

(英語) English Summary drafted by Chatham House.

Open Economies and the Challenge of Innovation in an Era of Populism and Economic Nationalism

20 April 2018

Introduction

This note summarizes the key points to emerge from an expert meeting which brought together a diverse group of experts from government, international organizations, foundations, the private sector and research institutions.

The event was held on the record and was co-hosted by Chatham House and the Japan Economic Foundation.

Background

Populist and nationalist pressures in Europe and the United States are calling into question some of the core assumptions underpinning globalization and the integrative elements of international trade and finance. In response, a number of national governments, including Japan, have reinforced their commitment to international institutions and stressed the mutual benefits of maintaining an open global economy. This meeting assessed how policy innovation in trade, social and welfare policy, and the technical changes associated with the Fourth Industrial Revolution, are helping to offset some of the negative effects of rising economic nationalism.

The resilience of free trade initiatives in Europe, Asia and North America and the sustainability of traditional, mass employment in advanced economies are under threat in the face of technical change. Further, how can individual economies best respond to major demographic challenges - both aging and migration - in developing appropriate social welfare policies? The meeting explored the role of entrepreneurship and

technical innovation in fostering long-term growth and increasing productivity in advanced economies.

Session 1: Globalization, rising populism and economic nationalism and free trade

Populism, polarization and democracy

The rise of populist politics and the challenge it poses for democracy in its current form is certainly alarming to Western governments. However, participants noted that populism is not a completely new concept and that it is arguably not an entirely bad thing. Populism possesses regenerative elements, it forces elites to adapt and respond to grievances they have ignored or failed to address. Hence, populism may have potential to be a corrective moment in the history of democracy.

This leads to the question of what type of democracy we currently have and how it can evolve. Representative democracies are losing their appeal as citizens increasingly want more involvement in how decisions are being made in the system. This desire is clear in the rise of grassroots movements, as well as with the rise of populism. The discontent with democracy in its current form is evident, hence the clear shift towards participatory democracy and increasing government accountability.

The factors that lead to populist politics were also explored, and participants questioned why the extreme left has seemingly been unable to mobilize in response to the rise of the extreme right. Populism is encouraging increased political engagement, especially with large numbers of non-voters re-entering the system, but the debates on key voter issues continue to be dominated by the far right. Therefore, it raises the question of whether democracy benefits from non-voters reengaging with the system, given that they are arguably doing so because it gives them a sense of agency in a process that they have previously felt alienated from.

Non-voters are far more receptive to populist politics given their prior lack of engagement; it is therefore a challenge for traditional political parties to find a way to better relate to the disillusioned, both voters and non-voters. This led to the question of whether populism is about voice and increasing accountability, or about excluding other voices in society.

Participants questioned the best ways to combat polarization given that people will continue to digest information that corresponds with their own values. The opportunity for politicians to engage voters through social media and new technologies has the potential to counter this polarization in cases where political parties are able to relate to their publics and communicate clear messages. One suggestion was that populism is the shadow that follows democracy, that populist politics challenge democracy to adapt and, whilst democracy remains, populism will continue.

Key Political Trends in Europe

In the context of the rise of populist politics, the meeting identified five key trends within Europe that have emerged as factors in the development of populism, including:

- 1) Political realignment: voters have lost faith in traditional parties and increasing numbers of voters have identified as independents in countries such as Germany, Sweden, France and the UK.
- 2) An increase in voter volatility: the number of voters switching party choices in between European elections is unprecedented. This creates a space for unconventional and sometimes extreme parties to breakthrough.
- 3) Population fragmentation: recently, 62% of Americans stated they would prefer a third party in their political system. The record numbers of active political parties, combined with the minimal points of differentiation between parties means that coalition governments are likely to become the norm.
- 4) The collapse of social democracy: traditional party longevity is increasingly being challenged due to the emergence of far-right parties which are attracting a significant number of working-class voters.
- 5) Finally, the rightward drift in European party systems is evident, especially in contrast to the parties of the 1980s. It was noted that the approaches of center-left parties at present on issues such as identity and migration align with the stances of right-wing parties in the 1980s.

These five trends are common throughout Europe and reflect a fundamental shift in the nature of politics in the West. In considering the nature and durability of these trends, participants discussed whether the world is approaching the end of a period of political volatility or whether we have reached a turning point and are at the beginning of a new period of political change. Upon reflection, the consensus was that these are durable trends, and populist politics will continue to challenge political norms. Thus, pragmatism is required on the part of politicians to respond to the new political

dynamics, and to address the lack of enthusiasm for traditional parties.

