

From an interview with Swedish Ambassador to Japan Lars Vargö

R eleasing the Potential of High-Tech Clusters

The Swedish Ambassador on a Winning Industrial Policy

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Japan is in need of major reforms. Continuing deflation, an enormous national debt, and an aging and shrinking population are just a few of the issues it needs to tackle in order to ensure a stable future. To restore the economy, the government is currently discussing a number of monetary policies, such as inflation targeting. In addition to macroeconomic policies, *Japan SPOTLIGHT* is now focusing on the possibility of Japan adopting a more active industrial policy. We recently talked to Lars Vargö, the Swedish ambassador, about Sweden's successful industrial policy and if it could work as a model for Japan.

Haraoka: How do you assess Sweden's economy and society, and the outlook for the future?

Ambassador Vargö: The Swedish economy is doing fairly well compared to other European countries. As a non-member of the eurozone, Sweden has not been directly hit by the crisis there. In fact, we have been accumulating a surplus. For several years, the last two governments have been enforcing a rigorous fiscal policy, which was based on available money only, and have thereby gradually reduced the national debt. Now the national debt has shrunk to around 30% of GDP, which is a significant development.

One of the problem areas we are tackling is unemployment. We are particularly concerned that immigrants and youth are the most affected groups of people among the 8% unemployed in Sweden.

Sweden's economic future is affected by its exports that make up 50% of its GDP. Our major export markets are Europe as a whole, followed by the United States. While Japan, China, and India are less important, their growth problems can still influence us indirectly, especially China's. Recently, the government revised its forecast for Sweden's growth down to around 2.5% or 3%, but this doesn't change the fact that Swedish industries are in general healthy. The country ranks probably equal to or better than Germany. It is, however, a global team-player and not self-reliant.

Aspects of Sweden's Economic Growth

Haraoka: What is the reason for Sweden's good economic performance? Do you think there is a link



Lars Vargö, Swedish ambassador to Japan

between its economic growth and the solid social coherence of society?

Ambassador Vargö: Certainly, but more important are the structural reforms we implemented early on. Neither the government nor the private sector attempts to keep non-viable or weak companies alive. The focus is on industries that have a future. For this reason, we have a solid system of welfare structures that acts as a safety-net whenever people become unemployed, thereby making a smooth transition from unreasonable to reasonable industries possible. In Sweden, the word welfare has in fact a quite positive connotation; it doesn't mean that you have given up. Welfare is a supporting structure;

also, for example, during childcare leave.

Moreover, gender equality is fully developed in the Swedish labor market, including mothers as a regular workforce. Much to our surprise, we have also realized that working women give birth to more children than housewives do — that is, provided that daycare centers exist and the fathers are partaking in child care.

It's those welfare and social structures, plus a willingness to let innovations lead the industrial structure, that have been the decisive factors in Sweden's economic growth. And because of our export-dependent economy, we also focus on educating future industries and staying on top of information.

Haraoka: Can you tell me more about how Sweden is staying on top of information?

Ambassador Vargö: First of all, we have very strong IT companies,

small and large, that don't hesitate to advance into new areas. But innovation requires that you have learned to think freely in school, as part of your education. And to stay ahead, you also need knowledgeable people who have the skill to analyze the national and international competition while embracing this free, innovative atmosphere.

Skype and Spotify, which were both invented by Swedish entrepreneurs, are success stories emerging from this kind of free environment. The Skype inventor became a zillionaire overnight, when he sold his company to a US firm.

Most important is that entrepreneurs in Sweden feel that success is within reach. And this conviction stems from a proper and free education, which enables you to get a clear picture of what is happening in the world and where your own opportunities lie.

Liberal Approach to Industrial Policy

Haraoka: What about industrial policy? Does it also play an important role in Sweden's good economic performance?

Ambassador Vargö: Industrial policy has many aspects. One is that you need to have mutual trust between employers and employees. In line with this thinking, Sweden established an agreement in the 1930s called The Saltsjöbaden Agreement. With this agreement the two sides agreed to cooperate under mutual respect to secure employees' rights as well as the company's need to make profit. The agreement is no longer a policy, but it has become a common understanding in Swedish society.

Sweden's actual industry policy is to create a company-friendly environment that is, as much as possible, free of obstacles. So, for example, even though Sweden is known for its high taxes, corporate taxes are kept within limits. On the other hand, there is nothing close to the exorbitant American salaries. We have bonus problems in Sweden, but those are on a completely different scale.

Also, companies should grow by themselves. We don't support companies with no future prospects, and neither do we excessively support the ones with future prospects. The policy is to have as few restrictions as possible while respecting each individual member of society by not overexploiting him or her.

Haraoka: My impression is that Sweden is very successful in structural reform.

Ambassador Vargö: Yes, I think so.

Haraoka: According to many political observers, Japan is in need of structural reform and this seems to be the kind of reform necessary to restore the economy.

