap and undermine domestic production unrelated to petroleum refining by overvaluing the domestic currency. Although the government has channeled state oil revenues into social and economic programs, including those intended to develop petroleum refining capacity and diversify the productive sector, the formal sector cannot absorb the workforce, pushing it into the informal sector.

As per a neoliberal perspective, resource revenues change how entrepreneurial talent decides about the shadow economy. Namely, increased revenues open the door for rent-seeking activities outside the formal sector. In addition, due to the lack of transparency surrounding resource rents and accountability in how such resources are handled, there are countless opportunities for money laundering and other illicit economic activity. Furthermore, the informal sector frequently experiences the “multiplier effect” of resource-intensive industries, especially in the case of mineral-based industries, where the emergence of informal industries is facilitated by a sizable mining sector (Blanton & Peksen, 2021).

Finally, Blanton and Peksen (2021) point out that institutional explanations focus on the congruence, or incongruence, between formal and informal institutions, arguing that entry into the informal economy is encouraged when both are incongruent. When these two institutional structures are complementary or compatible, citizens will abide by the formal rules. On the contrary, when they are not, citizens are likely to doubt the legitimacy of formal institutions and may not respect them. Thus, incongruence between formal and informal institutions will result in a larger informal economy. In that manner, Kpognon (2022) finds that natural resources have an increasing effect on the informal economy in Sub-Saharan Africa, which is known for its abundance of natural resources and its preponderance of the informal sector. Thus, the author argues that there is a resource curse, which can turn into a blessing provided good and strong institutions are built.

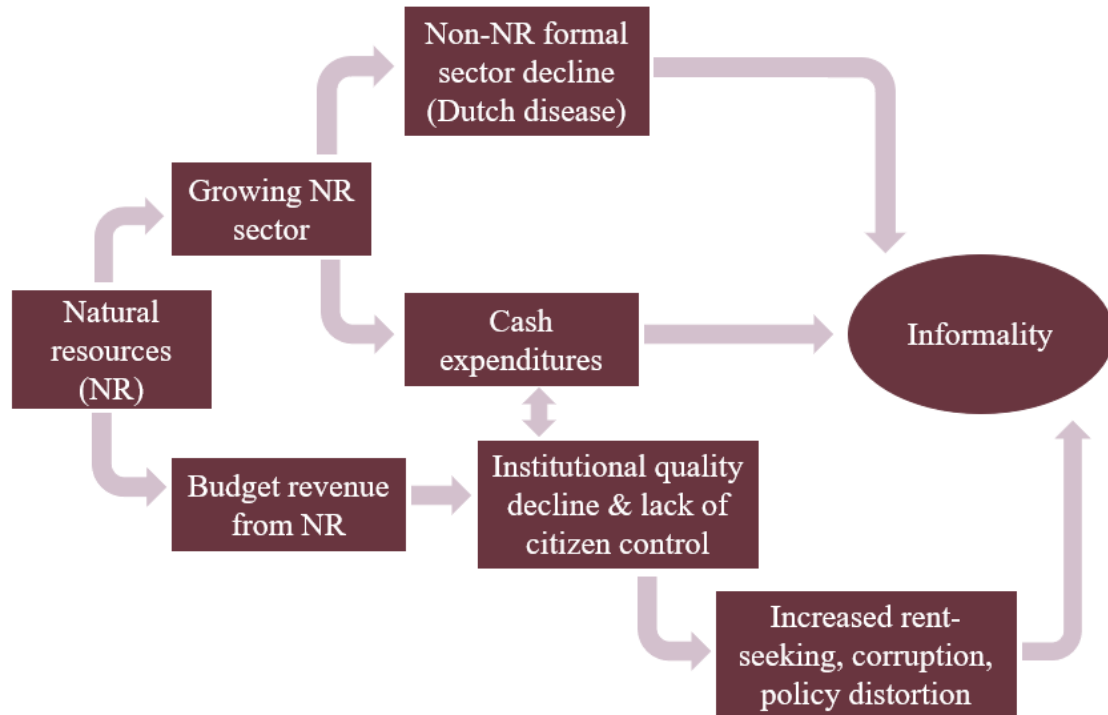
Specifically, a thorough analysis of Kazakhstan underlines the connection between an abundance of natural resources and the rise of informality. Since its independence in 1991, the country has started building an institutional framework to support its emerging oil and gas industry with institutions such as the national oil company KazMunayGas (KMG), thus having the central government controlling significant shares of domestic hydrocarbon reserves. Furthermore, the lack of transparency and efficiency combined with strengthened presidential control over the oil sector and diverging political interests formed a breeding ground for corruption (Pomfret, 2011). The redistribution of resources among the elite, permitted by a non-competitive political system and protectionism, ensures the establishment and the dominance of shadow groups while hindering modernization and inhibiting the development of small- and medium-sized businesses. In Kazakhstan, three layers of informal workers can be identified: the self-employed, who effectively dropped out of the social security system; the small- and medium-sized businesses, who are on the border between the formal and informal economies; the corruption services in state structures and national companies, closely associated with fraud (Satpayev, 2014). Good governance is hence highly linked with low corruption and informality in countries abundant in natural resources.

Figure 1.18 describes the mechanism linking the natural resources context with the informal sector development. Three channels can be identified. The first is called the “Dutch disease”: as prices in the formal sector increase due to the inflow of capital from natural resources, the economy tends to specialize in activities related to natural resources, and, as a result, the non-natural resources formal sector becomes no more competitive relative to imports. The second channel can be named cash expenditure or informal redistribution from the natural resources sector to informal activity, with a rather small part of natural resources revenues used in the local informal sector. Finally, the third channel corresponds to the decline of institutional quality since discretionary tax distribution with resource revenues leads to rent-seeking behavior and patronage spending. Voracity effects create inadequate genuine savings and low economic growth, negatively affecting the formal economy and providing huge incentives for informal sector development.

To examine the dynamics of the informality drivers in the context of natural resource abundance, we focus on Ghana as an illustrative example in the box below. Our decision to examine Ghana stems from this country being endowed with abundant and diverse natural resources. As of 2021, the ratio of total natural resources rents to GDP is estimated at 13.3% (World Bank, World Development Indicators, 2021b). By analyzing this case, we gain insights

into how a resource-rich environment enhances the effect of macro- and micro-drivers of the informal economy.

Figure 1.18: Natural resources and informality



Source: The analysis based on Najman et al. (2007)

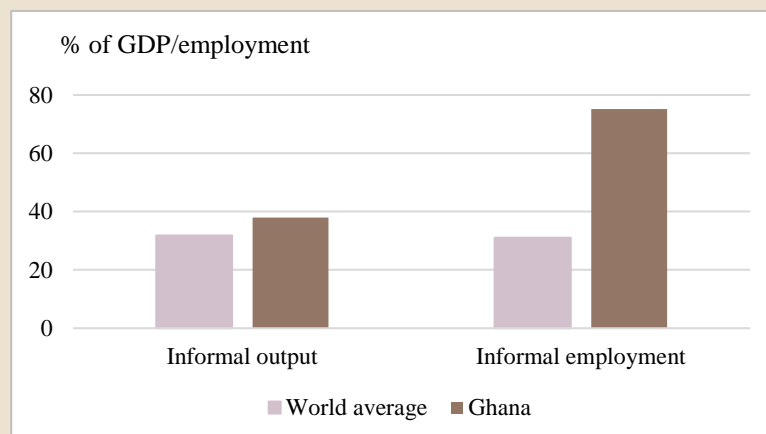
Box 1.3: The natural resources context in Ghana

Ghana is endowed with abundant and diverse natural resources such as gold, diamonds, timber, bauxite, manganese, oil, and cocoa. Natural resources have been pivotal in shaping the country's economic development. The context of natural resource abundance intensifies the impact of informality drivers.

According to Adu-Amankwah (1999), the roots of Ghana's informal economy can be found in the early days of colonial capitalism in the then-Gold Coast. A dualistic economy with two distinct sub-economies emerged. A small formal sector primarily covered capital investment in mining, transportation, infrastructure, business, social services, and administration. Conversely, encouraging the production of primary commodities for export and the importation of consumer goods for domestic trade led to the emergence of sizable labor force segments in agriculture and petty trade, which were either self-employed or hired under

traditional or informal arrangements (Ninsin, 1991). Used as a survival strategy, the informal sector significantly contributed to the reduction of widespread poverty in urban Ghana during the economic decline from 1970 to 1982 (Barwa, 1995). The large-scale labor retrenchment as a result of structural adjustment in Ghana in the mid-1980s, combined with the inability to employ the emerging labor force, led to a sizable pool of unemployed people who gravitated towards the informal sector (Osei-Boateng & Ampratwum, 2011). Therefore, formal sector employment shrank while the informal sector grew. While in the 1980s the informal sector employed twice as many people as the formal sector, by the 1990s it employed five and half times as many people (Nyamekye et al., 2009). High rates of rural-urban migration and urbanization have outpaced openings in the urban formal job market, resulting in a gap in the labor market (Peprah et al., 2019). Figure 1.19 demonstrates that the informal sector in Ghana accounts for 38% of GDP and 75.2% of all employment.

Figure 1.19: Informal output and employment in Ghana



Source: World Bank (2022)

Social benefits and labor regulations

According to Osei-Boateng and Ampratwum (2011), many Ghanaians rely on the informal sector as a survival strategy in the absence of adequate social protection mechanisms. The authors assert that very few workers in the informal sector have access to institutionalized social security programs that provide social benefits. Half the estimated informal sector workers are members of a National Health Insurance Scheme paying direct premiums. To help their members in the informal sector, some trade unions organizing informal sector groups have created welfare and microfinance programs. Informal workers also use traditional practices of social assistance such as “susu” and rotating savings schemes. Finally,

many operators in the informal sector also receive social assistance from traditional social networks. The government's COVID-19 protocols caused an outcry among the informal workers, making the government eventually ease the lockdown and launch the Corona Virus Alleviation Program, a comprehensive package aimed to address the socioeconomic effects of the pandemic on the population (Akuoko et al., 2021). This was the first state attempt to recognize and offer any kind of assistance to informal workers.

Discrimination based on socio-demographic characteristics

According to Koto (2015), the Ghanaian informal sector is dominated by people with low levels of education and hence, no otherwise employable skills. About 31% of Ghana's population aged 15 years and above have never attended school (Osei-Boateng & Ampratwum, 2011). The author also finds that the likelihood of working in the informal sector increases if parents own an enterprise in the informal sector. 91% of employed women work in the informal sector, compared with 81% of employed men (Budlender, 2015).

Job quality and occupation

In rural Ghana, informal sector activities are observed predominantly in agriculture (75%), fishing and fish processing, and agro-based processing (Osei-Boateng & Ampratwum, 2011). The following types of rural labor were identified: family labor, casual labor, apprenticeship, permanent labor, communal labor, and child labor (Adu-Amankwah, 1999). Most urban informal workers are primarily engaged in the services sector and, to a lesser extent, in the construction and manufacturing sectors. In the Ghanaian services sector, informal workers work primarily as urban food traders and processors, health and sanitation workers, domestic workers, repairers of watches, refrigeration equipment, radios, mechanical or electrical/electronic equipment, garages, graphic designers, audio-visual workers, hairdressers and barbers, and private security men (Adu-Amankwah, 1999). Meanwhile, construction workers perform the following jobs: masons, carpenters, steel benders, small-scale plumbers, house-wiring electricians, and carpenters. The manufacturing sector's main activities include food processing, textile and garments, wood processing, and metal works.

Lack of access to finance and land

Koto (2015) finds that financially constrained owners in Ghana are less likely to register their economic activities when they first begin operating. The sources of finance in the Ghanaian informal sector are primarily informal, such as personal savings and borrowing from friends

with interest rates closely linked to the prevailing high market rates (Barwa, 1995). Only a minor share of entrepreneurs in the informal sector reach out to banks or other government agencies for financial resources due to the complicated formalities and the need for more information on existing financial services (Yankson, 1992). Meanwhile, in their study on the differential impact of finance on the growth of informal firms in Ghana, Turkson et al. (2022) contend that formal financial institutions substantially affect firm growth more than informal sources.

Drawing on the information within the box featuring Ghana, we can discern important lessons about how the natural resources context affects such informality determinants as social protection mechanisms, discrimination based on socio-demographic characteristics, job quality, and lack of access to finance and land.

Next, we will shift our focus to the context of poverty and low productivity and its interplay with informality factors.

Poverty and low productivity

As underlined in many studies, informal firms are less productive than formal ones since they usually employ more low-skilled workers, often face restricted access to funding, services, and markets, have backward technologies, and lack economies of scale; they are sometimes nonproductive at all, which lowers the overall productivity growth of the economy (Harris & Todaro, 1970; De Soto, 1989 & 2000; Gardes & Starzec, 2009; Galal, 2005; El-Hamidi, 2011; World Bank, 2022). Farrell (2004) states, “informal companies become trapped in a self-reinforcing dynamic that confines them to subscale, inefficient, low-productivity work.” The author argues that informal businesses have a limited ability to invest in improving their operations since their legal status prevents them from borrowing from formal credit institutions. Such firms also lack access to governmental services, proper documentation, and infrastructure. Furthermore, it is risky for informal businesses to conduct business with individuals or entities outside their immediate community because they cannot rely on the legal system to uphold their agreements, protect their property rights, or settle disputes. Additionally, operating informally creates perverse disincentives for growth because a bigger business might draw more government attention. Informal businesses often also structure their entire value chain in an informal manner. They tend to employ unskilled (learning by doing) and less

productive workers, and their output is more labor intensive. For these reasons, one could easily conclude that the presence of informal firms would harm labor productivity. The productivity gap is found to be smaller for large informal firms than for small informal firms (Benjamin & Mbaye, 2012a).

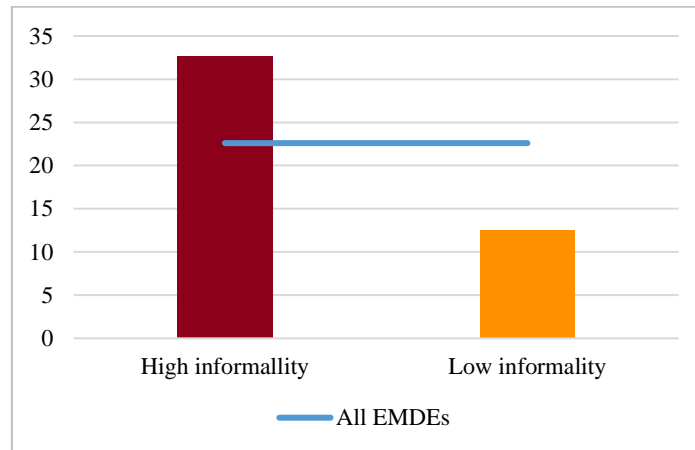
Various productivity gap estimates have been found in the literature due to various samples and definitions of informality. Thus, according to Farrell (2004), Amin and Okou (2020), and La Porta and Shleifer (2008), the average productivity of informal businesses is half, a quarter, and 15% of that of formal businesses, respectively. Additionally, evidence from Latin American and Caribbean countries suggests that the labor productivity of informal firms is about 29% lower than the productivity of formal firms (Perry et al., 2007).

Studies on the impact of the competition from informal firms on the productivity of firms in the formal sector reveal conflicting results depending, to some extent, on the reasons for firms to operate informally. As per the “dual economy” view, informality presents a survival strategy for low-productivity firms, and they operate in different markets than formal firms (La Porta & Shleifer, 2008, 2014; Rothenberg et al., 2016). Thus, there is no spillover from the informal to the informal sector. Meanwhile, the “parasite” view asserts that when productive firms use informality as an evasion strategy, the competition from informal firms can affect the productivity of formal firms (Amin & Okou, 2020; World Bank, 2022). It happens because informal businesses do not pay taxes and do not comply with costly regulations in contrast with formal businesses, thus obtaining such an unfair advantage and overtaking market share from established firms (Perry et al., 2007). This results in the decline of the production of formal firms, with lower prices having an adverse effect on their profitability, which decreases their motivation and access to investment funds and, thus, affects their productivity. On the other hand, formal firms may benefit and increase their productivity thanks to the development of the informal economy (Ali & Najman, 2016, 2017).

According to Lamb (2011), the informal economy provides the potential for income generation in regions with restricted formal employment opportunities and/or a large pool of unskilled labor. It generates most of the income of the marginalized and poor, representing most of the informal economy workforce (Sharma & Adhikari, 2020). In developing countries, the unrecorded economy is vital in providing a safety net for people experiencing poverty. Thus, EMDEs with above-average informality are characterized by higher poverty (Figure 1.20; World Bank, 2022). More pervasive informality, in turn, is associated with slower output and labor productivity growth, slowing down poverty reduction and income growth for

economically disadvantaged employees (World Bank, 2022). Rosenbluth (1994) argues that although the economy’s informal sector accounts for most of the poor, not all informal workers are poor.

Figure 1.20: Poverty and informality⁸



Source: World Bank (2022)

Evidence from India indicates that the incidence of poverty is more prevalent among informal sector participants than their formal sector counterparts (Pradhan et al., 1999). A greater presence of informal sector activities can partially account for the higher incidence of rural poverty, as, despite the sector’s significant contribution to the creation of jobs in rural areas, the value added from these activities is noticeably low, reflecting the low productivity of sector employees (Kathuria & Raj S.N., 2016). Nguyen et al. (2013) find that income from informal sources significantly contributes to poverty reduction in Vietnam. In Latin America, most working poor are found in the informal sector, where the prevalence of extreme poverty is higher (Sethuraman, 1997). In the EU member states, the size of the informal sector is positively associated with the percentage of the population at risk of poverty in a country (Williams, 2014). Evidence from Romania suggests that the key motive to participate in the informal economy is to escape from poverty, with the informal economy being used as a survival strategy to withstand negative income shocks (Kim, 2005). Regarding the causal relationship between informality and poverty, Amuedo-Dorantes (2004) finds that household

⁸ “High-informality” (“Low-informality”) are EMDEs with above-median (below-median) DGE-based estimates of informal output (in percent of official GDP). Group averages over the period 1990–2018 for countries with higher informality (above median) and those with lower informality (below median) are shown in bars. EMDE average over the period 1990–2018 is shown in a blue line. “Per capita income of bottom 40 percent” measures the annualized average growth of per capita real survey mean consumption or income for the bottom 40 percent of population.

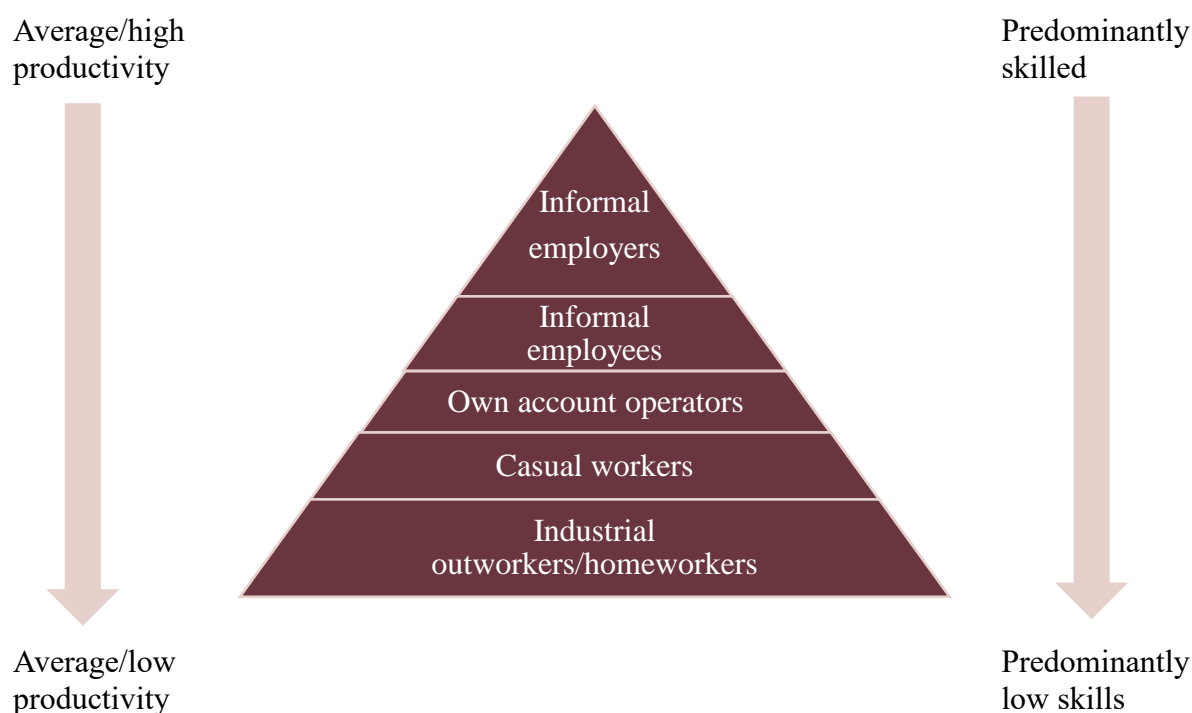
poverty is a common determinant of the household head's decision to take a job in the informal sector in addition to being one of the implications of low-pay household head's employment in the informal sector. In their turn, Blunch et al. (2001) reiterate that while poverty is a key characteristic of the informal sector, there is also an association between the incidence of poverty and participation in the informal sector, which, however, does not apply to all workers in the same way, since self-employed individuals typically earn more than minimum wage.

The literature provides the “marginalization” thesis, which asserts that marginalized groups, such as the unemployed and low-income groups, are more likely to engage in and benefit from the informal economy than other groups (Nobil Ahmad, 2008; Castree et al., 2004). However, the reinforcement thesis has emerged, which contends that the marginalized benefit less from the informal economy than those employed and higher-income populations (Williams, 2014). The poorest part of the population is probably stuck in poverty traps. The development of the informal economy may increase the productivity gap between the poorest part of the population and the richest one. A massive informal economy reinforces the poverty traps of the lowest productivity segment of the informal sector. Williams (2014) concludes that the marginality and reinforcement theses are not incompatible. Although marginalized groups participate more in the informal economy than others, they receive less of its benefits. As a result, the informal economy worsens rather than lessens the inequalities brought about by the formal economy. Therefore, informal work results in a “reinforced marginalization” of their position. Since they make less money overall from informal work than relatively affluent populations, the poor engage in it disproportionately, which only further entrenches their marginalized status.

We present the segmentation of the informal economy across skill levels and productivity (earnings) in Figure 1.21. The productivity/poverty trap is more widespread among casual workers and industrial outworkers/homeworkers.

Finally, in the box below, we analyze the interplay between the context of poverty and informality drivers, focusing on the case of Madagascar. We chose Madagascar due to the high prevalence of poverty, with the country's poverty headcount ratio at \$2.15 a day (2017 PPP) estimated to be 80.7% in 2012 (World Bank, World Development Indicators, 2021a), and most of the employment being informal.

Figure 1.21: Productivity and skills across informal economy segments



Source: Chen (2001)

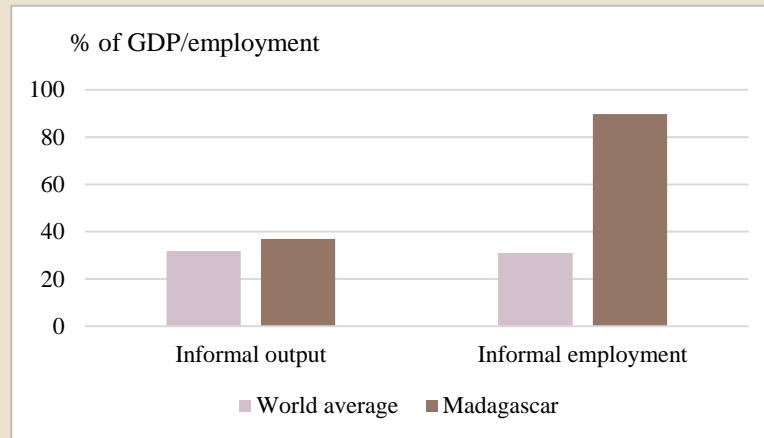
Box 1.4: The poverty context in Madagascar

Madagascar is one of the poorest economies in the world. As per the IMF (2023), informality is the main characteristic of economic activity in the country. The informal sector accounts for over 36.9% of GDP and provides 89.7% of the total employment (see Figure 1.22).

According to Vaillant et al. (2011), after its independence in 1960, Madagascar experienced a long period of economic decline, interrupted only by brief episodes of economic growth. The development of Export Processing Zones (EPZ), offering exporting companies an exemption from all duties and taxes on exports and imports, and the rise in tourism resulted in a remarkable phase of economic expansion over the 1995–2001 period. The growth, combined with public administration and state enterprise downsizing as a component of the structural adjustment program, manifested in a notable decline in the informal sector (Nordman et al., 2016). However, the 2002 political turmoil following the presidential elections reverted the trend of employment formalization. The informal sector integrated laid-off workers from closing formal enterprises and new entrants on the labor market, deprived of any alternative employment opportunities. Although the post-crisis recovery was rapid, a second political crisis of 2009 alongside the global economic downturn led to a new severe

economic disturbance, with the informal sector absorbing a critical share of the labor force (Rakotomanana et al., 2010).

Figure 1.22: Informal output and employment in Madagascar



Source: World Bank (2022)

Macroeconomic instability, growth, and international trade

Vaillant et al. (2011) assert that the Malagasy informal sector follows a counter-cyclical dynamic, contracting during periods of growth and absorbing excess labor during periods of crisis in line with the dualistic hypothesis. Interestingly, independent employment grew in the informal sector in both cases. Hence, the development of informal businesses was a significant trend not only during the crisis and recovery but also during favorable macroeconomic conditions. The informal sector saw primarily extensive growth, with most enterprises remaining very small and experiencing slow capital accumulation (Nordman et al., 2016). The exception was the smallest and owner-operated enterprises since they grew in line with the macroeconomic environment. Conversely, the growth of larger informal product units (IPUs) was somewhat disconnected from the context.

Discrimination based on socio-demographic characteristics

According to the IMF (2023), most informal workers in Madagascar are young and have low education, skills, and competencies. IPUs are primarily found in rural areas (71%) and usually operate without a set location (52%) or at home (28%). The Malagasy informal sector employs 97% of women and 94% of men. There is relatively high female participation in the informal sector, with women owning half of the informal businesses (Nordman et al., 2010; Vaillant et al., 2011). Despite being more prevalent among the self-employed, women own

only one-third of businesses that employ wage workers (Vaillant et al., 2011). Moreover, women are disproportionately employed in the most vulnerable and least financially beneficial jobs, such as providing domestic assistance to households and other forms of family support (Nordman et al., 2016). Studying a performance gap between businesses run by men and women in the informal sector, Nordman and Vaillant (2014) find that businesses run by women have a value-added that is 28% lower than those run by men. The authors examine how communal sharing norms and household task division impact the technical efficiency of businesses (Nordman & Vaillant, 2014, 2017). They assert that while women who run their own businesses from home experience the harmful effects of solidarity norms and domestic responsibilities on the management of their businesses, male entrepreneurs are under pressure to redistribute from the remote network.

Job quality and occupation

According to the IMF (2023), informal economic activities are predominantly concentrated in garment manufacturing (43%) and trade (34%). Most of these informal units only include one self-employed individual (72%), and only 8% employ salaried workers. The average size of an informal unit is about 1.4 people. IPU's operate for about 10.3 years on average, with longer lifespans for units located in rural areas and for units operating in both the manufacturing and agricultural sectors. In contrast, IPU's operating in trade and services have a shorter lifespan on average.

Vaillant et al. (2011) contend that while older IPU's with an average time in the business of over nine years are primarily found in the textile, other industries, construction, and service activities, younger IPU's operated for less than 7 years on average are principally in catering, food processing, and trade. Moreover, certain activities are clearly gender-specific: while textile and catering are run by women, construction and transport businesses are virtually entirely run by men (Vaillant et al., 2011).

Lack of access to finance and land

According to the IMF (2023), financial borrowing in the Malagasy informal sector is rare. Only around 3% of the IPU's resort to borrowing, with loans coming primarily from family and friends (48%), microfinance institutions (21%), and suppliers (15%) to primarily acquire raw materials. Individual savings finance 97% of the investment.

Madagascar inherited its land certification system from colonial times, which has led to land tenure insecurity, impeding development (“Madagascar,” 2019). The division of cultivable land into micro-plots, the lengthy procedure and challenges to acquire a land title, and the lack of access to property certificates persist as substantial obstacles for investments in rural regions. The lack of access to land forces small farmers to work in the informal sector, perpetuating poverty.

The information presented in the box above, highlighting Madagascar, offers valuable insights into the interaction between the context of poverty and such informality drivers as macroeconomic instability and growth, discrimination based on socio-demographic characteristics, job quality and occupation, and lack of access to finance and land.

Turning our attention to the last context, we will investigate how international and internal migration shapes the effect of informality drivers.

International and internal migration

Since the first study on the informal economy was published, migration has been at the heart of informal economy analysis (ILO, 1972; Harris & Todaro, 1970). Push and pull factors are mobilized to explain the mobility between sectors (formal and informal) and between countries or rural and urban areas.

Massive immigration from developing countries to developed ones is often seen to have boosted the informal sector in the latter. Most of the time, migrants prefer working legally, but the barriers (working permits) in host countries push them to work in the informal sector. Thus, Bosch and Farré (2014) find a positive relationship between immigration and the size of the informal economy in Spain. According to the authors, one of the sources of the recent increase in informality in developed countries is the inflow of undocumented immigrants from developing economies attracted by job opportunities. OECD estimates that a large proportion of the foreign-born labor force in most OECD countries is “illegal migrants.”⁹ However, Portes and Sassen-Koob (1987) argue that although immigrants may be well-positioned to take advantage of the opportunities presented by informalization, these opportunities are not

⁹ The migration of people across national borders in a way that violates the immigration laws of the destination country.

necessarily created by them. Immigrants are heavily involved in the informal sector due to marginalization in the labor market caused by a combination of educational shortcomings, a language barrier, spatial mismatches, and discrimination (Kloosterman et al., 1998; Bohn & Owens, 2012). Evidence from Indonesia suggests that recent migrants are more likely to work in the informal sector than long-term migrants and that children of migrants have a lower likelihood of finding formal-sector employment than children of non-migrants (Manning & Pratomo, 2013).

In Box 3.4, we center our analysis of the impact of the informality drivers in the context of immigration on the United States. We opted to analyze this country due to the significant share of immigrants in its population. Despite the relatively small informal sector in the United States, it is interesting to analyze informality and its dynamics in an advanced economy, which stands in contrast to the predominant research focus on developing countries and countries in transition.

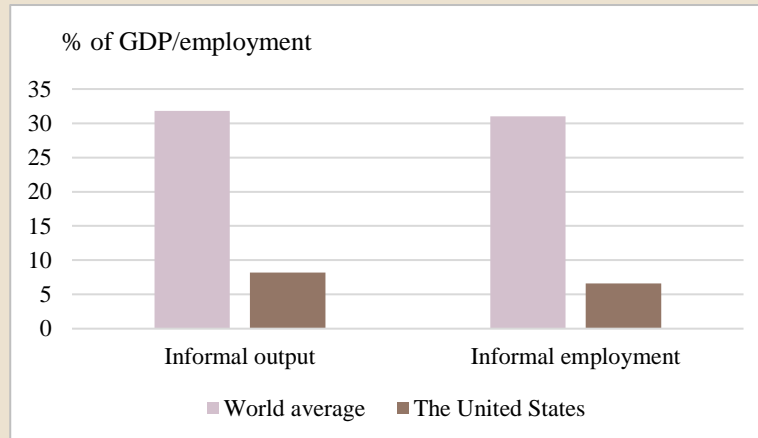
Box 1.5: The immigration context in the United States

With the immigrant population comprising 13.6% of the total US population as of 2021, short of the record high of 14.8% in 1890 (Ward & Batalova, 2023), immigration has shaped the nation's social and economic landscape. The context of immigration enhances the effects of drivers of informality.

Tanzi (1982) estimated the underground economy in the US from 1930 to 1980 and found it to be between 4.5% and 6.1% of the GNP in 1980. The underground economy had been steadily increasing since the mid-1960s and accelerated since the mid-1970s, possibly due to the substantial increase in marginal tax rates from 1975 to 1980. At the beginning of the 1980s, the US witnessed a further increase in the informal economy, attributed to the growing immigrant population reliant on it. The Great Recession of the late 2000s led to a higher number of informal workers (Siqueira, 2016). Thus, more recent estimates show that the average estimate of the US shadow economy from 1999 to 2007 is 8.6% of GDP, with Mississippi having the largest shadow economy (9.54%) and Delaware having the smallest (7.3%) (Buehn & Schneider, 2012; Wiseman, 2013). As shown in Figure 1.23, during 2010–2018, the national informal output was 8.2% of GDP, and informal employment was 6.6%.

Although the size of the shadow economy in the US is smaller than the global average, it has been significant at specific points in time and still constitutes a substantial proportion of overall economic activity.

Figure 1.23: Informal output and employment in the United States



Source: World Bank (2022)

Taxes and labor-income incentives

According to Cebula’s (1997) research, which used data on the underground economy from 1973 to 1994, the maximum marginal personal income tax rate positively impacts the size of the underground economy in the US. Additionally, the study shows that the percentage of tax returns audited and the penalties imposed by the Internal Revenue Service on unpaid taxes are negatively related to the size of the underground economy. Furthermore, the study conducted by Berdiev et al. (2015) employs a panel VAR model and draws upon data from 50 US states spanning the period 1998–2008 to analyze the dynamics of the shadow economy. Their findings indicate that higher capital tax rates increase operating costs in the formal sector, prompting companies to relocate their production to the shadow economy. Conversely, Dell’Ano and Solomon (2008) find that the tax burden has either an insignificant influence or, in the case of corporate taxation, a statistically significant negative influence.

Macroeconomic instability, growth, and international trade

Berdiev et al. (2015) employ real gross state product per capita as a measure to capture state-level development and institutional quality broadly. They find that the development of the official economy elevates the opportunity costs associated with operating in the shadow

economy. Thus, the authors observe that more prosperous states exhibit smaller shadow economies.

Social benefits and labor regulations

Wiseman (2013) studied the shadow economy of 50 US states from 1997 to 2008. The study reveals that higher labor market freedom, measured by minimum wage legislation, government employment, and union activity, is associated with lower participation in the shadow economy. In contrast, higher government insurance trust expenditures as a percentage of GDP per capita, an aggregate of expenditures directed toward unemployment, employee retirement, and workers' compensation, are also associated with lower participation in the underground economy.

In their turn, Berdiev et al. (2015) utilize union membership as a proxy for labor regulations and find that higher union participation is related to a growth in the shadow economy. The authors explain that union membership amplifies the cost of labor via higher wages and causes a decrease in employment opportunities in the official sector. As a result, firms and workers migrate toward the informal sector, expanding shadow production.

Discrimination based on socio-demographic characteristics

Economic and sociological research shows that workers on the margins are more likely to engage in informal employment. Immigrants are overrepresented at the margins of education and skill distributions in the United States, and a significant portion lacks documentation to work legally in the country, making them more likely to be excluded from the formal labor market. Bohn and Greene Owens (2012) find that immigrants, particularly low-skilled male immigrants, may be associated with informal work in general and in the construction and landscaping industries specifically. In particular, evidence from Los Angeles County and California overall (Marcelli et al., 1999; Marcelli, 2004) suggests informal economic activity is linked with lower wages, higher poverty rates, less education, being younger, being male, and more likely to be employed by others. Latino, both legal and unauthorized, immigrants are highly represented in more informal occupations, whereas other ethno-racial groups are underrepresented.

Conversely, research by Jensen et al. (2019), based on the national-level household survey of informal labor in the United States, finds that non-Hispanic blacks and non-Hispanics of other races (mostly Asians and Native Americans) are more likely to be in households with

informal work while being Hispanic does not have a significant effect. The authors also find that participation in the informal economy is more prevalent in rural than urban areas. In addition, the authors argue that neither the lowest income groups (whether rural or urban) nor households without workers are more likely to participate, indicating that informal work complements other livelihood strategies. Berdiev et al. (2015) use the percentage of the population aged 25 and above holding a bachelor's degree as a proxy for educational attainment to measure the effect of human capital accumulation on the spread of the shadow economy. The study's findings support the notion that higher levels of educational attainment lead to higher opportunity costs for workers to transition to the informal economy, as proposed by Gërxhani and Van de Werfhorst (2013) and Buehn and Farzanegan (2013).

