



A subdued World Economic Forum at Davos, reflected the attacks on globalization from Brexit and Donald Trump's America First presidency. WEF photo, Benedict von Loebell

Letter From Davos

Kevin Lynch

At its annual gathering of global political and economic thought leaders in January, the World Economic Forum grappled with the geopolitical implications of Donald Trump's presidency and China's ascendancy, and what the future will hold for millions of workers displaced by technology. In such an uncertain environment, Canada is well positioned to provide solutions.

After an exuberant gathering of the global policy elite at Davos last year, the 2017 edition was a subdued and rather anxious affair. Coming at the outset of Donald Trump's "America first" presidency and Theresa May's "hard Brexit" UK premiership, the World Economic Forum's mantra of the benefits of the Fourth Industrial Revolution, driven by globalization and technological change, was under siege by a surge of populism in many Western countries.

Trust in government, business and media—the elites—has declined across western democracies. Some surveys suggest a majority of citizens do not trust their governments, with middle classes feel-

ing under growing stress, and fretting that their governments don't get it and are not on their sides. Workers made redundant by robots and global supply chains, who are more aware every day of increasing income inequality and decreasing equality of opportunity in the society around them, are embracing populist tenets ranging from nationalism to protectionism, from distrust of "others" to anti-establishment resentment, from nostalgia to angst and anger. As history teaches us, bouts of fervent populism seldom end well.

Taken aback by this counter-revolution against the "Fourth Industrial Revolution", Davos discussions lacked a convincing understanding of the drivers of this populism that has surprised elites and pollsters alike in the U.S., Britain, France and elsewhere in the West. Elite angst and collective hand-wringing need to move smartly to examining solutions if we are to sustain the benefits delivered by innovation and global trade.

As Fareed Zakaria observed, this is not the time for Western business and government leaders to vacillate on whether globalization and technological change are good, either for their national economies or the global community—they are and always have been. The focus must shift to rebuilding growth, facilitating adjustment for firms and sectors and workers negatively impacted by technological change and the economics of global supply chains, and to do so at the required scale and scope. Remarkably, the strongest and clearest defence of globalization, trade, innovation and even capitalism at Davos came from President Xi Jinping of China.

We are living in highly uncertain, volatile and contradictory times. It is a world where 10 per cent of the world's public companies earn 80 per cent of the profits, and wealth inequality across the globe is equally striking; where short-termism is estimated by McKinsey & Company to have cost the U.S. economy alone up to 5 mil-

“ Elite angst and collective hand-wringing need to move smartly to examining solutions if we are to sustain the benefits delivered by innovation and global trade. ”

lion jobs; where global infrastructure needs exceed \$49 trillion between now and 2030 but the surplus funds are in private sector not government hands; where 85 per cent of U.S. job losses have been due to technology not trade, and technological change is accelerating; where mediocre growth is the new normal in most Western countries and even emerging economies have slowed, but trade has slowed even more. This is a world where global geopolitical leadership is hugely uncertain as America withdraws, China expands and Europe dithers.

“ Workers made redundant by robots and global supply chains, who are more aware every day of increasing income inequality and decreasing equality of opportunity in the society around them, are embracing populist tenets ranging from nationalism to protectionism. ”

A key theme reverberating across Davos conversations was that trust is missing in action in many countries, particularly in the West, with disenchanted middle classes giving rise to a "world of distrust" that nurtures populism.

Edelman produces an annual, multi-country trust barometer which measures public trust in government, business, media and NGOs, for both the "informed public" (aged 25-64, top quartile of income, financial lit-

eracy) and the "mass population" (the rest). What they found is that a majority of the mass population now distrusts these four key institutions (taken as a whole) in 20 of the 28 countries in their most recent survey, including Canada. Moreover, there is a pronounced "inequality of trust", with the informed public indicating significantly higher levels of trust in these institutions than the mass population—these "trust gaps" were an incredible 21 points for the U.S. and 19 points for the U.K. On the business front, CEO credibility with the mass population was down, with 67 per cent citing too much focus on short-term results and 57 per cent citing not enough focus on positive long-term impacts.

A post-Brexit drill down by Edelman for the U.K. showed the sharpest drops in trust were for the government and the media (particularly traditional media), with over 60 per cent of the mass population believing "the system" is failing them, and with two-thirds agreeing with the statement "we need to prioritize the interests of our country over those of the rest of the world." The echo chamber of post-trust populism was also evident, with a sizeable minority indicating that facts mattered less to them than authenticity and commitment, and that they tended to ignore information that supports a position they did not believe in.

