



ECONOMIC VIEWPOINT

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Avoidable Policy Mistakes Abound— And Their Consequences Can Be Severe

We are becoming immune to economic policy mistakes by officials who should know better. For a long time, economists have railed against the lack of significant carbon taxes and about the failures to look at demographic trends when designing public policies. Often, the counter-argument has been that citizens don't really think too far into the future, and thus public policy also has become myopic in most countries. To this one can of course add policies driven by either false information or non-economic influences, as seen vividly in the case of Brexit. However, three policy experiences witnessed recently deserve special mention for the simple reason that they are ill-advised, and predictably so using any kind of reasonable economic metric.

The first, of course, is the current fiscal policy stance in the United States. An economy that is close to full employment (or more accurately measured an economy without an output gap) can expect only one thing when confronted with expansionary fiscal policy: future inflation. This fact is not lost on markets, looking at a rise in the U.S. fiscal deficit of at least 2 percent of GDP through increased spending and tax breaks. The new reality of a "trillion dollar deficit" should be alarming, especially if combined with a depreciating dollar that will add to import costs and a possible tariff war that will do the same. Distributional issues aside, this can only lead to a self-induced need for correction in the form of higher and faster increases in the interest rate and an economic slowdown. Administration officials who are willing to shoot themselves and the country in both feet should be ashamed.

The second remarkable policy error in recent weeks was the quick rise in the minimum wage introduced in South Korea by the new Moon Jae-In administration. The goal of improving the steadily worsening income inequality in Korea was clearly laudable; however, the instrument chosen was counter-productive.

It seems that the 16.4 percent rise in the minimum wage has had the effect of significantly reducing employment, especially for older workers whose pensions are insufficient. This is doubly ironic since poverty in Korea is now firmly situated in the elderly and it is rising along with the aging of the population. This minimum wage is slated to rise further to 10,000 won from its current level of 7,530 won, which will further increase the unemployment rate in Korea, now at its highest level in 17 years. Whereas the government has the fiscal resources to institute a significant and targeted negative income tax, it chose instead to try and operate through the labor market, leaving many older Koreans worse off than before.

A final example of poor policy choices is seen in the worsening condition of India's state-owned banks. Recent estimates indicate that non-performing loans (NPLs) have reached 11 percent in India's state banking sector, and as supervisors often note, these figures are normally under-estimates, particularly for state banks. In the State Bank of India alone, recent revisions have added \$3.6 billion to the reported level of NPLs. This level of problems in the banking sector rivals those in the crisis countries of the European Union. In addition, the corporate sector is highly leveraged, adding to overall riskiness of the financial sector. Lessons from other countries have shown that ignoring the problem can be quite dangerous; yet, despite admonitions from the Reserve Bank of India, when led by Prof. Raghuram Rajan, to deal with the under-capitalization of banks and the need for orderly exit, very little has been done. So, the problem is growing. Independent assessments by the IMF and others notwithstanding, policy inertia prevails, while the costs of a full-blown banking crisis worldwide have been shown to cost countries years of economic growth. India, on the cusp of a break-out economic performance can ill-afford such a setback.

In these three cases—one epitomized by doing the wrong thing and ignoring its logical consequences; the second, choosing the wrong instrument and not analyzing its likely implications; and the third, choosing to do very little and hoping the problem will resolve itself—are all examples of poor public policy. There are no doubt policy problems that can stymie officials, such as how to deal with future labor market disruptions due to technological advances or how to deal with rising health care costs for aging populations; however, many policy problems are self-inflicted and avoidable. It's too bad that politics, short-sightedness and poor preparation get in the way of better policy choices.

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