Job quality and occupation

Jensen et al. (2019) find that the following informal economic activities are common in rural areas: growing or producing food; holding garage sales/flea markets; selling or trading recyclables; clothing; hunting, fishing, and gathering from the land; and doing landscaping, snow removal, or similar activities. Meanwhile, in urban areas, personal services, accounting, or computer work are more widespread.

Also, day labor work has served as an entry point into the labor market for migrant workers in the US (Theodore et al., 2009), with 93% of day laborers being foreign-born, mostly Mexican or Central American (Valenzuela et al., 2006). Day laborers primarily work for homeowners/renters and construction contractors, and their top occupations include construction laborer, gardener and landscaper, painter, roofer, and drywall installer (Valenzuela et al., 2006).

The content within the box above, showcasing the United States, demonstrates how the context of immigration in an advanced economy affects the impact of taxes, real gross state product per capita, labor regulations, socio-demographic features, and job quality on the informal economy at the national level and across the states.

Furthermore, we must also consider that rapid urbanization plays a significant role in growth and labor supply. Since the formal economy does not provide all the jobs, the urbanization process also attracts the informal economy into the cities. Most theoretical works view the informal sector as an unproductive and stagnant sector, serving as a temporary staging post for newly arriving rural migrants while they are searching for a formal sector job (Todaro, 1969;

Fields, 1975; Lal, 1973; Shonchoy & Junankar, 2014). Based on the case of Philippine cities, Koo and Smith (1983) find that the notion that migrants tend to enter the urban occupational structure through the informal sector seems to apply primarily to female migrants, underlining the fact that economic development in developing countries has generally failed to integrate women into the formal labor market and, instead, has resulted in their “marginalization” in the informal sector. However, this view is debunked by other works that find no evidence to suggest that the informal sector plays a predominant role as a point of entry into the labor market for fresh migrants to the urban area (Mazumdar, 1976; Banerjee, 1983).

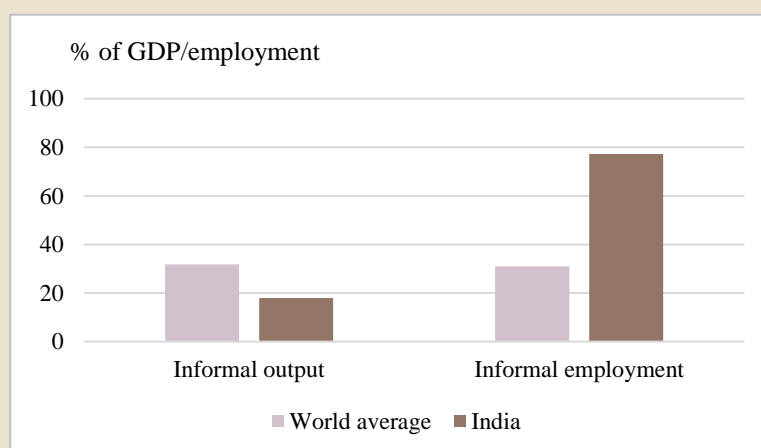
Moreover, there is a contrasting view with broad empirical support, which sees the informal sector as dynamic and efficient (Bhattacharya, 1993). Thus, the ILO’s study on Kenya (1972) suggests that it is not only the income opportunity in the formal sector but also in the informal one that attracts potential migrants. Likewise, the empirical evidence from India indicates that a substantial proportion of informal sector entrants were attracted to Delhi by opportunities in the informal sector (Banerjee, 1983). For instance, in the Philippines, the declining share of agriculture and industry in overall employment leads to massive poverty in the country and the expansion of the informal economy because of the stagnating agricultural sector and the lack of agro-industrial development. Many informal workers are thus mobile, meaning they move from one place to another to find a job on a seasonal and even day-to-day basis, undertaking home-based outwork, vending, and similar activities (Ofreneo, 2013). Interestingly, Meng (2001), based on the dataset on Chinese rural-urban migrants, finds that the wage-earner and self-employed groups in the informal sector have played different roles in attracting migrants compared to the formal sector. The self-employed group seems to be a desirable employment option, whereas the wage-earner group may offer migrants short-term employment opportunities. According to the World Bank (2022), recent large-scale rural-to-urban migration in EAP has been accompanied by declining output informality but increasing employment informality due to lagging social protection.

Having the largest rural population in the world, India experiences significant rural exodus. The informal sector provides employment for most of the country’s population. Against this background, we decided to focus on India in order to analyze how the context of rural-urban migration amplifies the effect of informality drivers (Box 1.6).

Box 1.6: The rural-urban migration context in India

The informal sector in India constitutes 17.9% of GDP and 77.3% of total employment (see Figure 1.24). According to Bhattacharya's (1996) findings, the informal sector was responsible for a significant proportion of the rise in non-agricultural employment in India during the 1970s. This upsurge in informal sector employment was not confined to traditional informal sector activities such as trade, construction, and services but also extended to the manufacturing sector. The entirety of the agricultural sector falls under the informal category (Sakthivel & Joddar, 2006). In contrast, only one-fifth of non-farm workers are found in the organized segment. It is estimated that, as we ascend the income ladder in non-farm sectors, the share of the informal sector gradually diminishes. Nonetheless, in the agricultural sector, the proportion of the unorganized workforce remains constant, regardless of economic class.

Figure 1.24: Informal output and employment in India



Source: World Bank (2022)

The prevalence of poverty and unemployment in rural areas and smaller towns has resulted in a considerable increase in the urban informal sector as a means of livelihood for many people (Bhowmik, 2002). As the organized sector's job opportunities decline, people with skills also find themselves in need of informal employment for survival. As a result, the informal sector has rapidly grown in most Indian cities, accounting for 79% of the urban workforce (Chen & Raveendran, 2014).

Governance and institutions

Political institutions have a significant impact on the magnitude of the informal economy and corrupt practices in India (Schneider et al., 2003). The functioning of a democratic system

plays a crucial role in shaping taxpayers' perceptions about the appropriate utilization of their tax payments, leading to a reduced prevalence of shadow economy activities. Dutta et al. (2013) ascertain that excessive bureaucratic intervention and corruption at all levels of economic operations are significant factors contributing to participation in the informal sector. The authors empirically show that higher levels of corruption are associated with larger informal sectors. However, when state-level productivity increases, the positive association between corruption and employment in the informal sector is nullified.

On the other hand, Bhattacharyya and Ghose (1998) contend that the regulatory environment imposed on firms in India is the main contributor to corruption, which is manifested through bribes and kickbacks. To compensate for the costs associated with bribery, firms tend to conceal their actual production output and produce a hidden economy.

Macroeconomic instability, growth, and international trade

Sinha (2000) asserts that a recession negatively affects labor productivity when regular wages are increasingly rigid, leading to formal workers losing their jobs and joining the informal labor force.

Kathuria et al. (2013) observe that the economic reforms in India, such as tariff reforms, industrial de-licensing, and the withdrawal of reservation of products for small firms implemented since the mid-1980s, had a positive impact on overall technical efficiency in the manufacturing sector, covering both formal and informal sectors. However, at the same time, economic reforms have increased the efficiency differentials between the more efficient formal firms and the less efficient informal firms due to the informal sector's declining performance.

Social benefits and labor regulations

Besley and Burgess (2004) find that pro-worker labor regulation in India, namely pro-worker amendments to the Industrial Disputes Act, resulted in lower output, employment, investment, and productivity in the formal manufacturing sector but increased output in the informal sector. These findings are disputed by Bhattacharjea (2006), who argues that the results of these studies are ambiguous and suffer from methodological problems and that a more accurate measure of the impact of labor laws on economic performance would need to consider the role of the executive and judiciary.

The majority of informal economy workers experience a lack of job security and social security benefits, thereby rendering their employment precarious (Unni & Rani, 2002). Social security arrangements have virtually excluded non-farm unorganized sector workers (Sakthivel & Joddar, 2006).

Discrimination based on socio-demographic characteristics

According to Shonchoy and Junankar (2014), in India, people who are less educated, come from poorer households, and are from lower social classes, represented by castes and religions, are more likely to work in the informal sector. Caste and religion play an important role in employment and job placement, with Brahmins and high-caste people more likely to be in higher-level occupations, while Dalits and Muslims are primarily employed in non-agricultural day labor or as artisans. Most of the informal sector's casual workforce in urban areas comprises individuals from the scheduled castes (Mehta & Shah, 2003). This contrasts with the findings of Bairagya (2012), who argues that all the marginalized communities have less exposure to employment in the informal sector.

Furthermore, Bairagya (2012) finds that the relationship between informality and age follows the U-turn: the likelihood of being employed in the informal sector decreases with age up to a certain point, after which it starts to increase again, as there are no age restrictions on informal sector participation. In addition, according to the author, males have a higher probability than females of getting absorbed into the informal sector. On the other hand, according to Mohapatra (2012), the process of informalization has exhibited greater prevalence among female workers. Most female employment, accounting for approximately 96%, occurs within the unorganized sector, which is higher than the corresponding proportion of male employment at approximately 91%. The author observes that women workers in the Indian informal sector experience double discrimination as members of specific caste, class, or ethnic group in addition to experiencing gendered vulnerabilities.

Job mismatch

According to Talreja (2014), the Indian labor force experiences polarization of skill matches. Those with low skills end up in the informal industry, those with high skills end up in the small formal sector, and those with medium skills are left with a mismatch in the informal economy's organized and unorganized sectors. This leaves many educated youth

unemployed. In addition, Mukherjee and Paul (2012) find that high over-education rates characterize blue-collar and traditional jobs mainly in the informal sector.

Job quality and occupation

According to Gurtoo and Williams (2009), 49% of informal workers are working on their own accounts, 30% are daily wage workers, and just 21% are waged employees. Regarding the type of work informal entrepreneurs perform, approximately 75% are engaged in retail jobs such as selling fruits, vegetables, tea, etc. According to Chen and Raveendran (2014), urban informal employment in India was predominantly concentrated in three industry groups: manufacturing, trade, and non-trade services, with respective proportions of 26%, 29%, and 32% in 2009–2010. In particular, more than twice as many men as women informal workers are engaged in trade, while women are overrepresented in non-trade services and manufacturing. Additionally, there are 11 times as many men as women informal workers in the transport sector. Mohapatra (2012) identifies the following major categories of female workers in the Indian informal sector: rag pickers, domestic workers, coolies, vendors, beauticians, construction laborers, and garment workers.

Lack of access to finance and land

Ayyagari et al. (2013) find that financial deepening has a significant negative impact on rural poverty in India, with entrepreneurship and migration acting as channels through which financial depth reduces rural poverty. The pro-poor effects of financial deepening can arise through different channels, and financial development can result in important labor market and migration effects. Later, Beck and Hoseini (2014) examine the impact of financial sector development on India's formal and informal manufacturing sectors. Their study finds that financial depth and outreach are positively associated with the share of formal enterprises, especially in industries that rely on external finance. However, financial depth is more critical regarding production efficiency, particularly in industries that depend on external finance. The results suggest that financial outreach and financial depth are crucial for reducing informality in manufacturing in India.

Furthermore, Sharma et al. (2019) assert that the Jan-Dhan account in India is considered a significant milestone in providing access to finance and promoting financial inclusion by offering formal bank accounts to virtually every family in the country. However, true financial inclusion requires access to various financial schemes and services, such as credit and insurance, which are crucial for achieving desired outcomes. Unfortunately, the informal

nature of jobs presents a significant challenge for financial institutions to provide these services to a large section of society.

Drawn upon a wealth of literature on the informal sector in India, the evidence presented in the box helps to understand how the main macro- and micro-drivers of informality manifest and behave against the background of rural-urban migration.

Finally, concerning the informal sector in the context of emigration, Docquier and Iftikhar (2019), analyzing a subset of sub-Saharan African countries, show that the informal economy acts as a buffer zone that neutralizes human capital and emigration shocks. The authors argue that skilled emigration expands the size of the informal sector, increases the income and formal employment levels of the highly skilled, and decreases the welfare of the low-skilled.

Considering this backdrop, in Box 3.6, we examine the interplay between the informal economy drivers and the emigration context, focusing on the case of Croatia, where the net migration rate¹⁰ is -2.6 (United Nations, Department of Economic and Social Affairs, Population Division, 2022).

Box 1.7: The emigration context in Croatia

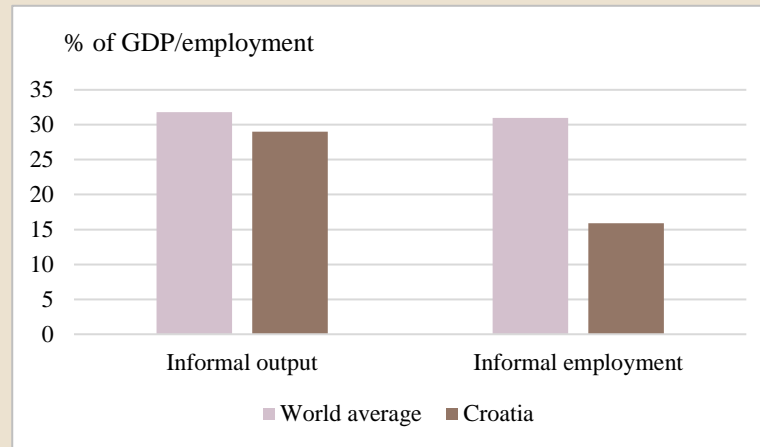
According to the European Statistical Office, from 2015 to 2019, the population of Croatia fell by 4.26 inhabitants per 1,000 citizens only due to the emigration rate. This has been the second biggest migration-related population decline in the European Union. Therefore, we will look into the dynamics of informality drivers in the emigration context in Croatia.

Although various evaluation methods provide different estimates of the informal economy in the country, the results regarding the trend throughout the years stay consistent. Up to 1993, the informal economy in relation to GDP in the country increased due to the war, hyperinflation, and the beginning of transition (Bejaković, 2004). Then, as a result of economic stabilization, the rise in personal incomes, as well as the strengthening of the ethical and legal system, the share of the informal sector to GDP steadily followed a downward trend starting in 1994 with a temporary setback during the recession (Bicanic & Ott, 1997; Ott, 2002; Ott, 2004; Bejaković, 2004; Svec, 2009; Bejaković, 2014). The informal economy in

¹⁰ The number of immigrants minus the number of emigrants over a period, divided by the person-years lived by the population of the receiving country over that period. It is expressed as net number of migrants per 1,000 population.

Croatia is estimated at 29% of GDP and accounts for 15.9% of total employment, being one of the largest in the region (see Figure 1.25).

Figure 1.25: Informal output and employment in Croatia



Source: World Bank (2022)

Governance and institutions

Based on the study of Croatia, Williams (2019) argues that the likelihood of participation in the informal economy is influenced not that much by the penalties and risks of detection but by the level of horizontal and vertical trust. Hence, there is a higher likelihood that citizens will engage in the informal economy when their norms, values, and beliefs do not align with those of the state in terms of the codified laws and regulations. Thus, the wider the gap between state and civic morality, the greater the propensity to participate in the informal economy (Williams & Franic, 2016).

Taxes and labor-income incentives

Estimating the size of the non-official economy in Croatia, Klarić (2011) highlights the tax burden as a primary cause of the non-official economy. According to Ott (2004), the transition also led to significant changes in Croatia's tax system. Following the introduction of the tax administration, customs administration, and financial police in the mid-1990s, the high tax burden decreased, leading to the decline of the informal sector. However, as a result of the global financial crisis, credit terms deteriorated, and the Croatian government introduced a new special tax on income above specific amounts and increased the standard VAT rate from 22% to 23% in order to improve its fiscal position (Lovrinčević et al., 2011; Baric & Williams, 2013). It inevitably induced an increase in informal economic activities at that time.

Macroeconomic instability, growth, and international trade

Analyzing the trend of underground economy share in Croatia's GDP, Lovrinčević et al. (2011) and Nagyszombaty (2012) argue that the official and underground economies in Croatia are substitutes. In times of economic growth, a share of the unofficial economy is decreasing, while during economic downturns, it contributes to fewer overall adverse effects on people's incomes. Thus, the trend of a decreasing share of the underground economy in GDP stopped in 2008 and turned around in 2009 (Bejaković, 2014). Moreover, the elasticity of the underground economy in relation to economic activity is higher during recessions than in periods of growth (Lovrinčević et al., 2011).

Discrimination based on socio-demographic characteristics

Williams (2019) demonstrates that men rather than women, younger age groups, single or cohabiting individuals, people who live in larger households, and the unemployed are more likely to work in the informal economy. The author finds a U-shaped relation between individuals' participation in the informal sector and their financial situation and net income from formal employment. This means that both those who are in financial difficulty and those who are not show a greater propensity to engage in the informal economy, as well as those with no formal incomes and those with higher formal incomes. Finally, informal work is observed to be more prevalent in rural areas than in urban ones.

Job quality and occupation

Analyzing the undeclared economy in Croatia over the period 1990–1999, Bicanic and Ott (1997) find that the undeclared economy in agriculture ranged between 6.8–16.9% of GDP between 1990 and 1999. In industry, it ranged from 2.3% in 1996 to 5.2% in 1998, while in trade, it ranged from 60% of trade as a whole to around 35%. Overall, during the studied period, the amount of unreported work decreased in trade, remained stable in agriculture, and increased in the industry as the transition into a market economy varied across sectors.

Based on the World Bank Enterprise Survey 2007, Baric and Williams (2013) state that informal work was the most prevalent in the food sector, manufacturing, and retailing. According to Williams (2019), most undeclared workers in Croatia are employed in home maintenance and repair, auto repair, domestic cleaning, selling goods or services related to their hobby, selling food produce, tutoring, IT assistance, gardening services, waitressing, babysitting, and home removal. 81% of work in the informal economy is done on a self-

employed basis, and only 13% of this work is waged employment for businesses (Williams, 2019).

The box above, featuring Croatia, provides observations on the effect of the context of emigration on such drivers of the informal economy as trust in institutions, taxes, macroeconomic instability and growth, socio-demographic characteristics, and job quality and occupation.

Building upon the previous analysis, we will unravel how the interplay between the abovementioned contexts impacts the informal sector in the next section.

1.4 Relations and interactions between contexts

To understand the dynamic in which the informal economy develops, it is crucial to analyze the interaction between the different elements of the specific context. The causal relationships between wars and natural resources and inequality/poverty are largely studied in social sciences literature. However, their aggregate or articulated impact on the informal economy is not always exposed.

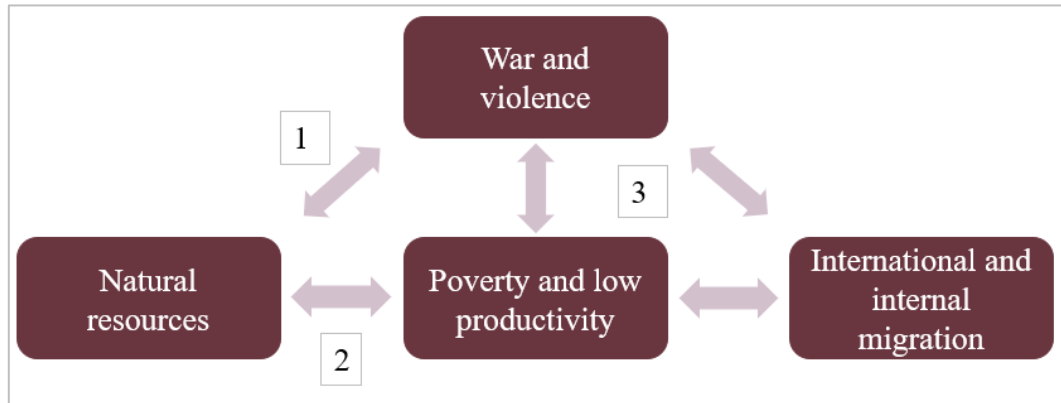
Informal economy contexts interactions

We can propose three informal economy contexts interactions as shown in Figure 1.26:

- The first interaction involves the war and violence context and the natural resources. This environment enhances the rapid growth of the informal economy. It also leads to massive redistribution and poverty increase (See relation 1 in Figure 1.26). A representative illustration is South Africa (prevalent violence).
- The second interaction is between the natural resources and poverty contexts. In this setting, the informal economy develops at a more progressive pace. Additionally, migration, when not forced, may play the role of stabilizer by smoothing the decline in income through remittances (See relation 2 in Figure 1.26). Such contexts interaction is observed in Ghana.
- The last interaction emerges as a result of a conflict situation largely reinforced by poverty and forced migration. It can be considered as a similar informal economy pattern as the first

interaction, but we consider it to be more destructive (See relation 3 in Figure 1.26). An illustrative case here is Yemen.

Figure 1.26: Informal economy context interactions



Source: Authors' construction

Drawing on the preceding analysis, we will now evaluate the impact of the studied contexts on the relative importance of informality drivers.

The impact of contexts on the relative importance of informality drivers

We present how a specific context influences the relative importance of micro- and macro-drivers of the informal economy. Drawn upon the literature review and our expert analysis, we rank the interplay between each context and each informality driver in Table 1.2 from 1 to 10. We use quantitative and case studies as well as expert assessment of the informal sector's main determinants against the background of the four proposed contexts.

Table 1.2: Main informal economy drivers across contexts

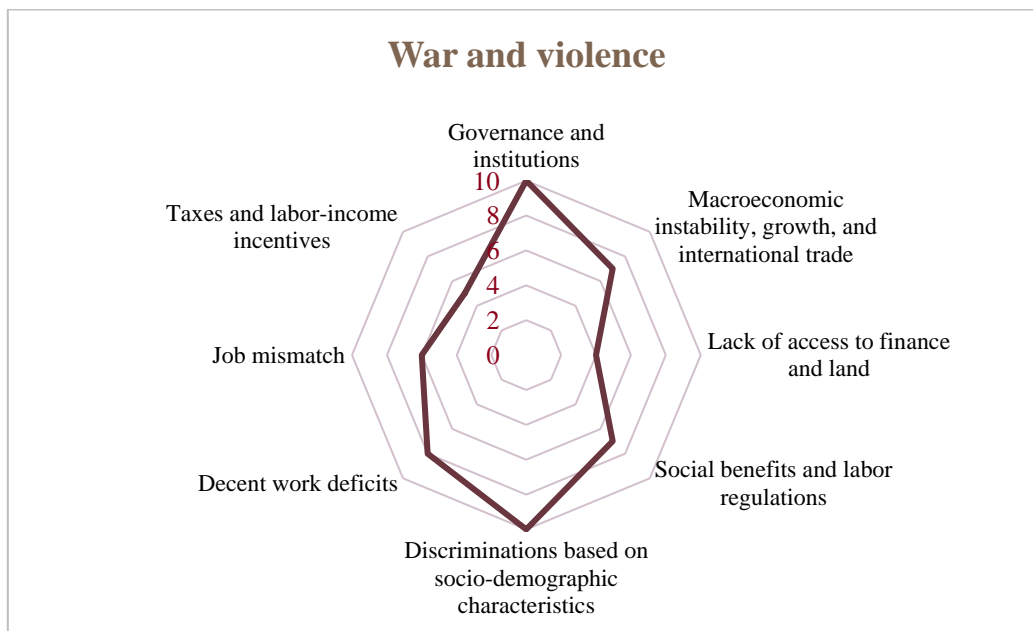
Contexts Drivers	War and violence	Natural resources	Poverty and low productivity	International and internal migration
Informal economy macro-drivers				
Governance and institutions				
Macroeconomic instability, growth, and international trade				
Social benefits and labor regulations				
Taxes and labor-income incentives				
Informal economy micro-drivers				
Discrimination based on socio-demographic characteristics				
Job quality and occupation				
Job mismatch				
Lack of access to finance and land				

Note: in dark purple: main drivers; in light purple second-order drivers according to the context

War and violence as destruction of institutions

First, we underline the crucial role of violence and military conflicts within some countries (Botswana, Bosnia and Herzegovina, Liberia, Guatemala, Colombia, Pakistan, and Ukraine). Even though the level of wars and conflicts tends to decrease globally, many not officially war-torn countries experience a very high level of violence (such as in Central and Latin America), which can be compared with an internal conflict. During deep crises or conflicts, the informal economy is usually booming, mainly because of the state and institutional failure but also because the virtuous circle described further slows down (see Figure 1.27). In the context of war, depending on its intensity and duration, economic stability and governance are undermined, and social policies such as social benefits are usually among the first to be cut.

Figure 1.27: Informal economy drivers ranking in the context of war and violence



Source: Authors' construction

All the micro-drivers are affected by a war context. Yet, discrimination will probably be the main micro-driver to be enhanced, as some conflicts target specific populations, rendering large groups vulnerable. The first group is displaced populations, which usually can make an income only by turning toward informal economic activities. Forced migrations are, therefore, a possible consequence of wars and violence. The potential impact on institutions and governance is even more significant in this case.

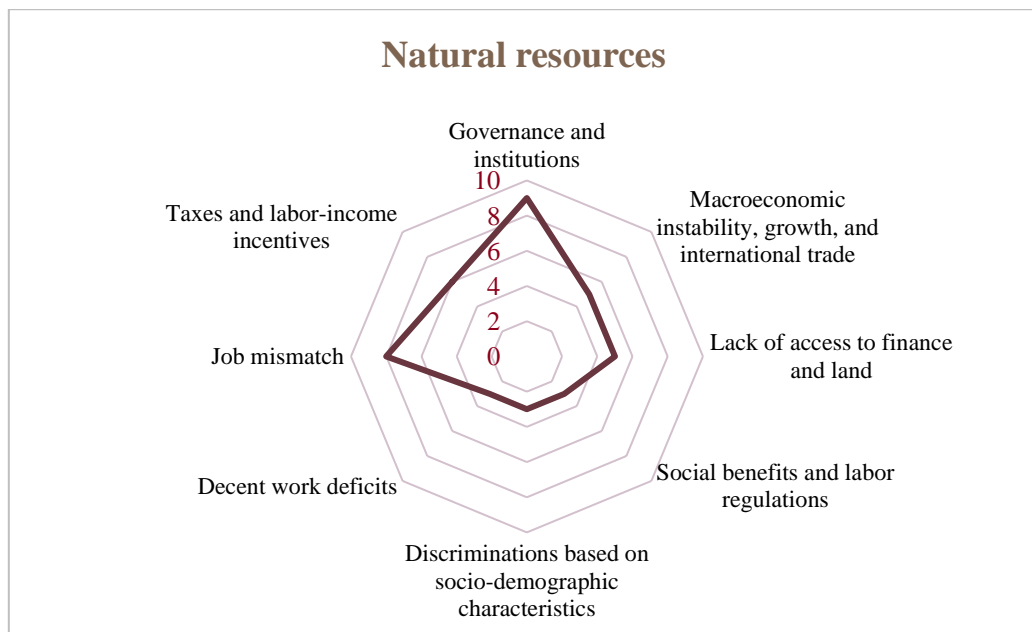
Natural resources undermining governance and economic diversity

The natural resources context mainly affects the governance-and-institutions' driver through the channel of corruption and conflict of interest. As taxes and budget revenues are mainly derived directly from the mining and natural resources sectors against the background of the natural resources' abundance, citizens who face lower income and labor taxes are less likely to be concerned about the transparency and accountability of public institutions.

The main rents redistribution channel is through spending and the inflow of cash into the economy partly through small informal activities (Najman et al., 2007). Therefore, probably the best policy is to push for the formalization of the informal economy. Most of the time, natural resource rents are not channeled to social policies or formal employment. Because

many natural resources economies (for instance, Nigeria, Kazakhstan, and Algeria) tend to suffer from the Dutch disease, they specialize in a very limited number of sectors. Therefore, many young people struggle to find employment in the country. Many are forced to accept activities that do not necessarily correspond to their competencies in the informal economy. Nonetheless, some countries (primarily Norway) have managed to freeze, in oil funds, their natural resources rents in order to avoid Dutch disease and governance failures (see also Figure 1.28).

Figure 1.28: Informal economy drivers ranking in the context of natural resources

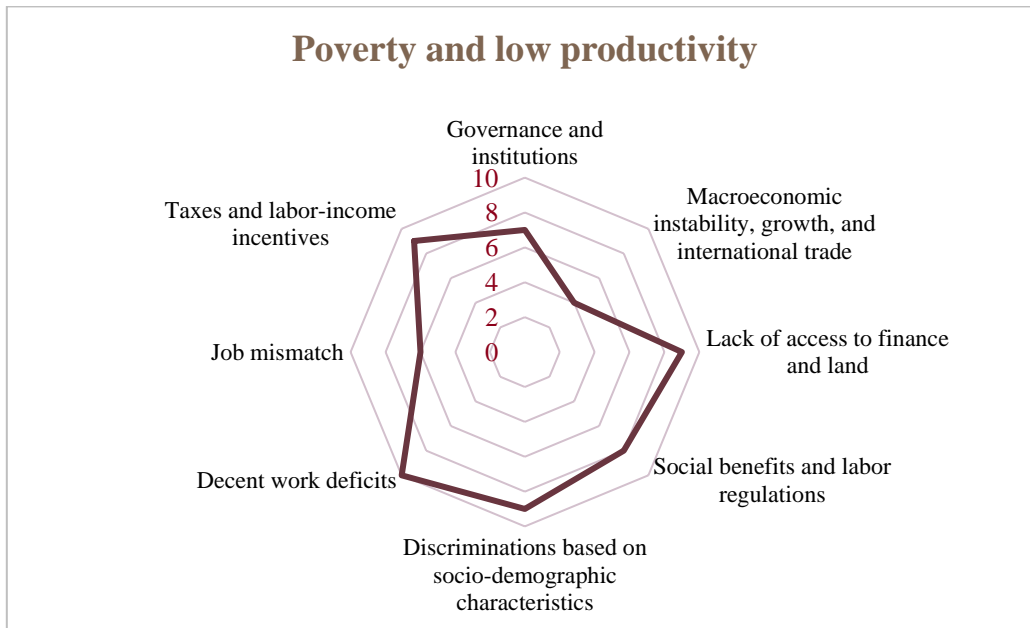


Source: Authors' construction

Poverty and low productivity affecting social protection and job quality

Poverty and low productivity constitute the most typical context for developing countries, for example, in Sub-Saharan Africa. These countries suffer from weak financial intermediation, and their population lacks adequate social protection. In addition, most labor regulations are not implemented, making decent jobs rare for low-skilled workers. Therefore, the quality of employment in terms of labor conditions is low and contributes to lowering labor productivity. A large segment of informal workers and their economic activities may be trapped in poverty and low productivity. On the other hand, the informal sector may have contributed to an increase in formal enterprise productivity (Ali & Najman, 2017; Figure 1.29).

Figure 1.29: Informal economy drivers ranking in the context of poverty



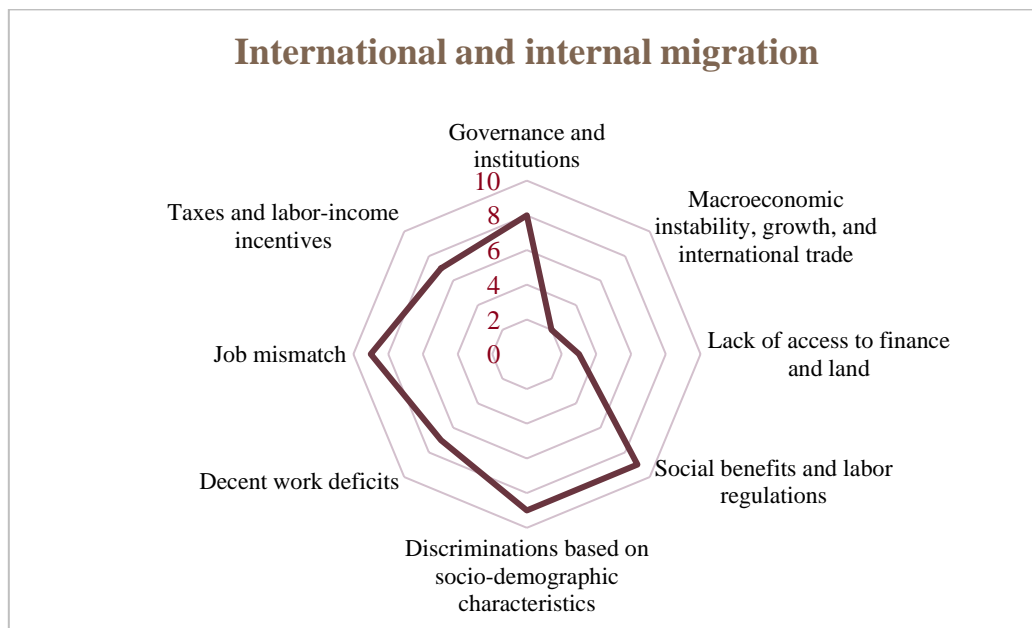
Source: Authors' construction

Migration as a signal of discrimination and social protection crisis

Internal and international migration context is typical for many developing countries. Migrations mainly influence the governance-and-institutions' driver through the capacity of NGOs/citizens/migrants to be aware of and contest bad governance through their voice (Hirschmann, 1970; Figure 1.30). It applies to both emigrants who advocate for changes in their home while abroad and immigrants who demand changes in their country of destination. Migration, including internal mobility, may facilitate social benefits avoidance as migrants often do not have the same rights as natives or urban residents.

Considering the informal economy micro-drivers, the context of migration often coincides with high discrimination against migrants. Besides, since migrants tend to have difficulties recognizing their diplomas and competencies in their host countries, often having to accept underqualified jobs in the informal sector, the job mismatch is reinforced.

Figure 1.30: Informal economy drivers ranking in the context of migration



Source: Authors' construction

In the upcoming section, we will draw conclusions based on the undertaken analysis.

1.5 Conclusion

Our analysis of the informal economy development is inspired mainly by institutional economics. In other words, we address the question of why people work in the informal economy, taking into account the existing institutional framework.

In this chapter, we analyze the recent literature on informal economy drivers and identify and rank informal economy main drivers according to four contexts, primarily common in developing economies. We discuss the possibility of having sound policies toward the informal economy. We classify four main informal economy drivers into four macro- and four micro-drivers:

Macro-drivers: governance and institutions; macroeconomic instability, growth, and international trade; taxes and labor-income incentives; and social benefits and labor regulations.

Micro-drivers: discrimination based on socio-demographic characteristics; job quality and occupation; job mismatch; and lack of access to finance and land.

We discuss the impact of these drivers on the informal economy according to four specific contexts: war and violence; natural resources; poverty and low productivity; and international and internal migration.

We assert that the interaction between the specific contexts and micro- and macro-drivers can have two types of effects on the informal economy: rapid and more gradual ones. War as well as persistent poverty contexts create conditions for state failure (or institutional breakdown), thus accelerating the development of the informal economy.

In the particular context of poverty, many micro-drivers, such as job quality and mismatch, socio-demographic factors, or even discrimination, may strengthen the informal economy.

On the contrary, migration may mitigate the influence of the informal economy drivers when migrants are not discriminated against and face weak governance or job mismatch. The natural resources context may increase the informal economy through weak governance and job mismatch.

In all four contexts, the quality of institutions is the central informal economy driver because, in the end, it is intertwined with almost all the other drivers.

Chapter 2

When political supply creates its own demand: Populism in the European Union

“Believe in truth. To abandon facts is to abandon freedom. If nothing is true, then no one can criticize power, because there is no basis upon which to do so. If nothing is true, then all is spectacle. The biggest wallet pays for the most blinding lights.”