Populism in the Japanese context

The Japanese political environment resembles the Western, public opinion-focused environment. As a result of recent controversies, Prime Minister Shinzo Abe is increasingly sensitive to public approval ratings; however, it was noted that this does not necessarily qualify as a populist driven phenomenon. In terms of economics and migration, two key voter issues, Japan is somewhat stable. The country has relatively low immigration numbers and a consistent trade balance surplus, which has meant that the anti-globalism and nationalistic sentiment evident in many other countries is not as prevalent in Japan.

Globalization and voters

Participants questioned whether voters being irrational or un- and/or mis- informed are really a driving factor behind the increase in economic nationalism. Participants suggested that increased detachment and alienation from existing political and economic systems may have led voters to increasingly choose the easiest solution to, or explanation for, difficult and complex questions. In terms of politics, information shortcuts mean voters will typically vote for their previously preferred parties or a party which claims to address the issue of most importance to them. It is thus the challenge, not only for traditional political parties, but increasingly for intermediaries such as the media, civil society and academics to not only better inform but to effectively reengage with voters.

In terms of economics, participants noted that the majority of median voters in the UK and Europe favor economic protectionism to free trade despite the clear benefits of open economies. Free trade increases overall economic gain, yet the median voters either do not believe or accept this. Hence, redistribution of the welfare gains from free trade to ensure that median voter reaps the benefits from trade liberalization will help to maximize public support going forward.

Economic nationalism

As global GDP growth has slowed, the impact of the economic slowdown have been felt heavily across the world. The political response to the challenges posed by lower rates of economic growth has been polarization and economic protectionism. Government

objectives to stop migration, limit globalization and heavily regulate international corporations reflect a nationalistic approach which reduces opportunities for trade and economic growth.

The validity of this approach is questionable in some respects. For example, given that there is no fixed amount of work in an economy, the idea of migration causing job loss for local populations is inaccurate. Economics and migration are dynamic and where managed effectively migrants can have a notable impact on economic growth.

Whilst trade nationalism is a harmful approach in a globalized world, the motivations behind it also need to be understood. Global trade was constructed and regulated around the practice of comparative advantage, but participants noted that it has shifted to a system dictated by those with the most economic leverage. Thus, to regain public and political support for free trade, participants suggested that a collective international effort be implemented, to limit tax arbitrage and identify where value is being added and what should be taxed.

Additionally, on the theme of economic reform, regulation convergence was highlighted as a key issue to be addressed through the creation of global uniform regulations which incorporate understanding of the benefits of particular environments and the developmental elements of trade. A key part of the regulatory discussion is the question of who is leading the international value chains of suppliers. Are these currently state-led or corporation-led, and how can this be reformed to ensure fairness in the system?

Open economies are emerging from a period of rapid economic growth where global trade had an impact on income, but growth cannot continue at such a rate, hence the benefits of trade are becoming less apparent to the public. To increase public satisfaction, it is important for governments to ensure wealth redistribution from trade activity reaches lower income families and workers.

Value chains of suppliers that have been built are now well established and the process of globalization is seemingly irreversible, hence the logical step for governments is to fix the current system and make it more universal. Regulating trade so that corporations are unable to take advantage of weak government regulations and law enforcement is a good first step to counter the populist-driven resistance to free trade agreements.

Economic nationalism and free trade agreements

There is growing public resentment towards free trade agreements for a number of reasons. This can partly be attributed to slowing global GDP growth and the misunderstanding that free trade has undermined individual countries' economic success.

Participants questioned whether the growing economic nationalism we are seeing across the globe is inherently linked to the rise of populism, as well as a fear of globalization. The consensus was that global economic growth had begun to slow prior to the Global Financial Crisis, but increased visibility of this slowing in recent years has become a platform in populist politics. The public has become increasingly weary of globalization, fearing that it entails a loss of both identity and sovereignty, and the subsequent loss of control to global corporations and actors. It was noted that part of the problem is the way in which free trade is presented to the public and the failure of government to ensure that the benefits are enjoyed by the working class. Finally, trade reform is also required to ensure that trade agreements and practices adhere to the principles of trade, including comparative advantage, thus restoring public faith in international trade.

Addressing populism in the long term

Participants discussed the longevity of these political and economic trends, and it was agreed that populism will continue so long as populations feel a sense of a loss of identity making identity a much more important element of voting practices than it has been previously. Thus, government has a role in adapting to this new environment, and reaffirming national identity, without taking a hostile approach to trade and international relations.