Ambassador Vargö: Yes, I think that is true.

Haraoka: So Sweden's industrial policy is not about picking winners but about accommodating a growth

environment based on rather free competition?

Ambassador Vargö: Yes, exactly. There are no real subsidies for companies. The kinds of subsidies we have are in general applied to promote a growth environment.

Haraoka: You mentioned that your fiscal situation is growing solid compared to other European countries. This seems to be the result of a successful tax policy which establishes the right balance between corporate competitiveness and social welfare. What makes the Swedish tax policy so successful?

Ambassador Vargö: One important point is that we have a very efficient tax collection system. It is more or less impossible to escape. At the same time, the people understand the effort political parties put into lowering taxes whenever possible. However, before taking measures like lowering taxes the general consensus is first to collect sufficient resources for the different social structures to be guaranteed.

Most important, however, is transparency: people know what the money is used for, which creates a feeling of trust in the system. This is the reason why the public advocate it.

Social Cohesion in Sweden & Japan

Haraoka: This means that Sweden's economic growth is also due to a combination of good policy governance and social cohesion. It sounds quite easy to achieve a consensus in Sweden.

Ambassador Vargö: Yes, that is true. As in Japan, income differences are in general small; and a small gap between rich and poor people means less tension. This, of course, is a result of our system and social structures. If we need to raise taxes, the government explains why and people debate about it. It's an open process with all figures disclosed to the public.

Gender equality is also an important factor. Women are, like men, part of government structures, on national as well as on local levels. Women are also equally represented in industries. This influences the way companies act and think, creating a healthy balance: women can, with their perspective on things, counter arguments that men emphasize. Having a balance between men and women is therefore very important. It creates a sounder atmosphere too.

And while I can't prove it, I also believe that gender equality makes it more difficult for corruption to grow.

Haraoka: You must have been in Japan for a long time.

Ambassador Vargö: Yes, 18-19 years.

Haraoka: Then maybe you noticed at the beginning of your career as a diplomat that Japan used to be successful in achieving social cohesion. However,

now things seem to have changed. What do you think is the reason for this change?

Ambassador Vargö: Well, scandals like the Olympus scandal and corruption have more or less been ongoing for ages. In the early 1970s, the Lockheed scandal had caused an uproar in the media. Back then, I thought this was only temporary, but I was wrong — one scandal after another followed.

There seems to be a gap between the young and the old generation in Japan. The young generation is shaped by modern economic thinking, whereas the old generation was shaped by the economic thinking of the 1920s and 1930s and the postwar era. It seems to me that there is a growing mistrust between these generations. In order to rebuild trust, people need to open up more, think more broadly, and become more globalized.

I am not sure to what extent this could be connected to Japan's geography as an insular country. Looking at Japan's early history and the Meiji Restoration, very few countries have been exposed to such an enormous impact from the outside world. You can compare it with the huge changes going on in China now, but as in Japan the changes remain incomplete. Japan can benefit if it starts to deal with these as yet unchanged parts.

Haraoka: Foreigners used to be surprised at seeing how good Japanese teamwork was in both companies and in government. As in Sweden, there was trust between the people and the government in Japan, but it seems to have vanished, in particular since the earthquake.

Ambassador Vargö: Well, I can understand that. In a certain respect, Sweden and Japan are very similar in terms of social structures. A Swedish system could therefore work in Japan and help to reestablish social cohesion. However, this requires transparency whatever system and whatever tax level you may use. Otherwise you won't gain trust from the voters. I think the reason for the strong resistance against raising the consumption tax in Japan is because it's unclear how the money is used.

Also, the older generation is putting a brake on current development in Japan. In my opinion, Japan needs a generational change to introduce comprehensive reforms. Younger people need to get into all kinds of decision-making structures.

Haraoka: So we need younger people and women to participate in the decision-making process.

Ambassador Vargö: Yes, absolutely.

The Principle of High-Tech Clusters

Haraoka: Let us get back to industrial policy. You mentioned that Sweden is not practicing a policy where it picks winners. At the same time, the

information technology industry is becoming very successful in Sweden. How come?

Ambassador Vargö: Yes, that's right. In fact, local governments support the IT industry. This morning, for example, I had a visit from four Swedish businessmen. They represented a so-called IT cluster from an area near Malmö. A cluster is a place where the local authorities cooperate with local universities to support new IT entrepreneurs and industries. The aim is to create synergetic effects and an inspirational environment, similar to Silicon Valley.

But even though local governments support selected IT projects they find interesting, money itself is secondary. What counts is our belief that nobody can make it alone, and this is why universities and new, small companies need to be close. In such locations, you also need to make sure that office space and research facilities are affordable.

On top of this, there is an IT trend among young people. Somehow they have come to believe that coming up with an innovation in the IT industry is a sure key to success. IT is so in vogue that it probably would rank high up in popularity next to new cuisine and healthy food.

In short, it's self-driven. Local governments only support it to a certain degree.