— Timothy Snyder

2.1 Introduction

A spotlight has been cast on the resurgence of populist leaders on the global contemporary political arena with the presidential triumphs of Donald Trump in the USA, Jair Bolsonaro in Brazil, Rodrigo Duterte in the Philippines, and Nicolás Maduro in Venezuela, in parallel with the prime ministers’ mandates secured by Recep Tayyip Erdoğan in Turkey, Viktor Orbán in Hungary, Giorgia Meloni in Italy, and Narendra Modi in India. When it comes to the European Union (EU), this tendency has been reflected in the strong electoral performance of populist parties from both sides of the ideological spectrum, such as the French National Rally (RN) and La France Insoumise (LFI), Alternative for Germany (AfD), Polish Law and Justice (PiS), Italian Lega Nord (LN) and Five Star Movement (M5S), Fidesz – Hungarian Civic Alliance, Freedom Party of Austria (FPÖ), Czech Action of Dissatisfied Citizens (ANO), Slovak Direction – Social Democracy (SMER), Spanish Podemos, and Greek Coalition of the Radical Left – Progressive Alliance (SYRIZA).

These political developments are alarming and require not only keen scholarly understanding but urgent policy solutions. Populism thrives on the antagonism between “pure people” and “corrupt elites” (Mudde, 2004). Populist politicians and governments attack and undermine the national and supranational formal institutions of liberal democracy, such as the EU, seen as corrupt creations of the “elites” (Grzymała-Busse et al., 2020). The long road to democracy and peace on the European continent may face a swifter turnaround under the surging

prominence of populists. Once autocracy takes root, it becomes extremely challenging to reverse its course since democratic checks and balances become weakened or eroded. The onset of “illiberal democracies” in Hungary and Poland under the tenure of Fidesz and PiS constitute examples of these processes. Furthermore, Russia’s full-scale invasion of Ukraine has shown that peace is fragile and the established world order can be shattered. Here, a close eye should be paid to Europe’s populists. European populists across the political spectrum have frequently been flirting with the Kremlin regime, receiving its endorsement, channeling its propaganda into the masses, and helping it to undermine Europeans’ trust in liberal democratic institutions such as the EU (Rohac, 2017).

Against this background, our study is prompted by a desire to understand the driving forces behind support for populism. The ongoing scholarly discussion examines this subject matter from the standpoint of different demand- and supply-side factors. Yet, an unexplored avenue lies in investigating the potential role of populist political supply in creating its own demand. Our research endeavors to address this gap by exploring the mechanism through which populist political supply influences its demand. Moreover, the primary focus of prior research looks at a separate factor determining the rise in populism. Instead, we undertake a multi-factorial approach ensuring a more comprehensive assessment of this complex issue. Our research is focused on populism in the EU. Building upon the prior literature, we proxy support for populism by distrust in the EU, which European populist leaders depict as a technocratic and bureaucratic elite-driven organization far from the interests and the needs of the people (Fortunato & Pecoraro, 2022). In addition, we give preference to the measure of distrust in the EU rather than distrust in the national institutions in each member state also due to the heterogeneity in the national institutions across the countries.

To guide our empirical analysis, we propose a theoretical model grounded in the existing literature. Embedded within our theoretical framework are four hypotheses that inform our empirical exploration. We aim to test whether populists leverage economic insecurity, the isolation of individuals, political polarization, and social media reliance to spur public grievances to induce demand. Additionally, we are interested in whether populist leaders target a specific socio-demographic voter profile in their campaigns. To test our hypotheses, we employ cross-sectional data from the Eurobarometer surveys spanning from 2012 to 2023 and perform a probit analysis.

Our findings show that populists influence demand through four main supply-side factors. First, we provide evidence of populists capitalizing on economic insecurity in order to drive

electoral support. These results align with the economic insecurity thesis (Guiso et al., 2017; 2022). However, we look at it from the supply side. Hence, numerous populist actors focused their political campaigns around the global economic crisis and subsequent austerity measures, emphasizing supranational institutions such as the EU as the primary target of blame for the people's economic hardships (Guriev & Papaioannou, 2022).

Second, we uncover that populist actors might exploit the isolation of individuals to induce electoral demand. The underlying idea stems from the political philosophy of Hannah Arendt (1951, 1953), who posits that totalitarian leaders exercise terror and isolation to turn people against each other and themselves. This makes individuals distrustful of themselves and others. No longer able to rely on their own judgment and distinguish facts from fiction, people seek refuge in ideology. Building upon this concept, we argue that, similarly to totalitarian leaders, populist leaders may aim to isolate the "atomized individuals" to turn them against each other and the established elites such as the EU.

Third, our study exposes that political polarization may be another tool used by populists to propel electoral demand. We find that those exhibiting extreme political leanings are, on average, more prone to distrust the EU than those with moderate political views. Consequently, seeking to place themselves strategically in relation to their competitors and leveraging anti-establishment sentiments, populist politicians typically lean towards the extremes of the political spectrum (Downs, 1957; Figueira, 2018; Handlin, 2018; Mols & Jetten, 2020; Schulze et al., 2020).

Fourth, it becomes apparent from our research that social media can be seen as an essential ally of populist leaders. Our results reveal that reliance on social media as the primary source for news on European politics is positively related to distrust in the EU. Social media allows for the bypass of traditional media gatekeepers, letting populist politicians communicate with the electorate without constraints and turn to post-truth tools aiming to read and shape public grievances to fuel demand (Manucci, 2017; Engesser et al., 2017; Iosifidis & Wheeler, 2018; Flew & Iosifidis, 2020). Social media algorithms also tend to lock people in so-called "echo chambers" (Flew & Iosifidis, 2020; Heiss & Matthes, 2020), further intensifying isolation and fostering political polarization, which plays into the hands of populists.

Additionally, we unravel the socio-demographic profile of the voter more prone to support populists. Reinforcing the findings of the prior studies, our results uncover a higher likelihood among men to support populism, as well as those with lower levels of education, rural and

suburban residents, unemployed, retired, and those belonging to the working class. We find an inverted U-shaped pattern between age and support for populism.

This study contributes to the literature on populism in several ways. As far as we know, this is the first study that investigates support for populism through the mechanism of political supply creating its own demand. Furthermore, while most prior research on the subject focuses on one specific factor as a determinant of populism, we examine it by applying a multi-factorial approach. Such an encompassing approach enables us to account for the combined effects of factors that impact populism's rise, allowing for a comprehensive understanding of the phenomenon. Focusing on the EU, our research sheds light on how populists capitalize on economic insecurity, weaponize the isolation of individuals, foster political polarization, and exploit social media tools to gain and retain political power.

The chapter is organized as follows. In the next section, we review the related literature. Then we propose the theoretical framework, including the hypotheses to be tested against the empirical data. Section 2.4 details the data used, the construction of variables, and descriptive analysis, followed by Section 2.5, which sets out the empirical strategy. While Section 2.6 presents and discusses the results of the econometric analysis, Section 2.7 provides robustness checks to ensure the validity of our results. Section 2.8 analyzes our study's limitations. Finally, the last section concludes this chapter.

2.2 Literature review

Defining populism

Prior to delving into our analysis, it is essential to navigate the existing definitions of the term “populism” and identify the parameters of our study. One of the first references of the term was used by Shils (1956) in the context of the US security policy and McCarthyism¹¹, who argued that populism is based on the belief that the people surpass both the political elites and the urban middle classes associated with them. Populists exhibit a strong skepticism towards

¹¹ McCarthyism was a term coined to describe activities associated with Republican senator Joseph R. McCarthy of Wisconsin. He served in the Senate from 1947 to 1957. The term McCarthyism soon evolved to describe the practice of publicly accusing government employees of political disloyalty or subversive activities and using unsavory investigatory methods to prosecute them. The practice held sway between 1950 and 1954, a period of intense suspicion during which the U.S. government was actively engaged in countering Communism — in particular, the Communist Party of the United States of America (CPUSA).

bureaucracy and advocate that legislative bodies accurately represent the supreme “will of the people” (Shils, 1956; Worsley, 1969; Kessel, 2011). Wiles (1969) specifies the distinctions of populist movements: leader-centered, loosely organized, pseudointellectual, anti-establishment, and nostalgic for their vision of the past.

Mudde (2004) defines populism as a “thin-centered ideology” that splits society into two homogeneous and antagonistic groups of moral “pure people” and amoral “corrupt elite” in the Manichean manner, where opponents are not people with different views, but evil with whom compromise is not possible. According to the author, political decision-making should serve as a manifestation of “the general will of the people” through the lens of populism. In addition, populists invoke a longing for “the heartland,” which represents an idealized world constructed from a past that has been lost (Taggart, 2004). Seen as a thin ideology, populism exhibits a chameleon-like ability to adjust its ideological colors in line with the environment and coexists with other, more comprehensive, ideologies, including, among others, communism, ecologism, nationalism, or socialism (Taggart, 2000; Mudde, 2004; Stanley, 2008). Against this backdrop, the basis for the ideational approach to populism emerges. This approach perceives populism as one instance of a specific level or type of idea that attaches itself to some “host” ideology (Mudde, 2017; Hawkins & Kaltwasser, 2017). This is the approach we will draw our analysis on since it allows us to attach authoritarian undertones and Eurosceptic leanings to it, with the latter assessed through distrust in the EU.

Populism is closely intertwined with authoritarianism since the former is associated with the erosion of checks and balances of the executive branch, the targeting of minority groups, and increased instances of violence (Eichengreen, 2018). In their turn, Norris and Inglehart (2019) distinguish authoritarian populism – which is based on the three fundamental values prioritizing conformity with strict compliance – with conventional norms, security against dangers that justifies stringent enforcement and aggression toward those who pose a threat to the security or the established norms of the group, and loyalty to the leader and the group. The authors argue that this type of populism presents the gravest dangers to liberal democracy by undermining trust in the established mechanisms that safeguard democratic checks and balances, such as the protection of minority rights, the free press, the independence of the judiciary, and pluralistic debates within civil society. Consequently, it creates a vacuum that allows charismatic leaders who claim to speak on behalf of the populace to seize power.

Looking at the intersection between populism and Euroscepticism, Csehi and Zgut (2021) distinguish Eurosceptic populism by incorporating anti-EU sentiments within an ideational

approach to populism. The authors contend that Eurosceptic populism contests the EU as “the corrupt elite” with the citizens of a member state as “the pure people.” Furthermore, Eurosceptic populists denounce the EU for undermining the democracy by failing¹² to represent “the general will of the people” (Reungoat, 2010; Csehi & Zgut, 2021). Building upon the above discussion on the definition of “populism,” our analysis will adopt the ideational approach, proxying support for populism through the opposition towards “the corrupt elites” measured by distrust in the EU.

Demand side of populism

The existing literature argues that the demand for populism stems from the people’s grievances. Scholars postulate two major theses to explain the nature of grievances: economic insecurity and cultural backlash, which we describe below.

Economic insecurity

Guiso et al. (2017, 2022), employing the data from the European Social Survey (ESS), capture heterogeneity in economic insecurity through three measures: experience of unemployment, experience of income difficulties, and the indicator of exposure to globalization. Additionally, the authors use measures of sentiments towards immigrants to reflect fear of displacement in the labor market due to the potential inflow of a cheaper workforce. The empirical results reveal that economic insecurity elevates voters’ likelihood to support a populist party. Those who face income difficulties and are exposed to both globalization and to competition from immigrants are more likely to vote for a populist party. This corresponds to our findings which reveal that facing difficulties paying bills fosters a leaning toward populism. However, our results contrast the authors’ on the unemployed having no statistically significant effect on the support for a populist party, which they explain due to their abstention to vote.

In addition, Guiso et al. (2017, 2022) argue that economic insecurity can also indirectly impact voting for populist politicians. Thus, the authors employ the following two measures from the ESS as proxies for trust in politics and institutions: trust in political parties and average trust in parties and institutions, constructed as the average of the trust levels assigned to the country’s

¹² Democracy here is understood as a will for the participation, control or representation of the people.

parliament, political parties, politicians, and the European Parliament. They find that those who experience a decline in trust in parties and institutions are more prone to cast their votes for a populist party. Since citizens can associate the deteriorating economic conditions with the incumbent politicians and traditional institutions, their confidence in both can decline, resulting in a rise in populist politicians' influence. We employ the channel of distrust in institutions as a dependent variable in our econometric regression.

However, Inglehart and Norris (2016) find mixed and inconsistent results concerning the economic insecurity thesis. On the one hand, their findings confirm that the experience of unemployment and subjective economic insecurity are positively associated with populist voting, measuring it by reported hardship of living on current household incomes. On the other hand, those relying on social benefits as the main source of household income turn out to be less supportive of populists. Instead, the authors assert that cultural rather than economic aspects are key in explaining growing support for populists. They develop the cultural backlash thesis, into which we delve further.

Cultural backlash

Inglehart and Norris (2016) put forth the cultural backlash thesis, which posits that the support for populist parties can be explained to a large extent by a reaction against value change processes. The essence of this idea is grounded in the "silent revolution" theory introduced by Inglehart (1977), which states that due to the unprecedentedly high levels of existential security, post-industrial societies since the 1970s experienced an intergenerational shift from materialist to post-materialist values such as cosmopolitanism, multiculturalism, international cooperation, democratic governance, environmental protection, human rights, and gender and racial equality. These processes, however, were met by opposition from those who hold onto traditional norms and values. Cultural backlash has been particularly prominent in Western societies over the last decades. Inglehart and Norris (2016) argue that it has increased the support of populism among specific cohorts of society that resent, feel threatened by, or are marginalized due to the progressive cultural change. As predicted, using the data from the European Social Survey, the authors find that older generations, men, those with lower levels of education, ethnic majority groups, and the religious followers are more favorable towards populist parties. These findings are overall in accordance with ours. In addition, populist voting significantly relates to cultural value measures such as anti-immigrant attitudes, mistrust of

global governance, distrust of national governance, support for authoritarian values, and left-right ideological self-placement. In a similar vein, our analysis focuses on distrust in institutions as an indicator of support for populism and employs distrust in the EU as the response variable. Our findings overall corroborate the cultural backlash thesis.

Interestingly, Mudde and Rovira Kaltwasser (2018) call for revising the interpretation of cultural backlash to align it more with populism than nativism. Drawing attention to populists' contrasting the pure "low culture" of the people against the corrupt "high culture" of the elite (Ostiguy, 2017) and manifesting themselves as "(wo)men of the people," the authors assert that this is a backlash against the unauthentic global liberal elite.

Cultural backlash and economic insecurity intertwined

Already drawing on the analysis of the studies above, we can observe that both economic insecurity and cultural backlash theses are, in fact, closely intertwined. Thus, Inglehart and Norris (2016) maintain that economic insecurity and inequality may interact with traditional values and reinforce cultural backlash.

Furthermore, there are many studies that show how immigration can have an impact on the rise of populism through both economic and cultural channels. Peaks of immigration can increase competition in the labor market and trigger cultural backlash (Mols & Jetten, 2020). Interestingly, Mols and Jetten (2017) and Jetten (2019) present evidence that anti-immigration sentiments and the consequent voting for populist parties are positively related not only to economic insecurity but also to economic security. Evidence at the macro level shows that both economic downturns and economic booms, measured by changes in GDP and unemployment levels, are associated with the increased popularity of populist parties (Mols & Jetten, 2017; Jetten, 2019). Moreover, the authors find that both relatively economically deprived and relatively economically gratified groups of the population are more likely to be hostile towards immigrants and favor populist politicians, representing a V-curve relationship (Jetten et al., 2015). Such attitudes amidst times of economic prosperity and among more affluent groups manifest as a "wealth paradox" (Mols & Jetten, 2017). This phenomenon can be attributed to fear of failing (Ehrenreich, 1990), threat to status (Mutz, 2018; Gest et al., 2018), and upward mobility pressure experienced by the wealthy (Jetten, 2019).

Rooduijn and Burgoon (2018), analyzing the European Social Survey (ESS) data, argue that a socio-economic context, measured through the levels of unemployment, inequality, social

welfare expenditure, and GDP per capita, as well as a socio-cultural context, measured by net migration level, play a crucial role in mediating the impact of individual perceived economic position on voting for populist parties. They find economic insecurity to foster radical right voting amidst the favorable socio-economic context and radical left voting amidst a modest level of net migration. These results indicate a paradox: individual economic insecurity might induce support for populist politicians across the political spectrum, however, they are mainly affected in the context of favorable socio-economic conditions at the country level. The authors attribute such paradox to a relative deprivation mechanism in the case of radical right voting and a risk aversion mechanism in the case of both radical right and radical left voting. Several other studies have also revealed that individual economic well-being is negatively related to support for radical left (Gomez & Ramiro, 2019) and radical right parties (Lubbers et al., 2002, Werts et al., 2013). Interestingly, Gomez and Ramiro (2019) find that economic insecurity, measured by the unemployment level, has a direct impact on voting for radical left parties, while Lubbers et al. (2002) maintain that economic insecurity affects voting for radical right parties indirectly through the perceptions of economic malaise and competition with immigrants. These results might be related to the distinctive political discourses between the radical left and radical right, with the former primarily revolving around economic issues, such as unemployment and income distribution, and the latter around immigration and national identity. In our analysis, we look at the impact of the extreme political leaning on the support for populism without separating the extreme right and left alignments.

Ford and Goodwin (2014) show that both economic insecurity and cultural backlash aspects played a role in support for UKIP, a right-wing populist party in the United Kingdom. The changes in economic and social structure and long-term generational values have “left behind” a cohort of voters: older, working-class, whiter voters with lower levels of education. Our findings corroborate the “left behind” thesis. On the other hand, Dorling (2016) and Antonucci (2017) find that, contrary to widespread beliefs, it was rather those individuals self-identifying as middle class rather than the working class who voted “Leave” during the Brexit referendum in the United Kingdom in 2016. Similarly, studying Trump’s voters in the USA and employing the cross-sectional indicators of past economic hardship or anticipated hardship, Mutz (2018) rejects the “left behind” thesis.

We can conclude by saying that the existing literature explains the demand side of support for populists through the cultural framing of economic insecurity (Gidron & Hall, 2017; Mudde & Rovira Kaltwasser, 2018). Furthermore, some authors argue that while economic insecurity is

salient in explaining the growing support for left-wing populists, the cultural backlash is instrumental in understanding the rise of right-wing populists (Manucci et Weber, 2017). Given that our study does not distinguish between right-wing and left-wing populism, our empirical findings support both the economic insecurity and cultural backlash theses. Most importantly, we posit that it is the supply side that influences the demand side.

The above analysis of the literature on the demand side of populism depicts a profile of a voter that populists on the supply side aim to target. Further, we examine the findings of the existing literature on socio-demographic characteristics that tend to be more likely to be linked with populist voting.

Unraveling the voter profile

It is important to understand the socio-demographic profile of a voter more inclined to vote for populist politicians and, thus, becomes a target of appeal for populists.

On one hand, the prevailing literature finds men rather than women to be more likely to vote for populists (Werts & al., 2012; Ford & Goodwin, 2014; Inglehart & Norris, 2016; Guiso et al., 2017). In a similar vein, studies using Eurobarometer data (Hudson, 2006; Muñoz et al., 2011; Hartevelde et al., 2013; Torcal & Christmann, 2019) find distrust towards the EU and its institutions to be more prevalent among men. These results align with ours. However, on the other hand, Ehrmann et al. (2013) and Van Klingeren et al. (2013), also relying on the Eurobarometer survey, find women to be more distrustful towards the European Central Bank and more Eurosceptic, respectively.

Furthermore, the existing literature reveals mixed results on the relationship between the age of voters and their inclination towards populism. Some authors find that populist support is generally stronger among the older generation (Ford & Goodwin, 2014; Inglehart & Norris, 2016; Algan et al., 2017). Others find it, on the contrary, to be more prevalent among the youth, especially when it comes to voting for both radical right and radical left parties (Werts & al., 2013, Luis Ramiro, 2014; Ramiro, 2016; Rooduijn & Burgoon, 2018; Gomez & Ramiro, 2019, Santana et al., 2020). Furthermore, several studies relying on the Eurobarometer survey find older people to exhibit higher trust towards the EU and its institutions (Hartevelde et al., 2013; Ehrmann 2013; Torcal & Christmann, 2019). While others, Muñoz et al. (2011), find the opposite results based on the Eurobarometer data. In line with Hudson (2006), who also

employs the Eurobarometer data, we find the relationship between age and distrust in the EU to follow an inverted U-curve.

Overall, populists tend to mobilize less educated people (Lubbers et al., 2002; Werts & al., 2012; Ford & Goodwin, 2014; Inglehart & Norris, 2016; Guiso et al., 2017). Similarly, scholars employing the Eurobarometer surveys' data find distrust in the EU and its institutions tends to decrease with the level of education (Hudson, 2006; Hartevelt et al., 2013; Van Klingeren et al., 2013; Torcal & Christmann, 2019). These results are consistent with our findings. However, the probability of voting for the radical left seems to increase with education (Ramiro, 2014; Rooduijn & Burgoon, 2018; Gomez & Ramiro, 2019).

The previous studies find the unemployed and retired to be more likely to show support for populist politicians (Lubbers & al., 2002; Werts & al., 2012; Inglehart & Norris, 2016; Rooduijn & Burgoon, 2018; Gomez & Ramiro, 2019). Scholars that employ the Eurobarometer data (Hudson, 2006; Drakos et al., 2019; Torcal & Christmann, 2019) discover a consistent pattern that aligns with our results.

Finally, harmonious with our observations, supporters of populists are found to be more common among the rural population (Inglehart & Norris, 2016; Rooduijn & Burgoon, 2018). Likewise, Hudson (2006) and Torcal and Christmann, (2019), applying Eurobarometer data, find rural residents to be more distrustful towards the EU. In line with these studies, we find those living in rural and suburban areas to be more likely to distrust the EU. Furthermore, the probability of populist voting is significantly higher among the working class (Lubbers & al., 2002; Werts & al., 2012; Ford & Goodwin, 2014; Ramiro, 2014; Gomez & Ramiro, 2019), which aligns with our findings.

Populists formulate their political strategy and discourse based on analyzing the potential voter profile and adjusting them in line with the current contextual developments. Further, we will look at the literature examining the supply side of populism.

Supply side of populism

The supply-side literature examines the phenomenon of populism from several angles. We group them around four main factors, which will serve as a basis for our theoretical framework and empirical analysis. These factors are economic instability, the isolation of individuals, political polarization, and media.

Capitalizing on economic instability and insecurity

Economic instability caused by the Great Recession of 2008–2009 and the subsequent 2010–2012 economic crisis in the European periphery cultivated a favorable foundation for the recent rise of populism. Therefore, economic instability is not only a demand-side factor but also a supply-side factor, which populists can leverage, aiming to increase the support from the electorate.

Guriev and Papaioannou (2022) name four factors which populist actors successfully capitalized on because of the Great Recession. Initially, since parties more at the center were in authority prior to the crisis, populists could attribute responsibility to the political establishment. Then, the widespread dissatisfaction with bank bailouts provided populists with an opportunity to assert that bankers, affiliated with the mainstream parties, evaded accountability for their wrongdoings. Third, within countries that implemented austerity measures in the aftermath of the crisis, the weakening of social safety nets resulted in widespread inequality. Finally, given that austerity measures are enforced by the International Monetary Fund and the European Union within broader economic adjustment programs, populist actors could focus their discourses on anti-globalization and anti-EU agendas.

Furthermore, Guiso et al. (2017) contend that the economic crisis leads to the emergence of populist actors that leverage the decline in trust for mainstream political actors and institutions, especially in the context of weak checks and balances and higher political fragmentation. In addition, Rodrik (2020) posits that in response to economic shocks political actors can embrace more populist agendas. As a result, voters may need to choose from more polarized political platforms.

Algan et al. (2017) examine the implications of the recession on populist voting and trust in institutions using regional data across Europe. To investigate causal effects, they extract the portion of unemployment increases attributed to the pre-crisis economic structure, specifically the construction sector's regional value-added share, which is closely tied to the crisis buildup and burst. The authors find that crisis-driven increases in unemployment, rather than the level of unemployment, play a significant role in fostering populism and reducing trust toward national and EU institutions.

To sum up, populist actors can capitalize on and even frame socio-economic challenges, such as economic instability and insecurity, in such ways that will fuel public grievances inducing demand for populism (Mols & Jetten, 2020). This is in line with our findings where economic

insecurity, proxied by difficulties paying bills, is positively related to the rise of populism, measured through distrust in the EU.

Weaponizing the isolation of individuals

In her book “The Origins of Totalitarianism” (1951), German-born American historian and political philosopher Hannah Arendt argues that Nazi Germany and Stalin’s USSR commenced as populist movements. The author mentions that populists target the masses without concrete political ideology and those who do not feel represented by the established political order, inducing fear and chaos.

Moreover, in her “The Origins of Totalitarianism” (1951) and “Ideology and Terror” (1953), Hannah Arendt makes a distinction between solitude, isolation, and loneliness. According to the author, solitude creates space for a thinking activity, for the inner dialogue necessary to make moral judgments and be able to tell fact from fiction. Arendt perceives isolation as the incapacity to come and act together with others, which is seen as the source of an individual’s political power. Loneliness is linked to the state of being “deserted by all human companionship.” Thus, while isolation concerns only the political sphere of life, loneliness also concerns the private one. Hannah Arendt maintains that totalitarian leaders, through the use of isolation and terror, turn the temporary experience of loneliness into a permanent one. Arendt writes, “The isolation of atomized individuals provides the mass basis for totalitarian rule”. By intensifying isolation and destroying the space of solitude, totalitarianism turns people against each other and themselves. It makes individuals cynical and teaches them to distrust themselves and others. As a result, people can no longer rely on their own judgment and distinguish between fact and fiction. In given circumstances, they become susceptible to ideology, which appeals to their loneliness. Also, in his book “The True Believer” (1951), American philosopher Eric Hoffer contends that “estrangement from the self” is a prerequisite to becoming part of a large-scale ideological movement. Likewise, Kornhauser’s (1959) mass society theory posits that society experiences growing atomization and loss of community, which results in the increased willingness to embrace new ideologies, particularly those that satisfy the need for community.

Loneliness has become a widespread sentiment in the current context of globalization, automation, attention economy, the COVID-19 pandemic, and economic recessions (Hertz, 2020). Against this background, populist actors worldwide appeal to this feeling of alienation

and foster the division between “us” versus “them”, further spreading cynicism, isolating people against each other, and polarizing society. Weakening social connections make those who feel “left behind” and isolated more prone to blame “the elites” (Guriev & Papaioannou, 2022). In a vicious circle, this further creates a favorable environment for populist discourse (Manucci, 2017). Along these lines, Renström et al. (2020) posit that social exclusion is a pathway to radicalization. Moreover, Langenkamp and Bienstman (2022) find weak social belonging to be positively linked to the probability of voting for populist parties. In line with the literature described above, our analysis finds the isolation of individuals to be positively related to the distrust in “the elites”.

In addition, as economic development has focused on the urban areas while the rural areas have been experiencing long-term economic decline, the rural populations have felt socially marginalized, neglected by the political establishment, and have lost trust in mainstream politicians (Mamonova & Franquesa, 2020; McKay et al., 2021). This has only amplified the feelings of isolation and loneliness amongst rural populations (Stulberg, 2022; Guriev & Papaioannou, 2022). Populists have capitalized on underlying place-based grievances and fueled so-called “revenge of the places that don’t matter” against “the elites” (Rodríguez-Pose, 2022).

Fostering political polarization

Populist actors are argued to seek ways to position themselves strategically in relation to other political actors (Algan et al., 2017; Mols & Jetten, 2020; Rodrik, 2020). While mainstream parties on both right and left tend to move towards the center prior to elections, populist parties capitalize on the vacant electoral space at the extreme ends of the political spectrum and adopt either a radical-right or radical-left ideology, which fosters political and societal polarization (Downs, 1957; Figueira, 2018; Mols & Jetten, 2020; Schulze et al., 2020; Bértoa & Rama, 2021).

Moreover, per the polarizing populism thesis, populist actors, leveraging anti-establishment sentiments, promote political programs that deviate significantly from their mainstream counterparts, creating a new electoral space (Handlin, 2018; Mols & Jetten, 2020). As a result, the electorate moves away from the center when disappointed in the mainstream parties. Analyzing the level of electoral polarization in 47 European democracies since 1900, Bértoa

and Rama (2021) show that, on average, party politics in Europe have never been as polarized as over the last decade, especially in Western Europe.

Interestingly, a case study analysis of the populist radical right party Fidesz in Hungary suggests that, once in power, populists maintain or radicalize their discourse even further (Hegedüs, 2019). Our empirical findings reveal a positive relationship between political polarization and support for populism. In addition, populists have been deploying media, especially social media, to spur antagonism and polarize society, which we describe in more detail below.

Media as a right hand of populists

Media constitutes one of the key supply-side factors of populism. It plays the role of a medium through which populist leaders perform, interact with, and influence their audience – the people (Moffitt, 2016). To a large extent, through media, populist politicians can channel all the previously discussed supply-side drivers, affecting the demand side.

Considerable research has been conducted to examine the relationship between populism and media. The success of populist politicians may be explained by their ability to shape the agenda or capitalize on the existing media agenda for their electoral purposes (Boomgaarden & Vliegenthart, 2007). Furthermore, the literature suggests that their success is closely linked to the process of the mediatization of politics, which refers to the ongoing convergence between media-logic and political-logic (Mazzoleni, 2008; Manucci, 2017). This transformation has shifted political communication in the media space towards sensational news and personalities rather than policies (Ellinas, 2010). In this regard, populism is considered to be the form of political discourse that best suits the commercial motives that drive the media industry (Manucci, 2017). By providing controversial, newsworthy, and emotion-provoking content underpinned by the persuasive influence of charismatic personalities, populist messages align with the commercial logic of the media, which in its turn increases the visibility of populist politicians compared to their mainstream counterparts (Meny & Surel, 2002).

Against this backdrop, commercial television channels and tabloid newspapers are expected to be the primary supporters of populists (Manucci, 2017; Manucci & Weber, 2017). Meanwhile, the empirical studies overall have not found a significant link between populism and conventional media outlets, such as television, press, and radio (Akkerman, 2011; Rooduijn, 2013; Manucci & Weber, 2017). These findings can be attributed to two main reasons. First,

populist actors blame conventional media for favoring or even being controlled by mainstream politicians and their inclination to serve the status quo (Mazzoleni, 2008; Manucci, 2017). Second, populists encounter difficulties in passing the media's gatekeepers and disseminating their messages without restrictions (Shoemaker & Vos, 2009).

On the other hand, new media are deemed to play a pivotal role in the growing success of populist politicians. Populist actors can formulate and spread their messages without restraints as new media allows to circumvent the gatekeepers of traditional media (Manucci, 2017; Engesser et al., 2017). Furthermore, new media facilitates more direct and unmediated communication between populist politicians and citizens (Bimber, 1998; Engesser et al., 2017; Flew & Iosifidis, 2020). Since populist actors establish their credibility by emphasizing their links with ordinary people, the ability of such direct communication with the electorate reinforces their perception as approachable individuals (Manucci, 2017). Moreover, being more informal and favoring short acerbic messages, often driven by emotions rather than facts, new media platforms resonate more with a populist discursive style (Barlett, 2014; Manucci, 2017; Engesser et al., 2017). Engesser et al. (2017) argue that populist actors disseminate their ideology in a fragmented form on social media to make it more comprehensible for social media users, to keep it ambiguous to leverage the inclusiveness of "personal action frames" and promote its circulation more discreetly in the face of potential filters. Social media have also facilitated new forms of political mobilization beyond, and frequently in opposition to, the existing political establishments, which aligns with the populist narrative (Flew & Iosifidis, 2020).

In addition, social media, such as Facebook and Twitter, have served as channels for spreading conspiracy theories and "fake news," in part through "troll factories" and propaganda bots (Iosifidis & Wheeler, 2018; Flew & Iosifidis, 2020). Their increased dissemination has facilitated the emergence of post-truth politics, which has been reflected, for instance, in Russian misrepresentations of the West, the manipulation of the United Kingdom's Brexit vote, and the recurrent statements made by Donald Trump during his presidency in the United States (Bergmann, 2020). Furthermore, new media algorithms, predominantly showing the information that reinforces one's existing views, may foster isolation and trap users in "echo chambers," making them no longer exposed to opposing viewpoints (Flew & Iosifidis, 2020; Heiss & Matthes, 2020). This increases polarization, providing a conducive environment for populist actors (Bergmann, 2020). Also, social media allows populists to assess voters' reaction to specific issues and events and frame the information in a way that would allow them to

cultivate grievances and induce demand (Mols & Jetten, 2020). Our econometric analysis shows that the reliance on social media as the primary source for news is associated with support for populism.

There are also numerous cases when populist political leaders either exploit their existing links with or take control over media outlets through legislation and judicial decisions to curb the voices of the opposition (Manucci, 2017; Acemoglu & Tokgoz, 2023). For instance, in Hungary, Prime Minister Orbán has tightened his grip on the media to silence opposing viewpoints. Media outlets supportive of the government include tightly controlled public broadcasters, companies owned by individuals friendly to the regime, and almost 500 titles under the Central European Press and Media Foundation (KESMA), a non-profit group comprising the media holdings formerly owned by associates of the prime minister (Dunai, 2022). Likewise, in Poland, the government led by Law and Justice (the PiS) took control over public service media by assuming authority over the process of public media policy execution (Surowiec & Štětka, 2020). Through a combination of post-truth tactics, infused with conflict and negativity, and media control populism poses a threat to democracy. By weakening checks and balances, populist leaders establish a firm grip on power.

Populism's self-perpetuating spiral

Previously populism was seen prevailing through the lens of the “normal-pathology thesis,” arguing it to be incompatible with the mainstream values in Western democracies (Betz, 1994). In contrast to this viewpoint, Mudde (2004) observes that while initially challenger or outsider politicians resorted to populism, since the early 1990s mainstream politicians started to employ it too, primarily to counter populist challengers. Politicians across the spectrum now predominantly focus on the importance of popular dimensions such as democratic facets, with debates culminating around the perceived “gap between citizens and politics” or the “democratic deficit” within the EU. Hence, the author coined the term “populist Zeitgeist” to describe the phenomenon of populism permeating and becoming mainstream in the politics of Western democracies. Furthermore, while Mudde (2004) suggests that populism is episodic and populist Zeitgeist will subside once the populist challenger has reached its peak, Pappas (2014) presents a contrasting standpoint. The author posits that the populist challenger not only gains political power but also endangers liberal democracy in the long term by replacing it with

populist democracy, defined as a situation where both the party in power and at least the major opposition forces are populist.

While there is a substantial body of research examining the support for populism, limited attention has been given to exploring it from the angle of how populist political supply creates demand. Furthermore, most of the studies focus on one factor influencing the rise in populism. Thus, there is a gap in investigating the subject matter through a multi-factorial approach. Addressing these gaps could offer valuable insights into support for populism.

Having reviewed the existing literature and identified its gaps, the forthcoming section is dedicated to outlining the theoretical framework that will guide our empirical analysis.

2.3 Theoretical framework

In this section, we will present the theoretical framework on which our research is based. Our main objective is to investigate and empirically test the proposition that supply creates its own demand in case of support for populist political actors. Given the complexity of the studied phenomenon, we aim to understand how the supply side affects the demand side by adopting a multi-factorial approach. Drawing upon the existing literature described above, we propose that four key supply-side factors impact support for populism. Namely, we suggest that populists leverage economic insecurity, manipulate the feeling of loneliness and isolation, spur political polarization, and exploit social media to their benefit in order to cater to and foment grievances to induce demand. We also posit that populist leaders, through the analysis of data and trends, have a keen understanding of a socio-demographic profile of a voter who is more susceptible to their messages and, thus, whom they primarily target in their campaigns. The proposed mechanism is depicted in Figure 2.1.