Session 2: Immigration, aging society and the political economy of social welfare and healthcare

What happens to social security with an aging population?

Participants discussed immigration and aging populations and whether they weaken social welfare provision. Japan feels a sense of urgency in addressing these issues given it is currently challenged by its aging population. Financing social security is becoming

increasingly difficult, as the country's pay-as-you-go finance scheme relies primarily on the younger population to fund the social benefits scheme. Whilst the pay-as-you-go social security system works well to take account of different population demographics, it is an unsustainable system where there is a rapidly aging population, combined with a sharply declining birth rate, as is the case in Japan. The challenges posed by Japan's changing demographics require pragmatism and policy innovation in addressing social welfare issues.

To highlight the severity of Japan's social security challenges, in 2015, the older age dependency ratio stipulated that 100 young people were supporting the pensions of 42.7 people, whereas in 2000, they were supporting just 24.9 people. Further, a large portion of social security funding is also directed to fund the medical costs of the aging population. The sustainability of the country's current scheme is decreasing, and Japan has proposed a number of reforms to ensure future support for its population.

Subsidizing the growing social security deficit through government general accounts was one of the government's initial approaches, however the longevity of this approach is questionable given that it is only sustainable in the short-term whereas the aging population is a more permanent issue.

A more promising proposal is the 'Abenomics' fiscal consolidation policies, which involve a strategy to make up the deficit through economic growth, without serious economic reform so as not to disrupt the system too deeply. Further increasing the consumption tax is another potential solution, given that this is currently the only way the government collects money from elderly and retired people, who are no longer paying income tax or social security premiums. However, this is a contentious issue for Japanese voters.

Stimulating economic growth to combat aging population

As Japan's population continues to age and the country suffers from a labour shortage, the question remains as to why its immigration numbers remain so low. Increased immigration was proposed as a potential solution to Japan's population crisis, given that migrants are commonly highly-skilled and skilled workers, there is potential that they will stimulate an economic boom. Currently, there are just eight million foreigners living in Japan, which has a population of over 125 million people. The same number live in Sweden, which has a population of less than 10 million. Participants pointed to the Swedish reaction to its own population decline and economic stagnation, where the

response was to increase career opportunities for women rather than increase migration. In the case that Japan remains opposed to increasing migration numbers, mobilizing the female workforce was suggested as an alternative approach.

Migration challenges

Temporary migration is preferred in Japan, emphasized by the fact that foreigners must have lived in the country for five years to apply for citizenship and ten years to apply for permanent residence, with the citizenship application process being more challenging than the latter. Additionally, it is a challenge to integrate migrants into Japanese society; there are currently 25,000 non-Japanese speaking students in schools. Higher incidences of criminality are often cited among foreign residents in Japan. However, these individuals are commonly caught committing 'special code' offences, which Japanese cannot commit, such as migration crimes. Integration is crucial to mobilizing the migrant workforce and these are issues which need to be addressed in Japanese government policy.

Participants noted that there is a strong sense of entrepreneurship among migrant communities which is clearly economically beneficial. Approximately thirty percent of venture capitalists in the United States are foreign-born, so why could this not be a solution to Japan's demographic challenge? It was also noted that most migrants will retire in their home country, meaning that they will not burden the Japanese social welfare system. Hence, increasing migration is a viable strategy to stimulate economic growth in the immediate short term whilst not threatening Japan's social welfare and healthcare system in the long term.

Depopulation

With low population growth and low migration numbers, Japan is not only facing the challenges of an aging population but also of depopulation, with half of Japan's land area depopulating since 1990.

Japan has the world's 11th largest population, and this population boom, combined with economic development has caused substantial environmental damage.

Depopulation is a potential opening for environmental restoration yet no benefits have been seen in these depopulating areas in decades. Rather, per capita energy consumption continues to grow in these areas. This is an area of opportunity for Japan to take a leadership role in environmental restoration and to utilize depopulation as a

tool in the political- economic approach. It does not have to remain a zero-sum game, where increased economic activity reduces environmental effectiveness.

The energy demands of depopulating countries have been underestimated in IEA energy consumption predictions. Additionally, the underuse of housing and infrastructure is inefficient in energy terms. For example, it is increasingly common to see one person living in a house where six people once lived. The lack of change in energy consumption boils down to government employment policy, such as that in factories and agriculture. Depopulation should be seen as a policy opportunity to improve environmental sustainability through energy reform.

