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Economics Group

Special Commentary

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Disruptions and Decisions: Nonlinear Policy Making

Praise for tech disruptors is common and often given a positive spin to the view of change. However, in decision making at the public policy level, the view of disruptors is far less positive. Disruptors upset the status quo in any area they approach. This has been the history of disruption in the order of economic events. Railroads across America upset the established business of ferries crossing rivers. Autos upset the buggy whip industry. Ongoing disruption occurs today in the communications and entertainment sectors.

“The afternoon knows what the morning never suspected.”
– Robert Frost

When economic and/or financial activity cannot be sustained, leadership enters the fray with a disruption in the order of events. Sometimes disturbing the old order came partly by circumstance as the old order could no longer be sustained. Upsetting the standards in financial markets and regulation were the immediate challenge to the methods of housing finance of the prior decade. While the financial regulation pendulum swings back and forth, sometimes the old order cannot be sustained and a new pendulum is put to work. Alternatively, policymakers, facing rising costs for medical care, acted to upset the existing modes of the health care industry. In neither financial nor health care fields are the outcomes from these disruptions likely to be permanent. Change is the only constant, so policymakers will alter the rules of the game ahead. The pendulum swings both ways and where the pendulum ends up is never certain. For example, financial/banking regulation in the U.S. has been ongoing since 1862 and even back to Andrew Jackson!

Today we face disruption in financial, tax and trade policies. As expected, each faces opposition from the established domestic and foreign interests. So, the pendulum on financial, tax policy and trade policies are swinging back again. America has a history of pendulum swings in policy and is constantly searching for new solutions to new problems.

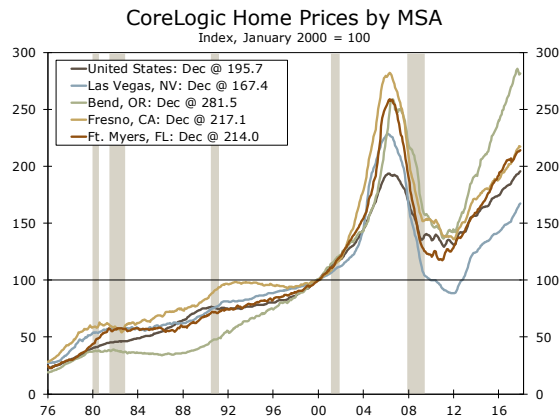
For financial policy, the fundamental problem is how to allocate credit to provide for opportunity and growth without wasting capital on non-economic activities. Unfortunately, that balance has never been achieved in financial history and is unlikely to be achieved anytime soon. The housing bust was not the first and not the worst in U.S. history and not likely to be the last. Deregulation changes during the last year have moved the pendulum again. In perspective, it is not likely that we will “know” the correct balance—only time and experience will tell. In prior experience, the excesses of commercial paper, high yield bonds and home prices (Figure 1) were only known in hindsight. In the meantime, each of these innovations altered the established order.

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Together we'll go far

Figure 1



Source: CoreLogic Realty Information, Inc. and Wells Fargo Securities

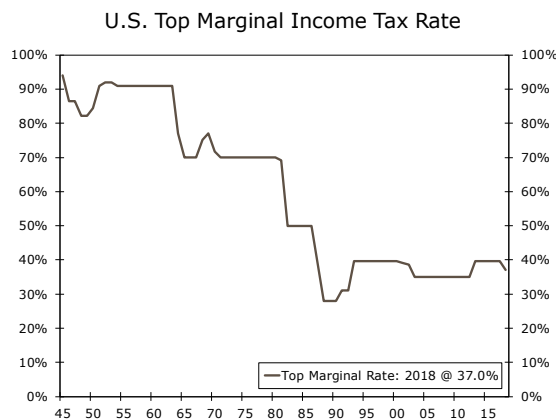
Tax policy has disrupted the received policy regime and, as expected, there are protests from the established order. Protagonists talk growth. Antagonists talk fairness. This is the perennial debate in tax policy simply because both criteria have no absolute standard. Moreover, tax policy, like financial regulation, has been part of the evolution of the American economy (Figure 2).

Whereas some policymakers focus on fairness, others focus on growth.

Whereas some policymakers focus on fairness (however defined), others focus on growth (however defined). This is the challenge of making public policy in an environment where both goals are laudable but neither has an agreed upon measurable target.

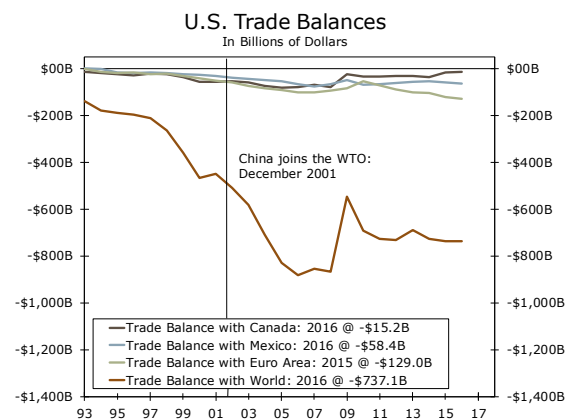
Trade policy represents the newest effort in chasing the pendulum. Moreover, we face the same challenges quantifying success given the relative disparity of trade deficits among our major trading partners (Figure 3).

Figure 2



Source: Tax Policy Center, International Monetary Fund and Wells Fargo Securities

Figure 3



Disruption is in the character of the American experiment.

As new initiatives are undertaken but disrupt existing trade relationships, what are the standards for “fairer” trade and more “growth?” All of this sounds familiar. Yet, President Trump was elected to disrupt. Therefore, it is not surprising that established interests are opposed. Once again, this disruption/protest has a long history in America from the era of Jefferson/Tariff of Abominations and Smoot-Hawley. No matter what the outcomes of any one tariff law, the reality is that disruption is in the character of the American experiment. As in regulation and tax policy, trade policy disruptions are an experiment—the final result on growth and fairness will await history.

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