

Moon vows to expand fiscal spending for new jobs, welfare

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SEOUL, April 12 (Yonhap) -- President front-runner Moon Jae-in said Wednesday that he will double the rate of increase in the government's fiscal spending if elected, and redirect government spending to create more jobs and support corporate employees.

The presidential candidate of the liberal Democratic Party noted the country's fiscal spending was designed to increase by an annual average of 3.5 percent on-year under the current mid and long-term plans.

"I will actively expand the increase to an annual average of 7 percent," he said at a press conference on his economic policies.

Moon did not specify how much such an increase will amount to in additional spending, but said an additional 50 trillion won (US\$43.54 billion) will come from a natural rise in tax revenues over a five-year period.

The additional money, along with a greater part of the existing budget, will go to the people instead of businesses, as they often did in under past administrations, he said.



Moon Jae-in (R), the presidential candidate of the liberal Democratic Party, announces his economic policy pledges at the party headquarters in Seoul on April 12, 2017. (Yonhap)

"Up until now, economic policies have centered on providing everything the country had to companies. We hoped such investment in companies would trickle down as benefits to workers and people," Moon said.

"But limits of such policies have been identified. I will change the order. I will change the economic structure to one centered on the people, in which the government will invest in people, who will then improve the competitiveness of companies and the country," he added.

Such efforts will include fresh and increased investment in 10 major areas that include the fourth industrial revolution and the social services sector.

The investment will help create more than 500,000 new jobs per year over the next five years, he insisted.

The presidential front-runner also pledged increased spending on public education, welfare and environment.

"Areas such as childcare, education, medical service, safety and environment have limits when only entrusted to the market. The government will actively support such areas to make sure all citizens will be provided with adequate services," he said.

To prevent companies, especially large conglomerates, from making excessive or unwarranted profits based on their market dominance or vast resources, Moon said he will work to enable class action through legal revisions while also reforming the state watchdog, the Fair Trade Commission.

"Fairness means innovation. Innovation means integration. Fairness, innovation and integration are keys to a people-oriented economy," he said.

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(END)

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Macroeconomics Commentary

The chosen article explains Moon Jae-in's plan to reduce unemployment and "support corporate employees" in South Korea through an expansionary fiscal policy where he increases expenditure by "doubling the rate of yearly increase in government's fiscal spending" from 3.5% to 7.0%. The expenditure is targeted to generate jobs, and improve health-care, education and welfare in the economy, and will be facilitated using additional tax revenues and greater allocated budget.

Aggregate demand (AD) refers to the total spending on goods and services over a period of time and is calculated using the formula:

$$C + I + G + (X-M)$$

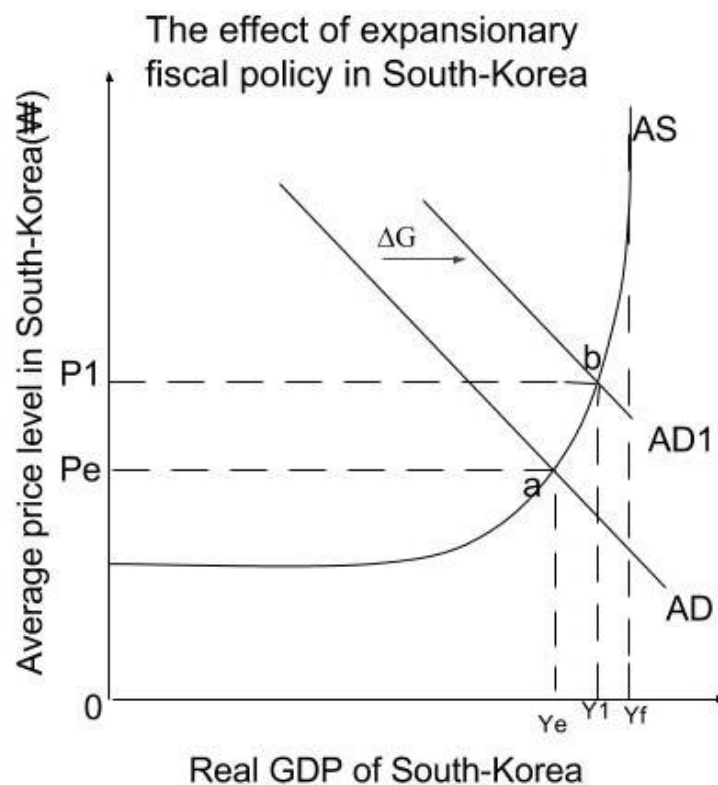


Diagram 1

The economy initially operates below full-employment, thereby allocating resources inefficiently at equilibrium a, where Real GDP is Y_e and average price level (APL) is P_e . Being a component of aggregate demand, increased government spending stimulates AD, causing a rightwards shift to AD1 and reducing the deflationary gap from $Y_e Y_f$ to $Y_1 Y_f$.