Haraoka: As far as I know, Silicon Valley succeeded without government support. Still, people say that you need government policies if you want to spur innovation. What is your opinion?

Ambassador Vargö: The question for me is: What can the government do? If the central government gets too involved, it is counterproductive. But the case is different with local governments as their involvement can be more concrete. Again, they too have their limits since subsidies would probably break WTO rules.

Haraoka: Biotechnology and environmental technology industries, such as recycling, are two examples of successful industries in Sweden. How does the government support them?

Ambassador Vargö: When it comes to biotechnology, the government influences where the money is allocated. It decides which universities and research institutions will receive the support and thereby emphasizes specific areas and guides things in certain directions. But it does this in cooperation with research institutes, universities, and private companies. So, usually, both government and private money flow into those projects.

With regard to environmental technology, the Swedish government promotes the creation of sustainable solutions in cities and regions. This is one important part, for example, of its environmental policy to reduce greenhouse gas emissions and meet our targets.

We often show foreign visitors to Sweden our sustainable areas

located in Stockholm. Their concept and construction are entirely designed to be environmentally sustainable: how you create heat, how you use or collect your waste etc., using highly advanced technologies.

Interestingly enough, the smallest companies, with sometimes only one or two people, were the driving forces behind these areas. Such small companies of course need partners and advisors in order to succeed. Central and local governments direct and tell them which projects they find promising and supply them with a moderate amount of financial support. Once these small companies have received this kind of coaching, they proceed by their own force and generate their own ideas.

So all investments are always a mixture of private, government, and local money.

Haraoka: And what about biotechnology?

Ambassador Vargö: Biotechnology is highly advanced in certain regions equipped with highly advanced research departments. We pay much attention to research: in biotechnology, in medicine — no matter what area — you will find all the facilities placed where the research department is located. And whereas the number of research departments at university hospitals is smaller than in Japan, they far outgrow Japanese departments in size.

However, isolated work is doomed to fail. This is why Swedish researchers are internationally connected and cooperate with researchers in the US and other countries, also in Japan.

Haraoka: Japan has to cope with major changes that are underway, such as an aging society and a probable change in energy policy after the nuclear energy crisis. This is why the Swedish research projects in environmental and other areas are interesting for us. These projects could also be promoted together with Japanese research institutes.

Ambassador Vargö: I agree. I think Japanese and Swedish companies and institutions would be interested in cooperating, as we have similar ways of thinking and finding solutions.

Our neighboring countries sometimes call us the Japanese of Europe, because we need a lot more time to make a decision than they do. Every single decision we make is consensus-based and well thought through. In fact, as I recall, Swedes and Japanese have always found it easy to work together.

And although we are a very egalitarian society, Swedes can, like the Japanese, be quite hierarchical in certain structures and situations. Those hierarchies are applied with purpose, though, and don't allow people to ride a high horse.

Possible Future Policies for Japan

Haraoka: This means we share some cultural traits regarding social cohesion. Unfortunately, social

cohesion has declined in Japan. But by following the Swedish model, maybe we will be able to regain it.

Ambassador Vargö: I am often asked whether it would be feasible for Japan to change to a Swedish system. Certainly, a series of painful changes would have to take place.

The taxation system, for example, is one of many things that is different. Japan is planning to raise the consumption tax from 5% to 10%. In Sweden, the consumption tax is 25% on 90% of all services and goods. Our income tax is much higher than yours too. Besides, we don't have an early retirement system and most people work until they are at least 65.

This means, while we started from a similar kind of cultural thinking, Japan and Sweden have pursued different paths and ended up with two very different systems. However, it also means that, with similar ways of thinking, we should be able to produce similar systems and structures.

Haraoka: The OECD has recently created a new concept called “well-being”. According to this concept, GDP or GNP shouldn't any longer be the almighty criteria to measure economic success and progress of a society but instead well-being. Do you think that Sweden would welcome this concept?

Ambassador Vargö: Yes. But especially Japan. As Japan has a high national debt and continuing deflation, visitors from Sweden expect Japanese people to have a gloomy air and that nothing works here, but they are surprised to see how well Japan functions.

Generally speaking, Japanese society is very healthy: there are no slums; people have money; there is a relatively good education system; the transport system is extremely efficient; Japanese people live remarkably long; and the crime rate is very low. All these things are seldom seen in economic statistics.

So if these points were included on a well-being scale, Japan would probably surpass all other countries.

I feel so, too. When I arrive at Narita airport, I somehow relax, because I know that things work here and that there is nothing to worry about.

Haraoka: This means that with the concept of well-being, Japan could achieve more social consensus than with GDP. Is this also true for Sweden?

Ambassador Vargö: Yes, absolutely. People complain, of course, but Swedish and Japanese people are in general satisfied with what they have. Japanese people say that they are happy to be born in Japan, and Swedish people say the same thing about being born in Sweden.

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