PERSPECTIVE:

The Policy-Makers' Dilemma

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In Singapore, as across much of the developed world, governments are facing pressure to change economic and social models in order to address a range of emerging challenges such as inequality, slowing growth, fiscal imbalances, and environmental pressures. Changes need to be made to the prevailing policy approaches to ensure that policy settings are appropriate to a new context, and so that governments can continue to deliver the desired outcomes. And over the next few decades, governments will need to respond to the substantial, disruptive changes that are likely across the world, from the increasing role of emerging markets to an aging population.

A modified version of the policy status quo is unlikely to be sufficient to address many of these challenges. The better analogy would be periods of more significant policy change, such as in the 1930s/40s and the 1970s/80s, in response to major new economic and social challenges.

And yet there has been relatively little policy change to date. This is broadly true in Singapore, where there has been a consistency of policy direction, as it is elsewhere across developed countries. Although there is awareness in many governments that the world is changing, it is difficult to identify major structural policy change. Rather, there seems to be a common view that an improved version of the current policy approach is all that all is required to respond satisfactorily.

So what explains this apparent policy inertia? One part of the answer is policy-maker risk aversion. Almost by definition, policy change is costly and uncertain. Alternative approaches are uncertain and unproven, and the politics of major change can be challenging. In such an environment, there is a clear incentive for decision-makers to delay making a change: waiting may either resolve some of the challenges or make the need to respond more pressing and obvious.

This is particularly the case for governments of successful countries. These governments may have become accustomed to a particular policy approach working very well, and have an expectation that this will continue. So when economic and social outcomes worsen relative to historical standards of performance, the government's tendency may be to stick with the status quo while the policy approach is still working tolerably well. A new approach will often not seem warranted – at least not yet.

The choice between 'kicking the can down the road' (or making tactical adjustments to the current approach) and making a structural change to the strategic direction is a difficult one. I call the challenge of determining how seriously – and when – to respond to a challenge 'the policy-maker's dilemma', because of the similarities with the famous innovator's dilemma in the private sector.

Harvard academic Clayton Christensen developed this latter concept after observing the tendency for established incumbent firms to ignore disruptive innovations because they were not seen as important enough to require change to the established business model. Firms were more responsive to existing ways of doing things and not sensitive enough to disruptive innovations. They were often aware of the change, but it was not seen as worthwhile to respond. The dilemma is the extent to which the firm incurs costs, and moves away from a successful model, to respond to this disruption.

The difficulty in responding is why market leaders are commonly overtaken by new dynamics. By the time that the competitive threat becomes large enough to get the full attention of the firm, it may be too late. Challenger firms (think Amazon, Google) can become dominant before the incumbents think it sufficiently important to respond.

Ironically, perhaps, it is the more successful firms that are more likely to act in this way. Well-performing firms can be held captive by the success of their existing approaches and there is understandable reluctance to move away from a model that is still working tolerably well. Indeed, Christensen argues that it is exactly the successful, well-managed firms that may be at most risk of failure to respond to disruption. Management practices and capacity that enable them to succeed in mainstream markets are also those that make it more likely that they don't respond well to disruptive innovation. The things that have made them successful may make failure more likely.

Of course, countries do not go out of business in the way that firms do. But a failure of national governments to respond to structural changes in their operating environment can lead to compromised outcomes. Economic history over the past century is full of examples of countries whose performance deteriorates substantially (Argentina was once one of the richest countries in the world, for example). This can be because governments continue with a policy approach that is no longer appropriate for a changed environment.

And there is significant variation in economic performance across the decades, with high-performing countries often not able to sustain this performance. Countries, and particularly small countries, need to be sensitive to the changing strategic environment and to be able to judge when a change in strategic policy direction is required. A failure to do so can lead to lagging economic and social performance – and the longer that change is delayed, the more such problems can accumulate (as has been seen recently in several European countries).

Governments seem to find it difficult to make the strategic policy choices to respond to the emerging disruptions, in a similar way as the firms that Christensen documents. This is sometimes because the alternatives are not yet clear, or because elected officials are using a short-term decision-making horizon. And sometimes it may be because there is not sufficient social consensus (or low trust in politicians) to allow policy-makers to make the change.

But the observed inertia in responding to disruptive change is also due to the nature of the decision-making process within government. So what are the things that can be done to strengthen the capacity of governments to address the policy-maker's dilemma? I would suggest three things:

First, investments should be made to understand the changing world and the strategic challenges and opportunities that will be presented. This understanding allows governments to better judge when structural change is required as opposed to a tactical response, and avoid having tensions accumulate into a crisis. For example, dealing with declining competitiveness directly through measures to improve productivity is preferable to short-term measures such as loose fiscal policy that can create more problems than they resolve.

Second, conversations about change should be informed by rich data so that there is a shared understanding of the outcomes that are being generated – and how they compare with historical outcomes, and with other countries. And the policy conversations should also be informed by how other, similar countries are responding to these dynamics. Given the extent of uncertainty, it is important to understand how other countries are interpreting the change and responding. Context matters, and there is no template for success, but countries can learn from their peers. These country observations will make the debate about the need for change more concrete and real.

And third, there need to be institutions and cultures that are comfortable with challenging the status quo. 'Faith-based policy' – a dogmatic attachment to the existing policy approach – needs to be confronted. A review of the IMF's performance before the crisis identified an "institutional culture that discouraged contrarian views" as a major factor in explaining why some warning signs were missed. And these behaviours are seen in many governments. To address this, it is important to encourage strong debate, a constant testing of existing approaches, and investing in a pipeline of new ideas. This is often done through dedicated units or teams who have a mandate to constructively challenge the orthodoxy and develop policy alternatives – and who are less attached to the current approach than the mainstream government agencies.

In a period of disruptive change across the advanced economies, governments need to be strengthening their strategic capacity to enable them to respond to the policy-maker's dilemma. And particularly for small country governments, developing the capacity to detect weak signals of emerging change is important so that they can better judge when and how to respond. The existence of the policy-maker's dilemma needs to be recognised and deliberately addressed.

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