ARTICLE FOR THE EDGE

SHOULD INVESTORS FEAR A "LEFTWARD" TILT IN POLICIES?

Major crises often shake up existing policy frameworks and usher in fundamentally new ones. As the world endures the worst pandemic in modern history, massive failures in public policy and political leadership have been exposed in many countries, undermining the current order and making a big break with past policy approaches more likely. In the US, the Democratic candidate for the presidency, Joseph Biden, is leading the opinion polls. This matters because Biden has committed himself to the most progressive Democratic election manifesto since 1972, and there is an increasing feeling that a ground-breaking change is in the offing in the US. And where the US goes, quite often others will follow.

What shake up in policies should we expect around the world and where will that leave Southeast Asia?

Much has gone wrong – and that makes change unavoidable

The current pandemic has certainly shone an unforgiving light on policy failures. But these failures are not new and many have been accumulating over the past two decades. What is new is that these debacles in policy have reached a critical point where political convulsions are possible if people do not see progress. To see why this is the case, just look at the litany of failures, the many areas where ordinary people feel let down.

First, large swathes of the population in developed as well as developing nations feel frustrated and neglected. The pool of people "just about managing" has grown hugely. In many countries, median incomes have stagnated in recent years while there is a growing sense of insecurity about jobs, incomes, healthcare and retirement needs. This is most shockingly the case in the US where for decades the average household has seen very little improvement in its standard of living despite the impressive expansion of the economy in that period. The sharp rise in housing costs and those for higher education have left many, especially the young, feel that the economy is bypassing them. In both the US and in Europe, there are a large number of under-funded pension systems – which means that many retirees may never receive the pension payments they were promised.

Clearly, the fruits of growth in the economy have been usurped by a narrow minority in the population, leaving a considerable proportion of the citizenry feeling left out. Inequality has deepened and there is a sense that social mobility has slowed.

Second, the succession of crises in the past decade and a half has undermined confidence in the political class and its policy mandarins. They are seen as having failed to anticipate and prevent the financial shocks that caused so much damage. Or, as in the case of the less predictable pandemic, of badly fumbling the management of the crisis. The global financial crisis and the Eurozone sovereign debt crisis caused much pain to the average citizen who

was left embittered by the way in which the banks and other large corporations were bailed out but the average citizen was not.

Third, there is dissatisfaction with the way globalisation and other forms of integration with the world economy have panned out. In theory, international trade and migration produce net benefits for everyone. But in practice, there are winners and losers. It is only when the state intervenes to compensate the losers through measures to create new engines of growth, extend assistance with re-skilling and job searches and provide adequate social safety nets that most citizens feel that they are winners. Somehow, in the past 20-30 years, that simple lesson was lost. Thus, the backlash against globalisation as well as free trade and the growing hostility against immigrants.

Fourth, there is growing consternation especially among the young over climate change. There are more and more reports of extreme weather patterns – such as droughts and floods – causing havoc. The long term impact of climate change – rising sea levels, higher temperatures and more extreme fluctuations in weather – is becoming more palpably evident. Yet, there is no global consensus around mitigation policies. Indeed, some large countries such as the US and even Australia are run by political leaders who espouse bizarre ideas about climate change.

These are big failures and there are too many of them. Voters around the world are fed up and want change. The question is what kind of change could actually emerge?

The main areas of policy change

Once the pandemic crisis is over, we are likely to see transformational change in several areas.

The first is more radical measures to reverse the trends in inequality through tax reforms to bring about more redistribution of wealth and incomes: That means higher taxes on the incomes of the well-off and a rise in corporate taxes. High net worth individuals and companies should also expect fewer tax benefits such as exemptions on mortgage interest payments. It is possible that new forms of inheritance taxes will be employed as well since there is a deepening sense that concentrations of wealth have grown as a result of the abolition of estate duties.

Second, governments will need to alleviate growing social anxiety and address demands for improved social mobility through higher social spending:

- Social protections will have to be expanded – more generous unemployment insurance schemes, greater support for retirees through higher pension payouts and elder care, more public subsidies for medical care and a greater willingness of governments to provide affordable housing.

