Moon urged to adjust economic policies

Trade dispute, China slowdown pose major risks to Korean economy

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Institute for Global Economics (IGE) Chairman Jun Kwang-woo — Courtesy of IGE

Times Interview

"Policies should be revised to enable a flexible response to changes in internal and external environments."

The government needs to exercise flexibility in revising its income-led growth and other policies given the circumstances of the local economy, according to the chief of the Institute for Global Economics (IGE).

This was a comment on the government pushing through minimum wage hikes that came as a shock to small businesses, and have adversely affected employment growth.

"The Moon Jae-in administration's economic policies over the last two years have generated significant side effects, but the government has been reluctant to revise its policies," IGE Chairman Jun Kwang-woo told The Korea Times in a recent interview.

"Policies should be revised to enable a flexible response to changes in internal and external environments," he said.

Risks and challenges

After Moon took office in May 2017, Korea's GDP growth rate stood at 3.1 percent, but fell to 2.7 percent in 2018. The economy contracted 0.4 percent in the first quarter of this year from the fourth quarter of 2018, the worst performance in 41 quarters.

In May, Fitch and Goldman Sachs lowered their forecasts for Korea's GDP growth rate for this year to 2 percent and 2.1 percent, respectively. The government has lowered its 2019 growth outlook to a range of 2.4 percent to 2.5 percent from its earlier prediction of 2.6 percent to 2.7 percent made in December.

While the U.S. and China recently agreed to resume trade talks, Korea has been afflicted by and is set to continue to be adversely affected by their trade dispute. The slump in semiconductor exports, the country's growth driver, has heightened uncertainty.

"Korea has great external dependency as a small and open economy," Jun said, citing the fact that China and the U.S. are Korea's top trading partners, accounting for about 40 percent of trade.

A cloud is cast over the Korean economy because the trade dispute is expected to continue.

"Because a power struggle lies behind the bilateral trade war, short-term, partial stitches are possible but a fundamental resolution will not be achieved overnight," the former chief financial economist at the Word Bank said.

Meanwhile, China's slowing growth is another risk, Jun said.

"Because Korea's trade with China accounts for 25 percent of the total, and 30 percent when counting Hong Kong, of course we are affected by China's economic trends," he said.

At this rate, Jun forecasted it will be difficult to achieve the Bank of Korea's (BOK) GDP growth estimate of 2.5 percent for this year.

"The likelihood has decreased significantly and the BOK repeatedly lowering its estimate over the past months shows this," the economist said, adding global agencies' lowered forecasts also back this.

Rate cut is inevitable

Under such circumstances, it appears the BOK has no choice but to lower its key rate.

While factors such as consumer prices and financial markets should also be taken into account along with economic growth when adjusting the rate, low inflation backs circumstances for a rate cut, Jun said.

Along with revising its income-led growth policy, the former Financial Services Commission chairman cautioned against excessive expenditure, especially ahead of a general election next year.

"Although Korea is known to be a fiscally sound economy, its welfare expenditures are set to increase as the population ages. Policies that harm the country's fiscal soundness will have a long-lasting impact on the economy," he said.

"Fiscal expansion policies should be well targeted, so that the economy is supported and competitiveness is heightened."

Jun said Korea needs to increase capital investment and enhance labor productivity, to increase the country's competitiveness and falling growth rates. The latter should be achieved through fixing the wage system so that it becomes performance-based, he said.

The former chief of the National Pension Service also noted that while it would be going in the right direction to extend the retirement age, "this should be implemented when the economy is strong enough to allow new recruitment at the same time, to prevent endangering youth employment."