Economic Policy in an Age of Rising Geopolitical Risks

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Introduction

Many people today in the OECD nations and some developing countries as well feel completely deprived of any ability to participate in the policy decision-making process and that they are not well represented by the political elites heading their national governments. They feel their interests are being ignored and even disrespected by them. One result of this is that they have turned against the policies being pushed by these establishment elites, as witnessed by the increase in anti-free trade or anti-globalization movements. Although free trade and globalization have usually been considered the best economic policies by the governing elites, they have not always been consistent with the interests of ordinary people. Globalization, for example, could threaten job opportunities, while more nationalistic or protectionist policies could work to secure ordinary people's jobs. Geopolitical crises, including the US-China tech cold war or trade conflicts triggered by such a backlash, seem to be intensified by this anti-elite sentiment.

But it is true that globalization has some negative aspects that are recognized even by the governing elites. Some industrial sectors or individuals that have failed to adapt to globalization have suffered from loss of income or employment as a result of losing competitiveness to global rivals. Such drawbacks should have been mitigated by maximizing the benefits of globalization, but in reality this has not happened. So these reactionary movements may as well be welcomed as providing a good opportunity for addressing these issues.

Expanding income disparity is certainly a big drawback of globalization and a principal cause of anti-elite political movements. But this is an old issue that economists have examined even before globalization got fully underway. About 100 years ago at the peak of industrialization based on new revolutionary technologies such as automation, a significant income gap began to develop between the rich, who earned revenues from the industrial revolution, and the poor, who were mostly laborers left behind by the trend toward innovation and replaced by machines.

So we do not need new economics to resolve this issue today. While we may need political science to examine today's anti-establishment movements since income inequality is not the sole reason for it, the old economics can handle this issue. Even 100 years ago, economists knew that income equality would not necessarily be assured, even at the point of optimal resource allocation, by market mechanisms. Government intervention would be necessary to correct inequalities.

In this short essay, I would like to look at how current economics can contribute to resolving the challenges arising from today's geopolitical crises.

Causes of Income Inequality

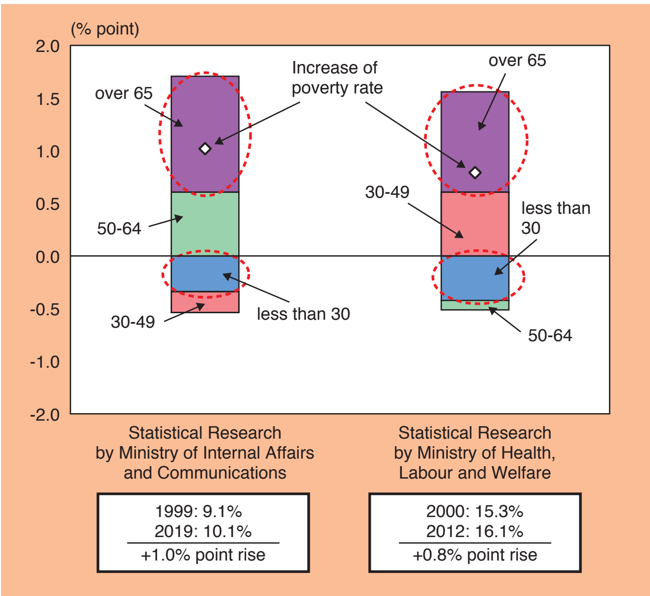
Globalization has produced both winners and losers and increased income inequality between them. But in the long run, this inequality will disappear, since the losers – companies that have lost their competitiveness under globalization such as steel companies in the Rust Belt region of the United States – will leave the business and their production elements such as labor and capital (production facilities) will be transferred to the winners (successful companies). This is what we call the structural adjustment process, which governments are expected to promote as smoothly as possible. In the short term, these loser industries or companies may need help from their government to make these transitions much less challenging and avoid a radical rise in unemployment. In the structural adjustment process, governments are expected to play a key role in mitigating the income inequality between winners and losers.