This is beneficial as the increase in Real GDP means economic growth and increased standards of living in the economy. Furthermore, the spending targets “public education” and creates jobs, which leads to increased quantity and quality of labor, translating to faster long-run growth and an increase in potential output. Lastly, focusing on education and environment suggests sustainable economic growth coupled with economic development in South Korea.

However, the average price level increases from P_e to P_1 , a proportionately higher increase than Real GDP, highlighting the opportunity cost of accelerating inflation shall this policy be implemented. The multiplier effect makes this worse as the increase in government expenditure leads to a greater change in income, shifting aggregate demand by more than the change in government spending as shown below, to AD_2 . The resulting equilibrium c , although closer to full employment output level, increases APL to P_2 , creating further inflationary pressures in South Korea.

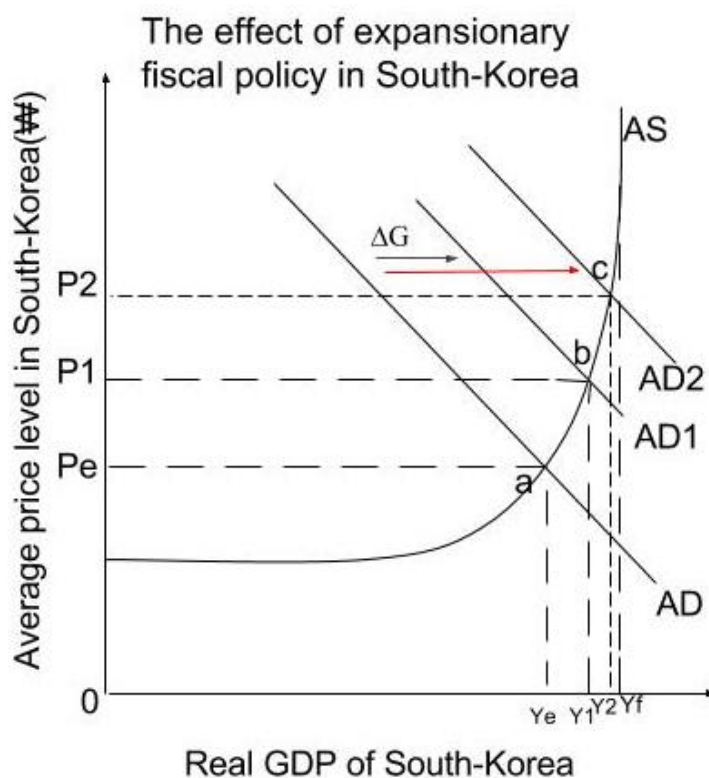


Diagram 2

Furthermore, since the government is forecasted to accumulate tax revenues worth “50 trillion won”, it is unlikely it finances the spending by borrowing from the non-bank private

sector. The demand for loanable funds will not increase, causing no increase in the interest rates and thereby no crowding out effect that reduces the inflationary pressures by decreasing aggregate demand.

Hence, although this expansionary fiscal policy has strengths, such as its direct impact on national income compared to indirect monetary policies, accelerating economic growth and increased employment, its inflationary consequences have detrimental effects on stakeholders in the economy. The uncertainty caused by rapid inflation, coupled with the government's lessened direct spending on firms, discourages the private sector from investing in new technologies and the economy. Although the policy creates jobs and increases disposable income, living standards may deteriorate instead if prices rise faster than incomes, rendering Moon Jae-in's people-oriented approach counter-productive in the short-run. Lastly rises an opportunity cost of allocating the government spending elsewhere, such as technological and infrastructural improvements that can increase potential output.

Another option is pro-market supply-side policies. Targeted to increase the economy's aggregate supply in the long-run by liberating markets, these policies offer relief from the inflationary pressures as there is little government spending involved, thereby not stimulating aggregate demand and causing rapid inflation. These policies have other benefits such as, deregulation and privatization may reduce monopoly power and increase competition in free markets, enhancing market efficiency. Decreasing corporate and income taxes encourage firms to invest in new technologies and increase labour productivity by motivating employees to work harder. However, these benefits usually materialize in the long-run, leaving short-run problems undealt with. Furthermore, decreasing taxes will increase spending on investment and consumption in the economy, thereby shifting aggregate demand rightwards in the short-run and increasing the average price level.

Therefore, the government must increase taxes as fiscal spending increases, in order to lower private investment and consumption in the economy by decreasing retained profits and disposable income, somewhat countering the increase in aggregate demand caused by increased government spending, and maintaining mild inflation. This resolves the main opportunity cost in Moon Jae-in's plan and also provides additional tax revenues.

Furthermore, investments in technological development are recommended because free markets often fail to realize that labour productivity depends on the technology available to

the workforce. A faster rate of technological progress increases labour productivity, enhancing Moon's "people" centred growth, and also shifts the long-run aggregate supply rightwards. While increased taxes provide short-run disincentives to workers by reducing their direct financial remuneration, it is the optimal solution to counteract negative outcomes of Moon's policy and maintain price stability in the South Korean economy.

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