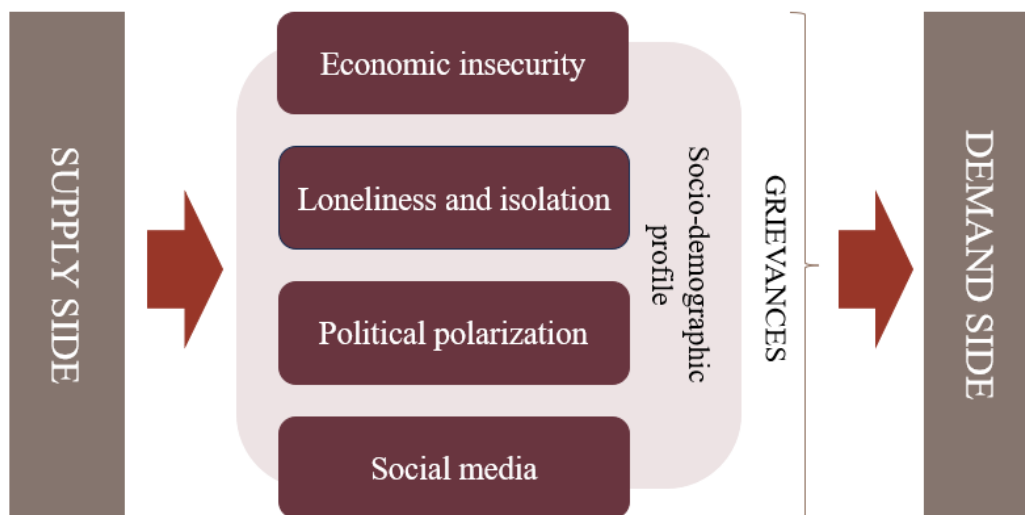
Economic insecurity

One argument of the prior scholarly work posits that economic insecurity is at heart of support for populism (Algan et al., 2017; Guiso et al., 2017, 2022; Guriev & Papaioannou, 2022). While the prevailing literature often approaches the economic factor from the demand-side angle, there are authors who shed light on its supply-side dimension. Capitalizing on the economic hardships people face, populists influence trust in the political establishment, including supranational bodies such as the EU, by assigning blame for such misfortune to the latter

(Guriev & Papaioannou, 2021). Times of economic disturbances provide a conducive ground for the emergence of new and strengthening of the existing populist political forces and narratives (Guiso et al. 2017; Rodrik, 2020). Building on the theory put forth by Mols and Jetten (2020), we contend that populists frame the mainstream “corrupt elites” as responsible for economic difficulties the people experience, feeding into and nurturing the grievances. This strategy erodes public trust in the established institutions and fosters support for populist actors. Against this backdrop, we propose our first hypothesis:

H1: The higher ones’ economic insecurity is the more prone they are to support populist political actors.

Figure 2.1: Mechanism of populist political supply’s impact on its demand



Source: Authors’ construction.

Isolation of individuals

Analyzing the rise and nature of the totalitarian regimes, Hannah Arendt (1951, 1953) maintains that totalitarian regimes started as populist movements. The author posits that totalitarian leaders used isolation and terror as a tool to turn people against each other and convert the temporary experience of loneliness into a permanent one. “The isolation of atomized individuals” makes them prone to seek refuge in ideology resonating with their loneliness and offering a sense of community (Arendt, 1951; Kornhauser, 1959). We assert that populist actors seek to weaponize and intensify the isolation of individuals in order to incite

hostility of the people towards “the elites” and induce demand for populism. Accordingly, we formulate our second hypothesis:

H2: The more isolated someone feels, the more likely they are to support populist political actors.

Political polarization

In order to position themselves strategically in relation to their competitors, populist political actors tend to move into vacant electoral space or create new electoral space (Mols & Jetten, 2020). Prior to elections, the mainstream political actors across the political spectrum are likely to gravitate towards the center. In their turn, populists are eager to fill in the vacant space at the radical left and right fringes (Downs, 1957; Figueira, 2018; Mols & Jetten, 2020; Schulze et al., 2020; Bértoa & Rama, 2021). Moreover, capitalizing on anti-establishment sentiments, populist actors advocate the political programs that diverge radically from those proposed by their mainstream counterparts and in this way create new electoral space (Handlin, 2018; Mols & Jetten, 2020). Thus, populist political actors may spur political polarization in their efforts to gain or retain power. To test this argument, we formulate our third hypothesis which reads:

H3: Extreme political leaning is positively associated with support for populist political actors.

Social media

Social media allows populist actors to spread their messages without constraints imposed by the traditional media gatekeepers and interact with the electorate more directly (Manucci, 2017; Engesser et al., 2017; Bimber, 1998; Engesser et al., 2017; Flew & Iosifidis, 2020). Social media platforms facilitate a short and fragmented nature of messages, which permits populists to formulate and spread sometimes ambiguous messages to which a great number of people could relate (Engesser et al., 2017). Moreover, populists may use social media channels to resort to post-truth politics tools in order to alter the reality in the way which would provide them with increased support (Iosifidis & Wheeler, 2018; Flew & Iosifidis, 2020; Bergmann, 2020). Lastly, social media algorithms, tending to expose individuals to information reinforcing their existing viewpoints, may trap them in “echo chambers.” Building on this growing body of literature that examines the relationship between social media and support for populism, we

want to test whether populist actors may use social media to prompt political demand. Thus, our third hypothesis states as follows:

H4: One's reliance on social media to receive news on politics increases their likelihood to support populist political actors.

Additionally, building on the existing literature, we aim to test whether populist leaders are more likely to target and have a successful outcome with a specific socio-demographic profile of a voter by leveraging the described four supply-side factors.

Our theoretical mechanism and hypotheses lay the groundwork for further empirical analysis of how populism supply creates its own demand. By testing the outlined hypotheses, we seek to contribute to a better understanding of the role played by supply-side factors in support for populism.

2.4 Data, construction of variables, and descriptive analysis

Data

This section describes our data, explains how we construct the dependent and independent variables, and provides summary statistics.

To test our hypotheses, we use data from the Eurobarometer. The Eurobarometer comprises a collection of surveys undertaken by the European Commission since the 1970s to monitor public opinion in Europe regarding a wide range of topics related to the European Union as well as attitudes towards issues of political and social character. Since then, the Eurobarometer has undergone substantial evolution and expansion. For the purposes of our research, we pooled all suitable Eurobarometer surveys from 2012¹³ to 2023. Specifically, our analysis focuses on the 27 Member States of the European Union and the United Kingdom. Therefore, our dataset consists of repeated cross-sectional surveys with data collected from distinct individuals at different time points. Each respondent provides their responses in a single survey wave without being tracked over time. This cross-sectional dataset allows us to analyze the key determinants of distrust towards the EU. A summary of descriptive statistics is provided in Table 2.1.

¹³ Starting from 2012, all the employed variables, except the one on “social media use,” are available.

Table 2.1: Descriptive statistics

Variables	Categories	Obs	Mean	SD	Min	Max
Trust in EU dummy		656,425	0.515	0.500	0	1
Difficulties paying bills	Almost never/never	1,866,021	0.642	0.479	0	1
	From time to time	1,866,021	0.260	0.439	0	1
	Most of the time	1,866,021	0.098	0.298	0	1
Political discussions	Never	1,782,435	0.323	0.468	0	1
	Occasionally	1,782,435	0.537	0.499	0	1
	Frequently	1,782,435	0.140	0.347	0	1
Married dummy		1,901,322	0.531	0.499	0	1
Household size	One person	1,668,760	0.220	0.415	0	1
	Two	1,668,760	0.353	0.478	0	1
	Three	1,668,760	0.175	0.380	0	1
	Four and more	1,668,760	0.251	0.434	0	1
Extreme political leaning dummy		1,371,396	0.178	0.383	0	1
Social media dummy		192,427	0.045	0.208	0	1
Male dummy		1,919,064	0.457	0.498	0	1
Age		1,918,613	50.673	18.106	15	98
Education	Up to 15	1,738,376	0.154	0.361	0	1
	16–19	1,738,376	0.464	0.499	0	1
	20+	1,738,376	0.382	0.486	0	1
Rural/suburban dummy		1,918,388	0.715	0.451	0	1
Occupation status	Employed	1,691,260	0.576	0.494	0	1
	Unemployed	1,691,260	0.075	0.263	0	1
	Retired	1,691,260	0.349	0.477	0	1
Social class	Working class	1,833,061	0.300	0.458	0	1
	Middle class	1,833,061	0.691	0.462	0	1
	Higher class	1,833,061	0.008	0.091	0	1

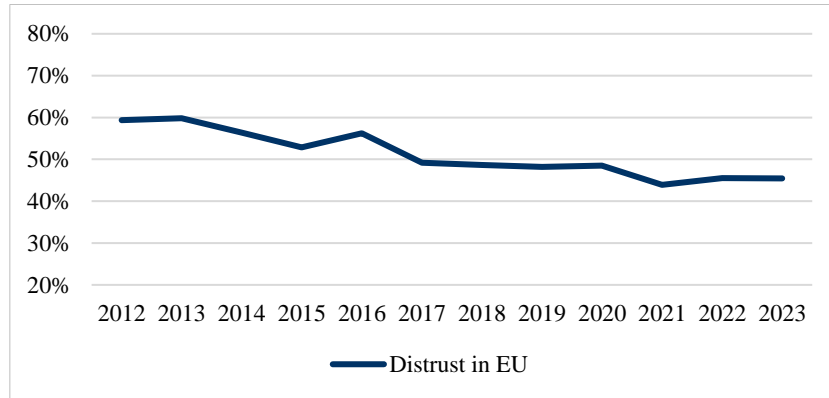
Source: Based on data from Eurobarometer (2012–2023)

Dependent variable

Building upon compelling research which has established a strong and positive association between distrust in national and subnational political establishments, including the EU institutions, and populist voting (Oesch, 2008; Inglehart & Norris, 2016; Algan et al., 2017; Guiso et al., 2017; Norris & Inglehart, 2019), we have decided to adopt distrust in the EU as a proxy variable for support for populism. We prefer this measure to the ones on distrust towards national institutions since the latter are specific to the national contexts. Distrust in the EU is a binary variable that takes on value 1 when the respondent tends not to trust the EU and value 0 when they tend to trust the EU. 51.5% of the individuals in our sample tend to distrust the EU. Figure 2.2 shows the evolution of distrust in the EU throughout 2012–2023. Despite some fluctuations, we observe an overall declining trend in the percentage of respondents who tend not to trust the EU, decreasing from 59.4% in 2012 to 43.9% in 2021. However, in 2022, the

trend reversed, with a slight increase in the percentage of respondents distrusting the EU. As of 2023, 45.4% of the respondents tend not to trust the EU.

Figure 2.2: Distrust in the EU, 2012–2023 (% of the sample)



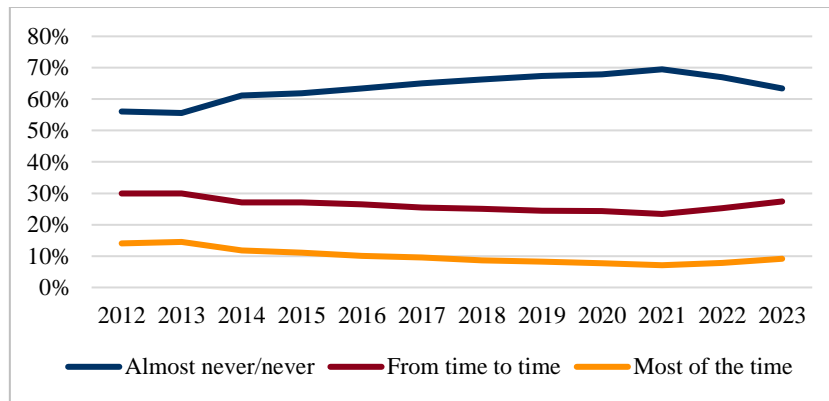
Source: Based on data from Eurobarometer

Independent variables

Economic insecurity

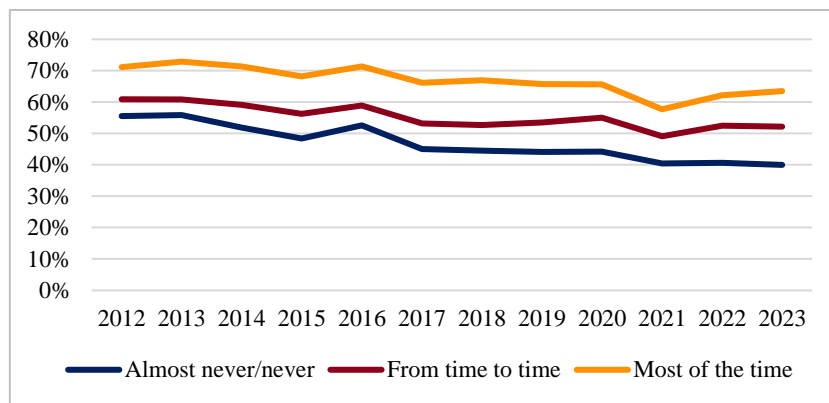
As per our H1, we want to test whether economic insecurity plays a role in support for populism. Following the example of Parth and Vlandas (2022), as a proxy for economic insecurity, we employ a variable on difficulties paying bills from the Eurobarometer. It is a categorical variable that measures whether during the last twelve months an individual had difficulties paying their bills at the end of the month (1) almost never/never, (2) from time to time, or (3) most of the time. Some 47.9%, 43.9%, and 29.8% of the individuals from our sample have faced difficulties paying bills almost never/never, from time to time, and most of the time, respectively. We can observe an overall decreasing pattern in the percentage of the population that faced difficulties paying bills at the end of the month, with this trend, however, reversing starting in 2022. Furthermore, the prevalence to distrust of the EU is the highest among those who face difficulties in paying bills most of the time, followed by those experiencing such hardships from time to time (Figure 2.3).

Figure 2.3: Difficulties paying bills, 2012–2023 (% of the sample)



Source: Based on data from Eurobarometer

Figure 2.4: Distrust in EU based on difficulties to pay bills, 2012–2023 (% of the sample)

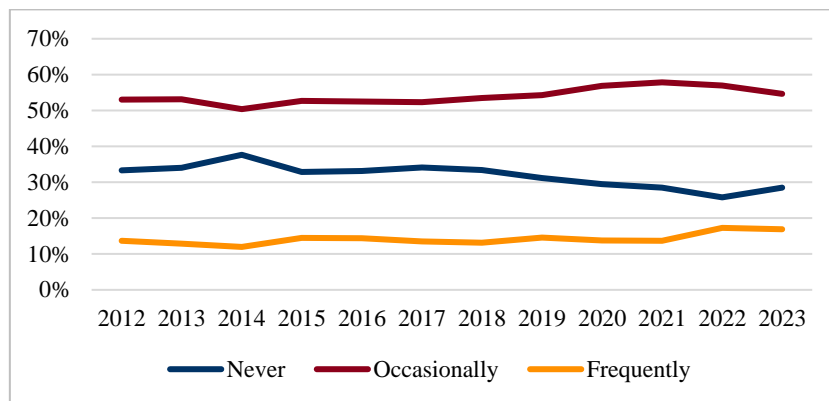


Source: Based on data from Eurobarometer

Isolation of individuals

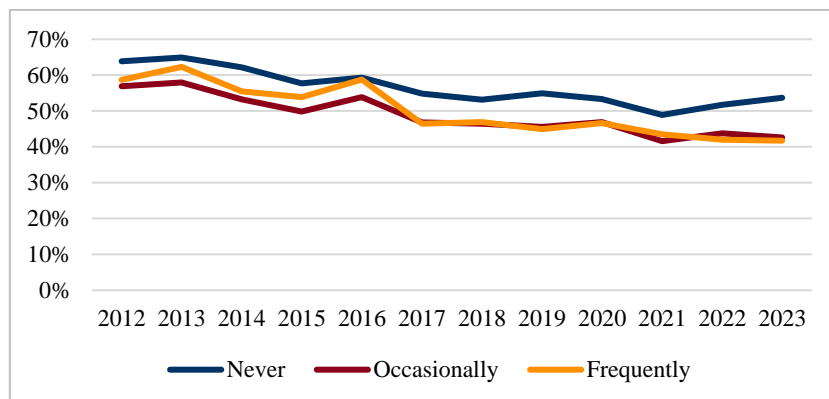
To test our H2, we employ a variable on frequency to discuss European political matters with friends and relatives as a proxy for the isolation of individuals. This is a categorical variable, which reflected three available options: (1) never, (2) occasionally, and (3) frequently. The distribution of discussions frequency among the respondents is as follows: 32.3% reported “never” discussing European political matters when meeting with friends and relatives, 53.7% engaged in the discussions occasionally, and 14% talked about them frequently. Overall, we can discern a modest general increase in the percentage of people who discuss European political matters with friends and relatives over the studied period (Figure 2.5). As seen in Figure 2.6, the share of people who distrust the EU is higher among those who never engage in such discussions compared to those who do so frequently and occasionally.

Figure 2.5: Discussing European politics, 2012–2023 (% of the sample)



Source: Based on data from Eurobarometer

Figure 2.6: Distrust in EU based on frequency of political discussions, 2012–2023 (% of the sample)



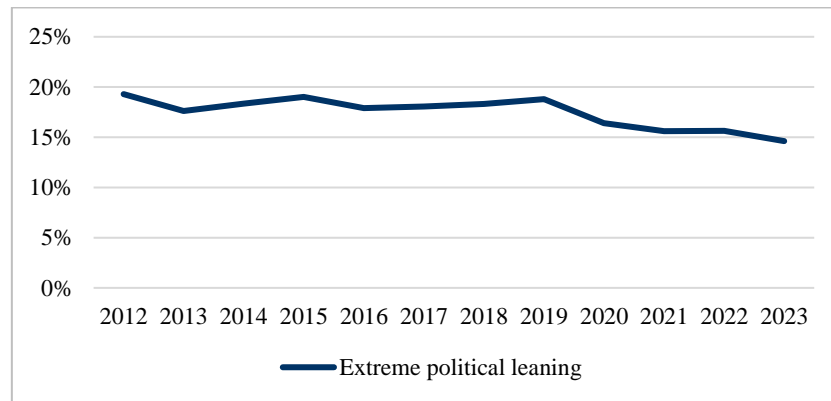
Source: Based on data from Eurobarometer

Political polarization

To test our H3, we construct a dummy variable measuring extreme political leaning. We expect to find an impact of extremism rather than ideological position on distrust in the EU similar to Van Klingeren et al. (2013) and Van der Eijk and Franklin (2004). Therefore, we recode the 10-point scale left-right political self-placement variable into a binary one. We assigned this new variable the value of 1 for the previous values of 1–2 (extreme left) and 9–10 (extreme right) and 0 otherwise. Thus, 17.8% of the individuals in our sample exhibit extreme political views. Interestingly, Figure 2.7 illustrates a downward trajectory in the EU population’s extreme political inclination throughout the analyzed timeframe. In addition, we observe that

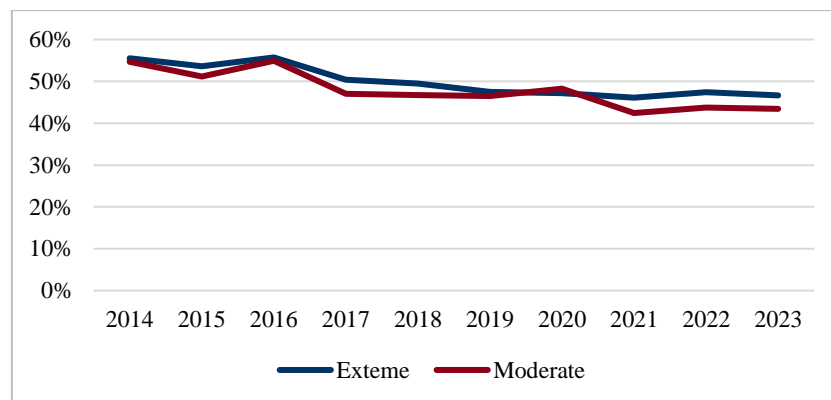
the proportion of those who tend to distrust the EU is higher overall among those who exhibit extreme political leaning compared to those with moderate views (Figure 2.8).

Figure 2.7: Extreme political leaning, 2012–2023 (% of the sample)



Source: Based on data from Eurobarometer

Figure 2.8: Distrust in EU in relation to political leanings, 2012–2023 (% of the sample)



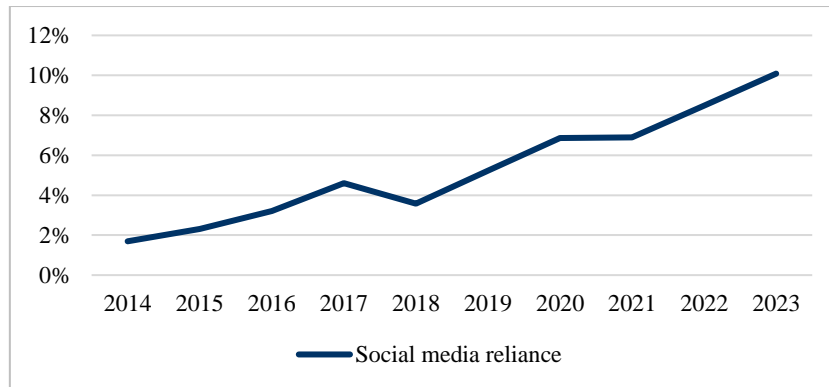
Source: Based on data from Eurobarometer

Reliance on social media for news

To verify our H4, we employ our fourth key independent variable, which signifies a strong reliance on social media to obtain the news. Following Moland and Michailidou’s (2023) example, we construct a binary variable, where those who mention social media networks as their primary source of news on European political matters are coded with a 1, and everyone else with a 0. Although the Eurobarometer surveys included this question in 2014–2018, 2021, and 2023, and thus there is a gap in the coverage for our research period, we still opt specifically for this variable as it captures best the reliance on social media for obtaining news about European politics. 4.5% of the individuals in our sample rely on social media as their primary

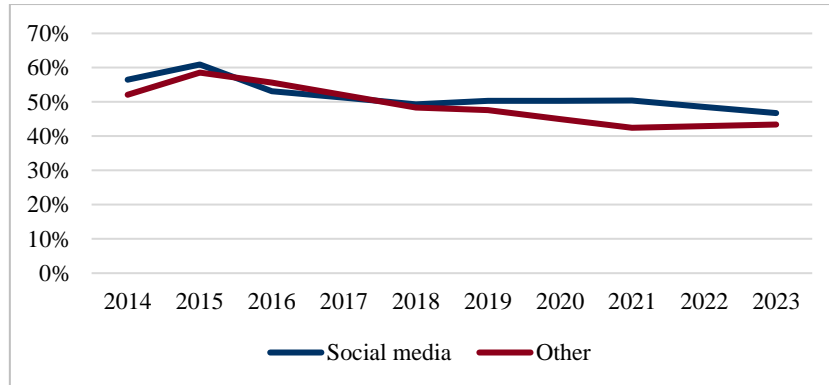
source of news on European political matters. Figure 2.9 depicts a steady increase in the role of social media as the primary source of European news throughout the observed time span. Importantly, the percentage of those who distrust the EU is overall higher among those who rely on social media as the primary source for news compared to those who rely on other channels, particularly over the recent years (Figure 2.10).

Figure 2.9: Reliance on social media for news, 2014–2023 (% of the sample)



Source: Based on data from Eurobarometer

Figure 2.10: Distrust in EU in relation to primary news source, 2014–2023 (% of the sample)



Source: Based on data from Eurobarometer

Control variables

Building on the existing literature, we control for various socio-demographic characteristics such as gender, age, level of education, type of community, occupation status, and social class. Men and women tend to exhibit different views regarding trust in the EU institutions (Hudson, 2006; Muñoz et al., 2011; Ehrmann et al., 2013; Hartevelt et al., 2013; Van Klingeren et al., 2013; Torcal & Christmann, 2019). We employ a male dummy variable scored as 1 if male and

0 if female. Support for populism is also often found to vary across age (Muñoz et al., 2011; Inglehart & Norris, 2016; Algan et al., 2017; Rooduijn & Burgoon, 2018; Gomez & Ramiro, 2019). We incorporate a continuous variable of age in our model. However, following the example of Hudson (2006), we are interested in examining whether the relationship between age and distrust in the EU follows a non-linear pattern. Thus, we also include the squared term of age. Furthermore, higher levels of education are associated with increased trust in the EU (Harteveld et al., 2013, Van Klingeren et al., 2013). In the Eurobarometer dataset, education was measured categorically as the age of completion of full-time education. We keep three relevant categories for our study: (1) up to 15, (2) 16–19, and (3) 20 and more. Regarding the type of settlement, we recode the original categorical measure as a binary variable that takes on the value of 1 if an individual lives in a rural area, village, small or middle town, and 0 if they live in a large city. Our decision to construct a dummy variable on rural and suburban residency is grounded in the existing literature that has found a positive association between this type of residency and support for populism (Hudson, 2006; Van Klingeren et al., 2013; Inglehart & Norris, 2016; Rooduijn & Burgoon, 2018; Torcal & Christmann, 2019). Moreover, previous studies have found that the unemployed and retired are more likely to support populists (Hudson, 2006; Werts & al., 2012; Inglehart & Norris, 2016; Rooduijn & Burgoon, 2018; Gomez & Ramiro, 2019; Torcal & Christmann, 2019; Drakos et al., 2019). Against this backdrop, we control for occupational status, being peculiarly interested in how being unemployed and retired in comparison to being employed affects our dependent variable. Finally, support for populism is often found to be contingent on social class (Lubbers & al., 2002; Werts & al., 2012; Ford & Goodwin, 2014; Gomez & Ramiro, 2019). We recode the original five categories for social status from the Eurobarometer survey into three broader ones: (1) working class, (2) middle class, and (3) higher class.

2.5 Empirical strategy

Since our dependent variable of distrust in the EU is dichotomous, we resort to a probit regression model using cross-sectional data described above. *Trust in the EU*_{ict} is a binary variable that takes the value of 1 if an individual *i* in country *c* surveyed in year *t* reported to tend not to trust the EU and 0 otherwise.

First, we run the four regressions with each key variable of interest separately to test each of our four hypotheses. α is a constant, ε_{ict} is the error term, and β_n are unknown parameters to

be estimated. In our analysis, we accounted for clustering effects at the individual level, which allows us to obtain robust standard errors. In the first model (2.1), since we are interested in the impact of economic insecurity on populist support, we introduce a categorical variable *Difficulties paying bills*_{ict}. This independent variable reflects potential differences in distrust towards the EU due to how often an individual experiences difficulties paying their bills at the end of the month. In the second model (2.2), we test the impact of isolation on the tendency to support populists. Hence, we include a categorical variable *Political discussions*_{ict} that captures potential differences in distrust towards the EU stemming from variance in the frequency of discussing European political matters with friends and relatives. In the third model (2.3), we incorporate a binary variable *Extreme political leaning*_{ict} to indicate potential variations in distrust towards the EU based on individuals' extreme or moderate political leaning. To examine the effect played by social media in the success of populist politicians, we introduce a binary variable *Social media*_{ict} in our fourth model (2.4). This dummy variable represents the possible variance in distrust in the EU attributed to differences in reliance on social media as the primary news source on European political matters.

Furthermore, *Characteristics*_{ict} is a set of socio-demographic variables such as gender, age, education, type of settlement, occupation status, and social class. Additionally, we control for country-unobservable characteristics by adding country-fixed effects (η_c) to ensure that the estimated coefficients capture the effects of the independent variables of interest while accounting for country-specific factors that may affect the dependent variable. Since our dataset is cross-sectional, meaning there is no observation of variation over time for the same individuals, we do not account for year-fixed effects.

$$\text{Distrust in } EU_{ict} = \alpha + \beta_1(\text{Difficulties paying bills}_{ict}) + \beta_2(\text{Characteristics}_{ict}) + \eta_c + \varepsilon_{ict} \quad (2.1)$$

$$\text{Distrust in } EU_{ict} = \alpha + \beta_1(\text{Political discussions}_{ict}) + \beta_2(\text{Characteristics}_{ict}) + \eta_c + \varepsilon_{ict} \quad (2.2)$$

$$\text{Distrust in } EU_{ict} = \alpha + \beta_1(\text{Extreme political leaning}_{ict}) + \beta_2(\text{Characteristics}_{ict}) + \eta_c + \varepsilon_{ict} \quad (2.3)$$

$$\text{Distrust in } EU_{ict} = \alpha + \beta_1(\text{Social media}_{ict}) + \beta_2(\text{Characteristics}_{ict}) + \eta_c + \varepsilon_{ict} \quad (2.4)$$

As the analysis progresses, we specify the comprehensive model that incorporates all four key variables of interest to jointly assess their impact on the dependent variable (2.5).

$$\begin{aligned} \text{Distrust in EU}_{ict} = & \alpha + \beta_1(\text{Difficulties paying bills}_{ict}) + \\ & \beta_2(\text{Political discussions}_{ict}) + \beta_3(\text{Extreme political leaning}_{ict}) + \\ & \beta_4(\text{Social media}_{ict}) + \beta_5(\text{Characteristics}_{ict}) + \eta_c + \varepsilon_{ict} \end{aligned} \quad (2.5)$$

In the next section, we discuss the econometric results of these models.

2.6 Results and discussion: multi-factorial analysis

This section presents and discusses the results of the econometric analysis, which seeks to determine the key supply-side factors of support for populism. Appendix 2.1 reports the results of our probit models' estimates. However, the coefficients cannot be directly interpreted for a probit model. Therefore, to assess the magnitude of the coefficients, we have computed and presented marginal effects at the mean in Table 2.2.

As we can see in Table 2.2, Models 1–4 shows a positive and statistically significant relationships between economic insecurity (1), the isolation of individuals (2), political polarization (3), and reliance on social media for political news (4) on one side, and distrust towards the EU on the other side. The results confirm all four of our hypotheses. We want to highlight that even when we introduce the variable on social media reliance in Model 4, which reduces our sample due to some gaps in its coverage, all the relationships explored in Models 1–3 remain, which signifies the robustness of our findings. Once we incorporate all four key variables of interest in Model 5, the established relationships hold. The results are robust as all the estimated coefficients for the independent variables remain statistically significant and do not vary significantly across all the models.

Focusing on comprehensive Model 5, we will proceed with our analysis by presenting and discussing our findings in five subsequent subsections. A separate subsection will be dedicated to examining the impact of each variable of interest on the dependent variable. In the last subsection, we will analyze the effects of control socio-demographic variables on our outcome variable. In this way, we will explore how each of the four supply-side factors may influence support for populism and what socio-demographic profile is more susceptible to being targeted by populists. In each subsection, after interpreting the results of our econometric analysis, we will compare them with the existing literature and link them to real-life cases where relevant.

Table 2.2: Marginal effects at the mean for the independent variables in the baseline models

Variables	(1) Distrust in EU	(2) Distrust in EU	(3) Distrust in EU	(4) Distrust in EU	(5) Distrust in EU
Difficulties paying bills (Base: Almost never/never)					
From time to time	0.079*** (0.002)				0.081*** (0.004)
Most of the time	0.166*** (0.003)				0.170*** (0.006)
Political discussions (Base: Never)					
Occasionally		-0.068*** (0.002)			-0.062*** (0.004)
Frequently		-0.060*** (0.002)			-0.038*** (0.005)
Extreme political leaning dummy			0.029*** (0.002)		0.030*** (0.004)
Social media dummy				0.060*** (0.008)	0.062*** (0.008)
Male dummy	0.006*** (0.001)	0.007*** (0.001)	0.010*** (0.002)	0.006*** (0.003)	0.016*** (0.003)
Age	0.009*** (0.000)	0.010*** (0.000)	0.010*** (0.000)	0.010*** (0.001)	0.011*** (0.001)
Age ²	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)
Education (Base: Up to 15)					
16–19	-0.035*** (0.002)	-0.036*** (0.002)	-0.041*** (0.003)	-0.049*** (0.005)	-0.034*** (0.006)
20+	-0.109*** (0.002)	-0.115*** (0.003)	-0.124*** (0.003)	-0.137*** (0.005)	-0.109*** (0.006)
Rural/suburban dummy	0.030*** (0.002)	0.027*** (0.002)	0.033*** (0.002)	0.029*** (0.003)	0.030*** (0.004)
Occupation status (Base: Employed)					
Unemployed	0.048*** (0.003)	0.078*** (0.003)	0.078*** (0.003)	0.080*** (0.006)	0.047*** (0.007)
Retired	0.031*** (0.002)	0.033*** (0.002)	0.030*** (0.003)	0.033*** (0.005)	0.032*** (0.005)
Social class (Base: Working class)					
Middle class	-0.069*** (0.002)	-0.083*** (0.002)	-0.079*** (0.002)	-0.082*** (0.004)	-0.060*** (0.004)
Higher class	-0.080*** (0.008)	-0.097*** (0.008)	-0.137*** (0.009)	-0.166*** (0.016)	-0.144*** (0.017)
Constant	-	-	-	-	-
Country fixed effects	Yes	Yes	Yes	Yes	Yes
Prob > chi2	0.000	0.000	0.000	0.000	0.000
Pseudo R ²	0.055	0.050	0.047	0.052	0.059
Observations	545,591	524,455	403,854	123,361	106,314

Note: The dependent variable “Distrust in EU” is binary (1 = if an individual tends not to trust in the EU, 0 otherwise). The variable “Extreme political leaning dummy” is binary (1 = if an individual has an extreme political leaning, 0 if moderate). The variable “Social media dummy” is binary (1 = if an individual reported that social media networks are the primary source for their news on European political matters, 0 otherwise). The “Male dummy” variable is binary (1 = if an individual is a male, 0 if a female). The variable “Rural/suburban dummy” is binary (1 = if an individual resides in a rural area, village, small or middle town, 0 if in a large city).

***, **, and * represent significance at 1%, 5%, and 10%, respectively.

Capitalizing on economic insecurity to discredit “the elites”

First, the results suggest that those who have difficulties paying bills at the end of the month from time to time and most of the time have a higher probability of distrusting the EU by 8.1% and 17%, respectively, compared to those who almost never or never face such hardships. The estimated relationship is statistically significant at a 1% level. This result confirms our H1 and is consistent with the economic insecurity thesis (Guiso et al., 2017, 2022). Following the conceptual framework of Mols and Jetten (2020), we posit that populist actors can leverage economic hardships and blame them on the established elites in order to further foster societal grievances inducing demand for populism. Therefore, economic insecurity might be one of the main supply-side factors of support for populism. For example, the radical-left SYRIZA political party in Greece, led by Alexis Tsipras, capitalized on the widespread discontent among the Greek population due to the severe economic crisis and the subsequent austerity measures imposed on the country by the Troika (the European Commission, the International Monetary Fund, and the European Central Bank) as conditions for financial bailouts. Holding a strong anti-austerity stance, SYRIZA attributed the economic hardships of the Greeks to the exploitative powers of supranational institutions, feeding into the people’s grievances.

Considering the limited availability of research examining economic insecurity as the supply-side driver for populism, our research represents a valuable addition to the literature.

Isolating atomized individuals to gain control

Second, the model reveals that the probability of distrusting the EU decreases by 6.2% for individuals who occasionally discuss European political matters with friends and family and by 3.8% for individuals who frequently discuss them, compared to those who never do so. The observed effect is statistically significant at the 1% level and supports our H2. Our findings align with those of Torcal and Christmann (2019), who also discover the relationship between engagement in discussions on European politics and distrust in the EU to follow this pattern.

Building on the work of Hannah Arendt (1951, 1953), we suggest that populist actors, similar to totalitarian leaders, exploit the isolation of individuals. “The isolation of atomized individuals,” as phrased by Arendt (1951), provides a conducive ground for populists. By weaponizing and intensifying the isolation of individuals, populists turn people against each other and instigate hostility towards “the corrupt elite,” whom they associate, among others, with supranational institutions such as the EU. Our results are in line with those of Mayer and

Perrineau (1992), who find a higher level of social isolation among the voters for the populist far-right Front National in France. Similarly, Langenkamp and Bienstman (2022) argue that weak social belonging is associated with the probability of voting for populist parties, which aligns with our observation.

Our research adds substantial value to the literature by shedding light on weaponizing the isolation of individuals as one of the vital supply-side factors for support for populism through empirical analysis, expanding the current understanding of the phenomenon.