Session 3: Productivity, educational and technological innovation and the growth of smart cities

The meeting considered the challenges of the 'Fourth Industrial Revolution' in relation to human well- being in advanced economies and its impact on productivity. The world's rapid technological and cyber developments, coined as the Fourth Industrial Revolution, is presenting unprecedented challenges to societies for a number of reasons, which has negative political and economic impacts.

To put the revolution into context, participants briefly revisited the previous revolutions to differentiate the Fourth from its predecessors. The first revolution of the 18th and 19th centuries in the US involved mechanization, and the transition from rural to urban, agriculture to factories. The second revolution, between 1870 and 1914, saw the emergence of new industries such as steel, oil and electrical power, as well as the invention of the telephone and increased power. The third revolution of the 1970s and 1980s prompted a shift from analogue to digital across many industries, the introduction of automation and increased mass production, as well as new communication and information technologies.

What is the Fourth Industrial Revolution?

The fourth revolution focuses on rapid cyber developments, including real-time

communication as well as cloud computing, 3D printing, autonomous vehicles and smart cities. In contrast to previous revolutions, some participants suggested that this revolution will prove more difficult for societies to adapt to. The challenges are being presented by companies such as Tesla creating an autonomous truck, which will have a significant impact on jobs in the United States, as well as IKEA launching a robot in Singapore that is able to assemble the framework of an IKEA chair within twenty minutes.

Participants questioned what this means for the global labour force going forward, and whether the global minimum income is a practical and sustainable idea to address the socio-economic challenges of large-scale job loss. Arguments in favour of the basic minimum income suggest that it will foster increased creativity and has the potential to generate better job and life satisfaction.

Whilst it was accepted that the fourth revolution is presenting a number of new challenges, the discussion highlighted that every revolution involves a period of social disruption during the adjustment period.

Arguably, we are in the period of adjustment and setbacks are to be expected, but moving forward, new processes for building technology will emerge.

Why is this revolution different? Participants noted three key differences between the Fourth Industrial Revolution and its predecessors. Firstly, the sheer volume of data that is being generated is creating a new economy which is a challenge to regulate. Secondly, the emergence of new IT-enabled business models along with a range of platforms (including iPhone, Airbnb, Uber) have created an ecosystem for innovators to build upon. They have also enabled a system of entrepreneurship which is not easily controlled by governments. Thirdly, artificial intelligence has the possibility of self-improvement meaning that technologies will evolve even more rapidly than ever.

The risks of such rapid technological development are obvious, and innovations in job creation are essential to address the job paradigm shift, especially in developed countries such as Japan. Where artificial intelligence substitutes jobs in various industries, including agriculture and the service industry, there is also the danger of wage reduction in those jobs that are now carried out by artificial intelligence. However, participants also highlighted potential opportunities created by the Fourth Industrial Revolution to resolve social issues. Finding the balance between investment in new technologies and the benefits of the investment return is therefore essential to

reap the benefits of the industrial revolution.

Moving forward with the Fourth Industrial Revolution

The primary challenge of the Fourth Industrial Revolution is its impact on the economy, and the job shortage it is bound to create where robots replace humans for example. Participants discussed how to recreate meaningful social activity that responds to new technologies and job shortages created by robots replacing the human labour force. Whilst governments will attempt to replace these jobs in new industries, the question is whether it can create enough jobs and whether it can maintain social cohesion in the transformation process. In the instance that the government is unable to generate enough new jobs, it is likely they will need to explore the idea of the minimum basic income as well as meaningful work. The discussion turned to the potential that volunteerism could become a new mechanism for social cohesion.

In addition to work shortages, participants discussed the notion of productivity and its future. Will there be less incentive for productivity in a labour market where human labour and contributions have become less valuable? Considering the scenario where lower-level jobs are replaced by computers, participants discussed whether this will lead to increased laziness in workers and declining creativity.

Another issue to be addressed by governments during this technological revolution is the emergence of cryptocurrencies, and the decreasing need for a central bank. Although the impact of this is yet to be seen, the replacement of central banks signifies that there is less need to trust in and rely upon governments. Whilst the role of government going forward is not entirely clear, the introduction of new technologies and industries creates an entirely new ecosystem that will need to be regulated. Arguably, these new challenges mean the government has a greater role to play as the world navigates the Fourth Industrial Revolution.

Given people are generally satisfied when their work is contributing to a cause, social entrepreneurship and social innovation are clearly the next steps forward. Enabling entrepreneurship and innovation through education is vital. The discussion highlighted that adapting education system to include more practical, real-world learning, rather than theoretical is a potential way to foster innovation.