If trust is on the decline, so too is support for globalization. The United States, the key architect of the post-Second World War system of global institutions and international trade liberalization through the World Trade Organization, has signalled an "America first" approach that em-



Chinese President Xi Jinping adroitly occupied the Davos agenda space vacated by absent western leaders. WEF photo, Manuel Lopez

braces protectionism, eschews global rules and risks trade frictions turning into trade wars.

With this Trump trade policy approach, and the growing tensions within the EU, the new face of globalization risks being shaped more by national policies in major nations than through a set of global rules arrived at by negotiations involving the international community. Power will trump process, nationalism will take precedence over the international community, and zero sum thinking will replace cooperative models of trade and growth. This should be cause for concern for countries like Canada, who benefit from global rules of the game,

In the U.S. (and U.K.), according to former Treasury Secretary and National Economic Council Director Larry Summers, the middle class feels that the government is not “fighting for them”, and we need to find effective ways to bring the

shrinking U.S. middle class back into the mainstream—economically, socially and politically. Rising income inequality and declining equality of opportunity at home, an inadequate focus on international tax and regulatory havens, and no focus on adjustment programs for firms and workers to respond to shifting economics of trade, has reduced middle class American trust and confidence in globalization.

While it is true that globalization has widened wealth gaps within countries and narrowed wealth gaps among countries, this obscures the crucial point that the vast majority of job losses in the United States have been the result of automation, digitization, and other cost reduction innovations, not trade and globalization. And, the rate of technological change is accelerating not slowing down. The march of the robots is clearly not consistent with the Trump

narrative of why American jobs have disappeared and who the job stealing culprits are.

“*The march of the robots is clearly not consistent with the Trump narrative of why American jobs have disappeared and who the job stealing culprits are.*”

All voices have not turned negative or fallen silent on the globalization front: China is offering to fill the void. As *New York Times* columnist Tom Friedman quipped, “If you closed your eyes and just listened to President Xi’s Davos speech, you would be forgiven for thinking that President Obama had come to Davos after all to deliver a stirring defence of globalization, technological change, and capitalism.” Indeed, the contrast with President Trump’s Inauguration Address, in which he stated: “We must protect our borders from the ravages of other countries making our products, stealing our companies and destroying our jobs. Protection will lead to great prosperity and strength,” could not be more stark.

President Xi’s strategic decision to be the first Chinese leader to address Davos and to do so at this time to fill the void created by the U.S. president’s antipathy to globalization and embrace of protectionism was masterful: He flattered the Davos elites; he launched a robust defence of globalization and free trade; he warned about the dangers of protectionism leading to trade wars (“No one will emerge as a winner.”); he acknowledged the voices against globalization and indicated we need to bring their concerns into our discussions; he called for more effective and shared governance of the global system; and he lauded the dynamic benefits of technological change, calling for an innovation-driven growth model for China.

It was a bravura performance. To Trans-Pacific Partnership countries, his message was that the U.S. is un dependable and you should join our alternative regional economic alliance. To Asian countries, it was that there is a new sheriff in the hood. To the global community, it was that the international system needs new protectors and new reforms and China expects to be a leader in both. And to the United States, the message could not have been clearer—don't mess with China.

And then there is the march of the robots. After populism, the most commonly heard phrase at Davos this year was AI (artificial intelligence)—the current “tech superstar”. As in recent years, Davos was awash with tech titans, with Google, Facebook, Microsoft, IBM, Salesforce, Infosys and Alibaba very prominent. While continuing to beat the drum of accelerating technological change and its benefits, driven by a range of disruptive technologies including robotics, AI, blockchain, big data, internet of things, virtual and augmented realities, biotech and energy storage, there was a new tone of concern about technological job displacement, not unrelated to the populism in the U.S. and elsewhere.

According to World Economic Forum research, 86 per cent of U.S. manufacturing job losses between 1997 and 2007 were the result of technology-induced productivity increases, compared to less than 14 per cent because of trade. The OECD has demonstrated that technological change is shifting the distribution of income from labor to capital in Western economies. And, most experts expect rapid advances in robotics, sensors, machine learning and big data to impact an increasing range of non-manufacturing sectors in the coming years, with positive implications for productivity and growth but with inevitable job displacement and skill shifting.

Satya Nadella of Microsoft noted that we are only in the first phase of AI, where the applications are largely hu-

“ According to World Economic Forum research, 86 per cent of U.S. manufacturing job losses between 1997 and 2007 were the result of technology-induced productivity increases, compared to less than 14 per cent because of trade. ”

man augmentation, but longer term it will replace humans in a variety of occupations including highly skilled professions such as radiologists. AI is not IT on steroids: it is disruptive and transformative, and massively reduces the costs of inference and prediction. Investors will fund AI innovations that either do something that cannot be done today, or do something to add current value, or cuts costs, usually through worker displacement. McKinsey estimates that 45 per cent of all work activities in the United States have the potential to be automated through machine learning technologies. The challenge, as in previous industrial revolutions, is the creation of new, quality jobs in sufficient numbers, at the right pace, and the successful retraining of workers for these new jobs.