Political polarization as a weapon to seize and maintain power

Third, exhibiting extreme political leaning increases the probability of distrusting the EU by 3%, and the result is statistically significant at a 1% level. This finding provides empirical support for our H3. The positive association between extreme political views and support for populism observed in our study corroborates the findings of previous research (Downs, 1957; Figueira, 2018; Handlin, 2018; Mols & Jetten, 2020; Schulze et al., 2020; Bértoa & Rama, 2021), suggesting that populist actors fuel political polarization by capitalizing on anti-establishment sentiments and leveraging the vacant electoral space at the extreme ends of the political spectrum. We posit that political polarization might be one of the populists' tools to gain or stay in power. This conclusion aligns with the findings of Hegedüs (2019), who, through conducting a case study analysis of the populist radical right party Fidesz in Hungary, contends that, once in power, populists maintain or radicalize their discourse even further.

Consistent with prior studies, our research provides empirical evidence that identifies political polarization as one of the main supply-side factors of support for populism.

Social media as the key facilitator of populism

Fourth, individuals who rely on social media as the primary source for their news on European political matters are 6.2% more likely to distrust the EU in comparison to those who do not, and this relationship is statistically significant at a 1% level. The results confirm our H4. Our findings diverge from those of Moland and Michailidou (2023), who observed no straightforward relationship between relying on social media for news about the EU polity and becoming less trustful of its institutions, except for the European Central Bank. However, our study aligns with the conclusions of other studies, building on the notion that social media,

allowing to bypass the gatekeepers of traditional media, serves as a pivotal medium for populists to interact directly with and influence people (Moffitt, 2016; Manucci, 2017; Engesser et al., 2017). As an illustration, during the general elections in Italy in 2018, two populist politician leaders, Matteo Salvini, the leader of the far-right Lega Nord (LN) political party, and Luigi Di Maio, the leader of the anti-establishment Five Star Movement (M5S), dominated Facebook by exploiting video and live broadcasts to circumvent the mainstream media (Kalia et al., 2018). According to the data collected by the University of Pisa's MediaLab, all 25 most-shared Facebook posts in the two months before the elections were either from Salvini or Di Maio.

Furthermore, we argue that the observed positive relationship between the reliance on social media for news and distrust in the EU might be attributed to the intentional utilization of social media by populists as a platform to resort to post-truth politics tools, including conspiracy theories and “fake news,” partially using “troll factories” and propaganda bots, to influence public views. This idea is derived from the insights of previous research investigating the role of social media in shaping modern politics (Iosifidis & Wheeler, 2018; Flew & Iosifidis, 2020). We now turn to real-life examples that illustrate this connection. For instance, in the case of Brexit, one study revealed the existence of a network of over 13,000 bots on Twitter, mainly supporting the Leave vote ((Bastos & Mecea, 2019). Likewise, ahead of the European Parliament elections in 2019, less than 0.1 % of social media users across Germany, France, Spain, Italy, and Poland, many of whom linked to populist actors and some of whom appeared to be bots, generated around 10% of content related to politics and the European elections, fostering anti-immigration and anti-establishment views and pushing them into mainstream debates (Scott & Cerulus, 2019).

Finally, drawing upon the work of Mols and Jetten (2020), we contend that populists can evaluate social media users' reactions to different events and employ message framed to nurture grievances and subsequently elicit demand. Along these lines, Alonso-Muñoz and Casero-Ripolles (2020) find that, in response to the economic and refugee crises, European populist parties from across the political spectrum disseminated Eurosceptic discourse on social media. Our research contributes empirically to the growing literature investigating the impact of social media on the rise in populism.

Socio-demographic characteristics attracting populists

Now we will examine which socio-demographic features are more likely to be related to the distrust in the EU. This will allow us to understand a socio-demographic profile of a voter that populists are more prone to target. The observed relationships between all the studied socio-demographic characteristics and distrust in the EU are statistically significant at the 1% level. On average, the probability of a man supporting populism is 1.6% higher compared to a woman. This result is consistent with the prevailing research (Muñoz et al., 2011; Hartevelde et al., 2013; Inglehart & Norris, 2016; Torcal & Christmann, 2019). Therefore, our findings support the cultural backlash thesis proposed by Inglehart and Norris (2016), which posits that men may be more likely to perceive traditional values to be under threat and, thus, may be more prone to gravitate towards populism.

Moreover, the positive coefficient for age and the negative coefficient for age squared in our model suggest that the relationship between age and support for populism follows an inverted U-shape. Our findings are in line with those of Hudson (2006). As individuals get older, they are more likely to have higher support for populists until this relationship reverses at the age of around 52 years old. This means that individuals around 52 years old are most predisposed to exhibit the strongest support for populists. Our findings of a positive relationship between age and support for populism resonate with prior studies (Muñoz et al., 2011; Ford & Goodwin, 2014; Inglehart & Norris, 2016; Algan et al., 2017). One of plausible explanations for such a connection could be rooted in the cultural backlash thesis (Inglehart & Norris, 2016). As individuals get older, they might be more likely to experience nostalgia and feel threatened by the contemporary value change processes. Populist leaders often appeal to such nostalgic sentiments, promising to defend traditional values. In our view, another factor contributing to these results might be that age is positively related to isolation. As demonstrated previously, social isolation affects support for populism (H3). Furthermore, a possible explanation for the inverted U-shaped pattern between age and distrust in the EU can be that those who lived through World War II and its aftermath might be more appreciative of the European integration project aimed to promote lasting peace.

Congruent with prior literature (Lubbers et al., 2002; Werts & al., 2012; Ford & Goodwin, 2014; Inglehart & Norris, 2016; Guiso et al., 2017), we find education to be negatively associated with support for populism. Holding other factors constant, individuals who completed their full-time education at the age of 16–19 have a 3.4% lower probability of distrusting the EU compared to those who completed it up to 15 years old. Moreover,

completing a full-time education at 20 years old or more reduces the likelihood of distrusting the EU by 10.9% in comparison to completing it before 15 years old. Higher levels of education might contribute to a more nuanced understanding of political processes and foster tolerance and openness. Schooling also often shapes subsequent socio-economic status, while a more stable economic situation was found to be connected to lower support for populism (H1).

Individuals living in rural and suburban areas are, on average, 3% more likely to support populists compared to those living in large cities. Our results are in accordance with prior studies by Inglehart and Norris (2016) and Rooduijn and Burgoon (2018), who also observed stronger support for populists among the rural population. Several factors may underlie this relationship. The de-industrialization and de-agrarianisation in rural areas led to economic decline and out-migration, with the economic development focusing mainly on the urban areas (Mamonova & Franquesa, 2020; Rodríguez-Pose, 2022). These processes have left the rural population feeling socially marginalized, isolated, and forgotten by the political establishment (Mamonova & Franquesa, 2020; McKay et al., 2021; Stulberg, 2022; Guriev & Papaioannou, 2022). We argue that populists can exploit underlying place-based grievances and fuel, as Rodríguez-Pose (2022) framed in his research, “revenge of the places that don’t matter” against “the elites.” Furthermore, for instance, in Hungary, the ruling political party Fidesz eliminated most liberal progressive grassroots organizations from the countryside (Dorosz, 2018). These organizations continue their work now only in big cities, and their online outreach is mainly limited to liberal bubbles. This is one of the mechanisms populists use to amplify the rural-urban divide for their own benefit.

In accordance with previous studies (Lubbers & al., 2002; Werts & al., 2012; Inglehart & Norris, 2016; Rooduijn & Burgoon, 2018; Gomez & Ramiro, 2019), we find the unemployed and retired to be more likely to support populists. Being unemployed is associated with a 4.7% higher likelihood of endorsing populists compared to being employed. Similarly, support for populism is 3.2% more prevalent among retired than among employed. This might be explained through both economic insecurity (H1) and isolation (H2) theses.

Finally, we find support for populism to be 6% less likely among individuals who self-assess as belonging to the middle class in contrast to those who identify as working class. Furthermore, those who perceive themselves as higher class exhibit a 14.4% lower likelihood to support populists compared to their working-class counterparts. Our findings corroborate other scholars’ findings (Lubbers & al., 2002; Werts & al., 2012; Ford & Goodwin, 2014; Ramiro, 2014; Gomez & Ramiro, 2019).

Having provided a multi-factorial analysis aimed at capturing the real-life complexity of the supply side of support for populism, we will proceed with conducting robustness checks to verify the reliability and robustness of our findings.

2.7 Robustness checks

In this section, we conduct robustness checks using Model 5 as the reference to ascertain the reliability and credibility of our main findings. These complementary analyses aim to ensure our results remain valid and robust under different conditions. We undertake two types of robustness checks: an alternative model specification and different sample periods. We report the results of these regressions in Appendix 2.2. Since we employ probit and logistic models, the coefficients cannot be directly interpreted. To comment on the magnitude of the coefficients, we have calculated and reported the average marginal effects in Table 2.3. Below we will discuss the results of each robustness check.

Alternative model specification

First, to evaluate the robustness of our findings for our comprehensive probit model (5), we apply a logistic model (6) as the alternative model. Both probit and logit models are widely used when the dependent variable is a binary response. While the probit model assumes a standard distribution of errors, the logit model assumes a logistic distribution of errors. We are interested in examining whether the results drawn from the probit model hold when employing a logistic model. Comparing the results for the probit (5) and logit (6) models in Table 2.3, we witness that the marginal effects estimated using both the probit and logistic models are consistent. The sign and statistical significance of the coefficients are preserved across both models. The values of the coefficients are almost identical, with only a slight deviation between the two, which does not alter the substantive interpretation of the effects of the independent variables on the dependent variable. The observed robustness across different modeling approaches strengthens the validity of our findings regarding the impact of such supply-side factors as exploitation of economic insecurity, the isolation of individuals, political polarization, and social media reliance for news on support for populism.

Table 2.3: Marginal effects at the mean for the independent variables in the robustness models

Variables	(5) Probit	(6) Logit	(7) <2022	(8) >=2022
Difficulties paying bills (Base: Almost never/never)				
From time to time	0.081*** (0.004)	0.082*** (0.004)	0.077*** (0.004)	0.099*** (0.010)
Most of the time	0.170*** (0.006)	0.174*** (0.006)	0.166*** (0.007)	0.184*** (0.016)
Political discussions (Base: Never)				
Occasionally	-0.062*** (0.004)	-0.063*** (0.004)	-0.056*** (0.004)	-0.090*** (0.010)
Frequently	-0.038*** (0.005)	-0.039*** (0.005)	-0.029*** (0.006)	-0.068*** (0.012)
Extreme political leaning dummy	0.030*** (0.004)	0.030*** (0.004)	0.030*** (0.005)	0.019* (0.011)
Social media dummy	0.062*** (0.008)	0.064*** (0.008)	0.075*** (0.010)	0.063*** (0.014)
Male dummy	0.016*** (0.003)	0.016*** (0.003)	0.016*** (0.003)	0.014* (0.008)
Age	0.011*** (0.001)	0.011*** (0.001)	0.010*** (0.001)	0.011*** (0.002)
Age squared	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)
Education (Base: Up to 15)				
16–19	-0.034*** (0.006)	-0.035*** (0.006)	-0.036*** (0.006)	-0.023 (0.014)
20+	-0.109*** (0.006)	-0.111*** (0.006)	-0.113*** (0.006)	-0.088*** (0.015)
Rural/suburban dummy	0.030*** (0.004)	0.031*** (0.004)	0.026*** (0.004)	0.044*** (0.008)
Occupation status (Base: Employed)				
Unemployed	0.047*** (0.007)	0.048*** (0.007)	0.044*** (0.007)	0.039** (0.019)
Retired	0.032*** (0.005)	0.032*** (0.005)	0.030*** (0.006)	0.026** (0.013)
Social class (Base: Working class)				
Middle class	-0.060*** (0.004)	-0.062*** (0.004)	-0.059*** (0.004)	-0.070*** (0.010)
Higher class	-0.144*** (0.017)	-0.147*** (0.017)	-0.140*** (0.019)	-0.168*** (0.038)
Constant	-	-	-	-
Country fixed effects	Yes	Yes	Yes	Yes
Prob > chi2	0.000	0.000	0.000	0.000
Pseudo R ²	0.059	0.059	0.059	0.070
Observations	106,314	106,314	88,022	18,292

Note: The dependent variable “Distrust in EU” is binary (1 = if an individual tends not to trust in the EU, 0 otherwise). The variable “Extreme political leaning dummy” is binary (1 = if an individual has an extreme political leaning, 0 if moderate). The variable “Social media dummy” is binary (1 = if an individual reported that social media networks are primary source for their news on European political matters, 0 otherwise). The variable “Male dummy” is binary (1 = if an individual is a male, 0 if a female). The variable “Rural/suburban dummy is binary (1 = if an individual resides in rural area, village, small or middle town, 0 if in a large city).

***, **, and * represent significance at 1%, 5%, and 10%, respectively.

Different sample periods

To further validate the robustness of our findings, we divide our dataset into two periods: 2014–2021 (7) and 2022–2023 (8). Our decision to split our dataset precisely this way was guided by the start date of the Russian full-scale invasion of Ukraine. We assume that Russia’s genocidal war against Ukraine might have affected the supply-side factors of support for populism, in particular, identified through distrust towards the EU when it concerns the EU population. As seen in Table 2.3, the sign and significance of the coefficients for our four variables of interest hold. This consistency indicates that the relationship between our variables of interest and the dependent variable is robust and unaffected by external shocks. The magnitude of the influence of the variables of interest on the outcome variable slightly differs for the two periods. While economic insecurity and isolation exhibit somewhat stronger effects on the rise of populism in the second period than in the first one, extreme political views and reliance on social media, on the contrary, show a slightly weaker impact on it in the last two years.

Furthermore, from 2022 to 2023, we observe a change in the results for a control variable measuring educational level. In particular, the completion of full-time education at the age of 16–19 no longer has a statistically significant impact on the likelihood of distrusting the EU compared to its completion at up to 15 years old. Interestingly, completing a full-time education after 20 years old compared to finishing it before 15 years old has a stronger negative effect on support for populism in the second period than in the first.

Overall, our final robustness check indicates that the relationship between the four supply-side factors and support for populism remains reliable and consistent, even amidst a major external shock, such as Russia’s full-scale invasion of Ukraine. At the same time, it is noteworthy that slight variations in the magnitude of coefficients for the independent variables between the two periods might suggest that Russia’s war in Europe has caused a subtle change in the strength of the relationship between the studied supply-side factors and support for populism. This opens avenues for further research to unravel how Russia’s war of aggression against Ukraine is affecting the drivers behind support for populism, particularly on the European continent.

Although we have run a series of robustness checks reinforcing the consistency and reliability of our results, we do not exclude potential limitations of our study, discussed in the next section.

2.8 Potential limitations

Although we have applied robustness checks, we acknowledge that our study may have possible caveats. First, since the data comes from the Eurobarometer survey, it might suffer from subjectivity. Different respondents might interpret survey questions differently, causing variability in the responses. Respondents might also answer in ways they consider socially desirable rather than reflecting their true opinion. Moreover, the emotional state when taking the survey may affect the respondents' answers. Additionally, people might provide consistent responses across multiple questions, especially when it concerns those that are phrased similarly. Another concern regarding the dataset is that the survey did not cover the question of the primary source for news on European politics throughout all the years of our interest. Thus, although we deem the inclusion of the reliance on social media for news variable important in capturing reality more comprehensively, we acknowledge that it reduced our sample size. All this might have implications for the generalizability and reliability of our results.

Furthermore, another limitation of our research might be related to the utilization of proxy variables to measure variables such as populism and the isolation of individuals. There might be a lack of direct relevance to the actual concepts. However, the approach to using the measures of distrust in supranational institutions such as the EU is grounded in the existing literature and described in the dependent variable sub-section. Also, although the Eurobarometer does not include questions that would directly assess the state of one's isolation, the question on the frequency of having political discussions in the circle of family and friends is the closest proxy measure for this concept available in the survey.

In addition, reverse causality might be another potential issue in our study. Distrust in the EU might affect an individual's political leaning and increase the reliance on alternative news sources, such as social media, instead of traditional and mainstream sources. Finally, we do not exclude the possibility of endogeneity when there is a correlation between the independent variables and the error term since there might be an unobserved supply-side factor that influences support for populism. While we recognize these potential limitations, the nature of the data did not allow for a direct investigation of these issues. To address these issues, future research might consider using alternative data sources and methodologies.

2.9 Conclusion

Populism has been the subject of intensive scholarly attention due to its notable resurgence in various parts of the world over recent decades. This study contributes to the ongoing discussion by approaching this subject matter from the supply side. To the best of our knowledge, our research is the first to propose a mechanism that investigates the rise of populism through the lens of political supply creating its own demand. Moreover, instead of looking at a specific supply-side factor, we apply a multi-factorial theoretical framework and corresponding empirical analysis to allow for a more comprehensive understanding of the issue. Regardless of the attached ideology, be it on the right or the left of the political spectrum, populist actors at their core thrive on the antagonism between “pure people” and “corrupt elites,” both national and supranational such as the EU. Drawing upon prior research, we proxy support for populism by distrust in the EU. We opt for this indicator to measure populism since distrust in national institutions is specific to the country’s context. Furthermore, in the last 2019 European Parliament election, populists achieved significant gains. French National Rally (RN) and Italian Lega Nord (LN) won the most votes in France’s and Italy’s elections to the European Union, respectively. German Alternative für Deutschland (AfD) also garnered considerable electoral backing. Despite the 51% turnout (Henley, 2019), these results may reflect the surge in support for populist actors at the country level as well.

We apply a probit analysis using the data from the Eurobarometer surveys spanning from 2012 to 2023. We find that populist political actors influence electoral support by utilizing four key supply-side factors. First, our empirical results support the economic insecurity thesis (Guiso et al., 2017, 2022). We posit that populists leverage economic insecurity to enhance electoral support, represented in our model by the frequency of experiencing difficulties paying bills. On average, those who have such difficulties from time to time and frequently are about 8% and 17%, respectively, more likely to support populists compared to those who almost never or never face them. In this respect, the global economic crisis and subsequent austerity measures became a central cornerstone of numerous populist actors’ political campaigns. Capitalizing on the economic hardships and shaping the people’s grievances against the established elites, populists often succeeded in gaining popularity and entering power.

The results of this study also suggest that populist leaders may exploit and intensify the isolation of individuals in order to gain or retain political power. Individuals who occasionally and frequently discuss European political matters with friends and family are approximately

6% and 4% less inclined to distrust the EU, respectively. Building on the political philosophy of Hannah Arendt (1951, 1953), we maintain that populist leaders, similarly to totalitarian ones, may aim to isolate the “atomized individuals” and turn them against each other and “the elites,” including supranational elites such as the EU. As per Arendt (1951, 1953), turning distrustful of themselves and others, people can no longer rely on their own judgment and distinguish fact from fiction. As a result, individuals might seek refuge in populism. In this aspect, our research enriches the sparse empirical analysis of the relationship between the isolation of individuals and populist support.

Furthermore, our findings reveal a positive relationship between extreme political views and support for populism. Exhibiting extreme political leaning increases an individual’s likelihood of distrusting the EU by 3% compared to those with moderate political views. In line with the conceptual framework suggested by Mols and Jetten (2020), we argue that by seeking to position themselves strategically vis-à-vis their competitors as well as capitalizing on the anti-establishment public sentiments, populist actors move into vacant electoral space or create new electoral space at the extreme ends of the political spectrum. Hence, we consider political polarization to be another key supply-side factor used by populists to induce electoral demand.

We also find empirical evidence that suggests social media is an indispensable tool for populists. Those who rely on social media as the primary source for their news on European political matters tend to be around 6% more prone to distrust the EU in comparison to those who rely primarily on other sources. Social media enables political leaders to speak directly to their voters, bypassing traditional media gatekeepers and resorting to post-truth politics tools to read and shape public grievances to spur demand (Manucci, 2017; Engesser et al., 2017; Iosifidis & Wheeler, 2018; Flew & Iosifidis, 2020). Social media algorithms often trap individuals in “echo chambers” (Flew & Iosifidis, 2020; Heiss & Matthes, 2020), further fostering isolation and polarization, which creates a conducive ground for populist actors. Against this backdrop, our study empirically contributes to the recently growing literature examining social media as a supply-side factor of populist success.

Moreover, our analysis reveals that an individual’s specific socio-demographic characteristics are more likely to be associated with populist support. We find men, those with lower levels of education, rural and suburban residents, unemployed, retired, and those belonging to the working class to be, on average, more prone to distrust the EU. Importantly, our results indicate an inverted U-shaped pattern between age and support for populism. Overall, these findings corroborate with prior research, reinforcing the prevailing knowledge. We posit that by

understanding the socio-demographic profile of a voter more susceptible to being influenced by their messages, populist leaders can center their outreach efforts more on this particular voter category.

To ensure the reliability and consistency of our findings, we perform robustness checks, such as an alternative model specification and different sample periods. The relationship between the four supply-side factors and support for populism remains consistent throughout all the robustness checks. Still, we acknowledge that our study is not without limitations, such as risks of possible reverse causality and endogeneity. Nevertheless, by introducing a novel mechanism suggesting that populist supply creates its own demand and using a multi-factorial approach, our study offers new insights into understanding the surge in populism. Future research endeavors could delve into refining this mechanism while tackling the mentioned limitations by using alternative data sources and methodologies.

On a final note, the rise of populism is an alarming phenomenon that requires not only close attention from the scholarly community but also serious consideration and effective measures from policymakers due to its possible implications on democracy and the international world order. Often there is a thin line between populism and autocracy, as seen, for instance, in the cases of Hungary and Poland, where Fidesz and PiS are moving the countries toward “illiberal democracies.” By destroying the counter-powers (Grzymała-Busse et al., 2020), populism makes it challenging to put back liberal institutions in place. Furthermore, the war Russia has waged against Ukraine, unprecedented in scale in Europe since World War II, unveils the fragile nature of peace. The divided Europe and polarized societies play into the hand of the Kremlin regime. Considering their links with and sympathies for the Russian state sponsor of terrorism, a number of European populist parties could be a Trojan horse meant to destroy democracy and peace throughout the European continent.

2.10 Appendix

Appendix 2.1: Probit estimates for distrust in EU

Variables	(1) Distrust in EU	(2) Distrust in EU	(3) Distrust in EU	(4) Distrust in EU	(5) Distrust in EU
Difficulties paying bills (Base: Almost never/never)					
From time to time	0.198*** (0.004)				0.203*** (0.010)
Most of the time	0.426*** (0.007)				0.432*** (0.016)
Political discussions (Base: Never)					
Occasionally		-0.172*** (0.004)			-0.156*** (0.010)
Frequently		-0.152*** (0.006)			-0.095*** (0.013)
Extreme political leaning dummy			0.072*** (0.005)		0.074*** (0.011)
Social media dummy				0.151*** (0.019)	0.156*** (0.021)
Male dummy	0.014*** (0.003)	0.019*** (0.004)	0.024*** (0.004)	0.016** (0.007)	0.039*** (0.008)
Age	0.022*** (0.001)	0.026*** (0.001)	0.024*** (0.001)	0.025*** (0.001)	0.026*** (0.002)
Age ²	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)
Education (Base: Up to 15)					
16–19	-0.090*** (0.006)	-0.091*** (0.006)	-0.102*** (0.007)	-0.124*** (0.013)	-0.085*** (0.014)
20+	-0.276*** (0.006)	-0.289*** (0.006)	-0.311*** (0.007)	-0.345*** (0.013)	-0.273*** (0.015)
Rural/suburban dummy	0.074*** (0.004)	0.067*** (0.004)	0.082*** (0.005)	0.073*** (0.008)	0.076*** (0.009)
Occupation status (Base: Employed)					
Unemployed	0.121*** (0.007)	0.196*** (0.007)	0.196*** (0.008)	0.201*** (0.015)	0.119*** (0.017)
Retired	0.077*** (0.006)	0.081*** (0.006)	0.076*** (0.007)	0.083*** (0.012)	0.080*** (0.013)
Social class (Base: Working class)					
Middle class	-0.174*** (0.004)	-0.209*** (0.004)	-0.199*** (0.005)	-0.207*** (0.009)	-0.151*** (0.010)
Higher class	-0.202*** (0.019)	-0.245*** (0.019)	-0.346*** (0.023)	-0.420*** (0.042)	-0.365*** (0.044)
Constant	-0.005 (0.020)	0.150*** (0.020)	0.010 (0.023)	0.131*** (0.042)	-0.095** (0.047)
Country fixed effects		Yes	Yes	Yes	Yes
Prob > chi2	0.000	0.000	0.000	0.000	0.000
Pseudo R ²	0.055	0.050	0.047	0.052	0.059
Observations	545,591	524,455	403,854	123,361	106,314

Note: The dependent variable “Distrust in EU” is binary (1 = if an individual tends not to trust in the EU, 0 otherwise). The variable “Extreme political leaning dummy” is binary (1 = if an individual has an extreme political leaning, 0 if moderate). The variable “Social media dummy” is binary (1 = if an individual reported that social media networks are primary source for their news on European political matters, 0 otherwise). The variable “Male dummy” is binary (1 = if an individual is a male, 0 if a female). The variable “Rural/suburban dummy” is binary (1 = if an individual resides in rural area, village, small or middle town, 0 if in a large city).

***, **, and * represent significance at 1%, 5%, and 10%, respectively.

Appendix 2.2: Robustness checks using a logit model and different sample periods

Variables	(5) Baseline	(6) Logit	(7) <2022	(8) >=2022
Difficulties paying bills (Base: Almost never/never)				
From time to time	0.203*** (0.010)	0.329*** (0.016)	0.194*** (0.011)	0.252*** (0.024)
Most of the time	0.432*** (0.016)	0.708*** (0.027)	0.424*** (0.018)	0.465*** (0.040)
Political discussions (Base: Never)				
Occasionally	-0.156*** (0.010)	-0.254*** (0.016)	-0.141*** (0.011)	-0.227*** (0.025)
Frequently	-0.095*** (0.013)	-0.155*** (0.021)	-0.072*** (0.014)	-0.172*** (0.031)
Extreme political leaning dummy	0.074*** (0.011)	0.121*** (0.017)	0.075*** (0.012)	0.049* (0.028)
Social media dummy	0.156*** (0.021)	0.256*** (0.034)	0.187*** (0.026)	0.162*** (0.036)
Male dummy	0.039*** (0.008)	0.063*** (0.013)	0.041*** (0.009)	0.036* (0.019)
Age	0.026*** (0.002)	0.043*** (0.003)	0.025*** (0.002)	0.027*** (0.004)
Age squared	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)	-0.000*** (0.000)
Education (Base: Up to 15)				
16–19	-0.085*** (0.014)	-0.139*** (0.023)	-0.090*** (0.015)	-0.058 (0.036)
20+	-0.273*** (0.015)	-0.445*** (0.024)	-0.283*** (0.016)	-0.223*** (0.039)
Rural/suburban dummy	0.076*** (0.009)	0.124*** (0.015)	0.066*** (0.010)	0.113*** (0.021)
Occupation status (Base: Employed)				
Unemployed	0.119*** (0.017)	0.193*** (0.027)	0.109*** (0.018)	0.099** (0.048)
Retired	0.080*** (0.013)	0.129*** (0.021)	0.076*** (0.014)	0.066** (0.033)
Social class (Base: Working class)				
Middle class	-0.151*** (0.010)	-0.246*** (0.016)	-0.147*** (0.011)	-0.178*** (0.025)
Higher class	-0.365*** (0.044)	-0.595*** (0.073)	-0.353*** (0.048)	-0.440*** (0.107)
Constant	-0.095** (0.047)	-0.159** (0.076)	-0.082 (0.051)	-0.106 (0.116)
Country fixed effects	Yes	Yes	Yes	Yes
Prob > chi2	0.000	0.000	0.000	0.000
Pseudo R ²	0.059	0.059	0.059	0.070
Observations	106,314	106,314	88,022	18,292

Note: The dependent variable “Distrust in EU” is binary (1 = if an individual tends not to trust in the EU, 0 otherwise). The variable “Extreme political leaning dummy” is binary (1 = if an individual has an extreme political leaning, 0 if moderate). The variable “Social media dummy” is binary (1 = if an individual reported that social media networks are primary source for their news on European political matters, 0 otherwise). The variable “Male dummy” is binary (1 = if an individual is a male, 0 if a female). The variable “Rural/suburban dummy is binary (1 = if an individual resides in rural area, village, small or middle town, 0 if in a large city).

***, **, and * represent significance at 1%, 5%, and 10%, respectively.

Chapter 3

Oil, bloodshed, and power

3.1 Introduction

A simple search in Google News for “political survival” reveals an overwhelming array of articles pertaining to the fight of political leaders across the globe to remain in office. Per the selectorate theory, the primary goal of political leaders is to maintain power, irrespective of secondary policy considerations (Bueno de Mesquita et al., 2005). While in the previous chapter we saw how political leaders employ populism as a strategy to win the voters over, we now aim to approach the matter of political leadership duration from the macro-level. Our prior acquaintance with the history, economy, and geopolitical dynamics of the countries in Eastern and Southern Europe and Central Asia has driven our interest in delving deeper into understanding the forces behind political durability, focusing specifically on this region. The heterogeneity in political survival among countries in this geographical area provides a well-suited setting for conducting a robust empirical analysis and a better understanding of the phenomenon. While the average political leadership duration is around two years in Latvia, Romania, and Bosnia and Herzegovina, it exceeds nine years in Russia, Belarus, Montenegro, Azerbaijan, Tajikistan, Kazakhstan, Turkmenistan, and Uzbekistan. Considering this diversity, our study seeks to understand the underlying factors driving the diversity in duration of political leadership.

Russia provides a striking example of the extensive duration of political leadership in the studied region. Putin has been in power for almost 25 years now amidst ample gas and oil resources and countless military conflicts, culminating with the full-scale Russia’s invasion of Ukraine, which did not topple him from power but arguably consolidated it even further. Against this background and in the pursuit of answers, our attention was drawn to the two distinctive strands of literature, with one linking political survival to natural resource endowment and the other to military conflicts. The first branch of the literature is rooted in the “resource curse” theory, which states natural resource abundance has an adverse effect on a country’s governance and economic development (Auty, 1993; Ross, 2015). So-called “rentier states” do not need to tax their populations much or at all, providing more autonomy and less

accountability (Anderson, 1987; Beblawi & Luciani, 1987; Luciani, 1990). Natural resource rents, therefore, serve as both motivation and a means to stay in power (Jensen & Wantchekon, 2004). The prior studies find the relationship between particularly oil wealth and political survival to be statistically significant due to the practical aspects of oil investment and the strategic implications of oil (Omgba, 2009). Oil revenues equip political leaders with ample financial resources to apply a range of strategies to secure power, including “petro-populistic” redistribution and spending policies directed towards the population (Parenti, 2005; Bueno de Mesquita & Smith, 2010; Arezki & Brückner, 2012; Matsen et al., 2016), co-optation and patronage aimed to bribe opponents and dissatisfied political elites (Ross, 2001; Acemoglu et al., 2004; Robinson et al., 2006; Crespo Cuaresma et al., 2011; Bjorvatn & Naghavi, 2011; Wright et al., 2015), and scaling up repressive apparatuses to quell dissent and deter challengers (Wintrobe, 1998; Ross, 2001; Acemoglu et al., 2010; Cotet & Tsui, 2013; Wright et al., 2015; Ishak, 2019). Furthermore, the geopolitics of global oil demand holds a noteworthy place in shaping the survival of political elites in oil-rich countries (Rajan, 2012; Bellin, 2004). Our research is built upon empirical studies examining the link between natural resources, particularly oil, and political leadership survival (Ross, 2008; Omgba, 2009; Crespo Cuaresma et al., 2011; Andersen & Aslaksen, 2013; Wright et al., 2013). The studied region displays varying levels of oil wealth, ranging from no recorded oil rents as a percentage of GDP in Armenia, Bosnia and Herzegovina, Kosovo, and Montenegro to over 2% in Uzbekistan, Russia, Kazakhstan, Turkmenistan, and Azerbaijan.

The second strand of the literature relates to the diversionary theory of war, which postulates that political leaders can launch military conflicts to divert the public’s attention away from domestic discontent with their rule and bolster their political standing (Levy, 1989). Although initially the diversionary theory of war was specifically applied to interstate wars, it has been expanded to intrastate wars, where the embattled leaders may target marginalized groups within a country to strengthen political support (Tir & Jasinski, 2008). The literature distinguishes two core mechanisms through which political leaders can benefit from war – the “rally around the flag” and “gambling for resurrection” theses (Haynes, 2017). The “rally around the flag” effect is theoretically derived from social psychology’s in-group/out-group hypothesis, which states that a conflict with an external group promotes the cohesion of an internal group (Simmel, 1898; Coser, 1956). Incorporating this hypothesis into the realm of international relations, Simmel (1955) argues that a state might use a war with an outsider as the last option to combat internal antagonisms, which is expected to enhance the people’s feelings of patriotism and

loyalty to the state and its political leadership (Tir, 2010). In its turn, the “gambling for resurrection” thesis maintains that political leadership might initiate armed conflicts as a strategy of last resort in an unfavorable domestic context to prove their competence to their constituents through the successful implementation of aggressive external policy (Richards et al., 1993; Downs & Roche, 1994; Tarar, 2006; Goemans & Fey, 2009; Haynes, 2017). In the geographical area of our focus, Armenia, Azerbaijan, Croatia, Kyrgyzstan, Montenegro, Russia, Serbia, Tajikistan, and Uzbekistan have initiated at least one instance of military aggression within the last 30 years.

Considering the discussed literature, we develop the theoretical framework and formulate hypotheses that guide our empirical analysis. We seek to test whether a greater oil wealth and military aggression instigation increases the probability of political survival. Furthermore, we are interested in examining whether the nature of the impact of oil and conflict on political durability is interdependent.

Our analysis leverages data from a diverse set of sources, including Zárate’s Political Collections dataset, Database of Political Institutions, World Bank’s World Development Indicators’ database, UCDP/PRIO dataset, and Freedom House, allowing us to explore the intricate relationship between oil wealth, military aggression, and political survival. We build a panel dataset covering 29 countries in Eastern and Southern Europe and Central Asia for the 1990–2021 period, and we use an empirical methodology grounded in survival analysis that draws upon prior studies (Ulfelder, 2007; Ross, 2008; Omgba, 2009; Crespo Cuaresma et al., 2011; Andersen & Aslaksen, 2013). As a preliminary step in our survival analysis, we employ the nonparametric Kaplan-Meier estimator to obtain the initial insights of the association both oil endowment and armed conflict have on political durability. To investigate the relationship between oil, conflict, and political durability more rigorously, we apply the semi-parametric Cox proportional-hazards model.

Our empirical results suggest that oil wealth and instigating military aggression matter for political survival. Delving into the mechanisms behind the uncovered relationship is outside the scope of this study. Nevertheless, the straightforward interpretation of the positive association between oil and political durability is that oil revenues equip political leaders with a means to employ a range of strategies to maintain power. As discussed previously, such strategies might include redistribution and unsustainable spending, patronage and co-optation, and repression against dissidents, political rivals, or even political elites. In its turn, the positive relationship between armed conflict initiation and political survival substantiates the core tenets

of the diversionary theory of war, which might manifest through two key mechanisms: the “rally around the flag effect” and “gambling for resurrection.” Additionally, we uncover an interdependent dynamic between oil and conflict in terms of their influence on political survival. While oil endowment is linked to higher political durability in peaceful countries, this effect is not only nullified in aggressor states, but even slightly reversed. Furthermore, we find that diversionary military aggression evokes a protective effect on political survival up to a threshold of 10% in the oil rents to GDP ratio, beyond which the effect becomes somewhat adverse. Finally, the studied countries are characterized by different political regime types, and our results show that the less democratic a country is, the longer political leaders can stay in power.

This chapter makes several key contributions to the existing literature. While prior studies have examined political survival separately through the lenses of the “resource curse” theory and the diversionary theory of war, our approach is distinctive in that it integrates the insights of both theories, offering a more comprehensive analysis. Furthermore, in its pioneering endeavor, our study delves into the impact of the interplay between oil wealth and military aggression on political durability, which provides us with a more nuanced understanding of the complex relationship between these three factors. In addition, the region of Eastern and Southern Europe and Central Asia has not been the central focus of scholarly work on political survival either from the perspective of the “resource curse” or the diversionary theory of war. Our study addressed this gap by centering on this geographical area.

