


## Thinking the Better Macro Policy Mix



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**T**he ultimate goal of economic policy is to achieve internal and external equilibrium contemporaneously. Internal equilibrium requires economic growth at potential growth rate, maintenance of full employment, and stable prices. External equilibrium implies the balance of current accounts. The history of capitalism shows rare cases with which an economy accomplishes all the policy goals mentioned above because pursuit of internal equilibrium often results in sacrificing external equilibrium and vice versa. But in spite of the difficulties, the achievement of double equilibria must be recognized as the ideal setting where the economic policy must pursue continuously. The macroeconomic policy tools, which a government can utilize to reach the ideal, consist of monetary,

fiscal, and exchange rate policies. Policy makers seek the ultimate goal with the proper mix of the macroeconomic policy tools.

Let me infer and provide the macro policy mix of the Korean economy to help reach its internal and external equilibria. The growth rate is below its potential and employment is far from its full capacity. The government announced that it will increase the employment rate to 70% from the current 60%. The consumer price index increases around 1%, which is far below the bottom of BOK's inflation target (2.5–3.5%). The current account is continuously in surplus during the last 15 years after the foreign exchange crises and it is forecasted to be more than \$60 billion in the year 2013.

In light of the trends of economic indicators, the policy objective, which the government primarily pursues, is obvious: It must focus on the internal equilibrium, in particular, the increase in growth and employment. The environment is provided where the policy makers can concentrate on growth and employment. Not much policy effort is required to obtain the external equilibrium because this year's current account surplus is expected to reach 5–6% GDP. Because excessively large surplus may cause unnecessary trade dispute, the government can allow a gradual appreciation of the Won by utilizing market mechanism and inducing import demand. By this policy we can expect the soft landing of the current account surplus at the level of 1–2% GDP.

The first policy tool to achieve internal equilibrium is to increase the flexibility of interest rate adjustment. The Bank of Korea has decreased its call rate only thrice (0.25% each time) during the last two years. Considering the low inflation rate and weak growth, the monetary policy must have been more responsive to the movement of economic indicators that could have resulted in a few more decreases in the interest rate. The recent trend of economy still provides the environment for the more active interest rate policy. The expansionary fiscal policy is also an essential policy tool and the government seems to take the position as it executed additional budget early this year. Currently, the main issue of the fiscal policy is related to the construction of the basis of welfare state. The fiscal expansion that focuses on the welfare expenditure will help achieve internal equilibrium because it increases the aggregate demand. The increase in welfare expenditure is also inevitable because the government must be more proactive in the care of the aging population, oversee the improvement of the health insurance, provide child care, etc. If instilled practice instilled in the construction of welfare state is firm among the majority of the citizenry, the next problem

is how to finance the expenditure. One can think of the choice between the issuance of government bonds and the increase of taxes. Keep in mind that the construction of welfare state is not a short- or medium-term project. It will span a period of 20–30 years. Thus heavy reliance on government bonds is not sustainable because it will result in serious damage to the economy's fiscal soundness. Thus, tax increase, based on plebiscite, is the inevitable choice.

Summarizing the above discussion, I think the desirable macroeconomic policy mix for the current economy of Korea consists of more flexible monetary policy, expansionary fiscal policy, tax increase for the welfare expenditure, and depending more on market mechanisms in the foreign exchange market. **KIEP**