- Improving social mobility is much more complex. But, at the least, we foresee more aggressive efforts in early intervention programmes to help children from disadvantaged

families, even though such programmes could be very expensive. The first few years of a child's development are critical and there is a growing acceptance that large expenditures here will save a lot more money in the future since well-designed programmes can help make these children successful members of society instead of perpetuating the cycle of poverty.

Third, an overhaul of regulation and supervision is needed to address the politically unacceptable clout of large companies, improve the ability to prevent crises and empower consumers.

- Cutting corporate giants down to size: It is not only people on the left that perceive large companies as having grown too powerful. The public expressions of anger at the conduct of companies such as some of the tech giants or the more controversial financial behemoths who always seem to get away with their scandalous behaviour can no longer be downplayed. We are likely to see a strengthening of competition laws to limit the size of these companies or maybe even to break them up. Also expect more emphasis on fair trading laws to rectify the balance between large companies and the small companies that are either suppliers or customers of these giants.

- Containing crises, especially financial crises: While the regulations put in place since the global financial crisis have helped to protect the banking sector in this pandemic, there are signs of excesses in financial markets. Long years of easy money and ultra-low or even negative interest rates are likely to encourage speculation and excessively risky practices which will almost certainly lead to a future crisis. In other words, regulation has to go beyond box-checking compliance regulations to creating the right set of incentives so that those in the financial industry spontaneously conduct themselves in a less risky manner.

- Consumer protection needs to be improved, so that dominant companies are not able to employ pricing or other strategies to gouge consumers. With data now seen as highly valuable, new regulatory systems are needed so that consumers enjoy some return on the data that companies currently derive from them for free.

Fourth, governments are likely to return to some forms of industrial policy – for several reasons:

- In the US and the west, there is a growing realisation that they need to build up their industrial capacity if they are to win the strategic competition with China and to improve their resilience should there be more crises like the current pandemic. The free market alone will not help. Policies to encourage re-shoring – already being introduced by Japan – will be used more in the US and Europe.

- More policy intervention will be needed in order to strengthen the response to climate change.

- As labour-saving technologies are more widely used, there will be a need to create new engines of growth so as to generate sufficient jobs for the future.

Fifth, an expanded provision of public goods is needed. In the US and in poorer countries, there has been a woeful provision of physical infrastructure such as mass transit, roads, airports and the like.

So, to conclude – should investor fear leftward policies and, if so, where?

Almost certainly, there is going to be a fundamental re-orientation of policies. In the 1980s, the right-ward shift in policies instigated by British Prime Minister Thatcher and US President Reagan in the 1980s greatly influenced the rest of the world. Much of that will be reversed. So investors will have to accept that higher taxes and greater regulation could constrain profitability to some extent. However, such changes will improve political stability and sustainability in the long term. Moreover, the policy shifts will probably be implemented in a pragmatic fashion over time and companies should have the ability to adjust to the new environment. After all, companies still prospered and enjoyed reasonably good returns in the 1950s and 1960s when taxes and regulations were rigorously enforced.

China and India also seem to be reconfiguring their policy approaches. China is adapting to a more hostile America by putting greater emphasis on developing home-grown technology and building domestic engines of growth. As a series of important statements coming out of Beijing in recent weeks shows, this does not mean China is turning inwards. It will remain open to foreign investors and engage more with the outside world. It may even open up its capital markets further to the outside world. However, the economy is likely to be driven much more by the state than in the past. India's emphasis on self-reliance seems real. While not a throwback to the 1950s when it cut itself off from the world economy, it does look like India will be less interested in trade integration with other parts of the world.

Where does this leave Southeast Asia? There are two implications for this part of the world.

First, the region is not immune to the growing tide of political feeling described above. As the current protests in Thailand show and as the recent election in Singapore hinted at, regional governments also need to re-orient policies if they want to stay ahead of the curve.

Second, as the US and other developed countries, China and India change policy gears, this region will have to adapt. If all these countries ramp up social protections for their citizens, it will be harder for regional governments to deny their citizens similar reforms. Separately, the region may gain from production relocation as factories move out of China but it may have to compete harder with India and even developed countries who will lean on their companies to bring some production home.

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