The remainder of the chapter is structured as follows: We first review two key strands of the existing literature related to our research – one pertaining to the relationship between oil wealth and political survival and the other dedicated to the relationship between military conflicts and political survival. In Section 3.3, we outline the theoretical setting and formulate the hypotheses based on it, underpinning our empirical analysis. Section 3.4 presents the data employed, the construction of the variables, and descriptive statistics, and Section 3.5 is devoted to the empirical strategy. The results of the econometric analysis are presented and discussed in Section 3.6. Section 3.7 provides a case study, while the final section concludes, highlighting the possible avenues for future research.

3.2 Literature review

In this section, we analyze the existing body of literature related to our research topic. Our study is grounded in two main strands of the literature, with one examining the relationship between oil and political survival and another the increase in the popular support for political leadership instigating an armed conflict.

Oil and political survival

As per Acemoglu et al. (2005), the distribution of de facto political power is substantially shaped by the allocation of resources in society, as those with greater resources can wield more power through legitimate and informal means. The strand of the literature on oil and political survival is part of the larger “resource curse” literature, which considers natural resource endowment to tend to negatively affect a country’s governance and economic development (Auty, 1993; Ross, 2015). The literature on the “resource curse” is extensive and multifaceted, and its thorough review is outside the scope of our chapter. Therefore, we will focus specifically on the studies related to the impact of natural resources on political durability.

Rentier state theory

The key explanation of the relationship between oil and political survival is rooted in the “rentier state” theory. The concept of “rentier state” was coined by Mahdavy (1970) to describe economies in the Middle East, in particular Iran, that “receive on a regular basis substantial amounts of external rent,” which are “rentals paid by foreign individuals, concerns, or governments to individuals, concerns or governments of a given country.” Beblawi (1987) adds that a “rentier state” is characterized by the predominance of rent situations in the economy, the economy’s reliance on substantial external rent, engagement only of a few in the rent generation and the majority in its distribution, and the government being the principal recipient of the external rent. Natural resource endowment both increases the interest in staying in power in order to acquire more rents and provides a means to secure a solid grip on power (Jensen & Wantchekon, 2004). With ample oil revenues, political leadership in a rentier state has the possibility to allocate their significant portion to secure its hold on power through a range of strategies to address threats of being ousted by people, political rivals, and political elites.

First, reliance on external revenues such as oil income reduces a government's need to tax its citizens, which lets the state operate more autonomously from societal interests and reduces citizens' demands for its accountability and representation (Anderson, 1987; Beblawi & Luciani, 1987; Luciani, 1990; Ulfelder, 2007). Second, aiming to secure popular support, the political elite in oil-rich countries can resort to redistribution and adopt unsustainable spending policies, commonly referred to as "petro populism" (Parenti, 2005; Bueno de Mesquita & Smith, 2010; Arezki & Brückner, 2012; Boucekkine et al., 2016; Matsen et al., 2016). Hugo Chávez's regime in Venezuela serves as an illustrative case of petro populism since his popularity has been linked to the oil boom and the related increase in government spending (Parenti, 2005; Matsen et al., 2016). In a similar vein, to contain the spread of the Arab Spring, the Algerian government implemented food subsidies and youth employment support programs (Boucekkine & Boukalia-Hassane, 2011). Third, natural resource rents provide the political elite with significant means to bribe opponents and discontented regime insiders through co-optation and patronage by providing them with jobs, profitable government contracts, business subsidies, high wages, cheap fuel, and more rents in order to retain power (Ross, 2001; Acemoglu et al., 2004; Robinson et al., 2006; Fjelde, 2009; Crespo Cuaresma et al., 2011; Bjorvatn & Naghavi, 2011; Wright et al., 2015). The Mobutu regime in Zaire is a classic example of how rents from natural resources can be used to sustain power by buying off political rivals (Acemoglu et al., 2004).

Furthermore, political leadership reliant on oil rents can inhibit the provision of coordination goods such as a free press, transparency, and easy communication to mitigate mass political movements threatening their political survival (Bueno de Mesquita & Smith, 2010). The regime in power, in particular in non-democratic settings, might also use resource rents to finance repressive apparatuses through the military during peacetime to be able to suppress dissent and dissuade challengers when needed and increase the likelihood of holding onto power (Wintrobe, 1998; Ross, 2001; Acemoglu et al., 2010; Cotet & Tsui, 2013; Wright et al., 2015; Ishak, 2019). For instance, in prerevolutionary Iran, much of the revenues from oil and natural gas exports were spent on the military (Skocpol, 1982). Moreover, examining the reasons behind resistance to democratization in the Middle East and North Africa, Bellin (2004) distinguishes tenacious coercive apparatus subsidized by abundant rents as the critical factor in suppressing political change.

Finally, minerals, especially oil, are produced predominantly for export markets. Therefore, the role of the political economy of global oil demand should not be overlooked in the domestic

political elite's consolidation of oil wealth and power (Rajan, 2012). Foreign powers dependent on fuel imports have been interested in the stability of their suppliers, which has contributed to the survival of these often-authoritarian regimes (Bellin, 2004). Bellin (2004) argues that, for instance, authoritarian regimes in Saudi Arabia, Egypt, Jordan, Tunisia, and Algeria exploit the West's concerns of safeguarding reliable oil and gas supplies, thereby retaining international patronage to a large extent due to the West's belief that these regimes would deliver on these concerns.

On the other hand, there is literature underpinning a positive relationship between natural resources endowment and political downfall. The government more easily appropriates natural resources compared to other sources of wealth (Caselli, 2006). Thus, an abundance of natural resources generates rent-seeking power struggles, with potential challengers being more tempted to undertake a coup d'état to capture natural resource rents, thus leading to a shorter survival of the existing political elite (Caselli, 2006; Acemoglu et al., 2010). For example, endowed with immense oil wealth, Nigeria has experienced eight successful coups since its independence in 1960 (Caselli, 2006). In a similar vein, rents from natural resources present incentives for insurgents to instigate a rebellion or a conflict to control state power along with opportunities to finance it (Fearon & Laitin, 2003; Collier & Hoeffler, 2004; Ross, 2004; Collier & Hoeffler, 2005; Lujala, 2010). The above studies outline the possible causal mechanisms explaining a relationship between natural resource abundance, particularly oil wealth, and political survival. In turn, we will introduce a new factor – instigating an armed conflict – not yet accounted for in this research area, as far as we are aware.

Oil and regime durability

The initial empirical studies on the effects of resource wealth on political durability stem from the “oil hinders democracy” literature. In his seminal work, Ross (2001) posits that oil and nonfuel mineral wealth impedes democratization, which implies the prolongation of an authoritarian rule. Wantchekon (2002), Jensen and Wantchekon (2004), and Ross (2008) also corroborate this relationship. On the other hand, Herb (2005), Dunning (2008), and Haber and Menaldo (2011) find weak support for the thesis that resource abundance inhibits democracy.

Further, studies emerged analyzing the relationship between natural resources, particularly oil, and regime durability. In this regard, Smith (2004) assesses the impact of oil wealth on regime survival in the developing world. The author focuses specifically on the regime's duration and

not on the political leadership's tenure. The Polity dataset (Marshall & Jaggers, 2002) is used to determine regime type. A logistic regression is employed using the data drawn from 107 developing countries from 1960 to 1999. The analysis reveals a positive association between oil dependence and higher regime durability. Moreover, adding the squared term of the democracy score, the author finds a U-curve relationship between regime coherence and regime failure. Also focusing on the regime duration and relying on the Polity dataset for the dependent variable, Ulfelder (2007) studies the effect of natural resource wealth on the survival of autocracy. The author applies survival modeling to a sample of 1,775 country-years over the 1973–2002 period. A positive relationship between natural resource abundance and regime durability is established when the model is estimated from all countries. However, when the sample is broken into two groups of autocracies and democracies, it is found that resource wealth is still significant for autocracies, with its effect almost twice as strong compared to the whole sample estimation, while resource endowment is not statistically significant for democracies, with its effect being reversed. Given this result, we account for the regime type in our econometric analysis.

In a similar vein, in a recent study, Zallé (2023) also examines the impact of natural resource rents on political regime durability, using the Polity dataset and running a finite mixture model to a sample of 129 countries over the course of 1980 to 2020. The analysis implies that patterns of political regime durability can be segmented into three regime types. While the first regime type is defined by the absence of a relationship between natural resource wealth and regime durability, the second and the third types are marked by an increase and a decrease in political regime durability, respectively, due to natural resource abundance. In addition, the results indicate that countries with a low risk of internal and external conflicts and ethnic tensions tend to belong to the second type. In contrast, countries with a low risk of corruption and good socioeconomic conditions are less disposed to fall into the third type.

Oil and political leadership duration

Our research relates the most to the studies examining the impact of natural resources on political leadership duration. The empirical analysis of this very relationship is limited; thus, our study brings additional insights. Ross (2008) assesses the impact of oil rents on the longevity of political rulers, employing a dataset covering up to 170 states from 1960 to 2002. The preliminary findings of the survival analysis suggest that higher levels of oil wealth tend

to prolong political tenure. Once the sample is split into authoritarian and democratic states, the results indicate that oil wealth lowers the probability of an autocratic leader's departure, whereas it exerts no influence on the political durability of democratic leaders. In addition, the author finds the relationship between oil rents and the political duration of authoritarian leaders to be mainly driven by the extended rule of monarchs in the oil-rich Middle East. Omgba (2009) examines the tenure of heads of state of 26 African countries from 1958 to 2000. Our study also focuses on a specific geographic region, namely Central and Eastern Europe and Central Asia. Applying a survival analysis, the author finds a positive and significant link between oil rents and the incumbency of the executive branch. Other mineral resources do not exhibit the same stabilizing effect.

In their turn, Crespo Cuaresma et al. (2011) assess the relationship between oil endowment and the duration of autocratic leaders. Initially, they designed a static version of the intertemporal leadership turnover model proposed by Gallego and Pitchik (2004). The theoretical setting highlights the impact of natural resources on the duration of dictatorships while taking into consideration the dictator's incentives to maximize oil profits and kingmakers' incentives to take power. The model suggests that autocratic rulers in countries relatively better endowed with oil tend to retain power longer. Using a survival model for 106 dictators from 1980 through 2004, the authors empirically support this hypothesis. The results hold for both a relatively large sub-sample and a sample of the most extreme dictators.

Andersen and Aslaksen (2013) extend the previous studies by incorporating a larger number of countries split into subgroups based on regime setup and evaluating the effects of different types of natural resources on political survival. While Omgba (2009) and Crespo Cuaresma et al. (2011) assess the duration of individual leaders, Andersen and Aslaksen (2013) analyze the duration of the political party in power. The authors exploit a sample of over 600 political leadership durations in 152 countries from 1975 to 2006. The survival analysis results suggest that the effect of natural resources on political durability is conditioned on the type of resources and regime type. The research demonstrates that oil wealth is positively associated with political durability in non-democracies but not democracies. Meanwhile, minerals are found to be linked to a shorter duration in political office in non-democracies. Building upon these studies, we also employ a survival analysis in our research on political durability in the concerned region.

Finally, Wright et al. (2013) use autocratic regime data from Geddes et al. (2014), which defines an end of an autocratic regime as a change in the identity of the group from which leaders can

be chosen or the group that can choose major policies. This approach allows the authors to account as well for autocracy-to-autocracy transitions. We consider this definition of political regime to overlap with political leadership and be close to the one we use in our empirical analysis. By applying an ordinary logit model and a conditional logit model to the sample of 261 autocratic regimes in 114 countries over the 1947–2007 period, the authors corroborate the findings of previous studies that higher oil wealth increases autocratic regime durability. Interestingly, they find that oil abundance reinforces autocratic regimes by reducing the risk of being overthrown by competing autocratic groups rather than by deterring the forces of democratization.

War initiation and political survival

Another strand of literature examines the relationship between war initiation and political survival. The notion that political leaders can instigate a war in order to strengthen popular support and thus increase their chances of staying in power is not novel (Miller, 1999). Bodin (1955, p. 168) posits that “the best way of preserving a state, and guaranteeing it against sedition, rebellion, and civil war is ... to keep the subjects in amity one with another, and to this end, to find an enemy against whom they can make common cause” (quoted in Levy, 1989, p. 259). Further, Wright (1965, p. 727) describes war as a “necessary or convenient means ... to establish, maintain, or expand the power of a government, party, or class within a state.”

Numerous empirical studies find that political leaders instigating wars are prone to experience at least short-term boosts in popular support (Mueller, 1970; Kernell, 1978; Ostrom & Simon, 1985; Marra et al., 1990; Hetherington & Nelson, 2003; Lai & Reiter, 2005; Mueller, 2005; Norpoth & Sidman, 2007; Haynes, 2017; Kuijpers, 2019). Conversely, other studies find that the initiation of wars, on the contrary, makes the political leaders lose their popularity or has no significant impact (Cotton, 1986; Lian & Oneal, 1993; Bueno de Mesquita & Siverson, 1995; Seo & Horiuchi, 2023). Our study builds on and intends to contribute to the ongoing discourse on this subject.

Diversionsary theory of war

Against this background, the diversionsary theory of war stipulates that political leaders can generate an armed conflict to divert the public’s attention away from discontent with their rule

and strengthen domestic political support (Levy, 1989). The scholars argue that political elites are the most insecure and are thus the most inclined to resort to military force in the periods preceding elections, during economic downturns, or when their domestic political support is weakened (Levy, 1998). According to Morgan and Bickers (1992), nearly all wars since 1800 have been associated, to some extent, with the attempts of a national government to address domestic issues. The Falklands War of 1982 is often mentioned in the literature as an illustrative example of this phenomenon. Amidst severe economic stagnation and widespread societal unrest, the Argentine junta headed by Leopoldo Galtieri invaded the Falklands Islands, which enhanced the regime's political power, although only in the short term (Levy & Vakili, 1993; Bueno de Mesquita & Siverson, 1995; Miller, 1999; Miller & Elgün, 2011). While originally the diversionary theory of war was specifically applied to interstate wars, it has also been extended to intrastate wars. According to Tir and Jasinski (2008), the embattled leader may militarily target marginalized groups such as ethnic minorities in order to garner public support. The author argues that, for instance, the wars in the Balkans, Rwanda, and Chechnya in the 1990s indicate the presence of domestic diversionary incentives. This expanded definition of the diversionary theory of war serves as a framework for our study. Therefore, we consider both interstate and intrastate armed conflicts that political leaders in our sample of countries have initiated.

Despite robust theoretical foundations and several case studies, the empirical findings on the diversionary theory of war reveal inconsistency. On one hand, many empirical studies corroborate the hypothesis (Ward & Widmaier, 1982; Ostrom & Job, 1986; James & O'Neal, 1991; Morgan & Bickers, 1992; DeRouen, 1995; Hess & Orphanides, 1995; Fordham, 1998; Morgan & Anderson, 1999; DeRouen, 2000; Enterline & Gleditsch, 2000; Fordham, 2002; Zeigler et al., 2014). On the other hand, many other studies produce mixed results or results that challenge it (Meernik & Waterman, 1996; Leeds & Davis, 1997; Gowa, 1998; Mitchell et al., 2002; Chiozza & Goemans, 2003).

The literature on the diversionary theory of war distinguishes two main mechanisms through which political leaders can benefit from war – the “rally around the flag” and “gambling for resurrection” theses that we describe below (Haynes, 2017).

The “rally around the flag effect” thesis

The “rally around the flag effect” is theoretically rooted in social psychology’s in-group/out-group hypothesis, which maintains that a conflict with an external group fosters the cohesion of an internal group (Simmel, 1898; Coser, 1956). Elaborating upon the hypothesis within the realm of international relations, Simmel (1955) posits that war with an outsider might be the last option for a state to tackle internal antagonisms. Thus, applying military force is expected to increase the feeling of patriotism and loyalty to the state and its leadership (Tir, 2010). Mueller (1970) was the first to examine the “rally around the flag effect” systematically. The author employs multiple regression analyses to study the patterns in responses to the Gallup Poll’s Presidential popularity question in the 24-year span from the Truman administration’s onset to the Johnson administration’s conclusion in the US. The findings indicate that an international crisis or a similar event increases the likelihood of a short-term increase in a president’s popularity. Another explanation for the rally effect is connected to the absence of the opposition (Kuijpers, 2019). In times of crisis, opposition political leaders tend to refrain from criticizing the government or even show some support (Brody & Shapiro, 1989; Brody, 1991). This makes the media outlets display an uncritical mix of news on political leadership policies, resulting in public opinion becoming more firmly aligned with the leadership and the so-called “rally effect” being manifested (Lai & Reiter, 2005). In addition, the media overall is considered to play a role in shaping the rally effect due to it being an intermediary between policymakers and the public (Baum et al., 2008; Aday, 2010). In particular, media influence public opinion on an armed conflict through news framing techniques (Dimitrova & Strömbäck, 2005).

The “gambling for resurrection” thesis

The “gambling for resurrection” thesis posits that embattled leaders might rationally initiate risky conflicts as a last-resort strategy to prove their competence to their constituents (Richards et al., 1993; Downs & Rocke, 1994; Goemans & Fey, 2009; Haynes, 2017). Richards et al. (1993) articulate the diversionary argument as a principal-agent problem, where a political leader serves an agent contracted by the public whose decision to retain or dismiss the leader hinges on their assessment of the agent’s competence. Thus, during economic downturns or other unfavorable domestic conditions, the leader’s successful implementation of aggressive foreign policy might make the electorate reevaluate the leader’s competence and lead to

potential reelection, although only if the target of this policy is sufficiently strong (Tarar, 2006). The leader might also initiate minor disputes without causing a complete breakdown in the relationship or even target extremely powerful states with the aim of securing minor concessions before promptly de-escalating the crisis and declaring victory back home (Oakes, 2012; Haynes, 2017). As put by Haynes (2017), in normal circumstances, taking such a gamble would be irrational, given that the high likelihood of failure and its associated costs outweigh the slim chance of success and marginal gains. However, when leaders are already facing a probable loss of office, the failure becomes associated only with minimal costs, while the success, though uncertain, might allow them to remain in power. Moreover, Downs and Rocke (1994) argue that under the “gambling for resurrection” mechanism, a well-informed leader might continue an unsuccessful war since halting it would result in their removal from office.

The investigation of the mechanism behind the diversionary war effects falls outside the scope of this study. Our goal is to examine whether instigating an armed conflict has an impact on political survival.

Political regime and diversionary war

According to the scholars, the type of the political regime influences the decision of the political leadership to start a war as a diversionary tactic (Ross, 1995; Gelpi, 1997; Miller, 1999; Pickering & Kisangani, 2005; Lai & Slater, 2006; Pickering & Kisangani, 2010; Kisangani & Pickering, 2011). Levy (1998) posits that since autocrats need to secure their political support, even if among narrowly defined groups such as the military and economic elites, they might resort to diversionary policies. In this respect, Miller (1999) finds autocratic leaders to be more likely to engage in diversionary policies compared to their democratic counterparts due to being less affected by strategic interaction opportunities limited by potential adversaries. Authoritarian leaders are argued to have a greater tendency to initiate wars in response to domestic revolutions or international crises and rivalries, as opposed to domestic unrest for which they can use domestic policy options such as repression or co-optation (Wilkenfeld, 1968; Kisangani & Pickering, 2009; Ferraro, 2023). Furthermore, Bueno de Mesquita and Siverson (1995) argue that authoritarian leaders who pursue wars are less prone to lose power than democratic ones. The authors also argue that authoritarian leaders tend to be involved in lengthier wars after coming to power than democratic leaders. However, being ousted from

power may entail more severe personal costs for authoritarian leaders (Levy, 1998). Additionally, conflicts could also strengthen authoritarian regimes or harm democratic systems by endorsing repressive policies since, in times of threats, society is more inclined to accept restrictions on civil liberties in return for security measures (Davis & Silver, 2004; Krebs, 2010; Ferraro, 2023). Similarly, autocrats can leverage their victories in armed conflicts as evidence that authoritarianism is more efficient in countering diverse threats and ensuring security compared to democratic regimes. (Ferraro, 2022).

On the other hand, the greater political accountability of leaders in democratic countries might make them more prone to resort to war as a diversionary tactic (Levy, 1998). In particular, democratic leadership is argued to be more predisposed to engage in conflict when facing domestic unrest (Wilkenfeld, 1968; Kisangani & Pickering, 2009). Through analyzing a challenger's decision to use force in 180 international crises from 1948 to 1982, Gelpi (1997) contends that in response to domestic turmoil, democratic leaders are more inclined to respond by diverting attention through military action. Conversely, the authors argue that authoritarian leaders are more disposed to suppress the unrest directly and thus are less prone to use force internationally. Kisangani and Pickering (2009) corroborate these findings and add that leaders in democracies are also more likely to gain domestic political and economic benefits from initiating conflict than their counterparts in non-democracies. In addition, democratic leaders are expected to opt for wars that carry a lower risk of failure in contrast to their authoritarian counterparts (Bueno de Mesquita & Siverson, 1995). Finally, Mansfield and Snyder (2002) argue that countries with an incomplete democratic transition from an autocratic to a partially democratic—or anocratic—regime are more likely to instigate conflicts to boost nationalism and gain popular support. Given the political regime's importance in initiating a war as a diversionary strategy and its impact on political survival, we account for it in our model.

Oil and armed conflict

Additionally, there is ample scholarly work linking natural resources, especially oil, and armed conflict. While these studies do not look at political survival, which is at the core of our research question, we should not overlook the importance of the explored relationship between these two key variables of our interest. Colgan (2010) distinguishes this literature by three concepts of “resource war”: resource conflict describing intrastate conflicts triggered or intensified by resource abundance, resource competition entailing international conflicts stemming from the

pursuit of scarce resources, and resource-backed aggression characterizing international conflicts instigated by resource-rich states. The last category is the most relevant to our study since, when looking at an armed conflict, we focus specifically on aggressor states and not on the attacked states. Of particular importance in this regard is the work of Jeff D. Colgan. Colgan (2010; 2011; 2013; 2014) contends that oil-rich countries have a higher propensity to instigate an armed conflict compared to their non-oil-rich counterparts. The author argues that the relationship holds particularly for those oil-rich states led by revolutionary leaders. Oil revenues exacerbate the tendency of revolutionary governments to engage in international conflicts since oil reduces the leader's likelihood of facing domestic repercussions for their foreign policy (Colgan, 2013). An illustrative example is Iraq, led by Saddam Hussein, who revolutionized Iraqi domestic politics and harnessed its oil rents to consolidate authority and establish a powerful military apparatus, consequently invading Iran and Kuwait as well as engaging in numerous armed conflicts abroad (Colgan, 2013).

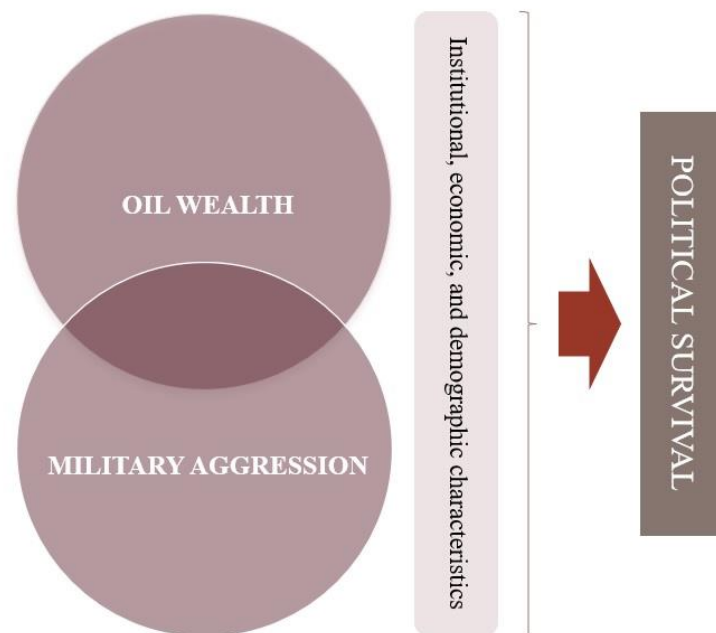
The existing body of literature offers valuable insights into the individual impact of natural resources and armed conflict on political survival. Nevertheless, to the best of our knowledge, the research attention has omitted how both natural resources and armed conflict jointly as well as their interaction influence political durability. Therefore, the aim of this chapter is to address this gap.

Having explored the current state of research, we will proceed to construct the theoretical framework that will direct our empirical analysis.

3.3 Theoretical framework

In this section, we will establish the theoretical framework upon which our research is grounded. The main objective of our study is to empirically examine the impact of oil wealth and armed conflict instigation as well as their interplay on political survival. As discussed in the previous section, the two separate strands of the existing scholarly work have investigated the relationship between oil wealth and political survival on one hand and armed conflict and political survival on the other. Despite the ample body of literature, no previous study has attempted to interconnect both strands. Seeking to provide insights into this unexplored area, we propose a theoretical mechanism for the interaction between oil wealth, military aggression, and political survival, depicted in Figure 3.1.

Figure 3.1: Mechanism of impact of oil wealth and military aggression on political survival



Source: Authors' construction

Oil wealth

In our study, we focus on the role played specifically by oil on political survival rather than other natural resources for several reasons, as inferred from prior research (Andersen & Aslaksen, 2013). First, oil is usually exploited predominantly by a state's government. Offshore oil and subsoil oil reservoirs are often challenging to technically appropriate and demand substantial technology and significant investments, which either government or large corporations typically fund. In addition, resources of this nature are also among the so-called "point source" resources that governments often find more feasible to tax compared to "diffuse" resources. Second, oil rents provide political leaders with financial resources that can be harnessed to extend their tenure through a number of strategies such as redistribution and spending policies, co-optation and patronage, repression of dissidents and deterrence of political rivals (Parenti, 2005; Bueno de Mesquita & Smith, 2010; Arezki & Brückner, 2012; Boucekine et al., 2016; Matsen et al., 2016; Ross, 2001; Acemoglu et al., 2004; Robinson et al., 2006; Fjelde, 2009; Crespo Cuaresma et al., 2011; Bjorvatn & Naghavi, 2011; Wright et al., 2015; Wintrobe, 1998; Acemoglu et al., 2010; Cotet & Tsui, 2013; Ishak, 2019). Third, prior research has generally found a significant link specifically between political survival and oil, but usually not other natural resources (Smith, 2004; Ross, 2008; Omgba, 2009; Crespo Cuaresma et al., 2011; Andersen & Aslaksen, 2013; Wright et al., 2013). Against this

background, we aim to test whether oil rents may enable political leadership to remain in power. Hence, we formulate our first hypothesis:

H1: A greater size of oil wealth increases the likelihood of political leadership survival.

Military aggression

In this research, we are interested specifically in how instances of instigated military aggression influence political survival. In other words, our focus is directed towards the armed conflicts initiated by the political leadership in power of a given country. Our approach is guided by the literature on the diversionary theory of war, the “rally around the flag effect,” and “gambling for resurrection” thesis, discussed in the section above. As the diversionary theory of war posits, political leaders may launch a military aggression to shift the public attention from domestic issues and boost their political approval (Levy, 1989). Although the theory initially pertained to interstate armed conflicts, Tir (2008) has expanded it to include also intrastate wars, targeted particularly against marginalized groups. Therefore, our analysis encompasses both external and internal acts of military aggression. A conflict with an external group, be it another country or an ethnic minority within the country, may enhance the cohesion of an internal group and rally it behind the political leadership by stirring nationalist sentiments, as per the “rally around the flag effect” thesis (Simmel, 1898; Coser, 1956; Simmel, 1955; Mueller, 1970; Oakes, 2006). Furthermore, political leaders may generate an armed conflict to demonstrate competence to their constituents, as positioned by the “gambling for resurrection” thesis (Richards et al., 1993; Downs & Roche, 1994; Tarar, 2006; Goemans & Fey, 2009; Haynes, 2017). In this study, we specifically seek to examine the outcome aspect of the diversionary war strategy, namely whether the instigation of an armed conflict may secure political leaders with a longer tenure. Thus, our second hypothesis reads as follows:

H2: Instigating a military aggression either at home or abroad results in a higher probability of political leadership survival.

Interplay between oil wealth and military aggression

In our study, we embark on a novel exploration of the interdependent impact of oil wealth and the initiation of military aggression on political survival. While existing research has examined the effect of oil and conflict independently, this will be the first attempt to systematically

investigate how these two factors operate in tandem and effect the longevity of political leadership. We intend to test whether the influence of each of these two factors on political survival is contingent on the other. Accordingly, we propose the following hypothesis:

H3: The nature of the impact of oil wealth and war on political survival is interdependent.

Finally, drawing upon prior research, we test whether political survival is affected by institutional, economic, and demographic country characteristics.

Our theoretical framework elucidates the complex relationship between oil wealth, military aggression, and political survival. Through the empirical testing of the presented hypotheses, we aim to contribute to the current body of literature by offering new insights into the role played by oil and armed conflict instigation as well as their interaction on the longevity of political leadership.

3.4 Data, construction of variables, and descriptive analysis

In this section, we present our data, describe how we construct the dependent and independent variables, and provide descriptive statistics. To test our hypotheses, we build a panel dataset covering 29 countries in Eastern and Southern Europe and Central Asia (for the list of the countries, please consult Appendix 3.1) over the period from 1990 to 2021. We focus on this timespan due to the dissolution of the Soviet Union and Yugoslavia. We rely on several data sources described below. Table 3.1 presents the descriptive statistics of the variables used in our econometric analysis.

Table 3.1: Descriptive statistics

Variables	Categories	Obs	Mean	SD	Min	Max
Political leadership duration		895	6.601	6.909	1	31
Oil rents		841	2.634	6.350	0	39.581
Military aggression		928	0.066	0.248	0	1
Regime type	Democratic	928	0.371	0.483	0	1
	Intermediate	928	0.360	0.480	0	1
	Autocratic	928	0.269	0.444	0	1
GDP per capita (log)		860	8.426	0.903	5.918	10.116
GDP growth		840	2.864	7.634	-44.9	88.958
Trade openness		841	96.005	32.820	13.388	189.804
Age dependency		928	51.468	9.177	38.658	94.972

Source: Based on data from Zárte's Political Collections dataset, Database of Political Institutions, UCDP/PRIO dataset, Freedom House, and World Bank (1990–2021)

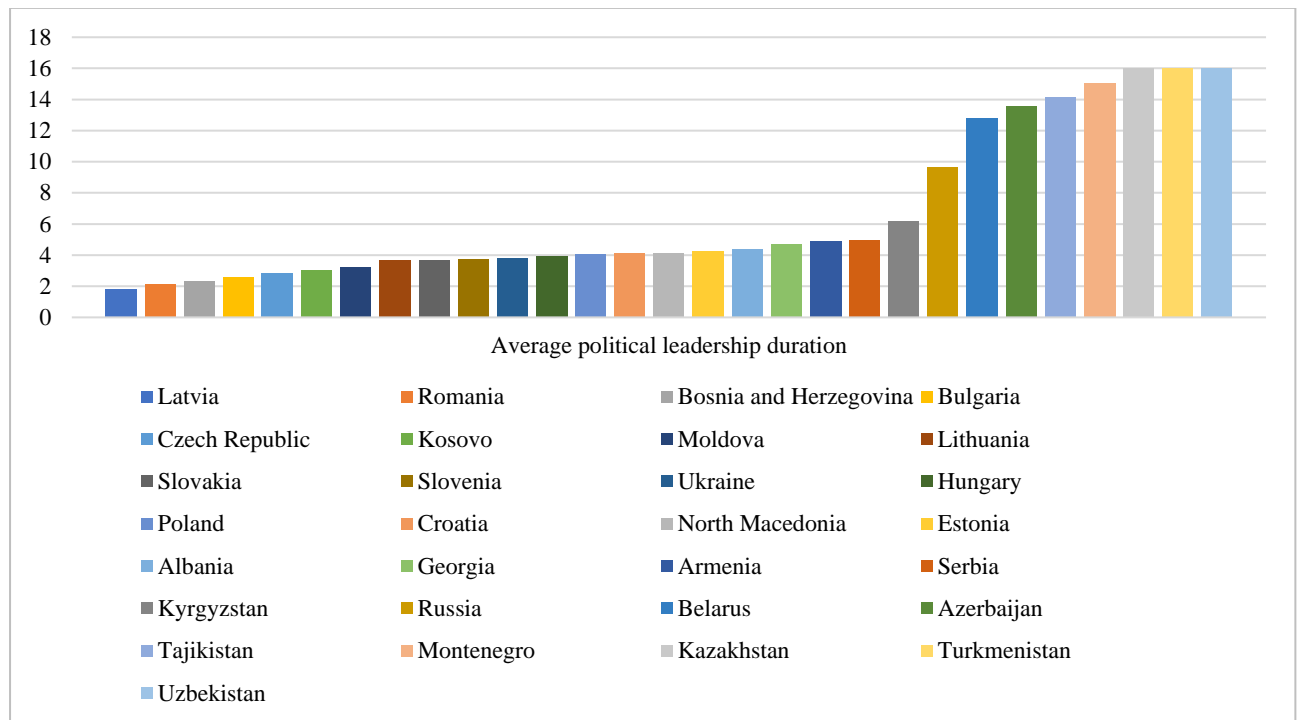
Dependent variable

Building upon prior studies conducting a survival analysis to examine political leadership durability, our dependent variable is the time until a change in political leadership occurs (Omgba, 2009; Crespo Cuaresma et al., 2011; Andersen & Aslaksen, 2013; Wright et al., 2013). To construct the entry and exit of leadership in power, we rely on the information provided in Zárate's Political Collections dataset and the Database of Political Institutions (DPI). First, we consult the DPI to determine whether a country has a presidential or parliamentary system. Then we check in Zárate's Political Collections dataset the dates of entry into and exit from power of either president or prime minister depending on the type of political system. We consider a change in political leadership to have taken place when a new chief executive belongs to a new party. We opt for this definition of political leadership for several reasons. We aim to account for the level of executive and legislative power of the president and prime minister in a respective political system. Furthermore, presidential systems typically have regulations governing the maximum number of presidential terms. Thus, the change of president does not necessarily indicate a change in political leadership. Similarly, the change of prime minister does not imply it either. We believe a party affiliation of the chief executive better demonstrates political leadership. In cases when the chief executive is not associated with a specific party, political durability changes with the beginning and the end of their tenure. Moreover, when power is transferred within a family or an influential elite in non-democracies, we do not consider it as a break in political leadership.

In our dataset, the observations are brought back to January 1 of each year as part of the construction process. We create a survival time variable that denotes the duration of a respective political leadership being in office. We start counting years of tenure when the given political leadership was in power or elected as of January 1. For instance, on September 13, 2018, in Slovenia, which is a parliamentary republic, Marjan Sarec, affiliated with the List of Marjan Sarec party, assumed office as the prime minister after the term of Miro Cerar from Modern Centre Party (SMC). In our dataset, we record the year 2018 as the last year of the tenure of Miro Cerar and the year 2019 as the first year of the tenure of Marjan Sarec. In addition, we need to create an event indicator in the survival analysis, indicating whether the event occurred (1) or not (0). In our case, this variable takes a value of 1 if a change in the political leadership occurs and 0 otherwise. In the example of Slovenia, for 2018, the event indicator equals 1.

As seen in Table 3.1 and Figure 3.2, the average political leadership duration is 6.6 years, with very large variability ranging from around 2 years for such countries as Latvia, Romania, and Bosnia and Herzegovina to over 9 years for countries such as Russia, Belarus, Montenegro, Azerbaijan, Tajikistan, Kazakhstan, Turkmenistan, and Uzbekistan.