While inequality born of globalization is by nature transitory, there is another aspect of inequality that is structural in nature, as pointed out by Thomas Piketty in his book *Capital in the Twenty-First Century* (2013). He referred to the famous episode in Honoré de Balzac's novel *Le Père Goriot* (1835) in which a poor college student learning law is convinced that in order to be wealthy, it would be far easier to get married to a girl from a wealthy family than work hard to be a lawyer. The episode shows that whether you are from a wealthy family or not can be a major factor in causing inequality rather than individual efforts. As the economy matures and stabilizes, the wealthy would become wealthier by earning stable revenues from their investments, while the poor would remain poor as their wages will not rise much due to stable prices. Social status is almost fixed for all people. This fixed income inequality would remain even with a market economy that functions well. Global competition could achieve optimal resource allocation and economic efficiency, but it could not change fixed income inequality as such.

Educational background is another important structural inequality. This is more crucial now than ever, with the advent of the Fourth

CHART 1

Age factor of heads of households pushing up poverty rate in Japan
(changes during 1999-2009 & 2000-2012)



Source: Ministry of Internal Affairs and Communications; Ministry of Health, Labour and Welfare

Industrial Revolution. AI and IoT and other information technologies will replace human labor, both simple and intelligent, and eventually a large part of the human working population. This will lead to significant income inequality between people with high skills and advanced knowledge and less intellectual ones. We should not overlook the fact that only wealthy families will be able to give their children a high-level education in light of costs. Such labor-saving technological changes could encourage further non-permanent labor employment and this would increase another income gap between permanent workers and non-permanent ones.

The rapid aging of societies in developed nations, and in the near future in many developing countries, will be another source of structural income inequality. Elderly people are mostly retired and with limited income sources. The growing ratio of such people to the total population will lead to structural income inequality. For example, in Japan, the country with the most rapidly aging population in the world *(Chart 1)*, the increase in households with heads over 65 years old pushed up the poverty rate (the percentage of households whose head has an income below around $10,000 per year) significantly during the first decade of the 21st century.

However, it is true that poverty among young people today is increasingly affecting changes in the poverty rate *(Chart 2)*. The peak of poverty in 2012 was seen in the young age group of 20-24 years

CHART 2 (a)

Change in poverty rate among men in different age groups (1985-2012)

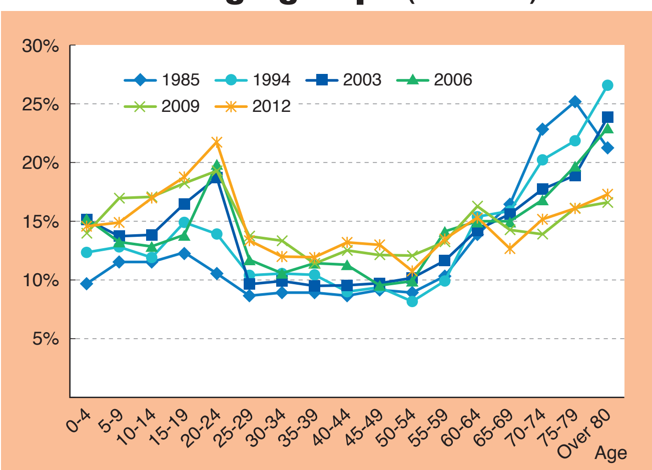
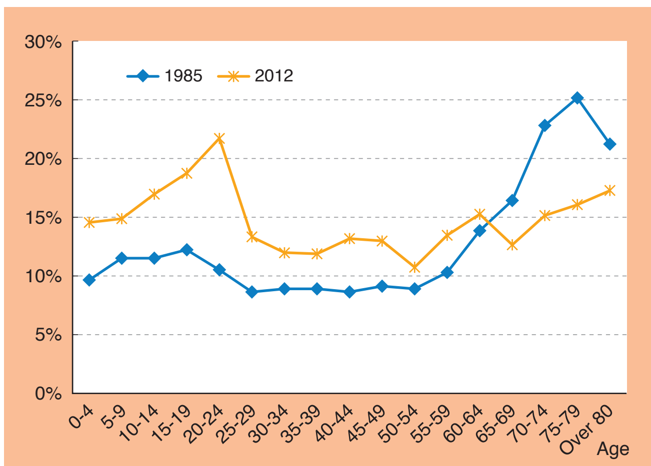


CHART 2 (b)

Comparison between 1985 & 2012



Notes: 1. The peak of poverty in 2012 is seen clearly in the young age group of 20-24 years old.
2. In the working age groups, the poverty rate has been clearly rising since 1985, though its rising trend is recently slowing down.
3. In the age groups over 60 years old, the poverty rate has been significantly decreasing in 2012 in comparison with 1985 and it is still continuing to decline even now.