Entrepreneurship – a Western concept?

On the subject of entrepreneurship, the discussion considered the concept in the Japanese and UK context. Whilst entrepreneurship is an established practice in Europe, the idea is yet to find its place in the Japanese economic ecosystem. Start-ups are not particularly active in Japan, which can be attributed to the unwillingness of large companies to collaborate with them. The competition between large companies to find new ideas and to take ownership of innovations prevails over the potential to invent more rapidly with a partner.

This reluctance to take advantage of entrepreneurs is not only an issue amongst large companies, but also with the government. Whilst Abe's 'Abenomics' policy is centred on innovation, participants questioned the government's commitment given its investment in entrepreneurship. Japan has the world's third largest economy (by GDP ranking) and yet invests less than two percent of what the United States does in venture capitalism.

Given that UK investment in venture capital is far higher than other European countries, participants discussed the potential for cooperation between the UK and Japan, especially in relation to science, with the aim of boosting innovation in both countries. In terms of global innovation, the UK currently ranks third on the list, whilst Japan comes in at thirteenth. Collaboration between the two could see both parties move up the rankings.

Participants also acknowledged the challenges created by entrepreneurship, and potential reasoning behind reluctance in Japan to embrace the concept. As Germany is adapting and creating Industry 4.0, with the objective of allowing the consumer to customize everything they are purchasing based on their needs, this generates issues with security, stability and reliability of products, legal concerns and, most notably, job losses.

Smart cities and Society 5.0

The innovation discussion considered smart cities, an initiative aiming to utilize technology to improve efficiency, share information with the public and improve government services and the quality of life in cities. There are currently more than 160 cities and over 400 companies involved in this program. The overall objective is to make replicable models through sharing of information on key clusters including transportation, health and the environment, and energy. The key ideas of this concept are clear in Japan's Society 5.0, which is framed in terms of social needs rather than a

technological push.

Connected to the idea of smart cities, the Abe government has introduced the concept of Society 5.0, a model which seeks to address the economic and social challenges Japan is currently facing, including its ageing population and weak economic growth. Part of the country's 2017 Growth Strategy, the idea is that Japan will become a smart society, where everything is connected by technology, and all necessary goods and services are provided in a timely manner and in the quantities needed, thus ensuring better quality of life.

Whilst Society 5.0 is an attainable idea given the current direction of technological development, the discussion highlighted several obstacles to its attainment. Japan is currently facing a severe labour shortage, mainly due to low immigration numbers and its aging population, and this is an issue which needs to be addressed to mobilize a larger and perhaps more diverse workforce. Additionally, participants highlighted that without innovation and entrepreneurship, Japan's Society 5.0 is highly unlikely.

Hence, promoting innovation is critical in working towards Society 5.0. It was noted that there is an underestimation of company contributions towards innovation in Japan, however the lack of collaboration between large companies and start-ups is concerning given that, in the US and other innovative countries, large companies are purchasing many of their innovative ideas from technology start-ups. This culture has not yet developed in Japan, as large companies seek ownership of their innovation but increasing these partnerships is crucial to achieving Society 5.0.

Conclusions

The meeting generated a balance between optimistic and precautionary thoughts on addressing the challenges of innovation, populism and economic nationalism. Populism has generated increased grassroots activity, and thus created an appetite for governments to address limitations within their own societies. The question is whether this can be expanded more broadly to address global problems, such as technological innovation and adapting economically. Participants also noted that populism challenging democracy may not necessarily be entirely negative, given that it has forced mainstream parties to adapt and progress in the face of various challenges.

However, one area which governments have failed to address is the issue of globalization, and the established perception within society that free trade agreements are a threat to national economies. This impression needs to change and free trade should be encouraged in order to stimulate economic growth across the globe. Globalization was a rapid process and economic growth cannot possibly remain at the same rate forever, hence the slowing of the global economy should not be attributed to free trade agreements.

Whilst populism has created a sense of uncertainty in politics, and the Fourth Industrial Revolution is creating economic insecurity internationally, there are clear attempts by stakeholders to address these challenges. There was general consensus in the meeting that the opportunities for collaboration and information-sharing are increasing, both between governments as well as the public and private sector. Further, outside the government realm, there is evidence of innovation and adaptation within companies of all sizes, which is a positive signal towards the resilience of different societies. Given that innovation is a shared challenge across the globe, cooperation between stakeholders is critical to overcome challenges and stimulate economic growth and productivity.