Figure 3.2: Average political leadership duration, 1990–2021 (in years)



Source: Based on data from Zarate’s Political Collections dataset and DPI

Independent variables

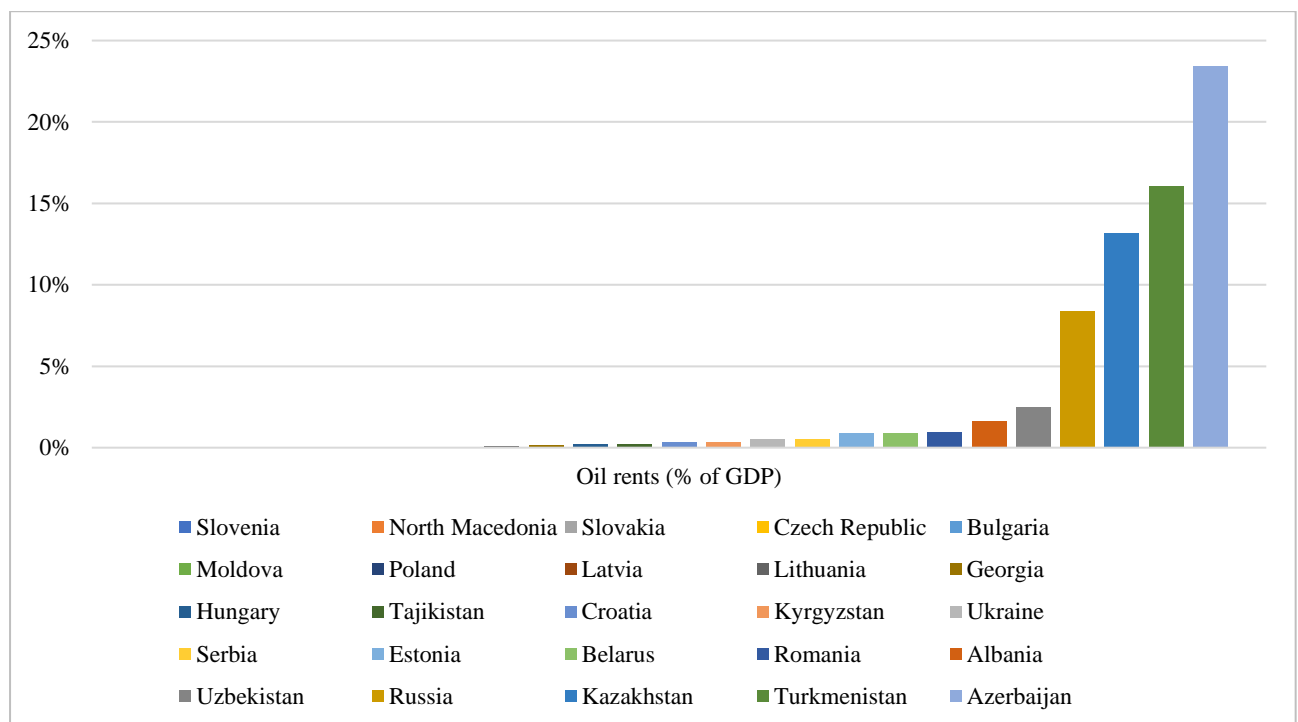
Oil rents

Many earlier studies used a dummy variable denoting a country’s oil wealth. However, as noted by Ross (2001), the dummy variable employs an arbitrary cut point to differentiate between “oil states” and “non-oil states,” suggesting in our case that the impact of oil on political survival is minimal or negligible until a certain threshold is attained. In this study, we assume that political leadership uses oil rents to stay in power. Therefore, building upon Elbadawi and Soto (2015) and Bjorvatn and Farzanegan (2015), we employ the variable on oil rents (% of GDP) from the World Bank’s World Development Indicators’ database as our first independent variable of interest, which allows for the measurement of economic rents collected from oil—revenues above the cost of extracting the resources—as well as the approximation of the degree

of an economy’s oil dependence. Oil rents are calculated as the difference between the value of crude oil production at regional prices and the total production costs. On the contrary to produced goods and services, oil resources in fixed supply often generate returns that significantly suppress their production costs.

With oil rents representing around 2.6% of GDP on average across the countries in our sample (Table 3.1), we can observe a significant disparity in oil wealth among them (Figure 3.3). As per the World Bank’s data, oil rents (% of GDP) for such countries as Armenia, Bosnia and Herzegovina, Kosovo, and Montenegro are equal to 0. On the other hand, oil rents for such countries as Uzbekistan, Russia, Kazakhstan, Turkmenistan, and Azerbaijan account for more than 2% of their GDP.

Figure 3.3: Average oil rents, 1990–2021 (% of GDP)¹⁴

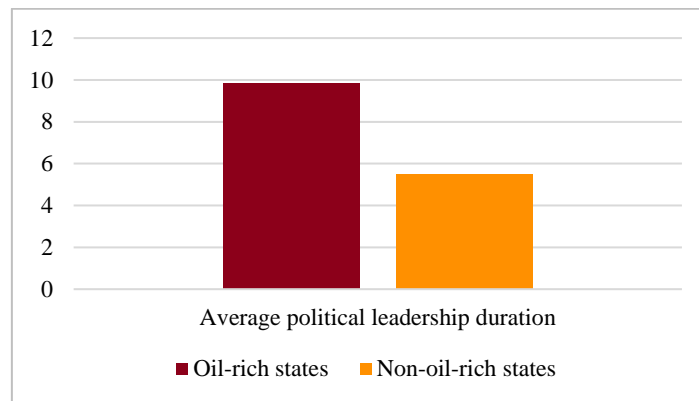


Source: Based on data from World Bank’s World Development Indicators’ database

Figure 3.4 depicts the difference in the average political leadership duration between oil-rich and non-oil-rich states. While political leadership in oil-rich states lasts almost 10 years on average, a change in political leadership in non-oil-rich states occurs nearly every 5.5 years on average.

¹⁴ In Armenia, Bosnia and Herzegovina, Kosovo and Montenegro, oil rents (% of GDP) equal 0 according to the World Bank’s data.

Figure 3.4: Average political leadership duration in relation to oil rents, 1990–2021 (in years)¹⁵



Source: Based on data from Zarate’s Political Collections dataset, DPI, and World Bank’s World Development Indicators’ database

Regarding the typology of countries in our sample according to political leadership duration and oil wealth, as seen in Table 3.2, most of the countries in our sample are characterized by low political leadership duration and low oil endowment. Some oil-rich states that experience high political leadership duration are Azerbaijan, Kazakhstan, Russia, Turkmenistan, and Uzbekistan.

Table 3.2: Typology of countries according to political leadership duration and oil wealth, 1990–2021¹⁶

<i>Characteristics</i>	<i>Oil-rich states (oil rents=>2%)</i>	<i>Non-oil rich states (oil rents<2%)</i>
High political leadership duration (>5 years)	Azerbaijan, Kazakhstan, Russia, Turkmenistan, Uzbekistan	Belarus, Kyrgyzstan, Montenegro, Tajikistan
Low political leadership duration (=<5 years)		Albania, Armenia, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kosovo, Latvia, Lithuania, Moldova, North Macedonia, Poland, Romania, Serbia, Slovakia, Slovenia, Ukraine

Source: Based on data from Zarate’s Political Collections dataset, DPI, and World Bank’s World Development Indicators’ database

¹⁵ We define oil-rich states as those where the ratio of oil rents to GDP is equal or higher than 2%, and non-oil-rich states as those where this ratio is below 2%.

¹⁶ We employ a threshold for a high political leadership duration as exceeding a duration of 5 years, and low political leadership duration as being equivalent to or less than 5 years. We define oil-rich states as those where the ratio of oil rents to GDP is equal or higher than 2%, and non-oil-rich states as those where this ratio is below 2%.

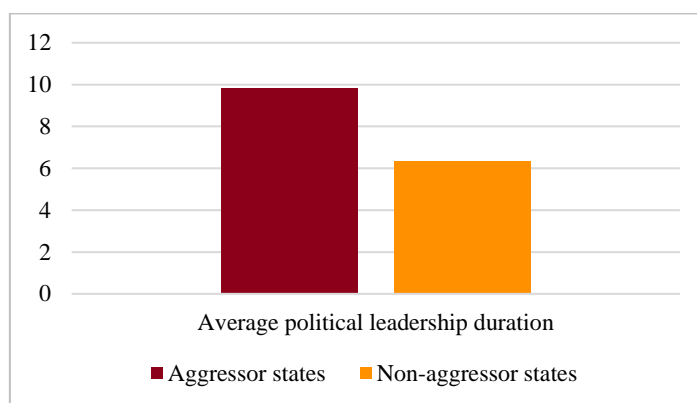
Military aggression

To construct our second independent variable of interest—military aggression—we use the UCDP/PRIO dataset prepared by the Uppsala Conflict Data Program (UCDP) at the Department of Peace and Conflict Research, Uppsala University, and the Centre for the Study of Civil War at the International Peace Research Institute in Oslo (PRIO), in particular Dataset version 23.1. The dataset is described in Gleditsch et al. (2002). This database contains data on both interstate and intrastate conflicts. We follow the UCDP/PRIO’s definition of an armed conflict, which is “a contested incompatibility that concerns government and/or territory where the use of armed force between two parties, of which at least one is the government of a state, results in at least 25 battle-related deaths in a calendar year” on the contrary to applying a higher threshold of at least 1000 battle-related deaths in order to not miss relatively less severe acts of aggression in our dataset. We consider the following types of armed conflict in the dataset: interstate, intrastate, and internationalized intrastate. As per our theoretical framework, we are interested specifically in states whose role in a conflict is an aggressive power and not a defensive one. Therefore, based on the collected data, we build a dummy variable on military aggression, which takes the value of 1 if the government of a state in a given year is pursuing military aggression either abroad or at home and 0 otherwise. Our judgment regarding the aggressor side of an armed conflict is guided by the United Nations Security Council Resolutions.

6.6% of our observations denote the incidences of conflict occurrence (Table 3.1). Figure 3.5 shows that aggressor states are more inclined toward longer-lasting political leadership compared to non-aggressor states. On average, political leadership of a state that has instigated an interstate or intrastate armed conflict lasts around 9.8 years, while a political leadership in a peaceful state lasts approximately 6.3 years.

Table 3.3 classifies the countries in our sample in relation to political leadership duration and armed conflict initiation. Most of the countries in our sample are characterized by low political leadership duration and peaceful policies. Among the countries whose political leaderships have instigated an armed conflict externally or internally at least once over the researched timeframe and managed to retain political power for an extended period are Azerbaijan, Kyrgyzstan, Montenegro, Russia, Tajikistan, and Uzbekistan. On the other hand, political leaderships in Armenia, Croatia, and Serbia have faced more frequent political failure, although they initiated military aggression at one point over the studied timespan.

Figure 3.5: Average political leadership duration in relation to war, 1990–2021 (in years)¹⁷



Source: Based on data from Zarate’s Political Collections dataset, DPI, and UCDP/PRIO dataset

Table 3.3: Typology of countries according to political leadership duration and military aggression, 1990–2021

Characteristics	Aggressor states	Non-aggressor states
High political leadership duration (>5 years)	Azerbaijan, Kyrgyzstan, Montenegro, Russia, Tajikistan, Uzbekistan	Belarus, Kazakhstan, Turkmenistan
Low political leadership duration (=<5 years)	Armenia, Croatia, Serbia	Albania, Bosnia and Herzegovina, Bulgaria, Czech Republic, Estonia, Georgia, Hungary, Kosovo, Latvia, Lithuania, Moldova, North Macedonia, Poland, Romania, Slovakia, Slovenia, Ukraine

Source: Based on data from Zarate’s Political Collections dataset, DPI, and UCDP/PRIO dataset

Control variables

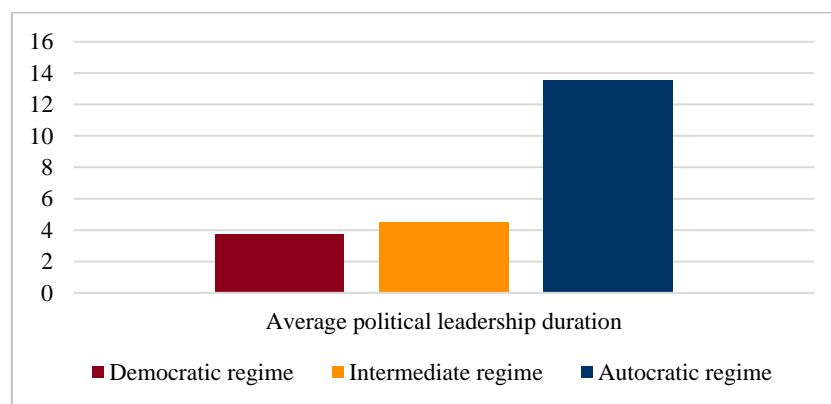
Building upon the prior research, we incorporate institutional, economic, and demographic controls usually applied in the models on political survival to elucidate the independent influence of oil wealth and armed conflict initiation on political leadership durability after accounting for these variables.

¹⁷ We employ a threshold for a high political leadership duration as exceeding a duration of 5 years, and low political leadership duration as being equivalent to or less than 5 years. We define an aggressor state as a state whose government has initiated at least once an interstate or intrastate armed conflict within the studied period of 1990–2021, otherwise a state is a non-aggressor state.

Given the important role of political regimes exposed by the prior studies (Ulfelder, 2007; Omgba, 2009; Andersen & Aslaksen, 2013), we use Freedom House’s civil liberties and political freedoms indices to construct a variable on political regime type. We opt for Freedom House’s indices in favor of other institutional indices because they cover the researched timespan. First, we calculate the average value of two indices. Then, we treat a new scalar index as a categorical variable to encompass substantial nonlinearities in how it impacts the probability of political survival. We combine values of 1–2.5 into a single group labeled “democratic,” values of 3–5 under the “intermediate” group, and values of 5.5–7 under the “autocratic” group.

37.1% of the country–year observations in our sample are characterized by democratic regime, 36% by intermediate, and 26.9% by autocratic (Table 3.1). As we can observe in Figure 3.6, on average, political leadership in democratic regimes remains in office for around 3.7 years, in intermediate regimes for around 4.5 years, and in autocratic regimes for about 13.5 years. Thus, political survival is, on average, longer in less democratic states.

Figure 3.6: Average political leadership duration in relation to regime type, 1990–2021 (in years)



Source: Based on data from Zarate’s Political Collections dataset, DPI, and Freedom House

Furthermore, as seen in Table 3.4, most of the countries in our sample with democratic and intermediate political regimes in place experience low political leadership durability. Conversely, almost all the countries characterized by an autocratic political regime have leadership that holds power for an extended period. The exceptions are Kyrgyzstan and Montenegro, which, having an intermediate political regime, exhibit high political leadership durability.

Table 3.4: Typology of countries according to political leadership duration and regime type, 1990–2021¹⁸

<i>Characteristics</i>	<i>Democratic regime</i>	<i>Intermediate regime</i>	<i>Autocratic regime</i>
High political leadership duration (>5 years)		Kyrgyzstan, Montenegro,	Azerbaijan, Belarus, Kazakhstan, Russia, Tajikistan, Turkmenistan, Uzbekistan
Low political leadership duration (≤5 years)	Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia	Albania, Armenia, Bosnia and Herzegovina, Georgia, Kosovo, Moldova, North Macedonia, Serbia, Ukraine	

Source: Based on data from Zarate's Political Collections dataset, DPI, and Freedom House

All the economic and demographic control variables are obtained from the World Bank's World Development Indicators' database. We account for the country's level of economic development, which is approximated by (log of) GDP per capita in constant 2015 US dollars and expected to have a positive effect on political survival as per prior research (Smith, 2004; Omgba, 2009; Andersen & Aslaksen, 2011; Bjorvatn & Farzanegan, 2015). Moreover, we include the measure of economic growth (GDP growth) in line with the methodology of Smith (2004) and Bueno de Mesquita and Smith (2010), anticipating that economic growth should extend the political leadership durability. Finally, as per the work of Andersen and Aslaksen (2013), we account for trade openness (% of GDP) as well as the age-dependency ratio to reflect the country's demographic environment.

3.5 Empirical strategy

Having outlined the theoretical framework and presented our data, in this section, we specify an empirical model. Based on the prior research (Ross, 2008; Omgba, 2009; Crespo Cuaresma et al., 2011; Andersen & Aslaksen, 2013), the empirical investigation on political leadership

¹⁸ We employ a threshold for a high political leadership duration as exceeding a duration of 5 years, and low political leadership duration as being equivalent to or less than 5 years. We define an aggressor state as a state whose government has initiated at least once an interstate or intrastate armed conflict within the studied period of 1990–2021, otherwise a state is a non-aggressor state.

We classify political regimes into three categories: democratic, intermediate, and autocratic according to the procedure described in the paragraph on the construction of the regime type categorical variable. Based on the average value across the studied period of this categorical variable for each country, we organize all the countries in our sample in the distinct regime types.

durability can be performed by developing a survival model. We opt for the Cox proportional-hazards model, developed by Cox (1972), which is applied to examine a time-to-event outcome as a function of one or more risk factors (Fox & Weisberg, 2002). The Cox model is semi-parametric, with the baseline hazard taking any form and the covariates entering the model linearly. This model assumes proportional hazards, meaning that the effects of independent variables on survival are constant over time and additive over a specific scale. In the Cox model, to interpret the results, we need to examine the coefficients for each independent variable. A positive regression coefficient for an independent variable means that the hazard of an event occurring is higher, therefore the prognosis of survival is worse. A negative regression coefficient means that the hazard is lower, thus the prognosis for survival is better. Furthermore, the measure of the effect of an independent variable on the probability of the event of interest is the hazard ratio (HR). The hazard ratio signifies the relative probability of the event taking place for a given unit change in the independent variable, where a hazard ratio greater than 1 suggests a higher risk and a hazard ratio lower than 1 suggests a reduced risk. We can write the Cox proportional hazards regression model as follows:

$$h_i(t) = h_0(t) \exp(\beta_1 X_1 + \beta_2 X_2 + \dots + \beta_k X_k)$$

Where $h_i(t)$ is the expected hazard for i th individual at time t , $\beta_1, \beta_2, \dots, \beta_k$ are regression parameters, X_1, X_2, \dots, X_k are the predictor variables, and $h_0(t)$ stands for the baseline hazard at time t , which is the hazard of an individual having the predictors set to zero.

The choice of the Cox model fits to investigate our research question since it allows us to examine the impact of the specified factors on the survival of political leadership, or, in other words, on the time it takes for political leadership in power to experience a failure or a change.

In the first model (3.1), to obtain insights into the association between oil wealth and political leadership survival, we introduce a continuous variable $Oil\ rents_{ict}$. This independent variable captures potential differences in political leadership's risk of experiencing a change stemming from variance in a state's oil wealth. In the second model (3.2), we introduce a binary variable $Military\ aggression_{ict}$, reflecting potential differences in the likelihood of political leadership survival attributed to a state's policy to undertake or not an armed conflict. In the third model (3.3), we employ both key independent variables of interest $Oil\ rents_{ict}$ and $Military\ aggression_{ict}$ to study the partial effects of these factors on political survival while holding the other factor fixed. In the fourth model (3.4), we introduce an interaction term

between $Oil\ rents_{ict}$ and $Military\ aggression_{ict}$ to test whether the relationship between our two main independent variables of interest and the dependent variable is moderated by the presence of their interaction. In the fifth model (3.5), we incorporate a categorical variable $Regime\ type_{ict}$ to account for potential differences in political leadership survival based on variance in political regime type.

$$h_i(t) = h_0(t) \exp (\beta_1 Oil\ rents_{ic(t-1)} + n_c + n_t) \quad (3.1)$$

$$h_i(t) = h_0(t) \exp (\beta_1 Military\ aggression_{ic(t-1)} + n_c + n_t) \quad (3.2)$$

$$h_i(t) = h_0(t) \exp (\beta_1 Oil\ rents_{ic(t-1)} + \beta_2 Military\ aggression_{ic(t-1)} + n_c + n_t) \quad (3.3)$$

$$h_i(t) = h_0(t) \exp (\beta_1 Oil\ rents_{ic(t-1)} + \beta_2 Military\ aggression_{ic(t-1)} + \beta_3 Oil\ rents_{ic(t-1)} * Military\ aggression_{ic(t-1)} + n_c + n_t) \quad (3.4)$$

$$h_i(t) = h_0(t) \exp (\beta_1 Oil\ rents_{ic(t-1)} + \beta_2 Military\ aggression_{ic(t-1)} + \beta_3 Oil\ rents_{ic(t-1)} * Military\ aggression_{ic(t-1)} + \beta_4 Regime\ type_{ict} + n_c + n_t) \quad (3.5)$$

As we delve deeper into the econometric analysis, in the consequent models (3.6–3.9), we employ one by one economic and demographic control variables in model 3.5 to ensure the robustness of the established relationships between the independent variables and the outcome. Finally, we include the panel of all the control variables together to formulate the final comprehensive model (3.10).

$$h_i(t) = h_0(t) \exp (\beta_1 Oil\ rents_{ic(t-1)} + \beta_2 Military\ aggression_{ic(t-1)} + \beta_3 Oil\ rents_{ic(t-1)} * Military\ aggression_{ic(t-1)} + Economic\ or\ demographic\ control_{ic(t-1)} + \beta_4 Regime\ type_{ict} + n_c + n_t) \quad (3.6-3.9)$$

$$h_i(t) = h_0(t) \exp (\beta_1 Oil\ rents_{ic(t-1)} + \beta_2 Military\ aggression_{ic(t-1)} + \beta_3 Oil\ rents_{ic(t-1)} * Military\ aggression_{ic(t-1)} + \beta_4 Regime\ type_{ict} + Economic\ and\ Demographic\ controls_{ic(t-1)} + n_c + n_t) \quad (3.10)$$

In all the model specifications, we account for country- and year-fixed effects. We include country-fixed effects to control for unobserved heterogeneity among states. By taking into consideration country-specific, time-invariant characteristics that might affect political leadership survival, such as geography, culture, history, and ethnicity, we can isolate the effects of the variables of interest and reduce the risk of omitted variables bias (Bjorvatn &

Farzanegan, 2015). In their turn, year-fixed effects are introduced to account for the influence of common shocks or time-constant characteristics that affect all countries in the sample simultaneously in a given year. Following the example of Bjorvatn and Farzanegan (2015), we employ cluster-robust standard errors at the country level to mitigate heteroskedasticity and serial correlation.

Finally, following the practice adopted in other studies on the subject, we lag all of the independent variables except of *Regime type* by one year in order to mitigate the risk of endogeneity and to establish a temporal order (Ulfelder, 2007). We decide not to lag the variable *Regime type* since its changes occur gradually.

3.6 Results and discussion: survival analysis

In this section, we introduce and discuss the findings derived from the econometric analysis aimed at examining how oil wealth and military aggression initiation affect political leadership durability. First, we analyze the interaction between the main predictor variables and the outcome variable through a nonparametric approach. We employ the Kaplan-Meier estimator to estimate and plot the survival probability of political leadership based on the presence of oil wealth and the initiation of military aggression.

In a first analysis, we convert a numeric variable on oil rents into a binary form, which takes the value of 1 for cases when oil rents are equal to or exceed 2% of GDP and 0 otherwise. Thus, we categorize the dataset into two groups: oil-rich and non-oil-rich country-year pairs. If oil wealth does not affect the survival of political leadership, the survival function curve of political leaderships of oil-rich country-year pairs and that of non-oil-rich country-year pairs should align. In Figure 3.7, we observe that the two survival function curves initially overlap, suggesting similar political leadership survival at the onset. However, they start to diverge as time progresses, with the oil-rich group exhibiting better survival rates than the non-oil-rich group. These results suggest that, while the presence or absence of oil wealth may not significantly impact political leadership survival in the short term, its effect on survival becomes substantial and distinctively positive in the longer term. Additionally, the results of the log-test, reported in Table 3.5, indicate that the null hypothesis of the two survival functions being equal is rejected at the 1% significance level. In other words, in the countries studied, oil wealth has a significant impact on the duration of political leadership.

Figure 3.7: Kaplan-Meier Survival estimate, by oil wealth

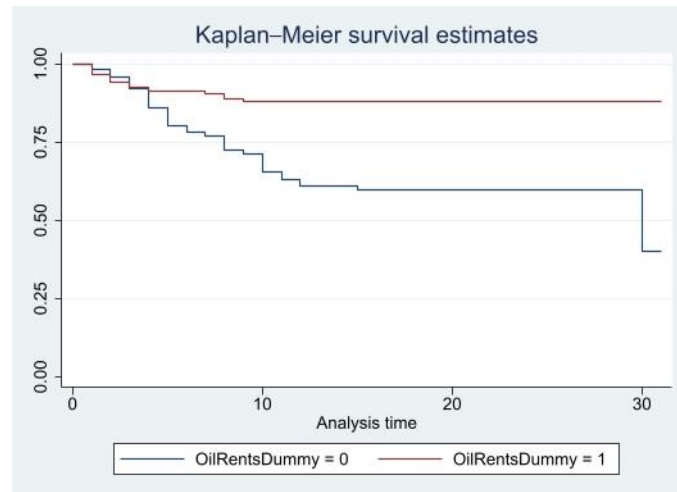


Table 3.5: Test for equality of survival functions by oil wealth

Log-rank test			
Oil wealth	Events observed	Events expected	Statistics
0	114	90.01	$\text{chi}^2(1) = 20.15$
1	22	45.99	$\text{Pr} > \text{chi}^2 = 0.0000$

In a second analysis, we employ a binary variable of military aggression initiation, which takes the value of 1 if military aggression occurs and 0 otherwise. Based on it, we separate our country-year pairs into two groups: one with instances of military aggression and one without. As seen in Figure 3.8, the survival function curves of the political leadership of country-year pairs with military aggression and that without military aggression overlap only at the very onset of the time analysis. However, right after the short initial period, the curve representing the survival function of political leadership in aggressor states is at each time above the one representing the survival function of leadership in non-aggressor states. Notably, the flat curve with one step suggests that the group characterized by military aggression has relatively consistent and high political leadership survival probabilities over time. In contrast, the curve with many steps indicates that the group without an armed conflict has more variability in political leadership survival. These findings are corroborated by the log-rank test, exposed in Table 3.6, which rejects the null hypothesis of the equality of the two survival functions and suggests that the group with military aggression exhibits significantly different political leadership survival experiences compared to the one without it at the 1% level.

Figure 3.8: Kaplan-Meier Survival estimate, by military aggression

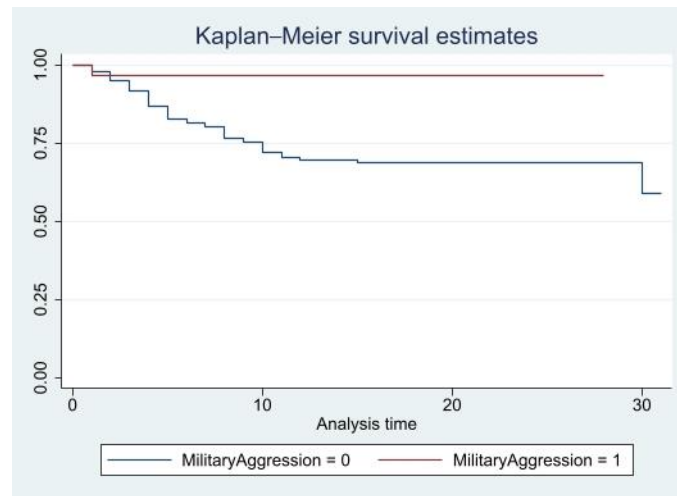


Table 3.6: Test for equality of survival functions by military aggression

Log-rank test			
Oil wealth	Events observed	Events expected	Statistics
0	134	124.92	chi2(1) = 8.38
1	2	11.08	Pr>chi2 = 0.0038

Now, we proceed with a semi-parametric survival analysis employing the Cox proportional hazards model. Table 3.7 provides the results of the Cox model's estimates. This table shows our estimated coefficients (β) for the independent variables for each model specification. These coefficients represent the impact of each independent variable on the log hazard rate. A positive coefficient indicates that as the independent variable increases, the log hazard rate increases, suggesting an increased risk of change in political leadership. A negative coefficient indicates that as the independent variable increases, the log hazard rate decreases, implying a reduced risk of political leadership failure. Furthermore, hazard ratios are obtained from the coefficients and provide information on the effect magnitude of independent variables on the hazard of political leadership failure. The hazard ratio (HR) is calculated as the exponential of the regression coefficient ($HR = \exp(\beta)$). We report hazard ratios for all model specifications in Appendix 3.2. A hazard ratio provides information on how many times higher or lower the hazard rate is when the value of the independent variable associated with the hazard ratio is increased by one unit.

The stand-alone effects of oil rents and military aggression

As shown in Table 3.7, we investigate the association between oil endowment and political leadership change in the first model (1). The negative coefficient for the variable of oil rents suggests that an increase in the oil rents is associated with a decrease in the hazard of the political leadership experiencing a failure. In other words, higher oil rents relative to GDP are related to longer-lasting political leadership survival. The corresponding effect is statistically significant at the 5% level. Furthermore, we examine the relationship between military aggression instigation and political leadership survival in the second model (2). Although the coefficient for the variable of military aggression is negative, indicating that the relationship is negative, it is not statistically significant. Thus, we do not have sufficient evidence to conclude that launching a military aggression on its own has a significant effect on political leadership remaining in power.

Simultaneous impact of oil rents and military aggression

In the next model (3), we investigate the simultaneous impact of oil wealth and military aggression initiation on political survival since we want to assess how both factors jointly influence political leadership durability while controlling for each other's effect. The results remain consistent. While oil wealth still has a statistically significant negative effect on changes in political leadership at the 1% level, the negative impact of military aggression is not statistically significant.

Interaction between oil rents and military aggression

Based on our assumption that oil wealth and military aggression initiation may not act independently in their effects on political survival but rather interact in a way that could impact the outcomes, we introduce the interaction term between these two main factors of interest (4). Both oil rents and military aggression as well as their interaction term are statistically significant at the 5% level, suggesting that the two independent variables influence each other's impact on the dependent variable. The positive coefficient of the interaction term indicates that the effect of one factor on the outcome is moderated by the other one.

Table 3.7: Political leadership survival: Cox proportional hazards model's estimates, regression coefficients reported

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	Political failure	Political failure	Political failure	Political failure	Political failure	Political failure	Political failure	Political failure	Political failure	Political failure
Oil rents	-0.306** (0.136)		-0.395** (0.157)	-0.715** (0.296)	-0.595** (0.280)	-0.518* (0.284)	-0.674** (0.275)	-0.670* (0.365)	-0.578** (0.283)	-0.693** (0.350)
Military aggression		-0.567 (1.250)	-2.325 (1.715)	-8.724** (3.544)	-6.451** (2.721)	-5.704** (2.894)	-7.282*** (2.659)	-6.961* (3.564)	-6.269** (2.740)	-7.253** (3.507)
Oil rents x Military aggression				0.598** (0.287)	0.633** (0.275)	0.544* (0.285)	0.707*** (0.269)	0.680** (0.344)	0.616** (0.279)	0.697** (0.331)
Regime type (Base: Democratic)										
Intermediate					-1.327*** (0.500)	-1.353** (0.537)	-1.464*** (0.554)	-1.343*** (0.469)	-1.391*** (0.519)	-1.525*** (0.566)
Autocratic					-8.396*** (2.695)	-8.400*** (2.612)	-8.385*** (2.623)	-7.614** (3.150)	-8.849*** (2.802)	-8.054*** (3.043)
GDP per capita (log)						1.089 (1.144)				0.239 (1.492)
GDP growth							-0.010 (0.009)			-0.009 (0.010)
Trade openness								-0.006 (0.010)		-0.033 (0.058)
Age dependency									-0.036 (0.055)	-0.004 (0.012)
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	806	890	806	806	806	806	791	788	806	775
#Subjects	806	890	806	806	806	806	791	788	806	775
#Failures	119	136	119	119	119	119	119	117	119	117
Time at risk	5,570	5,891	5,570	5,570	5,570	5,522	5,527	5,519	5,570	5,478
Wald chi2(28)	1005.35	6022.99	5234.68	955.87	4325.20	1383.07	3145.93	15731.49	9974.96	15985.55
Prob > chi2	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Log pseudolikelihood	-556.79224	-672.87285	-555.25382	-552.54828	-532.09262	-531.1183	-530.17065	-519.72993	-531.59345	-517.63204

Note: The dependent variable "Political failure" is binary (1 = if political leadership experiences a failure in the given year, 0 otherwise). The variable "Military aggression" is binary (1 = if an incidence of military aggression occurs, 0 otherwise).

Robust standard errors are in parentheses.

***, **, and * represent significance at 1%, 5%, and 10%, respectively.

The role of regime type

Moreover, to reduce the possibility of confounding, we introduce the variable on the political regime (5), which prior studies found to be associated with both military aggression and political survival (Andersen & Aslaksen, 2013; Wright et al., 2013; Ross, 1995; Gelpi, 1997; Miller, 1999; Pickering & Kisangani, 2005; Lai & Slater, 2006; Pickering & Kisangani, 2010; Kisangani & Pickering, 2011; Davis & Silver, 2004; Krebs, 2010; Ferraro, 2023). We find that, on average, autocratic regimes are characterized by the lowest risk of political leadership failure, followed by intermediate regimes, with democratic regimes having the highest risk.

Controlling for economic and demographic factors

In order to ensure the reliability and robustness of our findings, we add several economic and demographic control variables based on the earlier scholarly work (Ulfelder, 2007; Omgba, 2009; Andersen & Aslaksen, 2013). Initially, we introduce each control variable into our Cox model one by one: GDP per capita (log of) (6), GDP growth (7), trade openness (8), and age dependency (9). This step allows us to isolate the effect of each control variable on the hazard ratios associated with our main independent variables of interest. As we see in Table 3.4, the individual effect of each control variable on the dependent variable is statistically insignificant. However, importantly, our key independent variables of interest, the interaction term between them, and the regime type variable remain statistically significant. In the final model (10), we include all control variables collectively. Although the control variables are still not statistically significant, the consistent statistical significance of our key independent variables of interest, their interaction term, and the regime type variable indicate that their influence on the dependent variable is robust.

The interpretation of the comprehensive model

Further, we will discuss our results in more detail, focusing on the final comprehensive model (10). Due to the control variable panel inclusion, we consider this model the most accurate, as it is especially important in interpreting the effect of the interaction between oil wealth and instigating a conflict since, as seen in the Table 3.7, the respective three coefficients slightly change over the model specifications. To calculate the main effect of oil rents and military aggression, we calculate the value of the partial effect for each row in our dataset and take the

average of all the partial effects. The average regression coefficient for oil rents equals -0.647. This suggests that, keeping all the other factors constant, for every percentage increase in oil rents as a fraction of GDP the log-hazard rate of political leadership failure decreases by 0.647 on average. The hazard ratio for oil rents is equal to 0.5237, which means that for every percentage increase in oil rents in relation to a country's GDP, the risk of experiencing political leadership failure decreases by a factor of 0.5237, or 47.63%, on average. This relationship is statistically significant at the 5% level. Our findings on the positive relationship between oil wealth and political survival corroborate those of Ross (2008) and Omgba (2009).

The average regression coefficient for military aggression is -5.590, suggesting that, holding all the other factors fixed, there is a 5.590 unit decrease in the expected log of the relative hazard of failure for political leadership in aggressor states compared to non-aggressor states. The hazard ratio for military aggression equals 0.0037, indicating that the expected hazard of political leadership failure is 0.0037 times, or 99.63%, lower in aggressor states compared to non-aggressor states, on average. The estimated relationship is statistically significant at the 5% level. Our results lend support to the diversionary theory of war, particularly finding that instigating an armed conflict might lead to prolonged political tenure.

Given that we have introduced an interaction term between the continuous variable on oil rents and the binary variable on military aggression, we can interpret the obtained results by looking at the impact of oil wealth on political survival separately for two scenarios: in the absence of the military aggression and in its presence. When conflict is absent, the hazard ratio for oil rents equals 0.5003. On the other hand, for the scenario when conflict is present, the hazard ratio for oil rents is equal to 1.004. This implies that if a state does not instigate military aggression, keeping all the other factors constant, for every percentage increase in oil rents in relation to GDP, the hazard of political leadership failing decreases by a factor of 0.5003, or 49.97%. In contrast, if a state initiates an armed conflict, every percentage increase in oil rents as a fraction of GDP yields a very minor (0.42%) increase in the hazard of political leadership failure. Indeed, as we can see in Figure 3.9, when calculating the marginal effect of the oil rents on the predicted hazard of political failure, while considering scenarios with military aggression initiation and without, oil wealth decreases the likelihood of failure in non-aggressor states, but slightly increases it in aggressor states. We also look at the impact of the interplay between oil rents and military aggression from a different angle, namely by assessing the marginal effect of military aggression initiation for different levels of oil rents. As shown in Figure 3.10, instigating a military aggression provides a protective effect on political survival up to a

threshold of 10% in the oil rents to GDP ratio, beyond which it starts to have a minimal adverse effect, slightly increasing the risk of political leadership change.