So, where does this declining trust, rising populism, rising protectionism and increasing technological change leave the world economy? The contradictions are striking: despite the deep funk in many quarters as a result of the Trump victory (and Brexit), stock market valuations are up in the U.S. and the U.K., so too are business and CEO confidence surveys, and short-term economic forecasts have been notched upwards in the U.S. and elsewhere. U.S. business executives at Davos cited lower corporate taxes, a rebalancing of the regulatory burden, expansionary fiscal policy (infrastructure spending and military procurement) and generally a more pro-growth environment by the Trump administration as reasons for their economic optimism.

Balanced against this short-term economic optimism is enormous uncer-

tainty as the Trump policy agenda is remarkably vague on specifics despite its bluster and rhetoric. In this regard, key questions, and uncertainties for 2017 include:

- Whether Congress cooperates with President Trump's infrastructure ambitions (up to \$1 trillion), and plans for tax reform and business regulatory reform will importantly influence the prospects for a sustained rebound in business investment spending, a key driver of long-term productivity performance and growth.
- How aggressively and broadly the Trump administration moves against China and the nature of the Chinese response will determine whether trade protectionist measures by the U.S. lead to tit-for-tat frictions or an all-out trade war. In attempting to anticipate the Chinese response, remember that this is a year of political transition in China, and President Xi would prefer to minimize instability.
- With the triggering of Article 50 in March, the great Brexit unwinding will begin, fraught with complexity, a two-year prescribed time frame, and an unhappy and restive Eurozone with elections in France, Germany and the Netherlands, and perhaps Italy, this year, all with invigorated populist movements. It was likened it to a divorce proceeding with 28 partners and no judge.
- How far the Fed will go in raising rates, and how high the U.S. dollar will go in response, will impact on debt-servicing costs (both government and corporate) in indebted emerging markets where

growth has only just recently firmed up.

- Whether the U.S. will lift sanctions on Russia and scupper the Iran deal, both of which are entangled with European politics, and would have major geopolitical and economic implications.
- Whether the Saudi-brokered energy supply agreement holds and how price-responsive American shale oil producers have become will shape oil price movements.
- How U.S. demands for renegotiation of NAFTA—and the Canadian and Mexican responses—will determine whether there are significant shifts in North American trade patterns.

In a world undergoing multiple complex transitions—towards technological change of unprecedented depth and speed, towards new global economic and geopolitical balances, towards redistribution of wealth, within and among economies, towards a lower-carbon future—one

lesson from recent elections is that governments have not been able to bring voters along with them on the journey. What can be done?

Elements of what must be an integrated and forceful response to today's populism surfaced at Davos. Short-termism, a too prevalent feature of corporations and financial markets, needs to be reversed: more investing in capital and innovation for the longer term and less managing for quarterly results is in the best interests of shareholders, employees and the economy. Job displacement from technological change will require reskilling and retraining at a scale not seen since demobilization after the war and delivered over working lifetimes with new partnerships and delivery models between firms, education institutions, employees and government. Production displacement from trade should call for adjustment support, not protectionism, assisting affected sectors and firms to move up the

value-added curve in what they produce and how they produce it. And, a sea change in communications by government and business is a crucial part of the rebuilding of public trust. The corporate sector needs to speak to society more on public issues and less to analysts on quarterly results.

In this environment, Canada has considerable scope to provide policy leadership and to burnish the Canada brand. While Prime Minister Trudeau's absence from Davos was a missed opportunity, given the dearth of Western political leaders, Davos 2018 will be focussed on identifying solutions to the populist threat. If the government is able to move beyond rhetoric on its objective of inclusive growth, and design and implement policies that move the needle on both inclusion and growth, Canada could have a strong story to tell at Davos next year. **P**

Contributing Writer Kevin Lynch is Vice Chair, BMO Financial Group, and former Clerk of the Privy Council.

NAVIGATOR

Cannabis in Canada

THE ONLY MONTHLY POLL & ANALYSIS
EXCLUSIVELY FOCUSED ON MARIJUANA

Subscribe to Navigator's proprietary monthly survey of Canadians exclusively focused on the marijuana sector in Canada. It's the only one of its kind in Canada.

SUBSCRIBE TODAY

www.navltd.com/subscribe

Will Stewart, Managing Principal
wstewart@navltd.com | 416 642 6337

Legalize **D**

Subscribe to Navigator's podcast, our in-depth look at the emerging cannabis market in Canada. For more information please visit:

Legalized.fm