Source: Poverty Statistics (2015) by Prof. Aya Abe of Tokyo Metropolitan University from "Combatting Poverty Among Young People" (Cover Story 6) from Japan SPOTLIGHT Nov./Dec. 2016 issue.

old. This was largely due to the increased ratio of non-permanent employees to total employees in Japan whose incomes are much lower than those of permanent employees. This shows that poverty in Japan cannot be entirely attributed to the aging society.

According to OECD statistics in 2016, the Japanese poverty rate was 15.7%, ranked 14th among the 42 surveyed countries, while the rate in China was 28.8%, the highest among those surveyed, in India 19.7%, ranked fifth, in the United States 17.8%, ranked sixth, and in South Korea 17.6%, ranked eighth. This means income inequality is as important a policy issue for Japan as for those nations. It is often said that having a relatively small immigrant population in Japan may not provoke more anti-globalization or anti-elite political movements than in nations with larger immigrant populations, but this income disparity could provoke such movements even in Japan.

Suggested Economic Policies

Even now when skepticism about globalization is growing, mainstream economists, usually well regarded by today's political elites, speak of the advantages of globalization, in the belief that over the long term globalization will produce the largest economic benefits for all nations. These benefits may contribute to mitigating income inequality by a trickle-down effect to the poorer levels. But as I have mentioned, we are now faced with structural income inequality caused by a number of factors that will not be allayed even in the long run without relevant economic policies. Economists will need to return to what economists in the 19th century said about the doctrine of *laissez-faire* and income equality, namely the latter cannot be ensured by the former. The absence of a convincing theory of rising inequality, downward social mobility and resulting pathologies must be corrected, and criticisms of market mechanisms that originally existed in economics should be restored. But as capitalism proceeds and markets expand, this view has been marginalized. It is now only economists themselves who can reverse this marginalization, and the rise in anti-elite political movements should be considered as providing a good occasion for them to reflect on policies to correct income distribution that favors the incumbent wealthy. They could, for example, consider the following prescriptions for the maladies possibly caused by income inequality.

In coping with digitalization replacing human labor and obliging an increasing number of employees to follow non-standard contracts as non-permanent employees, the government should establish a "basic income" to ensure the minimum wage for all workers, in particular for the interests of non-skilled labor. This would assure all citizens of a minimum standard of living regardless of their status of employment or amount of wages. Assuming that digital technology could replace a large portion of the workforce who would not be able to earn enough wages to maintain an ordinary standard of living regardless of their qualifications or skills, economists should suggest a drastic reform of the existing social security system.

There is a belief among OECD nations including Japan that stagnant real wages for less educated workers are one of the principal causes of widening income inequalities. We need to know why real wages for the less educated fail to rise. We must examine the behavior of corporations, their increasing reliance on outsourcing, and how their market dominance as a monopoly or oligopoly under the waning of antitrust enforcement influences their employees' wages. We also need to study the role of anti-labor politics and policies and labor law, and also the decline of the power of the unions.

It is also necessary for us to eliminate implicit discrimination against minorities that could lead to inequality. For example, gender discrimination can lead to serious inequality of opportunity. We see a very low percentage of female managers in Japan, because the opportunities for management positions given to Japanese men have not been equally shared with Japanese women. In education as well, there has been a dominant presumption in Japanese culture that girls will not be good at mathematics or natural sciences, while boys will not be good at handicrafts, meaning a loss of opportunity for those in both categories to realize their natural gifts. We need to eliminate these implicit discriminations rooted in our culture in order to achieve equal opportunities for all and take full advantage of everyone's abilities.

And this is true of not only gender discrimination but also age or nationality or discrimination based on handicaps. Direct intervention in such implicit discrimination against minorities is necessary, such as imposing obligations on companies to ensure a certain percentage of their managers are women.

Industrial policy to empower the private sector should also be recommended by economists. To create an economy caring for a worker's interest, the public sector should engage in a public-private partnership in which it plays a vital coordinating role and enhances the competitiveness of private business, ensuring its efforts are not scattered, haphazard or wasted in order to secure jobs for workers.

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