Figure 3.9: Average marginal effects of oil rents on political survival by military aggression

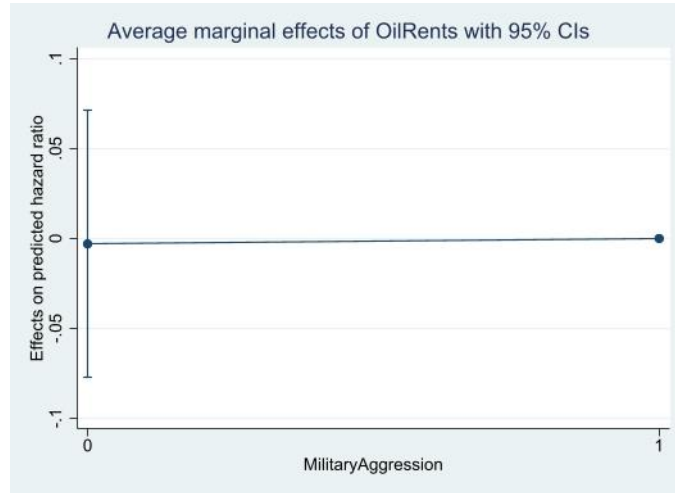
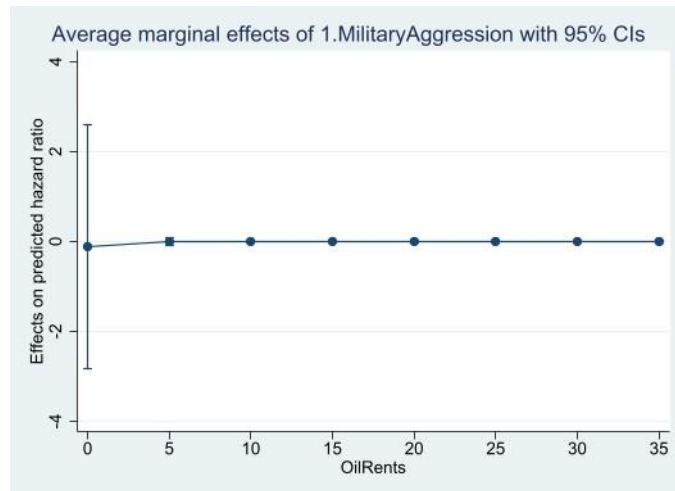


Figure 3.10: Average marginal effects of military aggression on political survival by different levels of oil wealth



Our main findings introduce a new dimension to the understanding of the impact of oil wealth and military aggression on political survival. When we consider the individual effects of oil wealth and the initiation of an armed conflict, holding other factors constant, it becomes apparent that both factors prolong the political survival. Once we introduce an interaction term between oil rents and military aggression, we observe that the influence of oil endowment on political survival is contingent upon whether a state launches a military action. We find that in peaceful countries, higher levels of oil wealth are associated with longer political survival. In

contrast, we observe that an initiation of an armed conflict not only negates the positive effect of oil wealth on political durability but causes a slightly negative impact of the former on the latter. The possible explanation could be that without launching a war, political leadership may use oil rents to fund domestic strategies to stay in power, including “petro populist” redistribution and spending, co-optation and patronage, as well as repression. However, once political leaders go to war, this decision supersedes all other factors. Furthermore, while at lower levels of oil wealth military aggression leads to a “rally around the flag effect,” greater oil wealth cancels out this effect. We assume that this finding might be explained by political leaders in countries with ample oil wealth being financially well-equipped to lead several domestic strategies aimed at prolonging their tenure in the long term compared to diversionary wars, which tend to have a short-term impact.

Finally, we examine the role of the regime type on political survival. The regression coefficient for the intermediate regime is -1.525. This means that the log hazard for an intermediate regime is -1.525 units lower than the log hazard for a democratic regime. The hazard ratio for the intermediate regime is equal to 0.2177. This means that, all else being equal, the hazard ratio of political leadership failure is lower by a multiple of 0.2177, or 78.23%, in intermediate regimes compared to democratic regimes. Further, the log hazard for an autocratic regime is 7.253 units lower than that for a democratic regime. The hazard ratio for the autocratic regime is 0.0003. This means that the hazard of political leadership failure is significantly lower in autocratic regimes compared to democratic regimes, with a risk reduction of about 99.97%. The established relationships between the regime type and political leadership duration are significant at the 1% level. We conclude that the less democratic the regime is, the longer the political leadership tends to stay in power, which aligns with the prior research. This finding somewhat contrasts the prior studies, which posit that intermediate regimes are less durable than both democratic and autocratic leadership (Gurr, 1974; Epstein et al., 2006; Gates et al., 2006; Goldstone et al., 2010; Knutsen & Nygård, 2015).

3.7 Case of Russia

Russia is an infamous example of a state where the political leadership uses both oil wealth and military aggression to grip the reins of power.

Putin has leveraged the energy sector to ensure his political survival since the beginning of his rule back in 2000. Coincidentally, with the onset of his presidency, the world oil market

experienced tight supplies and energy prices surged to record highs as a result (Newnham, 2011). The energy sector went through a privatization process during the Yeltsin years, but under Putin it was moved under state control with a state-owned oil corporation “Rosneft” and a gas corporation “Gazprom” being pivotal in these efforts. Consequently, Putin consolidated state control over the energy enterprises, controlled by a closely-knit oligarchic circle (Ahmed, 2022), enabling Putin to garner the support of key interest groups in the country (Gustafson, 2012). The prominent example is the case of the Yukos oil company, considered one of the best-run private enterprises. Its founder Mikhail Khodorkovsky opposed the state’s reassertion of power in the energy sector and funded political forces opposed to Putin. This resulted in Yukos being dismantled and his 10-year detention in a Siberian prison on charges of tax evasion and fraud, widely considered to be fabricated (Newnham, 2011; Gustafson, 2012). As of the beginning of 2022, Russia has been the world’s largest exporter of oil and gas combined, including not only crude oil and natural gas but also refined petroleum products such as gasoline, diesel, and jet fuel, among others (Montgomery, 2016). Oil and gas represent 60% of Russia’s total exports. According to the International Energy Agency, oil and gas-related taxes and export tariffs account for 45% of Russia’s federal budget and the energy sector constitutes around 25% of the country’s GDP (Ahmed, 2022).

The Kremlin regime has used oil revenues to finance patronage, co-optation, and repression to solidify its grip on power. Graham (2023) notes that Putin relies on a vast system of patronage that shapes the ruling elite, which includes senior government officials and special services officers, top military personnel, oligarchs and heads of major corporations, leading scholars, and media figures (Graham, 2023). The author argues that Putin also appoints loyal individuals to oversee the military and special services, main economic and financial bodies, the national media, and key corporations, particularly in the energy industry. Furthermore, Putin has extensively leaned on repression, criminalizing free speech, banning grassroots movements, suppressing criticism as a threat to national security, imprisoning and poisoning political rivals, and purging the elite ranks (Wallander, 2021; Khvostunova, 2022). Putin’s regime has been described as a personalist petrostate dictatorship (Weeks & Colgan, 2022).

Putin’s thirst for power does not stop there. In order to secure power, he is eager to conduct wars and genocides, which have proven to increase his popularity back home. Moreover, oil has kept fueling Russia’s war machine (Turrentine, 2022; Weeks & Colgan, 2022; McKibben, 2022). As pointed out by Cullen Hendrix, a professor at the University of Denver, Russia launched an invasion of Georgia under Putin’s leadership in 2008, shortly after global oil prices

reached their historical high (Lavelle, 2022). In 2014, during a period of turbulent yet elevated oil prices following the global recession, Russia annexed Ukraine's Crimea and started the invasion in the Donbas region. A few weeks prior to the beginning of Russia's full-scale invasion of Ukraine on 24 February 2022, Russia's finance ministry revealed an unexpected budget surplus for 2021 attributed to the remarkably high oil and gas prices (Lavelle, 2022).

Each military conflict the Kremlin has undertaken has led to a substantial increase in support for Putin, as seen in Figure 3.11, according to the figures provided by the presumably independent Levada-Center. Thus, as noted by Ferraro (2022), Putin's tough stance in the Second Chechen War (1999–2000) boosted his popularity and contributed to his victory in the initial round of the 2000 presidential elections. A dissident from the security service claimed that the 1999 apartment bombings, a major trigger for the war, were orchestrated by the security service to generate social turmoil, legitimize the war, and exploit it for political gains. The familiar to us in-group/out-group construct has been applied (Simmel, 1898; Coser, 1956). Having fought with the Chechens as "internal enemies," the Kremlin focused on constructing the "external enemies." After accusing Georgian president Mikheil Saakashvili's regime of committing atrocities and claiming to avert genocide and protect Russian citizens living in Georgia, Russia invaded Georgia and occupied 20 percent of its territory in 2008 (Pupcenoks & Klein, 2022). Russia's military aggression yet again resulted in an increase in Putin's approval. Furthermore, since the Orange Revolution in Ukraine in 2004 and even more so since the Revolution of Dignity in 2013–2014, the Kremlin propaganda machine has relentlessly worked on constructing and spreading the narratives about, as distinguished by Ferraro (2022), "Ukrainian nationalists," the "collective West," and its allied "liberal traitors" inside Russia that pose a threat to Russia's security. In the aftermath of the global financial crisis, Russia's GDP growth nearly came to a standstill, resulting in Putin's approval rating dropping from 88% in September 2008 to a near-historic-low of 61% in November 2013 (Gurieva, 2022). This was when Putin decided to divert attention from domestic issues by starting other military aggressions to secure his political survival. Russia's illegal occupation of Crimea in March 2014 and the war in the Donbas region of Ukraine launched in April 2014 following the ouster of Yanukovich as the result of the Revolution of Dignity brought Putin's approval levels back to record-highs, with this effect having lasting pattern (Ferraro, 2022). Notably, with the annexation of Crimea, Russia took control of more than 80% of the offshore oil and gas reserves from Ukraine (Turrentine, 2022). At the same time, after providing political and military backing to the political leadership of Bashar al-Assad in Syria since 2011, Russia

launched a direct military intervention in Syria in 2015, siding with the Assad regime in its war on the Syrian population.

Figure 3.11: Russia’s war initiation and Putin’s popularity



Source: Built by the authors based on the results of surveys conducted by the Levada-Center (2023)

As we can observe in Figure 3.11, Putin’s popularity started to fade away in the middle of 2018 as the corrupt and oligarchic economy continued to stagnate (Guriev, 2022). Once again, the Kremlin sought salvation through the bloodshed, which, horrifyingly, seems to have been effective. As Russia launched its full-scale invasion of Ukraine on 24 February 2022, Putin’s approval rate from February 2022 to March 2022 jumped from 71% to 83%, indicating a strong “rally around the flag.” At the moment of writing, Russia is conducting a genocidal war in Ukraine with its troops having killed and injured tens of thousands of people, forced around 6 million people to become refugees and over 3,5 million people to be internally displaced, caused widespread destruction and humanitarian catastrophe, as well as an environmental disaster. Meanwhile, Russians’ support for Putin has continued to be at its almost record high, standing at 80% in September 2023 (OCHA, 2023; Figure 3.11). A strong support for Putin’s bloody and tyrannical regime in Russian society apparently has not been offset until now even by the immense amount of battlefield deaths of its own people.

Here again oil plays its detrimental role. Russia consumes only around 30% of the oil it produces, exporting the remainder (Turrentine, 2022). Thus, while Russia is the world’s third-largest oil producer, it is the world’s largest exporter of oil and the second-largest crude oil exporter (IEA, 2022). As of 2021, around 60% of Russia’s oil exports were destined for OECD member states in Europe, while another 20% were directed towards China (IEA,

2022). Revenues from oil exports constitute over one-third of Russia's federal budget (Turrentine, 2022). As described in the literature review section, foreign countries dependent on fuel imports are interested in the stability of their supplies, often contributing to the survival of political leaders in exporting countries (Bellin, 2004). Oil-rich autocrats are well-positioned to quash domestic dissent as well as instigate armed conflicts with or without limited pressure or resistance from the international community (Girod et al., 2018; Korteweg, 2018). This is what we are witnessing in the case of Russia. The country faced few, if any, repercussions following its past military interventions. In 2003, British multinational oil and gas company BP signed a deal with Russian oil company TNK even though widespread mass killings and indiscriminate carpet bombing of civilians in Grozny were documented by human rights organizations ("How Big Oil," 2022). Russia's war against Georgia did not change the West predisposition towards Russian fossil fuels. In 2012, the American multinational oil and gas corporation ExxonMobil entered into an agreement with Rosneft to invest over \$500 billion to develop energy reserves in the Arctic and Black Sea (Busvine & Soldatkin, 2012). In 2013 and 2014, the French energy and petroleum company TotalEnergies struck an agreement with the Russian oil company Lukoil for a fracking project in Western Siberia ("How Big Oil," 2022). After Russia's annexation of the Ukrainian Crimea, the invasion of the Donbas region in Ukraine, and war crimes in Syria, western governments and major oil companies issued only minor restrictions, primarily affecting future production rather than current output, and continued to advocate for the deals and pipelines with Russia, fueling Putin's regime and funding the Russian military apparatus ("How Big Oil," 2022). Russia saw only limited immediate consequences, with the country experiencing its most significant oil production growth in 11 years in 2016 and achieving record-high gas exports to Europe in 2016 and 2017 ("How Big Oil," 2022). For instance, TotalEnergies advocated for the removal of the sanctions, undertook the construction of the Yamal LNG project in the Arctic, and entered into an agreement with Novatek to acquire a 10% stake in another substantial gas venture, Arctic LNG 2.

Due to their paramount dependence on Russian fuels, the West did not strike directly at the oil and energy sector after Russia launched its large-scale invasion of Ukraine (Lavelle, 2022). Only in December 2022, the G7 group implemented the \$60 oil price cap, and the EU imposed a ban on seaborne oil products from Russia (Ribakova et al., 2023; Smith, 2023). Although these measures are reported to have reduced Russia's export earnings and budget revenues, price cap violations have been taking place (Ribakova et al., 2023). Moreover, according to the

report by the NGO Transport & Environment published in July 2023, instead of cutting oil consumption, the EU has increased it by 2% compared to the beginning of Russia's invasion of Ukraine, importing oil products even from countries that acquire their oil from Russia, including India, China, and some African nations (Ghantous, 2023). Furthermore, in the first seven months of 2023, European Union countries increased their imports of liquefied natural gas (LNG) from Russia compared to the same period in 2021 (Abnett, 2023). Against this background, the real cost of oil becomes apparent. Russia transfers oil and gas revenues into munition to kill people in Ukraine, and, as Jeff D. Colgan said, in Europe we should be aware that we "have paid for this war" (Lavelle, 2022). The way forward is outlined by the urgent clean energy transition (O'Sullivan & Bordoff, 2022).

3.8 Conclusion

Understanding the cornerstones of political survival is not only essential but urgent in the troubled world of today since political leadership, to a large extent, determines not only the destinies of the people within a country's borders, but also outside of them. As far as we are aware, this study is the first one to have empirically investigated political survival by integrating insights from two strands of literature, with one on the "resource curse" and the other on the diversionary theory of war. Our research objective was to assess how oil wealth and military aggression instigation, as well as their interplay, affect political survival in Central and Eastern Europe and Central Asia since this region has not yet been the subject of specific focus in this field. With this objective in mind, we conducted a survival analysis, employing the Cox proportional hazards model, on a sample of 29 countries in the region of interest over the 1990–2021 period to uncover the dynamics between oil wealth, military aggression initiation, and political durability.

Drawing upon prior research aimed to examine political leadership survival, we design our dependent variable as the time until a change in political leadership occurs (Omgba, 2009; Crespo Cuaresma et al., 2011; Andersen & Aslaksen, 2013; Wright et al., 2013). Using the information from Zárate's Political Collections dataset and the Database of Political Institutions (DPI), we considered a change in political leadership to have occurred when a new chief executive belonged to a new party. There were several reasons why we opted for this definition of political survival. First, it allows for the accounting of the level of executive and legislative power of president and prime minister have in a respective political system. Second,

with presidential systems usually having regulations governing the maximum number of presidential terms, the change of president does not necessarily imply a change in political leadership. Third, the change of prime minister is not an indication of this either. Against this backdrop, we found the party affiliation of the chief executive to be a much better indicator of political leadership. When the chief executive was not associated with a specific party, the beginning and the end of their tenure marked changes in political leadership. Furthermore, power transfer within a family or an influential elite was not counted as a break in political leadership.

As inferred from prior research, we were interested specifically in the effect of oil on political survival rather than other natural resources (Andersen & Aslaksen, 2013). Hence, building on the approach of Elbadawi and Soto (2015) and Bjorvatn and Farzanegan (2015), we applied oil rents (% of GDP) as our first key independent variable of interest with the data drawn from the World Bank's World Development Indicators' database. Moreover, guided by the rationale behind the diversionary theory of war, we focused precisely on the impact of the instigation of an armed conflict on political leadership durability. We constructed the variable on military aggression initiation based on the UCDP/PRIO dataset. The panel of institutional, economic, and demographic controls was sourced from the Freedom House and the World Bank.

Our empirical study revealed that political leaders might exploit oil wealth and instigate an armed conflict in pursuing their goal to remain in power. Our survival analysis unveiled the significant partial effect of oil endowment on political survival, showing that, on average, one percentage increase in oil rents in relation to a country's GDP decreases the risk of political leadership experiencing failure by 47.63%, holding other factors constant. Our findings on the relationship between oil and political survival align with those of Ross (2008) and Omgba (2009). Furthermore, we exposed a substantial partial effect of military aggression initiation on political durability. Specifically, *ceteris paribus*, the expected hazard of political failure is, on average, 99.63% lower for leaders in aggressor states compared to non-aggressor states. These results provide empirical support for the diversionary theory of war (Levy, 1989), showing that launching a war might enable political leadership to hold a firm grip on power.

Striving to offer a more nuanced and comprehensive understanding of political survival, our study, in its pioneering effort, also explored how the interplay between oil wealth and armed conflict shapes political durability. In this light, we introduced the interaction term between oil rents and military aggression to see whether the impact of each of these factors on political survival is dependent on the other one. Our results confirmed that the effect of one factor on

the outcome is moderated by the other one. We find that while in non-aggressor states, the oil wealth decreases the risk of political failure, in aggressor states, its protective effect is not only negated but slightly reversed. Namely, in a peaceful state, *ceteris paribus*, for every percentage increase in oil rents as a fraction of GDP, the hazard of political change decreases by 49.97%. In contrast, if a country instigates a war, every percentage increase in oil rents leads to a very minor increase of 0.42% in this hazard. Our findings suggest the presence of the “rentier state” effect in a non-war context, with political leaders exploiting oil wealth to retain power through a range of strategies, including redistribution and spending, co-optation and patronage, and repression at home. However, once a state goes to war, this decision assumes paramount importance, eclipsing all other factors. We also investigated the interdependent impact of oil wealth and an armed conflict on political survival from another perspective, namely how the decision to go to war plays out for leaders of states with different levels of oil endowment. We find that launching a military conflict decreases the risk of political change for the levels of oil rents representing up to 10% of GDP, beyond which the effect reverses, slightly increasing this risk. While at lower levels of oil wealth we observe that a war instigation is followed by a “rally around the flag effect,” greater oil wealth negates this effect. Perhaps, with the extensive oil reserves political leaders become financially well-equipped to lead multiple strategies domestically that would be more likely to prolong their tenure in the long term compared to their diversionary destructive policies, which are more likely to have only a short-term effect. Moreover, we found political regime type to be a crucial factor in determining political survival. The hazard of political failure is 78.23% and 99.97% lower in intermediate and autocratic regimes, respectively, than in democratic. These results suggest that the less democratic the regime is, the longer political leaders succeed in remaining in power, which is somewhat in contrast with the previous scholarly work, arguing that intermediate regimes are less durable than both democratic and autocratic (Knutsen & Nygård, 2015).

Additionally, incorporating a panel of economic and demographic control variables bolstered the reliability and stability of the uncovered relationship between oil wealth, military aggression, and political survival, affirming the robustness of our findings. Yet, while being the first scholarly work to examine the interdependent impact of oil wealth and military aggression on political survival, it is evident that further refinements are needed to enhance the robustness of our results and capture the nuances of the studied relationship. Against this backdrop, our study highlights possible avenues for future research. While our study focuses only on one region, expanding it towards all the regions would enhance its robustness and increase the

generalizability of the findings. Such a sample expansion would allow us to split it into subsamples according to the regime type and test the studied relationship for each group, building upon the approach of Andersen and Aslaksen (2013). We attempted to do so, however, due to the limited sample, we encountered a technical error in Stata. Moreover, although the correlation matrix rejects the presence of multicollinearity between oil wealth and military aggression initiation, we know from the scholarly work of Colgan (2010, 2011, 2013, 2014) that petro-states are more likely to instigate armed conflicts using oil revenues to finance them. Future studies could consider employing a more advanced model to account for this aspect. Furthermore, while we examined the impact of the war incidence on political durability, it might differ depending on the war duration. Hence, subsequent academic work could examine how a war affects political survival throughout its duration. Building on prior studies (Mueller, 1970; Kernell, 1978; Ostrom & Simon, 1985; Marra et al., 1990; Hetherington & Nelson, 2003; Lai & Reiter, 2005; Mueller, 2005; Norpoth & Sidman, 2007; Haynes, 2017; Kuijpers, 2019), we would assume that a war instigation leads to a short-term “rally around the flag,” which diminishes over time.

In closing, our findings not only enrich the existing literature on political survival, but also hold practical relevance for the international community stakeholders. Our work underscores the pressing necessity for coordinated efforts at a global scale towards cutting the dependence on fossil fuels and accelerating long-overdue clean energy transition. Besides, international instruments to halt wars fall far short of proving their effectiveness in practice. The case of Russia illustrates how both the dependence on fossil fuels and the policy of appeasement in the face of military aggression create and empower tyrants and turn all the involved into hostages. As if it was not yet bad enough, the impunity of Putin even following Russia’s genocidal war against Ukraine and the continued world’s purchase of Russia’s oil might unleash a domino effect, encouraging other political leaders to exploit their oil wealth and/or resort to military aggression in a bid to consolidate their rule.

3.9 Appendix

Appendix 3.1: List of countries

Albania	Lithuania
Armenia	North Macedonia
Azerbaijan	Moldova
Belarus	Montenegro
Bosnia and Herzegovina	Poland
Bulgaria	Romania
Croatia	Russia
Czech Republic	Serbia
Estonia	Slovakia
Georgia	Slovenia
Hungary	Tajikistan
Kazakhstan	Turkmenistan
Kosovo	Ukraine
Kyrgyzstan	Uzbekistan
Latvia	

Appendix 3.2: Political leadership survival: Cox proportional hazards model's estimates, hazard ratios reported.

Variables	(1) Political failure	(2) Political failure	(3) Political failure	(4) Political failure	(5) Political failure	(6) Political failure	(7) Political failure	(8) Political failure	(9) Political failure	(10) Political failure
Oil rents	0.7366** (0.0999)		0.6737** (0.1059)	0.4891** (0.1447)	0.5515** (0.1545)	0.5957* (0.1691)	0.5097** (0.1400)	0.5117* (0.1869)	0.5610** (0.1587)	0.5003** (0.1751)
Military aggression		0.5672 (0.7087)	0.0978 (0.1677)	0.0002** (0.0006)	0.0016** (0.0043)	0.0033** (0.0096)	0.0007*** (0.0018)	0.0009* (0.0034)	0.0019** (0.0052)	0.0007** (0.0025)
Oil rents x Military aggression				1.8183** (0.5215)	1.8840** (0.5173)	1.7227* (0.4904)	2.0272*** (0.5449)	1.9731** (0.6796)	1.8517** (0.5164)	2.0072** (0.6638)
Regime type (Base: Democratic)										
Intermediate					0.2654 *** (0.1328)	0.2584** (0.1388)	0.2314*** (0.1283)	0.2611*** (0.1226)	0.2488*** (0.1291)	0.2177*** (0.1233)
Autocratic					0.0002*** (0.0006)	0.0002*** (0.0006)	0.0002*** (0.0006)	0.0005** (0.0016)	0.0001*** (0.0004)	0.0003*** (0.0010)
GDP per capita (log)						2.9701 (3.3980)				1.2698 (1.8941)
GDP growth							0.9898 (0.0087)			0.9911 (0.0100)
Trade openness								0.9936 (0.0102)		0.9674 (0.0564)
Age dependency									0.9645 (0.0531)	0.9964 (0.0115)
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	806	890	806	806	806	806	791	788	806	775
#Subjects	806	890	806	806	806	806	791	788	806	775
#Failures	119	136	119	119	119	119	119	117	119	117
Time at risk	5,570	5,891	5,570	5,570	5,570	5,570	5,527	5,519	5,570	5,478
Wald chi2(28)	1005.35	6022.99	5234.68	955.87	4325.20	1383.07	3145.93	15731.49	9974.96	15985.55
Prob > chi2	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
Log pseudolikelihood	-556.7922	-672.8729	-555.2538	-552.5483	-532.0926	-531.1183	-530.1707	-519.7299	-531.5935	-517.6320

Note: The dependent variable "Political failure" is binary (1 = if political leadership experiences a failure in the given year, 0 otherwise). The variable "Military aggression" is binary (1 = if an incidence of military aggression occurs, 0 otherwise).

Robust standard errors are in parentheses.

***, **, and * represent significance at 1%, 5%, and 10%, respectively.

General Conclusion

This thesis consists of three individual but intricately entwined chapters pertaining to populism, political survival, and informal economy. It contributes to the theoretical and empirical literature by shedding light on drivers and specific contexts of informality, supply-side factors of populism, and oil and war as means of political survival. In this light, the findings of this thesis provide insights into an understanding of multi-dimensional challenges confronting the current global landscape.

The first chapter delves into the unanswered questions regarding the nexus between drivers of informality and specific contexts. The informal sector plays a vital role worldwide, providing livelihoods for a significant share of the population. This study seeks to investigate the factors that drive people into informality. Moreover, do these factors gain heightened relevance in specific contexts?

This chapter distinguishes four main macro-drivers of informality: (1) governance and institutions, (2) taxes and labor-income incentives, (3) macroeconomic instability, growth, and international trade, and (4) social benefits and labor regulations. Regulations are commonly found to be positively associated with the informal sector. The impact of taxes on informality is contingent on the level of economic development. Taxes and informality are positively related in developing economies; however, this appears less in developed economies due to more robust legal and enforcement systems, lower levels of corruption, and better public goods provisions. The informal economy is believed to be counter-cyclical, expanding during economic downturns and contracting during economic growth. On the other hand, steady economic growth might also result in an increase in informal employment for small entrepreneurial firms and sub-contracted and outsourced activities associated with the global production system. In contrast to classical trade theories, globalization and trade reforms lead to competition in the formal sector, potentially yielding a decline in formal employment in the short term and, thus, a surge in the informal economy. Moreover, given that social protection is not free, people might be motivated to forego it altogether and seek employment in the informal sector instead, especially when social security systems are inadequately run. In a similar vein, firms might prefer to employ workers informally rather than pay high employer social security contributions.

Furthermore, in this study, we define four main micro-drivers of the informal economy: (1) discrimination based on socio-demographic characteristics, (2) job mismatch, (3) lack of access to finance and land, (4) and job quality and occupation. Socially and economically disadvantaged groups, such as minorities, rural-urban migrants, workers with immigrant backgrounds, residents of underdeveloped regions, women, and those with lower levels of education, are more exposed to employment in the informal sector due to excessive discrimination. In addition, the mismatch of skills due to demographic changes and the educational system might contribute to the rise of the informal economy. It is also evident that informality is usually more prevalent in sectors and occupations with lower job quality without labor protection. At last, both lack of access to finance and lack of access to land spur informality.

Ultimately, the following four specific contexts and their impact on the drivers of informality mentioned above are introduced: war and violence, natural resources, poverty, and international and internal migration. We differentiate rapid and more gradual informal economy growth contexts. The rapid context related to war and violence generates an unstable economic environment where informal employment can act as a survival strategy. Conversely, the more gradual context associated with natural resource abundance, poverty, and migration is more progressive due to slower changes in the institutional framework. First, in the context of war, the informal economy thrives primarily due to state and institutional failure and secondarily due to economic instability and weakened governance. Conflicts enhance all the micro-drivers, especially discrimination. Second, the natural resource abundance predominantly influences the governance-and-institutions' driver through the channel of corruption and conflict of interest. Third, poverty results, among others, in inadequate social protection and unenforced labor regulations. Fourth, at the macro-level, significant migration flows affect the governance-and-institutions' driver, while at the micro-level, they induce discrimination and job mismatch.

The second chapter is an investigative study to determine the causal factors behind the recent resurgence in populism. Building on the existing literature, we approach this subject matter by proposing a novel theoretical framework hypothesizing that it is populist political supply that creates its own demand. In other words, we develop a premise that these are political appeals that shape electoral decision-making rather than vice versa. In contrast to prior studies, this chapter focuses not on one factor but instead adopts a multi-factorial approach, seeking a more comprehensive understanding of the studied phenomenon. We test these theoretical

assumptions by conducting a probit analysis focusing on the European Union with cross-sectional data from the Eurobarometer surveys spanning from 2012 to 2023.

Our empirical analysis shows that populist actors affect political demand through four key supply-side channels. First, the findings suggest that populists capitalize on economic insecurity to enhance electoral support. This was particularly apparent when numerous populist politicians centered their political campaigns around the global economic crisis and subsequent austerity measures, portraying supranational institutions such as the EU as the primary culprit of the people's economic struggles. Second, drawing upon the political philosophy of Hannah Arendt, we find that populist actors might weaponize and induce the isolation of individuals to gain support. The "atomized individuals" turned against each other and the established elites, such as the EU, may seek refuge in populism. Third, the evidence is also found that populists might foster political polarization to increase electoral demand. This result corroborates that populist actors move into vacant electoral space or create new electoral space at political fringes, seeking to position themselves strategically vis-à-vis their competitors and leveraging the anti-establishment public sentiments. Fourth, we find that social media is another supply-side factor used by populists to propel support. By allowing populists to communicate directly with the electorate and bypass traditional media gatekeepers, social media enables populists to read and shape public grievances to fuel demand.

In addition, this chapter paints the socio-demographic profile of the voter more prone to support populists. Men, those with lower levels of education, rural and suburban residents, unemployed, retired, and those belonging to the working class are more likely to vote for populists. The relationship between age and support for populism is found to follow an inverted U-shaped pattern.

To summarize, the rise in populism can be explained through the mechanism of political supply creating its own demand, with populist actors leveraging economic insecurity, manipulating the isolation of individuals, inducing political polarization, and exploiting social media tools to gain and retain political power.

This thesis's third and final chapter explores the impact of oil wealth and war instigation on political survival. To the best of our knowledge, it is the first study to incorporate the insights from the "resource curse" theory and diversionary theory of war to examine political durability. Based on these two strands of literature, we develop a theoretical framework postulating that greater oil wealth and military aggression initiation increase the probability of political

survival. Moreover, in its pioneering endeavor, looking for a more nuanced understanding of the complex relationship between these three factors, this chapter hypothesizes that the nature of the influence of oil and conflict on political durability is interdependent. To assess the theoretical assumptions, we perform a survival analysis using a panel dataset covering 29 countries in Eastern and Southern Europe and Central Asia for the 1990–2021 period.

The empirical findings suggest that political leaders might exploit oil wealth and instigate wars seeking to remain in power. The positive relationship between oil and political durability could be due to oil revenues equipping political leaders with a financial means to employ a range of strategies to retain a firm grip on power. Such strategies may include redistribution and unsustainable spending, patronage and co-optation, and repression against dissidents, political opponents, or even political elites. Meanwhile, the positive association between military conflict initiation and political survival lends support to the diversionary theory of war, which may manifest through two key mechanisms: the “rally around the flag effect” and “gambling for resurrection.” In addition, this study reveals that oil wealth and war instigation impact political survival interdependently. Oil wealth has a more significant influence on political survival in non-aggressor states than in aggressor states, while the effect of conflict on political survival diminishes with greater levels of oil wealth. Moreover, the type of political regime matters for political survival. The less democratic a country is, the longer political leaders tend to exercise their power.

To recap, each chapter of this thesis is dedicated to studying aspects in the realm of political economy that have received insufficient scholarly attention. The first chapter delves into examining the main macro- and micro-drivers of informality and how specific contexts, such as wars, natural resources, poverty, and migration, enhance them. The second chapter unveils a new perspective in terms of looking at the recent resurgence in populism through the mechanism of political supply creating its own demand by applying a multi-factorial approach. Finally, the third chapter investigates how oil wealth and war instigation as well as a hitherto unexamined interplay between them affect political survival.

With Russia’s barbaric war against Ukraine shaking the diligently built and long-lasting peace in Europe, we have come to realize that there is no “end of history” predicted by Francis Fukuyama, but rather that the established liberal world order is fragile. The recent resurgence of populist leaders and parties in the West, thriving on the antagonism between “us” versus “them” and oftentimes enforced by the Kremlin regime, poses an existential threat to the very foundations of liberal democracy. These developments undermine state institutions, resulting,

among others, in the economic instability and breakdown of the formal economy, impoverishing the people and making them turn to the informal sector as a survival strategy. Against this background, we want to refer to one of the slogans on the posters raised during the Revolution of Dignity in Ukraine that reads, “I am a drop in the ocean,” meaning that although each of us is just a water droplet, drop by drop, the group becomes an ocean. Hence, to conclude this thesis, along similar lines, we quote Václav Havel:

“The salvation of this human world lies nowhere else than in the human heart, in the human power to reflect, in human meekness and human responsibility.”

Agenda for future research

In each chapter of the thesis, we have attempted to discuss the limitations of our work and the avenues it paves for future research. While Chapter 1 outlines the theoretical foundation of how specific contexts reinforce key macro- and micro-drivers, future studies could investigate this relationship empirically by applying an econometric analysis using an interaction term between the drivers and their contexts. Focusing on one specific context would allow for precision in the research question and a more in-depth exploration of the factors relevant to that setting. These could be both micro- and macro-level studies. It would also be interesting to compare the uncovered relationships between developing and developed countries.

Although we apply a series of robustness checks to ensure the reliability and consistency of our findings on the factors behind the resurgence in populism in Chapter 2, reverse causality and endogeneity remain possible. Future studies could refine the uncovered mechanism of political supply creating its own demand while tackling the mentioned limitations by employing alternative data sources and methodologies. Since this chapter is focused specifically on the European Union, its extension could be to replicate the same empirical methodologies to assess whether the findings hold for the other geographical regions or political and economic blocs. Exploring whether the importance of the studied four supply-side factors of populism varies across emerging and advanced economies could provide valuable insights. Moreover, there is academic interest in investigating the differential impact of actual versus perceived threats on the propensity of populist voting.

In the case of Chapter 3, the empirical evidence on the relationship between oil wealth, conflict instigation, and political survival is confined to the region of Eastern and Southern Europe and

Central Asia. Future research endeavors may consider expanding the analysis to the rest of the world to assess the universal applicability of the identified outcomes. Furthermore, encompassing other geographical areas would allow a sample to be split into sub-samples according to the regime type and test whether the established relationship is consistent across different regime types. Since wars are often financed by oil rents, a more advanced empirical model could be developed to capture this nuanced aspect instead of treating oil wealth and war instigation as two explanatory variables of political survival at the same level. Finally, while this chapter investigates the effect of war incidence on political survival, future scholarly work could explore how war duration impacts it.

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